

# Statement **2009** of Financial Condition

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with independent auditor's report

As of Decemember 31, 2009



Technology makes it work. **People make it happen.**

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of Capital Institutional Services, Inc.:

We have audited the accompanying statement of financial condition of Capital Institutional Services, Inc. as of December 31, 2009. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement of financial condition is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement of financial condition. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the statement of financial condition referred to above presents fairly, in all material respects, the financial position of Capital Institutional Services, Inc. as of December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

CF & Co., L.L.P.  
Dallas, Texas  
February 24, 2010



### CAPITAL INSTITUTIONAL SERVICES, INC. Statement of Financial Condition - December 31, 2009

#### ASSETS

Cash .....	\$	69,348
Cash segregated under federal regulations .....		2,034,685
Short-term investments .....		23,678,245
Investments .....		2,809,672
Receivables from brokers and dealers .....		1,232,635
Deferred research costs, net .....		2,418,681
Furniture and equipment, at cost, less accumulated depreciation of \$2,262,654 .....		2,960,613
Other assets .....		2,553,320
Total Assets .....	\$	37,757,199

#### LIABILITIES AND SHAREHOLDERS' EQUITY

##### Liabilities

Accounts payable and accrued liabilities .....	\$	3,331,731
Accrued commissions and bonuses .....		1,998,679
Accrued research services .....		12,605,843
Accrued state income taxes .....		121,590
Total liabilities .....		18,057,843

##### Commitments and contingencies

##### Shareholders' equity

Voting common stock, \$0.01 par value, 1,000,000 shares authorized, 20,842 shares issued and outstanding .....		209
Non-voting common stock, \$0.01 par value, 9,000,000 shares authorized, 187,578 shares issued and outstanding ...		1,875
Additional paid-in capital .....		27,355
Retained earnings .....		19,669,917
Total shareholders' equity .....		19,699,356
Total Liabilities and Shareholders' Equity .....	\$	37,757,199

The accompanying notes are an integral part of this financial statement.

## NOTES TO STATEMENT OF FINANCIAL CONDITION DECEMBER 31, 2009

### 1. Nature of Operations and Summary of Significant Accounting Policies

Capital Institutional Services, Inc. (the "Company") is a securities broker/dealer and is a member firm of the New York Stock Exchange and other principal exchanges. The Company executes debt and equity transactions for domestic and international investment advisors, money managers and plan sponsors (the "Money Managers"). The Company transacts business out of its offices in Dallas, Texas.

**Use of Estimates** - The preparation of the statement of financial condition in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of assets and liabilities at the date of the financial statement. Actual results may differ from these estimates.

**Research Credit** - The Company conducts a portion of its business within the safe harbor of Section 28(e) of the Securities Exchange Act of 1934, as amended. In that regard, the Company executes brokerage transactions from the Money Managers at a negotiated commission rate. As an incentive to use the Company's facilities for the execution of such brokerage transactions, the Company has developed a system to provide third-party research services to Money Managers based upon the frequency of use of its facilities.

The amount of third-party research services that the Company will furnish to the Money Managers is based on the amount of commissions that the Company receives or expects to receive for execution of brokerage transactions and is measured by the Company in terms of Research Credit. It is understood by the Money Managers and the Company that Research Credit is not redeemable in cash and, when redeemed, may only be used to obtain third-party research services through the Company. Accordingly, management does not consider Research Credit to be a financial instrument. The accumulated Research Credit of Money Managers is reduced when the Company provides third-party research at the request of such Money Managers.

Amounts relating to Money Managers with a positive Research Credit balance are reflected in the accompanying statements of financial condition as accrued research services. Such amounts represent the estimated third-party research services to be provided to Money Managers from whom the Company has earned commissions for execution of brokerage transactions. Amounts relating to Money Managers with a negative Research Credit balance are reflected in the accompanying statement of financial condition as deferred research costs. Such amounts represent the amount of research services paid on behalf of Money Managers for which future commissions are expected to be received.

The reserve for uncollectible negative Research Credit balances is determined using a method which approximates net realizable value.

**Securities Transactions** - Securities transactions are normally recorded on a settlement date basis, generally the third business day following the transaction date, which is not materially different than on a trade-date basis.

**Fair Value of Financial Instruments** - The carrying amount of cash and short-term investments approximates fair value due to the short maturity of those instruments. Investments are carried at fair value which is estimated based on quoted market prices for those or similar instruments (see Note 5).

**Furniture and Equipment** - Furniture and equipment is stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets.

**Proprietary Accounts of Introducing Brokers** - Proprietary accounts held at clearing brokers ("PAIB Assets") are considered allowable assets in the computation of net capital pursuant to an agreement between the Company and its clearing brokers which requires, among other things, for the clearing brokers to perform a computation of PAIB Assets similar to the customer reserve computation set forth in Rule 15c3-3.

**Recent Pronouncements** - The Financial Accounting Standards Board ("FASB") issued Statement No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles ("SFAS 168") (FASB ASC 105-10). SFAS 168 replaces all previously issued accounting standards and establishes the FASB Accounting Standards Codification ("FASB ASC" or the "Codification") as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP. SFAS 168 is effective for all annual periods ending after September 15, 2009. The FASB ASC is not intended to change existing U.S. GAAP. The adoption of this pronouncement only resulted in changes to the Company's financial statement disclosure references. As such, the adoption of this pronouncement had no effect on the Company's financial statement.

In May 2009, the FASB issued Statement No. 165, Subsequent Events ("SFAS 165"), included in the Codification under FASB ASC 855, which establishes general standards of accounting for and disclosure of events occurring after the balance sheet date, but before the financial statement is issued or available to be issued. SFAS 165 also requires entities to disclose the date through which it has evaluated subsequent events and the basis for that date. The Company adopted SFAS 165 for its year ended December 31, 2009. The adoption did not have a material impact on the Company's financial statement.

See Note 14 for more information regarding the Company's evaluation of subsequent events.

### 2. Cash Segregated Under Federal Regulations

Cash of \$2,034,685 has been segregated in a special bank account for the benefit of customers under Rule 15c3-3 of the Securities and Exchange Commission.

### 3. Concentration Risk

At December 31, 2009, and at various other times throughout 2009, the Company had cash balances in excess of Federally insured limits. Cash accounts at banks are currently insured by the FDIC up to \$250,000.

### 4. Short-Term Investments

Short-term investments consist of money market funds which are highly liquid instruments readily convertible to known amounts

of cash as well as certificates of deposit with maturities of less than one year. At December 31, 2009, money market funds and certificates of deposit were \$23,452,029 and \$226,216, respectively.

## 5. Investments

The cost and estimated market values of investment securities at December 31, 2009 are as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. Treasury notes	\$2,059,150	\$ --	\$ (41,521)	\$ 2,017,629
Mutual funds	797,119	--	(5,076)	792,043
Total	\$2,856,269	--	\$ (46,597)	\$ 2,809,672

The Company is subject to the provisions of FASB ASC 820, Fair Value Measurements, which defines fair value as 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; that is, an exit price. The exit price assumes the asset or liability is exchanged in an orderly transaction; it is not a forced liquidation or distressed sale. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. FASB ASC 820 also establishes a hierarchy that prioritizes the inputs to valuation techniques giving the highest priority to readily available unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements) when market prices are not readily available or reliable. The three levels of the hierarchy under FASB ASC 820 are described below:

- Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.
- Level 2—Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly.
- Level 3—Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Changes in valuation techniques may result in transfers in or out of an investment's assigned level within the hierarchy.

Investments in U.S. Treasury Notes and Mutual Funds are traded on a national exchange and are stated at the last reported sales price on the day of valuation. The Company considers all such investments to be Level 1 investments.

At December 31, 2009, the Company did not hold any financial liabilities measured at fair value.

## 6. Furniture and Equipment

The following is a summary of furniture and equipment as of December 31, 2009:

	Estimated Useful Life	
Automobile	5 years	\$ 134,105
Furniture, fixtures and lease hold improvements	7 years	1,330,202
Computer equipment	5 years	1,733,419
Computer software	5 years	2,025,541
		5,223,267
Less – accumulated depreciation		(2,262,654)
Total		\$ 2,960,613

## 7. Customer Protection – Reserves and Custody Securities

The Company does not hold funds or securities for customers and, accordingly, is exempt from the provisions of Rule 15c3-3 under the Securities Exchange Act of 1934, pursuant to Paragraph (k) (2)(ii) of such rule. Rule 15c3-3 provides for the maintenance by broker dealers of basic reserves with respect to customers' cash and securities and enumerates standards relating to the physical possession of customer securities.

Included in the receivable from brokers and dealers is \$883,178 of customer cash held at the clearing broker. This amount relates to commission recapture and is offset by \$883,178 recorded in accounts payable and accrued liabilities.

The Company carries no customer regulated commodities futures accounts; therefore, the computation of segregated funds pursuant to Section 4d(2) of the Commodity Exchange Act is not applicable.

## 8. Income Taxes

The Company has elected S corporation status under the Internal Revenue Code ("IRC") and is not subject to federal income taxes. Profits or losses of the Company are included in the federal income tax returns of its shareholders. The provisions for income tax and accrued income taxes payable included in the accompanying financial statements represent estimated state and local income taxes.

On December 30, 2008, the Financial Accounting Standards Board ("FASB") issued Staff Position ("FSP") No. FIN 48-3 (FASB ASC 740), "Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Entities," which permitted the Company to defer the implementation of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FASB ASC 740) until its fiscal year beginning January 1, 2009. FASB ASC 740 clarifies that management is expected to evaluate an income tax position taken, or expected to be taken, for likelihood of realization, before recording any amounts for such position in the financial statements. FASB ASC 740 also requires expanded disclosure with respect to income tax positions taken that are not certain to be realized. The Company adopted FASB ASC 740 for its year ended December 31, 2009. The adoption did not have a material

impact on the Company's financial statement.

The Company files income tax returns in the U.S. federal jurisdiction and in various state and local jurisdictions. The Company's federal income tax returns generally remain subject to examination by the Internal Revenue Service for three years from the date the return is due, including extensions. The Company's state and local income tax returns are subject to examination by the respective state and local authorities over various statutes of limitations, most ranging from three to five years from the date of filing.

## 9. Net Capital Requirements

The Company is subject to the Securities and Exchange Commissions' Uniform net Capital Rule (Rule 15c3-1). The Company has elected to compute minimum net capital under the Alternative Net Capital method under Rule 15c3-1(a)(1)(ii), which requires maintenance of minimum net capital of the greater of 2% of aggregate debit items or \$250,000. At December 31, 2009, the Company had net capital as defined by Rule 15c3-1 of \$11,070,536 which was \$10,820,536 in excess of the required minimum net capital.

Capital distributions to shareholders can be made under a capital distribution policy approved by the Company's Board of Directors. Periodic distributions approved by the Board of Directors are made to enable shareholders to pay federal income taxes on the Company's profits, among other purposes. Such distributions totaled \$2,258,774 in 2009.

During January 2010, the Company made cash distributions of \$191,694 to shareholders.

## 10. Commitments

The Company leases office and equipment under operating leases with expiration dates through March, 2016. Certain leases provide for renewal options.

Future minimum rentals at December 31, 2009 are as follows:

Year Ending December 31	Amount
2010	797,133
2011	647,165
2012	542,352
2013	543,771
2014	548,729
Thereafter	704,030
Total	\$ 3,783,180

In September 2003, the Company vacated office space in London, England and is currently subleasing this property. At December 31, 2009, the Company had accrued \$150,377 associated with the exit of its London office. This amount represents the present value of the difference between future rent payments and anticipated sublease income.

## 11. Employee Benefits

The Company adopted an employee savings plan (the "Plan") effective January 1, 1991, with employer participation in accordance with the provisions of Section 401(k) of the IRC.

Substantially all of the Company's employees are eligible to become participants in the Plan after three months of service. The Plan allows participants to make pretax contributions up to 60% of their salary and commissions, not to exceed amounts allowable under the IRC, with the Company making discretionary matching contributions. All amounts contributed to the Plan are deposited in a trust fund which is administered by an independent financial institution.

In 2004, the Company implemented a Deferred Compensation Plan (the "DCP") for eligible management employees to defer a portion of their compensation and bonus compensation. The DCP is funded through employee contributions, employer contributions, and the Company's matching contributions up to a specific limit. Investments are made at the participants' discretion. All assets associated with the DCP are classified as investments with the related liability to deferred compensation.

At December 31, 2009, the Company had no obligation to provide other post-retirement benefits to current or former employees.

## 12. Financial Instruments with Off-Balance Sheet Risk

The Company clears all of its securities transactions through clearing brokers on a fully disclosed basis. Pursuant to the terms of the agreements between the Company and the clearing brokers, the clearing brokers have the right to charge the Company for losses that result from a counterparty's failure to fulfill its contractual obligations.

As the right to charge the Company has no maximum amount and applies to all trades executed through the clearing broker, the Company believes there is no maximum amount assignable to this right. At December 31, 2009, the Company has recorded no liabilities with regard to the right.

In addition, the Company has the right to pursue collection or performance from the counterparties who do not perform under their contractual obligations. The Company monitors the credit standing of the clearing brokers and all counterparties with which it conducts business.

## 13. Common Stock

During the year ended December 31, 2009 the Company amended its Articles of Incorporation to provide for Non-Voting Common Stock. Voting and Non-Voting Common Stock are treated equally with respect to the declaration and payment of dividends, the making of any distribution in connection with the dissolution and winding up of the Company, or in any merger or consolidation. Holders of Voting Common Stock have voting rights at all meetings of shareholders, whereas holders of Non-Voting Common Stock have no voting rights.

On September 16, 2009, the Board of Directors authorized a stock dividend to existing shareholders. In connection with this stock dividend, the Company issued nine shares of Non-Voting Common Stock for each share of Voting Common Stock.

## 14. Subsequent Events

In preparing the accompanying financial statement, the Company has reviewed events that have occurred after December 31, 2009, through February 24, 2010, the date the financial statement was available to be issued. During this period, the Company did not have any material subsequent events.



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800.247.6729 | [www.capis.com](http://www.capis.com) | 1601 Elm Street, Suite 3900 | Dallas, Texas 75201

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