
MANAGEMENT'S DISCUSSION AND ANALYSIS

The financial statements that appear on pages 41–56 in this annual report present the financial position, operating results and cash flows of the Alberta Securities Commission (ASC) or the Commission in accordance with Canadian public sector generally accepted accounting principles (GAAP) for the fiscal year ended March 31, 2010. The comments in this Management's Discussion and Analysis (MD&A), prepared as of June 15, 2010, analyze the ASC's financial performance during the fiscal year ended March 31, 2010, and present a view for the future.

NOTE: In this MD&A, references to years, for example F2010, refer to the fiscal years of the ASC ending March 31.

This MD&A should be read in conjunction with the financial statements. Certain statements outlining F2010 expectations are forward-looking and are subject to risks and uncertainties. Furthermore, assumptions, although reasonable at the date of publication, are not guarantees of future performance. The results or events predicted in these statements and assumptions may differ materially from actual results or events. Factors that could cause results or events to differ from current expectations are described in the "Risks and Uncertainties" section of this MD&A.

The ASC maintains accounting and internal control systems to provide reasonable assurance that its financial information is complete, reliable and accurate and that its assets are adequately protected. The Commission Members, in conjunction with the Audit Committee, have an oversight role to ensure the integrity of the reported information. Specific processes that enhance ASC financial accountability and oversight include:

- preparation of an annual budget, which is reviewed by the Audit Committee and approved by the Commission;
- a commitment to continuous improvement and annual staff performance assessment;
- quarterly reports of actual versus budget performance and updated full-year forecasts;
- the requirement of Commission approval of significant unbudgeted expenses or re-allocations; and
- quarterly testing of the design and effectiveness of critical financial controls.

Overview

The ASC, a provincial corporation without share capital, is the regulatory agency responsible for administering the province's securities laws. It is entrusted with protecting investors and fostering a fair and efficient capital market in Alberta. As a provincial corporation, the ASC is exempt from income taxes. The ASC is funded from fees paid by securities market participants. As a member of the Canadian Securities Administrators (CSA), the ASC works to improve, coordinate and harmonize the regulation of Canada's capital markets.

The ASC is also an administrative tribunal with quasi-judicial powers. Panels consisting of two or more Members of the Commission hear enforcement proceedings and contested applications and consider applications for discretionary exemptions from the requirements of Alberta securities laws. In addition, the ASC has jurisdiction as an appeal body to hear appeals from decisions of the Executive Director of the ASC, the TSX Venture Exchange (TSXV), the Natural Gas Exchange Inc. (NGX) and recognized self-regulatory organizations.

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Selected Annual Information

<i>(\$ Thousands)</i>	F2010	F2010	F2009	F2008
	Budget	Actual	Actual	Actual
Revenue	\$ 26,186	\$ 32,733	\$ 23,107	\$ 16,769
Expense	36,720	28,392	26,517	2,517
Net income (loss)	\$ (10,534)	\$ 4,341	\$ (3,410)	\$ 2,356

Assets

Cash	\$ 11,343	\$ 8,188	\$ 4,395
Investments	\$ 30,749	\$ 28,826	\$ 34,671
Capital assets	\$ 2,028	\$ 2,305	\$ 2,938
Total assets	\$ 44,895	\$ 39,757	\$ 42,668

Non-current financial liabilities

Lease inducement	\$ —	\$ 124	\$ 247
Accrued benefit liability	\$ 3,782	\$ 3,316	\$ 2,888
Retained earnings	\$ 37,772	\$ 33,431	\$ 36,841
Capital additions	\$ 895	\$ 916	\$ 733

Highlights

The ASC earned \$4.3 million in F2010 compared to a budgeted loss of \$10.5 million and a net loss of \$3.4 million in F2009. Investment income in F2010 of \$3.9 million, compared to an investment loss in F2009 of \$3.2 million, resulted from a significant recovery in investment equity values. Fee revenues increased \$800,000 as capital markets began to recover. Enforcement receipts of \$3.0 million from a record number of insider trading and other settlements, and the recovery of penalties assessed in prior years, exceeded F2009 receipts by \$2.0 million. These receipts fluctuate annually because of the unique nature of cases and the timing of their resolution. Revenue increases were partially offset by increased compensation costs of \$1.5 million for additional staff and salary increases, information technology project related expenses of \$300,000 and investor education initiatives.

At March 31, 2010, the ASC had cash and investments of \$42.1 million. The increase of \$5.1 million from the prior year is the result of investment gains and enforcement receipts.

Actual Results Compared with Budget

The ASC prepares an annual budget that is approved by the Commission Members and Alberta's Minister of Finance and Enterprise and is consolidated with the Government of Alberta budget.

The ASC's income for F2010 of \$4.3 million exceeded the budgeted loss of \$10.5 million. Fee revenues, primarily exempt distributions, exceeded budget by \$1.0 million. Administrative penalties, settlement receipts and cost recoveries exceeded budget by \$2.4 million. Investment income reflected the strong equity market recovery and was greater than budgeted by \$2.4 million. Expenses were \$8.3 million less than budget because of staff vacancies and operating cost control and because the \$3.3 million provision for unanticipated expenses was not required.

The ASC may need to increase fees in the future. The ASC will ensure that fee increases support only required processes that enable the ASC to fulfil its regulatory mandate effectively and efficiently. Future fee increases require authorization by Government of Alberta "Order in Council" prior to implementation.

Analysis of Fiscal 2010 Operating Results and Financial Position

Revenue

<i>(\$ Thousands)</i>	F2010	F2010	F2009
	Budget	Actual	Actual
Revenue			
Distribution of securities fees	\$ 10,534	\$ 11,658	\$ 11,126
Registration fees	8,772	9,082	9,025
Annual financial statement fees	4,530	4,686	4,470
Order (application) fees	225	318	300
Total fees	24,061	25,744	24,921
Investment income (loss)	1,500	3,930	(3,234)
Settlements and cost recoveries	–	2,499	1,246
Administrative penalties	600	542	153
Other	25	18	21
Total revenue	\$ 26,186	\$ 32,733	\$ 23,107

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The ASC administers the Alberta capital market regulatory system and collects fees from those who participate in the system. The ASC does not receive transfers from government tax revenues. The ASC funding model matches total costs and revenues because many ASC processes, such as enforcement actions and policy development, have no related fees but are required to maintain the regulatory system. As a result, specific transaction fees paid by issuers and registrants are not based on the cost of those transactions. These participant transaction fees, in addition to some enforcement receipts and investment income, all contribute to funding ASC operations.

Issuers are primarily companies or mutual funds that pay fees for specific filings, such as prospectuses, distributions of securities in Alberta and other specified disclosure documents.

Distribution fees These fees are paid by issuers for the distribution of securities. Distribution fees have both a fixed and variable component. The fixed component is charged for each prospectus or exempt distribution by an Alberta issuer. The fixed component of distribution fees totalled \$5.6 million (\$5.1 million in F2009). The variable fee component is calculated based on the proceeds obtained from public (prospectus) and private (prospectus exempt) distributions of securities sold in Alberta. The variable fee component accounted for \$6.0 million in F2010 (\$6.0 million in F2009) and 23 per cent (24 per cent in F2009) of ASC fee revenues.

The ASC receives fees paid in connection with prospectus distributions and exempt financings for non-mutual fund issuers shortly after the distribution date; however, the ASC receives mutual fund fee revenue (approximately 69 per cent of distribution fees, including that for exempt distributions) an average of six months after the mutual fund sale date. There is, therefore, always a lag between mutual fund sales and the receipt of mutual fund fees.

Distribution fees vary with the level of capital market activity, equity appreciation and mutual fund sales. When equity market values are rising or falling, ASC distribution revenues also increase or decrease because of changes in public and private securities distributions and mutual fund sales. However, while equity market activity swings have an impact on ASC revenues, the majority of Commission fee revenues are relatively stable.

Registration fees Fees of \$9.1 million in F2010 (\$9.0 million in F2009) from registered firms and individuals accounted for approximately 35 per cent of fee revenues, consistent with the historical average of 33 per cent. Registration fees are relatively stable with a base in Alberta of almost 600 firms and more than 26,000 individuals. In addition, average individual turnover rates of 15 per cent to 20 per cent annually provide additional fee revenue during any given year. This turnover rate fluctuates minimally, even in years of poor market performance.

Financial statement filing fees Reporting issuers pay financial statement filing fees and these fees account for approximately 18 per cent of fees. The total number of active reporting issuers in Alberta (those that have not been cease traded) is approximately 6,800 (7,000 in F2009) and remains reasonably stable from year to year. Filing fees totalled \$4.7 million in F2010 (\$4.5 million in F2009).

Other Revenue Sources

Investment income In F2010, investment income was \$3.9 million compared to a loss in F2009 of \$3.2 million. Investment income included equity gains of \$2.6 million (\$4.9 million loss in F2009), interest income of \$1.2 million (\$1.4 million in F2009) and dividends of \$142,000 (\$276,000 in F2009).

Application fees For the most part, only reporting issuers having Alberta as their principal regulator pay application fees. There were approximately 425 applications processed in F2010 (400 in F2009).

The mutual fund industry There are approximately 3,000 active mutual fund issuers (included in the reporting issuer population of 6,800) and more than 10,000 salespersons in Alberta. Revenues from mutual funds in F2010 included fees of: \$3.7 million from prospectus filings; approximately \$1.9 million from prospectus distributions; \$2.1 million from exempt distributions; \$915,000 from annual financial statement filing fees; and \$3.0 million from mutual fund registration fees. These mutual fund revenues totalled \$11.6 million (\$11.1 million in F2009) or 45 per cent of total fee revenues.

Enforcement Receipts

<i>(\$ Thousands)</i>	F2010	F2009
Administrative penalties		
Assessed	\$ 1,190	\$ 1,903
Uncollectible	(1,075)	(1,835)
Recoveries from prior years	425	77
Interest income and other	2	8
Total	\$ 542	\$ 153
Settlement receipts		
Assessed	\$ 1,818	\$ 1,212
Uncollectible	-	(111)
Recoveries from prior years	-	-
Cost recoveries		
Assessed	401	729
Uncollectible	(139)	(635)
Recoveries from prior years	419	51
Total	\$ 2,499	\$ 1,246

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Administrative penalties, settlement payments and cost recoveries depend on the circumstances of specific cases and vary from year to year. An administrative penalty receipt occurs following collection of a financial penalty imposed by an ASC hearing decision. A settlement receipt arises from a negotiated settlement that contains a financial payment. Cost recovery receipts arise on collection of assessed costs. Cost recoveries arise in both settlements and hearing decisions. Current year receipts of \$3.0 million (\$1.4 million in F2009) compare to a five-year average of approximately \$1.3 million exclusive of a record receipt of \$7.6 million in F2007. The ASC actively pursues unpaid amounts, including the use of external legal counsel, writ filing and examinations in aid of execution. Recoveries are often limited because respondents have minimal resources, are unable to pay and recovery may not be cost effective to recover judgements; however, the ASC collected over \$800,000 of prior-year assessments and costs in F2010.

The ASC annually transfers administrative penalties revenue less eligible expenditures to a restricted cash account. Restricted cash is segregated from other assets because of statutory limitations on the use of these funds. The *Securities Act* (Alberta) allows administrative penalties revenue to be used only to fund certain expenses incurred to enhance the knowledge and information of persons about the operation of the securities markets. In F2010, the ASC incurred eligible investor education program costs of \$469,000 (\$216,000 in F2009), while the ASC received related fees from education programs of \$17,000 (\$15,000 in F2009). Restricted cash, composed of interest-bearing deposits, was \$280,000 at March 31, 2010 (\$190,000 in F2009). The increase in restricted cash was the result of receiving \$542,000 (\$153,000 in F2009) of administrative penalty receipts and \$17,000 (\$15,000 in F2009) of program fees and deducting \$469,000 (\$216,000 in F2009) of eligible expenditures.

Expenses

<i>(\$ Thousands)</i>	F2010	F2010	F2009
	Budget	Actual	Actual
Salaries and benefits	\$ 21,948	\$ 19,501	\$ 18,017
Professional services	3,501	2,591	2,877
Administration	3,460	2,468	2,125
Premises	2,350	2,170	2,197
Amortization	1,456	1,193	1,085
Investor education	667	469	216
	33,382	28,392	26,517
Contingency	3,338	-	-
Total expenses	\$ 36,720	\$ 28,392	\$ 26,517

Comparative and Budget Expense Analysis

Expenses increased 7 per cent to \$28.4 million from \$26.5 million in F2009, but were 23 per cent less than the F2010 budget of \$36.7 million. Details by expense category follow.

Salaries and benefits Compensation expenses accounted for 69 per cent of operating costs (68 per cent in F2009) and increased \$1.5 million in F2010. Increases were the result of staff additions and annual salary adjustments of 2.9 per cent. There were an average 153 full-time staff during the year (147 in F2009). Compensation costs were less than budgeted because of an average vacancy of 13 positions. Compensation includes a performance-based incentive program that represented 7.5 per cent (7.1 per cent in F2009) of total salary and benefit costs.

Professional services Expenses were \$286,000 less than the prior year and \$910,000 less than budget. Costs for litigation and CSA support, a major information technology systems project, recruitment, training and office administration projects were less than budget. The ASC is a member of the CSA and funds a portion of CSA operations. All CSA projects, including the development of harmonized securities policies and rules and shared CSA information systems, are coordinated through a permanent Secretariat located in Montréal. The operating costs of the Secretariat are borne on a formula basis by CSA members and the ASC pays approximately 10 per cent. In F2010, the ASC contributed \$276,000 (\$247,000 in F2009) toward all CSA costs.

Administration Costs increased \$343,000 in F2010, but were \$1.0 million less than budget. The administration cost category includes: travel; Member fees; office operations including insurance, freight and postage, rental equipment, telephones and communications, repairs and maintenance, and materials and supplies; and other administration costs of advertising, business consultation and audit fees. Travel expenses increased marginally but were \$258,000 less than budget. Travel expenses are required for investor education, enforcement activities and coordination with other CSA jurisdictions on national projects, policy development and rule formulation.

Member fees increased \$157,000 in F2010 but were \$144,000 less than budget because there were more hearing days than the prior year but less than budgeted. Office operation costs including maintenance, supplies, equipment and rent increased \$132,000 in F2010 because of staff increases and technology initiatives. However, these costs were \$555,000 less than budget because office costs were reduced in preparation for the F2011 relocation of ASC offices.

Premises Costs decreased and were less than budget because of operating cost reductions.

Investor education Costs were greater than the prior year, because some programs were cancelled in F2009, as a result of market conditions. Costs were less than budgeted in F2010 because of program cost control.

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Expenses by Division

<i>(\$ Thousands)</i>	F2010	F2010	F2009
	Budget	Actual	Actual
Office of the Chair and Members	\$ 3,346	\$ 2,936	\$ 2,654
Office of the Executive Director	1,052	1,135	926
Enforcement	6,397	5,516	5,447
Corporate Finance	5,682	4,749	4,401
Market Regulation	2,559	2,145	1,896
Office of the General Counsel	1,174	953	838
Office of the Chief Accountant	693	446	464
Administration			
Corporate Resources	5,270	4,073	3,850
Communications	1,301	1,183	1,093
Financial Services	688	527	549
	7,259	5,783	5,492
Expenses not allocated	8,558	4,729	4,399
Total	\$ 36,720	\$ 28,392	\$ 26,517

Division expenses are primarily for staff and professional services. These costs were greater than the prior year for most Divisions because of increases in compensation and staff numbers.

Independent Member fees are recorded in the Office of the Chair and Members and include a \$10,000 annual retainer, \$2,500 for Committee membership, \$5,000 for the Committee chair and \$5,000 for the Lead Independent Member position. Meeting attendance fees include \$1,000 per day for an ASC meeting and \$750 for a Committee meeting. Hearing fees are payable as to \$1,000 per hearing day and \$125 per hour of related preparation, review and decision writing. Members' fees are variable because the duration and number of hearings are not easily forecast. Independent Member fees and related hearing costs increased \$157,000 in F2010 because of an increase in hearing days.

Market Regulation cost increases reflect the expanded role of this Division in national policy initiatives, the recognition of Alberta-based energy marketplaces and expanded registration compliance processes.

Capital Expenditures

<i>(\$ Thousands)</i>	F2010	F2010	F2009
	Budget	Actual	Actual
Leasehold improvements	\$ 520	\$ 319	\$ 159
Information technology	275	538	287
Office furniture and equipment	100	59	6
Total	\$ 895	\$ 916	\$ 452

The ASC is planning to move to a new office location in December 2010. As a result, leasehold improvements were principally for relocation design and preliminary office planning. Information technology expenditures were principally for hardware, licensed software and software development costs to replace the Commission's primary information system and related data management and reporting processes. Furniture expenses were primarily for the design of furniture for the new offices.

2010 Capital Budget Capital expenditures approved by the ASC include:

- \$520,000 of design fees required for relocation planning;
- \$275,000 for completion of the Commission's information technology software development project and software upgrades; and
- \$100,000 for meeting room office conversion and related furniture to accommodate staff growth prior to relocation.

The existing office lease term ends in March 2011. In July 2009, the ASC committed to relocation and a 15-year lease commencing in December 2010. Capital expenditures of up to \$11.1 million are estimated for relocation. A lease inducement of \$3.5 million will offset a portion of these relocation cash requirements.

Liquidity and Financial Position

Liquidity The ASC has sufficient resources to fund its operations and capital purchases with cash of \$11.3 million (\$8.2 million in F2009) and investments of \$30.7 million (\$28.8 million in F2009). The increase in cash and investments resulted from enforcement receipts and investment income that exceeded budgets and effective cost control.

Accounts receivable Accounts receivable at the end of March 2010 were \$148,000 (\$22,000 in F2009) and include a \$70,000 recovery of lease operating costs, \$51,000 (\$10,000 in F2009) of current administrative penalty receivables and \$27,000 (\$12,000 in F2009) of employee loans for computer acquisitions.

Investments The ASC's investments are independently managed by the Alberta Investment Management Corporation (AIMCo). AIMCo is a provincial corporation responsible to the Minister of Finance and Enterprise. The ASC does not participate in capital market investment decisions or transactions.

The ASC's investment policy provides guidance relevant to the governance, purpose, size, access, management and annual income of the investments (designated investments totalling \$30.7 million in F2010 and \$28.8 million in F2009).

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The target balance for the investments is between 50 per cent and 100 per cent of the ASC's average of expected expenses for the current and subsequent year. This range is \$15.8 million to \$31.5 million during F2011. The 2011 year-end balance of investments and cash is estimated to be \$30.8 million, which is within the acceptable range. This \$11.2 million reduction in investments and cash when compared to the F2010 balance of \$42 million is due to cash expenditures for the relocation that is budgeted for \$7.2 million (net of \$3.5 million lease inducement) and a budgeted cash loss from operations of \$4.0 million.

Rates of return on investments:

- Bond fund—The rate of return (based on market value) was 11 per cent in F2010 compared with a 4.3 per cent loss in the prior year.
- Equity funds—The average rate of return (based on market value) for the equity funds was 47 per cent in F2010, compared with a 33 per cent loss in the prior year.
- Money market funds—These returned an average 1 per cent in F2010 and 3 per cent in the prior year.

Investments include fixed income government and corporate bonds and Canadian equities that trade in active markets. While investments are classified as non-current because of their long-term retention objective, they can be accessed on two weeks' notice and are available to fund ASC cash needs as required.

Bond investments are sensitive to interest rate fluctuations. At March 31, 2010, ASC investments included bonds with market values of approximately \$22.3 million, an effective market yield of 5 per cent per annum and a duration of 5.85 years. A 1 per cent increase in the interest rate, assuming no other changes, would reduce market value by 5.85 per cent.

Investment risk management and the use of derivatives

AIMCo uses several types of derivatives across most product areas to cost-effectively manage asset exposure, hedge interest rate and foreign currency risk, and enhance return. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows. Derivatives include:

- Bond and equity futures. These standardized exchange-listed contracts enable AIMCo to quickly create and dispose of broad market exposures at far less cost and with little or no risk of market disruption.
- Forwards. These over-the-counter contracts, negotiated by two parties, are used to hedge foreign currency and interest rate risk.
- Swaps. These over-the-counter contracts involve the exchange of two streams of cash flows based on a notional amount. They are used to obtain or change portfolio interest rate, currency and market value exposures without having to directly sell or purchase the underlying asset.
- Options. These over-the-counter equity option contracts offer the right, but not the obligation, to buy or sell shares at a set price during a set period. They enable AIMCo to adjust exposures on certain securities without directly purchasing or selling the underlying security.

ASC's proportionate share of the notional amounts and fair value of these derivatives at March 31, 2010 are:

	Maturity (Years)			2010		2009	
	Under 1	1 to 3	Over 3	Notional	Net Fair	Notional	Fair
				Amount	Value (i)	Amount	Value (i)
	(Per cent)			(\$ Thousands)		(\$ Thousands)	
Futures contracts	–	–	–	\$ 332	\$ 18	\$ 2,333	\$ 461
Forward foreign exchange contracts	–	–	–	737	22	533	(15)
Equity and bond index and option swap contracts	96	4	–	3,589	70	3,301	50
Cross-currency interest rate and interest rate swaps	19	42	39	3,385	176	4,540	(209)
Credit default swap contracts	30	38	32	18,660	(145)	31,536	(422)
				\$ 26,703	\$ 141	\$ 42,243	\$ (135)

(i) Current credit exposure is represented by the replacement cost of all outstanding contracts in favourable position (positive fair value).

Quarterly Results Summary

	F2010				F2009			
	Q4 (Jan-Mar)	Q3 (Oct-Dec)	Q2 (July-Sept)	Q1 (Apr-June)	Q4 (Jan-Mar)	Q3 (Oct-Dec)	Q2 (July-Sept)	Q1 (Apr-June)
<i>Revenues</i>								
Fees & other	\$ 15,446	\$ 3,938	\$ 4,613	\$ 4,806	\$ 13,267	\$ 3,178	\$ 3,850	\$ 6,046
Investment income	906	160	1,331	1,533	(1,347)	(2,146)	(589)	848
	16,352	4,098	5,944	6,339	11,920	1,032	3,261	6,894
<i>Expenses</i>								
Salaries & benefits	5,234	4,831	4,695	4,741	4,880	4,298	4,327	4,512
Other	2,722	2,332	1,861	1,976	2,805	1,975	1,876	1,844
	7,956	7,163	6,556	6,717	7,685	6,273	6,203	6,356
Net income (loss)	\$ 8,396	\$ (3,065)	\$ (612)	\$ (378)	\$ 4,235	\$ (5,241)	\$ (2,942)	\$ 538
Investments	\$ 30,749	\$ 29,861	\$ 29,710	\$ 28,395	\$ 28,826	\$ 30,209	\$ 34,874	\$ 35,487
Cash	\$ 11,343	\$ 3,224	\$ 5,944	\$ 7,319	\$ 8,188	\$ 1,607	\$ 1,713	\$ 3,460
Restricted cash	\$ 280	\$ 191	\$ 191	\$ 191	\$ 190	\$ 245	\$ 242	\$ 241

Quarterly Variance Analysis

Fee revenue Quarterly fee revenue is variable because the timing of fee-related filings varies among the reporting issuer population and certain fee revenue fluctuates with market activity. Further, annual registration renewal fees of \$7.7 million (\$7.7 million in F2009) are received in January and result in increased fourth quarter fee revenue each year.

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Expenses Salary and benefit costs increased in the fourth quarter because of increased staffing, accelerated payment of federal pension and employment insurance deductions and determination of final variable incentive compensation amounts. Fourth quarter registration renewal fees for Investment Industry Regulatory Organization of Canada (IIROC) registrants are subject to external administration costs of approximately \$700,000 that increase fourth quarter costs. Other expenses vary from quarter to quarter because of timing variability. For example, professional services for litigation support depend on the nature and progress of investigations and technology project timing depends on resource availability.

Contractual Obligations

Commitments to outside organizations with respect to contracts in place as at March 31, 2010 amounted to \$58 million (\$64 million in F2009). Commitments include the lease of premises to March 31, 2025 and rental of office equipment. A 15-year lease of premises commencing December 2010 was added in 2009. These commitments become expenses of the ASC when the terms of the contracts are met.

(\$ Thousands)

2010–11	\$	3,052
2011–12		2,605
2012–13		2,647
2013–14		2,691
2014–15		2,737
Thereafter		44,237
Total	\$	57,969

The ASC also has contractual commitments for a supplemental pension plan maintained for certain senior executives. Payment amounts are dependent on the future decisions of plan participants and are not included in the summary of contractual obligations because they are recorded as liabilities.

Financial Instruments

The ASC's financial instruments include cash, funds held for others, accounts receivable, restricted cash, investments, accounts payable and accrued liabilities, accrued vacation and benefit liabilities and a lease inducement. AIMCo manages investments that include derivative contracts for effective investment risk and return management. Details of these financial instruments are described in the Investment section of the MD&A and in Notes 1, 2 and 4 of the ASC's financial statements.

Related-Party Transactions

The ASC is related through common ownership to all provincial government ministries, agencies, boards, commissions and crown corporations. The ASC conducted all transactions with these entities as though they were unrelated parties and recorded transaction costs of \$35,000 (\$32,000 in F2009) in administration expense primarily for postage and investment management services.

National Filing Systems

CDS Inc. (CDS) operates the System for Electronic Document Analysis and Retrieval (SEDAR), National Registration Database (NRD) and System for Electronic Disclosure by Insiders (SEDI) systems on behalf of the CSA under

various operating agreements. These systems enable electronic filings by issuers, registrants and insiders. Approximately 86 per cent (88 per cent in F2009) of the ASC's fee revenue is collected through the SEDAR and NRD systems. CDS also collects fees from filers to fund the operation of the systems. CDS has backup and disaster recovery processes for these systems that are tested annually and confirmed in annual audit reports of system control processes.

The ASC, as one of the operating agreement signatories, commits to pay CDS up to 11.7 per cent of any shortfall from approved system operating costs that exceed revenues. Alternatively, CDS must pay revenues to CSA in excess of system operating costs (surplus). The surplus is not divisible; the CSA Principal Administrators (BCSC, ASC, OSC and AMF) own it as a group.

Funds in trust CDS has accumulated system operating surpluses since inception and interest earned that totalled \$49,135 for F2010 (\$35,188 in F2009). This amount is held in trust by the Ontario Securities Commission. The CSA principal administrators, including the ASC, have agreed that surplus amounts can only be used to offset any shortfall in revenues, develop or enhance the systems, and reduce fees charged to users. The CSA has initiated a systems renewal project designed to update and replace the major CSA systems, commencing with SEDAR. Preliminary design commitments with external information technology specialists are less than \$1.0 million for F2011. Accumulated surpluses held in trust will fund future project expenditures.

International Financial Reporting Standards (IFRS)

The ASC reports financial results under Canadian generally accepted accounting principles for the public sector. The adoption of IFRS reporting for the public sector was clarified following a 2009 public review and comment process by the Public Sector Accounting Board. The ASC is an "other government organization" and is permitted to self-select either IFRS accounting or public sector accounting. The ASC has decided not to adopt IFRS so as to maintain consistency with the accounting standards of the Government of Alberta.

Risk Management Initiatives

Business continuity The ASC has emergency response plans and processes in place and maintains information technology systems in a secure off-site environment with backup and recovery capability that is subject to annual audit. Should this facility fail, the ASC has backup capability within its own offices that is tested regularly. Remote access capability exists to all critical ASC systems. This access enables ASC staff to continue critical information technology supported work within four hours if ASC offices are not accessible.

Risk assessment and mitigation Risks to the effective functioning of the ASC include disruption or loss of computing systems, ineffective crisis management or a loss of public confidence in the ASC. The ASC believes that existing business processes are well designed to minimize these risks. During F2010, the ASC reviewed and updated its risk register, identified risk responses, identified key risk mitigation processes and tested these processes for effectiveness. The review concluded that adequate controls exist, are operational and minimize risk.

Ministerial Budget Approval

On November 15, 2003, Alberta's Minister of Finance and Enterprise entered into a Memorandum of Understanding (MOU) with the ASC that outlines the ongoing roles, responsibilities and accountability relationships between the two parties. Significant MOU financial requirements include Ministerial approval of annual ASC budgets and any subsequent changes that materially modify the budget and quarterly reporting to the Minister of actual financial results and budget updates. During the current year, in collaboration with the Ministry of Finance and Enterprise, the ASC prepared a Mandate and Roles Document as required by the *Alberta Public Agencies Governance Act*.

Upon execution by the Minister and the Chair and CEO of the ASC, the Mandate and Roles Document will replace the MOU, and it includes similar financial reporting terms and conditions as the MOU.

Fiscal 2011 Outlook and Assumptions

Revenues The F2011 budget revenues of \$27.8 million assume fee increases of \$1.8 million as capital market activity returns to pre-recession norms. Investment income forecasts of \$1.4 million assume investment returns of 5 per cent for bonds and 7 per cent for equities. A contingency is available and could be used to offset revenue shortfalls, if required.

Expenses Expenses are budgeted at \$36.5 million, an increase of \$8.1 million over F2010 actual expenses of \$28.4 million. The projected increase includes:

- annual compensation and variable incentive compensation adjustments; additional staff, primarily for Market Regulation, Enforcement and Administration; and reduced vacancies of 7 positions, totalling \$3.7 million;
- a 5 per cent contingency provision of \$1.8 million; and
- \$2.0 million, for a period of rent overlap during office relocation and related relocation expenses.

Loss The ASC forecasts an operating loss of \$8.6 million that assumes full use of the \$1.8 million contingency and limited revenue growth. Actual experience over the last seven years has consistently resulted in under-expenditure primarily due to professional staff vacancies and no requirement for the use of the contingency.

Liquidity and cash flow The ASC operates primarily on a cash basis. Cash requirements for F2011 are estimated at \$11.2 million. Cash is available from existing cash and investment balances.

Risks and Uncertainties

Budgets for F2011 are based on the ASC's experience and assessment of historical and future trends, and the application of key assumptions relating to future events that include: fee income recovery as capital markets return to historic activity levels, modest investment income of 5 per cent for bonds and 7 per cent for equities, a 3 per cent staff vacancy rate, inflationary salary increases, and specific project costs for information technology, training and recruitment. Factors that could cause actual results to differ materially include:

- capital market volatility and the impact on fees paid in connection with the distribution of securities and investment income;
- business plan changes and their impact on cost assumptions; and
- disruption of CDS fee processing that delays fee receipts at ASC's year end.

National Regulator

As described in the Chair's message, uncertainty exists with respect to the potential financial implications for the ASC in the event that a national securities regulator (NSR) is established. Unless and until the constitutionality of the federal proposal for an NSR is determined, the statutory and administrative processes for the ASC's interaction with an NSR are uncertain and the ASC cannot forecast resource requirements. The legislation and resulting processes may not be determined until mid-2010 or later. Regardless of the outcome of the determination, the ASC would continue to support relationships with other Canadian securities regulators (NSR or otherwise) that minimize additional costs and administrative burden on Alberta registrants and issuers.

MANAGEMENT'S REPORT

The financial statements included in this Annual Report are the responsibility of management and have been approved by the Members of the Commission. These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP) for the public sector. Financial information contained elsewhere in this Annual Report is consistent with the financial statements. The Auditor General of Alberta has examined the financial statements. The ASC's Audit Committee meets with management and with the Auditor General to review issues relating to audit plans and outcomes, internal control, accounting policy and financial reporting. The Audit Committee reports its findings to the Commission Members for their consideration in approving the financial statements.



William S. Rice, Q.C.
Chair and Chief Executive Officer



David C. Linder, Q.C.
Executive Director