This document was prepared as of May 22, 2012 and is provided to assist readers in understanding the key financial events and actions and how they have influenced the OSC's operations during the past year. An outlook on OSC 2012-2013 plans is also provided. Additional details on 2012-2013 plans are set out in the OSC Statement of Priorities and the OSC Strategic Plan which are available at www.osc.gov.on.ca.

Certain statements included in this document are forward looking and are subject to risks and uncertainties. The financial performance or events forecast in these statements may differ materially from actual financial performance or events. Factors which could cause financial performance or events to differ from current expectations are described in the risks and uncertainties section. The words "believe", "plan", "intend", "estimate", "expect" or "anticipate" and similar expressions, as well as future or conditional verbs such as "will", "should", "would" and "could" often identify forward-looking statements. The OSC has based these forward-looking statements on its current views with respect to future events and financial performance. Readers should note that any assumptions, although reasonable at the time of publication, are not guarantees of future performance.

This document should be read in conjunction with the financial statements. The financial statements present the OSC's financial performance with 2011 comparatives as at March 31, 2012, March 31, 2011, April 01, 2010 and accompanying notes. Unless otherwise specified, references to a year, for example 2012, refers to the fiscal year of the OSC ended March 31 of that year. The factors which affected the OSC's operations during 2012, as well as the factors that reasonably may be expected to affect future operations and financial performance, are set out in this document.

This is the first year the OSC has prepared its financial statements in accordance with International Financial Reporting Standards (IFRS). IFRS requires that management make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements, as well as the reported amounts of revenues and expenditures for the period. An accounting estimate is considered critical if the estimate requires us to make assumptions about matters that are highly uncertain at the time the estimate is made; or we could have reasonably used different estimates in the current period, or changes in the estimate are reasonably likely to occur from period to period, that would have a material impact on our financial condition, our changes in financial condition or our results of operations. Actual amounts can differ from these estimates to the extent future outcomes differ significantly from management's forecast expectations. Estimates and underlying assumptions are reviewed on an ongoing basis. The transition date to IFRS for the OSC was April 01, 2010.

Overview

The OSC is a Crown corporation without share capital and is the body responsible for regulating Ontario's capital markets. Its work in protecting investors and fostering fair and efficient capital markets in Ontario involves striking an appropriate balance between facilitating timely access to the material information needed by investors to make informed investment decisions without imposing undue regulatory burdens on market participants. As a member of the Canadian Securities Administrators (CSA), the OSC works with other Canadian securities regulators to improve, co-ordinate and harmonize the regulation of Canada's capital markets.

The OSC achieves its objectives through a variety of regulatory tools, including:

- imposing requirements through rules and other regulatory instruments
- providing guidance to market participants
- assessing compliance and directing corrective action
- taking enforcement action

The OSC is also an administrative tribunal with quasi-judicial powers. Panels of Commissioners hear enforcement proceedings and contested applications and consider applications for discretionary exemptions from the requirements of Ontario securities laws. Certain authorities are delegated by statute to OSC Directors and other staff as designated under the *Securities Act* and the *Commodity Futures Act*.

Selected Three-Year Annual Information

(Thousands)	**2012***	2011*	2010**
Revenues	**$ 85,638**	$ 72,955	$ 61,466
Expenses	**91,163**	84,584	80,320
Deficiency of Revenue over Expenses (before recoveries)	**(5,526)**	(11,629)	(18,854)
Recoveries of enforcement costs	**1,139**	703	870
Deficiency of Revenue over Expenses	**(4,387)**	(10,926)	(17,984)
General Surplus	**13,485**	17,872	28,767
Capital Expenditures	**1,877**	1,321	1,373

*as per IFRS **as per Canadian Generally Accepted Accounting Principles

Certain financial statement amounts have been rounded for discussion purposes, however, percentages are calculated from the financial statement amounts. As a result, small differences in calculations may arise. Where these occur, they are not considered to be material.

The fiscal year ended March 31, 2012 represents our first annual reporting period under IFRS. Previous annual financial statements were prepared under Canadian GAAP. Comparative figures as at March 31, 2011 and April 01, 2010 have been restated to comply with IFRS. For a summary of the impact of adoption of IFRS on our financial statements, see the Note 21 – Transition to IFRS.

Analysis of Financial Performance

Revenues increased by $12.7 million or 17.4% due to higher participation fee revenues. Expenses were $6.6 million or 7.8% higher. Key drivers of the increase in expenses were costs for salaries and benefits ($3.4 million) and professional services ($3.3 million). Employee compensation and occupancy costs account for 83.3% (2011 – 85.8%) of expenses (before recoveries).

Consistent with its plan to reduce its surplus, the OSC had a net deficiency of revenues over expenses of $4.4 million in 2012 (2011 – $10.9 million). The deficiency was $6.0 million less than budgeted because revenues were $5.4 million higher than planned and spending was $681,000 under budget. The OSC's deficiency of revenues over expenses was reduced by the recovery of $1.1 million in enforcement costs through settlements and orders. Recoveries were $436,000 higher than 2011.

The premises and equipment balance was essentially unchanged.

OSC Fee Structure

Securities market participants fund our operations through the fees they pay. The current fee structure under the *Securities Act* (Ontario) and the *Commodity Futures Act* was established in 2003. When the OSC implemented the fee structure, it committed to re-evaluating its fee levels every three years. The OSC fee rules were last amended April 2010. The fee structure is intended to recover OSC costs of operation in fulfilling its mandate while allowing it to remain financially stable. The fee rule 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 OSC's average cost to provide 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 average market capitalization across their fiscal year; fees for registrants are based on their revenues. As a market participant grows, it moves through various tiers which have increasingly higher fees.

The OSC is currently developing a revised fee rule which is expected to be in force in April 2013. The new fee rule will be designed to:

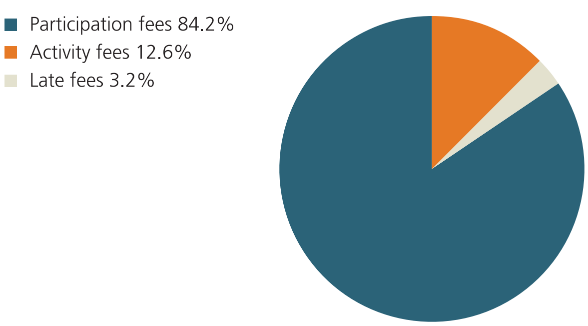
- improve the predictability of OSC fee revenues;
- improve the matching of fees to costs so that, where practical, the sectors that are generating costs to the OSC bear appropriate fees;
- generate fees that allow the OSC to adapt to market changes and invest in staff or infrastructure to address them, and
- expand the range of both activity and participation fees to provide a fairer allocation of costs to all market participants and better reflect the range of activities undertaken by the OSC.

Detailed Analysis of Fiscal 2012 Financial Performance

Revenues (Thousands)	% of Total 2012	**2012**	2011	Change	% Change
Participation fees	84.2	**$ 71,694**	$ 58,404	$ 13,290	22.8
Activity fees	12.6	**10,728**	11,777	(1,049)	(8.9)
Late fees	3.2	**2,760**	2,386	374	15.7
Total fees	100.0	**85,182**	72,567	12,615	17.4
Investment income		**344**	298	46	15.4
Miscellaneous		**112**	90	22	24.4
Total revenues		**85,638**	72,955	12,683	17.4

Figure 1 shows the sources of the OSC's fee revenues:

Figure 1 – OSC Fees by Type



The impact of stronger than expected market performance in conjunction with higher fee rates had a positive impact on OSC revenues. Revenues for the year were $85.6 million, up from $73.0 million in 2011. The variance is explained below.

Participation fees were higher by $13.3 million or 22.8%. In 2012, participation fee rates rose by 9% for registrants and 17% for issuers. The difference in fee increases for issuers and registrants is intended to better align revenues generated from each group with its level of participation in the Ontario capital markets.

Issuer participation fee revenues were higher by $5.9 million due to year over year increases in the market capitalizations of issuers coupled with higher fee rates. Registrant participation fee revenues were higher by $7.4 million due to a year over year increase in registrants' revenues coupled with the higher fee rates.

Activity fees fell by $1.0 million or 8.9%. The decline was due to lower issuer activity fee revenues as lower market activity resulted in decreased numbers of preliminary short form prospectuses, applications for relief, and exempt distributions filings. Registrant activity fees were virtually unchanged.

Late filing fees were $374,000 or 15.7% higher than last year due to an increase in late filings of annual and interim financial statements and insider reports. This is likely related to the reduction in the insider filing deadline from ten to five days which occurred midway through 2011.

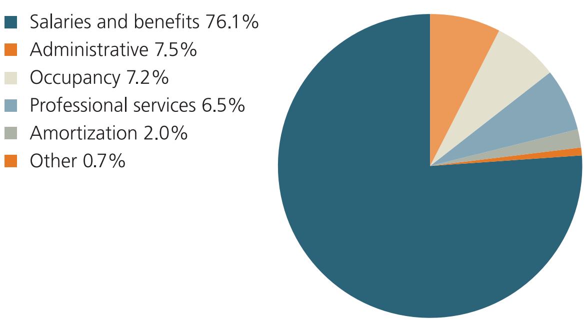
Investment income rose by $46,000 or 15.4%, due to higher interest rates on slightly higher than expected cash balances. The average rate of return on cash balances and investments was 1.2% (2011 – 0.9%) and was 33% higher than 2011.

Expenses (Thousands)	% of 2012 Expenses	**2012**	2011	Change	% Change
Salaries and benefits	76.1	**$ 69,415**	$ 66,044	$ 3,371	5.1
Administrative	7.5	**6,818**	6,195	623	10.1
Occupancy	7.2	**6,544**	6,526	18	0.3
Professional services	6.5	**5,920**	2,649	3,271	123.5
Depreciation	2.0	**1,844**	2,729	(885)	(32.4)
Other	0.7	**623**	441	182	41.3
Total Expenses	100.0	**91,163**	84,584	6,579	7.8
Recoveries		**1,139**	703	436	62.0
Total Expenses (net of recoveries)		**90,025**	83,881	6,144	7.3

Total expenses (net of recoveries) for 2012 increased 7.3% to $90.0 million (2011 – $83.9 million).

The key contributors to the expenditure increase were as follows:

Figure 2 – OSC Expenses by Type



Salaries and Benefits costs increased by 5.1% to $69.4 million (2011 – $66.0 million) and accounted for 76.1% (2011 – 78.1%) of total expenses. The full-year cost of staff hired during 2011, as well as the costs for new staff were key sources of the increase. Staff was added to support and coordinate operation of the OSC Investor Advisory Panel and to improve the timeliness of OSC adjudicative processes. Other staff was added across various branches to address operational priorities.

The OSC operates in a competitive market for required skills and expertise. Compensation under its performance-based variable pay program increased by $394,000. Salary increases put in place at the beginning of the fiscal year complied with Government guidelines averaging 1.9%. The increases totalled $887,000 (2011 – $614,000). These increases were partially offset by savings of $873,000 on salaries and benefits that were recovered for staff seconded to the CSTO. Severance costs were $1.1 million, $346,000 lower than 2011.

Administrative costs increased by 10.1% to $6.8 million (2011 – $6.2 million) and accounted for 7.5% (2011 – 7.3%) of total expenses. Training costs were $275,000 higher reflecting increased management training across the organization. Other key contributors to the increase included a $147,000 rise in information technology maintenance and support costs and higher Commission costs ($89,000).

Occupancy costs, which accounted for 7.2% (2011 – 7.7%) of the OSC's total expenses, were essentially flat.

Professional Services spending increased 123.5% from $2.6 million to $5.9 million and accounted for 6.5% (2011 – 3.1%) of the OSC's total expenses. Additional spending on enforcement matters related to emerging markets accounted for more than two thirds of this increase. The other main cost contributor was the OSC's strategic planning initiative which accounted for about 20% of the increase.

The OSC is a member of the CSA, which is a forum of Canadian securities regulators. 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. Total CSA spending on shared projects in 2012 was higher at $3.0 million (2011 – $2.7 million) of which the OSC contributed $1.1 million (2011 – $1.1 million). OSC staff time spent on CSA projects is not included in these totals. 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 2012, the OSC contributed $250,000 (2011 – $242,000) to the cost of the CSA Secretariat and $470,000 (2011 – $405,000) to the cost of the Systems Office.

Depreciation costs decreased to $1.8 million (2011 – $2.7 million) and accounted for 2.0% (2011 – 3.2%) of the OSC's total expenses. Depreciation expenses declined reflecting a lower capital base than last year, the impact of the change in depreciation method as a result of the transition to IFRS and the change in estimates of the useful lives of the computer hardware and related applications.

Other expenses, which are travel and related expenses, increased by $182,000 or 41.3% to $623,000 (2011 – $441,000) and accounted for 0.7% (2011 – 0.5%) of the OSC's total expenses. In 2012, travel expenses rose mainly due to an increase in number of trips, especially trips related to ongoing investigations of emerging markets issues by enforcement staff. More travel related to our international work with IOSCO and other international regulatory bodies also was a key factor.

Liquidity and Financial Position

Financial Instruments

Financial instruments used by the OSC consist of Cash, Funds held pursuant to designated settlements and orders, Funds held for CSA systems redevelopment, and Reserve fund assets, all of which are recorded at fair value. Trade and other receivables, trade and other payables and accrued liabilities are recorded at cost which approximates fair value given their short-term maturities. Cash, Funds held pursuant to designated settlements and orders and Funds held for CSA systems redevelopment and Reserve fund assets are held in a Canadian deposit account with a Schedule 1 bank, earning interest at 1.75% below the prime rate.

It is management's opinion that the OSC is not exposed to significant interest rate, currency or liquidity risks arising from its investments due to their short-term nature and because virtually all transactions occur in Canadian dollars. The OSC's concentrations of credit risk with respect to trade and other receivables are limited as they are made up of a large number of debtors owing individually immaterial balances, and amounts receivable from the Government of Canada for the recovery of the Harmonized Sales Tax (HST) paid during the year and from the Canadian Securities Transition Office for staff seconded to that office.

Liquidity

As at March 31, 2012, the OSC held $23.1 million (2011 – $26.5 million) in cash, had current assets of $26.8 million (2011 – $29.4 million) and current liabilities of $15.2 million (2011 – $13.5 million) for a current ratio of 1.8:1 (2011 – 2.2:1). The OSC holds cash and marketable securities to ensure that sufficient liquidity is available to meet forecasted cash requirements.

In setting fees for the three years ending March 2013, the OSC planned to operate at a deficiency in each year so as to eliminate the surplus by the end of the period. In 2012, the OSC had an operating deficiency of $4.4 million and the year-end surplus was reduced to $13.5 million. As a result of its planned deficiency of revenues over expenses, the OSC's cash position decreased by $3.4 million or 13.0% in 2012. Cash flows from operating activities continued to be negative with an outflow of $1.5 million (2011 – $7.7 million). Purchases of premises and equipment used $1.9 million (2011 – $1.3 million).

In 2013, the OSC is expecting an operating deficiency of $6.5 million. In March 2013, the cash balance is projected to decrease to approximately $7.8 million and the general surplus is projected to be $7.0 million.

The OSC faces significant cash flow challenges each year due to a mismatch between the timing of its revenues and expenditures. Since more than 75% of the OSC's annual revenues are received in the last quarter of each fiscal year, and expenses are incurred relatively evenly throughout the year, this results in negative cash balances that peak in

December of each year. Prior to 2012, the OSC managed this issue by using its accumulated surplus. With the planned reduction in this surplus, the OSC needed to fully use its $20 million reserve in 2012. The OSC also used its credit line for the first time in December 2011. In January 2012, when the majority of registrant fees were received, the credit line was repaid and the $20 million reserve was restored.

Currently, the OSC has approval for a $7.5 million revolving line of credit which expires on June 30, 2012. The OSC is currently seeking approval for a 2 year, $35 million revolving line of credit to address anticipated short-term cash deficiencies for the period July 01, 2012 to June 30, 2014. The OSC expects that drawings on the line of credit will be required beginning in September 2012 and rising to about $20 million by December 2012. The credit line will be repaid in January 2013.

With the general surplus and the expected re-establishment of its credit facility, the OSC expects to have sufficient liquidity to finance its operations and purchases of premises and equipment.

Revenues

Revenue generation remains a source of risk as all the OSC's revenues are correlated to market activity. The degree to which the OSC's revenues vary along with market fluctuations is greater than was anticipated when its fee structure was developed. Additional discussion is provided under "Financial Risk" later in the document.

Reserves

Since 2001, the OSC has had a $20.0 million general reserve as an operating contingency for revenue shortfalls or unexpected expenses. The prime investment consideration for the reserve is the protection of capital and liquidity. The OSC records income generated by the reserve in general operations.

Trade and other receivables

Trade and other receivables increased 25.4% to $2.7 million (2011 – $2.2 million). The key driver of the increase is the amount owing from the Government of Canada for the recovery of HST ($704,000) (2011 – $437,000).

Funds held pursuant to designated settlements and orders

The OSC has a number of settlement agreements and orders arising from enforcement proceedings where monies from these settlements and orders are to be set aside and allocated to such third parties as the OSC may determine. Funds that are not so designated at the time that settlements are approved or orders are made are to be paid to the Consolidated Revenue Fund of the Government of Ontario and may not be used to fund OSC operations. Amendments to the *Securities Act* in December 2004 removed the requirement for Ministerial approval of allocations of designated funds. With regard to monetary sanctions imposed, a fair and appropriate use for these monies will be determined in accordance with applicable laws, court orders and in the public interest.

In 2012, the OSC collected $2.8 million (2011 – $4.5 million) through designated settlements and orders. As authorized by the Board, the OSC paid $4.4 million to the Investor Education Fund (2011 – $3.0 million). At March 31, 2012, the OSC holds $47.2 million (2011 – $43.6 million) pursuant to designated settlements and orders. The OSC and IIROC recently appointed Ernst & Young Inc. to administer the distribution of funds that were collected through enforcement settlements to eligible investors who purchased third-party Asset-Backed Commercial Paper (ABCP). The OSC has committed to pay $27.6 million as part of this process. The intent is to distribute the funds directly to eligible investors by September 2012. Subsequent to year-end, on April 24, 2012, the OSC Board authorized a further $3.9 million to be paid to the Investor Education Fund to provide funding for the 2013 fiscal year.

The OSC has the power to impose monetary sanctions for breaches of Ontario securities law and has exercised this authority since 2005. The OSC continues to face challenges in collecting sanctions as respondents often have limited assets, poor credit, or have left Ontario. Although the OSC pursues outstanding amounts vigorously, only $112.2 million (46.3%) has been collected of $242.3 million sanctioned since 2005. Of the $130.2 million outstanding, $5.4 million is likely collectible and accrued in the OSC's financial statements. About 41% ($54 million) of the $130.2 million outstanding relates to two cases.

Funds held for CSA systems redevelopment

To March 31, 2012, the OSC has received $79.2 million (2011 – $62.6 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 2012 was $3.8 million (2011 – $2.9 million) which is included in the funds held for CSA systems redevelopment balance.

As described in Note 7 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. In 2012, there were no SEDAR deficits. As at March 31, 2012, $28.2 million (2011 – $25.8 million) of the total funds held for CSA systems redevelopment is available for SEDAR, $15.3 million (2011 – $10.9 million) is available for SEDI, and $37.0 million (2011 – $28.1 million) is available for NRD. The OSC has committed to paying its share of annual shortfalls resulting from the operations of SEDAR (45.1%), SEDI (25%) and NRD (36.07%), should they occur and accumulated surpluses are unavailable.

During the year, work started to develop a request for proposals (RFP) for a new service provider to operate the CSA IT systems. In addition groundwork was completed on preliminary requirements for the redevelopment of these systems. As at March 31, 2012, total accumulated payments related to this redevelopment project totalled $2.5 million. Redevelopment work will be funded by the amount held in trust.

Premises and equipment

Expenditures on premises and equipment rose 42.1% to $1.9 million (2011 – $1.3 million). This increase related to spending to refresh our laptops.

(Thousands)	**2012**	2011	% Change
Furniture and equipment	**$ 55**	$ 40	38
PCs, laptops and other IT equipment	**1,751**	1,134	54
Leaseholds and other capital items	**71**	147	(52)
Total	**1,877**	1,321	42

Liabilities

Trade and other payables increased 13.9% to $15.2 million (2011 – $13.4 million). Key contributors to the increase were higher accruals for bonuses ($389,000) and payroll ($502,000).

The accrued pension liability of $2.0 million (2011 – $2.0 million) represents future obligations relating to supplementary pension plans for the current and former Chairs and Vice-Chairs. The unfunded supplemental pension plans' defined benefit obligation at March 31, 2012, was $2.4 million (2011 – $2.0 million). The recognized pension liability was $2.0 million (2011 – $2.0 million). The OSC's related expense for the year was $117,000 (2011 – $307,000) and is included in salaries and benefits. The decrease was mainly related to the amortization of past service costs on transition to IFRS.

The OSC is committed to lease payments as outlined in Note 11 to the financial statements.

Internal Control Over Financial Reporting (ICFR)

During the year, the OSC's ICFR processes were reviewed and documentation updated where necessary. Operating effectiveness was tested using the framework and criteria established in "Internal Control –Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Staff performed an evaluation, under the supervision and with the participation of management, of the effectiveness of the OSC's ICFR as at March 31, 2012. Based on this evaluation, the OSC has concluded that the ICFR was operating effectively and that there are no material weaknesses.

There have been no changes that occurred during the most recent year ended March 31, 2012, that have materially affected, or are reasonably likely to materially affect, the OSC's ICFR. The Chair and the Controller certify the design and effectiveness of ICFR in the Statement of Management's Responsibility and Certification.

Critical Accounting Estimates

The preparation of financial statements in accordance with IFRS requires that management make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements, as well as the reported amounts of revenues and expenditures for the period. An accounting estimate is considered critical if the estimate requires us to make assumptions about matters that are highly uncertain at the time the estimate is made; or we could have reasonably used different estimates in the current period, or changes in the estimate are reasonably likely to occur from period to period, that would have a material impact on our financial condition, our changes in financial condition or our results of operations. Actual amounts can differ from these estimates to the extent future outcomes differ significantly from management's forecast expectations. To address this, the OSC uses various estimating techniques and assumptions to prepare the financial statements. Estimates were used in the following accounts: collectability of trade and other receivables, valuation of pension liabilities, estimated useful life of premises and equipment, total trade and other payables and collectability of designated settlements and orders. Judgment was used to decide whether to consolidate the Investor Education Fund. Where appropriate, such as for pension matters, the OSC obtains independent professional expertise to assist in the calculation of these estimates. It is management's opinion that none of the estimates as described in Note 2 of the 2012 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".

Risks and Uncertainties

The range of risks the OSC must manage continues to grow due to the pace of change and the continuing globalization of financial entities and their operations:

- *Developments in the overall investment marketplace*: These changes may be product based, market structure based or relate to transactions or the activities of market intermediaries.
- *Developments in the domestic and international regulatory arena*: As economies and markets have become more globally linked so has the need to consider changes to the way many aspects of financial services regulation are viewed.
- *Developments in stakeholder perceptions of regulatory effectiveness*: Despite extensive efforts and resource expenditures of regulators, there remains a gap between the expectations of the public and its perceptions of regulatory effectiveness.

Improving risk identification and management was identified as a key goal during the OSC's recently completed strategic planning exercise. Understanding those we regulate is necessary to allow us to respond to emerging risks in a more timely and appropriate manner. A strong focus on risk to ensure that we both identify and mitigate risk effectively is necessary. The OSC will establish an emerging risk committee to work with our added research and analysis capability to develop a comprehensive framework for the identification and analysis of risks for the OSC. It will ensure that this program is rolled out across the organization and updated on an ongoing basis. The OSC will use the increased understanding gained through these activities to refine its regulatory approaches.

Operational Risk

Operational risk can be defined as the risk of direct or indirect loss resulting from the organizational environment or external events, or from inadequate internal processes, staff resources, or supporting systems. Management is responsible for the day-to-day control of operational risk by ensuring that appropriate procedures, internal controls and processes or other actions and compliance with such programs are established to reduce operational risk.

Specialist support groups, such as Human Resources, Corporate Services and the Office of the General Counsel, assist operational management by maintaining oversight in areas such as corporate data security, staff conduct requirements, technology stability and reliability, financial controls, corporate insurance and legal compliance, among others. The OSC has established policies and processes to identify, manage and control operational risk. Key components include:

- regular reviews of systems security measures to monitor controls and identify potential vulnerabilities to external parties accessing OSC data;
- mitigation of risk to assets through insurance where practical and appropriate; and
- separation of duties across key functions.

Operational risk can include risk to the OSC's reputation. Reputational risk is addressed at the OSC by its Code of Conduct and governance practices established by its Board of Directors (additional details available at www.osc.gov.on.ca) as well as other specific risk management programs, policies, procedures and training.

The OSC, from time to time, 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, OSC management does not expect the outcome of any of these proceedings, individually or in aggregate, to have a material impact on its financial position.

Disruption to the operation of any of the major systems applications (SEDAR, NRD and SEDI) operated by CDS INC. (CDS) on behalf of the CSA (including the OSC) is a potential source of risk. CDS recovers its costs to operate these systems through the application of user fees to filers. In 2012, 92.9% (2011 – 91.1%) of total regulatory fee revenue at the OSC was collected through these national applications (SEDAR 38.6% and NRD 54.3%). No material change is expected in the volume of fees collected through these systems. The current operating agreement with CDS for these systems has been extended until October 2013. A strategy for redevelopment of the systems has been created by the CSA IT Systems Office and an implementation plan has been agreed to. In addition, it has been agreed to competitively tender operation of the current systems in parallel with the development of replacement systems.

The CSA requires CDS to provide an annual third-party audit report (CSAE 3416) that provides a review of the design of the internal controls for each system. In addition, CDS is required to have an operating disaster recovery site for these systems that is annually tested.

Financial Risk

The OSC maintains a strong internal control environment, including management oversight to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

The majority of OSC revenue is generated through participation fees. The OSC fee model uses a tiered structure to moderate the impact of market fluctuations in an effort to provide revenue stability. While the fee model has achieved this objective across multi-year periods, in any given year, the predictability of OSC revenues is less certain as participation fees are still subject to market fluctuations. The OSC's 2013 revenue forecast reflects a 5% market growth projection. Should this growth rate not be achieved, revenues could be materially lower than forecast but would not be expected to impair OSC operations.

Business Continuity

In the event of an external disruption, the OSC maintains a robust Business Continuity Plan to ensure the continuation of critical regulatory services. Detailed business continuity plans are in place for each priority business function. Each functional plan includes documented recovery procedures including manual workarounds and other mitigation strategies. Offsite recovery services and facilities have been contracted and were successfully tested during 2012. Remote access capability exists to enable staff to access all critical OSC systems. The OSC plan is continually reviewed and refined to include strategies to recover data and functionality and to resume operations under various disruption scenarios. Another key element of the OSC plan addresses its interfaces with self-regulatory organizations and other key market participants and includes strategies to effectively address various market disruption scenarios.

2013 Outlook

The 2012/2013 OSC Statement of Priorities sets out the Commission's priorities and proposed initiatives for the upcoming year. The document is available at www.osc.gov.on.ca. The OSC has identified five broad priorities for 2013:

1. Deliver Responsive Regulation

2. Deliver Effective Enforcement and Compliance

3. Deliver Strong Investor Protection

4. Run a Modern, Accountable and Efficient Organization

5. Support and Promote Financial Stability

Details on planned initiatives toward achievement of these priorities are set out earlier in the Annual Report.

OSC Revenues and Surplus

Overall, the OSC is forecasting revenues in 2012–2013 to increase by 9.2% from 2011–2012 actual revenues. This forecast reflects the fee increases in place for the coming year and a market growth assumption of 5%. When the OSC reset fee rates for three years in April 2010, fees were set at levels to generate revenues that would be below expected costs. The intent was to eliminate the surplus that had been accumulated in the prior three year period. Based on the projected revenues and proposed 2012–2013 OSC Budget, the OSC expects to operate at a deficit in 2012–2013. As a result, the OSC surplus is projected to be about $7.0 million as at March 31, 2013.

2012–2013 Budget Approach

The prevailing financial environment poses challenges for those that the OSC regulates and the OSC itself. Despite improving global economic conditions, uncertainties remain around the possible outcomes for the economy and financial market volatility persists. The main environmental factors affecting the OSC's work are set out earlier in the Annual Report.

The OSC's job continues to expand. The OSC requires new tools and resources with specialized skills to meet the evolving demands that it faces. Consultation both domestically and abroad is becoming a more integral element of its operations. The OSC also faces the challenge to try to remain aligned to the Government's fiscal objectives. During the past year the OSC redeployed significant existing internal resources to address priorities related to emerging markets. As the OSC moves to meet its ever-changing challenges it will need to continue to aggressively pursue process efficiencies and ways to reduce its costs and to do more within its existing resources.

The 2012–2013 OSC Budget is focused on investment in the key strategies identified in its recently completed three-year OSC Strategic Plan. While these initiatives will be staffed in part through redeployment of existing resources, the scope of the initiatives is such that more resources are needed.

The budget reflects a projected increase of $10.0 million or 11.1% over 2011–2012 spending and 10.2% above the 2011–2012 budget. Salaries and benefits, which comprise $74.8 million or 74.8% of the budget, reflect an increase of $5.4 million or 7.7% over 2011–2012 spending. The increase in salaries and benefits cost reflects:

- new positions approved to achieve the strategic initiatives;

- full-year costs for vacancies and staff hired throughout 2011–2012, and

- higher projected restructuring costs due to realignment with OSC Strategic Plan priorities.

The 2012–2013 budget includes funding for new staff focused in the following areas to:

- address market structure issues that are increasing both in number and complexity;
- establish and staff a new Office of the Investor;
- set up the OSC's new CA Training Office accredited by the Institute of Chartered Accountants of Ontario, and
- provide analytical and research support to allow the OSC to undertake a more fact based approach.

These initiatives will support the regulatory results the OSC is seeking. The OSC is committed to becoming a 21st century regulator and needs to attract, retain and motivate staff with the required skills and experience. The OSC believes that becoming a leading employer will help it attract skilled staff. Therefore, resources have been allocated to various human resources initiatives with the goal to create the appropriate organizational structure and development environment.

				2012-13 Budget to 2011-12 Budget		2012-13 Budget to 2011-12 Actual	
(Thousands)	2011-12 Budget	2011-12 Actual	2012-13 Budget	Change	**% Change**	Change	**% Change**
Revenues	$ 80,287	$ 85,638	$ 93,524	$ 13,237	**16.5**	$ 7,886	**9.2**
Expenses	90,706	90,025	99,986	9,280	**10.2**	9,961	**11.1**
Deficiency of Revenue compared with Expenses	$ (10,419)	$ (4,387)	$ (6,462)	$ 3,957			
Capital Expenditures	$ 2,396	$ 1,877	$ 8,057	$ 5,661			

The significant increase in the capital budget primarily reflects the build-out of recently acquired additional space as well as the realignment and refurbishment of the OSC's existing space. The budget also includes considerable investments to support upgrading and expansion of OSC information technology which will help to facilitate excellence in the execution of the OSC's operations.