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SECURITIES COMMISSION

Washington, D.C. 20549

Washington, DC  
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**ANNUAL AUDITED REPORT  
FORM X-17A-5  
PART III**

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8- 27030

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 01/01/08 AND ENDING 12/31/08  
MM/DD/YY MM/DD/YY

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER: Waddell & Reed, Inc.

OFFICIAL USE ONLY  
FIRM I.D. NO.

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

6300 Lamar Ave.  
(No. and Street)  
Overland Park KS 66202-4200  
(City) (State) (Zip Code)

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

Mark A. Schieber 913-236-1980  
(Area Code - Telephone Number)

**B. ACCOUNTANT IDENTIFICATION**

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

KPMG  
(Name - if individual, state last, first, middle name)  
1000 Walnut Street, Ste. 160 Kansas City MO 64106-2170  
(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)

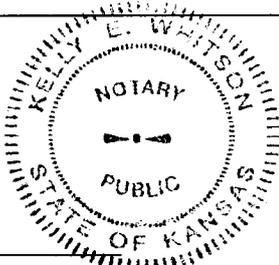
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OATH OR AFFIRMATION

I, Mark A. Schieber, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Waddell & Reed, Inc., 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:

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



Kelly E. Whitson  
Notary Public

Mark A. Schieber

Signature

Sr. Vice President/Controller

Title

My Appointment Expires 8/30/09

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 Proprietors' 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 15c3-3 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).



**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Consolidated Financial Statements and Supplemental Schedules and  
Report on Internal Control as Required by SEC Rule 17a-5

December 31, 2008

(With Independent Auditors' Report Thereon)



KPMG LLP  
Suite 1000  
1000 Walnut Street  
Kansas City, MO 64106-2162

SEC Mail  
Mail Processing  
Section

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## Independent Auditors' Report

The Board of Directors  
Waddell & Reed, Inc.:

We have audited the accompanying consolidated balance sheet of Waddell & Reed, Inc. and subsidiaries (the Company), a wholly owned subsidiary of Waddell & Reed Financial, Inc., as of December 31, 2008, and the related consolidated statements of operations, changes in stockholder's equity, comprehensive income, 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 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 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 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 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 financial statement presentation. We believe that our audit provides 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 Waddell & Reed, Inc. and subsidiaries as of December 31, 2008, and the results of their operations and their cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included 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 of 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.

**KPMG LLP**

Kansas City, Missouri  
February 25, 2009

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Consolidated Balance Sheet

December 31, 2008

(In thousands)

<b>Assets</b>	
Cash and cash equivalents	\$ 113,745
Cash and cash equivalents – restricted	47,182
Investment securities	19,208
Receivables:	
Funds and separate accounts	24,173
Customers and other	54,019
Due from affiliates	3,417
Deferred income taxes	9,249
Prepaid expenses and other current assets	5,606
Total current assets	276,599
Property and equipment, net	48,230
Deferred sales commissions, net	25,059
Deferred income taxes	6,199
Goodwill and identifiable intangible assets	35,095
Other assets	5,834
Total assets	\$ 397,016
<b>Liabilities</b>	
Accounts payable	\$ 36,196
Payable to investment companies for securities	67,848
Accrued compensation	19,390
Due to affiliates	2,596
Income taxes payable	6,830
Other current liabilities	29,132
Total current liabilities	161,992
Accrued pension and postretirement costs	20,204
Other non-current liabilities	16,854
Total liabilities	199,050
Commitments and contingencies (note 14)	
Stockholder's equity:	
Common stock, \$1.00 par value. Authorized, issued, and outstanding 1,000 shares	1
Additional paid-in capital	196,446
Retained earnings	22,078
Accumulated other comprehensive loss	(20,559)
Total stockholder's equity	197,966
Total liabilities and stockholder's equity	\$ 397,016

See accompanying notes to consolidated financial statements.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Consolidated Statement of Operations

Year ended December 31, 2008

(In thousands)

Revenues:		
Investment management fees	\$	214,887
Underwriting and distribution fees		241,495
Shareholder service fees		94,575
Total		<u>550,957</u>
Expenses:		
Underwriting and distribution		264,892
Compensation and related costs (including share based compensation of \$21,886)		102,904
General and administrative		54,435
Subadvisory fees		3,357
Depreciation		10,963
Goodwill impairment		7,222
Total		<u>443,773</u>
Operating income		107,184
Investment and other income		1,586
Interest expense		<u>(22)</u>
Income before provision for income taxes		108,748
Provision for income taxes		<u>42,218</u>
Net income	\$	<u><u>66,530</u></u>

See accompanying notes to consolidated financial statements.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Consolidated Statement of Changes in Stockholder's Equity

Year ended December 31, 2008

(In thousands)

	Common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholder's equity
	Shares	Amount				
Balance at December 31, 2007	1,000	\$ 1	191,315	36,548	1,993	229,857
Net income	—	—	—	66,530	—	66,530
Dividends to parent – cash	—	—	—	(81,000)	—	(81,000)
Excess tax benefits from share-based payment arrangements	—	—	5,131	—	—	5,131
Unrealized loss on available-for-sale investment securities	—	—	—	—	(2,355)	(2,355)
Pension and postretirement benefits	—	—	—	—	(20,197)	(20,197)
Balance at December 31, 2008	<u>1,000</u>	<u>\$ 1</u>	<u>196,446</u>	<u>22,078</u>	<u>(20,559)</u>	<u>197,966</u>

See accompanying notes to consolidated financial statements.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Consolidated Statement of Comprehensive Income

Year ended December 31, 2008

(In thousands)

Net income	\$	66,530
Other comprehensive income:		
Available-for-sale investments:		
Net unrealized depreciation of investments during the year, net of income taxes of \$(1,353)		(2,355)
Pension and postretirement benefits:		
Pension and postretirement benefits, net of income taxes of \$(11,578)		<u>(20,197)</u>
Comprehensive income	\$	<u><u>43,978</u></u>

See accompanying notes to consolidated financial statements.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Consolidated Statement of Cash Flows

Year ended December 31, 2008

(In thousands)

Cash flows from operating activities:	
Net income	\$ 66,530
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	10,945
Amortization of deferred sales commissions	9,993
Goodwill impairment	7,222
Excess tax benefits from share-based payment arrangements	(5,131)
Net purchases and sales of trading securities	(1,985)
Unrealized loss on trading securities	3,864
Loss on sale and retirement of property and equipment	792
Capital gains and dividends reinvested	(391)
Deferred income taxes	(1,544)
Changes in assets and liabilities:	
Cash and cash equivalents – restricted	51,394
Receivables from funds and separate accounts	922
Other receivables	13,617
Due from affiliates, net	(2,371)
Deferred sales commissions	(19,337)
Prepaid expenses and other assets	9,868
Accounts payable	20,152
Payable to investment companies for securities	(91,303)
Accrued compensation	(8,446)
Income taxes payable	10,235
Other liabilities	444
Net cash provided by operating activities	<u>75,470</u>
Cash flows from investing activities:	
Proceeds from maturities of available-for-sale investment securities	1,750
Additions to property and equipment	(23,487)
Net cash used in investing activities	<u>(21,737)</u>
Cash flows from financing activities:	
Dividends to Parent	(81,000)
Excess tax benefits from share-based payment arrangements	5,131
Net cash used in financing activities	<u>(75,869)</u>
Net decrease in cash and cash equivalents	(22,136)
Cash and cash equivalents at beginning of year	<u>135,881</u>
Cash and cash equivalents at end of year	<u>\$ 113,745</u>
Supplemental disclosure for cash flow:	
Cash paid for income taxes (net)	\$ 34,207

See accompanying notes to consolidated financial statements.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Financial Statements

December 31, 2008

**(1) Summary of Significant Accounting Policies**

**(a) Organization**

Waddell & Reed, Inc., a broker-dealer, and subsidiaries (the Company, we, our, and us) derive revenues primarily from investment management, investment product underwriting and distribution, and shareholder services administration provided to the Waddell & Reed Advisors Group of Mutual Funds (the Advisors Funds), Ivy Funds Variable Insurance Portfolios, Inc. (the Ivy Funds VIP) renamed from W&R Target Funds, Inc. in 2008, Ivy Funds, Inc., and the Ivy Funds portfolios (collectively, the Ivy Funds), which are underwritten by an affiliate, and Waddell & Reed InvestEd Portfolios, Inc. (InvestEd) (collectively, the Funds), and institutional and separately managed accounts. The Funds and the institutional and separately managed accounts operate under various rules and regulations set forth by the United States Securities and Exchange Commission (the SEC). Services to the Funds are provided under investment management agreements that set forth the fees to be charged for these services. The majority of these agreements are subject to annual review and approval by each Fund's board of directors/trustees and shareholders. Our revenues are largely dependent on the total value and composition of assets under management, which include mainly domestic equity securities, but also include debt securities and international equities. Accordingly, fluctuations in financial markets and composition of assets under management can significantly impact revenues and results of operations. The Company is an indirect wholly owned subsidiary of Waddell & Reed Financial, Inc. (WDR), a publicly traded company. Consolidated financial statements of WDR are available.

The Company's underwriting agreements with the Funds allows the Company the exclusive right to distribute redeemable shares of the Funds on a continuous basis. The Company has entered into a limited number of selling agreements authorizing third parties to offer certain of the Funds. In addition, the Company also receives Rule 12b-1 asset-based service and distribution fees from certain of the Funds for purposes of advertising and marketing the shares of such funds and for providing shareholder-related services. The Company must pay certain costs associated with underwriting and distributing the Funds, including commissions and other compensation paid to financial advisors, sales force management and other marketing personnel, compensation paid to other broker-dealers, plus overhead expenses relating to field offices, sales programs, and the costs of developing and producing sales literature and printing of prospectuses, which may be either partially or fully reimbursed by certain of the Funds. The Funds are sold in various classes that are structured in ways that conform to industry standards (i.e. front-end load, back-end load, level-load, and institutional).

The Company operates its investment advisory business and its transfer agency and accounting services business through its primary subsidiaries, Waddell & Reed Investment Management Company and Waddell & Reed Services Company, respectively.

**(b) Basis of Presentation and Consolidation**

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The accompanying

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Financial Statements

December 31, 2008

consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. Intercompany transactions and balances are eliminated in consolidation.

(c) *Use of Estimates*

GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses in the consolidated financial statements and accompanying notes, and related disclosures of commitments and contingencies. Estimates are used for, but are not limited to, depreciation and amortization, taxes, valuation of assets, pension and postretirement obligations, and contingencies. Actual results could differ from those estimates.

(d) *Cash and Cash Equivalents*

Cash and cash equivalents include cash on hand and short-term investments. We consider all highly liquid investments with original or remaining maturities of 90 days or less at the date of purchase to be cash equivalents. At December 31, 2008, our cash and cash equivalents balance is comprised of commercial paper of \$36.3 million, money market assets of \$5.3 million, and cash of \$72.1 million. Cash and cash equivalents-restricted represents cash held for the benefit of customers segregated in compliance with federal and other regulations. Substantially all cash balances are in excess of federal deposit insurance limits.

(e) *Disclosures About Fair value of Financial Instruments*

Fair value of cash and cash equivalents, receivables, and payables approximates carrying value. Fair values for investment securities are based on quoted market prices, where available. Otherwise, fair values are based on quoted market prices of comparable instruments.

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS No. 157) effective January 1, 2008. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosure of fair value measurements. The Company did not have a transition adjustment to beginning retained earnings as a result of adopting this standard. SFAS No. 157 applies to all financial instruments that are measured and reported on a fair value basis. This includes those items reported in investment securities on the balance sheet.

In conjunction with the adoption of SFAS No. 157, the Company also adopted SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an Amendment of SFAS No. 115*, (SFAS No. 159) as of January 1, 2008. SFAS No. 159 provides companies the option to report select financial assets and liabilities at fair value on an instrument-by-instrument basis with changes in fair value reported in earnings. Additionally, the transition provisions of SFAS No. 159 permit a one-time election for existing positions at the adoption date with a cumulative-effect adjustment included in beginning retained earnings and future changes in fair value reported in earnings. This statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. After the initial adoption, the election is made at the acquisition of a

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Financial Statements

December 31, 2008

financial asset or financial liability and it may not be revoked. The adoption of SFAS No. 159 did not result in a transition adjustment to beginning retained earnings.

**(f) *Investment Securities***

Our investment securities are comprised of United States, state and government obligations, corporate debt securities, and investments in affiliated mutual funds. Investments are classified as available-for-sale or trading. Waddell & Reed, Inc. (W&R Inc.) investments are classified as trading. The subsidiaries of W&R Inc. hold both available-for-sale and trading securities. Unrealized holding gains and losses on securities available-for-sale, net of related tax effects, are excluded from earnings until realized and reported as a separate component of comprehensive income. For trading securities, unrealized holding gains and losses, net of related tax effects, are included in earnings. Realized gains and losses are computed using the specific identification method for investment securities, other than mutual funds. For mutual funds, realized gains and losses are computed using the average cost method.

Our available-for-sale investments are reviewed and adjusted for other than temporary declines in value. We consider factors affecting the issuer and the industry the issuer operates in, general market trends, and our ability and intent to hold an investment until it has recovered. Consideration is given to the length of time an investment's market value has been below carrying value and prospects for recovery to carrying value. When a decline in fair value of an available-for-sale investment is determined to be other than temporary, the unrealized loss recorded net of tax in other comprehensive income is realized as a charge to net income, and a new cost basis is established for financial reporting purposes.

**(g) *Property and Equipment***

Property and equipment are carried at cost. The costs of improvements that extend the life of a fixed asset are capitalized, while the costs of repairs and maintenance are expensed as incurred. Depreciation and amortization are calculated and recorded using the straight-line method over the estimated useful life of the related asset (or lease term if shorter), generally five to ten years for furniture, fixtures, data processing equipment, computer software, and equipment and machinery; and up to fifteen years for leasehold improvements.

**(h) *Software Developed for Internal Use***

Certain internal costs incurred in connection with developing or obtaining software for internal use are capitalized in accordance with the American Institute of Certified Public Accountants' Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. The costs of designing and implementing software are expensed as incurred. Internal costs capitalized are included in "Property and equipment, net" on the consolidated balance sheet, and were \$14.3 million as of December 31, 2008. Amortization begins when the software project is complete and ready for its intended use and continues over the estimated useful life, generally five to ten years.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Financial Statements

December 31, 2008

(i) ***Goodwill and Identifiable Intangible Assets***

Goodwill represents the excess of the cost of the Company's investment in the net assets of acquired companies over the fair value of the underlying identifiable net assets at the dates of acquisition. Goodwill is not amortized, but is tested at least annually for impairment.

Identifiable intangible assets with indefinite useful lives are not amortized. Indefinite life intangible assets represents advisory management contracts for managed assets obtained in acquisitions. We consider these contracts to be indefinite lived intangible assets as they are expected to be renewed without significant cost or modification of terms. We complete an ongoing review of the recoverability of identifiable intangible assets on an annual basis or more frequently whenever events occur or circumstances change, which would more likely than not reduce their fair value.

Factors that are considered important in determining whether an impairment of goodwill or intangible assets might exist include significant continued underperformance compared to peers, the likelihood of termination or nonrenewal of a mutual fund advisory contract or substantial changes in revenues earned from such contract, significant changes in the business and products, material and ongoing negative industry or economic trends, or other factors specific to each asset or subsidiary being evaluated. Because of the significance of goodwill and other intangible assets to our consolidated balance sheet, any changes in key assumptions about our business or prospects, or changes in market conditions or other externalities, could result in an impairment charge and such a charge could have a material effect on our financial condition and results of operations.

Based on our annual review of goodwill in 2008, in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, (SFAS No. 142) we recorded an impairment charge of \$7.2 million related to a subsidiary. The impairment charge is described in note 3. All goodwill related to this subsidiary has now been written off. It was determined that no other impairment existed during our annual review of goodwill or of identifiable intangible assets during 2008.

(j) ***Deferred Sales Commissions***

The Company defers certain costs, principally sales commissions and related compensation, that are paid to financial advisors and broker/dealers in connection with the sale of certain mutual fund shares sold without a front-end load sales charge. The costs incurred at the time of the sale of Class B shares are amortized on a straight-line basis over five years, which approximates the expected life of the shareholders' investments. The costs incurred at the time of the sale of Class C shares are amortized on a straight-line basis over 12 months. The Company recovers such costs through Rule 12b-1 and other distribution fees, which are paid on Class B and Class C shares of the Advisor Funds, along with contingent deferred sales charges (CDSC's) paid by shareholders who redeem their shares prior to completion of the required holding period (three years for shares of certain asset allocation products, six years for a Class B share and 12 months for a Class C share). Should the Company lose the ability to recover such sales commissions through distribution fees or CDSC's, the value of these assets would immediately decline, as would future cash flows. In addition, the costs incurred at the time of the sale of shares for certain asset allocation products are deferred and then amortized on a straight-line basis, not to exceed three years. The Company periodically reviews the recoverability of the deferred sales commission assets as events or changes

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Financial Statements

December 31, 2008

in circumstances indicate that the carrying amount may not be recoverable and adjust them accordingly.

**(k) Revenue Recognition**

We recognize investment management fees as earned over the period in which services are rendered. We charge the Advisors Funds and Ivy Funds VIP daily based upon average daily net assets under management in accordance with investment management agreements between the Advisors Funds and Ivy Funds VIP and the Company. In general, the majority of investment management fees earned from institutional and separate accounts are charged quarterly based upon an average of net assets under management at the end of the months within the quarter in accordance with such agreements.

Underwriting and distribution revenues resulting from the sale of investment products are recognized on the trade date.

We also recognize distribution revenues monthly on certain types of investment products, primarily variable annuity products, which are generally calculated based upon average daily net assets under management.

Shareholder service fees are recognized monthly and are calculated based on the number of accounts or assets under management as applicable. Other administrative service fee revenues are recognized as contractual obligations are fulfilled or as services are provided.

**(l) Advertising and Promotion**

The Company expenses all advertising and promotion costs as incurred. Advertising expense was \$1.1 million for the year ended December 31, 2008 and is classified in underwriting and distribution expense on the consolidated statement of operations.

**(m) Income Taxes**

The Company files consolidated federal income tax returns with WDR. The Company's provision for income taxes has been made on the same basis as if the Company filed separate federal income tax returns.

Income tax expense is based on pre-tax financial accounting income, including adjustment made for the recognition or derecognition related to uncertain tax positions. The recognition or derecognition of income tax expense related to uncertain tax positions is determined under the guidance as prescribed by Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* (FIN 48). Deferred tax assets and liabilities are recognized for the future tax attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and deferred tax liabilities are measured using enacted tax rates expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in earnings in the period that includes the enactment date.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Financial Statements

December 31, 2008

The Company recognizes tax benefits from equity awards in WDR stock granted to its employees. These tax benefits are reflected as an increase to additional paid-in capital with a corresponding reduction to income taxes payable. The excess tax benefits from share-based payments were \$5.1 million for 2008.

**(2) Investment Securities (Available for Sale and Trading)**

Investments at December 31, 2008 are as follows (in thousands):

	<u>Amortized cost</u>	<u>Unrealized gains</u>	<u>Unrealized losses</u>	<u>Fair value</u>
Available-for-sale securities:				
Mortgage-backed securities	\$ 11	1	—	12
Municipal bonds	5,290	—	(1,086)	4,204
Affiliated mutual funds	<u>5,500</u>	<u>—</u>	<u>(1,462)</u>	<u>4,038</u>
Total available-for-sale securities	<u>10,801</u>	<u>1</u>	<u>(2,548)</u>	<u>8,254</u>
Trading securities:				
Mortgage-backed securities				108
Municipal bonds				372
Corporate bonds				93
Common stock				37
Affiliated mutual funds				<u>10,344</u>
Total trading securities				<u>10,954</u>
Total investment securities				<u>\$ 19,208</u>

A summary of available-for-sale securities with fair values below carrying values at December 31, 2008 is as follows (in thousands):

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
Municipal bonds	\$ 4,204	(1,086)	—	—	4,204	(1,086)
Affiliated mutual funds	<u>4,038</u>	<u>(1,462)</u>	<u>—</u>	<u>—</u>	<u>4,038</u>	<u>(1,462)</u>
Total temporarily impaired securities	<u>\$ 8,242</u>	<u>(2,548)</u>	<u>—</u>	<u>—</u>	<u>8,242</u>	<u>(2,548)</u>

Based upon our assessment of the available-for-sale investment securities with unrealized depreciation at December 31, 2008, the timeframe investments have been in a loss position, our intent to hold such securities until they have recovered, and our history of holding bonds until maturity, we determined that a write-down was not appropriate at this time.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Financial Statements

December 31, 2008

Mortgage-backed securities and municipal bonds accounted for as available-for-sale as of December 31, 2008 mature as follows (in thousands):

	<b>Amortized cost</b>	<b>Fair value</b>
After one year but within ten years	\$ 4,300	3,541
After ten years	1,001	675
	\$ 5,301	4,216

Investment securities classified as trading with fair value of \$0.9 million were sold during 2008.

The Company matches mutual fund investment holdings classified as trading securities to the funding obligations created by its deferred compensation plans. These plans allow employees to choose investment vehicles in which to invest their deferred compensation, primarily from Company sponsored mutual funds.

SFAS No. 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. In accordance with SFAS No. 157, these inputs are summarized in the three broad levels listed below:

- Level 1 – Quoted prices in active markets for identical securities
- Level 2 – Other significant observable inputs (including quoted prices in active markets for similar securities)
- Level 3 – Significant unobservable inputs (including the Company’s own assumptions in determining the fair value of investments)

In determining the appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to SFAS No. 157.

The following table presents fair value measurements as of December 31, 2008 (in thousands):

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Investment securities	\$ 14,419	4,789	—	19,208

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Financial Statements

December 31, 2008

**(3) Goodwill and Identifiable Intangible Assets**

Goodwill represents the excess of purchase price over the tangible assets and identifiable intangible assets of acquired business. Our goodwill is not deductible for tax purposes. The activity related to goodwill and identifiable intangible assets (all considered indefinite lived) is summarized as follows (in thousands):

	<u>December 31, 2007</u>	<u>Goodwill impairment</u>	<u>December 31, 2008</u>
Goodwill	\$ 26,073	(9,559)	16,514
Accumulated amortization	<u>(10,609)</u>	<u>2,337</u>	<u>(8,272)</u>
Total goodwill	15,464	(7,222)	8,242
Total identifiable intangible assets	<u>26,853</u>	<u>—</u>	<u>26,853</u>
Total	<u>\$ 42,317</u>	<u>(7,222)</u>	<u>35,095</u>

Goodwill is not amortized, but instead is reviewed annually and when events or circumstances occur, which indicate that goodwill might be impaired. Impairment of goodwill is tested at the Company's reporting unit level. To determine fair value, our review process uses the income and market approaches. In performing the analysis, we use the best information available under the circumstances, including reasonable and supportable assumptions and projections. If the carrying amount of the reporting unit exceeds its implied fair value, goodwill is considered impaired, and a second step is performed to measure the amount of impairment loss, if any.

In 2008, we recorded a goodwill impairment charge of \$7.2 million to the carrying amount of one subsidiary based on a decline in the subsidiary's assets under management and the adverse impact of that on its earnings potential. The goodwill impairment charge was not deductible for income tax purposes and as a result, no tax benefit has been recognized for the charge.

Identifiable intangible assets are mutual fund management advisory contracts (all considered indefinite lived) with a carrying value at December 31, 2008 of \$26.9 million.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Financial Statements

December 31, 2008

**(4) Property and Equipment**

A summary of property and equipment at December 31, 2008 is as follows (in thousands):

		<u>Estimated useful lives</u>
Furniture and fixtures	\$ 25,038	5 – 10 years
Data processing equipment	16,001	5 – 10 years
Computer software	48,805	5 – 10 years
Equipment and machinery	3,150	5 – 10 years
Leasehold improvements	<u>14,285</u>	1 – 15 years
Property and equipment, at cost	107,279	
Accumulated depreciation	<u>(59,049)</u>	
Property and equipment, net	<u>\$ 48,230</u>	

At December 31, 2008, we have property and equipment under capital lease with a cost of \$715,000 and accumulated depreciation of \$101,000.

**(5) Restructuring**

In 2008, we initiated a restructuring plan to reduce our operating costs. We completed the restructuring by December 31, 2008, which included a voluntary separation of employees and the termination of various projects under development. We recorded a pre-tax restructuring charge of \$12.4 million, consisting of employee compensation and other benefit costs, \$453 thousand for accelerated vesting of nonvested stock, and \$717 thousand in project development costs, including \$500 thousand for the early termination of a contract. The restructuring charge is included in general and administrative expenses in the statement of operations.

The activity in the accrued restructuring liability is summarized as follows (in thousands):

	<u>Restructuring charges</u>	<u>Cash payments</u>	<u>Noncash settlements and other</u>	<u>Accrued liability as of December 31, 2008</u>
Employee compensation and other benefits	\$ 11,194	(180)	(215)	10,799
Share based compensation expense	453	—	(453)	—
Contract termination and project development costs	<u>717</u>	<u>—</u>	<u>(217)</u>	<u>500</u>
Employee compensation and other benefits	<u>\$ 12,364</u>	<u>(180)</u>	<u>(885)</u>	<u>11,299</u>

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Financial Statements

December 31, 2008

We expect the remaining restructuring costs to be paid out through 2010, with the majority paid out by the end of 2009. The long-term portion of the restructuring liability of \$2.4 million is included in other liabilities and the short-term portion of \$8.9 million is included in other current liabilities on the balance sheet.

**(6) Income Taxes**

The provision for income taxes for the year ended December 31, 2008 consists of the following (in thousands):

Currently payable:		
Federal	\$	42,632
State		1,941
		44,573
Deferred taxes		(2,355)
Provision for income taxes	\$	42,218

The following table reconciles the statutory federal income tax rate to the Company's effective income tax rate:

Statutory federal income tax rate	35.0%
State income taxes, net of federal tax benefits	1.5
State tax incentives	(0.4)
Nondeductible goodwill impairment expense	2.3
Other items	0.4
Effective income tax rate	38.8%

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Financial Statements

December 31, 2008

The tax effect of temporary differences that give rise to significant portions of deferred tax liabilities and deferred tax assets at December 31, 2008 is presented as follows (in thousands):

Deferred tax liabilities:	
Deferred sales commissions	\$ (805)
Property and equipment	(6,250)
Benefit plans	(4,752)
Purchase of fund assets	(3,547)
Prepaid expenses	(1,279)
Other	(12)
Total gross deferred liabilities	(16,645)
Deferred tax assets:	
Additional pension and post retirement liability	10,856
Accrued expenses	10,255
Nonvested stock based compensation	7,998
State net operating loss carryforwards	3,814
Federal benefit on state liabilities	1,605
Unrealized losses on investment securities	928
Unused state tax credits	264
Other	94
Total gross deferred assets	35,814
Valuation allowance	(3,721)
Net deferred tax asset	\$ 15,448

As of December 31, 2008, the Company has net operating loss carryforwards in certain states in which the Company files on a separate company basis and has recognized a deferred tax asset for such loss carryforwards. The deferred tax asset, net of federal tax effect, related to the carryforwards is approximately \$3.8 million at December 31, 2008. The carryforwards, if not utilized, will expire between 2009 and 2027. Management believes it is not more likely than not that the Company will generate sufficient future taxable income in certain states to realize the benefit of the net operating loss carryforwards, and accordingly, a valuation allowance in the amount of \$3.7 million has been established at December 31, 2008. The Company generated state tax credits of \$145,000 in 2008 and \$119,000 in prior years that will expire between 2028 and 2029 if not utilized. The Company anticipates these credits will be fully utilized prior to their expiration dates.

As of December 31, 2008, the Company had unrecognized tax benefits, including penalties and interest, of \$5.2 million (\$3.6 million net of federal benefit) that, if recognized, would impact the Company's effective tax rate. As of December 31, 2007, the Company had unrecognized tax benefits, including penalties and interest, of \$6.9 million (\$4.6 million net of federal benefit) that, if recognized, would impact the Company's effective tax rate. The unrecognized tax benefits that are not expected to be settled within the next 12 months are included in other liabilities in the accompanying balance sheet; unrecognized tax benefits that are expected to be settled within the next 12 months are included in income taxes payable.

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December 31, 2008

The Company's historical accounting policy with respect to interest and penalties related to tax uncertainties has been to classify these amounts as income taxes, and the Company continued this classification upon the adoption of FIN 48. The total amount of penalties and interest, net of federal benefit, related to tax uncertainties recognized in the statement of income for the year ended December 31, 2008 was \$526,000. The total amount of accrued penalties and interest related to uncertain tax positions at December 31, 2008 of \$1.7 million (\$1.4 million net of federal benefit) is included in the total unrecognized tax benefits described above. The total amount of accrued penalties and interest related to uncertain tax positions at December 31, 2007 was \$1.6 million (\$1.2 million net of federal benefit.)

The following table summarizes the Company's reconciliation of unrecognized tax benefits (excluding penalties and interest) for the year ended December 31, 2008 (in thousands):

		<u>Unrecognized tax benefits</u>
Balance at January 1, 2008	\$	5,219
Increases during the year:		
Gross increases – tax positions in prior period		633
Gross increases – current – period tax positions		280
Decreases during the year:		
Decreases due to settlements with taxing authorities		(2,396)
Decreases due to lapse of statute of limitations		(225)
Balance at December 31, 2008	\$	<u>3,511</u>

In the ordinary course of business, many transactions occur for which the ultimate tax outcome is uncertain. In addition, respective tax authorities periodically audit our income tax returns. These audits examine our significant tax filing positions, including the timing and amounts of deductions and the allocation of income among tax jurisdictions. In 2008, the Company settled four open tax years that were undergoing audit by a state jurisdiction in which the Company operates. The Company also received notification of a favorable outcome on a tax position in which the Company had previously considered partially uncertain and, therefore, had not previously recognized the full tax benefit. The 2005, 2006, and 2007 federal income tax returns are the only open tax years that remain subject to potential future audit. State income tax returns for all tax years after 2004 and, in certain states, income tax returns after 2003 are subject to potential future audit by tax authorities in the Company's major state jurisdictions.

The Company is currently under audit in three other state jurisdictions. It is reasonably possible that audit settlement will occur in these jurisdictions within the next 12-month period. It is estimated that the Company's FIN 48 liability could decrease by approximately \$1.1 million to \$1.7 million (\$732,000 to \$1.2 million net of federal benefit) upon settlement of these audits. Such settlements are not anticipated to have a significant impact on reported income.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Financial Statements

December 31, 2008

**(7) Pension Plan and Postretirement Benefits Other Than Pensions**

The Company participates in the WDR sponsored noncontributory retirement plan (the Plan) that covers substantially all employees. Benefits payable under the Plan are based on an employee's years of service and compensation during the final ten years of employment. WDR allocates pension expense to the Company for the Plan. Such costs for 2008 were \$3.5 million.

The total projected benefit obligation of the Plan is \$98.6 million, of which \$82.7 million relates to the Company. The total pension benefits liability (representing the projected benefit obligation in excess of the pension plan assets) recorded on the balance sheet of WDR at December 31, 2008 is \$20.6 million, of which \$15.3 million relates to our company.

The Company also participates in the WDR sponsored unfunded defined benefit postretirement medical plan (medical plan) that covers substantially all employees including Waddell & Reed advisors. The medical plan is contributory with retiree contributions adjusted annually. All contributions to the medical plan are voluntary as it is not funded and is not subject to any minimum regulatory funding requirements. The contributions for each year represent claims paid for medical expenses. For the year ended December 31, 2008, net accrued medical plan costs in the amount of \$5.2 million are included in other current liabilities and accrued postretirement costs on the balance sheet. During 2008, WDR allocated \$513,000 of medical plan expense to the Company for the Plan. Information reflecting the components of net periodic medical plan cost and the actuarial present value of the benefit obligations attributable to the Company's employees is not segregated within the medical plan.

**(8) Employee Savings Plan**

The Company participates in the WDR sponsored defined contribution plan that qualifies under Section 401(k) of the Internal Revenue Code to provide retirement benefits for employees following the completion of an eligibility period. As allowed under Section 401(k), the plan provides tax-deferred salary deductions for eligible employees. The Company's matching contributions to the plan for the year ended December 31, 2008 were \$3.3 million.

**(9) Net Capital Requirements**

The Company is subject to the SEC 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 15.0 to 1.0. A broker/dealer may elect to not be subject to the Aggregate Indebtedness Standard of paragraph (a)(1)(i) of Rule 15c3-1, in which case net capital must exceed the greater of \$250 thousand or 2% of aggregate debit items computed in accordance with the Formula for Determination of Reserve Requirements for broker/dealers. Our Company made this election during the current year and thus is not subject to the aggregate indebtedness ratio as of December 31, 2008. At December 31, 2008, the Company had net capital of \$7.5 million that was \$7.2 million in excess of its required net capital of \$250,000. The primary difference between net capital and stockholder's equity are the nonallowable assets that are excluded from net capital. See schedule I for additional information regarding net capital.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Financial Statements

December 31, 2008

**(10) Share-Based Compensation**

WDR allocates expenses for nonvested shares of WDR stock to the Company that, in turn, are granted to certain key personnel of the Company under its stock incentive plans. Nonvested stock awards are valued on the date of grant, have no purchase price and vest over four years in 33 ⅓% increments on the second, third and fourth anniversaries of the grant date. Under the parent company's stock plans, shares of nonvested stock may be forfeited upon the termination of employment with the Company, dependent upon the circumstances of termination. Except for restrictions placed on the transferability of nonvested stock, holders of nonvested stock have full stockholders' rights during the term of restriction, including voting rights and the rights to receive cash dividends. The Company pays the Parent for expense related to these awards. For the year ended December 31, 2008, the Company recorded share-based compensation expense totaling \$21.9 million that is included in compensation and related costs in the statement of operations.

**(11) Rental Expense and Lease Commitments**

The Company leases home office buildings, certain sales, and other office space and equipment under long-term operating leases. Rent expense for the year ended December 31, 2008 was \$18.1 million. Future minimum rental commitments under noncancelable operating leases are as follows (in thousands):

2009	\$	15,720
2010		13,494
2011		11,222
2012		9,144
2013		4,801
Thereafter		<u>8,378</u>
	\$	<u><u>62,759</u></u>

New leases are expected to be executed as existing leases expire. Thus, future minimum lease commitments are not expected to be less than those in 2008.

**(12) Transactions with Related Parties**

The current amounts due from affiliates at December 31, 2008 includes noninterest-bearing advances for current operating expenses and commissions due from the sales of affiliates' products. The current amounts due to affiliates at December 31, 2008 include amounts due for administrative and other services.

The Company charges affiliated companies for telephone, accounting, legal, marketing, rent, and other services. The Company received \$5.7 million for the year ended December 31, 2008 for these services.

The amount classified as income tax payable at December 31, 2008 consists entirely of amounts due to WDR for tax allocations.

The Company earns point of sale commissions and Rule 12b-1 fees on sales of the Ivy Funds by the Company's licensed financial advisors. Accordingly, during 2008, the Company recorded \$30.4 million in revenues from the sale of Ivy Funds.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Financial Statements

December 31, 2008

The Company compensates affiliates for point of sale commissions and Rule 12b-1 fees on sales of the Advisor Funds by the affiliates. The Company recorded \$609,000 for these charges for 2008. As described in note 1 a portion of these charges were capitalized as deferred sales commissions.

**(13) Subsidiaries not Consolidated in the Company's FOCUS Report Form X-17A-5**

The statement of financial condition of the Company filed in accordance with instructions to FOCUS Form X-17A-5 Part II for the year ended December 31, 2008 was not consolidated with its subsidiaries. The condensed combined statement of assets and liabilities of the Company's subsidiaries at December 31, 2008 that were not consolidated in the December 31, 2008 FOCUS Form X-17A-5 Part II statement of financial condition is presented as follows (in thousands):

Assets:	
Cash	\$ 68,166
Receivables and prepaids	27,989
Investment securities	8,254
Property and equipment, net	33,572
Goodwill and intangible assets, net	26,854
Deferred income taxes	7,235
Other assets	367
	<hr/>
	172,437
	<hr/>
Liabilities:	
Other liabilities	55,224
Current income taxes	14,766
	<hr/>
	69,990
	<hr/>
Company equity in net assets	\$ <u>102,447</u>

**(14) Contingencies**

The Company is involved from time to time in various legal proceedings, regulatory investigations and claims incident to the normal conduct of business, which may include proceedings that are specific to us and others generally applicable to business practices within the industries in which we operate. A substantial legal liability or a significant regulatory action against us could have an adverse effect on our business, financial condition and on the results of operations in a particular year.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Computation of Net Capital Requirement – Rule 15c3-1 of the  
Securities and Exchange Commission

December 31, 2008

(In thousands)

Total stockholder's equity per balance sheet	\$	197,966
Additions to capital – deferred tax adjustment		8,083
		206,049
Total stockholder's equity for computation of net capital		206,049
Nonallowable assets, including equity in subsidiaries		(196,721)
Haircuts on securities		(1,833)
		7,495
Net capital		7,495
Minimum net capital requirement		250
		7,245
Excess of net capital over minimum net capital requirement	\$	7,245
Aggregate indebtedness	\$	134,288
Ratio aggregate indebtedness to net capital		N/A

Note: A reconciliation of the Company's net capital computation under Rule 15c3-1 is not necessary pursuant to Rule 17a-5(d)(4).

See accompanying independent auditors' report.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Computation for Determination of Reserve Requirements under Rule 15c3-3 of the  
Securities and Exchange Commission

December 31, 2008

The Company is exempt from Rule 15c3-3 pursuant to the provisions of subparagraphs (k)(2)(i) of that rule.

See accompanying independent auditors' report.

**WADDELL & REED, INC. AND SUBSIDIARIES**

(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Information for Possession or Control Requirements under Rule 15c3-3 of the  
Securities and Exchange Commission

December 31, 2008

The Company did not have any customers' fully paid securities and excess margin securities that were not in the Company's possession or control as of December 31, 2008 for which instructions to reduce to possession or control had been issued as of December 31, 2008, but for which the required action was not taken by the Company within the time frames specified under Rule 15c3-3 of the Securities Exchange Act of 1934. The Company also did not have any customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of December 31, 2008, excluding items arising from "temporary lags that result from normal business operations" as permitted under Rule 15c3-3 of the Securities Exchange Act of 1934.

See accompanying independent auditors' report.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Reconciliation of Total Assets Included in the December 31, 2008  
Audited Financial Statements and Total Assets Included in the  
Unaudited December 31, 2008 FOCUS Report

(In thousands)

Total assets per the 2008 FOCUS Report	\$	340,337
Reclassifications/adjustments		<u>56,679</u>
Total assets per the December 31, 2008 audited consolidated financial statements	\$	<u><u>397,016</u></u>

See accompanying independent auditors' report.



**KPMG LLP**  
Suite 1000  
1000 Walnut Street  
Kansas City, MO 64106-2162

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

The Board of Directors  
Waddell & Reed, Inc.

In planning and performing our audit of the consolidated financial statements and supplemental schedules of Waddell & Reed, Inc. (the Company) as of and for the year ended December 31, 2008, 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 consolidated 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 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, comparisons, and recordation of differences required by Rule 17a-13
2. Complying with the requirements for prompt payment for securities under Section 8 of Federal Revenue 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 conformity with U.S. 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 and 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 deficiency in internal control 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 and correct misstatements on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected on a timely basis.

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 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 a material inadequacy for such purposes. Based on this understanding and on our study, we believe that the Company's practices and procedures, as described in the second paragraph of this report, were adequate at December 31, 2008 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 broker-dealers, and is not intended to be, and should not be, used by anyone other than these specified parties.

KPMG LLP

Kansas City, Missouri  
February 25, 2009