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**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 10/01/05 AND ENDING 09/30/06  
MM/DD/YY MM/DD/YY

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER: <sup>DBA</sup> STERNE AGEE FINANCIAL SERVICES, INC.  
ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)  
*Sal Financial Services, Inc.*  
800 SHADES CREEK PARKWAY, SUITE 700

OFFICIAL USE ONLY  
FIRM I.D. NO.

(No. and Street)  
BIRMINGHAM ALABAMA 35209  
(City) (State) (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT  
CHERYL WITT (205) 380-1728  
(Area Code - Telephone Number)

**B. ACCOUNTANT IDENTIFICATION**

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

KPMG LLP

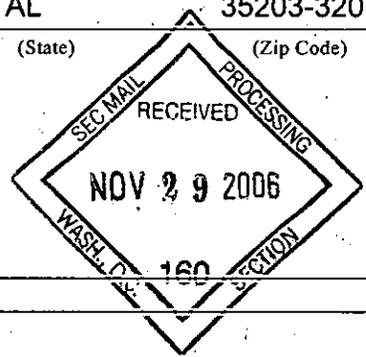
(Name - if individual, state last, first, middle name)

420 20TH STREET N, SUITE 1800 BIRMINGHAM AL 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.

DEC 07 2006  
THOMSON FINANCIAL



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\*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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### OATH OR AFFIRMATION

We, F. Eugene Woodham 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, 2006, 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.

*F. Eugene Woodham*  
Signature

*Treasurer*  
Title

*Cheryl Witt*  
Signature

*CFO*  
Title



*Daniel C. Cheek*  
Notary Public

NOTARY PUBLIC STATE OF ALABAMA AT LARGE  
MY COMMISSION EXPIRES: Feb 15, 2010  
BONDED THRU NOTARY PUBLIC UNDERWRITERS

### 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 Group, Inc.)

Statements of Financial Condition

September 30, 2006 and 2005

(With Independent Auditors' Report Thereon)



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

## Independent Auditors' Report

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

We have audited these statements of financial condition of Sterne Agee Financial Services, Inc. (a wholly owned subsidiary of Sterne Agee Group, Inc.) (the Company) as of September 30, 2006 and 2005, that you are filing pursuant to Rule 17a-5 under the Securities Exchange Act of 1934. 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 financial statements 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, 2006 and 2005, in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

November 27, 2006

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

Statements of Financial Condition

September 30, 2006 and 2005

Assets	<u>2006</u>	<u>2005</u>
Cash and cash equivalents	\$ 2,088,424	1,713,942
Cash segregated for regulatory purposes	26,452	25,487
Due from affiliates	57,482	64,039
Receivables	772,657	146,447
Furniture and equipment (less accumulated depreciation of \$119,259 in 2006 and \$80,076 in 2005)	118,011	151,226
Intangible assets, net	258,917	338,667
Other assets	156,127	171,489
Total assets	<u>\$ 3,478,070</u>	<u>2,611,297</u>
<b>Liabilities and Stockholder's Equity</b>		
Due to parent company	\$ 111,561	43,117
Due to affiliates	121,936	—
Other liabilities	1,827,332	1,015,663
Total liabilities	<u>2,060,829</u>	<u>1,058,780</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	1,658,998
Accumulated deficit	(241,759)	(106,483)
Total stockholder's equity	<u>1,417,241</u>	<u>1,552,517</u>
Total liabilities and stockholder's equity	<u>\$ 3,478,070</u>	<u>2,611,297</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements

September 30, 2006 and 2005

**(1) Organization and Summary of Significant Accounting Policies**

**(a) *Description of Business and Principles of Consolidation***

Sterne Agee Financial Services, Inc. (the Company), a wholly owned subsidiary of Sterne Agee Group, Inc. (SA Group), 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 U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements. 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 purchases 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 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 SA Group for a brokerage license which was contributed to the Company as part of its original capitalization.

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

Notes to Financial Statements

September 30, 2006 and 2005

Intangible assets at September 30, 2006 and 2005 are summarized as follows:

	2006	2005
Intangible assets subject to amortization	\$ 212,667	292,417
Unamortized intangible asset (brokerage license)	46,250	46,250
Total intangible assets	\$ 258,917	338,667

**(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) Cash and Cash Equivalents**

Cash and cash equivalents include short-term highly liquid investments with original maturities of three months or less.

**(g) Recent Accounting Pronouncements**

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies that the benefit of a position taken or expected to be taken in a tax return should be recognized in a company's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*, when it is more likely than not that the position will be sustained based on its technical merits. FIN 48 also prescribes how to measure the tax benefit recognized and provides guidance on when a tax benefit should be derecognized as well as various other accounting, presentation, and disclosure matters. This interpretation is effective for the Company beginning in fiscal year 2007. The Company does not believe the adoption of FIN 48 will have a material impact on its results of operations and financial position.

**(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, 2006 and 2005, the Company had net capital of \$643,785 and \$645,816, respectively, which was \$506,397 and \$575,578 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.

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

Notes to Financial Statements

September 30, 2006 and 2005

**(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.

**(4) Related-Party Transactions**

SA 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 SA Group provide office space, communications, and clearing services to the Company in the normal course of operations. These amounts are primarily allocated expenses from SAL and SA Group.

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 Company is included in the consolidated federal income tax return filed by SA Group. Federal income taxes are calculated as if the companies filed on a separate return basis, and the amount of current tax or benefit calculated is either remitted to or received from the Parent. 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 assets and liabilities are determined under the liability method based on the differing bases of assets and liabilities for financial reporting and income tax reporting purposes using enacted tax rates in effect for the applicable tax periods. In accordance with SFAS No. 109, *Accounting for Income Taxes*, the Company has recorded the following:

	<b>Year ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Deferred tax assets:		
Fixed assets	\$ 5,165	15,134
Intangible amortization	67,250	53,378
Total deferred and net tax assets	\$ <u>72,415</u>	<u>68,512</u>

Management has concluded that the realization of deferred tax assets is more likely than not; accordingly, there were no valuation allowances during either 2006 or 2005.

Note: A copy of Sterne Agee Financial Services, Inc. most recent financial statements is available for examination at their principal location, and at the regional office of the Securities and Exchange Commission located in Atlanta, Georgia.