Management's Discussion and Analysis
Financial Statements

Management's Discussion and Analysis

(Dated May 9, 2007)

The financial statements present the results of the OSC for the year ended March 31, 2007, with 2006 comparatives and accompanying notes. Unless otherwise specified, references to years, for example 2007, refer to the fiscal years of the OSC ended March 31. The following comments analyze the factors which affected the OSC's operations during 2007, as well as the factors that reasonably may be expected to affect future operations and financial results.

This document should be read in conjunction with the financial statements. Certain statements included in this annual report are forward looking and are subject to important risks and uncertainties. The results or events forecast in these statements may differ materially from actual results or events. Factors which could cause results or events to differ from current expectations are described in the risks and uncertainties section. Readers should note that some assumptions, although reasonable at the time of publication, are not guarantees of future performance.

Overview

The OSC is a corporation without share capital. The OSC functions as an independent regulatory agency and administrative tribunal responsible for overseeing the securities marketplace in Ontario. As a Crown corporation, the OSC is exempt from income taxes. The OSC's operations are funded through fees paid by securities market participants. Employee compensation and occupancy costs account for 81.7% (2006 – 81.1%) of OSC expenses.

Internal Control over Financial Reporting

The OSC believes that its own governance practices should be robust, transparent and where applicable, conform to the best practices advocated for public companies. Recognizing the importance of high quality, reliable and transparent financial reporting, the Audit and Finance Committee and management decided to implement the reporting issuer provisions of Multilateral Instrument 52-109 with respect to internal control over financial reporting (ICFR). We believe this is an opportunity for the OSC to show leadership and help develop best practices in disclosure.

This led to a process of research and planning, identification of risk areas, review and documentation of controls and identification of areas for improvement. This process involved OSC staff and management, with the assistance of external resources.

The statement of Management's Responsibility for the financial statements included in last year's Annual Report has been revised and expanded to include the appropriate certification. In addition, we will be implementing certain improvements in internal control where we already have compensating controls, identified in our review:

- our design did not include a formal fraud risk assessment. The OSC believes it has a strong overall system of internal control and maintains an internal audit function using an external provider, which assesses and addresses the overall risk factors faced by the OSC, and reports to the Audit and Finance Committee, but it has not focussed specifically on the risk of fraud. This will be addressed for the coming year;
- the OSC strongly supports the value that a "whistleblower" procedure provides as part of an internal control environment. We have delayed implementing a whistleblower procedure at the OSC in light of the anticipated coming into force of the new *Public Service of Ontario Act, 2006* and the desire for our procedures to align with the provisions of this initiative. Among other things, the *Public Service of Ontario Act, 2006* establishes a process which enables public servants, including OSC employees, to disclose wrongdoing in the Ontario public service and be protected from reprisals;
- management is reassigning duties among staff to achieve the appropriate segregation of duties in the OSC's finance department and its financial information systems areas; and
- management is implementing changes in access and reassignment of duties to attain the desired level of control over access to certain systems, records and assets.

OSC Fees

The OSC fee schedule is designed to generate fees that reflect the OSC's cost of providing services to market participants. Starting April 1, 2003, the OSC has set fee levels every three years, most recently at April 1, 2006. Fee levels are adjusted to offset accumulated deficits or surpluses. The forecasted surplus at March 31, 2006, was used to establish a reduced level of participation fees for the new fee schedule that became effective April 1, 2006. The fee schedule requires the payment of "activity fees" and "participation fees".

Activity fees are designed to represent the direct cost of OSC staff resources used in undertaking certain activities requested of staff by market participants. Activity fees are charged for a limited number of activities and are flat rates based on the average cost to the OSC of providing the service.

Participation fees are based on the cost of a broad range of regulatory services that cannot be practically or easily attributed to individual activities or entities and are intended to serve as a proxy for the market participant's use of the Ontario capital markets. Participation fee levels are set using a tiered structure. Fees for issuers are based on capital; fees for registrants are based on their revenues. As a market participant grows, it moves through various tiers which have increasingly higher fees. The breadth of the tiers was designed to minimize movement through tiers due to market fluctuations and thereby reduce the volatility in OSC revenues due to positive or negative market changes.

As we have gained more experience with the fee structure we have learned that it is more closely correlated to market activity levels than anticipated. In 2007, participation fees grew along with the financial markets, and were $9.0 million higher than budgeted. This was the key contributor to the OSC generating a $1.8 million surplus rather than a planned deficit of $12.2 million. In the coming year we plan to re-examine the fee structure to determine what changes need to be made to achieve our goals of stable OSC revenues, fairness to market participants and matching our revenues and expenses.

The *Securities Act* states that, when ordered to do so by the responsible Minister, the OSC shall pay into the Consolidated Revenue Fund such of its surplus funds as determined by the Minister. The Minister has confirmed that the OSC is not required to remit its surpluses subject to appropriate terms and conditions to be agreed with the Ministry. As noted above, the OSC has committed to re-evaluate its fee levels every three years and to take into account any accumulated surplus in setting fees for the ensuing period. Any deficits will be funded either through surpluses previously generated or that may be generated in the future, or from the OSC's reserve.

Analysis of Operating Results

We actively manage our expenses by:

- Preparing an annual budget approved by the Board;
- Continually assessing and improving the efficiency of our processes;
- Reporting actual versus budget performance and updated full-year forecasts to the Board every quarter; and
- Requiring Board approval of significant unbudgeted expenses or re-allocations.

2007 Actual versus 2007 Budget

(Thousands)	2007 Actual	2007 Budget
Revenues	$ 71,067	$ 60,016
Expenses	69,304	72,168
Excess of Revenue over Expenses	$ 1,763	$ (12,152)

Our budget was for a deficit of revenue over expenses of $12.2 million in 2007. Our actual excess was $1.8 million. Revenues were $11.0 million higher than budget primarily due to surplus participation fees ($9.0 million) as previously discussed, late filing fees ($0.8 million) and investment income ($0.9 million). Expenses reflected lower than expected spending on employee compensation, occupancy and training ($1.3 million) and professional services ($0.7 million).

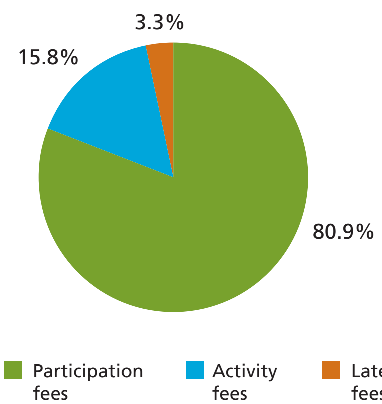
Revenues

(Thousands)	% of Total Fees	2007 Actual	2007 Budget	Variance	% Variance
Participation fees	80.9	$ 54,814	$ 45,823	$ 8,991	19.6
Activity fees	15.8	10,732	10,486	246	2.3
Late fees	3.3	2,238	1,400	838	59.9
Total fees	100.0	$ 67,784	$ 57,709	$ 10,075	17.5
Investment income		3,140	2,207	933	42.3
Miscellaneous		143	100	43	43.0
Total revenues		$ 71,067	$ 60,016	$ 11,051	18.4

Participation fees are the largest revenue source, accounting for 80.9% of fees. Actual fees earned exceeded budget by $9.0 million. Issuer participation fees were $4.7 million above plan. As noted above, buoyant capital markets resulted in higher than expected growth in the market capitalization of issuers which generated higher revenues. Registrant participation fees were $4.3 million above plan. Similarly, the increase was due to growth in registrant firm revenues which generated higher participation fees.

Figure 1 shows the sources of OSC fees:

Figure 1 – OSC Fees by Type



Activity fees accounted for 15.8% of total fees. Activity fee volumes are driven by market demand for our services. Issuer activity fees were $444K over plan due to higher than expected fees from filings of preliminary and/or final prospectuses, private placements and takeover bids. These increases were partially offset by lower than forecast volumes of applications for relief. Registrant activity fees were $198K under plan mainly due to lower investment fund prospectus activity.

Late fees accounted for 3.3% of fees and were greater than planned by $838K, or 60%. The variance occurred mostly due to higher than expected late filings of insider trading reports ($520K) and interim and annual statements ($241K).

Investment income generated by deposits and other investments was $933K or 42% above plan. The positive variance occurred due to higher interest rates combined with higher than expected cash balances. Interest on cash balances generated $1.9 million (2006 – $926K). These balances earn interest at a rate of 1.75% below the prime rate or 0.25% below bankers' acceptances. Investments in short and mid term instruments with the Ontario Financing Authority generated $1.3 million (2006 – $946K). The average rate of return on these instruments was 3.92% (2006 – 2.96%).

Miscellaneous revenues were $143K versus a budget of $100K.

Expenses

(Thousands)	2007 Actual	2007 Budget	% Variance	2006 Actual	2005 Actual	2004 Actual
Salaries and benefits	$ 51,508	$ 52,066	1.1	$ 48,871	$ 44,287	$ 40,147
Administrative	5,143	5,936	13.4	5,263	5,464	4,349
Occupancy	5,104	5,533	7.8	4,570	4,037	3,973
Professional services	4,827	5,557	13.1	3,827	3,416	2,170
Amortization	1,771	1,757	-0.8	2,329	3,267	3,233
Other	951	1,319	27.9	963	1,158	1,099
Total expenses	$ 69,304	$ 72,168	4.0	$ 65,823	$ 61,629	$ 54,971

Salaries and benefits spending was $558K or 1.1% under budget. Savings were due to vacancies and delays in hiring as well as a decision to outsource part of the System for Electronic Disclosure by Insiders (SEDI) modernization project rather than using internal resources.

Administrative costs were $793K or 13.4% under budget. Commission expenses were $235K less than budgeted despite an increase in the number of hearing days. Costs were lower because there were more hearings held using fewer than three Commissioners. There were also vacant Commissioner positions during the year. Training was lower by 29.8% or $307K as planned activities were deferred due to other workload priorities.

Occupancy costs were $429K or 7.8% lower than plan due to lower maintenance and operating costs and delays in obtaining leased space for the SEDI project team.

Professional services costs were $730K or 13.1% under budget. Planned audits under our internal audit program were postponed as efforts were focused on reviewing our risks and development of an audit plan. For various other projects, including the registration reform project and for industry specific continuous disclosure reviews, internal resources were used. Contingencies for certain CSA initiatives and for outside expert legal opinions were also not fully used. Recruitment costs were significantly over budget due to greater use of external firms to address strong market demand for certain positions and more senior recruitment during the year. Spending on the SEDI modernization project was over budget for professional services, due to the decision to outsource the project management of this initiative rather than using internal resources, as discussed earlier. It should be noted that, while the OSC led the initial work to scope out the requirements of the new SEDI system, the CSA decided to defer a decision to proceed with the project pending completion of a CSA information technology strategic plan.

Amortization costs were on budget.

Other expenses were lower by 27.9% or $368K, mostly due to the deferral or postponement of some IOSCO and CSA related travel. Some planned travel was replaced with conference calls, and some meetings, projected to be held out of town, were held in Toronto.

2007 Actual versus 2006 Actual

(Thousands)	2007 Actual	2006 Actual
Revenues	$ 71,067	$ 83,050
Expenses	69,304	65,823
Excess of Revenue over Expenses	$ 1,763	$ 17,227

Excess of Revenue over Expenses

The excess of revenue over expenses for 2007 was $1.8 million (2006 – $17.2 million) down $15.4 million from 2006. Revenues dropped as participation fees were $10.9 million lower and activity fees fell by $1.4 million. These declines reflected the impact of our new fee schedule, however, the declines were less than planned due to strong capital markets, as discussed above. Higher investment income was offset by lower miscellaneous revenues. The overall increase in expenses related to higher staff-related costs for salaries and benefits, occupancy and recruitment. Revenues and expenses are discussed in more detail below.

Revenues

(Thousands)	% of Total Fees	2007 Actual	2006 Actual	Change	% Change
Participation fees	80.9	$ 54,814	$ 65,759	$ (10,945)	–16.6
Activity fees	15.8	10,732	12,127	(1,395)	–11.5
Late fees	3.3	2,238	2,092	146	7.0
Total fees	100.0	$ 67,784	$ 79,978	$ (12,194)	–15.2
Investment income		3,140	1,872	1,268	67.7
Miscellaneous		143	1,200	(1,057)	–88.1
Total revenues		$ 71,067	$ 83,050	$ (11,983)	–14.4

Revenues for the year were $71.1 million, down $12.0 million from 2006. The variance is related to the following:

Participation fees for issuers were $14.0 million lower than last year. About 80% of this decline reflected lower participation fee rates in the new fee schedule. The balance is due to the remaining impact of National Instrument 51-102 *Continuous Disclosure Obligations* that accelerated the filing deadlines. The 2005 fiscal year was the first full year for this rule and many issuers missed the filing deadline, which resulted in the additional fees being recorded in the 2006 fiscal year. Registrant participation fees were higher by $3.0 million due to overall market growth. Changes to the fee schedule were revenue neutral because the lowest three fee tiers (85% of registrants) were reduced while the higher tiers had slight fee increases.

Activity fees were lower by $1.4 million mainly because of the impact of the new fee schedule.

Late fees were $146K or 7.0% higher as the net revenue from late SEDI filings increased. We issued 8.5% fewer SEDI late fee invoices resulting in a $124K revenue reduction. However, we granted 58.9% fewer credits, which resulted in the overall net revenue increase.

Miscellaneous revenue was lower mainly due to the $964K returned to the OSC by CDS in 2006, representing the return of the contribution the OSC made to CDS in 2005 for SEDI improvements.

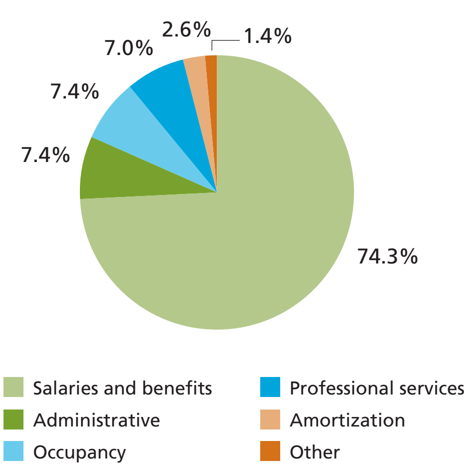
Investment income was higher related to the higher cash balances and interest rates. The average rate of return was 3.92% which was 96 basis points higher than in 2006.

Expenses

(Thousands)	% of Total Expenses		2007		2006	% Change		2005		2004
Salaries and benefits	74.3	$	51,508	$	48,871	5.4	$	44,287	$	40,147
Administrative	7.4		5,143		5,263	-2.3		5,464		4,349
Occupancy	7.4		5,104		4,570	11.7		4,037		3,973
Professional services	7.0		4,827		3,827	26.1		3,416		2,170
Amortization	2.6		1,771		2,329	-24.0		3,267		3,233
Other	1.4		951		963	-1.2		1,158		1,099
Total expenses	100.0	$	69,304	$	65,823	5.3	$	61,629	$	54,971

Total expenses for 2007 (Figure 2) increased 5.3% to $69.3 million (2006 – $65.8 million).

Figure 2 – OSC Expenses by Type



The key contributors to the expenditure increase were as follows:

Salaries and Benefits costs increased by 5.4% to $51.5 million (2006 – $48.9 million) and accounted for 74.3% of total OSC expenses. The addition of 29 staff was a significant contributor to this increase. However, for 2007 the impact was reduced because the hirings occurred throughout the year. Also contributing to the variance was the impact of the salary increases put in place at the beginning of the fiscal year totalling approximately $1.5 million. The full year cost impact of staff hired during the year in 2006 also contributed to the increase. As a result of operating in a competitive environment for professional talent, our compensation system includes performance-based incentives. These incentives represented 9.4% of total salaries and benefits costs (2006 – 8.8%).

Administrative costs accounted for 7.4% (2006 – 8.0%) of the OSC's total expenses. Expenditures on administrative costs decreased by 2.3% to $5.1 million (2006 – $5.3 million). Spending for training rose by 31.4% to $724K (2006 – $551K). Commission related expenses fell 5.2% to $1.0 million (2006 –

$1.1 million). The decrease occurred despite higher than expected meeting and hearings activity. The number of matters before the Commission increased 26% to 43 (2006 – 34). The number of hearing days almost doubled to 131 (2006 – 67). However, more hearings involved fewer than three Commissioners which resulted in reduced cost. There were also vacant Commissioner positions during the year. Communications costs were 3.6% lower at $1.3 million (2006 – $1.4 million) due to reduced printing of court documents for Enforcement matters and lower translation costs.

Occupancy costs accounted for 7.4% (2006 – 6.9%) of the OSC's total expenses. Expenditures on occupancy increased $534K or 11.7% to $5.1 million. The increase reflected the impact of higher lease costs and the acquisition of additional space to accommodate staff growth.

Professional Services costs increased 26.1% from $3.8 million to $4.8 million and accounted for 7.0% (2006 – 5.8%) of the OSC's total expenses. We contract third party professional services when it is not cost-effective to perform the work ourselves, or when we do not have the skills.

($ millions)	2007	2006
Actual costs	4.8	4.5
Less recoveries of costs	0.0	0.7
Net Professional Services	4.8	3.8

Spending on enforcement-related matters, including the use of external legal and forensic accounting resources and other specialized expertise, was $1.7 million lower than in 2006. The number of cases requiring external resources in 2007 was lower than in 2006 but is expected to return to higher levels in 2008. Other professional services spending was up by $1.4 million mainly due to the SEDI modernization project, the stakeholder survey completed in May 2006 and higher recruitment costs. External cost recoveries from enforcement actions were $649K lower.

The OSC is a member of the CSA, which is a forum of provincial securities regulators. Total CSA spending on shared projects was $2.2 million in 2007 (2006 – $1.9 million), of which the OSC contributed $895K (2006 – $787K). Professional services include costs to operate CSA offices (allocated on a formula basis) as well as our portion of professional services costs incurred on joint CSA projects.

A central secretariat co-ordinates all CSA projects, including the development of harmonized securities policies and rules. A CSA systems office manages the CSA's business relationships with third party technology providers. In 2007, the OSC contributed $172K (2006 – $193K) to the cost of the CSA Secretariat and $230K (2006 – $211K) to the cost of the systems office.

Key initiatives funded through this process included:

Investor education initiatives	$113K
Alternative Trading Systems Consolidator	$ 67K
National cease trade order system	$ 44K
Joint Forum initiatives	$ 39K

Amortization costs accounted for about 2.6% (2006 – 3.5%) of the OSC's total expenses. Amortization expenses decreased to $1.8 million (2006 – $2.3 million) due to lower amounts for leasehold improvements and furniture and fixtures.

Other expenses, which reflect travel and related expenses, declined by $12K or 1.2% to $951K (2006 – $963K) and accounted for 1.4% (2006 – 1.5%) of the OSC's total expenses. Less travel due to the deferral or postponement of some international work with IOSCO and CSA-related travel and some planned travel that was replaced with conference calls were the key sources of this decrease.

Liquidity and Financial Position

Liquidity

The OSC has sufficient liquidity to finance its operations and capital purchases. Our cash position increased by $2.9 million or 5.1% in 2007. Cash flows from operations were $3.7 million. Purchases of capital assets used $988K.

As at March 31, 2007, the OSC held $58.8 million (2006 – $55.9 million) in cash, had current assets of $61.3 million (2006 – $57.7 million) and current liabilities of $10.9 million (2006 – $10.1 million) for a current ratio of 5.6:1 (2006 – 5.7:1). Our general surplus increased by $1.8 million, reflecting our excess of revenues over expenses.

Revenues and Reserves

Revenue generation remains a source of risk for the OSC as all revenues are still correlated to market activity to some extent. As noted earlier, the degree to which the OSC's revenues vary along with market fluctuations is greater than was anticipated when the fee structure was developed. We will be studying the fee structure to develop steps to address this in 2008.

To manage this uncertainty, the OSC has a $20.0 million reserve as an operating contingency for revenue shortfalls or unexpected expenses. The OSC has an additional $12.0 million reserve that may only be used to offset costs incurred related to the proposed merger of the OSC with the Financial Services Commission of Ontario.

The rate of return on investments is low as the funds are invested in treasury bills. The prime investment consideration for the reserve is the protection of capital and the appropriate liquidity to meet unanticipated cash flow needs. The OSC records income generated by the reserve in general operations.

Accounts receivable

Accounts receivable increased 17% to $1.7 million (2006 – $1.5 million). Outstanding late fees, which accounted for 32.6% of accounts receivable, increased 7.7% to $561K (2006 – $521K). We also increased our allowance for doubtful accounts by $245K. Other key receivables are interest receivable $919K (2006 – $554K) and $103K from the Investor Education Fund (2006 – $128K).

Funds held pursuant to designated settlements and orders

In 2007, the OSC received $712K through designated settlements and orders arising from enforcement proceedings. Funds that are received as a result of settlements or orders may, under the terms of the settlement or order, be designated to or for the benefit of third parties. Funds that are not designated at the time that settlements are approved or orders are made are paid to Consolidated Revenue Fund of the Government of Ontario.

The OSC currently holds $5.6 million (2006 – $4.7 million) pursuant to designated settlements and orders. Amendments to the *Securities Act* in December 2004 removed the requirement for Ministerial approval of allocations of designated settlement funds. The Minister retained the right to establish guidelines for the allocation of these funds. The OSC is subject to Ministerial approval to transfer to third parties $1.9 million of the designated settlement balances relating to the period prior to December 2004.

Funds in trust

As at March 31, 2007, the OSC has received $15.5 million from the operator of the System for Electronic Document Analysis and Retrieval (SEDAR), the National Registration Database (NRD) and SEDI, representing the accumulated surplus from the operations of SEDAR, NRD and SEDI from their inception. Interest earned on these funds to 2007 was $710K. These funds are held by the OSC in trust, in accordance with agreements amongst the OSC, the Alberta Securities Commission, the British Columbia Securities Commission, L'Autorité des marchés financiers and, in the case of the NRD, the IDA. These funds may be used only for the purposes set out in these agreements and listed in Note 4 of the financial statements.

Capital expenditures

Capital expenditures during 2007 included:

(Thousands)		2007		2006	% Change
Furniture and Equipment	$	42	$	372	-88.7
PC's, Laptops and other IT equipment		915		1,148	-20.3
Leaseholds and other capital items		31		919	-96.6
Total	$	988	$	2,439	-59.5

Capital assets decreased 19.6% to $3.2 million (2006 – $4.0 million). The significantly higher expenditures in 2006 on furniture and equipment and leaseholds and other capital items related to renovations to new and existing space. Capital purchases totalling $988K (2006 – $2.4 million) were made during 2007. More than 90% of the purchases were technology related ($915K), including equipment purchased for increased staff complement and replacement of computer equipment to ensure the currency of our technology base.

Liabilities

Accounts payable and accrued liabilities increased 8.2% to $10.7 million (2006 – $9.9 million). Key accrual increases included general payables ($382K) and bonuses ($530K), vacations ($79K) and payroll ($24K) which all reflect higher staffing levels. Our severance accrual declined by $191K.

The accrued pension liability of $1.4 million (2006 – $1.2 million) represents future obligations relating to supplementary pension plans for the current and former Chairs and Vice-Chairs. The unfunded supplemental pension plans had an accrued benefit obligation of $1.3 million (2006 – $1.2 million) at March 31, 2007. The OSC's related expense for the year was $249K (2006 – $170K) and is included in salaries and benefits.

Risks and Uncertainties

Operational and Infrastructure Risk

We are exposed to many types of operational risks including the risk of fraud by employees or others, unauthorized transactions by employees, and operational or human error. We also face the risk that computer or telecommunications systems could fail, despite our efforts to maintain these systems in good working order. Shortcomings or failures of our internal processes, employees or systems, including any of our financial, accounting or other data processing systems, could lead to financial loss and damage to our reputation. In addition, despite the contingency plans we have in place, our ability to conduct business may be adversely affected by a disruption in the infrastructure that supports our operations and the communities in which we do business.

The OSC has policies and processes to identify, manage and control operational risk. Key components of our operational risk approach include:

- A Board of Directors responsible for sound corporate governance.
- Independent third party internal auditors who, through periodic, risk-based audits, are responsible for verifying that significant risks are identified, assessing the appropriateness of our controls and recommending changes as required.
- Periodically, our internal auditors conduct a comprehensive review of our risk universe (most recently in fall 2006) which is used to target our internal audit plan.
- A strong internal control environment, the adequacy of the design of which was confirmed through the ICFR process discussed earlier.
- Our Economic Analysis, Strategy & Project Planning Branch works with our program areas to develop risk-based solutions for their operations.
- We mitigate risk to our assets through insurance where practical and appropriate.
- Regular reviews of our systems security measures to monitor our controls and identify potential vulnerabilities against external parties accessing our data.

We also monitor and manage operational risk through activities such as business continuity planning and risk-based approaches to compliance.

Business continuity

The OSC has a Business Continuity Plan to ensure the continuation of critical regulatory services should the OSC face a significant disruption to its operations. Detailed business continuity plans are in place for each priority business function. Each plan includes documented recovery procedures including manual workarounds and mitigation strategies. Offsite recovery services and facilities are in place and were successfully tested during 2007. We continually refine our plan to include strategies to recover and resume our operations for various disruption scenarios.

Risk-based compliance

In delivering on our mandate we take a risk-based approach for many of our disclosure review and compliance activities. Our Corporate Finance group continues to enhance its risk-based screening procedures so that a substantial proportion of its review population receives some form of meaningful assessment each year, while ensuring that resources are only invested into a full review when it is merited. The group completed 423 reviews or 30% of Ontario-based reporting issuers this year.

Our Investments Funds group recently initiated reviews of continuous disclosure filings made under National Instrument 81-106, *Investment Funds Continuous Disclosure*. As part of this process, staff is compiling a list of compliance issues, which vary depending on the nature of the fund reviewed, with a view to developing a risk-based process for these reviews.

Our Compliance team in the Capital Markets Branch uses a risk-based approach in selecting advisers, fund managers and limited market dealers for field reviews. The topics for targeted reviews are determined annually.

Enforcement also uses a risk-based approach to ensure cases that are brought forward are subject to consistent scrutiny, involve significant breaches of Ontario securities law, and give appropriate consideration to OSC priorities.

Reputational Risk

The OSC actively manages its reputational risk through our corporate governance practices, code of conduct (By-law 2) and risk management framework. In order to build and maintain the OSC's reputation, each year our Commissioners and all employees must provide written certification that they have conducted themselves in accordance with our Code of Conduct. The activities of our Communications Branch and our offices of the General Counsel, Corporate Secretary and Office of Domestic and International Affairs are key participants in managing our reputational risk.

People risk

As a knowledge-based entity our ability to attract and retain people is critical to our success. We track a range of measures (e.g., turnover and compensation surveys) to manage this risk. Turnover decreased to 28 staff or 7.0% from 44 staff or 11.6% in 2006. Knowledge management is a key focus and we continue to pursue initiatives to improve our ability to retain corporate memory and to ensure effective knowledge transfer.

National approaches to securities regulation

The implications of the ongoing national discussions on approaches to securities regulation in Canada are a source of uncertainty and could have a material impact on OSC operations.

Reliance on CDS

CDS operates a number of major systems on behalf of the CSA and the OSC. The NRD system was launched on March 31, 2004. The current operating agreement for the NRD expires March 2009. SEDI became fully operational in May 2003. The current operating agreement for SEDI runs until May 2010. The SEDAR system was launched in January 1997. The current operating agreement for SEDAR runs until May 2010.

CDS recovers its costs to operate these systems by charging user fees to filers. In 2007, 89% (2006 - 90%) of our fee revenue was collected through national systems: SEDAR (39%) and the NRD (50%). No material change is expected in the volume of fees collected through these systems. If CDS becomes unwilling or unable to operate one or all of these systems, the OSC and the CSA will need to ensure the continued operation of these systems as disruptions in processing our fees through these systems would materially affect our cash flows.

Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenditures for the period. Actual amounts could differ from these estimates because future events may differ significantly from management's expectations. The OSC uses various estimates to prepare the financial statements. Key areas where estimates were used included valuation of supplemental pension obligations and the useful life of capital assets.

Changes in Accounting Policies

Management is responsible for selecting the significant accounting policies and preparing the financial statements, including the accompanying notes, in accordance with Canadian GAAP. The significant accounting policies and their application have not changed. In 2007, no new accounting or reporting standards were introduced which would impact the Commission's statements.

2008 Outlook

Our draft 2007/2008 Statement of Priorities sets out our priorities and proposed initiatives for the upcoming year. The document is available at www.osc.gov.on.ca. The 2007/2008 budget will allow us to move toward achievement of the following goals:

1. Identify the important issues and deal with them in a timely way.
2. Deliver fair, vigorous and timely enforcement and compliance programs.
3. Champion investor protection, especially for retail investors.
4. Support and promote a more flexible, efficient and accountable organization.

Our 2008 budget projects a deficit of $7.2 million. We are able to operate at a deficit because surplus funds earned during prior years have been used to allow us to set lower fees than would have otherwise been possible.

(Thousands)	2007 Actual	2008 Budget	Year over Year Change +/-	
Revenues	$ 71,067	$ 75,189	$ 4,122	5.8%
Expenses	69,304	82,437	13,133	18.9%
Excess/(Deficiency) of Revenue over Expenses	$ 1,763	$ (7,248)	$ (9,011)	
Capital Expenditures	$ 988	$ 3,698	$ 2,710	274.3%

Revenues

The OSC remains committed to ensuring that fees paid by issuers and registrants reflect the projected costs to regulate each group. Our revised fee schedule became effective April 1, 2006. In setting the activity fees we reviewed each service activity and its related cost. The revised fee schedule affects market participants differently in order to better reflect the services they receive and the benefits they derive from participating in Ontario's capital markets.

In 2007, $71.1 million was earned in revenue. In 2008, participation fee revenues are forecast to increase by 6.8% from issuers and by 8.1% from registrants. As in 2007, these increases will result from market growth, rather than fee increases. The fees will remain at the levels set April 1, 2006. Total activity fee revenues are projected to increase by 1.8%. Late fees are forecast to rise by 7.2%. Investment income is forecast to fall by 12.1% or $381K due to expected lower cash balances.

Expenses

(Thousands)	2006 Actual	2007 Actual	2008 Budget
Staff	412	441	464
Expenses	$ 65,823	$ 69,304	$ 82,437

Salaries and benefits costs are projected to rise 16.5% to $60.0 million (2007 – $51.5 million) accounting for 63% of the total budget increase. This increase reflects a decision to increase approved staffing by 5.2% from 441 to 464. About 70% of the new staffing is in Enforcement. The rest of the cost increase is generated by annual performance-related changes to salaries of current staff, additional bonus requirements arising from staff growth and the annualized impact of various in-year staff changes and vacancies.

Administrative costs are expected to rise by 27% or $1.4 million. Staff training is projected to increase by $400K. Training was underspent against budget as planned activities, including a management development program, were deferred due to other workload priorities. Commissioners' costs are projected to rise by $276K as vacancies are filled and for additional planned training. Higher information technology maintenance ($274K) costs are due to various IT expenses such as software licenses, maintenance agreements, business continuity plan costs as well as new applications and related consulting. Communications is budgeted $377K higher, reflecting costs for investor communication initiatives and increases in online research and information services.

Occupancy costs are projected to rise 21% to $6.2 million (2007 – $5.1 million). This reflects inflation of operating costs on the existing space (base rent is fixed until September 2008), the proposed addition of approximately 20,000 square feet of additional space to accommodate growth, and transitional accommodations in the building until the new space is complete.

Amortization costs are expected to decline 13.6% to $1.5 million for 2008 (2007 – $1.8 million). Capital expenditures were low in 2007; once the proposed leasehold improvements are complete, amortization will increase accordingly in 2008/09.

Professional services costs are projected to rise 34.8% to $6.5 million for 2008 (2007 – $4.8 million). In Enforcement, there is a proposed increase of $1.5 million in professional services including $1.3 million in litigation-related costs for expert witnesses, etc. Our share of the costs for CSA shared projects is expected to rise by $294K.

Other expenses are forecast to increase 63.3% to $1.6 million (2007 – $951K). The key increases are $155K in travel for IOSCO purposes and $104K for CSA travel which will include a "road show" for the Registration Reform Project. There will also be increased travel in Enforcement and for compliance audits.

Capital is budgeted at $3.7 million, 274% higher than the $988K spent in 2007. More than 70% is budgeted for leasehold improvements ($1.6 million) and related furniture ($1.1 million). The remaining spending is planned for information technology-related capital expenditures ($1.0 million).

Surplus/Deficit

The table below reflects our original and current forecast for our operating surplus/deficit position at the end of each year. The original forecast prepared as part of the fee-setting process projected no surplus at the end of the three year cycle. Fees were set to generate a cumulative deficit equal to the $39.5 million forecasted surplus as at March 31, 2006. However, the actual surplus as at March 31, 2006, was $50.0 million. Also, due to the strong performance of our capital markets we are now projecting a operating deficit of only $15.5 million for the 2007 to 2009 period. This will result in a $34.5 million surplus as at March 31, 2009.

3 Year Operating Surplus/(Deficit) Forecast

(Thousands)	2006/2007	2007/2008	2008/2009	3-Year Total
Original Forecast Operating Deficit	$ (12,000)	$ (13,500)	$ (14,000)	$ (39,500)
Current Forecast Operating Surplus/(Deficit)	1,763	(7,248)	(10,050)	(15,535)
Change in Forecast Operating Surplus	$ 13,763	$ 6,252	$ 3,950	$ 23,965

We currently plan to return the accumulated surplus to market participants when we revise the fees for the next three year cycle. However, as noted, we will be reviewing our fee structure during 2008.