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SECURITIES AND EXCHANGE COMMISSION

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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

SEC FILE NUMBER
8-50200

REGULATION

**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, 2008 AND ENDING December 31, 2008  
MM/DD/YY MM/DD/YY

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER:

Principal Funds Distributor, Inc.

OFFICIAL USE ONLY

FIRM ID. NO.

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

711 High Street

Des Moines	(No. and Street)	Iowa	50392
<small>(City)</small>		<small>(State)</small>	<small>(Zip Code)</small>

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

Jill R. Brown

(916) 941-4657

(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

<small>(Address)</small>	<small>(City)</small>	<small>(State)</small>	<small>(Zip Code)</small>
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**CHECK ONE:**

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

**FOR OFFICIAL USE ONLY**

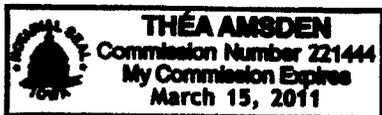
*\*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).*

SEC 1410 (6-02)

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## Oath or Affirmation

I, Jill R. Brown, affirm that to the best of my knowledge and belief, the accompanying financial statements and supplemental information pertaining to the firm of Principal Funds Distributor, Inc. as of December 31, 2008, 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

*Thea Amstden*

Notary Public

This report contains:

- (a) Facing page
- (b) Statement of Financial Condition
- (c) Statement of Operations
- (d) Statement of Cash Flows
- (e) Statement of Changes in Stockholder's Equity
- (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) Supplementary Report of Independent Registered Public Accounting Firm on Internal Control Required by SEC Rule 17a-5

Principal Funds Distributor, Inc.

Financial Statements and Supplemental Information

Years Ended December 31, 2008 and 2007

**Contents**

Report of Independent Registered Public Accounting Firm .....	1
Audited Financial Statements	
Statements of Financial Condition.....	2
Statements of Operations .....	3
Statements of Changes in Stockholder's Equity .....	4
Statements of Cash Flows.....	5
Notes to Financial Statements.....	6
Supplemental Information	
Supplemental Schedules:	
Computation of Net Capital – Part IIA .....	13
Statement Relating to Certain Determinations	
Required Under Rule 15(c)3-3 – Part IIA.....	15
Statement Pursuant to Rule 17a-5(d)(4) .....	16
Supplementary Report of Independent Registered Public Accounting	
Firm on Internal Control Required by SEC Rule 17a-5(g)(1) .....	17

## Report of Independent Registered Public Accounting Firm

To The Board of Directors and Stockholder  
Principal Funds Distributor, Inc.

We have audited the accompanying statements of financial condition of Principal Funds Distributor, Inc. (the Company) as of December 31, 2008 and 2007, and the related statements of operations, 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 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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits 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 financial position of Principal Funds Distributor, Inc. at December 31, 2008 and 2007, and the 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 financial statements taken as a whole. The supplemental information is presented for purposes of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by Rule 17a-5 of the Securities Exchange Act of 1934. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Ernst & Young LLP*

February 22, 2009

Principal Funds Distributor, Inc.

Statements of Financial Condition

	December 31	
	2008	2007
<b>Assets</b>		
Cash and cash equivalents	\$ 28,543,777	\$ 21,284,225
Receivables:		
Affiliates	6,462,766	7,730,350
Others	202,941	212,659
Total receivables	<u>6,665,707</u>	<u>7,943,009</u>
Deferred sales commissions, net of amortization of \$25,696,774 and \$8,028,472 in 2008 and 2007, respectively	19,502,360	15,718,494
Income tax receivable under tax allocation agreement	5,117,718	5,828,566
Other assets	214,588	145,438
Total assets	<u>\$ 60,044,150</u>	<u>\$ 50,919,732</u>
<b>Liabilities and stockholder's equity</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 6,858,912	\$ 9,894,621
Deferred income tax liability, net	6,387,120	3,911,718
Payables:		
Principal Life Insurance Company	5,840,703	4,549,016
Other affiliates	1,800,652	611,761
Total liabilities	<u>20,887,387</u>	<u>18,967,116</u>
Stockholder's equity:		
Common stock, \$10 par value – authorized, 10,000 shares; issued and outstanding, 10,000 shares	100,000	100,000
Additional paid-in capital	171,838,345	131,379,444
Accumulated deficit	(132,781,582)	(99,526,828)
Total stockholder's equity	<u>39,156,763</u>	<u>31,952,616</u>
Total liabilities and stockholder's equity	<u>\$ 60,044,150</u>	<u>\$ 50,919,732</u>

*See accompanying notes.*

Principal Funds Distributor, Inc.

Statements of Operations

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Revenues</b>		
Distribution fees (12b-1 fees)	\$ 88,539,810	\$ 89,712,036
Underwriting fees	5,140,383	7,625,208
Contingent deferred sales charges	3,928,727	1,736,394
Interest income	83,357	164,662
Other income	2,769	79,896
Total revenues	<u>97,695,046</u>	<u>99,318,196</u>
<b>Expenses</b>		
Distribution expenses (12b-1 fees)	73,851,641	76,672,207
Compensation and related expenses	31,004,651	30,676,426
Amortization of deferred sales commissions	17,668,302	8,028,472
General and administrative expenses	30,323,414	31,684,602
Total expenses	<u>152,848,008</u>	<u>147,061,707</u>
Loss before income tax benefit	(55,152,962)	(47,743,511)
Income tax benefit	21,910,861	19,025,594
Net loss	<u>\$ (33,242,101)</u>	<u>\$ (28,717,917)</u>

*See accompanying notes.*

Principal Funds Distributor, Inc.

Statements of Changes in Stockholder's Equity

	<b>Common Stock</b>	<b>Additional Paid-In Capital</b>	<b>Accumulated Deficit</b>	<b>Total Stockholder's Equity</b>
Balance at January 1, 2007	\$ 100,000	\$ 79,275,748	\$ (70,791,745)	\$ 8,584,003
Net loss	-	-	(28,717,917)	(28,717,917)
Capital contributions in the form of forgiveness of allocated stock-based compensation expense	-	676,629	(17,166)	659,463
Capital contributions from Principal Management Corporation	-	54,945,465	-	54,945,465
Dividends paid to Principal Management Corporation	-	(3,518,398)	-	(3,518,398)
Balance at December 31, 2007	100,000	131,379,444	(99,526,828)	31,952,616
Net loss	-	-	(33,242,101)	(33,242,101)
Capital contributions in the form of forgiveness of allocated stock-based compensation expense	-	356,970	(12,653)	344,317
Capital contributions from Principal Management Corporation	-	40,101,931	-	40,101,931
Balance at December 31, 2008	<u>\$ 100,000</u>	<u>\$ 171,838,345</u>	<u>\$ (132,781,582)</u>	<u>\$ 39,156,763</u>

*See accompanying notes.*

Principal Funds Distributor, Inc.

Statements of Cash Flows

	Year Ended December 31	
	2008	2007
<b>Operating activities</b>		
Net loss	\$ (33,242,101)	\$ (28,717,917)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of deferred sales commissions	17,668,302	8,028,472
Allocation of stock-based compensation	356,970	676,629
Equity distribution in the form of common stock to employees	(12,653)	(17,166)
Depreciation of fixed assets	-	263,696
Deferred tax expense	2,475,402	4,457,654
Sales commissions deferred	(16,350,237)	(17,488,995)
Changes in operating assets and liabilities:		
Income tax receivable under tax allocation agreement	710,848	(5,828,566)
Receivables from affiliates	1,267,584	(1,500,427)
Other receivables	9,718	61,548
Other assets	(69,150)	(13,288)
Accounts payable and accrued expenses	(3,035,709)	73,681
Payable to Principal Life Insurance Company	1,291,687	4,549,016
Payable to other affiliates	1,188,891	611,761
Net cash used in operating activities	(27,740,448)	(34,843,902)
<b>Financing activities</b>		
Capital contributions from Principal Management Corporation	35,000,000	48,141,558
Net cash provided by financing activities	35,000,000	48,141,558
Net increase in cash and cash equivalents	7,259,552	13,297,656
Cash and cash equivalents at beginning of year	21,284,225	7,986,569
Cash and cash equivalents at end of year	\$ 28,543,777	\$ 21,284,225
<b>Supplemental disclosures</b>		
Noncash financing activities:		
Capital contribution from Principal Management Corporation	\$ 5,101,931	\$ 6,803,907
Dividend distribution to Principal Management Corporation	\$ -	\$ 3,518,398

See accompanying notes.

# Principal Funds Distributor, Inc.

## Notes to Financial Statements

December 31, 2008

### 1. Organization

#### Organization and Nature of Business

Principal Funds Distributor, Inc. (the Company) is a broker/dealer registered with the Financial Industry Regulatory Authority (FINRA). The Company is incorporated under the laws of the state of Washington and is a wholly owned subsidiary of Principal Management Corporation (PMC). PMC is a wholly owned subsidiary of Principal Financial Services, Inc. (PFSI), which is a wholly owned subsidiary of Principal Financial Group, Inc. (PFG). The Company serves as the principal contracted distributor of the Principal Mutual Funds (the Funds). The Company does not receive or hold funds of subscribers or securities of issuers and does not hold customer funds or securities. Main sources of revenue include distribution and underwriting fees earned for providing services to the Funds.

During 2007, the name of the Company was changed from WM Funds Distributor, Inc. to Principal Funds Distributor, Inc. The Company was purchased by PMC on December 31, 2006.

The accompanying financial statements have been prepared using the Company's historical basis of accounting. The fair value adjustments related to the PMC purchase have not been pushed down to these financial statements.

### 2. Recent Accounting Pronouncements

On September 15, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* (SFAS 157). This standard, which provides guidance for using fair value to measure assets and liabilities, applies whenever other standards require or permit assets or liabilities to be measured at fair value, but does not expand the use of fair value measurement. SFAS 157 establishes a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, and requires fair value measurements to be separately disclosed by level within the hierarchy. The Company's adoption of SFAS 157 on January 1, 2008, for assets and liabilities measured at fair value on a recurring basis and financial assets and liabilities measured at fair value on a nonrecurring basis did not have a material impact on the Company's financial statements as the only asset or liability of the Company measured at fair value is the Company's money market investment, which is a cash equivalent. The fair value of the money market investment approximates its carrying amount.

## Principal Funds Distributor, Inc.

### Notes to Financial Statements (continued)

#### **2. Recent Accounting Pronouncements (continued)**

SFAS 157 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 (an exit price). For SFAS 157 disclosures, SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels.

- **Level 1** – Unadjusted quoted prices in active markets for identical assets or liabilities. The Company's money market fund of \$2,417,088 at December 31, 2008, is a Level 1 asset. The Company has no Level 1 liabilities.
- **Level 2** – Inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. The Company has no Level 2 assets or liabilities.
- **Level 3** – Significant unobservable inputs for the asset or liability. The Company has no Level 3 assets or liabilities.

#### **3. Summary of Significant Accounting Policies**

##### **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. It is possible that actual experience could differ from the estimates utilized.

##### **Cash and Cash Equivalents**

The Company's cash equivalents include money market funds. The Company considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents.

## Principal Funds Distributor, Inc.

### Notes to Financial Statements (continued)

#### **3. Summary of Significant Accounting Policies (continued)**

##### **Deferred Sales Commission**

Commission costs related to sales of Class B, Class C, Class J and certain Class A shares are capitalized. Deferred sales commissions related to Class B shares are amortized over a period of five to six years using the straight-line method. Deferred sales commissions related to Class C shares are amortized over a period of 12 months using the straight-line method. Deferred sales commissions related to Class J and Class A shares are amortized over a period of 18 months using the straight-line method. Such Class A commissions are those associated with payments made when the customer is not required to pay a load, typically for Class A share purchases of \$1,000,000 or more.

##### **Federal and State Taxes on Income**

The Company's results of operations are included in the consolidated federal and combined state income tax returns of PFG. In accordance with the intercompany tax sharing agreement, the Company is allocated income taxes to the extent it increases or reduces the consolidated group tax liability.

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 benefits are based on the changes in the asset or liability from period to period.

##### **Revenue Recognition**

The majority of the Company's revenues are derived from services provided to the Funds. The Company receives 12b-1 fees from each fund based on a percentage of the Fund's average net assets. Such fees are booked as revenues as they are earned.

#### **4. Transactions With Affiliates**

As set forth in the statements of operations, the Company receives distribution (Rule 12b-1) and shareholder servicing fees from the Funds.

## Principal Funds Distributor, Inc.

### Notes to Financial Statements (continued)

#### 4. Transactions With Affiliates (continued)

Substantially all revenue recorded by the Company is for services provided to the Funds. Pursuant to the terms of agreements approved by the Funds' shareholders under the provisions of Rule 12b-1 of the Investment Company Act of 1940, the Company receives 12b-1 fees from each fund based on a stipulated percentage of the Fund's average net assets. Receivables from the Funds related to reimbursements of expenses totaled \$6,462,766 and \$7,730,350 at December 31, 2008 and 2007, respectively.

Additionally, the Company pays to selling broker dealers a portion of these fees. Fees received under the provisions of rule 12b-1 are listed as distribution fees (12b-1 fees) and fees paid to selling broker dealers are listed as distribution expenses (12b-1 fees). The Company is affiliated with Prncor Financial Services Corporation (PFSC) through common ownership and management. Distribution expenses (12b-1 fees) paid to PFSC for the sale of shares of the Funds totaled \$16,228,213 and \$7,352,260 for the years ended December 31, 2008 and 2007, respectively.

In July 2008, the Company received a non-cash capital contribution from its parent which consisted of \$5,101,931 of prepaid commissions on Class J shares. In January 2007, the Company received a non-cash capital contribution from its parent which consisted of \$6,257,971 of prepaid commissions on Class A and B shares and the corresponding deferred tax asset of \$545,936. In addition, in January 2007, the Company made a non-cash dividend distribution to its parent company which consisted of \$3,376,837 of prepaid commissions on Class A and C share sales made prior to the acquisition of the Company by PMC and corresponding deferred tax assets of \$141,561.

The Company has entered into an expense reimbursement agreement with Principal Life Insurance Company (PLIC). PLIC performs certain functions on its own behalf and on behalf of many subsidiaries, including the Company, and shares the use of certain equipment, personnel and facilities with its subsidiaries. On a monthly basis PLIC bills the subsidiaries, including the Company, for amounts due for the performance of such services and functions and the use of such equipment, personnel and facilities. Amounts billed to the Company by PLIC for the years ended December 31, 2008 and 2007, were \$62,237,659 and \$64,480,320, respectively.

Principal Financial Group, Inc. has allocated the expenses associated with its stock-based compensation plans to each of its subsidiaries, with the allocation aggregating \$356,970 and \$676,629 to the Company for the years ended December 31, 2008 and 2007, 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.

Principal Funds Distributor, Inc.

Notes to Financial Statements (continued)

**5. Income Taxes**

Income tax expense (benefit) for the years ended December 31, 2008 and 2007, consists of the following:

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
Current:		
Federal	\$ (19,624,073)	\$ (18,781,794)
State	(4,762,190)	(4,701,454)
	<u>(24,386,263)</u>	<u>(23,483,248)</u>
Deferred:		
Federal	2,007,221	3,542,388
State	468,181	915,266
	<u>2,475,402</u>	<u>4,457,654</u>
Income tax benefit	<u>\$ (21,910,861)</u>	<u>\$ (19,025,594)</u>

The effective tax rate differs from the federal statutory rate of 35% primarily due to the effect of state income taxes.

Principal Funds Distributor, Inc.

Notes to Financial Statements (continued)

**5. Income Taxes (continued)**

The tax effects of temporary differences that gave rise to the net deferred tax liability at December 31, 2008 and 2007, were as follows:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Deferred tax assets:		
Benefit and medical plan contribution	\$ 436,060	\$ 116,117
Vacation accrual	92,350	149,347
Deferred sales commission	149,347	112,320
Total deferred tax assets	<u>677,757</u>	<u>377,784</u>
Deferred tax liabilities:		
Deferred sales commissions	(6,970,827)	(4,281,716)
Other deferred tax liabilities	(94,050)	(7,786)
Total deferred tax liabilities	<u>(7,064,877)</u>	<u>(4,289,502)</u>
Net deferred tax liability	<u>\$ (6,387,120)</u>	<u>\$ (3,911,718)</u>

**6. Contingencies**

The Company is regularly involved in litigation, both as a defendant and as a plaintiff, but primarily as a defendant. Litigation naming the Company as a defendant ordinarily arises out of the Company's business operations as a provider of asset management and accumulation products and services. Some of the lawsuits are class actions, or purport to be, and some include claims for punitive damages. In addition, regulatory bodies, such as, the Securities and Exchange Commission, the Financial Industry Regulatory Authority and other regulatory bodies regularly make inquires and conduct examinations or investigations concerning the Company's compliance with, among other things, securities laws and laws governing the activities of broker-dealers. The Company receives requests from regulators and other governmental authorities relating to other industry issues and may receive additional requests, including subpoenas and interrogatories, in the future.

## Principal Funds Distributor, Inc.

### Notes to Financial Statements (continued)

#### 6. Contingencies (continued)

On February 28, 2007, Luz Zapien (*Zapien*) filed a securities class action against Washington Mutual, Inc. (WaMu), Principal Financial Group, Inc. (PFG) and certain mutual fund-related entities. The Compliant alleged that WaMu had inadequately disclosed an alleged shelf-space arrangement that misled fund investors during the putative class period. PFG was named in the Compliant based on its December 2006 purchase of the distributor, investment advisor and assets of the relevant WaMu mutual funds (the acquired business). This action was dismissed with prejudice on June 17, 2008, and its on appeal to the Ninth Circuit Court of Appeals. In addition, on August 20, 2008, counsel for the Plaintiffs filed a new class action, *Robinson v. WM Trust I, et al.*, in the United States District Court for the Western District of Washington, making the same allegations that were contained in *Zapien*. On September 26, 2008, the Robinson Plaintiffs filed a First Amended Compliant which dropped the WaMu defendants, added four directors of the Principal Mutual Funds entity in their individual capacity, and amended the putative class to include “all persons or entities that purchased or otherwise acquired shares, units or like interests in any of the WM Funds (including through the reinvestment of Fund dividends) between March 1, 2002, and December 31, 2006, inclusive.” A new lead plaintiff, “Dumdie” has been substituted for Robinson. The Purchase Agreement of the acquired business contained an indemnification provision from WaMu that we believed would have significantly limited PFG’s exposure in these lawsuits. The bankruptcy filing by WaMu raises concerns as to the availability of any indemnification protection for PFG. PFG is aggressively defending both lawsuits.

While the outcome of any pending or future litigation or regulatory matter cannot be predicted, management does not believe that any pending litigation or regulatory matter will have a material adverse effect on the Company’s business or financial position. The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible that such outcomes could materially affect net income in a future period.

#### 7. Regulatory Requirements

The Company is subject to the Securities and Exchange Commission Uniform Net Capital Rule (Rule 15c3-1). The Company computes its net capital requirements under the alternative method provided for in Rule 15c3-1. At December 31, 2008, the Company had net capital of \$12,848,797 which was \$12,598,797 in excess of its required minimum net capital of \$250,000.

The Company is exempt from maintaining a special reserve bank account under Rule 15c3-3(k)(1).

# Supplemental Information

Principal Funds Distributor, Inc

Computation of Net Capital – Part IIA

December 31, 2008

Computation of Net Capital

1. Total ownership equity from statement of financial condition		\$39,156,763
2. Deduct ownership equity not allowable for net capital		<u>–</u>
3. Total ownership equity qualified for net capital		<u>39,156,763</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>39,156,763</u>
6. Deductions and/or charges:		
A. Total nonallowable assets from statement of financial condition (Notes B and C)	\$26,259,624	
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>	26,259,624
7. Other additions and/or allowable credits		<u>–</u>
8. Net capital before haircuts on securities positions		<u>12,897,139</u>
9. Haircuts on securities (computed, where applicable, pursuant to 15c3-1 (f)):		
A. Contractual securities commitments	<u>–</u>	
B. Subordinated securities borrowings	<u>–</u>	
C. Trading and investment securities:		
1. Exempted securities	<u>–</u>	
2. Debt securities	<u>–</u>	
3. Options	<u>–</u>	
4. Other securities	<u>48,342</u>	
D. Undue concentration	<u>–</u>	
E. Other	<u>–</u>	48,342
10. Net capital		<u>\$12,848,797</u>

Principal Funds Distributor, Inc

Computation of Net Capital – Part IIA (continued)

Computation of Alternate Net Capital Requirement

Part B

22.	2% of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits	\$ —
23.	Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	<u>250,000</u>
24.	Net capital requirement (greater of line 22 or 23)	<u>250,000</u>
25.	Excess net capital (line 10 less 24)	<u>12,598,797</u>
26.	Net capital in excess of: 5% of combined aggregate debit items or \$120,000	<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. 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.

Principal Funds Distributor, Inc

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

December 31, 2008

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

Exemptive Provision

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)

          X          

B. (k)(2)(i) – “Special Account for the Exclusive Benefit of Customers” maintained

C. (k)(2)(ii) – All customer transactions cleared through another broker-dealer on a fully disclosed basis. Name of clearing firm:

D. (k)(3) – Exempted by order of the Commission

Principal Funds Distributor, Inc

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

December 31, 2008

There were no differences between Net Capital which is included in this audited report and Net Capital in the Company's corresponding unaudited Focus Report (Form X-17A-5, Part IIA) filing as of December 31, 2008.

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

The Board of Directors  
Principal Funds Distributor, Inc.

In planning and performing our audit of the financial statements of Principal Funds Distributor, Inc. (the Company) as of and for the year ended December 31, 2008, 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 in any of the following:

1. Making quarterly securities examinations, counts, verifications, and comparisons and recordation of differences required by Rule 17a-13.
2. Complying with the requirements for prompt payment for securities under Section 8 of Federal Reserve Regulation T of the Board of Governors of the Federal Reserve System.

The management of the Company is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls and of the practices and procedures referred to in the preceding paragraph and to assess whether those practices and procedures can be expected to achieve the SEC's 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 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. 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.

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, 2008, 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 it is not intended to be and should not be used by anyone other than these specified parties.

*Ernst + Young LLP*

February 22, 2009

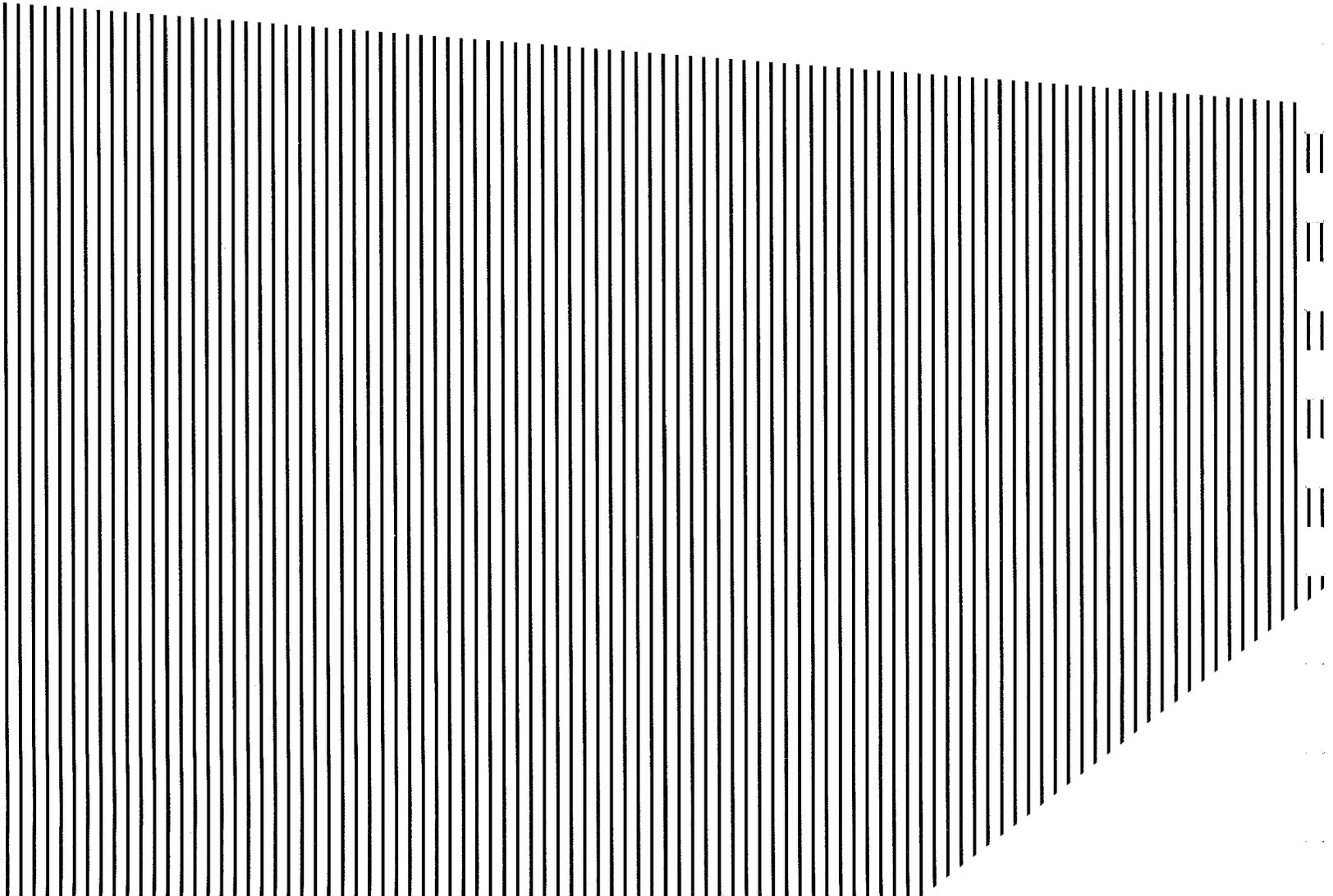
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FINANCIAL STATEMENTS AND  
SUPPLEMENTAL INFORMATION

Principal Funds Distributor, Inc.  
Years Ended December 31, 2008 and 2007  
With Report and Supplementary Report of Independent  
Registered Public Accounting Firm