

Court File No. 06-CL-6746

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

**IN THE MATTER OF THE *COMPANIES' CREDITORS*
ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED
AND IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT WITH RESPECT TO 3791351 CANADA INC. CARRYING ON
BUSINESS AS "CU-CONNECT" (THE "APPLICANT")**

**FIRST REPORT OF
KPMG INC., MONITOR**

December 5, 2006

Table of Contents

- I. PURPOSE, QUALIFICATIONS AND RESTRICTIONS OF THIS REPORT1**
- II. LEGAL PROCEEDINGS.....3**
- III. CASH FLOW FORECAST4**
- IV. CASH FLOW AND DRAWS UNDER THE DIP FACILITY5**
- V. POST FILING ACTIVITIES.....7**
 - A. OVERVIEW7
 - B. NOTICE TO CREDITORS.....7
 - C. FINANCIAL CONTROLS7
 - D. RELATIONSHIPS WITH KEY STAKEHOLDERS8
 - E. NO DISASTER RECOVERY PROGRAM.....8
- VI. SALE PROCESS.....10**
- VII. ONGOING FORENSIC INVESTIGATION11**
- VIII. CU-CONNECT’S REQUEST TO EXTEND THE STAY PERIOD.....12**
- IX. SUMMARY AND CONCLUSIONS.....13**

I. PURPOSE, QUALIFICATIONS AND RESTRICTIONS OF THIS REPORT

On November 20, 2006, 3791351 Canada Inc, carrying on business as “CU-Connect” (the “Applicant” or the “Company” or “CU-Connect”), filed for and obtained protection from its creditors under the *Companies’ Creditors Arrangement Act* R.S.C. 1985 c. C-36, as amended (the “CCAA”). The terms of this proceeding are governed by an Order of this Court dated November 20, 2006 (the “Initial Order”). Pursuant to the Initial Order, KPMG Inc. (“KPMG”) was appointed as monitor (the “Monitor”) of the Applicant during these CCAA proceedings. Capitalized terms not defined in this report (as defined below) are as defined in the Initial Order.

The purpose of this First Report of the Monitor (the “Report”) is to provide information to this Honourable Court and the Applicant’s stakeholders in connection with the following:

- (i) the status of the legal proceedings involving the Company;
- (ii) the Company’s cash flow forecast for the 13-week period November 20, 2006 to February 16, 2007;
- (iii) the Company’s post-filing cash flow and draws under the DIP financing facility;
- (iv) key post-filing activities of the Company and the Monitor;
- (v) the Company’s proposed sale process;
- (vi) the status of the ongoing forensic investigation; and
- (vii) the Company’s request to extend the stay of proceedings to February 16, 2007.

The information contained in this report has been obtained from the records of the Company and is based on discussions with, and representations made by, management of the Company, and other professional advisors retained in this matter.

The financial information of the Company has not been audited, reviewed or otherwise verified by the Monitor as to its accuracy or completeness, nor has it necessarily been prepared in accordance with generally accepted accounting principles and the reader is cautioned that this report may not disclose all significant matters about the Company. Accordingly, the Monitor does not express an opinion or any other form of assurance on the financial or other information presented herein. The Monitor may refine or alter its observations as further information is obtained or is brought to its attention after the date of this report.

The Monitor assumes no responsibility or liability for any loss or damage occasioned by any party as a result of the circulation, publication, reproduction or use of this report. Any use which any party makes of this report, or any reliance on or decision to be made based on this report, is the sole responsibility of such party.

All references to dollars are in Canadian currency unless otherwise noted.

II. LEGAL PROCEEDINGS

On November 20, 2006, the Company filed for and obtained protection from its creditors under the CCAA. The terms of this proceeding are governed by the Initial Order which, amongst other things, provide for the following:

- (i) that the Applicant will remain in possession and control of its current and future assets, and continue to carry on business in a manner consistent with the preservation of the value associated with its current and past Business and Property;
- (ii) that until and including December 19, 2006, or such later date as the Court may order, no proceeding or enforcement process in any court or tribunal shall be commenced or continued against or in respect to the Company or the Monitor, or affecting the Business or the Property, except with the written consent of the Applicant and the Monitor, or with leave of the Court;
- (iii) that Mr. Terry Chapman be appointed as Chief Restructuring Officer (“CRO”) of the Applicant to manage the business, affairs and the restructuring of the Applicant (including the preservation of, and realization of, the assets of the present and former businesses of the Applicant), as an officer of the Court, with the powers and obligations set out in the Initial Order;
- (iv) that the Applicant is authorized and empowered to obtain and borrow under a credit facility from CU Connection Limited in order to finance the Applicant’s working capital requirements and other general corporate purposes and capital expenditures, provided that borrowing under such credit facility (the “DIP Facility”) shall not exceed \$500,000 unless permitted by further Order of the Court. By order of the Court, the DIP Lender’s Charge ranks second behind an Administrative Charge (to the maximum of \$300,000) and ahead of a Directors’ Charge (to the maximum of \$100,000); and
- (v) that the Applicant shall pursue all avenues of refinancing and offers for material parts of its Business or Property, in whole or part, subject to the prior approval of this Court being obtained before any material refinancing or any sale (with the exception of the disposition of redundant or non-material assets not exceeding \$50,000 in any one transaction or \$500,000 in the aggregate).

The Monitor has made the Initial Order issued by this Honourable Court in this matter, and other information, available on its website at www.kpmg.ca/cu-connect.

III. CASH FLOW FORECAST

The Company prepared the cash flow forecast for the 13-week period November 20, 2006 to February 16, 2007 (the "Cash Flow") which was appended to the Affidavit of Terry Chapman sworn on November 16, 2006 (the "Chapman Affidavit") and filed with this Honorable Court in connection with the Company's application for the Initial Order.

According to the Cash Flow, the Company's opening cash position as at November 20, 2006 was expected to be in an overdraft of approximately \$1,000. The overdraft position is projected to increase throughout the forecast period.

By the end of week two, the Cash Flow shows cumulative net cash outflows of approximately \$152,000. During week two the Company anticipated significant expenditures related primarily to payroll, professional fees and maintenance costs. As a result, the first advance under the DIP Facility was expected to be approximately \$152,000 during the week of November 27, 2006. Further draws on the DIP Facility are projected throughout the 13-week period, with a peak projected cumulative draw on the DIP Facility of approximately \$242,000 during the week ending December 25, 2006.

IV. CASH FLOW AND DRAWS UNDER THE DIP FACILITY

The Company's cash receipts and disbursements from November 20 to December 3, 2006 are summarized below and are compared with the first two weeks of the Cash Flow.

3791351 Canada Inc. (o/a CU-Connect)			
Summary of Actual Versus Projected Cash Flow			
For the Period November 20 to December 3, 2006			
Unaudited (in CDN\$)	Actual Results [1]	CCAA Projection [2]	Variance Favourable/ (Unfavourable)
Inflows:			
Fees - Switching and Prepaid Card Program	67,699	67,200	499
Collection of A/R	30,811	14,000	16,811
Foreign Exchange & Other	26,934	8,200	18,734
Total Inflows	125,444	89,400	36,044
Outflows:			
Payroll	(22,958)	(64,500)	41,542
Communications	-	(15,000)	15,000
Rent & Utilities	-	(10,000)	10,000
Maintenance - Software & Hardware	-	(20,000)	20,000
Selling, General and Admin	(1,359)	(12,800)	11,441
Professional Fees	(110,000)	(100,000)	(10,000)
Interest/Capital CU-Connection Ltd.	(16,925)	(18,000)	1,075
Total Outflows	(151,241)	(240,300)	89,059
Net Cash Inflow/(Outflow)	(25,797)	(150,900)	125,103
Opening Cash	2,317	(1,000)	3,317
Draws on DIP Facility	110,000	151,900	(41,900)
Closing Cash [3]	86,520	-	86,520
Cumulative Draws on DIP Facility	110,000	151,900	41,900
Notes:			
<i>[1] Actual results include actual cash flow experience for the period November 20 to December 3, 2006. Amounts are presented on the basis that cheques/wire transfers are issued and cleared on the same day.</i>			
<i>[2] Projected amounts are those set out in the cash flow forecast that was appended to the Affidavit of Terry Chapman, CRO of CU-Connect, sworn November 16, 2006, and filed in support of the CCAA application.</i>			
<i>[3] The closing cash balance of \$86,520 has not been fully reconciled to the Company's records. The Company's records indicate a balance of approximately \$100,000. The Monitor is working with the Company to reconcile the difference and will report on the outcome once the work is completed.</i>			

Overall, the Company has experienced net cash flow variances which are, in aggregate, approximately \$125,000 favourable relative to those set out in the Cash Flow.

Management attributes the cash outflow variances primarily to timing differences. Payments for communications, payroll, rent and maintenance expenses will be made during the week of December 4, 2006. The first draw on the DIP Facility occurred on December 1, 2006 in the amount of \$110,000.

V. POST FILING ACTIVITIES

A. Overview

Management has informed the Monitor that, with the exception of the lack of a Disaster Recovery Program (“DRP”), which is discussed later in this Report, to date, it is not aware of any material changes to the Company’s operations which have occurred subsequent to the date of the Initial Order. Information provided to the Monitor from the Company in the post-filing period indicates that transactions and service fee collections are continuing at levels consistent with the pre-filing period. Additionally, management has informed the Monitor that the Company’s relationship with various stakeholders, including its primary customers, suppliers and employees have continued in a satisfactory manner and that the Company’s operations continue to experience general support from its stakeholders.

B. Notice to Creditors

In accordance with paragraph 51 of the Initial Order the Company sent a copy of the Initial Order to its known creditors, other than employees and creditors to which the Company owed less than \$5,000, on November 20, 2006. In addition, the Company provided notices along with copies of the Initial Order to its Credit Union and Prepaid Debit Card program clients during the week of November 24, 2006.

C. Financial Controls

The Company maintains accounting and treasury functions at its head office in Toronto, Ontario which are responsible for the orderly administration and record-keeping of the Company. In addition to the Company’s regular controls over cash receipts and disbursements, at the Monitor’s request, the Company has implemented certain additional controls as described below.

The general controls include review by the Monitor of:

- daily bank reconciliations for all operating bank accounts;
- weekly review of bank statements for the inactive US operating account, and Canadian Clearing Account used as a settling account for pass-through with traffic with CU-Connect for non-members;
- actual versus forecast cash receipts and disbursements on a weekly basis and investigation of any significant variances; and
- ongoing purchase commitments.

The controls over cash receipts include review by the Monitor of:

- all receipts on a daily basis and reconciliation of such receipts to daily bank reconciliations; and
- actual versus forecast total receipts on a weekly basis and investigation of any significant variances.

The controls over disbursements include review by the Monitor of:

- all proposed disbursements greater than a minimum threshold amount prior to such disbursements being made; and

- actual versus forecast disbursements on a weekly basis and investigation of any significant variances.

D. Relationships with Key Stakeholders

In general, the Company appears to be enjoying continued support from its key stakeholders as required to continue operations. Certain details regarding these relationships post-filing are provided below.

Customers/Credit Unions

As previously indicated in this Report, management has advised the Monitor that service fee and A/R collections are continuing at levels consistent with the pre-filing period. Management has advised the Monitor that no customers have provided formal notice to attempt to exit their contract/relationship with the Company prior to December 4, 2006.

Suppliers and Other Creditors

Those suppliers which were identified as being most important to the continued operations of the Company were contacted by management immediately after the issuance of the Initial Order to arrange continued post-filing supply. Generally, the supply of goods and services to the Company has continued without interruption.

Legal counsel to one supplier has written to the Company to assert that it is a "critical" supplier and has requested payment of amounts due to it for pre-filing services. The Monitor understands that the Company and its legal counsel will be responding to that creditor.

Correspondence has been exchanged between counsel for the Company and counsel for the receiver and manager of JAWZ Canada Inc., an unsecured creditor and non-voting shareholder of CU-Connect, regarding the appointment of Mr. Chapman as CRO and the proposed sale process. This correspondence is appended to the Affidavit of Terry Chapman, sworn December 4, 2006 (the "Second Chapman Affidavit"). The Monitor understands that the Company's legal counsel is continuing to respond to legal counsel for the receiver and manager and is resolving the request that Mr. Chapman be cross-examined with respect to the Chapman Affidavit.

Employees

The Monitor has been advised by management that the Company continues to enjoy the general support of its workforce. There have been no resignations by any of the employees since the date of the Initial Order.

E. No Disaster Recovery Program

Management has informed the Monitor that CU-Connect does not have a DRP which is a major concern to the Company. As indicated in the Second Chapman Affidavit, the former CEO of CU-Connect had previously made representations that a DRP was operational and could be transitioned to within 24 hours. This is now known to be incorrect. Management has noted that the Company's current switch has historically been very reliable and has operated at a level at least equal to that of other Interac network association members; however, in the event of a fire or other disaster the primary computer site could be rendered inoperable resulting in the loss of use of the Credit Unions' debit cards. The best practice would be to have a back-up site for use in case of such an emergency. Currently, CU-Connect does not have the time or monetary resources to establish a DRP. In the Second Chapman Affidavit, Mr. Chapman

indicates that a purchaser of all of the assets of CU-Connect may be in a position to have a DRP in place in approximately 60 days following the closing of a sale transaction. The Monitor has not independently verified this comment. The Monitor will work with management to monitor the effects on CU-Connect's business of not having a DRP.

VI. SALE PROCESS

The Order to be sought in a motion by the Company on December 7, 2006, among other things, contemplates a sales process (the “Sale Process”), detailed in the Second Chapman Affidavit, with respect to all of the operating assets (but excluding those assets associated with the now discontinued vault cash program (the “Vault Program”)), which includes the following steps:

- (i) advertisement of the availability of the CU-Connect assets for sale in *The Globe and Mail* on either Friday December 8, 2006 or Saturday December 9, 2006;
- (ii) upon signing a form of non-disclosure agreement, satisfactory to CU-Connect, potential purchasers will be provided with access to the books and records and management personnel of the Company in order to conduct due diligence;
- (iii) a standard form Asset Purchase Agreement (the “Standard Agreement”), as appended to the Second Chapman Affidavit, will be distributed to interested parties in order to assist in moving forward with offers quickly and to facilitate consistency amongst the offers that are submitted;
- (iv) the Standard Agreement requires that a deposit of 10% be submitted with the completed Standard Agreement;
- (v) offers are to be submitted no later than December 22, 2006; and
- (vi) under the sale process, neither the highest and best offer nor any other offer would necessarily be accepted. CU-Connect will retain the right to reject all offers submitted and to proceed towards completion of further negotiations.

From its discussions with the Company, the Monitor has been informed that since the date of the Initial Order, Mr. Chapman has been in contact with nine parties that have expressed interest in purchasing all or certain of the assets of CU-Connect. Of the nine interested parties, eight have executed non-disclosure agreements and have met with Mr. Chapman for more detailed discussions regarding the businesses and assets of the Company. Four of these interested parties were provided information to assist in their due diligence, including information related to assets, normalized operating statistics, employees and customers.

The proposed Sale Process is intended to provide the stakeholders of CU-Connect with maximum returns, in the circumstances, while recognizing that the Company must proceed quickly due to its limited cash/funding resources and to preserve the value of its assets and its customer base. The Company expects to have the proposed Sale Process completed by execution of a Standard Agreement, with the approval of the Court, as soon as possible after expiry of the deadline for submission of offers.

The Monitor does not foresee any reason why the proposed Sale Process would not benefit all affected stakeholders and recommends its approval by this Honourable Court.

VII. ONGOING FORENSIC INVESTIGATION

As outlined in the Chapman Affidavit, BDO Dunwoody LLP (“BDO”) was engaged on October 2, 2006 to conduct a forensic investigation related to the Company’s Vault Program, which was subsequently discontinued on October 20, 2006. The Company’s Vault Program supplied cash for white label and unbranded ATM machine owners. Under the Vault Program, Kawartha Credit Union (“Kawartha”) and North York Community Credit Union Limited (“NYCCU”) advanced a significant amount of funds to CU-Connect, which in turn, advanced cash to ATM owners to stock their ATMs.

During the months of August and September 2006, NYCCU became aware of apparent irregularities with respect to the administration of the Vault Program and informed Mr. Chapman of such irregularities on September 14, 2006. Following certain initial work by the Company and BDO, such apparent irregularities include:

- funds advanced by NYCCU and/or Kawartha for the Vault Program that may have been transferred into CU-Connect accounts and used to fund certain of CU-Connect’s operating expenses;
- that there may have been co-mingling of NYCCU vault cash, Kawartha vault cash and the CU-Connect operating accounts;
- that reconciliations of CU-Connect’s vault cash clearing account were not completed on a timely basis;
- CU-Connect had not obtained valid cash reconciliations from its ATM customers and had not collected or billed these customers for monthly cash rental fees for a significant period of time; and
- that there is a potential shortfall in the vault cash accounts in excess of \$6 million.

The Monitor has had discussions with Mr. Chapman and BDO to determine the status of BDO’s investigation. As at the date of this report, the forensic investigation is continuing and BDO is in the process of reconstructing and analyzing various records. It is expected that BDO will complete its field work and report its findings and recommended next steps by the end of December 2006.

VIII. CU-CONNECT'S REQUEST TO EXTEND THE STAY PERIOD

The stay period provided by the Initial Order expires December 19, 2006. In order to allow sufficient time to continue to develop, explore and implement restructuring initiatives and to implement a sale process for the benefit of all stakeholders, the Company is requesting an extension of the stay of proceedings to February 16, 2007.

The Monitor does not foresee any reason why an extension of the stay period would not benefit all affected stakeholders and recommends such an extension, subject to the approval of this Honourable Court.

IX. SUMMARY AND CONCLUSIONS

The Company's operations have generally been stable post-filing, and the Company appears to be enjoying continued support from its key stakeholders as required to continue operations.

The Monitor believes that the Company is acting in good faith and with due diligence in these proceedings.

The Monitor respectfully recommends that the Court approve the Sales Process as described in the Second Chapman Affidavit.

The Monitor respectfully recommends that the Court approve the extension of the Stay Period (as defined in the Initial Order) to February 16, 2007 to allow sufficient time to conduct the Sales Process.

RESPECTFULLY SUBMITTED,

Dated the 5th day of December, 2006.

KPMG INC.
In its Capacity as Court-Appointed Monitor of
3791351 Canada Inc, Carrying on Business as "CU-Connect"



Per: Alan J. Hutchens
Senior Vice-President
416-777-8916

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

Court File No: 06-CL-6746

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO 3791351 CANADA INC. CARRYING ON BUSINESS AS "CU-CONNECT"

(The "Applicant")

ONTARIO

**SUPERIOR COURT OF JUSTICE
(Commercial List)**

Proceeding commenced at Toronto

FIRST REPORT OF KPMG INC., MONITOR

**Borden Ladner Gervais LLP
Barristers and Solicitors
Scotia Plaza
40 King Street West
Toronto, Ontario M5H 3Y4**

Roger Jaipargas

Phone: 416-367-6266

Fax: 416-361-7067

Solicitors for KPMG Inc., Monitor