**Consolidated Financial Statements of**

# MORNEAU SOBECO INCOME FUND

**For the Years Ended December 31, 2009 and 2008**

## MANAGEMENT STATEMENT OF RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements for Morneau Sobeco Income Fund (the "Fund") have been prepared by management and approved by the Board of Trustees of the Fund. Management is responsible for the preparation and presentation of these financial statements and all the financial information contained in the Annual Report within reasonable limits of materiality. The Fund's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. In the preparation of these financial statements, estimates are necessary because a precise determination of certain assets and liabilities is dependent on future events. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying consolidated financial statements.

To assist management in discharging these responsibilities, the Fund maintains a system of internal controls, which is designed to provide reasonable assurance that the Fund's assets are safeguarded, that transactions are executed in accordance with management's authorization and that the financial records form a reliable base for the preparation of accurate and timely financial information.

Management recognizes its responsibilities for conducting the Fund's affairs in compliance with established financial reporting standards and applicable laws, and for the maintenance of proper standards of conduct in its activities.

KPMG LLP, Chartered Accountants, were appointed as external auditors by the Trustees of the Fund and have audited the consolidated financial statements of the Fund in accordance with Canadian generally accepted auditing standards. Their report outlines the nature of their audit and expresses their opinion on the consolidated financial statements of the Fund.

The Board of Trustees of the Fund has appointed an Audit Committee composed of three Trustees who are not members of management. The Audit Committee meets periodically with management and the external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee is responsible for reviewing the Fund's annual and interim consolidated financial statements and the report of the external auditors. The Audit Committee reports the results of such reviews to the Board of Trustees of the Fund and makes recommendations with respect to the appointment of the Fund's external auditors. In addition, the Board of Trustees may refer to the Audit Committee on other matters and questions relating to the financial position of the Fund and its subsidiaries.

The Board of Trustees of the Fund is responsible for ensuring that management fulfills its responsibilities for financial reporting and is responsible for approving the consolidated financial statements of the Fund.

*"Alan Torrie"*

**Alan Torrie**
President and CEO

*"Scott Milligan"*

**Scott Milligan**
Chief Financial Officer

**KPMG LLP**
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# AUDITORS' REPORT

To the Unitholders of Morneau Sobeco Income Fund

We have audited the consolidated balance sheets of Morneau Sobeco Income Fund (the "Fund") as at December 31, 2009 and 2008 and the consolidated statements of income and comprehensive income, unitholders' equity and cash flows for the years 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 audits.

We conducted our audits 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 consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

March 9, 2010

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**MORNEAU SOBECO INCOME FUND**

CONSOLIDATED BALANCE SHEETS

As at December 31

(In thousands of dollars)

| | 2009 | 2008 |
|---|---|---|
| **ASSETS** | | |
| **Current assets:** | | |
| Cash | $ 1,606 | $ - |
| Accounts receivable | 53,791 | 52,930 |
| Unbilled fees | 17,526 | 15,861 |
| Income taxes recoverable | 1,796 | 1,484 |
| Prepaid expenses and other | 3,288 | 5,482 |
| Current portion of deferred implementation costs | 167 | - |
| | 78,174 | 75,757 |
| Future income taxes (note 13) | 12,180 | 7,740 |
| Foreign exchange contracts (note 22) | 479 | - |
| Deferred implementation costs | 929 | - |
| Capital assets (note 4) | 15,333 | 16,069 |
| Intangible assets (note 5) | 253,659 | 290,623 |
| Goodwill (note 6) | 300,792 | 299,676 |
| | $ 661,546 | $ 689,865 |
| **LIABILITIES AND UNITHOLDERS' EQUITY** | | |
| **Current liabilities:** | | |
| Bank indebtedness (note 7) | $ - | $ 504 |
| Accounts payable and accrued liabilities | 39,139 | 40,033 |
| Deferred revenues | 1,795 | 2,245 |
| Current portion of long-term debt (note 7) | 11,500 | 7,000 |
| Current portion of promissory note (note 8) | 4,306 | 31,632 |
| Future consideration related to acquisition (note 3) | 2,457 | 684 |
| Unitholder distributions payable (including non-controlling) | 3,759 | 3,233 |
| | 62,956 | 85,331 |
| **Insurance premium liabilities:** | | |
| Payable to insurance companies | 9,313 | 12,037 |
| Less related cash and investments held | (9,313) | (12,037) |
| | - | - |
| Long-term debt (note 7) | 158,887 | 135,418 |
| Promissory notes (note 8) | - | 43,917 |
| Interest-rate swaps and foreign exchange contracts (note 7 and 22) | 6,656 | 11,917 |
| Future consideration related to acquisition (note 3) | - | 1,727 |
| Other liabilities (note 9) | 10,206 | 8,611 |
| Future income taxes (note 13) | 24,359 | 33,090 |
| | 263,064 | 320,011 |
| Non-controlling interests (note 11) | 46,137 | 51,724 |
| Unitholders' equity (note 10) | 352,345 | 318,130 |
| | $ 661,546 | $ 689,865 |

**Commitments and Contingencies (notes 3, 7,17 and 18 )**

***Economic dependence (note 19)***

**See accompanying notes to consolidated financial statements**

***"Robert Chisholm"***
**Robert Chisholm**
**Trustee, Audit Committee Chair**

***"Alan Torrie"***
**Alan Torrie**
**Trustee, President & CEO**

MORNEAU SOBECO INCOME FUND
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands of dollars, except per unit amounts)

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| Revenue | | |
| **Fees** | **$ 309,315** | **$ 227,235** |
| **Commissions** | **22,044** | **21,940** |
| **Other** | **344** | **538** |
| | **331,703** | **249,713** |
| Expenses | | |
| **Salary, benefit and contractor expenses** | **211,543** | **156,707** |
| **Other operating expenses** | **60,184** | **42,895** |
| **Amortization of capital assets** | **4,012** | **3,301** |
| **Amortization of intangible assets** | **41,139** | **30,759** |
| **Interest expense (note 7)** | **13,211** | **11,172** |
| | **330,089** | **244,834** |
| **Income before income taxes and non-controlling interest** | **1,614** | **4,879** |
| **Income taxes (recovery) (note 13)** | | |
| **Current** | **813** | **27** |
| **Future** | **(11,427)** | **(5,689)** |
| | **(10,614)** | **(5,662)** |
| **Income before non-controlling interest** | **12,228** | **10,541** |
| **Non-controlling interest (note 11)** | **(1,402)** | **(1,745)** |
| Net income | **10,826** | **8,796** |
| Other comprehensive income (loss) | | |
| **Unrealized gain (loss) on interest rate cash flow hedges, net of tax effect (note 7)** | **4,524** | **(11,096)** |
| Comprehensive income (loss) for the year | **$ 15,350** | **$ (2,300)** |
| Net income per Unit (basic) (note 15) | **$ 0.27** | **$ 0.30** |
| Net income per Unit (diluted) (note 15) | **$ 0.26** | **$ 0.30** |

**See accompanying notes to consolidated financial statements**

*MORNEAU SOBECO INCOME FUND*

# CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

Years Ended December 31, 2009 and 2008
(In thousands of dollars)

| | Unitholders' Capital | Contributed Surplus | Accumulated Other Comprehensive Income/(Loss) | Deficit | Total |
|---|---|---|---|---|---|
| Balance, December 31, 2007 | **$ 211,833** | **$ -** | **$ -** | **$ (14,165)** | **$ 197,668** |
| **Exchange of Class B LP Units** | **4,556** | **-** | **-** | **-** | **4,556** |
| **Issuance of Units** | **153,000** | **-** | **-** | **-** | **153,000** |
| **Issuance costs, net of future income tax benefits** | **(7,166)** | **-** | **-** | **-** | **(7,166)** |
| **Net income for the year** | **-** | **-** | **-** | **8,796** | **8,796** |
| **Comprehensive loss for the year** | **-** | **-** | **(11,096)** | **-** | **(11,096)** |
| **Distributions** | **-** | **-** | **-** | **(27,628)** | **(27,628)** |
| Balance, December 31, 2008 | **$ 362,223** | **$ -** | **$ (11,096)** | **$ (32,997)** | **$ 318,130** |
| **Change in accounting policy related to EIC 173 (note 2(p)(ii))** | **-** | **-** | **627** | **-** | **627** |
| **As restated, January 1, 2009** | **362,223** | **-** | **(10,469)** | **(32,997)** | **318,757** |
| **Exchange of Class B LP Units (note 10)** | **1,721** | **-** | **-** | **-** | **1,721** |
| **Issuance of Units (note 10)** | **55,000** | **-** | **-** | **-** | **55,000** |
| **Issuance costs, net of future income tax benefits (note 10)** | **(2,467)** | **-** | **-** | **-** | **(2,467)** |
| **Long-term incentive plan – conversion (note 12)** | **(3,176)** | **1,650** | **-** | **-** | **(1,526)** |
| **Long-term incentive plan – non-cash expense (note 12)** | **-** | **2,258** | **-** | **-** | **2,258** |
| **Long-term incentive plan – vested Units (note 12)** | **73** | **(73)** | **-** | **-** | **-** |
| **Long-term incentive plan – sale of Treasury Units (note 10)** | **2,293** | **-** | **-** | **(407)** | **1,886** |
| **Net income for the year** | **-** | **-** | **-** | **10,826** | **10,826** |
| **Comprehensive income for the year** | **-** | **-** | **4,524** | **-** | **4,524** |
| **Distributions** | **-** | **-** | **-** | **(38,634)** | **(38,634)** |
| Balance, December 31, 2009 | **$ 415,667** | **$ 3,835** | **$ (5,945)** | **$ (61,212)** | **$ 352,345** |

**See accompanying notes to consolidated financial statements**

MORNEAU SOBECO INCOME FUND
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands of dollars)

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| Cash provided by (used in): | | |
| Operating activities | | |
| **Net income** | **$ 10,826** | **$ 8,796** |
| **Items not involving cash:** | | |
| **Amortization of capital assets** | **4,012** | **3,301** |
| **Amortization of intangible assets** | **41,139** | **30,759** |
| **Amortization of debt issue costs (note 7)** | **469** | **355** |
| **Non-controlling interest of Class B LP Units** | **1,402** | **1,745** |
| **Gain on sale of intangible assets** | **(94)** | **-** |
| **Long-term incentive plan** | **2,258** | **-** |
| **Future income taxes (recovery)** | **(11,427)** | **(5,689)** |
| **Salary component of Heath acquisition (note 3(d))** | **-** | **1,212** |
| **Accretion on promissory notes (note 7)** | **3,488** | **4,191** |
| **Fair value of forward exchange contracts (note 22)** | **(1,299)** | **821** |
| **Fair value of interest-rate swap agreements** | **-** | **785** |
| **Changes in sublease loss provisions** | **1,956** | **-** |
| **Write-down of leasehold improvements related to sublease loss provisions** | **1,338** | **-** |
| **Other** | **(503)** | **299** |
| | **53,565** | **46,575** |
| **Change in non-cash operating working capital (note 16)** | **(4,610)** | **(11,280)** |
| | **48,955** | **35,295** |
| Financing activities | | |
| **Issuance of units (note 10)** | **55,000** | **153,000** |
| **Expenses related to issuance of units (note 10)** | **(3,500)** | **(10,287)** |
| **Proceeds from long-term debt (note 7)** | **23,000** | **137,000** |
| **Repayment of promissory note (note 8)** | **(74,730)** | **-** |
| **Repayment of term loan** | **-** | **(35,000)** |
| **Deferred financing cost** | **-** | **(1,854)** |
| **Change in revolving loan (note 7)** | **4,500** | **7,000** |
| **Proceeds from sale of treasury Units (note 10)** | **1,886** | **-** |
| **Distributions paid** | **(43,377)** | **(31,530)** |
| | **(37,221)** | **218,329** |
| Investing activities | | |
| **Business acquisition – Leong & Associates (note 3(a))** | **-** | **(2,410)** |
| **Business acquisition – Shepell•fgi (note 3(b))** | **-** | **(248,763)** |
| **Business acquisition – Cowan (note 3(c))** | **(930)** | **(1,360)** |
| **Business acquisition – Heath (note 3(d))** | **-** | **(1,755)** |
| **Cash assumed from acquisitions (note 3(a) & (b))** | **-** | **343** |
| **Additions to intangible assets** | **(4,325)** | **(1,332)** |
| **Proceeds from sale of intangible assets** | **218** | **-** |
| **Purchase of capital assets** | **(4,587)** | **(1,749)** |
| | **(9,624)** | **(257,026)** |
| Net increase (decrease) in cash for the year | **2,110** | **(3,402)** |
| **(Bank indebtedness) Cash, beginning of year** | **(504)** | **2,898** |
| Cash (Bank indebtedness), end of year | **$ 1,606** | **$ (504)** |

***See accompanying notes to consolidated financial statements***

## 1. ORGANIZATION AND NATURE OF THE BUSINESS

Morneau Sobeco Income Fund (the "Fund") is an unincorporated, open-ended, limited purpose trust established under the laws of the Province of Ontario on August 22, 2005.

The Fund is a Canadian-owned firm providing human resource consulting and outsourcing services, delivering solutions to assist employers in managing the financial security, health and productivity of their employees. The Fund offers its services to organizations that are situated in Canada, in the United States and around the globe.

## 2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Fund have been prepared by management in accordance with Canadian generally accepted accounting principles and the significant accounting policies are summarized below:

(a) Basis of presentation

These consolidated financial statements include the assets, liabilities, revenue and expenses of the following entities:

| | % Ownership |
|---|---|
| Morneau Sobeco Trust ("Trust") | 100.0 |
| Morneau Sobeco GP Inc. ("MS GP") | 100.0 |
| Morneau Sobeco Limited Partnership ("MSLP") | 88.6 |
| Morneau Sobeco Group Limited Partnership ("MS Group LP") | 88.6 |
| Morneau Sobeco, Ltd. | 88.6 |
| HRCO Inc ("HRCO") | 88.6 |
| FGI World France S.A.R.L. | 88.6 |
| FGI World New Caledonia | 88.6 |
| 1137273 Ontario Limited | 88.6 |
| Morneau Sobeco IT Solutions Inc. (formerly 2183573 Ontario Inc) | 88.6 |
| Innu-Med Inc. | 42.5 |

All intercompany transactions and balances have been eliminated upon consolidation.

(b) 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 disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period.

The most significant estimates that the Fund is required to make relate to the recoverability of its intangible assets, goodwill, accounts receivable, derivative financial instruments and the valuation of future income tax assets and liabilities. The estimated value of these assets and liabilities usually depend upon estimates of the profitability of the related business which, in turn, depend upon assumptions regarding future conditions in the general or specific industry, including the effects of economic cycles, and other factors that affect the operating revenue.

These assumptions are limited by the availability of reliable comparable data, economic uncertainty and the uncertainty of predictions concerning future events. Accordingly, by their nature, estimates of fair value are subjective and do no necessarily result in precise determinations. Should the underlying

assumptions change, the estimated value could change by a material amount.

**2. SIGNIFICANT ACCOUNTING POLICIES** (continued)

(c) Revenue recognition and unbilled fees

Revenues include fees generated from administrative, actuarial, and consulting services, employee assistance programs (EAP), and outsourcing contracts.

Fees for administrative, actuarial and consulting services are billed either on a time-and-material basis or on a fixed-fee basis. On time-and-material engagements, revenue is recognized as services are rendered and expenditures are incurred. On fixed-fee engagements, revenue is recognized in the period in which the services are rendered.

EAP revenue is recognized through a combination of the minimum contracted amount and incremental usage above the minimum thresholds. The minimum contracted amount is recognized on a basis consistent with provision of EAP services. Incremental usage is recognized when the minimum usage threshold is exceeded.

Outsourcing engagements typically involve both an implementation and administration component. Revenues associated with these contracts have been recognized in accordance with CICA Handbook EIC-142 *Revenue Arrangements with Multiple Deliverables*, to determine whether each component of the outsourcing contract qualifies for treatment as a separate unit of account. Multiple deliverable arrangements are determined to exist if all of the following criteria are met:

- The delivered item has value to the customer on a stand-alone basis;
- There is objective evidence of the fair value of the undelivered item; and
- If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item is considered probable and substantially in the control of the vendor.

If these criteria are not met, deliverables (components) included in an arrangement are accounted for as a single unit of accounting and revenue is deferred and recognized on a basis consistent with elements of the service contract.

Unbilled fees are recorded at the lower of unbilled hours worked at normal billing rates and the amount which is estimated to be recoverable upon invoicing.

Commissions are recognized when earned, which is at the later of the billing or the effective date of the policy, net of a provision for return commissions due to policy cancellations or change of brokers.

Other revenue includes investment income recorded on the accrual basis.

(d) Deferred implementation costs and deferred outsourcing revenues

Implementation costs incurred in connection with the outsourcing service contracts, relate to those costs necessary to set up clients and their human resource or benefit programs onto the Fund's systems and operating processes. Such costs may include internal and external costs for coding and customizing systems, client data conversion costs, and contract negotiation costs. On outsourcing contracts that are accounted for as a combined unit of accounting, specific, incremental, and direct costs of the implementation component are deferred and amortized over the term of the service contract. For outsourcing contracts where each component is considered a separate unit of accounting, those costs are deferred and amortized over the remaining term of each component.

**2. SIGNIFICANT ACCOUNTING POLICIES** (continued)

Implementation fees are typically received from clients either up-front or over the course of the implementation period. These fees are initially deferred and recognized as revenue over the term of the service contract if accounted for as a combined unit of accounting, or over the term of the implementation period, if accounted for as a separate unit of accounting. If a client terminates an outsourcing contract prior to its end, a loss on the contract may be recorded (if necessary), and any remaining deferred implementation revenues and costs would be recognized into income over the remaining implementation period through to the date of termination.

(e) Foreign currency translation

The Fund's and its subsidiaries' functional currency is the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the exchange rates prevailing at the consolidated balance sheet dates. Non-monetary items have been translated into Canadian dollars at the exchange rates prevailing when the assets were acquired or obligations incurred. Revenues and expenses have been translated at rates in effect on the transaction dates. Exchange gains or losses are reflected in income for the year.

(f) Capital assets

Capital assets are stated at their initial capital cost less accumulated amortization. Amortization is recognized over the assets' estimated useful lives as follows:

| Asset | Basis | Rate |
|---|---|---|
| **Computer equipment** | **Declining balance** | **30%** |
| **Furniture and equipment** | **Declining balance** | **20%** |
| **Leasehold improvements** | **Straight-line** | **Over term of the lease** |

(g) Intangible assets

Intangible assets consist of customer relationships, customer contracts, proprietary software, non-compete agreements, and trade names acquired through acquisitions or business combinations, internally-developed software for internal use, and purchased software. Intangible assets acquired through acquisitions or business combinations are initially recognized at fair value based on an allocation of the purchase price. Internally-developed proprietary software for internal use is recognized at the aggregate fair value of all eligible development costs, determined in accordance with Section 3064, *Goodwill and Intangible Assets*. Eligible expenditures capitalized as part of proprietary software developed for internal use include external direct costs of materials and services consumed in development, and payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use computer software project (to the extent that their time was spent directly on the project). All costs incurred in the preliminary research stage of the projects are expensed as incurred.

Intangible assets with a finite life are amortized on a straight-line basis over their estimated useful lives, or on a declining balance basis for purchased software. Intangible assets with an indefinite life are not amortized, but are tested for impairment annually or more frequently if events or circumstances indicate there may be an impairment by comparing the estimated discounted future net cash flows from the asset to its carrying amount.

**2. SIGNIFICANT ACCOUNTING POLICIES** (continued)

**Amortization is recognized over the assets' estimated useful lives as follows:**

| Asset | Estimated useful lives |
|---|---|
| **Customer relationships** | **15 to 20 years** |
| **Customer contracts** | **1 to 2 years** |
| **Proprietary software** | **5 years** |
| **Non-compete agreements** | **16 months** |
| **Trade names** | **Indefinite** |
| **Internally-developed software** | **5 years** |
| **Purchased software** | **30% to 50% declining balance** |

(h) Impairment of long-lived assets

Long-lived assets with finite lives are reviewed for impairment annually or whenever events or changes in circumstances cause their carrying amount to exceed the total undiscounted cash flows expected from their use and eventual disposition. An impairment loss is measured at the amount by which the carrying amount of the long-lived asset exceeds its fair value.

(i) Goodwill

Goodwill is not amortized and is subject to an annual impairment test. Goodwill impairment is assessed based on a comparison of the estimated fair value of each of the Fund's reporting units and the carrying value of its net assets including goodwill. An impairment loss will be recognized if the carrying amount of the reporting unit's net assets exceeds its estimated fair value.

(j) Insurance premium liabilities and related cash and investments

In its capacity as consultants, the Fund collects premiums from insurers and remits premiums, net of agreed deductions, such as taxes, administrative fees and commissions, to insurance underwriters. These are considered flow-through items for the Fund and, as such, the cash and investment balances relating to these liabilities are deducted from the related liability in the consolidated balance sheets.

(k) Long-term incentive plan

Under the Fund's long-term incentive plan ("LTIP") consisting of a restricted stock unit plan (the "RSU plan") and a deferred stock unit plan (the "DSU plan"), participants are eligible to receive Units. The amount awarded under the DSU plan is valued at the Unit's fair value on the date of the award, and the RSU plan is based on the purchased amount. The amounts awarded are recorded as salary, benefit and contractor expenses in line with the vesting dates which range from one to three years. As the Units vest, they are transferred or issued to the plan participant and are recorded as Unitholders' Capital. Unvested DSUs (note 12) are entitled to cash bonuses equivalent to the distributions paid on the Fund Units and the amounts are recorded as expenses as distributions are declared.

## 2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(l) Employee future benefits

The Fund offers a pension benefit plan for its eligible employees, which includes a defined benefit option and a defined contribution option.

The defined benefit option was closed effective January 1, 1998 and included 6 employees, 11 retirees and 46 deferred vested members as at December 31, 2009. All other employees are covered by the defined contribution option of the plan.

The Fund accrues its obligations under the defined benefit option of the plan as the employees render the services necessary to earn the pension. For the defined contribution option, the Fund matches member contributions and may be required to make additional contributions at the option of the member, up to the limits defined in the plan text.

(m) Income taxes

The Fund uses the asset and liability method of accounting for income taxes. Future income taxes are recognized for the temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws that are expected to apply to taxable income in the years in which those temporary differences are expected to be reversed or settled. A valuation allowance is recorded against a future income tax asset if it is not anticipated that the asset will be realized in the foreseeable future. The effect on future income tax assets and liabilities of a change in tax rate is recognized in income in the period that includes the date of enactment or substantive enactment.

(n) Deferred lease inducements

Lease inducements comprise rent-free periods and leasehold improvement allowances. Lease inducements are deferred and amortized to rental expense on a straight-line basis over the term of the related lease.

(o) Financial instruments

Financial assets and financial liabilities are initially measured at fair value, defined as the amount of consideration that could be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. In certain circumstances, however, the initial fair value may be based on other observable current market transactions in the same instrument, without modification or on a valuation technique using market based inputs. Subsequent measurement of the Fund's financial assets and liabilities is dependent on their classification as held for trading, loans and receivables, other financial liabilities, or derivative instruments.

Held for trading financial assets and liabilities are measured at fair value as at the date of the consolidated balance sheet, and any unrealized gains or losses from market fluctuations are included in the consolidated statement of income.

Loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method of amortization.

**2. SIGNIFICANT ACCOUNTING POLICIES** (continued)

Derivative financial instruments are used by the Fund in the management of its interest rate risk exposure on debt financing and foreign exchange risk arising due to fluctuations in the United States dollar. Derivatives that have been designated and function effectively as a hedge are accounted for using hedge accounting principles. The effective portions of changes in fair value of derivatives that qualify for hedge accounting are recorded in other comprehensive income. Any ineffective portions of changes in the fair value are recognized in net income in the period in which the change occurred. If the hedging relationship ceases to be effective, the cumulative change in the fair value of the interest-rate swap are recognized into income beginning in the period in which the change occurs. Derivatives that do not qualify for hedge accounting are recorded on the consolidated balance sheet at fair value with changes in fair value recorded as income or expense in the consolidated statement of income.

Fair value measurements recognized in the balance sheet are categorized using a fair value hierarchy that reflects the significant inputs used in determining the fair values, in accordance with the amendment to CICA Handbook Section 3862 in June 2009:

(i) Level 1 - Inputs unadjusted quoted prices of identical instruments in active markets

(ii) Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly

(iii) Level 3 – One or more significant inputs used in a valuation technique are unobservable in determining fair values of the instruments

Each type of fair value is categorized based on the lowest level input that is significant to the fair value measurement.

The Fund does not use derivative financial instruments for trading or speculative purposes.

(p) New accounting policies

Effective January 1, 2009 the Fund adopted the following new accounting standards:

1. Section 3064, *Goodwill and Intangible Assets*, which replaces the existing Section 3062, *Goodwill and Other Intangible Assets* and Section 3450, *Research and Development Costs*. This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. The standards concerning goodwill are unchanged from the standards included in the previous section 3062. The adoption of this section has not impacted the Fund's consolidated net comprehensive income, but did result in the reclassification of computer software costs from capital assets to intangible assets in the amount of $1,198 as at December 31, 2008.

2. EIC 173, *Credit Risk and Fair Value of Financial Assets and Financial Liabilities*. This Abstract establishes that an entity's own credit risk and that of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, inclusive of derivative instruments. EIC 173 has been applied retrospectively without restatement of prior periods for the period commencing January 1, 2009. The adoption of EIC 173 resulted in an adjustment to opening accumulated other comprehensive loss of $627, net of tax effect.

**2. SIGNIFICANT ACCOUNTING POLICIES** (continued)

(q) Future accounting changes

(i) Business combinations – In January 2009, the CICA issued new Handbook Section 1582, *Business Combinations*, replacing the former Section 1581, *Business Combinations*, and representing the Canadian equivalent to International Financial Reporting Standards 3, *Business Combinations*. The new Section expands the definition of a business subject to an acquisition and establishes significant new guidelines on the measurement of consideration given, and the recognition and measurement of assets acquired and liabilities assume in a business combination. The new Section requires that all business acquisitions be measured at the full fair value of the acquired entity at the acquisition date even if the business combination is achieved in stages, or if less than 100% of the equity interest in the acquiree is owned at the acquisition date. Subsequent changes in fair value of contingent consideration classified as a liability will be recognized in earnings and not as an adjustment to the purchase price. Restructuring and other direct costs of a business combination are no longer considered part of the acquisition accounting and such costs will be expensed as incurred, unless they constitute the costs associated with debt or equity issuance.

(ii) Consolidated financial statements and non-controlling interests – In January 2009, the CICA issued new Handbook Sections 1601, *Consolidated Financial Statements*, and Section 1602, *Non-controlling Interests*, replacing Section 1600, *Consolidated Financial Statements*. These two Sections are the equivalent to the corresponding provisions of International Accounting Standard 27, Consolidated and Separate Financial Statements. The new Sections require that, for each business combination, the acquirer measure any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. The new Sections also require non-controlling interest to be presented as a separate component of unitholders' equity. Under Section 1602, consolidated net income and other comprehensive income are allocated to the controlling and non-controlling interests based on relative ownership interests.

(iii) International Financial Reporting Standards ("IFRS") – The Canadian Accounting Standards Board confirmed in February 2008 plans to converge Canadian Generally Accepted Accounting Principles ("GAAP") with IFRS for interim and annual reporting periods commencing January 1, 2011. The Fund's first annual IFRS consolidated financial statements will be for the year ended December 31, 2011, and will include the comparative period for the year ended December 31, 2010. Starting with the first quarter of 2011, the Fund will provide unaudited consolidated financial statements in accordance with IFRS, including comparative figures for 2010.

**3. BUSINESS ACQUISITIONS**

(a) Leong & Associates Actuaries And Consultants Inc. ("Leong & Associates")

On October 1, 2008, a subsidiary of the Fund acquired all the issued and outstanding shares of Leong & Associates, a British Columbia based actuarial and pension consulting firm in Western Canada.

The purchase price is contingent on business results and is expected to be approximately $7,600 payable in three instalments. The first instalment was satisfied on closing through cash and equity consideration. The second and third instalments, which are subject to revenue adjustments plus interest calculated at annual rates of 3.27% and 3.87% will be settled on January 1, 2010 and April 1, 2011, respectively.

**3. BUSINESS ACQUISITIONS** (continued)

The contingent consideration has been recognized to the extent the acquired assets net of liabilities assumed exceed the first instalment of the purchase price. The acquisition has been accounted for by the purchase method, based on management's best estimates of the fair value of the net identifiable assets and liabilities.

| **Assets and liabilities acquired:** | |
|---|---|
| **Cash** | **$ 71** |
| **Accounts receivable** | **1,200** |
| **Unbilled fees** | **132** |
| **Prepaid expenses and other** | **57** |
| **Capital assets** | **19** |
| **Intangible assets** | **5,797** |
| **Goodwill** | **870** |
| **Accounts payable and accrued liabilities** | **(737)** |
| **Other liabilities** | **(280)** |
| **Future income tax liabilities** | **(1,662)** |
| | **$ 5,467** |

| **Consideration:** | |
|---|---|
| **Cash** | **$ 2,410** |
| **Exchangeable Units** | **600** |
| **Future considerations** | **2,457** |
| | **$ 5,467** |

Goodwill and future consideration have been adjusted by $870 to reflect the second instalment determined to be payable of $2,457 (December 31, 2008 - $1,727).

**These consolidated financial statements include the results of Leong & Associates from the date of acquisition on October 1, 2008.**

(b) Shepell·FGI Holdings LP ("Shepell•fgi" )

On June 2, 2008, the Fund indirectly acquired certain assets, shares of certain subsidiaries, liabilities and contracts of Shepell•fgi. The total purchase price is $320,121 including transaction cost of $1,404. The consideration was satisfied by cash of $247,359 and two non-interest bearing promissory notes of $75,000 and $4,500 repayable on July 2, 2009 and July 2, 2010, respectively. The promissory notes were recorded at their combined present value of $71,358.

The acquisition was financed by the issuance of the Fund's Units for proceeds of $153,000, net of underwriters' fees and estimated issuance expenses of approximately $10,287. The remaining amount was financed through cash from operations and the utilization of a new credit facility. $245,223 of the cash consideration, excluding transaction costs, was paid on closing and the remainder of $2,136 was settled in July 2008 after the finalization of the working capital. The acquisition has been accounted for by the purchase method based on management's best estimate of the fair value of the identifiable assets and liabilities acquired.

**3. BUSINESS ACQUISITIONS** (continued)

| **Assets and liabilities acquired:** | |
|---|---|
| **Cash** | **$ 272** |
| **Accounts receivable** | **14,672** |
| **Unbilled fees** | **9,956** |
| **Income taxes recoverable** | **572** |
| **Prepaid expenses and other** | **2,225** |
| **Capital assets** | **7,669** |
| **Intangible assets:** | |
| **Customer relationships** | **90,000** |
| **Customer contracts** | **27,500** |
| **Trade name** | **70,000** |
| **Non-compete agreements** | **5,000** |
| **Proprietary software** | **6,000** |
| **Goodwill** | **125,628** |
| **Accounts payable and accrued liabilities** | **(23,139)** |
| **Deferred revenue** | **(2,298)** |
| **Future income tax liabilities** | **(5,948)** |
| **Other liabilities** | **(7,988)** |
| | **$ 320,121** |
| **Consideration:** | |
| **Cash** | **$ 247,359** |
| **Transaction costs** | **1,404** |
| **Promissory notes issued to vendors, at present value** | **71,358** |
| | **$ 320,121** |

These consolidated financial statements include the results of Shepell•fgi from the date of acquisition on June 2, 2008.

(c) Cowan Benefits Consulting Limited (“Cowan”)

On June 1, 2007, a subsidiary of the Fund directly acquired certain assets, liabilities and contracts of the defined benefit pension administration and actuarial consulting practices (“Cowan DB business”) of Cowan, a benefits consulting firm based in the Waterloo region, in Ontario. The purchase price, based on the final pension administration and actuarial consulting services revenue and certain other integration conditions, was $6,073 and paid in three instalments.

The first instalment was made on the closing date of June 1, 2007 and was funded by $3,800 of the operating line of credit. In addition, the Fund issued a standby letter of credit in the amount of $400, which was paid on December 31, 2008 as the vendor performed its transition services obligations. The second instalment of $960 was paid on August 1, 2008. On August 1, 2009, the final instalment relating to this acquisition was made for cash consideration of $930, of which $684 was accrued for as contingent consideration on acquisition in 2007.

(d) Heath Benefits Consulting Inc. (“Heath”)

On June 1, 2006, the Fund indirectly acquired all of the issued and outstanding shares of Heath, a Vancouver-based benefits consulting firm with over 90 employees across Canada.

The acquisition was accounted for using the purchase method based on management's best estimate of the fair value of the identifiable assets and liabilities assumed, and the purchase price was $16,853. A portion of the purchase price was conditional on the continuing employment of certain selling shareholders ("salary component of the Heath acquisition") and has been recorded as salary expense over the required employment period to December 2008.

The second and final instalments related to this acquisition were fully satisfied on June 30, 2008 and December 1, 2008 respectively, through aggregate cash consideration of $1,755 and the issuance of 485,991 Class B LP Units of MS Group LP totaling $3,042.

The expenses related to the salary component of the Heath acquisition for the year ended December 31, 2008 was $1,212.

## 4. CAPITAL ASSETS

**The Fund's capital assets are comprised of:**

| | Cost | Accumulated Amortization December 31, 2009 | Net Book Value December 31, 2009 |
|---|---|---|---|
| **Computer equipment** | **$ 7,319** | **$ (2,566)** | **$ 4,753** |
| **Furniture and equipment** | **6,985** | **(2,936)** | **4,049** |
| **Leasehold improvements** | **11,622** | **(5,091)** | **6,531** |
| | **$ 25,926** | **$ (10,593)** | **$ 15,333** |

| | Cost | Accumulated Amortization December 31, 2008 | Net Book Value December 31, 2008 |
|---|---|---|---|
| **Computer equipment** | **$ 3,657** | **$ (1,371)** | **$ 2,286** |
| **Furniture and equipment** | **6,911** | **(2,205)** | **4,706** |
| **Leasehold improvements** | **13,474** | **(4,397)** | **9,077** |
| | **$ 24,042** | **$ (7,973)** | **$ 16,069** |

## 5. INTANGIBLE ASSETS

**The Fund's intangible assets are comprised of:**

| | Cost | Accumulated Amortization December 31, 2009 | Net Book Value December 31, 2009 |
|---|---|---|---|
| **Customer relationships** | **$199,557** | **$ (32,057)** | **$ 167,500** |
| **Customer contracts** | **27,500** | **(26,125)** | **1,375** |
| **Proprietary software** | **46,000** | **(35,900)** | **10,100** |
| **Internally-developed software** | **3,169** | **-** | **3,169** |
| **Purchased software** | **2,943** | **(1,428)** | **1,515** |
| **Non-compete agreements** | **5,000** | **(5,000)** | **-** |
| **Trade names** | **70,000** | **-** | **70,000** |
| | **$354,169** | **$ (100,510)** | **$ 253,659** |

As at December 31, 2009, the internally-developed software remained under development and had not yet been put into use.

## 5. INTANGIBLE ASSETS (continued)

| | Cost | Accumulated Amortization December 31, 2008 | Net Book Value December 31, 2008 |
|---|---|---|---|
| **Customer relationships** | **$199,708** | **$ (20,270)** | **$ 179,438** |
| **Customer contracts** | **32,500** | **(14,625)** | **17,875** |
| **Proprietary software** | **46,000** | **(26,700)** | **19,300** |
| **Purchased software** | **1,840** | **(642)** | **1,198** |
| **Non-compete agreements** | **5,000** | **(2,188)** | **2,812** |
| **Trade names** | **70,000** | **-** | **70,000** |
| | **$355,048** | **$ (64,425)** | **$ 290,623** |

## 6. GOODWILL

| | 2009 | 2008 |
|---|---|---|
| **Balance, beginning of year** | **$ 299,676** | **$ 169,451** |
| **Acquisition - Shepell•fgi (note 3(b))** | **-** | **125,628** |
| **Acquisition - Heath (note 3(d))** | **-** | **4,597** |
| **Acquisition - Cowan (note 3(c))** | **246** | **-** |
| **Acquisition - Leong & Associates (note 3(a))** | **870** | **-** |
| | **$ 300,792** | **$ 299,676** |

## 7. BANK INDEBTEDNESS AND LONG-TERM DEBT

| | 2009 | 2008 |
|---|---|---|
| **Non-revolving term loans** | **$ 160,000** | **$ 137,000** |
| **Revolving loans** | **11,500** | **7,000** |
| | **171,500** | **144,000** |
| **Less: current portion of long-term debt** | **(11,500)** | **(7,000)** |
| **Less: debt issue costs, net of accumulated amortization** | **(1,113)** | **(1,582)** |
| | **$ 158,887** | **$ 135,418** |

On June 30, 2009, the Fund received an advance under the non-revolving facility of $23,000 to finance the repayment of the promissory note.

At December 31, 2009 the Fund had available and utilized the following credit facilities:

- $160,000 of term loans. The term loans are repayable in full on June 1, 2012 and bear interest at one month banker acceptance (“BA”) rate plus an applicable margin ranging between 2.00% and 2.375%.
- $11,500 of the $15,000 revolving loans available. The revolving loans are BA loans which mature in January 2010, but are eligible for and are renewed on a monthly basis under the terms of the revolving loan until June 1, 2012. The loans bear interest at BA rate plus an applicable margin ranging between 2.00% and 2.375%.
- $Nil of the $5,000 revolving facility (bank indebtedness) available. The overdraft carries interest at prime plus an applicable margin ranging between 2.00% and 2.375%.

**7. BANK INDEBTEDNESS AND LONG-TERM DEBT** (continued)

The credit facilities are secured by a general assignment of all of the assets of the Fund. The credit facilities also require the Fund to maintain the following financial covenants on a consolidated basis:

(i) Debt to Adjusted EBITDA ratio shall not exceed 3.5:1.0 for the period up to December 30, 2009 and declining to 3.0:1.0 on December 31, 2009 and 2.5:1.0 on June 30, 2011 and thereafter.
(ii) EBITDA to interest expense ratio of not less than 3.0 to 1.0

EBITDA is defined as net income before interest expense, income taxes (recovery), depreciation, amortization and non-controlling interest. During the year, EBITDA was amended to also exclude the loss provisions associated with the subleases (note 9). Adjusted EBITDA is defined as the rolling twelve months earnings before interest, taxes, depreciation and amortization of the Fund and Shepell•fgi and Leong & Associates.

The Fund complied with all the required financial covenants and the ratios as at December 31, 2009 were 2.7 and 5.9 respectively.

Interest-rate swaps

In connection with the additional $23,000 drawn on the term facility on June 30, 2009, the Fund entered into a new interest-rate swap agreement in the notional amount of $23,000 from June 30, 2009 to and ending on June 1, 2012. This swap was used to fix the variable component of the interest rate at 2.22%, before the applicable margin, for the duration of the term and has been designated as a cash flow hedge. The fair value of the swap as at December 31, 2009 was $(298).

As at December 31, 2009, the fair value of the existing interest-rate swap, previously entered into in connection with the term loan at the total notional amount of $137,000, to fix the variable component of the interest rate at 3.647%, before the applicable margin, and as designated as a cash flow hedge, was $(6,358) (December 31, 2008 – $(11,096)).

Interest expense

**Interest expense is comprised of the following:**

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Interest on term loans** | **$ 8,581** | **$ 5,197** |
| **Accretion of interest on promissory notes (note 8)** | **3,488** | **4,191** |
| **Interest on Leong & Associates' instalments (note 3(a))** | **156** | **41** |
| **Interest on revolving loan, bank indebtedness and other charges** | **517** | **407** |
| **Amortization of debt issue costs** | **469** | **355** |
| **Swap termination fees** | **-** | **196** |
| **Interest-rate swap agreements fair value adjustment** | **-** | **785** |
| | **$ 13,211** | **$ 11,172** |

## 8. PROMISSORY NOTES

| | 2009 | 2008 |
|---|---|---|
| **Promissory notes, initial present value** | **$ 3,690** | **$ 71,358** |
| **Accreted interest** | **616** | **4,191** |
| | **4,306** | **75,549** |
| **Less: current portion of promissory note** | **(4,306)** | **(31,632)** |
| | **$ -** | **$ 43,917** |

The promissory notes issued as part of the Shepell•fgi acquisition in the amounts of $75,000 and $4,500 are due on July 2, 2009 and July 2, 2010, respectively. The notes are non-interest bearing and are secured by a general assignment of all the assets of the Fund, which is subordinated to the credit facilities. The notes have been recorded at their initial combined present value.

On March 24, 2009, the Fund used the net proceeds from the Offering (note 10) to prepay $51,500 of the $75,000 note, and agreed to pay $23,230 on June 30, 2009, to satisfy the remainder of the note. During the second quarter, the Fund paid the remaining $23,230. To finance the repayment, the Fund utilized the $23,000 senior secured non-revolving term facility with the remaining balance being funded through working capital. Total accretion interest expense related to the $75,000 note for the year December 31, 2009 was $2,872.

The Fund has the option to repay up to 100% of the $4,500 promissory note through the issuance of Units, the number determined by dividing the dollar amount by the then market trading price discounted by 5%, subject to the Fund's ability to issue new Units under the guidance for income trusts that qualify for the four-year transitional relief.

The promissory note also includes a covenant that the Fund and its subsidiaries shall not incur any debt other than permitted debt as defined in the promissory note agreements unless, after the incurrence of such debt, the Fund would have on a pro forma consolidated basis a ratio of debt to adjusted EBITDA of not greater than 4.5:1.0 determined as of the end of the fiscal quarter ending immediately prior to the date of determination. The Fund complied with all the required covenants.

## 9. OTHER LIABILITIES

| | 2009 | 2008 |
|---|---|---|
| **Acquired above-market rent leases** | **$ 5,221** | **$ 5,486** |
| **Sub-lease losses** | **3,336** | **1,766** |
| **Deferred lease obligations** | **1,649** | **1,359** |
| | **$ 10,206** | **$ 8,611** |

As part of the Shepell•fgi acquisition, the Fund assumed lease agreements for several offices. The above amounts include the difference between estimated market rates and the lease agreements. The estimated sub-lease losses are as a result of excess office spaces assumed from the the Shepell•fgi and Leong & Associates acquisitions and transactions entered into during the year.

During the year, the Fund sub-leased out, in two separate transactions ("Subleases"), excess office space. As a result of the Subleases, the Fund recognized an aggregate loss of $3,538, which includes a write down of the carrying value of leasehold improvements associated with the sub-leased premises of $1,338. The loss is reported under Other operating expenses.

**10. FUND UNITS**

The Fund is authorized to issue an unlimited number of Units and an unlimited number of special voting units ("Special Voting Units"). Special Voting Units are not entitled to any beneficial interest in any distribution from the Fund. The Special Voting Units may be issued in series and will only be issued in connection with, or in relation to, Class B LP Units or other securities that are, directly or indirectly, exchangeable for Units, in each case for the sole purpose of providing voting rights at the Fund level to the holders of such securities.

Units are redeemable at any time on demand by the Unitholders up to an aggregate maximum monthly amount of $50. Trustees may, in their sole discretion, waive this limitation. The redemption price is calculated based on the lesser of:

a) 90% of the "market price", as defined in the prospectus, as of the date on which the Units were surrendered for redemption; and

b) 100% of the "closing market price", as defined in the prospectus, on the redemption date.

**The following details the issued and outstanding Units and Special Voting Units:**

| | Units Issued | Special Voting Units | Total Units | Amount |
|---|---|---|---|---|
| **Balance, December 31, 2007** | **22,192,919** | 5,591,441 | **27,784,360** | **211,833** |
| **Exchange of Class B LP Units** | **437,605** | (437,605) | **-** | **4,556** |
| **Class A LP Units** | **12,750,000** | **-** | **12,750,000** | **153,000** |
| **Issuance costs** | **-** | - | **-** | **(7,166)** |
| **Class B LP Units** | **-** | 542,755 | **542,755** | **-** |
| **Balance, December 31, 2008** | **35,380,524** | 5,696,591 | **41,077,115** | **$ 362,223** |
| **Exchange of Class B LP Units** | **233,265** | (233,265) | **-** | **1,721** |
| **Units issued in public offering** | **6,666,700** | - | **6,666,700** | **55,000** |
| **Issuance costs, net of future income tax benefits** | **-** | - | **-** | **(2,467)** |
| **Treasury Units related to Long-term incentive plan** | **-** | - | **-** | **(810)** |
| **Balance, December 31, 2009** | **42,280,489** | 5,463,326 | **47,743,815** | **$ 415,667** |

On March 24, 2009, the Fund completed a public offering ("Offering"). Pursuant to the Offering, the Fund issued 6,666,670 Units at a price of $8.25 per unit for cash proceeds of $55,000. The issuance costs, net of future income tax benefits of $1,033, were $2,467.

On May 13, 2009, certain participants of the RSU plan exchanged their awarded Units for new LTIP DSUs (note 12). Pursuant to the exchange, the Fund indirectly re-acquired 277,016 Fund Units, of which 200,000 Units were sold in December 2009 at an average price of $9.431 per unit, for net proceeds of $1,886. The Units were valued at a cost of $11.465 per Unit, resulting in a loss of $407, which has been accounted for through the deficit balance in Unitholders' Capital. In December 2009, 8,429 of the re-acquired Units were also used to satisfy vested RSU awards. The remaining 68,587 Units are being held in treasury and have not been cancelled, and will be used to satisfy future vested RSU rewards.

On December 1, 2008, the Fund issued 242,994 Special Voting Units in connection with the settlement of the third & final instalment of the Heath acquisition.

On October 1, 2008, the Fund issued 56,764 Special Voting Units to satisfy the first instalment of the Leong & Associates acquisition.

On June 30, 2008, the Fund issued 242,997 Special Voting Units in connection with the settlement of the second instalment of the Heath acquisition.

On June 2, 2008, as part of the Shepell•fgi acquisition, the Fund completed a public offering and issued 12,750,000 Units at price of $12.00 per unit for cash proceeds of $153,000. The issuance costs, net of future income tax benefits of $3,121, is $7,166.

## 11. NON-CONTROLLING INTERESTS

The former shareholders of Morneau Sobeco, Heath and Leong & Associates own 5,463,326 Class B LP Units of MS Group LP (a subsidiary of the Fund). The Class B LP Units are fully exchangeable for an equal number of Units in the Fund which equates to a non-controlling interest of 11.44% (December 31, 2008 – 13.9%) in the Fund.

| | Unit issued | Amount |
|---|---|---|
| **Balance, December 31, 2007** | **5,591,441** | **$ 54,452** |
| **Units issued related to Heath acquisition** | **485,991** | **3,815** |
| **Units issued related to Leong & Associates acquisition** | **56,764** | **600** |
| **Salary component of Heath acquisition** | **-** | **758** |
| **Exchanged Units** | **(437,605)** | **(4,556)** |
| **Share of income for the year** | **-** | **1,745** |
| **Distributions for the year** | **-** | **(5,090)** |
| **Balance, December 31, 2008** | **5,696,591** | **$ 51,724** |
| **Exchanged Units** | **(233,265)** | **(1,721)** |
| **Share of income for the year** | **-** | **1,402** |
| **Distributions for the year** | **-** | **(5,268)** |
| **Balance, December 31, 2009** | **5,463,326** | **$ 46,137** |

## 12. LONG-TERM INCENTIVE PLAN

The Fund has two types of long-term incentive plans: a restricted stock unit plan (“RSU plan”) and a Deferred Stock Unit Plan (“DSU plan”).

***RSU plan***

Under the Fund’s RSU plan an individual is awarded a dollar amount, which will be used by the trustees of the RSU plan to purchase Units of the Fund in the open market. The Units will be held by the trustees until such time as ownership vests to each participant. Units will vest within a period of three years from end of the year in respect of which the grant was made, based upon the determination made by the Compensation, Nominating and Corporate Governance Committee (“CNCG Committee”) and/or Board at the time of the grant. Participants will be entitled to receive distributions on all Units held for their account prior to the applicable vesting date. Unvested Units held by the trustees for a participant will typically be forfeited if the participant resigns or is terminated prior to the applicable vesting date. Forfeited Units will be sold and the proceeds returned to the Fund, or as otherwise directed by the Fund.

**The expense recognized for the year ended December 31, 2009 was $599.**

## 12. LONG-TERM INCENTIVE PLAN (continued)

***DSU Plan***

The Fund's DSU plan offered by its subsidiary, HRCO Inc., received Unitholders' approval on May 13, 2009.

At the option of the Fund, each DSU represents the right of the employee to receive, on a deferred basis: one Fund Unit issued from treasury; or the equivalent cash value; or an award of one exchangeable share of HRCO Inc., subject to such restrictions as the compensation committee may determine. Holders of DSUs receive cash bonuses equivalent to the distributions paid on the Units. DSUs are non-assignable other than by will or the laws of descent and distribution, and generally vest over one to three years. The compensation committee can accelerate the vesting of DSUs at its discretion.

A maximum of 1,750,000 Units or securities exchangeable for Units that are issued and outstanding, may be issued under the DSU Plan.

During the year, the Fund granted 535,284 DSUs primarily to senior management of Shepell•fgi, related to the 2008 acquisition of Shepell•fgi. In addition, certain participants of the RSU plan exchanged their awarded Units under the RSU plan for new LTIP DSUs ("the exchange") on a one for one basis with identical vesting. The exchange resulted in the Fund indirectly re-acquiring 277,016 Fund Units.

The measurement date for the awards for accounting purposes occurred once the DSU plan received Unitholder approval. It is the Fund's intention to settle all of the DSU obligations through the issuance of Units. Consequently, the DSUs will not be re-measured at each reporting period.

As at December 31, 2009, the total LTIP DSUs held by the participants was 812,300 Units and the expense, including bonuses in lieu of distributions, recognized for the year ended December 31, 2009 was $3,003.

## 13. INCOME TAXES

The Fund currently qualifies as a Mutual Fund Trust for Canadian income tax purposes. Prior to new legislation relating to the federal income taxation of publicly-listed or traded trusts, as discussed below, income earned by the Fund and distributed annually to Unitholders was not, and would not be, subject to taxation in the Fund. For financial statement reporting purposes, the tax deductibility of the Fund's distributions was treated as an exemption from taxation as the Fund distributed and was committed to continue distributing all of its income to its Unitholders. Accordingly, the Fund did not previously record a provision for income taxes, or future income tax assets or liabilities, in respect of the Fund and its flow-through entities. The Fund, however, recorded current and future income tax liabilities relating to the corporate subsidiaries.

On June 22, 2007, legislation relating to the federal income taxation of a "specified investment flow-through" trust or partnership (a "SIFT"), received Royal Assent (the "SIFT Rules"). A SIFT includes a publicly-listed or traded partnership and trust, such as an income trust and a real estate investment trust. The Fund is a SIFT, as discussed below.

Under the SIFT Rules, following a transition period for qualifying SIFTs, certain distributions from a SIFT will no longer be deductible in computing a SIFT's taxable income, and a SIFT will be subject to tax on such distributions at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. Distributions paid by a SIFT as returns of capital will not be subject to the tax.

## 13. INCOME TAXES (continued)

A SIFT which was publicly listed on or before October 31, 2006 (an "Existing Trust") will become subject to the tax on distributions commencing with the 2011 taxation year end. However, an Existing Trust may become subject to this tax prior to the 2011 taxation year if its equity capital increases beyond certain limits measured against the market capitalization of the Existing Trust at the close of trading on October 31, 2006.

As a result of the SIFT Rules, the Fund commenced recognizing future income tax assets and liabilities with respect to the temporary differences between the carrying amounts and tax bases of its assets and liabilities, and those of its flow-through entities that are expected to reverse in or after 2011. Future income tax assets or liabilities are recorded using tax rates and laws expected to apply when the temporary differences are expected to reverse.

On December 4, 2008, the Department of Finance (Canada) announced an acceleration of the safe harbour amounts for 2009 and 2010 such that after December 4, 2008, they became immediately available. The safe harbour rules remained cumulative such that after December 4, 2008, the maximum amount that could be issued by a SIFT under the safe harbour rule is 100% of its October 31, 2006 market capitalization less the value of any units issued after October 31, 2006 (other than any issuances of units that would not be subjected to the Normal Growth Guidelines).

The difference between income taxes calculated using the Fund's effective income tax rates and the amounts that would result from the application of the statutory income tax rates arises from the following:

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Income taxes at statutory rates:** | | |
| **Federal** | **19.00%** | **19.50%** |
| **Provincial** | **12.98%** | **13.00%** |
| | **31.98%** | **32.50%** |
| **Income tax provision applied to income before income taxes:** | | |
| **Combined basic federal and provincial income taxes at statutory rates applied to income from continuing operations** | **$ 517** | **$ 1,586** |
| **Income taxed in the hands of the Unitholders** | **(13,091)** | **(9,401)** |
| **Non-deductible expenses** | **999** | **645** |
| **Adjustment to future income assets and liabilities for change in income tax rate** | **(1,559)** | **173** |
| **Non-deductible portion of intangible amortization** | **1,911** | **1,161** |
| **Other** | **609** | **174** |
| | **$ (10,614)** | **$ (5,662)** |

## 13. INCOME TAXES (continued)

The significant components of future income tax assets and liabilities related to continuing operations are as follows:

| | 2009 | 2008 |
|---|---|---|
| **Future income tax assets:** | | |
| **Fund Unit issuance costs** | **$ 3,191** | **$ 4,091** |
| **Capital assets** | **748** | **740** |
| **Loss carryforward** | **7,532** | **2,909** |
| **Interest-rate swaps** | **709** | **-** |
| | **$ 12,180** | **$ 7,740** |
| **Future income tax liabilities:** | | |
| **Intangible assets** | **$ 24,300** | **$ 31,825** |
| **Other liabilities** | **59** | **1,265** |
| | **$ 24,359** | **$ 33,090** |

The Fund has losses available to offset future taxable income of $27,153, of which $9,517 expire in 2027 and the remainder in 2029.

## 14. EMPLOYEE FUTURE BENEFITS

The Fund offers a pension benefit plan for its employees, which includes a defined benefit option and a defined contribution option. The defined benefit option was closed to new members effective January 1, 1998.

Under the defined contribution option, each member is required to contribute a specific dollar amount based on the member's job level classification. Each member may elect to make an optional contribution of between 50% and 300% of the member's required contribution. The Fund matches required contributions. For employees with less than 10 years of service, the Fund contributes 50% of optional contributions and for members with 10 or more years, 75% of optional contributions.

The pension fund assets and obligations are measured as at December 31, 2009. Information about the pension plan's defined benefit option is as follows:

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Fair value of plan assets** | **$ 2,855** | **$ 2,662** |
| **Accrued benefit obligation** | **3,129** | **2,594** |
| **Funded status – surplus (deficit)** | **$ (274)** | **$ 68** |
| **Plan assets:** | | |
| **Fair value, beginning of year** | **$ 2,662** | **$ 2,897** |
| **Actual return on plan assets** | **206** | **(287)** |
| **Employer contributions** | **215** | **288** |
| **Benefits paid** | **(228)** | **(236)** |
| **Fair value, end of year** | **$ 2,855** | **$ 2,662** |

## 14. EMPLOYEE FUTURE BENEFITS (continued)

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Accrued benefit obligation:** | | |
| **Balance, beginning of year** | **$ 2,594** | **$ 3,218** |
| **Current service cost** | **46** | **55** |
| **Interest cost** | **183** | **174** |
| **Benefits paid** | **(228)** | **(236)** |
| **Actuarial loss (gains)** | **534** | **(617)** |
| **Balance, end of year** | **$ 3,129** | **$ 2,594** |

| **Reconciliation of plan assets to accrued benefit obligation, end of year:** | | |
|---|---|---|
| **Fair value of plan assets** | **$ 2,855** | **$ 2,662** |
| **Accrued benefit obligation** | **3,129** | **2,594** |
| **Funded status – surplus (deficit)** | **(274)** | **68** |
| **Unamortized net actuarial gain** | **190** | **(335)** |
| **Unamortized transitional obligation** | **179** | **269** |
| **Accrued benefit asset** | **$ 95** | **$ 2** |

| **End of year allocation of fair value of plan assets (%):** | | |
|---|---|---|
| **Pooled Equities Fund** | **55%** | **45%** |
| **Pooled Bond Fund** | **45%** | **55%** |
| | **100%** | **100%** |

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Pension plan cost** | | |
| **Current service cost** | **$ 46** | **$ 55** |
| **Interest cost on accrued benefit obligation** | **183** | **174** |
| **Return on plan assets** | **(206)** | **287** |
| **Actuarial loss (gain) during the year on accrued benefit obligation** | **534** | **(617)** |
| | **$ 557** | **$ (101)** |
| **Other adjustments:** | | |
| **Difference between actual and expected return on plan** | **20** | **(492)** |
| **assets** | **(545)** | **791** |
| **Amortization of actuarial losses** | **90** | **90** |
| **Transitional amounts** | | |
| **Net pension plan expense** | **$ 122** | **$ 288** |

**Other information about the Fund's defined benefit option is as follows:**

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Employer contributions** | **$ 215** | **$ 288** |
| **Benefits paid** | **$ 228** | **$ 236** |

Actuarial valuation for the Fund's pension plan is generally required every three years. The most recent actuarial valuation of the Fund's pension plan was conducted as of December 31, 2006. The next actuarial valuation for funding purposes for the defined benefit pension plan is currently in progress and scheduled to be completed in 2010, with an effective date of December 31, 2009.

**Weighted average assumptions:**

| **Weighted average of the amounts assumed in accounting for the plan:** | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Discount rate at the end of the current fiscal period used to determine the accrued benefit obligation** | **5.75%** | **7.25%** |
| **Discount rate at the end of preceding period used to determine the benefit cost** | **7.25%** | **5.50%** |
| **Rate of compensation increase used to determine the accrued benefit obligation** | **3.50%** | **3.50%** |
| **Rate of compensation increase used to determine the benefit cost** | **3.50%** | **2.50%** |
| **Expected long-term rate of return on plan assets** | **7.00%** | **7.00%** |

The net expense for the Fund’s defined contribution option for the year ended December 31, 2009 was $2,268 (for the year ended December 31, 2008 - $2,055). In addition, the employees of Shepell•fgi participate in a Group RRSP program in which Shepell•fgi matches 50% of the first 6% of salary contribution. The related expense for the period ended December 31, 2009 was $600 (for the year ended December 31, 2008 - $327).

## 15. NET INCOME PER UNIT

Net income per Unit is calculated by dividing net income by the weighted average number of Units outstanding during the year. The following table reconciles the weighted average number of Units outstanding used in computing basic net income per Unit to weighted average number of Units in computing diluted Net income per Unit:

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Basic:** | | |
| **Net income** | **$ 10,826** | **$ 8,796** |
| **Weighted average number of Units outstanding** | **40,509,313** | **29,822,127** |
| | | |
| **Diluted:** | | |
| **Net income** | **$ 10,826** | **$ 8,796** |
| **Non-controlling interest** | **1,402** | **1,745** |
| **Net income available to Unitholders and Class B LP Unitholders** | **$ 12,228** | **$ 10,541** |
| | | |
| **Weighted average number of Units outstanding – Basic** | **40,509,313** | **29,822,127** |
| **Weighted average exchangeable Class B LP Units outstanding** | **5,584,311** | **5,539,991** |
| **Dilutive effect of LITP – DSU plan** | **239,858** | **-** |
| **Dilutive effect of Class B LP Units in connection with the Heath acquisition** | **-** | **342,583** |
| **Weighted average number of Units outstanding - Diluted** | **46,333,482** | **35,704,701** |
| | | |
| **Net income per Unit – Basic** | **$ 0.27** | **$ 0.30** |
| **Net income per Unit – Diluted** | **$ 0.26** | **$ 0.30** |

Due to its anti-dilutive effect, the effect of the potential issuance related to the promissory note has been excluded from the net income per unit calculation.

## 16. SUPPLEMENT DISCLOSURE OF CASH FLOW INFORMATION

**Change in non-cash operating working capital:**

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Accounts receivable** | **$ (915)** | **$ (9,258)** |
| **Unbilled fees** | **(1,665)** | **(3,706)** |
| **Income taxes recoverable/payable** | **(312)** | **(564)** |
| **Prepaid expense and other** | **668** | **(1,184)** |
| **Deferred implementation costs** | **(1,096)** | **-** |
| **Accounts payable and accrued liabilities** | **(840)** | **4,292** |
| **Deferred revenue** | **(450)** | **(860)** |
| | **$ (4,610)** | **$ (11,280)** |

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Interest paid** | **$ 8,958** | **$ 5,391** |
| **Income taxes paid (refunded)** | **$ 1,768** | **$ 637** |
| **Promissory notes issued to vendors on acquisition of Shepell•fgi** | **$ -** | **$ 71,358** |

Excluded from the consolidated statements of cash flows were the following non-cash transactions:

For the year ended December 31, 2009, the exchange of RSUs to DSUs (note 12) resulted in an increase in contributed surplus of $1,650, decrease of Unitholders' Capital of $3,176 and a decrease in prepaid expenses and other of $1,526.

## 17. COMMITMENTS

The Fund has lease commitments for office premises and equipment with options for renewal. As at December 31, 2009 the minimum payments not including operating expenses, due in each of the next five years and thereafter, are expected to be as follows for each year ending December 31:

| | |
|---|---|
| **2010** | **$ 10,352** |
| **2011** | **9,170** |
| **2012** | **7,809** |
| **2013** | **6,881** |
| **2014** | **5,401** |
| **Thereafter** | **35,749** |
| **Total** | **$ 75,362** |

The Fund is party to various subleases to which the Fund would be liable for the rental payment in the case of a default by the subtenants. The minimal payments related to these premises have been included above. The terms of the subleases extend through July 2022 and the aggregate sublease income on these subleases is

$22,407. The Fund considers the risk of default by the subtenants to be low therefore no accrual has been set up for the guarantee.

Subsequent to December 31, 2009, the Fund entered into a new lease agreement for additional space at its principle office location. The terms of the lease extends through August 2024, and will result in additional average annual rent of $2,061.

## 18. CONTINGENCIES

From time to time, the Fund is involved in routine litigation incidental to the Fund's business. Management believes that adequate provisions have been made where required and the ultimate resolution with respect to any claim will not have a material adverse effect on the financial position or results of operations of the Fund.

## 19. ECONOMIC DEPENDENCE

Revenue from the Fund's largest client was approximately 5% of the Fund's total revenue for the year ended December 31, 2009 (for the year ended December 31, 2008 – 7%). The Fund's top 10 clients, in the aggregate, accounted for approximately 22% of the total revenue for the year ended December 31, 2009 (for the year ended December 31, 2008 – 24%).

Accounts receivable from the Fund's largest client was approximately 1% of the total accounts receivable as at December 31, 2009 (December 31, 2008 – 2%). The Fund's top 10 clients accounted for approximately 19% of the Fund's total accounts receivable as at December 31, 2009 (December 31, 2008 – 23%).

## 20. SEGMENTED INFORMATION

The Fund's operations consist of one reporting segment, which provides human resource, consulting and outsourcing services. Geographic data is as follows:

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Revenue:** | | |
| **Canada** | **$ 308,464** | **$ 231,928** |
| **United States** | **23,239** | **17,785** |
| | **$ 331,703** | **$ 249,713** |

| | 2009 | 2008 |
|---|---|---|
| **Assets:** | | |
| **Canada** | **$ 654,696** | **$ 680,903** |
| **United States** | **6,850** | **8,962** |
| **Liabilities:** | | |
| **Canada** | **$ 306,299** | **$ 369,118** |
| **United States** | **2,902** | **2,617** |

## 21. MANAGEMENT OF CAPITAL

The Fund views its capital as the combination of its cash (bank indebtedness), long-term debt, promissory notes, non-controlling interests and Unitholders' equity. The Fund's objectives when managing capital are to safeguard the entity's ability to continue as a going concern while maintaining the distributions to its Unitholders and the growth of the Fund's business through organic growth and new acquisitions.

The Fund manages the capital structure and makes adjustments to it in accordance with the aforementioned objectives, as well as taking into consideration changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Fund may adjust the amount of distributions paid to Unitholders, issue new or repurchase existing Units and assume new or repay existing debt. The Fund will also review its level of equity in the context of the change in taxation impacting the Fund commencing in 2011.

The credit facilities and promissory notes require the Fund to maintain certain financial covenants. Management also uses these ratios as key indicators in managing the Fund's capital.

Distributions are made to Unitholders monthly. Various ratios of distributions to available cash, cash from operating activities and EBITDA are used by management and the Board of Trustees to assist with the determination of distributions.

## 22. FINANCIAL INSTRUMENTS

Fair value represents management's estimates of the market value at a given point in time. The fair value of the Fund's financial assets and liabilities approximate their carrying values due to their short-term nature or, in relation to long-term debt instruments, because they bear interest at market rates.

The following table summarizes information regarding the carrying and fair value of the Fund's financial instruments:

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Held for trading (i)** | **$ 2,085** | **$ (821)** |
| **Loans and receivables (ii)** | **53,791** | **52,930** |
| **Other financial liabilities (iii)** | **230,254** | **272,759** |

(i) Includes cash and derivative financial instruments not designated as hedges.
(ii) Includes accounts receivable.
(iii) Includes accounts payable and accrued liabilities, unitholder distributions payable, bank indebtedness, future considerations related to acquisition, long-term debt, promissory notes and other liabilities.

**22. FINANCIAL INSTRUMENTS** (continued)

The fair value hierarchy of financial instruments measured at fair value on the balance sheet is as follows:

| | Level 1 | Level 2 | Level 3 |
|---|---|---|---|
| **Financial Assets:** | | | |
| **Cash** | **1,606** | **-** | **-** |
| **Foreign exchange contracts asset** | **-** | 479 | **-** |
| | | | |
| **Financial Liabilities:** | | | |
| **Interest-rate swaps liability** | **-** | **6,656** | **-** |

The fair value of interest-rate swaps was determined using estimated future discounted cash flows using a comparable market rate of interest. Since fair value estimates represent point-in-time estimates, they may not reflect fair value in the future. These calculations are subjective in nature, involve uncertainties, and are a matter of significant judgment; as a result, changes in assumptions could significantly affect these estimates.

*Interest rate risk*

The Fund is subject to interest rate risk as its secured term loan bears interest at market rates. Interest-rate swap agreements are used as part of the Fund's program to manage the fixed and floating interest rate mix of the Fund's total debt outstanding and related overall cost of borrowing. The interest-rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based.

A sensitivity analysis that assumes interest rates increased or decreased by 50 basis points with all other variables held constant would result in an increase (decrease) of the Fund's interest expense, excluding the interest subjected to interest-rate swap agreements, by $68.

*Credit risk*

The Fund's exposure to credit risk is limited to carrying amount of cash, accounts receivable and foreign exchange contracts recognized at the balance sheet date.

The aging of fees receivable was:

| | Year Ended December 31, 2009 | Year Ended December 31, 2008 |
|---|---|---|
| **Current** | **$ 22,309** | **$ 21,353** |
| **Past due 1 - 30 days** | **12,835** | **13,443** |
| **Past due 31 - 90 days** | **11,298** | **9,592** |
| **Past due over 90 days** | **7,236** | **8,195** |
| | **$ 53,678** | **$ 52,583** |

## 22. FINANCIAL INSTRUMENTS (continued)

The Fund believes that the credit risk of accounts receivable is limited for the following reasons:

(1) Risk associated with concentration of credit risk with respect to accounts receivable is limited due to the credit rating of the Fund's top 10 clients.

(2) Management regularly reviews and assesses customer accounts and credit risk. Historically, bad debt as a percentage of revenue has been minimal.

The Fund determines its allowance for doubtful accounts based on it's best estimate of the net recoverable amount by customer account. Accounts that are considered uncollectible are written off. The allowance for doubtful accounts as at December 31, 2009 was $632 (December 31, 2008 - $683).

The credit risk on cash and foreign exchange contracts is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

*Foreign exchange risk*

The Fund realizes a portion of sales in U.S. dollars and has operations in the United States and thus is exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar. The net revenue exposure after accounting for related expenses denominated in U.S. dollars for the year ended December 31, 2009 was $8,839.

The Fund entered into multiple forward exchange contracts to manage foreign exchange exposure on anticipated U.S. dollars sales transactions and collection of the related accounts receivables. These contracts have maturities of less then two years. As at December 31, 2009 the aggregate amount of contracts outstanding was US$6,359. As the Fund does not account for these forward contracts using the hedge accounting, these contracts are measured at fair value with changes recognized in earnings. The unrealized gain as at December 31, 2009 was $479.

As at December 31, 2009, the Fund's net exposure to currency risk through its current assets and liabilities dominated in U.S. dollars was US$3,727. Assuming that all other variables remain constant, a 5% depreciation or appreciation of the Canadian dollar against the US dollars would result in an increase (decrease) of $196 in the Fund's net income.

*Liquidity risk*

Liquidity risk is the risk that the Fund is not able to meet its financial obligations as they fall due. The Fund manages liquidity risk through regular monitoring of financial results and actual cash flows, and also the management of its capital structure and financial leverage as outlined in note 21.

The Fund's principal liquidity needs arise from working capital requirements, debt servicing and repayment obligations, capital expenditures, distributions to Unitholders and acquisition funding requirements.

The Fund has historically utilized cash from operations to satisfy the above needs, with the exception of acquisition funding requirements.

The Fund has two components of bank indebtedness: a revolving facility which matures monthly but is eligible for renewal until expiry in 2012, and a non-revolving facility which matures in 2012. Since the Fund's current cash position could not accommodate its full repayment, a refinancing scenario may result.

There is a risk that lenders will not refinance maturing debt on terms and conditions acceptable to the Fund.

The accounts payable and accrued liabilities and Unitholder distributions payable are due for payment within twelve months of the balance sheet date, along with the second instalment related to the Leong & Associates payable in January 2010.

## 23. COMPARATIVE FIGURES

Certain comparative figures have been reclassified or regrouped to conform with the financial presentation adopted in the current year.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Morneau Sobeco Income Fund (the "Fund") was formed on August 22, 2005 and commenced operations on September 30, 2005 when it completed an initial public offering.

This Management's Discussion and Analysis ("MD&A") covers the year ended December 31, 2009 and should be read in conjunction with the accompanying Audited Consolidated Financial Statements of the Fund and notes thereto for the year ended December 31, 2009.

All financial information is presented in Canadian dollars and in accordance with Canadian generally accepted accounting principles ("GAAP") unless otherwise noted. Certain totals, subtotals and percentages may not reconcile due to rounding.

This MD&A contains "forward-looking statements" within the meaning of applicable securities laws, such as statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical facts. Use of words such as "may", "will", "expect", "believe", or other words of similar effect may indicate a "forward-looking" statement. These statements are not guarantees of future performance and are subject to numerous risks and uncertainties, including those described in our publicly filed documents (available on SEDAR at www.sedar.com) and in this MD&A under the heading "Risks and Uncertainties". Those risks and uncertainties include income tax matters, ability to maintain profitability and manage growth, reliance on information systems and technology, reputational risk, dependence on key clients, reliance on key professionals and general economic conditions. Many of these risks and uncertainties can affect our actual results and could cause our actual results to differ materially from those expressed or implied in any forward-looking statement made by us or on our behalf. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. All forward-looking statements in this MD&A are qualified by these cautionary statements. These statements are made as of the date of this MD&A and, except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. Additionally, we undertake no obligation to comment on analyses, expectations or statements made by third parties in respect of the Fund, its financial or operating results or its securities.

To assist investors in assessing the Fund's financial performance, this discussion also makes reference to certain non-GAAP measures such as Standardized EBITDA, Adjusted Standardized EBITDA, Standardized Distributable Cash, Adjusted Consolidated Distributable Cash, Standardized Distributable Cash Payout Ratio and Adjusted Consolidated Distributable Cash Payout Ratio. Standardized EBITDA is intended to represent an indication of the entity's capacity to generate income from operations before taking into account management's financing decisions and costs of consuming tangible and intangible capital assets, which vary according to their vintage, technological currency, and management's estimate of their useful life. Accordingly, Standardized EBITDA comprises revenues less operating costs before interest expense, capital asset amortization and impairment charges, and income taxes, while Adjusted Standardized EBITDA represents Standardized EBITDA before taking into account non-recurring expenditures. We believe both Standardized EBITDA and Adjusted Standardized EBITDA are useful measures in evaluating the performance of the Fund. The Fund utilizes them to monitor compliance with debt covenants and to make decisions related to distributions to Unitholders rather than net income due to the significant amount of amortization expense related to our intangible assets. We also believe that Standardized Distributable Cash, Adjusted Consolidated Distributable Cash, Standardized Distributable Cash Payout Ratio and Adjusted Consolidated Distributable Cash Payout Ratio are useful supplemental measures of performance as they are generally used by Canadian open-ended business income funds as indicators of financial performance. See the footnotes to the "Results of Operations" chart for more details. Non-GAAP measures do not have any standard meaning prescribed by GAAP and therefore may not be comparable to similar measures presented by other issuers.

This MD&A is in all material respects in accordance with the recommendations provided in CICA's publication *Standardized Distributable Cash in Income Trusts and Other Flow-Through Entities: Guidance on Preparation and Disclosure* and the CICA's publication *Improved Communication with Non-GAAP Financial Measures: General Principles and Guidance for Reporting EBITDA and Free Cash Flow.*

**FORMATION AND OWNERSHIP STRUCTURE OF THE FUND**

The Fund is an unincorporated, open-ended, limited purpose trust established under the laws of Ontario. It indirectly owns 42,280,489 Class A Limited Partnership units of Morneau Sobeco Group Limited Partnership ("MS Group LP"), which represents a 88.6% ownership interest. MS Group LP owns directly and indirectly 100% of Morneau Sobeco Limited Partnership and Morneau Sobeco, Ltd. (the "Morneau Sobeco Operating Entities"). The 11.4% non-controlling interest in MS Group LP is held through Class B LP units of the limited partnership (the "Class B LP Units") and an equal number of Special Voting Units of the Fund, which together are exchangeable into Units. Management employees and former owners of the predecessors of the Morneau Sobeco Operating Entities ("Management Securityholders") hold this non-controlling interest.

As at March 10, 2010, 42,280,489 Units and 5,463,326 Special Voting Units of the Fund were issued and outstanding, and 5,463,326 MS Group LP Class B LP Units were issued and outstanding.

**BUSINESS OVERVIEW**

Morneau Sobeco Income Fund is the largest Canadian-owned firm providing human resource consulting and outsourcing services. The firm delivers solutions to assist employers in managing the financial security, health and productivity of their employees. With approximately 2,400 employees in offices across North America, the Fund offers its services to over 8,000 organizations in Canada, the United States and around the globe directly and through our distribution channel partners.

We derive our revenue primarily from fees charged to clients for consulting engagements, outsourcing engagements, employee assistance program services and work place health and productivity solutions. Fees from consulting engagements are charged based on billable hours or on a fee-for-service basis. In some cases, consulting engagements may be billed on a fixed-fee basis, although these engagements are typically much smaller and the services are delivered over a shorter period of time. For some benefits consulting assignments which involve the purchase of an insurance policy underwritten by an insurance company, we may be paid commissions (in lieu of fees) by the client's insurance company, which is a common practice in the industry. These commissions are based on a percentage of the premiums paid by the client to the insurance company and our policy is to disclose them to our client. We assume no underwriting risk as the insurance policy is underwritten by the insurance company. In addition, we earn interest income from our cash balances which is included in other revenue. Fees from outsourcing engagements are generally based on negotiated fees or a formula tied to the nature of the service being provided.

Our outsourcing business is characterized by fixed contracts, which typically have three-year to five-year terms. Most outsourcing contracts contain an upfront implementation fee and an ongoing monthly service fee. Implementations usually take three to twelve months and involve transferring the administration of a client's pension and/or benefits plans onto our systems, tailoring our systems and training our employees. Additional services provided that are outside the scope of the outsourcing contract are usually paid on a fee-for-service basis.

In the billing for Employee Assistance Program ("EAP") services, a portion of the EAP client agreements require payment of a minimum retainer and incremental usage-based fees. The remainder of the EAP agreements are billed based on a actual usage or fixed fees. Most EAP agreements may be terminated by the client upon 30 to 60 days' notice to the Fund, however, it is typical for EAP agreements to continue for multiple years and many automatically renew on an annual basis.

Our largest operating expense is compensation and related costs. This includes salaries, annual performance-based bonuses, benefits, payroll taxes, independent service providers and temporary staffing services. The remaining operating expenses include occupancy costs, technology costs (equipment leases, telecommunications and software), non-recoverable client service costs (such as printing, travel and third-party professional services), training, marketing, office costs, professional services and insurance.

**SUMMARY AND OUTLOOK**

The results of 2009 met our expectations. For the year ended December 31, 2009 revenue growth was 32.8% compared to the same period in 2008, and 7.1% on a pro-forma basis when normalizing for twelve months' revenues from Shepell•fgi. Beyond the growth from our 2008 acquisitions of Shepell•fgi in June 2008 and Leong & Associates in October 2008, the primary contributors to growth were our EAP and pension consulting practices. Net income growth for the year here ended was 23.1%, reaching $10.8 million compared to $8.8 million in 2008. Standardized EBITDA growth for the year ended December 31, 2009 was 22.4% compared to the same period in 2008, and 3.2% on a pro-forma basis. Adjusted Standardized EBITDA growth for the year ended December 31, 2009 was 28.6% compared to the same period in 2008, and 8.4% on a pro-forma basis. Standardized EBITDA margin and Adjusted Standardized EBITDA margin for the year ended December 31, 2009 were 18.5% and 19.4% respectively, compared to 20.1% for the same period in 2008. Standardized EBITDA per Unit (basic) and Adjusted Standardized EBITDA per Unit (basis) for 2009 were $1.33 and $1.40 respectively, compared to $1.42 for the same period in 2008.

We have succeeded in achieving positive results and are pleased with our revenue and EBITDA improvements for the year. These results reflect not only the success of our acquisition of Shepell•fgi in June 2008, and its own organic growth, but also the continued strength of our existing business. These results have allowed us to solidify our position within our markets and therefore, we remain positive about our prospects going forward.

The Fund announced plans to convert from an income trust to a corporation effective January 1, 2011. The conversion is being made in response to the legislative changes enacted by the Federal government that will apply a tax at the income trust level on unitholder distributions commencing January 1, 2011. The current monthly distribution level of $0.07871 per unit (or $0.94 per unit annualized) is expected to remain unchanged for the balance of 2010. Starting in January 2011, the monthly dividend level is expected to be $0.065 per share (or $0.78 per share annualized) with a sustainable payout ratio of 65% to 80% of cash flow. The dividend represents a 10.6% increase to the current distribution on an after tax basis for unitholders at the highest marginal tax rate. This dividend policy will facilitate the repayment of debt, while providing investors with an attractive yield. Going forward, our intention is to continue to reward our investors with dividends in line with business performance. A special meeting of unitholders will be held in the second half of 2010 to obtain unitholder approval of the reorganization.

The foregoing dividend policy will be subject to the discretion of the board of directors of the company and may vary depending on, among other things, the company's operating cash flow, financial requirements, limitations and restrictions in credit facilities, the satisfaction of solvency tests imposed by the corporate laws for the declaration of dividends and other conditions existing at such future time.

## DISTRIBUTIONS TO UNITHOLDERS

Monthly distributions are declared by the Fund for Unitholders of record on the last business day of each month and are paid on about the 15th day of the following month.

Monthly distributions were $0.07871 per unit for the year.

The following table presents excess (shortfall) cash flow from operating activities and net income over distributions to Unitholders for the years ended December 31, 2009, 2008 and 2007.

| *(In thousands of dollars)* | **Year ended December 31, 2009** | **Year ended December 31, 2008** | **Year ended December 31, 2007** |
|---|---|---|---|
| Cash flow from operating activities | $ 48,955 | $ 35,295 | $ 27,878 |
| Net income | 10,826 | 8,796 | 12,120 |
| Distributions to Unitholders, including Class B LP Units | 43,902 | 32,718 | 24,257 |
| Excess of cash flow from operating activities over distributions | 5,053 | 2,577 | 3,621 |
| (Shortfall) of net income from operating activities over distributions | (33,076) | (23,922) | (12,137) |

We consider the amount of cash generated by the business in determining the amount of distributions payable to Unitholders. In general, we do not take into account quarterly working capital fluctuations as these tend to be temporary in nature. We do not generally consider net income in setting the level of distributions as this is a non-cash metric and is not reflective of the level of cash flow that we generate. The divergence is particularly relevant for us since we have a relatively high level of amortization expense as well as non-controlling interest related to the Class B LP Units. Our annual excess cash from operating activities over distributions has been used to finance growth in accounts receivable, capital expenditures and acquisitions.

The Standardized Distributable Cash Payout Ratio was 109.6% on a twelve-month rolling basis ending December 31, 2009 compared to 101.0% for the same period in 2008. The Adjusted Consolidated Distributable Cash Payout Ratio for the year ended December 31, 2009 was 98.3% compared to 75.2% for the same period in 2008. The higher Standardized Distributable Cash Payout and Adjusted Consolidated Distributable Cash Payout ratios for 2009 reflect increased distributions from the issuance of additional Units on March 24, 2009, and from the inclusion of an additional five months' results for the Shepell•fgi business. These ratios also reflect increased capital expenditures of $5.8 million, primarily due to software development costs related to the Shepell•fgi business of $3.2 million.

## ANALYSIS OF 2009 OPERATING RESULTS

| **Results of Operations** | **Three Months Ended December 31** | | **Year Ended December 31** | |
|---|---|---|---|---|
| Selected Unaudited Consolidated Financial Information | **2009** | **2008** | **2009** | **2008** |
| *(In thousands of dollars except per unit amounts )* | | | | |
| **Revenue** | **$ 83,316** | $ 82,298 | **$ 331,703** | $ 249,713 |
| Deduct: | | | | |
| Salary, benefit and contractor expenses | **51,632** | 51,127 | **211,543** | 156,707 |
| Other operating expenses | **16,735** | 13,870 | **60,184** | 42,895 |
| Interest expense | **2,683** | 4,150 | **13,211** | 11,172 |
| Amortization of capital and intangible assets | **10,770** | 11,384 | **45,151** | 34,060 |
| Income taxes (recovery) | **(3,212)** | (1,709) | **(10,614)** | (5,662) |
| Non-controlling interest | **539** | 475 | **1,402** | 1,745 |
| **Net income for the period** | **4,169** | 3,001 | **10,826** | 8,796 |
| Add (deduct): | | | | |
| Interest expense | **2,683** | 4,150 | **13,211** | 11,172 |
| Amortization of capital and intangible assets | **10,770** | 11,384 | **45,151** | 34,060 |
| Income taxes (recovery) | **(3,212)** | (1,709) | **(10,614)** | (5,662) |
| Impairment of leasehold improvements | **790** | - | **1,338** | - |
| Non-controlling interest | **539** | 475 | **1,402** | 1,745 |
| **Standardized EBITDA**[1] | **$ 15,739** | $ 17,301 | **$ 61,314** | $ 50,111 |
| Adjustments: [7] | | | | |
| Sublease loss provision | **1,822** | - | **2,200** | - |
| Severance related to integration | **913** | - | **913** | - |
| **Adjusted Standardized EBITDA** | **$ 18,474** | $ 17,301 | **$ 64,427** | $ 50,111 |
| Standardized EBITDA margin | **18.9%** | 21.0% | **18.5%** | 20.1% |
| Adjusted Standardized EBITDA margin | **22.2%** | 21.0% | **19.4%** | 20.1% |
| **Cash from operating activities** | **$ 18,649** | $ 20,060 | **$ 48,955** | $ 35,295 |
| Deduct: Capital expenditures | **2,399** | 1,434 | **8,912** | 3,081 |
| Consolidated Distributable Cash [2] | **16,250** | 18,626 | **40,043** | 32,214 |
| Deduct: Consolidated Distributable Cash available to non-controlling interest | **1,885** | 2,547 | **4,851** | 4,865 |
| **Standardized Distributable Cash** (available for Unitholders) [3] | **$ 14,365** | $ 16,079 | **$ 35,192** | $ 27,349 |
| Consolidated Distributable Cash [2] | **$ 16,250** | $ 18,626 | **$ 40,043** | $ 32,214 |
| Add: Changes in Non-cash operating working capital | **(3,854)** | (3,695) | **4,610** | 11,280 |
| **Adjusted Consolidated Distributable Cash** [4] | **$ 12,396** | $ 14,931 | **$ 44,653** | $ 43,494 |
| Net income per Unit (basic) | **$ 0.10** | $ 0.09 | **$ 0.27** | $ 0.30 |
| Net income per Unit (diluted) | **$ 0.10** | $ 0.09 | **$ 0.26** | $ 0.30 |
| Standardized EBITDA per Unit (basic) | **$ 0.33** | $ 0.42 | **$ 1.33** | $ 1.42 |
| Adjusted Standardized EBITDA per Unit (basic) | **$ 0.39** | $ 0.42 | **$ 1.40** | $ 1.42 |
| Standardized Distributable Cash per Unit (basic) | **$ 0.34** | $ 0.46 | **$ 0.87** | $ 0.92 |
| Adjusted Consolidated Distributable Cash per Unit (basic) | **$ 0.26** | $ 0.37 | **$ 0.97** | $ 1.23 |
| Standardized Distributions declared per Unit (basic) | **$ 0.24** | $ 0.24 | **$ 0.95** | $ 0.92 |
| Standardized Distributable Cash Payout Ratio [5] | **69.1%** | 51.9% | **109.8%** | 101.0% |
| Adjusted Consolidated Distributable Cash Payout Ratio [6] | **90.6%** | 64.7% | **98.3%** | 75.2% |
| Twelve-month rolling Standardized Distributable Cash Payout Ratio | **109.6%** | 101.0% | **109.6%** | 101.0% |

| | | | | |
|---|---|---|---|---|
| Twelve-month rolling Adjusted Consolidated Distributable Cash Payout Ratio | **98.3%** | 75.2% | **98.3%** | 75.2% |

Footnotes:

(1) "Standardized EBITDA" is defined as net income before interest expense, income taxes (recovery), depreciation, amortization, impairment charges, and non-controlling interest.

(2) "Consolidated Distributable Cash" is defined as cash from operating activities adjusted for capital expenditures.

(3) "Standardized Distributable Cash" is defined as cash from operating activities, including the effects of changes in non-cash operating working capital, less capital expenditures and Consolidated Distributable Cash available to non-controlling interest.

(4) "Adjusted Consolidated Distributable Cash" is defined as Consolidated Distributable Cash excluding changes in non-cash operating working capital.

(5) "Standardized Distributable Cash Payout Ratio" is defined as declared distributions divided by Standardized Distributable Cash.

(6) "Adjusted Consolidated Distributable Cash Payout Ratio" is defined as declared distributions divided by Adjusted Consolidated Distributable Cash.

(7) Represents significant non-recurring expenses related to the integration of Shepell•fgi operations with Morneau Sobeco.

## ANALYSIS OF 2009 ANNUAL RESULTS

### *Revenue*

Revenue for the year ended December 31, 2009 increased by $82.0 million, or 32.8%, to $331.7 million compared to $249.7 million for the same period in 2008. The increase in revenue was primarily due to increased Shepell•fgi revenue of $63.2 million resulting from the inclusion of twelve months' revenue in 2009 compared to seven months in 2008, and increased Leong & Associates revenue of $2.9 million resulting from the inclusion of twelve months' revenues in 2009 compared to three months in 2008. The remaining increase is attributable to continued growth in our EAP business of $5.6 million, pension consulting practice of $5.1 million, and pandemic diseases crisis management services of $4.6 million.

### *Salary, Benefit and Contractor Expenses*

Salary, benefit and contractor expenses for the year ended December 31, 2009 increased by $54.8 million, or 35.0%, to $211.5 million compared to $156.7 million for the same period in 2008. The increase was mainly attributable to increased Shepell•fgi salary, benefit and contractor expenses of $43.9 million due to the inclusion of twelve months' expense in 2009 compared to seven months in 2008, and increased Leong & Associates salary, benefit and contractor expenses of $1.5 million from the inclusion of twelve months' expense in 2009 compared to three months in 2008. The remaining increase is primarily due to increased long-term incentive plan expenditures of $1.5 million related to the Shepell•fgi management, which was expected as part of the acquisition, general merit increase of $2.6 million, and general increases as a result of growth in business and corporate activities.

### *Other Operating Expenses*

Other operating expenses for the year ended December 31, 2009 increased by $17.3 million, or 40.3%, to $60.2 million compared to $42.9 million for the same period in 2008. The increase was primarily attributable to increased Shepell•fgi operating expenses of $10.9 million due to the inclusion of twelve months' expense in 2009 compared to seven months in 2008, and increased Leong & Associates expense of $0.6 million due to the inclusion of twelve months' expense in 2009 compared to three in 2008. The remaining increase can be primarily attributable to increased rent and occupancy costs of $1.1 million from office expansions at various office locations, an aggregate $1.3 million write down of leasehold improvements and $2.2 million of provision for future rental loss associated with the sublease of excess office spaces, and $1.0 million in capital tax expense primarily due to an unfavorable reassessment during the year.

### *Interest Expense*

Interest expense for the year ended December 31, 2009 increased by $2.0 million, or 17.9%, to $13.2 million compared to $11.2 million for the same period in 2008. The increase was primarily due to higher interest expense of $2.9 million on the new term loan obtained in the second quarter of 2008 to finance the Shepell•fgi acquisition, and $0.5 million on the delayed draw facility utilized in second quarter of 2009 to finance the repayment of the $75 million promissory note issued in connection with the Shepell•fgi acquisition. This increase was offset by a decrease in accretion interest of $0.7 million with the repayment of the $75 million promissory note, and an unfavorable fair value adjustment related to previous interest-rate swap agreements of $0.8 million in the prior year which did not recur.

### *Amortization of Capital and Intangible Assets*

Amortization for the year ended December 31, 2009 increased by $11.1 million, or 32.6%, to $45.2 million compared to $34.1 million for the same period in 2008. This increase was primarily attributable to increased amortization on those intangible assets acquired in fiscal 2008 in connection with the Shepell•fgi and Leong & Associates acquisitions of $10.8 million.

### *Income Tax Recovery*

Income tax recovery for the year ended December 31, 2009 increased by $4.9 million to a recovery of $10.6 million compared to the $5.7 million recovery for the same period in 2008. The increase was primarily due to the tax loss generated by a taxable subsidiary due to the availability of eligible tax deductions from the acquisition of Shepell•fgi.

### *Net Income*

As a result of the changes noted above, the net income for the year ended December 31, 2009 was $10.8 million compared to the net income of $8.8 million for the same period in 2008.

### *Non-GAAP Financial Measures: Standardized EBITDA, Adjusted Standardized EBITDA, Standardized Distributable Cash and Adjusted Consolidated Distributable Cash*

### *Standardized EBITDA and Adjusted Standardized EBITDA*

Standardized EBITDA for the year ended December 31, 2009 increased by $11.2 million, or 22.4%, to $61.3 million compared to $50.1 million for the same period in 2008. The increase was due to increased revenue of $82.0 million offset by $70.8 million of increased salary, benefit and contractor expenses and other operating expenses, before impairment of leasehold improvements.

In 2009, as a result of the integration of Shepell•fgi with Morneau Sobeco, excess office premises were identified and subleased out. These transactions resulted in an aggregate sublease loss of $2.2 million before the write-down of related leasehold improvements, representing the future rental losses associated with the subleased premises. In addition, the Fund incurred higher than normal severance expenses in the fourth quarter of $0.9 million as part of the efforts of integrating Shepell•fgi with Morneau Sobeco. Standardized EBITDA for the year ended December 31, 2009 was adjusted for these non-recurring items, to arrive at Adjusted Standardized EBITDA of $64.4 million.

### *Standardized Distributable Cash*

Standardized Distributable Cash for the year ended December 31, 2009 increased by $7.9 million to $35.2 million compared to $27.3 million for the same period in 2008. This increase was primarily due to increased cash from operating activities of $13.7 million which was partially offset by increased capital expenditure spending of $5.8 million.

### *Adjusted Consolidated Distributable Cash*

Adjusted Consolidated Distributable Cash for the year ended December 31, 2009 increased by $1.2 million to $44.7 million compared to $43.5 million for the same period in 2008. The increase was primarily due to increased Standardized EBITDA of $11.2 million, partially offset by increased capital expenditures of $5.8 million, and increased interest payments of $2.7 million related to the debts obtained for the Shepell•fgi acquisition, and a non-cash gain on the fair value of the foreign exchange contracts held of $1.3 million compared to a loss of $0.8 million in the prior year.

## ANALYSIS OF 2009 FOURTH QUARTER RESULTS

### *Revenue*

Revenue for the three months ended December 31, 2009 remained comparable to the same period in 2008, increasing by $1.0 million, or 1.2%, to $83.3 million from $82.3 million.

### *Salary, Benefit and Contractor Expenses*

Salary, benefit and contractor expenses for the three months ended December 31, 2009 remained comparable to the same period in 2008, increasing by $0.5 million, or 1.0%, to $51.6 million from $51.1 million.

### *Other Operating Expenses*

Other operating expenses for the three months ended December 31, 2009 increased by $2.8 million, or 20.1%, to $16.7 million compared to $13.9 million for the same period in 2008. The increase was mainly attributable to a $0.8 million write-down of leasehold improvements and $1.8 million of provision for future rental loss associated with the sublease of excess office space.

### *Interest Expense*

Interest expense for the three months ended December 31, 2009 decreased by $1.5 million, or 36.6%, to $2.6 million compared to $4.1 million for the same period in 2008. The decrease was primarily attributable to decreased accretion interest of $1.7 million due to the repayment of the $75 million promissory note during the second quarter of 2009.

### *Amortization of Capital and Intangible Assets*

Amortization for the three months ended December 31, 2009 decreased by $0.6 million, or 5.3%, to $10.8 million compared to $11.4 million for the same period in 2008. The decrease was primarily attributable to the non-compete intangible asset, acquired as part of the Shepell•fgi acquisition, being fully amortized as at the end of the third quarter of 2009, resulting in a reduction of $0.9 million.

### *Income Tax Recovery*

Income tax recovery for the three months ended December 31, 2009 increased by $1.5 million to $3.2 million compared to $1.7 million for the same period in 2008. The increase was primarily attributable to the

tax loss generated by a taxable subsidiary due to the availability of the eligible tax deductions from the acquisition of Shepell•fgi.

***Net Income***

As a result of the changes noted above, the net income for the three months ended December 31, 2009 was $4.2 million compared to the net income of $3.0 million for the same period in 2008.

***Non-GAAP Financial Measures: Standardized EBITDA, Adjusted Standardized EBITDA, Standardized Distributable Cash and Adjusted Consolidated Distributable Cash***

***Standardized EBITDA and Adjusted Standardized EBITDA***

Standardized EBITDA, adjusted for the impact of the $1.8 million provision for the future rental loss associated with the sublease of excess office space and the $0.9 million in severance related to integration, increased by $1.2 million, or 6.9%, to $18.5 million compared to $17.3 million for the same period in 2008.

Inclusive of the above non-recurring adjustments, Standardized EBITDA for the three months ended December 31, 2009 decreased by $1.6 million, or 9.2%, to $15.7 million compared to $17.3 million for the same period in 2008. This decrease was due to increased salary, benefit and contractor expenses and other operating expenses, excluding impairment of leasehold improvements, of $2.6 million, offset by increased revenue of $1.0 million.

***Standardized Distributable Cash***

Standardized Distributable Cash for the three months ended December 31, 2009 decreased by $1.7 million to $14.4 million compared to $16.1 million for the same period in 2008. This decrease was primarily due to decreased cash from operating activities of $1.4 million and increased capital expenditures mainly for technology spending of $1.0 million, offset by a $0.7 million decrease in Consolidated Distributable Cash available to non-controlling interest.

***Adjusted Consolidated Distributable Cash***

Adjusted Consolidated Distributable Cash for the three months ended December 31, 2009 decreased by $2.5 million to $12.4 million compared to $14.9 million for the same period in 2008. The decrease was primarily due to decreased Standardized EBITDA of $1.6 million, increased capital expenditures of $1.0 million, and increased interest payments of $0.5 million related to the debts obtained surrounding the Shepell•fgi acquisition. This was partially offset by a reduction in non-cash loss on the fair value of foreign exchange contracts in the period of $0.7 million.

## LIQUIDITY AND CAPITAL RESOURCES

***Cash Flows***

The following table provides an overview of the Fund's cash flows for the periods indicated:

| **Cash Flow Information** | **Three Months Ended** | | **Year Ended** | |
|---|---|---|---|---|
| Selected Unaudited Consolidated Financial Information | **December 31** | | **December 31** | |
| *(In thousands of dollars)* | **2009** | **2008** | **2009** | **2008** |
| Cash provided by (used in): | | | | |
| Operating activities | **$ 18,649** | $ 20,060 | **$ 48,955** | $ 35,295 |

| | | | | |
|---|---|---|---|---|
| Investing activities | **(2,399)** | (5,276) | **(9,624)** | (257,026) |
| Financing activities | **(11,845)** | (12,437) | **(37,221)** | 218,329 |
| Increase (decrease) in cash | **$ 4,405** | $ 2,347 | **$ 2,110** | $ (3,402) |

**2009 Annual Results**

Cash from operating activities for the year ended December 31, 2009 increased by $13.7 million to $49.0 million compared to $35.3 million for the same period in 2008. This increase was primarily due to an increase in net income of $2.0 million, a decrease use of cash related to the changes in non-cash operating working capital of $6.7 million and a positive change in non-cash operating items of $5.0 million. The increase in non-cash items represents primarily increased amortization charges of $11.1 million offset by increased future income taxes recovery of $5.7 million.

Changes in non-cash operating working capital for the year ended December 31, 2009 improved by $6.7 million to a use of cash of $4.6 million compared to a use of cash of $11.3 million for the same period in 2008. The increase was primarily attributable to $10.4 million source of cash from accounts receivable and unbilled fees as a result of timing of customer billings and improved collections, and changes in prepaid of $1.9 million, offset by changes in accounts payable and accrued liabilities of $5.1 million.

Cash used in investing activities for the year ended December 31, 2009 increased by $247.4 million to cash outflows of $9.6 million compared to cash outflows of $257.0 million for the same period in 2008. This increase is primarily due to cash consideration paid net of cash assumed during 2008 related to various business acquisitions of $253.9 million, of which did not recur in 2009 with the exception of one business acquisition-related payment in the amount of $0.9 million. This decrease was partially offset by an increase in capital expenditures related to investments in technology spending of $5.8 million to support new services and growth in the business.

Cash provided by financing activities for the year ended December 31, 2009 decreased by $255.5 million to a use of cash of $37.2 million compared to a source of cash of $218.3 million for the same period in 2008. This decrease was primarily attributable to the inclusion of $242.9 million of funds obtained through issuance of Units and proceeds from additional debt to finance the Shepell•fgi acquisition in 2008 and increased distribution payments of $11.9 million as a result of Units issued in June 2008 and in March 2009 in conjunction with the Shepell•fgi acquisition. This decrease was further increased by a reduction in drawings on the revolving loan of $2.5 million, but partially offset by proceeds received from the sale of Units held in Treasury related to the LTIP of $1.9 million.

**2009 Fourth Quarter Results**

Cash from operating activities for the three months ended December 31, 2009 decreased by $1.4 million to $18.7 million compared to $20.1 million for the same period in 2008. This change was primarily attributable to an increase in net income of $1.2 million and an increased source of cash from non-cash operating working capital of $0.2 million. This is offset by decreased non-cash items of $2.7 million primarily represented by higher income tax recovery of $1.8 million, lower accretion on promissory notes of $1.7 million, lower amortization expense of $0.9 million, and offset by the sublease loss provision of $1.8 million.

Changes in non-cash operating working capital for the three months ended December 31, 2009 remained comparable to the same period in 2008, increasing by $0.2 million to $3.9 million in 2009 from $3.7 million.

Cash used in investing activities for the three months ended December 31, 2009 decreased by $2.9 million to cash outflow of $2.4 million compared to cash outflows of $5.3 million for the same period in 2008. This decrease was primarily due to cash consideration paid net of cash assumed during 2008 related to various business acquisitions of $3.9 million of which did not recur in 2009, and was partially offset by $1.0 million of increased capital expenditures mainly due to technology spending.

Cash used in financing activities for the three months ended December 31, 2009 decreased by $0.6 million to a use of cash of $11.8 million compared to a use of cash of $12.4 million for the same period in 2008. This increase was primarily attributable to proceeds from the sale of treasury Units of $1.9 million, partially offset by an increased distribution payments of $1.6 million as a result of Units issued in June 2008 and in March 2009 in conjunction with the Shepell•fgi acquisition.

***Capital Expenditures***

Our capital expenditures typically include information technology hardware and software (external and internally developed), facility improvement and office furniture. Additional capital expenditure requirements may result from significant business expansion. Such amounts are expected to be funded from our operating cash flow.

***Contractual Obligations***

**Commitments**

We lease office space and selected equipment under operating lease agreements with terms ranging from one to fifteen years. We also have a term loan, a delayed draw facility, a revolving loan and a promissory note described under "Capital Resources". Future expected payments are as follows:

**Summary of Contractual Obligations**

*(In thousands of dollars)*

| | Total | 2010 to 2011 | 2012 to 2013 | Beyond 2013 |
|---|---|---|---|---|
| Term loan | $ 160,000 | $ - | $ 160,000 | $ - |
| Revolving loan | 11,500 | - | 11,500 | - |
| Promissory notes | 4,500 | 4,500 | - | - |
| Operating leases | 75,362 | 19,522 | 14,690 | 41,150 |
| Total | $ 251,362 | $ 24,022 | $ 186,190 | $ 41,150 |

The Fund is party to various subleases to which the Fund would be liable for the rental payment in the case of a default by the subtenants. The minimal payments related to these premises have been included above. The terms of the subleases extend through July 2022 and the aggregate sublease income on these subleases is $22,407. The Fund considers the risk of default by the subtenants to be low therefore no accrual has been set up for the guarantee.

**Contingent Consideration**

The purchase price for Leong & Associates is contingent on business results and is expected to be approximately $7.6 million payable in three instalments. The first instalment of $2.6 million was satisfied on closing through cash and equity consideration, and the second instalment of $2.5 million was satisfied in January 2010. The third and final instalment, which is subject to revenue adjustments plus interest calculated at annual rates of 3.27% and 3.87%, will be settled on April 1, 2011.

The Fund has no material contractual obligations other than those described in this MD&A and has no off-balance sheet financing arrangements.

***Capital Resources***

The following table provides an overview of the Fund's capital resources:

| **Capital Resources**<br>*(In thousands of dollars)* | **As at December 31, 2009** | **As at December 31, 2008** |
|---|---|---|
| Bank indebtedness | $ - | $ 504 |
| Revolving loan | $ 11,500 | $ 7,000 |
| Long-term debt, net of unamortized debt issue cost | $ 158,887 | $ 135,418 |
| Promissory notes | $ 4,306 | $ 43,917 |
| Non-controlling interests | $ 46,137 | $ 51,724 |
| Unitholders' equity | $ 352,345 | $ 318,130 |

As at December 31, 2009, the Fund's working capital (current assets minus current liabilities, excluding the current portion of promissory note and future considerations related to acquisition),was approximately $22.0 million compared to $22.7 million as at December 31, 2008.

In 2008, as part of the Shepell•fgi acquisition, the Fund entered into a credit agreement with a syndicate of Canadian chartered banks for a period of four years maturing on June 1, 2012. Under the agreement, the following credit facilities are available:

- $20 million senior secured revolving facility ("revolving loan").
- $137 million senior secured non-revolving term loan ("term loan").
- $23 million senior secured non-revolving delayed draw term facility (reduced from the initial balance of $40 million on March 24, 2009).

The interest rates for the facilities are floating, based on a margin over certain reference rates of interest. The applicable margin may vary up and down depending on the ratio of the Fund's consolidated debt to Adjusted EBITDA as calculated in the new credit agreement. EBITDA is defined as net income before interest expense, income taxes (recovery), depreciation, amortization and non-controlling interest. During the year, EBITDA was amended to also exclude the loss provisions associated with the sublease of excess office spaces. Adjusted EBITDA is defined as the rolling twelve months earnings before interest, taxes, depreciation and amortization of the Fund, Shepell•fgi and Leong & Associates.

The credit facilities are secured by a general assignment of all the assets of the Fund. The new credit agreement also requires the Fund to maintain the following financial covenants on a consolidated basis:

(iii) Ratio of debt to Adjusted EBITDA shall commence at 3.5:1.0 for the period up to December 30, 2009 and declining to 3.0:1.0 on December 31, 2009 and 2.5:1.0 on June 30, 2011 and thereafter.
(iv) Ratio of EBITDA to interest expense of not less than 3.0:1.0

The Fund complied with all the required financial covenants and the ratios as at December 31, 2009 were

2.7:1 and 5.9:1 respectively.

***Promissory notes***

As part of the Shepell•fgi acquisition, the Fund issued two non-interest bearing promissory notes secured by a general assignment of all the assets of the Fund, which is subordinated to the credit facilities in the amounts of $75.0 million and $4.5 million due on July 2, 2009 and July 2, 2010, respectively.

On March 24, 2009, the Fund completed a public offering, in which 6,666,700 Units were issued at a price of $8.25 per Unit for cash proceeds, net of issuance costs, of $52.4 million. Using the proceeds generated therein, the Fund prepaid $51.5 million of the $75 million note.

On June 30, 2009, the Fund utilized the $23 million senior secured non-revolving delayed draw term facility to repay the remaining $23.2 million of the $75 million note.

The Fund has the option to repay up to 100% of the $4.5 million promissory note through the issuance of Units, the number determined by dividing the dollar amount by the then market trading price discounted by 5%.

The promissory note also includes a covenant that the Fund and its subsidiaries shall not incur any debt other than permitted debt as defined in the promissory note agreements unless, after the incurrence of such debt, the Fund would have on a pro forma consolidated basis a ratio of debt to Adjusted EBITDA of not greater than 4.5:1.0 determined as of the end of the fiscal quarter ending immediately prior to the date of determination.

## SELECTED BALANCE SHEET DATA

The following table provides an overview of the Fund's selected balance sheet data:

| **Selected Balance Sheet Data** *(in thousands of dollars)* | **As at December 31, 2009** | **As at December 31, 2008** |
|---|---|---|
| Current assets | $ 78,174 | $ 75,757 |
| Other long-term assets | $ 583,372 | $ 614,108 |
| Current liabilities | $ 62,956 | $ 85,331 |
| Long-term financial liabilities (1) | $ 158,887 | $ 179,335 |

(1) Comprised of long-term debt and promissory note.

### Current Assets

Current assets as at December 31, 2009 increased by $2.4 million to $78.2 million from $75.8 million as at December 31, 2008. The increase was primarily due to increase in accounts receivable net of unbilled fees of $2.5 million as a result of growth in revenue, and increased cash balance of $1.6 million from

proceeds received on the sale of Units re-acquired in the RSU exchange and subsequently held in treasury in December 2009. This is partially offset by a decrease in prepaid expenses of $2.2 million mainly due to the changes related to the long-term incentive plan.

**Other Long-Term Assets**

Other long-term assets as at December 31, 2009 decreased by $30.7 million to $583.4 million from $614.1 million as at December 31, 2008. The decrease was primarily due to the amortization of capital and intangible assets of $45.2 million, which was partially offset by capital expenditures of $8.9 million, increased implementation expenditures on outsourcing contracts of $0.9 million, and increased future income tax assets of $4.4 million.

**Current Liabilities**

Current liabilities as at December 31, 2009 decreased by $22.3 million to $63.0 million from $85.3 million as at December 31, 2008. The decrease was primarily the result of the repayment of the first promissory note and of the acquisition-related payment related that resulted in decreases of $31.6 million and $0.7 million respectively, which were partially offset by increased borrowings on the revolving credit facility of $4.5 million to manage operational cash flow, and the inclusions of the second instalment payable to Leong & Associates and the promissory note issued in connection with the Shepell•fgi acquisition of $2.5 million and $4.3 million, respectively.

**Long-Term Financial Liabilities**

Long-term financial liabilities as at December 31, 2009 decreased by $20.4 million to $158.9 million from $179.3 million as at December 31, 2008. The decrease was primarily the result of the repayment of the first promissory note which had a carrying value, including accretion interest of $40.0 million as at December 31, 2008, and the reclassification of the second promissory note of $3.9 million as at December 31, 2008 to current liabilities in 2009. The decrease was partially offset by a $23.0 million increase in long-term debt resulting from the utilization of the non-revolving delayed draw term to fund the repayment.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements, in accordance with GAAP, requires us to make estimates and assumptions that affect the reported values of assets and liabilities as well as disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Accordingly, actual results could differ from these estimates. The accounting policies and estimates that are critical to the Fund's business relate to the following items:

***Revenue Recognition***

We earn fee-for-service revenue based on hourly rates and the time spent delivering those services. We also earn contracted revenue based on negotiated fixed amounts or on a formula tied to the nature of the service, rather than the time spent. Revenue is recognized in the period that the service is rendered, irrespective of when it is invoiced. EAP revenue is recognized through a combination of the minimum contracted amount and incremental usage above the minimum thresholds. The minimum contracted amount is recognized on a straight-line basis over the term of the contract. Incremental usage is recognized when the minimum usage threshold is exceeded up to a cap where applicable. Unbilled fees are recorded at the lower of unbilled hours worked at standard billing rates and the amount which we estimate can be recovered upon invoicing. Expenses are recognized as incurred. Losses on fixed-fee contracts are recognized during the period in which the loss becomes probable. Billings in excess of revenue are recorded as a deferred revenue liability until services are rendered. Revenue does not include reimbursements for recoverable expenses, such as

employee travel expenses, outside printing and third-party professional services. Reimbursements are accounted for as a reduction to expenses. Outsourcing engagements typically involve both an implementation and administration component; unless it can be determined that the implementation phase is independent of the administrative one, revenues (and related expenses) are deferred and recognized over the term of the service contract period.

We also earn commission revenue as payment for the provision of benefits consulting services to clients, as a percentage of insurance premiums paid by our clients. Commission revenue is received annually, semi-annually, quarterly or monthly. Annual fees are typically paid at the beginning of the insurance policy period and are recognized as income at the later of the billing or effective date of the policy, net of a provision for return commissions due to policy cancellations or change of broker.

***Intangible Assets and Goodwill***

Intangible assets consist of trade names, customer relationships, purchased and internally-developed software, proprietary software, and customer contracts. Intangible assets acquired through acquisitions or business combinations are initially recognized at fair value based on an allocation of the purchase price. Internally-developed proprietary software for internal use is recognized at the aggregate fair value of all eligible development costs, determined in accordance with Section 3064, *Goodwill and Intangible Assets*. Eligible expenditures capitalized as part of proprietary software developed for internal use include external direct costs of materials and services consumed in development, and payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use computer software project (to the extent that their time was spent directly on the project). All costs incurred in the preliminary research stage of the projects are expensed as incurred. Intangible assets with a finite life are amortized on a straight-line basis over their estimated useful lives, or on a declining balance basis for purchased software. Intangible assets with an indefinite life are not amortized but are tested for impairment annually or more frequently if events or circumstances indicate there may be an impairment by comparing the estimated discounted future net cash flows from the asset to its carrying amount.

Goodwill is not amortized and is subject to an annual impairment test. Goodwill impairment is assessed based on a comparison of the estimated fair value of each of the Fund's reporting units and the carrying value of the reporting unit's net assets including goodwill. An impairment loss will be recognized if the carrying amount of the Fund's net assets exceeds its estimated fair value.

***Allowance for Doubtful Accounts***

A provision for accounts receivable resulting from the potential risk that the accounts receivable will not be collected has been recorded. We continually monitor past due accounts to assess the likelihood of collection to estimate the required provision.

***Litigation and Claims***

We are involved in litigation and other claims arising in the normal course of business. We must use judgment to determine whether or not a claim has any merit, the amount of the claim and whether to record a provision, which is dependent upon the potential success of the claim. We believe that none of the current claims will have a material adverse impact on the financial position of the Fund.

***Future Income Taxes***

The Fund uses the asset and liability method of accounting for income taxes. Future income taxes are recognized for the temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws that are expected to apply to taxable income in the years in which those temporary differences are expected to be reversed or settled. A valuation allowance

is recorded against a future income tax asset if it is not anticipated that the asset will be realized in the foreseeable future. The effect on future income tax assets and liabilities of a change in tax rate is recognized in income in the period that includes the date of enactment or substantive enactment.

***Financial Instruments***

Financial assets and financial liabilities are initially measured at fair value, defined as the amount of consideration that could be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. In certain circumstances, however, the initial fair value may be based on other observable current market transactions in the same instrument, without modification or on a valuation technique using market based inputs. Subsequent measurement of the Fund's financial assets and liabilities is dependent on their classification as held for trading, loans and receivables, other financial liabilities, or derivative instruments.

Held for trading financial assets and liabilities are measured at fair value as at the date of the consolidated balance sheet, and any unrealized gains or losses from market fluctuations are included in the consolidated statement of income.

Loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method of amortization.

Derivative financial instruments are used by the Fund in the management of its interest rate risk exposure on debt financing and foreign exchange risk arising due to fluctuations in the United States dollar. Derivatives that have been designated and function effectively as a hedge are accounted for using hedge accounting principles. The effective portions of changes in fair value of derivatives that qualify for hedge accounting are recorded in other comprehensive income. Any ineffective portions of changes in the fair value are recognized in net income in the period in which the change occurred. If the hedging relationship ceases to be effective, the cumulative change in the fair value of the interest-rate swap are recognized into income beginning in the period in which the change occurs. Derivatives that do not qualify for hedge accounting are recorded on the consolidated balance sheet at fair value with changes in fair value recorded as income or expense in the consolidated statement of income.

Fair value measurements recognized in the balance sheet are categorized using a fair value hierarchy that reflects the significant inputs used in determining the fair values, in accordance with the amendment to CICA Handbook Section 3862 in June 2009:

(iv) Level 1 - Inputs unadjusted quoted prices of identical instruments in active markets

(v) Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly

(vi) Level 3 – One or more significant inputs used in a valuation technique are unobservable in determining fair values of the instruments

Each type of fair value is categorized based on the lowest level input that is significant to the fair value measurement.

The Fund does not use derivative financial instruments for trading or speculative purposes.

***New Accounting Policies***

Effective January 1, 2009 the Fund adopted the following new accounting standards:

1. Section 3064, *Goodwill and Intangible Assets,* which replaces the existing Section 3062, *Goodwill and Other Intangible Assets* and Section 3450, *Research and Development Costs.* This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. The standards concerning goodwill are unchanged from the standards included in the previous section 3062. The adoption of this section has not impacted the Fund's consolidated net comprehensive income, but did result in the reclassification of computer software costs from capital assets to intangible assets of $1.2 million as at December 31, 2008.

2. EIC 173, *Credit Risk and Fair Value of Financial Assets and Financial Liabilities.* This Abstract establishes that an entity's own credit risk and that of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, inclusive of derivative instruments. EIC 173 has been applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods commencing January 20, 2009. The adoption of EIC 173 resulted in an adjustment to opening accumulated other comprehensive loss of $0.6 million.

***Future Accounting Changes***

*1. Business Combinations* - The CICA issued new Handbook Section 1582, *Business Combinations*, in January 2009, to replace the former Section 1581, *Business Combinations*, and representing the Canadian equivalent to International Financial Reporting Standards 3, *Business Combinations*. The new Section expands the definition of a business subject to an acquisition and establishes significant new guidelines on the measurement of consideration given, and the recognition and measurement of assets acquired and liabilities assume in a business combination. The new Section requires that all business acquisitions be measured at the full fair value of the acquired entity at the acquisition date even if the business combination is achieved in stages, or if less than 100% of the equity interest in the acquiree is owned at the acquisition date. Subsequent changes in fair value of contingent consideration classified as a liability will be recognized in earnings and not as an adjustment to the purchase price. Restructuring and other direct costs of a business combination are no longer considered part of the acquisition accounting and such costs will be expensed as incurred, unless they constitute the costs associated with debt or equity issuance.

*2. Consolidated Financial Statements and Non-Controlling Interests* - Also in January, 2009, the CICA issued new Handbook Sections 1601, *Consolidated Financial Statements*, and Section 1602, *Non-controlling Interests*, to replace Section 1600, *Consolidated Financial Statements*. These two Sections are the equivalent to the corresponding provisions of International Accounting Standard 27, Consolidated and Separate Financial Statements. The new Sections require that, for each business combination, the acquirer measure any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. The new Sections also require non-controlling interest to be presented as a separate component of unitholders' equity. Under Section 1602, consolidated net income and other comprehensive income are allocated to the controlling and non-controlling interests based on relative ownership interests.

**International Financial Reporting Standards**

The Canadian Accounting Standards Board confirmed in February 2008 that publicly accountable entities will be required to adopt International Financial Reporting Standards ("IFRS") for interim and annual financial statements for periods beginning on January 1, 2011. The Fund's established project plan for implementing IFRS consists of four phases (initial scoping and planning, detailed assessment, design, and

implementation) and is designed to address:

- Changes to accounting policies and disclosure requirements;
- Changes to information systems and business processes;
- Changes to internal control over financial reporting and disclosure controls and procedures; and
- Training requirements and communications.

The Fund has completed the initial scoping and planning phase of the project plan, which involved the identification of the key differences between IFRS and Canadian GAAP, and an assessment of the exemptions and elections available upon transition under IFRS 1, *First-time Adoption of International Reporting Standards*. The completion of this phase yielded the following key differences between IFRS and Canadian GAAP:

| Standard | Deviation from GAAP | Anticipated Impact |
|---|---|---|
| IAS 1: Presentation of Financial Statements | IFRS requires significantly more disclosure than existing Canadian GAAP. In addition, classification and presentation may be different for some balance sheet and income statement items. | The Fund is analyzing the impact of the classification and presentation changes on its financial statements. |
| IFRS 1: First-time Adoption of IFRS | A number of mandatory and optional exemptions and elections are available upon first-time adoption of IFRS.<br><br>For the Fund, the material exemptions relate primarily to the restatement of prior business combinations.<br><br>The most significant election for the Fund relates to the valuation of fixed and intangible assets on the date of transition at deemed cost. | The Fund has completed an analysis on the impact of IFRS 1 on the Fund and has made the following tentative conclusions:<br><br>The Fund expects not to restate business combinations executed prior to January 1, 2010.<br><br>The Fund expects the net book value of its capital and intangible assets at January 1, 2010 to approximate its fair value. |
| IAS 36: Impairment of Assets | IFRS uses a one-step approach for both testing for and measurement of impairment, with asset carrying values compared directly with the higher of fair value less costs to sell, and value in use. | Impairment losses may be recognized earlier, or recorded when they may not have been recorded at all under existing GAAP. |
| IAS 32: Financial Instruments: Presentation | Under IFRS, a financial instrument which gives the holder the right to put the instrument back to the issuer for cash should be classified as a financial liability, unless certain criteria are met to allow for classification as equity. | The Fund is currently analyzing the impact of this section on its classification as equity. |
| IAS 16: Property, Plant, and | IFRS requires the componentization of assets, where all significant components of an asset are | The Fund is currently analyzing the impact of this section, but does not |

| Equipment | recognized and depreciated separately.<br><br>IFRS allows the periodic revaluation of property, equipment and leaseholds. | anticipate this to be material.<br><br>The Fund has elected not to periodically revalue its property, equipment and leaseholds. |
|---|---|---|
| IAS 37:<br>Provisions, Contingent Liabilities and Contingent Assets | Under IFRS, provisions are recognized if they are "more likely than not", a lower threshold than the existing GAAP criterion, "probable". This determination can be dictated by the past (and confirmed in the future). | Some provisions may be recorded earlier, or recorded when they may not have been recorded at all under existing GAAP. The Fund is analyzing the impact of the changes on its financial statements. |
| IAS 12:<br>Income taxes | While IAS 12 is similar to the existing CICA standard, any material adjustments to balances resulting from the adoption of IFRS would have a corresponding effect on future income taxes balances. | Any impact will depend primarily on other adjustments made upon transition to IFRS. |

Several IFRS standards are in the process of being amended by the International Accounting Standards Board ("IASB"), and are expected to remain as such up to the date of transition January 1, 2011. As a result, the differences highlighted above may differ from those actually realized as at the date of transition. The Fund will continue to monitor the status of upcoming amendments to existing standards.

The Fund is currently completing the detailed assessment phase of the project plan, which involves:

- Finalizing the impact of those key accounting differences identified in phase one, and of the IFRS 1 exemptions and elections to be taken;
- Assessing the Fund's current information systems environment and accounting processes to identify where changes are needed in order to support the transition to IFRS;
- Finalizing accounting and policy disclosure choices required under IFRS.

This phase is expected to be completed by the second quarter of 2010.

The design phase will immediately follow the completion of the detailed assessment phase, during which the Fund will perform the following:

- Designing and implementing business and accounting processes that will facilitate the collection of data required in a timely and accurate manner
- Designing and implementing internal controls required by the new business and accounting processes

The Fund anticipates the completion of this phase during the latter part of 2010.

The fourth and final phase, implementation, will commences on January 1, 2011 with the adoption of IFRS. All new policies, processes, and controls will be implemented and monitored to ensure efficient and effective delivery.

At December 31, 2009, the Fund cannot reasonably determine the full impact that adopting IFRS would have on its financial statements, as the current status of the project reflects the Fund's most recent assumptions and expectations. Circumstances may arise, such as changes in existing IFRS, or changes in the regulatory or economic environment, which could alter our above assumptions and expectations. These disclosures reflect the Fund's expectations based on information available at December 31, 2009. Changes in IFRS standards or circumstances relating to the Fund may cause the Fund to revise its expectations, its project plan, and its potential IFRS accounting policy choices prior to the conversion

date.

## RISKS AND UNCERTAINTIES

The results of operations, business prospects and financial condition of the Fund are subject to a number of risks and uncertainties and are affected by a number of factors outside our control.

***Risk Related to the Business of Morneau Sobeco***

### Ability to Maintain Profitability and Manage Growth

There can be no assurance that Morneau Sobeco will be able to sustain profitability in future periods. Morneau Sobeco's future operating results will depend on a number of factors, including its ability to continue to successfully execute its strategic initiatives.

There can be no assurance that Morneau Sobeco will be successful in achieving its strategic plan or that its strategic plan will enable the firm to maintain its historical revenue growth rates or to sustain profitability. Failure to successfully execute any material part of Morneau Sobeco's strategic plan could have a material adverse effect on its business, financial condition and operating results, and the ability of the Fund to make distributions on the Units.

There can be no assurance that Morneau Sobeco will be able to effectively manage its growth, and any failure to do so could have a material adverse effect on the Fund's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

### Reliance on Information Systems and Technology

Information systems are an integral part of Morneau Sobeco's business and the products and services offered to its clients. Morneau Sobeco relies on systems to maintain accurate records and to carry out required administrative functions in accordance with the terms of its contractual obligations to its clients. In order to maintain the level of security, service and reliability that clients require, Morneau Sobeco may be required to make significant investments in the online means of delivering services. The adoption of additional laws or regulations with respect to the Internet may impede the efficiency of the Internet as a medium of exchange of information and decrease the demand for Morneau Sobeco's services.

Any disruptions in Morneau Sobeco's systems, the failure of the systems to operate as expected, or the firm's ability to use the Internet effectively to deliver services could, depending on the magnitude of the problem, result in a loss of current or future business and/or potential claims against Morneau Sobeco, all of which could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

### Reliance on Key Professionals

Morneau Sobeco's operations are dependent upon the abilities, experiences and efforts of its professionals, many of whom have excellent reputations and a significant number of contacts in the industry in which Morneau Sobeco operates. Morneau Sobeco's business depends, in part, on its professionals' ability to develop and maintain client relationships and alliances with businesses such as financial services

companies, healthcare organizations, insurance companies, business process outsourcing organizations and other companies, in order to develop, market and deliver its services. Profitability could be negatively impacted if Morneau Sobeco's client relationships or business alliances are discontinued due to the loss of professional staff or if the firm has difficulty developing new alliances,. Should any member of its professional staff be unable or unwilling to continue his or her relationship with Morneau Sobeco, this change could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

**Reputational Risk**

Morneau Sobeco depends to a large extent upon its relationships with its clients and its reputation for high-quality services. As a result, the impact of client dissatisfaction with Morneau Sobeco's services or products may be more damaging in Morneau Sobeco's business than in other businesses. Moreover, if the firm fails to meet its contractual or regulatory obligations, Morneau Sobeco could be subject to legal liability and a loss of client relationships.

**Economic Conditions**

An economic slowdown could cause a decline in demand for Morneau Sobeco's services. Growth in its clients' businesses may be affected by the economic slowdowns and could therefore potentially have an impact on the Fund's operating results. During an economic downturn, Morneau Sobeco clients and potential clients may reduce or delay services or projects, or defer contracts currently underway. This situation could also lead to greater delays and defaults in payments or debt collection, resulting in lower operating results. Because of lower revenue during an economic slowdown, competition may increase and prices may be reduced by certain competitors to maintain or expand their market share. Pricing and profitability could be adversely affected as a result.

**Dependence on Key Clients**

For the year ended December 31, 2009, Morneau Sobeco's largest client accounted for approximately 5% of the Fund's total revenue (for the year ended December 31, 2008 - 7%) and the top 10 clients accounted for approximately 22% of the Fund's total revenue for the year ended December 31, 2009 (for the year ended December 31, 2008 – 24%). As clients may terminate engagements with minimum notice, there can be no assurance that Morneau Sobeco will be able to retain relationships with its largest clients. Moreover, there can be no assurance that such clients will continue to use Morneau Sobeco's services in the future. Any negative change involving any of Morneau Sobeco's largest clients, including but not limited to a client's financial condition or desire to continue using the firm's services, could result in a significant reduction in revenue which could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

**Risk of Future Legal Proceedings**

Morneau Sobeco may be threatened with, or may be named as a defendant in, or may become subject to, various legal proceedings in the ordinary course of conducting its business, including lawsuits based upon professional errors and omissions.

The pension and benefits consulting and outsourcing service involves assumptions and estimates concerning future events, the actual outcome of which cannot be known with certainty in advance. In addition, computational, software programming or data management errors could occur. For example, possible legal proceedings could result from a client's assertion that actuarial assumptions used in a pension plan were unreasonable, leading to plan underfunding; a claim that inaccurate data was used, which could lead to an underestimation of plan liabilities; or a claim that employee benefits plan documents were misinterpreted or plan amendments were misstated in plan documents, which could lead to overpayments to beneficiaries. The employee health and productivity services involve confidential

counseling, occupational health activities and disability case management. Each of these activities could potentially put the Fund in conflict with its customers, their employees, or both. Possible legal proceedings could also result from matters such as an employee claiming for breach of confidence, failure to provide adequate counsel, or denial of benefits or employment as a result of Morneau Sobeco's actions.

Defending lawsuits of this nature could require much management attention, which could divert its focus from operations. Such claims could produce negative publicity that could harm Morneau Sobeco's reputation and business. A significant judgment against Morneau Sobeco, or the imposition of a significant fine or penalty as a result of a finding that Morneau Sobeco failed to comply with laws or regulations, could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

**Insurance**

Morneau Sobeco believes that its professional errors and omissions insurance and director and officer liability insurance coverage address all material insurable risks, provides coverage that is similar to that which would be maintained by a prudent operator of a similar business and is subject to deductibles, limits and exclusions which are customary or reasonable given the cost of procuring insurance and current operating conditions. However, there can be no assurance that such insurance will continue to be offered on economically feasible terms, that all events that could give rise to a loss or liability are insurable, or that the amounts of insurance will at all times be sufficient to cover each and every loss or claim that may occur involving Morneau Sobeco's assets or operations.

**Competition**

Morneau Sobeco operates in a highly competitive North American market. As a result, Morneau Sobeco competes with many domestic and international firms. Some of its competitors have achieved substantially more market penetration in certain of the areas in which Morneau Sobeco competes. In addition, some of Morneau Sobeco's competitors have substantially more financial resources and/or financial flexibility than Morneau Sobeco. Further, Morneau Sobeco's business relies, in part, upon its ability to develop and implement technology solutions, in a cost effective manner that anticipate and keep pace with rapid and continuing changes in technology, industry standards and client preferences. Morneau Sobeco's competitors may offer new technologies more efficiently or cost effectively than Morneau Sobeco. Competitive forces could result in reduced market share and thus have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

**Relationship with Channel Partners**

Morneau Sobeco markets its services directly to end-user employers as well as through certain channel partners, primarily insurance companies (many of which compete amongst themselves directly). There can be no assurance that Morneau Sobeco will be able to maintain its existing relationships with all these channel partners, which could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

**Satisfactory Performance of Obligations**

In its contracts with clients, Morneau Sobeco is sometimes committed to meeting identified service levels and/or timelines. If the service levels/timelines are not met, Morneau Sobeco may experience reduced revenues, incur significant additional costs or be held responsible for the costs incurred by the client for failure to meet the service level/timeline. Morneau Sobeco's success depends in large part upon whether it fulfills these and other contractual obligations with clients and maintains client satisfaction. If Morneau Sobeco fails to satisfactorily perform its contractual obligations, its clients could terminate contracts

and/or take legal action against Morneau Sobeco. Such occurrences could result in a loss of its professional reputation and in extra costs needed to defend or rectify the situation and thus have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

**Implications of Fixed-Price Contracts**

A portion of Morneau Sobeco's revenue comes from fixed-price contracts. A fixed-price contract requires Morneau Sobeco to perform either all or a specified portion of work under the contract for a fixed price. Fixed-price contracts expose Morneau Sobeco to a number of risks, including underestimation of costs, ambiguities in specifications, unforeseen costs or difficulties, problems with new technologies, delays beyond the control of Morneau Sobeco, failures of subcontractors to perform, and economic or other changes that may occur during the contract period. Losses under fixed-price contracts could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

**Confidentiality of Client Information**

Morneau Sobeco depends to a large extent on its relationships with its customers and its ability to properly maintain confidential client information. The failure of Morneau Sobeco to maintain client confidentiality could, depending on the magnitude of the problem, result in a loss of future business and/or potential claims against Morneau Sobeco which could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions.

**Protection of Intellectual Property**

Morneau Sobeco continually develops and improves its proprietary technology solutions for the delivery of its services. No assurance can be given that Morneau Sobeco's competitors will not develop substantially similar technology. Morneau Sobeco relies on one or more of the following to protect its proprietary rights: trademarks, copyrights, trade secrets, confidentiality procedures and contractual provisions. Despite Morneau Sobeco's efforts to protect its proprietary rights, unauthorized parties may attempt to obtain and use information that Morneau Sobeco regards as proprietary. Stopping unauthorized use of Morneau Sobeco's intellectual property may be difficult, time-consuming and costly. There can be no assurance that Morneau Sobeco will be successful in protecting its proprietary rights and, if it is not, this could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

**Potential Undisclosed Liabilities Associated with Acquisition/Limited Indemnification**

In connection with acquisitions completed by the Fund, there may be liabilities and contingencies that the Fund failed to discover or was unable to quantify in its due diligence which it conducted prior to the execution of an acquisition, and the Fund may not be indemnified for some or all of these liabilities and contingencies. The existence of any material liabilities or contingencies could have a material adverse effect on the Fund's business, financial condition, liquidity and results of operations.

**Indebtedness and Interest Rates**

The ability of Morneau Sobeco to make distributions or make other payments or advances will be subject to applicable laws and contractual restrictions contained in the instruments governing any indebtedness of those entities. The degree to which MSGLP or Morneau Sobeco is leveraged could have important consequences to the Unitholders including: Morneau Sobeco's ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited; a significant portion of Morneau Sobeco's cash flow from operations may be dedicated to the payment of the principal of and

interest on its indebtedness, thereby reducing funds available for future operations; certain borrowings will be at variable rates of interest, which exposes Morneau Sobeco to the risk of increased interest rates; and Morneau Sobeco may be more vulnerable to economic downturns and be limited in its ability to withstand competitive pressures. These factors may increase the sensitivity of distributable cash to interest rate variations. Interest rate swap agreements are used as part of the Fund's program to manage the fixed and floating interest rate of the Fund's total debt outstanding and related overall cost of borrowing.

The advance of the Credit Facilities has significantly increased the amount of Morneau Sobeco's debt compared to historical levels. The Credit Facilities contain numerous restrictive covenants that limit the discretion of management with respect to certain business matters. These covenants place significant restrictions on, among other things, the ability of Morneau Sobeco to create liens or other encumbrances, to pay distributions or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidated with another entity. In addition, the Credit Facilities contain a number of financial covenants that require Morneau Sobeco to meet certain financial ratios and financial condition tests. A failure to comply with the obligations in the Credit Facilities could result in a default which, if not cured or waived, could result in a reduction or termination of distributions by Morneau Sobeco and permit acceleration of the relevant indebtedness. If the indebtedness under the Credit Facilities was to be accelerated, there can be no assurance that the assets of Morneau Sobeco would be sufficient to repay in full that indebtedness. In addition, the Credit Facilities mature on June 1, 2012. There can be no assurance that future borrowings or equity financing will be available to the Fund or Morneau Sobeco or available on acceptable terms, in an amount sufficient to fund the Fund's or Morneau Sobeco's needs.

**Foreign Exchange Risk**

A portion of Morneau Sobeco's sales are in U.S. dollars and thus Morneau Sobeco is exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar. Morneau Sobeco has entered into a currency hedge swap agreement. The net revenue exposure after accounting for the hedge and related expenses denominated in U.S. dollars was $nil for the year ended December 31, 2009. An increase in foreign revenues would expose the Fund to fluctuations in exchange rates which may have a material adverse effect on Morneau Sobeco's business, financial condition, and operating results, and on the ability of the Fund to make distributions on the Units.

***Risk Related to the Structure of the Fund***

**Income Tax Matters**

There can be no assurance that Canadian federal income tax laws and administrative policies respecting the treatment of mutual fund trusts will not be changed in a manner which may adversely affect the Unitholders.

The Fund's Declaration of Trust provides that a sufficient amount of the Fund's net income and net realized capital gains shall be distributed each year to Unitholders in order to eliminate the Fund's liability for tax under Part 1 of the *Income Tax Act (Canada)*. Where such amount of net income and net realized capital gains of the Fund in a taxation year exceeds the cash available for distribution in the year, such excess net income and net realized capital gains will be distributed to Unitholders in the form of additional Units. Unitholders are generally required to include an amount equal to the fair market value of those Units in their taxable income, in circumstances when they do not directly receive a cash distribution.

On June 22, 2007, legislation that proposed changes to the taxation of publicly traded income trusts (the "SIFT Rules") received Royal Assent. Certain income of (and distributions made by) the Fund will be taxed in a manner similar to income earned by (and distributions made by) a corporation in the 2011 taxation year.

As a result, the Fund has recognized a $2.7 million future income tax liability as at June 30, 2007 on temporary differences in the reported amounts for financial statement and tax purposes relating to intangible and capital assets. The Fund will be liable for income tax on its non-portfolio income at a rate that would apply to a corporation commencing January 1, 2011.

This legislation is effective for the 2007 taxation year with respect to trusts which commenced public trading after October 31, 2006, but the application of the rules will be delayed to the 2011 taxation year with respect to trusts which were publicly traded prior to November 1, 2006.

On December 20, 2007, the Department of Finance (Canada) announced technical amendments to clarify certain aspects of the new rules (which, as discussed above, will be effective on January 1, 2011, subject to compliance with the normal growth guidelines). One of the amendments is intended to exempt from the new rules a subsidiary partnership that (i) is not publicly traded, and (ii) is wholly-owned by a publicly traded trust or partnership, a taxable Canadian corporation or a combination of these entities. Although the MS Group LP is not publicly traded, the amendments do not appear to exempt a partnership with individual partners. Legislation implementing these amendments was included in Bill C-10 which received royal assent on March 12, 2009. However, the Fund believes that the MS Group LP will not be subject to tax under the new rules prior to January 2011, assuming that the Fund and MS Group LP comply with the normal growth guidelines.

On December 4, 2008, the Department of Finance (Canada) announced an acceleration of the safe harbour amounts for 2009 and 2010 such that after December 4, 2008, they became immediately available. The safe harbour rules remained cumulative such that after December 4, 2008, the maximum amount that could be issued by a SIFT under the safe harbour rule is 100% of its October 31, 2006 market capitalization less the value of any units issued after October 31, 2006 (other than any issuances of units that would not be subjected to the Normal Growth Guidelines).

This legislation may adversely affect the marketability of the Fund's Units and the ability of the Fund to undertake financings and acquisitions, and, at such time as the SIFT Rules apply to the Fund, the distributable cash of the Fund may be materially reduced.

**Dependence on Morneau Sobeco Group LP and Its Subsidiaries**

The Fund is an unincorporated open-ended, limited purpose trust that is entirely dependent upon the operations and assets of the Trust. Cash distributions to Unitholders will be dependent upon, among other things, the ability of the Trust to pay interest on the Trust Notes (see "Description of the Trust – Trust Notes") and to make cash distributions in respect of the Trust Units, which, in turn, are dependent upon MSGLP making cash distributions. MSGLP's ability to make cash distributions is dependent upon the ability of its subsidiaries to make cash distributions or other payments or advances. This will be subject to applicable laws and regulations and contractual restrictions contained in the instruments governing any indebtedness of those entities, including restrictive covenants in the credit facilities.

**Cash Distributions Are Not Guaranteed and Will Fluctuate With the Business Performance**

Although the Fund intends to distribute the interest received in respect of the Trust Notes (see Trust Notes) and the cash distributions received in respect of the Trust Units, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Units, there can be no assurance regarding the amounts of income to be generated by MSGLP's businesses or ultimately distributed to the Fund. The ability of the Fund to make cash distributions, and the actual amount distributed, will be entirely dependent upon the operations and assets of MSGLP (and its subsidiaries), and will be subject to various factors including each of its financial performance, its obligations under applicable credit facilities, fluctuations in its working capital, the sustainability of its margins and its capital expenditure requirements. The market value of the Units may deteriorate if the Fund is unable to meet its distribution targets in the future, and that deterioration may be significant. In addition, the composition of cash

distributions for tax purposes may change over time and may affect the after-tax return for investors (see Income Tax Matters).

**Restrictions on Potential Growth**

The payout by Morneau Sobeco of substantially all of its operating cash flow will make additional capital and operating expenditures dependent upon increased cash flow or additional financing in the future. Lack of those funds could limit the future growth of Morneau Sobeco and its cash flow.

**Nature of Units**

The Units share certain attributes common to both equity securities and debt instruments. The Units do not represent a direct investment in the businesses of Morneau Sobeco and should not be viewed by investors as direct securities of HRCO Inc. or its subsidiaries. Unitholders will not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring "oppression" or "derivative" actions or rights of dissent. The Units represent a fractional interest in the Fund. The Fund's primary assets are Trust Units and Trust Notes.

The Units are not "deposits" within the meaning of the *Canada Deposit Insurance Corporations Act (Canada)* and are not insured under the provisions of that Act or any other legislation. Furthermore, the Fund is not a trust company and, accordingly, is not registered under any trust and loan company legislation, as it does not carry on or intend to carry on the business of a trust company.

**Market Price of Units**

Publicly traded investment trusts such as the Fund do not necessarily trade at prices determined solely by reference to the underlying value of their investments. Increases in market rates of interest may lead purchasers to demand a higher yield on the Units, which may adversely affect their price. In addition, the market price for the Units may be affected by changes in general market conditions, fluctuations in the markets for equity securities and other factors beyond the Fund's control.

The market value of the Units may deteriorate if the Fund is unable to meet its distribution targets in the future, and that deterioration may be material. In addition, the composition of cash distributions for tax purposes may change over time and may affect the after-tax return for investors.

**Dilution of Existing Unitholders and MSGLP Unitholders**

The Fund's Declaration of Trust authorizes the Fund to issue an unlimited number of Units for that consideration and on the terms and conditions as established by the Fund's Board of Trustees (the "Trustees") (the "Trustees") without the approval of any Unitholders. The Unitholders will have no pre-emptive rights in connection with such further issues. Additional Units will be issued by the Fund in connection with the indirect exchange of the Class B MSGLP Units. In addition, MSGLP is permitted to issue additional MSGLP Units for any consideration and on any terms and conditions.

Morneau Sobeco has the option to satisfy up to $4.5 million owing under the promissory note due July 2, 2010, issued in connection with Morneau Sobeco's acquisition of the business of Shepell•fgi, in the form of newly-issued Fund Units. Issuances of additional Fund Units will dilute an investor's investment in Morneau Sobeco, which may adversely affect the market price of the Fund Units.

**Distribution of Securities on Redemption or Termination of the Fund**

It is anticipated that the redemption right will not be the primary mechanism for Unitholders to liquidate their investments. Upon redemption of Units or termination of the Fund, the Trustees may distribute the Trust Notes and Trust Units directly to the Unitholders, subject to obtaining all required regulatory

approvals. Trust Units and Trust Notes so distributed may not be qualified investments for registered plans (i.e., trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans, each as defined in the *Income Tax Act* (Canada), depending upon the circumstances at the time. There is currently no market for the Trust Notes and the Trust Units.

**Future Sales of Units by the Management Securityholders**

The Management Securityholders hold all of the Class B LP Units, representing in aggregate 11.4% of the outstanding MSGLP Units which, pursuant to the Exchange Agreement, can be exchanged for Units at any time, subject to certain conditions. Certain of the Management Securityholders have also been granted certain registration rights by the Fund. See "Management Securityholders – Exchange Agreement. If the Management Securityholders sell a substantial number of Units in the public market, the market price of the Units could fall. The perception among the public that these sales will occur could also contribute to a decline in the market price of the Units.

**Restrictions on Certain Unitholders and Liquidity of Units**

The Fund's Declaration of Trust imposes various restrictions on Unitholders. Non-resident Unitholders are prohibited from beneficially owning either more than 40% of the issued and outstanding Units and/or the Special Voting Units (on a non-diluted and fully diluted basis). These restrictions may limit (or inhibit the exercise of) the rights of certain persons, including non-residents of Canada and U.S. persons, to acquire Units, to exercise their rights as Unitholders and to initiate and complete takeover bids in respect of the Units. As a result, these restrictions may limit the demand for Units from certain Unitholders and thereby adversely affect the liquidity and market value of the Units held by the public.

**Statutory Remedies**

The Fund is not a legally recognized entity within the relevant definitions of the *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act* and in some cases, the *Winding up and Restructuring Act*. As a result, in the event that a restructuring of the Fund is necessary, the Fund and its stakeholders may not be able to access the remedies and procedures available thereunder.

## SELECTED ANNUAL INFORMATION

| *(In thousands of dollars except per unit amounts)* | Year ended December 31, 2009 | Year ended December 31, 2008 | Year ended December 31, 2007 |
|---|---|---|---|
| Revenue | $ 331,703 | $ 249,713 | $ 147,086 |
| Net Income | 10,826 | 8,796 | 12,120 |
| Net income per Unit (basic) | 0.27 | 0.30 | 0.55 |
| Net income per Unit (diluted) | 0.26 | 0.30 | 0.55 |
| Distributions declared per Unit | 0.94 | 0.92 | 0.87 |
| Total Assets | 661,546 | 689,865 | 334,428 |
| Total long-term financial liabilities | 158,887 | 179,335 | 34,913 |

The 2008 actual comparative financial information presented includes only seven months of operating results for Shepell•fgi. The following table presents selected financial information on a pro-forma basis, adjusting for the inclusion of twelve months' results of Shepell•fgi in 2008:

| *(In thousands of dollars)* | Year ended December 31, 2009 (Unaudited) | Year ended December 31, 2008 (Pro-forma) |
|---|---|---|
| Revenue | $ 331,703 | $ 309,731 |
| Standardized EBITDA | 61,314 | 59,436 |
| Adjusted Standardized EBITDA | 64,427 | 59,436 |
| Standardized EBITDA margin | 18.5% | 19.2% |
| Adjusted Standardized EBITDA margin | 19.4% | 19.2% |

## SUPPLEMENTARY SUMMARY OF QUARTERLY RESULTS

Operating results, distribution summary and condensed balance sheet history are as follows:

**Operating Results, Distribution and Condensed Balance Sheets**
Selected Unaudited Consolidated Financial Information (In thousands of dollars except per unit amounts)

| **Quarter ended** | December 31 **2009** | September 30 **2009** | June 30 **2009** | March 31 **2009** | December 31 **2008** | September 30 **2008** | June 30 **2008** | March 31 **2008** |
|---|---|---|---|---|---|---|---|---|
| Revenue | $83,316 | $81,728 | $84,903 | $81,756 | $82,298 | $75,918 | $52,363 | $39,134 |
| Net income (loss) | 4,169 | 3,900 | 3,288 | (531) | 3,001 | 557 | 2,456 | 2,780 |
| Standardized EBITDA | 15,739 | 17,253 | 15,987 | 12,335 | 17,301 | 13,933 | 10,486 | 8,389 |
| Adjusted Standardized EBITDA | 18,474 | 17,631 | 15,987 | 12,335 | 17,301 | 13,933 | 10,486 | 8,389 |
| Standardized EBITDA margin | 18.9% | 21.1% | 18.8% | 15.1% | 21.0% | 18.4% | 20.0% | 21.4% |
| Adjusted Standardized EBITDA margin | 22.2% | 21.6% | 18.8% | 15.1% | 21.0% | 18.4% | 20.0% | 21.4% |
| Standardized Distributable Cash [(1)] | 14,365 | 15,154 | 45 | 5,697 | 16,079 | 3,345 | 8,182 | (258) |
| Adjusted Consolidated Distributable Cash | 12,396 | 11,662 | 11,416 | 9,179 | 14,931 | 11,133 | 9,730 | 7,700 |
| Distributions declared | 11,230 | 11,214 | 11,234 | 10,224 | 9,661 | 9,629 | 7,296 | 6,132 |
| Net income (loss) per Unit (basic) | 0.10 | 0.09 | 0.08 | (0.02) | 0.09 | 0.02 | 0.09 | 0.13 |
| Net income (loss) per Unit (diluted) | 0.10 | 0.09 | 0.08 | (0.02) | 0.09 | 0.02 | 0.09 | 0.13 |
| Standardized EBITDA per Unit (basic) | 0.33 | 0.36 | 0.34 | 0.30 | 0.42 | 0.34 | 0.33 | 0.30 |
| Adjusted Standardized EBITDA per Unit (basic) | 0.39 | 0.37 | 0.34 | 0.30 | 0.42 | 0.34 | 0.33 | 0.30 |
| Standardized Distributable Cash per Unit (basic) [(1)] | 0.34 | 0.36 | 0.00 | 0.16 | 0.46 | 0.10 | 0.31 | (0.01) |
| Adjusted Consolidated Distributable Cash per Unit (basic) | 0.26 | 0.25 | 0.24 | 0.22 | 0.37 | 0.27 | 0.31 | 0.28 |
| Distributions declared per Unit (basic) | 0.24 | 0.24 | 0.24 | 0.24 | 0.24 | 0.24 | 0.23 | 0.22 |
| Standardized Distributable Cash Payout Ratio (basic) [(2)] | 69.1% | 65.4% | NM | 156.0% | 51.9% | 248.6% | 73.9% | NM |
| Adjusted Consolidated Distributable Cash Payout Ratio[(3)] | 90.6% | 96.2% | 98.4% | 111.4% | 64.7% | 86.5% | 75.0% | 79.6% |
| Twelve-month rolling Standardized Distributable Cash Payout Ratio [(4)] | 109.6% | 100.2% | 140.9% | 94.9% | 101.0% | 126.2% | 87.0% | 90.8% |
| Twelve-month rolling Adjusted Consolidated Distributable Cash Payout Ratio | 98.3% | 89.7% | 87.3% | 81.8% | 75.2% | 81.8% | 82.9% | 86.2% |
| Total assets | $661,546 | $667,708 | $677,847 | $682,664 | $689,865 | $683,273 | $688,804 | $328,665 |
| Total long-term debt | $158,887 | $158,769 | $158,652 | $135,535 | 135,418 | 135,280 | 135,162 | 34,926 |

(1) The Standardized Distributable Cash for the three months ended March 31, 2008 was negative as the Fund paid its employees all of their annual bonuses in the first quarter of that year. The Standardized Distributable Cash for three months ended March 31, 2009 and June 30, 2009 were also low primarily due to the payment of annual bonuses in the quarters.

(2) This ratio is not presented for the quarter ended June 30, 2009 and March 31, 2008 since it is not a meaningful % when the Standard Distributable Cash per unit is a negative figure or close to break even.

(3) The Adjusted Consolidated Distributable Cash payout ratio for the three months ended March 31, 2009 was 111.4% as a result of the timing of the EAP revenue.

(4) The twelve-month rolling Standardized Distributable Cash payout ratio ended June 30, 2009 was 140.9% which reflects the

growth in receivables in line with revenue growth and the seasonality of the Shepell•fgi business. In December 31, 2008 this payout ratio was 101.0%. At year end, receivables were $2.4 million higher than normal due to delayed payments from one of our large outsourcing clients. This amount was subsequently collected after our year end. Removing the effect of the late payment, the Standardized Distributable Cash Payout Ratio for the year ended December 31, 2008 would have been 93.6 %.

## Disclosure Controls and Procedures

The Fund's disclosure controls and procedures have been designed to provide reasonable assurance that all relevant information is identified to its Disclosure Committee to ensure appropriate and timely decisions are made regarding public disclosure.

The Chief Executive Officer and the Chief Financial Officer have concluded that the disclosure controls and procedures are appropriately designed as at December 31, 2009.

## Internal control over financial reporting

Management is responsible for designing internal controls over financial reporting, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. In designing these controls, Management used the *Internal Control – Integrated Framework* (COSO Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission.

The Chief Executive Officer and the Chief Financial Officer have concluded that the internal controls over financial reporting are appropriately designed and operating effectively to provide this assurance based on the evaluation of these controls conducted as at December 31, 2009.

No changes were made in the Fund's internal controls over financial reporting during the fourth quarter ended December 31, 2009, that have materially affected, or are reasonably likely to materially affect, the Fund's internal controls over financial reporting.

## Additional Information

The Fund's Units trade on the Toronto Stock Exchange under the symbol MSI.UN. Additional information relating to the Fund, including all public filings, is available on the SEDAR Web site (www.sedar.com) and on our own Web site at www.morneausobeco.com.

The content of this MD&A reflects information known as of March 10, 2010.