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

OMB APPROVAL	
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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 01/01/2012 AND ENDING 12/31/2012  
MM/DD/YY MM/DD/YY

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER: Key Investment Services LLC

OFFICIAL USE ONLY
FIRM I.D. NO.

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

4900 Tiedeman Road

(No. and Street)

Brooklyn

(City)

Ohio

(State)

44144

(Zip Code)

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

Mr. Matt Gulla, Chief Financial Officer

216-813-6033

(Area Code - Telephone Number)

**B. ACCOUNTANT IDENTIFICATION**

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

Ernst & Young LLP

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

Suite 1300, 925 Euclid Ave.

(Address)

Cleveland

(City)

Ohio

(State)

44115-1476

(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)

OATH OR AFFIRMATION

I, Matt Gulla, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Key Investment Services LLC, as of December 31, 2012, 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:

Security accounts of principal officers and directors are classified as customer accounts (debits \$0, credits \$0)

CLAIRE PILDNER  
Notary Public, State of Ohio  
My Commission Expires March 28, 2015

Signature

Chief Financial Officer

Title

Claire Pildner 2/28/2013  
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 Changes in Financial Condition.
- (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietors' Capital.
- (f) Statement of Changes in Liabilities Subordinated to Claims of 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).

**Securities and Exchange Commission**

Washington, D.C 20549

**Annual Audit Report**

Year Ended December 31, 2012

**Key Investment Services LLC**  
**(Name of Respondent)**

4900 Tiedeman Road

Brooklyn, Ohio 44144

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(Address of principal executive office)

**Mr. Matt Gulla**  
**Chief Financial Officer**  
**Key Investment Services LLC**

4900 Tiedeman Road  
Brooklyn, Ohio 44144  
Telephone No. (216) 813-6033

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**FINANCIAL STATEMENTS AND  
SUPPLEMENTAL INFORMATION**

**Key Investment Services LLC  
Year Ended December 31, 2012  
With Report and Supplementary Report of  
Independent Registered Public Accounting Firm**

# Key Investment Services LLC

## Financial Statements and Supplementary Information

December 31, 2012

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## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholder  
Key Investment Services LLC

We have audited the accompanying financial statements of Key Investment Services LLC (the Company), which comprise the statement of assets, liabilities and member's interest as of December 31, 2012, and the related statements of operations, changes in member's interest, and cash flows for the year then ended that are filed pursuant to Rule 17a-5 under the Securities Exchange Act of 1934, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

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. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Key Investment Services LLC as of December 31, 2012, and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

## Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The information contained in Schedules I and II is presented for purposes of additional analysis and is not a required part of the financial statements, but is supplementary information required by rule 17a-5 under the Securities Exchange Act of 1934. 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. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Ernst + Young LLP*

February 28, 2013

## Key Investment Services LLC

### Statement of Assets, Liabilities and Member's Interest

December 31, 2012

<b>Assets</b>	
Cash	\$ 2,390,266
Marketable securities, at fair value	23,260,655
Receivable from brokers and dealers	4,447,114
Prepaid expenses	1,165,135
Furniture and equipment, at cost, less accumulated depreciation of \$289,102	166,127
Deferred tax assets, net	1,246,067
Other assets	120,000
Total assets	<u>\$32,795,364</u>
<b>Liabilities and Member's interest</b>	
<b>Liabilities:</b>	
Securities sold, but not yet purchased	\$ 101,871
Accrued compensation	6,773,822
Income taxes payable to Parent	218,038
Accrued contingency costs	1,117,000
Accrued clearing costs	467,516
Intercompany payable to Parent	463,739
Reserve for annuity & insurance sales	530,727
Other liabilities	242,797
Total liabilities	<u>9,915,510</u>
<b>Member's interest</b>	<u>22,879,854</u>
Total liabilities and Member's interest	<u>\$32,795,364</u>

*See accompanying notes to financial statements.*



# Key Investment Services LLC

## Statement of Operations

Year Ended December 31, 2012

### Revenues

Commissions	\$ 69,593,214
Principal transactions	3,452,409
Other revenues	<u>3,496,329</u>
Total revenues	<u>76,541,952</u>

### Expenses

Employee compensation and benefits	45,598,766
Communications	1,380,331
Occupancy and equipment	12,093,835
Promotion and development	1,829,199
Floor brokerage and clearance	3,946,981
Taxes, other than income taxes	143,086
Other operating expenses	<u>3,758,418</u>
Total expenses	<u>68,750,616</u>

Income before income taxes 7,791,336

Provision for income taxes 2,967,624

Net increase in Member's interest resulting from operations \$ 4,823,712

*See accompanying notes to financial statements.*

Key Investment Services LLC

Statement of Changes in Member's Interest

Year Ended December 31, 2012

Balance at January 1, 2012	\$ 18,056,142
Net increase in Member's interest resulting from operations	<u>4,823,712</u>
Balance at December 31, 2012	<u>\$ 22,879,854</u>

*See accompanying notes to financial statements.*

# Key Investment Services LLC

## Statement of Cash Flows

Year Ended December 31, 2012

### Operating activities

Net increase in Member's interest resulting from operations	\$ 4,823,712
Adjustments to reconcile net increase in Member's interest to net cash provided by (used in) operating activities:	
Depreciation	115,633
Deferred income taxes	401,416
Changes in operating assets and liabilities:	
Decrease (increase) in receivable from brokers and dealers	(1,190,328)
Decrease (increase) in other assets	211,121
Decrease (increase) in marketable securities	117,781
Decrease (increase) in prepaid expenses	(634,591)
Increase (decrease) in accrued compensation	(453,401)
Increase (decrease) in securities sold, but not yet purchased	101,808
Increase (decrease) in federal and state taxes payable	(3,682,706)
Increase (decrease) in accrued clearing costs	78,610
Increase (decrease) in intercompany payable to Parent	310,599
Increase (decrease) in reserve for annuity and insurance sales	(130,661)
Increase (decrease) in other liabilities	(464,191)
Net cash used in operating activities	<u>(395,198)</u>

### Investing activities

Purchases of furniture and equipment	<u>(86,557)</u>
Decrease in cash	(481,755)
Cash at beginning of fiscal year	<u>2,872,021</u>
Cash at end of fiscal year	<u><u>\$ 2,390,266</u></u>

### Additional disclosures relative to cash flow

Taxes paid to Parent	<u><u>\$ 6,248,913</u></u>
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*See accompanying notes to financial statements.*

# Key Investment Services LLC

## Notes to Financial Statements

December 31, 2012

### **1. Organization**

Key Investment Services LLC (the Company), is an Ohio limited liability company whose sole member is KeyBank National Association (the Bank), which in turn is a wholly owned subsidiary of KeyCorp (the Parent). The Company is a registered full service introducing broker-dealer under the Securities Exchange Act of 1934 and a member of the Financial Industry Regulatory Authority, Inc. (FINRA). The Company was formed on June 8, 2005 with a capital contribution of \$1,000,000 on June 22, 2005. FINRA (formerly NASD) granted approval on November 17, 2005. The Company sells primarily investment company shares and fixed and variable rate annuity contracts through licensed/registered representatives located in some of the Bank's branches in Ohio, Michigan, Indiana, Kentucky, New York, Maine, Vermont, Washington, Oregon, Alaska, Idaho, Colorado and Utah. In addition to sales of investment company shares and annuity contracts, the Company sells corporate debt and equity securities, unit investment trusts, US government securities, managed products, and life insurance contracts.

The Company clears its securities transactions on a fully disclosed basis through Pershing, LLC.

### **2. Significant Accounting Policies**

#### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

#### **Cash**

Cash is on deposit at the Bank. Cash balances may be in excess of FDIC insurance limits.

#### **Marketable Securities**

Marketable securities, including primarily money market securities and mutual funds, are recorded on a settlement date basis which approximates trade date basis. Marketable securities are valued at quoted market prices which represents fair value.

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### **2. Significant Accounting Policies (continued)**

##### **Receivable from Brokers and Dealers**

Receivable from brokers and dealers represents commissions earned through the sales of various products net of various clearing and administrative charges. The carrying amount of receivables is reduced by a valuation allowance that reflects management's best estimate of amounts that are not expected to be collectible. In the opinion of management, at December 31, 2012, all receivables were considered collectible and no allowance was necessary.

##### **Prepaid Expenses**

Prepaid expenses include retention payments, licensing fees, and insurance premiums that are being amortized over various periods ranging from twelve to twenty-four months.

##### **Furniture and Equipment**

Furniture and equipment are stated at cost less accumulated depreciation and amortization. The Company depreciates furniture and equipment using the straight-line method over the estimated useful lives of the particular assets. Accumulated depreciation and amortization on furniture and equipment totaled \$289,102 at December 31, 2012.

##### **Income Taxes**

The Company is a single member LLC treated for tax purposes as a division of the Bank and therefore is included in the consolidated federal income tax return filed by the Parent. For financial reporting purposes, the Parent follows the policy of allocating the consolidated income tax provision among the Parent and its subsidiaries on a separate return basis, which includes any tax credits or carryovers and carrybacks, subject to recognition of such items on a consolidated basis. The Company files separate state tax returns.

##### **Accrued Compensation**

Accrued compensation includes employee salaries, commissions, incentive compensation, payroll taxes, and benefits. Salaries, payroll taxes, and benefits are accrued based on days worked. Commissions are accrued on the settlement date basis and vary based on individual commission rates and production volume. Incentive compensation includes both discretionary and non-discretionary amounts. Discretionary amounts are accrued during the year based on estimated payouts. Non-discretionary amounts are accrued as pre-determined benchmarks are met.

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### **2. Significant Accounting Policies (continued)**

##### **Accrued Clearing Costs**

Accrued clearing costs include various custodial fees charged by the Company's clearing firm as incurred.

##### **Reserve for Annuity and Insurance Sales**

The Company estimates a reserve against revenue related to certain annuity and insurance contracts that have the potential to be cancelled at a future date. At December 31, 2012, the reserve for annuity and insurance sales was \$530,727.

##### **Revenue Recognition**

The Company earns commission income through the sales of various securities products; primarily consisting of investment company shares and fixed and variable rate annuity contracts. Commission income and related expenses are recorded in the accompanying financial statements on a settlement date basis. No material differences resulted from recognizing revenue and related expenses on a settlement date basis, rather than on a trade date basis.

##### **Principal Transactions**

Principal transactions are riskless principal trades entered into by the Company only when it has a confirmed customer order and are recorded on a settlement date basis, rather than on a trade date basis. No material differences resulted from recording principal transactions revenue on a settlement date basis, rather than on a trade date basis.

##### **Fair Value Measurements**

The Company follows the applicable accounting guidance for fair value measurements and disclosures for all applicable financial and nonfinancial assets and liabilities. This guidance defines fair value, establishes a framework for measuring fair value, expands disclosures about fair value measurements, and applies only when other guidance requires or permits assets or liabilities to be measured at fair value; the guidance does not expand the use of fair value to any new circumstances.

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### **2. Significant Accounting Policies (continued)**

Accounting guidance defines fair value as the price to sell an asset or transfer a liability in an orderly transaction between market participants in the Company's principal market. In other words, fair value represents an exit price at the measurement date. Market participants are buyers and sellers who are independent, knowledgeable, and willing and able to transact in the principal (or most advantageous) market for the asset or liability being measured. Current market conditions, including imbalances between supply and demand, are considered in determining fair value.

The Company values its assets and liabilities based on the principal market where each would be sold (in the case of assets) or transferred (in the case of liabilities). The principal market is the forum with the greatest volume and level of activity. In the absence of a principal market, the valuation is based on the most advantageous market (i.e., the market where the asset could be sold at a price that maximizes the amount to be received or the liability transferred at a price that minimizes the amount to be paid). In the absence of observable market transactions, management considers liquidity valuation adjustments to reflect the uncertainty in pricing the instruments.

In measuring the fair value of an asset, the Company assumes the highest and best use of the asset by a market participant – not just the intended use – to maximize the value of the asset. The Company also considers whether any credit valuation adjustments are necessary based on the counterparty's credit quality.

When measuring the fair value of a liability, the Company assumes that the transfer will not affect the associated nonperformance risk. Nonperformance risk is the risk that an obligation will not be satisfied and encompasses not only the Company's own credit risk (i.e., the risk that the Company will fail to meet its obligation), but also other risks such as settlement risk (i.e., the risk that upon termination or sale, the contract will not settle). The Company considers the effect of its own credit risk on the fair value for any period in which fair value is measured.

There are three acceptable techniques for measuring fair value: the market approach, the income approach and the cost approach. The appropriate technique for valuing a particular asset or liability depends on the exit market, the nature of the asset or liability being valued, and how a market participant would value the same asset or liability. Ultimately, selecting the appropriate valuation method requires significant judgment, and applying the valuation technique requires sufficient knowledge and expertise.

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### **2. Significant Accounting Policies (continued)**

Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability. Inputs can be observable or unobservable. Observable inputs are assumptions based on market data obtained from an independent source. Unobservable inputs are assumptions based on the Company's own information or assessment of assumptions used by other market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date.

All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy that gives the highest ranking to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest ranking to unobservable inputs (Level 3). Fair values for assets or liabilities classified as Level 2 are based on one or a combination of the following factors: (a) quoted market prices for similar assets or liabilities; (b) observable inputs, such as interest rates or yield curves; or (c) inputs derived principally from or corroborated by observable market data. The level in the fair value hierarchy ascribed to a fair value measurement in its entirety is based on the lowest level input that is significant to the measurement. The Company considers an input to be significant if it drives 10% or more of the total fair value of a particular asset or liability. Assets and liabilities may transfer between levels based on the observable and unobservable inputs used at the valuation date, as the inputs may be influenced by certain market conditions. Transfers between levels of the fair value hierarchy are recognized at the end of the reporting period.

Typically, assets and liabilities are considered to be fair valued on a recurring basis if fair value is measured regularly. At a minimum, the Company conducts its valuations quarterly.

Additional information regarding fair value measurements and disclosures is provided in Note 9, *Fair Value Measurements*.

#### **Subsequent Events**

In preparing these financial statements, subsequent events were evaluated through the time the financial statements were issued. Financial statements are considered issued when they are widely distributed to financial statement users or filed with the SEC. In compliance with applicable accounting standards, all material subsequent events have been either recognized in the financial statements or disclosed in the notes to the financial statements.



## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### 2. Significant Accounting Policies (continued)

##### Accounting Guidance Adopted in 2012

**Fair value measurement.** In May 2011, the Financial Accounting Standards Board (FASB) issued accounting guidance that changed the wording used to describe many of the current accounting requirements for measuring fair value and disclosing information about fair value measurements. This accounting guidance clarified the FASB's intent about the application of existing fair value measurement requirements. It was effective for the interim and annual periods beginning on or after December 15, 2011 (effective January 1, 2012, for the Company). The adoption of this accounting guidance did not have a material effect on the Company's financial condition or results of operations.

#### 3. Related-Party Transactions

In the ordinary course of business, the Company enters into transactions with the Bank and its affiliates.

The Bank and affiliated companies provide certain support services to the Company. Services include legal, human resources, payroll, tax, risk management, insurance, communications, facilities, distribution, printing, and computer processing. The company may be provided these services under one or more service agreements with the respective providing affiliate. Charges from affiliates for 2012 were:

Occupancy and equipment	\$ 6,566,635
Communications	1,266,475
Corporate management fee	1,919,000
Corporate computer processing and technology services	4,501,621
	<u>\$ 14,253,731</u>

Of the expenses recorded above, \$463,739 is payable to the Parent at December 31, 2012.

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### 4. Income Taxes

The Company is a single member LLC treated for tax purposes as a division of the Bank and therefore is included in the consolidated federal income tax return filed by the Parent. For financial reporting purposes, the Parent follows the policy of allocating the consolidated income tax provision among the Parent and its subsidiaries on a separate return basis, which includes any tax credits or carryovers and carrybacks, subject to recognition of such items on a consolidated basis. The Company files separate state tax returns.

Income taxes included in the statement of operations are summarized below:

Current:	
Federal	\$ 2,304,187
State	262,021
Total current	<u>2,566,208</u>
Deferred:	
Federal	393,776
State	7,640
Total deferred	<u>401,416</u>
Total income tax expense	<u>\$ 2,967,624</u>

The difference between income taxes and the amount computed by applying the statutory Federal tax rate of 35% to income before taxes is as follows:

Expected income tax at U.S. statutory tax rate	\$ 2,726,968
State taxes, net of federal tax benefit	175,279
Disallowed meals and entertainment	65,013
Other	364
Income tax expense	<u>\$ 2,967,624</u>

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### 4. Income Taxes (continued)

The deferred income tax expense (benefit) for the year ended December 31, 2012, consists of the following:

Employee compensation accruals	\$ 348,811
State taxes	314,668
Prepaid expenses	180,614
Furniture and equipment	(1,048)
Deferred income and fees	(87,200)
Non-tax accruals	(354,429)
Total deferred tax expense	<u>\$ 401,416</u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets as of December 31, 2012 are as follows:

Deferred tax assets:	
Employee compensation accruals	\$ 681,418
Furniture and equipment	7,645
Accruals	752,097
Total deferred tax assets	<u>\$ 1,441,160</u>
Deferred tax liabilities:	
Prepaid expenses	\$ 180,614
State taxes	14,479
Total deferred tax liabilities	<u>195,093</u>
Total net deferred tax assets	<u>\$ 1,246,067</u>

Deferred tax assets are recoverable from the Parent when they are able to be used. An assessment is conducted of all available evidence to determine the amount of deferred tax assets that are more-likely-than-not to be realized, and therefore recorded. This evidence includes taxable income in prior periods, projected future taxable income and projected future reversals of deferred tax items. Based on these criteria, the Company currently believes it is more-likely-than-not that the net deferred tax asset will be realized in future periods.

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### **4. Income Taxes (continued)**

During the year ended December 31, 2012, the Company paid the Parent \$6,248,913 for Federal and State income taxes. At December 31, 2012, the Company had a \$218,038 intercompany payable to the Parent for federal and state income taxes.

The Company's management believes that there is no tax liability resulting from unrecognized tax benefits related to uncertain tax positions taken at December 31, 2012.

#### **5. Commitments and Contingencies**

Since the Company is an introducing broker-dealer, securities transactions are processed by a clearing broker-dealer on a fully disclosed basis. Therefore, the Company is exempt from the provisions of Rule 15c3-3 under the Securities Exchange Act of 1934. The services provided by the clearing broker-dealer include the execution of certain securities transactions, the preparation of customer trade confirmations, the maintenance of customer accounts, and the custody and delivery of securities. In conjunction with this arrangement, the Company is contingently liable for the payment of securities purchased and the delivery of securities sold by customers. No losses from such contingencies have been incurred or are anticipated by management for the year ended December 31, 2012.

During the year ended December 31, 2011, the Company's advisory services business was examined by the SEC. As a result of the examination, the SEC has questioned the validity of the fees charged by the Company related to this specific business. The Company has recorded a reserve of \$1,117,000 in anticipation of settling this matter which is still pending with the SEC. At December 31, 2012 the Company cannot determine if final resolution of this matter would reasonably be expected to have a material adverse effect on our financial condition.

#### **6. Net Capital Requirements**

The Company is subject to the uniform net capital rule under the Securities Exchange Act of 1934. This rule prohibits the Company from engaging in any securities transactions whenever its "aggregate indebtedness" (as defined) exceeds 15 times its "net capital" (as defined). Under such rule, the Company may be required to reduce its business if its "net capital ratio" (as defined) exceeds 12 to 1. The Company may also be prohibited from expanding its business if its net capital ratio exceeds 10 to 1.

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### 6. Net Capital Requirements (continued)

As a full service introducing broker-dealer, the Company is required to maintain minimum net capital of the greater of \$250,000 or 6 2/3% of aggregate indebtedness. At December 31, 2012, the minimum amount required was \$654,243. At December 31, 2012, the Company's net capital was \$19,143,209, which was \$18,488,966 in excess of its required net capital, and the Company's aggregate indebtedness to net capital ratio was 0.51 to 1.

#### 7. Employee Benefit Plans

Employees of the Company are covered under a 401(k) plan sponsored by the Parent, which permits eligible employees to contribute from 1% to 25% of eligible compensation with up to 6% being eligible for matching contributions. The plan also permits the Company to distribute an annual profit-sharing contribution, which was 2.4% for 2012 for eligible employees as of December 31, 2012. For the year ended December 31, 2012, the Company's contribution expense was \$ 2,306,782.

Effective December 31, 2009, the Parent amended its pension plans to freeze all benefit accruals and close the plans to new employees. The Company will continue to credit participants' existing account balances for interest until they receive their plan benefits. Substantially all of the Company's employees who meet certain specified conditions are eligible for benefits under group medical and dental plans, and postretirement health care and life insurance plans established by the Parent. The costs related to the plans incurred by the Parent on behalf of the Company's employees are allocated to the Company based on management's estimate of the Company's proportionate share of the related costs. The Company's allocated cost for the year ended December 31, 2012 was \$1,841,512.

#### 8. Fair Value Measurements

##### Fair Value Determination

As defined in the applicable accounting guidance, fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants in the Company's principal market. The Company has established and documented its process for determining the fair values of its assets and liabilities, where applicable. Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, management determines the fair value of the Company's assets and liabilities

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### 8. Fair Value Measurements (continued)

using pricing models (either by a third party pricing service or internally) or quoted prices of similar securities. Both of these approaches rely on market-based parameters when available, or unobservable inputs. Unobservable inputs may be based on management's judgment, assumptions and estimates related to credit quality, liquidity, interest rates and other relevant inputs.

Valuation adjustments, such as those pertaining to counterparty and the Company's own credit quality and liquidity, may be necessary to ensure that assets and liabilities are recorded at fair value. Credit valuation adjustments are made when market pricing does not accurately reflect the counterparty's credit quality.

Management makes liquidity valuation adjustments to the fair value of certain assets to reflect the uncertainty in the pricing and trading of the instruments when they are unable to observe recent market transactions for identical or similar instruments. Liquidity valuation adjustments are based on the following factors:

- the amount of time since the last relevant valuation;
- whether there is an actual trade or relevant external quote available at the measurement date; and
- volatility associated with the primary pricing components.

The Company ensures that its fair value measurements are accurate and appropriate by relying upon various controls, including:

- an independent review and approval of valuation models and assumptions;
- recurring detailed reviews of profit and loss; and
- a validation of valuation model components against benchmark data and similar products, where possible.

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### 8. Fair Value Measurements (continued)

On a quarterly basis, management reviews any changes to its valuation methodologies to ensure they are appropriate and justified, and refines its valuation methodologies as more market-based data becomes available. Formal documentation in the form of fair value valuation methodologies are prepared detailing the asset or liability class and related general ledger accounts, valuation techniques, fair value hierarchy level market participants, accounting methods, valuation methodology, group responsible for valuations, and valuation inputs. The Company recognizes transfers between levels of the fair value hierarchy at the end of the reporting period.

#### Qualitative Disclosures of Valuation Techniques

- **Marketable Securities.** Marketable securities are classified as Level 1 when quoted market prices are available in an active market for the identical securities. Level 1 instruments include exchange-traded equity securities. Marketable securities are classified as Level 2 if quoted prices for identical securities are not available, and the Company determines fair value using pricing models (either by a third party pricing service or internally) or quoted prices of similar securities. These instruments include money market securities, unit investment trusts and mutual funds, which are valued using the net asset value provided by the mutual fund companies where the positions are held. Marketable securities are classified as Level 3 when there is limited activity in the market for a particular instrument. In such cases, the Company uses pricing models based on certain assumptions to determine fair value. There are currently no financial instruments that are measured at fair value on a recurring or nonrecurring basis or that utilize Level 3 inputs.

On a quarterly basis, management validates the pricing valuation received from the broker dealer of record to ensure the fair value determination is consistent with the applicable accounting guidance and that the assets are properly classified in the fair value hierarchy. To perform this validation, management substantiates the fair values determined for a sample of positions by comparing the price provided by the broker dealer of record to prices from other independent sources for the same and similar securities.

## Key Investment Services LLC

### Notes to Financial Statements (continued)

#### 8. Fair Value Measurements (continued)

##### Assets and Liabilities Measured at Fair Value on a Recurring Basis

Certain assets and liabilities are measured at fair value on a recurring basis in accordance with U.S. generally accepted accounting principles. The following table presents these assets and liabilities at December 31, 2012.

	December 31, 2012			
	Level 1	Level 2	Level 3	Total
<b>Assets measured on a recurring basis</b>				
Total assets on a recurring basis at fair value:				
Money market accounts	\$ —	\$ 23,225,938	\$ —	\$ 23,225,938
Unit Investment Trusts	—	34,662	—	34,662
Mutual funds	—	55	—	55
Total (a)	\$ —	\$ 23,260,655	\$ —	\$ 23,260,655
<b>Liabilities measured on a recurring basis</b>				
Total liabilities on a recurring basis at fair value:				
Securities sold, but not yet purchased:				
Certificate of deposit	\$ —	\$ 99,994	\$ —	\$ 99,994
Mutual funds	—	1,137	—	1,137
Equities	740	—	—	740
Total (a)	\$ 740	\$ 101,131	\$ —	\$ 101,871

(a) There were no transfers between Level 1 and Level 2 or in and out of Level 3 during 2012.



## Supplementary Information

Key Investment Services LLC

Schedule I

Computation of Net Capital Pursuant to Rule 15c3-1

Year Ended December 31, 2012

NET CAPITAL

Total Member's interest qualified for net capital \$22,879,854

DEDUCTIONS AND OTHER CHARGES:

Nonallowable assets:

Furniture and equipment	\$ (166,127)	
Prepaid expenses	(1,165,135)	
Deferred tax assets	(1,246,067)	
Other assets	(589,308)	
		<u>(3,166,637)</u>

HAIRCUTS ON SECURITIES AND INVENTORY (570,008)

NET CAPITAL \$19,143,209

AGGREGATE INDEBTEDNESS- Items included in statement of financial condition:

Liabilities	\$ 9,915,510	
Securities sold not yet purchased	(101,871)	
		<u>\$ 9,813,639</u>

DIVIDED BY 15

MINIMUM NET CAPITAL REQUIREMENT \$ 654,243

MINIMUM DOLLAR REQUIREMENT \$ 250,000

NET CAPITAL REQUIREMENT \$ 654,243

EXCESS NET CAPITAL \$18,488,966

RATIO: AGGREGATE INDEBTEDNESS TO NET CAPITAL 0.51 TO 1

NOTE: The above computation does not differ from the computation of net capital under Rule 15c3-1 as of December 31, 2012 as filed on the original and amended Form X-17A-5 by the Company.

*See accompanying Supplementary Report of Independent Registered Public Accounting Firm on Internal Controls.*

Key Investment Services LLC

Schedule II

Statement Regarding Rule 15c3-3

December 31, 2012

The Company is exempt from Rule 15c3-3 of the Securities and Exchange Commission under paragraphs (k)(2)(i) and (k)(2)(ii) of that Rule.

*See accompanying Supplementary Report of Independent Registered Public Accounting Firm on Internal Controls.*

# Supplementary Report on Internal Controls

## **Supplementary Report of Independent Registered Public Accounting Firm on Internal Control Required by SEC Rule 17a-5(g)(1)**

**The Board of Directors and Shareholder  
Key Investment Services LLC**

In planning and performing our audit of the financial statements of Key Investment Services LLC (the Company), as of and for the year ended December 31, 2012, in accordance with auditing standards generally accepted in the United States, we considered its 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. The 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 including 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 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 entity'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 was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or 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, 2012, to meet the SEC's objectives.

This report is intended solely for the information and use of the Board of Directors, management, the SEC, the Financial Industry Regulatory Authority 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.

*Ernst + Young LLP*  
February 28, 2013

## Report of Independent Registered Public Accounting Firm on Applying Agreed-Upon Procedures

The Member  
Key Investment Services LLC

We have performed the procedures enumerated below, which were agreed to by the Member and management of Key Investment Services LLC (the Company), the Securities Investor Protection Corporation (SIPC), the Securities and Exchange Commission, and the Financial Industry Regulatory Authority, in accordance with Rule 17a-5(e)(4) of the Securities Exchange Act of 1934. We performed the procedures solely to assist the specified parties in evaluating the Company's compliance with the applicable instructions of the General Assessment Reconciliation (Form SIPC-7) for the year ended December 31, 2012. The Company's management is responsible for the Company's compliance with those requirements. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures we performed and our findings are as follows:

1. Compared the listed assessment payments in Form SIPC-7 with respective cash disbursement record entries including the general ledger and bank statements.

There were no findings.

2. Compared the amounts reported on the audited Form X-17A-5 for the year ended December 31, 2012 with the amounts reported in Form SIPC-7 for the year ended December 31, 2012.

There were no findings.

3. Compared any adjustments reported in Form SIPC-7 with supporting schedules and working papers.

There were no findings.

4. Proved the arithmetical accuracy of the calculations reflected in Form SIPC-7 and in the related supporting schedules and working papers supporting the adjustments.

There were no findings.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on compliance with the applicable instructions of the General Assessment Reconciliation (Form SIPC-7) for the year ended December 31, 2012. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the specified parties listed above and is not intended to be and should not be used by anyone other than these specified parties.

*Ernst + Young LLP*

February 28, 2013



**SIPC-7**  
(33-REV 7/10)

SECURITIES INVESTOR PROTECTION CORPORATION  
P.O. Box 92185 Washington, D.C. 20090-2185  
202-371-8300  
**General Assessment Reconciliation**

**SIPC-7**  
(33-REV 7/10)

For the fiscal year ended December 31, 2012  
(Read carefully the instructions in your Working Copy before completing this Form)

**TO BE FILED BY ALL SIPC MEMBERS WITH FISCAL YEAR ENDINGS**

1. Name of Member, address, Designated Examining Authority, 1934 Act registration no. and month in which fiscal year ends for purposes of the audit requirement of SEC Rule 17a-5:

066999 FINRA DEC  
Key Investment Services LLC 16\*16  
ATTN: Gary Marousek  
4900 Tiedeman Rd Mailcode OH-01-49-0215  
Brooklyn OH 44144

Note: If any of the information shown on the mailing label requires correction, please e-mail any corrections to form@sipc.org and so indicate on the form filed.

Name and telephone number of person to contact respecting this form.

Matt Gulla 216-813-6033

WORKING COPY

- 2. A. General Assessment (item 2e from page 2) \$ 19,886
- B. Less payment made with SIPC-6 filed (exclude interest) ( 10,395 )  
7/25/12  
Date Paid
- C. Less prior overpayment applied ( )
- D. Assessment balance due or (overpayment) 9,491
- E. Interest computed on late payment (see instruction E) for \_\_\_\_\_ days at 20% per annum \_\_\_\_\_
- F. Total assessment balance and interest due (or overpayment carried forward) \$ 9,491
- G. PAID WITH THIS FORM:  
Check enclosed, payable to SIPC  
Total (must be same as F above) \$ 9,491
- H. Overpayment carried forward \$( )

3. Subsidiaries (S) and predecessors (P) included in this form (give name and 1934 Act registration number):

The SIPC member submitting this form and the person by whom it is executed represent thereby that all information contained herein is true, correct and complete.

Key Investment Services LLC

(Name of Corporation, Partnership or other organization)

[Signature]

(Authorized Signature)

Dated the 15 day of February, 20 13.

CFO

(Title)

This form and the assessment payment is due 60 days after the end of the fiscal year. Retain the Working Copy of this form for a period of not less than 6 years, the latest 2 years in an easily accessible place.

SIPC REVIEWER

Dates:            Postmarked            Received            Reviewed             
Calculations            Documentation            Forward Copy             
Exceptions:             
Disposition of exceptions:

**DETERMINATION OF "SIPC NET OPERATING REVENUES"  
AND GENERAL ASSESSMENT**

Amounts for the fiscal period  
beginning January 1, 2012  
and ending December 31, 2012  
Eliminate cents

Item No.

2a. Total revenue (FOCUS Line 12/Part IIA Line 9, Code 4030)

\$ 76,541,952

2b. Additions:

(1) Total revenues from the securities business of subsidiaries (except foreign subsidiaries) and predecessors not included above.

(2) Net loss from principal transactions in securities in trading accounts.

(3) Net loss from principal transactions in commodities in trading accounts.

(4) Interest and dividend expense deducted in determining item 2a.

(5) Net loss from management of or participation in the underwriting or distribution of securities.

(6) Expenses other than advertising, printing, registration fees and legal fees deducted in determining net profit from management of or participation in underwriting or distribution of securities.

(7) Net loss from securities in investment accounts.

2,457

2,457

Total additions

2c. Deductions:

(1) Revenues from the distribution of shares of a registered open end investment company or unit investment trust, from the sale of variable annuities, from the business of insurance, from investment advisory services rendered to registered investment companies or insurance company separate accounts, and from transactions in security futures products.

68,451,797

(2) Revenues from commodity transactions.

(3) Commissions, floor brokerage and clearance paid to other SIPC members in connection with securities transactions.

138,088

(4) Reimbursements for postage in connection with proxy solicitation.

(5) Net gain from securities in investment accounts.

(6) 100% of commissions and markups earned from transactions in (i) certificates of deposit and (ii) Treasury bills, bankers acceptances or commercial paper that mature nine months or less from issuance date.

(7) Direct expenses of printing advertising and legal fees incurred in connection with other revenue related to the securities business (revenue defined by Section 16(9)(L) of the Act).

(8) Other revenue not related either directly or indirectly to the securities business.  
(See Instruction C):

(9) (i) Total interest and dividend expense (FOCUS Line 22/PART IIA Line 13, Code 4075 plus line 2b(4) above) but not in excess of total interest and dividend income. \$ \_\_\_\_\_

(ii) 40% of margin interest earned on customers securities accounts (40% of FOCUS line 5, Code 3960). \$ \_\_\_\_\_

Enter the greater of line (i) or (ii)

Total deductions

68,589,885

\$ 7,954,524

\$ 19,886

(to page 1, line 2.A.)

2d. SIPC Net Operating Revenues

2e. General Assessment @ .0025