



06005389

COMMISSION

549

BTB 3/17 AB 3/30

OMB APPROVAL	
OMB Number:	3235-0123
Expires:	January 31, 2007
Estimated average burden hours per response . . .	12.00

SEC FILE NUMBER
8-13975

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

FACING PAGE

Information Required of Brokers and Dealers Pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

REPORT FOR THE PERIOD BEGINNING January 1, 2005 AND ENDING December 31, 2005
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

Princor Financial Services Corporation

OFFICIAL USE ONLY
FIRM ID. NO.

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

711 High Street

(No. and Street)

Des Moines, Iowa 50392-0200

(City)

(State)

PROCESSED

JUN 07 2006

THOMSON FINANCIAL

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

Jill R. Brown

515-248-2285

(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

Ernst & Young LLP

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

801 Grand Avenue, Suite 3000 Des Moines, Iowa 50309

(Address)

(City)

(State)

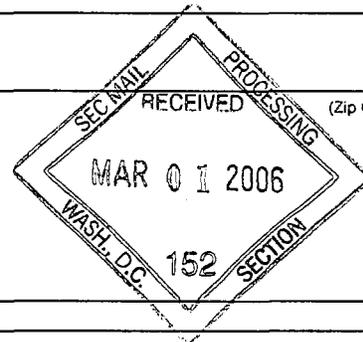
(Zip Code)

CHECK ONE:

Certified Public Accountant

Public Accountant

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



FOR OFFICIAL USE ONLY

*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2)

SEC 1410 (6-02)

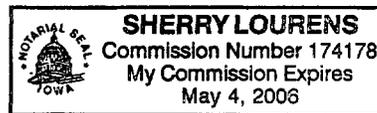
Persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

Oath or Affirmation

I, Jill R. Brown, affirm that, to the best of my knowledge and belief the accompanying financial statements and supporting schedules pertaining to the firm of Prncor Financial Services Corporation, as of December 31, 2005, are true and correct. I further affirm that neither the Company nor any principal officer or director has any proprietary interest in any account classified solely as that of a customer.

Jill Brown
Chief Financial Officer

5-4-2006
Sherry Lourens
Notary Public



This report contains:

- (X) (a) Facing page
- (X) (b) Statement of Financial Condition
- (X) (c) Statement of Income
- (X) (d) Statement of Cash Flows
- (X) (e) Statement of Changes in Stockholder's Equity
- () (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors
- (X) (g) Computation of Net Capital
- (X) (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
- (X) (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
- (X) (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
- (X) (o) Supplementary Report of Independent Registered Public Accounting Firm on Internal Control Required by Rule 17a-5

FINANCIAL STATEMENTS AND SUPPLEMENTAL
INFORMATION
(For SEC Filing Purposes)

Princor Financial Services Corporation
Years Ended December 31, 2005 and 2004
With Report of Independent Registered Public Accounting Firm

Princor Financial Services Corporation
Financial Statements and Supplemental Information
Years Ended December 31, 2005 and 2004

Contents

Report of Independent Registered Public Accounting Firm.....	1
Audited Financial Statements	
Consolidated Balance Sheets	2
Consolidated Statements of Income.....	3
Consolidated Statements of Changes in Stockholder's Equity.....	5
Consolidated Statements of Cash Flows.....	6
Notes to Consolidated Financial Statements.....	7
Supplemental Information	
Supporting Schedules:	
Computation of Net Capital – Part IIA	14
Statement Relating to Certain Determinations Required Under Rule 15c3-3 – Part IIA	17
Statement Pursuant to Rule 17a-5(d)(4)	18
Supplementary Report of Independent Registered Public Accounting Firm on Internal Control Required by Rule 17a-5.....	19

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholder
Princor Financial Services Corporation

We have audited the accompanying consolidated balance sheets of Princor Financial Services Corporation (an indirect, wholly-owned subsidiary of Principal Financial Group, Inc.) as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in stockholder's equity, and cash flows for the years then ended. 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 the standards of the Public Company Accounting Oversight Board (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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included 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, and 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 consolidated financial position of Princor Financial Services Corporation at December 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The accompanying supporting schedules are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements, but are supplementary information required by Rule 17a-5 under the Securities Exchange Act of 1934. Such information has been subjected to the auditing procedures applied in our audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

January 19, 2006

Ernst & Young LLP

Princor Financial Services Corporation

Consolidated Balance Sheets

	December 31	
	2005	2004
Assets		
Cash	\$ 8,224,226	\$ 7,347,068
Short-term investments, at cost (approximates market)	26,375,822	19,694,700
Long-term investments, at market value (amortized cost: 2005 – \$8,669,633; 2004 – \$8,368,851)	8,441,499	8,316,387
Accrued interest and dividends receivable	17,474	17,474
Due from:		
Mutual funds and other affiliates	10,441,132	7,064,617
Others	966,122	752,368
Deferred commission expense	10,407,018	11,120,900
Prepaid expenses	524,385	293,132
Deferred income taxes	2,574,162	1,353,091
Other assets	90,310	90,310
Total assets	<u>\$68,062,150</u>	<u>\$56,050,047</u>
Liabilities and stockholder's equity		
Liabilities:		
Commissions payable	\$ 1,724,164	\$ 1,484,935
Accounts payable	8,924,015	3,980,046
Income taxes payable	1,356,430	638,063
Due to:		
Principal Life Insurance Company	9,081,209	7,543,478
Mutual funds and other affiliates	5,850,399	5,283,518
Total liabilities	<u>26,936,217</u>	<u>18,930,040</u>
Stockholder's equity:		
Common Stock, par value \$10.00 per share – authorized 50,000 shares, issued and outstanding 40,000 shares (all owned by Principal Financial Services, Inc., a wholly-owned subsidiary of Principal Financial Group, Inc.)	400,000	400,000
Additional paid-in capital	16,437,464	15,559,319
Retained earnings	24,288,469	21,160,688
Total stockholder's equity	<u>41,125,933</u>	<u>37,120,007</u>
Total liabilities and stockholder's equity	<u>\$68,062,150</u>	<u>\$56,050,047</u>

See accompanying notes.

Princor Financial Services Corporation

Consolidated Statements of Income

	Year Ended December 31	
	2005	2004
Brokerage revenues:		
Commissions:		
Principal Mutual Funds	\$ 10,440,826	\$ 9,434,602
Other mutual funds	42,117,122	40,722,386
Variable annuities	32,827,357	29,503,883
Flexible variable life policies	16,830,612	17,593,855
General securities	22,859,421	18,005,504
Distribution and shareholder servicing fees	24,997,299	18,946,947
Total brokerage revenues	<u>150,072,637</u>	<u>134,207,177</u>
Less commission related expenses:		
Principal Mutual Funds	13,483,681	11,792,340
Other mutual funds	40,568,663	39,490,925
Variable annuities	31,660,420	28,149,993
Flexible variable life policies	16,830,612	17,593,855
General securities	15,752,773	12,826,056
Distribution fees	8,694,895	6,787,770
Reimbursement for field personnel and services	5,264,039	4,670,815
Total commission related expenses	<u>132,255,083</u>	<u>121,311,754</u>
Net brokerage revenues	17,817,554	12,895,423
Other revenues:		
Management fees	163,535,035	103,654,116
IRA custodial fees	2,830,950	2,551,013
Interest and dividends	685,305	497,187
Net investment losses	(175,670)	(142,806)
Other	11,953	9,169
Total other revenues	<u>166,887,573</u>	<u>106,568,679</u>

Princor Financial Services Corporation

Consolidated Statements of Income (continued)

	Year Ended December 31	
	2005	2004
General and administrative expenses:		
Management and services	\$ 24,186,560	\$ 19,828,493
Expense reimbursements to mutual funds	2,139,436	899,931
Asset fees paid to affiliate	108,446,659	58,195,838
Licenses and fees	303,329	156,578
Professional fees	4,058,468	1,515,920
Investment advisory fees	17,492,686	14,458,144
Blanket bond expense	491,914	352,076
Other	2,205,462	1,962,705
Total general and administrative expenses	<u>159,324,514</u>	<u>97,369,685</u>
Income before income taxes	25,380,613	22,094,417
Federal and state income taxes	<u>9,252,832</u>	<u>8,390,458</u>
Net income	<u>\$ 16,127,781</u>	<u>\$ 13,703,959</u>

See accompanying notes.

Princor Financial Services Corporation

Consolidated Statements of Changes in Stockholder's Equity

	Common Stock	Additional Paid-In Capital	Retained Earnings	Total
Balance at January 1, 2004	\$400,000	\$14,759,533	\$15,456,729	\$30,616,262
Net income for 2004	-	-	13,703,959	13,703,959
Capital contribution in the form of forgiveness of allocated stock-based compensation expense	-	799,786	-	799,786
Dividends paid to parent	-	-	(8,000,000)	(8,000,000)
Balance at December 31, 2004	400,000	15,559,319	21,160,688	37,120,007
Net income for 2005	-	-	16,127,781	16,127,781
Capital contribution in the form of forgiveness of allocated stock-based compensation expense	-	878,145	-	878,145
Dividends paid to parent	-	-	(13,000,000)	(13,000,000)
Balance at December 31, 2005	<u>\$400,000</u>	<u>\$16,437,464</u>	<u>\$24,288,469</u>	<u>\$41,125,933</u>

See accompanying notes.

Princor Financial Services Corporation

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2005	2004
Operating activities		
Net income	\$16,127,781	\$13,703,959
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferral of commission expense	(6,803,134)	(5,787,877)
Amortization of deferred commission expense	7,517,016	6,715,303
Amortization of premiums and discounts on long-term investments	2,335	4,743
Reinvested dividends from (long-term) mutual funds	(303,117)	(323,598)
Net investment losses	175,670	142,806
Capital contribution in the form of forgiveness of allocated stock-based compensation expense	878,145	799,786
Deferred income taxes	(1,221,071)	(712,445)
Changes in operating assets and liabilities:		
Accrued interest and dividends receivable, due from others, prepaid expenses and other assets	(445,007)	181,135
Due to Principal Life Insurance Company	1,537,731	59,638
Due to/from mutual funds and other affiliates	(2,809,634)	(4,855,558)
Commissions payable, accounts payable and income taxes payable	5,901,565	(743,121)
Net cash provided by operating activities	<u>20,558,280</u>	<u>9,184,771</u>
Investing activities		
Sale and maturities of long-term investments	-	1,000,000
Net cash provided by investing activities	-	1,000,000
Financing activities		
Dividends paid to parent	(13,000,000)	(8,000,000)
Net cash used in financing activities	<u>(13,000,000)</u>	<u>(8,000,000)</u>
Increase in cash and cash equivalents	7,558,280	2,184,771
Cash and cash equivalents at beginning of year	27,041,768	24,856,997
Cash and cash equivalents at end of year	<u>\$34,600,048</u>	<u>\$27,041,768</u>
Supplemental disclosure of cash flow information		
Net cash paid during the year for income taxes	<u>\$ 9,603,071</u>	<u>\$ 9,179,007</u>
<i>See accompanying notes.</i>		

Princor Financial Services Corporation

Notes to Consolidated Financial Statements

December 31, 2005

1. Significant Accounting Policies

Organization and Basis of Presentation

Princor Financial Services Corporation (the Company) engages primarily in the sale of shares of mutual funds, including open-end investment companies (Principal Mutual Funds) organized by Principal Life Insurance Company (Principal Life), an affiliate, and registered variable annuity contracts and flexible variable life policies issued by Principal Life. Commission income is derived from the sale of mutual fund shares, direct participation programs, variable annuity contracts, flexible variable life policies, certificates of deposit, wrap products of a registered investment advisor and general securities and is recorded on a trade-date basis. A wholly-owned subsidiary of the Company, Principal Management Corporation, serves as manager and investment advisor for the mutual funds whose shares are sold by the Company and receives compensation based on contracts approved annually by the funds' Boards of Directors.

The Company is a wholly-owned subsidiary of Principal Financial Services, Inc., who in turn, is an indirect, wholly-owned subsidiary of Principal Financial Group, Inc., a Delaware business corporation.

The consolidated financial statements (see Note 2) include the accounts of the Company and its wholly-owned subsidiary, Principal Management Corporation. Significant intercompany accounts and transactions have been eliminated in consolidation.

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

Investments

Short-term investments are valued at cost, which approximates market. The Company has an arrangement whereby a substantial portion of its short-term funds (\$14,338,850 and \$9,254,685 at December 31, 2005 and 2004, respectively) are pooled with the funds of other affiliates and invested by Principal Life. The Company has access to these funds at

Princor Financial Services Corporation

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

any time and is credited with interest approximating the yield earned by Principal Life Insurance Company Separate Account Money Market, which invests in commercial paper. The Company's long-term investments consist of corporate bonds, and investments in various Principal Mutual Funds, which are reported at market value. Market values of the corporate bonds are determined using the last reported bid price. Market values of the mutual funds are determined by reference to published net asset values per share. The resulting change in the difference between cost and market value is included in net income.

The net unrealized appreciation or depreciation of long-term investments consisted of gross unrealized gains of \$7,304 and gross unrealized losses of \$235,438 at December 31, 2005 and gross unrealized gains of \$41,722 and gross unrealized losses of \$94,186 at December 31, 2004. Realized gains and losses on sales of investments are determined on the basis of specific identification of securities sold.

Deferred Sales Costs

The Company defers commissions on the sale of Class B shares of the Principal Mutual Funds which are subject to contingent deferred sales charges (CDSC). The deferred commission amounts are amortized over a period of six to seven years using the straight-line method. Certain mutual funds sponsored by Principal Life offer Class J shares. The Company pays commissions in connection with the sale of Class J shares. The Company also pays finders fees in connection with the sale of Class A shares of Principal Mutual Funds. The Company defers these expenditures and amortizes these deferrals over 18 months, the period of time the shares are subject to CDSC fees, using the straight-line method.

Total amortization of deferred expenses was \$7,517,016 and \$6,715,303 during the years ended December 31, 2005 and 2004, respectively. The Company periodically evaluates whether events or circumstances have occurred which may affect the recoverability of the remaining deferred commission expense asset.

Princor Financial Services Corporation

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Cash and Cash Equivalents

The Company considers all liquid investments with a maturity of three months or less when purchased (including all of its short-term investments) to be cash equivalents.

Deferred Income Taxes

Deferred income tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. Deferred income tax expenses or credits are based on the changes in the asset or liability from period to period.

2. Summarized Financial Information of Parent Company Only

The Company reports information pursuant to Section 17 of the Securities Exchange Act of 1934 and prepares its net capital computation in accordance with Rule 15c3-1 of the Securities and Exchange Commission (see Note 4) on an unconsolidated basis. Summarized financial data for the Company (parent only) as of and for the years ended December 31, 2005 and 2004, is as follows:

	December 31	
	2005	2004
Investment in wholly owned subsidiary*	\$ 8,652,805	\$ 6,719,796
Other assets	42,326,145	36,803,032
Total assets	<u>\$50,978,950</u>	<u>\$43,522,828</u>
Other liabilities	\$ 9,853,017	\$ 6,402,821
Stockholder's equity	41,125,933	37,120,007
Total liabilities and stockholder's equity	<u>\$50,978,950</u>	<u>\$43,522,828</u>

Princor Financial Services Corporation

Notes to Consolidated Financial Statements (continued)

2. Summarized Financial Information of Parent Company Only (continued)

	Year Ended December 31	
	2005	2004
Revenues	\$151,311,662	\$135,531,961
Expenses	(152,563,847)	(137,368,613)
Equity in income of subsidiary*	17,379,966	15,540,611
Net income	<u>\$ 16,127,781</u>	<u>\$ 13,703,959</u>

*Eliminated in consolidation.

3. Income Taxes

The Company is taxed at corporate rates on taxable income based on existing tax laws. The Company's taxable income or loss is included in consolidated federal and state income tax returns filed by Principal Financial Group, Inc. The companies have adopted the policy of allocating income tax expenses and benefits to members of the consolidated group based upon their pro rata contribution of taxable income or operating losses. Deferred income taxes have been established by each member of the consolidated group based upon the temporary differences within each company.

Income tax expense differed from the amount computed by applying the statutory federal income tax rate to income before income taxes due primarily to prior year true-ups between expected tax expense and actual tax expense, nondeductible meals and entertainment and state income taxes.

Deferred income taxes reflect the net income 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 and liabilities as of December 31, 2005 and 2004 are as follows:

Princor Financial Services Corporation

Notes to Consolidated Financial Statements (continued)

3. Income Taxes (continued)

	December 31	
	2005	2004
Deferred income tax liabilities:		
Deferred commission expense	\$ -	\$ 395,827
State taxes	162,788	56,138
Other items	120,192	14,854
Total deferred income tax liabilities	<u>282,980</u>	<u>466,819</u>
Deferred income tax assets:		
Deferred commission expense	(233,268)	-
Benefit and medical plan contributions not currently deductible for tax	(1,272,957)	(841,128)
Unrealized appreciation of long-term investments	(56,409)	-
Vacation accrual	(378,207)	(328,680)
Bonus accrual	(196,615)	(196,055)
Stock options	(668,762)	(438,874)
Other items	(50,924)	(15,173)
Total deferred income tax assets	<u>(2,857,142)</u>	<u>(1,819,910)</u>
Net deferred income tax asset	<u><u>\$ (2,574,162)</u></u>	<u><u>\$ (1,353,091)</u></u>

Significant components of the provision for income taxes are as follows:

	Year Ended December 31	
	2005	2004
Current:		
Federal	\$ 9,637,448	\$8,112,516
State	836,455	990,387
Total current	<u>10,473,903</u>	<u>9,102,903</u>
Deferred:		
Federal	(967,974)	(636,654)
State	(253,097)	(75,791)
Total deferred	<u>(1,221,071)</u>	<u>(712,445)</u>
	<u><u>\$ 9,252,832</u></u>	<u><u>\$8,390,458</u></u>

Princor Financial Services Corporation

Notes to Consolidated Financial Statements (continued)

4. Net Capital Requirements

The Company is subject to the Securities and Exchange Commission uniform net capital rule (Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. At December 31, 2005, the Company had defined net capital of \$17,468,671, which was \$16,811,803 in excess of its required net capital of \$656,868. The Company's defined net capital ratio (unconsolidated) was .56 to 1.

The Company has a special bank account, with a balance of \$3,212,829 and \$494,998 at December 31, 2005 and 2004, respectively, as required under Rule 15c3-3(k)(2)(i), designated "Special Account for the Exclusive Benefit of Customers".

The Securities and Exchange Commission rules related to the calculation of minimum net capital requirements require the Company to maintain capital at least equal to 6-2/3% of aggregate indebtedness, with a minimum fixed dollar amount of \$250,000.

The Company is an introducing broker and clears certain securities transactions with and for customers on a fully disclosed basis with the Pershing Division of Donaldson and Lufkin & Jenrette Securities Corporation (the clearing broker-dealers). The Company promptly transmits all customer funds and securities to the clearing broker-dealers. In connection with this arrangement, the Company is contingently liable for its customers' transactions.

5. Related Party Transactions

As set forth on the consolidated statements of operations, the Company receives the following fees from Principal Life and Principal Mutual Funds:

- The Company collects commissions for the sale of Principal Mutual Funds and variable annuity and flexible variable life products offered by Principal Life;
- The Company receives distribution (Rule 12b-1) and shareholder servicing fees from Principal Mutual Funds and nonproprietary mutual funds used by other product lines offered by Principal Life;
- The Company receives investment advisory and management fees from Principal Mutual Funds based on the underlying funds' average daily net assets; and

Princor Financial Services Corporation

Notes to Consolidated Financial Statements (continued)

5. Related Party Transactions (continued)

- The Company receives IRA custodial fees from customers of Principal Life and Principal Mutual Funds for assets for which Principal Life acts as custodian.

During 2005 and 2004, the Company had agreements with certain Principal Mutual Funds, whereby the funds reimburse the Company for expenses incurred in distributing and promoting the sale of shares of the funds. These distribution and shareholder servicing fees are based on a plan approved annually by the funds' Boards of Directors. In addition, services of employees and other operating costs, including commissions which have been deferred are initially paid by Principal Life and charged directly to the Company and subsidiaries. For the year ended December 31, 2005 and 2004, these amounts aggregated \$121,867,170 and \$67,013,884, respectively.

At December 31, 2005, the due from mutual funds and due to mutual funds balances included \$6,720,418 (2004 - \$4,943,351) and \$2,442,451 (2004 - \$2,790,272) respectively, which relate to the Principal Mutual Funds.

Principal Financial Group, Inc. has elected to adopt the fair value method of accounting for stock-based compensation as defined by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*. Principal Financial Group, Inc. elected to apply the prospective method of transition as prescribed by SFAS 123. Principal Financial Group, Inc. has allocated the expenses associated with SFAS No. 123 and 148 to each of its subsidiaries, with the allocation aggregating \$878,145 and \$799,786 to the Company for the years ended December 31, 2005 and 2004, respectively. As Principal Financial Group, Inc. has not required the allocation to be settled in cash, the amount has been treated as a capital contribution.

6. Contingencies

In the ordinary course of business, the Company is involved in and subject to asserted and unasserted claims from customers and other contractual disputes. In the opinion of management, adequate provision has been made for any potential losses which may result from these actions.

Supplemental Information

Princor Financial Services Corporation

Computation of Net Capital – Part IIA

December 31, 2005

Computation of Net Capital

1. Total ownership equity from Statement of Financial Condition			<u>\$41,125,933</u>
2. Deduct ownership equity not allowable for Net Capital			<u>–</u>
3. Total ownership equity qualified for Net Capital			<u>41,125,933</u>
4. Add:			
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital			<u>–</u>
B. Other (deductions) or allowable credits			<u>–</u>
5. Total capital and allowable subordinated liabilities			<u>41,125,933</u>
6. Deductions and/or charges:			
A. Total nonallowable assets from Statement of Financial Condition (Notes B and C):			
1. Due from mutual funds, other affiliates and others	<u>\$ 1,053,793</u>		
2. Deferred commission expense	<u>10,407,018</u>		
3. Prepaid expenses	<u>260,571</u>		
4. Income taxes recoverable	<u>143,439</u>		
5. Deferred income taxes	<u>2,154,496</u>		
6. Investment in subsidiary	<u>8,652,805</u>	<u>22,672,122</u>	
B. Secured demand note deficiency		<u>–</u>	
C. Commodity futures contracts and spot commodities – proprietary capital charges		<u>–</u>	
D. Other deductions and/or charges		<u>–</u>	<u>22,672,212</u>
7. Other additions and/or allowable credits			<u>–</u>
8. Net capital before haircuts on securities positions			<u>\$18,453,811</u>

Princor Financial Services Corporation

Computation of Net Capital – Part IIA (continued)

Computation of Net Capital (continued)

9. Haircuts on securities [computed, where applicable, pursuant to 15c3-1(f)]:		
A. Contractual securities commitments	\$	–
B. Subordinated securities borrowings		–
C. Trading and investment securities:		
1. Exempted securities		–
2. Debt securities		729,151
3. Options		–
4. Other securities		255,989
D. Undue Concentration		–
E. Other		–
10. Net Capital		<u>985,140</u> <u>\$17,468,671</u>

Computation of Basic Net Capital Requirement

Part A

11. Minimum net capital required (6-2/3% of line 19)	\$	656,868
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)		250,000
13. Net capital requirement (greater of line 11 or 12)		656,868
14. Excess net capital (line 10 less 13)		16,811,803
15. Excess net capital at 1000% (line 10 less 10% of line 19)		16,483,369

Computation of Aggregate Indebtedness

16. Total A.I. liabilities from Statement of Financial Condition:		
• Commissions payable		1,724,164
• Accounts payable		3,698,535
• Due to Principal Life Insurance Company		4,321,930
• Due to mutual funds and other affiliates		108,387
		<u>9,853,016</u>
17. Add:		
A. Drafts for immediate credit	\$	–
B. Market value of securities borrowed for which no equivalent value is paid or credited		–
C. Other unrecorded amounts		–
19. Total aggregate indebtedness		<u>9,853,016</u>

Princor Financial Services Corporation

Computation of Net Capital – Part IIA (continued)

Computation of Aggregate Indebtedness

20. Percentage of aggregate indebtedness to net capital (line 19 ÷ by line 10)	<u>56%</u>
21. Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1 (d)	<u>—</u>

Notes

- (A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
 2. 6-2/3% of aggregate indebtedness or 2% of aggregate debits if alternative method is used.
- (B) Do not deduct the value of securities borrowed under subordination agreements or secured demand note covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.
- (C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

Princor Financial Services Corporation

Statement Relating to Certain Determinations
Required Under Rule 15c3-3 – Part IIA

December 31, 2005

**Computation for Determination of Reserve Requirements
Pursuant to Rule 15c3-3:**

Exemptive Provision

25. If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only)

- A. (k)(1) – Limited business (mutual funds and/or variable annuities only)
- B. (k)(2)(A) – “Special Account for the Exclusive Benefit of customers” maintained
- C. (k)(2)(B) – All customer transactions cleared through another broker-dealer on a fully disclosed basis.
Name of clearing firms: **Pershing Division of Donaldson and Lufkin & Jenrette Securities Corporation**
- D. (k)(3) – Exempted by order of the Commission

X

Princor Financial Services Corporation

Statement Pursuant to Rule 17a-5(d)(4)

December 31, 2005

There were no differences between the computation of net capital under Rule 15c3-1 included in this audited report and the computation included in the Company's corresponding unaudited Form X-17A-5 Part IIA filing submitted to the National Association of Securities Dealers, Inc.

This audited report includes the consolidated financial statements of the Company and its wholly-owned subsidiary, Principal Management Corporation, as of and for the year ended December 31, 2005. For reconciliation purposes, Note 2 to the consolidated financial statements presents summarized financial information of the parent company only.

Supplementary Report of Independent Registered Public Accounting Firm on Internal Control Required by Rule 17a-5

The Board of Directors and Stockholder
Princor Financial Services Corporation

In planning and performing our audit of the consolidated financial statements of Princor Financial Services Corporation (the Company) for the year ended December 31, 2005, we considered its internal control, including control activities for safeguarding securities, to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide assurance on 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 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 the quarterly securities examinations, counts, verifications, and comparisons; (2) recordation of differences required by Rule 17a-13; and (3) 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 accounting principles generally accepted in the United States. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in 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.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control, including control activities for safeguarding securities, and its operation 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 were adequate at December 31, 2005, 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 National Association of Securities Dealers, 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

January 19, 2006