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

SEC FILE NUMBER

8-37809

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 11/01/03 AND ENDING 10/31/04  
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

CALLAHAN FINANCIAL SERVICES, INC.

REC'D S.E.C.

MAR 10 2005

1086

OFFICIAL USE ONLY

FIRM ID. NO.

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

1001 CONNECTICUT AVE. NW; SUITE 1001

(No. and Street)

WASHINGTON

(City)

DC

(State)

20036

(Zip Code)

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

Jay Johnson

(202) 223-3920

(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

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

Crowe Chizek and Company LLC

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

10 West Broad Street, Suite 1700,

(Address)

Columbus,

(City)

Ohio

(State)

43215-3713

(Zip Code)

CHECK ONE:



Certified Public Accountant



Public Accountant



Accountant not resident in United States or any of its possessions.

PROCESSED

MAR 29 2005

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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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SEC 1410 (06-02)

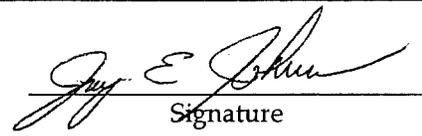
Handwritten initials

Handwritten date 3/28/05 and initials

OATH OR AFFIRMATION

I, Jay Johnson, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of CALLAHAN FINANCIAL SERVICES, INC., as of October 31, 2004, 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

Executive Vice President  
Title

  
Notary Public

SHASHI BHAGAT  
NOTARY PUBLIC DISTRICT OF COLUMBIA  
My Commission Expires January 1, 2010

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

- (a) Facing page.
- (b) Statement of Financial Condition.
- (c) Statement of Income (Loss).
- (d) Statement of Changes in Financial Condition (Statement of Cash Flows).
- (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietor's Capital.
- (f) Statement of Changes in Liabilities Subordinated to Claims or 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).

**CALLAHAN FINANCIAL SERVICES, INC.**

**FINANCIAL STATEMENTS**

October 31, 2004 and 2003

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CALLAHAN FINANCIAL SERVICES, INC.

FINANCIAL STATEMENTS

October 31, 2004 and 2003

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**Crowe Chizek and Company LLC**  
Member Horwath International

## REPORT OF INDEPENDENT AUDITORS

Board of Directors  
Callahan Financial Services, Inc.  
Washington, D.C.

We have audited the accompanying balance sheets of Callahan Financial Services, Inc. (the "Company," a Delaware corporation, as of October 31, 2004 and 2003 and the related statements of income, changes in shareholder's equity, and cash flows for the years then ended that you are filing pursuant to rule 17a-5 under the Securities Exchange Act of 1934. These financial statements and the schedules referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules 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 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 audits provide 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 Callahan Financial Services, Inc. as of October 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of the Company as of October 31, 2004: Computation of Net Capital for Brokers and Dealers Pursuant to Rule 15c3-1 under the Securities Exchange Act of 1934 and Computation for Determination of Reserve Requirements for Brokers and Dealers Pursuant to Rule 15c3-3 under the Securities Exchange Act of 1934 are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by Rule 17a-5 under the Securities Exchange Act of 1934. Such schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all materials respects in relation to the basic financial statements taken as a whole.

As disclosed in Note 2, the Company adopted new accounting guidance for reimbursed expenses in 2003.

*Crowe Chizek and Company LLC*

Crowe Chizek and Company LLC

Oak Brook, Illinois  
December 17, 2004

CALLAHAN FINANCIAL SERVICES, INC.  
BALANCE SHEETS  
October 31, 2004 and 2003

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	<u>2004</u>	<u>2003</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 76,851	\$ 359,568
Investment in limited liability limited partnership	10,100	10,100
Equity in undistributed earnings from limited liability limited partnership	123,442	147,822
Account receivable from related party	3,377	22,586
Other assets	<u>4,258</u>	<u>2,346</u>
	<u>\$ 218,028</u>	<u>\$ 542,422</u>
 <b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
<b>LIABILITIES</b>		
Accrued expenses and payables	\$ 26,899	\$ 24,582
Total liabilities	26,899	24,852
 <b>SHAREHOLDER'S EQUITY</b>		
Capital stock, no par value; 1,000 shares authorized; 100 shares issued and outstanding	15,000	15,000
Additional paid-in capital	323,606	513,350
Retained earnings	<u>(147,477)</u>	<u>(10,510)</u>
Total shareholder's equity	<u>191,129</u>	<u>517,840</u>
Total liabilities and shareholder's equity	<u>\$ 218,028</u>	<u>\$ 542,422</u>

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The accompanying notes are an integral part of these financial statements.

CALLAHAN FINANCIAL SERVICES, INC.  
STATEMENTS OF INCOME  
For the Years Ended October 31, 2004 and 2003

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	<u>2004</u>	<u>2003</u>
<b>Income</b>		
Earnings in limited partnership	\$ 277,389	\$ 257,859
Reimbursements	110,799	81,077
Interest income	<u>1,621</u>	<u>3,613</u>
Total revenues	389,809	342,549
<b>Expenses</b>		
Contract services	\$ 58,039	\$ 51,261
Regulatory and compliance	19,826	18,744
Other	<u>32,934</u>	<u>11,072</u>
Total expenses	<u>110,799</u>	<u>81,077</u>
<b>Income before income taxes</b>	279,010	261,472
Income tax expense	<u>110,256</u>	<u>101,000</u>
<b>Net income</b>	<u>\$ 168,754</u>	<u>\$ 160,472</u>

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The accompanying notes are an integral part of these financial statements.

CALLAHAN FINANCIAL SERVICES, INC.  
 STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY  
 For the Years Ended October 31, 2004 and 2003

	<u>Number of Shares</u>	<u>Capital Stock (No Par Value)</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Total</u>
<b>Balance, November 1, 2002</b>	100	\$ 15,000	\$ 412,350	\$ 33,916	\$ 461,266
Capital contribution	-	-	101,000	-	101,000
Cash dividends declared	-	-	-	(204,898)	(204,898)
Net income	-	-	-	<u>160,472</u>	<u>160,472</u>
<b>Balance, October 31, 2003</b>	100	15,000	513,350	(10,510)	517,840
Capital contribution	-	-	110,256	-	110,256
Return of capital	-	-	(300,000)	-	(300,000)
Cash dividends declared	-	-	-	(305,721)	(305,721)
Net income	-	-	-	<u>168,754</u>	<u>168,754</u>
<b>Balance, October 31, 2004</b>	<u>100</u>	<u>\$ 15,000</u>	<u>\$ 323,606</u>	<u>\$ (147,477)</u>	<u>\$ 191,129</u>

The accompanying notes are an integral part of these financial statements.

CALLAHAN FINANCIAL SERVICES, INC.  
STATEMENTS OF CASH FLOWS  
For the Years Ended October 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
<b>Cash flows from operating activities:</b>		
Net income	\$ 168,754	\$ 160,472
Adjustments to reconcile net income to net cash provided by operating activities:		
Earnings from limited partnership	(277,389)	(257,859)
Changes in		
Accounts receivable	19,209	5,683
Other assets and liabilities	405	(4,679)
Total adjustments	<u>(257,775)</u>	<u>(256,855)</u>
Net cash from operating activities	(89,021)	(96,383)
<b>Cash flows from investing activities:</b>		
Distributions received from limited partnership	301,769	198,060
<b>Cash flows from financing activities:</b>		
Capital contribution received from parent	110,256	101,000
Return of capital	(300,000)	-
Dividends paid to parent	<u>(305,721)</u>	<u>(204,898)</u>
	(495,465)	(103,898)
<b>Net change in cash and cash equivalents</b>	(282,717)	(2,221)
Cash and cash equivalents at beginning of year	<u>359,568</u>	<u>361,789</u>
Cash and cash equivalents at end of year	<u>\$ 76,851</u>	<u>\$ 359,568</u>

The accompanying notes are an integral part of these financial statements.

## NOTE 1 - ORGANIZATION AND NATURE OF BUSINESS

Callahan Financial Services, Inc. (the "Company"), was incorporated on March 13, 1987, for the purpose of serving as the general partner (with an initial 15 percent ownership interest) in Callahan Credit Union Financial Services LLLP (the "Partnership" or "CUFSLP," see Note 3). The Partnership was organized to serve as the administrator of the Trust for Credit Unions (the "Trust"), a diversified management investment company for investment by state and federally chartered credit unions. In addition to serving as the general partner of the Partnership, the Company acts as a co-distributor, with Goldman, Sachs & Co., of the units of the portfolios of the Trust. The Company is a wholly-owned subsidiary of Callahan & Associates, Inc.

The primary source of revenue for the Company is its equity interest in the earnings and losses of the Partnership. The primary source of revenue for the Partnership is an administration fee paid by the Trust. Under an amended and restated administration agreement effective June 1991, the Partnership established two separate portfolios for investment by the Trust, a Money Market Portfolio and a Government Securities Portfolio. On October 10, 1992, a third portfolio, the Mortgage Securities Portfolio, was established. On July 1, 1993, a fourth portfolio, the Target Maturity Portfolio, composed of mutual fund investments, was established. This portfolio liquidated and terminated operations on June 28, 1996 upon reaching maturity. Two additional target maturity portfolios, composed of mutual fund investments, were established on February 15, 1994, and May 19, 1994. Upon reaching their scheduled maturity dates, these portfolios liquidated and terminated on February 28, 1997 and May 15, 1997. In June 2004, the Government Securities Portfolio was renamed the Ultra-Short Duration Government Portfolio, and the Mortgage Securities Portfolio was renamed the Short Duration Portfolio.

Effective July 1, 1997, the Partnership voluntarily agreed to limit its administration fee with respect to the Money Market Portfolio to 2 basis points of the average daily net assets. The impact of the Partnership voluntarily limiting the administration fees resulted in fees waived in 2004 and 2003 of approximately \$1,597,000 and \$1,275,000. From July 1, 1995, to June 30, 1997, the Partnership voluntarily agreed to limit its administration fee for the Money Market Portfolio to 5 basis points times the average daily net assets of the Money Market Portfolio of the Trust on assets up to \$500 million, 4 basis points on \$500 million to \$750 million, and 3 basis points over \$750 million. Prior to July 1, 1995, the agreement called for 5 basis points on assets up to \$300 million and on assets over \$1 billion and 10 basis points on assets from \$300 million to \$1 billion. In addition, the Partnership agreed that to the extent the total annualized expenses (excluding interest, taxes, brokerage, and extraordinary expenses) of the Money Market Portfolio exceed 20 basis points of the average daily net assets of the Money Market Portfolio, the Partnership will either reduce the administration fees otherwise payable or pay such expenses of the Money Market Portfolio. No reimbursements were made under this agreement for 2004 or 2003.

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(Continued)

**NOTE 1 - ORGANIZATION AND NATURE OF BUSINESS (Continued)**

The administration fee for the Ultra-Short Duration Government Portfolio is paid at an annual rate of 10 basis points times the average daily net assets after expense limitations of the Ultra-Short Duration Government Portfolio of the Trust. CUFSLP and Goldman, Sachs & Co. have each voluntarily agreed to limit the other annualized ordinary expenses (excluding advisory fees, administration fees, interest, taxes, brokerage and extraordinary expenses) of the Ultra-Short Duration Government Portfolio such that CUFSLP will reimburse expenses that exceed 5 basis points up to 10 basis points of the Ultra-Short Duration Government Portfolio's average daily net assets, and Goldman, Sachs & Co. will reimburse expenses that exceed 10 basis points up to 15 basis points of the Ultra-Short Duration Government Portfolio's average daily net assets. For 2004 and 2003, no expenses were required to be reimbursed by CUFSLP and Goldman, Sachs & Co. under this agreement.

The administration fee for the Short Duration Portfolio is paid at an annual rate of 5 basis points times the average daily net assets of the Short Duration Portfolio of the Trust. The administration fee for the target maturity portfolios were paid at an annual rate of 5 basis points times the average daily net assets of the target maturity portfolios.

Beginning in November 1988, Goldman, Sachs & Co. began paying certain expenses related to the marketing and administration of the Trust that previously had been the responsibility of the Partnership. While there can be no assurance that Goldman, Sachs & Co. will continue to pay the expenses that it is currently paying, management of the Company does not anticipate any change in the expense-sharing arrangement currently in place.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of Presentation: The Company's records are maintained on the accrual basis of accounting, and its financial reporting and accounting policies conform with accounting principles generally accepted in the United States of America.

Income Taxes: The Company files a consolidated federal income tax return with its parent. Income taxes are based on an allocation calculated as if the Company was filing a separate tax return. In addition, the Company files a District of Columbia income tax return.

Investment in Limited Liability Limited Partnership: The Company accounts for its investment in the limited liability limited partnership using the equity method.

Cash and Cash Equivalents: Cash and cash equivalents includes cash, deposits in financial institutions and highly liquid mutual fund investments. For these instruments, the carrying amount approximates fair value.

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(Continued)

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Use of Estimates: The preparation of financial statements 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 financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Financial Statement Presentation: Certain items in prior year's financial statements have been reclassified to conform to the current presentation.

Recently Adopted Accounting Guidance: On November 1, 2002, the Company adopted the guidance in Emerging Issues Task Force 01-14: Income Statement Characterization of Reimbursements Received for "Out-of-Pocket" Expenses Incurred, which requires the Company to reflect reimbursements received for expenses incurred as revenue in the income statement. Adoption of this guidance resulted in the Company's recording of revenue and expense related to Company expenses that are reimbursed by the Partnership, which totaled \$110,799 and \$81,077 for 2004 and 2003.

On January 1, 2003, the Company adopted Interpretation 45, Guarantor's Accounting and Disclosure Requirements for Guarantees. On July 1, 2003, the Company adopted Statement 149, amendment of Statement 133 on Derivative Instruments and Hedging Activities, and Statement 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equities. On November 1, 2003, the Company adopted Interpretation 46, Consolidation of Variable Interest Entities. Adoption of the new standards did not materially affect the Company's operating results or financial condition.

**NOTE 3 - INVESTMENT IN LIMITED LIABILITY LIMITED PARTNERSHIP**

The Company initially acquired a 15 percent interest in the Partnership for an investment of \$100. The Company continues to serve as the general partner to the Partnership, while the majority interest belongs to various credit unions and credit union service organizations that serve as limited partners. The net profits and losses of the Partnership are allocated among the partners in accordance with the terms of the Certificate and Agreement of Limited Partnership, as amended. Should the Partnership be terminated, net assets available for distribution will be distributed first in proportion to the partners' net capital accounts until such capital accounts have been reduced to zero and then to the partners in accordance with their respective participation percentages.

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(Continued)

**NOTE 3 - INVESTMENT IN LIMITED LIABILITY LIMITED PARTNERSHIP (Continued)**

Profits and losses of the Partnership are generally allocated among the partners in accordance with their Partnership interests. However, the terms of the Certificate and Agreement of Limited Partnership, as amended, through January 31, 1991, preclude allocating any further losses to a partner or class of partners once the partner's capital account reaches zero, as long as another partner or class of partners maintains a positive capital balance. In accordance with partnership dividend policy, all net earnings in excess of those allocated to recover partner capital contributions are distributed as dividends to the partners consistent with their partnership interests. These allocations are in accordance with Section 704(b) of the Internal Revenue Code. The Partnership distributed \$769,737 in May 2004 and will distribute an additional \$617,209 in December 2004, which relates to fiscal year 2004.

During fiscal year 1991 and in accordance with the approval of the Class A limited partners, Callahan & Associates, Inc. purchased the Class B limited partner's interest in the Partnership. This interest was purchased for its original face value of \$10,000 from the original Class B limited partner. This Class B interest was contributed to the Company and increased its total partnership interest in the Partnership to 20 percent.

The Company accounts for its investment in the Partnership using the equity method of accounting. Under the equity method of accounting, the investment is recorded at its initial cost and is increased or decreased for the Company's share of the subsequent earnings or losses of the Partnership, as specified in the Certificate and Agreement of Limited Partnership, as amended, and is decreased by distributions received. The Company's share of losses is limited to the amount of its investment, as long as another partner or class of partners maintains a positive capital balance. The amounts reported in the accompanying financial statements reflect this allocation method.

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(Continued)

CALLAHAN FINANCIAL SERVICES, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 October 31, 2004 and 2003

**NOTE 3 - INVESTMENT IN LIMITED LIABILITY LIMITED PARTNERSHIP (Continued)**

The Partnership's condensed balance sheets as of October 31, 2004 and 2003, and condensed statements of income for the years ended October 31, 2004 and 2003, are as follows:

**Condensed Balance Sheets**

	October 31,	
	<u>2004</u>	<u>2003</u>
<b>Assets:</b>		
Cash, cash equivalents and certificates of deposit	\$ 2,251,090	\$ 3,920,027
Investment in loan participations	1,512,429	-
Receivables	<u>274,956</u>	<u>222,330</u>
Total assets	<u>\$ 4,038,475</u>	<u>\$ 4,142,357</u>
<b>Liabilities:</b>		
Accrued expenses and accounts payable	\$ 209,166	\$ 191,148
Distributions payable	<u>617,209</u>	<u>739,109</u>
Total liabilities	826,375	930,257
<b>Partners' capital:</b>		
General partner	100	100
Class A limited partners	3,202,000	3,202,000
Class B limited partner	<u>10,000</u>	<u>10,000</u>
Total partners' capital	<u>3,212,100</u>	<u>3,212,100</u>
Total liabilities and partners' capital	<u>\$ 4,038,475</u>	<u>\$ 4,142,357</u>

**Condensed Statements of Income**

	For the Years Ended	
	October 31,	
	<u>2004</u>	<u>2003</u>
Revenues	\$ 2,454,901	\$ 2,312,544
Expenses	<u>(1,067,955)</u>	<u>(1,024,948)</u>
Net Income	<u>\$ 1,386,946</u>	<u>\$ 1,287,596</u>

(Continued)

#### NOTE 4 - RELATED-PARTY TRANSACTIONS

The Company shares office space with and obtains clerical support from its parent, Callahan & Associates, Inc., which charges the Company for these costs based on an expense-sharing agreement. Under the terms of the Certificate and Agreement of Limited Partnership, the majority of expenses charged to the Company by Callahan & Associates, Inc. and incurred by the Company, were paid by the Partnership. Expenses paid by the Partnership under the terms of this agreement for the years ended October 31, 2004 and 2003, were \$110,799 and \$81,077. The partnership also pays regulatory compliance costs incurred by the Company in fulfilling its responsibility as general partner of the Partnership.

The Company had funds on deposit with the NIH Federal Credit Union, a limited partner of the Partnership, totaling \$41,661 and \$25,772 as of October 31, 2004 and 2003. The accounts receivable of \$3,377 and \$22,586 at October 31, 2004 and 2003 are receivable from the Partnership. At October 31, 2004, the Company had an account payable of \$16,899 to the Partnership. The Company had investments in Goldman, Sachs & Co. mutual funds of \$29,150 and \$327,758 at October 31, 2004 and 2003.

#### NOTE 5 - NET CAPITAL REQUIREMENTS

As a broker-dealer, the Company is subject to the regulatory capital requirements set forth by the Securities and Exchange Commission Uniform Net Capital Rule. This rule requires the maintenance of minimum net capital, as defined. As of October 31, 2004 and 2003, the Company's net capital totaled \$49,369 and \$328,431, which is in excess of its required capital of \$5,000 and \$250,000, respectively. Additionally, under this rule, "aggregate indebtedness," as defined, cannot exceed 1,500 percent of net capital. The Company's percentage of aggregate indebtedness to net capital was 54% and 7% at October 31, 2004 and 2003.

As a condition of approval by the National Association of Securities Dealers, Inc., to conduct business as a self-clearing broker, the Company was required to maintain minimum net capital of \$250,000. Because the Company only conducts limited business activities, during 2004 the Company's required minimum net capital was reduced to \$5,000. The Company was in compliance with net capital requirements as of October 31, 2004 and 2003.

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(Continued)

CALLAHAN FINANCIAL SERVICES, INC.  
NOTES TO FINANCIAL STATEMENTS  
October 31, 2004 and 2003

**NOTE 6 - RECONCILIATION OF ASSETS, LIABILITIES, AND SHAREHOLDER'S EQUITY TO REGULATORY REPORTS**

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and differ in certain respects from the accounting prescribed by the Securities and Exchange Commission's general instructions to Form X-17A-5. For example, under the Securities and Exchange Commission's general instructions, certain amounts are classified differently for regulatory reporting purposes. A reconciliation of amounts reported herein to amounts reported by the Company as of October 31, 2004 on Form X-17A-5, as filed with the Securities and Exchange Commission is as follows:

	Amount Per Form X-17A-5 <u>Unaudited</u>	Reclassifications and <u>Adjustments</u>	Amount Per Financial <u>Statements</u>
<b>Assets:</b>			
Cash and cash equivalents	\$ 45,202	\$ 31,649	\$ 76,851
Cash segregated in compliance with regulations	2,500	(2,500)	-
Investment in and receivables from affiliates, subsidiaries and associated partnerships	114,116	(114,116)	-
Other securities	29,150	(29,150)	-
Investment in limited partnership	-	10,100	10,100
Equity in undistributed earnings from limited partnership	-	123,442	123,442
Account receivable from related party	-	3,377	3,377
Other assets	<u>3,305</u>	<u>953</u>	<u>4,258</u>
	<u>\$ 194,273</u>	<u>\$ 23,755</u>	<u>\$ 218,028</u>
<b>Liabilities and shareholder's equity:</b>			
Accounts payable and accrued liabilities	\$ 50,654	\$ (23,755)	\$ 26,899
Capital stock	15,000	-	15,000
Additional paid-in capital	213,350	110,256	323,606
Retained earnings	<u>(84,731)</u>	<u>(62,746)</u>	<u>(147,477)</u>
	<u>\$ 194,273</u>	<u>\$ 23,755</u>	<u>\$ 218,028</u>

Some of the reclassifications and adjustments exist due to audit adjustments reflected in these audited financials and not reflected in the unaudited Form X-17A-5. The audit adjustments relate to adjustments to tax expense and related party revenue and expense.

**SUPPLEMENTARY INFORMATION**

CALLAHAN FINANCIAL SERVICES, INC.  
 COMPUTATION OF NET CAPITAL FOR BROKERS AND DEALERS PURSUANT  
 TO RULE 15c3-1 UNDER THE SECURITIES EXCHANGE ACT OF 1934  
 As of October 31, 2004

**NET CAPITAL**

TOTAL STOCKHOLDER'S EQUITY QUALIFIED FOR NET CAPITAL \$ 191,129

**DEDUCTIONS AND/OR CHARGES:**

Nonallowable assets:

Investment in and receivable affiliates, subsidiaries, and  
 associated partnerships 136,919

Other assets 4,258

Total deductions and/or charges 141,177

Net capital before haircuts on security positions 49,952

**HAIRCUTS ON SECURITIES:**

Trading and investment securities:

Other securities 583

Total haircuts 583

NET CAPITAL \$ 49,369

**AGGREGATE INDEBTEDNESS**

TOTAL AGGREGATE INDEBTEDNESS \$ 26,899

**COMPUTATION OF BASIC NET CAPITAL REQUIREMENT**

MINIMUM NET CAPITAL REQUIRED (6-2/3% of aggregate indebtedness  
 or \$5,000 minimum) 5,000

EXCESS NET CAPITAL 44,369

EXCESS NET CAPITAL AT 1000% 46,679

PERCENTAGE OF AGGREGATE INDEBTEDNESS TO NET CAPITAL 54.49%

**Reconciliation with the Company's Computation:**

(included in Part II of Form X-17a-5 for the Year Ended October 31, 2004)

Net capital, as reported in Company's unaudited Part II Focus report \$ 25,614

Audit adjustments\* 23,755

Net capital, per above computation \$ 49,369

\*Audit adjustments relate to adjustments to tax expense and related party revenue and expense.

CALLAHAN FINANCIAL SERVICES, INC.  
COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR  
BROKERS AND DEALERS PURSUANT TO RULE 15c3-3 UNDER THE  
SECURITIES EXCHANGE ACT OF 1934  
As of October 31, 2004

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Callahan Financial Services, Inc. (the "Company") is exempt from the provisions of Rule 15c3-3 under the Securities Exchange Act of 1934 (the "Rule"), in that the Company's activities are limited to those set forth in the conditions for exemption appearing in paragraph (K)(1) of the Rule.



Crowe Chizek and Company LLC  
Member Horwath International

## REPORT OF INDEPENDENT AUDITORS ON INTERNAL ACCOUNTING CONTROL

Board of Directors  
Callahan Financial Services, Inc.  
Washington, D.C.

In planning and performing our audit of the financial statements of Callahan Financial Services, Inc. (the "Company,"), a Delaware corporation, for the year ended October 31, 2004, we considered its internal control, including procedures for safeguarding securities, in order to determine our audit 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 (the "SEC"), we have made a study of the practices and procedures followed by the Company including tests of such practices and procedures that we considered relevant to the objectives stated in Rule 17a-5(g) in making the periodic computations of aggregate indebtedness (or aggregate debits) and net capital under Rule 17a-3(a)(11) and for determining compliance with the exemptive provisions of Rule 15c3-3. Because the Company does not carry securities accounts for customers or perform custodial functions relating to customer securities, we did not review the practices and procedures followed by the Company in any of the following:

1. Making quarterly securities examinations, counts, verifications, 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 internal control policies and procedures 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 Commission'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

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(Continued)

transactions are executed in conformity with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in any 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 the effectiveness of their design and operation may deteriorate. Our consideration of 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 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 Commission to be adequate for its purposes in accordance with the Securities Exchange Act of 1934 and related regulations, and that practices and procedures that do not accomplish such objectives in all material respects indicate a material inadequacy for such purposes. Based on this understanding and on our consideration of the internal control, we believe that the Company's practices and procedures were adequate at October 31, 2004, to meet the Commission's objectives.

This report is intended solely for the use of management, the Securities and Exchange Commission, the National Association of Securities Dealers Regulation, Inc., and other regulatory agencies that rely on Rule 17a-5(g) under the Securities and Exchange Act of 1934 in 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.

*Crowe Chizek and Company LLC*

Crowe Chizek and Company LLC

Oak Brook, Illinois  
December 17, 2004