



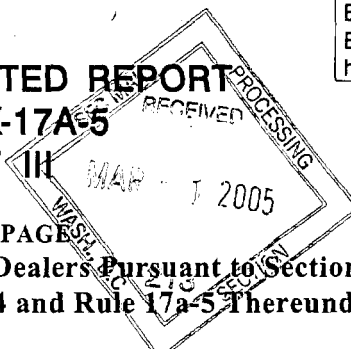
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**ANNUAL AUDITED REPORT**  
**FORM X-17A-5**  
**PART III**



SEC FILE NUMBER
8-48611

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 01/01/04 AND ENDING 12/31/04  
MM/DD/YY MM/DD/YY

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER:

**STANFORD GROUP COMPANY**

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

**5050 WESTHEIMER**

(No. and Street)

**HOUSTON**

**TEXAS**

**77056**

(City)

(State)

(Zip Code)

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

**A. J. RINCON (AKA A.J. RINCOHN)**

**(713) 964-8327**

(Area Code - Telephone Number)

**B. ACCOUNTANT IDENTIFICATION**

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

**BDO SEIDMAN, LLP**

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

**333 CLAY STREET, SUITE 4700**

**HOUSTON**

**TEXAS 77002**

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

Certified Public Accountant

Public Accountant

Accountant not resident in United States or any of its possessions

PROCESSED

MAR 31 2005

FOR OFFICIAL USE ONLY

THOMSON FINANCIAL

\*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)

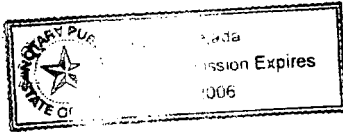
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OATH OR AFFIRMATION

I, A. J. RINCON, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of STANFORD GROUP COMPANY, as of FEBRUARY 22, 2005, 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:



[Signature]  
Notary Public

[Signature]  
Signature

Executive V.P./Chief Financial Officer  
Title

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

- (a) Facing Page.
- (b) Statement of Financial Condition.
- N/ (c) Statement of Income (Loss).
- N/ (d) Statement of Changes in Financial Condition.
- N/ (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietors' Capital.
- N/ (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- N/ (g) Computation of Net Capital.
- N/ (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- N/ (i) Information Relating to the Possession or Control Requirements Under Rule 15c3-3.
- N/ (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.
- N/ (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- (l) An Oath or Affirmation.
- N/ (m) A copy of the SIPC Supplemental Report.
- N/ (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.
- X (o) Independent Auditors' Report on Internal Control.


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



**Stanford Group Company  
and Subsidiary**

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**Consolidated Statement of  
Financial Condition  
and Supplemental Material  
Filed Pursuant to SEC Rule 17a-5(e)(3)  
Under the Securities Exchange Act of 1934  
as a Public Document  
Year Ended December 31, 2004**



# Stanford Group Company and Subsidiary

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## Independent Auditors' Report

The Board of Directors  
Stanford Group Company  
and subsidiary

We have audited the accompanying consolidated statement of financial condition of Stanford Group Company and subsidiary as of December 31, 2004. This consolidated financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement 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 statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. 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 consolidated statement of financial condition referred to above presents fairly, in all material respects, the financial position of Stanford Group Company and subsidiary, as of December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

Houston, Texas  
February 18, 2005

*BDO Seidman, LLP*

# Stanford Group Company and Subsidiary

## Consolidated Statement of Financial Condition

<i>December 31,</i>	2004
<b>Assets</b>	
Cash and cash equivalents	\$ 20,429,523
Due from broker-dealers (Note 1)	1,132,072
Marketable securities owned (Notes 1 and 2)	2,760,036
Accounts receivable	638,334
Receivables from affiliates (Note 6)	2,374,361
Accrued interest receivable	41,148
Prepaid expenses and other assets (Note 4)	6,074,414
Property, equipment and leasehold improvements, net (Note 3)	1,329,656
Federal income taxes receivable	21,000
Deferred tax asset (Note 8)	2,216,000
	<b>\$ 37,016,544</b>
<b>Liabilities and Stockholder's Equity</b>	
<b>Liabilities</b>	
Due to broker-dealers (Note 1)	\$ 2,955,615
Accounts payable and accrued expenses	1,922,338
Interest payable (Note 5)	918,840
Payables to affiliates (Note 6)	5,321,518
	<b>11,118,311</b>
Liabilities subordinated to claims of creditors – affiliate (Note 5)	<b>4,000,000</b>
Commitments and contingencies (Notes 9 and 10)	
<b>Stockholder's equity (Note 9)</b>	
Common stock	1,000
Additional paid-in capital	27,847,361
Accumulated deficit	(5,950,128)
Total stockholder's equity	<b>21,898,233</b>
	<b>\$ 37,016,544</b>

*See accompanying independent auditors' report, summary of significant accounting policies and notes to consolidated financial statement.*

# Stanford Group Company and Subsidiary

## Summary of Significant Accounting Policies

### **Organization and Nature of Business**

Stanford Group Company (the Company) is a wholly-owned subsidiary of Stanford Group Holdings, Inc. (SGH), a Delaware corporation. The Company was incorporated in Texas on July 21, 1995. The Company is registered with the Securities and Exchange Commission (SEC) and various state regulatory jurisdictions as a broker-dealer and an investment adviser and is a member of the National Association of Securities Dealers, Inc. (NASD). Further, the Company is registered with the National Futures Association (NFA) and the Commodity Futures Trading Commission (CFTC) as an introducing broker-dealer. The Company is licensed to execute security trades for customers as agent and principal as well as trading for its own accounts.

The Company has agreements ("Agreements") with Bear Stearns Securities Corp. and First Southwest Company (Clearing Brokers) to clear securities transactions, carry customers' accounts on a fully disclosed basis and perform certain recordkeeping functions. Accordingly, the Company operates under the exemptive provisions of SEC Rule 15c3-3(k)(2)(ii). Pursuant to the Agreements, the Clearing Brokers provide investor protection coverage for the net equity of customer funds and securities positions held by the Clearing Brokers.

### **Principles of Consolidation**

The consolidated statement of financial condition includes the accounts of the Company and its wholly-owned subsidiary, Stanford Agency, Inc., a licensed insurance company that offers variable annuity and life insurance products. All significant intercompany transactions and balances have been eliminated in consolidation.

### **Cash Equivalents**

The Company considers short-term investments with original maturities of three months or less as cash equivalents.

### **Marketable Securities**

The Company accounts for its marketable securities in accordance with Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS No. 115). In accordance with SFAS No. 115, the Company has classified its marketable securities as trading securities. Trading securities are recorded at fair value with the change in fair value during the year included in earnings.

# Stanford Group Company and Subsidiary

## Summary of Significant Accounting Policies

### **Securities Transactions**

Securities listed on a national exchange are valued at the last sales price on the date of valuation. Securities not listed on a national exchange are valued at the last sales price on the date of valuation or, if such price is not available, at the bid price for securities owned and the ask price for securities sold but not yet purchased at the close of business.

### **Property, Equipment and Leasehold Improvements**

Property, equipment and leasehold improvements are stated at cost. Depreciation is computed for financial reporting purposes by the straight-line method and accelerated methods for income tax purposes over their estimated useful lives. Leasehold improvements are amortized over the shorter of the useful life of the asset or the term of the leased property to which they are attached.

The Company reviews its fixed assets for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be fully recoverable. The Company has determined that there has been no impairment of its property and equipment.

### **Income Taxes**

The taxable income of the Company is included in a consolidated federal tax return filed by SGH, its parent company. Income taxes are provided by the Company for its financial statements as if it filed a separate tax return.

The Company uses an asset and liability method of accounting for income taxes that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. In estimating future tax consequences, all expected future events are considered other than enactment of changes in the tax law or rates.

The Company adjusts the deferred tax asset valuation allowance based on judgments as to future realization of the deferred tax benefits supported by demonstrated trends in the Company's operating results.

### **Concentration of Credit Risk**

The Company maintains cash and cash equivalents in bank deposit accounts that, at times, may exceed federally insured limits. At December 31, 2004, the Company's uninsured cash and cash equivalents balances totaled approximately \$19,252,664. The Company has not experienced any losses in such accounts and management believes that the possibility of any credit loss is minimal.



# Stanford Group Company and Subsidiary

## Summary of Significant Accounting Policies

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### **Management's Estimates and Assumptions**

The preparation of the statement of financial condition in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the statement of financial condition. The actual results could differ from these estimates.

# Stanford Group Company and Subsidiary

## Notes to Consolidated Financial Statement

1. **Due to or from Broker-Dealers**      The Agreement with the Clearing Brokers provide the Brokers with liens on all the Company's property held by the Brokers including, but not limited to, securities, deposits, monies and receivables. These liens secure the Company's liabilities and obligations to the Brokers.

2. **Marketable Securities Owned**      Marketable securities owned are stated at market values and consist of the following at December 31, 2004:

	Amount
Municipal securities	\$ 2,416,532
Corporate bonds, debentures, and notes	312,164
Mutual funds	20,973
Corporate equities	10,367
	\$ 2,760,036

3. **Property, Equipment and Leasehold Improvements**      Property, equipment and leasehold improvements consist of the following at December 31, 2004:

	Useful Lives (Years)	
		Amount
Furniture and fixtures	10	\$ 101,735
Office art work	5-7	130,799
Equipment	7-10	324,456
Leasehold improvements	7-10	1,736,599
Computer equipment and software	3-5	1,767,321
Total property and equipment		4,060,910
Less accumulated depreciation and amortization		(2,731,254)
		\$ 1,329,656

# Stanford Group Company and Subsidiary

## Notes to Consolidated Financial Statement

### 4. Prepaid Expenses and Other Assets

Prepaid expenses and other assets consist of the following at December 31, 2004:

	Amount
Advanced compensation arrangements, net	\$ 5,036,799
Prepaid expenses	613,374
Prepaid rent	298,064
Prepaid insurance	24,144
Other assets	102,033
	<u>\$ 6,074,414</u>

Advanced compensation arrangements represent "upfront payments" to Company brokers, which are subject to conditions set forth in promissory note agreements. Upfront payments are earned and, therefore, not repayable by the note holder upon their continued employment with the Company for periods of generally five years. Accordingly, these upfront payments are amortized and charged to amortization of advanced compensation arrangements expense by the Company in accordance with such employment terms. In circumstances where the brokers terminate prior to the expiration of their agreements, the noteholder is obligated to repay any unearned balance due to the Company. The Company maintains reserves for estimated unrecoverable amounts due under these arrangements. At December 31, 2004, the Company had reserves of approximately \$1,098,000 for estimated unrecoverable amounts. (See Note 10.)

### 5. Liabilities Subordinated to Claims of Creditors

On May 31, 2000, the Company entered into a loan agreement with an entity related through common ownership, for a total of \$4,000,000. This note payable matures on or before May 31, 2010. The interest rate is 4.94%, which is based on the Applicable Federal Rate prescribed by the I.R.S. at the date of the agreement. The principal and all interest accrued thereon is payable any time prior to or upon maturity.

# Stanford Group Company and Subsidiary

## Notes to Consolidated Financial Statement

The loan agreement was approved by the NASD as a satisfactory subordinated loan agreement for equity capital pursuant to the provisions of 17 CFR 240.15c3-d. In accordance with Appendix D of SEC Rule 15c3-1, the Company is required to obtain written approval of the NASD before any principal or interest repayment of the subordinated loan agreement can be made. Additionally, pursuant to the provisions of 17 CFR 240.15c3-1(e), no equity capital of the Company or its subsidiaries may be withdrawn or distributed if it would cause certain ratios of aggregate indebtedness to net capital, as defined, to not be met.

The Company has not made repayments of principal or interest as of December 31, 2004. (See Note 7.)

### 6. **Related Party Transactions**

Pursuant to joint marketing agreements, the Company and an affiliated foreign financial institution agreed to jointly market and offer fixed income and trust products to their respective customers. In connection therewith, the Company is entitled to referral fees based upon percentages of the referred portfolio as defined in the respective agreements. These agreements are automatically renewable for successive one year periods unless terminated by either party on thirty days prior written notice. At December 31, 2004, the Company had receivables from affiliates of \$1,059,919 related to such referrals. Additionally, the Company has approximately \$1,314,442 in receivables from affiliates primarily related to certain cost allocations and routine transactions in the normal course of business.

At December 31, 2004, the Company had payables to affiliates of \$5,321,518 related to operating expenses incurred with the affiliates. The expenses incurred were primarily for leasing of furniture, computers and computer related equipment, advertising, rent, insurance, telecommunication and commission expenses. In 2004, the Company entered into a new service agreement with an affiliate wherein the Company incurred additional operating expenses relating primarily to business promotion, information technology and legal services.

# Stanford Group Company and Subsidiary

## Notes to Consolidated Financial Statement

### 7. Fair Value of Financial Instruments

The financial instruments of the Company are reported in the consolidated statement of financial condition at market or fair values, or at carrying amounts that approximate fair values.

The Company's subordinated loan agreement with an affiliate, included in liabilities subordinated to claims of creditors in the consolidated statement of financial condition, is recorded at its original carrying amount. The fair value of the loan is estimated based on the current market rate that could be obtained by the related party lender for the same or similar debt with the same remaining maturity. The carrying amount and estimated fair value of the subordinated loan at December 31, 2004 is \$4,000,000 and \$5,754,000, respectively.

### 8. Income Taxes

Deferred taxes are determined based on temporary differences between the financial statement and income tax bases of assets and liabilities as measured by enacted tax rates, which will be in effect when these differences are expected to reverse.

Deferred income taxes consist of the following at December 31, 2004:

	Amount
Capital loss carryover	\$ 220,000
Reserve for advanced compensation arrangements	373,000
Property and equipment	42,000
Self-insurance reserves	150,000
Net operating loss carryforward	1,347,000
Other	102,000
Gross deferred tax asset	2,234,000
Valuation allowance	(18,000)
Net deferred tax asset	\$ 2,216,000

At December 31, 2004, the Company had a net operating loss carryforward of approximately \$3,960,000 for income tax reporting purposes, available to offset future years' taxable income through 2024.

# Stanford Group Company and Subsidiary

## Notes to Consolidated Financial Statement

At December 31, 2004, the Company had capital loss carryforwards for tax reporting purposes totaling approximately \$648,000, which are available to offset future taxable income and income tax through the year 2008. At December 31, 2004, the Company provided a valuation allowance against a portion of the capital loss carryover since the future realizability of capital losses of \$107,000 expiring in 2005 is not reasonably assured.

### 9. Regulatory Net Capital Requirements

The Company is subject to the Securities and Exchange Commission's Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum regulatory net capital. The Company has elected to use the alternative method, permitted by the rule, which requires the Company to maintain minimum regulatory net capital, as defined, equal to the greater of \$250,000 or 2% of aggregate debit balances arising from customer transactions, as defined. Regulatory net capital may fluctuate on a daily basis. At December 31, 2004, the Company had regulatory net capital, as defined under SEC Rule 15c3-1, of \$12,757,584, which was \$12,507,584 in excess of its required regulatory net capital of \$250,000.

The Company is also subject to the Commodity Futures Trading Commission's Net Capital Rule in accordance with Section 1.10 of the Commodity Exchange Act, which requires the maintenance of a minimum regulatory net capital amount of \$30,000.

### 10. Commitments and Contingencies

#### *Customer Transactions*

In the normal course of business, the Company executes, as agent, securities transactions on behalf of its customers. If the agency transactions do not settle because of failure to perform by either the customer or the counterparty, the Company may be obligated to discharge the obligation of the nonperforming party and, as a result, is subject to market risk if the market value of the securities is different from the contract amount of the transactions.

The Company does not anticipate nonperformance by customers or counterparties in the above situations. The Company's policy is to monitor its market exposure and counterparty risk. In addition, the Company has a policy of reviewing, as considered necessary, the credit standing of each counterparty and customer with which it conducts business.

# Stanford Group Company and Subsidiary

## Notes to Consolidated Financial Statement

### *Legal Matters*

The Company is involved in various legal actions and other claims arising in the ordinary course of business. The Company believes it is unlikely that the final outcome of any claim or litigation to which the Company is a party will have a material adverse effect on the Company's financial position or results of operations; however due to uncertainty of litigation, there can be no assurance that the resolution of any particular claim would not have a material adverse effect on the Company's results of operations.

During the year the Company was involved in various matters with former brokers, which, in some cases, were arbitrated by an NASD panel, seeking to recover amounts due the Company under advanced compensation arrangements. At December 31, 2004, the Company has similar matters pending under arbitration. Management believes, based on the opinion of its legal council, that the final disposition of these matters will not have a material adverse effect on the Company's financial condition.

### *Self-Insurance*

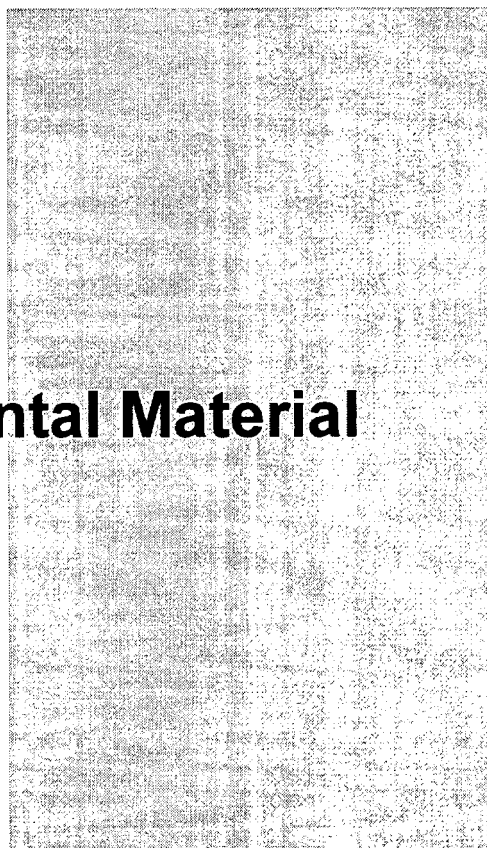
The Company has a self-insured program for medical and dental benefits for its employees. The program is administered by a third party insurance company, which in addition to charging an administrative fee, also provides insurance for claims in excess of an individual stop-loss of \$75,000 per participant per year, and an aggregate stop-loss of \$950,769 per year.

### *Operating Leases*

The Company leases office space and certain equipment under operating lease agreements (some of which are month-to-month) expiring through 2015. At December 31, 2004, the future minimum rental payments required under these leases were as follows:

<i>Year Ending December 31,</i>	<i>Amount</i>
2005	\$ 2,045,692
2006	1,835,494
2007	1,783,527
2008	1,724,659
2009	1,431,873
Thereafter	6,871,709
<b>Total</b>	<b>\$ 15,692,954</b>

# **Supplemental Material**





**Independent Auditors' Report  
on Internal Control Required  
By SEC Rule 17a-5 and Section 1.16 of  
the Commodity Exchange Act**

**The Board of Directors  
Stanford Group Company  
and Subsidiary**

In planning and performing our audit of the consolidated statement of financial condition of Stanford Group Company and subsidiary as of December 31, 2004, we considered its internal control, including control activities for safeguarding securities, in order to determine our auditing control activities for the purpose of expressing our opinion on the statement of financial condition as of December 31, 2004, and not to provide assurance on internal control.

Also, as required by Rule 17a-5(g)(1) of the Securities and Exchange Commission ("SEC") and Section 1.16 of the Commodity Exchange Act ("CEA"), we have made a study of the practices and procedures followed by the Company, including tests of compliance with such practices and procedures that we considered relevant to the objectives stated in SEC Rule 17a-5(g) and Commodity Futures Trading Commission ("CFTC") Section 1.16, in making the periodic computations of aggregate indebtedness and net capital under SEC Rule 17a-3(a)(11) and Section 1.18 of the CEA, in making the periodic computations of aggregate indebtedness (or aggregate debits) and net capital under Rule 17a-3(a)(11) and for determining 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 the quarterly securities examinations, counts, verifications, and comparisons
2. Recordation of differences required by Rule 17a-13
3. Complying with the requirements for prompt payment for securities under Section 8 of Federal Reserve Regulation T of the Board of Governors of the Federal Reserve System

The management of the Company is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls, and of the practices and procedures referred to in the preceding paragraph, and to assess whether those practices and procedures can be expected to achieve the SEC's above-mentioned objectives. Two of the objectives of internal control and the practices and procedures are to provide management with reasonable but not absolute assurance that assets for which the Company has responsibility are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit preparation of financial statements in accordance with generally accepted accounting principles. SEC Rule 17a-5(g) and Section 1.12 of the CEA list 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, errors 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 effectiveness of their design and operation may deteriorate. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control, including procedures 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 and the CFTC ("the Commissions") to be adequate for its purposes in accordance with the Securities Exchange Act of 1934 and related regulations, as well as the CEA 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 December 31, 2004, to meet the Commissions' objectives.

This report is intended solely for the information and use of the Board of Directors, of management, the SEC, the National Association of Securities Dealers, Inc. and other state and federal regulatory agencies which rely on SEC Rule 17a-5(g) under the Securities Exchange Act of 1934 in their regulation of registered brokers and dealers, and should not be used for any other purpose. Further, this report is intended for the use of the National Futures Association and the CFTC which rely on Section 1.16 and 1.18 of the CEA.

*BDO Seidman, LLP*

Houston, Texas  
February 18, 2005