

# FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND

To the Shareholders of the Flaherty & Crumrine Preferred Income Opportunity Fund (“PFO”):

The Fund completed a successful fiscal year on November 30, 2006, returning **+5.3%**<sup>(1)</sup> total return on net asset value (“NAV”) during the fourth fiscal quarter and **+10.8%**<sup>(1)</sup> for the full year. The total return based on the market price of the Fund’s common shares for the year was even better, with the combination of income and share price appreciation totaling **+15.2%**, and the Fund’s discount from NAV narrowed significantly.

The table below compares the return on the Fund since its inception with a broad group of fixed-income, closed-end funds. Although the investment strategies used by the Fund differ significantly from the strategies used by these other fixed-income funds, we believe that the Fund addresses similar investment goals with better results. As the numbers indicate, the Fund has performed very well, benefiting from strength in the overall market for preferred securities as well as some strategic shifts in the portfolio.

## TOTAL RETURN PER YEAR ON NET ASSET VALUE<sup>(1)</sup> FOR PERIODS ENDED NOVEMBER 30, 2006

	<u>One Year</u>	<u>Three Years</u>	<u>Five Years</u>	<u>Ten Years</u>	<u>Life of Fund<sup>(2)</sup></u>
<b>Flaherty &amp; Crumrine Preferred Income Opportunity Fund</b> . . . . .	<b>10.8%</b>	<b>7.4%</b>	<b>9.6%</b>	<b>8.7%</b>	<b>10.0%</b>
Lipper Domestic Investment Grade Funds <sup>(3)</sup> . . . . .	7.3%	5.7%	6.3%	6.6%	7.0%

- (1) Based on monthly data provided by Lipper Inc. in each calendar month during the relevant period. Distributions are assumed to be reinvested at NAV in accordance with Lipper’s practice, which differs from the methodology used elsewhere in this report.
- (2) Since inception on February 13, 1992.
- (3) Includes all funds in Lipper’s U.S. Government, U.S. Mortgage and Corporate Debt BBB Rated categories in each month during the period.

The steady stream of new preferred issues continued during the past quarter. In the twelve months ended November 30, 2006, roughly \$75 billion of preferred securities were issued – over \$23 billion in the last quarter alone. The recently-devised enhanced preferred security structure has been very popular with issuers and investors, and these issues comprised a large portion of the new supply. However, issuers have also brought to market traditional hybrid preferred securities and traditional DRD and QDI eligible issues, with both adjustable and fixed coupons. For us old-timers, it has been interesting to observe that billion dollar deals are commonplace and that investors usually can’t get enough to satisfy their interest.

The Fund has benefited from the vibrant new issue market – not only have we been able to pick and choose from a variety of issues and issuers, but the new supply has improved liquidity in older issues as well. You can see the results of this new supply and additional liquidity in the turnover of the Fund’s portfolio when compared to recent years.

Although the investor base for preferred securities appears to have grown materially, the current pace of new-issue supply has us wondering if demand can keep up. The trend is healthy, but only time will tell if these new investors are in it for the long haul.

In a number of instances, proceeds from new issues were used to redeem older, more expensive (from the issuer's perspective) issues. This is a trend we have anticipated and discussed often in the past, but it is worth reviewing once again. Just like a homeowner may refinance a mortgage when there are savings to be had, issuers of preferred securities will replace older issues with newer ones when there are benefits in doing so. The benefit may be simply to lower the "payments," or the issuer may find additional benefits from adding some features that weren't available previously.

We work hard to anticipate redemptions. This is important because if the issuer can save money by "refinancing," the investor is probably going to earn less. While this trend may reduce the amount of income available for distribution to Common Stock Shareholders of the Fund, there are ways to mitigate the impact. The best way to avoid redemptions is to own securities that issuers either can't or don't want to redeem. We can also lessen the impact of redemptions by selling the security prior to the date it can be redeemed. This provides us with greater flexibility in replacing the position.

Forecasting redemptions is a critical step in determining the dividend rate the Fund can pay its Common Stock Shareholders. Some redemptions of securities held by the Fund are inevitable, and better understanding the income the Fund will receive guides us in making recommendations to the Board of Directors about dividend policy.

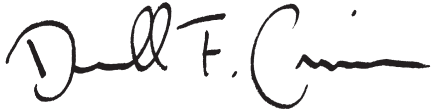
Since dividends are effectively driven by the *net* income of the Fund's portfolio, forecasting the Fund's expenses is also crucial in setting the dividend rate. A primary variable in the Fund's expenses is the cost of its use of leverage, which has been fairly unpredictable over the past several years. The Fund's leverage cost is directly impacted by the short-term interest rates set by the Federal Reserve. As the Federal Reserve raised interest rates (an unprecedented 17 consecutive times between June 2004 and June 2006), the cost of leverage increased by approximately 190%, from \$1.0 million for the year ended November 30, 2004 to \$2.9 million for the year ended November 30, 2006. During a two-year period in which the income earned on the portfolio increased only moderately, this additional cost had a negative impact on the amount of income available to be distributed to the holders of the Fund's 11.6 million outstanding shares of Common Stock.

Even in today's interest-rate environment, however, the use of leverage continues to be a beneficial strategy to the Fund's Common Stock Shareholders. In other words, the preferred securities in the portfolio continue to have a higher return than the short-term rates the Fund pays for its leverage, and that difference in return is passed on to the Fund's Common Stock Shareholders.

In August 2006, the Federal Reserve finally gave markets a reprieve from its relentless increasing of short-term interest rates, and now the market is unsure if the Federal Reserve will lower, increase or keep rates the same during coming months. These decisions will impact the Fund's available distributable income. If the Federal Reserve maintains its current pause on short-term rates, and long-term rates do not decrease materially, the Fund's leverage should continue to produce similar amounts of additional distributable income to what it does now. Of course, if the Federal Reserve lowers short-term interest rates, the Fund should see a greater benefit from its use of leverage and consequently have additional distributable income for its Common Stock Shareholders.

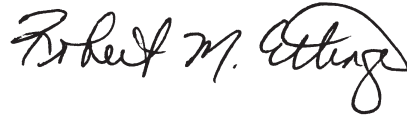
We hope investors will take advantage of the Fund's website at [www.preferredincome.com](http://www.preferredincome.com). It contains a wide range of useful and up-to-date information about the Fund, and the "Frequently Asked Questions" section has enhanced discussions about many of the topics discussed in this Annual Report.

Sincerely,

A handwritten signature in black ink, appearing to read "Donald F. Crumrine". The signature is fluid and cursive, with a long horizontal stroke at the end.

Donald F. Crumrine  
Chairman of the Board

January 23, 2007

A handwritten signature in black ink, appearing to read "Robert M. Ettinger". The signature is cursive and includes a large, looping flourish at the end.

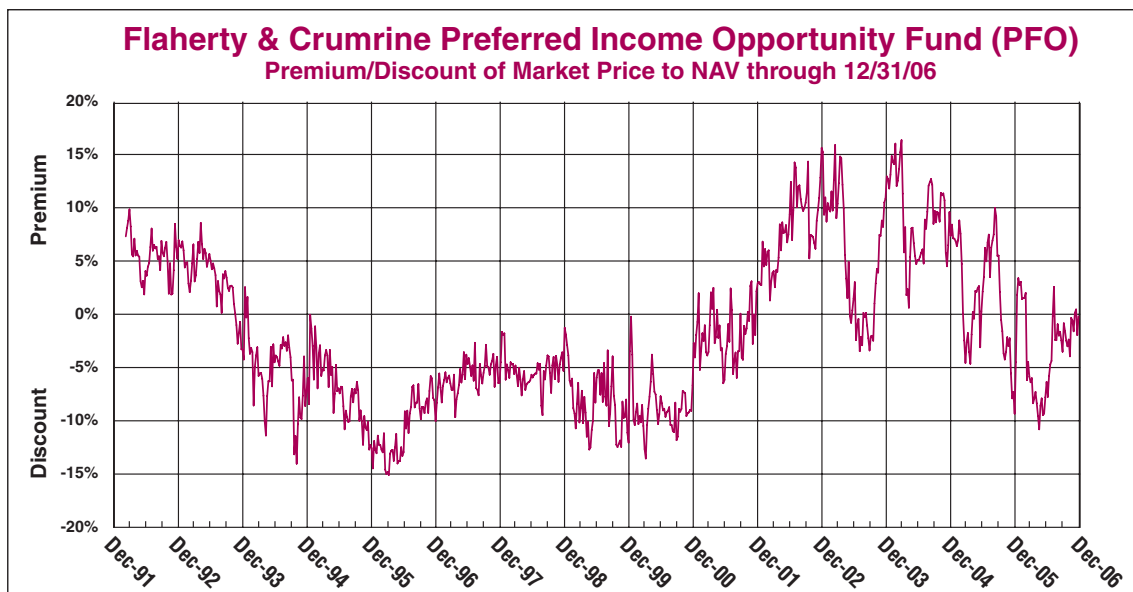
Robert M. Ettinger  
President

## QUESTIONS & ANSWERS

### How does the market price of the Fund's shares relate to net asset value?

While our focus is primarily on managing the Fund, we realize that an investor's actual return is comprised of monthly dividend payments plus changes in the market price of the Fund. We're pleased that for the year ended November 30, 2006 the market has responded favorably to the Fund's total return on *net asset value* of 10.8% — the total return on *market value* for the Fund's common shares was 15.2%. During the fourth quarter alone, the total return on *market value* was 5.7%.

We've often said that in a perfect world the market price would closely track net asset value; however, as seen in the chart below, in the real world deviations can be large. Over the past year, shareholders saw some significant improvement in the discount between net asset value and market price.



For additional information about premiums and discounts, please see the "Frequently Asked Questions" section of the Fund's website at [www.preferredincome.com](http://www.preferredincome.com).

### Are there any federal tax advantages to the distributions made by the Fund in 2006?

Yes. In 2006, the Fund passed on a portion of its income to individuals in the form of qualified dividend income or QDI. QDI is taxed at a maximum 15% rate instead of an individual's ordinary income tax rate. In calendar year 2006, 78.2% of the distributions made by the Fund was eligible for QDI treatment. For an individual in the 28% tax bracket, this means that the Fund's total distributions will only be taxed at a blended 17.8% rate versus the 28% rate which would apply to distributions by a fund comprised of traditional corporate bonds.

This tax advantage means that, all other things being equal, an individual in the 28% tax bracket who held 100 shares of Common Stock of the Fund for the calendar year would have had to receive approximately \$90 in distributions from a traditional corporate bond fund to net the same after-tax amount as the \$79 in distributions paid by the Fund.

For detailed information about the tax treatment of the particular distributions you received from the Fund, please see the Form 1099 you receive from either the Fund or your broker.

Corporate shareholders also receive a federal tax benefit from the 71.8% of the distributions that were eligible for the inter-corporate dividends received deduction or DRD.

It is important to remember that portfolio composition and income distributions can change from one year to the next and that the QDI or DRD portions of next year's distributions may not be the same (or even similar) to this year's.

### **What were the components of the Fund's total return on net asset value for the year?**

One technique to better understand the Fund's net asset value (NAV) performance is to begin with the Fund's total return on its investment portfolio, and then adjust for the impact of hedging, expenses and leverage to arrive at total return based on NAV (which factors in all of these items).

During fiscal 2006, the Fund's unhedged portfolio before the impact of leverage and expenses returned 10.1%. Over the first half of the Fund's fiscal year, intermediate and long-term U.S. Treasury yields increased significantly, and the Fund's interest rate hedging strategies contributed positively to its results. However, in the past six months longer-term Treasury yields reversed direction, ending the fiscal year almost unchanged. Consequently, the hedged portfolio's annual return before the impact of expenses and leverage declined slightly to 9.9%.

Converting these returns on the portfolio to the returns on the Fund's Common Stock requires the consideration of two additional factors: the favorable impact of leverage and the expenses incurred in operating the Fund. As discussed in greater detail below, the Fund's use of leverage served to boost the Fund's return on its portfolio by 2.4%. After accounting for the Fund's 1.5% expense ratio on the Common Stock, this resulted in the Fund's overall total return on NAV of 10.8%.

### **How does the Fund receive a benefit from its use of leverage when the U.S. Treasury Yield Curve is flat or inverted?**

As long as short-term U.S. Treasury interest rates are not dramatically above long-term rates, the Fund continues to benefit from the use of leverage in a flat or inverted yield curve. As discussed above, during fiscal 2006 the leverage utilized by the Fund both completely offset the expenses of the Fund and boosted the Fund's overall total return on net asset value.

Fundamentally, leverage is the use of borrowed funds to improve one's rate of return from an investment, although with an increase in risk. The Fund acquires its additional funds through the issuance of Money Market Cumulative Preferred™ Stock (MMP®). Generally, the rate paid on the MMP® is well below the rate the Fund can earn on its total investment portfolio, and the rate the Fund pays on the MMP® is relatively low compared with other means of financing. This is particularly true because of the tax advantages to corporations and U.S. individual taxpayers of investing in MMP®. The additional cash flow generated by leverage produces additional income available for distribution to Common Stock Shareholders.

The incremental income is greatest when the "spread" between the income generated by the portfolio and the rate paid on the MMP® is wide. However, the converse is also true; as the U.S. Treasury yield curve "flattens" (short-term rates and long-term rates approach equality), the amount of additional income generated by the leverage will decrease. The Fund still benefits from additional income generated by the leverage, just not as much as when the Treasury yield curve is steeper. Of course, nothing is that simple. The

Fund's income is determined by several factors, the cost of leverage being only one.

In the case of a slightly inverted U.S. Treasury yield curve (short-term rates higher than long-term rates), the Fund should continue to benefit from the use of leverage. Preferred and debt securities generally trade at yields higher than the Treasury yields, commonly referred to as the "credit spread." So, although the Treasury curve may be inverted, the securities in the portfolio ordinarily will continue to have a higher return than the short-term rates the Fund pays for its leverage.

If the Federal Reserve maintains its current pause on short-term rates and long-term rates do not decrease materially, the Fund's leverage should continue to produce similar amounts of additional distributable income to what it does now. If the Federal Reserve resumes raising short-term rates, the Fund's leverage could produce lesser amounts of additional distributable income. Of course, if the Fed lowers short-term interest rates, the Fund should see a greater benefit from its use of leverage and consequently have more additional distributable income for its Common Stock Shareholders.

### **What are enhanced preferred securities?**

Over the past eighteen months, the preferred securities market has seen significant innovation in the form of "enhanced" preferred securities, with over \$46 billion of U.S. dollar issuance since August 2005. As discussed below, this new breed of securities offers issuers higher equity credit treatment by their rating agencies. Essentially, higher equity treatment of an issuer's preferred securities can result in a higher senior debt rating for the issuer – or help it to avoid a downgrade. These enhanced preferred securities offer this better equity credit treatment at a lower cost than issuing common shares, and without the dilution of earnings per share that would come with it. In addition, many of these securities have accomplished this feat while maintaining the tax-deductibility of interest payments. The combination of equity credit and tax deductibility makes for an attractive financing vehicle, so it's no surprise that issuance has been brisk.

The change that prompted the emergence of enhanced preferred securities was the adoption in February 2005 by Moody's Investors Service of a revised methodology for preferred and hybrid preferred securities which granted an issuer varying degrees of equity credit, ranging from 0% to 100%, depending upon the terms of the issue. Just prior to that time, Moody's generally gave no equity credit for hybrid preferred securities, no matter what features they contained, and limited equity credit for traditional perpetual preferred securities. Because other rating agencies already gave issuers some equity credit for preferred securities, Moody's action relieved a critical constraint upon the financing decisions of issuers, and thus on the preferred securities market in general.

It has taken Wall Street bankers time to obtain tax opinions, master the accounting and line up issuers, and structures have continued to evolve – each seeking the right combination of terms for the market, the rating agencies and the regulators. While structures have begun to converge into more standardized forms, there has been a good deal of experimentation, and the past year has produced a number of unique structures. We view this as good news for the Fund's shareholders and we have actively traded in these new structures. The heterogeneity of preferred securities is why we invest in them. Enhanced preferred securities, in all their various permutations, simply add to the complexity and allow managers who specialize in this market to excel.

For additional information regarding enhanced preferred securities, including a description of how Moody's analysis works, please visit the "Frequently Asked Questions" section of the Fund's website at [www.preferredincome.com](http://www.preferredincome.com).

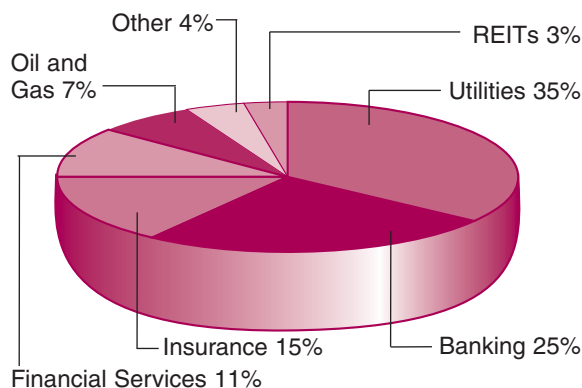
## PORTFOLIO OVERVIEW

November 30, 2006 (Unaudited)

### Fund Statistics on 11/30/06

Net Asset Value	\$	12.60
Market Price	\$	12.42
Discount		1.43%
Yield on Market Price		6.28%
Common Stock Shares Outstanding		11,695,372

### Industry Categories



Moody's Ratings	% of Portfolio
AAA	0.7%
AA	1.8%
A	17.9%
BBB	55.6%
BB	13.9%
Not Rated	8.7%

Below Investment Grade\* 17.2%

\* Below investment grade by both Moody's and S&P.

### Top 10 Holdings by Issuer

Top 10 Holdings by Issuer	% of Portfolio
Interstate Power & Light	5.0%
Goldman Sachs	4.6%
Xcel Energy	3.7%
EOG Resources	3.0%
First Republic Bank	3.0%
Cobank	2.9%
North Fork Bancorporation	2.8%
HSBC	2.7%
RenaissanceRe Holdings	2.4%
Public Storage	2.4%

	% of Portfolio**
Holdings Generating Qualified Dividend Income (QDI) for Individuals	66%
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	59%

\*\* This does not reflect year-end results or actual tax categorization of Fund distributions. These percentages can, and do, change, perhaps significantly, depending on market conditions. Investors should consult their tax advisor regarding their personal situation. See accompanying notes to the financial statements for the tax characterization of 2006 distributions.

## PORTFOLIO OF INVESTMENTS

November 30, 2006

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — 92.5%</b>		
<b>Banking — 24.7%</b>		
\$ 3,000,000	Astoria Capital Trust I, 9.75% 11/01/29 Capital Security, Series B . . . . .	\$ 3,505,908
	Auction Pass-Through Trust, Cl. B:	
9	Series 2006-5, Variable Rate Pfd., 144A**** . . . . .	272,250*
9	Series 2006-6, Variable Rate Pfd., 144A**** . . . . .	272,250*
90,000	Banco Santander, 6.80% Pfd., 144A**** . . . . .	2,310,300** <sup>(1)</sup>
\$ 1,000,000	Barclays Bank PLC, Adj. Rate Pfd. . . . .	1,004,600** <sup>(1)</sup>
\$ 1,750,000	Capital One Capital III, 7.686% Pfd. . . . .	2,037,875
19,648	Citizens Funding Trust I, 7.50% Pfd. 09/15/66 . . . . .	509,007
	Cobank, ACB:	
45,000	7.00% Pfd., 144A**** . . . . .	2,318,850*
75,000	Adj. Rate Pfd., 144A**** . . . . .	4,077,900*
\$ 500,000	Comerica (Imperial) Capital Trust I, 9.98% 12/31/26 Capital Security, Series B . . .	536,006
4,500	FBOP Corporation, Adj. Rate Pfd., 144A**** . . . . .	4,592,531*
\$ 2,250,000	First Hawaiian Capital I, 8.343% 07/01/27 Capital Security, Series B . . . . .	2,368,726 <sup>(1)</sup>
	First Republic Bank:	
200,000	6.25% Pfd. . . . .	5,143,760*
5,000	6.70% Pfd. . . . .	127,657*
640	First Republic Preferred Capital Corporation, 10.50% Pfd., 144A**** . . . . .	723,750
22,500	First Republic Preferred Capital Corporation II, 8.75% Pfd., Series B, 144A**** . . .	589,500
5,000	Fleet Capital Trust VIII, 7.20% Pfd. 03/15/32 . . . . .	127,969
\$ 4,349,000	GreenPoint Capital Trust I, 9.10% 06/01/27 Capital Security . . . . .	4,601,668
\$ 3,500,000	HBOS Capital Funding LP, 6.85% Pfd. . . . .	3,547,600 <sup>(1)</sup>
5,000	HSBC Series II, Variable Inverse Pfd., Pvt. . . . .	5,640,000*
3,250	HSBC USA, Inc., \$2.8575 Pfd. . . . .	164,970*
12,000	Keycorp Capital VIII, 7.00% Pfd. 06/15/66 . . . . .	316,126
25,000	Keycorp Capital IX, 6.75% Pfd. 12/15/66 . . . . .	630,000
\$ 1,000,000	Lloyds TSB Group PLC, Variable Rate, Capital Security, 144A**** . . . . .	1,015,657** <sup>(1)</sup>
5,000	National City Capital Trust II, 6.625% Pfd. 11/15/36 . . . . .	125,950
\$ 1,500,000	North Fork Capital Trust I, 8.70% 12/15/26 Capital Security . . . . .	1,564,756
16,000	PFGI Capital Corporation, 7.75% Pfd. . . . .	412,160
\$ 650,000	RBS Capital Trust B, 6.80% Pfd. . . . .	659,815** <sup>(1)</sup>
10	Roslyn Real Estate, 8.95% Pfd., Series C, 144A**** . . . . .	1,119,312
70,500	Sovereign Bancorp, 7.30% Pfd., Series C . . . . .	1,949,769*
20,375	Sovereign Capital Trust V, 7.75% Pfd. 05/22/36 . . . . .	545,031
6,000	USB Capital XI, 6.60% Pfd. 09/15/66 . . . . .	153,840
25,000	Wells Fargo Capital Trust IV, 7.00% Pfd. 09/01/31 . . . . .	627,345
		<u>53,592,838</u>

The accompanying notes are an integral part of the financial statements.



**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2006

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Financial Services — 10.7%</b>		
9,000	Cabco Trust For Goldman Sachs Capital I, Adj. Rate Pfd. 02/15/34, Series GS . . .	\$ 208,407
	Goldman Sachs Group, Inc.:	
75,000	Adj. Rate Pfd., Series D . . . . .	1,966,500*
25	Pass-Through Certificates, Class B, 144A**** . . . . .	2,862,500*
3,500	STRIPES Custodial Receipts, Pvt. . . . .	3,981,250*
94,505	Lehman Brothers Holdings, Inc., 5.94% Pfd., Series C . . . . .	4,774,393*
3,000	Merrill Lynch Series II STRIPES Custodial Receipts, Pvt. . . . .	3,184,500*
47,000	Morgan Stanley Capital Trust VI, 6.60% Pfd. . . . .	1,208,784
94,150	SLM Corporation, 6.97% Pfd., Series A . . . . .	5,131,175*
		<u>23,317,509</u>
<b>Insurance — 12.8%</b>		
20,000	ACE Ltd., 7.80% Pfd., Series C . . . . .	517,500**(1)
	Arch Capital Group Ltd.:	
10,000	7.875% Pfd., Series B . . . . .	261,875**(1)
4,400	8.00% Pfd. . . . .	115,060**(1)
	Axis Capital Holdings:	
73,950	7.25% Pfd., Series A . . . . .	1,938,880**(1)
17,750	Variable Rate Pfd., Series B . . . . .	1,883,985 <sup>(1)</sup>
22,300	Berkley W.R. Capital Trust II, 6.75% Pfd. 07/26/45 . . . . .	556,804
12,400	Corporate-Backed Trust Certificates, 8.125% Pfd. 12/15/45, Series BER . . . . .	129,332
64,600	Endurance Specialty Holdings, 7.75% Pfd. . . . .	1,667,326**(1)
13,750	Everest Re Capital Trust II, 6.20% Pfd., Series B . . . . .	335,156 <sup>(1)</sup>
140,000	MetLife Inc., 6.50% Pfd., Series B . . . . .	3,666,250*
\$ 1,925,000	Oil Insurance Ltd., Variable Rate Pfd., 144A**** . . . . .	2,018,002 <sup>(1)</sup>
4,900	PartnerRe Capital Trust I, 7.90% Pfd. 12/31/31 . . . . .	124,950**(1)
175,000	Principal Financial Group, 6.518% Pfd. . . . .	4,875,500*
\$ 511,000	Provident Financing Trust I, 7.405% 03/15/38 Capital Security . . . . .	534,637 <sup>(2)</sup>
\$ 4,000,000	Renaissancere Capital Trust, 8.54% 03/01/27 Capital Security, Series B . . . . .	4,171,028 <sup>(1)</sup>
	Renaissancere Holdings Ltd.:	
25,000	6.08% Pfd., Series C . . . . .	598,500**(1)
22,000	8.10% Pfd., Series A . . . . .	551,320**(1)
115,500	Scottish Re Group Ltd., 7.25% Pfd. . . . .	2,661,120**(1)
\$ 560,000	USF&G Capital, 8.312% 07/01/46 Capital Security, 144A**** . . . . .	706,944
22,850	XL Capital Ltd., 8.00% Pfd., Series A . . . . .	591,244**(1)
		<u>27,905,413</u>

The accompanying notes are an integral part of the financial statements.

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2006

<u>Shares/\$ Par</u>	<u>Value</u>
<b>Preferred Securities — (continued)</b>	
<b>Utilities — 34.2%</b>	
Alabama Power Company:	
4,980 4.60% Pfd. ....	\$ 444,017*
6,485 4.72% Pfd. ....	589,122*
868 4.92% Pfd. ....	82,772*
6,579 Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993 .....	690,179*
10,000 Calenergy Capital Trust III, 6.50% Pfd. 09/01/27 .....	483,800
1,628 Central Hudson Gas & Electric Corporation, 4.35% Pfd., Series D, Pvt. ....	136,719*
3,798 Central Maine Power Company, 4.75% Pfd. ....	335,971*
11,119 Central Vermont Public Service Corporation, 8.30% Sinking Fund Pfd., Pvt. ....	1,154,597*
Connecticut Light & Power Company:	
2,050 4.50% Pfd., Series 1956 .....	85,075*
10,000 4.50% Pfd., Series 1963, Pvt. ....	402,500*
25,000 5.28% Pfd., Series 1967 .....	1,222,500*
883 \$2.04 Pfd., Series 1949 .....	33,218*
2,900 \$2.20 Pfd., Series 1949 .....	117,682*
9,652 \$3.24 Pfd. ....	503,714*
2,000 Consolidated Edison Company of New York, 4.65% Pfd., Series C .....	176,300*
7,500 Dayton Power and Light Company, 3.90% Pfd., Series C .....	477,656*
\$ 1,500,000 Dominion Resources Capital Trust III, 8.40% 01/15/31 Capital Security .....	1,868,979
15,030 Duquesne Light Company, 3.75% Pfd. ....	499,898*
Entergy Arkansas, Inc.:	
2,840 4.56% Pfd. ....	237,452*
3,050 4.56% Pfd., Series 1965 .....	255,010*
1,435 6.08% Pfd. ....	150,531*
90,000 6.45% Pfd. ....	2,349,000*
2,441 Entergy Gulf States, Inc., 7.56% Pfd. ....	246,150*
36,000 Entergy Louisiana, Inc., 6.95% Pfd., 144A**** .....	3,699,360*
Entergy Mississippi, Inc.:	
4,616 4.36% Pfd. ....	346,062*
5,000 4.92% Pfd. ....	417,188*
4,400 Florida Power Company, 4.75% Pfd. ....	402,336*
18,500 FPC Capital I, 7.10% Pfd., Series A .....	463,656
101,000 FPL Group Capital, Inc., 6.60% Pfd. 10/01/66, Series A .....	2,610,224
8,900 Georgia Power, 6.125% Pfd. ....	231,679*
Great Plains Energy, Inc.:	
1,625 4.20% Pfd. ....	132,535*
2,000 4.35% Pfd. ....	164,500*

The accompanying notes are an integral part of the financial statements.

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2006

<u>Shares/\$ Par</u>	<u>Value</u>
<b>Preferred Securities — (continued)</b>	
<b>Utilities — (continued)</b>	
Hawaiian Electric Company, Inc.:	
2,471 5.00% Pfd., Series D .....	\$ 45,170*
7,438 5.00% Pfd., Series E .....	135,967*
1,383 5.00% Pfd., Series I .....	25,281*
\$ 3,750,000 Houston Light & Power Capital Trust II, 8.257% 02/01/37 Capital Security .....	3,919,125
30,500 Indianapolis Power & Light Company, 5.65% Pfd. ....	2,973,750*
340,000 Interstate Power & Light Company, 8.375% Pfd., Series B .....	10,801,800*
2,588 New York State Electric & Gas, \$4.50 Pfd., Series 1949 .....	230,461*
Ohio Power Company:	
3,018 4.20% Pfd. ....	250,977*
1,251 4.40% Pfd. ....	108,987*
Pacific Enterprises:	
13,680 \$4.36 Pfd. ....	1,132,294*
24,985 \$4.50 Pfd. ....	2,134,219*
15,730 \$4.75 Pfd., Series 53 .....	1,433,396*
Pacific Gas & Electric Co.:	
7,600 4.50% Pfd., Series H .....	157,168*
41,500 5.00% Pfd., Series D .....	920,470*
83,000 5.00% Pfd., Series E .....	1,907,340*
PacifiCorp:	
5,672 \$4.56 Pfd. ....	480,475*
6,708 \$4.72 Pfd. ....	588,157*
8,750 \$7.48 Sinking Fund Pfd. ....	890,859*
1,250 PECO Energy Company, \$4.30 Pfd., Series B .....	103,963*
\$ 1,500,000 PECO Energy Capital Trust III, 7.38% 04/06/28 Capital Security, Series D .....	1,666,500
12,748 Portland General Electric, 7.75% Sinking Fund Pfd. ....	1,294,432*
14,020 Public Service Electric & Gas Company, 5.28% Pfd., Series E .....	1,409,431*
70,210 San Diego Gas & Electric Company, \$1.70 Pfd. ....	1,832,046*
South Carolina Electric & Gas Company:	
13,974 5.125% Purchase Fund Pfd., Pvt. ....	717,844*
7,774 6.00% Purchase Fund Pfd., Pvt. ....	395,619*
Southern California Edison:	
5,000 4.24% Pfd. ....	103,000*
11,300 6.00% Pfd. ....	1,155,779*
Southern Union Company:	
\$ 700,000 Variable Rate Pfd. 11/01/66, Capital Security .....	708,271
60,000 7.55% Pfd. ....	1,564,200*

The accompanying notes are an integral part of the financial statements.

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2006

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Utilities — (continued)</b>		
\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37 Capital Security .....	\$ 782,028
	Union Electric Company:	
5,700	4.56% Pfd. ....	487,350*
10,156	\$7.64 Pfd. ....	1,048,302*
	Virginia Electric & Power Company:	
1,665	\$4.04 Pfd. ....	130,186*
2,470	\$4.20 Pfd. ....	200,811*
1,673	\$4.80 Pfd. ....	155,422*
2,878	\$6.98 Pfd. ....	296,974*
12,500	\$7.05 Pfd. ....	1,293,750*
11,200	Virginia Power Capital Trust, 7.375% Pfd. 07/30/42 .....	286,651
2,262	Washington Gas & Light Company, \$4.25 Pfd. ....	195,007*
12,863	Wisconsin Power & Light Company, 6.20% Pfd. ....	1,320,468*
	Xcel Energy, Inc.:	
15,000	\$4.08 Pfd., Series B .....	1,201,200*
20,040	\$4.10 Pfd., Series C .....	1,612,619*
35,510	\$4.11 Pfd., Series D .....	2,864,237*
17,750	\$4.16 Pfd., Series E .....	1,449,288*
10,000	\$4.56 Pfd., Series G .....	895,000*
		<u>74,316,656</u>
<b>Oil and Gas — 4.8%</b>		
8,000	Devon Energy Corporation, 6.49% Pfd., Series A .....	819,750*
\$ 272,000	Enterprise Products Partners, Variable Rate Pfd. ....	295,602
6,125	EOG Resources, Inc., 7.195% Pfd., Series B .....	6,601,464*
\$ 1,650,000	KN Capital Trust III, 7.63% 04/15/28 Capital Security .....	1,603,147
10,000	Lasmo America Limited, 8.15% Pfd., 144A**** .....	1,063,600*(1)
		<u>10,383,563</u>
<b>Real Estate Investment Trust (REIT) — 3.2%</b>		
	BRE Properties, Inc.:	
12,600	6.75% Pfd., Series D .....	320,119
18,900	8.08% Pfd., Series B .....	486,085
10,000	Equity Office Property Trust, 7.75% Pfd., Series G .....	251,250
1,000	Equity Residential Properties, 8.29% Pfd., Series K .....	58,020

The accompanying notes are an integral part of the financial statements.

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2006

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Real Estate Investment Trust (REIT) — (continued)</b>		
	Public Storage, Inc.:	
13,600	6.18% Pfd., Series D .....	\$ 330,226
109,075	6.45% Pfd., Series F .....	2,713,241
2,900	6.75% Pfd., Series E .....	74,494
79,900	7.25% Pfd., Series K .....	2,102,369
3,700	7.625% Pfd., Series U .....	94,466
20,000	Realty Income Corp., 6.75% Pfd., Series E .....	503,200
		<u>6,933,470</u>
<b>Miscellaneous Industries — 2.0%</b>		
13,600	E.I. Du Pont de Nemours and Company, \$4.50 Pfd., Series B .....	1,180,650*
35,000	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A****(1) .....	3,127,250*
26,000	Touch America Holdings, \$6.875 Pfd. ....	—†
		<u>4,307,900</u>
<b>U.S. Government Securities — 0.1%</b>		
5,600	Federal Home Loan Mortgage, Adj. Rate Pfd., Series B .....	232,400*
		<u>232,400</u>
<b>Total Preferred Securities</b>		
	(Cost \$187,239,789) .....	<u>200,989,749</u>
<b>Corporate Debt Securities — 6.6%</b>		
<b>Financial Services — 0.4%</b>		
36,300	Saturns-GS, 6.00% 02/15/33, Series Goldman Sachs .....	907,954
		<u>907,954</u>
<b>Insurance — 2.6%</b>		
\$ 900,000	Farmers Exchange Capital, 7.20% 07/15/48, 144A**** .....	960,390
\$ 4,417,000	Liberty Mutual Insurance, 7.697% 10/15/97, 144A**** .....	4,730,638
		<u>5,691,028</u>
<b>Utilities — 1.2%</b>		
\$ 1,000,000	Duquesne Light Holdings, 6.25% 08/15/35 .....	924,259
10,000	Entergy Louisiana LLC, 7.60% 04/01/32 .....	255,625

The accompanying notes are an integral part of the financial statements.

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2006

<u>Shares/\$ Par</u>	<u>Value</u>
<b>Corporate Debt Securities — (continued)</b>	
<b>Utilities — (continued)</b>	
Southern Union Company:	
\$ 750,000    7.60% 02/01/24, Senior Notes . . . . .	\$    815,226
\$ 500,000    8.25% 11/15/29, Senior Notes . . . . .	584,505
	<u>2,579,615</u>
<b>Oil and Gas — 2.0%</b>	
\$ 2,000,000    KN Energy, Inc., 7.45% 03/01/98 . . . . .	1,925,780
97,900    Nexen, Inc., 7.35% Subordinated Notes . . . . .	2,523,989 <sup>(1)</sup>
	<u>4,449,769</u>
<b>Miscellaneous Industries — 0.4%</b>	
\$ 750,000    Reliance Steel & Aluminum, 6.85% 11/15/36, 144A**** . . . . .	761,023
	<u>761,023</u>
<b>Total Corporate Debt Securities</b>	
(Cost \$13,635,851) . . . . .	<u>14,389,389</u>
<b>Option Contracts — 0.0%</b>	
1,400    March Put Options on March U.S. Treasury Bond Futures, Expiring 02/23/07 . . . . .	97,125†
<b>Total Option Contracts</b>	
(Cost \$347,532) . . . . .	<u>97,125</u>

The accompanying notes are an integral part of the financial statements.

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2006

<u>Shares/\$ Par</u>	<u>Value</u>
<b>Money Market Fund — 0.7%</b>	
1,588,765 BlackRock Provident Institutional, TempFund .....	\$ 1,588,765
<b>Total Money Market Fund</b> (Cost \$1,588,765) .....	<u>1,588,765</u>
<b>Securities Lending Collateral — 0.3%</b>	
551,880 Institutional Money Market Trust .....	551,880
<b>Total Securities Lending Collateral</b> (Cost \$551,880) .....	<u>551,880</u>
<b>Total Investments</b> (Cost \$203,363,817 <sup>***</sup> ) .....	100.1% 217,616,908
<b>Other Assets And Liabilities</b> (Net) .....	<u>(0.1%) (259,582)</u>
<b>Total Net Assets Available to Common and Preferred Stock</b> .....	<u>100.0%† \$ 217,357,326</u>
<b>Money Market Cumulative Preferred™ Stock (MMP®) Redemption Value</b> .....	<u>(70,000,000)</u>
<b>Total Net Assets Available To Common Stock</b> .....	<u>\$ 147,357,326</u>

\* Securities eligible for the Dividends Received Deduction and distributing Qualified Dividend Income.

\*\* Securities distributing Qualified Dividend Income only.

\*\*\* Aggregate cost of securities held.

\*\*\*\* Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration to qualified institutional buyers. These securities have been determined to be liquid under the guidelines established by the Board of Directors.

<sup>(1)</sup> Foreign Issuer.

<sup>(2)</sup> A portion of this security is on loan.

† Non-income producing.

‡ The percentage shown for each investment category is the total value of that category as a percentage of net assets available to Common and Preferred Stock.

**ABBREVIATIONS:**

**Pfd.** — Preferred Securities

**Pvt.** — Private Placement Securities

**REIT** — Real Estate Investment Trust

## STATEMENT OF ASSETS AND LIABILITIES

November 30, 2006

### ASSETS:

Investments, at value (Cost \$203,363,817) . . . . .	\$217,616,908
Receivable for Investments sold . . . . .	255,305
Dividends and interest receivable . . . . .	1,609,045
Prepaid expenses . . . . .	<u>75,055</u>
Total Assets . . . . .	219,556,313

### LIABILITIES:

Payable for securities lending collateral . . . . .	\$ 551,880
Payable for Investments purchased . . . . .	1,128,750
Dividends payable to Common Stock Shareholders . . . . .	92,671
Investment advisory fee payable . . . . .	98,817
Administration, Transfer Agent and Custodian fees payable . . . . .	29,466
Professional fees payable . . . . .	64,759
Directors' fees payable . . . . .	641
Accrued expenses and other payables . . . . .	16,182
Accumulated undeclared distributions to Money Market Cumulative Preferred™ Stock Shareholders . . . . .	<u>215,821</u>
Total Liabilities . . . . .	<u>2,198,987</u>

<b>Money Market Cumulative Preferred™ Stock (700 shares outstanding) redemption value</b> . . . . .	<u>70,000,000</u>
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<b>NET ASSETS AVAILABLE TO COMMON STOCK</b> . . . . .	<u>\$147,357,326</u>
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### NET ASSETS AVAILABLE TO COMMON STOCK consist of:

Distributions in excess of net investment income . . . . .	\$ (233,907)
Accumulated net realized loss on investments sold . . . . .	(2,053,131)
Unrealized appreciation of investments . . . . .	14,253,091
Par value of Common Stock . . . . .	116,954
Paid-in capital in excess of par value of Common Stock . . . . .	<u>135,274,319</u>
Total Net Assets Available to Common Stock . . . . .	<u>\$147,357,326</u>

### NET ASSET VALUE PER SHARE OF COMMON STOCK:

Common Stock (11,695,372 shares outstanding) . . . . .	<u>\$ 12.60</u>
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**STATEMENT OF OPERATIONS**  
**For the Year Ended November 30, 2006**

**INVESTMENT INCOME:**

Dividends† . . . . .	\$ 11,083,005
Interest . . . . .	<u>2,993,467</u>
Total Investment Income . . . . .	14,076,472

**EXPENSES:**

Investment advisory fee . . . . .	\$1,188,172
Administrator's fee . . . . .	207,632
Money Market Cumulative Preferred™ Stock broker commissions and auction agent fees . . . . .	189,930
Professional fees . . . . .	121,709
Insurance expense . . . . .	148,661
Transfer agent fees . . . . .	58,970
Directors' fees . . . . .	70,475
Custodian fees . . . . .	26,628
Compliance fees . . . . .	38,299
Other . . . . .	<u>116,197</u>
Total Expenses . . . . .	<u>2,166,673</u>

<b>NET INVESTMENT INCOME</b> . . . . .	<u>11,909,799</u>
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**REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS**

Net realized gain/(loss) on investments sold during the year . . . . .	3,470,490
Change in net unrealized appreciation/depreciation of investments held during the year . . . . .	<u>2,218,263</u>

<b>NET REALIZED AND UNREALIZED GAIN ON INVESTMENTS</b> . . . . .	<u>5,688,753</u>
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**DISTRIBUTIONS TO MONEY MARKET CUMULATIVE PREFERRED™  
 STOCK SHAREHOLDERS:**

From net investment income (including changes in accumulated undeclared distributions) . . . . .	<u>(2,877,427)</u>
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<b>NET INCREASE IN NET ASSETS TO COMMON STOCK RESULTING      FROM OPERATIONS</b> . . . . .	<u><u>\$ 14,721,125</u></u>
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† For Federal income tax purposes, a significant portion of this amount may not qualify for the inter-corporate dividends received deduction ("DRD") or as qualified dividend income ("QDI") for individuals.

**STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK<sup>(1)</sup>**

	Year Ended November 30, 2006	Year Ended November 30, 2005
<b>OPERATIONS:</b>		
Net investment income . . . . .	\$ 11,909,799	\$ 11,145,051
Net realized gain/(loss) on investments sold during the year . . . . .	3,470,490	4,238,243
Change in net unrealized appreciation/depreciation of investments held during the year. . . . .	2,218,263	(4,421,911)
Distributions to MMP <sup>®*</sup> Shareholders from net investment income, including changes in accumulated undeclared distributions	<u>(2,877,427)</u>	<u>(1,937,548)</u>
<b>Net increase in net assets resulting from operations . . . . .</b>	<b>14,721,125</b>	<b>9,023,835</b>
<b>DISTRIBUTIONS:</b>		
Dividends paid from net investment income to Common Stock Shareholders <sup>(1)</sup> . . . . .	<u>(9,312,018)</u>	<u>(10,602,545)</u>
<b>Total Distributions to Common Stock Shareholders . . . . .</b>	<b>(9,312,018)</b>	<b>(10,602,545)</b>
<b>FUND SHARE TRANSACTIONS:</b>		
Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan. . . . .	<u>231,696</u>	<u>1,150,181</u>
<b>Net increase in net assets available to Common Stock resulting from Fund share transactions . . . . .</b>	<b>231,696</b>	<b>1,150,181</b>
<b>NET INCREASE/(DECREASE) IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE YEAR</b>	<b><u>\$ 5,640,803</u></b>	<b><u>\$ (428,529)</u></b>
<b>NET ASSETS AVAILABLE TO COMMON STOCK:</b>		
Beginning of year. . . . .	\$141,716,523	\$142,145,052
Net increase/(decrease) in net assets during the year . . . . .	<u>5,640,803</u>	<u>(428,529)</u>
End of year (including distributions in excess of net investment income of (\$233,907) and (\$209,391), respectively). . . . .	<u>\$147,357,326</u>	<u>\$141,716,523</u>

\* Money Market Cumulative Preferred™ Stock.

<sup>(1)</sup> May include income earned, but not paid out, in prior fiscal year.

**FINANCIAL HIGHLIGHTS****For a Common Stock share outstanding throughout each year.**

Contained below is per share operating performance data, total investment returns, ratios to average net assets, and other supplemental data. This information has been derived from information provided in the financial statements and market price data for the Fund's shares.

	<b>Year Ended November 30,</b>				
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>PER SHARE OPERATING PERFORMANCE:</b>					
Net asset value, beginning of year	\$ 12.14	\$ 12.27	\$ 12.59	\$ 10.78	\$ 11.60
<b>INVESTMENT OPERATIONS:</b>					
Net investment income	1.02	0.96	0.98	1.02	1.07
Net realized and unrealized gain/(loss) on investments	0.49	(0.01)	(0.27)	1.85	(0.87)
<b>DISTRIBUTIONS TO MMP** SHAREHOLDERS:</b>					
From net investment income	(0.25)	(0.17)	(0.09)	(0.08)	(0.11)
Total from investment operations	1.26	0.78	0.62	2.79	0.09
<b>DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:</b>					
From net investment income	(0.80)	(0.91)	(0.94)	(0.98)	(0.91)
Total distributions to Common Stock Shareholders	(0.80)	(0.91)	(0.94)	(0.98)	(0.91)
Net asset value, end of year	<u>\$ 12.60</u>	<u>\$ 12.14</u>	<u>\$ 12.27</u>	<u>\$ 12.59</u>	<u>\$ 10.78</u>
Market value, end of year	<u>\$ 12.42</u>	<u>\$ 11.53</u>	<u>\$ 13.53</u>	<u>\$ 13.51</u>	<u>\$ 11.72</u>
Total investment return based on net asset value**	<u>11.02%</u>	<u>6.36%</u>	<u>4.68%</u>	<u>26.57%</u>	<u>0.63%</u>
Total investment return based on market value**	<u>15.22%</u>	<u>(8.40%)</u>	<u>7.57%</u>	<u>24.92%</u>	<u>12.61%</u>
<b>RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:</b>					
Total net assets, end of year (in 000's)	\$147,357	\$141,717	\$142,145	\$144,303	\$122,258
Operating expenses	1.52%	1.53%	1.52%	1.54%	1.56%
Net investment income †	6.34%	6.30%	7.11%	7.85%	8.67%
<b>SUPPLEMENTAL DATA:††</b>					
Portfolio turnover rate	68%	57%	28%	28%	29%
Total net assets available to Common and Preferred Stock, end of year (in 000's)	\$217,357	\$211,717	\$212,145	\$214,411	\$192,361
Ratio of operating expenses to total average net assets available to Common and Preferred Stock	1.02%	1.03%	1.03%	1.02%	1.00%

\* Money Market Cumulative Preferred™ Stock.

\*\* Assumes reinvestment of distributions at the price obtained by the Fund's Dividend Reinvestment and Cash Purchase Plan.

† The net investment income ratios reflect income net of operating expenses and payments to MMP\*\* Shareholders.

†† Information presented under heading Supplemental Data includes MMP\*\*.

**FINANCIAL HIGHLIGHTS (Continued)**

**Per Share of Common Stock**

	<u>Total Dividends Paid</u>	<u>Net Asset Value</u>	<u>NYSE Closing Price</u>	<u>Dividend Reinvestment Price <sup>(1)</sup></u>
December 31, 2005 .....	\$0.0705	\$12.24	\$11.09	\$11.43
January 31, 2006 .....	0.0705	12.28	12.63	12.28
February 28, 2006 .....	0.0705	12.38	12.39	12.38
March 31, 2006 .....	0.0650	12.25	11.46	11.54
April 30, 2006 .....	0.0650	12.11	11.22	11.27
May 31, 2006 .....	0.0650	12.00	11.05	11.20
June 30, 2006 .....	0.0650	11.86	11.10	11.21
July 31, 2006 .....	0.0650	11.83	11.53	11.79
August 31, 2006 .....	0.0650	12.16	11.94	12.02
September 30, 2006 .....	0.0650	12.29	11.85	12.05
October 31, 2006 .....	0.0650	12.41	11.95	12.08
November 30, 2006 .....	0.0650	12.60	12.42	12.46

<sup>(1)</sup> Whenever the net asset value per share of the Fund's Common Stock is less than or equal to the market price per share on the payment date, new shares issued will be valued at the higher of net asset value or 95% of the then current market price. Otherwise, the reinvestment shares of Common Stock will be purchased in the open market.

**FINANCIAL HIGHLIGHTS (Continued)**

The table below sets out information with respect to Money Market Cumulative Preferred™ Stock currently outstanding.

<u>Date</u>	<u>Total Shares Outstanding (1)</u>	<u>Asset Coverage Per Share (2)</u>	<u>Involuntary Liquidating Preference Per Share (3)</u>	<u>Average Market Value Per Share (1)(3)</u>
11/30/06	700	\$310,819	\$100,000	\$100,000
11/30/05	700	302,788	100,000	100,000
11/30/04	700	303,137	100,000	100,000
11/30/03	700	306,301	100,000	100,000
11/30/02	700	274,802	100,000	100,000

(1) See note 6.

(2) Calculated by subtracting the Fund's total liabilities (excluding the MMP® and accumulated undeclared distributions to MMP®) from the Fund's total assets and dividing that amount by the number of MMP® shares outstanding.

(3) Excludes accumulated undeclared dividends.

## **NOTES TO FINANCIAL STATEMENTS**

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### **1. Organization**

Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated (the “Fund”) was incorporated as a Maryland corporation on December 10, 1991, and commenced operations on February 13, 1992 as a diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the “1940 Act”). The Fund’s investment objective is to provide its common shareholders with high current income consistent with the preservation of capital.

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

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The preparation of the financial statements is in conformity with the U.S. generally accepted accounting principles (“US GAAP”) and requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates.

*Portfolio valuation:* The net asset value of the Fund’s Common Stock is determined by the Fund’s Administrator no less frequently than on the last business day of each week and month. It is determined by dividing the value of the Fund’s net assets available to Common Stock by the number of shares of Common Stock outstanding. The value of the Fund’s net assets attributable to Common Stock is deemed to equal the value of the Fund’s total assets less (i) the Fund’s liabilities and (ii) the aggregate liquidation value of the outstanding Money Market Cumulative Preferred™ Stock (“MMP®”).

The Fund’s preferred and debt securities are valued on the basis of current market quotations provided by independent pricing services or dealers approved by the Board of Directors of the Fund. Each quotation is based on the mean of the bid and asked prices of a security. In determining the value of a particular preferred or debt security, a pricing service or dealer may use information with respect to transactions in such investments, quotations, market transactions in comparable investments, various relationships observed in the market between investments, and/or calculated yield measures based on valuation technology commonly employed in the market for such investments. Common stocks that are traded on stock exchanges are valued at the last sale price or official close price on the exchange, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available mean price. Futures contracts and option contracts on futures contracts are valued on the basis of the settlement price for such contracts on the primary exchange on which they trade. Investments in over-the-counter derivative instruments, such as interest rate swaps and options thereon (“swaptions”), are valued using prices supplied by a pricing service, or if such prices are unavailable, prices provided by a single broker or dealer that is not the counterparty or, if no such prices are available, at a price at which the counterparty to the contract would repurchase the instrument or terminate the contract. Investments for which market quotations are not readily available or for which management determines that the prices are not reflective of current market conditions are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including reference to valuations of other securities which are comparable in quality, maturity and type. Investments in money market instruments and all debt and preferred securities which mature in 60 days or less are valued at amortized cost. Investments in money market funds are valued at the net asset value of such funds.

## **NOTES TO FINANCIAL STATEMENTS (Continued)**

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*Securities transactions and investment income:* Securities transactions are recorded as of the trade date. Realized gains and losses from securities sold are recorded on the identified cost basis. Dividend income is recorded on ex-dividend dates. Interest income is recorded on the accrual basis. The Fund also amortizes premiums and accretes discounts on fixed income securities.

*Options:* Purchases of options are recorded as an investment, the value of which is marked-to-market at each valuation date. When the Fund enters into a closing sale transaction, the Fund will record a gain or loss depending on the difference between the purchase and sale price. The risks associated with purchasing options and the maximum loss the Fund would incur are limited to the purchase price originally paid.

When the Fund writes an option, an amount equal to the premium received by the Fund is recorded as a liability, the value of which is marked-to-market at each valuation date. When a written option expires, the Fund realizes a gain equal to the amount of the premium originally received. When the Fund enters into a closing purchase transaction, the Fund realizes a gain (or loss if the cost of the closing purchase transaction exceeds the premium received when the option was written) without regard to any unrealized gain or loss on the underlying security, and the liability related to such option is eliminated. When a call option is exercised, the Fund realizes a gain or loss from the sale of the underlying security and the proceeds from such sale are increased by the amount of the premium originally received. When a put option is exercised, the amount of the premium originally received will reduce the cost of the security which the Fund purchased upon exercise.

The risk in writing a call option is that the Fund may forego the opportunity for profit if the market price of the underlying security increases and the option is exercised. The risk in writing a put option is that the Fund may incur a loss if the market price of the underlying security decreases and the option is exercised.

*Repurchase agreements:* The Fund may engage in repurchase agreement transactions. The Fund's investment adviser reviews and approves the eligibility of the banks and dealers with which the Fund may enter into repurchase agreement transactions. The value of the collateral underlying such transactions is at least equal at all times to the total amount of the repurchase obligations, including interest. The Fund maintains possession of the collateral through its custodian and, in the event of counterparty default, the Fund has the right to use the collateral to offset losses incurred. There is the possibility of loss to the Fund in the event the Fund is delayed or prevented from exercising its rights to dispose of the collateral securities.

*Federal income taxes:* The Fund intends to continue to qualify as a regulated investment company by complying with the requirements under subchapter M of the Internal Revenue Code of 1986, as amended, applicable to regulated investment companies and intends to distribute substantially all of its taxable net investment income to its shareholders. Therefore, no federal income tax provision is required.

*Dividends and distributions to shareholders:* The Fund expects to declare dividends on a monthly basis to shareholders of Common Stock ("Shareholders"). Distributions to Shareholders are recorded on the ex-dividend date. Any net realized short-term capital gains will be distributed to Shareholders at least annually. Any net realized long-term capital gains may be distributed to Shareholders at least annually or may be retained by the Fund as determined by the Fund's Board of Directors. Capital gains retained by the Fund are subject to tax at the capital gains corporate tax rate. Subject to the Fund

## NOTES TO FINANCIAL STATEMENTS (Continued)

qualifying as a regulated investment company, any taxes paid by the Fund on such net realized long-term capital gains may be used by the Fund's Shareholders as a credit against their own tax liabilities.

Income and capital gain distributions are determined and characterized in accordance with income tax regulations which may differ from US GAAP. These differences are primarily due to (1) differing treatments of income and gains on various investment securities held by the Fund, including timing differences, (2) the attribution of expenses against certain components of taxable investment income, and (3) federal regulations requiring proportionate allocation of income and gains to all classes of shareholders.

Distributions from net realized gains for book purposes may include short-term capital gains, which are included as ordinary income for tax purposes, and may exclude amortization of premium on certain fixed income securities, which are not reflected in ordinary income for tax purposes. The tax character of distributions paid, including changes in accumulated undeclared distributions to MMP® Shareholders, during 2006 and 2005 was as follows:

	<u>Distributions paid in fiscal year 2006</u>		<u>Distributions paid in fiscal year 2005</u>	
	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>
Common	\$9,312,018	\$0	\$10,602,545	\$0
Preferred	\$2,877,427	\$0	\$1,937,548	\$0

As of November 30, 2006, the components of distributable earnings (i.e., ordinary income and capital gain/loss) available to Common and Preferred Stock Shareholders, on a tax basis, were as follows:

<u>Capital (Loss) Carryforward</u>	<u>Undistributed Ordinary Income</u>	<u>Undistributed Long-Term Gain</u>	<u>Net Unrealized Appreciation/(Depreciation)</u>
(\$1,918,273)	\$321,816	\$0	\$14,118,233

At November 30, 2006, the composition of the Fund's \$1,918,273 accumulated realized capital losses was \$1,223,987 and \$694,286 in 2002 and 2004, respectively. These losses may be carried forward and offset against any future capital gains through 2010 and 2012, respectively.

*Reclassification of accounts:* During the year ended November 30, 2006, reclassifications were made in the Fund's capital accounts to report these balances on a tax basis, excluding temporary differences, as of November 30, 2006. Additional adjustments may be required in subsequent reporting periods. These reclassifications have no impact on the net asset value of the Fund. The calculation of net investment income per share in the financial highlights excludes these adjustments. Below are the reclassifications:

<u>Paid-in Capital</u>	<u>Undistributed Net Investment Income</u>	<u>Accumulated Net Realized Loss on Investments</u>
\$11,066	\$255,130	(\$266,196)



## **NOTES TO FINANCIAL STATEMENTS (Continued)**

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*Excise tax:* The Internal Revenue Code of 1986, as amended, imposes a 4% nondeductible excise tax on the Fund to the extent the Fund does not distribute by the end of any calendar year at least (1) 98% of the sum of its net investment income for that year and its capital gains (both long-term and short-term) for its fiscal year and (2) certain undistributed amounts from previous years. The Fund is subject to a payment of an estimated \$31,000 of Federal excise taxes attributable to calendar year 2006. The Fund paid \$16,000 of Federal excise taxes attributable to calendar year 2005 in March 2006.

*Additional Accounting Standards:* In June 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation 48 (“FIN 48”), “Accounting for Uncertainty in Income Taxes.” This standard defines the threshold for recognizing the benefits of tax-return positions in the financial statements as “more-likely-than-not” to be sustained by the taxing authority and requires measurement of a tax position meeting the more-likely-than-not criterion, based on the largest benefit that is more than 50 percent likely to be realized. FIN 48 is effective as of the beginning of the first fiscal year beginning after December 15, 2006, with early application permitted if no interim financial statements have been issued. At adoption, companies must adjust their financial statements to reflect only those tax positions that are more likely- than-not to be sustained as of the adoption date.

In addition, in September 2006, Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (“SFAS 157”) was issued and is effective for fiscal years beginning after November 15, 2007. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

Management is currently evaluating the impact the adoption of FIN48 and SFAS 157 will have on the Fund’s financial statements.

### **3. Investment Advisory Fee, Administration Fee, Transfer Agent Fee, Custodian Fee, Directors’ Fees and Chief Compliance Officer Fee**

Flaherty & Crumrine Incorporated (the “Adviser”) serves as the Fund’s investment adviser. The Fund pays the Adviser a monthly fee at an annual rate of 0.625% of the value of the Fund’s average monthly total net assets available to Common and Preferred Stock up to \$100 million and 0.50% of the value of the Fund’s average monthly total net assets available to Common and Preferred Stock in excess of \$100 million.

For purposes of calculating the fees payable to the Adviser, Administrator and Custodian, the Fund’s average weekly total managed assets means the total assets of the Fund minus the sum of accrued liabilities. For purposes of determining total managed assets, the liquidation preference of any preferred shares issued by the Fund is not treated as a liability.

PFPC Inc., a member of the PNC Financial Services Group, Inc. (“PNC Financial Services”), serves as the Fund’s Administrator. As Administrator, PFPC Inc. calculates the net asset value of the Fund’s shares attributable to Common Stock and generally assists in all aspects of the Fund’s administration and operation. As compensation for PFPC Inc.’s services as Administrator, the Fund pays PFPC Inc. a monthly fee at an annual rate of 0.10% of the first \$200 million of the Fund’s average weekly total managed assets, 0.04% of the next \$300 million of the Fund’s average weekly total managed assets, 0.03% of the next \$500 million of the Fund’s average weekly total managed assets and 0.02% on the Fund’s average weekly total managed assets above \$1 billion.

## **NOTES TO FINANCIAL STATEMENTS (Continued)**

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PFPC Inc. also serves as the Fund's Common Stock dividend-paying agent and registrar (Transfer Agent). As compensation for PFPC Inc.'s services, the Fund pays PFPC Inc. a fee at an annual rate of 0.02% of the first \$150 million of the Fund's average weekly net assets attributable to Common Stock, 0.0075% of the next \$350 million of the Fund's average weekly net assets attributable to Common Stock, and 0.0025% of the Fund's average weekly net assets attributable to Common Stock above \$500 million, plus certain out of pocket expenses. For the purpose of calculating such fee, the Fund's average weekly net assets attributable to Common Stock are deemed to be the average weekly value of the Fund's total assets minus the sum of the Fund's liabilities. For this calculation, the Fund's liabilities are deemed to include the aggregate liquidation preference of any outstanding Fund preferred shares.

PFPC Trust Company ("PFPC Trust") serves as the Fund's custodian. PFPC Trust is an indirect subsidiary of PNC Financial Services. As compensation for PFPC Trust's services as custodian, the Fund pays PFPC Trust a monthly fee at the annual rate of 0.010% of the first \$200 million of the Fund's average weekly total managed assets, 0.008% of the next \$300 million of the Fund's average weekly total managed assets, 0.006% of the next \$500 million of the Fund's average weekly total managed assets and 0.005% of the Fund's average weekly total managed assets above \$1 billion.

The Fund currently pays each Director who is not a director, officer or employee of the Adviser a fee of \$9,000 per annum, plus \$500 for each in-person meeting of the Board of Directors or any committee and \$150 for each telephone meeting. The Audit Committee Chairman receives an additional annual fee of \$2,500. The Fund also reimburses all Directors for travel and out-of-pocket expenses incurred in connection with such meetings.

The Fund currently pays the Adviser a fee of \$37,500 per annum for Chief Compliance Officer services and reimburses out-of-pocket expenses incurred in connection with providing services in this role.

#### **4. Purchases and Sales of Securities**

For the year ended November 30, 2006, the cost of purchases and proceeds from sales of securities excluding short-term investments, aggregated \$145,678,496 and \$142,073,165, respectively.

At November 30, 2006, the aggregate cost of securities for federal income tax purposes was \$203,498,675, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$17,844,594 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$3,726,361.

**NOTES TO FINANCIAL STATEMENTS (Continued)****5. Common Stock**

At May 31, 2006, 240,000,000 shares of \$0.01 par value Common Stock were authorized.

Common Stock transactions were as follows:

	<u>Year Ended 11/30/06</u>		<u>Year Ended 11/30/05</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
Shares issued under the Dividend Reinvestment and Cash Purchase Plan .....	<u>18,787</u>	<u>\$ 231,696</u>	<u>90,012</u>	<u>\$ 1,150,181</u>

**6. Money Market Cumulative Preferred™ Stock (MMP®)**

The Fund's Articles of Incorporation authorize the issuance of up to 10,000,000 shares of \$0.01 par value preferred stock. The MMP® is senior to the Common Stock and results in the financial leveraging of the Common Stock. Such leveraging tends to magnify both the risks and opportunities to Common Stock Shareholders. Dividends on shares of MMP® are cumulative.

The Fund is required to meet certain asset coverage tests with respect to the MMP®. If the Fund fails to meet these requirements and does not correct such failure, the Fund may be required to redeem, in part or in full, MMP® at a redemption price of \$100,000 per share plus an amount equal to the accumulated and unpaid dividends on such shares in order to meet these requirements. Additionally, failure to meet the foregoing asset requirements could restrict the Fund's ability to pay dividends to Common Stock Shareholders and could lead to sales of portfolio securities at inopportune times.

If the Fund allocates any net gains or income ineligible for the Dividends Received Deduction to shares of the MMP®, the Fund is required to make additional distributions to MMP® Shareholders or to pay a higher dividend rate in amounts needed to provide a return, net of tax, equal to the return had such originally paid distributions been eligible for the Dividends Received Deduction.

An auction of the MMP® is generally held every 49 days. Existing MMP® Shareholders may submit an order to hold, bid or sell such shares at par value on each auction date. MMP® Shareholders may also trade shares in the secondary market, if any, between auction dates.

At November 30, 2006, 700 shares of MMP® were outstanding at the annualized rate of 3.94%. The dividend rate, as set by the auction process, is generally expected to vary with short-term interest rates. These rates may vary in a manner unrelated to the income received on the Fund's assets, which could have either a beneficial or detrimental impact on net investment income and gains available to Common Stock Shareholders. While the Fund expects to structure its portfolio holdings and hedging transactions to lessen such risks to Common Stock Shareholders, there can be no assurance that such results will be attained.

**7. Portfolio Investments, Concentration and Investment Quality**

The Fund invests primarily in a diversified portfolio of preferred securities. This includes traditional preferred stocks eligible for the inter-corporate dividends received deduction ("DRD") and fully taxable (hybrid) preferred securities. Under normal market conditions, at least 80% of the value of the Fund's net

## **NOTES TO FINANCIAL STATEMENTS (Continued)**

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assets will be invested in preferred securities. Also, under normal market conditions, the Fund invests at least 25% of its assets in securities issued by companies in the utility industry and a significant percentage, but no more than 25% of its assets, in securities issued by companies in the banking industry. The Fund's portfolio may therefore be subject to greater risk and market fluctuation than a portfolio of securities representing a broader range of investment alternatives.

The Fund may invest up to 25% of its assets at the time of purchase in securities rated below investment grade. These securities must be rated at least either "Ba3" by Moody's Investors Service, Inc. or "BB-" by Standard & Poor's or, if unrated, judged to be comparable in quality by the Adviser, in any case, at the time of purchase. However, these securities must be issued by an issuer having a class of senior debt rated investment grade outstanding.

The Fund may invest up to 15% of its assets in common stocks and, under normal market conditions, up to 20% of its assets in debt securities. Certain of its investments in hybrid, i.e., fully taxable, preferred securities will be subject to the foregoing 20% limitation to the extent that, in the opinion of the Adviser, such investments are deemed to be debt-like in key characteristics. Typically, a security will not be considered debt-like (a) if an issuer can defer payment of income for eighteen months or more without triggering an event of default and (b) if such issue is a junior and fully subordinated liability of an issuer or its ultimate guarantor.

In addition to foreign money market securities, the Fund may invest up to 30% of its total assets in the securities of companies organized or having their principal place of business outside the United States. All foreign securities held by the Fund will be denominated in U.S. dollars.

### **8. Special Investment Techniques**

The Fund may employ certain investment techniques in accordance with its fundamental investment policies. These may include the use of when-issued and delayed delivery transactions. Securities purchased or sold on a when-issued or delayed delivery basis may be settled within 45 days after the date of the transaction. Such transactions may expose the Fund to credit and market valuation risk greater than that associated with regular trade settlement procedures. The Fund may also enter into transactions, in accordance with its investment policies, involving any or all of the following: short sales of securities, futures contracts, interest rate swaps, swap futures, options on futures contracts, options on securities, swaptions and certain credit derivative transactions, including, but not limited to, the purchase and sale of credit protection. As in the case of when-issued securities, the use of over-the-counter derivatives, such as interest rate swaps, swaptions, and credit default swaps may expose the Fund to greater credit, operations, liquidity, and valuation risk than is the case with regulated, exchange traded futures and options. These transactions are used for hedging or other appropriate risk-management purposes, or, under certain other circumstances, to increase return. No assurance can be given that such transactions will achieve their desired purposes or will result in an overall reduction of risk to the Fund.

**NOTES TO FINANCIAL STATEMENTS (Continued)**

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**9. Securities Lending**

The Fund may lend up to 15% of its total assets (including the value of the loan collateral) to certain qualified brokers in order to earn additional income. The Fund receives compensation in the form of fees or interest earned on the investment of any cash collateral received. The Fund also continues to receive interest and dividends on the securities loaned. The Fund receives collateral in the form of cash or securities with a market value at least equal to the market value of the securities on loan, including accrued interest. In the event of default or bankruptcy by the borrower, the Fund could experience delays and costs in recovering the loaned securities or in gaining access to the collateral. The Fund has the right under the lending agreement to recover the securities from the borrower on demand. As of November 30, 2006, the market value of securities loaned by the Fund was \$534,637. The loans were secured with collateral of \$551,880. Income from securities lending for fiscal year 2006 was \$563.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders  
Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated

We have audited the accompanying statement of assets and liabilities of the Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated, including the portfolio of investments, as of November 30, 2006, and the related statement of operations for the year then ended, the statements of changes in net assets for each of the years in the two-year period then ended, and the financial highlights for each of the years in the five-year period then ended. These financial statements and financial highlights are the responsibility of management. Our responsibility is to express an opinion on these financial statements and financial highlights 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 and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of November 30, 2006 by correspondence with the custodian and brokers, or by other appropriate auditing procedures. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of the Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated, as of November 30, 2006, and the results of its operations for the year then ended, the changes in its net assets for each of the years in the two-year period then ended, and the financial highlights for each of the years in the five-year period then ended, in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

Boston, Massachusetts  
January 17, 2007

**SUPPLEMENTARY TAX INFORMATION (Unaudited)**

Distributions to Common Stock and MMP® Shareholders are characterized as follows for purposes of Federal income taxes:

**Fiscal Year 2006**

	<u>Individual Shareholder</u>		<u>Corporate Shareholder</u>	
	<u>QDI</u>	<u>Ordinary Income</u>	<u>DRD</u>	<u>Ordinary Income</u>
	MMP® and Common Stock	78.93%	21.07%	72.84%

**Calendar Year 2006**

	<u>Individual Shareholder</u>		<u>Corporate Shareholder</u>	
	<u>QDI</u>	<u>Ordinary Income</u>	<u>DRD</u>	<u>Ordinary Income</u>
	MMP®	78.09%	21.91%	71.56%
Common Stock	78.22%	21.78%	71.76%	28.24%

Qualified Dividend Income (“QDI”) distributions are taxable at a maximum 15% personal tax rate.

## **ADDITIONAL INFORMATION (Unaudited)**

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### **Dividend Reinvestment and Cash Purchase Plan**

Under the Fund's Dividend Reinvestment and Cash Purchase Plan (the "Plan"), a shareholder whose Common Stock is registered in their own name will have all distributions reinvested automatically by PFPC Inc. as agent under the Plan, unless the shareholder elects to receive cash. Distributions with respect to shares registered in the name of a broker-dealer or other nominee (that is, in "street name") may be reinvested by the broker or nominee in additional shares under the Plan, but only if the service is provided by the broker or nominee, unless the shareholder elects to receive distributions in cash. A shareholder who holds Common Stock registered in the name of a broker or other nominee may not be able to transfer the Common Stock to another broker or nominee and continue to participate in the Plan. Investors who own Common Stock registered in street name should consult their broker or nominee for details regarding reinvestment.

The number of shares of Common Stock distributed to participants in the Plan in lieu of a cash dividend is determined in the following manner. Whenever the market price per share of the Fund's Common Stock is equal to or exceeds the net asset value per share on the valuation date, participants in the Plan will be issued new shares valued at the higher of net asset value or 95% of the then current market value. Otherwise, PFPC Inc. will buy shares of the Fund's Common Stock in the open market, on the New York Stock Exchange or elsewhere, on or shortly after the payment date of the dividend or distribution and continuing until the ex-dividend date of the Fund's next distribution to holders of the Common Stock or until it has expended for such purchases all of the cash that would otherwise be payable to the participants. The number of purchased shares that will then be credited to the participants' accounts will be based on the average per share purchase price of the shares so purchased, including brokerage commissions. If PFPC Inc. commences purchases in the open market and the then current market price of the shares (plus any estimated brokerage commissions) subsequently exceeds their net asset value most recently determined before the completion of the purchases, PFPC Inc. will attempt to terminate purchases in the open market and cause the Fund to issue the remaining dividend or distribution in shares. In this case, the number of shares received by the participant will be based on the weighted average of prices paid for shares purchased in the open market and the price at which the Fund issues the remaining shares. These remaining shares will be issued by the Fund at the higher of net asset value or 95% of the then current market value.

Plan participants are not subject to any charge for reinvesting dividends or capital gains distributions. Each Plan participant will, however, bear a proportionate share of brokerage commissions incurred with respect to PFPC Inc.'s open market purchases in connection with the reinvestment of dividends or capital gains distributions. For the year ended November 30, 2006, \$2,519 in brokerage commissions were incurred.

The automatic reinvestment of dividends and capital gains distributions will not relieve Plan participants of any income tax that may be payable on the dividends or capital gains distributions. A participant in the Plan will be treated for Federal income tax purposes as having received, on the dividend payment date, a dividend or distribution in an amount equal to the cash that the participant could have received instead of shares.



## **ADDITIONAL INFORMATION (Unaudited) (Continued)**

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In addition to acquiring shares of Common Stock through the reinvestment of cash dividends and distributions, a shareholder may invest any further amounts from \$100 to \$3,000 semi-annually at the then current market price in shares purchased through the Plan. Such semi-annual investments are subject to any brokerage commission charges incurred by PFPC Inc. under the Plan.

A shareholder whose Common Stock is registered in his or her own name may terminate participation in the Plan at any time by notifying PFPC Inc. in writing, by completing the form on the back of the Plan account statement and forwarding it to PFPC Inc., or by calling PFPC Inc. directly. A termination will be effective immediately if notice is received by PFPC Inc. not less than 10 days before any dividend or distribution record date. Otherwise, the termination will be effective, and only with respect to any subsequent dividends or distributions, on the first day after the dividend or distribution has been credited to the participant's account in additional shares of the Fund. Upon termination and according to a participant's instructions, PFPC Inc. will either (a) issue certificates for the whole shares credited to the shareholder's Plan account and a check representing any fractional shares or (b) sell the shares in the market. Shareholders who hold Common Stock registered in the name of a broker or other nominee should consult their broker or nominee to terminate participation.

The Plan is described in more detail in the Fund's Plan brochure. Information concerning the Plan may be obtained from PFPC Inc. at 1-800-331-1710.

### **Proxy Voting Policies and Proxy Voting Record on Form N-PX**

The Fund files Form N-PX with its complete proxy voting record for the 12 months ended June 30<sup>th</sup> no later than August 31<sup>st</sup> of each year. The Fund filed its latest Form N-PX with the Securities and Exchange Commission ("SEC") on August 16, 2006. This filing, as well as the Fund's proxy voting policies and procedures, are available (i) without charge, upon request, by calling the Fund's transfer agent at 1-800-331-1710 and (ii) on the SEC's website at [www.sec.gov](http://www.sec.gov). In addition, the Fund's proxy voting policies and procedures are available on the Fund's website at [www.preferredincome.com](http://www.preferredincome.com).

### **Portfolio Schedule on Form N-Q**

The Fund files a complete schedule of portfolio holdings with the SEC for the first and third fiscal quarters on Form N-Q, the latest of which was filed for the quarter ended August 31, 2006. The Fund's Form N-Q is available on the SEC's website at [www.sec.gov](http://www.sec.gov) or may be viewed and obtained from the SEC's Public Reference Room in Washington D.C. Information on the operation of the Public Reference Section may be obtained by calling 1-800-SEC-0330.

## **ADDITIONAL INFORMATION (Unaudited) (Continued)**

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### **Portfolio Management Team**

In managing the day-to-day operations of the Fund, the Adviser relies on the expertise of its team of money management professionals, consisting of Messrs. Crumrine, Ettinger, Stone and Chadwick. The professional backgrounds of each member of the management team are included in the “Information about Fund Directors and Officers” section of this report.

### **Certifications**

Included in the Annual Written Affirmation submitted to the New York Stock Exchange, Donald F. Crumrine, as the Fund’s Chief Executive Officer, has certified that, as of May 22, 2006, he was not aware of any violation by the Fund of applicable NYSE corporate governance listing standards. The Fund’s reports to the SEC on Forms N-CSR and N-Q contain certifications by the Fund’s principal executive officer and principal financial officer that relate to the Fund’s disclosure in such reports and that are required by Rule 30a-2(a) under the 1940 Act.

**ADDITIONAL INFORMATION (Unaudited) (Continued)****Information about Fund Directors and Officers**

The business and affairs of the Fund are managed under the direction of the Fund's Board of Directors. Information pertaining to the Directors and officers of the Fund is set forth below.

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
<b>NON-INTERESTED DIRECTORS:</b>					
<b>David Gale</b> Delta Dividend Group, Inc. 220 Montgomery Street Suite 426 San Francisco, CA 94104 Age: 57	Director	Class I Director since January 1997	President & CEO of Delta Dividend Group, Inc. (investments).	4	Metromedia International Group, Inc. (telecommunications). Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.
<b>Morgan Gust</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 59	Director	Class III Director since February 1992	President of Giant Industries, Inc. (petroleum refining and marketing) since March 2002, and for more than five years prior thereto, Executive Vice President, and various other Vice President positions at Giant Industries, Inc.	4	CoBiz, Inc. (financial services); Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.

\* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

**Class I Director** – three year term expires at the Fund's 2009 Annual Meeting of Shareholders; director may continue in office until his successor is duly elected and qualified.

**Class II Directors** – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class III Directors** – three year term expires at the Fund's 2008 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**ADDITIONAL INFORMATION (Unaudited) (Continued)**

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
<b>NON-INTERESTED DIRECTORS:</b>					
<b>Karen H. Hogan†</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 45	Director	Class III Director since April 2005	Retired; Community Volunteer; from September 1985 to January 1997, Senior Vice President of Preferred Stock Origination at Lehman Brothers and previously, Vice President of New Product Development.	4	Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.
<b>Robert F. Wulf</b> P.O. Box 753 Neskowin, Oregon 97149 Age: 69	Director	Class II Director since February 1992	Financial Consultant; Trustee, University of Oregon Foundation; Trustee, San Francisco Theological Seminary.	4	Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.

\* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

**Class I Director** – three year term expires at the Fund's 2009 Annual Meeting of Shareholders; director may continue in office until his successor is duly elected and qualified.

**Class II Directors** – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class III Directors** – three year term expires at the Fund's 2008 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† As a Director, represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.

**ADDITIONAL INFORMATION (Unaudited) (Continued)**

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
<b>INTERESTED DIRECTOR:</b>					
<b>Donald F. Crumrine</b> †, †† 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 59	Director, Chairman of the Board and Chief Executive Officer	Class II Director since February 1992	Chairman of the Board and Director of Flaherty & Crumrine Incorporated.	4	Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.

\* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

**Class I Director** – three year term expires at the Fund's 2009 Annual Meeting of Shareholders; director may continue in office until his successor is duly elected and qualified.

**Class II Directors** – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class III Directors** – three year term expires at the Fund's 2008 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† As a Director, represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.

†† "Interested person" of the Fund as defined in the Investment Company Act of 1940. Mr. Crumrine is considered an "interested person" because of his affiliation with Flaherty & Crumrine Incorporated which acts as the Fund's investment adviser.

**ADDITIONAL INFORMATION (Unaudited) (Continued)**

<b>Name, Address, and Age</b>	<b>Position(s) Held with Fund</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupation(s) During Past Five Years</b>
<b>OFFICERS:</b>			
<b>Robert M. Ettinger</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 48	President	Since October 2002	President and Director of Flaherty & Crumrine Incorporated.
<b>R. Eric Chadwick</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 31	Chief Financial Officer, Vice President and Treasurer	Since October 2002	Director of Flaherty & Crumrine Incorporated since June 2006; Vice President of Flaherty & Crumrine Incorporated since August 2001; and previously (since January 1999) portfolio manager of Flaherty & Crumrine Incorporated.
<b>Chad C. Conwell</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 34	Chief Compliance Officer, Vice President and Secretary	Since July 2005	Chief Compliance Officer of Flaherty & Crumrine Incorporated since September 2005, and since July 2005, Vice President of Flaherty & Crumrine Incorporated; from September 1998 through June 2005, Attorney with Paul, Hastings, Janofsky & Walker LLP.
<b>Bradford S. Stone</b> 392 Springfield Avenue Mezzanine Suite Summit, NJ 07901 Age: 47	Vice President and Assistant Treasurer	Since July 2003	Director of Flaherty & Crumrine Incorporated since June 2006; Vice President of Flaherty & Crumrine Incorporated since May 2003; from June 2001 to April 2003, Director of U.S. Market Strategy at Barclays Capital.
<b>Christopher D. Ryan</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 39	Vice President	Since April 2005	Vice President of Flaherty & Crumrine Incorporated since February 2004; October 2002 to February 2004, Product Analyst of Flaherty & Crumrine Incorporated. From 1999 to 2002, graduate student.
<b>Laurie C. Lodolo</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 43	Assistant Compliance Officer, Assistant Treasurer and Assistant Secretary	Since July 2004	Assistant Compliance Officer of Flaherty & Crumrine Incorporated since August 2004; since February 2004, Secretary of Flaherty & Crumrine Incorporated; since January 1987, Account Administrator of Flaherty & Crumrine Incorporated.



## Directors

Donald F. Crumrine, CFA  
Chairman of the Board  
David Gale  
Morgan Gust  
Karen H. Hogan  
Robert F. Wulf, CFA

## Officers

Donald F. Crumrine, CFA  
Chief Executive Officer  
Robert M. Ettinger, CFA  
President  
R. Eric Chadwick, CFA  
Chief Financial Officer,  
Vice President and Treasurer  
Chad C. Conwell  
Chief Compliance Officer,  
Vice President and Secretary  
Bradford S. Stone  
Vice President and  
Assistant Treasurer  
Christopher D. Ryan, CFA  
Vice President  
Laurie C. Lodolo  
Assistant Compliance Officer,  
Assistant Treasurer and  
Assistant Secretary

## Investment Adviser

Flaherty & Crumrine Incorporated  
e-mail: flaherty@pfdincome.com

## Questions concerning your shares of Flaherty & Crumrine Preferred Income Opportunity Fund?

- If your shares are held in a Brokerage Account, contact your Broker.
- If you have physical possession of your shares in certificate form, contact the Fund's Transfer Agent & Shareholder Servicing Agent —  
PFPC Inc.  
P.O. Box 43027  
Providence, RI 02940-3027  
1-800-331-1710

**This report is sent to shareholders of Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated for their information. It is not a Prospectus, circular or representation intended for use in the purchase or sale of shares of the Fund or of any securities mentioned in this report.**



**Flaherty & Crumrine**  
**PREFERRED INCOME**  
**OPPORTUNITY FUND**

# Annual Report

November 30, 2006

[www.preferredincome.com](http://www.preferredincome.com)