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REC'D O.E.C.  
April 29 2002  
EX-103

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

OMB APPROVAL  
OMB Number: 3235-0123  
Expires: September 30, 1998  
Estimated average burden  
hours per response . . . 12.00

SEC FILE NUMBER  
8- 52262

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

FACING PAGE

Information Required of Brokers and Dealers Pursuant to Section 17 of the  
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

REPORT FOR THE PERIOD BEGINNING 01/01/2001 AND ENDING 12/31/2001  
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: Capital Investment Services, Inc.

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

800 Douglas Road, Suite 240

(No. and Street)

Coral Gables,

Florida

(City)

(State)

(Zip Code)

PROCESSED

MAY 06 2002

THOMSON  
FINANCIAL

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

(Area Code — Telephone No.)

B. ACCOUNTANT IDENTIFICATION

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

Bauknight Pietras & Stormer, P.A.

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

1517 Gervais Street

Columbia, SC

29202

(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

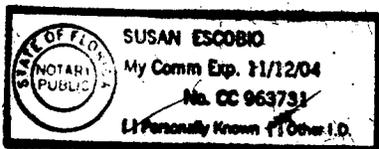
\*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

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4/29

OATH OR AFFIRMATION

I, Robert J. Escobio, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Capital Investment Services, Inc., as of December 31, 2001, 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:

No Exceptions



[Signature]  
Signature

President  
Title

[Signature]  
Notary Public

This report<sup>\*\*</sup> 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 Farmers' or Sole Proprietor's Capital.
- (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- (g) Computation of Net Capital
- (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- (i) Information Relating to the Possession or control Requirements Under Rule 15c3-3.
- (j) A Reconciliation, including appropriate explanation, of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- (l) An Oath or Affirmation.
- (m) A copy of the SIPC Supplemental Report.
- (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.
- (o) Independent Auditors' Report on Internal control required by SEC Rule 17a-5.

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

A report containing a statement of financial condition has been included; accordingly, ~~it is requested that this report be given confidential treatment.~~

Capital Investment Services, Inc.  
Financial Statements  
and Required Supplementary Information  
Year Ended December 31, 2001

**Contents**

Report of Independent Auditors.....	1
Audited Financial Statements	
Statement of Financial Condition .....	2
Statement of Operations.....	3
Statement of Changes in Stockholders' Equity .....	4
Statement of Cash Flows .....	5
Notes to Financial Statements.....	6-8
Required Supplementary Information	
Schedule I - Computation of Net Capital Under Rule 15c3-1 of the Securities and Exchange Commission .....	10
Schedule II – Exemption from Rule 15c3-3 Special Reserve Bank Account Arrangements under Rule 15c3-3(k)(2)(ii) of the Securities and Exchange Commission .....	11
Independent Auditors' Supplementary Report on Internal Control.....	12-13

**BAUKNIGHT PIETRAS & STORMER, P.A.**

CERTIFIED PUBLIC ACCOUNTANTS  
POST OFFICE BOX 1330  
COLUMBIA, SOUTH CAROLINA 29202  
(803) 771-8943

KENNETH H. BAUKNIGHT, CPA  
RUSSELL L. BAUKNIGHT, CPA  
THOMAS D. PIETRAS, CPA  
CHRISTIAN R. STORMER, CPA

1517 GERVAIS STREET  
COLUMBIA, SC 29201  
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**Report of Independent Auditors**

Board of Directors  
Capital Investment Services, Inc.  
Coral Gables, Florida

We have audited the accompanying statement of financial condition of Capital Investment Services, Inc. as of December 31, 2001 and the related statements of operations, changes in stockholders' equity, and cash flows for the year then ended that you are filing pursuant to regulation 1.10 under the Commodity Exchange Act and rule 17a-5 under the Securities and Exchange Act of 1934. 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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 financial statements referred to above present fairly, in all material respects, the financial position of Capital Investment Services, Inc. as of December 31, 2001 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The required supplementary information contained in schedules I and II is presented for purposes of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by regulation 1.10 under the Commodity Exchange Act and/or rule 17a-5 under the Securities and Exchange Act of 1934. Such information has been subjected to the auditing procedures applied in our 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.

*Bauknight Pietras + Stormer, P.A.*

January 20, 2002

Capital Investment Services, Inc.  
Statement of Financial Condition  
December 31, 2001

**Assets**

Cash and cash equivalents	\$ 133,012
Accounts receivable	29,313
Income tax receivable	5,038
Prepaid expenses	9,329
Investment	15,600
Due from a related party	56,397
Leasehold improvements and office equipment, at cost, less accumulated depreciation of \$5,084	<u>12,708</u>
Total assets	<u><u>\$ 261,397</u></u>

**Liabilities and stockholders' equity**

Accounts payable	<u>\$ 73,106</u>
Total liabilities	73,106
Stockholders' equity:	
Common stock, \$1 par value; 1,000,000 authorized shares; 165,000 shares issued and outstanding; 180,000 shares subscribed	345,000
Accumulated deficit	<u>(156,709)</u>
Total stockholders' equity	<u>188,291</u>
Total liabilities and stockholders' equity	<u><u>\$ 261,397</u></u>

Capital Investment Services, Inc.  
Statement of Operations  
Year Ended December 31, 2001

Revenues:

Commissions on securities trades, net of clearing charges	\$ 677,901
Interest	94,369
Other miscellaneous income	<u>12,179</u>
Total revenues	<u>784,448</u>

Expenses:

Operating expenses	460,924
Selling, general and administrative	<u>482,142</u>
Total expenses	<u>943,066</u>

Net loss before income taxes (158,618)

Income taxes 163

Net loss \$ (158,781)

Capital Investment Services, Inc.  
Statement of Changes in Stockholders' Equity  
Year Ended December 31, 2001

	Common Shares Outstanding		Common Shares Subscribed		Amount	Accumulated Deficit	Total
	Amount	Shares	Amount	Shares	Amount	Deficit	Total
Balance at December 31, 2000	165,000 \$			--	\$ --	2,072	\$ 167,072
Common shares subscribed	--	180,000	\$ 180,000		--	--	180,000
Net loss	--		--		--	(158,781)	(158,781)
Balance at December 31, 2001	165,000 \$	180,000	\$ 180,000		\$ (156,709)		\$ 188,291

See accompanying notes.

Capital Investment Services, Inc.  
Statement of Cash Flows  
Year Ended December 31, 2001

**Operating activities**

Net loss	\$ (158,781)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation	4,015
Changes in operating assets and liabilities:	
Accounts receivable	70,874
Prepaid expenses	7,353
Accounts payable	139,447
Income taxes receivable	(5,331)
Net cash provided by operating activities	<u>57,577</u>

**Investing activities**

Proceeds from sale of certificate of deposit	104,968
Purchase of investment	(15,600)
Purchases of property and equipment	(10,531)
Net cash provided by investing activities	<u>78,837</u>

**Financing activities**

Net change in amounts due to/from related party	(71,058)
Net cash used in financing activities	<u>(71,058)</u>

Net change in cash and cash equivalents	65,356
Cash and cash equivalents, beginning of year	<u>67,656</u>
Cash and cash equivalents, end of year	<u>\$ 133,012</u>

Capital Investment Services, Inc.  
Notes to Financial Statements  
December 31, 2001

**1. Description of Business and Significant Accounting Policies**

Capital Investment Services, Inc., a Florida corporation (the "Company"), was organized on June 10, 1999. The Company is registered as an introducing broker/dealer with the Securities and Exchange Commission, National Association of Securities Dealers, and National Futures Association. The Company uses a fully disclosed basis of operations. Under this basis, it forwards as a broker all transactions and accounts to another broker who carries all the accounts of such customers and maintains and preserves such books and records as are customarily made and kept by a clearing broker. BNY Clearing Services, LLC currently performs the transaction clearing functions and related services for the Company.

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, as well as their related disclosures. Such estimates and assumptions also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Revenue Recognition**

Commissions from securities transactions are recorded on a settlement date basis, generally the third business day following the transaction date, which is not significantly different than if recorded on a trade date basis.

**Cash and Cash Equivalents**

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The carrying value of cash equivalents approximates fair value.

The Company maintains cash balances at two commercial banks located in the states of Florida and New York. One of the commercial banks requires the Company to maintain balances of not less than \$100,000. Cash accounts at commercial banks are insured by the FDIC for up to \$100,000. At December 31, 2001, the Company had approximately \$108,000 of cash on deposit in excess of federally insured limits.

**Investment**

The Company owns 1,200 shares of common stock in The Nasdaq Stock Market, Inc. Since the market value of the stock cannot be readily determinable, it is recorded at cost.

Capital Investment Services, Inc.  
Notes to Financial Statements  
December 31, 2001

**1. Description of Business and Significant Accounting Policies (continued)**

**Property and Equipment**

Property and equipment is recorded at cost. Depreciation is computed using the straight-line method over the 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.

**Income Taxes**

The Company provides for income taxes currently payable and, in addition, provides for deferred income taxes resulting from temporary differences between financial and taxable income.

The Company records deferred tax liabilities and assets based on the expected future income tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which differences are expected to reverse.

**Concentration of Credit Risk**

As a securities broker, the Company enters into various debt and equity transactions as principal and agent. The execution of such transactions may result in off-balance sheet risk or concentrations of credit risk. Pursuant to its agreement with its clearing brokers, the Company is liable for amounts uncollected from customers introduced by the Company.

**2. Net Capital Requirements**

The Company is subject to the Uniform Net Capital Rule (Rule 15c-1) of the Securities and Exchange Act of 1934 which requires the Company to have and maintain net capital of not less than \$50,000. In addition, the Company is subject to a limitation on "Aggregate Indebtedness" (as defined by Rule 15c3-1) which cannot exceed 15 times net capital. At December 31, 2001, the Company's "Aggregate Indebtedness" was \$73,106 and the Company had "Net Capital" (as defined) of \$77,861, which was \$27,861 in excess of its required net capital of \$50,000. At December 31, 2001, the Company's percentage of "Aggregate Indebtedness" to "Net Capital" was 93.89%.

**3. Related Party Transactions**

One of the Company's stockholders is also a 100 percent stockholder in Southern Trust Securities Holding Corp. As of December 31, 2001, \$56,397 was due from this related party.

Capital Investment Services, Inc.  
Notes to Financial Statements  
December 31, 2001

**4. Income Taxes**

At December 31, 2001, the Company had net operating loss carryforwards of approximately \$142,000 for federal and \$152,000 for state income tax reporting purposes. The net operating loss carryforwards expire in 2016 (Federal) through 2020 (Florida). The net deferred tax asset resulting from these carryforwards was fully offset by a valuation allowance at December 31, 2001 due to the uncertainty surrounding the ultimate realization of the deferred tax asset. During 2001, the Company made income tax payments totaling \$5,495.

**5. Employee Benefit Plan**

The Company has established a retirement and savings plan for the benefit of employees who have at least one hour of service and have attained the age of 21 years. Under the provisions of the plan, participants may contribute up to 25 percent of their compensation. The Company has the option of matching a percentage of employee contributions. The Company did not make any contributions to the Plan in 2001.

**6. Commitments**

The Company leases its Coral Gables office under a noncancelable operating lease agreement, which expires in 2002. Required lease payments for 2002 are \$43,602. The Company paid approximately \$58,000 for rent in 2001.

**7. Common Stock**

During the year, commissions payable to the stockholder's wife were converted to 180,000 shares of common stock. This transaction has been treated as a non-cash financing transaction in the accompanying statements of cash flows.

**Required Supplementary Information**

## Schedule I

Capital Investment Services, Inc.  
 Computation of Net Capital Under Rule 15c3-1  
 of the Securities and Exchange Commission  
 Year Ended December 31, 2001

<b>Net capital</b>	
Total stockholders' equity	\$ 188,291
Deductions and/or charges:	
Nonallowable assets:	
Unsecured receivables, prepaid expenses, deposits, investment, and property and equipment, net	<u>110,430</u>
Net capital before haircuts on securities	77,861
Haircuts on securities:	
Other securities	<u>--</u>
Net capital	<u><u>\$ 77,861</u></u>
<b>Aggregate Indebtedness</b>	
Items included in statement of financial condition:	
Accounts payable	<u>\$ 73,106</u>
Total aggregate indebtedness	<u><u>\$ 73,106</u></u>
<b>Basic net capital requirement</b>	
Minimum (15:1)	<u>\$ 4,874</u>
Minimum dollar amount	<u>\$ 50,000</u>
Greater of the above	<u><u>\$ 50,000</u></u>
Excess net capital	\$ 27,861
Ratio of aggregate indebtedness to net capital	93.89%

There is no significant difference between net capital as reported above and the amount of net capital, as reported in the Company's Part II (unaudited) FOCUS report. No reconciliation is required.

Schedule II

Capital Investment Services, Inc.  
Exemption from Rule 15c3-3 Special Reserve Bank  
Account Arrangements under Rule 15c3-3(k)(2)(ii) of the  
Securities and Exchange Commission  
Year Ended December 31, 2001

The Company operates so as to meet the exemption under Securities and Exchange Commission Rule 15c3-3(k)(2)(ii) from the special reserve requirement of Rule 15c3-3.

During the period covered by this report there were no customer funds or securities.

**BAUKNIGHT PIETRAS & STORMER, P.A.**

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1517 GERVAIS STREET  
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FAX: (803) 771-8958

**Independent Auditors' Supplementary Report  
on Internal Control**

Board of Directors  
Capital Investment Services, Inc.  
Coral Gables, Florida

In planning and performing our audit of the financial statements of Capital Investment Services, Inc. for the year ended December 31, 2001, we considered its internal control, including procedures for safeguarding customer and firm assets, in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control.

Also, as required by Rule 17a-5(g)(1) of the Securities Exchange Commission ("SEC"), we have made a study of the practices and procedures (including tests of compliance with such practices and procedures) followed by Capital Investment Services, Inc. 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 for customers or perform custodial functions relating to customer securities, we did not review the practices and procedures followed by the Company in making quarterly securities examinations, counts, verification, and comparisons, recordation of differences required by Rule 17a-13, or compliance 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.

In addition, as required by Regulation 1.16 under the Commodity Exchange Act ("CEAct"), we have made a study of the practices and procedures (including tests of compliance with such practices and procedures) followed by the Company that we considered relevant to the objectives stated in Regulation 1.16 in making the periodic computations of minimum financial requirements pursuant to Regulation 1.17.

Management of the Company is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraphs. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures and of the practices and procedures referred to in the preceding paragraphs

## **Independent Auditors' Supplementary Report on Internal Control (continued)**

and to assess whether those practices and procedures can be expected to achieve the SEC's and the Commodity Futures Trading Commission's ("CFTC") 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. Rule 17a-5(g) and Regulation 1.16(d)(2) list additional objectives of the practices and procedures listed in the preceding paragraphs.

Because of inherent limitations in any internal control or the practices and procedures referred to above, errors, irregularities, 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.

Our consideration of the internal control would not necessarily disclose all matters in the 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 elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements 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 the 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 and third paragraphs of this report are considered by the SEC and CFTC to be adequate for their purposes in accordance with the Securities Exchange Act of 1934, the CEAct, 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 were adequate at December 31, 2001 to meet the SEC's and CFTC's objectives.

This report is intended solely for the use of management, the SEC, the CFTC, the National Association of Securities Dealers, Inc., and other regulatory agencies which rely on Rule 17a-5(g) under the Securities Exchange Act of 1934 and/or Regulation 1.16 under the CEAct for their regulation of registered brokers and dealers, and is not intended to be and should not be used by anyone other than these specified parties.

*Banknight Pectros + Stover, P.A.*

January 20, 2002

Financial Statements  
and Required Supplementary Information

Capital Investment Services, Inc.

*Year Ended December 31, 2001*  
*with Report of Independent Auditors*