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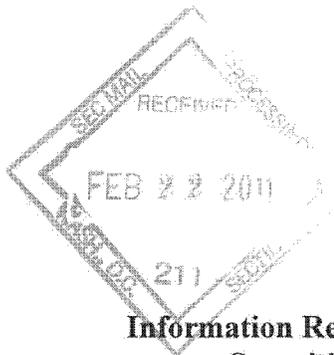
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**ANNUAL AUDITED REPORT
FORM X-17A-5
PART III**

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 01/01/10 AND ENDING 12/31/10
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:
Callaway Financial Services, Inc.

OFFICIAL USE ONLY

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

FIRM ID. NO.

721 N. Fielder Road, Suite C

(No. and Street)

Arlington

(City)

Texas

(State)

76012

(Zip Code)

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

Corey N. Callaway

817-274-4877

(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

Brad A. Kinder, CPA

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

815 Parker Square

(Address)

Flower Mound

(City)

Texas

(State)

75028

(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).

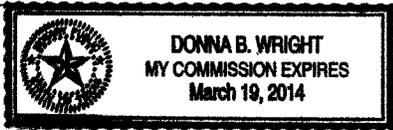
SEC 1410 (06-02)

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OATH OR AFFIRMATION

I, Corey Callaway, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Callaway Financial Services, Inc., as of December 31, 2010, 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:

NONE



[Signature]
Signature
Pres: [Signature]
Title

[Signature]
Notary Public
Donna B. Wright

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

- (a) Facing page.
- (b) Statement of Financial Condition.
- (c) Statement of Income (Loss).
- (d) 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 of Creditors. **NONE**
- (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 auditor's report on the internal control as required by SEC rule 17a-5.

*The Company is exempt from the filing of the SIPC Supplement Report as net operating revenues are less that \$500,000.

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

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BRAD A. KINDER, CPA

CERTIFIED PUBLIC ACCOUNTANT

815 PARKER SQUARE • FLOWER MOUND, TX 75028
972-899-1170 • Fax 972-899-1172

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Callaway Financial Services, Inc.

We have audited the accompanying statement of financial condition of Callaway Financial Services, Inc. as of December 31, 2010, and the related statements of income, changes in stockholder's equity, and cash flows for the year then ended that you are filing pursuant to rule 17a-5 under the Securities 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 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 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 Callaway Financial Services, Inc. as of December 31, 2010, 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 of America.

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


BRAD A. KINDER, CPA

Flower Mound, Texas
February 11, 2011

CALLAWAY FINANCIAL SERVICES, INC.
Statement of Financial Condition
December 31, 2010

ASSETS

Cash	\$ 11,688
Commissions receivable	20,459
Advance	752
Prepaid expenses	175
Clearing deposit	<u>25,000</u>
TOTAL ASSETS	<u><u>\$ 58,074</u></u>

LIABILITIES AND STOCKHOLDER'S EQUITY

Liabilities

Accounts payable	\$ 232
Commissions payable	13,078
Settlement payable	<u>22,000</u>
TOTAL LIABILITIES	<u>35,310</u>

Stockholder's Equity

Common stock, 100,000,000 shares authorized with \$.01 par value, 20,000 shares issued and outstanding	200
Additional paid-in capital	29,800
Retained deficit	<u>(7,236)</u>
TOTAL STOCKHOLDER'S EQUITY	<u>22,764</u>
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	<u><u>\$ 58,074</u></u>

CALLAWAY FINANCIAL SERVICES, INC.
Statement of Income
Year Ended December 31, 2010

Revenue

Securities commissions	<u>\$ 321,768</u>
TOTAL REVENUE	<u>321,768</u>

Expenses

Compensation and related costs	127,516
Clearing charges	102,040
Cost sharing expenses - Parent	30,000
Occupancy	4,800
Professional fees	31,466
Regulatory fees and expenses	3,377
Settlement expense	22,000
Other expenses	<u>17,384</u>
TOTAL EXPENSES	<u>338,583</u>
Net loss before income taxes	(16,815)
Income taxes	<u>-</u>
NET LOSS	<u><u>\$ (16,815)</u></u>

CALLAWAY FINANCIAL SERVICES, INC.
Statement of Changes in Stockholder's Equity
Year Ended December 31, 2010

	<u>Common Shares</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings/ Deficit</u>	<u>Total</u>
Balances at December 31, 2009	20,000	\$ 200	\$ 29,800	\$ 9,579	\$ 39,579
Net loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>(16,815)</u>	<u>(16,815)</u>
Balances at December 31, 2010	<u>20,000</u>	<u>\$ 200</u>	<u>\$ 29,800</u>	<u>\$ (7,236)</u>	<u>\$ 22,764</u>

CALLAWAY FINANCIAL SERVICES, INC.
Statement of Cash Flows
Year Ended December 31, 2010

Cash flows from operating activities:

Net loss	\$ (16,815)
Adjustments to reconcile net loss to net cash provided by operating activities	
Change in assets and liabilities:	
Increase in commissions receivable	(11,343)
Increase in advance	(752)
Decrease in prepaid expenses	150
Increase in accounts payable	232
Increase in commissions payable	8,481
Increase in settlement payable	<u>22,000</u>
Net cash provided by operating activities	<u>1,953</u>
Net increase in cash	1,953
Cash at beginning of year	<u>9,735</u>
Cash at end of year	<u><u>\$ 11,688</u></u>

Supplemental Disclosures of Cash Flow Information:

Cash paid during the year for:

Interest	<u><u>\$ -</u></u>
Income taxes	<u><u>\$ -</u></u>

CALLAWAY FINANCIAL SERVICES, INC.
Notes to Financial Statements

Note 1 - Nature of Business and Summary of Significant Accounting Policies

Nature of Business:

Callaway Financial Services, Inc. (the Company) was organized in January 2000 as a Texas corporation. The Company is a wholly owned subsidiary of CFS Holdings, Inc., an S corporation, (Parent). The Company is a broker/dealer in securities registered with the Securities and Exchange Commission (SEC) and is a member of the Financial Industry Regulatory Authority (FINRA). The Company's customers consist primarily of individuals and retirement plans located in Texas.

The Company operates pursuant to the exemptive provisions of Rule 15c3-3(k)(2)(ii) of the Securities Exchange Act of 1934, and accordingly, is exempt from the remaining provisions of that Rule. The Company does not hold customer funds or securities, but as an introducing broker/dealer, will clear all transactions on behalf of customers on a fully disclosed basis through a clearing broker/dealer. The clearing broker/dealer carries all of the accounts of the customers and maintains and preserves all related books and records as are customarily kept by a clearing broker/dealer. Under these exemptive provisions, the Computation for Determination of Reserve Requirements and Information Relating to the Possession and Control Requirements are not required.

Significant Accounting Policies:

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 the assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value of Financial Instruments

Substantially all of the Company's financial asset and liability amounts reported in the statement of financial condition are short term in nature and approximate fair value.

CALLAWAY FINANCIAL SERVICES, INC.
Notes to Financial Statements

Note 1 - Nature of Business and Summary of Significant Accounting Policies, continued

Security Transactions

Securities commissions and the related expenses are recorded on the trade date.

Income Taxes

The Company has adopted financial reporting rules regarding recognition and measurement of tax positions taken or expected to be taken on a tax return. The Company has reviewed all open tax years and concluded that there is no impact on the Company's financial statements and no tax liability resulting from unrecognized tax benefits relating to uncertain income tax positions taken or expected to be taken on a tax return. As of December 31, 2010, open Federal tax years include the tax years ended December 31, 2007 through December 31, 2009.

Note 2 - Net Capital Requirements

The Company is subject to the SEC uniform net capital rule (Rule 15c3-1), which requires the maintenance of a minimum amount of net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. Rule 15c3-1 also provides that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1. At December 31, 2010, the Company had net capital and net capital requirements of \$21,837 and \$5,000, respectively. The Company's net capital ratio was 1.62 to 1.

Note 3 - Transactions with Clearing Broker/Dealer

The agreement with the clearing broker/dealer provides for clearing charges at a fixed rate multiplied by the number of tickets traded by the Company. The agreement also requires the Company to maintain a minimum of \$25,000 as a deposit in an account with the clearing broker/dealer.

CALLAWAY FINANCIAL SERVICES, INC.
Notes to Financial Statements

Note 4 - Related Party Transactions

The Company and its Parent are under common control and the existence of that control creates operating results and financial position significantly different than if the companies were autonomous.

The Company has a Cost Sharing Agreement with its Parent and another related party effective June 30, 2009. Under the Agreement, the Parent is to provide certain overhead costs, including office facilities, associated with the operations of the Company. The fee under this Agreement is \$2,500 per month. The fee represents the Company's allocable share of expenses in proportion to its use of facilities provided by the Parent. The Company at its sole discretion may deny payment and incur no obligation to the Parent for providing these overhead costs. The Agreement can be amended quarterly. Cost sharing expenses – Parent, incurred and paid, totaled \$30,000 under this Agreement for the year ended December 31, 2010.

Included in commissions payable is \$2,872 due to the Parent's sole shareholder.

Note 5 - Concentration of Revenue / Economic Dependency

The Parent's sole shareholder generated approximately 52% of the Company's revenue.

Note 6 - Income Taxes

The Company had current year taxable income due to a current year expense of \$22,000 that will be deductible in 2011. The current year taxable income has been fully offset by prior years' net operating loss carryforwards; therefore, there is no provision for current income taxes. The Company has a net operating loss carryforward remaining of \$6,113 available to offset future taxable income, which expires in 2023. The Company also has a 2011 tax deduction relating to the \$22,000 settlement. (See note 9) The net operating loss carryforward and 2011 tax deduction create a deferred tax asset of approximately \$4,200 which is fully reserved with a valuation allowance, therefore, there is no deferred tax asset recognized in the accompanying statement of financial condition.

CALLAWAY FINANCIAL SERVICES, INC.
Notes to Financial Statements

Note 7 - Off-Balance-Sheet Risk and Concentration of Credit Risk

As discussed in Note 1, the Company's customers' securities transactions are introduced on a fully disclosed basis with its clearing broker/dealer. The clearing broker/dealer carries all of the accounts of the customers of the Company and is responsible for execution, collection and payment of funds, and receipt and delivery of securities relative to customer transactions. Off-balance-sheet risk exists with respect to these transactions due to the possibility that customers may be unable to fulfill their contractual commitments wherein the clearing broker/dealer may charge any losses it incurs to the Company. The Company seeks to minimize this risk through procedures designed to monitor the credit worthiness of its customers and that customer transactions are executed properly by the clearing broker/dealer.

The Company has a clearing deposit and commissions receivable held by and due from its clearing broker/dealer of \$25,000 and \$20,459, respectively, totaling \$45,459, which represents approximately 78% of the Company's total assets.

Note 8 - Contingencies

The nature of the Company's business subjects it to various claims, regulatory examinations, and other proceedings in the ordinary course of business.

The Company was sued by the trustee of a bankruptcy estate in connection with the Company's sale of a private placement to one customer. (See note 9)

The ultimate outcome of any such action against the Company could have an adverse impact on the financial condition, results of operations, or cash flows of the Company.

Note 9 - Subsequent Events

The Company settled the lawsuit in mediation on February 3, 2011. The settlement requires the Company to pay the trustee a total of \$22,000 in quarterly payments of \$5,500 beginning February 15, 2011. The settlement has been accrued and an expense recognized in these financial statements.

Management has evaluated the Company's events and transactions that occurred subsequent to December 31, 2010, through February 11, 2011, the date the financial statements were available to be issued.

Schedule I

CALLAWAY FINANCIAL SERVICES, INC.
Computation of Net Capital and Aggregate
Indebtedness Pursuant to Rule 15c3-1
December 31, 2010

Total stockholder's equity qualified for net capital	<u>\$ 22,764</u>
Deductions and/or charges	
Non-allowable assets:	
Advance	752
Prepaid expenses	<u>175</u>
Total deductions and/or charges	<u>927</u>
Net capital before haircuts on securities positions	21,837
Haircuts on securities:	-
	<u>-</u>
Net Capital	<u><u>\$ 21,837</u></u>
Aggregate indebtedness	
Accounts payable	232
Commissions payable	13,078
Settlement payable	<u>22,000</u>
Total aggregate indebtedness	<u><u>\$ 35,310</u></u>
Computation of basic net capital requirement	
Minimum net capital required (greater of \$5,000 or 6 2/3% of aggregate indebtedness)	<u><u>\$ 5,000</u></u>
Net capital in excess of minimum requirement	<u><u>\$ 16,837</u></u>
Ratio of aggregate indebtedness to net capital	<u><u>1.62 to 1</u></u>

Schedule II

**CALLAWAY FINANCIAL SERVICES, INC.
Reconciliation of the Computation of Net Capital
with that of the Registrant as Originally
Filed in Part IIA of Form X-17a-5
December 31, 2010**

Net capital as originally reported by Company in Part IIA of Form X-17a-5 as of December 31, 2010 (unaudited)	<u>\$ 43,837</u>
Adjustments	
Increase in settlement payable and the related expense	<u>(22,000)</u>
Net capital as computed on Schedule I	<u>\$ 21,837</u>

BRAD A. KINDER, CPA

CERTIFIED PUBLIC ACCOUNTANT

815 PARKER SQUARE • FLOWER MOUND, TX 75028
972-899-1170 • FAX 972-899-1172

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL REQUIRED BY SEC RULE 17A-5(G)(1)

Board of Directors
Callaway Financial Services, Inc.

In planning and performing our audit of the financial statements of Callaway Financial Services, Inc. (the Company), as of and for the year ended December 31, 2010 in accordance with auditing standards generally accepted in the United States of America, we considered the Company's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

Also, as required by rule 17a-5(g)(1) of the Securities and Exchange Commission (SEC), we have made a study of the practices and procedures followed by the Company including consideration of control activities for safeguarding securities. This study included 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 and recordation of differences required by rule 17a-13
2. 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 controls 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 SEC'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 transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with generally accepted accounting principles. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in internal control and the practices and procedures referred to above, error 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.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the company's financial statements will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first and second paragraphs and would not necessarily identify all deficiencies in internal control that might be material weaknesses. We did not identify any deficiencies in internal control and control activities 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 paragraph of this report are considered by the SEC 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 study, we believe that the Company's practices and procedures, as described in the second paragraph of this report, were adequate at December 31, 2010, to meet the SEC's objectives.

This report is intended solely for the information and use of the Board of Directors, management, the SEC, Financial Industry Regulatory Authority, Inc., and other regulatory agencies that rely on rule 17a-5(g) under the Securities 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.


BRAD A. KINDER, CPA

Flower Mound, Texas
February 11, 2011