

## Management's discussion and analysis

The financial statements present the results of the OSC for the year ended March 31, 2008 with 2007 comparatives and accompanying notes. Unless otherwise specified, references to years, for example 2008, refer to the fiscal years of the OSC ended March 31. The following comments analyze the factors which affected the OSC's operations during 2008, 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.

The preparation of financial statements that conform with Canadian generally accepted accounting principles (GAAP) requires estimates and assumptions to be made that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Estimates are calculated based on historical experience, current trends and other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

### Overview

The OSC is a corporation without share capital and is the regulatory body responsible for regulating the province's capital markets. 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 83.0% (2007 – 81.7%) 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, in 2007 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).

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. As a result, the statement of Management's Responsibility for the financial statements was expanded to include the appropriate certification.

In 2008, improvements in internal control were made to address items that were discussed in last year's report. The documentation of controls was also reviewed and updated and no material weaknesses were found in the design of controls.

### OSC revenue

The OSC fee structure 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. The current fees have been in place since April 1, 2006. The fee structure is being reviewed to determine if there are ways to improve the predictability of revenues, fairness to market participants and matching of revenues and expenses. Implementation of a revised fee schedule is planned for April 1, 2009. The fee schedule requires the payment of "activity fees" and "participation fees".

**Activity fees** are set at a level to reflect an estimate of the direct cost of OSC staff resources used in undertaking those activities requested of staff by market participants. Activity fees are charged at 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 market capitalization; 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.

Having gained more experience with the fee structure it has been noted that it is more closely correlated to market performance than anticipated. In 2008, participation fees were \$2.0 million higher than budgeted. This increase was due to higher than expected growth in registrant firm revenues, which generated higher participation fees. Higher than planned revenues accounted for about one quarter of the surplus over the 2008 budget.

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 is determined by the Minister. Following the move to the current fee structure in April 2003, the then responsible Minister 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 remains committed to re-evaluating its fee levels every three years and to take into account any accumulated surplus in setting fees for the ensuing period. Any future deficits will be funded either through existing or future surpluses or from the OSC's reserve.

### Selected three-year annual information

(Thousands)	2008	2007	2006
Revenues	\$ 78,238	\$ 71,067	\$ 83,050
Expenses	\$ 73,621	\$ 69,304	\$ 65,823
Excess of revenue	\$ 4,617	\$ 1,763	\$ 17,227
Capital assets	\$ 2,658	\$ 3,229	\$ 4,017

### Analysis of operating results

The OSC actively manages expenses by:

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

## 2008 actual versus 2007 actual

(Thousands)	2008 actual	2007 actual
Revenues	<b>\$ 78,238</b>	\$ 71,067
Expenses	<b>\$ 73,621</b>	\$ 69,304
Excess of revenue	<b>\$ 4,617</b>	\$ 1,763

### Excess of revenue over expenses

The excess of revenue over expenses for 2008 was \$4.6 million, up \$2.8 million from 2007. Revenues increased as participation fees were \$6.1 million higher. Slightly lower revenues from issuer participation fees were more than offset by higher revenues from registrant participation fees. Overall, activity fee revenues grew by 2.7% or \$295,000. In all cases, the revenue changes were due to growth in registrant revenues and issuer market capitalization, as the fee schedule has remained unchanged since April 1, 2006. Investment income rose 8.8% or \$277,000, reflecting higher rates of return and larger than planned cash balances.

The overall increase in expenses is primarily related to increased staff-related costs for salaries and benefits and occupancy. Revenues and expenses are discussed in more detail below.

### Revenues

(Thousands)	% of total fees	2008 actual	2007 actual	Change	% change
Participation fees	81.5	<b>\$ 60,913</b>	\$ 54,814	\$ 6,099	11.1
Activity fees	14.8	<b>11,027</b>	10,732	295	2.7
Late fees	3.7	<b>2,754</b>	2,238	516	23.1
Total fees	100.0	<b>74,694</b>	67,784	6,910	10.2
Investment income		<b>3,417</b>	3,140	277	8.8
Miscellaneous		<b>127</b>	143	(16)	(11.2)
Total revenues		<b>\$ 78,238</b>	\$ 71,067	\$ 7,171	10.1

**Figure 1**  
OSC fees by type

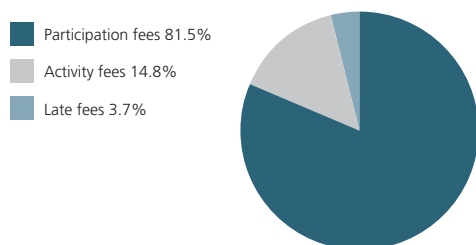


Figure 1 shows the sources of OSC fee revenues.

Revenues for the year were \$78.2 million, up \$7.2 million from 2007. The variance is related to the following:

**Participation fees** for registrants, which are based on registrant revenue levels, were higher by \$6.4 million due to higher revenues for registrant firms. This was partially offset by issuers participation fees, which were \$300,000 lower than last year.

**Activity fees** were higher by \$295,000 mainly due to increased numbers of prospectus filings (both for reporting issuers and investment funds), private placement filings, and applications for relief.

**Late fees** were \$516,000 or 23.1% higher as revenues increased across most late filings categories.

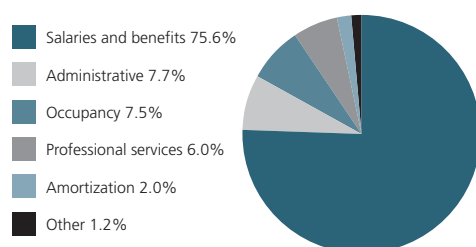
**Miscellaneous revenue** generally remained unchanged.

**Investment income** was higher due to the higher cash balances and interest rates. The average rate of return on investments was 4.23%, which was 31 basis points higher than in 2007.

## Expenses

(Thousands)	% of total expenses	2008	2007	% change	2006	2005
Salaries and benefits	75.6	\$ 55,609	\$ 51,508	8.0	\$ 48,871	\$ 44,287
Administrative	7.7	5,655	5,143	10.0	5,263	5,464
Occupancy	7.5	5,533	5,104	8.4	4,570	4,037
Professional services	6.0	4,445	4,827	(7.9)	3,827	3,416
Amortization	2.0	1,483	1,771	(16.3)	2,329	3,267
Other	1.2	896	951	(5.8)	963	1,158
Total expenses	100.0	\$ 73,621	\$ 69,304	6.2	\$ 65,823	\$ 61,629

**Figure 2**  
OSC expenses by type



Total expenses for 2008 (Figure 2) increased 6.2% to \$73.6 million (2007 – \$69.3 million).

The key contributors to the expenditure increase were as follows.

**Salaries and benefits costs** increased by 8.0% to \$55.6 million (2007 – \$51.5 million) and accounted for 75.6% of total OSC expenses. The full-year cost impact of staff hired during 2007 as well as the costs for 23 new positions approved in the budget and hired throughout 2008 were significant contributors to the increase. Sixteen of these positions were added to the Enforcement Branch to improve the effectiveness of work on enforcement matters. Included in this staffing

was the establishment of a new “Boiler Room” unit to address the sales of unapproved securities by unregistered individuals, frequently to small, often unsophisticated, investors. The remaining seven positions were needed to address workload in various operational areas.

Also contributing to the variance was the impact of the salary increases put in place at the beginning of the fiscal year totalling approximately \$1.9 million. Because the OSC operates in a competitive environment for professional talent, the OSC’s compensation system includes performance-based incentives. These incentives represented 9.4% of total salaries and benefits costs (2007 – 9.4%).

**Administrative costs** accounted for 7.7% (2007 – 7.4%) of the OSC’s total expenses. Expenditures on administrative costs increased by 10% to \$5.6 million (2007 – \$5.1 million). Spending for training decreased by 18.0% to \$594,000 (2007 – \$724,000) as Mutual Reliance Review System (MRRS) training, which occurs every other year, did not take place in 2008. Commission-related expenses increased 23.5% to \$1.3 million (2007 – \$1.0 million). The increase reflected increased meeting and hearings activity as the number of matters before the Commission increased 49% to 64 (2007 – 43). The number of sitting days rose by 36%, the number of committee meetings was up by about 10% and the number of preparation and deliberation days was up by about 30% (due to an increase in the number and complexity of cases and longer hearings). Communications costs were 17.8% higher at \$1.6 million (2007 – \$1.3 million). Increases in online research and information services were the largest component of this increase. Information technology maintenance and support costs rose 12.5% to \$1.0 million (2007 – \$925,000). Spending on supplies increased 3.0% to \$727,000 (2007 – \$706,000).

**Occupancy costs** accounted for 7.5% (2007 – 7.4%) of the OSC’s total expenses. Expenditures on occupancy increased \$429,000 or 8.4% to \$5.5 million. The increase reflected the impact of higher lease costs and the acquisition of additional space to accommodate staff growth.

**Professional services costs** decreased 7.9% from \$4.8 million to \$4.4 million and accounted for 6.0% (2007 – 7.0%) of the OSC’s total expenses. The OSC contracts third-party professional services when it is not cost-effective to perform the work itself or when it is seeking specialized skills.

## Management's discussion and analysis

There was no spending on the System for Electronic Disclosure by Insiders (SEDI) modernization project (\$1.2 million in 2007) as work was postponed in 2008 pending the completion of the Canadian Securities Administrators' (CSA) information technology strategic plan. Recruitment costs were \$109,000 lower due to less reliance on external recruitment services. Spending on enforcement-related professional services, including the use of external legal and forensic accounting resources and other specialized expertise, was \$847,000 higher than in 2007 as a greater number of cases required external resources in 2008. External cost recoveries from enforcement actions were \$54,000 higher.

The OSC is a member of the CSA, which is a forum of provincial securities regulators. Total CSA spending on shared projects in 2008 was unchanged at \$2.2 million; the OSC contributed \$873,000 (2007 – \$895,000). Professional services include costs to operate CSA offices (allocated on a formula basis) as well as the OSC's portion of professional services costs incurred on joint CSA projects.

All CSA projects, including the development of harmonized securities policies and rules, are co-ordinated through a central secretariat. The CSA's business relationships with third-party technology providers are managed through the CSA systems office. In 2008, the OSC contributed \$217,000 (2007 – \$172,000) to the cost of the CSA Secretariat and \$235,000 (2007 – \$230,000) to the cost of the systems office.

**Amortization costs** accounted for about 2.0% (2007 – 2.6%) of the OSC's total expenses. Amortization expenses decreased to \$1.5 million (2007 – \$1.8 million) due to lower amounts for leasehold improvements and furniture and fixtures.

**Other expenses**, which are travel and related expenses, declined by \$55,000 or 5.8% to \$896,000 (2007 – \$951,000) and accounted for 1.2% (2007 – 1.4%) of the OSC's total expenses. Key sources of this decrease were less travel due to the deferral or postponement of some international work with the International Organization of Securities Commissions (IOSCO) and replacement of some planned CSA-related travel with conference calls.

### 2008 actual versus 2008 budget

(Thousands)	2008 actual	2008 budget
Revenues	<b>\$ 78,238</b>	\$ 75,189
Expenses	<b>\$ 73,621</b>	\$ 82,437
Excess of revenue	<b>\$ 4,617</b>	\$ (7,248)

The budget called for a deficiency of revenue over expenses of \$7.2 million in 2008. The actual result was an excess of \$4.6 million. Revenues were \$3.0 million higher than budget primarily due to surplus participation fees (\$2.0 million) as previously discussed, late filing fees (\$0.4 million) and investment income (\$0.7 million). Expenses reflected lower than expected spending across all expense categories. Employee salaries and benefits (\$3.7 million) and professional services (\$2.4 million) were the two most significant areas of underspending.

### Revenues

(Thousands)	% of total fees	2008 actual	2008 budget	Variance	% variance
Participation fees	81.5	<b>\$ 60,913</b>	\$ 58,943	\$ 1,970	3.3
Activity fees	14.8	<b>11,027</b>	10,925	102	0.9
Late fees	3.7	<b>2,754</b>	2,400	354	14.8
Total fees	100.0	<b>74,694</b>	72,268	2,426	3.4
Investment income		<b>3,417</b>	2,759	658	23.8
Miscellaneous		<b>127</b>	162	(35)	(21.6)
Total revenues		<b>\$ 78,238</b>	\$ 75,189	\$ 3,049	4.1

**Participation fees** collected exceeded budget by \$2.0 million. Issuer participation fees (28.2% of the total) were \$1.7 million below plan. The negative variance in these fees was mainly due to timing as fees expected in March 2008 were not earned until April. Registrant participation fee revenues (53.3% of the total) were \$3.7 million above plan due to higher than expected growth in registrant firm revenues, which generated higher participation fees.

**Activity fee** volumes are driven by market demand for OSC services. Issuer activity fees were \$334,000 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 \$232,000 under plan mainly due to fewer applications for exemptive relief and lower investment fund prospectus activity.

**Late fees** were greater than planned by \$354,000, or 14.8%. The variance occurred mostly due to more late filings of registration information forms, interim and annual statements and other required filings.

**Investment income** generated by deposits and other investments was \$658,000 or 23.8% above plan. The positive variance occurred due to higher interest rates combined with higher than expected cash balances. Interest on cash balances generated \$2.1 million. These balances earn interest at a rate of 1.75% below the prime rate. Investments in Government of Ontario treasury bills with the Ontario Financing Authority generated \$1.3 million. The average rate of return on these instruments was 4.23%.

## Expenses

(Thousands)	2008 actual	2008 budget	% variance	2007 actual	2006 actual	2005 actual
Salaries and benefits	\$ 55,609	\$ 60,002	7.3	\$ 51,508	\$ 48,871	\$ 44,287
Administrative	5,655	6,525	13.3	5,143	5,263	5,464
Occupancy	5,533	6,174	10.4	5,104	4,570	4,037
Professional services	4,445	6,649	33.1	4,827	3,827	3,416
Amortization	1,483	1,534	3.3	1,771	2,329	3,267
Other	896	1,553	42.3	951	963	1,158
Total expenses	\$ 73,621	\$ 82,437	10.7	\$ 69,304	\$ 65,823	\$ 61,629

**Salaries and benefits** spending was \$4.4 million or 7.3% under budget. Funds were budgeted to address any necessary mid-year market-related adjustments; however, a decision on major changes in the salary administration was deferred pending the completion and approval of a revised total compensation strategy. Planned adjustments to salary ranges that did not take place accounted for \$1.5 million or 34.1% of the underspending.

The balance of the savings was due to vacancies and delays in hiring. The OSC continues to experience delays in hiring as there are certain areas in the OSC where challenges in attracting and/or retaining staff persist, in particular: litigators in the Enforcement Branch; accountants generally; and investigators. The OSC had an approved permanent staff at March 31, 2008, of 467.

**Administrative costs** were \$870,000 or 13.3% under budget. Training was lower by 47.2% or \$530,000 as planned activities were replaced by training sessions using internal resources or were deferred due to other workload priorities. Spending on information technology maintenance was down because business continuity and network costs were lower by 15% or \$76,000 and licensing and support costs were lower by 11% or \$61,000 due to appreciation in the value of the Canadian dollar.

**Occupancy costs** were \$641,000 or 10.4% lower than plan because savings were achieved by negotiating a better rate for new space, a later effective start date for renovations, and obtaining the transition space at no cost.

## Management's discussion and analysis

**Professional services costs** were \$2.2 million or 33.1% under budget. In Enforcement, which accounts for 35.8% of the variance, spending on some of the cases identified did not occur or was less than planned. Other initiatives that were underspent include: work on various policy initiatives (e.g., PPN rule, scholarship plans, data modelling for TREATS), a contingency for cost benefit analysis work was not used, and the biennial OSC stakeholder survey was deferred. Savings also occurred due to delays on planned audits under the internal audit program. Contingencies for outside expert legal opinions and for certain CSA initiatives were also not fully used. The contingency included in the OSC share of the CSA budget (\$194,000) was not required. Recruitment costs were \$154,000 or 48.9% over budget due to greater than expected use of external firms to address strong market demand for certain positions and unplanned senior recruitment during the year.

**Amortization costs** were essentially on budget.

**Other expenses** were lower by 42.3% or \$657,000. Planned travel for the Registration Reform project was less than projected as some travel was replaced with conference calls, and some meetings, projected to be held out of town, were held in Toronto. Deferral or postponement of some IOSCO- and CSA-related travel was the other key source of savings.

### Liquidity and financial position

#### Financial instruments

Financial instruments used by the OSC consist of Cash, Funds held pursuant to designated settlements and orders, Funds in trust, and Reserve fund assets, all of which are recorded at fair value, and accounts receivable and accounts payable and accrued liabilities, which are recorded at face value which approximates fair value, given their short-term maturities. Cash, Funds held pursuant to designated settlements and orders and Funds in trust are held in a Canadian deposit account with a Schedule 1 bank earning interest at 1.75% below the prime rate. Reserve fund assets are invested with the Ontario Financing Authority in highly liquid Government of Ontario treasury bills with maturities of one year or less. It is management's opinion that the OSC is not exposed to significant interest rate, currency or liquidity risks arising from its financial instruments due to their short-term nature. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the OSC's customer base. The carrying values of financial instruments approximate their fair values because of the short-term nature of these financial instruments.

#### Liquidity

The OSC has sufficient liquidity to finance its operations and purchases of premises and equipment. The cash position increased by \$5.8 million or 9.9% in 2008. Cash flows from operating activities were \$6.2 million. Purchases of premises and equipment used \$891,000.

As at March 31, 2008, the OSC held \$64.6 million (2007 – \$58.8 million) in cash, had current assets of \$66.8 million (2007 – \$61.3 million) and current liabilities of \$11.3 million (2007 – \$10.9 million) for a current ratio of 5.9:1 (2007 – 5.6:1). The general surplus increased by \$4.6 million, reflecting the excess of revenues over expenses.

Due to the timing of revenues over the year, the OSC's cash balance is expected to decrease during the year to an estimated low of \$17.5 million in December 2008 and then increase to approximately \$52.3 million in March 2009.

#### Revenues and reserves

Revenue generation remains a source of risk for the OSC as all revenues are correlated to market activity. 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. Various options are being considered to address this when the revised fee schedule is implemented April 1, 2009.

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 a 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 six-month and one-year Government of Ontario 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 decreased 3.2% to \$1.65 million (2007 – \$1.7 million). Outstanding late fees, which accounted for 35.8% of accounts receivable, increased 1.1% to \$592,000 (2007 – \$561,000). The allowance for doubtful accounts was also reduced by \$188,000 as a result of improved collection results. Other key receivables are interest receivable \$772,000 (2007 – \$919,000) and \$118,000 from the Investor Education Fund (2007 – \$103,000) for services provided to it by the OSC.

### Funds held pursuant to designated settlements and orders

In 2008, the OSC received \$787,000 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 so designated at the time that settlements are approved or orders are made are to be paid to Consolidated Revenue Fund of the Government of Ontario.

The OSC currently holds \$4.9 million (2007 – \$5.6 million) pursuant to designated settlements and orders. In 2008, the Board of the OSC authorized transfers of \$1.75 million to the Investor Education Fund (2007 – \$0). Amendments to the *Securities Act* in December 2004 removed the requirement for Ministerial approval of allocations of designated 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, 2008, the OSC has received \$22.4 million from the operator of the System for Electronic Document Analysis and Retrieval (SEDAR), the National Registration Database (NRD) and the System for Electronic Disclosure by Insiders (SEDI), representing the accumulated surplus from the operations of SEDAR, NRD and SEDI from their inception. Interest earned on these funds to 2008 was \$1.5 million.

As described in Note 4 of the financial statements, these funds may be used to enhance the systems, reduce systems fees or offset shortfalls in revenue in SEDAR, SEDI, and NRD. As at March 31, 2008, \$16.1 million (2007 – \$12.5 million) of the total funds held in trust are available for SEDAR. The OSC has committed to paying 45.1% of annual shortfalls resulting from the operations of SEDAR, where SEDAR operating costs exceed revenues. In the current year, there were no SEDAR deficits.

### Premises and equipment

Expenditures on premises and equipment during 2008 included:

(Thousands)	2008	2007	% change
Furniture and equipment	\$ 66	\$ 42	57.1
PCs, laptops and other IT equipment	\$ 704	\$ 915	(23.1)
Leaseholds and other capital items	\$ 147	\$ 31	374.2
Total	\$ 917	\$ 988	(7.2)

Premises and equipment decreased 17.7% to \$2.7 million (2007 – \$3.2 million). Purchases totalling \$917,000 (2007 – \$988,000) were made during 2008. More than three quarters of the purchases were technology related (\$704,000), including equipment purchased for increased staff complement and replacement of computer equipment to ensure the currency of the technology base. The higher expenditures in 2008 on furniture and equipment and leaseholds and other capital items related to minor renovations to new and existing space.

## Management's discussion and analysis

### Liabilities

Accounts payable and accrued liabilities increased 3.7% to \$11.1 million (2007 – \$10.7 million). Key increases included bonuses (\$492,000), vacations (\$163,000) and payroll (\$254,000), which all reflect higher staffing levels. General payables declined (\$468,000) and the severance accrual by \$98,000.

The accrued pension liability of \$1.5 million (2007 – \$1.4 million) represents future obligations relating to supplementary pension plans for the current and former Chairs and Vice-Chairs. The unfunded supplemental pension plans accrued benefit obligation of \$1.3 million at March 31, 2008 was essentially unchanged. The OSC's related expense for the year was \$238,000 (2007 – \$249,000) and is included in salaries and benefits.

The OSC is committed to lease payments as follows:

### Capital leases

2009	\$ 196,700
2010	\$ 59,100
2011	\$ 3,900
Total minimum lease payments	\$ 259,700
Less: Amount representing interest at 6%	\$ 10,500
Balance of the obligation	<u>\$ 249,200</u>

### Operating leases

	Total	<1 year	1 to 3 years	4 to 5 years
	\$25,866,000	\$ 5,802,000	\$11,748,000	\$ 8,316,000

## Risks and uncertainties

### Operational and infrastructure risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The OSC is exposed to many types of operational risks. There is also the risk that computer or telecommunications systems could fail, despite efforts to maintain these systems in good working order. Shortcomings or failures of internal processes, employees or systems, including any of the financial, accounting or other data processing systems, could lead to financial loss and damage to the OSC's reputation and the risk of unauthorized transactions by employees, operational or human error, and fraud by employees or others. In addition, despite the contingency plans in place, the ability to conduct business may be adversely affected by a disruption in the infrastructure that supports operations and the communities in which the OSC does business.

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

- > A Board of Directors responsible for sound corporate governance.
- > A strong internal control environment, including management oversight. A part of this was addressed by reviewing the adequacy of the design of internal controls over financial reporting, as discussed earlier.
- > Regular reviews of systems security measures to monitor controls and identify potential vulnerabilities against external parties accessing OSC data.

- > Mitigation of risk to assets through insurance where practical and appropriate.
- > Work by the Economic Analysis, Strategy & Project Planning Branch with program areas to develop risk-based solutions for their operations.
- > Independent third-party internal auditors who, through periodic, risk-based audits, are responsible for verifying that significant risks are identified, assessing the appropriateness of controls and recommending changes as required.

Operational risk is monitored and managed 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 2008. The plan is continually refined to include strategies to recover and resume operations for various disruption scenarios. The independent third-party internal auditors, referred to above, reviewed the OSC's business continuity plan and confirmed that it is fundamentally sound with no high-risk weaknesses. Opportunities for improvement identified through this review will be addressed in the coming year.

### **Risk-based compliance**

In delivering on the mandate, a risk-based approach is taken for many of the disclosure review and compliance activities of market participants. The Corporate Finance Branch 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 474 reviews, representing 32% of Ontario-based reporting issuers this year.

The Investments Funds Branch conducts selective reviews of continuous disclosure filings made under National Instrument 81-106 *Investment Fund Continuous Disclosure*. In 2007–08, staff increased the number of CD reviews to gauge how investment funds are complying with this requirement. In spring 2008, the OSC published OSC Notice 81-709 *Report on Staff's Continuous Disclosure Review of Investment Funds*, identifying areas where compliance can improve and providing guidance for enhancing the quality and presentation of the management discussion accompanying financial statements.

The Compliance team in the Compliance and Registrant Regulation 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.

The Enforcement Branch 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 corporate governance practices, a code of conduct (which includes Bylaw No. 2) and risk management framework. In order to build and maintain the OSC's reputation, each year all Commissioners and all employees must provide written certification that they have conducted themselves in accordance with the OSC code of conduct. In response to the new *Public Service of Ontario Act, 2006*, the OSC has developed a new Code of Conduct. Certain aspects of the new Code must be approved by the Conflict of Interest Commissioner of Ontario. If, and when approved, the new Code will come into effect in August 2008. A position to oversee compliance will be established.

### **People risk**

As a knowledge-based entity, the OSC's ability to attract and retain people is critical to its success. A range of measures (e.g., turnover and compensation surveys) are tracked to manage this risk. Turnover increased to 33 staff or 7.7% from 28 staff or 7.0% in 2007 and remains at acceptable levels. Knowledge management is a key focus and the OSC continues to pursue initiatives to improve its ability to retain corporate memory and to ensure effective knowledge transfer.

## Management's discussion and analysis

### 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 (SEDAR, NRD and SEDI) 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. In conjunction with the CSA, during 2009 the OSC will be examining options to manage these systems beyond the expiration of the current operating agreements.

CDS recovers its costs to operate these systems by charging user fees to filers. In 2008, 90% (2007 – 89%) of total fee revenue was collected through national systems: SEDAR (35%) and the NRD (55%). No material change is expected in the volume of fees collected through these systems. CDS has backup and disaster recovery processes for these systems that are tested annually. However, 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 fees through these systems would materially affect cash flows.

### Transactions with the Province of Ontario

In the course of normal operations, the OSC entered into transactions with the Province of Ontario as follows:

- a. The *Securities Act* states that when ordered to do so by the responsible Minister, the OSC shall remit to the Province of Ontario such surplus funds as determined by the Minister. In light of the fee model as described in note 8 of the financial statements and the OSC's practice of setting fees in three-year cycles, the OSC is not required to make remittances of its surplus to the Consolidated Revenue Fund. Surpluses retained by the OSC are subject to appropriate terms and conditions to be agreed with the Ministry.
- b. Costs of non-pension benefits for eligible pensioners are paid by the Government of Ontario and are not included in the Statement of Operations and Operating Surplus.

### Contingencies

The OSC is involved in various legal actions arising from the ordinary course and conduct of business. Settlements, if any, concerning these contingencies will be accounted for in the period in which the settlement occurs. The outcome and ultimate disposition of these actions are not determinable at this time; however, management does not expect the outcome of any of these proceedings, individually or in aggregate, to have a material impact on the OSC's financial position.

### 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. Estimates were used in the following accounts: collectibility of accounts receivable, valuation of pension liabilities, estimated useful life of premises and equipment, total accrued liabilities and collectibility of designated settlements and orders. Where appropriate, such as for pension matters, the OSC obtains independent expertise to assist in these estimates. It is management's opinion that none of the estimates detailed in Note 2 of the 2008 financial statements requires the OSC to make assumptions about matters that are highly uncertain. For these reasons, none of the estimates is considered a "critical accounting estimate" as defined in Form 51-102F1 published by the OSC.

### Changes in accounting policies

The CICA issued a new standard dealing with the disclosure of information about an entity's capital and how it is managed by requiring the entity to disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.

The CICA also issued new standards with respect to the disclosure and presentation of financial instruments, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

These new standards will be effective for the March 31, 2009 financial statements and it is management's opinion that these new standards will not materially impact the OSC's financial statements.

### 2009 Outlook

The OSC's draft 2008/2009 Statement of Priorities sets out priorities and proposed initiatives for the upcoming year. The document is available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca). The 2009 budget is designed to achieve 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.

By their nature, forward-looking statements require assumptions to be made and are subject to inherent risks and uncertainties. There is significant risk that predictions, forecasts, conclusions or projections will not prove to be accurate, that assumptions may not be correct and that actual results may differ materially from such predictions, forecasts, conclusions or projections. Readers of this document are cautioned not to place undue reliance on the forward-looking statements as a number of factors could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed in the forward-looking statements. The future outcomes that relate to forward-looking statements may be influenced by many factors, including but not limited to: general economic and market conditions; interest rate and currency value fluctuations; changes in monetary policy; changes in laws; judicial or regulatory proceedings; the ability to execute strategic plans; critical accounting estimates; operational and infrastructure risks; and technological changes. The foregoing list is not exhaustive of all possible factors; other factors could adversely affect results.

The 2009 budget projects a deficit of \$7.1 million. This is consistent with the OSC's plan for the three years ending 2009, in which it was planned to operate at a deficit by using surplus funds available from prior years to reduce participation fees, thereby returning the surplus to market participants.

### 2008 actual versus 2009 budget

(Thousands)	2009 budget	2008 actual	Year over year change
Revenues	\$ 79,064	<b>\$ 78,238</b>	\$ 826
Expenses	\$ 86,172	<b>\$ 73,621</b>	\$ 12,551
Excess/(deficiency) of revenue over expenses	\$ (7,108)	<b>\$ 4,617</b>	\$ (11,725)
Expenditures on premises and equipment	\$ 5,669	<b>\$ 917</b>	\$ 4,752

## Management's discussion and analysis

### Revenues

The OSC remains committed to ensuring that fees paid by issuers and registrants reflect the projected costs to regulate each group. The current fee schedule became effective April 1, 2006. In 2008, \$78.2 million was earned in revenue. In 2009, participation fee revenues are forecast to be similar from issuers and to increase by 3.0% from registrants. As in 2008, these changes 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 3.4%. Late fees are forecast to decrease by 2.5%. Investment income is forecast to fall by 19.1% or \$651,000 due to expected lower cash balances. As noted earlier, the OSC plans to implement a revised fee structure effective April 1, 2009.

### Expenses

The expense budget proposed for 2009 is \$86.2 million, an increase of \$12.6 million or 17.0% over the actual results for 2008. The key drivers of the increase are:

(Millions)

Salaries and benefits	\$	6.5
Administrative		1.3
Occupancy		0.9
Professional services		3.7
Amortization		(0.3)
Other		0.5
Total	\$	<u>12.6</u>

**Salaries and benefits** are projected to rise 11.7% to \$62.1 million (2008 – \$55.6 million), accounting for 51.7% of the total budget increase. This increase reflects a decision to increase approved staffing by 1.7% from 467 to 475. The bulk of this new staffing is in the Enforcement Branch.

The budget increase primarily reflects the impact of prior years' decisions, including the full year's cost of positions approved in the 2008 budget that were filled over the course of the year (so that a full year's salary was not incurred in 2008). Also, certain positions were vacant during 2008 primarily due to turnover and hiring delays; the budget includes the cost of having these positions filled for the entire year. The rest of the cost increase is attributable to 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 22.3% or \$1.3 million. Spending on staff training is projected to increase by \$573,000 because training was underspent in 2008 because planned activities, including a management development program, were deferred due to other workload priorities. Also, the 2009 budget includes funding for the CSA MRRS training, which did not occur in 2008. Commissioners' costs are projected to go up by \$99,000, reflecting continued high hearing workload. Information technology maintenance costs are planned to rise 38.1% to \$1.4 million. These expenditures will improve the OSC's ability to interact with market stakeholders and the public electronically through electronic submissions, provide support for improved knowledge and document management, and provide additional support for new equipment and services due to the continued expansion of the OSC's information storage requirements.

**Occupancy costs** are projected to rise 16.6% to \$6.5 million (2008 – \$5.5 million). This reflects the annualized cost of additional space acquired in 2008 and the impact of higher operating costs and increased rent rates effective September 2008.

**Amortization costs** are expected to decline 21.2% to \$1.2 million for 2009 (2008 – \$1.5 million). Expenditures related to the purchase of premises and equipment were low in 2008; once the proposed leasehold improvements are complete, amortization will increase accordingly in 2010.

**Professional services costs** are projected to rise 82.2% to \$8.1 million for 2009 (2008 – \$4.4 million). The proposed increases are primarily one-time consulting requirements related to information technology infrastructure (which flow out of the OSC’s information technology Strategic Plan, which will enhance operational efficiency), expenditures for external expertise to assist staff with ICFR compliance, redesign of the OSC website, completing an OSC Stakeholder Survey and funding for the Four Year Review Committee.

The increase also reflects the OSC’s involvement with CSA initiatives and a higher share of costs flowing from the CSA IT Strategic Plan, including new CSA IT staff additions and work on drafting contracts/RFP etc. related to shared systems (SEDAR, SEDI and NRD). The OSC’s share of the costs for CSA-shared projects is expected to rise to \$1.6 million (2008 – \$783,000).

**Other expenses** are forecast to increase 59.9% to \$1.4 million (2008 – \$896,000). Key elements of higher travel costs include projected growth in travel requirements related to enforcement activities and involvement in mutual recognition discussions with the U.S. Securities and Exchange Commission. International travel must be pre-approved and is planned on a trip-by-trip basis, based upon the participation of the Chair, Vice-Chairs and staff on various Committees and at the relevant meetings.

**Premises and equipment** is budgeted at \$5.7 million (2008 – \$917,000). The budget includes \$3.2 million for leasehold improvements and furnishings. The accommodation project was initially budgeted for 2008, but the scope and planning issues expanded, deferring the renovations to 2009. The budget includes costs to refurbish certain parts of the existing space to accommodate moves and other operational needs driven by operational reorganization (e.g., new Market Regulation Branch, etc.). Significant growth in hearing activity has generated needs for expanded Hearing Room facilities and additional working space for Commissioners.

The proposed budget for the purchase of information technology related premises and equipment is \$2.4 million higher. The key initiatives driving this increase in infrastructure spending are:

- > To improve and increase storage to facilitate current and future document management processes, an OSC-wide document management system and business continuity.
- > Related to information and data management, information security, access and identity; and for redevelopment and content management of the OSC website.

### Surplus/deficit

The table below reflects the original and current forecast for the OSC’s 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. Due to the strong performance of the capital markets the OSC is now projecting a three-year operating deficit of only \$728,000. This is forecasted to result in a \$49.3 million surplus as at March 31, 2009. The OSC currently plans to return the accumulated surplus to market participants when the fees are revised for the next three-year cycle. As noted, the OSC will be introducing a revised fee structure in April 2009.

### Three-year operating surplus/(deficit) forecast

(Thousands)	2006–07	2007–08	2008–09	3-year total
Original forecast operating deficit	\$ (12,000)	\$ (13,500)	\$ (14,000)	\$ (39,500)
Current forecast and actual operating surplus/(deficit)	1,763	4,617	(7,108)	(728)
Change in forecast operating surplus	\$ 13,763	\$ 18,117	\$ 6,892	\$ 38,772