LET RIGHT PREVAIL

The Law Society of Upper Canada | Barreau du Haut-Canada

2007

Annual Report Financial Statements

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THE LAW SOCIETY OF UPPER CANADA

Annual General Meeting, 2008

Wednesday, May 7, 2008

at 5:15 p.m.

Osgoode Hall, Toronto

ORDER OF BUSINESS

- Minutes of the previous Annual General Meeting
- Report of the work of the Society and the committees of Convocation
- Presentation of the audited financial statements
- Matters of professional interest that are related to the work of the Society

2007 ANNUAL REPORT

Financial Statements

Contents

GENERAL FUND

Management Discussion and Analysis

The Law Society of Upper Canada's General Fund is composed of a number of funds included in these financial statements. The Unrestricted Fund is the Society's operating fund representing the bulk of its revenues and expenses. There are a number of special purpose funds restricted by Convocation. These are the Paralegal, Capital Allocation, Invested in Capital Assets, County Libraries, Special Projects, Repayable Allowance, Endowment and the Working Capital Reserve funds. Separate financial statements are prepared for the Compensation Fund, LibraryCo Inc. and the Errors and Omissions Insurance Fund.

The Law Society of Upper Canada's (the "Society's") success in fulfilling its mandate is not measurable in terms of profits or the creation of members' equity value, but rather through qualitative, non-financial results discussed in the Performance Highlights section of the Annual Report. Nevertheless, management does have financial stewardship responsibilities, which this report references within the broader context of fulfilling the mandate. In addition, a number of financial factors are common to all activities highlighted in this report, including close control of operating expenditures.

Accounting Standards Change – Financial Instruments

The Canadian Institute of Chartered Accountants introduced a new accounting standard for reporting financial instruments this year. Under this requirement, the Fund's portfolio investments are reported at fair (market) value.

As required by this standard, the nature and intent of the long-term investment portfolio was reviewed and the investments were classified as "held for trading". This classification method appropriately discloses the Society's resources and funds available for distribution.

Selection of the held for trading classification requires that all gains and losses, realized or unrealized, be reported as income of the period. As a transitional step, accumulated unrealized gains of $249,000 as at January 1, 2007 are reported on the Statement of Changes in Fund Balances.

Paralegal Fund

A separate fund to track activity related to paralegal regulation has been set up.

Convocation approved the paralegal startup budget in February 2007. The budget projected a deficit in the fund of $2.4 million at the end of 2007. The actual number of grandparent and transitional applicants exceeded the conservative estimate used in the startup budget and it is expected that the actual deficit of $822,000 will be eliminated in the first quarter of 2008 with the realization of examination fee revenue. In 2008, Convocation approved an operating budget for the ongoing regulation of paralegals.

Results of Operations

A summary of operations for the Society's General Fund is set out below with further details provided in the rest of the analysis.

	2007 $000s	2006 $000s	Explanation
Total revenues	65,697	59,213	Annual fees increased and $1.2 million was received from the Law Foundation of Ontario as a grant for CanLII.
Total expenses	66,087	58,645	Planned increases in expenses in most departments, particularly Regulation and Paralegal startup.
(Deficit) / Surplus for the year	(390)	568	The deficit is primarily the result of the amortization of capital assets. Fee revenue is not raised to cover the cost of amortization.

Balance Sheet

Cash and short-term investments

Cash and short-term investments of $20.2 million have increased by $5 million from 2006 because more 2008 annual fees were received from lawyers before January 1, 2008, as well as examination fees were paid by paralegal grandparent applicants for exams to be written in 2008.

Portfolio investments

Portfolio, or long-term investments increased slightly to $10.5 million from $9.7 million and comprise North American equities (12%) and Canadian fixed income investments (88%). The portfolio is managed in compliance with the General Fund's investment policy. Fixed income investments include a diversified mix of government, provincial and corporate bonds with an investment rating of BBB or better. Equity investments include a diversified mix of equities listed on the major U.S. and Canadian stock exchanges.

As noted above, in 2007, portfolio investments are shown at market value compared to valuation at cost in 2006. Unrealized losses of $414,000 at December 31, 2007 are included in investment income.

Capital assets

Capital assets are recorded at cost and amortized over their useful lives according to the Society's capital asset policy. Capital asset additions are typically financed from the Society's Capital Allocation Fund.

The decrease in capital assets from $22.9 million to $21.5 million reflects the amortization for the period offset by $1.7 million in additions, for such projects as upgrading the women benchers' robing room, various mechanical and electrical upgrades, as well as continued expansion of the Society's regulatory case management system.

Deferred revenue

Deferred revenue of $8.9 million has increased from $5.5 million, representing fees paid in advance. The balance is made up of $6.7 million of 2008 lawyer fee revenue and $2.2 million of paralegal grandparent examination fees.

Unclaimed trust funds

Unclaimed trust funds continue to increase reaching $1.7 million in 2007 (2006: $1.4 million). These are trust monies turned over to the Society by licensees who are unable to locate or identify the clients to whom the monies are owed. By statute, the Society administers these funds, in perpetuity, with the net income from the funds transferred to the Law Foundation of Ontario annually. The Society is reimbursed for expenses associated with the administration of unclaimed trusts to a limit of the annual income earned on funds held.

Other trust funds

Included in the notes to the financial statements, but not the balance sheet, is a reference to other trust funds held by the Society. The Society administers client funds for licensees under voluntary or court-ordered trusteeships. These funds and matching liabilities are not reflected on the Balance Sheet as they are held temporarily and with a restricted administrative mandate. Money paid to the Society is held in trust until it is repaid to the clients or transferred to Unclaimed Trust Funds. At the end of 2007, total funds held in trust amounted to $1.2 million (2006: $1.2 million). The volume and value of balances depend on trusteeships at the time.

Statement of Revenues and Expenses

Revenues

Lawyers' fees have increased from $40.1 million in 2006 to $44.1 million in 2007 with an increase of approximately 825 lawyers and a fee increase of $92 per lawyer.

The major components of Professional Development and Competence ("PD&C") revenues are the lawyer's licensing process and post-call education programs. PD&C revenues increased from $9.3 million to $9.7 million primarily because the licensing process fee increased by $150 to $2,750 per candidate.

Included in investment income is a $3.25 million (2006: $3 million) transfer of investment income from the Errors and Omissions Insurance Fund assisting the increase in total investment income to $4.4 million from $4.1 million.

Other revenues have increased approximately $1.9 million over 2006, primarily attributable to the $1.2 million in funding for CanLII expenses from the Law Foundation. Also in other revenues are a variety of items such as lawyer referral service fees, royalties, catering revenues, litigation and enforcement cost recoveries, charges for fee payment plans and other miscellaneous revenues. Application fees for paralegals are included in other revenue in the restricted funds.

Expenses

Total net expenses of $66.1 million have increased from $58.6 million in 2006, with increases generally spread across most departments although the biggest individual departmental changes were in regulation and the new expenses associated with paralegals.

Professional Development & Competence expenses

PD&C expenses of $14.6 million decreased marginally attributable to:

- the timing of staffing vacancies in the Library
- small reductions in some program costs in Continuing Legal Education
- reductions in exam administration, materials production and instruction expenses as the streamlined licensing process in its second year transitioned from the bar admission course. The Skills & Professional Responsibility program was reduced from five weeks to four weeks.

The only notable expense increase arose in the expanded practice review program.

Professional Regulation expenses

Direct Professional Regulation expenses increased from $13.3 million in 2006 to $15.4 million in 2007.

The increased costs include additional staff – two in Investigations, three in Complaints Resolution, four in Discipline and two in Trustee Services. These increases are driven directly by the increasing volume and complexity of complaints including mortgage fraud.

The other significant incremental expense in 2007 was an increase in outside counsel fees. The increasing costs of outside counsel in 2006 and 2007 are generally attributable to a number of sensitive or unusual matters, including the following:

- the accelerated use of experts on mortgage fraud cases
- potentially high profile matters involving complex issues
- highly contested unauthorized practice matters
- some matters assigned to outside counsel deemed especially significant to our role as a regulator.

Administrative expenses

Administrative expenses of $8 million, increased from $7.1 million in 2006, comprise Finance, Information Systems and Human Resources departmental expenses. The increase was spread across all three areas as operations of the Law Society are enhanced and services expanded in line with the cumulative increase in licensees over recent years. For instance, in Information Systems the case management system was expanded, and Human Resources experienced increased recruitment and training costs.

Other expenses

Other expenses include bencher-related payments (total increase in expense reimbursements, functions and remuneration of $370,000), payments to the Federation of Law Societies and the virtual reference library CANLII (funding increased by $200,000 in 2007), insurance and audit fees, catering costs, payments to the County & District Law Presidents' Association, the Ontario Lawyers' Assistance Program, Pro Bono Law Ontario, the Advocates Society, the Ontario Law Commission (new support of $100,000 in 2007), severance payments and other miscellaneous expenses of the Society. Total other expenses of $6.1 million have increased from $5.3 million in 2006 for the reasons noted above.

Amortization

Amortization of $3.1 million has increased from the $2.4 million in 2006 with the amortization of the renovation costs of the north wing of Osgoode Hall over a ten-year period beginning in 2007.

Paralegal Fund

A separate fund to track activity related to paralegal regulation has been set up. During 2007, fees totaling $1.1 million were recognized and $1.9 million was expended, primarily on application processing and competence initiatives such as exam development.

Statement of Changes in Fund Balances

Unrestricted Fund

In addition to the previous discussion on operational revenues and expenses, several other items impact the Society's Unrestricted Fund balance.

The new disclosure requirements relating to financial instruments are being implemented in 2007. This means unrealized gains on investments at the beginning of 2007 of $249,000 are separately identified on the Statement of Changes in Fund Balances in the Unrestricted Fund and portfolio investments are shown at market value on the Balance Sheet. Changes in unrealized gains / losses during 2007 are included in investment income.

There are several interfund transfers between the Unrestricted Fund and the Society's Restricted Funds.

- Transfer to Special Projects of $89,000. This is unused 2007 budgeted funds for the McMurtry Gardens of Justice and the Task Force on the Retention of Women in Private Practice transferred to Special Projects for expenditure in 2008.
- Asset capitalization of $35,000. This represents the acquisition of a capital asset through the Unrestricted Fund. The expenditure qualifies as a capital asset under the Society's accounting policies and is therefore reported as a capital addition in the Invested in Capital Assets Fund.
- Transfer to county libraries of $119,000. Annual fees raised for county libraries were under budget by $119,000 as a result of net full fee paying equivalent membership increasing less than the budgeted 1,000. This transfer eliminates what would otherwise have been a deficit in the County Libraries Fund. A similar transfer of $147,000 was made in 2006.
- Transfer to Capital Allocation Fund of $1.2 million. This represents the grant payment from the Law Foundation of Ontario provided for the Society's contribution to CANLII in 2005 and 2006. In return, the Society agreed to refund to the Law Foundation the $1.2 million grant it made to the Society for the acquisition of a building in Ottawa that the Society disposed of in 2006. The Society recorded an expense of $600,000 in each of 2006 and 2007 in the Capital Allocation Fund.
- Transfer to repayable allowance fund of $100,000. This is an annual transfer of funds raised through the lawyers' licensing process to provide funding for repayable allowances.

Restricted Funds

A **Paralegal Fund** has been set up to track activity related to paralegal regulation. During 2007, fees totaling $1.1 million were received and $1.9 million was expended, primarily on application processing and competence initiatives such as exam development. The balance at December 31, 2007 was a deficit of $822,000. The deficit will be eliminated in 2008 with the recognition of examination and licensing application fee revenue from paralegal grandparent applicants.

The **Capital Allocation Fund** is the funding source for approved capital projects. The fund is augmented on an annual basis by a portion of licensee fees (currently $75, unchanged for six years) dedicated to capital funding.

Expenditures capitalized and reported as capital assets are maintained in the **Invested in Capital Assets Fund** which has decreased to $21.5 million as amortization for the year outstripped the value of assets capitalized.

In 2007, the $7.1 million in **County Library** expenses show a small increase from previous years. The Society levied $224 per lawyer, then collected and remitted these funds for county library purposes to LibraryCo Inc. on a basis determined when the annual budgets were approved.

In 2007, the Law Society's **Repayable Allowance** program provided $83,000 to 30 students (2006: $94,000 to 28 students).

The Society administers the J. Shirley Denison **Endowment Fund** established to provide relief and assistance to lawyers, students and former members. During the year, $47,000 was paid to 11 applicants (2006: $53,000 to 15 applicants).

The **Special Projects Fund** is maintained to ensure that financing is available for ongoing projects that have been approved, funded but not completed in the fiscal year. The 2007 year-end balance is $210,000 primarily to fund the Licensing & Accreditation Task Force, the McMurtry Gardens of Justice and the Retention of Women in Private Practice Working Group.

The **Working Capital Reserve** of $7.9 million is unchanged since 2002 at a level equivalent to two months of the Society's operating expenses. Since that time, operating expenses have increased so that the reserve now represents 1.6 months of operating expenses.

GENERAL FUND

Auditors' Report

To the Members of The Law Society of Upper Canada

We have audited the balance sheet of The Law Society of Upper Canada – General Fund as at December 31, 2007 and the statements of revenues and expenses, changes in fund balances and of cash flows for the year then ended. These financial statements are the responsibility of the Society's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statement present fairly, in all material respects, the financial position of the General Fund as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Licensed Public Accountants
February 22, 2008

GENERAL FUND

Balance Sheet

Stated in thousands of dollars
As at December 31

	2007	2006
Assets		
Current assets		
Cash	**6,059**	3,937
Short-term investments	**14,106**	11,268
Cash and short-term investments	**20,165**	15,205
Accounts receivable (note 4)	**1,400**	1,646
Prepaid expenses	**266**	196
Total current assets	**21,831**	17,047
Portfolio investments (note 5)	**10,488**	9,751
Capital assets (note 6)	**21,505**	22,880
Total Assets	**53,824**	49,678
Liabilities and Fund Balances		
Current liabilities		
Accounts payable and accrued liabilities	**6,628**	5,995
Deferred revenue	**8,937**	5,518
Total current liabilities	**15,565**	11,513
Unclaimed trust funds (note 7)	**1,651**	1,416
Total Liabilities	**17,216**	12,929
Fund Balances		
Unrestricted fund	**3,538**	1,915
Restricted funds		
Paralegal	**(822)**	–
Capital allocation	**3,917**	3,546
Invested in capital assets	**21,505**	22,880
Repayable allowance	**69**	52
Endowment	**216**	253
Special projects	**210**	128
Working capital reserve	**7,975**	7,975
Total Fund Balances	**36,608**	36,749
Total Liabilities and Fund Balances	**53,824**	49,678

See accompanying notes

On behalf of Convocation

Gavin MacKenzie

Treasurer

Beth Symes

Chair of Audit Committee

GENERAL FUND

Statement of Revenues and Expenses

Stated in thousands of dollars for the year ended December 31

	2007			2006		
	Unrestricted fund	**Restricted funds**	**Total**	Unrestricted fund	Restricted funds	Total
Revenues						
Lawyers' fees	**34,662**	**9,404**	**44,066**	31,086	9,007	40,093
Professional development and competence	**9,747**	**–**	**9,747**	9,345	–	9,345
Investment income (note 3)	**4,421**	**–**	**4,421**	4,145	12	4,157
Other (note 9)	**6,233**	**1,230**	**7,463**	4,813	805	5,618
Total revenues	**55,063**	**10,634**	**65,697**	49,389	9,824	59,213
Expenses						
Professional regulation	**15,364**	**–**	**15,364**	13,283	–	13,283
Professional development and competence	**14,584**	**–**	**14,584**	14,696	–	14,696
Administrative	**8,086**	**–**	**8,086**	7,135	–	7,135
Other (note 10)	**6,147**	**–**	**6,147**	5,333	–	5,333
Client service centre	**4,252**	**–**	**4,252**	3,947	–	3,947
Facilities	**3,543**	**–**	**3,543**	3,180	–	3,180
Policy and legal services	**1,782**	**–**	**1,782**	2,051	–	2,051
Communications	**1,109**	**–**	**1,109**	1,117	–	1,117
Equity	**814**	**–**	**814**	795	–	795
Tribunals	**747**	**–**	**747**	660	–	660
Paralegal fund	**–**	**1,899**	**1,899**	–	–	–
Capital allocation fund	**–**	**1,628**	**1,628**	–	1,104	1,104
Invested in capital assets – amortization	**–**	**3,113**	**3,113**	–	2,416	2,416
County libraries fund	**–**	**7,164**	**7,164**	–	6,801	6,801
Repayable allowance fund	**–**	**83**	**83**	–	94	94
Endowment	**–**	**47**	**47**	–	53	53
Special projects fund	**–**	**7**	**7**	–	2	2
Total expenses	**56,428**	**13,941**	**70,369**	52,197	10,470	62,667
Less: Expenses allocated to Compensation Fund (note 1)	**(4,282)**	**–**	**(4,282)**	(4,022)	–	(4,022)
Net expenses	**52,146**	**13,941**	**66,087**	48,175	10,470	58,645
Surplus (deficit)	**2,917**	**(3,307)**	**(390)**	1,214	(646)	568

See accompanying notes

GENERAL FUND

Statement of Changes in Fund Balances

Stated in thousands of dollars for the year ended December 31

	2007											2006
		RESTRICTED FUNDS										
	Unrestricted fund	Paralegal	Capital allocation	Invested in capital assets	County libraries	Repayable allowance	Endowment	Special projects	Working capital reserve	Total restricted funds	Total	Total
Fund balances, beginning of year	**1,915**	**–**	**3,546**	**22,880**	**–**	**52**	**253**	**128**	**7,975**	**34,834**	**36,749**	36,181
Unrealized gain on investments, beginning of year (note 2)	**249**	–	–	–	–	–	–	–	–	–	**249**	–
Adjusted fund balances, beginning of year	**2,164**	**–**	**3,546**	**22,880**	**–**	**52**	**253**	**128**	**7,975**	**34,834**	**36,998**	36,181
Revenues	**55,063**	**1,077**	**2,502**	**–**	**7,045**	**–**	**10**	**–**	**–**	**10,634**	**65,697**	59,213
Expenses	**52,146**	**1,899**	**1,628**	**3,113**	**7,164**	**83**	**47**	**7**	**–**	**13,941**	**66,087**	58,645
Surplus (deficit)	**2,917**	**(822)**	**874**	**(3,113)**	**(119)**	**(83)**	**(37)**	**(7)**	–	**(3,307)**	**(390)**	568
Interfund transfers												
Special projects	**(89)**	–	–	–	–	–	–	**89**	–	**89**	–	–
Asset capitalization	**(35)**	–	**(1,703)**	**1,738**	–	–	–	–	–	**35**	–	–
County libraries	**(119)**	–	–	–	**119**	–	–	–	–	**119**	–	–
Capital allocation	**(1,200)**	–	**1,200**	–	–	–	–	–	–	**1,200**	–	–
Repayable allowance	**(100)**	–	–	–	–	**100**	–	–	–	**100**	–	–
Total Interfund Transfers	**(1,543)**	–	**(503)**	**1,738**	**119**	**100**	–	**89**	–	**1,543**	–	–
Fund Balances, end of year	**3,538**	**(822)**	**3,917**	**21,505**	**–**	**69**	**216**	**210**	**7,975**	**33,070**	**36,608**	36,749

See accompanying notes

GENERAL FUND

Statement of Cash Flows

Stated in thousands of dollars for the year ended December 31

	2007	2006
Net inflow (outflow) of cash related to the following activities		
Operating		
General fund (deficit) surplus	**(390)**	568
Item not affecting cash:		
Amortization of capital assets	**3,113**	2,416
	2,723	2,984
Net change in non-cash operating items:		
Accounts receivable	**246**	351
Prepaid expenses	**(70)**	95
Accounts payable and accrued liabilities	**633**	(3,302)
Deferred revenue	**3,419**	(1,708)
Fund contribution – unclaimed trusts	**235**	150
Cash from (used in) operating activities	**7,186**	(1,430)
Investing		
Short-term investments (net)	**(2,838)**	3,065
Portfolio investments (net)	**(737)**	325
Unrealized gain on investments beginning of the year (note 2)	**249**	–
Capital asset additions	**(1,738)**	(2,235)
Proceeds on sale of assets held for resale	**–**	2,176
Cash (used in) from investing activities	**(5,064)**	3,331
Net inflow (outflow) of cash, during the year	**2,122**	1,901
Cash, beginning of year	**3,937**	2,036
Cash, end of year	**6,059**	3,937

See accompanying notes

GENERAL FUND

Notes to Financial Statements

Stated in whole dollars except where indicated
For the year ended December 31, 2007

1. Background

The Law Society of Upper Canada (the "Society") was founded in 1797 and incorporated in 1822 with the enactment of the *Law Society Act.* The *Law Society Act* was amended by the *Access to Justice Act,* which came into full effect on May 1, 2007, to legislate the regulation of paralegals by the Society.

The Society exists to govern legal service providers in the public interest by ensuring that the people of Ontario are served by lawyers and paralegals who meet high standards of learning, competence and professional conduct and by upholding the independence, integrity and honour of the professions, for the purpose of advancing the cause of justice and the rule of law. The governing body of the Society, which is known as Convocation, carries out this mandate. Convocation comprises benchers and the Treasurer, who presides over Convocation.

These financial statements present the financial position and operations of the Law Society of Upper Canada – General Fund, which is composed of a number of funds. The Unrestricted Fund is the Society's operating fund, representing the majority of its revenues and expenses. There are a number of special purpose funds restricted by Convocation. These are the Capital Allocation, Invested in Capital Assets, County Libraries, Special Projects, Repayable Allowance, Endowment, Working Capital Reserve and Paralegal funds. The Society's annual fees are based on the financial requirements of the restricted and unrestricted funds.

The Society is not subject to income or capital taxes because it is a not-for-profit corporation.

The General Fund financial statements do not purport to present all of the assets and liabilities under the control of the Society. Separate financial statements have been prepared for the following related entities, which have not been consolidated into the General Fund statements.

Compensation Fund

The Society maintains the Compensation Fund pursuant to section 51 of the *Law Society Act* to relieve or mitigate loss sustained by any person in consequence of dishonesty on the part of a licensee, in connection with the licensee's professional business or in connection with any trust of which the licensee was a trustee. Licensees' annual fees and investment income finance the Compensation Fund. The Compensation Fund reports fees collected by the General Fund as revenues. The Compensation Fund reimburses the General Fund for certain administrative expenses, spot audit expense and a portion of the costs of operating the investigation and discipline functions of the Society. In 2007, these amounted to $4,282,000 (2006 – $4,022,000).

Errors & Omissions Insurance Fund and Lawyers' Professional Indemnity Company

The Society provides professional liability insurance to lawyers through the Errors and Omissions Insurance Fund ("E&O Fund") and the Lawyers' Professional Indemnity Company ("LAWPRO"). The E&O Fund was originally set up in the Society's accounts to record insurance claims and expenses and related levies and their investment. LAWPRO took over underwriting the program commencing in 1990. LAWPRO, a wholly owned subsidiary of the Society, was incorporated in 1990 and is licensed to provide lawyer's professional liability and title insurance. On an annual basis the E&O Fund provides the General Fund with income derived from its surplus earnings. This income, reported as Investment Income of the General Fund, amounted in 2007 to $3,250,000 (2006 – $3,000,000). LAWPRO paid $186,000 (2006 – $238,000) primarily for shared information systems and governance costs.

LibraryCo Inc.

LibraryCo Inc., a wholly owned, not-for-profit subsidiary of the Society, was established to develop policies, procedures, guidelines and standards for the delivery of county law library services and legal information across Ontario and to administer funding on behalf of the Society. LibraryCo Inc. was initially incorporated under the *Business Corporations Act* of Ontario in 2001. In June 2007, the corporate structure was amended, whereby 25 of the 100 Special shares previously held by the County and District Law Presidents' Association ("CDLPA") were issued to the Toronto Lawyers Association ("TLA") for $25. The Society continues to hold all of the 100 Common shares. The Society may appoint up to four directors, CDLPA may appoint up to three directors and TLA may appoint one director.

The Society levies and collects funds for county and district law library purposes and transfers these funds to LibraryCo Inc. Convocation internally restricts these funds for use by county and district law libraries to carry out their annual operations and any special projects approved by Convocation.

The Society administers the operations of LibraryCo Inc. under an administrative services agreement signed in March 2007. The total amount billed by the Society was $410,000 (2006 – $82,000) for administrative services and certain other services and publications. Included in accounts receivable are amounts due to the Society of $43,000 (2006 – $16,000).

Law Society Foundation

The Law Society Foundation ("LSF"), a registered charity, was incorporated by Letters Patent in 1962. The objectives of the LSF are to foster, encourage and promote legal education in Ontario, provide financial assistance to licensing process candidates in Ontario, restore and preserve land and buildings of historical significance to Canada's legal heritage, receive gifts of muniments and legal memorabilia of interest and significance to Canada's legal heritage, maintain a collection of gifts of books and other written material for use by educational institutions in Canada, receive donations and maintain a fund for the relief of poverty by providing meals to persons in need. The Society provides facilities, administration, accounting, security and certain other services at no cost to the LSF.

The Law Foundation of Ontario

The Law Foundation of Ontario ("LFO"), a corporation without share capital established in 1974, was created to receive interest accruing on monies held in licensee's mixed trust accounts and to establish and maintain a fund to be used for the purposes of legal education and legal research, legal aid and the establishment, maintenance and operation of law libraries. For 2007, the LFO approved grants of $1,000,000 to the General Fund (2006 – $1,000,000) for the operation of the Licensing Process, $80,000 (2006 – $76,000) for legal heritage programs and $1,200,000 (2006 – nil) to assist the Law Society's funding of CanLII, an electronic law library.

2. Change in Accounting Policy

On January 1, 2007, the General Fund adopted the Canadian Institute of Chartered Accountants' ("CICA") revised standards on recognition and measurement and presentation of financial instruments for not-for-profit organizations. As required, the revised standards have been applied retrospectively as at January 1, 2007, without restatement of the comparative amounts.

Under the new standards for recognizing and measuring financial instruments, all financial assets are classified into one of the following four categories: held for trading, held to maturity, loans and receivables or available for sale. All financial liabilities are classified into one of the following two categories: held for trading or other financial liabilities.

The General Fund's financial assets and financial liabilities are classified and measured as follows:

Asset / Liability	Category	Measurement
Cash and short-term investments	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Portfolio investments	Held for trading	Fair value
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Unclaimed trust funds	Other financial liabilities	Amortized cost

Other amounts noted on the Balance Sheet such as prepaid expenses, capital assets and deferred revenue are not within the scope of the new accounting standards, as they are not financial instruments.

With the exception of portfolio investments, there was no change in the measurement of any of the General Fund's financial assets and liabilities. Compliance with the new accounting standards meant that at January 1, 2007 the measurement of portfolio investments changed from being recorded at cost, net of amortization of premiums and discounts, to fair value. The adoption of these new standards resulted in transitional adjustments which increased the opening fund balance and portfolio investments by $249,000. For other financial instruments, there was no impact on the Fund's opening balance sheet as a result of the application of these new accounting policies because there was no change in their measurement.

The General Fund has not entered into any derivative transactions. In addition, the General Fund does not have any embedded features in contractual arrangements.

3. Significant Accounting Policies

Basis of presentation

The financial statements have been prepared in accordance with the accounting standards for not-for-profit organizations published by the CICA using the restricted fund method of reporting revenues.

General Fund

The General Fund is composed of the Unrestricted Fund and a number of special purpose funds restricted by Convocation

The **Unrestricted Fund** accounts for the Society's program delivery and administrative activities. This fund reports unrestricted resources.

Restricted Funds

The **Paralegal Fund** records transactions related to the Society's regulation of paralegals. Convocation approved the paralegal startup budget in February 2007. During 2007, fees totaling $1,077,000 were received and $1,899,000 was expended, primarily on application processing and competence initiatives, such as exam development. The balance at December 31, 2007 was a deficit of $822,000 (2006 – nil). The deficit is expected to be eliminated in 2008 with the recognition of examination and licensing fee revenue.

The **Capital Allocation Fund** is maintained to provide a source of funds for the acquisition and maintenance of the Society's capital assets. These include buildings and major equipment including computers. Amounts of assets capitalized, according to the Society's capital asset policy, are transferred to the Invested in Capital Assets Fund. Expenditures not capitalized are expended in the Capital Allocation Fund. At December 31, 2007 the balance was $3,917,000 (2006 – $3,546,000).

The **Invested in Capital Assets Fund** records transactions related to the Society's capital assets, specifically acquisitions, amortization and disposals. At December 31, 2007 the balance was $21,505,000 (2006 – $22,880,000).

The **County Libraries Fund** records transactions related to the Society's support of county law libraries. As approved by Convocation, the fund accumulates fees for county library purposes which are remitted to LibraryCo Inc. At December 31, 2007 the fund balance was nil (2006 – nil).

The **Repayable Allowance Fund** provides candidates in the licensing process for lawyers with funding for tuition and living expenses and is based on a candidate's ability to repay the grant within a specified period of time following the candidate's non-participation in the licensing process. At December 31, 2007, the balance was $69,000 (2006 – $52,000).

The **Endowment Fund,** the J. Shirley Denison Fund, provides relief and assistance to lawyers, student lawyers and former members who find themselves in difficult financial circumstances. Contributions for endowments are recognized as revenue in the Endowment Fund. At December 31, 2007, the Endowment Fund balance was $216,000 (2006 – $253,000).

The **Special Projects Fund** is maintained to ensure that financing is available for ongoing special projects approved by Convocation. The balance at December 31, 2007 was $210,000 (2006 – $128,000).

The **Working Capital Reserve** is maintained to ensure adequate cash reserves for the continuous financing of the General Fund operations for up to two months. At December 31, 2007, the balance was $7,975,000 (2006 – $7,975,000).

Cash and short-term investments

Cash (bank balances and investments of less than 90 days' duration) and short-term investments (less than one year) are amounts on deposit and invested in short-term investment vehicles according to the General Fund's investment policy. They are subject to insignificant risk of a change in value. Investment income, except income earned on resources held for endowment, is retained in and reported by the Unrestricted Fund.

Portfolio investments

Portfolio investments are categorized as held for trading and are recorded at fair value. The General Fund manages financial risk associated with portfolio investments as summarized below.

- Currency risk. At year-end, 6% of the portfolio was invested in securities denominated in United States dollars. Under the General Fund's investment policy, foreign denominated bonds are not permitted, non-North American equities are not permitted and the range for equity holdings is between 5% and 20% of the portfolio.
- Interest rate risk. An analysis of maturity dates for the fixed income securities is set out below.

MATURITY	Interest Rate Range	2007	2006
2008-2012	4.5%-7.15%	**7,228,000**	5,917,000
2013 and beyond	3.96%-6.15%	**1,946,000**	1,899,000
Total		**9,174,000**	7,816,000

- Market risk is managed by the General Fund's investment policy which requires a diversified portfolio of government bonds, corporate bonds, and Canadian and United States equities meeting specified quality requirements.
- Credit risk. At year end, all long-term debt was rated A or better. Under the General Fund's investment policy, no more than 10% of the portfolio can be invested in bonds rated BBB.
- Liquidity risk. All securities are listed on the Toronto or New York stock exchanges and the General Fund has $20,165,000 in cash and short-term investments.

- Cash flow risk. No single instrument is individually significant to the future cash flows of the General Fund and investment income is not a primary source of revenue for the General Fund.

The total amount of the unrealized reduction in the fair value of portfolio investments recognized as a reduction of investment income for the year is $414,000.

Capital assets

Assets are capitalized and subject to amortization when they are determined to have a minimum useful life of three years and an acquisition cost of $10,000 for equipment, furniture and computers, $25,000 for computer software and $25,000 for building improvements. Capital assets are presented at cost net of accumulated amortization. For purposes of calculating the first year's amortization, all capital assets are deemed to be acquired, put into service, or completed on July 1st. Amortization is charged to expenses on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings	30 years
Building improvements	10 years
Furniture, equipment and computer hardware and software	3 to 5 years

Revenue recognition

Licensee fees are recognized in the year to which they relate if the amount can be reasonably estimated and collection is reasonably assured. Accordingly, fees for the next fiscal year received prior to December 31 have been deferred and are recognized as revenue in the next year.

Professional development and competence, realized investment income and other revenues are recognized when receivable if the amounts can be reasonably estimated and collection is reasonably assured. Capital gains/losses are recognized with changes in the fair value of financial instruments.

Collections

The General Fund owns a collection of legal research and reference material as well as a collection of portraits and sculptures. The cost of additions to the collections is expensed as incurred. No value is recorded in these financial statements for donated items.

Volunteer services

Convocation, consisting of the Treasurer and benchers, governs the Society. Benchers may be elected by lawyers, appointed by the provincial government or have ex-officio status by virtue of their office or past service as elected benchers or Treasurers. In addition, under the *Access to Justice Act*, the provincial government appointed five paralegals to the Paralegal Standing Committee, two of whom are also benchers. The province remunerates their appointed individuals. Elected and ex-officio benchers are only eligible for remuneration after contributing 26 days of voluntary time. The work of the Society is also dependent on other voluntary services by lawyers and paralegals. No value has been included in these financial statements for gratuitous services.

Measurement uncertainty

The preparation of the financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingencies at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

4. Accounts Receivable

Included in accounts receivable are certain related parties amounts as follows:

	2007	2006
The Law Foundation of Ontario	**289,000**	293,000
LibraryCo Inc.	**43,000**	16,000

5. Portfolio Investments

($000s)	**2007 Fair value**	2006 Book value	2006 Fair value
Debt Securities	**9,174**	7,865	7,816
Canadian Equities	**660**	743	961
United States Equities	**654**	1,143	1,228
	10,488	9,751	10,005

6. Capital Assets

($000s)	**2007 Cost**	**2007 Accumulated amortization**	**2007 Net**	2006 Net
Land and buildings	**25,395**	**17,768**	**7,627**	8,179
Building improvements	**18,693**	**5,869**	**12,824**	13,307
Furniture, equipment and computer hardware and software	**5,967**	**4,913**	**1,054**	1,394
	50,055	**28,550**	**21,505**	22,880

7. Unclaimed Trust Funds

Section 59.6 of the *Law Society Act* permits a licensee who has held money in trust for or on account of a person for a period of at least two years to apply in accordance with the by-laws for permission to pay the money to the Society. Money paid to the Society is held in trust in perpetuity for the purpose of satisfying the claims of the persons who are entitled to the capital amount. Subject to certain provisions in the Act enabling the General Fund to recover its expenses associated with maintaining these funds, net income from the money held in trust shall be paid to the Law Foundation of Ontario. Unclaimed money held in trust amounts to $1,651,000 (2006 – $1,416,000).

8. Other Trust Funds

The Society administers client funds for licensees under voluntary or court-ordered trusteeships. These funds and matching liabilities are not reflected on the Balance Sheet. Money paid to the Society is held in trust until it is repaid to the clients or transferred to the Unclaimed Trust Funds. At December 31, 2007, total funds held in trust amount to $1,164,000 (2006 – $1,168,000).

9. Other Revenue

Included in other revenue are income from royalties, catering, the Lawyer Referral Service, specialist certification and other miscellaneous revenues.

10. Other Expenses

Included in other expenses are payments to the Federation of Law Societies, County and District Law Presidents' Association, insurance, professional fees, termination payments, catering, other corporate expenses and governance related disbursements. The total remuneration of elected and ex-officio benchers during the year was $357,000 (2006 – $159,000). The Treasurer's honorarium for the year was $99,000 (2006 – $97,000). The total value of bencher expenses reimbursed was $572,000 (2006 – $489,000).

11. Pension Plan

The Society maintains a defined contribution plan for all eligible employees of the Society. Law Society employees can choose matching employee and employer contributions between 1% and 6% of annual earnings, with the exception of designated employees for whom the Society contributes 12% of annual earnings, up to the maximum deduction allowed by the Canada Revenue Agency. The General Fund pension expense in 2007 amounted to $1,443,000 (2006 – $1,356,000).

12. Commitments

The Society is committed to monthly lease payments for property under leases having various terms up to April 2010. Aggregate minimum annual payments to the expiry of the leases are as follows:

2008	620,000
2009	651,000
2010	220,000
Total	1,491,000

In 2007, the Society made a commitment in the amount of $100,000 spread equally over 2007, 2008 and 2009 to the Ontario Gardens of Justice to support the sculpture collection. The first installment has been included in the Special Projects Fund. The Society also made a five-year commitment, commencing in 2007, in the annual amount of $100,000 to the Ontario Law Commission to support its operations.

13. Contingent Liabilities

A number of claims or potential claims are pending against the Society. It is not possible for the Society to predict with any certainty the outcomes of such claims or potential claims. Management is of the opinion that based on the information presently available, it is unlikely that any liability, to the extent not covered by insurance or inclusion in the financial statements, would be material to the General Fund's financial position.

14. Guarantees

In the normal course of business, the Society has entered into agreements that meet the definition of a guarantee, including indemnities in favour of third parties, such as confidentiality agreements, engagement letters with advisors and consultants, outsourcing agreements, leasing contracts, information technology agreements and service agreements. Under the terms of these agreements, the Society agrees to indemnify the counterparties for various items including, but not limited to, all liabilities, losses, suits, and damages arising during, on or after the term of the agreement. The maximum amount of any potential future payment cannot be reasonably estimated.

The Society has also provided indemnification to all directors and officers of the Society. Under Section 9 of the *Law Society Act*:

> No action or other proceedings for damages shall be instituted against the Treasurer or any bencher, official of the Society or person appointed in Convocation for any act done in good faith in the performance or intended performance of any duty or in the exercise or in the intended exercise of any power under this Act, a regulation, a by-law or a rule of practice and procedure, or for any neglect or default in the performance or exercise in good faith of any such duty or power.

Notwithstanding Section 9, the Society has also purchased errors and omissions insurance for past and present officers, employees, committee members, benchers, agents and volunteers acting on behalf of the Society, its subsidiaries and affiliates, to mitigate the cost of any potential suit or action. No estimate of the maximum exposure under these indemnifications can be made and historically the Society has not made any significant payments under such or similar indemnification agreements. Therefore no amount has been accrued in the financial statements with respect to these agreements.

15. Comparative Figures

Certain of the prior year's comparative figures have been reclassified to conform to the current year's financial statement presentation.

COMPENSATION FUND

Management Discussion and Analysis

The Compensation Fund is maintained by the Law Society, in accordance with the *Law Society Act*, to relieve or mitigate loss sustained by any person in consequence of dishonesty on the part of a licensee. The Fund is financed by annual fees and investment income.

Results of Operations

The financial position of the Compensation Fund remains strong. Results for the year identify a surplus of $907,000 compared to $1.4 million for 2006. The reduced surplus is primarily due to a reduction in investment income.

Expenses are relatively consistent between 2007 and 2006, with some variation in the components of the net grant expense as discussed below.

The fund balance at the end of 2007 is $21.4 million, up from $19.4 million at the same time last year. In six of the last seven years, the fund balance has increased.

Balance Sheet

Cash and short-term investments

The Compensation Fund's short-term investments, which together with cash total $7.5 million, are invested in banker's acceptances and Government of Canada T-bills. The increase in this balance from $6.2 million arises from the increase in the fund balance.

Portfolio investments

Portfolio, or long-term investments of $23.5 million, compared to $22.2 million in 2006, are made up of Canadian fixed income securities (88%) and North American equities (12%). The portfolio is managed in compliance with the Compensation Fund's investment policy. Fixed income investments comprise a diversified mix of government, provincial and corporate bonds with an investment rating of BBB or better. Equity investments comprise a diversified mix of equities listed on the major U.S. and Canadian stock exchanges.

The Canadian Institute of Chartered Accountants introduced a new accounting standard for reporting financial instruments this year. Under this requirement, the Fund's portfolio investments are reported at fair (market) value.

As required by this standard, we reviewed the nature and intent of the long-term investments held and classified them as "held for trading". This classification method most appropriately discloses the results of the Fund's long-term transaction investments.

Selection of the held for trading classification requires that all gains and losses, realized or unrealized, be reported as income of the period. As a transitional step, unrealized gains of $1.2 million as at January 1, 2007 are reported in the change in fund balance section of the Statement of Revenues and Expenses and Change in Fund Balance. Unrealized losses of $939,000 for the year reduced the value of the portfolio at December 31, 2007 to $23.5 million.

Reserve for unpaid grants

Based upon the actuarial valuation, the reserve for unpaid grants has increased by $600,000 to $9.8 million during the year.

Statement of Revenues and Expenses and Change in Fund Balance

Revenues

Lawyers' fees

Lawyers' fees increased from $6.1 million in 2006 to $6.3 million in 2007 due to an increase of approximately 825 lawyers.

Investment Income

Investment income has decreased from $1.3 million in 2006 to $806,000 in 2007 as a result of unrealized losses on portfolio investments of $939,000 at year end. These unrealized losses during the year is reducing the $1.2 million gain accounted for at the beginning of the year, to bring the portfolio investments to market value.

Expenses

Net grants expense

The net grants expense was $1.3 million, in line with 2006, but the components of the expense varied substantially from the prior year.

- Grants paid during the year decreased from $4 million in 2006 to $1.1 million.
- The reduction in grants paid was offset by an increase in the reserve for unpaid grants of $592,000 (2006 – a decrease of $1.4 million). The change in the reserve was brought about by a combination of favourable developments on previously reserved amounts, a higher level of claims incurred during the year and lower grant payments.
- Recoveries of grants paid at $409,000 were just under half of 2006 levels, but recoveries do not follow any pattern.

Other expenses

The Compensation Fund's 2007 other expenses were generally stable compared to 2006.

Paralegals

A separate funding pool for paralegal licensees within the Compensation Fund will be established by fees collected from paralegals as part of their annual fee in 2008 and subsequent years.

Auditors' Report

To the Members of The Law Society of Upper Canada

We have audited the balance sheet of The Law Society of Upper Canada Compensation Fund as at December 31, 2007 and the statements of revenues and expenses and change in fund balance and of cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statement present fairly, in all material respects, the financial position of the Fund as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Licensed Public Accountants
February 22, 2008

COMPENSATION FUND

Balance Sheet

Stated in thousands of dollars
As at December 31

	2007	2006
Assets		
Current assets		
Cash	**1,957**	1,484
Short-term investments	**5,601**	4,723
Cash and short-term investments	**7,558**	6,207
Interest and other receivables	**206**	172
Total current assets	**7,764**	6,379
Portfolio investments (note 5)	**23,514**	22,241
Total Assets	**31,278**	28,620
Liabilities and Fund Balance		
Current Liabilities		
Accounts payable and accrued liabilities	**12**	19
Reserve for unpaid grants	**9,835**	9,243
Total Liabilities	**9,847**	9,262
Fund Balance	**21,431**	19,358
Total Liabilities and Fund Balance	**31,278**	28,620

See accompanying notes

On behalf of Convocation

Gavin MacKenzie

Treasurer

Beth Symes

Chair of Audit Committee

COMPENSATION FUND

Statement of Revenues and Expenses and Change in Fund Balance

Stated in thousands of dollars for the year ended December 31

	2007	2006
Revenues		
Lawyers' fees	**6,291**	6,125
Investment income (note 3)	**806**	1,346
Total Revenues	**7,097**	7,471
Expenses		
Grants paid	**1,143**	4,001
Increase/(decrease) in reserve for unpaid grants	**592**	(1,435)
Recoveries	**(409)**	(1,149)
Net grants expense	**1,326**	1,417
Spot audit	**2,103**	2,034
Share of investigation and discipline	**1,221**	1,092
Administrative	**1,107**	1,054
Salaries and benefits	**433**	451
Total Expenses	**6,190**	6,048
Surplus	**907**	1,423
Fund balance, beginning of year	**19,358**	17,935
Unrealized gains, beginning of year (note 2)	**1,166**	–
Fund Balance, end of year	**21,431**	19,358

See accompanying notes

COMPENSATION FUND

Statement of Cash Flows

Stated in thousands of dollars for the year ended December 31

	2007	2006
Net inflow (outflow) of cash related to the following activities		
Operating		
Surplus	**907**	1,423
Items not affecting cash:		
Increase (decrease) in reserve for unpaid grants	**592**	(1,435)
	1,499	(12)
Net change in non-cash operating items:		
Interest and other receivables	**(34)**	(6)
Accounts payable and accrued liabilities	**(7)**	(337)
Cash from (used in) operating activities	**1,458**	(355)
Investing		
Short-term investments (net)	**(878)**	1,497
Portfolio investments (net)	**(1,273)**	(560)
Unrealized gain on investments beginning of the year (note 2)	**1,166**	?–
Cash (used in) from investing activities	**(985)**	937
Net inflow (outflow) of cash, during the year	**473**	582
Cash, beginning of year	**1,484**	902
Cash, end of year	**1,957**	1,484

See accompanying notes

COMPENSATION FUND

Notes to Financial Statements

Stated in whole dollars except where indicated
For the year ended December 31, 2007

1. Description of Fund

The Compensation Fund (the "Fund"), formerly the Lawyers Fund for Client Compensation, is maintained by The Law Society of Upper Canada (the "Society") pursuant to section 51 of the *Law Society Act* to relieve or mitigate loss sustained by any person in consequence of dishonesty on the part of a licensee, in connection with the licensee's professional business or in connection with any trust of which the licensee was a trustee. The Fund is financed by licensees' annual fees and investment income.

The *Law Society Act* was amended by the *Access to Justice Act* with full effect on May 1, 2007 to legislate the regulation of paralegals by the Society.

The *Law Society Act* now provides for a Compensation Fund, with separate pools of money, for lawyers and paralegals. In January 2008, the governing body of the Society, which is known as Convocation, approved policies and procedures for the paralegal Compensation Fund pool that mirrored those for the lawyer Compensation Fund pool. Paralegals will first receive licences in 2008, and at December 31, 2007 the paralegal Compensation Fund pool had not been funded.

The Fund is not subject to income or capital taxes because it is a fund of the Society, a not-for-profit corporation.

The Fund reimburses the Society's General Fund for certain administrative expenses, spot audit expenses and a portion of the costs of operating the investigation and discipline functions of the Society. The charges for the year amount to $4,282,000 (2006 – $4,022,000).

2. Change in Accounting Policy

On January 1, 2007, the Fund adopted the Canadian Institute of Chartered Accountants' ("CICA") revised standards on recognition and measurement and presentation of financial statements for not-for-profit organizations. As required, the revised standards have been applied retrospectively as at January 1, 2007, without restatement of the comparative amounts.

Under the new standards for recognizing and measuring financial instruments, all financial assets are classified into one of the following four categories: held for trading, held to maturity, loans and receivables or available for sale. All financial liabilities are classified into one of the following two categories: held for trading or other financial liabilities.

The Fund's financial assets and financial liabilities are classified and measured as follows:

Asset / Liability	Category	Measurement
Cash and short-term investments	Held for trading	Fair value
Interest and other receivables	Loans and receivables	Amortized cost
Portfolio investments	Held for trading	Fair value
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost

The reserve for unpaid grants is not within the scope of the new accounting standards as it is not a financial instrument.

With the exception of portfolio investments, there was no change in the measurement of any of the Fund's financial assets and liabilities. Compliance with the new accounting

assets and liabilities. Compliance with the new accounting standards meant that at January 1, 2007 the measurement of portfolio investments changed from being recorded at cost, net of amortization of premiums and discounts, to fair value. The adoption of these new standards resulted in transitional adjustments, which increased the opening fund balance and portfolio investments by $1,166,000. For other financial instruments, there was no impact on the Fund's opening balance sheet as a result of the application of these new accounting policies because there was no change in their measurement.

The Fund has not entered into any derivative transactions. In addition, the Fund does not have any embedded features in contractual arrangements.

3. Significant Accounting Policies

Basis of presentation

The financial statements have been prepared in accordance with the accounting standards for not-for-profit organizations published by the CICA, using the restricted fund method of reporting revenues. The Fund accounts for the program delivery, administration and payment of grants from the Fund. The Fund is restricted in use by the *Law Society Act*.

Cash and short-term investments

Cash (bank balances and investments of less than 90 days' duration) and short-term investments (less than one year) are amounts on deposit and invested in short-term investment vehicles according to the Fund's investment policy. They are subject to insignificant risk of a change in value.

Portfolio investments

Portfolio investments are recorded at fair value. The Fund manages financial risk associated with portfolio investments as summarized below.

- Currency risk is limited, as at year end, less than 6% of the portfolio was invested in securities not denominated in Canadian dollars. Under the Fund's investment policy, foreign denominated bonds are not permitted, non-North American equities are not permitted, and the range for equity holdings is between 5% and 20% of the portfolio.
- Interest rate risk. An analysis of maturity dates for the fixed income securities is set out below.

MATURITY	Interest rate range	2007	2006
2008-2012	3.55%-4.65%	**7,944,000**	8,876,000
2013 and beyond	3.70%-8.00%	**12,665,000**	9,842,000
Total		**20,609,000**	18,718,000

- Market risk. The investments consist of a diversified portfolio of government bonds, corporate bonds, and Canadian and United States equities according to the Fund's investment policy.
- Credit risk. At year end, all long-term debt was rated A or better. Under the Fund's investment policy, no more than 10% of the portfolio can be invested in bonds rated BBB.
- Liquidity risk. All securities are listed on the Toronto or New York stock exchanges and the Fund has $7,558,000 in cash and short-term investments.
- Cash flow risk. No single instrument is individually significant to the future cash flows of the Fund and investment income is not a primary source of revenue for the Fund.

The total amount of the unrealized change in the fair value of portfolio investments recognized as a reduction of investment income for the year is $939,000.

Revenue recognition

Licensee fees are recognized in the year to which they relate if the amount can be reasonably estimated and collection is reasonably assured. Interest and dividend income is recognized when receivable if the amount can be reasonably estimated. Capital gains/losses are recognized with changes in the fair value of financial instruments.

Grants

Pursuant to section 51(5) of the *Law Society Act,* the payment of grants from the Fund is at the discretion of Convocation, the governing body of the Society. Grants paid from the lawyer pool of the Compensation Fund are subject to a $100,000 limit per applicant. A reserve for unpaid grants is recorded as a liability on the balance sheet. This reserve represents an estimate of the present value of grants to be paid for unprocessed claims and the associated administrative costs, as determined by an actuary. The related net grants expense represents grant payments during the year plus the current year experience gain/loss of the reserve for unpaid grants, net of recoveries.

4. Measurement Uncertainty

The valuation of unpaid grants anticipates the combined outcomes of events that are yet to occur. There is uncertainty inherent in any such estimation and therefore a limitation upon the accuracy of these valuations. Future loss emergence may deviate from these estimates. No provision has been made for otherwise unforeseen changes to the legal or economic environment in which claims are settled, nor for causes of loss

which are not already reflected in the historical data. Management believes that the techniques employed and assumptions made are appropriate and the conclusions reached are reasonable given the information currently available. The estimate of unpaid grants is reviewed on a quarterly basis by an actuary and, as adjustments become necessary, they are reflected in current operations.

5. Portfolio Investments

	2007	2006	
($000s)	**Fair value**	Book value	Fair value
Debt securities	**20,609**	18,456	18,718
Canadian equities	**1,466**	1,265	1,968
United States equities	**1,439**	2,520	2,721
Total	**23,514**	22,241	23,407

6. Guarantees

In the normal course of business, the Society has entered into agreements that meet the definition of a guarantee, including indemnities in favour of third parties, such as confidentiality agreements, engagement letters with advisors and consultants, outsourcing agreements, leasing contracts, information technology agreements and service agreements. Under the terms of these agreements, the Society agrees to indemnify the counterparties for various items including, but not limited to, all liabilities, loss, suits, and damages arising during, on or after the term of the agreement. The maximum amount of any potential future payment cannot be reasonably estimated.

The Society has also provided indemnification to all directors and officers of the Society. Under Section 9 of the *Law Society Act:*

> No action or other proceedings for damages shall be instituted against the Treasurer or any bencher, official of the Society or person appointed in Convocation for any act done in good faith in the performance or intended performance of any duty or in the exercise or in the intended exercise of any power under this Act, a regulation, a by-law or a rule of practice and procedure, or for any neglect or default in the performance or exercise in good faith of any such duty or power.

Notwithstanding Section 9, the Society has also purchased errors and omissions insurance for past and present officers, employees, committee members, benchers, agents and volunteers acting on behalf of the Society, its subsidiaries and affiliates, to mitigate the cost of any potential suit or action. No estimate of the maximum exposure under these indemnifications can be made and historically the Society has not made any significant payments under such or similar indemnification agreements. Therefore no amount has been accrued in the financial statements with respect to these agreements.

ERRORS AND OMISSIONS INSURANCE FUND

Management Discussion and Analysis

Accounting Changes

The Fund adopted accounting standards changes under Canadian generally accepted accounting principles effective January 1, 2007 that impact its 2007 financial statements. These changes have been discussed in detail in the Fund's combined financial statements. In summary, the Fund is required to account for its investments at fair market value under the new standards rather than at cost or amortized cost as had previously been the case. As a result, at December 31, 2007 unrealized gains and losses on the investment portfolio are accounted on the combined balance sheet and reflected in surplus. In prior years, unrealized gains and losses on the investment portfolio were disclosed in the notes to the financial statements but not recorded in the accounts.

Due to the accounting changes, the December 31, 2006 and December 31, 2007 combined balance sheets are not directly comparable and should be read in conjunction with the notes to the combined financial statements. The Fund's new accounting policy choices have, however, substantially retained the comparability of its combined statement of operations for 2006 and 2007.

Combined Balance Sheet

Investments

Investment assets, inclusive of cash and cash equivalents, increased by $31.0 million to $467.1 million at December 31, 2007. The increase represents cash provided by operations and investment income. As explained in the financial statements, with the introduction of new accounting standards in 2007, investments are measured at fair market value on the balance sheet at December 31, 2007 but were measured at cost at December 31, 2006. Investment assets are managed in accordance with investment policy in a diversified, high quality portfolio of fixed income securities (86%) and equities (14%).

Provision for unpaid claims and adjustment expenses and reinsurers' share thereof

The provision for unpaid claims represents the amount required to satisfy all of the Errors and Omission Insurance Fund's obligations to claimants prior to recoveries from reinsurers. The provision has increased by $10.0 million in 2007. Reinsurance recoveries have declined by $10.7 million and accordingly the net increase in the provision is $20.7 million at December 31, 2007. This increase is attributable to the higher estimate of claims for the 2007 insurance program year and the impact of changes in reinsurance arrangements made since 2002 as the percentage ceded under quota share reinsurance in respect of the Ontario mandatory professional liability insurance program declined from 57% in 1995 to nil effective January 1, 2003.

Surplus

The surplus has increased by $16.9 million representing the excess of revenue over expenses for the year and net unrealized losses on the investment portfolio which flow directly to the combined balance sheet through surplus.

Combined Statement of Revenue and Expenses

In 2007, the Errors and Omissions Insurance Fund generated an excess of revenue over expenses of $18.4 million, an increase of $10.2 million from 2006. Total expenses increased by $6.6 million in 2007 to $109.8 million and revenues increased by $16.7 million to $128.2 million.

Insurance premiums

Insurance premiums under the Society's mandatory professional liability insurance program amounted to $85.0 million, an $8.3 million increase over 2006. The base annual levy for the Ontario professional liability program was decreased by $100 per lawyer to $2,600 in 2007. Insurance premiums also included a transfer of $10.1 million from the Premium Stabilization Fund triggered under the funding requirements for the 2007 insurance program and under the provisions of the Society's contract with LAWPRO for the insurance program.

Investment Income

The Fund generated $29.4 million of investment income, an increase of $8.7 million from the prior year, which includes net capital gains of $12.2 million (2006 – $3.4 million) realized on the disposition of assets. At December 31, 2007, the cost of the portfolio exceeded market value by $1.2 million (2006 – market value exceeded cost by $17.6 million).

Net Claims and Adjustment Expenses

Incurred claims of $72.3 million are $0.4 million higher than the prior year. Favorable development of prior years' claims in the amount of $14.1 million partly offset the higher claims incurred in respect of the 2007 insurance program year.

Reinsurance Premiums

Reinsurance arrangements and their costs are fairly consistent with prior year, $5.4 million in 2007 compared with $4.9 million in 2006, the increase reflecting the growth of the Excess program in 2007.

General Expenses

General expenses in 2007 are substantially as anticipated and slightly lower than the prior year by $0.3 million.

ERRORS AND OMISSIONS INSURANCE FUND

Auditors' Report

To the Members of The Law Society of Upper Canada

We have audited the combined balance sheet of the Law Society of Upper Canada – Errors and Omissions Insurance Fund as at December 31, 2007 and the combined statements of operations, of changes in surplus and of cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these combined financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Licensed Public Accountants
February 8, 2008

ERRORS AND OMISSIONS INSURANCE FUND

Report of the Valuation Actuary

To the Members of The Law Society of Upper Canada

Role of the Valuation Actuary

The valuation actuary is appointed by the Audit Committee of Lawyers' Professional Indemnity Company in its capacity as manager of the Law Society of Upper Canada Errors and Omissions Insurance Fund. With respect to the preparation of these combined financial statements, the actuary is required to carry out a valuation of the claim liabilities and to report thereon to the Audit Committee, and through it to the membership of the Law Society. The valuation is carried out in accordance with accepted actuarial practice, and regulatory requirements. The scope of the valuation encompasses the claim liabilities, that is the provision for unpaid claims and adjustment expenses on claims incurred and reported as of December 31, 2007, the date of these combined financial statements.

In performing a valuation of the liabilities, which by their very nature are inherently variable, the actuary makes assumptions as to future rates of claims severity, inflation, reinsurance recoveries, expenses and other matters, taking into consideration the circumstances of the Errors and Omissions Insurance Fund, Lawyers' Professional Indemnity Company and the nature of the insurance coverage being offered. The valuation is necessarily based on estimates; consequently the final values may vary significantly from those estimates. The actuary also makes use of management information provided by the Law Society and Lawyers' Professional Indemnity Company, and uses the work of the auditor with respect to the verification of the underlying data used in the valuation.

Valuation Actuary's Report

I have valued the claim liabilities arising on the errors and omissions insurance coverage arranged by the Law Society of Upper Canada for its Errors and Omissions Insurance Fund combined balance sheet as at 31 December 2007, and their changes in its combined statement of operations for the year then ended, in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of the claim liabilities makes appropriate provision for all such obligations, and the financial statements fairly present the results of the valuation.

Brian G. Pelly
Fellow, Canadian Institute of Actuaries

Toronto, Ontario
February 8, 2008

ERRORS AND OMISSIONS INSURANCE FUND

Combined Balance Sheet

Stated in thousands of dollars
As at December 31

	2007	2006
Assets		
Cash and cash equivalents	**7,917**	2,765
Investments (note 3)	**459,169**	433,345
Investment income due and accrued	**2,539**	3,026
Accounts receivable	**7,925**	10,216
Reinsurers' share of provision for:		
Unpaid claims and adjustment expenses (note 5)	**55,443**	66,187
Other assets	**1,014**	343
Capital assets (note 4)	**729**	432
Future income taxes (note 10)	**2,931**	7,750
Total Assets	**537,667**	524,064
Liabilities and surplus		
Provision for unpaid claim and adjustment expenses (note 5)	**341,970**	331,958
Premium stabilization fund (note 7)	**22,649**	32,701
Accounts payable and accrued liabilities	**6,143**	9,401
	370,762	374,060
Surplus (note 11)	**166,905**	150,004
Total Liabilities and Surplus	**537,667**	524,064

See accompanying notes

On behalf of Convocation

Gavin MacKenzie

Treasurer

Beth Symes

Chair of Audit Committee

ERRORS AND OMISSIONS INSURANCE FUND

Combined Statement of Operations

Stated in thousands of dollars for the year ended December 31

	2007	2006
Revenue		
Insurance premiums, mandatory insurance program (notes 2 and 6)	**84,948**	76,633
Other insurance premiums	**12,328**	10,338
Reinsurance commissions	**1,473**	3,727
Investment income	**29,432**	20,779
Other revenue	**47**	50
Total Revenue	**128,228**	111,527
Expenses		
Net claims and adjustment expenses (note 5)	**72,337**	71,946
Reinsurance premiums	**5,388**	4,886
General expenses	**15,457**	15,706
Transfer to the Society's General Fund (note 8)	**3,250**	3,000
Premium taxes	**2,919**	2,610
Income taxes (note 10)	**10,487**	5,138
Total Expenses	**109,838**	103,286
Excess of Revenue over Expenses	**18,390**	8,241

See accompanying notes

ERRORS AND OMISSIONS INSURANCE FUND

Combined Statement of Changes in Surplus

Stated in thousands of dollars for the year ended December 31

Surplus at December 31, 2005	**141,763**
Excess of revenue over expenses for the year ended December 31, 2006	8,241
Surplus at December 31, 2006	**150,004**
Transitional adjustments on adoption of new accounting standards (note 2):	
Investments – net unrealized gains (net of taxes of $5,883)	11,694
Provision for unpaid claims and adjustment expenses (net of taxes of $1,105)	(1,545)
Surplus at January 1, 2007	**160,153**
Excess of revenue over expenses for the year ended December 31, 2007	18,390
Changes in unrealized gains and losses on available for sale financial assets (net of taxes of $1,636)	(3,571)
Reclassification adjustment for net realized (gains) losses included in the statement of operations (net of taxes of $4,071)	(8,067)
Surplus at December 31, 2007	**166,905**

See accompanying notes

ERRORS AND OMISSIONS INSURANCE FUND

Combined Statement of Cash Flows

Stated in thousands of dollars for the year ended December 31

	2007	2006
Operating Activities		
Excess of revenue over expenses	**18,390**	8,241
Items not affecting cash:		
Future income taxes	**516**	(1,573)
Amortization of capital assets	**440**	311
Realized gains	**(12,172)**	(3,413)
Amortization of premiums and discounts on bonds	**(1,749)**	(1,438)
Changes in unrealized gains and losses	**1,457**	–
	6,882	2,128
Change in non-cash balances:		
Investment income due and accrued	**487**	608
Accounts receivable	**2,291**	764
Provision for unpaid claims and adjustment expenses	**11,312**	5,610
Reinsurers' share of provision for unpaid claims & adjustment expenses	**6,793**	13,673
Premium Stabilization Fund	**(10,052)**	172
Other assets	**(671)**	(36)
Accounts payable and accrued liabilities	**1,974**	2,014
Net cash inflow from operating activities	**19,016**	24,933
Investing Activities		
Purchase of capital assets	**(736)**	(154)
Purchase of investments	**(326,716)**	(336,514)
Proceeds of sale of investments	**313,588**	311,852
Net cash outflow from investing activities	**(13,864)**	(24,816)
Net increase in cash and cash equivalents during the year	**5,152**	117
Cash and cash equivalents, beginning of year	**2,765**	2,648
Cash and cash equivalents, end of year	**7,917**	2,765
Cash and cash equivalents at end of year consists of:		
Cash	**4,397**	2,493
Cash equivalents	**3,520**	272
	7,917	2,765

See accompanying notes

Notes to Financial Statements

Stated in whole dollars except where indicated
For the year ended December 31, 2007

1. The insurance program and its risk retention and reinsurance structure

The combined financial statements of the Errors and Omissions Insurance Fund present the accounts of the lawyers' professional liability insurance program of the Law Society of Upper Canada ("the Society"). The program requires practising members to pay levies that contribute towards premiums to fund the anticipated costs of professional liability claims made in each annual policy period. Indemnification of members is subject to the terms of the insurance policy, including financial limits per claim and aggregate limits per member in each policy period.

These financial statements combine the results of operations, financial positions and cash flows of:

- the Errors and Omissions Insurance Fund of the Society ("the Fund"), the fund originally set up in the Society's accounts to record insurance claims and expenses and related levies and their investment; and
- Lawyers' Professional Indemnity Company ("LAWPRO" or "the Company"), a wholly owned subsidiary of the Society that was incorporated in 1990 as an insurance company which is licensed to provide lawyers' professional liability insurance and title insurance.

The risk retention and reinsurance structures employed through these two entities are described in the following paragraphs.

Prior to July 1, 1990, the Society's Errors and Omissions Insurance Program was underwritten by various insurance carriers subject to a policy deductible. LAWPRO took over the underwriting of the program commencing July 1, 1990. The Society maintained financial responsibility for the policy deductible through to December 31, 1994. The policy deductible was a combination of a group deductible and the individual member deductibles. For the periods noted below, the combined policy deductibles were as follows:

July 1989 to June 1990	$ 250,000	Per occurrence
July 1990 to December 1991	$ 200,000	Per occurrence
January 1992 to December 1994	$ 250,000	Per occurrence

The Society was not able to arrange Stop Loss reinsurance on its group deductible after the policy period ending June 1989. As a result, the full financial risk of the deductible rested with the Society, from July of 1989 through the policy period ended December 1994.

LAWPRO also had a net retention above the policy's group deductible as follows:

- July 1, 1990 to December 31, 1991: LAWPRO is liable for $50,000 of all individual losses in excess of $200,000
- January 1, 1992 to December 31, 1992: LAWPRO is liable for an aggregate of $2,500,000 from individual losses incurred in excess of $250,000 plus a further 10% of all losses above $250,000 once the initial $2,500,000 limit has been reached
- January 1, 1993 to December 31, 1994: LAWPRO is liable in each policy year for an aggregate of $4,000,000 if incurred losses are above or exceed $250,000 plus a further 10% of all losses in excess of $250,000 once the initial $4,000,000 limit has been reached.

It was decided, effective January 1, 1995, to eliminate the self-insured group deductible. Commencing January 1, 1995, 100% of the risk over the individual member deductibles is insured within LAWPRO. LAWPRO in turn reinsures a portion of its risk retention with third party Canadian licensed reinsurers.

The annual policy limits for each of the years effective January 1, 1995 through December 31, 2007 are $1 million per claim and $2 million in aggregate per member.

2. Significant accounting policies

(amounts in thousands of dollars)

These combined financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The significant accounting policies used in the preparation of these financial statements are summarized below. These accounting policies conform, in all material respects, to Canadian generally accepted accounting principles.

Changes in accounting policies

Effective January 1, 2007, the Company and the Fund adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"): CICA Handbook Section 1506, *Accounting Changes; Section 3855, Financial Instruments – Recognition and Measurement; Section 3861, Financial Instruments – Disclosure and Presentation;* Section 3865, *Hedges* and Section 3251, *Equity*. In addition the Company also adopted Section 1530, *Comprehensive Income* to account for and present unrealized gains and losses on available for sale financial instruments in its statement of comprehensive income. For the purpose of the combined financial statements, unrealized gains and losses on available for sale financial instruments are accounted for and presented directly in the statement of changes in surplus.

The adoption of these new accounting standards resulted in changes in the accounting for financial instruments, the cumulative effect of which has been recorded as transitional adjustments to surplus as described below. The Fund and the Company adopted these standards at the beginning of the year and in accordance with the transitional adjustments, prior period balances were not restated. The adoption of these new accounting standards had no significant impact on results from operations for the year ended December 31, 2007.

Prior to the adoption of the new accounting standards, the Fund and the Company measured investments in fixed income securities at amortized cost and its investments in equities at cost. Under the previous accounting standards, the Fund and Company valued the provision for unpaid claims and adjustment expenses based on a discount rate at which the present value of future cash flows from assets backing its provision for unpaid claims and adjustment expenses was equal to the sum of the amortized cost and accrued investment income of those assets at the valuation date.

Financial instruments – recognition and measurement

In accordance with the new standards, financial assets are classified as held for trading, available for sale, held to maturity or loans and receivables. Financial liabilities are classified as held for trading or as other financial liabilities. These classifications are determined based on the characteristics of the financial assets and liabilities, the Fund and Company's choice and/or the Fund and Company's intent and ability. As permitted under the standards, the Fund and Company have the ability to designate any financial instrument irrevocably on initial recognition or adoption of the standards, as held for trading under the fair value option ("FVO") as long as its fair value can be reliably measured. The Fund and Company's financial assets and liabilities are measured on the balance sheet at fair value on initial recognition and are subsequently measured at fair value or amortized cost depending on their classification as indicated below.

Held for trading financial assets

Financial assets classified as held for trading are measured at fair value on the combined balance sheet with realized gains and losses and net changes in unrealized gains and losses recorded in investment income along with dividends and interest earned.

As at January 1, 2007, the Company's cash flow matched investment portfolio totaling $248,840 (fair value $251,653), previously accounted for at cost or amortized cost, were designated as held for trading under the FVO. The cash flow matched portfolio consists of fixed income investment securities and is intended to substantially match the expected timing and magnitude of future payments on the provision for unpaid claims and adjustment expenses. The cash flow matched portfolio represents a significant component of the Company's risk management strategy to meet its claims obligations. The designation of the financial assets in the cash flow matched investment portfolio as held for trading is intended to significantly reduce the measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognizing gains and losses thereon under different bases.

Financial assets purchased for short-term investment objectives are classified as held for trading. At January 1, 2007, cash and cash equivalents totaling $2,765 in the combined balance sheet (fair value $2,765), previously accounted for at cost and amortized cost were classified as held for trading. Cash and cash equivalents consist of cash on hand, balances with banks, and short-term investments with maturities of three months or less at the time of acquisition.

Available for sale financial assets

Financial assets classified as available for sale are measured at fair value on the balance sheet. Net changes in unrealized gains and losses are recorded in the changes in surplus, outside the combined statement of operations, until realized, at which time the cumulative gain or loss is reclassified to investment income in

the statement of operations. When unrealized losses on available for sale securities are determined to be other than temporary, the unrealized loss previously recorded in surplus is reclassified within investment income in the statement of operations. Previously, such securities were written down to net realizable value. Investments in equity securities classified as available for sale that do not have quoted market prices in an active market are measured at cost. Dividends and interest income from available for sale securities, including amortization of premiums and the accretion of discounts, are recorded in investment income in the statement of operations.

Financial assets in the Company's surplus portfolio (consisting of all investments outside the cash-flow matched portfolio) including fixed income securities, equities and pooled funds, totaling $117,673 (fair value $131,552), previously accounted for at cost or amortized cost were classified as available for sale on January 1, 2007. The entire investment portfolio of the Fund totaling $66,832 (fair value $67,717) including fixed income securities and pooled funds, previously accounted for at cost or amortized cost was classified as available for sale on January 1, 2007.

Provision for unpaid claims and adjustment expenses

Under the new accounting standards the valuation of the provision for unpaid claims is based on a discount rate that is determined on a fair value basis, under the new accounting standards, rather than an amortized cost basis used previously. As a result of changes to the discount rate used in the actuarial valuation, the provision for unpaid claims and adjustment expenses increased by $1,545 (net of taxes, $1,105) with a corresponding reduction in opening surplus at January 1, 2007.

Other financial assets and liabilities

Neither the Fund nor the Company has designated any financial assets as held to maturity. Loans and receivables and other financial liabilities are carried at amortized cost. Given the short-term nature of other financial assets and other financial liabilities, amortized cost approximates fair value.

Fair values of financial instruments

Fair values of financial instruments are based on quoted market prices in active markets and are determined using bid prices for financial assets and ask prices for financial liabilities. Fair values of third party pooled funds are based on the net asset values as advised by the funds.

Transaction costs related to financial assets and liabilities are expensed as incurred. The purchase and sale of securities is accounted for on the basis of trade date.

Transitional adjustments

On January 1, 2007, the Fund and the Company recognized all financial assets and liabilities on the combined balance sheet according to their classification. Any adjustment made to a previous carrying amount was recognized as an adjustment to surplus in the combined balance sheet. A summary of the impact on the balance sheet of adopting the new standards is as follows:

	As at December 31, 2006	Adjustment on adoption of new standards	As at January 1, 2007
Investments	433,345	17,577	450,922
Provision for unpaid claims and adjustment expenses	331,958	3,220	335,178
Reinsurers' share of provision	66,187	570	66,757
Future income taxes	7,750	(4,778)	2,972
Surplus	150,004	10,149	160,153

There was no impact on the reported excess of revenue over expenses for the year ended December 31, 2006.

Capital assets

Capital assets are carried at amortized cost. Amortization is charged to expense on a straight-line basis over the estimated useful lives of the assets as follows:

Leasehold improvements	Term of lease
Furniture and fixtures	3 to 5 years
Computer equipment and software	1 to 3 years

Premium related balances

Insurance policies under the professional liability insurance program are effective on a calendar year basis. Professional liability insurance premium income is earned on a pro rata basis over the term of coverage of the underlying insurance policies; generally one year, except for policies for retired lawyers, which have terms of up to five years. The portion of premiums related to the unexpired term of coverage at the balance sheet date is recorded as unearned premiums. Title insurance premiums are earned at the inception date of policies.

Premiums receivable are recorded as amounts due from insureds in other assets in the combined balance sheet, net of any required provision for doubtful amounts. Premiums received from insureds in advance of the effective date of the insurance policy are recorded as amounts due to insureds in accounts payable and accrued liabilities in the combined balance sheet.

The Company defers policy acquisition expenses, primarily premium taxes on its written professional liability insurance premiums to the extent these costs are considered recoverable. These costs are expensed on the same basis that the related

premiums are earned. The method to determine recoverability of deferred policy acquisition expenses takes into consideration future claims and adjustment expenses to be incurred as premiums are earned and anticipated investment income. Deferred policy acquisition expenses are not material at year-end.

Other income

Other income is income other than premium income or investment income and is recognized when it is earned.

Claims related balances

a) *Provision for unpaid claims and adjustment expenses*

The provision for unpaid claims and adjustment expenses is an estimate of the ultimate cost of all insurance claims not paid as at the balance sheet date and is determined using case-basis evaluations and an amount for the expected future development of claims incurred as at the balance sheet date. The provision takes into account the time value of money.

b) *Deductibles*

The lawyers' professional liability insurance policy requires insureds to pay deductibles to the maximum extent of $25 each on individual claims. Expected deductible recoveries on paid and unpaid claims are recognized net of any required provision for uncollectible accounts at the same time as the related claim liabilities.

Reinsurance

Net premiums earned and claims incurred are recorded net of amounts ceded to, and recoverable from, reinsurers in the statement of operations. Amounts relating to reinsurance in respect of the premiums and claims related balances in the balance sheet are recorded separately. Amounts recoverable from reinsurers are estimated and recognized in a manner consistent with the method of determining the related policy liability associated with the reinsurance policy.

Employee future benefits

The Company maintains a defined contribution pension plan for its employees, as well as a supplemental defined benefit pension plan for certain designated employees which provides benefits to those employees in excess of the benefits provided by the Company's defined contribution pension plan. The benefit liability under the supplemental defined benefit pension plan is actuarially determined using the projected benefit method pro-rated on service and management's assumptions about discount rates, expected plan assets' performance, salary growth and retirement ages of employees. The discount rate is determined on the basis of market conditions at year-end and other assumptions are based on long-term expectations.

Adjustments for plan amendments are recognized fully into income in the year to which they relate. Changes in assumptions and actuarial gains and losses are recognized into income in the year following the actuarial valuation of the benefit liability to which they relate.

Income taxes

LAWPRO uses the asset and liability method of accounting for income taxes. Under this method of tax allocation, future income tax assets and liabilities are determined based on the differences between the financial reporting and tax basis of assets and liabilities, and are measured using the tax rates and laws that are expected to be in effect in the periods in which the future income tax assets or liabilities are expected to be settled or realized, where those tax rates and laws have been substantively enacted.

Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates and changes in estimates are recorded in the year in which they are determined. The most significant assets and liabilities which require estimation in their determination are the provision for unpaid claims and adjustment expenses and reinsurers' share thereof (note 5).

3. Investments

Investment summary

The Company and the Fund hold diversified portfolios consisting of equities and fixed income securities with investment grades of BBB or better. Effective January 1, 2007 fixed income securities and equities are carried on the balance sheet at fair value as indicated in note 2 to the financial statements. At December 31, 2006, fixed income securities and equities were carried at amortized cost and cost respectively on the balance sheet. The estimated fair values of fixed income securities, common and preferred equities are based on quoted market values that approximate bid prices.

($000s)	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
	December 31, 2007			
Available for sale				
Fixed income securities	145,800	1,162	(737)	146,225
Common equities	46,507	2,979	(5,983)	43,503
	192,307	4,141	(6,720)	189,728
Held for trading under FVO				
Fixed income securities	266,481	2,072	(735)	267,818
Preferred equities	1,605	22	(4)	1,623
	268,086	2,094	(739)	269,441
Total	**460,393**	**6,235**	**(7,459)**	**459,169**
Reconciled in aggregate to asset classes as follows:				
Fixed income securities	412,281	3,234	(1,472)	414,043
Equities	48,112	3,001	(5,987)	45,126
Total	**460,393**	**6,235**	**(7,459)**	**459,169**

($000s)	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
	December 31, 2006			
Fixed income securities	372,631	4,952	(737)	376,846
Common equities	58,115	14,005	(805)	71,315
Preferred equities	2,599	164	–	2,763
Total	**433,345**	**19,121**	**(1,542)**	**450,924**

Realized gains and losses

The realized capital gains (losses) and increase (decrease) in the unrealized gains and losses on available for sale investments for the year ended December 31, 2007 are as follows:

	Net realized gains (losses)		
($000s)	Gross	Tax	Net
Investments – available for sale			
Fixed income securities	787	(303)	484
Common equities	11,351	(3,768)	7,583
Total	**12,138**	**(4,071)**	**8,067**

	Increase (decrease) in unrealized gains and losses		
($000s)	Gross	Tax	Net
Investments – available for sale			
Fixed income securities	(1,141)	320	(821)
Common equities	(16,204)	5,387	(10,817)
Total	**(17,345)**	**5,707**	**(11,638)**

Investment income

Investment income arising from investments classified as held for trading under FVO and from investments classified as available for sale recorded in the statement of operations is as follows:

	2007			2006
($000s)	Held for trading under FVO	Available for sale	Total	Total
Interest	11,253	5,905	17,158	15,864
Dividends	106	2,229	2,335	2,245
Net realized gains	34	12,138	12,172	3,413
Changes in net unrealized gains and losses	(1,457)	–	(1,457)	–
	9,936	20,272	30,208	21,522
Less: investment expenses	(276)	(500)	(776)	(743)
Investment income	**9,660**	**19,772**	**29,432**	**20,779**

Financial risk management objectives and policies

Investments represent the most significant component of financial assets and are subject to a variety of risks including market risk, interest rate risk, currency risk, credit risk, liquidity risk and cash flow risks. A significant portion of the investment portfolio is invested with the primary objective of matching the investment asset cash flows with the expected future payments on the Company's claim liabilities. This portion, referred to as the cash flow matched investment portfolio consists of fixed income securities that are intended to address the liquidity and cash flow needs of the Company as claim payments crystallize in the future. The cash flow matched portfolio has been designated as held for trading under the FVO. The remainder of the investment portfolio is categorized as available for sale and is invested in fixed income securities and equities with the objective of preserving capital and achieving an appropriate return consistent with the objectives of the Fund and the Company.

In addition to managing its own investments, the Company also manages the investments of the Fund. Governance processes around investments include oversight by the Investment Committee of the Company's board of directors. The oversight includes reviews of the Company's and the Fund's third party investment managers, investment performance and adherence to the Company's and the Fund's investment policy. The investment policy statement is reviewed at least on an annual basis and addresses various matters including investment objectives, risks and management. Guidelines and limits have been established in respect of asset classes, issuers of securities and the nature of securities to address matters such as quality and concentration of risks in the context of the investment portfolio.

Market risk relates to changes in the market price of securities caused by a variety of factors that may be specific to individual securities or that may have a broader impact on the portfolio. At December 31, 2007, unrealized losses in the portfolio are considered to be temporary. Less than 20% of the portfolio is invested in equities. Approximately half of the equities portfolio is subject to currency risk exposure on the portion of holdings that are invested outside Canada. This risk is borne by the Company and the Fund and is reflected in the investment income.

The maturity profile of fixed income securities as at December 31, 2007 and its analysis by type of issuer is as follows:

($000s)	Within 1 year	1 to 5 years	Over 5 years	Fair Value
Available for sale				
Issue or guaranteed by:				
Canadian federal government	628	42,565	16,225	59,418
Canadian provincial and municipal government	–	3,388	1,962	5,350
NHA mortgage backed securities	–	4,399	9,993	14,392
Corporate debt	750	11,365	54,950	67,065
	1,378	61,717	83,130	146,225
Held for trading under FVO				
Issue or guaranteed by:				
Canadian federal government	39,281	66,663	–	105,944
Canadian provincial and municipal government	–	11,232	51,009	62,241
Other government	–	5,078	–	5,078
NHA mortgage backed securities	895	–	–	895
Corporate debt	15,925	55,880	21,855	93,660
	56,101	138,853	72,864	267,818
Total	**57,479**	**200,570**	**155,994**	**414,043**
Percent of total	**14%**	**48%**	**38%**	

The weighted average duration of fixed income securities at December 31, 2007 is 4.30 years (2006: 4.98 years). The effective yield on fixed income securities as at December 31, 2007 is 3.97% (2006: 3.88%).

4. Capital assets

($000s)	Cost	2007 Accumulated amortization	Carrying value	2006 Carrying value
Furniture & fixtures	1,172	(1,140)	32	56
Computer equipment	3,014	(2,475)	539	229
Computer software	2,410	(2,252)	158	111
Leasehold improvements	935	(935)	–	36
Total	**7,531**	**(6,802)**	**729**	**432**

5. Provision for unpaid claims and adjustment expenses

The determination of the provision for unpaid claims and adjustment expenses is a complex process based on known facts, interpretations and judgment and is influenced by a variety of factors. Consequently, the measurement of the ultimate settlement costs of claims made to date that underlies the provision for unpaid claims and adjustment expenses and any related recoveries for reinsurance and deductibles, involves estimates and measurement uncertainty. The amounts are based on estimates of future trends in claim severity and other factors, which could vary as claims are settled.

Variability can be caused by several factors including the emergence of additional information on claims, changes in judicial interpretation and significant changes in severity or frequency of claims from historical trends. Ultimate costs incurred could vary from current estimates. Although it is not possible to measure the degree of variability inherent in such estimates, management believes that the methods of estimation that have been used will produce reasonable results given the current information. An actuary performs a valuation of claim liabilities at least annually. As adjustments to estimated claim liabilities become necessary, they are reflected in current operations.

To limit losses through the spreading of risks, the Company cedes reinsurance to other insurers. In the event that a reinsurer is unable to meet obligations assumed under reinsurance agreements, the Company is liable for such amounts. The Company has guidelines and a review process in place to ascertain the credit worthiness of the companies to which it cedes. Based on current information of the financial health of the reinsurers, no provision for doubtful debts has been made in the financial statements in respect of reinsurers.

Changes in provisions for unpaid claims and adjustment expenses recorded in the balance sheet comprise the following:

($000s)	2007	2006
Provision for unpaid claims and adjustment expenses – beginning of year – net	**265,771**	246,488
Transitional adjustment on adoption of new accounting standards	**2,650**	–
	268,421	246,488
Change in net provision for claims and adjustment expenses due to:		
Prior years' incurred claims	**(14,092)**	(12,309)
Current year's incurred claims	**91,045**	83,989
Net claims and adjustment expenses paid in relation to:		
Prior years	**(47,765)**	(45,742)
Current year	**(6,810)**	(6,921)
Impact of discounting	**(4,272)**	266
Provision for unpaid claims and adjustment expenses – end of period – net	**286,527**	265,771
Reinsurers' share of provisions for unpaid claims and adjustment expenses	**55,443**	66,187
Provision for unpaid claims and adjustment expenses – end of period – gross	**341,970**	331,958

As the provision for unpaid claims and adjustment expenses is recorded on a discounted basis and reflects the time value of money, its carrying value is expected to provide a reasonable basis for the determination of fair value. However, determination of fair value also requires the practical context of a buyer and seller, both of whom are willing and able to enter into an arm's length transaction. In the absence of such a practical context, the fair value is not readily determinable.

6. Insurance premiums – mandatory lawyers' professional liability insurance program

Insurance premiums relating to the mandatory lawyers' professional liability insurance program are comprised of annual base levies of $2,600 per member (2006 – $2,700) and additional levies that are charged based on a lawyer's claims history, status, and on the volume of specified categories of legal transactions. In 2007, additional levies contributing towards insurance premiums totalled $23.1 million (2006 – $24.1 million). Insurance premiums relating to the mandatory professional liability insurance program are presented net of any retrospective premium rating adjustment under the insurance policy between the Society and LAWPRO.

7. Premium stabilization fund

Revenues from transaction-based levies are subject to change from year to year based on levels of legal transactions that, in part, reflect the changing economic climate. Revenues from transaction and claims history levies that are deemed to contribute to a surplus over required premium for the year, may be held for future insurance purposes in the Premium Stabilization Fund and applied to premiums under the insurance program in future years. If there is deemed to be a shortfall of the required premium for the year, the shortfall may be met by additional contributions from the Premium Stabilization Fund. The premium contributions from the Premium Stabilization Fund in 2007 was $7.8 million (2006 – nil).

Retrospective rating provisions under the insurance policy between the Society and LAWPRO are accounted for as transfers between the Premium Stabilization Fund and premiums under the insurance program. As a result of the retrospective rating adjustments as of December 31, 2007, LAWPRO estimated an additional premium of $2.3 million in premiums due from the Premium Stabilization Fund (2006 - $0.2 million refund of premium).

8. Transfer to the Society's General Fund

Investment income earned by the Fund, amounting to $3.3 million (2006 - $3.0 million), was determined to be in excess of the operating requirements of the insurance program and was transferred to the Society for general purposes.

9. Employee future benefits

(amounts in thousands of dollars)

LAWPRO has a defined contribution pension plan which is mandatory for all its employees upon meeting the eligibility requirements. Each employee is required to contribute 4.5% of yearly maximum pensionable earnings and 6% in excess thereof, of an employee's annual base earnings. Under the plan, LAWPRO matches all employee contributions. LAWPRO made payments of $447 in 2007 (2006 – $421) and recorded pension expenses of $453 (2006 – $424).

LAWPRO also has a supplemental defined benefit pension plan. Funding for the supplemental plan commenced in 2005. Funding requirements are reviewed annually with an actuarial valuation for funding purposes effective as at December 31. The most recent actuarial valuation for funding purposes was at an effective date of December 31, 2006. For reporting purposes, all assets and liabilities associated with pension benefits have been measured using values as at December 31, 2007.

Defined benefit plan obligations		
($000s)	**2007**	2006
Accrued benefit obligation		
Balance, beginning of the year	**2,164**	1,705
Current service cost	**145**	134
Interest cost	**115**	94
Actuarial loss (gain)	**(76)**	139
Special termination benefit	**373**	–
Curtailment	**(409)**	–
Plan amendment	**–**	92
Balance, end of year	**2,312**	2,164

Defined benefit plan assets		
($000s)	**2007**	2006
Fair value of plan assets		
Market value of plan assets		
– beginning of the year	**1,560**	644
Actual return on plan assets, net of expenses	**(37)**	83
Employer contribution	**823**	833
Market value of plan assets – end of year	**2,346**	1,560

The defined benefit plan assets arise primarily from employer contributions that are originally allocated equally between deposits held with the government of Canada and investments in the units of a balanced pooled fund, representing a portfolio mix of equities and debt securities.

Reconciliation of funded status surplus (deficit) of the benefit plans to the amounts recorded in the financial statements:

($000s)	**2007**	2006
Fair value of plan assets	**2,346**	1,560
Accrued benefit obligation	**(2,312)**	(2,164)
Funded status surplus (deficit)	**34**	(604)
Unamortized net actuarial loss	**25**	45
Accrued benefit asset (liability)	**59**	(559)

The accrued benefit asset is included in other assets and the accrued benefit liability is included in accounts payable and accrued liabilities in the combined balance sheet.

Components of defined benefit costs recognized in the year:		
($000s)	**2007**	2006
Current service cost	**145**	134
Interest cost	**115**	94
Actuarial return on assets	**37**	(83)
Actuarial loss (gain)	**(76)**	138
Special termination benefit	**373**	–
Curtailment	**(409)**	–
Plan amendment	**–**	92
Difference between actual and recognized actuarial losses	**121**	168
Difference between actual and expected return on assets	**(100)**	47
Defined benefit costs recognized in the statement of income	**206**	590

The defined benefit plan was amended in 2007 to reflect retirement arrangements for a senior executive effective in 2008. The pending retirement triggered a plan curtailment due to the member's expected years of future service being reduced and it also triggered a special termination benefit. The curtailment reduced the benefit obligation by $409; the special termination benefit increased the benefit obligation by $373.

The significant assumptions used by LAWPRO are as follows (weighted average):

	2007	2006
Discount rate	**5.25%**	5.00%
Expected long term rare of return on plan assets	**6.00%**	6.00%
Rate of compensation increase	**3.50%**	3.50%

10. Income taxes

LAWPRO's effective tax rate does not differ significantly from the applicable Canadian statutory income tax rate of 36.12%. LAWPRO's income tax expense has the following components:

($000s)	**2007**	2006
Current tax expense	**9,971**	6,711
Future tax (recovery)	**516**	(1,573)
Total income tax expense	**10,487**	5,138

LAWPRO's future income tax asset is the result of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The sources of these temporary differences and the tax effects for each year are as follows:

($000s)	**2007**	2006
Investments	**(1,668)**	2,832
Net provision for unpaid claims and adjustment expenses	**4,505**	4,599
Other	**94**	319
Total	**2,931**	7,750

During the year, LAWPRO made payments of $9.0 million and received refunds of $0.4 million from tax authorities.

11. Surplus

Surplus recorded in the combined balance sheet includes LAWPRO's shareholder's equity. At December 31, 2007 the shareholder's equity of LAWPRO, as reported in its financial statements was $135.8 million (2006 – $119.0 million).

12. Operating lease rentals

(amounts in thousands of dollars)

During 2007, the Company had commitments for monthly lease payments in respect of the premises at 1 Dundas Street West from which it operated as at December 31, 2007. The lease expired on January 31, 2008 and remaining lease obligation payable in respect of this lease in 2008 of $114 was paid subsequent to year end. The Company entered into a lease effective February 1, 2008 for new premises at 250 Yonge Street and moved its operations to the new location subsequent to year end.

At December 31, 2007, lease obligations on office premises were as follows:

2008	1,222
2009	1,220
2010	1,220
2011	1,220
2012	1,220
Thereafter	6,608
Total	12,710

The Company has commitments arising from the change in location towards capital expenditures of approximately $4,000 relating primarily to leasehold improvements and furniture and equipment of which $677 was paid by December 31, 2007 and is included within Other assets on the balance sheet. The balance is expected to be paid in 2008.

13. Comparative figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

14. Future accounting changes

On January 1, 2008 the Company and the Fund will adopt CICA Handbook Section 1535, Capital Disclosures; Section 3862, Financial Instruments – Disclosures and Section 3863, Financial Instruments – Presentation.

Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

Section 3862 on financial instruments disclosures, requires the disclosure of information about: (i) the significance of financial instruments for the entity's financial position and performance and (ii) the nature and extent of risks arising from financial instrument to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 on the presentation of financial instruments is unchanged from the presentation requirements included in Section 3861.

LIBRARYCO INC.

Management Discussion and Analysis

LibraryCo Inc. is mandated to carry on the central management of the Ontario County and District Law Library system on a not-for-profit basis. LibraryCo is financed by lawyers' annual fees remitted by the Law Society of Upper Canada and grants from the Law Foundation of Ontario.

Changes During 2007

In June 2007, the corporate structure was amended, whereby 25% of the 100 Special Shares, previously held by the County and District Law Presidents' Association ("CDLPA") were issued to the Toronto Lawyers Association ("TLA") for $25. The Law Society continues to hold all of the 100 Common shares and may appoint up to four directors. CDLPA may appoint up to three directors and TLA may appoint one director.

The Law Society took over administration of LibraryCo based on an Administrative Services Agreement signed in March 2007.

The Canadian Institute of Chartered Accountants introduced a new accounting standard for reporting financial instruments this year. Because of the nature of LibraryCo's financial instruments (cash, short-term investments, receivables, accounts payable and accrued liabilities), there was no change in measurement of the organization's assets and liabilities.

Results of Operations

Results for the year identify a deficit of $111,299 compared to a surplus of $26,335 in 2006. The deficit is attributable to expenses incurred as LibraryCo transitioned to the new administrative arrangement. As approved by the Board of Directors, the deficit has been financed from the Reserve Fund which ends the year with a balance of $997,452.

Total revenues increased from $7.8 million in 2006 to $8.2 million due to an increase in the grant from the Law Society. Total expenses experienced a similar increase to $8.3 million with increases mainly in administration and higher grants to the county libraries.

Balance Sheet

Cash and short-term investments

Cash and near cash balances at $1.2 million are $136,000 higher than 2006 primarily because the initial advance of Law Foundation funding for 2008 of $212,500 was received prior to year-end. Typically this funding would be received in February.

Capital Assets

Capital assets were written off during the year due to the closure of LibraryCo's Burlington office.

Deferred Revenue

As noted above, the initial advance of Law Foundation funding for 2008 of $212,500 was received prior to year-end.

General Fund

The General Fund has a nil balance at year-end as the opening balance of $3,933 and transfer from the Reserve Fund of $99,469 funded the deficit in 2007.

Reserve Fund

In compliance with Board policy, $99,469 from the Reserve Fund was transferred to the General Fund as deficit financing. The Board policy on the Reserve Fund established in 2007 is that LibraryCo maintains a reserve of at least $500,000 including general, capital and special needs components. Any expenses of this Fund that would reduce the Fund Balance below $500,000 will be budgeted in the following year.

Invested in Capital Assets Fund

In previous years, expenditures capitalized and reported as capital assets were maintained in the Invested in Capital Assets Fund. In 2007, all capital assets were written off due to the closure of LibraryCo's Burlington office.

Statement of Revenues and Expenses

Revenues

Law Society of Upper Canada grant

This is the lawyer-based fee totaling $7.2 million in 2007 (2006 - $6.8 million) that is transferred to LibraryCo from the Law Society. The 2007 County Library Levy collected by the Law Society was $224 per lawyer (2006 - $219). The increase in the per lawyer charge was necessary due to the increases in costs, particularly publishing costs.

Law Foundation grant

The total for 2007 of $984,000 was slightly less than 2006 because the Virtual Reference Service is being phased out, although this was slightly offset by revenue for computer upgrades. Grants include funding for electronic resources, the advoCHAT project, and computer upgrades.

Expenses

Salaries & administration

These expenses increased from $243,508 to $579,532 in 2007 as a result of the administrative transition.

Professional fees

Professional fees have reduced from $66,907 in 2006 to $40,404 in 2007 due to lower accounting and consulting fees during the year.

Other Expenses

Other Expenses include insurance and board expenses. At $77,589 they are $21,000 lower than 2006 as costs associated with head office operations were discontinued in the latter part of the year.

Electronic products and services

Electronic products and services expenditures at $1.7 million for the year are nearly $50,000 higher than 2006 due to the continued pattern of increases in publishing costs over recent years.

Computers

These are grants provided to assist the libraries with replacing and upgrading of aging computers and related accessories. The program was not in place in 2006.

Other library expenses

Other library related expenses include staff travel, COLAL and CDLPA Library Committee meetings and bulk purchase publications for the library system. The reduction from $323,000 in 2006 to $179,000 in 2007 is mainly attributable to the change in administrative arrangements.

County and District Law Libraries – grants

The remittances by LibraryCo to the county libraries totaled $5.3 million in 2007 compared to $5 million in 2006 based on approved increases in budgets including catching up on previous reductions in collections budgets.

Statement of Changes in Fund Balances

An analysis of the Statement of Changes in Fund Balances is provided in the Balance Sheet section above.

LIBRARYCO INC.

Auditors' Report

To the Shareholders of LibraryCo Inc.

We have audited the balance sheet of LibraryCo. Inc. as at December 31, 2007 and the statements of revenues and expenses, changes in fund balances and of cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statement present fairly, in all material respects, the financial position of the Organization as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Licensed Public Accountants
February 8, 2008

LIBRARYCO INC.

Balance Sheet

Stated in dollars
As at December 31

	2007	2006
Assets		
Current assets		
Cash and short-term investments	**1,222,971**	1,087,262
Accounts receivable	**41,469**	47,877
Prepaid expenses	**10,866**	15,144
	1,275,306	1,150,283
Capital assets	–	7,897
Total Assets	**1,275,306**	1,158,180
Liabilities, Share Capital and Fund Balances		
Accounts payable and accrued liabilities (note 8)	**65,154**	49,229
Deferred revenue	**212,500**	–
	277,654	49,229
Share Capital and Fund Balances		
Share capital (note 4)	**200**	200
General fund	–	3,933
Invested in capital assets fund	–	7,897
Reserve fund (note 2)	**997,452**	1,096,921
Total Share Capital and Fund Balances	**997,652**	1,108,951
Total Liabilities, Share Capital and Fund Balances	**1,275,306**	1,158,180

See accompanying notes

On behalf of the Board of Directors

David S Thompson

Chair – Board of Directors

B Hutchison

Chair – Audit and Finance Committee

LIBRARYCO INC.

Statement of Revenues and Expenses

Stated in dollars for the year ended December 31

	2007	2006
Revenues		
Law Society of Upper Canada grant	**7,164,196**	6,801,232
Law Foundation of Ontario grant	**983,825**	995,401
Interest income	**25,829**	26,259
Total Revenues	**8,173,850**	7,822,892
Expenses		
Head office/administration		
Salaries and administration	**579,532**	243,508
Professional fees	**40,404**	66,907
Other (note 5)	**77,589**	98,597
	697,525	409,012
County and District Law Libraries – centralized purchases		
Electronic products and services	**1,693,253**	1,650,269
Group benefits	**266,769**	266,297
Computers	**86,021**	–
Other (note 6)	**178,603**	323,471
	2,224,636	2,240,037
County and District Law Libraries – grants (note 7)	**5,321,085**	5,060,518
Capital and special needs grants	**41,903**	86,990
Total County and District Law Libraries expenses	**7,587,624**	7,387,545
Total Expenses	**8,285,149**	7,796,557
Excess of (expenses over revenues) revenues over expenses	**(111,299)**	26,335

See accompanying notes

LIBRARYCO INC.

Statement of Changes in Fund Balances

Stated in dollars for the year ended December 31

	2007				2006
	General Fund	Invested in Capital Assets Fund	Reserve Fund	**Total**	Total
Balance, beginning of year	3,933	7,897	1,096,921	**1,108,751**	1,082,416
Excess of (expenses over revenues) revenues over expenses	(103,402)	(7,897)	–	**(111,299)**	26,335
Inter-fund transfer	99,469	–	(99,469)	**–**	–
Balances, end of year	–	–	997,452	**997,452**	1,108,751

See accompanying notes

LIBRARYCO INC.

Statement of Cash Flows

Stated in dollars for the year ended December 31

	2007	2006
Net inflow (outflow) of cash related to operating activities:		
Excess of (expenses over revenues) revenues over expenses	**(111,299)**	26,335
Items not affecting cash:		
Amortization of capital assets	**1,419**	3,425
Write-off of capital assets	**6,478**	–
Net change in non-cash operating working capital items:		
Accounts receivable	**6,408**	(43,352)
Prepaid expenses	**4,278**	(680)
Accounts payable and accrued liabilities	**15,925**	511
Deferred revenue	**212,500**	(9,080)
Cash provided by (used in) operating activities	**135,709**	(22,841)
Cash and short-term investments, beginning of year	**1,087,262**	1,110,103
Cash and Short-term Investments, end of year	**1,222,971**	1,087,262

See accompanying notes

LIBRARYCO INC.

Notes to Financial Statements

Stated in whole dollars except where indicated
For the year ended December 31, 2007

1. General

LibraryCo Inc. ("the Organization") was established to develop policies, procedures, guidelines and standards for the delivery of county law library services and legal information across Ontario and to administer funding from licensees of the Law Society of Upper Canada ("the Society"). LibraryCo Inc. was initially incorporated under the *Business Corporations Act* of Ontario in 2001.

In June 2007, the corporate structure was amended, whereby 25% of the 100 Special shares, previously held by the County and District Law Presidents' Association ("CDLPA"), were issued to the Toronto Lawyers Association ("TLA") for $25. The Society continues to hold all of the 100 Common shares. The Society may appoint up to four directors, CDLPA may appoint up to three directors and TLA may appoint one director.

As a not-for-profit organization, LibraryCo Inc. is not subject to federal and provincial income and capital taxes.

Under an Administrative Services Agreement, the Society assumed most of the administrative functions of the Organization in March 2007.

2. Significant Accounting Policies

Basis of presentation

The financial statements have been prepared in accordance with the accounting standards for non-profit organizations published by the Canadian Institute of Chartered Accountants ("CICA"), using the restricted fund method of reporting contributions.

The General Fund accounts for the delivery, management and administration of library services. The Reserve Fund is restricted for specific purposes as periodically determined and approved by the board of directors. The Invested in Capital Assets Fund records the capital assets of the Organization.

Cash and short-term investments

Cash and short-term investments are amounts on deposit and invested in short-term (less than one year) investment vehicles according to the Organization's investment policy.

Reserve Fund

The Reserve Fund is maintained to assist the Organization's cash flows and act as a contingency fund. In accordance with a 2007 board resolution, the Fund will be maintained at a minimum of $500,000, comprising a general component of $200,000, a capital and special needs component of $150,000, and a staffing and severance component of $150,000. Any expenses of this Fund that would reduce the Fund balance below $500,000, should be replenished in the following year. As at December 31, 2007, the balance was $997,452 (2006 – $1,096,921).

Revenue recognition

Restricted contributions related to the general operations are recognized as revenue of the General Fund in the year in which the related expenses are incurred. All other restricted contributions are recognized as revenue of the appropriate restricted fund.

Measurement uncertainty

The preparation of the financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingencies at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Change in Accounting Policy

On January 1, 2007, the Organization adopted the CICA's revised standards on recognition and measurement and presentation of financial statements for not-for-profit organizations. As required, the revised standards have been applied retrospectively, as at January 1, 2007 without restatement of the comparative amounts.

Under the new standards for recognizing and measuring financial instruments, all financial assets are classified into one of the following four categories: held for trading, held to maturity, loans and receivables or available for sale. All financial liabilities are classified into one of the following two categories: held for trading or other financial liabilities.

The Organization's financial assets and financial liabilities are classified and measured as follows:

Asset / Liability	Category	Measurement
Cash and short-term investments	Held for trading	Fair value
Receivables	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost

The other amounts noted on the balance sheet are not within the scope of the new accounting standards as they are not financial instruments.

There was no impact on the Organization's opening balance sheet as a result of the application of the new accounting policy because there was no change in the measurement of any of the Organization's financial assets or liabilities.

The Organization has not entered into any derivative transactions. In addition, the Organization does not have any embedded features in contractual arrangements.

4. Share Capital

Authorized

Unlimited number of Common shares

Unlimited number of Special shares

Issued	2007	2006
100 Common shares	**100**	100
100 Special shares	**100**	100
	200	200

At incorporation, the organization issued 100 Common shares to the Law Society of Upper Canada and 100 Special shares to the County & District Law Presidents' Association for cash consideration of $100 each. In June 2007, CDLPA transferred 25 Special shares to the Toronto Lawyers Association for $25.

5. Other Expenses – Head Office/Administration

Included in these expenses are costs associated with administration by the Society, directors' and officers' insurance, board of directors' meetings and other miscellaneous items.

6. Other Expenses – County and District Law Libraries – centralized purchases

Included in these expenses are costs associated with staffing and travel, document delivery, publications, committee meetings and miscellaneous items.

7. County and District Law Library Grants

These grants represent the quarterly distribution of funds to the 48 County and District Law Libraries. They are distributed in accordance with policies and procedures as established by the Organization's board of directors.

The following individual library grants were distributed by the Organization during 2007 and 2006:

	2007	2006
Algoma District Law Association	**113,944**	110,625
Brant Law Association	**73,238**	71,106
Bruce Law Association	**45,918**	44,581
Carleton Law Association	**558,836**	542,559
Cochrane Law Association	**34,272**	35,017
Dufferin Law Association	**47,149**	45,775
Durham County Law Association	**113,823**	110,508
Elgin Law Association	**64,447**	54,730
Essex Law Association	**235,496**	228,637
Frontenac Law Association	**128,302**	124,565
Grey Law Association	**56,047**	46,575
Haldimand Law Association	**25,219**	23,999
Halton Law Association	**112,418**	103,792
Hamilton Law Association	**368,886**	358,142
Hastings Law Association	**72,490**	62,538
Huron Law Association	**63,477**	53,788
Kenora Law Association	**74,956**	72,773
Kent Law Association	**60,440**	50,840
Lambton County Law Association	**53,294**	43,902
Lanark Law Association	**22,623**	21,478
Leeds & Grenville Law Association	**62,713**	56,304
Lennox & Addington Law Association	**23,258**	22,581
Lincoln Law Association	**143,358**	139,182
Manitoulin Law Association	**6,365**	6,180
Middlesex Law Association	**295,187**	286,590
Muskoka Law Association	**42,231**	34,156
Nipissing Law Association	**69,178**	61,810
Norfolk Law Association	**60,409**	58,649
Northumberland County Law Association	**60,206**	58,453
Oxford Law Association	**63,492**	59,653
Parry Sound Law Association	**27,486**	24,987
Peel Law Association	**244,806**	237,675
Perth Law Association	**53,668**	46,131
Peterborough Law Association	**94,620**	86,512
Prescott & Russell Law Association	**4,726**	9,462
Rainy River Law Association	**24,182**	22,992
Renfrew County Law Association	**99,661**	96,758
Simcoe Law Association	**119,400**	115,922
Stormont, Dundas & Glengarry Law Association	**63,879**	54,179
Sudbury District Law Association	**158,865**	138,409
Temiskaming Law Association	**43,379**	35,271
Thunder Bay Law Association	**135,776**	131,821
Toronto Lawyers Association	**507,979**	493,184
Victoria Haliburton Law Association	**71,482**	69,400
Waterloo Law Association	**205,379**	199,397
Welland Law Association	**76,903**	74,662
Wellington Law Association	**61,520**	63,684
York Region Law Association	**175,702**	170,584
	5,321,085	5,060,518

8. Related Party Transactions

The Society provides administrative services to the Organization (note 1), as well as certain other services and publications. The total amount billed by the Society for 2007 was $410,297 (2006 – $82,424). Included in accounts payable are amounts due to the Society of $42,898 (2006 – $3,115).

9. Contingencies and Guarantees

In the normal course of business, the Organization enters into agreements that meet the definition of a guarantee. The Organization's primary guarantees are as follows:

(a) Indemnity has been provided to all directors and/or officers of the Organization for various items including, but not limited to, all costs to settle suits or actions due to their involvement with the organization, subject to certain restrictions. The Organization has purchased directors' and officers' liability insurance to mitigate the cost of any potential future suits or actions. The term of the indemnification is not explicitly defined, but is limited to the period over which the indemnified party served as a trustee, director or officer of the Organization. The maximum amount of any potential future payment cannot be reasonably estimated.

(b) In the normal course of business, the Organization has entered into agreements that include indemnities in favour of third parties, such as purchase and sale agreements, engagement letters with advisors and consultants, leasing contracts, information technology agreements and service agreements. These indemnification agreements may require the Organization to compensate counterparties for losses incurred by the counterparties as a result of breaches in representation and regulations or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnities are not explicitly defined and the maximum amount of any potential reimbursement cannot be reasonably estimated.

The nature of these indemnification agreements prevents the Organization from making a reasonable estimate of the maximum exposure due to the difficulties in assessing the amount of liability that stems from the unpredictability of future events and the unlimited coverage offered to counterparties. Historically, the Organization has not made any significant payments under such or similar indemnification agreements and therefore no amount has been accrued in the financial statements with respect to these agreements.

10. Comparative Figures

Certain of the prior year's comparative figures have been reclassified to conform to the current year's financial statement presentation.