



D.A. DAVIDSON & CO.

Statements of Financial Condition

September 30, 2006 and 2005

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

Independent Auditors' Report

To the Board of Directors
D.A. Davidson & Co.:

We have audited the accompanying statements of financial condition of D.A. Davidson & Co. (a wholly-owned subsidiary of Davidson Companies) as of September 30, 2006 and 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 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 of a statement of financial condition includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement of financial condition, 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 audits provide a reasonable basis for our opinion.

In our opinion, the statements of financial condition referred to above present fairly, in all material respects, the financial position of D.A. Davidson & Co. as of September 30, 2006 and 2005 in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

November 17, 2006

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| <u>Assets</u> | <u>2006</u> | <u>2005</u> |
|--|-----------------------|--------------------|
| Cash and cash equivalents | \$ 62,516,934 | 25,415,306 |
| Receivables: | | |
| Customers, net | 74,469,262 | 88,739,852 |
| Brokers, dealers and clearing organizations | 9,107,854 | 10,560,065 |
| Related parties | 1,743,083 | 1,236,511 |
| Other | 3,074,902 | 7,422,014 |
| | <u>88,395,101</u> | <u>107,958,442</u> |
| Securities at market value: | | |
| Municipal bonds | 16,467,387 | 11,723,029 |
| U.S. Government obligations | 1,891,256 | 3,045,984 |
| Corporate bonds | 374,547 | 1,745,269 |
| Common and preferred stock | 957,411 | 844,398 |
| | <u>19,690,601</u> | <u>17,358,680</u> |
| Exchange memberships at cost (estimated fair market value \$53,500 in 2006 and \$52,000 in 2005) | 15,750 | 15,750 |
| Equipment and leasehold improvements (less accumulated depreciation and amortization of \$15,609,386 in 2006 and \$13,744,063 in 2005) | 7,701,075 | 7,245,499 |
| Cash surrender value - life insurance | 730,883 | 706,487 |
| Notes receivable, net | 11,251,001 | 7,923,693 |
| Goodwill, net | 2,395,337 | 2,395,337 |
| Other intangible assets, net | 104,167 | 187,500 |
| Other assets | 7,554,909 | 10,277,627 |
| Deferred tax asset, net | 7,943,912 | 6,625,321 |
| | <u>37,697,033</u> | <u>35,377,214</u> |
| | <u>\$ 208,299,668</u> | <u>186,109,642</u> |
| <u>Liabilities and Shareholder's Equity</u> | | |
| Liabilities: | | |
| Checks in advance of deposits | \$ 4,610,843 | 5,595,121 |
| Payables: | | |
| Brokers, dealers and clearing organizations | 2,552,062 | 1,627,259 |
| Customers | 57,307,257 | 53,307,635 |
| Related parties | 4,458,280 | 3,031,130 |
| Market value of securities sold, but not yet purchased | 1,029,298 | 952,422 |
| Income taxes | 1,460,663 | 1,218,721 |
| Accrued payroll and profit sharing | 42,743,504 | 36,782,262 |
| Other payables and accrued liabilities | 4,615,422 | 4,018,342 |
| Total liabilities | <u>118,777,329</u> | <u>106,532,892</u> |
| Commitments and contingencies | | |
| Shareholder's equity: | | |
| Common stock (\$.10 par value. Authorized 3,000,000 shares; 1,000 shares issued and outstanding) | 100 | 100 |
| Additional paid-in capital | 13,222,742 | 12,447,360 |
| Retained earnings | 76,299,497 | 67,129,290 |
| Total shareholder's equity | <u>89,522,339</u> | <u>79,576,750</u> |
| | <u>\$ 208,299,668</u> | <u>186,109,642</u> |

See accompanying notes to the statements of financial condition.

D.A. DAVIDSON & CO.

Notes to Statements of Financial Condition

September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies

Organization

D.A. Davidson & Co. (the Company) is a broker-dealer registered with the Securities and Exchange Commission (SEC) and is a member of various exchanges and the National Association of Securities Dealers, Inc. The Company is a Montana corporation that is a wholly-owned subsidiary of Davidson Companies (the Parent). The Company's activities as a securities broker-dealer comprise several classes of services, including principal transactions, agency transactions, investment banking and investment advisory services. These services are provided to its customers throughout the nation from its offices primarily located in the Pacific Northwest and Rocky Mountain regions.

(a) Revenue Recognition

Customer securities transactions are reported on a settlement date basis. Proprietary securities transactions are reported on a trade date basis and the related gains or losses are recorded net in principal trading. Amounts receivable and payable for proprietary securities transactions that have not reached their contractual settlement date are recorded net on the statement of financial condition. Marketable securities are valued at market value, and securities not readily marketable are valued at fair value as determined by the Board of Directors with the related gains and losses recorded net in principal trading. Investment banking revenues include gains, losses, and fees, net of syndicate expenses, arising from securities offerings in which the Company acts as an underwriter or agent. Investment banking revenues also include fees earned from providing merger-and-acquisition and financial restructuring advisory services. Investment banking management fees are recorded on the offering date, sales commissions are recorded on settlement date, and underwriting fees are recognized at the time the underwriting is completed and the gain or loss is readily determinable. Advisory and administrative fees are recorded as earned, with billed but not paid amounts reflected as accounts receivable and amounts received but not earned reflected as deferred fee income. Investment company administrative 12b-1 fees are recorded when received.

(b) Investment Securities

Investment securities at September 30, 2006 and 2005 consist of municipal, government and corporate debt and equity securities. The Company generally classifies its investments as trading securities. Trading securities are bought and held principally as inventory for the purpose of sales in the near term. Trading securities are recorded at fair value with unrealized gains and losses included in earnings.

(c) Securities Lending Activities

Securities borrowed and securities loaned are recorded at the amount of cash collateral advanced or received. Securities borrowed transactions require the Company to deposit cash with the lender. With respect to securities loaned, the Company receives cash in an amount generally in excess of the market value of securities loaned. The Company monitors the market value of securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as necessary.

(Continued)

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(d) *Income Taxes*

The Company and its sister corporations are included in the consolidated federal and combined state income tax returns filed by the Parent. Federal income taxes are calculated as if the companies filed on a separate return basis.

The Company accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. When applicable, a valuation allowance is established to reduce any deferred tax asset when it is determined that it is more likely than not that some portion of the deferred tax asset will not be realized.

(e) *Cash Equivalents*

Cash equivalents consist primarily of money market funds which invest in United States Treasury bills, notes and commercial paper with original maturities of 90 days or less, and amounted to \$57,000,000 and \$17,800,000 at September 30, 2006 and 2005, respectively.

(f) *Receivable from and Payable to Customers*

Accounts receivable from and payable to customers include amounts due on cash and margin transactions. Securities owned by customers are held as collateral for receivables.

(g) *Equipment and Leasehold Improvements*

Equipment and leasehold improvements are recorded at cost. Depreciation is provided on a straight-line or accelerated basis using estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the economic useful life of the improvement or the term of the lease. Estimated useful lives range from 2 to 10 years.

(h) *Goodwill*

Goodwill represents the excess of costs over fair value of net assets of businesses acquired. Goodwill and intangible assets acquired in a business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS Statement No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*. As of September 30, 2006 and 2005, the balance of goodwill, net of \$735,559 of accumulated amortization, was \$2,395,337.

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The Company is required to identify the related reporting unit that pertains to any goodwill balance and to test goodwill for impairment by comparing the fair value of the reporting unit to the carrying amount of the goodwill. The Company has identified its related reporting unit as its equity capital markets business and has allocated goodwill accordingly. The Company estimated the fair value of the reporting unit, and determined that the unit's fair value exceeds its carrying value, and consequently, no impairment is evident at September 30, 2006.

The Company acquired an intangible asset for the right to hire desired employees in the purchase of Kirkpatrick, Pettis, Smith, Polian, Inc. (see note 14).

(i) Allowance for Doubtful Receivables

The Company provides an allowance for losses on doubtful and impaired customer accounts and notes receivable based on management's evaluation of existing accounts outstanding and historical experience related to such activity. The receivable is considered impaired when, based upon current information and events, it is probable that the Company will be unable to collect, on a timely basis, all principal and interest according to the contractual terms of the receivable's original agreement. When a specific receivable is determined to be doubtful or impaired, the allowance for receivables is increased through a charge to expense for the amount of the estimated loss or impairment. The Company continues to accrue interest on the impaired loans which is added to the outstanding principal. The Company reserves all of the accrued interest by increasing the allowance for receivables similar to an impairment charge.

The Company's investment in impaired customer accounts and notes receivable for which there is not a related allowance for credit losses totaled \$720,000 at September 30, 2006 and 2005. The remaining impaired loan balance of \$2,467,076 and \$2,220,883 at September 30, 2006 and 2005, respectively, has been fully reserved. Allowances for estimated losses and impairment on customer accounts and notes receivable totaled \$2,601,727 and \$2,813,385 at September 30, 2006 and 2005, respectively.

(j) Estimates

The preparation of statements 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 certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(k) Stock-Based Compensation

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the grant date market price of the underlying stock exceeded the exercise price.

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In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R). This Statement is a revision to SFAS No. 123 and supersedes APB Opinion No. 25 and its related implementation guidance. For nonpublic companies, this Statement will require measurement of the cost of employee services received in exchange for stock compensation based on the grant-date fair value (precluding the use of the minimum value method) of the employee stock options. Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized. This Statement is effective for the Company as of October 1, 2006. The adoption of SFAS No. 123R's fair value method will have no impact on the Company's statement of financial condition.

(l) *Impairment of Long-Lived Assets*

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets such as property, plant and equipment, and intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an asset is deemed impaired and an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. As of September 30, 2006 there were no long-lived assets that were considered impaired.

(m) *Fiscal Year*

The Company's fiscal year end is September 30. Unless otherwise noted, reference to a fiscal year refers to the year in which such fiscal year ends.

(n) *Reclassifications*

Certain reclassifications have been made to the 2005 statement of financial condition to conform to the 2006 presentation.

(2) *Net Capital Requirements*

D.A. Davidson & Co. is subject to the Uniform Net Capital Rule (15c3-1) pursuant to the Securities Exchange Act of 1934. Under the alternate method, the Company is required to maintain a net capital amount in excess of the greater of \$250,000 or 2% of aggregate debit balances as defined in the Formula for Reserve Requirements under SEC Rule 15c3-3. At September 30, 2006, the Company's net capital of \$47,468,361 was 62.3% of aggregate debit items and net capital exceeded the required capital of \$1,524,238 by \$45,944,123.

The net capital computation included in the Company's FOCUS report and filed with the National Association of Securities Dealers, Inc. on October 24, 2006, reported net capital of \$48,744,376, which differed from the amount above due to period end adjustments for the change in deferred tax assets and other items.

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(3) Receivables From and Payables to Brokers, Dealers and Clearing Organizations

Amounts receivable from and payable to brokers, dealers and clearing organizations consist of the following:

| | <u>Receivable</u> | <u>Payable</u> |
|---|----------------------|------------------|
| September 30, 2006: | | |
| Deposits for securities borrowed/loaned | \$ 1,819,400 | - |
| Securities failed-to-deliver/receive | 1,999,614 | 1,105,637 |
| Payable to clearing broker | - | 1,446,425 |
| Receivable from clearing broker | 3,011,535 | - |
| Receivable from clearing organizations | 1,257,550 | - |
| Other | 1,019,755 | - |
| | <u>\$ 9,107,854</u> | <u>2,552,062</u> |
| September 30, 2005: | | |
| Deposits for securities borrowed/loaned | \$ 3,106,600 | - |
| Securities failed-to-deliver/receive | 471,205 | 945,606 |
| Payable to clearing broker | - | 681,653 |
| Receivable from clearing broker | 5,926,755 | - |
| Receivable from clearing organizations | 599,198 | - |
| Other | 456,307 | - |
| | <u>\$ 10,560,065</u> | <u>1,627,259</u> |

The Company held securities belonging to counterparties as collateral under stock borrow agreements, with the right to re-pledge or sell the assets, with fair market values of \$1,739,934 and \$2,954,926 as of September 30, 2006 and 2005, respectively.

(4) Securities Owned and Sold, Not Yet Purchased

Marketable securities owned and sold, not yet purchased, consist of trading and investment securities at market values, as follows:

| | <u>2006</u> | | <u>2005</u> | |
|-----------------------------|----------------------|--------------------------------|-------------------|--------------------------------|
| | <u>Owned</u> | <u>Sold, Not Yet Purchased</u> | <u>Owned</u> | <u>Sold, Not Yet Purchased</u> |
| Municipal bonds | \$ 16,467,387 | - | 11,723,029 | - |
| U.S. government obligations | 1,891,256 | 114,289 | 3,045,984 | 12 |
| Corporate bonds | 374,547 | 19,770 | 1,745,269 | 92,905 |
| Common and preferred stock | 957,411 | 895,239 | 844,398 | 859,505 |
| | <u>\$ 19,690,601</u> | <u>1,029,298</u> | <u>17,358,680</u> | <u>952,422</u> |

There were no securities not readily marketable at September 30, 2006 or 2005.

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(5) Secured and Unsecured Loans

The Company has two revolving lines of credit with banks totaling \$45,000,000, secured by certain Company or customer margin assets, and one unsecured revolving line of credit with a bank for \$10,000,000. The revolving lines of credit bear interest at an intra-day federal funds rate plus .50% to .75% and the lines of credit do not have an expiration date. There were no outstanding borrowings under these lines of credit at September 30, 2006 or 2005.

(6) Employee Benefit Plans

Employees of the Company participate in the Parent's retirement savings and profit sharing plan and employee stock ownership plan. Each plan is a defined contribution plan covering all employees who have completed a year of service. Participants become 100% vested in the employer contribution account after seven years of service. The proportionate cost of the respective plans is borne by the Company through annual contributions in amounts determined by the board of directors of the Parent. Investments of the employee stock ownership plan consist entirely of common stock of the Parent. The Parent's common stock is appraised twice annually as of the end of each plan year by an independent certified business appraiser to determine the current fair market value.

Participants may contribute to the Parent's retirement savings and profit sharing plan under the retirement savings portion of the plan. Contributions are based on a participant's choice of a percentage up to limits established by the plan.

(7) Income Taxes

Differences between the financial statement carrying amounts and the tax bases of assets and liabilities that give rise to significant portions of deferred tax assets and liabilities are as follows:

| | 2006 | 2005 |
|---|--------------|-------------|
| Deferred tax assets: | | |
| Employee compensation and benefits | \$ 7,106,963 | 5,994,581 |
| Equipment and leasehold improvements, principally differences in depreciation | 896,527 | 651,349 |
| Allowance for doubtful receivables | 51,948 | 70,286 |
| Accrued expenses | 222,800 | 87,490 |
| Impairment of assets | - | 20,697 |
| State taxes | - | 30,411 |
| Other | 282,735 | 221,074 |
| Total deferred tax assets | 8,560,973 | 7,075,888 |
| Deferred tax liabilities: | | |
| Prepaid expenses | 594,497 | 450,567 |
| State taxes | 22,564 | - |
| Total deferred tax liabilities | 617,061 | 450,567 |
| Net deferred tax asset | \$ 7,943,912 | 6,625,321 |

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In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the existence of, or generation of, taxable income in the periods in which those temporary differences are deductible. Management considers the scheduled reversal of deferred tax liabilities, taxes paid in carryback years, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and estimates of future taxable income over the periods in which the deferred tax assets are deductible, at September 30, 2006, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

(8) Related Party Transactions

The Parent wholly owns the Company and the Company's five sister corporations: Davidson Investment Advisors, Inc., Davidson Travel, Inc., Davidson Trust Co., Davidson Fixed Income Management, Inc. and Davidson Funding Company 1. Additional related parties consist of significant shareholders of the Parent, directors and principal officers.

In the normal course of business, the Company advances funds to and receives funds from related parties. These receivables and payables bear interest at broker call rates.

Notes receivable consist of loans to the Company's financial consultants. These notes earn interest at rates consistent with current market rates and are repaid over a term of three to ten years. Repayment is made with the consultants' bonus compensation.

The Company rents its Great Falls office space from a partnership whose partners include a significant shareholder of the Parent and their immediate family.

(9) Stock Based Compensation

The Parent's stock option plan (the "Plan") provides for the granting of Parent common stock options to officers, key employees and directors of the Parent and its subsidiaries. Options granted under the Plan are designated as either incentive stock options or as non-qualified stock options. All options currently outstanding vest or are earned over periods ranging from one to five years.

Stock activity for D.A. Davidson & Co.'s portion of the Plan for the years ended September 30, 2006 and 2005 is as follows:

| | Options Outstanding | |
|---|-----------------------------|--|
| | Number of Shares | Weighted Average Exercise Price |
| Outstanding at September 24, 2004 (143,329 exercisable) | 580,145 | \$ 13.34 |
| Granted | 184,729 | 14.26 |
| Exercised | (31,720) | 13.18 |
| Expired | (91,840) | 13.46 |
| Outstanding at September 30, 2005 (204,155 exercisable) | 641,314 | 13.60 |
| Granted | 205,300 | 15.35 |
| Exercised | (75,292) | 13.01 |
| Expired | (74,151) | 13.58 |
| Outstanding at September 30, 2006 (236,525 exercisable) | 697,171 | \$ 14.17 |

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The options issued and outstanding under the Plan are exercisable at various prices, depending upon terms under which the option is issued and the stock price on the issuance date. As of September 30, 2006, the quantities and prices of various options outstanding are:

| Outstanding | | | Exercisable | | |
|---------------------|--|---|---------------------|--|--|
| Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Term to Expiration | Number of Shares | Weighted Average Exercise Price | |
| 95,277 | \$ 14.06 | 3 months | 89,165 | \$ 14.06 | |
| 97,014 | 13.22 | 15 months | 64,455 | 13.23 | |
| 235,580 | 13.41 | 33 months | 68,905 | 13.28 | |
| 269,300 | 15.22 | 51 months | 14,000 | 14.84 | |
| 697,171 | | | 236,525 | | |

The Company also has a non-compensatory employee stock purchase plan which allows employees to purchase stock of the Parent at a discount subject to certain limits specified by the plan.

(10) Financial Instruments

Financial Instruments With Off-Balance-Sheet Risk

In the normal course of business, the Company enters into when-issued underwriting and purchase commitments. Transactions relating to such commitments open at September 30, 2006, and subsequently settled, had no material effect on the statements of financial condition.

The Company's normal business activities also involve the execution, settlement and financing of various securities transactions. These activities may expose the Company to credit and market risks in the event the customer or counterparty is unable to fulfill its contractual obligations. Such risks may be increased by volatile trading markets. These risks are not recorded in the statement of financial condition.

As part of its normal brokerage activities, the Company sells securities not yet purchased (short sales) for its own account and will therefore be obligated to purchase such securities at a later date. The Company has recorded these obligations in the financial statements at market values of the related securities and will incur a loss in the event prices increase subsequent to year end.

The Company seeks to control the risk associated with its customer receivables by requiring customers to maintain margin collateral in compliance with various regulatory and internal guidelines. The Company monitors required margin levels daily and, pursuant to such guidelines, requires customers to deposit additional collateral or to reduce positions when necessary.

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A portion of the Company's customer activity involves the sale of securities not yet purchased and the writing of option contracts. Such transactions may require the Company to purchase or sell financial instruments at prevailing market prices in order to fulfill the customer's obligation.

The Company arranges secured financing by pledging firm and unpaid customer securities for bank loans, securities loaned, and to satisfy deposits required by various clearing organizations. In the event the counterparty is unable to return such securities pledged, the Company may be exposed to the risks of acquiring the securities at prevailing market prices or holding collateral possessing a market value less than that of the related pledged securities. The Company continues to report assets it has pledged as collateral in secured borrowing and other arrangements when the secured party cannot sell or re-pledge the assets. The Company seeks to control these risks by monitoring the market value of securities pledged and requiring adjustments of collateral levels where necessary.

(11) Concentration of Credit Risk

The Company is engaged in various trading and brokerage activities whose counterparties primarily include broker-dealers, banks, and other financial institutions. In the event the counterparties do not fulfill their obligations, the Company may be exposed to risk. The risk of default depends on the creditworthiness of the counterparty or issuer of the instrument. It is the Company's policy to review, as necessary, the credit standing of each counterparty with which it conducts business.

(12) Fair Value Considerations

Substantially all the Company's financial instruments are carried at fair value or amounts that approximate fair value. Receivables from customers, primarily consisting of floating rate loans collateralized by margin securities, earn interest at rates similar to other such loans made throughout the industry. The Company's remaining financial instruments are generally short-term in nature and liquidate at their carrying values. The estimated fair value amounts have been determined by the Company using available market information and appropriate methodologies. Considerable judgment is necessarily required in interpreting market data to develop the estimates at fair value and, accordingly, the estimates are not necessarily indicative of the amounts that the Company could realize in a current market exchange.

(13) Commitments and Contingencies

The Company conducts its operations from leased facilities. The following is a schedule by year of future minimum rental payments required under leases that have remaining non-cancelable lease terms in excess of one year as of September 30, 2006:

| | <u>Related Party</u> | <u>Third Party</u> |
|------------|--------------------------|------------------------|
| 2007 | \$ 726,519 | 4,541,636 |
| 2008 | 737,416 | 3,798,674 |
| 2009 | 748,477 | 3,245,851 |
| 2010 | 759,704 | 2,703,465 |
| 2011 | 771,100 | 1,894,020 |
| Thereafter | <u>1,709,803</u> | <u>3,163,825</u> |
| | <u>\$ 5,453,019</u> | <u>19,347,471</u> |

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The Parent has a partially self-insured plan for eligible employee medical and dental expenses. Stop loss insurance is maintained for individual claims in excess of \$125,000 for each policy year. In addition, the Parent has an aggregate stop loss in place of approximately \$6,355,332 at September 30, 2006. The Parent is also self-insured for employee short-term disability coverage. The maximum coverage period is fifty weeks. Benefits are subject to certain weekly compensation limits.

In the normal course of business, the Company is involved in various claims and litigation. In the opinion of management, following consultation with legal counsel, the ultimate liability or disposition thereof is not expected to have a material adverse effect on the financial condition of the Company.

(14) Acquisition

On December 31, 2004, the Company completed an asset acquisition of Kirkpatrick, Pettis, Smith, Polian, Inc. (KPSP). The purchase price paid of \$414,459 was based on the fair value of the assets acquired of \$853,145 less liabilities assumed at closing of \$688,686, plus a premium of \$250,000.

The \$250,000 premium paid has been recorded as an intangible asset and is being amortized on a straight-line basis over its estimated useful life of 3 years. As of September 30, 2006 and 2005, the balance of the intangible, net of amortization, was \$104,167 and \$187,500, respectively. Amortization expense of \$83,333 and \$62,500 was recorded during the years ended September 30, 2006 and 2005, respectively. Estimated amortization expense for the next two years is \$83,333 in 2007, and \$20,834 in 2008.

In conjunction with the acquisition, the Company entered into employment agreements with certain key KPSP employees obligating the company to pay compensation over three years up to a maximum amount of \$4,650,000. A portion of this compensation is dependent upon the acquired group attaining certain revenue levels over the three year period. The compensation is being expensed over the three year term of the employment agreements.