

Brookfield Power



CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2005

Attached are the consolidated financial statements of Brookfield Power Inc., formerly Brascan Power Inc. Brookfield Power Inc. is a subsidiary of Brookfield Asset Management Inc., formerly Brascan Corporation, and provides certain guarantees for the operations and debt of Brookfield Power Corporation, formerly Brascan Power Corporation.

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005

MANAGEMENT'S RESPONSIBILITY

To the Shareholders of Brookfield Power Inc.

The attached consolidated financial statements have been prepared by Brookfield Power Inc.'s ("the Company") management which is responsible for their integrity and objectivity. To fulfill this responsibility, the Company maintains systems of internal control and policies and procedures to ensure that its reporting practices and accounting and administrative procedures are appropriate to provide a high degree of assurance that relevant and reliable financial information is produced and assets are safeguarded. These controls include the careful selection and training of employees, the establishment of well-defined areas of responsibility and accountability for performance and the communication of policies and code of conduct throughout the Company. These statements have been prepared in conformity with Canadian generally accepted accounting principles and, where appropriate, reflect estimates based on judgments of management.

Deloitte & Touche LLP, the independent auditors appointed by the shareholders, have examined the financial statements of the Company in accordance with Canadian generally accepted auditing standards to enable them to express to the shareholders their opinion on the financial statements. Their report as auditors is attached.



Donald Tremblay
Senior Vice-President and Chief Financial Officer
March 3, 2006

AUDITORS' REPORT

To the Shareholders of Brookfield Power Inc.

We have audited the consolidated balance sheets of Brookfield Power Inc. (formerly Brascan Power Inc.) as at December 31, 2005 and 2004 and the consolidated statements of income, (deficit) retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance as to 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 Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants
Toronto, Canada
March 3, 2006

BROOKFIELD POWER INC. CONSOLIDATED BALANCE SHEET

As at December 31

<i>US millions</i>	<i>note</i>	2005	2004
			<i>(restated - note 3)</i>
Assets			
<i>Current assets</i>			
Cash and cash equivalents	7	\$ 100	\$ 142
Accounts receivable and other	8	281	264
Short-term investments	9	267	819
		648	1,225
Due from related parties	6	689	-
Other assets	10	894	846
Long-term investments	11	140	300
Power generating assets	5, 12	2,997	2,765
		\$ 5,368	\$ 5,136
Liabilities			
<i>Current liabilities</i>			
Accounts payable and other		\$ 217	\$ 183
Credit facilities	14	-	26
Current portion of property specific borrowings and term debentures	15, 16	112	260
		329	469
Due to related party	6	177	-
Property specific borrowings	15	1,659	1,423
Term debentures and other	16	1,246	1,278
Future income tax and other long-term liabilities	17	242	245
Debt portion of capital securities	3, 18	1,104	1,119
		4,757	4,534
Non-controlling interests	21	255	297
Shareholders' equity	3, 22	356	305
		\$ 5,368	\$ 5,136

See accompanying notes to the consolidated financial statements.

Approved on behalf of Brookfield Power Inc.:



Richard Legault
President and Chief Operating Officer



Donald Tremblay
Senior Vice-President and Chief
Financial Officer

BROOKFIELD POWER INC. CONSOLIDATED STATEMENT OF INCOME

Years ended December 31

<i>US millions</i>	note	2005	2004
			<i>(restated - note 3)</i>
Revenues	6	\$ 774	\$ 667
Net operating income			
Power generation		439	345
Transmission and distribution		24	20
		463	365
Investment income and other	6, 9, 11	48	68
		511	433
Expenses			
Interest and financing fees	23	228	176
Interest on capital securities	18	120	43
Depreciation and amortization		102	74
Non-controlling interests		16	31
(Recovery of) provision for income taxes	19	(15)	33
		451	357
Net income		\$ 60	\$ 76

See accompanying notes to the consolidated financial statements.

BROOKFIELD POWER INC. CONSOLIDATED STATEMENT OF (DEFICIT) RETAINED EARNINGS

Years ended December 31

<i>US millions</i>	note	2005	2004
			<i>(restated - note 3)</i>
(Deficit) retained earnings, beginning of year		\$ (222)	\$ 368
Net income		60	76
Distributions to holders of common shares and capital securities	22	(53)	(666)
Deficit, end of year		\$ (215)	\$ (222)

See accompanying notes to the consolidated financial statements.

BROOKFIELD POWER INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

Years ended December 31

<i>US millions</i>	note	2005	2004
			<i>(restated - note 3)</i>
Operating activities			
Net income		\$ 60	\$ 76
Add (deduct) non-cash items			
Depreciation and amortization		102	74
Non-controlling interests		16	31
Tax and other		(4)	10
		174	191
Net change in non-cash working capital	24	11	72
		185	263
Financing activities and shareholder distributions			
Borrowings		916	1,102
Issuance of capital securities		200	842
Debt repayments		(954)	(316)
Capital securities repayment		(202)	-
Distributions:			
- Non-controlling interest distributions		(34)	(31)
- Common shareholder distributions	22	(53)	(666)
Other long-term liabilities		5	3
		(122)	934
Investing activities			
Sale of securities		79	145
Change in demand deposits		289	(252)
Additions to long-term investments	11	(75)	(28)
Acquisition of equity interest	6	(75)	-
Acquisitions of power generating assets	5	(113)	(881)
Additions to existing power generating assets		(224)	(74)
Proceeds on sale of power generating assets	12	44	-
Due from related parties, net		(15)	-
Other assets		(15)	(17)
		(105)	(1,107)
Cash and cash equivalents			
Increase (decrease)		(42)	90
Balance, beginning of year		142	52
Balance, end of year		\$ 100	\$ 142
Supplementary information			
Interest paid		\$ 381	\$ 174
Taxes paid		\$ 9	\$ 2

See accompanying notes to the consolidated financial statements.

BROOKFIELD POWER INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005

1. NATURE AND DESCRIPTION OF THE COMPANY

Brookfield Power Inc. (the "Company") is incorporated under the laws of Ontario and develops and operates hydroelectric and other power generating facilities in Canada and the United States and a transmission and distribution system in northern Ontario. The Company also conducts investment activities, which include the receipt of interest and dividends on the Company's financial assets as well as gains and losses realized on investment transactions. The Company is wholly owned directly or indirectly by Brookfield Asset Management Inc. ("Brookfield") (formerly Brascan Corporation).

Effective January 27, 2006, the Company changed its name from Brascan Power Inc. to Brookfield Power Inc.

2. SUMMARY OF ACCOUNTING POLICIES

These consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles ("GAAP"), applied on a consistent basis with the prior year with the exception of the changes in accounting policies described in note 3. All figures are reported in United States dollars, unless otherwise noted.

The significant accounting policies are summarized below:

Principles of consolidation

The consolidated financial statements include:

- i. the accounts of all subsidiaries and other controlled entities of the Company including Great Lakes Power Limited ("Great Lakes Power"), Great Lakes Hydro Income Fund (the "Income Fund"), Lake Superior Power, Valerie Falls Power, Hydro Pontiac Inc. ("Pontiac Power"), Brookfield Energy Marketing Inc. ("BEMI") (formerly Brascan Energy Marketing Inc.), Brookfield Energy Marketing LP (formerly Brascan Energy Marketing LP), and Brookfield Power US Holding America Co. (formerly Great Lakes Holding America Co.);
- ii. the accounts of all wholly owned holding companies, which carry out investing and other financial transactions for the Company;
- iii. the accounts of incorporated and unincorporated joint ventures and partnerships to the extent of the Company's proportionate interest in their respective assets, liabilities, revenue and expenses, including the Company's investments in Pingston Creek Hydro Joint Venture ("Pingston") and Bear Swamp Power Co. LLC ("Bear Swamp"); and
- iv. as a result of the adoption of Accounting Guideline 15, *Consolidation of variable interest entities* ("AcG 15"), 100% of Catalyst Old River Hydroelectric Limited Partnership ("CORHLP") versus the equity accounting method previously used, and, as part of the Income Fund, 100% of Powell River Energy Inc. ("PREI") and Powell River Energy Limited Partnership ("PREP") versus the 50% proportionate consolidation method previously used.

All significant intercompany balances and transactions have been eliminated upon consolidation.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. During the years presented, management has made a number of estimates and valuation assumptions in the determination of accruals, useful lives, asset impairment, purchase price allocations and pension amounts. Estimates are based on historical experience, current trends and various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

Revenue and expense recognition

The Company records revenues from the sale of energy, energy-related products and energy services, under the accrual method of accounting, in the period when energy commodities or products are delivered or services are rendered. Sales contracts that are eligible for accrual accounting include non-derivative transactions and derivative commodity contracts that will be physically delivered.

CORHLP sells power at predetermined fixed rates. These rates increase and decrease over the term of the power sales contract, which expires December 31, 2031. Power sales are recognized on a levelized basis over the term of the contract. The difference between levelized power sales and cash received is recorded as accrued levelized revenue on the balance sheet. CORHLP also pays royalty expenses at a rate that fluctuates during the term of the contract. These are also recognized on a levelized basis over the term of the contract. The difference between levelized royalty expense and cash paid is recorded as accrued levelized royalty expense on the balance sheet. As at December 31, 2005, an amount of \$543 million (2004 - \$535 million) pertaining to accrued levelized revenues is classified under other assets and an amount of \$74 million (2004 - \$70 million) pertaining to accrued levelized expenses is classified under other long-term liabilities.

Investment income is recorded on the accrual basis.

The Company maintains hydrological insurance which partially compensates for the effect of variations in water inflows when measured against long-term averages. Hydrology insurance income is recognized when insurance proceeds can be estimated and collection is reasonably assured. For 2005, revenues include \$2 million of hydrology insurance claims (2004 - nil).

Power purchases are recorded upon delivery and are included as a component of net operating income. All other expenses are recorded on an accrual basis when incurred.

Financing costs

Expenses related to the issuance of debt are deferred and amortized over the term of the debt.

Income taxes

The Company uses the asset and liability method in accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities, and measured using the enacted, or substantively enacted, tax rates and laws that will be in effect when the differences are expected to reverse, taking into account the organization of the Company's financial affairs and its impact on taxable income and tax losses.

Derivative financial instruments

The Company uses derivative financial instruments to manage commodity price risk, interest rate risk and foreign exchange risk associated with the Company's production, operating and risk management financing activities. Financial instruments approved and entered into to mitigate the risks described above are interest rate swaps, foreign exchange swaps, electricity swaps and gas swaps.

Hedge accounting is applied when the derivative financial instrument is designated and documented as a hedge of a specific exposure and there is reasonable assurance that the hedging relationship has been and will continue to be highly effective as a hedge based on an expectation of offsetting cash flows or fair values. Gains or losses on hedging instruments are recognized in income over the term of the contract when the underlying hedged transactions occur. Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the hedging relationship is terminated or the anticipated transaction is no longer probable. When a hedging relationship is terminated, changes in fair value that were not recognized by the application of hedge accounting are deferred and recognized in income when the original hedged transaction is recorded through income. When a hedged item ceases to exist, any associated deferred gains or losses are recognized in the current period's income.

Derivatives not designated as hedges are recorded as assets or liabilities with the changes in fair value recorded through income in the current period. Derivative financial instruments that are not designated as hedges are carried at estimated fair values and gains and losses arising from changes in fair values are recognized in income in the period the changes occur. The use of hedging and of non-hedging derivative contracts is governed by documented risk management policies and approved limits.

The fair value of derivative instruments is based on the spot rates or the forward rates or prices in effect at market closing at the balance sheet date. In the absence of this information for a given instrument, the Company uses the available forward rate or price for an equivalent instrument.

(a) Commodity derivative instruments

The Company generates power in Ontario, Quebec, British Columbia, New York, New England and Louisiana. Some of the generation is sold on the wholesale markets at the prevailing market price. The Company mitigates its price exposure to power and natural gas sales by entering into derivative contracts. To reduce price risk caused by market fluctuations, the Company, through two wholly owned subsidiaries, enters into derivative contracts that mitigate price exposure such as swaps that exchange the floating clearing price for a fixed price to manage its anticipated exposures.

The changes in fair value of commodity derivative instruments that qualify as hedges are deferred and recorded in power generation income in the same period as the hedged commodity sale transaction. Those commodity derivative instruments that are not accounted for as hedges are recorded at fair value. Changes in fair value of these commodity derivative instruments are recorded in power generation income each period.

(b) Interest rate hedging instruments

The Company enters into interest rate swap agreements to alter the interest characteristics of a portion of its outstanding debt. These agreements involve the receipt of fixed-rate amounts in exchange for floating rate interest payments or vice-versa over the life of the agreement without an exchange of the underlying principal amount. The differential paid or received as a result of interest rate swap agreements designated as hedges is recognized on an accrual basis as an adjustment to interest expense related to the debt.

(c) Foreign exchange and hedges of net investments in foreign operations

The accounts of self-sustaining foreign operations are translated using the current rate method, under which all assets and liabilities are translated at the exchange rate prevailing at year end, and revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the period. Gains or losses on translation of these amounts are not included in the consolidated statements of income, but deferred and shown as a separate component of shareholders' equity. Gains or losses on foreign currency liabilities and forward foreign exchange contracts that are designated as hedges of a net investment in self-sustaining foreign operations are reported in shareholders' equity in the same manner as translation adjustments. Foreign-denominated monetary assets and liabilities of integrated operations are translated at the exchange rates prevailing at the year end, and revenue and expenses at average rates of exchange during the year. Exchange gains and losses arising on the translation of these amounts are included in investment and other income.

Cash and cash equivalents

All highly liquid investments with original maturities of three months or less are classified as cash and cash equivalents. The fair value of cash and cash equivalents approximates cost due to their short-term nature.

Short-term investments

Short-term investments consist of investments that are short-term in nature and demand promissory notes issued by Brookfield. These are carried at the lower of cost and their estimated net realizable value. Short-term investments also include demand deposits held with affiliates which are recorded at cost and approximates fair value due to their short-term nature.

Long-term investments

Long-term investments are carried at the lower of cost and net realizable value.

Capital securities

Capital securities that are convertible into a fixed number of common shares at the Company's option and interest payments on the capital securities that can be paid by way of a variable number of common shares at the Company's option are classified partly as liabilities and partly as equity.

Power purchase agreements and licenses

Power purchase agreements (PPA) and Federal Energy Regulatory Commission ("FERC") licenses are recorded at cost and amortized on a straight-line basis over the remaining life of the agreements or licenses, which is between 6 and 39 years.

Power generating assets

Property, plant and equipment included in power generating assets are recorded at cost. The cost of the power generating assets less estimated residual value is depreciated over the service lives of the assets as follows:

	Method	Rate
Dams	Straight-line	40 to 60 years
Gas cogenerating stations	Straight-line	5 to 40 years
Hydroelectric generating stations	Straight-line	19 to 60 years
Buildings	Straight-line	5 to 60 years
Equipment	Straight-line	5 to 60 years
Transmission and distribution	Straight-line	5 to 50 years

Impairment of long-lived assets

Assets are tested for impairment based on an assessment of net recoverable amounts in the event of adverse developments. A write-down to estimated net realizable value is recognized if an asset's estimated undiscounted future cash flow is less than its carried value. The projections of the future cash flow take into account the operating plan and management's best estimate of the most probable set of economic conditions anticipated to prevail in the market.

Pension and employee future benefits

The cost of retirement benefits for the Company's defined benefit pension plans and post-employment benefits is recognized as the benefits are earned by employees. The Company uses the projected benefit method pro-rated on the length of service and management's best estimate assumptions to value its pension and other retirement benefits. Assets are valued at fair value for purposes of calculating the expected return on plan assets. Past service costs resulting from plan amendments are being amortized on a linear basis over the average remaining service period of active members expected to receive the benefits under the plan. Cumulative gains and losses in excess of 10% of the greater of the accrued benefit obligation and the market value of the plan assets are amortized over the average remaining service period of active members expected to receive benefits under the plan. The average remaining service life under each plan as at December 31, 2005 varies from 12.0 to 18.5 years. For the defined contribution plan, the Company expenses payments based on employee earnings.

Financial instruments

The carrying value of the Company's financial instruments approximate fair value, unless otherwise noted.

Sale and leaseback of a project

On August 25, 1990, CORHLP entered into a sale and leaseback agreement with regards to its power generating assets, for a term of 30 years, plus two renewal options: a fixed rate renewal option and periodic fair market renewal option. The finance debt obligation represents the proceeds from the sale and leaseback transaction plus accrued interest. See note 16 for further details.

Stock based compensation

The Company accounts for stock options using the fair value method. Under the fair value method, compensation expense for stock options is determined based on the fair value at the grant date using an option pricing model and charged to income over the vesting period. All shares issued under the Company's plan are Brookfield Asset Management shares.

Comparative figures

Certain of the prior year's figures have been reclassified to conform to the 2005 presentation.

3. CHANGES IN ACCOUNTING POLICIES

(a) Translation of foreign currencies

Effective January 1, 2005, the Company's functional currency changed from the Canadian ("CDN") dollar to the United States ("US") dollar as a result of the increase in US dollar denominated activity in its operations as compared to prior years. The Company has adopted the US dollar as its reporting currency.

Since January 1, 2005, the assets and liabilities of the Company's self-sustaining operations having a functional currency other than the US dollar have been translated into US dollars using the exchange rate prevailing at the period end and revenues and expenses have been translated at the rate of exchange in effect on the dates on which such items are recognized in income during the period. Exchange gains and losses on translation of the Company's net equity investment in these operations have been deferred and shown as a separate component of shareholders' equity. Gains or losses on foreign currency liabilities and forward foreign exchange contracts that are designated as hedges of a net investment in self-sustaining foreign operations have been reported in shareholders' equity in the same manner as translation adjustments. Foreign-denominated monetary assets and liabilities of integrated operations have been translated at the exchange rates prevailing at the period end, and revenue and expenses at average rates of exchange during the period. Exchange gains and losses arising on the translation of these amounts have been included in investment and other income. Non-monetary assets and liabilities are translated at historical rates of exchange.

In accordance with Canadian generally accepted accounting principles, the Company translated all amounts presented for comparative purposes into US dollars using the current rate method whereby all revenues, expenses and cash flows are translated at the average rates that were in effect during the period and all assets and liabilities are translated at the prevailing rate in effect at the end of the period. Equity transactions have been translated at historic rates, with opening equity restated at the rate of exchange on December 31, 1999. The resulting net translation adjustment on the change in reporting currency has been credited to the cumulative translation adjustment, a component of shareholders' equity.

(b) Capital securities

On January 1, 2005, the Company adopted the revisions to CICA Handbook Section 3860, *Financial Instruments – Disclosure and Presentation* on the classification of financial instruments as debt or equity, with retroactive restatement of prior periods. The new rules require that capital securities that are convertible into a variable number of common shares at the company's option and interest payments on the capital securities that can be paid by way of a variable number of common shares at the company's option, be classified as liabilities.

The Company reclassified the CDN \$248 million capital securities to liabilities and included it in debt portion of capital securities due to the fact that the principal and interest were convertible into a variable number of common shares. These securities were repaid on June 30, 2005.

The Company also reclassified CDN \$1,096 million of the CDN \$1,100 million capital securities maturing in June 2054 to debt portion of capital securities due to the fact that the interest may be paid in a variable number of common shares. These securities were converted to a US dollar equivalent on April 1, 2005.

For the year ended December 31, 2004, a total of \$43 million of interest expense on the capital securities has been reclassified from shareholders' equity to interest expense on the Consolidated Statement of Income, with the remainder recognized through retained earnings.

(c) Variable interest entities

On January 1, 2005, the Company adopted Accounting Guideline 15, Consolidation of Variable Interest Entities ("AcG 15"), issued by the Canadian Institute of Chartered Accountants ("CICA"). AcG 15 provides guidance for applying the principles in handbook section 1590, "Subsidiaries," to those entities (defined as Variable Interest Entities ("VIE")), in which either the equity at risk is not sufficient to permit that entity to finance its activities without additional subordinated financial support from other parties, or equity investors lack voting control, an obligation to absorb expected losses, or the right to share expected residual returns. AcG 15 requires consolidation of VIEs by the primary beneficiary, which is defined as the party which has exposure to the majority of a VIEs expected losses and/or expected residual returns. As a result of the adoption of this new standard, the Income Fund, of which the Company owns a 50.1% interest, is now fully consolidating its joint venture interests in PREI and PREP, versus the proportionate consolidation method previously used. The Company is also fully consolidating its 75% residual interest in CORHLP, versus the equity accounting method previously used. The consolidation of these entities did not have an impact on the Company's net income. All 2004 financial comparatives included within these consolidated financial statements have been restated to reflect the full consolidation of PREI, PREP and CORHLP.

The financial impact on the restatement of the comparative period for the adoption of AcG 15 is summarized as follows:

Balance sheet <i>millions</i>	December 31, 2004 <i>(restated)</i>	December 31, 2004 <i>(previously reported)</i> ¹	Net financial impact
Current assets	\$ 1,225	\$ 1,137	\$ 88
Long-term assets	3,911	2,991	920
Current liabilities	466	410	56
Long-term liabilities and Non-controlling interests	4,365	3,413	952

¹ Adjusted to reflect adoption of revisions to CICA Handbook Section 3860 and the change in reporting currency to the US dollar.

Statement of income <i>millions</i>	Year ended December 31, 2004 <i>(restated)</i>	Year ended December 31, 2004 <i>(previously reported)</i> ¹	Net financial impact
Revenues	\$ 667	\$ 528	\$ 139
Net operating income	365	251	114
Investment income and other	68	65	3
Interest and financing fees	176	85	91
Interest on capital securities	43	43	-
Depreciation and amortization	74	59	15
Provision for income taxes	33	33	-
Non-controlling interests	31	20	11
Net income	76	76	-

¹ Adjusted to reflect adoption of revisions to CICA Handbook Section 3860 and the change in reporting currency to the US dollar.

4. FUTURE ACCOUNTING POLICY CHANGES

The Company will be required to adopt the following accounting standards for Canadian generally accepted accounting principle purposes in future years, which includes three new accounting standards (effective for the Company on January 1, 2007) and one new abstract (effective for the Company for interim and annual reporting periods ending after March 31, 2006). The impact of implementing the new standards on the consolidated financial statements is not yet determinable as it will be dependent on the outstanding positions and their fair values at the time of transition. The impact of the new abstract is also not yet determinable as no estimate can be made at this time in relation to the associated fair values.

(a) Hedges, CICA Handbook section 3865

This new standard specifies the criteria under which hedge accounting can be applied and how hedge accounting can be executed for each of the permitted hedging strategies: fair value hedges, cash flow hedges and hedges of a foreign currency exposure of a net investment in a self-sustaining foreign operation. In a fair value hedging relationship, the carrying value of the hedged item is adjusted by gains or losses attributable to the hedged risk and recognized in net income. This change in fair value of the hedged item, to the extent that the hedging relationship is effective, is offset by changes in the fair value of the derivative. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative will be recognized in other comprehensive income. The ineffective portion will be recognized in net income. The amounts recognized in accumulated other comprehensive income will be reclassified to net income in the periods in which the net income is affected by the variability in the cash flows of the hedged item. In hedging a foreign currency exposure of a net investment in a self-sustaining foreign operation, foreign exchange gains and losses on the hedging instruments will be recognized in other comprehensive income.

(b) Financial instruments – recognition and measurement, CICA Handbook section 3855

Under the new standard, all financial instruments will be classified as one of the following: Held-to-maturity, Loans and Receivables, Held-for-trading or Available-for-sale. Financial assets and liabilities held-for-trading will be measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading, will be measured at amortized cost. Available-for-sale instruments will be measured at fair value with unrealized gains and losses recognized in other comprehensive income. The standard also permits designation of any financial instrument as held-for-trading upon initial recognition.

(c) Comprehensive income, CICA Handbook section 1530

As a result of adopting these standards, a new category, Accumulated Other Comprehensive Income, will be added to shareholders' equity on the consolidated balance sheet. Major components for this category will include unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign currency translation amounts, net of hedging, arising from self-sustaining foreign operations, and changes in the fair value of the effective portion of cash flow hedging instruments.

(d) Conditional asset retirement obligations, Emerging Issues Committee Abstract 159

Issued in December 2005 by the Emerging Issues Committee, this abstract requires an entity to recognize the fair value of a legal obligation to perform asset retirement activities, even though the timing and/or method of settlement may be uncertain.

5. ACQUISITIONS

All acquisitions that represent business combinations have been accounted for using the purchase method of accounting and the results of their operations have been included in these consolidated financial statements from the date of acquisition.

(a) Hydro Kennebec and West Delaware

On January 20, 2005, the Company acquired the leasehold interests, through acquisition of all partnership units, in two hydroelectric generating facilities in Maine and New York for \$33 million, including \$12 million of assumed debt.

The fair values assigned to the assets acquired were as follows:

<i>millions</i>		
Power generating assets	\$	6
Power purchase agreement		15
Other intangible assets		8
Working capital		4
Total assets acquired	\$	33

The acquisition was funded through:

<i>millions</i>		
Cash	\$	21
Senior secured term notes		12
Consideration paid	\$	33

The \$12 million senior secured term notes bear interest at 5.98% and are repayable in quarterly blended principal and interest payments, maturing on September 30, 2008.

(b) Harmony Wind

On March 31, 2005, the Company purchased all of the outstanding common shares of Harmony Wind from Brookfield. The related party acquisition has been accounted for at carrying value and results of operations have been included in these consolidated financial statements from the date of acquisition.

The acquisition was funded through the following non-cash consideration:

<i>CDN\$ millions</i>		
Common shares	\$	4
Promissory notes		1
Consideration - \$ CDN	\$	5
Consideration - \$ US	\$	4

The Company issued 129,024 of its common shares to Brookfield, valued at CDN \$30.87 per common share.

(c) Piney and Deep Creek

On April 27, 2005, the Company acquired the assets of two hydroelectric generating facilities in Pennsylvania and Maryland for cash consideration of \$43 million.

The fair values assigned to the assets acquired were as follows:

<i>millions</i>		
Intangible assets	\$	1
Power generating assets		42
Total assets acquired	\$	43

(d) Bear Swamp

On May 24, 2005, the Company completed the acquisition of the assets of two hydroelectric generating facilities in northern Massachusetts for cash consideration of \$49 million, through a 50/50 joint venture.

The fair values assigned to the assets acquired were as follows:

<i>millions</i>	Joint venture	Company's share
Power generating assets	\$ 98	\$ 49
Total assets acquired	\$ 98	\$ 49

6. RELATED PARTY TRANSACTIONS

The following is a summary of related party transactions not disclosed elsewhere in these financial statements.

(a) The Company had a power supply contract with Noranda Aluminum Inc. ("Noranda"), a wholly owned subsidiary of Falconbridge Limited (formerly Noranda Inc.), a company related by common ownership. The Company agreed to provide Noranda's aluminum smelter with its power requirement at a fixed price for a two-year period commencing June 1, 2003 in addition to a limited profit or loss sharing arrangement. The arrangement expired on May 31, 2005. At December 31, 2005, no amounts were receivable in relation to this arrangement (2004 - \$11 million).

(b) The Company provided gas to Falconbridge Limited at market value prices as required. This agreement expired in December 2004. There were no amounts receivable at December 31, 2005 (2004 - \$1 million).

(c) The Company was engaged in a financial transaction agreement during the year with Brookfield Properties Corporation ("Brookfield Properties"), a company related by common control, requiring periodic exchanges of payments without the exchange of the notional principal amount on which the payments were based. This agreement involved the payment of floating power rates in exchange for fixed power rates. The differential paid or received as a result of this swap agreement was accrued and recognized as an adjustment to power generation revenues. The agreement expired in December 2005.

(d) Pursuant to a power purchase agreement expiring in January 2012, the Company provides Katahdin Paper Company ("KPC"), a company related by common ownership, with energy at a fixed rate. At December 31, 2005, the Company has a balance receivable from KPC in the amount of \$3 million (2004 - \$4 million).

(e) Pursuant to a power purchase agreement expiring in December 2012, the Company provides Fraser New Hampshire ("FNH"), a company related by common ownership, with energy at a fixed rate. As a result, at December 31, 2005 FNH owed the Company \$1 million (2004 - \$1 million).

(f) Under a tolling agreement that was to expire in December 2013, the Company provided FNH with the use of a cogenerator. The payments under this agreement were comprised of a capacity charge and an energy charge based on energy supplied. Subsequent to the sale of the Company's membership interest in White Mountain Energy LLC ("WME"), this tolling agreement was terminated. See note 12 for further details.

(g) The Company has demand deposits in the amounts of \$112 million (2004 - \$401 million) and promissory notes of \$26 million (2004 - \$138 million) with Brookfield in both US and Canadian dollars. See note 9 for further details.

(h) The Company entered into interest rate swap agreements expiring June 16, 2023 with Brookfield requiring periodic exchange of payments without the exchange of the notional principal amount on which the payments were based. These agreements were terminated in March 2005.

(i) The Company holds securities and long-term investments with related parties, which produce investment income. See notes 9 and 11 for further details.

(j) In April 2005, the Company repaid \$11 million of its Great Lakes Hydro America ("GLHA") bridge loan facility outstanding from Brookfield.

(k) On July 1, 2005, the Company exchanged all of its common and preferred shares in wholly owned First Toronto Equities Inc. ("FTEI") for preferred shares in a new amalgamated company, Trilon Bancorp Inc. ("TBI"). TBI is wholly owned by Brookfield. Subsequently, on July 1, 2005, the Company purchased, through a subsidiary, all of the preferred shares of The Catalyst Group ("TCG") from TBI for \$75 million. The TCG preferred shares were owned by the Company through FTEI prior to the exchange of shares described above. As a result of these transactions, the Company recorded an increase in its contributed surplus of \$198 million, representing the excess of consideration received over that given up. In addition, the TCG \$177 million junior note that was previously payable to FTEI, and therefore eliminated upon consolidation, is now presented on the balance sheet as Due to related party.

On August 1, 2005, the Company redeemed all of its preferred shares in TBI for \$689 million. The consideration is presented on the balance sheet as Due from a related party.

(l) In October 2005, the Company paid an agency fee of \$1 million to Brookfield in relation to the issuance of the new Lièvre Power Limited Partnership ("LPLP") senior secured bonds described in note 15.

(m) On December 27, 2005, the Company sold its coal properties and all related assets and liabilities including any future royalty revenue stream, to Highvale Coal GP Ltd., an affiliated company through common ownership, for consideration of CDN \$10 million. The loss upon disposition of US \$8 million was recorded as a reduction to contributed surplus, given the related party nature of the transaction.

The following table summarizes the income statement impact of related party transactions for the year:

<i>millions</i>	2005	2004
Revenues		
Sale of power to Noranda	\$ 49	\$ 119
Physical gas sales to Falconbridge Limited	1	10
Sale of power and financial transactions with Brookfield Properties	2	10
Sale of power to KPC	25	23
Sale of power and tolling agreement with FNH	8	6
	\$ 85	\$ 168
Investment income and other		
Interest earned on demand deposits and promissory notes with Brookfield	\$ 14	\$ 7
Income from securities with affiliated companies	14	21
Income from long-term investments with affiliated companies	8	28
	\$ 36	\$ 56
Expenses		
Interest expense on note payable to TBI	\$ 18	\$ -
Interest expense on bridge facility with Brookfield	-	4
Income on interest rate swaps with Brookfield	-	(5)
Profit sharing with Noranda ¹	(5)	(13)
	\$ 13	\$ (14)

¹ Included in power purchases

7. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are composed of the following:

<i>millions</i>	2005	2004
Cash	\$ 60	\$ 140
Short-term deposits	40	2
	\$ 100	\$ 142

8. ACCOUNTS RECEIVABLE AND OTHER

The composition of accounts receivable and other is as follows:

<i>millions</i>	2005	2004
Coal royalty receivables	\$ -	\$ 58
Trade receivables	159	140
Commodity derivatives	25	-
Prepays and other	97	66
	\$ 281	\$ 264

9. SHORT-TERM INVESTMENTS

The composition of short-term investments by business sector or type is as follows:

<i>millions</i>	2005	2004
Securities		
Real estate	\$ 52	\$ 51
Natural resources	-	36
Financial services and diversified	55	172
Other	22	21
Demand deposits	112	401
Promissory notes	26	138
	\$ 267	\$ 819

The securities portfolio is comprised primarily of preferred shares. In determining fair values of securities, quoted market prices are used where available and, where not available, management estimates the amounts which could be recovered over time or through a transaction with knowledgeable and willing third parties under no compulsion to act. The securities consist of 67% floating rate securities (2004 – 69%) and 33% fixed rate securities (2004 – 31%) with an average yield at December 31, 2005 of 4.8% (2004 – 4.8%). Income earned on securities with affiliated companies in 2005 amounted to \$14 million (2004 - \$21 million).

The demand deposits are held with Brookfield in both Canadian and US dollars. They include both funds on deposit and payable to Brookfield, and are presented net given the Company's intention and ability to settle these balances on a net basis. These amounts are considered highly liquid in nature and can be settled with two days notice.

Within the demand deposits is \$27 million (2004 – \$26 million) held by CORHLP, which matures on May 1, 2006 and pays annual interest of 8.0%. All other demand deposits earn interest at banker's acceptance ("BA") plus 25 basis points on US balances and at BA plus 30 basis points on Canadian balances. Interest earned on the demand deposits for 2005 amounted to \$11 million (2004 – \$5 million).

Promissory notes were issued by Brookfield. These notes are due on demand and pay interest at the Canadian prime rate. Interest earned on the notes in 2005 amounted to \$3 million (2004 - \$ 2 million).

Affiliated companies include Brookfield, its subsidiaries and equity accounted investees. All short-term investments are with affiliates.

10. OTHER ASSETS

<i>millions</i>	2005			2004
	Cost	Accumulated amortization	Net book value	Net book value
Power purchase agreements	\$ 171	\$ 10	\$ 161	\$ 155
FERC licences	41	3	38	39
Deferred financing fees	76	29	47	41
Other	8	1	7	-
	296	43	253	235
Accrued levelized revenues	543	-	543	535
Commodity derivatives	27	-	27	-
Deferred loss on commodity derivatives	6	-	6	-
Cash held in escrow	56	-	56	76
Other	9	-	9	-
	\$ 937	\$ 43	\$ 894	\$ 846

In 2005, the Company obtained an additional \$17 million related to PPA and FERC licenses (2004 - \$190 million). These amounts are being amortized over their respective agreements and licences. Amortization for the year totalled \$12 million (2004 - \$1 million).

In 2005, the Company incurred \$18 million of financing fees (2004 - \$12 million) which have been deferred and are being amortized over the term of the underlying debt. Amortization for the year totalled \$8 million (2004 - \$5 million). During 2005, the Company wrote off deferred financing fees of \$4 million (2004 - \$nil).

11. LONG-TERM INVESTMENTS

Long-term investments include the Company's interests in Brookfield and its subsidiaries. The book values of the Company's long-term investments at December 31, 2005 and 2004 are shown below:

<i>millions</i>	2005	2004
Brookfield	\$ -	\$ 235
Brascan Brazil Ltd.	135	60
Other investments	5	5
	\$ 140	\$ 300

All long-term investments are with affiliates. In 2005, income from investments with affiliated companies amounted to \$8 million (2004 - \$28 million).

The decrease in Brookfield investments is due to the FTEI transaction. See note 6 for further details.

During the second quarter of 2005, the Company invested \$75 million in preferred shares of Brascan Brazil Ltd., a wholly owned subsidiary of Brookfield that owns, develops and operates hydroelectric generation plants in Brazil, thereby increasing the Company's total preferred share investment in Brascan Brazil Ltd. to \$135 million.

12. POWER GENERATING ASSETS

The composition of the Company's power generating assets is shown below:

As at December 31, 2005

<i>millions</i>	Cost	Accumulated depreciation	Net book value
Land	\$ 38	\$ -	\$ 38
Dams	712	41	671
Gas cogenerating stations	134	49	85
Hydroelectric generating stations	2,272	427	1,845
Buildings	52	2	50
Equipment	118	44	74
Transmission and distribution	191	61	130
Construction work in progress	104	-	104
	\$ 3,621	\$ 624	\$ 2,997

As at December 31, 2004

<i>millions</i>	Cost	Accumulated depreciation	Net book value
Land	\$ 38	\$ -	\$ 38
Dams	594	37	557
Gas cogenerating stations	128	39	89
Hydroelectric generating stations	2,207	400	1,807
Buildings	50	1	49
Equipment	106	36	70
Transmission and distribution	155	53	102
Construction work in progress	53	-	53
	\$ 3,331	\$ 566	\$ 2,765

On April 22, 2005, the Company sold its membership interests in WME, a 25 megawatt cogeneration power plant located in Berlin, New Hampshire, to Fraser Papers Inc. for total consideration of \$34 million. The gain on the sale of \$1 million was recorded in "Investment income and other".

On December 27, 2005, the Company sold its coal properties and all related assets and liabilities including any future royalty revenue stream, to Highvale Coal GP Ltd., an affiliated company through common ownership, for consideration of CDN \$10 million. The loss upon disposition of US \$8 million was recorded as a reduction to contributed surplus, given the related party nature of the transaction.

13. JOINT VENTURES

The following amounts represent the Company's proportionate interest in unincorporated joint ventures reflected in the Company's accounts. These amounts include Pingston and Bear Swamp.

<i>millions</i>	Ownership interest	Net income		Net assets	
		2005	2004	2005	2004
Pingston	50%	\$ 1	\$ 3	\$ 3	\$ 32
Bear Swamp	50%	4	-	49	-
		\$ 5	\$ 3	\$ 52	\$ 32

<i>millions</i>	2005	2004
Current assets	\$ 5	\$ -
Long-term assets	82	32
Current liabilities	5	-
Long-term liabilities	30	-
Operating revenues	12	4
Operating expenses	7	1
Net income	5	3
Cash flows from operating activities	8	3
Cash flows from (used in) investing activities	45	(2)
Cash flows (used in) from financing activities	\$ (51)	\$ (1)

14. CREDIT FACILITIES

The composition of the Company's short-term facilities as at December 31, 2005 and 2004 is as follows:

<i>millions</i>	Available		Drawn		Letters of credit	
	2005	2004	2005	2004	2005	2004
Credit facilities						
Great Lakes Power Trust	\$ -	\$ 42	\$ -	\$ 26	\$ -	\$ 5
Lièvre Power LP	22	-	-	-	3	-
Powell River Energy Inc.	4	3	-	-	-	1
Brookfield Power Corporation	200	-	-	-	130	-
Great Lakes Power Ltd.	-	15	-	-	-	-
Brookfield Power Inc.	-	83	-	-	-	60
	\$ 226	\$ 143	\$ -	\$ 26	\$ 133	\$ 66

In April 2005, the Company, through Brookfield Power Corporation, obtained a \$200 million revolving unsecured credit facility for general corporate purposes, which can be drawn upon in Canadian or US dollars to replace the CDN \$118 million unsecured credit facilities previously held for general corporate purposes. The credit facility is due in April 2008 and ranks pari passu with all senior unsecured indebtedness of the Company. The facility bears a floating interest rate and is guaranteed by the Company.

Previously, Great Lakes Power Trust ("GLPT"), a 100% wholly owned subsidiary of the Income Fund, had available a credit facility comprised of a CDN \$25 million line of credit and a CDN \$25 million term loan for general corporate purposes which could be drawn upon in Canadian or US dollars and bore interest based on Canadian prime rate, US base rate or LIBOR plus a margin. In October 2005, the GLPT credit facility was cancelled and replaced by the CDN \$25 million LPLP senior secured credit facility for general corporate purposes.

LPLP is a 100% wholly owned subsidiary of the Income Fund. The credit facility is secured by the power generating assets of LPLP, has a one year term and may be extended for additional individual periods of one year at the request of the borrower. The credit facility bears interest based on prime plus applicable margin. Standby fees, ranging from 15 to 37.5 basis points, are charged on the undrawn balance. If not renewed, the credit facility is due in October 2006.

PREI has a credit facility in the amount of CDN \$5 million available by way of advances in Canadian dollars of (i) prime rate loans (ii) BA loans and (iii) letters of credit. Standby fees of 17.5 basis points are charged on the undrawn PREI credit facility. If not renewed, the credit facility is due in December 2006.

The Company has a commercial paper program with an authorized amount of \$100 million (2004 – CDN \$100 million). The Company's commercial paper is currently rated R-1 (low) by Dominion Bond Rating Service and A-2 stable by Standard and Poor's. At December 31, 2005 and 2004, the Company had not drawn on the commercial paper program.

15. PROPERTY SPECIFIC BORROWINGS

<i>millions</i>	Maturity	Interest rates	2005	2004
Great Lakes Power Limited				
First mortgage bonds				
Series 1 (CDN \$384)	2023	6.60%	\$ 331	\$ 320
Subordinated debt (CDN \$115)	2023	7.80%	99	96
			430	416
Great Lakes Power Trust				
First mortgage bonds				
Series 1 (CDN \$50)	2005	7.33%	-	41
Series 2 (CDN \$25)	2010	7.55%	-	21
Series 3 (CDN \$25)	2015	7.78%	-	21
			-	83
Pontiac Power				
Mortgage loans				
Coulonge LP (CDN \$36)	2018	10.26%	31	31
Waltham LP (CDN \$21)	2020	10.99%	18	18
			49	49
Brookfield Power New York				
Bridge financing facility	2006	LIBOR + 100bps	-	500
Senior secured notes				
Series A	2017	5.45%	175	-
Series B	2025	5.91%	250	-
Series C	2030	5.96%	125	-
			550	500
Powell River Energy Inc.				
First mortgage bonds (CDN \$75)	2009	6.39%	65	62
Lake Superior Power senior secured note (CDN \$57)	2009	4.39%	49	61
Lièvre Power LP senior secured bonds (CDN \$225)	2025	5.56%	194	-
Valerie Falls first mortgage bonds (CDN \$32)	2042	6.84%	28	27
Mississagi Power first mortgage bonds (CDN \$175)	2020	6.92%	151	146
Pingston Power Inc. series 1 senior secured bonds (CDN \$35)	2015	5.28%	30	-
GLHA Senior secured notes	2014	5.60%	125	125
GLHA bridge facility	2006	US Prime + 150bps	-	11
Hydro Kennebec senior secured term notes	2008	5.98%	9	-
			\$ 1,680	\$ 1,480
Less: Current portion of property specific borrowings			(21)	(57)
			\$ 1,659	\$ 1,423

The fair value of the Company's property specific borrowings is \$1,734 million (2004 – \$1,439 million) based on current market prices for debt with similar terms and risks.

The property specific borrowings are generally secured by the assets of the related property. Payments are made on interest only with the exception of the following borrowings, which have blended interest and principal payments: the Lake Superior Power senior secured note; the Pontiac Power mortgage loans; the Valerie Falls first mortgage bonds (except for the period from December 19, 2013 until December 18, 2023 during which time no principal repayments are required); and the Hydro Kennebec senior secured term notes.

In April 2005, GLPT obtained a CDN \$125 million bridge facility, bearing a floating interest rate of bankers' acceptances plus stamping fees of 60 basis points. Proceeds of the bridge facility were mainly utilized to early redeem the CDN \$100 million first mortgage bonds and to repay the GLHA bridge facility. The bridge facility was repaid in October 2005 with proceeds from the LPLP senior secured bonds totalling CDN \$225 million.

In December 2005, the Company repaid the \$500 million bridge financing obtained to acquire the Brookfield Power New York ("BPNY") assets in 2004 with the proceeds from the issuance of the BPNY senior secured notes in the amount of \$550 million.

Principal repayments on the Company's outstanding property specific borrowings due over the next five years and thereafter are as follows:

<i>millions</i>	Annual repayments
2006	\$ 21
2007	20
2008	18
2009	74
2010	3
Thereafter	1,544
	\$ 1,680

16. TERM DEBENTURES AND OTHER

<i>millions</i>	2005	2004
US Corporate debentures		
Series 3	\$ -	\$ 200
CDN Corporate debentures		
Series 1 (CDN \$450; 2004 – CDN \$400)	388	333
Series 2 (CDN \$100)	86	84
Powell River Energy Inc.		
Shareholders note (CDN \$22)	19	18
CORHLP		
Finance debt obligation	813	816
Note payable	31	30
	\$ 1,337	\$ 1,481
Less: Current portion of term debentures and other	(91)	(203)
	\$ 1,246	\$ 1,278

The Series 3 US debentures were repaid upon maturity on March 1, 2005.

On January 27, 2005, the Company issued an additional CDN \$50 million in Series 1 Canadian unsecured term debentures. The CDN \$450 million debentures bear interest at 4.65% and are due December 16, 2009.

The CDN \$100 million Series 2 Canadian debentures bear interest at Canadian deposit offering rate plus 68 basis points and are due December 18, 2006.

The CDN \$22 million PREI shareholder note consists of a subordinated promissory note of CDN \$2 million bearing no interest due to a minority shareholder of PREI, and of a CDN \$20 million subordinated promissory note bearing interest, payable quarterly, based on PREI previous year income before interest, taxes, depreciation and amortization subject to a maximum of 18% and a minimum of 10%. The interest rate charged was 18% in 2005 (2004 – 18%). Both notes mature on December 31, 2020.

The finance debt obligation of CORHLP has an implicit annual interest rate of 10.30% and lease payments are due on a semi-annual basis until November 1, 2031. All revenues generated by CORHLP are contractually required to be deposited into a series of trust accounts administered by an independent collateral agent pursuant to a disbursement agreement which provides for the disbursement of funds for operating costs, lease and royalty payments. Under the terms of the disbursement agreement, in May of each year, the funds held in trust for the partners are distributed providing that all the terms of the agreement are satisfied. There are currently no restrictions on any partner distributions.

The CORHLP note payable is secured by 25% of the Company's partnership interest in CORHLP, bears a simple annual interest rate of 5.90% and is repayable on July 1, 2014.

The fair value of the Company's term debentures and other is \$1,340 million (2004 – \$1,481 million) based on current market prices for debt with similar terms and risks.

17. FUTURE INCOME TAX AND OTHER LONG-TERM LIABILITIES

Future income tax and other long-term liabilities are comprised of:

<i>millions</i>	2005	2004
Future income tax liability (note 19)	\$ 116	\$ 157
Accrued levelized expenses	74	70
Commodity derivatives	34	-
Pension and employee future benefits (note 20)	18	18
	\$ 242	\$ 245

18. CAPITAL SECURITIES

Capital securities are comprised of the following:

<i>millions</i>	2005			2004		
	Debt portion of capital securities	Equity portion of capital securities	Total	Debt portion of capital securities	Equity portion of capital securities	Total
Capital securities, CDN \$248	\$ -	\$ -	\$ -	\$ 206	\$ -	\$ 206
Capital securities, US \$909 million	905	4	909	913	3	916
Capital securities, US \$200 million	199	1	200	-	-	-
Total	\$ 1,104	\$ 5	\$ 1,109	\$ 1,119	\$ 3	\$1,122

On April 1, 2005, the CDN \$1,100 million capital securities owned by Brookfield were converted into an equivalent of US \$909 million. These debentures bear an annual interest rate of 11.3%, payable quarterly, mature on June 30, 2054, and are convertible in full at the option of Brookfield any time prior to the maturity date at \$25.51 per common share into 35.6 million common shares. Principal and interest are payable at the Company's option with common shares.

On June 30, 2005, the CDN \$248 million capital securities were repaid and capital securities totaling \$200 million were issued to Brookfield. These securities bear an annual interest rate of 11.3%, payable quarterly, and mature on June 30, 2054. The \$200 million capital securities are convertible in full, at the option of Brookfield, any time prior to the maturity date at \$23.98 per common share into 8.3 million common shares. Principal and interest are payable at the Company's option in common shares.

For the year ended December 31, 2005, \$120 million was recorded as interest on capital securities on the consolidated statement of income (2004 - \$43 million). Refer to note 3b) for further details.

19. INCOME TAXES

The Company's future income tax liability of \$116 million (2004 - \$157 million) is comprised principally of temporary differences relating to power generating assets and other reserves, net of unused non-capital losses, which total \$51 million, expiring in varying amounts between 2007 and 2025. The difference between taxes calculated at the statutory rate and those recorded and reconciled is as follows:

<i>millions</i>	2005	2004
Net income before tax	\$ 45	\$ 109
Statutory income tax rate	34%	36%
Statutory income tax rates applied to accounting income	15	39
Non-taxable dividends	(16)	(18)
Allowance for potential tax reassessments	-	10
Change in tax rates	(6)	-
Exchange translation items and other	(8)	2
(Recovery of) provision for income taxes	\$ (15)	\$ 33

For the year ended December 31, 2005, the Company's current tax recovery was \$4 million (2004 – tax expense of \$4 million) and future income tax recovery was \$11 million (2004 – tax expense of \$29 million).

20. PENSION AND EMPLOYEE FUTURE BENEFITS

(a) Description of benefit plans

The Company offers a number of pension plans to its employees, as well as certain health care, dental care, life insurance and other benefits to certain retired employees pursuant to Company policy. The benefit liabilities represent the amount of pension and other employee future benefits that the Company's employees and retirees have earned at year-end. The Company's obligation under these plans is determined through periodic actuarial reports which are based on the assumptions indicated in the following table.

<i>millions</i>	2005		2004	
	Defined benefit pension plans	Non-pension benefits plans	Defined benefit pension plans	Non-pension benefits plans
Benefit obligation				
Discount rate	5.00%-5.50%	5.00%-5.50%	5.75%-6.00%	5.75%-6.00%
Rate of compensation increase	3.50%-4.50%	3.50%-4.50%	3.50%-4.50%	3.50%-4.50%
Initial health care trend rate	-	6.69%-10.50%	-	6.89%-10.50%
Ultimate trend rate	-	4.24%-5.00%	-	3.90%-5.50%
Year ultimate rate reached	-	2016	-	2008
Benefit expense				
Discount rate	5.75%-6.00%	5.75%-6.00%	5.75%-6.00%	5.75%-6.00%
Long-term rate of return on plan assets	7.00%-7.50%	-	7.00%-7.50%	-
Rate of compensation increase	3.50%-4.50%	3.50%-4.50%	3.50%-4.50%	3.50%-4.50%
Initial health care trend rate	-	6.89%-9.75%	-	7.85%-10.50%
Ultimate trend rate	-	3.90%-5.50	-	3.90%-5.00%
Year ultimate rate reached	-	2008	-	2008
Accrued pension obligations				
Balance, beginning of year	\$ 68	\$ 15	\$ 40	\$ 6
Current service cost	2	1	1	-
Interest cost	4	1	3	1
Plan amendments	1	-	-	-
Benefits paid	(4)	-	(2)	-
Acquisitions	-	-	21	7
Net transfers in	-	-	-	1
Actuarial loss (gain)	10	2	1	(1)
Foreign exchange rate changes	2	-	4	1
Balance, end of year	\$ 83	\$ 19	\$ 68	\$ 15
Fair value plan assets				
Balance, beginning of year	\$ 54	-	\$ 35	-
Employer contributions	4	-	2	-
Employee contributions	-	-	-	-
Benefits paid	(4)	-	(2)	-
Acquisitions	-	-	12	-
Actual return on plan assets	6	-	4	-
Foreign exchange rate changes	2	-	3	-
Balance, end of year	\$ 62	-	\$ 54	-
Reconciliation of accrued benefit asset (liability)				
Plan deficit	\$ (21)	\$ (19)	\$ (14)	\$ (15)
Unamortized transitional obligation	2	4	2	5
Unamortized past service cost	1	-	-	-
Unamortized net actuarial loss	12	3	4	-
Accrued benefit liability	\$ (6)	\$ (12)	\$ (8)	\$ (10)

	2005		2004	
	Defined benefit pension plans	Non-pension benefits plans	Defined benefit pension plans	Non-pension benefits plans
Expense				
Current service costs	\$ 2	\$ 1	\$ 1	\$ -
Interest on accrued benefits	4	1	3	1
Actual return on plan assets	(6)	-	(4)	-
Plan amendment	1	-	-	-
Actuarial loss (gain)	10	2	1	(1)
Costs arising in the period	\$ 11	\$ 4	\$ 1	\$ -
Differences between costs arising in the period and costs recognized in the period in respect of:				
Actuarial loss (gain)	(10)	(2)	(1)	1
Return on plan assets	2	-	1	-
Plan amendment	(1)	-	-	-
Net expense	\$ 2	\$ 2	\$ 1	\$ 1

(b) Plan assets categories

The Company's defined benefit pension plan asset allocations at December 31, by asset category are as follows:

Asset category	% of total plan assets	
	2005	2004
Equity securities	58%	58%
Debt securities	34%	34%
Cash equivalents	8%	8%
Total	100%	100%

(c) Sensitivity analysis

The Company's sensitivity in the non-pension benefit plan to a 1% change in the health care cost trend rate, for the year ended December 31, 2005, is summarized as follows:

	Benefit obligation	Benefit expense
Impact of a 1% increase in health care cost trend rate	\$ 3	-
Impact of a 1% decrease in health care cost trend rate	\$ (2)	-

(d) Actuarial valuations

Actuarial valuations for the Company's pension plans are required every three years. The most recent actuarial valuations for the Company's pension and non-pension benefit plans ranged from January 1, 2003 to December 31, 2004. The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The Company may choose to perform valuations for these plans prior to the earliest required dates.

21. NON-CONTROLLING INTERESTS

Non-controlling interests include preferred shares, limited partnership interests and trust units owned by minority shareholders in the Company's consolidated subsidiaries, as follows:

<i>millions</i>	2005	2004
Preferred shares issued by consolidated subsidiaries	\$ 33	\$ 60
Limited partnership units issued by consolidated subsidiary	37	43
Trust units issued by consolidated subsidiaries	185	194
	\$ 255	\$ 297

22. SHAREHOLDERS' EQUITY

The Company is authorized to issue an unlimited number of common shares, of which the following were issued and outstanding as at December 31:

<i>Millions (except for share amounts)</i>	2005	2004
101,512,218 (2004 - 101,383,135)		
Common shares	\$ 422	\$ 419
Deficit	(215)	(222)
Contributed surplus (note 6)	197	-
Cumulative translation adjustment	(53)	105
	351	302
Capital securities (note 18)	5	3
	\$ 356	\$ 305

On March 31, 2005, the Company issued 129,024 common shares to Brookfield, valued at \$4 million, as non-cash consideration for the acquisition of the common shares of Harmony Wind. In the third quarter of 2005, the Company issued 59 common shares to Brookfield as non-cash consideration for the acquisition of the Company's common shares in FTEI.

The Company is authorized to issue an unlimited number of preferred shares, none of which are currently outstanding.

The following table summarizes the Company's distributions to common shareholders:

<i>millions</i>	2005	2004
Common share dividends	\$ 53	\$ 54
Special dividend	-	612
	\$ 53	\$ 666

On July 1, 2005, FTEI was amalgamated with two subsidiaries of Brookfield to form the amalgamated company, Trilon Bancorp Inc. ("TBI"), a new subsidiary of Brookfield.

The gain on disposition of FTEI resulted in contributed surplus of \$198 million, offset by a loss of \$8 million on the disposition of the Company's coal assets. During the year, the Company sold securities of affiliated companies to Brookfield which resulted in a gain of \$1 million recorded in contributed surplus. All shares issued under the Company's stock based compensation plan are Brookfield shares and are recorded as contributed surplus, which represents \$6 million in 2005.

The significant elements that gave rise to the change in the cumulative translation adjustment during 2005 are as follows:

<i>millions</i>	2005
Balance, beginning of year	\$ 105
Foreign exchange effect on net investment in self-sustaining operations	(23)
Impact of sale of foreign net investments	(158)
Impact of hedging activities	23
Balance, end of year	\$ (53)

23. INTEREST AND FINANCING FEES

Interest and financing fees are comprised of:

<i>millions</i>	2005	2004
Interest and financing fees on property specific borrowings	\$ 105	\$ 63
Interest on term debentures and other	121	112
Interest and financing fees on credit facilities and short-term debt	2	1
	\$ 228	\$ 176

24. CHANGE IN NON-CASH WORKING CAPITAL

The change in non-cash working capital is comprised of the following:

<i>millions</i>	2005
Accounts receivable and other	\$ (12)
Accounts and other payables	45
Effect of foreign exchange	(22)
	\$ 11

25. FINANCIAL RISK MANAGEMENT

The Company uses derivative financial instruments including commodity swaps, interest rate swaps and commodity and foreign exchange forward contracts to manage risk. Derivative financial instruments involve credit and market risk.

(a) Commodity price

The Company enters into energy derivative contracts primarily to manage the price risk associated with the sale of generated power at spot prices. The Company links forward electricity sale derivatives to specific periods and markets in which it anticipates generating electricity for sale. Cash flows related to energy are currently partially hedged until December 2010. The Company also enters into gas derivative contracts. Cash flows related to gas sales are currently partially hedged until December 2008.

The Company may enter into contracts that do not qualify for hedge accounting. At the end of the reporting period, these contracts are evaluated against market prices and an asset or liability is recorded. Non-hedging commodity swap settlements and unrealized gains and losses are recorded in power generation revenue.

<i>millions</i>	2005		2004	
Gain/(loss)	Recorded fair value of non-hedging swaps	Fair value of all swaps	Recorded fair value of non-hedging swaps	Fair value of all swaps
Energy and gas derivatives				
Forward contracts and swaps				
Commodity derivative asset	52	15	12	75
Commodity derivative liability	(68)	(204)	(4)	(74)
	(16)	(189)	8	(1)

The current portion of the recorded fair value of the non-hedging commodity swap liability is \$34 million (2004 - \$4 million) and the current portion of the recorded fair value of the non-hedging commodity swap asset is \$25 million (2004 - \$12 million).

The Company formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of the hedged items. For the periods ended December 31, 2004 and December 31, 2005, there was no ineffectiveness recorded in income for hedging contracts.

(b) Interest rate

The Company enters into interest rate swaps on its long-term debt. The swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company designates its interest rate swap agreements as hedges of the underlying debt. Interest expense is adjusted to include the payments made or received under the interest rate swaps.

In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instruments, any realized or unrealized gain or loss on such derivative instruments is recognized in income. In the event a derivative instrument in a designated hedge relationship is sold, extinguished or matures prior to the termination of the related hedged item, any realized or unrealized gain or loss is recognized in income on the same basis as the underlying hedged item.

All swap agreements were terminated in 2005. The total notional amount of principal underlying interest rate swap contracts as at December 31, 2004 was \$437 million.

(c) Foreign exchange

In 2004, prior to its change in functional currency, the Company used foreign exchange contracts and foreign-denominated liabilities to hedge the value of its investments in its foreign self-sustaining subsidiaries. As at December 31, 2005, the Company no longer holds any forward foreign exchange contracts (2004 - \$310 million) given the change of functional currency from CDN to US. For the fourth quarter of 2005, Canadian denominated liabilities in the amount of \$459 million were designated as a hedge of the net investments in Canadian operations. The impact of hedging activities in 2005 was \$23 million.

Refer to note 22 for the significant elements that gave rise to the change in the cumulative translation adjustment during the year.

Exchange gains and losses arising on the translation of foreign-denominated monetary assets and liabilities in the amount of \$6 million (2004 – \$3 million) are included in investment and other income.

(d) Credit risk

Credit risk arises from the potential for a counterparty to default on its contractual obligations and is limited to those contracts where the Company would incur a loss in replacing the defaulted transaction. The Company's financial instruments that are potentially exposed to credit risks are cash equivalents, accounts receivable, investments, demand deposits and accrued levelized revenues. The Company actively manages its exposure to credit risk by assessing the ability of counterparties to fulfill their obligations under the related contracts prior to entering into such contracts, and continually monitors these exposures. The Company's contracted power sales are with customers with long-standing credit history or investment grade ratings.

The Company minimizes credit risk with counterparties to derivative financial transactions through the selection, monitoring and diversification of counterparties, use of the International Swaps and Derivatives Association documentation, collateral and other credit risk mitigation techniques.

These risks are reviewed on a regular basis and the Company believes the exposures are manageable and not material in relation to its overall business operations.

26. GEOGRAPHIC SEGMENTED INFORMATION

The Company owns and operates high quality hydroelectric and cogeneration assets in both Canada and the United States with operations in seven distinct geographic regions across North America: Ontario, Quebec, British Columbia, New England, New York, Louisiana and Other. The "Other" reporting segment consists of the activities of the Company's transmission and distribution business, the Company's Cogenerating stations, the Company's pump storage facility, the Company's wholly owned holding companies and the transactions with Noranda. These seven regions represent the Company's reportable segments, which are used to manage the business, and are based on the location of the underlying generating and infrastructure facilities. The accounting policies of these reportable segments are the same as those described in notes 2 and 3.

The Company analyzes the performance of its operating segments based on net operating income which consists of revenues from the Company's power operations, net of operating and maintenance costs, fuel purchases for its cogeneration plants, power purchases, marketing and administration expenses and municipal and other generation taxes on its facilities. Net operating income is not a measure of performance under Canadian generally accepted accounting principles; however, management uses this measure to assess the operating performance of its reportable segments.

Information by segment

<i>millions</i>	Ontario	Quebec	British Columbia	New England	New York	Louisiana	Other	2005
Revenue	\$ 114	\$ 76	\$ 21	\$ 65	\$ 196	\$ 133	\$ 169	\$ 774
Net operating income	92	64	15	47	140	112	(7)	463
Depreciation and amortization	14	8	3	12	24	19	22	102
Interest and financing fees	32	21	8	8	33	95	31	228
Power generating assets	735	374	131	238	847	353	319	2,997
Total assets	1,034	412	138	255	1,073	1,170	1,286	5,368
Property specific borrowings	510	243	95	134	550	-	148	1,680

<i>millions</i>	Ontario	Quebec	British Columbia	New England	New York	Louisiana	Other	2004
Revenue	\$ 123	\$ 70	\$ 19	\$ 49	\$ 38	\$ 159	\$ 209	\$ 667
Net operating income	101	57	15	34	18	135	5	365
Depreciation and amortization	15	7	3	8	6	14	21	74
Interest and financing fees	28	11	7	8	6	86	30	176
Power generating assets	581	359	126	262	803	366	268	2,765
Total assets	545	370	134	287	939	1,003	1,858	5,136
Property specific borrowings	532	132	62	136	500	-	118	1,480

The Company had a contract with Noranda, a company related by common ownership, which expired in May 2005. In 2005, revenues from this contract represented 6% of total revenues (2004 - 18% of total revenues).

27. COMMITMENTS, CONTINGENCIES AND GUARANTEES

The Company and its subsidiaries may, from time to time, be involved in legal proceedings, claims and litigation that arise in the ordinary course of business which the Company believes would not reasonably be expected to have a material adverse effect on the financial condition of the Company.

In the course of its operations, the Company has entered into agreements for the use of water, land and/or dams. Payment under those agreements depends on the amount of power generated. The various renewable agreements extend through the year 2022 for Great Lakes Power, 2044 for Valerie Falls Power, 2011 to 2019 for Pontiac Power, 2025 for Lièvre River Power, 2012 for Brassua Power, 2023 for Errol Power, 2032 for Pontook Power, 2009 for Hydro Kennebec LP, 2031 for CORHLP and 2006 to 2042 for Erie Boulevard. The Company also entered into two gas supply agreements for the purchase of natural gas to run the cogeneration turbine engines at Lake Superior Power. The agreements extend to 2008 and 2009.

In the normal course of operations, the Company and its subsidiaries execute agreements that provide for indemnification and guarantees to third parties in transactions such as energy trading and marketing, business dispositions, capital project purchases, business acquisitions, and sales and purchases of assets and services.

In the normal course of operations, the Company has committed as at December 31, 2005 to spend approximately \$253 million (2004 - \$44 million) on capital projects in future years.

The Company has also agreed to indemnify its directors and certain of its officers and employees. The nature of substantially all of the indemnification undertakings prevents the Company from making a reasonable estimate of the maximum potential amount that the Company could be required to pay third parties as the agreements do not always specify a maximum amount and the amounts are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. Historically, neither the Company nor its subsidiaries have made significant payments under such indemnification agreements.

The Company limits the amount of guarantees for its energy trading activities to CDN \$350 million (2004 – CDN \$185 million), with a total of CDN \$347 million issued as of December 31, 2005 (2004 – CDN \$165 million). The terms of such obligations vary. Historically, the Company has not been obligated to make significant payments for these obligations. No amount was included in the Company's consolidated balance sheet for December 31, 2005 and 2004 relating to these parental guarantees.

The new wind energy system is expected to enter commercial operation in 2006. In late October 2005, the Company entered into a two year agreement with a turbine supplier, GE Energy, who will be responsible for the operation (in cooperation with the Company) and maintenance of the turbines. The energy generated by the wind facility will be sold to the government of Ontario under a power purchase agreement.

The Company has asset retirement obligations associated with its generating stations. The retirement date for these generating stations cannot be reasonably estimated and therefore, the fair value of the associated liability cannot be estimated at this time. As a result, no liability has been accrued in these financial statements.

28. SUBSEQUENT EVENTS

(a) On January 11, 2006, the Company entered into an agreement to acquire two hydroelectric generating facilities in Maine from Rumford Falls Power Company, owned by NewPage Corporation for cash consideration of \$144 million. These two run-of-the-river merchant facilities are located on the Androscoggin River and have the capacity to generate approximately 270 GWh of energy per year. This transaction, which is subject to various closing conditions (including regulatory approval), is expected to close in the second quarter of 2006.

(b) On December 28, 2005, the Company entered into an agreement to acquire the company Beaver Power Corporation and its four hydroelectric generating facilities in Northern Ontario totalling approximately 50 MW of generating capacity for an undisclosed cash consideration and assumption of debt. Generating facilities are located on the Groundhog River, Shekak River, the Serpent River and Aux Sables River. The purchase closed February 17, 2006.

Brookfield Power



BCE Place, Suite 300
181 Bay Street, P.O. Box 762
Toronto, Ontario M5J 2T3

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