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

SEC FILE NUMBER
8-24040

**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

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: COMMONWEALTH FINANCIAL NETWORK

Commonwealth Equity
Services

DBA 51

OFFICIAL USE ONLY
FIRM ID. NO.

29 SAWYER ROAD

(No. And Street)

WALTHAM

MASSACHUSETTS

02453-3483

(City)

(state)

(Zip Code)

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

PAUL J. IMS, CONTROLLER

(781)736-0700

(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

MARCUM LLP

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

53 STATE STREET, 38TH FLOOR

BOSTON

MA

02109

(Address)

(City)

(state)

Zip Code)

CHECK ONE:

Certified Public Accountant

Public Accountant

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

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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).

SEC 1410 (06-02)

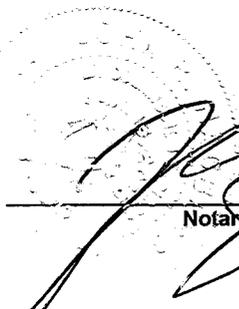
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OATH OR AFFIRMATION

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2/22/12

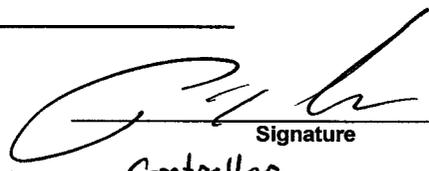
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2/22/12

I PAUL J. IMS swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of COMMONWEALTH FINANCIAL NETWORK 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:



Notary Public
2/14/13

COMMONWEALTH OF MASSACHUSETTS
My Commission Expires
January 16, 2015



Signature
Controller

Title

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.
- (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.

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



COMMONWEALTH FINANCIAL NETWORKSM
A REGISTERED SERVICE MARK OF
COMMONWEALTH EQUITY SERVICES, INC.

FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2011 AND 2010

MARCUM
ACCOUNTANTS ▲ ADVISORS



COMMONWEALTH FINANCIAL NETWORKSM
A REGISTERED SERVICE MARK OF
COMMONWEALTH EQUITY SERVICES, INC.

FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2011 AND 2010

COMMONWEALTH FINANCIAL NETWORKSM
A REGISTERED SERVICE MARK OF
COMMONWEALTH EQUITY SERVICES, INC.

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Commonwealth Financial NetworkSM
A Registered Service Mark for Commonwealth Equity Services, Inc.

We have audited the accompanying statements of financial condition of Commonwealth Financial NetworkSM ("Commonwealth" or the "Company"), a Registered Service Mark for Commonwealth Equity Services, Inc. as of December 31, 2011 and 2010 and the related statements of income, changes in subordinated borrowings, changes in shareholders' 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 and Regulation 1.16 under the Commodity Exchange Act ("CEAct"). 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 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 audits 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 financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2011 and 2010 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 audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information contained in Schedules I, II and III 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.

Marcum LLP

Boston, MA
February 14, 2012

COMMONWEALTH FINANCIAL NETWORKSM

STATEMENTS OF FINANCIAL CONDITION

DECEMBER 31, 2011 AND 2010

	2011	2010
Assets		
Cash and cash equivalents	\$ 48,669,151	\$ 41,799,072
Restricted cash and cash equivalents	3,480,762	3,562,895
Receivables:		
Brokers and clearing organizations	22,084,200	20,905,882
Employees and registered representatives	19,561,504	15,134,577
Other	60,936	368,110
Securities owned, at fair value	23,194,350	24,802,074
Property and equipment, net	20,961,890	21,988,905
Deferred tax assets	677,215	625,163
Other assets	2,546,257	1,426,254
Deposits with clearing organizations	50,000	50,000
Total Assets	\$ 141,286,266	\$ 130,662,932
Liabilities and Shareholders' Equity		
Accrued liabilities	\$ 8,626,303	\$ 12,197,026
Accrued deferred compensation	34,089,185	30,350,570
Payables:		
Brokers and clearing organizations	12,915,971	12,298,805
Trade and reimbursements	8,083,075	5,390,019
Dividends payable	5,893,534	4,627,166
Deferred revenue	1,333,333	625,002
Subordinated borrowings - related parties	61,905,000	57,905,000
Other liabilities	598,063	282,080
Due to affiliates	227,916	277,010
Total Liabilities	133,672,380	123,952,678
Commitments and contingencies (Note 10)		
Shareholders' Equity		
3,000,000 shares authorized and 2,400,000 shares issued and outstanding at December 31, 2011 and 2010	3,254,564	3,254,564
Retained earnings	4,359,322	3,455,690
Total Shareholders' Equity	7,613,886	6,710,254
Total Liabilities and Shareholders' Equity	\$ 141,286,266	\$ 130,662,932

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

COMMONWEALTH FINANCIAL NETWORKSM**STATEMENTS OF INCOME****FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

	2011	2010
Revenue		
Commissions and fees	\$ 523,617,043	\$ 463,158,170
Non-commission income	99,929,818	91,834,516
Principal transactions	4,051,474	7,634,650
Interest income	1,212,789	1,077,936
Total Revenues	<u>628,811,124</u>	<u>563,705,272</u>
Expenses		
Commissions	477,817,118	421,116,362
Compensation and benefits	72,442,926	73,984,965
Brokerage, exchange and clearing fees	8,950,583	9,401,205
Occupancy	4,821,200	4,568,334
Legal, professional and consulting fees	4,255,162	1,352,347
Communications	2,752,366	2,348,944
Recruiting and advertising	7,495,970	5,923,510
Depreciation and amortization	5,897,822	2,513,140
Data processing and technology	4,451,064	4,206,370
Interest expense	2,882,308	2,136,196
Regulatory	1,523,104	1,350,880
Miscellaneous (income) expense	(188,361)	97,702
Total Expenses	<u>593,101,262</u>	<u>528,999,955</u>
Net Income Before Taxes	35,709,862	34,705,317
Income Taxes	<u>1,114,110</u>	<u>1,287,279</u>
Net Income	<u>\$ 34,595,752</u>	<u>\$ 33,418,038</u>

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

COMMONWEALTH FINANCIAL NETWORKSM

STATEMENT OF CHANGES IN SUBORDINATED BORROWINGS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

Subordinated borrowings at January 1, 2010	\$ 48,305,000
Increases:	
Issuance of subordinated notes	9,600,000
Decreases:	
Payment of subordinated notes	<u> --</u>
Subordinated borrowings at December 31, 2010	57,905,000
Increases:	
Issuance of subordinated notes	4,000,000
Decreases:	
Payment of subordinated notes	<u> --</u>
Subordinated borrowings at December 31, 2011	<u>\$ 61,905,000</u>

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

COMMONWEALTH FINANCIAL NETWORKSM

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	Common Stock		Partnership Units			
	Number of Shares	Amount	Number of Units	Carrying Amount	Retained Earnings	Total Equity
Balance - December 31, 2009	--	\$ --	2,400,000	\$ 3,254,564	\$ 3,483,680	\$ 6,738,244
Conversion to Corporation	2,400,000	3,254,564	(2,400,000)	(3,254,564)	--	--
Dividends	--	--	--	--	(34,207,419)	(34,207,419)
Stock option expense	--	--	--	--	761,391	761,391
Net income	--	--	--	--	33,418,038	33,418,038
Balance - December 31, 2010	2,400,000	3,254,564	--	--	3,455,690	6,710,254
Dividends	--	--	--	--	(34,531,511)	(34,531,511)
Stock option expense	--	--	--	--	839,391	839,391
Net income	--	--	--	--	34,595,752	34,595,752
Balance - December 31, 2011	<u>2,400,000</u>	<u>\$ 3,254,564</u>	<u>--</u>	<u>\$ --</u>	<u>\$ 4,359,322</u>	<u>\$ 7,613,886</u>

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

COMMONWEALTH FINANCIAL NETWORKSM

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
Cash Flows from Operating Activities		
Net income	\$ 34,595,752	\$ 33,418,038
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,897,822	2,513,140
Deferred compensation expense	3,738,615	9,025,938
Deferred tax benefit	(52,052)	(76,318)
Stock option expense	839,391	761,391
Changes in assets and liabilities:		
Receivables	(5,298,072)	(1,752,449)
Securities owned, at fair value, net	1,607,724	(4,877,340)
Other assets	(1,037,870)	(428,478)
Payables	3,310,222	2,103,364
Accrued and other liabilities	(3,254,740)	2,602,815
Deferred revenue	708,331	(1,250,000)
Due to affiliates	(49,094)	201,337
Net Cash Provided by Operating Activities	41,006,029	42,241,438
Cash Flows from Investing Activities		
Acquisition of property and equipment	(4,870,807)	(9,301,366)
Net Cash Used in Investing Activities	(4,870,807)	(9,301,366)
Cash Flows from Financing Activities		
Dividends paid	(33,265,143)	(36,221,478)
Proceeds from issuance of subordinated debt - related parties	4,000,000	9,600,000
Net Cash Used in Financing Activities	(29,265,143)	(26,621,478)
Net Increase in Cash and Cash Equivalents	6,870,079	6,318,594
Cash and Cash Equivalents - Beginning	41,799,072	35,480,478
Cash and Cash Equivalents - Ending	\$ 48,669,151	\$ 41,799,072
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	\$ 2,881,789	\$ 2,131,463
Cash paid for taxes	\$ 713,316	\$ 1,648,976
Non-Cash Transactions:		
Dividends payable	\$ 1,266,368	\$ 4,627,166

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

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 1 – NATURE OF BUSINESS

Commonwealth Financial NetworkSM is a Registered Service Mark of Commonwealth Equity Services, Inc. (“Commonwealth” or the “Company”). The Company, organized in Massachusetts and founded in 1979, has offices in Waltham, Massachusetts and San Diego, California. The Company is an independent broker/dealer that is the “home office” for its national network of independent representatives. These representatives are licensed to sell securities through the Company with the Financial Industry Regulatory Authority (“FINRA”) and the Securities and Exchange Commission (the “SEC”) acting as the requisite federal and local regulatory agencies. The Company is also subject to the requirements of the U.S. Commodities Futures Trading Commission (the “CFTC”) and the National Futures Association. The Company clears its public customer accounts on an introducing basis with National Financial Services, LLC, a Fidelity Investments Company, and other providers. On November 22, 2010, the Company changed its legal organization from a Limited Liability Partnership to a Massachusetts corporation.

The Company operates under the provisions of Paragraph (k)(2)(ii) of rule 15c3-3 of the Securities Exchange Act of 1934 and, accordingly, is exempt from the remaining provisions of that rule. Essentially, the requirements of Paragraph (k)(2)(ii) provide that the Company clear all transactions on behalf of customers on a fully disclosed basis with a clearing broker-dealer and promptly transmit all customer funds and securities to the 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REVENUE RECOGNITION

Revenues are generated as a result of the purchase and sale of investment securities and related products. All commission revenues and related commission expenses are recorded on a settlement date basis; amounts recognized do not differ materially from those that would have been recognized on a trade date basis. Revenues also include 12b-1 fees received from certain mutual funds for a period of time after the sale of those funds. In recording revenues for 12b-1 fees, management makes estimates of amounts to be received subsequent to year end for fees earned before year end based on a model that reflects historical collection experience.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

SECURITIES OWNED

Proprietary securities transactions are reflected on a trade-date basis. The Company's proprietary security positions are recorded at fair value with the resulting net unrealized gains and losses reflected in current operations.

FAIR VALUE MEASUREMENT

The Company conducts its principal trading through two designated trading accounts. One of these accounts is used to facilitate fixed income trading on a same day buy-sell basis. The second account is used to facilitate fixed income trading for representatives and may carry positions overnight. These securities are normally held in the account for no longer than 30 days and are recorded at fair value.

The Financial Accounting Standards Board ("FASB") ASC 820 defines fair value, establishes a framework for measuring fair value, and establishes a fair value hierarchy which prioritizes the inputs to valuation techniques. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market. Valuation techniques that are consistent with the market, income or cost approach, as specified by FASB ASC 820, are used to measure fair value.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure Fair value into three broad levels:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities the Company has the ability to access.
- Level 2 inputs are inputs (other than quoted prices included within level 1) that are observable for the asset or liability, either directly or indirectly.
- Level 3 are unobservable inputs for the asset or liability and rely on management's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RECEIVABLE FROM AND PAYABLE TO BROKERS AND CLEARING ORGANIZATIONS

The balances shown as receivable from and payable to brokers and clearing organizations represent amounts due in connection with the Company's normal transactions involving trading of securities. Management considers all receivables to be collectible, therefore, no allowance for doubtful accounts has been provided for.

CASH AND CASH EQUIVALENTS

The Company defines cash equivalents as liquid overnight deposits held in the ordinary course of business, as well as all short-term investments with a maturity at the date of purchase of 90 days or less.

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 certain estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Accordingly, actual results could differ from those estimates.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful life of the related assets, over a period of three to five years. Leasehold improvements are recorded at cost and are amortized over the shorter of the lease term or estimated useful life. Routine repairs and maintenance are expensed as incurred.

The Company capitalizes certain costs incurred in connection with developing or obtaining internal use software. All capitalized internal use software development costs are amortized using the straight-line method over the estimated useful life, ranging from three to five years, once placed in service.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INCOME TAXES

For both the years ended December 31, 2011 and 2010, the Company has elected to be treated as an S Corporation. As such, the Company's federal taxable income is reported on the tax returns of its shareholders and, therefore, results in no federal income tax to the Company. However, the Company was liable for excise taxes to the state of Massachusetts related to net worth, as well as an additional state excise tax levied at 2.95% and 3.45% on S Corporations receipts in excess of \$9 million annually for the years ended December 31, 2011 and 2010, respectively. The Company was also liable for state income taxes at a rate of 1.50% in California.

The Company recognizes deferred tax liabilities and assets for expected future income tax consequences of events that have been recognized in the Company's financial statements. Deferred state income taxes result from temporary differences in reporting income for financial statement and income tax purposes.

ADVERTISING COSTS

The Company charges the costs of advertising to expense as incurred. For the years ended December 31, 2011 and 2010, the Company incurred \$1,470,396 and \$1,469,489, respectively, in advertising costs.

STOCK-BASED COMPENSATION

The Company records compensation expense based on the fair value for new awards and previously issued awards that are modified, repurchased, or cancelled after the adoption date. Such value is recorded over the requisite service period using the straight-line method.

DEFERRED COMPENSATION

The Company recognizes the obligation to provide postemployment benefits if the obligation is attributable to employees' services already rendered, employees' rights to those benefits accumulate or vest, payment of the benefits is probable, and the amount of the benefits can be reasonably estimated.

RECLASSIFICATIONS

Certain amounts in 2010 were reclassified to provide comparison with 2011 classifications. These reclassifications had no effect on previously reported results of operations or retained earnings.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

SUBSEQUENT EVENTS

The Company has evaluated subsequent events through February 14, 2012, the date the financial statements were available to be issued. All material subsequent events requiring adjustment to or disclosure in the financial statements are reflected therein.

NOTE 3 – FAIR VALUE MEASUREMENTS

The following tables present the Company's fair value hierarchy for those assets measured at fair value on a recurring basis as of December 31, 2011 and 2010:

	Assets at Fair Value as of December 31, 2011			
	Level 1	Level 2	Level 3	Total
Debt Securities				
Municipal Bonds	\$ --	\$ 2,193,130	\$ --	\$ 2,193,130
Auction Rate Securities	--	--	2,495,000	2,495,000
Equities				
Mutual Funds	11,339,736	--	--	11,339,736
Fixed Income Mutual Funds	7,166,484	--	--	7,166,484
Total Securities Owned	\$ 18,506,220	\$ 2,193,130	\$ 2,495,000	\$ 23,194,350
	Assets at Fair Value as of December 31, 2010			
	Level 1	Level 2	Level 3	Total
Debt Securities				
Municipal Bonds	\$ --	\$ 6,348,767	\$ --	\$ 6,348,767
Auction Rate Securities	--	--	2,010,750	2,010,750
Equities				
Mutual Funds	14,974,452	--	--	14,974,452
Fixed Income Mutual Funds	1,468,105	--	--	1,468,105
Total Securities Owned	\$ 16,442,557	\$ 6,348,767	\$ 2,010,750	\$ 24,802,074

Investments in mutual funds, including money market mutual funds, are generally priced at the ending net asset value (NAV) provided by the service agent of the funds. These securities will be categorized as Level 1 securities.

The fair value of municipal bonds is estimated using recently executed transactions, market price quotations and pricing models that factor in, where applicable, interest rates, bond or credit default swap spreads and volatility. Municipal bonds will be categorized in Level 2 of the fair value hierarchy.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 3 – FAIR VALUE MEASUREMENTS (CONTINUED)

The following table represents activity in assets measured using Level 3 inputs as of December 31, 2011 and 2010:

	Fair Value Measurements Using Level 3 Inputs				
	Investments				
	Level 3 Beginning Balance January 1, 2011	Realized and Unrealized Gains (Losses)	Purchases, Sales and Settlements	Net Transfers In and/or (Out) of Level 3	Level 3 Ending Balance December 31, 2011
Auction Rate Securities	\$ 2,010,750	\$ (15,750)	\$ 500,000	\$ --	\$ 2,495,000

	Fair Value Measurements Using Level 3 Inputs				
	Investments				
	Level 3 Beginning Balance January 1, 2010	Realized and Unrealized Gains (Losses)	Purchases, Sales and Settlements	Net Transfers In and/or (Out) of Level 3	Level 3 Ending Balance December 31, 2010
Auction Rate Securities	\$ 2,719,500	\$ (130,503)	\$ (578,247)	\$ --	\$ 2,010,750

The failed auction status and liquidity for our auction-rate securities requires the use of a valuation methodology that relies exclusively on Level 3 inputs, including market, tax status, credit quality, duration, recent market observations, and overall capital market liquidity. The valuation of the Company's auction-rate securities is subject to uncertainties that are difficult to predict. Factors that may impact the valuations include changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates, counterparty risk and ongoing strength and quality of market credit and liquidity.

NOTE 4 – RECEIVABLE FROM AND PAYABLE TO CLEARING ORGANIZATIONS

The Company has a margin account with its clearing firm, National Financial Services, LLC, for the purpose of buying and selling securities in the Company's inventory account. At December 31, 2011 and 2010, there were trades that were pending settlement, resulting in a receivable from clearing organizations of \$234,004 and a payable to clearing organizations of \$45,963, respectively, included in the statements of financial condition.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 5 – REPRESENTATIVE LOANS

In order to assist its representatives in setting up their respective businesses, the Company makes various loans to such individuals. These loans are generally forgivable over a five year period and forgiveness is based upon the achievement of specific quota of commissions. In some cases, loans are non-forgivable and are subject to an amortization schedule, with monthly payments of principal and interest required. As of December 31, 2011 and 2010, the balances of representative loans owed to the Company were \$19,244,831 and \$14,841,765, respectively. At December 31, 2011 and 2010, \$11,468,970 (60%) and \$9,041,475 (61%), respectively, of the outstanding amount was forgivable.

NOTE 6 – PROPERTY AND EQUIPMENT

The components of property and equipment are as follows at December 31:

	2011	2010
Computers, furniture and fixtures	\$ 18,063,525	\$ 15,511,205
Software	21,589,482	21,267,594
Leasehold improvements	5,402,048	3,405,449
	45,055,055	40,184,248
Less: accumulated depreciation	(24,093,165)	(18,195,343)
	<u>\$ 20,961,890</u>	<u>\$ 21,988,905</u>

Depreciation and amortization expense for the years ended December 31, 2011 and 2010 was \$5,897,822 and \$2,513,140, respectively.

NOTE 7 – SUBORDINATED BORROWINGS - RELATED PARTY

The lenders, consisting of the Company's principal partners, have, under all agreements, subordinated their right of collection of principal and claims to all other present and future senior creditors of the Company prior to the expiration of the respective notes. The subordinated borrowings are covered by agreements approved by FINRA and are thus available for computing net capital under the SEC's uniform net capital rule. To the extent that such borrowings are required for the Company's continued compliance with minimum net capital requirements, they may not be repaid. During 2011 and 2010, an additional \$4,000,000 and \$9,600,000, respectively, was loaned to the Company. At December 31, 2011 and 2010, subordinated loans amounted to \$61,905,000 and \$57,905,000, respectively.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 7 – SUBORDINATED BORROWINGS - RELATED PARTY (CONTINUED)

The Company has subordinated borrowings maturing as follows:

2012	\$	--
2013		20,300,000
2014		25,883,000
2015		<u>15,722,000</u>
Total	\$	<u>61,905,000</u>

The interest rate on all subordinated debt is at the prime lending rate, plus an additional amount ranging from one to three percent (4.25% to 6.25%), payable monthly. Interest expense on these loans for the years ended December 31, 2011 and 2010 totaled \$2,881,801 and \$2,131,463, respectively.

NOTE 8 – INCOME TAXES

In the year ended December 31, 2010, the Company underwent a tax-free F reorganization under Internal Revenue Code Section 368(a)(1)(F) in its conversion from a Limited Liability Partnership (“LLP”) to a Corporation for legal purposes. For tax purposes, the Company had previously elected under regulations to be an association taxed as a corporation, and had elected S Corporation status. Therefore, there was no change in income tax reporting requirements.

The Company has recorded a provision for state income taxes, based on its taxable income, as well as a deferred benefit for state taxes as a result of a deferred tax asset that is generated from the tax effect of temporary differences primarily resulting from capitalized software development costs, accruals, depreciation, and amortization. Deferred tax assets at December 31, 2011 and 2010 were \$677,215 and \$625,163, respectively.

The components of the provision for income taxes are as follows as of December 31:

	<u>2011</u>	<u>2010</u>
State income tax provision - current	\$ 1,166,162	\$ 1,363,597
State income tax benefit - deferred	<u>(52,052)</u>	<u>(76,318)</u>
	<u>\$ 1,114,110</u>	<u>\$ 1,287,279</u>

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 8 – INCOME TAXES (CONTINUED)

The components of deferred tax assets are as follows as of December 31:

	2011	2010
Depreciation and amortization	\$ 37,792	\$ 52,823
Accruals	1,000,553	1,226,160
Capitalized software	(313,520)	(545,774)
Other	(47,610)	(108,046)
	\$ 677,215	\$ 625,163

NOTE 9 - OPTION PLANS

STOCK OPTION PLAN

On July 1, 2000, the Company adopted the Commonwealth Non-Qualified Stock Option Plan (the “Plan”) designed to encourage employees to continue employment with the Company. The Plan permits the Company to grant options to its employees up to a maximum of 600,000 shares. Options granted under the Plan generally vest over a five-year period and expire 25 years from the grant date.

Information with respect to activity under the Plan is as follows:

	Number of Shares	Exercise Price per Share	Weighted Average Exercise Price
Options outstanding, December 31, 2009	424,396	\$19.40 - \$89.62	\$ 44.12
Granted	81,710	\$90.64 - \$96.94	\$ 94.45
Exercised	--	--	\$ --
Canceled	(36,740)	\$22.26 - \$96.94	\$ 54.36
Options outstanding, December 31, 2010	469,366	\$19.40 - \$96.94	\$ 65.85
Granted	81,220	\$90.64 - \$99.66	\$ 96.04
Exercised	--	--	\$ --
Canceled	(52,046)	\$19.40 - \$96.88	\$ 62.80
Options outstanding, December 31, 2011	498,540	\$19.81 - \$99.66	\$ 70.95
Options exercisable, December 31, 2010	356,700	\$19.40 - \$94.59	\$ 60.50
Options exercisable, December 31, 2011	392,718	\$19.81 - \$99.66	\$ 65.58

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 9 - OPTION PLANS (CONTINUED)

STOCK OPTION PLAN (CONTINUED)

The weighted average remaining contractual term in years was 20.92 for options outstanding at December 31, 2011 and 20.27 for options exercisable at December 31, 2011.

The following table provides a summary of the status of the Company's unvested stock options for the purchase of shares as of December 31, 2011 and the changes during the year then ended:

	Shares	Weighted Average Grant Date Fair Value
Non-vested - beginning of year	112,666	\$ 12.49
Granted	81,220	\$ 11.02
Vested	(77,150)	\$ 11.78
Forfeited	(10,914)	\$ 12.06
Non-vested - end of year	105,822	\$ 11.92

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants issued during the years ended December 31:

	2011	2010
Risk free interest rate	2.00%	2.50%
Expected dividend yield	0%	0%
Expected life	5 years	5 years
Volatility	6.32%	6.63%

The weighted average grant date fair value using the Black-Scholes option pricing model was \$11.02 and \$12.56 during the years ended December 31, 2011 and 2010, respectively. Total stock option compensation expense attributable to options granted during the years ended December 31, 2011 and 2010 was \$839,391 and \$761,391, respectively. In addition, the Company recognized \$1,599,199 and \$1,459,873 for the years ended December 31, 2011 and 2010, respectively, as an expense attributable to payouts for vested options.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 10 – COMMITMENTS AND CONTINGENCIES

OPERATING LEASE

The Company leases office space in Waltham, Massachusetts, San Diego, California and Marlborough, Massachusetts with expiration dates in 2020, 2016, and 2020, respectively.

During July 2005, the Company began to lease additional space in its Waltham office and extended the lease term through 2020. As part of the lessor's requirement for leasing this additional office space, the Company has set aside funds totaling approximately \$2,700,000, which is included in restricted cash and cash equivalents on the Statement of Financial Condition. Additionally, the Company subleases part of their Waltham and San Diego offices and the rental receipts reduce the Company's overall rental costs. Sublease rental income included in rent expense was \$588,555 and \$674,502 for the years ended December 31, 2011 and 2010, respectively. The Company has entered into various operating leases for office equipment and furniture.

Future minimum lease payments under operating leases are as follows:

	Facilities	Equipment and Furniture
2012	\$ 3,933,336	\$ 36,719
2013	3,930,546	38,448
2014	3,950,498	34,822
2015	3,970,457	23,892
2016	3,165,309	11,946
Thereafter	10,490,415	--
Total	<u>\$ 29,440,561</u>	<u>\$ 145,827</u>

Rent expense under these leases was \$3,693,844 and \$3,523,076 for the years ended December 31, 2011 and 2010, respectively. The total amount of minimum rentals to be received in the future under non-cancelable subleases is \$900,990 as of December 31, 2011.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 10 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

LITIGATION AND CLAIMS

The Company is involved with various judicial, regulatory, and arbitration proceedings concerning matters arising in connection with the conduct of its business. At December 31, 2011 and 2010, the Company was the co-defendant in several lawsuits. Management believes, based on current available information, that the results of such proceedings in the aggregate will not have a material adverse effect on the Company's financial condition. The Company has Errors and Omissions insurance to protect itself from potential damages and/or legal costs associated with the aforementioned lawsuits. The Company has accrued expenses for legal costs of approximately \$400,000 and \$350,000 for the years ended December 31, 2011 and 2010, respectively.

DEFERRED COMPENSATION

The Company has entered into agreements (the "Agreements") with ten employees (the "Employees") that provide for the payment of deferred compensation upon termination of employment, subject to five-year vesting schedules. Following termination of employment, each of the Employees will be entitled to receive cash payments that in total equal the value of his or her vested deferred compensation as determined under terms of the Agreements. The Company began recording accrued deferred compensation expense in 2006 in accordance with the vesting schedules. The Company recorded deferred compensation expense of \$3,738,615 and \$9,025,938 for the years ended December 31, 2011 and 2010, respectively, pursuant to the terms of the Agreements.

EQUITY REPURCHASE OBLIGATION – MINORITY OWNER

The Company is obligated to repurchase the equity interest of a minority owner, also an employee, as a result of an agreement signed in 1999 (the "1999 Agreement"). Following termination of his employment and in exchange for his entire equity ownership interest, the minority owner will receive six semi-annual cash payments that in total equals the value of his equity interest, as determined under the terms of the 1999 Agreement.

NOTE 11 – 401(K) PLAN

The Company maintains a qualified retirement plan (the "Plan") under Internal Revenue Code 401(k) covering substantially all employees. Employer contributions made to the Plan for the years ended December 31, 2011 and 2010 were \$1,485,396 and \$1,259,685, respectively.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 12 – RELATED PARTY TRANSACTIONS

DUE TO AFFILIATE

During the course of the year, the Company advances to and borrows from related parties to facilitate short-term cash flow requirements. These related parties are owned and controlled by a principal officer and shareholder of the Company. The balances consisted primarily of monies owed to and due from CES Insurance Agency, Inc. (“CESI”). CESI is an affiliated entity that assists the Company’s independent representatives in the selling of insurance-based products. The Company provides on-going operational and marketing services to CESI at prevailing market rates. At December 31, 2011 and 2010, the balance due to affiliated parties was \$227,916 and \$277,010, respectively. Expenses allocated to CESI for marketing and operational services was \$1,981,004 and \$1,253,116 for the years ended December 31, 2011 and 2010, respectively.

During the course of the year, the Company paid premiums to an affiliated insurance company, Claridge Insurance (“Claridge”). Claridge is owned and controlled entirely by a holding company that, in turn, is owned and controlled by a principal officer and shareholder of the Company. The Company pays premiums to Claridge on a monthly basis in exchange for errors and omissions coverage of up to \$1,000,000 per occurrence with a deductible of \$0. For the years ending December 31, 2011 and 2010, the Company paid Claridge a total of \$3,300,000 and \$3,300,000, respectively, in premiums.

DIVIDENDS

The Company declared dividends of \$34,531,511 and \$34,207,419 for the years ended December 31, 2011 and 2010, respectively.

NOTE 13 – CONCENTRATIONS

For the years ended December 31, 2011 and 2010, commissions receivable from the Company’s clearing firm, National Financial Services, LLC, was \$13,603,151 and \$12,951,128, respectively, or 62% and 62%, respectively, of all receivables from brokers, product sponsors, and clearing organizations.

COMMONWEALTH FINANCIAL NETWORKSM

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

NOTE 14 – NET CAPITAL REQUIREMENTS

The Company is a registered broker-dealer and, accordingly, is subject to the SEC Uniform Net Capital Rule (“SEC Rule 15c3-1”), which requires the Company to maintain minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. At December 31, 2011 and 2010, the Company had net capital of \$15,528,629 and \$14,449,652, respectively, which was sufficient to meet the required net capital of \$4,821,156 and \$4,506,198, respectively. The Company’s net capital ratio for December 31, 2011 and 2010 was 4.66 and 4.68 to 1, respectively.

No material differences existed between the audited net capital computation and the computation provided by the Company as of December 31, 2011 and 2010.

**SUPPLEMENTAL REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL
STRUCTURE REQUIRED BY SEC RULE 17a-5 AND CFTC REGULATION 1.16**

To the Shareholders of
Commonwealth Financial NetworkSM
A Registered Service Mark for Commonwealth Equity Services, Inc.

In planning and performing our audit of the financial statements of Commonwealth Financial NetworkSM, a Registered Service Mark for Commonwealth Equity Services, Inc. (“Commonwealth” or 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 audit 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 compliance with 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

In addition, as required by Regulation 1.16 of the Commodity Futures Trading Commission (“CFTC”), we have made a study of the practices and procedures followed by the Company, including consideration of control activities for safeguarding customer and firm assets. This study included tests of such practices and procedures that we considered relevant to the objectives stated in Regulation 1.16, in making the periodic computations of minimum financial requirements pursuant to Regulation 1.17. Because the Company is not engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility and; in or in conjunction with

such solicitation or acceptance of orders, nor does it accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result there from, we did not review the practices and procedures followed by the Company in any of the following:

1. The daily computations of the segregation requirements of Section 4d(a)(2) of the Commodity Exchange Act and the regulations thereunder and the segregation of funds based upon such computations.
2. The daily computations of the foreign futures and foreign options secured amount requirements pursuant to Regulation 30.7 of the CFTC.

The management of the Company is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraphs. 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 paragraphs and to assess whether those practices and procedures can be expected to achieve the SEC's and CFTC'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) and Regulation 1.16(d) lists additional objectives of the practices and procedures listed in the preceding paragraphs.

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.

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 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 the internal control was for the limited purpose described in the first, second and third paragraphs and would not necessarily identify any 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 first, second and third paragraphs of this report are considered by the SEC and the CFTC to be adequate for their purposes in accordance with the Securities Exchange Act of 1934, the Commodity

Exchange Act, 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 our study, we believe that the Company's practices and procedures, as described in the second and third paragraphs of this report, were adequate at December 31, 2011 to meet the SEC's and CFTC's objectives.

This report is intended solely for the information and use of management, the SEC, CFTC, and other regulatory agencies that rely on Rule 17a-5(g) under the Securities Exchange Act of 1934 and/or Regulation 1.16 under the CFTC or both in their regulation of registered brokers-dealers and futures commission merchants and is not intended to be and should not be used by anyone other than these specified parties.

Marcum LLP

Boston, MA
February 14, 2012

COMMONWEALTH FINANCIAL NETWORKSM

COMPUTATION OF NET CAPITAL PURSUANT TO RULE 15c3-1

YEAR ENDED DECEMBER 31, 2011

Schedule I

Total shareholders' equity		\$ 7,613,886
Subordinated loans for equity capital		<u>61,905,000</u>
Total capital and allowable subordinated liabilities		69,518,886
Less: non-allowable assets for the Statement of Financial Condition		<u>(50,913,946)</u>
Net capital before haircuts on securities		18,604,940
Less: haircuts on securities		<u>(3,076,311)</u>
Net capital		15,528,629
Minimum net capital requirement:		
1/15 x aggregate indebtedness	\$4,821,156	
or Minimum dollar net capital requirement	<u>100,000</u>	<u>4,821,156</u>
Excess net capital		<u>\$10,707,473</u>
Aggregate indebtedness		<u>\$72,317,341</u>
Percentage of aggregate indebtedness to net capital		<u>466%</u>

There were no material reconciling items per this report and the most recent quarterly filing by the Company of Part II of the Focus Report with respect to the computation of the Net Capital Pursuant to Rule 15c3-1.

See Independent Auditors' Report.

COMMONWEALTH FINANCIAL NETWORKSM

**COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENT
PURSUANT TO RULE 15c3-3**

YEAR ENDED DECEMBER 31, 2011

Schedule II

The Company is exempt from the reserve requirements pursuant to Rule 15c3-3 under paragraph (k)(2)(ii).

See Independent Auditors' Report.

COMMONWEALTH FINANCIAL NETWORKSM

INFORMATION RELATING TO POSSESSION OR CONTROL REQUIREMENTS
PURSUANT TO RULE 15c3-3

YEAR ENDED DECEMBER 31, 2011

Schedule III

Information relating to possession or control requirements is not applicable to Commonwealth Financial NetworkSM as the Company qualifies for exemption under Rule 15c3-3(k)(2)(ii).

See Independent Auditors' Report.