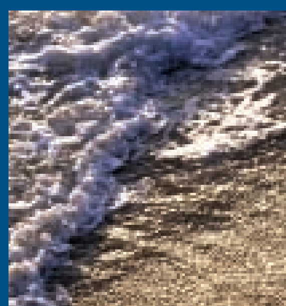
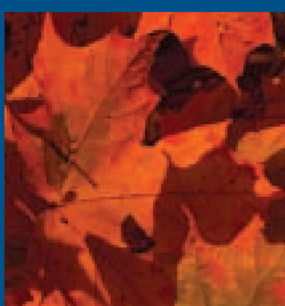
Morneau Sobeco 2005 Annual Report





Design and delivery of pension and benefits programs

MORNEAU SOBECO

MORNEAU SOBECO INCOME FUND

ABOUT MORNEAU SOBECO

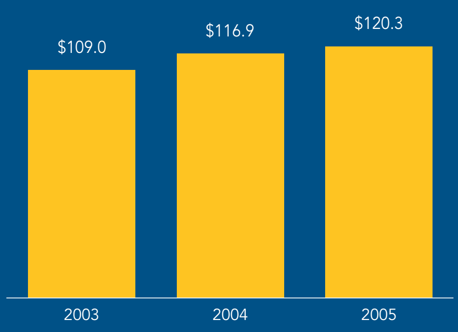
Morneau Sobeco is the largest Canadian-owned pension and benefits consulting and outsourcing firm, providing services to organizations across Canada and in the United States. With approximately 950 employees in offices in 11 cities across North America, Morneau Sobeco has focused on the integrated design and delivery of pension and benefits plans for over 40 years. Units of Morneau Sobeco Income Fund trade on the Toronto Stock Exchange under the symbol MSI.UN. Further information on Morneau Sobeco can be obtained on the firm's Web site at www.morneausobeco.com.

FINANCIAL HIGHLIGHTS

- Revenue grew by 3% in 2005 to $120.3 million
- Adjusted EBITDA grew by 8.4% in 2005 to $25.9 million
- Total Distributable Cash grew by 13% in 2005 to $24.2 million
- Clients representing over 98% of 2004 revenues recurred in 2005, generating increased 2005 revenues
- Clients generating over $100,000 annually in revenue increased to 199 in 2005, from 187 in 2004

Revenue Growth

($ millions)



Adjusted EBITDA Growth

($ millions)

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The Morneau Sobeco Focus

Providing pension and benefits solutions

Morneau Sobeco helps organizations manage their employees' health and financial security through pension and benefits programs. We focus on pension and benefits consulting, and outsourcing the administration of pension and benefits programs. Our integrated services are delivered from 11 offices to organizations that range from small, local firms to governments and large, blue-chip corporations.

On the consulting side of our business, we design, deliver and manage pension and benefits plans for employers. Our actuaries provide formal valuations on future payment obligations and funding adequacy, which form part of our clients' audited financial statements. Our benefits consultants provide advice on plan design and strategies to manage rising benefits costs.

On the outsourcing side of our business, we take over the costly and time-consuming work of delivering pension and benefits plans: we enable employees to match their pensions and benefits to their evolving needs, we process transactions, and we report back to employees and clients.

Both businesses are characterized by long-term client relationships that generate recurring revenues. Due to the increasing complexity of pensions and benefits—and to Morneau Sobeco's acknowledged expertise and high standards of client service—revenues have increased consistently.

Morneau Sobeco's Service Offerings

Pension & Benefits Consulting

Pension Consulting

- Defined benefit programs
- Defined contribution programs
- Asset management consulting

Benefits Consulting

- Traditional and flexible benefits arrangements
- Employee benefits for volume-purchasing groups
- Absence and disability management solutions

- Communication consulting services
- Compensation consulting services

Pension & Benefits Outsourcing

Pension Outsourcing

- Defined benefit plan administration
- Defined contribution plan administration
- Stock plans, group RRSP administration

Benefits Outsourcing

- Health and welfare plan administration
- Flexible benefits administration
- Insurance premium administration
- Total compensation administration

The Morneau Sobeco Focus

Consulting

The backdrop to our business headlines the media every day. North Americans are living longer, placing increasing demands on pensions and retirement savings, and increasing their demands on our health care systems: governments are struggling with these costs while employers and employees are carrying more of the total burden.

Everybody is concerned about pension plans: employees, because they are living longer and expect to need increased financial assets for their personal security through old age; regulators, because pension plan underfunding is increasingly recognized as a serious issue; corporate leaders, because pension plan liabilities are increasing as a function of their balance sheets; and employers, because the increased volatility of pension plan costs requires greater management focus to contain.

Employee benefits plans are equally challenging and have their own complexities, headed by skyrocketing costs that employers are struggling to manage. Even trends in the general population, such as the more frequent incidence of disability, require more management by employers. Further, employees' benefit needs are becoming less general and more customized, and this increases the requirement for highly flexible programs.

Within this highly challenging environment, Morneau Sobeco has been helping employers for more than four decades. We serve a broad range of clients, including small firms, trade and professional associations, not-for-profit organizations and governments. Among our many large clients are organizations such as National Bank of Canada, whom we have served as actuaries and consultants for more than 40 years, and Mercedes-Benz Canada Inc., for whom we manage pension plans within the context of a larger global organization. We seek long-term relationships with organizations that have long-term horizons.

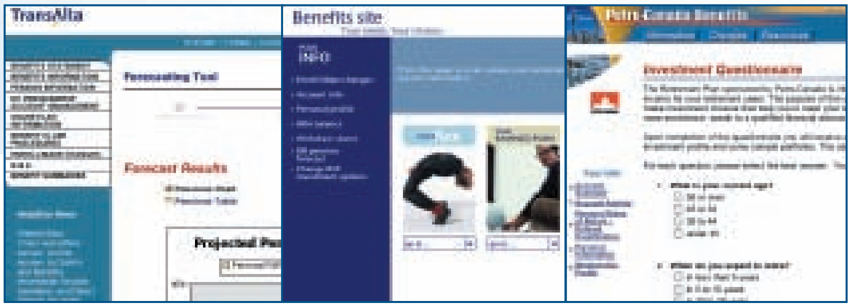
As consultants, our role is to help management best design their pension plans and benefits programs while recognizing and respecting the many challenges they confront. Employees want more, to protect their financial security for a comfortable old age and to guard against unforeseen health care costs. Employers want to offer programs to attract and retain valuable employees but within the contexts of managing costs and having predictable expenditures. Organizations also want to understand short- and long-term cost trends while making pension plans and benefits programs easier for employees to understand, and easier to align with their needs.

Delivering pensions and benefits effectively to employees is now an immense challenge. Employees care more about these arrangements than they ever have before and they care more frequently, as pension and benefits plans assume a greater role in their individual financial planning decisions. They need more information for effective decision-making.

Employees face a bewildering array of possibilities, including, but not limited to, flexible benefits plans, defined benefit

The Morneau Sobeco Focus

Outsourcing



pension plans, supplementary executive retirement plans, health care spending accounts, defined contribution plans, share ownership plans, and many more. The interplay between these programs is increasingly complex, both immediately and longer term.

Online communication technologies have become critical to the delivery of these pension and benefits programs. Employees want to understand their programs visually, and to see the value in a program. Employees and their families need to make choices, and want to understand the effects of those choices. Corporate intranets and the Internet have become key methods of delivering vital pension and benefits information. Morneau Sobeco is a leader in outsourcing the delivery of these programs. Designing and hosting Web sites to explain the choices to employees, and to enable the employees to administer their own solutions, is a critical part of Morneau Sobeco's service offering. For clients such as TransAlta, Bell Canada and Petro-Canada (whose Morneau Sobeco-hosted employee Web sites are shown above), we enable employees to go online to get information and to make choices about their pensions and benefits. We do this for more than 80 employers, providing online access to personalized information for more than one million employees.

Our industry-leading proprietary information technology platform, supported by our staff of over 130 information technology specialists, is a competitive advantage for our outsourcing services. As one of the largest benefits plan administrators in Canada, and with a growing presence in the United States, Morneau Sobeco serves a very large installed client base. We process transactions, answer employee calls, and manage employer administration needs in pensions and benefits.

Our resources

Morneau Sobeco's service offering is delivered by a highly experienced management team of 40 partners, heading a professional staff of approximately 950 professionals located in offices across Canada, and in technology centres in Toronto, Montréal and Pittsburgh. Over the past 14 years, we have expanded both our geographic coverage and the spectrum of services we provide, through the successful integration of five professional practices into our growing organization.

In all, Morneau Sobeco serves a base of more than 1,000 blue-chip clients, including corporations, not-for-profit organizations, and governments and their agencies. Due to the lead times and commitments in these assignments—consulting and outsourcing in both pensions and benefits—our client relationships are typically very long. Many clients, some of which are referenced in this annual report, have been served by Morneau Sobeco for more than 20 years.

As the largest Canadian-owned pension and benefits consultancy, Morneau Sobeco remains focused on continued excellence in the design, delivery, management and administration of pension and benefits plans, on continued profitable growth and on reliable distributions for unitholders.

PRESIDENT'S MESSAGE

Bill Morneau
President and
Chief Executive Officer

On September 30, 2005, Morneau Sobeco passed an important milestone in its corporate development with the successful completion of an initial public offering of trust units. The transition to public ownership brings important benefits: a broadened and strengthened Board and enhanced governance, public markets disciplines and significant new business opportunities.

Yet for all the things that change with the transition to public ownership, our core remains the same as it has been for 40 years; this is a long-term business. Designing and delivering pension and benefits programs imposes significant, continuing obligations, often for decades. Accordingly, we will manage this business for the long term, according to sound business principles.

The industry in which we operate is characterized by increasing complexity. Defined contribution pension plans are growing in popularity among employers, while defined benefit plans, even though some of them are not actively adding new members, are maintaining their memberships, and will have continuing coverage obligations for years to come. Many organizations have the additional complexity of having participants in multiple types of pension plans.

The benefits side of our business is equally complex, as an aging baby-boomer generation and its increasing demands on the health care delivery system confront finite taxpayer and employer resources.

Implicit in the continuing success of any long-term business are solid client relationships and a stable base of professionals with which to serve our clients and their evolving needs.

Looking first at building and maintaining long-term relationships with our clients, we recognize that this is a game of inches, in which small improvements and savings pay major rewards over the long term. We maintain a tightly focused service offering and execute well. As a result, clients representing more than 98 percent of our 2004 revenue remained with us in 2005, and we earned more revenue from them. Recognizing as well that we have client relationships for the long haul, we seek true partnerships with our clients and ask them for frequent feedback. We listen to our clients, and build a process of continuous improvement into the delivery of our services. Our overall client satisfaction score for 2005 was very positive, and exceeded our results for each of the last four years.

We seek to maintain long-term stable relationships with our clients by striving for continuity in the professional teams who serve them. Accordingly, we employ pension and benefits professionals who expect to enjoy an extended tenure with our company, and we strive to maintain a collegial, professional working environment both among our actuaries and among the other business professionals who complement and support their work. Our goal is to hire well, and to promote from within.

Our long-term focus, our commitment to superb execution and our values have made Morneau Sobeco the largest Canadian-owned pension and benefits consulting firm, and positioned the company for further growth. We now have a team of 950 professionals in offices across Canada and the United States, serving a very broad range of blue-chip corporate and government clients. In fact, in 2005 the number of Morneau Sobeco clients generating revenues of more than $100,000 increased to 199 from 187 in 2004.

Although the period covered by this report consists of a single day in September and the remaining three months of the calendar year, it is clear that in 2005 Morneau Sobeco's financial performance met expectations of steady growth, including a three percent increase in revenue. Revenue growth would have been much stronger had we not resigned a large account that did not meet our standards of profitability.

During the marketing phase of the initial public offering, we outlined three strategies for the continued growth of Morneau Sobeco: expanding relationships with established clients, adding new client relationships, and acquiring smaller regional and local firms with complementary businesses.

While we do not yet have an accretive acquisition to point to, unitholders can be confident that we are carefully evaluating potential acquisitions to ensure that they meet our goals of building our business and expanding our geographic footprint. As reported elsewhere in this report, we also made significant progress expanding our mandates with established clients and in launching relationships with new clients.

As the result of our continued focus on doing things right for our clientele, while revenues generally met expectations, our margins improved, enabling us to meet unitholder distribution targets, while reducing the distributable cash payout ratio.

Our success over the past year is a result of the hard work and creativity of our Morneau Sobeco people and the confidence placed in us by our clients. I would like to take this opportunity to thank our employees for their efforts and our clients for their trust.

As always, our objective remains to live up to the trust investors have placed in us, and to increase unitholder value.

William Morneau, Jr.
President and Chief Executive Officer

Delivering on our Plan

Growing our client mandates

During the company's initial public offering, we looked forward to continued business growth in three ways: through expanded client mandates, by establishing new client relationships and through accretive acquisitions to build our business or expand its geographic footprint. Here are selected examples of how we are delivering on our plan.

Morneau Sobeco is building its business and distributable cash for unitholders by winning new or expanded mandates from its current clients. The following highlights a few of the new mandates we have won in the short period between the initial public offering and the end of the year.

Having set up the pension plan, Morneau Sobeco has been retained by **Bermuda's Office of the Accountant General and Ministry of Finance** to provide continuing actuarial consulting services for the Public Service Superannuation Fund that covers all public service employees, and has assets of approximately US$300 million.

Morneau Sobeco has recently expanded its relationship with **Nova Chemicals** from benefit enrolment service partner for employees across North America to deliver benefits administration services for employees and retirees across North America as well.

Having taken over responsibility for **MDS Inc.**'s Canadian pension and benefits administration needs, Morneau Sobeco has been awarded additional responsibility for managing the client's U.S. benefits administration and integrating it with the Canadian corporate parent's benefits delivery.

For **GlaxoSmithKline**, Morneau Sobeco currently assists with the delivery of pension and benefits administration for all Canadian employees. Morneau Sobeco has recently been awarded an expanded mandate to help provide retirement planning services.

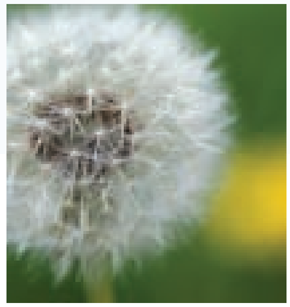
Morneau Sobeco's long track record of achievement is based on establishing and maintaining successful, long-term relationships with corporate and government clients. Following are selected examples of new clients and assignments awarded since the initial public offering.

For the **Government of Québec**, Commission administrative des régimes de retraite et d'assurances (CARRA), Morneau Sobeco is working together with IBM to revamp the administration system for 31 pension plans serving over one million participants.

For the **Nova Scotia Association of Health Organizations (NSAHO)**, Morneau Sobeco is developing the next generation of benefits administration capability for the province's hospital and health care workers.

Delivering on our Plan

Building new relationships



For the **State of Nevada**, Morneau Sobeco will be developing benefits administration services and providing the State with online benefits administration capabilities for over 20,000 employees.

For **Suncor Energy Inc.**, Morneau Sobeco is providing an application service provider platform for the administration of the company's pension plan, covering more than 5,000 plan members in Canada.

Morneau Sobeco has also recently won two engagements with the **Financial Services Commission of Jamaica**: developing pension policies and regulatory procedures to ensure compliance by plan sponsors, and training supervisory personnel in pension regulation.

In addition to growing our client mandates and building relationships with new clients, Morneau Sobeco will also grow through acquisitions of complementary businesses. As illustrated in the chart below, Morneau Sobeco has a proven track record of acquiring and successfully integrating new businesses.

We are actively looking to acquire businesses that will increase the range of services we offer clients—as well as the services offered to the acquired company's clients—and acquisitions that will increase the geographic markets we can serve, such as the underserved U.S. marketplace of mid-sized employers.

We have formal acquisition criteria, and we will be disciplined buyers when considering acquisition opportunities.

Over the years, Morneau Sobeco has grown through the acquisition and integration of complementary businesses. Acquisition continues to be an important growth strategy, subject to strict criteria.

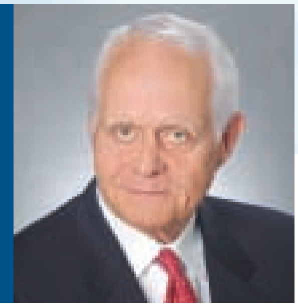
Acquisition Integration Expertise

1992	1997	1998	2001	2002
Coopers & Lybrand	Ernst & Young	Deloitte.	Deloitte.	Arthur Andersen
Acquisition of Canadian pension practice	Acquisition of Sobeco, Ernst & Young Canadian pension practice	Acquisition of Canadian pension practice	Acquisition of Canadian disability management practice	Acquisition of Canadian disability management practice

CHAIRMAN AND LEAD TRUSTEE LETTERS

W.F. Morneau, Sr.
Chairman

David Day
Lead Trustee



Morneau Sobeco's first annual report as a public company provides an opportunity to communicate some important ideas about the continuity of our corporate values and about our objectives for the company's corporate governance.

While ownership of the company I founded 40 years ago has now passed into public hands, I would like to offer a few words about the value of continuity in our business.

As it was for its first four decades, Morneau Sobeco remains focused on long-term relationships with our clients and with the employees and partners who serve them. We recognize that the future of this business and the value of the investments in Morneau Sobeco Income Fund depend on protecting and enhancing those relationships. Unitholders can be assured that this is management's commitment and priority.

As the company goes forward, you should also know that we are equally committed to the principles and practices of good corporate governance, including frequent communication with stakeholders and transparency in our dealings.

Morneau Sobeco Income Fund is on the right path.

W. F. Morneau, Sr.
Chairman

Morneau Sobeco Income Fund adheres to the mechanics of good corporate governance, and depends equally on good people—management and trustees alike—who have the skills, the time, the experience, the intellect and the independence to evaluate all the information provided and to assess its suitability for unitholders and other stakeholders.

Our corporate governance objective is simply stated: we will be leaders in the adoption of complete, enlightened disclosure, and in discussing the independence of trustees. We will have distinct, measurable targets for our operating and financial performance, and fully disclose our senior executives' compensation. We will provide complete transparency on the composition and reporting of distributable cash.

Morneau Sobeco Income Fund has made a very solid debut, and unitholders may have confidence both in the results reported herein and in the future direction of the company.

David Day
Lead Trustee

Management's Discussion and Analysis of 2005 Results

Morneau Sobeco Income Fund (the "Fund") was formed on August 22, 2005 and commenced operations on September 30, 2005 when it completed an initial public offering ("IPO"). Using the proceeds from the IPO, the Fund indirectly acquired a controlling interest in Morneau Sobeco Group Limited Partnership ("MS Group LP"), which in turn acquired Morneau Sobeco Corporation ("Morneau Sobeco"), the successor to W.F. Morneau Services, Inc. ("WFMS").

This Management's Discussion and Analysis ("MD&A") and accompanying consolidated financial statements of the Fund and notes thereto, cover the Fund's first fiscal period, August 22, 2005 to December 31, 2005. Since the Fund did not previously exist, no comparative information is provided in the Fund's audited consolidated financial statements. In order to provide meaningful information to the user, the following MD&A includes financial data of WFMS, which carried on the Morneau Sobeco business prior to September 30, 2005. WFMS data was used to provide full year operating data for 2005 and comparables for the fourth quarter and full year 2004.

All financial information is presented in Canadian dollars and in accordance with Canadian generally accepted accounting principles ("GAAP") unless otherwise noted. Certain totals, subtotals and percentages may not reconcile due to rounding.

This MD&A contains forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed under "Risk and Uncertainties". This discussion also makes reference to certain non-GAAP measures such as EBITDA, Adjusted EBITDA and Distributable Cash to assist investors in assessing the Fund's financial performance. (See footnotes to the "Results of Operations" chart and the section entitled "Non-GAAP financial measures: EBITDA, Adjusted EBITDA and Distributable Cash" for definitions.) Non-GAAP measures do not have any standard meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other issuers.

FORMATION AND OWNERSHIP STRUCTURE OF THE FUND

On September 30, 2005, the Fund completed an IPO of 19,979,284 trust units ("Units") at a price of $10.00 per Unit, for total net proceeds of $184,496,842. The proceeds were used to indirectly acquire a 72.7% interest in Morneau Sobeco with the previous shareholders retaining the balance of the interest. On October 18, 2005, the over-allotment option of the Fund's

IPO was exercised resulting in the issuance of an additional 1,997,928 Units. These proceeds were used to reduce the non-controlling interest in Morneau Sobeco to 20%. No additional Units have been issued since that date and thus, there remains a total of 21,977,212 Units issued and outstanding.

The previous owners of Morneau Sobeco own the non-controlling interest in Morneau Sobeco through a combination of 5,494,303 Class B Limited Partnership units ("Class B LP Units") of MS Group LP and an equal number of special voting units of the Fund, which together are exchangeable into Units provided that the Fund achieves certain objectives.

To reduce Unitholder risk, approximately 75% of the Class B LP Units are subordinated in their rights to distributions until Unitholders of the Fund receive their target distributions. This subordination is in place until September 30, 2007, or later if the Fund has not made its target distributions.

BUSINESS OVERVIEW

The Fund is the largest Canadian-owned pension and benefits consulting and outsourcing firm, providing services to organizations across Canada and in the United States. We focus on the integrated design and delivery of retirement and employee compensation and benefit programs. We have approximately 950 professionals and support staff with offices in 11 cities across North America. Our clients are primarily large and medium-sized organizations in Canada and the United States, which typically utilize our services on a recurring or contracted basis over a long term.

We derive our revenue primarily from fees charged to clients for pension and benefits consulting and outsourcing engagements. For some benefit consulting assignments which involve insurance, we may be paid commissions (in lieu of fees) by the client's insurance company, which is a common practice in the industry. These commissions are typically disclosed to the client and are based on a percentage of the premiums paid by the client to the insurance company. We assume no underwriting risk as the insurance policy is underwritten by the insurance company. In addition, we earn interest income from our cash balances which is included in other revenue. Fees from consulting engagements are charged based on billable hours or a fee-for-service basis. In some cases, consulting engagements can also be billed on a fixed-fee basis, although these engagements are typically much smaller and the services are delivered over a shorter period of time. Outsourcing engagements are generally based on negotiated fees or a formula tied to the nature of the service being provided. Our outsourcing business is characterized by fixed contracts, which usually have three to five year terms. Most outsourcing contracts contain an upfront implementation fee and an ongoing monthly service fee. Implementations usually take three to twelve months and involve transferring the administration of a client's pension and/or benefits plans onto our systems, tailoring our systems and training our employees. Additional services provided that are outside the scope of the outsourcing contract are usually paid on a fee-for-service basis.

Our largest operating expense is compensation and related costs, which includes salaries, annual performance-based bonuses, benefits (e.g., pension, health, dental), payroll taxes and temporary staffing services. For the comparable operating results of WFMS contained in this MD&A, compensation expense also includes distributions paid as bonuses to employee-shareholders. Other operating expenses include occupancy costs, technology costs (equipment leases, telecommunications and software), non-recoverable client service costs (such as printing, travel and third-party professional services), training, marketing, office costs, professional services (legal and audit) and insurance.

OVERVIEW AND OUTLOOK

The results for 2005 were as expected with revenue growth of 3% for the year. Removing the impact of two U.S. contracts which were terminated in 2005, the year-over-year growth was 7%. Adjusted EBITDA margin for the year was 22% compared to 20% for 2004.

The fourth quarter EBITDA margin was 24%, which reflects the expected strong final quarter for the year. Our fourth quarter Distributable Cash Payout Ratio(1) was 88% due to the seasonally high commission income earned during this period. On a quarterly basis, we expect some variability in Payout Ratio with the final quarter historically being the strongest. Over the course of 2006, we expect to meet our current rate of cash distributions of $0.825 per Unit.

Looking ahead, we expect to continue to perform well in 2006. We anticipate that our existing client relationships, together with new client engagements signed in 2005, will generate our expected solid revenue in 2006. There are no events so far that would lead us to believe our 2006 results will not be consistent with our past performance.

In 2006, we are continuing to execute our business strategy which includes focusing on our core services and striving to deliver high quality services in the most efficient and cost effective manner. Our strategy for future growth encompasses expanding relationships with current clients, continuing to attract new clients especially in the growing outsourcing market, targeting underserved markets and pursuing selected acquisitions.

(1) Payout Ratio is defined as declared distributions divided by Distributable Cash (see definition on page 12).

MANAGEMENT'S DISCUSSION AND ANALYSIS OF 2005 RESULTS

ANALYSIS OF 2005 OPERATING RESULTS

Results of Operations

Selected Unaudited Consolidated Financial Information *(In thousands of dollars)*	Quarter ended December 31 **2005**	2004	Year ended December 31 **2005**	2004
Revenue	**$ 30,071**	$ 28,936	**$ 120,323**	$ 116,862
Salaries and benefits expense	**17,024**	21,414	**81,117**	83,145
Other operating expense	**5,866**	6,598	**23,125**	23,781
Partnership distributions	**–**	719	**6,825**	2,875
Net income before non-controlling interest for the period	**2,624**	(259)	**2,161**	2,936
Add (Deduct):				
Gain of sale of property	**–**	(113)		(113)
Amortization	**4,025**	615	**5,920**	2,360
Taxes	**19**	(76)	**477**	1,679
Interest	**478**	38	**663**	199
EBITDA (1)	**7,146**	205	**9,221**	7,061
Adjustments:				
Executive compensation and employee-shareholder and partner distributions adjustments (2)	**–**	5,443	**16,703**	18,339
Tax credit adjustments (3)	**–**	(372)	**–**	(1,486)
Adjusted EBITDA (4)	**7,146**	5,276	**25,924**	23,914
Adjusted EBITDA Margin	**24%**	18%	**22%**	20%
Deduct:				
Interest	**478**	38	**663**	199
Current Taxes	**19**	(76)	**477**	1,679
Capital expenditures (5)	**106**	150	**556**	600
Total Distributable Cash (6)	**$ 6,543**	$ 5,164	**$ 24,228**	$ 21,436
Distributable Cash available to non-controlling interest	**$ 1,309**	n/a	**n/a**	n/a
Distributable Cash available for Unitholders	**$ 5,234**	n/a	**n/a**	n/a
Net income per Unit (basic and diluted)	**$ 0.09553**	n/a	**n/a**	n/a
Distributable Cash per Unit (basic and diluted)	**$ 0.23817**	n/a	**n/a**	n/a
Distributions declared per Unit (basic and diluted)	**$ 0.20854**	n/a	**n/a**	n/a
Payout ratio	**88%**	n/a	**n/a**	n/a

(1) "EBITDA" is defined as earnings before interest expense, income taxes, depreciation, amortization and non-controlling interest.
(2) Represents the difference between historical executive compensation (including employee-shareholder and partner distributions) and compensation arrangements in place since the acquisition of Morneau Sobeco by the Fund.
(3) Represents tax credits which were previously recorded as a reduction in salaries but for which Morneau Sobeco will no longer be eligible.
(4) "Adjusted EBITDA" is EBITDA adjusted for items that were applicable prior to the acquisition of Morneau Sobeco by the Fund in order to make historical comparisons more meaningful.
(5) Non-maintenance capital expenditures are not shown as a reduction from Distributable Cash for the periods prior to September 30, 2005 since these expenditures are considered non-recurring. The amounts shown for periods prior to September 30, 2005 reflect estimated capital expenditure requirements as a public company or $600,000 per year.
(6) "Distributable Cash" is defined as net income for the period adjusted for specific non-cash items, including amortization, future income taxes and maintenance capital expenditures. In the comparable data for the periods prior to September 30, 2005, Distributable Cash has also been adjusted for items that were applicable prior to the acquisition of Morneau Sobeco by the Fund in order to make historical comparisons more meaningful.

ANALYSIS OF 2005 ANNUAL RESULTS

Revenue

Revenue for the year ended December 31, 2005 increased by $3.5 million, or 3.0%, to $120.3 million compared to $116.9 million for 2004. The increase in revenue was a result of additional consulting and outsourcing business from a variety of clients, with one client increasing in revenue by $3.3 million. The increased fee revenue was partially offset by reduced commission revenue of $1.0 million as our business migrates to fee-based revenue and a $4.0 million reduction in outsourcing fees related to the termination of two contracts in the U.S.

U.S. revenue booked in our U.S. subsidiary declined to 7.2% of total revenue for the year ended December 31, 2005 from 11.3% of total revenue for 2004. The percentage decline was the result of the strengthening Canadian dollar compared to the U.S. dollar, the termination of a low margin U.S. contract, the in-sourcing of another U.S. contract and the growth of our Canadian revenues. During 2005 our Canadian subsidiaries increased the amount of revenue earned from U.S. clients. As this revenue is received in Canadian dollars, it is not subject to currency fluctuations.

Salaries and benefits

Salaries and benefits for the year ended December 31, 2005 decreased by $2.0 million, or 2.4%, to $81.1 million compared to $83.1 million for 2004. The decrease was attributable to reduced employee-shareholder distributions and one-time bonuses of $6.0 million, partially offset by salary increases of $2.4 million or 3.5% and the elimination of tax credits of $1.5 million.

Other operating expenses

Other operating expenses for the year ended December 31, 2005 decreased by $0.7 million, or 2.8%, to $23.1 million compared to $23.8 million for 2004. The decrease is primarily due to reduced technology spending of $0.5 million, $0.7 million in reduced discretionary expenses such as travel, advertising and client promotions and $0.1 in bad debt recovery. This was partially offset by increases in legal fees of $0.2 million, audit fees for our outsourcing practices of $0.2 million and our November 2004-2005 insurance renewal of $0.2 million.

Interest expense

Interest expense increased for the year ended December 31, 2005 by $0.5 million, or 233%, to $0.7 million due to the debt restructuring in connection with the change in ownership of the business on September 30, 2005 and the formation of the Fund. On September 30, 2005, the WFMS term loan of $10 million was repaid and the Fund entered into a new term credit facility of $35 million. The operating line was also drawn to $5 million for a 21 day period in connection with the IPO and acquisition of the controlling interest of Morneau Sobeco by the Fund. The operating line balance was $nil at December 31, 2005.

Amortization

Amortization for the year ended December 31, 2005 increased by $3.6 million, or 151%, to $5.9 million compared to $2.3 million for 2004. The increase was attributable to a valuation of the intangible assets as a result of the purchase of WFMS.

Partnership distributions

Distributions from WFMS's limited partnership subsidiary for the year ended December 31, 2005 increased by $3.9 million to $6.8 million compared to $2.9 million for the same period in 2004. The increase was attributable to the final partnership distribution negotiated in the buyout of the final external partner on April 29, 2005.

Income tax expense

Income tax expense for the year ended December 31, 2005 decreased by $1.2 million, or 71.6%, to $0.5 million compared to $1.7 million for the prior year. The decrease was primarily attributable to increased partnership and trust distributions.

Net income before non-controlling interest

As a result of the changes in revenue and expenses described above, net income for the year ended December 31, 2005 decreased by $0.8 million to $ 2.1 million compared to $2.9 million for 2004.

Non-GAAP financial measures: EBITDA, Adjusted EBITDA and Distributable Cash

Management believes that Adjusted EBITDA is a useful measure in evaluating the performance of the Fund as certain previous arrangements are non-recurring and will differ materially from ongoing arrangements as a public entity. Management also believes that Distributable Cash is a useful supplemental measure of performance as it is generally used by Canadian open-ended business income funds as an indicator of financial performance.

In order to make historical data of WFMS more comparable to the ongoing performance data of the Fund, we have made the following two adjustments to EBITDA and to Distributable Cash:

(i) As a private company, WFMS historically paid out substantial amounts of pre-tax income as distributions to its shareholders and partners each year. Distributions to employee-shareholders were reflected as salary expenses. Distributions to partners were reflected as partnership earnings. Since the practice of paying such distributions has been discontinued effective September 30, 2005, management believes that an adjustment to historical EBITDA to account for such distributions should be made to arrive at an adjusted amount of EBITDA. As the new executive compensation arrangements effective October 1, 2005 differ materially from the previous arrangements, management believes that adjustments relating to the new executive compensation arrangements are a more useful reflection of the results of operations of WFMS. To provide consistency, adjustments have been made to executive compensation arrangements as if the new compensation arrangements had been in place for all of 2005 and 2004.

(ii) We have also adjusted EBITDA in comparable WFMS data to remove the impact of a tax credit in relation to certain 'e-commerce' activities for which Morneau Sobeco is no longer eligible. This credit was historically recorded as a reduction to salaries and benefits expense.

Adjusted EBITDA

Adjusted EBITDA increased $2.0 million, or 8.4%, to $25.9 million for 2005 compared to $23.9 million for 2004. The increase is due to increased revenue of $3.5 million offset by expense growth of $1.7 million.

Total Distributable Cash

Total Distributable Cash increased by $2.8 million, or 13.0% to $24.2 million for 2005 relative to $21.4 million for 2004. This increase is primarily due to increased Adjusted EBITDA of $2.0 million as discussed above and lower taxes of $1.2 million, partially offset by higher interest expense of $0.5 million.

Distributions to Unitholders

Monthly distributions are declared by the Fund for Unitholders of record on the last business day of each month and are paid on about the 15th day of the following month.

The tax allocation of distributions declared for 2005 is 97.56% interest income and 2.44% return of capital.

ANALYSIS OF 2005 FOURTH QUARTER RESULTS

Revenue

Revenue for the three months ended December 31, 2005 increased by $1.1 million, or 3.9%, to $30.1 million compared to $29.0 million for the same period in 2004. The increase in revenue was a result of additional consulting and outsourcing business from a variety of clients, with one client increasing in revenue by $1.0 million. This was partially offset by reduced commission revenue of $1.0 million as our business migrates to fee-based revenue and a $1.1 million reduction in outsourcing fees related to the termination of two contracts in the U.S.

Salaries and benefits

Salaries and benefits for the three months ended December 31, 2005 decreased by $4.4 million, or (20.5)%, to $17.0 million compared to $21.4 million for the same period in 2004. The decrease was attributable to the elimination of employee-shareholder distributions and reduced executive compensation of $5.1 million and $0.2 million due to the closure of two U.S. offices. These decreases were partially offset by salary increases of $0.5 million or 3.0% and the elimination of tax credits of $0.4 million.

Other operating expenses

Other operating expenses for the three months ended December 31, 2005 decreased by $0.7 million, or 11.1%, to $5.9 million compared to $6.6 million for the same period in 2004. The decrease is primarily due to reduced technology spending of $0.2 million, $0.5 million in reduced discretionary expenses such as advertising, client promotions, entertainment and donations and $0.2 in bad debt recovery and reduced provision requirements. This was partially offset by increases in legal fees of $0.2 million.

Interest expense

Interest expense for the three months ended December 31, 2005 increased by $0.4 million to $0.5 million as a result of the debt restructuring in connection with the change in ownership of the business on September 30, 2005 and the formation of the Fund. On September 30, 2005, the Fund entered into a new term credit facility of $35 million. The operating line was also drawn to $5 million for a 21 day period in connection with the IPO and acquisition of the controlling interest of Morneau Sobeco by the Fund. This compares to an average debt of $4.0 million for the three months ended December 31, 2004.

Amortization

Amortization for the three months ended December 31, 2005 increased by $3.4 million, or 554%, to $4.0 million compared to $0.6 million for the same period in 2004. The increase was attributable to the increase in intangible assets as a result of the purchase of WFMS by the Fund.

Partnership distributions

Distributions from WFMS's limited partnership subsidiary for the three months ended December 31, 2005 was $nil compared to $0.7 million for the same period in 2004 as the final partnership distribution was paid on April 29, 2005.

Income tax expense

Income tax expense for the three months ended December 31, 2005 increased by $0.1 million, to $19 thousand compared to tax recovery of $76 thousand for the same period in 2004. The changes in tax expense are primarily attributable to changes in partner and trust distributions.

Net income before non-controlling interest

As a result of the changes in revenue and expenses described above, net income for the three months ended December 31, 2005 increased by $2.9 million to $2.6 million compared to a loss of $0.3 million for the same period in 2004.

Non-GAAP Financial Measures: EBITDA, Adjusted EBITDA and Distributable Cash

Adjusted EBITDA

Adjusted EBITDA increased $1.9 million, or 35.4%, to $7.2 million for the three months ended December 31, 2005 compared to $5.3 million for the same period in 2004. The increase is due to increased revenue net of compensation increases of $1.1 million and lower operating costs of $0.7 million.

Total Distributable Cash

Total Distributable Cash increased by $1.4 million, or 26.7%, to $6.6 million for the three months ended December 31, 2005 relative to $5.2 million for the same period in 2004. This increase is primarily due to increased Adjusted EBITDA of $1.9 million as discussed above, partially offset by higher taxes of $0.1 million and higher interest of $0.5 million.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows

The following table provides an overview of the Fund's cash flows for the periods indicated.

Cash Flow Information

Selected Unaudited Consolidated Financial Information *(In thousands of dollars)*	Quarter ended December 31 **2005**	2004	Year ended December 31 **2005**	2004
Operating Activities	**$ 6,393**	$ (86)	**$ 2,568**	$ 3,195
Less employee-shareholder distributions and one-time bonuses	**–**	(1,426)	**(17,664)**	(5,058)
Adjusted Operating Activities	**6,393**	1,340	**20,232**	8,253
Investing Activities	**(106)**	(242)	**(212,421)**	(1,823)
Financing Activities	**(8,628)**	1,275	**209,729**	(181)
Less partner distributions	**–**	1,750	**(2,500)**	368
Adjusted Financing Activities	**(8,628)**	(475)	**212,229**	(549)
Increase (decrease) in cash before employee-shareholder and partner distributions and one-time bonuses	**(2,341)**	623	**20,040**	5,881
Employee-shareholder and partner distributions and one-time bonuses[1]	**–**	324	**(20,164)**	(4,690)
Increase (decrease) in cash after employee-shareholder and partner distributions and one-time bonuses	**$ (2,341)**	$ 947	**$ (124)**	$ 1,191

(1) Represents the sum of the aggregate employee-shareholder and partner distributions and one-time bonuses deducted from Operating Activities and Financing Activities.

2005 Annual Results

Cash inflows from adjusted operating activities increased by $12.0 million or 145% to $20.2 million for the year ended December 31, 2005 from $8.2 million for 2004. This increase was due primarily to improved profits of $1.9 million, improved collections of receivables and unbilled fees of $6.2 million and reduced taxes receivable of $3.9 million.

Cash outflows from investing activities increased by $210.6 million for the year ended December 31, 2005 to $212.4 million from a $1.8 million outflow for 2004. This increase was attributable to the purchase of WFMS for $209.8 million and $1.2 million in dividends paid prior to the IPO, partially offset by reduced capital asset purchases of $0.4 million due to facility improvements.

Cash inflows from adjusted financing activities increased by $212.8 million for the year ended December 31, 2005 to $212.2 million from an outflow of $0.6 million for 2004. This increase was attributable to the proceeds from the IPO of $199.8 million less costs of $15.3 million and $31.5 million in additional term loans, partially offset by $3.3 million in distributions paid.

Cash outflows for employee-shareholder and partner distributions and one-time bonuses increased by $15.5 million or 330% to $20.2 million for the year ended December 31, 2005 from an outflow of $4.7 million for the same period in 2004. This was due to larger payments made in 2005 for both 2004 and 2005.

2005 Fourth Quarter Results

Cash inflows from adjusted operating activities increased by $5.1 million or 377%, to $6.4 million for the three months ended December 31, 2005 from $1.3 million for the same period in 2004. This increase was primarily due to improved profits of $1.8 million, improved collections of receivables and unbilled fees of $1.2 million, deferred financing charges of $0.2 million relating to the new credit facilities and reduced taxes receivable of $4.1 million. This was partially offset by reduced payables of $1.9 million related to the payment of IPO expenses.

Cash outflows from investing activities decreased by $0.1 million or 56% for the three months ended December 31, 2005 to $0.1 million from $0.2 million for the same period in 2004. This decrease was attributable to reduced capital asset purchases.

Cash outflows from adjusted financing activities increased by $8.2 million for the three months ended December 31, 2005 to $8.6 million from $0.4 million for the same period in 2004. This increase was attributable to the elimination of the $5.0 million temporary line of credit required to facilitate the cash transfers at closing, incremental IPO costs of $0.4 million and distributions paid of $3.3 million. This was partially offset by the reduction in debt for 2004 of $0.5 million.

Cash outflows from employee-shareholder and partner distributions and one-time bonuses remained flat at $nil for the three months ended December 31, 2005 compared to an inflow of $0.3 million for the same period in 2004. This was due to larger payments made in early 2005 for both 2004 and 2005.

Capital Expenditures

Pension and benefits consulting and outsourcing is not a capital intensive business. Historically, capital expenditures have included office furniture, facility improvements and information technology software and hardware. Over the two-year period ended December 31, 2005, we undertook non-recurring capital expenditures relating to buildings, office furniture, facility improvements and information technology software totaling $2.7 million. Going forward, we expect capital expenditures required to maintain our current platform will be approximately $600,000 per year, principally related to information technology hardware and telecommunications equipment, which over the last three years have averaged less than $450,000 per year. Additional capital expenditure requirements may result from significant business expansion. Such amounts are expected to be funded from our operating cash flow.

Contractual obligations

The Fund leases office space and selected equipment under operating lease agreements with terms ranging from one to nine years. It also has a term loan described under "Capital Resources". Future expected payments are as follows:

Summary of Contractual Obligations

Selected Unaudited Consolidated Financial Information

(In thousands of dollars)	Total	2006 to 2008	2009 to 2010	Beyond 2010
Term Loan	$ 35,000	–	$ 35,000	–
Operating Leases	24,204	$ 12,326	6,124	$ 5,754
Total	$ 59,204	$ 12,326	$ 41,124	$ 5,754

The Fund has no material contractual obligations other than those described elsewhere in this MD&A and has no off-balance sheet financing arrangements.

Capital Resources

Morneau Sobeco has historically utilized cash from operations to finance working capital requirements and fund growth. As at December 31, 2005, the Fund's working capital (current assets minus current liabilities) was approximately $21.5 million. Liabilities consist mainly of accounts payable and accrued liabilities of $4.2 million, accrued compensation and related benefits of $5.8 million and Unitholder distributions payable of $2.5 million.

Morneau Sobeco has also maintained credit facilities to manage working capital requirements throughout the year. The Fund's credit facilities include a term loan of $35 million repayable in full on September 30, 2009. The term loan bears interest at bankers' acceptance rates plus 1%, which have been fixed at 4.4% using an interest rate swap. The credit facilities also include a secured operating line of credit of up to $15 million bearing interest at bankers' acceptance rates plus 1% and a stand-by fee of 0.2% on the undrawn portion.

As at December 31, 2005, the operating line was undrawn and the Fund had excess cash of $4.3 million.

The following table provides an overview of the Fund's capital resources.

Capital Resources

Selected Unaudited Consolidated Financial Information

(In thousands of dollars)	As at December 31, 2005
Cash	$ 4,348
Long-term debt	$ 35,000
Working capital	$ 21,454
Unitholders' equity	$ 201,992

MANAGEMENT'S DISCUSSION AND ANALYSIS OF 2005 RESULTS

SELECTED BALANCE SHEET DATA

The balance sheet is not comparable to periods prior to the IPO because at that time financing was restructured and long-term assets were revalued to market value. Total Assets at December 31, 2005 were $303.7 million.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements, in accordance with GAAP, requires management to make estimates and assumptions that affect the reported values of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Accordingly, actual results could differ from these estimates. The accounting policies and estimates that are critical to the Fund's business relate to the following:

Revenue recognition

We earn fee-for-service revenue based on hourly rates and the time spent delivering those services. We also earn contracted revenue based on negotiated fixed amounts or on a formula tied to the nature of the service, rather than the time spent. Revenue is recognized in the period that the service is rendered, irrespective of when it is invoiced. Unbilled fees are recorded at the lower of unbilled hours worked at standard billing rates and the amount which management estimates can be recovered upon invoicing. Expenses are recognized as incurred. Losses on fixed fee contracts are recognized during the period in which the loss becomes probable. Billings in excess of revenue are recorded as a deferred revenue liability, included with accounts payable and accrued liabilities, until services are rendered. Revenue does not include reimbursements for recoverable expenses, such as employee travel expenses, outside printing and third-party professional services. Reimbursements are accounted for as a reduction to expenses.

We also earn commission revenue as payment for the provision of benefits consulting services to clients, as a percentage of insurance premiums paid by our clients. Commission revenue is received annually, semi-annually, quarterly or monthly. Annual fees are typically paid at the beginning of the insurance policy period and are recognized as income at the later of the billing or effective date of the policy, net of a provision for return commissions due to policy cancellations.

Amortization of finite-life intangible assets

The Fund has accounted for its acquisition of WFMS using the purchase method of accounting. Intangible assets consisting principally of customer relationships, proprietary software and customer contracts have been recognized on acquisition based on management's best estimate of the relative fair values. These finite-life intangible assets are being amortized over their estimated useful lives of twenty, five and three years respectively. Impairment is assessed annually or when events or changes in circumstances indicate the carrying amount of assets may not be recoverable.

Goodwill is not amortized and is subject to an impairment test. Goodwill impairment is assessed based on a comparison of the fair value of the Fund and its net assets including goodwill. An impairment loss will be recognized if the carrying amount of the Fund's net assets exceeds its fair value.

Allowance for doubtful accounts

A provision for accounts receivable resulting from the potential risk that the receivable will not be collected has been recorded. Management continually monitors past due accounts to assess the likelihood of collection to estimate the required provision.

Litigation and claims

The Fund is involved in litigation and other claims arising in the normal course of business. Management must use judgment to determine whether or not a claim has any merit, the amount of the claims and whether to record a provision, which is dependent upon the potential success of the claim. Management believes that none of the current claims will have a material adverse impact on the financial position of the Fund.

Future income tax

The Fund uses the asset and liability method of accounting for income taxes. Future income tax assets are recognized only to the extent that management determines it is more likely than not that the future income tax assets will be realized. Prior to legal restructuring of the Morneau Sobeco business in connection with the IPO, income taxes recoverable related to a tax credit for e-commerce activities which is no longer available.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The Fund's financial instruments consist of cash, accounts receivable, accounts payable and accrued liabilities, Unitholders' distributions payable, interest rate swaps and a term loan.

The Fund has a term loan of $35 million with two Canadian chartered banks repayable on September 30, 2009. The Fund has entered into interest rate swap agreements to fix the interest rate at 4.4% for the 4-year term. The Fund also has available an operating line of credit for $15 million. The line of credit bears interest at the bankers' acceptance rate plus 1%. There was no balance drawn on the line of credit at December 31, 2005.

The carrying value of the financial instruments approximates their fair values due to their short-term nature or, in the case of the term loan, due to the interest rate swap agreements in place.

The Fund is not engaged in currency hedging activities and does not own other instruments that may be settled by the delivery of non-financial assets. The Fund realizes a portion of its sales in U.S. dollars and is thus exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar. The net revenue exposure after accounting for related expenses denominated in U.S. dollars was approximately US$3.3 million for the year ended December 31, 2005.

In management's view, the Fund is not exposed to significant interest, currency or credit risks arising from financial instruments.

RISKS AND UNCERTAINTIES

The result of operations, business prospects and financial condition of the Fund are subject to a number of risks and uncertainties and are affected by a number of factors outside the control of management of the Fund.

Ability to Maintain Profitability and Manage Growth

There can be no assurance that the Fund will be able to sustain profitability in future periods. The Fund's future operating results will depend on a number of factors, including its ability to continue to execute its strategy successfully.

There can be no assurance that the Fund will be successful in achieving its strategic plan or that its strategic plan will enable it to maintain its historical revenue growth rates or to sustain profitability. Failure to execute any material part of the Fund's strategic plan successfully could have a material adverse effect on its business, financial condition and operating results and the ability of the Fund to make distributions on the Units.

There can be no assurance that the Fund will be able to manage its growth effectively, and any failure to do so could have a material adverse effect on its and the Fund's business, financial condition and results of operations and the ability of the Fund to make distributions on the Units.

Reliance on Information Systems and Technology

Information systems are an integral part of the Fund's business and the products and services offered to its clients. The Fund relies on systems to maintain accurate records and to carry out required administrative functions in accordance with the terms of its contractual obligations to its clients. We rely on the Internet as a key mechanism for delivering our services to our clients and achieving efficiencies in our service model. Any disruptions in our systems, the failure of our systems to operate as expected or our ability to use the Internet effectively to deliver our services could, depending on the magnitude of the problem, result in a loss of current or future business and/or potential claims against the Fund, all of which could materially adversely affect the Fund's business, financial condition and results of operations and the ability of the Fund to make distributions on the Units.

Reputational Risk

We depend to a large extent on our relationships with our clients and our reputation for high-quality outsourcing and consulting services. As a result, if a client is not satisfied with our services or products, it may be more damaging to our business than to other businesses. Moreover, if we fail to meet our contractual obligations, we could be subject to legal liability or loss of client relationships.

Dependence on Key Clients

For the twelve months ended December 31, 2005, the Fund's largest client accounted for approximately 14% of revenue and our top 10 clients, in the aggregate, accounted for approximately 37% of revenue. As clients may terminate engagements with minimal notice, there can be no assurance that we will be able to retain our relationships with our largest clients. Moreover, there can be no assurance that such clients will continue to use our services in the future. Any negative change involving any of the Fund's largest clients, including but not limited to a client's financial condition or desire to continue using our services, could result in a significant reduction in revenue, which could have a material adverse effect on the Fund's business, results of operations and financial condition and the ability of the Fund to make distributions on the Units.

Risk of Future Legal Proceedings

The Fund may be threatened with, or may be named as a defendant in, or may become subject to various legal proceedings in the ordinary course of conducting its business, including lawsuits based upon professional errors and omissions. The nature of the Fund's business involves assumptions and estimates concerning future events, the actual outcome of which the Fund cannot know with certainty in advance. In addition, the Fund could make computational, software programming or data management errors. The Fund's exposure to liability on a particular project may be greater than the profit opportunity of the project. For example, possible claims may include, without limitation: (i) a client's assertion that actuarial assumptions used in a pension plan were unreasonable, leading to plan underfunding; (ii) a claim arising out of the use of inaccurate data, which could lead to an underestimation of plan liabilities; and (iii) a claim that employee benefit plan documents were misinterpreted or plan amendments were misstated in plan documents, leading to overpayments to beneficiaries. Defending lawsuits of this nature or arising out of any of the services provided by the Fund could require substantial amounts of management attention, which could divert their focus from operations and could materially adversely affect the Fund's financial condition. Any such claims may produce negative publicity that could hurt the Fund's reputation and business. A significant judgment against the Fund or the imposition of a significant fine or penalty as a result of a finding that the Fund failed to comply with laws or regulations could have a significant adverse impact on the Fund's business, financial condition and results of operations and the ability of the Fund to make distributions on the Units.

Reliance on Key Professionals

The Fund's operations are dependent on the abilities, experience and efforts of its professionals, many of whom have significant reputations and contacts in the industry in which the Fund operates. The Fund's business depends, in part, on our professionals' ability to develop and maintain alliances with businesses such as brokerage firms, financial services companies, health care organizations, insurance companies, business process outsourcing organizations and other companies in order to develop, market and deliver its services. If the Fund's strategic alliances are discontinued, due to the loss of professional staff or otherwise, or if it has difficulty developing new alliances, profitability could be negatively impacted. Should any members of its professional staff be unable or unwilling to continue their relationship with the Fund, the business, financial condition and operating results of the Fund and the ability of the Fund to make distributions on the Units could be materially adversely impacted.

Competition

The Fund operates in a highly competitive North American market in its service areas. As a result, the Fund competes with many domestic and international firms. Some of its competitors have achieved substantially more market penetration in certain of the areas in which the Fund competes. In addition, some of the Fund's competitors have substantially more financial resources and/or financial flexibility than the Fund. These competitive forces could have a material adverse effect on the business, financial condition and results of operations of the Fund and the ability of the Fund to make distributions on the Units by reducing the Fund's current market share in the area it serves.

Further detail is provided in the "Risk Factors" section of the Annual Information Form available on SEDAR (www.sedar.com).

DISCLOSURE CONTROLS

As of December 31, 2005, an evaluation of the effectiveness of disclosure controls and procedures (as defined under *Multilateral Instrument 52-109*) was carried out by management under the supervision of the Chief Executive Officer and the Chief Financial Officer. Based on the evaluation, the Chief Executive Officer and the Chief Financial officer concluded that the design and operation of these disclosure controls and procedures were effective.

ADDITIONAL INFORMATION

The Fund's Units trade on the Toronto Stock Exchange under the symbol MSI.UN. Additional information relating to the Fund, including all public filings, is available on SEDAR (www.sedar.com) and on our Web site at www.morneausobeco.com.

The content of this MD&A reflects information known at March 16, 2006.

Consolidated Financial Statements

MANAGEMENT STATEMENT OF RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements for Morneau Sobeco Income Fund (the "Fund") have been prepared by management and approved by the Board of Trustees of the Fund. Management is responsible for the preparation and presentation of these financial statements and all the financial information contained in the Annual Report within reasonable limits of materiality. The Fund's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. In the preparation of these financial statements, estimates are necessary because a precise determination of certain assets and liabilities is dependent on future events. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying consolidated financial statements.

To assist management in discharging these responsibilities, the Fund maintains a system of internal controls, which is designed to provide reasonable assurance that the Fund's assets are safeguarded, that transactions are executed in accordance with management's authorization and that the financial records form a reliable base for the preparation of accurate and timely financial information.

Management recognizes its responsibilities for conducting the Fund's affairs in compliance with established financial reporting standards and applicable laws, and for the maintenance of proper standards of conduct in its activities.

KPMG LLP, Chartered Accountants, were appointed as external auditors by the Trustees of the Fund and have audited the consolidated financial statements of the Fund in accordance with Canadian generally accepted auditing standards. Their report outlines the nature of their audit and expresses their opinion on the consolidated financial statements of the Fund.

The Board of Trustees of the Fund has appointed an Audit Committee composed of three trustees who are not members of management. The Audit Committee meets periodically with management and the external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee is responsible for reviewing the Fund's annual and interim consolidated financial statements and the report of the external auditors. The Audit Committee reports the results of such reviews to the Board of Trustees of the Fund and makes recommendations with respect to the appointment of the Fund's external auditors. In addition, the Board of Trustees may refer to the Audit Committee on other matters and questions relating to the financial position of the Fund and its subsidiaries.

The Board of Trustees of the Fund is responsible for ensuring that management fulfills its responsibilities for financial reporting and is responsible for approving the consolidated financial statements of the Fund.

William Morneau, Jr.
President and CEO

Nancy Reid
Chief Financial Officer

AUDITORS' REPORT TO THE UNITHOLDERS

We have audited the consolidated balance sheet of Morneau Sobeco Income Fund ('the Fund') as at December 31, 2005 and the consolidated statements of income and deficit and cash flows for the period from August 22, 2005 to December 31, 2005. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2005 and the results of its operations and its cash flows for the period then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Toronto, Canada
March 10, 2006

MORNEAU SOBECO INCOME FUND
CONSOLIDATED BALANCE SHEET

(In thousands of dollars)	As at December 31, 2005
Assets	
Current assets:	
Cash	$ 4,348
Accounts receivable	22,562
Unbilled fees	4,482
Income taxes recoverable	659
Prepaid expenses and other	1,807
	33,858
Future income taxes (note 11)	600
Capital assets (note 4)	11,291
Intangible assets (note 5)	131,458
Goodwill (note 3)	126,511
	$ 303,718
Liabilities and Unitholders' Equity	
Current liabilities:	
Accounts payable and accrued liabilities	$ 4,179
Accrued compensation and related benefits	5,764
Unitholder distributions payable (including non-controlling)	2,461
	12,404
Insurance premium liabilities:	
Payable to insurance companies	5,413
Less related cash and investments held	(5,413)
	–
Long-term debt (note 6)	35,000
Non-controlling Interest (note 8)	54,322
Unitholders' Equity:	
Fund Units (note 7)	204,476
Deficit	(2,484)
	201,992
	$ 303,718

Commitments (note 13)
Contingencies (note 14)

Robert Chisholm
Trustee, Audit Committee Chair

William Morneau, Jr.
Trustee, President and CEO

See accompanying notes to consolidated financial statements

MORNEAU SOBECO INCOME FUND
CONSOLIDATED STATEMENT OF INCOME AND DEFICIT

(In thousands of dollars except unit and per unit amounts)	For the period from August 22, 2005 to December 31, 2005
Revenue	
Fees	$ 26,658
Commissions	3,337
Other	76
	30,071
Expenses	
Salaries and benefits	17,024
Other operating	5,866
Loss on disposal of capital assets	35
Amortization of capital assets (note 4)	483
Amortization of intangible assets (note 5)	3,542
Interest	478
	27,428
Income before income taxes	2,643
Income taxes (recovery) (note 11)	
Current	83
Future	(64)
	19
Income before non-controlling interest	2,624
Non-controlling interest	(525)
Net income	2,099
Distributions declared (note 9)	(4,583)
Deficit, end of period	$ (2,484)
Net income per Unit – (basic and diluted)	$ 0.09553

See accompanying notes to consolidated financial statements

MORNEAU SOBECO INCOME FUND
CONSOLIDATED STATEMENT OF CASH FLOWS

(In thousands of dollars)	For the period from August 22, 2005 to December 31, 2005
Cash provided by (used in):	
Operating activities	
Net income	$ 2,099
Items not involving cash:	
Amortization	4,025
Loss on disposal of capital assets	35
Non-controlling interest of Class B LP Units	525
	6,684
Change in non-cash operating working capital:	
Accounts receivable	2,790
Income taxes recoverable	1,601
Unbilled fees	(394)
Prepaid expenses and other	(464)
Accrued compensation and related benefits	(2,411)
Accounts payable and accrued liabilities	(1,477)
	6,329
Financing activities	
Issuance of units (note 7)	199,793
Expenses related to issuance of units (note 7)	(15,296)
Proceeds from long-term debt (note 6)	35,000
Issuance of over-allotment units	19,979
Distributions paid	(3,268)
Repayment of term loan (note 6)	(10,000)
	226,208
Investing activities	
Business acquisition of W.F. Morneau Services, Inc., net of cash acquired of $1,689 (note 3)	(208,104)
Additional acquisition through over-allotment (note 1)	(19,979)
Purchase of capital assets	(106)
	(228,189)
Increase in cash, being cash balance at end of period	$ 4,348
Supplemental disclosures:	
Interest paid	$ 314
Income taxes paid	$ 183
Income tax refund	$ (1,644)

See accompanying notes to consolidated financial statements.

MORNEAU SOBECO INCOME FUND
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the period from August 22, 2005 to December 31, 2005
(In thousands of dollars except unit and per unit amounts)

1. ORGANIZATION AND NATURE OF THE BUSINESS

Morneau Sobeco Income Fund (the "Fund") is an unincorporated, open-ended, limited purpose trust established under the laws of the Province of Ontario by a Declaration of Trust made as of August 22, 2005. The Fund was established through the issuance of one unit for ten dollars.

On September 30, 2005, the Fund completed an initial public offering ("IPO") and the sale of 19,979,284 trust units ("Units") for $10.00 per Unit, for total gross proceeds of $199,793. On October 18, 2005 the over-allotment option of the Fund's IPO was exercised resulting in the issuance of an additional 1,997,928 Units, for gross proceeds of $19,979.

The additional proceeds received by the Fund (net of expenses incurred by the Fund) were used to indirectly purchase exchangeable Class B limited partnership units ("Class B LP Units") of Morneau Sobeco Group Limited Partnership, held primarily by the Morneau family members.

The Fund is a leading Canadian-owned pension and benefits consulting and outsourcing firm, providing services to organizations across Canada and in the United States. The Fund focuses on the integrated design and delivery of retirement and employee compensation and benefit programs.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Fund have been prepared by management in accordance with Canadian generally accepted accounting principles and the significant accounting policies are summarized below:

(a) Basis of presentation

These consolidated financial statements include the assets, liabilities, revenue and expenses of the following entities:

	% Ownership
Morneau Sobeco Limited Partnership ("MSLP")	80%
Morneau Sobeco Group Limited Partnership ("MS Group LP")	80%
Morneau Sobeco, Ltd. ("MSUS")	80%
Morneau Sobeco Corporation ("MS Corp")	80%
Morneau Sobeco Trust ("Trust")	100%
Morneau Sobeco GP Inc. ("MS GP")	100%

As the Fund was established on August 22, 2005 and had no revenue or expenses until September 30, 2005 when the Fund acquired W.F. Morneau Services, Inc., the Consolidated Statement of Income and Deficit reflects the results of operations for the period from September 30, 2005 to December 31, 2005.

(b) Financial instruments

The fair value of the Fund's financial assets and liabilities approximate carrying values due to their short-term nature or with respect to the long-term debt instruments, because they bear interest at market rates. The Fund does not enter into financial instruments for trading or speculative purposes.

Interest rate swap agreements are used as part of the Fund's program to manage the fixed and floating interest rate mix of the Fund's total debt outstanding and related overall cost of borrowing. The interest-rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based and are recorded as an adjustment of interest expenses on the related debt instrument. The related amount payable to, or receivable from, swap counterparties is included as an adjustment to accrued interest.

(c) Measurement uncertainties

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(d) Revenue recognition and unbilled fees

Fees for administrative, actuarial and consulting services are recognized when the services are rendered.

Unbilled fees are recorded at the lower of unbilled hours worked at normal billing rates and the amount, which is estimated to be recoverable upon invoicing.

Commissions are recognized when earned which is at the later of the billing or effective date of the policy, net of a provision for return commissions due to policy cancellation.

Investment income is recorded on the accrual basis.

(e) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the exchange rate prevailing at the consolidated balance sheet dates.

Non-monetary items have been translated into Canadian dollars at the exchange rate prevailing when the assets were acquired or obligations incurred. Revenue and expenses have been translated at rates in effect on the transaction dates. Exchange gains or losses are reflected in income for the period.

For the period from August 22, 2005 to December 31, 2005
(In thousands of dollars except unit and per unit amounts)

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Capital assets

Capital assets are stated at their initial capital cost less accumulated amortization. Amortization is provided over the assets' estimated useful lives as follows:

Asset	Basis	Rate
Computer equipment	Declining balance	30%
Furniture and equipment	Declining balance	20%
Leasehold improvements	Straight-line	Over term of the lease

(g) Intangible assets and goodwill

Intangible assets consisting principally of customer relationships, proprietary software and customer contracts have been recognized on acquisition, based on management's best estimate of the relative fair values. These intangible assets are being amortized on a straight-line basis over their estimated useful lives of twenty, five and three years respectively.

Goodwill is not amortized and is subject to an impairment test. Goodwill impairment is assessed based on a comparison of the estimated fair value of the Fund and the carrying value of its net assets including goodwill. An impairment loss will be recognized if the carrying amount of the Fund's net assets exceeds its estimated fair value.

(h) Impairment of long-lived assets

The Fund periodically reviews the useful lives and the carrying values of its long-lived assets for continued appropriateness. The Fund reviews long-lived assets for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. An impairment loss is measured at the amount by which the carrying amount of the long-lived asset exceeds its fair value.

(i) Insurance premium liabilities and related cash and investments

In its capacity as consultants, the Fund collects premiums from insureds and remits premiums, net of agreed deductions, such as taxes and commissions, to insurance underwriters. These are considered flow-through items for the Fund and, as such, the cash and investment balances relating to these liabilities are deducted from the related liability in the consolidated balance sheet.

(j) Employee future benefits

The Fund has a pension benefit plan covering its employees, which includes a defined benefit option and a defined contribution option.

The defined benefit option was closed effective January 1, 1998 and includes 9 employees, 3 retirees and 55 deferred vested members. All other employees are covered by the defined contribution option of the plan.

The Fund accrues its obligations under the defined benefit option of the plan as the employees render the services necessary to earn the pension. For the defined contribution option, the Fund matches member contributions and may be required to make additional contributions at the option of the member, up to the limits defined in the plan text.

(k) Income taxes

The Fund uses the asset and liability method of accounting for income taxes. Under this method of tax allocation, future tax assets and liabilities are recognized on the basis of future tax consequences attributable to differences between the carrying amounts of assets and liabilities as recorded in the consolidated financial statements and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period in which the date of enactment or substantive enactment occurs.

3. BUSINESS ACQUISITION

On September 30, 2005, through a series of transactions subsequent to the IPO, the Fund indirectly acquired common shares of W.F. Morneau Services, Inc. ("Morneau Sobeco") with the former shareholders of Morneau Sobeco (comprised of the senior management of Morneau Sobeco and Morneau family members) retaining an approximate 27.3% interest in Morneau Sobeco. This interest was reduced to 20% when the over-allotment option of the IPO was exercised.

(In thousands of dollars except unit and per unit amounts)

3. BUSINESS ACQUISITION (CONTINUED)

The acquisition has been accounted for by the purchase method. The allocation of the purchase price is summarized as follows:

Assets and liabilities acquired:	
Cash	$ 1,689
Accounts receivable	25,352
Income taxes recoverable	2,325
Unbilled fees	4,087
Prepaid expenses and other	1,343
Future income taxes	536
Capital assets	11,703
Intangible assets	135,000
Goodwill	126,511
Accrued compensation and related benefits	(8,175)
Accounts payable and accrued liabilities	(5,656)
Payable to insurance companies	(5,964)
Related cash balances held	5,964
Term loan	(10,000)
	$ 284,715
Consideration:	
Cash	$ 209,793
Class B LP Units	74,922
	$ 284,715

4. CAPITAL ASSETS

The Fund's capital assets are comprised of:

	Cost	Accumulated amortization	Net book value
Computer equipment	$ 1,479	$ (94)	$ 1,385
Furniture and equipment	2,696	(123)	2,573
Leasehold improvements	7,599	(266)	7,333
	$ 11,774	$ (483)	$ 11,291

5. INTANGIBLE ASSETS

The Fund's intangible assets are comprised of:

	Cost	Accumulated amortization	Net book value
Customer relationships	$ 90,000	$ (1,125)	$ 88,875
Customer contracts	5,000	(417)	4,583
Proprietary software	40,000	(2,000)	38,000
	$ 135,000	$ (3,542)	$ 131,458

6. BANK INDEBTEDNESS AND LONG-TERM DEBT

On September 30, 2005, the Fund repaid the term loan of $10,000 relating to the business acquired (note 3).

At December 31, 2005, the Fund has a secured term loan of $35,000 with two Canadian chartered banks repayable in full on September 30, 2009. The term loan bears interest at the bankers' acceptance rate plus 1%. The Fund has entered into interest rate swap agreements in order to fix the interest rate at 4.4% for the duration of the loan. The fair value of the interest rate swap at December 31, 2005 is $72.

The Fund also has available a secured operating line of credit for $15,000 with no amount drawn at December 31, 2005. The line of credit bears interest at the bankers' acceptance rate plus 1% and the undrawn portion incurs a stand-by fee of 0.20%. The bank indebtedness and term loan are secured by a general assignment of the assets of the Fund.

7. FUND UNITS

The Fund is authorized to issue an unlimited number of Units. On September 30, 2005, the Fund issued 19,979,284 Units at a price of $10.00 per Unit. An additional 1,997,928 Units were issued on October 18, 2005 as a result of the exercise of the over-allotment option of the IPO.

Proceeds from the IPO of 19,979,284 Units	$ 199,793
Units' issuance costs	(15,296)
	184,497
Proceeds from exercise of the over-allotment of 1,997,928 Units	19,979
Net proceeds from Units issued	$ 204,476

(In thousands of dollars except unit and per unit amounts)

7. FUND UNITS (CONTINUED)

The Fund is also authorized to issue an unlimited number of special voting units ("Special Voting Units"). Special Voting Units are not entitled to any beneficial interest in any distribution from the Fund. On September 30, 2005, the Fund issued 7,492,231 Special Voting Units to the former shareholders of Morneau Sobeco. 1,997,928 of these were cancelled when the over-allotment option of the IPO was exercised. At December 31, 2005, the following voting units were issued and outstanding.

	At December 31, 2005	
	Units issued	Amount
Units	21,977,212	$ 204,476
Special Voting Units	5,494,303	–
	27,471,515	$ 204,476

8. NON-CONTROLLING INTEREST

As part of the transactions described in note 3, the former shareholders of Morneau Sobeco retained 5,494,303 Class B LP Units of MS Group LP after over-allotment, which reduced non-controlling interest. The LP Units are fully exchangeable for equal Units in the Fund, subject to certain restrictions and provide the former shareholders of Morneau Sobeco with a non-controlling interest of 20% in the Fund. Some of the Class B LP Units are subordinated in their rights to receive distributions.

	At December 31, 2005	
	Units issued	Amount
Subordinated Class B LP Units	4,095,060	$ 40,951
Non-subordinated Class B LP Units	1,399,243	13,992
	5,494,303	54,943
Share of net income for the year		525
Distributions for the year (note 9)		(1,146)
Balance – end of year		$ 54,322

Distributions on the Subordinated Class B LP Units will be subordinated in favour of the Fund Units and the Non-subordinated Class B LP Units. These distributions will be paid at the end of a fiscal quarter to the extent that an average monthly distribution of at least $0.06875 per Unit and Non-subordinated Class B LP Unit in respect of that quarter has been paid, and any deficiency in such distributions to holders of Units and Non-subordinated Class B LP Units during the subordination period, has been satisfied.

The subordination provisions of the Subordinated Class B LP Units apply until the date on which both of the following conditions have been satisfied: (i) for four consecutive fiscal quarters of the Fund beginning on December 31, 2006, the Fund has earned EBITDA of at least $25,169 during such period; and (ii) commencing with the 12 month period ending September 30, 2007, the Fund and MS Group LP have respectively paid an average distribution of at least $0.06875 per Unit and per Class B LP Unit per month for the preceding 12 month period. "EBITDA" is defined as earnings before interest, income taxes, depreciation and amortization.

9. DISTRIBUTIONS TO UNITHOLDERS

The Board of Trustees determines the amount of distributions. Distributions announced during the period ended December 31, 2005 were as follows:

Unitholder record date	Total	Per Unit	Paid or payable
Trust Units			
October 31, 2005	$ 1,561	$ 0.07104	November 15, 2005
November 30, 2005	1,511	0.06875	December 15, 2005
December 31, 2005	1,511	0.06875	January 16, 2006
	$ 4,583	$ 0.20854	
Class B LP Units			
Non-subordinated			
October 31, 2005	$ 100	$ 0.07104	November 15, 2005
November 30, 2005	96	0.06875	December 15, 2005
December 31, 2005	96	0.06875	January 16, 2006
Subordinated			
December 31, 2005	854	0.20854	January 31, 2006
	$ 1,146	$ 0.20854	

10. LONG-TERM INCENTIVE PLAN

Executives are eligible to participate in Morneau Sobeco's Long-Term Incentive Plan (LTIP), which is designed to align compensation with distributable cash earned by the Fund's subsidiaries. The LTIP provides compensation opportunities for performance resulting in the Fund exceeding its distributable cash targets. The Fund's Compensation, Nominating and Corporate Governance Committee of the Board of Trustees (the "Committee") will determine (i) who will participate in the LTIP; (ii) the level of participation; and (iii) the time or times when LTIP awards will vest or be paid to each participant.

Pursuant to the LTIP, Morneau Sobeco will set aside a pool of funds based upon the amount, if any, by which the distributable cash per Unit (fully diluted) exceeds certain defined threshold amounts. Morneau Sobeco or a Trustee will purchase Units in the market with this pool of funds and will hold the Units until such time as ownership vests to each participant. Generally, one-third of these Units will vest equally over the three years following the grant of the awards. LTIP participants will be entitled to receive distributions on all Units held for their account prior to the applicable vesting date. Unvested Units held by the Trustee for an LTIP participant will be forfeited if the participant resigns or is terminated prior to the applicable vesting date and those Units will be sold and the proceeds returned to Morneau Sobeco.

For the period from August 22, 2005 to December 31, 2005
(In thousands of dollars except unit and per unit amounts)

10. LONG-TERM INCENTIVE PLAN (CONTINUED)

Initially, the LTIP provides for awards that may be earned based on the amount by which distributable cash per Unit exceeds a base distribution threshold of $0.825 per Unit per annum. The percentage amount of that excess, which forms the LTIP incentive pool, will be determined in accordance with the table below:

Percentage by which Distributable Cash per Unit Exceeds Base Threshold(1)	Maximum Proportion of Excess Distributable Cash Available for LTIP Payments
5% or less	10%
over 5% to 10%	15% of any excess over 5% to 10%
greater than 10%	20% of any excess over 10%

(1) Annualized for fiscal periods of less than 12 months.

The base distribution threshold will be subject to review by the Committee at least annually.

Because this first fiscal period of the Fund consisted of approximately three months of operations, the Committee decided that the initial LTIP awards will be determined following the completion of the first complete fiscal year to December 31, 2006. At that time, the Committee will consider performance for the past fifteen months in order to determine an allocation for the LTIP. No accrual has been recorded for 2005.

11. INCOME TAXES

Income tax obligations relating to distributions from the Fund are obligations of the unitholders and, accordingly, no provision for income taxes has been made in respect of income of the Fund. A provision for income taxes is recognized for the Fund's subsidiaries that are subject to tax, including Large Corporations Tax.

The difference between income taxes calculated using the Fund's effective income tax rates and the amounts that would result from the application of the statutory income tax rates arises from the following:

Income taxes at statutory rates:		
Federal		22.12%
Provincial		11.98%
		34.10%
Income tax provision applied to earnings before income taxes:		
Combined basic federal and provincial income taxes at statutory rates applied to earnings from continuing operations	$	955
Earnings taxed in the hands of the unitholders		(1,774)
Non-deductible expenses		38
Non-deductible intangibles		1,045
Financing cost deductible for tax purposes		(252)
Effect of higher tax rates in non-Canadian jurisdictions		26
Non-capital loss carried forward		(79)
Other		60
	$	19

Future income tax assets and liabilities are provided for temporary differences between the financial statement carrying values of existing assets and liabilities and their respective tax bases. The significant components of future income taxes are as follows:

Future income tax assets:		
Excess of tax bases of capital assets and intangibles over their carrying values	$	589
Non-capital losses		11
Net future income tax asset	$	600

12. EMPLOYEE FUTURE BENEFITS

The Fund has a pension benefit plan covering its employees, which includes a defined benefit option and a defined contribution option. The defined benefit option was closed to new members effective January 1, 1998.

(In thousands of dollars except unit and per unit amounts)

12. EMPLOYEE FUTURE BENEFITS (CONTINUED)

As of January 1, 1998, all new members participate in a defined contribution option, whereby the Fund matches member contributions and may be required to make additional contributions at the option of the members up to a limit prescribed under the *Income Tax Act* (Canada). Under the defined contribution option, each member is required to contribute a specific dollar amount based on the member's job level classification. Each member may elect to make an optional contribution of between 50% and 300% of the member's required contribution. The Fund matches required contributions. For employees with less than 10 years of service, the Fund contributes 50% of optional contributions and for members with 10 or more years, 75% of optional contributions.

Information about the pension plan's defined benefit option is as follows:

Fair value of plan assets	$ 2,954
Accrued benefit obligation	3,896
Funded status – deficit	$ (942)
Accrued benefit obligation:	
Balance, beginning of period	$ 3,687
Current service cost	18
Interest cost	47
Benefits paid	(7)
Actuarial losses	151
Balance, end of period	$ 3,896
Plan assets:	
Fair value, beginning of period	$ 2,854
Actual return on plan assets	65
Employer contributions	42
Benefits paid	(7)
Fair value, end of period	$ 2,954
Reconciliation of accrued benefit obligation to accrued benefit asset, end of period:	
Plan assets at fair value	$ 2,954
Accrued benefit obligation	3,896
Funding status – plan deficit	(942)
Unamortized net actuarial loss	410
Unamortized transitional obligation	539
Accrued benefit asset:	$ 7
End of period allocation of fair value of plan assets (%)	
Pooled balanced fund (60% equities, 40% bonds)	90%
Pooled bond fund	10%
	100%

Pension plan cost		
Current service cost	$	18
Interest cost on accrued benefit obligation		47
Return on plan assets		(65)
Actuarial gains during the period on accrued benefit obligation		151
		151
Other adjustments to allocate cost to period in which service is rendered, specifically indicating:		
Difference between actual and expected return on plan assets		19
Amortization of actuarial gains		(151)
Transitional amounts		22
Net pension plan expense	$	41

Other information about the Fund's defined benefit option is as follows:

Employer contributions	$	42
Benefits paid		7

The net expense for the Fund's defined benefit option for the period ended December 31, 2005 is $41 and for the defined contribution option is $368.

Actuarial valuations:

Actuarial valuation for the Fund's pension plan is generally required every three years. The most recent actuarial valuation of the Fund's pension plan was conducted as of December 31, 2003.

Weighted average assumptions:

Weighted average of the amounts assumed in accounting for the plan:	
Discount rate at the end of the current fiscal period used to determine the accrued benefit obligation	4.75%
Discount rate at the end of preceding period used to determine the benefit cost	5.75%
Rate of compensation increase used to determine the accrued benefit obligation	2.50%
Rate of compensation increase used to determine the benefit cost	2.50%
Expected long-term rate of return on plan assets	7.00%

(In thousands of dollars except unit and per unit amounts)

13. COMMITMENTS

The Fund has lease commitments for office premises and equipment with options for renewal. Minimum payments not including operating expenses, due in each of the next five years and thereafter, are expected to be as follows for each year or period ending December 31:

2006	$ 4,445
2007	4,057
2008	3,824
2009	3,328
2010	2,796
Thereafter	5,754
Total	$ 24,204

14. CONTINGENCIES

From time to time, the Fund is involved in routine litigation incidental to the Fund's business. Management believes that adequate provisions have been made where required and the ultimate resolution with respect to any claim will not have a material adverse effect on the financial position or results of operations of the Fund.

15. ECONOMIC DEPENDENCE

The Fund's largest client accounts for approximately 14% of the Fund's revenue and its top 10 clients, in aggregate, account for approximately 37% of revenue. As clients may terminate engagements on minimal notice, there can be no assurance that the Fund will be able to retain its relationships with its largest clients. Moreover, there can be no assurance that such clients will continue to use the services of the Fund in the future. Any negative change involving any of the Fund's largest clients, including but not limited to a client's financial condition or desire to continue using the Fund's services, could result in a significant reduction in business, which could have a material adverse effect on the Fund's business, results of operations and financial condition and the ability of the Fund to make distributions on the Units.

16. SEGMENTED INFORMATION

The Fund's operations consist of one reporting segment, which provides employee pension and benefits consulting and outsourcing services. Geographic data are as follows:

	Canada	United States
Revenue	$ 27,959	$ 2,112

Assets held in the United States consisting of cash, accounts receivable, prepaids, computer equipment, furniture and office equipment had a book value of $1,962 and liabilities had a value of $325 as at December 31, 2005.

GENERAL INFORMATION

Executive Committee

Pierre Chamberland
Executive Vice President, Administrative Solutions, Quebec

Brian Chan
Executive Vice President & Chief Information Officer

Raymond Gaudet
Executive Vice President

William Morneau, Jr.
President & Chief Executive Officer

Randal Phillips
Executive Vice President, Administrative Solutions

Julien Ponce
Executive Vice President, Consulting, Quebec

Nancy Reid
Chief Financial Officer

Fred Vettese
Executive Vice President & Chief Actuary

Other Officers

Lynn Korbak
General Counsel

Board of Trustees

Robert Chisholm
Vice Chair, President & CEO, Domestic Banking and Wealth Management, The Bank of Nova Scotia

David Day
Corporate Director

Alan Torrie
Chief Operating Officer, Retirement Residences REIT

W.F. Morneau, Sr.
Corporate Director

William Morneau, Jr.
President & Chief Executive Officer

Audit Committee

Robert Chisholm (Chair)
David Day
Alan Torrie

Compensation, Nomination and Corporate Governance Committee

Robert Chisholm
David Day
Alan Torrie (Chair)

Lead Trustee

David Day

Head Office

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Facsimile: 416-445-4688
Web site: www.morneausobeco.com

Annual Meeting

Friday, April 28, 2006
2:00 p.m.
TSX Conference Centre
Toronto Stock Exchange
130 King Street West
Toronto, Ontario

Transfer Agent

CIBC Mellon Trust Company
320 Bay Street
Toronto, Ontario
M5H 4A6

Unitholder Information

Exchange and Symbol
Toronto Stock Exchange (TSX): MSI.UN

Units Outstanding
(as at December 31, 2005)

21,977,212

MORNEAU SOBECO

MORNEAU SOBECO INCOME FUND