

## Management's Responsibility Statement

The financial statements of Flaherty & Crumrine Investment Grade Fixed Income Fund (the "Fund") have been prepared by Brompton FFI Management Limited (the "Manager" of the Fund) and approved by the Board of Directors of the Manager. The Manager is responsible for the information and representations contained in these financial statements and the other sections of the annual report.

The Manager maintains appropriate procedures to ensure that relevant and reliable financial information is produced. Statements have been prepared in accordance with accounting principles generally accepted in Canada and include certain amounts that are based on estimates and judgements. The significant accounting policies applicable to the Fund are described in Note 2 to the financial statements.

The Board of Directors of the Manager is responsible for ensuring that management fulfills its responsibilities for financial reporting and has reviewed and approved these financial statements. The Board carries out this responsibility through the Audit Committee, which is comprised of independent directors of the Board.

The Manager, with the approval of its Board of Directors, has appointed the external firm of PricewaterhouseCoopers LLP as the auditors of the Fund. They have audited the financial statements of the Fund in accordance with Canadian generally accepted auditing standards to enable them to express to unitholders their opinion on the financial statements. The auditors have full and unrestricted access to the Audit Committee to discuss their findings.

(Signed)

**Raymond R. Pether**  
*Chief Executive Officer*  
*Brompton FFI Management Limited*  
 February 10, 2006

(Signed)

**Craig T. Kikuchi**  
*Chief Financial Officer*  
*Brompton FFI Management Limited*

## Auditors' Report to Unitholders

### To the Unitholders of Flaherty & Crumrine Investment Grade Fixed Income Fund:

We have audited the statement of investments of Flaherty & Crumrine Investment Grade Fixed Income Fund (the "Fund") as at December 31, 2005 and the statement of net assets as at December 31, 2005 and 2004 and the statements of operations and deficit, changes in net assets and cash flows for the year ended December 31, 2005 and for the period from December 15, 2004 (commencement of operations) to December 31, 2004. These financial statements are the responsibility of the Fund's Manager. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the investments of the Fund as at December 31, 2005, the net assets as at December 31, 2005 and 2004 and the results of its operations and deficit, the changes in its net assets and its cash flows for the year ended December 31, 2005 and for the period from December 15, 2004 (commencement of operations) to December 31, 2004 in accordance with Canadian generally accepted accounting principles.

(Signed)

**PricewaterhouseCoopers LLP**  
*Chartered Accountants*  
 Toronto, Ontario  
 February 10, 2006

## Statements of Net Assets

As at December 31	2005	2004
<b>Assets</b>		
Investments, at market value <sup>(1)</sup>	\$ 398,873,529	\$ 507,546,616
Unrealized gain on forward contracts (note 7)	16,806,574	8,192,087
Option contracts purchased, at market value (note 8)	3,693,837	4,068,094
Cash and short-term investments	1,592,870	25,957
Dividends and interest receivable	4,824,023	9,524,609
Other receivable (note 10)	1,638,841	—
Deferred financing costs (note 9)	4,755	33,365
<b>Total assets</b>	<b>427,434,429</b>	<b>529,390,728</b>
<b>Liabilities</b>		
Option contracts written, at market value (note 8)	5,160,877	—
Accounts payable and accrued liabilities	825,486	1,222,277
Distributions payable to unitholders (note 4)	1,626,317	—
Redemption payable to unitholders	394,182	—
Loans payable (note 8)	151,007,535	182,442,309
<b>Total liabilities</b>	<b>159,014,397</b>	<b>183,664,586</b>
<b>Unitholders' equity</b>		
Unitholders' capital (note 3)	283,742,681	351,573,451
Contributed surplus	4,134,692	—
Deficit	(19,457,341)	(5,847,309)
<b>Net assets representing unitholders' equity</b>	<b>\$ 268,420,032</b>	<b>\$ 345,726,142</b>
<b>Units outstanding (note 3)</b>	<b>12,011,203</b>	<b>14,882,310</b>
<b>Net asset value per unit</b>	<b>\$ 22.35</b>	<b>\$ 23.23</b>

<sup>(1)</sup> Investments, at market value, exclude the value of derivative contracts which are disclosed separately on the Statements of Net Assets.

Approved on behalf of Flaherty & Crumrine Investment Grade Fixed Income Fund, by the Board of Directors of Brompton FFI Management Limited, its Manager.

(Signed)

**Peter A. Braaten**  
Director

(Signed)

**James W. Davie**  
Director

*The accompanying notes are an integral part of these financial statements.*

## Statements of Operations and Deficit

For the year/period ended December 31	2005	2004 <sup>(1)</sup>
<b>Income</b>		
Interest income	\$ 27,263,397	\$ 993,055
Dividends	3,969,144	—
	<u>31,232,541</u>	<u>993,055</u>
<b>Expenses</b>		
Advisor fees (note 5)	2,404,241	108,670
Management fees (note 5)	1,273,852	57,192
Service fees (note 5)	981,565	47,437
Audit fees	25,128	24,075
Director fees	45,000	5,000
Trustee fees	21,878	835
Custodial fees	74,851	5,302
Legal fees	1,251	4,000
Unitholder reporting cost	77,351	128,293
Other administrative expenses	201,585	17,527
Interest and bank charges (note 9)	6,778,885	243,746
	<u>11,885,587</u>	<u>642,077</u>
Net investment income	19,346,954	350,978
Net realized gain (loss) on investments and foreign currency transactions (notes 6 & 9)	2,553,266	(1,626,319)
Net realized loss on forward contracts and options (notes 6 & 7)	(4,111,165)	—
Net change in unrealized loss on investments and foreign currency transactions (note 9)	(10,863,960)	(13,865,192)
Net change in unrealized gain on forward contracts and options (notes 7 & 8)	2,864,680	9,293,224
Increase (decrease) in net assets from operations	\$ 9,789,775	\$ (5,847,309)
Deficit, beginning of year/period	\$ (5,847,309)	\$ —
Distributions to unitholders (note 4)	(23,399,807)	—
<b>Deficit, end of year/period</b>	<b>\$ (19,457,341)</b>	<b>\$ (5,847,309)</b>
Increase (decrease) in net assets from operations per unit <sup>(2)</sup>	\$ 0.67	\$ (0.40)

<sup>(1)</sup> Period from December 15, 2004 (commencement of operations) to December 31, 2004.

<sup>(2)</sup> Based on the weighted average number of units outstanding for the period (note 3).

*The accompanying notes are an integral part of these financial statements.*

## Statements of Cash Flows

For the year/period ended December 31	2005	2004 <sup>(1)</sup>
<b>Cash flows from operating activities:</b>		
Increase (decrease) in net assets from operations	\$ 9,789,775	\$ (5,847,309)
Adjustments to reconcile net cash provided by (used in) operations:		
Net realized loss on sale of investments, options and foreign currency transactions	6,561,760	632,163
Net change in unrealized loss on investments and foreign currency transactions	10,864,371	12,763,892
Net change in unrealized gain on forward contracts and options	(2,864,680)	(8,192,087)
Amortization of deferred financing costs (note 9)	36,395	1,635
Decrease (increase) in dividends and interest receivable	4,700,586	(9,524,609)
Increase (decrease) in other receivable	(1,638,841)	—
Decrease (increase) in accounts payable and accrued liabilities	(396,791)	1,222,277
Purchase of investments and options (note 6)	(663,217,731)	(593,219,810)
Proceeds from sale of investments and options (note 6)	749,292,803	63,965,193
<b>Cash provided by (used in) operating activities</b>	<b>113,127,647</b>	<b>(538,198,655)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of units (note 3)	1,717,908	372,053,451
Agents' fees and issuance costs	4,453	(20,480,000)
Increase (decrease) in loans payable	(26,477,563)	186,686,161
Deferred financing costs paid	(7,785)	(35,000)
Distributions paid to unitholders	(21,773,490)	—
Proceeds from distribution reinvestment plan (note 4)	30,089	—
Repurchase of units (note 3)	(6,893,293)	—
Amounts paid for redemption of units (note 3)	(58,161,053)	—
<b>Cash provided by (used in) financing activities</b>	<b>(111,560,734)</b>	<b>538,224,612</b>
Net increase in cash and short-term investments	1,566,913	25,957
Cash and short-term investments, beginning of year/period	25,957	—
<b>Cash and short-term investments, end of year/period</b>	<b>\$ 1,592,870</b>	<b>\$ 25,957</b>
<b>Supplemental information:</b>		
Interest paid	\$ 6,617,307	\$ —

<sup>(1)</sup> Period from December 15, 2004 (commencement of operations) to December 31, 2004.

## Statements of Changes in Net Assets

For the year/period ended December 31	2005	2004 <sup>(1)</sup>
<b>Net assets, beginning of year/period</b>	<b>\$ 345,726,142</b>	<b>\$ —</b>
<b>Operations:</b>		
Increase (decrease) in net assets from operations	9,789,775	(5,847,309)
<b>Unitholder transactions:</b>		
Distributions to unitholders (note 4)		
Net investment income	(3,104,807)	—
Capital gains	(11,820,129)	—
Return of capital	(8,474,871)	—
Total	(23,399,807)	—
Proceeds from issuance of units (note 3)	1,717,908	372,053,451
Agents' fees and issuance costs	4,453	(20,480,000)
Proceeds from distribution reinvestment plan (note 4)	30,089	—
Repurchase of units (note 3)	(7,287,475)	—
Redemption of units (note 3)	(58,161,053)	—
Total unitholder transactions	(87,095,885)	351,573,451
Net increase (decrease) in net assets	(77,306,110)	345,726,142
<b>Net assets, end of year/period</b>	<b>\$ 268,420,032</b>	<b>\$ 345,726,142</b>
<b>Distributions per unit</b>	<b>\$ 1.6248</b>	<b>\$ —</b>

<sup>(1)</sup> Period from December 15, 2004 (commencement of operations) to December 31, 2004.

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

## Statement of Investments

As at December 31, 2005	Cost (USD)	Cost (CDN)	Market Value (USD)	Market Value (CDN)	% of Portfolio
<b>Shares/ Par Value \$US</b>					
<b>Preferred Securities</b>					
<b>Banking</b>					
70,400	BAC Capital Trust I, 7% Pfd.	\$ 1,810,556	\$ 2,225,360	\$ 1,785,344	\$ 2,085,560
50,400	BAC Capital Trust VIII, 6% Pfd.	1,257,984	1,534,801	1,213,128	1,417,123
52,600	Bank One Capital Trust VI, 7.2% Pfd.	1,347,090	1,611,145	1,343,404	1,569,305
\$ 9,000,000	Barclays Bank PLC, 6.278% December 15, 2034	8,785,000	10,625,144	9,140,202	10,677,182
\$ 1,264,000	Barnett Capital Trust I, 8.06% December 1, 2026 Capital Security	1,367,016	1,657,773	1,346,083	1,572,435
\$ 2,000,000	Chase Capital I, 7.67% December 1, 2026	2,145,000	2,605,305	2,120,379	2,476,933
163,000	Citigroup Capital VIII, 6.95% Pfd.	4,179,665	5,145,292	4,110,860	4,802,126
\$ 4,000,000	First Chicago NBD Capital Trust I, 7.75% December 1, 2026	4,290,000	5,210,611	4,239,220	4,952,070
\$ 5,000,000	First Empire Capital Trust II, 8.277% June 1, 2027 Capital Security	5,471,800	6,765,080	5,403,747	6,312,419
\$ 850,000	First Midwest Capital Trust I, 6.95% December 1, 2033 Capital Security	932,161	1,152,994	931,432	1,088,058
\$ 2,200,000	First of America Capital Trust I, 8.12% January 31, 2027	2,383,700	2,895,229	2,354,878	2,750,865
38,898	First Republic Preferred Capital Corp., 7.25% Pfd., Series D	990,953	1,228,323	972,450	1,135,973
\$ 6,840,000	Fleet Capital Trust II, 7.92% December 11, 2026	7,452,043	9,195,853	7,274,332	8,497,556
14,000	Fleet Capital Trust VII, 7.2% Pfd.	357,420	423,238	353,080	412,435
24,800	Fleet Capital Trust VIII, 7.2% Pfd.	636,616	759,169	630,416	736,424
\$ 1,500,000	Great Western Finance Trust II, 8.206% February 1, 2027 Capital Security, Series A	1,618,200	1,968,541	1,607,533	1,877,850
\$ 5,000,000	GreenPoint Capital Trust I, 9.1% June 1, 2027 Capital Security	5,712,500	7,032,673	5,481,201	6,402,898
\$ 2,000,000	Haven Capital Trust I, 10.46% February 1, 2027 Capital Security	2,300,000	2,845,232	2,214,085	2,586,397
\$ 5,600,000	HBOS Capital Funding, 6.85% March 23, 2049	5,803,000	7,101,685	5,782,313	6,754,643
20,000	Household Capital Trust VII, 7.5% Pfd.	536,400	661,544	510,800	596,694
\$ 1,000,000	J.P. Morgan Capital Trust I, 7.54% January 15, 2027 Capital Security	1,074,870	1,316,291	1,059,903	1,238,133
\$ 1,349,000	J.P. Morgan Capital Trust II, 7.95% February 1, 2027 Capital Security	1,459,711	1,784,105	1,439,207	1,681,218
50,000	J.P. Morgan Capital Trust X, 7% Pfd.	1,295,000	1,605,544	1,271,500	1,485,310
132,000	J.P. Morgan Capital Trust XVI, 6.35% Pfd.	3,300,000	4,169,720	3,302,640	3,857,999
\$ 725,000	Mellon Capital II, 7.995% January 15, 2027 Capital Security	795,687	977,695	773,705	903,808
10,900	Regions Financial Trust I, 8%, Pfd.	280,457	336,772	274,135	320,232
225,000	Royal Bank of Scotland PLC, 6.35% Pfd.	5,625,000	7,029,317	5,654,250	6,605,046
\$ 4,830,000	Wachovia Capital Trust V, 7.965% June 1, 2027 Capital Security	5,250,210	6,356,417	5,195,662	6,069,345
\$ 6,000,000	Webster Capital Trust I, 9.36% January 29, 2027 Capital Security	6,696,000	8,351,210	6,525,159	7,622,404
		<b>85,154,039</b>	<b>104,572,063</b>	<b>84,311,048</b>	<b>98,488,459</b>
					<b>24.7%</b>
<b>Financial Services</b>					
52,100	Cabco – Goldman, 6% Series GS	1,276,450	1,565,697	1,199,863	1,401,627
300,000	Lehman Capital Trust VI, 6.24% Pfd.	7,493,000	9,227,462	7,392,000	8,635,010
17,500	Merrill Lynch Capital Trust V, 7.28% Series F	466,375	559,276	457,100	533,964
38,600	Morgan Stanley Capital Trust V, 5.75% Pfd.	875,416	1,038,678	877,764	1,025,365
		<b>10,111,241</b>	<b>12,391,113</b>	<b>9,926,727</b>	<b>11,595,966</b>
					<b>2.9%</b>
<b>Insurance</b>					
\$ 6,000,000	ACE Capital Trust II, 9.7% April 1, 2030	7,971,645	9,808,683	8,371,559	9,779,287
160,000	ACE Ltd., 7.8% Pfd., Series C	4,203,200	5,048,464	4,176,000	4,878,220
385,000	Aegon NV, 6.375% Pfd.	9,650,650	12,058,397	9,725,100	11,360,435
40,000	Aegon NV, 6.5% Pfd.	994,000	1,161,541	995,200	1,162,549
\$ 2,000,000	AON Capital Trust A, 8.205% January 1, 2027 Capital Security	2,124,560	2,605,991	2,379,392	2,779,501
66,500	Axis Capital Holdings Limited, 7.5% Pfd.	6,881,243	8,038,291	6,923,249	8,087,435
63,500	Everest Capital Trust II, 6.2% Pfd., Series B	1,492,362	1,837,945	1,406,525	1,643,041
\$ 875,000	MMI Capital Trust I, 7.625% December 15, 2027 Capital Security, Series B	964,915	1,196,586	966,051	1,128,498
142,200	PartnerRe Ltd., 6.5% Pfd., Series D	3,505,450	4,249,615	3,331,746	3,891,999
125,000	PartnerRe Ltd., 6.75% Pfd., Series C	3,202,500	3,994,138	3,021,250	3,529,291
195,000	Prudential PLC, 6.5% Pfd.	4,875,000	5,875,156	4,943,250	5,774,487
130,000	Renaissance Holding, 6.08% Pfd., Series C	2,782,500	3,337,186	2,626,000	3,067,578
\$ 2,500,000	USF&G Capital III, 8.312% July 1, 2046 Capital Security	3,006,750	3,613,231	3,086,284	3,605,262
147,000	W.R. Berkley Capital Trust II, 6.75% Pfd.	3,650,950	4,411,371	3,675,000	4,292,974
32,800	XL Capital Ltd., 7.625% Pfd., Series B	885,528	1,086,965	836,400	977,046
\$ 4,020,000	ZFS Finance (USA) Trust II, 6.45% December 15, 2065	4,006,613	4,633,852	4,075,515	4,760,838
		<b>60,197,866</b>	<b>72,957,412</b>	<b>60,538,521</b>	<b>70,718,441</b>
					<b>17.7%</b>
<b>Oil and Gas</b>					
\$ 12,275,000	KN Capital Trust III, 7.63% April 15, 2028 Capital Security	13,983,157	17,159,507	13,605,034	15,892,803
					<b>4.0%</b>
<b>Utilities</b>					
\$ 7,500,000	Commonwealth Edison Co., 6.35% March 15, 2033	7,707,750	9,404,627	7,185,433	8,393,707
\$ 868,000	Dominion Resources Capital Trust I, 7.83% December 1, 2027	946,415	1,151,735	939,663	1,097,673
\$ 2,000,000	Dominion Resources Capital Trust III, 8.4% January 15, 2031	2,370,220	2,835,259	2,412,202	2,817,829
80,000	DTE Energy Trust II, 7.5% Pfd.	2,096,000	2,595,151	2,100,000	2,453,128
42,000	Georgia Power Capital Trust V, 7.125% Pfd.	1,079,400	1,275,359	1,059,660	1,237,848
\$ 10,140,000	PECO Energy Capital Trust IV, 5.75% June 15, 2033 Capital Security	9,910,532	12,116,601	9,752,475	11,392,413
13,580	Virginia Power Capital Trust, 7.375% July 30, 2042	362,586	445,525	347,920	406,424
		<b>24,472,903</b>	<b>29,824,257</b>	<b>23,797,353</b>	<b>27,799,022</b>
					<b>7.0%</b>
	<b>Total Preferred Securities</b>	<b>\$ 193,919,206</b>	<b>\$ 236,904,352</b>	<b>\$ 192,178,683</b>	<b>\$ 224,494,691</b>
					<b>56.3%</b>

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

## Statement of Investments (continued)

As at December 31, 2005		Cost (USD)	Cost	Market Value	Market Value (USD)	% of Portfolio
<b>Corporate Debt Securities</b>						
<b>Banking</b>						
\$ 4,300,000	Bank One Corporation, 7.75% July 15, 2025	\$ 5,428,363	\$ 6,670,062	\$ 5,320,559	\$ 6,215,243	1.6%
<b>Financial Services</b>						
82,450	Corporate Backed Trust Certificates, 6.3% Series GS	2,081,862	2,553,618	2,036,515	2,378,967	
2,300	CorTS Trust For General Electric Capital Corporation Notes, 6% March 15, 2032	59,110	72,741	56,925	66,497	
\$ 6,510,000	General Motors Acceptance Corporation, 8% November 1, 2031, Senior Bonds	6,276,341	7,556,914	6,448,187	7,532,489	
7,600	PreferredPLUS Trust Series GEC-1, 6.05% March 15, 2032	195,700	240,829	188,860	220,618	
		<b>8,613,013</b>	<b>10,424,102</b>	<b>8,730,487</b>	<b>10,198,571</b>	<b>2.6%</b>
<b>Insurance</b>						
\$ 9,000,000	Assurant Inc., 6.75% February 15, 2034 Senior Notes	9,763,020	12,019,279	9,895,497	11,559,485	
\$ 3,069,000	Liberty Mutual Insurance Co., 7.697% October 15, 2097	3,085,972	3,639,289	3,274,736	3,825,403	
\$ 857,000	Liberty Mutual Group Inc., 6.5% March 15, 2035	840,297	1,012,016	843,500	985,339	
\$ 2,600,000	OneAmerica Financial Partners, 7% October 15, 2033	2,830,672	3,472,110	2,860,169	3,341,124	
		<b>16,519,961</b>	<b>20,142,694</b>	<b>16,873,902</b>	<b>19,711,351</b>	<b>4.9%</b>
<b>Oil and Gas</b>						
\$ 4,000,000	Kinder Morgan Energy Partners L.P., 5.8% March 15, 2035, Senior Notes	3,828,800	4,859,500	3,841,303	4,487,241	1.1%
<b>Real Estate Investment Trust</b>						
\$ 9,000,000	EOP Operating L.P., 7.5% April 19, 2029, Senior Unsecured Notes	10,553,925	12,955,007	10,264,748	11,990,828	
\$ 4,000,000	EOP Operating L.P., 7.875% July 15, 2031, Senior Unsecured Notes	4,886,400	6,029,838	4,737,839	5,534,536	
\$ 5,000,000	Realty Income Corp., 5.875% March 15, 2035, Senior Unsecured Notes	4,843,200	5,832,651	4,741,675	5,539,017	
		<b>20,283,525</b>	<b>24,817,496</b>	<b>19,744,262</b>	<b>23,064,381</b>	<b>5.8%</b>
<b>Utilities</b>						
\$ 14,310,000	Constellation Energy Group, 7.6% April 1, 2032, Senior Notes	17,201,499	20,951,381	17,333,205	20,247,889	
\$ 10,000,000	Duquesne Light Holdings, Inc., 6.25% August 15, 2035, Senior Notes	9,889,880	11,829,362	9,837,994	11,492,313	
\$ 5,500,000	Progress Energy Inc., 7% October 30, 2031, Senior Notes	6,120,480	7,526,628	6,091,489	7,115,810	
\$ 9,843,000	Southern Union Company, 8.25% November 15, 2029	12,476,495	15,525,752	12,278,133	14,342,775	
\$ 10,000,000	TXU Corp., 6.5% November 15, 2024, Senior Notes	9,693,000	11,987,095	9,553,596	11,160,092	
\$ 5,000,000	UGI Utilities Inc., 6.133% October 15, 2034	5,318,000	6,544,345	5,082,024	5,936,597	
\$ 3,000,000	Westar Energy Inc., 5.875% July 15, 2036	2,998,170	3,688,648	2,912,429	3,402,171	
\$ 10,000,000	Westar Energy Inc., 5.95% January 1, 2035	9,907,900	11,851,839	9,815,157	11,465,636	
\$ 549,000	Wisconsin Electric Power Company, 6.875% December 1, 2095	643,527	798,460	627,422	732,927	
		<b>74,248,951</b>	<b>90,703,510</b>	<b>73,531,449</b>	<b>85,896,210</b>	<b>21.5%</b>
<b>Miscellaneous Industries</b>						
\$ 8,000,000	Disney Enterprises Inc., 7.55% July 15, 2093, Senior Notes	9,402,320	11,629,770	8,864,481	10,355,097	
30,900	Maytag Corp., 7.875% Pfd.	693,031	858,996	774,663	904,927	
12,624	PreferredPLUS Trust Series SPR-1, 7% November 15, 2028	325,510	386,348	308,278	360,117	
\$ 1,100,000	Pulte Homes Inc., 7.875% June 15, 2032	1,223,871	1,448,265	1,227,825	1,434,291	
\$ 10,700,000	Pulte Homes Inc., 6.375% May 15, 2033	10,303,837	12,437,769	10,059,794	11,751,409	
		<b>21,948,569</b>	<b>26,761,148</b>	<b>21,235,041</b>	<b>24,805,841</b>	<b>6.2%</b>
	<b>Total Corporate Debt Securities</b>	<b>\$ 150,871,182</b>	<b>\$ 184,378,512</b>	<b>\$ 149,277,003</b>	<b>\$ 174,378,838</b>	<b>43.7%</b>
	<b>Total</b>	<b>\$ 344,790,388</b>	<b>\$ 421,282,864</b>	<b>\$ 341,455,686</b>	<b>\$ 398,873,529</b>	<b>100.0%</b>

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

## Notes to the Financial Statements

December 31, 2005 and 2004

### 1. OPERATIONS

Flaherty & Crumrine Investment Grade Fixed Income Fund (the “Fund”) is a closed-end investment trust created under the laws of the Province of Alberta on November 25, 2004 pursuant to an amended and restated declaration of trust. Computershare Trust Company of Canada is the Trustee and Brompton FFI Management Limited is the Manager and is responsible for managing the affairs of the Fund. Flaherty & Crumrine Incorporated is the Portfolio Manager. RBC Dexia Investor Services Trust is the custodian of the Fund’s assets and prepares the weekly valuations of the Fund. The Fund commenced operations on December 15, 2004.

### 2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles and they include estimates and assumptions made by management that affect the reported amounts of assets and liabilities at the date of these financial statements and the reported amounts of income and expenses during the period for which the financial statements report. Actual results could differ from these estimates.

#### a) Valuation of Investments

The Fund’s investments are presented at estimated market value. Investments that are publicly traded are valued at their closing price. If a closing price is not available, these investments are valued using an average of the latest bid and ask prices. Short-term investments are valued at cost which, when taken together with accrued interest income thereon, is an approximation of their market value. Listed options are valued at market values as reported on recognized exchanges. The value of any security which is traded over-the-counter will be priced at the average of the last bid and ask prices quoted by a major dealer in such securities.

#### b) Investment Transactions and Income Recognition

Investment transactions are recorded on trade date and any realized gains or losses are recognized using the average cost of the investments. Interest income is recognized on an accrual basis. Dividend income is recognized on the ex-dividend date. Net realized gains (losses) on investments and options include net realized gains or losses from foreign currency changes.

Option premiums paid or received by the Fund are, so long as the options are outstanding, reflected as an asset or liability, respectively, in the Statement of Net Assets and are valued at an amount equal to the current market value of an option that would have the effect of closing the position.

#### c) Foreign Currency Forward Contracts

The Fund may enter into foreign currency forward contracts, which are agreements between two parties to buy and sell currencies at a set price on a future date. The market value of the contract will fluctuate with changes in currency exchange rates. The contract is marked-to-market and the change in market value is recorded as an unrealized gain or loss. When the contract is closed, the Fund records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed.

#### d) Income Taxes

The Fund qualifies as a mutual fund trust under the Income Tax Act (Canada). Provided the Fund makes distributions in each year of its net income and net realized capital gains, the Fund will not generally be liable for income tax. It is the intention of the Fund to distribute all of its net income and net realized capital gains on an annual basis. Accordingly, no income tax provision has been recorded.

#### e) Foreign Exchange

The market value of investments and other assets and liabilities that are denominated in foreign currencies are translated into Canadian dollars at the noon rate of exchange on each valuation date. Purchases and sales of investments and income derived from investments are translated at the rate of exchange prevailing at the time of such transactions.

#### f) Fair Value of Financial Instruments

The fair values of the Fund’s financial instruments, which are composed of cash and short-term investments, dividends and interest receivable, accounts payable and accrued liabilities and loans payable, approximate their book value.

#### g) Comparative Figures

Certain comparative figures have been reclassified in accordance with National Instrument 81-106 and to conform to the current period’s presentation of unitholders’ capital and retained earnings.

### 3. UNITS OF THE FUND

#### Authorized

The Fund is authorized to issue an unlimited number of transferable, redeemable units of beneficial interest, each of which represents an equal, undivided interest in the net assets of the Fund. Each unit entitles the holder to one vote and to participate equally with respect to any and all distributions made by the Fund.

Units may be redeemed at the option of unitholders by tendering units of the Fund, between twenty and forty-five business days prior to the second last business day in November (“Redemption Valuation Date”). Redemption of tendered units will be settled based on the net asset value per unit on the Redemption Valuation Date less associated costs of the redemption, including brokerage costs. Units tendered for redemption will be redeemed effective the Redemption Valuation Date and will be settled on or before the tenth business day in December.

Units may also be tendered for redemption at the option of unitholders at least ten business days prior to the second last business day of each month, except for the month of November. Unitholders whose units are redeemed will receive a redemption price per unit equal to the lesser of (i) 96% of the weighted average trading price of the units for the ten trading days preceding the redemption date, and (ii) 100% of the closing market price of the units, less associated costs of the redemption, including brokerage costs.

#### Issued

	2005		2004 <sup>(1)</sup>	
	Number of Units	Amount	Number of Units	Amount
Units, beginning of year	14,882,310	\$ 351,573,451	—	\$ —
Initial public offering, net	—	4,453	14,400,000	340,150,000
Exercise of over-allotment option, net	—	—	480,000	11,370,000
Units redeemed	(2,612,986)	(61,728,387)	—	—
Units repurchased pursuant to a normal course issuer bid	(332,500)	(7,854,833)	—	—
Units issued under the distribution reinvestment plan (note 4)	1,268	30,089	—	—
Issued for services (note 5)	73,111	1,717,908	2,310	53,451
<b>Units, end of year</b>	<b>12,011,203</b>	<b>\$ 283,742,681</b>	<b>14,882,310</b>	<b>\$ 351,573,451</b>

<sup>(1)</sup> Period from December 15, 2004 (commencement of operations) to December 31, 2004.

On December 15, 2004, the Fund completed its initial public offering of 14,400,000 units at a price of \$25.00 for proceeds, net of agents’ fees and issuance costs, of \$340,150,000.

On December 30, 2004, the Fund completed the issuance of an additional 480,000 units at a price of \$25.00 for proceeds, net of agents’ fees, of \$11,370,000. The issuance of these additional units was pursuant to the exercise of the over-allotment option granted to the agents in connection with the initial public offering.

For the year ended December 31, 2005, the Fund issued 73,111 (2004 – 2,310) units in respect of its management and advisor fees.

On November 29, 2005, 2,593,513 units were redeemed at \$22.2736. Pursuant to the monthly redemption option, 19,473 units were redeemed at an average price of \$20.2425 per unit.

The Fund received approval from the Toronto Stock Exchange for a normal course issuer bid program for the period from December 22, 2004 to December 21, 2005. Pursuant to the issuer bid, the Fund could purchase up to 1,436,000 units for cancellation. The Fund renewed the issuer bid for the period from December 22, 2005 to December 21, 2006, which allows the Fund to purchase up to 1,205,400 units for cancellation. The Fund may only repurchase units when the net asset value per unit exceeds its trading price. For the year ended December 31, 2005, 332,500 units (2004 – nil) were purchased.

As at December 31, 2005, since inception the Fund has accumulated contributed surplus of \$4,134,692 (2004 – nil). Contributed surplus is recorded when units of the Fund are redeemed or repurchased at prices per unit which are below the average cost per unit of unitholders’ capital.

The weighted average number of units for the year ended December 31, 2005 was 14,613,877 (2004 – 14,456,606).

### 4. DISTRIBUTIONS TO UNITHOLDERS

Distributions, as declared by the Manager, are made on a monthly basis to unitholders of record on the last business day of each month. The distributions are payable by the tenth business day of the following month. For the year ended December 31, 2005, the Fund declared total distributions of \$1.6248 (2004 – nil) per unit, which amounted to \$23,399,807 (2004 – nil). Under the Fund’s distribution reinvestment plan, unitholders may elect to reinvest monthly distributions in additional units of the Fund which may be issued from treasury or purchased on the open market. For the year ended December 31, 2005, 1,268 units (2004 – nil) were issued by the Fund pursuant to the reinvestment plan.

## Notes to the Financial Statements (continued)

### 5. MANAGEMENT, ADVISOR AND SERVICE FEES

Pursuant to a management agreement, the Manager provides management and administrative services to the Fund, for which it is paid a management fee equal to 0.35% per annum of the net asset value of the Fund, plus applicable taxes. The management fee may be paid in cash or units at the option of the Manager. To the extent that units are issued from treasury for this purpose, they will be issued at the net asset value per unit. During 2005, the entire management fee was paid in units. Flaherty & Crumrine Incorporated, the portfolio manager for the Fund, and Brompton Capital Advisors Inc. are entitled to receive an aggregate fee equal to 0.70% per annum of the net asset value, plus applicable taxes. Both fees are calculated and payable monthly. During 2005, 21,769 units were issued for the payment of advisor fees. The Fund also pays to the Manager a service fee equal to 0.30% per annum of the net asset value of the Fund. The service fee is in turn paid by the Manager to the investment dealers in proportion to the number of units held by clients of each dealer at the end of each calendar quarter.

### 6. INVESTMENT TRANSACTIONS

Investment transactions for the years ended December 31 were as follows:

	2005	2004
Proceeds from sale of investments and options	\$ 749,292,803	\$ 63,965,193
Less cost of investments and options sold:		
Investments and options at cost, beginning of year	528,622,454	—
Investments and options purchased during the year	663,217,731	593,219,810
Investments and options at cost, end of year	(424,592,441)	(528,622,454)
Cost of investments and options sold during the year	767,247,744	64,597,356
Net realized loss on sale of investments and options	\$ (17,954,941)	\$ (632,163)

Brokerage commissions on investments purchased and sold during the period ended December 31, 2005 amounted to \$420,549 (2004 – 21,724). For the years ended December 31, 2005 and 2004, there were no soft dollar amounts paid.

### 7. FOREIGN CURRENCY FORWARD CONTRACTS

The Fund uses foreign currency forward contracts to hedge foreign exchange risks associated with its US dollar investment portfolio. During 2005, the Fund realized gains in the amount of \$5,852,572 (2004 – nil) on the close out of certain contracts. At December 31, 2005 and 2004, the Fund had entered into the following foreign currency forward contracts with a Canadian chartered bank:

At December 31, 2005

Canadian Dollars Purchased	US Dollars Sold	Delivery Date	Forward Rate (USD/CAD)	Unrealized Gain (Loss)
\$ 27,782,930	\$ 23,800,000	January 12, 2006	\$ 0.86	\$ (8,797)
237,115,554	190,075,000	January 15, 2015	0.80	16,815,371
\$ 264,898,484	\$ 213,875,000			\$ 16,806,574

At December 31, 2004

Canadian Dollars Purchased	US Dollars Sold	Delivery Date	Forward Rate (USD/CAD)	Unrealized Gain
\$ 70,446,262	\$ 57,250,000	January 18, 2005	\$ 0.81	\$ 1,843,944
2,030,595	1,650,000	February 18, 2005	0.81	53,140
72,483,815	58,900,000	March 18, 2005	0.81	1,893,427
2,030,222	1,650,000	April 18, 2005	0.81	53,026
215,514,960	171,750,000	January 15, 2015	0.80	4,348,550
\$ 362,505,854	\$ 291,200,000			\$ 8,192,087

## 8. OPTION CONTRACTS

The Fund uses put options on US Treasury bond futures to hedge rapid increases in long-term interest rates. The Fund may also write or purchase options to generate additional income for the Fund. At December 31, 2005 and 2004, the Fund had the following option contracts outstanding:

At December 31, 2005

### Option Contracts Purchased

Underlying Interest	No. of Contracts	Option Type	Expiration Date	Strike Price per Contract	Current Price per Contract (USD)	Premium Paid	Market Value
30-year T-bond futures	825	Put	February 2006	\$ 116	\$ 2,062.50	\$ 2,677,824	\$ 1,987,691
30-year T-bond futures	2,150	Put	March 2006	110	218.75	3,537,288	549,398
30-year T-bond futures	1,625	Call	March 2006	116	609.375	1,151,082	1,156,748
						\$ 7,366,194	\$ 3,693,837

### Option Contracts Written

Underlying Interest	No. of Contracts	Option Type	Expiration Date	Strike Price per Contract	Current Price per Contract (USD)	Premium Received	Market Value
30-year T-bond futures	(1,625)	Call	March 2006	\$ 112	\$ 2,718.75	\$ (4,056,617)	\$ (5,160,877)

At December 31, 2004

### Option Contracts Purchased

Underlying Interest	No. of Contracts	Option Type	Expiration Date	Strike Price per Contract	Current Price per Contract (USD)	Premium Paid	Market Value
30-year T-bond futures	2,100	Put	March 2005	\$ 110	\$ 1,281.25	\$ 1,236,909	\$ 1,611,886
30-year T-bond futures	1,600	Put	March 2005	112	640.63	1,857,995	2,456,208
						\$ 3,094,904	\$ 4,068,094

## 9. LOANS PAYABLE

Pursuant to an agreement with a Canadian chartered bank, the Fund maintains a 364-day renewable revolving credit facility. The revolving credit facility provides for maximum borrowings of Cdn\$13.9 million for working capital purposes under one tranche and US\$153.8 million under the second tranche for investment purposes. Both tranches can be availed at either the prime rate of interest, the bankers' acceptance rate plus a fixed percentage, at the LIBOR rate plus a fixed percentage or by US base rate borrowings. At December 31, 2005, the Fund had a US dollar loan equivalent to \$151 million (US\$129.3 million) outstanding under this facility. For the year ended December 31, 2005, the Fund realized a foreign exchange gain in the amount of \$11,405,907 (2004 – nil) on the repayment of borrowings in US dollars and borrowings, in US dollars had an unrealized foreign exchange loss of \$2,192,118 (2004 – gain of \$4,243,852). The credit facility is secured by a first-ranking and exclusive charge on all of the Fund's assets. During the year ended December 31, 2005, the minimum and maximum amounts of borrowings were US\$152.3 million (2004 – US\$152.3 million) and US\$154.8 million (2004 – US\$152.3), respectively.

Costs incurred to establish the credit facility are deferred and amortized over its term. For the year ended December 31, 2005, the Fund recorded amortization of these costs in the amount of \$36,395 (2004 – \$1,635).

The credit facility is used by the Fund for the purchase of additional investments and for general Fund purposes.

## 10. SUBSEQUENT EVENT

On January 13, 2005, the Fund announced that its net asset value per unit was not reported accurately as the foreign currency forward contracts were not being valued in accordance with the Fund's valuation procedures.

As a result of the incorrect valuations, the redemption price paid to investors who redeemed their units in 2005 was \$1.64 million more than if the correct net asset value had been used. The Manager will ensure that the Fund is reimbursed for the overpayment and, accordingly, a receivable has been recorded. In addition, estimated excess management fees, advisor fees and service fees paid by the Fund as a result of incorrect net asset values have been netted against accrued liabilities.