Flaherty & Crumrine

INVESTMENT GRADE FIXED INCOME FUND

VALUE INTEGRITY PERFORMANCE

2005 ANNUAL REPORT

Management Report of Fund Performance

February 10, 2006

This annual management report of fund performance for Flaherty & Crumrine Investment Grade Fixed Income Fund (the "Fund") contains financial highlights but does not contain the complete audited annual financial statements. The complete audited annual financial statements are appended to this report.

Unitholders may obtain a copy of the Fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure, at no cost by calling 866-642-6001, or by sending a request to Suite 2930, P.O. Box 793, Bay Wellington Tower, BCE Place, 181 Bay Street, Toronto, Ontario, M5J 2T3.

Investment Objectives and Strategies

Flaherty & Crumrine Investment Grade Fixed Income Fund is a closed-end investment trust that is listed on the Toronto Stock Exchange under the symbol FFI.UN and is managed by Brompton FFI Management Limited (the "Manager"). Flaherty & Crumrine Incorporated, which is headquartered in Pasadena, California, manages the Fund's portfolio. The Fund's investment objectives are to provide unitholders with a stable stream of monthly distributions, to mitigate the impact of significant interest rate increases on the value of the portfolio through the use of the safety net hedge and to preserve the net asset value per unit.

The units of the Fund are currently rated P-2f by Standard & Poor's. The Fund invests in a portfolio of fixed income securities consisting primarily of US dollar denominated corporate debt and hybrid preferred securities of North American issuers. All securities purchased by the Fund are rated investment grade at the time of investment. Substantially all of the US dollar foreign exchange exposure of the Fund's portfolio is hedged to the Canadian dollar at all times. Also, under normal market conditions, 100% of the portfolio will be hedged using the safety net hedge strategy, which is intended to mitigate the impact of significant increases in long-term interest rates on the net asset value of the portfolio, while permitting the net asset value to appreciate when long-term interest rates decline. The Fund is RRSP, DPSP, RRIF and RESP eligible.

Risks

There are risks associated with an investment in units of the Fund. The prospectus that was issued in connection with the initial public offering of the Fund's units, as well as the Fund's annual information form, contains a discussion of these risks. These documents are available on the Fund's website at www.bromptongroup.com or on SEDAR at www.sedar.com. Below is a discussion of some of the more significant risks affecting the Fund in 2005.

Decline in the Net Asset Value of the Fund

The net asset value and the funds available for distribution will vary according to, among other things, the value of the securities held in the portfolio, which depend, in part, upon the performance of the issuers of such securities, the performance of the preferred and debt securities markets, generally, and the level of interest rates and any net foreign currency exposure. Fluctuations in the market values of the securities held in the portfolio may occur for a number of reasons beyond the control of the portfolio manager. It is possible that, due to declines in the market values of such securities in the portfolio, the Fund may not be able to achieve its monthly distribution objective or its objective to preserve the net asset value per unit.

The Fund is widely diversified which mitigates the exposure to the performance of any one issuer. The Fund also employs interest rate and foreign currency hedging strategies to reduce the risk of a change in these factors on the net asset value of the Fund. The net asset value of the Fund in 2005 was also affected by the cost of the safety net hedge and by the fact that it paid out more in distributions than it received in distributable income.

Interest Rate Exposure and Leverage

The Fund has borrowed amounts to invest in additional portfolio investments to increase the overall distributions of the Fund. If short-term interest rates increase relative to long-term interest rates during a period when leverage is utilized, increased interest costs may reduce income or cash available to be distributed. In 2005, short-term US interest rates rose as the US Federal Reserve Bank increased its overnight rate from 2.25% in January to 4.25% by the end of the year. The Fund borrows at short-term rates and, as a result, its income has been negatively affected by the rise in short-term rates without a similar rise in long-term rates.

Interest rate risk also includes the risk that debt obligations and preferred securities will decline in value because of increases in long-term interest rates. Net asset value may fluctuate with interest rate changes and the corresponding changes in the value of the securities in the investment portfolio. The Fund uses a "safety net hedge" to mitigate the impact of significant rapid increases in long-term interest rates on the investment portfolio.

Leverage can also impact the net asset value of the Fund as it will enhance the net asset value during a period when the Fund's investments have appreciated and will exacerbate the decline of net asset value during a falling market. The greater the amount of leverage, the greater the impact on net asset value of a rise or decline in market prices of the Fund's investments.

Foreign Currency Exposure

The net asset value is measured in Canadian dollars and payments to unitholders are made in Canadian dollars. However, the investments in the portfolio are securities denominated in US dollars. Accordingly, the net asset value may be affected by fluctuations in the value of the Canadian dollar relative to the US dollar. The Fund hedges this exposure using a combination of foreign currency forward contracts and borrowings in US dollars. During 2005, the Fund's foreign currency hedging generated realized and unrealized net gains of $19.4 million, which offset the foreign currency reduction in the value of the Fund's portfolio.

Significant Redemptions and Units Trading at a Discount

Units of the Fund are redeemable, at their net asset value per unit, on the second last business day of November each year. The purpose of the annual redemption right is to reduce the likelihood that units of the Fund trade at a substantial discount to net asset value per unit and to provide unitholders with the right to realize their investment once per year at net asset value per unit less costs associated with the redemption, including brokerage costs. While the redemption right provides unitholders the option of annual liquidity at net asset value, the Fund may trade at a significant discount during the year. In addition, if a significant number of units are redeemed, the trading liquidity of the units could be significantly reduced and expenses of the Fund would be spread over fewer units resulting in a higher management expense ratio ("MER") for the Fund. In 2005, 2,612,986 units were redeemed for proceeds of $58.2 million.

Recent Developments

Reduction in Distribution Rate

On March 24, 2006, the Fund announced that the annual distribution rate would be reduced from $1.625 per unit to $1.50 per unit commencing with the distribution with a record date of April 28, 2006 and payable on May 12, 2006. The distribution rate has been reduced in large part due to the continuous increase in short-term US interest rates without a corresponding increase in long-term interest rates resulting in a decrease in distributable income.

Restatement of Net Asset Values

On January 13, 2006, the Fund announced that its net asset value per unit was not reported accurately as a result of certain foreign currency contracts not being valued in accordance with the Fund's valuation procedures. At that time the most recent net asset value per unit on January 6, 2006 was recalculated by the Fund's valuation service provider and it resulted in a reduction of the net asset value per unit of $0.56 per unit or 2.5%. As a result of the incorrect valuations, the redemption price paid to unitholders who redeemed their units in 2005 was approximately $1.6 million more than if the correct net asset value had been used. The Manager of the Fund will ensure that the Fund is reimbursed for this overpayment and any excess management or advisor fees collected as a result of incorrect valuations.

Results of Operations

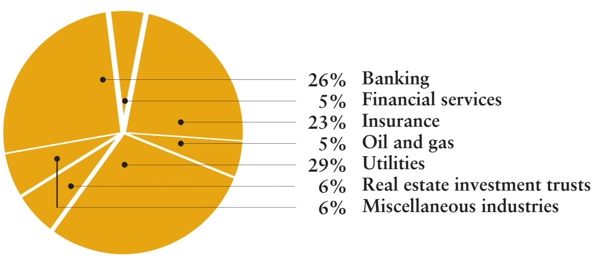
Distributions
During the year ended December 31, 2005, the Fund made regular monthly cash distributions which totalled $1.625 per unit.

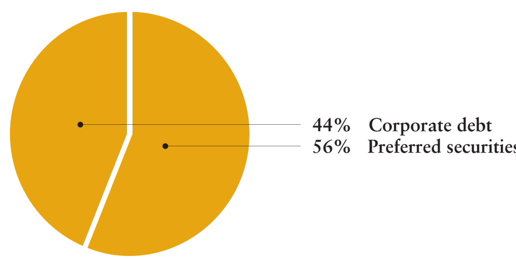
The Fund has a distribution reinvestment plan which allows participating unitholders to automatically reinvest monthly distributions in additional units of the Fund. For the year ended December 31, 2005, 4,028 units were acquired in the market pursuant to this plan at an average price of $22.46 per unit.

Net Asset Value
The net asset value per unit of the Fund decreased by $0.88 per unit or 3.8% from $23.23 to $22.35 over the year. The Fund's aggregate net assets declined from $346 million at December 31, 2004 to $268 million at December 31, 2005, due in large part to redemptions and repurchases under the issuer bid program. The decline in the net asset value per unit was primarily attributable to the cost of the safety net hedge and the fact that distributions exceeded cash available for distribution. These declines were partially offset by gains on the January 2015 foreign currency forward contracts resulting from changes in the US and Canadian long-term interest rate differential. The foreign currency forward contracts are discussed further below under "Currency Hedge."

Investment Portfolio
As of December 31, 2005, the Fund's investments included a total of 57 hybrid preferred securities and 27 debt securities which are diversified by issuer and industry. All of the securities of the Fund were rated investment grade by at least one rating agency at the time of purchase. Approximately 83% of the portfolio is invested in the banking, finance, insurance and utilities sectors, which are industries that are subject to regulatory oversight. The breakdown of the portfolio is shown in the pie charts below.

Portfolio Sectors





Net Investment Income
During the year, the Fund earned net investment income of $19.3 million and generated cash available for distribution in the amount of $21.7 million. The cash that was available for distribution was higher than net investment income primarily as a result of fees paid by the Fund in the form of units and to a lesser extent from undistributed cash from 2004. In 2005, the Fund paid the Manager all of its fees in the amount of $1.2 million by issuing units and, in addition, a portion of the advisor fees in the amount of $0.5 million were paid by issuing units.

The Fund declared monthly distributions totalling $1.625 per unit or $23.4 million in 2005. The total monthly distributions in excess of cash available for distribution in the amount of $1.7 million are primarily attributable to the lower yield on the US Treasuries that were held during the initial invest up period when the Fund was investing in corporate and preferred securities, and the increase in borrowing costs due to rising short-term US interest rates.

Currency Hedge
The Fund's portfolio is comprised of securities denominated in US dollars. The Fund hedges its foreign currency exposure by borrowing in US dollars and by entering into foreign currency forward contracts. Borrowing in US dollars creates a natural hedge as movement in the spot foreign exchange rate and its impact on the value of the portfolio are offset by opposite changes in the value of the loan when it is calculated in Canadian dollars. When using foreign currency forward contracts, the Fund agrees to sell to a counterparty a certain amount of US dollars and receive a set amount of Canadian dollars at a specified future date. Over the term of the forward contract, its value will fluctuate as the spot foreign exchange rate and interest rate differentials change. At December 31, 2005, approximately 65% of the portfolio's US dollar exposure was hedged using forward contracts, and the remaining 35% was hedged by the Fund's US dollar borrowings. On a regular basis, the total notional amount of these forwards is adjusted to match the Fund's net US dollar exposure.

As of December 31, 2005, the Fund had entered into two forward contracts, one with a maturity date in January 2015 and a notional value of US$190.1 million and one with a maturity date in January 2006 and a notional value of US$23.8 million. During 2005, the longer dated contract comprised approximately two-thirds of the total notional value of the forward contracts with the remaining one-third being in a one-month contract. At the end of the year, the January 2015 contract comprised nearly 90% of the notional value of all forward contracts. This higher weighting resulted when a portion of the Fund's US dollar portfolio was liquidated to fund the annual redemption in November. The Fund reduced the size of the short-dated contract to offset the smaller portfolio size.

Due to its longer duration, the value of the January 2015 forward contract is more sensitive to changes in the differential between US and Canadian long-term interest rates than short dated contracts such as a one-month contract. This sensitivity of the contract contributed to fluctuations in the net asset value of the Fund over the year.

In January 2006, the Fund closed-out the January 2015 forward contract and reinvested the proceeds in the portfolio. On the close-out, the Fund realized a gain of Cdn$17.3 million or US$15.0 million. The long-term contract resulted in approximately an additional Cdn$3.6 million of gains to the Fund as compared to a strategy of rolling one-month forward contracts. The new forward contract component of the foreign currency hedge is composed of four contracts with approximately 25% exposure in 3-years, 2-years, 1-year and 3 month terms.

Safety Net Hedge

The Fund uses the safety net hedge to mitigate the impact of significant increases in long-term interest rates. When long-term interest rates decline or increase only slightly, the Fund expects to lose money on the safety net hedge. Since the hedge is constructed primarily by purchasing put options on US Treasury bond futures, the Fund's loss on the hedge is limited to the cost of the put options. When long-term interest rates increase significantly, the Fund expects to make money on the safety net hedge.

The safety net hedge will not perfectly protect the Fund against increases in long-term interest rates. To reduce the ongoing cost of hedging, the hedge is typically structured so that the Fund bears some initial risk to the net asset value as interest rates increase. In addition, the Fund's portfolio investments may not track perfectly with the hedge instrument as interest rates change. However, even if the hedge results are less than perfect, if long-term interest rates rise significantly, any gains realized on the hedge may increase the Fund's income because the gains can be invested in additional income producing securities. Typically, long-term interest rates move higher with an increase in short-term rates; however, in 2005 the yield curve flattened as the yield on the 30-year US Treasury bond declined from 4.8% to 4.6% while the US Federal Reserve Bank increased its overnight rate from 2.25% to 4.25% over the year. In 2005 the Fund had net realized and unrealized losses on option contracts in the amount of approximately $15.7 million which is approximately 3% of the average value of the portfolio. The Fund intends to continue to use the safety net hedge to mitigate the impact of significant increases in long-term interest rates.

Liquidity and Capital Resources

As of December 31, 2005, the Fund had borrowings of $151 million (US$129.3 million) under its revolving credit facility, which represented 35.3% of total assets. The rate paid on these borrowings is adjusted monthly based on the London Interbank Offered Rate ("LIBOR"). The borrowings have been used to invest in additional portfolio investments to enhance the distributions paid by the Fund. During the year, the minimum and maximum amounts of borrowings of the Fund were US$129.3 million and US$154.8 million, respectively.

To provide liquidity, units of the Fund are listed on the TSX under the symbol FFI.UN. The Fund's normal course issuer bid program allows it to purchase its units on the TSX when they trade below net asset value per unit. As a result, purchases under the issuer bid are accretive to the net asset value per unit of the Fund. A total of 332,500 units were purchased in 2005 under this program at an average price of $21.92 per unit.

In addition to the annual redemption described earlier, on a monthly basis, unitholders may redeem units on the second last business day of each month at a price 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 on the redemption date. Unitholders must tender their units for redemption at least ten business days prior to the second last business day of the relevant month. On December 29, 2005, 19,473 units were redeemed on this basis at $20.24 per unit.

Related Party Transactions

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. In addition, 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 resulting in the issuance of 51,342 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. During 2005, another 21,769 units were issued for the payment of these 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. In 2005, management, advisor and service fees amounted to $1.3 million, $2.4 million and $1.0 million, respectively.

Financial Highlights

The following tables show selected key financial information about the Fund and are intended to help readers understand the Fund's financial performance for the fiscal periods indicated. This information is derived from the Fund's audited annual financial statements. The information in the following tables is presented in accordance with National Instrument ("NI") 81-106 and as a result, does not act as a continuity of opening and closing net asset value per unit. The increase (decrease) in net assets from operations is based on average units outstanding during the period and all other numbers are based on actual units outstanding at the relevant point in time.

Net Asset Value per Unit

		2005		2004[1]
Net asset value, beginning of year[2]	$	**23.23**	$	23.63
Increase (decrease) from operations:[3]				
Total revenue		**2.14**		0.07
Total expenses		**(0.81)**		(0.04)
Realized gain (loss) for the year		**(0.11)**		(0.11)
Unrealized gain (loss) for the year		**(0.55)**		(0.32)
Total increase (decrease) in net assets from operations	$	**0.67**	$	(0.40)
Distributions to unitholders:[2]				
From net investment income	$	**0.22**	$	—
From net realized gain on investments		**0.82**		—
Return of capital		**0.59**		—
Total distributions to unitholders	$	**1.63**	$	—
Net asset value, end of year[2]	$	**22.35**	$	**23.23**

(1) Period from December 15, 2004 (commencement of operations) to December 31, 2004.

(2) Net asset value per unit and distributions per unit are based on the actual number of units outstanding at the relevant time.

(3) The increase (decrease) in net assets from operations is based on the weighted average number of units outstanding over the fiscal period.

Ratios and Supplemental Data

		2005		2004
Net assets (in 000s)	$	**268,420**	$	345,726
Number of units outstanding (in 000s)		**12,011**		14,882
Management expense ratio ("MER")[1][2]		**3.45%**		9.21%
MER excluding interest expense and issuance costs[1]		**1.48%**		1.52%
Portfolio turnover rate[3]		**131.75%**		N/A
Trading expense ratio[4]		**0.12%**		N/A
Closing market price	$	**21.40**	$	24.95

(1) Annualized for the period from December 15, 2004 (commencement of operations) to December 31, 2004.

(2) Management expense ratio is based on the total expenses of the Fund for the stated period including interest expense and issuance costs and is expressed as an annualized percentage of the average net assets of the period.

(3) The Fund's portfolio turnover rate indicates how actively the Fund's portfolio advisor manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in its portfolio once in the course of the year. The higher the Fund's portfolio turnover rate in a year, the greater the trading costs payable by the Fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of the Fund. The portfolio turnover rate is not provided when a fund is less than one year old. Portfolio turnover rate is calculated by dividing the lesser of the cost of purchases and the proceeds of sales of portfolio securities for the period, excluding cash and short-term investments maturing in less than one year, by the average market value of investments during the period.

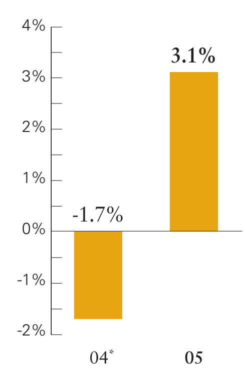
(4) The trading expense ratio represents total commissions expressed as an annualized percentage of daily average net assets of the Fund during the period. This disclosure is a new requirement under NI 81-106 and is not applied retroactively.

Past Performance

The following chart and table shows the past performance of the Fund and will not necessarily indicate how the Fund will perform in the future. The information shown is based on net asset value per unit and assumes that distributions made by the Fund in the periods shown were reinvested (at net asset value per unit) in additional units of the Fund.

Year-by-Year Returns

The bar chart shows the Fund's return (based on net asset value per unit) in each year since inception to December 31, 2005. The chart shows, in percentage terms, how an investment held on the first day of each fiscal year would have increased or decreased by the last day of the fiscal year.



* For the period from December 15, 2004 (commencement of operations) to December 31, 2004.

Annual Compound Returns

The following table shows the Fund's annual compound return for each period indicated, compared with the return for the Lipper Domestic (US) Investment Grade Bond Funds ("Lipper Benchmark"). The Lipper Benchmark includes all US government bond, mortgage bond and term trust and investment grade bond funds in Lipper's closed-end fund database at each point in time and provides a fixed income security benchmark for the Fund, although, generally the investment grade bond funds in the Lipper Benchmark do not hedge long-term interest rate exposure.

	1 year	Since Inception[1]
Flaherty & Crumrine Investment Grade Fixed Income Fund	3.1%	1.4%
Lipper Domestic (US) Investment Grade Bond Funds	3.5%	4.0%

[1] For the period from December 15, 2004 (commencement of operations) to December 31, 2005.

The Fund underperformed the Lipper Benchmark largely due to the cost of the safety net hedge and distributions exceeding cash available for distribution.

Summary of Investment Portfolio

As at December 31, 2005

Total net asset value	$ 268,420,032

Portfolio Composition	**% of NAV**
Preferred securities:	
Banking	36.7%
Insurance	26.3%
Utilities	10.4%
Oil and gas	5.9%
Financial services	4.3%
	83.6%
Corporate debt:	
Utilities	32.0%
Miscellaneous industries	9.2%
Real estate investment trust	8.6%
Insurance	7.3%
Financial services	3.8%
Banking	2.3%
Oil and gas	1.7%
	64.9%
Currency forward contracts	6.3%
Options	(0.5%)
Cash and short-term investments	0.6%
Total investment portfolio	154.9%
Other net liabilities	(54.9%)
Total net asset value	100.0%

Top 25 Holdings	**% of NAV**
Constellation Energy Group, *7.6% April 1, 2032, Senior Notes*	7.5%
KN Capital Trust III, *7.63% April 15, 2028 Capital Security*	5.9%
Southern Union Company, *8.25% November 15, 2029*	5.3%
EOP Operating L.P., *7.5% April 19, 2029, Senior Unsecured Notes*	4.5%
Pulte Homes Inc., *6.375% May 15, 2033*	4.4%
Assurant Inc., *6.75% February 15, 2034 Senior Notes*	4.3%
Duquesne Light Holdings, Inc., *6.25% August 15, 2035, Senior Notes*	4.3%
Westar Energy Inc., *5.95% January 1, 2035*	4.3%
PECO Energy Capital Trust IV, *5.75% June 15, 2033 Capital Security*	4.2%
Aegon NV, *6.375% Pfd.*	4.2%
TXU Corp., *6.5% November 15, 2024, Senior Notes*	4.2%
Barclays Bank PLC, *6.278% December 15, 2034*	4.0%
Disney Enterprises Inc., *7.55% July 15, 2093, Senior Notes*	3.9%
ACE Capital Trust II, *9.7% April 1, 2030*	3.6%
Lehman Capital Trust VI, *6.24% Pfd.*	3.2%
Fleet Capital Trust II, *7.92% December 11, 2026*	3.2%
Commonwealth Edison Co., *6.35% March 15, 2033*	3.1%
Axis Capital Holdings Limited, *7.5% Pfd.*	3.0%
Webster Capital Trust I, *9.36% January 29, 2027 Capital Security*	2.8%
General Motors Acceptance Corporation, *8% November 1, 2031, Senior Bonds*	2.8%
Progress Energy Inc., *7% October 30, 2031, Senior Notes*	2.7%
HBOS Capital Funding, *6.85% March 23, 2049*	2.5%
Royal Bank of Scotland PLC, *6.35% Pfd.*	2.5%
GreenPoint Capital Trust I, *9.1% June 1, 2027 Capital Security*	2.4%
First Empire Capital Trust II, *8.277% June 1, 2027 Capital Security*	2.4%

The investment portfolio may change due to ongoing portfolio transactions of the investment fund. Quarterly updates are available within 60 days of each quarter end.

2005 Tax Information

The following information is applicable to holders who, for the purpose of the Income Tax Act (Canada), are resident in Canada and hold Fund units as capital property outside of an RRSP, RRIF or DPSP. Unitholders should receive a T3 slip from their investment dealer providing this information.

T3 supplementary slips for holdings of the Fund will indicate Foreign Non-Business Income in Box 25, Other Taxable Income in Box 26, Capital Gains in Box 21 and Dividend Income in Box 23. Dividend income is subject to the standard gross-up and federal dividend tax credit rules.

The return of capital component is a non-taxable amount that serves to reduce the adjusted cost base of Fund units and is reported on the T3 supplementary slips Box 42.

The following table outlines the breakdown of the Fund's distributions declared in 2005 on a per unit basis.

Record Date	Payment Date	Return of Capital	Foreign Non-Business Income	Other Taxable Income	Dividend Income	Capital Gains	Total Distribution
Jan. 31, 2005	Feb. 14, 2005	$ 0.04904	$ 0.01785	$ 0.00011	$ —	$ 0.06840	$ 0.13540
Feb. 28, 2005	Mar. 14, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
Mar. 31, 2005	Apr. 14, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
Apr. 29, 2005	May 13, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
May 31, 2005	June 14, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
June 30, 2005	July 15, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
July 29, 2005	Aug. 15, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
Aug. 31, 2005	Sep. 15, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
Sep. 30, 2005	Oct. 17, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
Oct. 31, 2005	Nov. 14, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
Nov. 30, 2005	Dec. 14, 2005	0.04904	0.01785	0.00011	—	0.06840	0.13540
Dec. 30, 2005	Jan. 16, 2006	0.04904	0.01785	0.00011	—	0.06840	0.13540
Total distributions		**$ 0.58848**	**$ 0.21420**	**$ 0.00132**	**$ —**	**$ 0.82080**	**$ 1.62480**

Portfolio Manager

Flaherty & Crumrine Incorporated

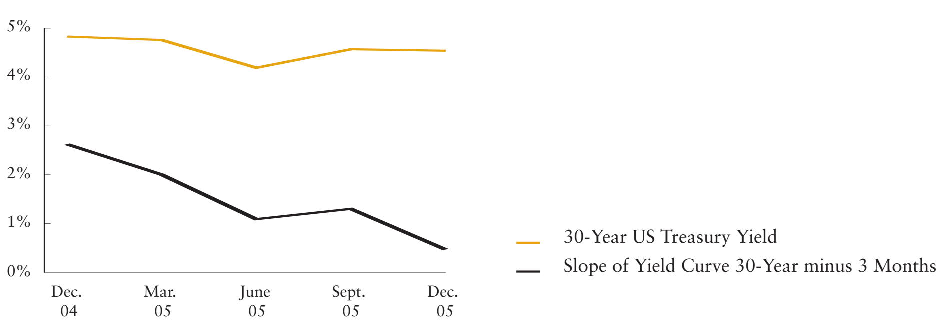
Flaherty & Crumrine Incorporated is the oldest and most experienced firm specializing in preferred securities with extensive additional experience in corporate debt instruments. Flaherty & Crumrine acts as portfolio manager for two Brompton funds – Flaherty & Crumrine Investment Grade Preferred Fund and Flaherty & Crumrine Investment Grade Fixed Income Fund, both of which invest in investment-grade corporate debt and preferred securities, primarily of US issuers. The firm uses intensive credit analysis and thorough analysis of securities' terms and structure and active portfolio management, exploiting pricing inefficiencies in the fixed income markets to provide attractive rates of return on its funds.

Flaherty & Crumrine's two oldest funds (NYSE: PFD and NYSE: PFO) have received Morningstar 4 and 5 star overall ratings, respectively, and have outperformed an index of Lipper Domestic US Investment Grade Bond Funds, while providing low levels of volatility. To achieve this, Flaherty & Crumrine employs a "safety-net" hedging strategy in the management of all its funds, mitigating the risk of significant rapid increases in long-term interest rates, but allowing the net asset value of the funds to increase if interest rates decline. As a result, the hedge permits distributions paid by the funds to increase if long-term interest rates increase significantly, while being relatively resistant to declining interest rates.

Portfolio Manager's Report

During 2005, the Fund continued to be impacted by several developments, including a flattening yield curve, as long-term interest rates remained relatively stable but short-term rates increased. Fueled by eight separate 1/4% increases in the US Fed funds rate during 2005 (following five in 2004 and one subsequent to year-end), the yield on 3-month US Treasury bills increased from 2.2% to 4.1% during the year. However, the yield on the 30-year US Treasury bond actually declined in yield during this period from 4.8% to 4.6%! As can be seen in the chart below, with little change in long-term interest rates (as shown by the line), the slope of the yield curve declined precipitously throughout the year (the bars) as short-term rates increased significantly.

Yield on 30-Yr US Treasury Bond vs. Slope of US Treasury Yield Curve



The stability of long-term interest rates in the face of a flattening yield curve impacted the Fund in several ways. First, maintaining the Fund's "safety-net" interest rate hedge proved an unproductive expense. To use an insurance analogy, we paid a premium for insurance against a significant increase in long-term interest rates, but the house didn't burn down. Long-term interest rates remained range bound, and the hedge produced positive results during only a couple of months in 2005. However, we have no intention of eliminating the "safety net" hedge going forward. At some point, it will earn its keep; in the meantime, we'll continue to attempt to minimize its cost.

The Fund has also been impacted as rising short-term interest rates have increased the cost of the Fund's leverage. Thus far, the Fund has coped reasonably well with higher short-term interest rates. We anticipate that significant further increases in short-term rates will at some point result in long-term rates also increasing, benefiting the hedge. While we have been puzzled by the relative stability of long-term interest rates in the face of strength in the economy and the US Federal Reserve's efforts to raise short-term interest rates, history has taught us there is little likelihood of current market conditions persisting for long. The good news is that while the flattening of the yield curve increases the cost of the Fund's leverage, it significantly reduces the cost of hedging going forward. Although these two factors offset each other to some degree, they do so only at total return.

A second major development in 2005 was the continuing evolution of the preferred market in the United States. Stimulated by Moody's Investors Services formalizing their equity treatment of preferreds early last year, both preferred issuance and the creation of new preferred structures has accelerated. Recently, an innovative twist on an old preferred structure has produced a new type of preferred security appropriate for the Fund. In classic Wall Street tradition, the bankers can't agree on what to call them; for now, we'll use the first coined acronym "ECAPS[SM]," which stands for "Enhanced Capital Advantage Preferred Security."

This new structure combines a variety of terms and covenants to create a security that captures some important characteristics of both debt and equity. As a result, these issues are considered "equity-like" by the rating agencies, yet the interest paid on the issue is deductible by the issuer as interest expense for tax purposes (both critical factors in a company's cost of capital). To date, corporations have sold twelve "enhanced" issues totaling almost US$7.5 billion. The winds of change continue to blow through the preferred market, presenting the opportunity to take advantage of mispricings due either to supply pressures or market unfamiliarity with new structures. For instance, late in 2005, a number of insurance companies issued new preferred securities to replenish capital after one of the worst hurricane seasons for the US on record. While many of these new issues didn't meet our credit standards, we identified several attractive issues and made meaningful additions to the portfolio.

We have avoided the temptation to boost the income from the Fund's investment portfolio by purchasing lower quality securities or those with high coupons but little call protection. While the Fund restricts itself to investment grade securities at the time of purchase, we have some flexibility within the investment grade universe. Balancing the tradeoff between credit quality and income is never easy, but we believe foregoing some current income in favour of higher long-term results is advantageous for Unitholders with a long-term investment horizon. A similar tradeoff exists in the coupon level of securities purchased. Reaching for yield by buying the higher coupon issues of an issuer may produce higher income in the short run, but doing so increases the portfolio's exposure to issuer call and compromises the sustainability of the income generated by the Fund.

Further information on the specific holdings in the Fund can be found by visiting a website maintained by Flaherty & Crumrine, www.preferredstockguide.com and using the "search" function.

FC Flaherty & Crumrine Incorporated

Forward-looking Statements

Some of the statements contained herein including, without limitation, financial and business prospects and financial outlook may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may," "will," "should," "could," "anticipate," "believe," "expect," "intend," "plan," "potential," "continue" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, we cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.

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
Assets		
Investments, at market value[1]	**$ 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
Total assets	**427,434,429**	529,390,728
Liabilities		
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
Total liabilities	**159,014,397**	183,664,586
Unitholders' equity		
Unitholders' capital (note 3)	**283,742,681**	351,573,451
Contributed surplus	**4,134,692**	—
Deficit	**(19,457,341)**	(5,847,309)
Net assets representing unitholders' equity	**$ 268,420,032**	$ 345,726,142
Units outstanding (note 3)	**12,011,203**	14,882,310
Net asset value per unit	**$ 22.35**	$ 23.23

[1] 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[1]
Income		
Interest income	$ 27,263,397	$ 993,055
Dividends	3,969,144	—
	31,232,541	993,055
Expenses		
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
	11,885,587	642,077
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)	—
Deficit, end of year/period	$ (19,457,341)	$ (5,847,309)
Increase (decrease) in net assets from operations per unit[2]	$ 0.67	$ (0.40)

[1] Period from December 15, 2004 (commencement of operations) to December 31, 2004.

[2] 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[1]
Cash flows from operating activities:		
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
Cash provided by (used in) operating activities	113,127,647	(538,198,655)
Cash flows from financing activities:		
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)	—
Cash provided by (used in) financing activities	(111,560,734)	538,224,612
Net increase in cash and short-term investments	1,566,913	25,957
Cash and short-term investments, beginning of year/period	25,957	—
Cash and short-term investments, end of year/period	$ 1,592,870	$ 25,957
Supplemental information:		
Interest paid	$ 6,617,307	$ —

[1] 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[1]
Net assets, beginning of year/period	$ 345,726,142	$ —
Operations:		
Increase (decrease) in net assets from operations	9,789,775	(5,847,309)
Unitholder transactions:		
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
Net assets, end of year/period	$ 268,420,032	$ 345,726,142
Distributions per unit	$ 1.6248	$ —

[1] 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

Shares/ Par Value $US	As at December 31, 2005 — Preferred Securities	Cost (USD)	Cost (CDN)	Market Value (USD)	Market Value (CDN)	% of Portfolio
	Banking					
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	412,453	
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	
		85,154,039	**104,572,063**	**84,311,048**	**98,488,459**	**24.7%**
	Financial Services					
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	
		10,111,241	**12,391,113**	**9,926,727**	**11,595,966**	**2.9%**
	Insurance					
$ 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	Renaissancere 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	
		60,197,866	**72,957,412**	**60,538,521**	**70,718,441**	**17.7%**
	Oil and Gas					
$ 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**	**4.0%**
	Utilities					
$ 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	
		24,472,903	**29,824,257**	**23,797,353**	**27,799,022**	**7.0%**
	Total Preferred Securities	**$ 193,919,206**	**$ 236,904,352**	**$ 192,178,683**	**$ 224,494,691**	**56.3%**

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
Par Value $US	**Corporate Debt Securities**					
	Banking					
$ 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%
	Financial Services					
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	
		8,613,013	**10,424,102**	**8,730,487**	**10,198,571**	**2.6%**
	Insurance					
$ 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	
		16,519,961	**20,142,694**	**16,873,902**	**19,711,351**	**4.9%**
	Oil and Gas					
$ 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%**
	Real Estate Investment Trust					
$ 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	
		20,283,525	**24,817,496**	**19,744,262**	**23,064,381**	**5.8%**
	Utilities					
$ 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	
		74,248,951	**90,703,510**	**73,531,449**	**85,896,210**	**21.5%**
	Miscellaneous Industries					
$ 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	
		21,948,569	**26,761,148**	**21,235,041**	**24,805,841**	**6.2%**
	Total Corporate Debt Securities	**$ 150,871,182**	**$ 184,378,512**	**$ 149,277,003**	**$ 174,378,838**	**43.7%**
	Total	**$ 344,790,388**	**$ 421,282,864**	**$ 341,455,686**	**$ 398,873,529**	**100.0%**

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[1]	
	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
Units, end of year	**12,011,203**	**$ 283,742,681**	14,882,310	$ 351,573,451

[1] 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.

Corporate Information

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P. Michael Nedham, BSc, MBA, CBV
Arthur R.A. Scace, QC, CM
Ken S. Woolner, BSc, PEng

Officers

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Chairman

Raymond R. Pether
Chief Executive Officer

Mark A. Caranci
President

Craig T. Kikuchi
Chief Financial Officer

David E. Roode
Senior Vice President

Moyra E. MacKay
Vice President and Corporate Secretary

Lorne J. Zeiler
Vice President

Jessica Leung
Controller

Ann P. Wong
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