

WEDBUSH MORGAN SECURITIES INC.

(SEC Identification No. 8-12987)

Statement of Financial Condition
(Unaudited)

December 31, 2007

The Company's audited statement of financial condition as of June 30, 2007, filed pursuant to S.E.C. Rule 17a-5, is available for examination at the Company's Los Angeles office and at the Los Angeles regional office of the Securities and Exchange Commission.

WEDBUSH MORGAN SECURITIES INC.

Statement of Financial Condition

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Assets

Cash and cash equivalents	\$	26,760,000
Segregated cash		106,150,000
Short-term investments – securities purchased under agreements to resell		1,227,017,000
Receivables:		
Brokers, dealers and clearing organizations		701,916,000
Customers, collateralized by securities		307,236,000
Other		21,175,000
Total receivables		<u>1,030,327,000</u>
Less allowance for doubtful receivables		(6,820,000)
Net receivables		<u>1,023,507,000</u>
Securities owned, at fair value		50,057,000
Memberships in exchanges, at cost (fair value, \$375,000)		6,000
Other assets		<u>3,451,000</u>
	\$	<u><u>2,436,948,000</u></u>

Liabilities and Stockholders' Equity

Bank loan payable	\$	—
Payables:		
Brokers, dealers and clearing organizations		687,153,000
Customers		1,484,485,000
Securities sold, not yet purchased, at fair value		43,307,000
Accounts payable and accrued liabilities		<u>42,930,000</u>
Total liabilities		<u>2,257,875,000</u>
Commitments and contingent liabilities		
Stockholders' equity:		
Preferred stock, \$100.00 par value. Authorized 10,000,000 shares; (Series A Preferred Stock, \$100 liquidation preference);		
143 shares outstanding		11,000
Common stock, \$0.10 par value. Authorized 20,000,000 shares;		
100 shares outstanding		1,000
Additional paid-in capital		8,658,000
Retained earnings		<u>170,403,000</u>
Total stockholders' equity		<u>179,073,000</u>
	\$	<u><u>2,436,948,000</u></u>

See accompanying notes to Statement of Financial Condition.

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Notes to Statement of Financial Condition

December 31, 2007

(1) Summary of Significant Accounting Policies

Wedbush Morgan Securities Inc. (the Company) is an investment bank registered with the U.S. Securities and Exchange Commission as a securities broker dealer. The Company is wholly owned by WEDBUSH, Inc.

(a) *Use of Estimates*

In preparing the statement of financial condition, management is required to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the statement of financial condition. Actual results could differ materially from those estimates.

(b) *Securities Transactions*

The Company records its securities transactions on a trade date basis.

(c) *Cash and Cash Equivalents*

Cash and cash equivalents include Company investments in money market funds.

(d) *Segregated Cash*

Segregated cash represents balances held in accounts for the exclusive benefit of customers and brokers in compliance with regulatory requirements.

(e) *Short-Term Investments*

Securities purchased under agreements to resell are treated as financing transactions and are carried at the amounts at which the securities will subsequently be resold, as specified in the related agreements. It is the policy of the Company to obtain collateral with a fair value equal to or in excess of the principal amount loaned under resell agreements. These investments are held in segregated accounts for the exclusive benefit of customers in compliance with regulatory requirements.

(f) *Receivables and Allowance for Doubtful Receivables*

Amounts due from customers are provided against at the time and to the degree to which the receivable is unsecured. The Company also establishes a general allowance against accounts receivable for amounts that it determines in its best estimate may become uncollectible. Factors considered by management in determining the amount of the allowance include past experience, degree of concentration, and quality of collateral.

(g) *Financial Instruments*

Substantially all of the Company's financial instruments, including "Securities owned" and "Securities sold, not yet purchased," are carried at fair value, based on publicly reported bid and offer quotations, or amounts approximating fair value. Assets, including securities borrowed or purchased under agreements to resell and certain receivables, are carried at fair value or contracted amounts that approximate fair value due to the short period to maturity. Similarly, liabilities, including securities loaned and certain other payables, are carried at amounts approximating fair value.

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At December 31, 2007, certain shares held in "Securities owned" were subject to restrictions on sale for one to three years. As a result of such restrictions, the carrying value of such securities were net of a discount of \$469,000 based on the quoted market price of \$4,222,000 at December 31, 2007. The Company considered the volatility of the shares and the time period over which the restrictions lapse in determining the amount of discount.

(h) *Income Taxes*

The Company recognizes deferred tax assets and liabilities for 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.

The Company joins in the filing of a consolidated tax return for federal tax purposes and in combined returns for certain states where such filing is required or permitted. The Company is also a party to a tax allocation agreement with its parent, whereby its share of consolidated or combined tax liabilities is determined as if the Company had filed separate returns.

(i) *Accounting Developments*

The FASB issued several new accounting pronouncements, none of which is expected to have any material impact on the Company's financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 establishes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. In February 2009, the FASB issued Staff Position No. 48-2, *Effective date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, that deferred the effective date of FIN 48 for nonpublic enterprises to after December 15, 2007; therefore, the Company will fully adopt the provisions of the Interpretation beginning July 1, 2008.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements required under other accounting pronouncements but does not change existing guidance as to whether or not a financial instrument is carried at fair value. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007; therefore, the Company will adopt the provisions of the Statement beginning July 1, 2008.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115* (SFAS 159). This Statement permits an entity to measure financial instruments and certain other items at estimated fair value. Most of the provisions of SFAS 159 are statement elective; however, the amendment to FASB No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, applies to all

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entities that own trading and available-for-sale securities. The fair value option created by SFAS 159 permits an entity to measure eligible items at fair value at specified election dates. The fair value option (a) may generally be applied instrument by instrument, (b) is irrevocable unless a new election date occurs, and (c) must be applied to the entire instrument and not to only a portion of the instrument. SFAS 159 allows for a one-time election for existing positions upon adoption, with the transition adjustment recorded to opening retained earnings. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007; therefore, the Company will adopt the provisions of the Statement on July 1, 2008. The Company is evaluating the impact that the adoption of SFAS 159 will have, if any, on its statement of financial condition.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141R). SFAS 141R expands the definition of transactions and events that qualify as business combinations; requires that the acquired assets and liabilities be recorded at the fair value determined on the acquisition date and changes thereafter reflected in revenue; and requires acquisition costs to be expensed as incurred. SFAS 141R is effective for financial statements issued for fiscal year beginning after December 15, 2008; therefore, the Company will fully adopt the provisions of the Interpretation beginning July 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51* (SFAS 160). SFAS 160 changes the presentation of minority interests to non-controlling interests and requires the classification of these interests as a component of equity. SFAS 160 is effective for financial statements issued for fiscal year beginning after December 15, 2008; therefore, the Company will fully adopt the provisions of the Interpretation beginning July 1, 2009, except for the presentation and disclosure requirements which will be applied retrospectively for all periods presented.

(2) Receivables from and Payables to Brokers, Dealers, and Clearing Organizations

Amounts receivable from and payable to brokers, dealers, and clearing organizations result from the Company's normal trading and securities borrowing and lending activities and consist of the following:

Securities failed to deliver	\$ 4,305,000
Deposits paid on securities borrowed	677,532,000
Amounts due from brokers and dealers through clearing organizations	6,743,000
Deposits with clearing organizations	<u>13,336,000</u>
Total receivables	<u>\$ 701,916,000</u>
Securities failed to receive	\$ 4,923,000
Deposits received for securities loaned	680,119,000
Other	<u>2,111,000</u>
Total payables	<u>\$ 687,153,000</u>

Deposits are paid for securities borrowed and are received for securities loaned based on the approximate fair value of the related securities. Fails to deliver and fails to receive represent the contractual value of securities that have not been delivered or received on or before the settlement date.

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(3) Receivables from and Payables to Customers

Amounts receivable from and payable to customers include amounts due or held on cash and margin transactions. The value of securities owned by customers and held as collateral for the receivables is not reflected in the statement of financial condition.

(4) Bank Credit Lines

The Company has uncommitted lines of credit with banks, at customary rates of interest, under which borrowings may be made on an unsecured basis. At December 31, 2007, there were no loans outstanding under these credit lines.

(5) Net Capital Requirement

The Company is subject to the Securities and Exchange Commission's Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital. The Company has elected to use the alternative method permitted by the rule, which requires the maintenance of minimum net capital, as defined, equal to the greater of \$1,000,000 or 2% of aggregate debit balances arising from customer transactions, as defined.

The alternative method prohibits withdrawal of equity capital or payment of cash dividends if net capital does not exceed 5% of aggregate debit items and also prohibits withdrawal of subordinated capital if net capital does not exceed 4% of aggregate debit items. At December 31, 2007, the Company had net capital of \$141,322,000 that was 61% of aggregate debit items and \$136,669,000 in excess of the \$4,653,000 required minimum net capital at that date.

(6) Stockholders' Equity

On November 21, 2007, WEDBUSH, Inc. acquired all the minority interests of the Company in a tax-free exchange. The rate of exchange was 1.1 WEDBUSH, Inc. shares for each share of the Company. In connection with the exchange, the Company retired 49,173 shares and paid \$1,032,633 to shareholders dissenting the transaction.

The Company also exchanged 650 common shares for 143 series A preferred shares. The Company may redeem, at its option, the preferred stock at a liquidation preference price of \$100 per share plus accumulated and unpaid dividends. The preferred shares are non-voting and are entitled to a 4% dividend, on a cumulative basis, per year of the outstanding liquidation preference.

As a result of the transaction, the common stock outstanding was changed to 100 shares.

(7) Profit-Sharing Retirement Plans

At December 31, 2007, the Company had two trustee defined contribution retirement plans. The Wedbush Morgan Securities Inc. Commissioned Employees' PS Retirement Plan (the CPS Plan) is qualified under Section 401(k) of the Internal Revenue Code and covers eligible employees compensated on a commission and/or incentive basis. The Company's annual contributions are a specified percentage of the voluntary employee contributions and are not required if earnings do not exceed defined levels.

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The Wedbush Morgan Securities Inc. Employees' PS Retirement Plan (the PS Plan) covers substantially all salaried employees. The Company's annual contributions under the Plan are determined by the board of directors, and are based on a percentage of employee compensation.

(8) Federal and State Income Taxes

Income taxes payable of \$1,451,000 at December 3, 2007 are included in "Accounts payable and accrued liabilities."

Temporary differences and carryforwards, which give rise to deferred tax assets and liabilities, consist of the following:

Deferred tax assets:	
Allowance for doubtful receivables	\$ 2,779,000
Legal reserves	2,434,000
Other	523,000
Total deferred tax assets	<u>5,736,000</u>
Less deferred tax liabilities:	
Unrealized gain not taxable	(2,718,000)
Allowance for expenses not yet incurred	(259,000)
Total deferred tax liability	<u>(2,977,000)</u>
Net deferred tax assets	<u>\$ 2,759,000</u>

Net deferred tax assets are included in other assets on the Statement of Financial Condition.

As of December 31, 2007, management has reviewed all of its current and deferred tax assets in accordance with the procedures established by SFAS No. 109, *Accounting for Income Taxes*, to assess whether a valuation allowance should be established for those tax assets. The Company's management believes that it is more likely than not that the net deferred tax assets will be realized.

(9) Commitments and Contingent Liabilities

(a) Legal Matters

The Company is subject to ongoing litigation and claims in the normal course of its business. Management accrues for the settlement of such litigation and claims when a liability is deemed probable and estimable. In the opinion of management, the potential and threatened claims in which the Company is involved are not expected to have a material impact on the Company's financial position or results of operations.

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(b) Lease Commitments

The Company's operations are conducted in leased premises under lease agreements requiring minimum annual payments as follows:

Fiscal year ending:	
2008	\$ 6,115,000
2009	5,795,000
2010	5,276,000
2011	1,908,000
2012	1,498,000
Thereafter	729,000
	<hr/>
	\$ 21,321,000

(10) Risks Related to Financial Instruments

In the normal course of business, the Company is involved in the execution, settlement, and financing of various customer and principal securities transactions. Customer activities are transacted on a cash, margin, or delivery-versus-payment basis. Securities transactions are subject to the risk of counterparty or customer nonperformance. However, transactions are collateralized by the underlying security, thereby reducing the associated risk to changes in the fair value of the security through settlement date or to the extent of margin balances.

The Company also has contractual commitments arising in the ordinary course of business for securities loaned; securities sold, not yet purchased; repurchase agreements; securities transactions on a when-issued basis; and underwritings. Each of these financial instruments contains varying degrees of risk whereby the fair values of the securities underlying the financial instruments may be in excess of the contract amount. The settlement of these transactions is not expected to have a material effect upon the Company's financial condition.

(11) Related-Party Transactions

In the normal course of business, employees, officers, directors, and affiliates may buy and sell securities through the Company. At December 31, 2007, included in "Receivables from and payables to customers" on the statement of financial condition, were receivables from officers and directors of \$8,387,000 and from affiliates of \$23,780,000, and payables to officers and directors of \$12,862,000 and to affiliates of \$7,560,000. Management believes that receivables from officers, directors, and affiliates are at market terms and rates of interest and are collateralized by securities.

Notes receivable from employees and other receivables from affiliates of \$10,215,000 at December 31, 2007 are included in "Other receivables" on the statement of financial condition. Notes receivable from employees are generally from recruiting activities, noninterest bearing, and forgiven over a period of three to five years. Deposits held and payable to employees of \$1,336,000 at December 31, 2007 are included in accounts payable and accrued liabilities.