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DIVISION OF MARKET REGULATION

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

SEC FILE NUMBER
8-36638

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 10/01/04 AND ENDING 09/30/05
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: SAL Financial Services, Inc, dba
Sterne Agee Financial Services, Inc.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)
800 Shades Creek Parkway, Suite 700

(No. and Street)

Birmingham Alabama 35209
(City) (State) (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT
C. Fred Wagstaff, III (205) 380-1716
(Area Code - Telephone Number)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

KPMG LLP

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

420 20th Street North, Suite 1800 Birmingham, Alabama 35203-3207
(Address) (City) (State) (Zip Code)

CHECK ONE:

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

PROCESSED
JAN 03 2006
THOMSON
FINANCIAL

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)

SEC 1410 (06-02)

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BT mhaber

OATH OR AFFIRMATION

We, Christopher L. Frankel and Cheryl Witt, swear (or affirm) that, to the best of our knowledge and belief the accompanying financial statements and supporting schedules pertaining to the firm of Sterne Agee Financial Services, Inc., as of September 30, 2005, are true and correct. We further swear (or affirm) that neither the Company nor any partner, proprietor, principal officer, or director has any proprietary interests in any account classified as that of customer.

C Frankel
Signature

CEO

Title

Cheryl Witt
Signature

CFO

Title



Janice Burt
Notary Public

CONTENTS OF REPORT

This report contains (check all applicable boxes)

- X (a) Facing page
- X (b) Statement of Financial Condition
- (c) Statement of Operations
- (d) Statement of Changes in Financial Condition
- (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietors' Capital
- (f) Statement of Changes in Liabilities Subordinated to Claims of General Creditors
- (g) Computation of Net Capital
- (h) Computation for Determination of Reserve Requirements for Broker-Dealers 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 15c3-3 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
- X (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.



STERNE AGEE FINANCIAL SERVICES, INC.
(A Wholly Owned Subsidiary of Sterne, Agee & Leach Group, Inc.)

Statements of Financial Condition

September 30, 2005 and 2004

(With Independent Auditors' Report Thereon)



KPMG LLP
SouthTrust Tower
Suite 1800
420 20th Street North
Birmingham, AL 35203

Independent Auditors' Report

The Board of Directors
Sterne Agee Financial Services, Inc.:

We have audited the accompanying statements of financial condition of Sterne Agee Financial Services, Inc. (a Delaware corporation and a wholly owned subsidiary of Sterne, Agee & Leach Group, Inc.) as of September 30, 2005 and 2004. These statements of financial condition are the responsibility of the Company's management. Our responsibility is to express an opinion on these statements of financial condition 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 statements of financial condition are 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the statements of financial condition. 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 statements of financial condition referred to above present fairly, in all material respects, the financial position of Sterne Agee Financial Services, Inc. as of September 30, 2005 and 2004, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

November 23, 2005

STERNE AGEE FINANCIAL SERVICES, INC.
(A Wholly Owned Subsidiary of Sterne, Agee & Leach Group, Inc.)

Statements of Financial Condition

September 30, 2005 and 2004

Assets	<u>2005</u>	<u>2004</u>
Cash and cash equivalents	\$ 1,713,942	1,491,140
Cash segregated for regulatory purposes	25,487	25,065
Due from affiliates	64,039	231,201
Receivables	146,447	270,329
Furniture and equipment (less accumulated depreciation of \$80,076 in 2005 and \$75,141 in 2004)	151,226	64,253
Intangible assets, net	338,667	418,417
Other assets	171,489	90,729
Total assets	<u>\$ 2,611,297</u>	<u>2,591,134</u>
Liabilities and Stockholder's Equity		
Due to parent company	\$ 43,117	7,277
Other liabilities	1,015,663	953,777
Total liabilities	<u>1,058,780</u>	<u>961,054</u>
Commitments and contingencies (note 3)		
Stockholder's equity:		
Preferred stock, \$0.001 par value. Authorized 500 shares, no shares issued or outstanding	—	—
Common stock, \$0.001 par value. Authorized, issued and outstanding 2,500 shares	2	2
Additional paid-in capital	1,658,998	1,833,998
Retained earnings (accumulated deficit)	<u>(106,483)</u>	<u>(203,920)</u>
Total stockholder's equity	<u>1,552,517</u>	<u>1,630,080</u>
Total liabilities and stockholder's equity	<u>\$ 2,611,297</u>	<u>2,591,134</u>

See accompanying notes to statements of financial condition.

STERNE AGEE FINANCIAL SERVICES, INC.
(A Wholly Owned Subsidiary of Sterne, Agee & Leach Group, Inc.)

Notes to Statements of Financial Condition

September 30, 2005 and 2004

(1) Organization and Summary of Significant Accounting Policies

(a) Description of Business and Principles of Consolidation

Sterne Agee Financial Services, Inc. (the Company), was incorporated on January 8, 2002 as a wholly owned subsidiary of Sterne, Agee & Leach Group, Inc. (SAL Group). During the month of incorporation, SAL Group contributed certain tangible and intangible assets as the Company's initial capitalization. During 2003, additional cash of \$825,000 was contributed by SAL Group to the Company. The Company changed its name from SAL Financial Services to Sterne Agee Financial Services in 2004.

The Company is a registered broker dealer with the Securities and Exchange Commission. Its principal business activities include the execution of securities transactions for institutional and retail customers, as well as sales of insurance products to retail customers. Institutional and retail customers are introduced to the Company through a network of independent brokers and third party marketing agreements with various banks. The Company also reintroduces customers through its discount brokerage operation. All securities transactions are settled through a clearing broker on a fully disclosed basis.

The Company contracts with Sterne, Agee & Leach, Inc. (SAL), an affiliate, to serve as the carrying broker, to clear and perform the majority of other back office operations and to maintain and preserve all books and records required by applicable provisions of law and applicable rules of the Securities and Exchange Commission. Under the terms of the Company's agreement, the Company has ultimate responsibility for any loss, liability, damage, cost, or expense incurred as a result of the failure of any account to make timely payment for the securities purchased or timely and good delivery of securities sold on the account, although management expects no losses under this agreement.

(b) Use of Estimates in Financial Statements

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 statement. Actual results could differ from those estimates.

(c) Accounting for Securities Transactions

Securities owned and receivables/payables with customers are recorded on a settlement date basis, which does not differ materially from a trade date basis.

(d) Intangible Assets

Intangible assets represent primarily the excess of consideration paid over the fair value of tangible assets acquired in connection with a purchase of assets and assumptions of liabilities. Assets purchased included broker/agent contracts, clearing contracts and client accounts. The amount by which the consideration paid exceeded the fair value of net tangible assets acquired was \$550,000. Under the requirements of Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill*

STERNE AGEE FINANCIAL SERVICES, INC.
(A Wholly Owned Subsidiary of Sterne, Agee & Leach Group, Inc.)

Notes to Statements of Financial Condition

September 30, 2005 and 2004

and Other Intangible Assets, the Company established this amount as an intangible asset with a definite life and is amortizing it over seven years which is considered representative of the estimated lives of the relationships and contracts acquired. Intangible assets also include approximately \$50,000 representing the amount paid by SAL Group for a brokerage license which was contributed to the Company as part of its original capitalization.

Intangible assets at September 30, 2005 and 2004 are summarized as follows:

	2005	2004
Intangible assets subject to amortization	\$ 292,417	372,167
Unamortized intangible asset (brokerage license)	46,250	46,250
Total intangible assets	\$ 338,667	418,417

(e) Furniture and Equipment

Furniture and equipment are recorded at cost. Depreciation and amortization are provided on a straight-line basis over the estimated useful lives of the assets.

(f) Recent Accounting Pronouncements

In July 2005, the Financial Accounting Standards Board (FASB) issued an exposure draft of a Proposed Interpretation, *Accounting for Uncertain Tax Positions*. This exposure draft proposes guidance on the recognition and measurement of uncertain tax positions and, if issued, may result in companies raising the threshold for recognizing tax benefits that have some degree of uncertainty. The exposure draft also addresses the accrual of any interest and penalties related to tax uncertainties. The comment period for this exposure draft recently concluded. The FASB is currently re-evaluating the proposed statement, including the effective date.

(2) Regulatory Requirements

The Company is subject to the Securities and Exchange Commission's Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital and which requires a ratio of aggregate indebtedness, as defined, of not more than 15 times net capital, as defined. At September 30, 2005 and 2004, the Company had net capital of \$645,816 and \$552,338, respectively, which was \$575,578 and \$488,267 in excess of required net capital, respectively.

The Company claims an exemption from the provisions of the Securities and Exchange Commission's Customer Protection - Reserves and Custody of Securities Rule (Rule 15c3-3) pursuant to Section (k)(2)(ii) of the Rule.

(3) Commitments and Contingencies

The Company, in its capacity as a broker dealer, is subject to litigation and various claims in the ordinary course of business. Management does not believe the ultimate outcome of these matters will have a material effect on the Company's financial position.

STERNE AGEE FINANCIAL SERVICES, INC.
(A Wholly Owned Subsidiary of Sterne, Agee & Leach Group, Inc.)

Notes to Statements of Financial Condition

September 30, 2005 and 2004

(4) Related Party Transactions

SAL Group provides management, consulting, and financial services to the Company for an annual fee. Such services include, but are not necessarily limited to, advice and assistance concerning any and all aspects of the operation, planning, and financing of the Company.

SAL and SAL Group provide office space, communications, and clearing services to the Company in the normal course of operations.

Cash and cash equivalents are held in accounts with SAL. SAL serves as the custodian for the Company for securities, cash, and other property owned by or in the fiduciary accounts.

(5) Income Taxes

The amount of current and deferred taxes payable or refundable is recognized as of the date of the financial statements, utilizing currently enacted tax laws, and rates.

Deferred tax liabilities and assets are determined under the liability method based on the differing bases of assets and liabilities for financial reporting and income tax reporting purposes using the enacted tax rates in effect for the applicable tax periods. In accordance with SFAS No. 109, *Accounting for Income Taxes*, the Company has recorded net deferred tax asset balances of \$68,512 and \$49,673 at September 30, 2005 and 2004, respectively, which primarily represents differences relating to depreciation and amortization.