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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 01/01/11 AND ENDING 12/31/11  
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

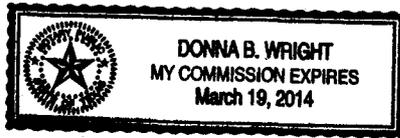
I, Corey Callaway, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Callaway Financial Services, Inc., as of December 31, 2011, are true and correct. I further swear (or affirm) that neither the company 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

President  
Title

[Signature]  
Notary Public



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.
- (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.

\*The Company is exempt from the filing of the SIPC Supplement Report as net operating revenues are less than \$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. (the Company) as of December 31, 2011, and the related statements of income, changes in stockholder's equity, and cash flows for the year then ended that are filed 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, 2011, 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 financial statements as a whole. The supplementary information contained in Schedule I required by Rule 17a-5 under the Securities Exchange Act of 1934 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

  
BRAD A. KINDER, CPA

Flower Mound, Texas  
February 13, 2012

**CALLAWAY FINANCIAL SERVICES, INC.**  
**Statement of Financial Condition**  
**December 31, 2011**

**ASSETS**

Cash	\$ 49,902
Commissions receivable	22,207
Advances	1,038
Prepaid expenses	514
Clearing deposit	<u>25,000</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 98,661</u></b>

**LIABILITIES AND STOCKHOLDER'S EQUITY**

**Liabilities**

Commissions payable	\$ 13,968
FINRA fine payable	<u>16,764</u>
<b>TOTAL LIABILITIES</b>	<b><u>30,732</u></b>

**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	79,800
Accumulated deficit	<u>(12,071)</u>
<b>TOTAL STOCKHOLDER'S EQUITY</b>	<b><u>67,929</u></b>
<b>TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY</b>	<b><u>\$ 98,661</u></b>

**CALLAWAY FINANCIAL SERVICES, INC.**  
**Statement of Income**  
**Year Ended December 31, 2011**

**Revenue**

Securities commissions	<u>\$ 415,786</u>
TOTAL REVENUE	<u>415,786</u>

**Expenses**

Compensation and related costs	176,804
Clearing charges	116,767
Communications	8,756
Services allocation - Parent	31,500
Occupancy	8,800
Professional fees	23,417
Regulatory fees and expenses	3,300
Fine expense	40,000
Other expenses	<u>11,277</u>
TOTAL EXPENSES	<u>420,621</u>
Net loss before income taxes	(4,835)
Income taxes	<u>-</u>
<b>NET LOSS</b>	<u><u>\$ (4,835)</u></u>

**CALLAWAY FINANCIAL SERVICES, INC.**  
**Statement of Changes in Stockholder's Equity**  
**Year Ended December 31, 2011**

	<u>Common Shares Issued</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Total</u>
Balances at December 31, 2010	20,000	\$ 200	\$ 29,800	\$ (7,236)	\$ 22,764
Additional capital contributed			50,000		50,000
Net loss	-	-	-	(4,835)	(4,835)
Balances at December 31, 2011	<u>20,000</u>	<u>\$ 200</u>	<u>\$ 79,800</u>	<u>\$ (12,071)</u>	<u>\$ 67,929</u>

**CALLAWAY FINANCIAL SERVICES, INC.**  
**Statement of Cash Flows**  
**Year Ended December 31, 2011**

**Cash flows from operating activities:**

Net loss	\$ (4,835)
Adjustments to reconcile net loss to net cash used in operating activities	

Change in assets and liabilities:

Increase in commissions receivable	(1,748)
Increase in advances	(286)
Increase in prepaid expenses	(339)
Decrease in accounts payable	(232)
Increase in commissions payable	890
Decrease in settlement payable	(22,000)
Increase in FINRA fine payable	<u>16,764</u>

Net cash used in operating activities	<u>(11,786)</u>
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**Cash flows from financing activities:**

Additional capital contributed	<u>50,000</u>
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Net increase in cash	38,214
Cash at beginning of year	<u>11,688</u>

Cash at end of year	<u><u>\$ 49,902</u></u>
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**Supplemental Disclosures of Cash Flow Information:**

Cash paid during the year for:

Interest	<u><u>\$ 764</u></u>
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Income taxes	<u><u>\$ -</u></u>
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**CALLAWAY FINANCIAL SERVICES, INC.**  
**Notes to Financial Statements**  
**December 31, 2011**

**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 U.S. generally accepted accounting principles 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**  
**December 31, 2011**

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

Security Transactions

Securities commissions and the related expenses are recorded on a trade date basis as securities transactions occur.

Income Taxes

As of December 31, 2011, open Federal tax years subject to examination include the tax years ended December 31, 2008 through December 31, 2010.

**Note 2 - Net Capital Requirements**

The Company is subject to the SEC Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum 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, 2011, the Company had net capital and net capital requirements of \$63,984 and \$5,000, respectively. The Company's net capital ratio was .48 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 Company is subject to a minimum clearing charge per month of \$2,500. 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**  
**December 31, 2011**

**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 Services Agreement with its Parent and another related party effective September 19, 2011. The Agreement is for a one year term, automatically renewed on a year to year basis unless terminated by any of the parties on 30 days notice prior to expiration of an annual term. Under the Agreement, and the predecessor agreement, the Parent is to provide office facilities, personal property and support services. The fee under this Agreement is \$3,000 per month and represents the Company's allocable share of services provided by the Parent. Services allocation – Parent, incurred and paid, totaled \$31,500 under this Agreement and the predecessor agreement for the year ended December 31, 2011.

Included in commissions payable is \$4,811 due to the Parent's sole shareholder.

**Note 5 - Concentration of Revenue / Economic Dependency**

The Parent's sole shareholder generated approximately 66% of the Company's revenue.

**Note 6 - Income Taxes**

The Company incurred a tax loss for the year, therefore, there is no provision for current income taxes. The Company has a net operating loss carryforward of \$32,948 available to offset future taxable income, which begins expiring in 2023. The net operating loss carryforward creates a deferred tax asset of approximately \$5,000 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**  
**December 31, 2011**

**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 commissions receivable and a clearing deposit held by and due from its clearing broker/dealer of \$19,814 and \$25,000, respectively, totaling \$44,814, which represents approximately 45% of the Company's total assets.

**Note 8 - Commitments and 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 censured and fined \$40,000 by FINRA during the year due to certain rule violations. The Company entered into a promissory note with FINRA related to this fine and \$16,764 is remaining to be paid at December 31, 2011. The remainder is due in required monthly principal payments of \$1,335, plus interest. Interest is accrued monthly at the prime rate plus 3% (6.26%) at December 31, 2011.

The ultimate outcome of any such future 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**

Management has evaluated the Company's events and transactions that occurred subsequent to December 31, 2011, through February 13, 2012, the date the financial statements were available to be issued.

There are no events or transactions that occurred during this period that materially impacted the amounts or disclosures in the Company's financial statements.

**Schedule I**

**CALLAWAY FINANCIAL SERVICES, INC.**  
**Supplementary Information Pursuant to Rule 17a-5**  
**December 31, 2011**

**Computation of Net Capital**

Total stockholder's equity qualified for net capital	<u>\$ 67,929</u>
Deductions and/or charges	
Non-allowable assets:	
Commissions receivable	2,393
Advances	1,038
Prepaid expenses	<u>514</u>
Total deductions and/or charges	<u>3,945</u>
Net capital before haircuts on securities positions	63,984
Haircuts on securities:	<u>-</u>
Net Capital	<u><u>\$ 63,984</u></u>
Aggregate indebtedness	
Commissions payable	\$ 13,968
FINRA fine payable	<u>16,764</u>
Total aggregate indebtedness	<u><u>\$ 30,732</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>\$ 58,984</u></u>
Ratio of aggregate indebtedness to net capital	<u><u>.48 to 1</u></u>

**Schedule I, continued**

**CALLAWAY FINANCIAL SERVICES, INC.  
Supplementary Information Pursuant to Rule 17a-5  
December 31, 2011**

**Reconciliation of Computation of Net Capital**

The above computation does not differ from the computation of net capital under Rule 15c3-1 as of December 31, 2011 as filed by Callaway Financial Services, Inc. on form X-17A-5. Accordingly, no reconciliation is deemed necessary.

**Statement of Changes in Liabilities Subordinated to Claims of General Creditors**

No statement is required as no subordinated liabilities existed at any time during the year.

**Statement Regarding Reserve Requirements and Possession or Control Requirements**

The Company operates pursuant to section (k)(2)(ii) exemptive provisions of Rule 15c3-3 of the Securities Exchange Act of 1934. Under these exemptive provisions, the Computation of the Determination of the Reserve Requirements and Information Relating to the Possession or Control Requirements are not required.

**SIPC Supplemental Report**

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

# 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, 2011, 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 previously 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 *deficiency in internal control* 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 and correct, 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 previously.

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, 2011, 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 13, 2012