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

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER:

Princor Financial Services Corporation

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

711 High Street

Des Moines, Iowa 50392-0200

(City)

(No. and Street)

(State)

OFFICIAL USE ONLY
FIRM ID. NO.

SEC  
With Proposed  
Section

FEB 27 2009

Washington, DC  
103

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

(Address)

(City)

(State)

(Zip Code)

**CHECK ONE:**

Certified Public Accountant

Public Accountant

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

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

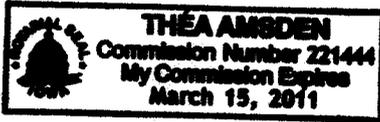
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## Oath or Affirmation

I, Jill R. Brown, affirm that, to the best of my knowledge and belief the accompanying financial statements and supporting schedules pertaining to the firm of Princor Financial Services Corporation, 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 Amsden

Notary Public

This report contains:

- (a) Facing page
- (b) Statement of Financial Condition
- (c) Statement of Income
- (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) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit
- (o) Supplementary Report of Independent Registered Public Accounting Firm on Internal Control Required by Rule 17a-5

Princor Financial Services Corporation  
Financial Statements and Supplemental Information

Years Ended December 31, 2008 and 2007

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## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholder  
Princor Financial Services Corporation

We have audited the accompanying balance sheets of Princor Financial Services Corporation (an indirect, wholly owned subsidiary of Principal Financial Group, Inc.) as of December 31, 2008 and 2007, and the related 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 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 Princor Financial Services Corporation 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 accompanying supporting schedules are presented for purposes of additional analysis and are not a required part of the basic 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 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

Princor Financial Services Corporation

Balance Sheets

	December 31	
	2008	2007
<b>Assets</b>		
Cash and cash equivalents	\$ 12,157,511	\$ 18,998,546
Long-term investments, at fair value (amortized cost: 2008 – \$9,349,018; 2007 – \$8,942,374)	7,457,434	8,521,441
Due from:		
Affiliates	1,800,652	3,198,269
Others	912,984	2,651,753
Deferred commission expense	–	5,018,805
Prepaid expenses	415,601	365,122
Net deferred income taxes	3,156,037	3,197,226
Income taxes recoverable	1,041,321	180,764
Total assets	<u>\$ 26,941,540</u>	<u>\$ 42,131,926</u>
<b>Liabilities and stockholder's equity</b>		
Liabilities:		
Commissions payable	\$ 381,911	\$ 568,661
Accounts payable	210,656	563,068
Due to:		
Principal Life Insurance Company	3,237,355	4,353,564
Other affiliates	506,673	724,071
Total liabilities	<u>4,336,595</u>	<u>6,209,364</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	400,000	400,000
Additional paid-in capital	6,043,876	10,908,976
Retained earnings	16,161,069	24,613,586
Total stockholder's equity	<u>22,604,945</u>	<u>35,922,562</u>
Total liabilities and stockholder's equity	<u>\$ 26,941,540</u>	<u>\$ 42,131,926</u>

*See accompanying notes.*

# Princor Financial Services Corporation

## Statements of Income

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
Brokerage revenues:		
Commissions:		
Principal Mutual Funds	<b>\$ 11,594,023</b>	\$ 10,864,835
Other mutual funds	<b>12,256,211</b>	13,870,589
General securities	<b>37,370,587</b>	37,300,311
Variable annuities and flexible variable life policies	<b>6,061,190</b>	7,266,143
Contingent deferred sales charges	<b>1,051,544</b>	1,740,833
Distribution and shareholder servicing fees	<b>21,973,937</b>	28,080,088
Retirement plan revenue	<b>199,777,752</b>	185,376,830
Total brokerage revenues	<b>290,085,244</b>	284,499,629
Less commission - related expenses:		
Commission to advisors	<b>26,529,474</b>	29,513,841
Commission to brokers	<b>14,443,120</b>	16,673,972
Commission to other broker-dealers	<b>859,058</b>	518,977
Amortization of deferred commissions	<b>4,065,070</b>	6,812,062
Distribution fees	<b>4,836,577</b>	6,042,852
Field personnel allocated expenses	<b>6,870,795</b>	6,952,140
Other distribution expenses	<b>10,533,438</b>	6,553,316
Retirement plan expenses	<b>199,777,752</b>	185,351,527
Total commission - related expenses	<b>267,915,284</b>	258,418,687
Net brokerage revenues	<b>22,169,960</b>	26,080,942
Other revenues (losses):		
Interest	<b>676,188</b>	1,100,376
Other	<b>3,229</b>	(98)
Net investment losses	<b>(1,470,651)</b>	(145,793)
Total other revenues (losses)	<b>(791,234)</b>	954,485

Princor Financial Services Corporation

Statements of Income (continued)

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
Operating expenses:		
Salaries and benefits	\$ 14,079,482	\$ 12,702,645
General and administrative expenses	13,013,057	9,938,730
Total operating expenses	<u>27,092,539</u>	<u>22,641,375</u>
(Loss)/income from operations before income taxes	(5,713,813)	4,394,052
Provision (benefit) for federal and state income taxes	(2,270,012)	1,683,678
Net (loss)/income	<u>\$ (3,443,801)</u>	<u>\$ 2,710,374</u>

*See accompanying notes.*

Princor Financial Services Corporation

Statements of Changes in Stockholder's Equity

	<b>Common Stock</b>	<b>Additional Paid-In Capital</b>	<b>Retained Earnings</b>	<b>Total</b>
Balance at January 1, 2007	\$ 400,000	\$ 16,965,853	\$ 21,914,042	\$ 39,279,895
Net income	-	-	2,710,374	2,710,374
Capital contribution in the form of forgiveness of allocated stock-based compensation expense	-	747,030	(10,830)	736,200
Return of prepaid commission to Parent	-	(6,803,907)	-	(6,803,907)
Balance at December 31, 2007	400,000	10,908,976	24,613,586	35,922,562
Net loss	-	-	(3,443,801)	(3,443,801)
Capital contribution in the form of forgiveness of allocated stock-based compensation expense	-	236,831	(8,716)	228,115
Dividends paid to Parent	-	-	(5,000,000)	(5,000,000)
Return of prepaid commission to Parent	-	(5,101,931)	-	(5,101,931)
Balance at December 31, 2008	<u>\$ 400,000</u>	<u>\$ 6,043,876</u>	<u>\$ 16,161,069</u>	<u>\$ 22,604,945</u>

*See accompanying notes.*

# Princor Financial Services Corporation

## Statements of Cash Flows

	Year Ended December 31	
	2008	2007
<b>Operating activities</b>		
Net (loss)/income	\$ (3,443,801)	\$ 2,710,374
Adjustments to reconcile net (loss)/income to net cash used in operating activities:		
Deferral of commission expense	(4,148,196)	(7,970,068)
Amortization of deferred commission expense	4,065,070	6,812,062
Amortization of premiums and discounts on long-term investments	-	98
Reinvested dividends from long-term mutual funds	(406,644)	(405,208)
Net investment losses	1,470,651	145,793
Capital contribution in the form of forgiveness of allocated stock-based compensation expense	236,831	747,030
Equity distribution in the form of common stock to employees	(8,716)	(10,830)
Deferred income taxes	41,189	(830,270)
Changes in operating assets and liabilities:		
Due from others and prepaid expenses	2,300,112	(2,176,193)
Due to/from Principal Life Insurance Company	(1,116,209)	1,604,545
Due to/from mutual funds and other affiliates	568,397	(1,234,257)
Commissions payable, accounts payable, and income taxes recoverable	(1,399,719)	(605,252)
Net cash used in operating activities	(1,841,035)	(1,212,176)
<b>Investing activities</b>		
Proceeds from maturity of bond	-	500,000
Net cash provided by investing activities	-	500,000
<b>Financing activities</b>		
Dividends paid to Parent	(5,000,000)	-
Net cash used in financing activities	(5,000,000)	-
Net decrease in cash and cash equivalents	(6,841,035)	(712,176)
Cash and cash equivalents beginning of year	18,998,546	19,710,722
Cash and cash equivalents end of year	\$ 12,157,511	\$ 18,998,546
<b>Noncash financing activity</b>		
Return of prepaid commissions to Parent	\$ (5,101,931)	\$ (6,803,907)
<b>Supplemental disclosure of cash flow information</b>		
Net cash (received)/paid during the year for income taxes	\$ (1,450,644)	\$ 3,067,894

*See accompanying notes.*

# Princor Financial Services Corporation

## Notes to Financial Statements

December 31, 2008

### 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.

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

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

The Company's long-term investments consist of investments in various Principal Mutual Funds, which are reported at fair value. Fair 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 fair value is included in net income.

The net unrealized appreciation or depreciation of long-term investments consisted of gross unrealized losses of \$1,891,584 at December 31, 2008, and gross unrealized losses of \$420,933 at December 31, 2007. There were no gross unrealized gains at December 31, 2008 and 2007. Realized gains and losses on sales of investments are determined on the basis of specific identification of securities sold.

# Princor Financial Services Corporation

## Notes to Financial Statements (continued)

### 1. Significant Accounting Policies (continued)

#### Deferred Sales Costs

In July of 2008 the Company stopped distributing Class J shares and executed a non-cash return of capital of \$5,101,931 to its Parent company, which consisted of prepaid commissions on Class J shares. Prior to July of 2008, the Company deferred commissions on the sale of Class J shares and amortized these deferrals over 18 months, the period of time the shares are subject to CDSC fees, using the straight-line method.

In January of 2007, the Company executed a non-cash return of capital of \$6,803,907 to its Parent company, which consisted of finders fees paid on Class A shares and prepaid commissions on Class B shares. Prior to January 2007, the Company deferred finders fees on the sale of Class A shares and amortized these deferrals over 18 months, the period of time the shares are subject to CDSC fees, using the straight-line method. Prior to January 2007, the Company deferred commissions on the sale of Class B shares and amortized these deferrals over a period of six to seven years, using the straight-line method.

Total amortization of deferred commissions was \$4,065,070 and \$6,812,062 during the years ended December 31, 2008 and 2007, respectively. The Company periodically evaluated whether events or circumstances had occurred that may affect the recoverability of the remaining deferred commission expense asset.

#### 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. Fair Value Measurement

The Company uses fair value measurements to record fair value of cash equivalents and long-term investments.

## Princor Financial Services Corporation

### Notes to Financial Statements (continued)

#### 2. Fair Value Measurement (continued)

##### Valuation Hierarchy

FASB Statement No. 157, *Fair Value Measurements*, (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. Our Level 1 assets include mutual funds.
- **Level 2** – Inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly.
- **Level 3** – Significant unobservable inputs for the asset or liability.

##### Determination of Fair Value

The techniques utilized in estimating the fair values of financial instruments are reliant on the assumptions used, including discount rates and estimates of the amount and timing of future cash flows. Care should be exercised in deriving conclusions about our business, its value or financial position based on the fair value information of financial instruments presented below.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial instrument, including estimates of timing, amount of expected future cash flows and the credit standing of the issuer. Such estimates do not consider the tax impact of the realization of unrealized gains or losses. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial instrument.

The following discussion describes the valuation methodologies used for assets and liabilities measured or disclosed at fair value.

Princor Financial Services Corporation

Notes to Financial Statements (continued)

**2. Fair Value Measurement (continued)**

**Long Term Investments at Market Value**

Long term investments at market value include mutual fund investments, for which the fair value is determined using the net asset value of the fund.

**Cash Equivalents**

Because of the nature of these assets, carrying amounts approximate fair values. Fair values of cash equivalents may be determined using public quotations, when available.

Assets measured at fair value on a recurring basis are summarized below. The Company does not have any liabilities measured at fair value.

	<b>As of December 31, 2008</b>			
	<b>Assets Measured at Fair Value</b>	<b>Fair Value Hierarchy Level</b>		
		<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>				
Long term investments at market value	\$ 7,457,434	\$ 7,457,434	\$ -	\$ -
Cash equivalents	4,216,007	4,216,007	-	-
<b>Total assets</b>	<b>\$ 11,673,441</b>	<b>\$ 11,673,441</b>	<b>\$ -</b>	<b>\$ -</b>

**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.

Princor Financial Services Corporation

Notes to Financial Statements (continued)

**3. Income Taxes (continued)**

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, 2008 and 2007, are as follows:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Deferred income tax liabilities:		
Other items	<b>\$ 167,192</b>	<b>\$ 98,857</b>
Total deferred income tax liabilities	<b>167,192</b>	<b>98,857</b>
Deferred income tax assets:		
Deferred commission expense	-	(33,253)
Benefit and medical plan contributions not currently deductible for tax	<b>(1,524,377)</b>	(1,420,752)
Unrealized loss on long-term investments	<b>(724,015)</b>	(132,814)
Vacation accrual	<b>(106,907)</b>	(282,281)
Bonus accrual	<b>(9,843)</b>	(68,152)
Stock options	<b>(958,087)</b>	(1,340,585)
Other items	-	(18,246)
Total deferred income tax assets	<b>(3,323,229)</b>	(3,296,083)
Net deferred income tax assets	<b><u><u>\$(3,156,037)</u></u></b>	<b><u><u>\$(3,197,226)</u></u></b>

Princor Financial Services Corporation

Notes to Financial Statements (continued)

**3. Income Taxes (continued)**

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

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
Current:		
Federal	\$ (1,855,047)	\$ 2,021,554
State	(456,154)	492,394
Total current	<u>(2,311,201)</u>	<u>2,513,948</u>
Deferred:		
Federal	8,556	(534,652)
State	32,633	(295,618)
Total deferred	<u>41,189</u>	<u>(830,270)</u>
	<u>\$ (2,270,012)</u>	<u>\$ 1,683,678</u>

**4. Net Capital Requirements**

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, Lufkin & Jenrette Securities Corporation (the clearing broker-dealer). The Company promptly transmits all customer funds and securities to the clearing broker-dealer. In connection with this arrangement, the Company is contingently liable for its customers' transactions.

The Company is subject to the SEC 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, 2008, the Company had defined net capital of \$15,226,487, which was \$14,937,381 in excess of its required net capital of \$289,106. The Company's defined net capital ratio was 0.28 to 1. The SEC 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 has a special bank account, with a balance of \$13,744 and \$81,681 at December 31, 2008 and 2007, respectively, as required under Rule 15c3-3(k)(2)(i), designated "Special Account for the Exclusive Benefit of Customers."

# Princor Financial Services Corporation

## Notes to Financial Statements (continued)

### 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.

Prior to January 1, 2006, Principal Financial Group, Inc. used the fair value method of accounting for stock-based compensation as defined by SFAS No. 123, *Accounting for Stock-Based Compensation*. Effective January 1, 2006, Principal Financial Group adopted SFAS No. 123R. Principal Financial Group, Inc. has allocated the expenses associated with SFAS No. 123 and SFAS No. 123R to each of its subsidiaries, with the allocation aggregating \$236,831 and \$747,030 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.

In July 2008, the Company returned capital in the amount of \$5,101,931 to PFSI which consisted of prepaid commissions on Class J shares.

During 2008 and 2007, 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 that have been deferred are initially paid by Principal Life and charged directly to the Company and subsidiaries. For the years ended December 31, 2008 and 2007, these amounts aggregated \$9,061,413 and \$32,999,972, respectively.

In December 2008, the Company paid a dividend in the amount of \$5,000,000 to PFSI which was a return of earnings.

Princor Financial Services Corporation  
Notes to Financial Statements (continued)

**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 that may result from these actions.

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 inquiries 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.

On August 28, 2007, two plaintiffs, Walsh and Young, filed a putative class action lawsuit in the United States District Court for the Southern District of Iowa against Principal Life and Princor Financial Services Corporation (the Principal Defendants). The lawsuit alleges that the Principal Defendants breached alleged fiduciary duties to participants in employer-sponsored 401(k) plans who were retiring or leaving their respective plans, including providing misleading information and failing to act solely in the interests of the participants, resulting in alleged violations of ERISA. The Principal Defendants are aggressively defending the lawsuit.

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.

# Supplemental Information

Princor Financial Services Corporation

Computation of Net Capital – Pursuant to Rule 15(c)3-1

December 31, 2008

Computation of net capital	
Total stockholder's equity	\$ 22,604,945
Subordinated note payable	—
Total regulatory capital	<u>\$ 22,604,945</u>
Deductions and/or charges:	
Nonallowable assets:	
Memberships in exchanges	—
Receivables from affiliates	\$ 6,001,099
Other assets	591,554
Other deductions	2,938
Total deductions and/or charges	<u>16,009,354</u>
Net capital before haircuts on securities positions	
Haircuts on securities positions	<u>782,867</u>
Net capital	<u><u>\$ 15,226,487</u></u>
Computation of alternative net capital requirement	
Net capital requirement (minimum)	<u>\$ 289,106</u>
Aggregate indebtedness	<u>\$ 4,336,595</u>
Excess net capital	<u><u>\$ 14,937,381</u></u>

Princor Financial Services Corporation

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

December 31, 2008

There were no differences between the computation of net capital under Rule 15(c)3-1 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 Financial Industry Regulatory Authority.

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

The Board of Directors  
Princor Financial Services Corporation

In planning and performing our audit of the financial statements of Princor Financial Services Corporation (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 (the 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 is not intended to be and should not be used by anyone other than these specified parties.

*Ernst & Young LLP*

February 22, 2009

Ernst & Young LLP

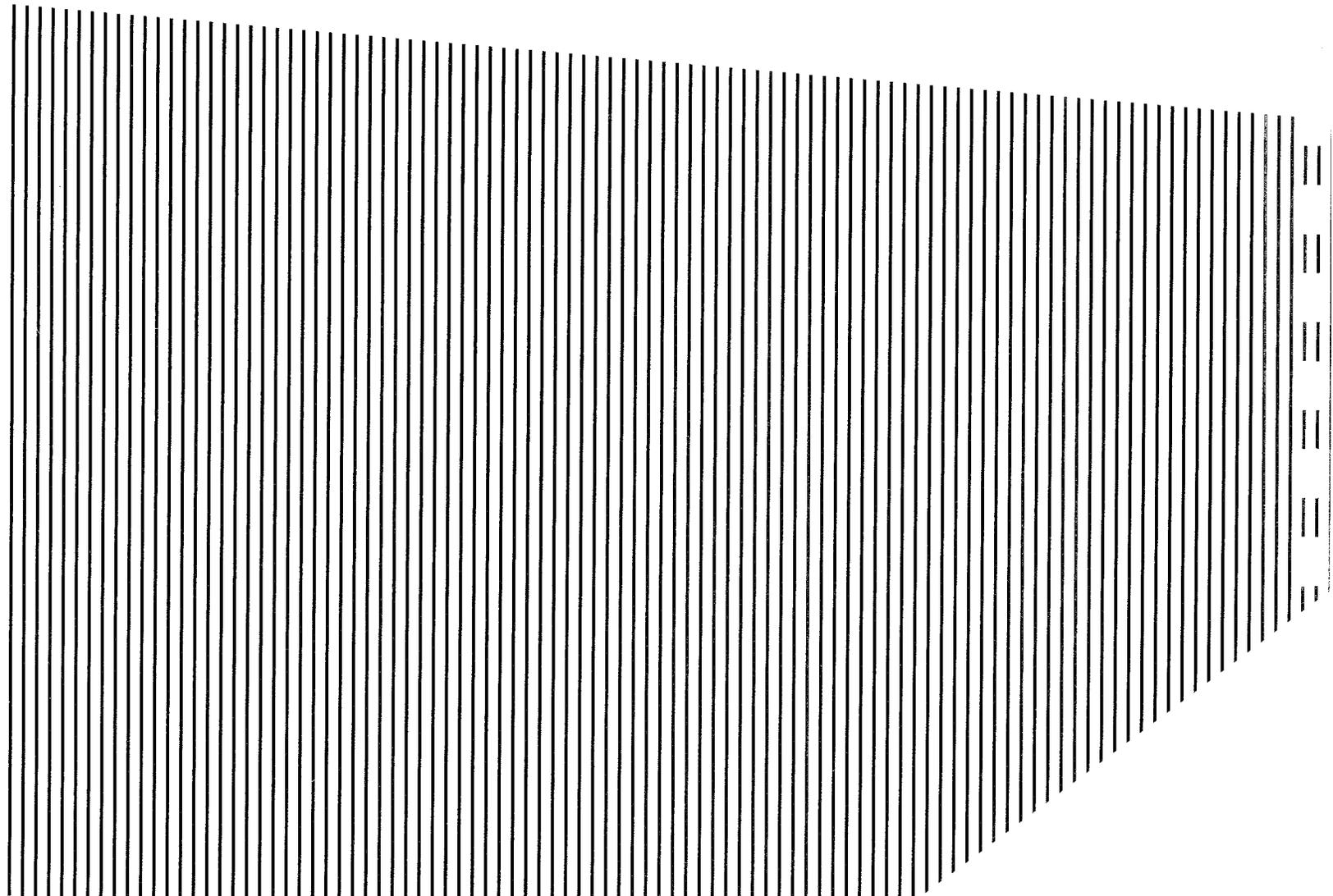
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FINANCIAL STATEMENTS AND  
SUPPLEMENTAL INFORMATION

Princor Financial Services Corporation  
Years Ended December 31, 2008 and 2007  
With Report and Supplementary Report of Independent  
Registered Public Accounting Firm