PUTNAM MANAGED MUNICIPAL INCOME TRUST
Form DEF 14A
September 12, 2005

SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(a)

OF THE SECURITIES EXCHANGE ACT OF 1934

Filed by the Registrant / X /

Filed by a party other than the Registrant / /

Check the appropriate box:

/ / Preliminary Proxy Statement

/ / Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e) (2))

/ X / Definitive Proxy Statement

/ / Definitive Additional Materials

/ / Soliciting Material Pursuant to Sec. 240.14a-11(c) or Sec. 240.14a-12

PUTNAM HIGH YIELD MUNICIPAL TRUST

PUTNAM INVESTMENT GRADE MUNICIPAL TRUST

PUTNAM MANAGED MUNICIPAL INCOME TRUST

PUTNAM MUNICIPAL BOND FUND

PUTNAM MUNICIPAL OPPORTUNITIES TRUST

PUTNAM NEW YORK INVESTMENT GRADE MUNICIPAL TRUST

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement,

if other than Registrant)

Payment of Filing Fee (Check the appropriate box):

/ X / No fee required

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(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

The proxy statement

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This proxy statement can help you decide how you want to vote on important issues relating to your Putnam fund. When you complete and sign your proxy ballot, the Trustees of the funds will vote on your behalf exactly as you have indicated. If you simply sign the proxy ballot, it will be voted in accordance with the Trustees recommendations on page 5 of the proxy statement.

Please take a few moments and decide how you want to vote. When shareholders don t return their proxies in sufficient numbers, follow-up solicitations are required, which cost your fund money.

You can vote by returning your proxy ballots in the envelope provided. Or you can call our toll-free number, or go to the Internet. See your proxy ballot for the phone number and Internet address. If you have proxy related questions, please call 1-800-780-7316 or contact your financial advisor.

[PUTNAM INVESTMENTS LOGO]

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PROXY CARD(S) ENCLOSED

If you have any questions, please contact us at 1-800-780-7316 or call your financial advisor.

A Message from the Chairman

Dear Fellow Shareholder:

[photo of John A. Hill]

I am writing to ask for your vote on important matters affecting your investment in the Putnam funds. While you are, of course, welcome to join us at your fund's meeting, most shareholders cast their vote by filling out and signing the enclosed proxy card(s) by calling or by voting via the Internet. We are asking for your vote on the following matters:

Fixing the number of Trustees at 12 and electing your fund s nominees for Trustees

Although Trustees do not manage fund portfolios, they play an important role in protecting fund shareholders, and are responsible for approving the fees paid to the fund s investment adviser and its affiliates, reviewing overall fund expenses, selecting the fund s auditors, monitoring conflicts of interest, overseeing the fund s compliance with federal securities laws and voting proxies for the fund s portfolio securities.

Consistent with the 1940 Act and SEC rules, more than three-quarters of your fund s Trustees currently are independent of the fund and Putnam Investments. Your fund s Trustees have also in the past two years been at the forefront of reform efforts affecting the mutual fund industry, including ending the practice of directing fund brokerage commissions to brokers in connection with sales of fund shares, the establishment of broad-based redemption fees for open-end funds to discourage excessive short-term trading and other initiatives to reduce shareholder expenses and improve fund disclosures.

Converting your fund to an open-end investment company *(Putnam High Yield Municipal Trust and Putnam Managed Municipal Income Trust only)*

Your fund s governing documents require the fund to submit for shareholder vote a proposal to convert the fund to an open-end investment company if the fund s shares trade at a discount from net asset value over a specified time period. The Trustees recommend that shareholders vote against converting your fund. As described in this Proxy Statement, the Trustees believe that your fund s status as a closed-end fund offers significant investment benefits, including the ability to remain fully invested at all times. The Trustees believe that, while conversion to open-end status would offer shareholders a one-time economic benefit by removing any discount from net asset value on their shares, it would reduce the fund s investment flexibility and could lead to increased fund expenses that would be borne by remaining shareholders. The Trustees do not believe that the current discount level justifies the fundamental changes and the associated risks that would result from conversion.

I m sure that you, like most people, lead a busy life and are tempted to put this proxy aside for another day. Please don t. When shareholders do not vote their proxies, their fund may have to incur the expense of follow-up solicitations. All shareholders benefit from the speedy return of proxies.

Your vote is important to us. We appreciate the time and consideration I am sure you will give these important matters. If you have questions about any of these proposals, please call a customer services representative at 1-800-780-7316 or contact your financial advisor.

Sincerely yours,

/s/ John A. Hill

John A. Hill, Chairman

PUTNAM HIGH YIELD MUNICIPAL TRUST

PUTNAM INVESTMENT GRADE MUNICIPAL TRUST

PUTNAM MANAGED MUNICIPAL INCOME TRUST

PUTNAM MUNICIPAL BOND FUND

PUTNAM MUNICIPAL OPPORTUNITIES TRUST

PUTNAM NEW YORK INVESTMENT GRADE MUNICIPAL TRUST

Notice of Annual Meeting of Shareholders

This is the formal agenda for your fund's shareholder meeting. It tells you what proposals will be voted on and the time and place of the meeting, in the event you attend in person.

To the Shareholders of Putnam High Yield Municipal Trust, Putnam Investment Grade Municipal Trust, Putnam Managed Municipal Income Trust, Putnam Municipal Bond Fund, Putnam Municipal Opportunities Trust and Putnam New York Investment Grade Municipal Trust:

The Annual Meeting of Shareholders of your fund will be held on October 28, 2005 at 11:00 a.m., Boston time, at the principal offices of the fund on the 8th floor of One Post Office Square, Boston, Massachusetts 02109, to consider the following:

1. Fixing the number of Trustees and electing your fund s nominees for Trustees. See page 7.

2. A proposal to convert your fund into an open-end investment company. (Putnam High Yield Municipal Trust and Putnam Managed Municipal Income Trust only). See page 39.

By Judith Cohen, Clerk, on behalf of the Trustees

John A. Hill, Chairman

George Putnam, III, President

We urge you to mark, sign, date, and mail the enclosed proxy in the postage-paid envelope provided or record your voting instructions by telephone or via the Internet so that you will be represented at the meeting.

September 9, 2005

Proxy Statement

This document will give you the information you need to vote on the proposals. Much of the information is required under rules of the Securities and Exchange Commission ("SEC"); some of it is technical. If there is anything you don't understand, please contact us at our toll-free number, 1-800-780-7316, or call your financial advisor.

Who is asking for your vote?

The enclosed proxy is solicited by the Trustees of Putnam High Yield Municipal Trust, Putnam Investment Grade Municipal Trust, Putnam Managed Municipal Income Trust, Putnam Municipal Bond Fund, Putnam Municipal Opportunities Trust and Putnam New York Investment Grade Municipal Trust for use at the Annual Meeting of Shareholders of the fund to be held on October 28, 2005, and, if your fund's meeting is adjourned, at any later meetings, for the purposes stated in the Notice of Annual Meeting (see pages 3-4). The Notice of Annual Meeting, the proxy and the Proxy Statement are being mailed on or about September 9, 2005.

How do your fund's Trustees recommend that shareholders vote on these proposals?

The Trustees recommend that you vote

1. FOR fixing the number of Trustees as proposed and electing your fund s nominees for Trustees; and

2. AGAINST converting your fund to an open-end investment company and authorizing certain related amendments to your fund s Agreement and Declaration of Trust (Putnam High Yield Municipal Trust and Putnam Managed Municipal Income Trust only).

Who is eligible to vote?

Shareholders of record at the close of business on August 1, 2005 are entitled to be present and to vote at the meeting or any adjourned meeting.

Each share is entitled to one vote. Unless otherwise noted, the holders of your fund s preferred shares and holders of your fund s common shares will vote as separate classes. Shares represented by your duly executed proxy will be voted in accordance with your instructions. If you sign the proxy, but don't fill in a vote, your shares will be voted in accordance with the Trustees' recommendations. If any other business is brought before your fund's meeting, your shares will be voted at the Trustees' discretion.

Shareholders of each fund vote separately with respect to each proposal. The outcome of a vote affecting one fund does not affect any other fund.

The Proposals

I. **ELECTION OF TRUSTEES**

Who are the nominees for Trustees?

The Board Policy and Nominating Committee of the Trustees of each fund makes recommendations concerning the nominees for Trustees of that fund. The Board Policy and Nominating Committee consists solely of Trustees who are not "interested persons" (as defined in the Investment Company Act of 1940, as amended (the 1940 Act)) of your fund or of Putnam Investment Management, LLC, your fund's investment manager ("Putnam Management"). Those Trustees who are not interested persons of your fund or Putnam Management are referred to as Independent Trustees throughout this Proxy Statement.

The Board Policy and Nominating Committee of the Trustees of your fund recommends that the number of Trustees be fixed at 12 and that you vote for the election of the nominees described in the following pages. Each nominee is currently a Trustee of your fund and of the other Putnam funds.

Pursuant to the bylaws of your fund and the 1940 Act, holders of the preferred shares of your fund, voting as a class, are entitled to elect two nominees for Trustees. The holders of the preferred shares and the common shares of your fund, voting together as a single class, are entitled to vote for the remaining 10 of the 12 nominees. Therefore, Messrs. Hill and Patterson have been nominated as Trustees to be elected by the holders of the preferred shares, while the other 10 Trustees have been nominated to be elected by the holders of the preferred shares and common shares voting together as a single class.

The nominees for Trustees and their backgrounds are shown in the following pages. This information includes each nominee s name, date of birth, principal occupation(s) during the past 5 years, and other information about the nominee s professional background, including other directorships the nominee holds. Each Trustee oversees all of the Putnam funds and serves until the election and qualification of his or her successor, or until he or she sooner dies, resigns or is removed. The address of all of the Trustees is One Post Office Square, Boston, Massachusetts 02109. At December 31, 2004, there were 110 Putnam funds.

Jameson A. Baxter (9/6/43), Trustee since 1994

[Photo]

Ms. Baxter is the President of Baxter Associates, Inc., a private investment firm that she founded in 1986.

Ms. Baxter serves as a Director of ASHTA Chemicals, Inc., Banta Corporation (a printing and digital imaging firm), Ryerson Tull, Inc. (a steel service corporation), the Mutual Fund Directors Forum, Advocate Health Care and BoardSource, formerly the National Center for Nonprofit Boards. She is Chairman Emeritus of the Board of Trustees, Mount Holyoke College, having served as Chairman for five years and as a board member for thirteen years. Until 2002, Ms. Baxter was a Director of Intermatic Corporation (a manufacturer of energy control products).

Ms. Baxter has held various positions in investment banking and corporate finance, including Vice President and Principal of the Regency Group, and Vice President of and Consultant to First Boston Corporation. She is a graduate of Mount Holyoke College.

Charles B. Curtis (4/27/40), Trustee since 2001

[Photo]

Mr. Curtis is President and Chief Operating Officer of the Nuclear Threat Initiative (a private foundation dealing with national security issues) and serves as Senior Advisor to the United Nations Foundation.

Mr. Curtis is a member of the Council on Foreign Relations and the Trustee Advisory Council of the Applied Physics Laboratory, Johns Hopkins University. Until 2003, Mr. Curtis was a member of the Electric Power Research Institute Advisory Council and the University of Chicago Board of Governors for Argonne National Laboratory. Prior to 2002, Mr. Curtis was a Member of the Board of Directors of the Gas Technology Institute and the Board of Directors of the Environment and Natural Resources Program Steering Committee, John F. Kennedy School of Government, Harvard University. Until 2001, Mr. Curtis was a member of the Department of Defense Policy Board and Director of EG&G Technical Services, Inc. (a fossil energy research and development support company).

From August 1997 to December 1999, Mr. Curtis was a Partner at Hogan & Hartson L.L.P., a Washington, D.C. law firm. Prior to May 1997, Mr. Curtis was Deputy Secretary of Energy. He served as Chairman of the Federal Energy Regulatory Commission from 1977 to 1981 and has held positions on the staff of the U.S. House of Representatives, the U.S. Treasury Department, and the SEC.

Myra R. Drucker (1/16/48),

Trustee since 2004

[Photo]

Ms. Drucker is a Vice Chair of the Board of Trustees of Sarah Lawrence College, a Trustee of Commonfund (a not-for-profit firm specializing in asset management for educational endowments and foundations) and a member of the Investment Committee of the Kresge Foundation (a charitable trust).

Ms. Drucker is an ex-officio member of the New York Stock Exchange (NYSE) Pension Managers Advisory Committee, having served as Chair for seven years and a member of the Executive Committee of the Committee on Investment of Employee Benefit Assets. She is Chair of the Advisory Board of Hamilton Lane Advisors (an investment management firm) and a member of the Advisory Board of RCM (an investment management firm). Until August 31, 2004, Ms. Drucker was Managing Director and a member of the Board of Directors of General Motors Asset Management and Chief Investment Officer of General Motors Trust Bank. Ms. Drucker also served as a member of the NYSE Corporate Accountability and Listing Standards Committee and the NYSE/NASD IPO Advisory Committee.

Prior to joining General Motors Asset Management in 2001, Ms. Drucker held various executive positions in the investment management industry. Ms. Drucker served as Chief Investment Officer of Xerox Corporation (a technology and service company in the document industry), where she was responsible for the investment of the company s pension assets. Ms. Drucker was also Staff Vice President and Director of Trust Investments for International Paper (a paper, paper distribution, packaging and forest products company) and previously served as Manager of Trust Investments for Xerox Corporation. Ms. Drucker received a B.A. degree in Literature and Psychology from Sarah Lawrence College and pursued graduate studies in economics, statistics and portfolio theory at Temple University.

John A. Hill (1/31/42),

Trustee since 1985 and Chairman since 2000

[Photo]

Mr. Hill is Vice Chairman of First Reserve Corporation, a private equity buyout firm that specializes in energy investments in the diversified worldwide energy industry.

Mr. Hill is a Director of Devon Energy Corporation, TransMontaigne Oil Company and various private companies controlled by First Reserve Corporation, as well as Chairman of TH Lee, Putnam Investment Trust (a closed-end investment company advised by an affiliate of Putnam Management). He is also a Trustee of Sarah Lawrence College. Prior to 2005, he was a Director of Continuum Health Partners of New York.

Prior to acquiring First Reserve Corporation in 1983, Mr. Hill held executive positions in investment banking and investment management with several firms and with the federal government, including Deputy Associate Director of the Office of Management and Budget, and Deputy Director of the Federal Energy Administration. He is active in various business associations, including the Economic Club of New York, and lectures on energy issues in the United States and Europe. Mr. Hill holds a B.A. degree in Economics from Southern Methodist University and pursued graduate studies there as a Woodrow Wilson Fellow.

Paul L. Joskow (6/30/47), Trustee since 1997

[Photo]

Dr. Joskow is the Elizabeth and James Killian Professor of Economics and Management, and Director of the Center for Energy and Environmental Policy Research at the Massachusetts Institute of Technology.

Dr. Joskow serves as a Director of National Grid plc (a UK-based holding company with interests in electric and gas transmission and distribution and telecommunications infrastructure) and TransCanada Corporation (an energy company focused on natural gas transmission and power services). He also serves on the Board of Overseers of the Boston Symphony Orchestra. Prior to February 2005, he served on the board of the Whitehead Institute for Biomedical Research (a non-profit research institution) and has been President of the Yale University Council since 1993. Prior to February 2002, he was a Director of State Farm Indemnity Company (an automobile insurance company), and prior to March 2000, he was a Director of New England Electric System (a public utility holding company).

Dr. Joskow has published five books and numerous articles on topics in industrial organization, government regulation of industry, and competition policy. He is active in industry restructuring, environmental, energy, competition and privatization policies serving as an advisor to governments and corporations worldwide. Dr. Joskow holds a Ph.D. and M. Phil from Yale University and a B.A. from Cornell University.

Elizabeth T. Kennan (2/25/38), Trustee since 1992

[Photo]

Dr. Kennan is a Partner of Cambus-Kenneth Farm (thoroughbred horse and cattle breeding). She is President Emeritus of Mount Holyoke College.

Dr. Kennan served as Chairman and is now Lead Director of Northeast Utilities. Until 2005, she was a Director of Talbots, Inc. She has served as Director on a number of other boards, including Bell Atlantic, Chastain Real Estate, Shawmut Bank, Berkshire Life Insurance and Kentucky Home Life Insurance. She is a Trustee of the National Trust for Historic Preservation, of Centre College and of Midway College in Midway, Kentucky. She is also a member of The Trustees of Reservations. Dr. Kennan has served on the oversight committee of the Folger Shakespeare Library, as President of Five Colleges Incorporated, as a Trustee of Notre Dame University, and is active in various educational and civic associations.

As a member of the faculty of Catholic University for twelve years, until 1978, Dr. Kennan directed the post-doctoral program in Patristic and Medieval Studies, taught history and published numerous articles. Dr. Kennan holds a Ph.D. from the University of Washington in Seattle, an M.S. from St. Hilda s College at Oxford University, and an A.B. from Mount Holyoke College. She holds several honorary doctorates.

John H. Mullin, III (6/15/41), Trustee since 1997

[Photo]

Mr. Mullin is the Chairman and CEO of Ridgeway Farm (a limited liability company engaged in timber and farming).

Mr. Mullin serves as a Director of The Liberty Corporation (a broadcasting company), Progress Energy, Inc. (a utility company, formerly known as Carolina Power & Light) and Sonoco Products, Inc. (a packaging company). Mr. Mullin is Trustee Emeritus of The National Humanities Center and Washington & Lee University, where he served as Chairman of the Investment Committee. Prior to May 2001, he was a Director of Graphic Packaging International Corp. Prior to February 2004, he was a Director of Alex Brown Realty, Inc.

Mr. Mullin is also a past Director of Adolph Coors Company; ACX Technologies, Inc.; Crystal Brands, Inc.; Dillon, Read & Co., Inc.; Fisher-Price, Inc.; and The Ryland Group, Inc. Mr. Mullin is a graduate of Washington & Lee University and The Wharton Graduate School, University of Pennsylvania.

Robert E. Patterson (3/15/45), Trustee since 1984

[Photo]

Mr. Patterson is Senior Partner of Cabot Properties, L.P. and Chairman of Cabot Properties, Inc. (a private equity firm specializing in real estate).

Mr. Patterson serves as Chairman Emeritus and Trustee of the Joslin Diabetes Center and as a Director of Brandywine Trust Group, LLC. Prior to June 2003, he was a Trustee of Sea Education Association. Prior to December 2001, he was President and Trustee of Cabot Industrial Trust (a publicly traded real estate investment trust). Prior to February 1998, he was Executive Vice President and Director of Acquisitions of Cabot Partners Limited Partnership (a registered investment adviser involved in institutional real estate investments). Prior to 1990, he served as Executive Vice President of Cabot, Cabot & Forbes Realty Advisors, Inc. (the predecessor company of Cabot Partners).

Mr. Patterson practiced law and held various positions in state government and was the founding Executive Director of the Massachusetts Industrial Finance Agency. Mr. Patterson is a graduate of Harvard College and Harvard Law School.

W. Thomas Stephens (9/2/42), Trustee since 1997

[Photo]

Mr. Stephens is Chairman and Chief Executive Officer of Boise Cascade, L.L.C. (a paper, forest products and timberland assets company).

Mr. Stephens serves as a Director of TransCanada Pipelines Limited. Until 2004, Mr. Stephens was a Director of Xcel Energy Incorporated (a public utility company), Quest Communications, and Norske Canada, Inc. (a paper manufacturer). Until 2003, Mr. Stephens was a Director of Mail-Well, Inc. (a diversified printing company). He served as Chairman of Mail-Well until 2001 and as CEO of MacMillan-Bloedel, Ltd. (a forest products company) until 1999.

Prior to 1996, Mr. Stephens was Chairman and Chief Executive Officer of Johns Manville Corporation. He holds B.S. and M.S. degrees from the University of Arkansas.

Richard B. Worley (11/15/45), Trustee since 2004

[Photo]

Mr. Worley is Managing Partner of Permit Capital LLC, an investment management firm.

Mr. Worley serves on the Executive Committee of the University of Pennsylvania Medical Center, is a Trustee of The Robert Wood Johnson Foundation (a philanthropic organization devoted to health care issues) and is a Director of The Colonial Williamsburg Foundation (a historical preservation organization). Mr. Worley also serves on the investment committees of Mount Holyoke College and World Wildlife Fund (a wildlife conservation organization).

Prior to joining Permit Capital LLC in 2002, Mr. Worley served as Chief Strategic Officer of Morgan Stanley Investment Management. He previously served as President, Chief Executive Officer and Chief Investment Officer of Morgan Stanley Dean Witter Investment Management and as a Managing Director of Morgan Stanley, a financial services firm. Mr. Worley also was the Chairman of Miller Anderson & Sherrerd, an investment management firm. Mr. Worley holds a B.S. degree from University of Tennessee and pursued graduate studies in economics at the University of Texas.

Interested Trustees

Charles E. Haldeman, Jr.* (10/29/48), Trustee since 2004

Mr. Haldeman is President and Chief Executive Officer of Putnam, LLC (Putnam Investments).

[Photo]

Prior to November 2003, Mr. Haldeman served as Co-Head of Putnam Investments Investment Division. Prior to joining Putnam Investments in 2002, Mr. Haldeman held executive positions in the investment management industry. Mr. Haldeman previously served as Chief Executive Officer of Delaware Investments and President & Chief Operating Officer of United Asset Management. Mr. Haldeman was also a partner and director of Cooke & Bieler, Inc. (an investment management firm).

Mr. Haldeman currently serves as a Trustee of Dartmouth College and as Emeritus Trustee of Abington Memorial Hospital. He is a graduate of Dartmouth College, Harvard Law School and Harvard Business School. Mr. Haldeman is also a Chartered Financial Analyst (CFA) charterholder.

George Putnam, III* (8/10/51), Trustee since 1984 and President since 2000

[Photo]

Mr. Putnam is President of New Generation Research, Inc. (a publisher of financial advisory and other research services), and of New Generation Advisers, Inc. (a registered investment adviser to private funds). Mr. Putnam founded the New Generation companies in 1986.

Mr. Putnam is a Director of The Boston Family Office, LLC (a registered investment adviser). He is a Trustee of St. Mark s School, Shore Country Day School, and until 2002 was a Trustee of the Sea Education Association.

Mr. Putnam previously worked as an attorney with the law firm of Dechert LLP (formerly known as Dechert Price & Rhoads) in Philadelphia. He is a graduate of Harvard College, Harvard Business School, and Harvard Law School.

*Nominees who are or may be deemed to be "interested persons" (as defined in the 1940 Act) of the fund, Putnam Management, Putnam Retail Management Limited Partnership (Putnam Retail Management) or Marsh & McLennan Companies, Inc., the parent company of Putnam Investments and its affiliated companies. Messrs. Putnam, III and Haldeman are deemed interested persons by virtue of their positions as officers of the funds, Putnam Management or Putnam Retail Management and as shareholders of Marsh & McLennan Companies, Inc. Mr. Haldeman is the President and Chief Executive Officer of Putnam Investments. Mr. Putnam, III is the President of your fund and each of the other Putnam funds. The balance of the nominees are not "interested persons."

All the nominees were elected by the shareholders of your fund on October 14, 2004.

The 10 nominees for election as Trustees by the holders of common and preferred shares, voting as a single class, at the shareholder meeting of your fund who receive the greatest number of votes from the preferred and common shareholders will be elected as Trustees of your fund. In addition, the 2 nominees for election as Trustees by the preferred shareholders, voting as a class, at the shareholder meeting of your fund who receive the greatest number of votes from the preferred shareholders will be elected as Trustees of your fund. The Trustees serve until their successors are elected and qualified. Each of the nominees has agreed to serve as a Trustee, if elected. If any of the nominees is unavailable for election at the time of the meeting, which is not anticipated, the Trustees may vote for other nominees at their discretion, or the Trustees may fix the number of Trustees to be elected by the holders of common and preferred shares voting as a single class at fewer than 10 for your fund.

What are the Trustees' responsibilities?

Your fund's Trustees are responsible for the general oversight of your fund's affairs and for assuring that your fund is managed in the best interests of its shareholders. The Trustees regularly review your fund's investment performance as well as the quality of other services provided to your fund and its shareholders by Putnam Management and its affiliates, including administration, custody, and shareholder servicing. At least annually, the Trustees review and evaluate the fees and operating expenses paid by your fund for these services and negotiate changes that they deem appropriate. In carrying out these responsibilities, the Trustees are assisted by an independent administrative staff and by your fund's auditors, independent counsel and other experts as appropriate, selected by and responsible to the Trustees.

Consistent with the 1940 Act and SEC rules, at least 75% of the trustees of your fund are required not to be interested persons (as defined in the 1940 Act) of your fund or your fund s investment manager. These independent trustees must vote separately to approve all financial arrangements and other agreements with your fund s investment manager and other affiliated parties. The role of independent trustees has been characterized as that of a watchdog charged with oversight to protect shareholders interests against overreaching and abuse by those who are in a position to control or influence a fund. Your fund s Independent Trustees meet regularly as a group in executive session. Ten of the 12 nominees for election as Trustee would be Independent Trustees.

Board committees. Your fund s Trustees have determined that the efficient conduct of your fund s affairs makes it desirable to delegate responsibility for certain specific matters to committees of the board. Certain committees (the Executive Committee, Distributions Committee, and Audit and Pricing Committee) are authorized to act for the Trustees as specified in their charters. The other committees review and evaluate matters specified in their charters and make recommendations to the Trustees as they deem appropriate. Each committee may utilize the resources of your fund s independent staff, counsel and auditors as well as other experts. The committees meet as often as necessary, either in conjunction with regular meetings of the Trustees or otherwise. The membership and chairperson of each committee are appointed by the Trustees upon recommendation of the Board Policy and Nominating Committee.

Audit and Pricing Committee. The Audit and Pricing Committee provides oversight on matters relating to the preparation of the funds' financial statements, compliance matters and Code of Ethics issues. This oversight is discharged by regularly meeting with management and the funds' independent registered public accounting firms and keeping current on industry developments. Duties of this Committee also include the review and evaluation of all matters and relationships pertaining to the funds' independent registered public accounting firms, including their independence. The members of the Committee include only Independent Trustees who are not interested persons of your fund or Putnam Management. Each member of the Committee is independent as defined in Sections 303.01(B)(2)(a) and (3) of the listing standards of the New York Stock Exchange and as defined in Section 121(A) of the listing standards of the American Stock Exchange. The Trustees have adopted a written charter for the Committee. The Audit and Pricing Committee's charter is available on the fund's web site at https://content.putnam.com/individual_investor/pdf/committee_charter.pdf. Printed copies of the charter are available free of charge upon request by calling 1-800-225-1581. The Committee also reviews your fund s policies and procedures for achieving accurate and timely pricing of the fund shares, including oversight of fair value determinations of individual securities made by Putnam Management or other designated agents of your fund. The Committee oversees compliance by money market funds with Rule 2a-7, interfund transactions pursuant to Rule 17a-7, and the correction of occasional pricing errors. The Committee also receives reports regarding the liquidity of portfolio securities. The Committee currently consists of Dr. Joskow (Chairperson), Ms. Drucker and Messrs. Patterson, Stephens and Worley.

Board Policy and Nominating Committee. The Board Policy and Nominating Committee reviews policy matters pertaining to the operations of the Board of Trustees and its Committees, the compensation of the Trustees and their staff and the conduct of legal affairs for the funds. The Committee also oversees the voting of proxies associated with portfolio investments of the Putnam funds, with the goal of ensuring that these proxies are voted in the best interest of the funds shareholders.

The Committee evaluates and recommends all candidates for election as Trustees and recommends the appointment of members and chairs of each board committee. The Committee also identifies prospective nominees for election as trustee by considering individuals that come to its attention through current Trustees, Putnam Management or shareholders. Candidates properly submitted by shareholders (as described below) will be considered and evaluated on the same basis as candidates recommended by other sources. The Committee may, but is not required to, engage a third-party professional search firm to assist it in identifying and evaluating potential nominees.

When evaluating a potential candidate for membership on the Board of Trustees, the Committee considers the skills and characteristics that it feels would most benefit the Putnam funds at the time the evaluation is made. The Committee may take into account a wide variety of attributes in considering potential trustee candidates, including, but not limited to: (i) availability and commitment of a candidate to attend meetings, (ii) other board experience, (iii) relevant industry and related experience, (iv) educational background, (v) financial expertise, (vi) an assessment of the candidate s ability, judgment and expertise, (vii) an assessment of the perceived needs of the Board of Trustees and its committees at that point in time and (viii) overall Board of Trustees composition. In connection with this evaluation, the Committee will determine whether to interview prospective nominees, and, if warranted, one or more members of the Committee, and other Trustees and representatives of the funds, as appropriate, will interview prospective nominees in person or by telephone. Once this evaluation is completed, the Committee recommends such candidates as it determines appropriate to the Independent Trustees for nomination, and the Independent Trustees select the nominees after considering the recommendation of the Committee.

The Committee will consider nominees for trustee recommended by shareholders of a fund provided shareholders submit their recommendations by the date disclosed in the paragraph entitled Date for receipt of shareholders proposals for the next annual meeting, and provided the shareholders recommendations otherwise comply with applicable securities laws, including Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the 1934 Act).

The Committee consists only of Independent Trustees. The Committee currently consists of Dr. Kennan (Chairperson), Ms. Baxter and Messrs. Hill, Mullin and Patterson.

Brokerage and Custody Committee. The Brokerage and Custody Committee reviews the policies and procedures of the funds regarding the execution of portfolio transactions for the funds, including policies regarding the allocation of brokerage commissions and soft dollar credits. The Committee reviews periodic reports regarding the funds' activities involving derivative securities, and reviews and evaluates matters relating to the funds' custody arrangements. The Committee currently consists of Messrs. Mullin (Chairperson) and Curtis, Ms. Baxter and Dr. Kennan.

Communication, Service and Marketing Committee. This Committee examines the quality, cost and levels of services provided to the shareholders of the Putnam funds. The Committee also reviews communications sent from the funds to their shareholders, including shareholder reports, prospectuses, newsletters and other materials. In addition, the Committee oversees marketing and sales communications of the funds' distributor. The Committee currently consists of Messrs. Putnam, III (Chairperson) and Stephens and Dr. Joskow.

Contract Committee. The Contract Committee reviews and evaluates, at least annually, all arrangements pertaining to (i) the engagement of Putnam Management and its affiliates to provide services to the funds, (ii) the expenditure of the funds' assets for distribution purposes pursuant to the Distribution Plans of the open-end funds and (iii) the engagement of other persons to provide material services to the funds, including in particular those instances where the cost of services is shared between the funds and Putnam Management and its affiliates or where Putnam Management or its affiliates have a material interest. The Committee recommends to the Trustees such changes in arrangements as it deems appropriate. After review and evaluation, the Committee recommends to the Trustees the proposed organization of new fund products and proposed structural changes to existing funds. Its oversight of the closed-end funds includes (i) investment performance, (ii) trading activity, (iii) determinations with respect to conversion of a closed-end fund to an open-end fund, (iv) disclosure practices and (v) the use and benefits of leverage. The Committee consists only of Independent Trustees. The Committee currently consists of Ms. Baxter (Chairperson), Messrs. Curtis and Mullin and Dr. Kennan.

Distributions Committee. This Committee oversees all fund distributions and approves the amount and timing of distributions paid by all the funds to the shareholders when the Trustees are not in session. The Committee also meets regularly with representatives of Putnam Management and its affiliates to review distribution levels and the funds' distribution policies. The Committee currently consists of Messrs. Patterson (Chairperson) and Putnam, III and Dr. Joskow.

Executive Committee. The functions of the Executive Committee are twofold. The first is to ensure that the funds' business may be conducted at times when it is not feasible to convene a meeting of the Trustees or for the Trustees to act by written consent. The Committee may exercise any or all of the power and authority of the Trustees when the Trustees are not in session. The second is to establish annual and ongoing goals, objectives and priorities for the Board of Trustees and to ensure coordination of all efforts between the Trustees and Putnam Management and its affiliates on behalf of the shareholders of the Putnam funds. The Committee currently consists of Messrs. Hill (Chairperson) and Putnam, III, Dr. Joskow and Ms. Baxter.

Investment Oversight Committees. These Committees regularly meet with investment personnel of Putnam Management to review the investment performance and strategies of the Putnam funds in light of their stated investment objectives and policies. Each such Committee will, among its duties, identify any compliance issues that are unique to the category of funds under its review and work with the appropriate board committees to ensure that any such issues are properly addressed. Investment Oversight Committee A currently consists of Mses. Drucker (Chairperson) and Baxter and Mr. Putnam, III. Investment Oversight Committee B currently consists of Messrs. Curtis (Chairperson), Hill and Stephens. Investment Committee C currently consists of Messrs. Mullin (Chairperson) and Patterson and Dr. Kennan. Investment Oversight Committee D currently consists of Mr. Worley (Chairperson) and Dr. Joskow.

How large a stake do the Trustees and nominees have in the Putnam family of funds?

The Trustees allocate their investments among the Putnam funds based on their own investment needs. The table below shows the number of shares beneficially owned by each nominee for Trustee and the value of each nominee s holdings in the fund and in all of the Putnam funds as of June 30, 2005. As a group, the Trustees owned shares of the Putnam funds valued at approximately $49 million as of June 30, 2005.

Putnam High Yield Municipal Trust

Name of Nominee	Dollar Range of Putnam High Yield Municipal Trust Shares Owned	Shares Beneficially Owned	Aggregate Dollar Range of Shares Held in all of the Putnam Funds
Jameson A. Baxter	$1 $10,000	203.997	over $100,000
Charles B. Curtis	$1 $10,000	114.314	over $100,000
Myra R. Drucker	$1 $10,000	100	$50,001 - $100,000
Charles E. Haldeman,Jr.	$1 $10,000	500	over $100,000
John A. Hill	$1 $10,000	212.71	over $100,000
Paul L. Joskow	$1 $10,000	100	over $100,000
Elizabeth T. Kennan	$1 $10,000	201.315	over $100,000
John H. Mullin, III	$1 $10,000	113.317	over $100,000
Robert E. Patterson	$1 $10,000	300	over $100,000
George Putnam, III	$1 $10,000	300	over $100,000
W. Thomas Stephens	$1 $10,000	100	over $100,000
Richard B. Worley	$1 $10,000	100	over $100,000

Putnam Investment Grade Municipal Trust

Name of Nominee	Dollar Range of Putnam Investment Grade Municipal Trust Shares Owned	Shares Beneficially Owned	Aggregate Dollar Range of Shares Held in all of the Putnam Funds
Jameson A. Baxter	$1 $10,000	212.401	over $100,000
Charles B. Curtis	$1 $10,000	117.85	over $100,000
Myra R. Drucker	$1 $10,000	100	$50,001 - $100,000
Charles E. Haldeman,Jr.	$1 $10,000	330	over $100,000
John A. Hill	$1 $10,000	215.108	over $100,000
Paul L. Joskow	$1 $10,000	100	over $100,000
Elizabeth T. Kennan	$1 $10,000	109.015	over $100,000
John H. Mullin, III	$1 $10,000	115.842	over $100,000
Robert E. Patterson	$1 $10,000	300	over $100,000
George Putnam, III	$1 $10,000	300	over $100,000
W. Thomas Stephens	$1 $10,000	149.671	over $100,000
Richard B. Worley	$1 $10,000	100	over $100,000

Putnam Managed Municipal Income Trust

Name of Nominee	Dollar Range of Putnam Managed Municipal Income Trust Shares Owned	Shares Beneficially Owned	Aggregate Dollar Range of Shares Held in all of the Putnam Funds
Jameson A. Baxter	$1 $10,000	212.25	over $100,000
Charles B. Curtis	$1 $10,000	115.677	over $100,000
Myra R. Drucker	$1 $10,000	100	$50,001 - $100,000
Charles E. Haldeman,Jr.	$1 $10,000	450	over $100,000
John A. Hill	$1 $10,000	214.734	over $100,000
Paul L. Joskow	$1 $10,000	100	over $100,000
Elizabeth T. Kennan	$1 $10,000	108.92	over $100,000
John H. Mullin, III	$1 $10,000	115.421	over $100,000
Robert E. Patterson	$1 $10,000	300	over $100,000
George Putnam, III	$1 $10,000	300	over $100,000
W. Thomas Stephens	$1 $10,000	100	over $100,000
Richard B. Worley	$1 $10,000	100	over $100,000

Putnam Municipal Bond Fund

Name of Nominee	Dollar Range of Putnam Municipal Bond Fund Shares Owned	Shares Beneficially Owned	Aggregate Dollar Range of Shares Held in all of the Putnam Funds
Jameson A. Baxter	$10,001 $50,000	3,570	over $100,000
Charles B. Curtis	$1 $10,000	119.102	over $100,000
Myra R. Drucker	$1 $10,000	100	$50,001 - $100,000
Charles E. Haldeman,Jr.	$1 $10,000	250	over $100,000
John A. Hill	$1 $10,000	311.137	over $100,000
Paul L. Joskow	$1 $10,000	196	over $100,000
Elizabeth T. Kennan	$1 $10,000	189.709	over $100,000
John H. Mullin, III	$1 $10,000	226.984	over $100,000
Robert E. Patterson	$1 $10,000	293	over $100,000
George Putnam, III	$10,001 $50,000	984	over $100,000
W. Thomas Stephens	$1 $10,000	196	over $100,000
Richard B. Worley	$1 $10,000	100	over $100,000

Putnam Municipal Opportunities Trust

Name of Nominee	Dollar Range of Putnam Municipal Opportunities Trust Shares Owned	Shares Beneficially Owned	Aggregate Dollar Range of Shares Held in all of the Putnam Funds
Jameson A. Baxter	$1 $10,000	207.003	over $100,000
Charles B. Curtis	$1 $10,000	119.405	over $100,000
Myra R. Drucker	$1 $10,000	100	$50,001 - $100,000
Charles E. Haldeman,Jr.	$1 $10,000	270	over $100,000
John A. Hill	$1 $10,000	215.324	over $100,000
Paul L. Joskow	$1 $10,000	100	over $100,000
Elizabeth T. Kennan	-10-		

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Estimates of future financial results are inherently unreliable.

From time to time, the Company and its representatives may make public predictions or forecasts regarding the Company's future results, including estimates regarding future revenues, expense levels, tax rates, acquisition expenses, capital expenditures, earnings or earnings from operations. Any forecast regarding our future performance reflects various assumptions and judgments by management regarding the likelihood that certain possible future events will in fact occur. These assumptions and judgments are subject to significant uncertainties and shifting market dynamics, and, as a matter of course, many of them will prove to be incorrect. Further, events that may seem unlikely or relatively certain at the time a given prediction is made may in fact occur or fail to occur. Many of the factors that can influence the outcome of any prediction or projection are beyond our control. As a result, there can be no assurance that our performance will be consistent with any management forecasts or that the variation from such forecasts will not be material and adverse. Investors are cautioned that any prediction, projection or other forward looking statement made by us should be considered current only as of the date made. Investors are encouraged to utilize the entire available mix of historical and forward-looking information made available by us, and other information relating to our Company and our products and services, when evaluating our prospective results of operations.

Legislation or regulation could impair our ability to collect and use data, increase our operating costs or otherwise harm our business.

Existing and new laws and regulations relating to consumer privacy protection could harm our ability to collect and use consumer data, increase our operating costs or otherwise harm our business. We collect personal data about consumers for use in our check authorization products. Due to increasing public concern over consumer privacy rights, Congress and state legislatures have adopted and are considering adopting laws and regulations restricting the purchase, sale and sharing of personal information about consumers. We are unable to predict whether more restrictive legislation or regulations will be adopted in the future. A material increase in the scope of these types of restrictions could impair the efficacy of our check authorization products.

We have a general history of losses and may not operate profitably in the future.

We have incurred losses for the last five fiscal years. Our net losses and negative cash flow may continue for the foreseeable future. As of March 31, 2007, our accumulated deficit was $31,985,794. We believe that our planned growth and profitability will depend in large part on our ability to expand our client base. Accordingly, we intend to invest in marketing, development of our client base and development of our marketing technology and operating infrastructure. If we are not successful in expanding our client base, it will have a material adverse effect on our financial condition and our ability to continue to operate our business.

Demand for many of our products and services is sensitive to the level of consumer transactions generated by our customers, and accordingly, our revenues could be impacted negatively by a general economic slowdown or any other event causing a material slowing of consumer spending.

A significant portion of our revenue is derived from transaction processing fees. Any changes in economic factors that adversely affect consumer spending and related consumer debt, or a reduction in check writing or credit and debit card usage, could reduce the volume of transactions that we process, and have an adverse effect on our business, financial condition and results of operations.

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We have a long sales cycle for a significant number of our products and if we fail to close sales after expending significant time and resources to do so, our business, financial condition, and results of operations may be adversely affected.

The implementation of some of our products often involves significant capital commitments by our customers. Potential customers generally require us to expend substantial time, effort and money educating them as to the value of our products and services. We incur substantial costs in order to obtain each new customer. We may expend significant funds and management resources during the sales cycle and ultimately fail to close the sale. Our sales cycle may be extended due to our customers' budgetary constraints or for other reasons. If we are unsuccessful in closing sales after expending significant funds and management resources or we experience delays, it could have a material adverse effect on our business, financial condition, and results of operations.

Failure to maintain existing contracts/customers

Because a small number of customers have historically accounted for a substantial portion of our revenue, our revenue could be materially adversely affected if we are unable to retain customers.

We have had in the past and may have in the future, a small number of customers that have accounted for a significant portion of our revenue. During the fiscal year ended March 31, 2007, revenue from and associated with our two largest customers amounted to approximately 53% of total revenue. Our revenue could materially decline because of a delay in signing agreements with a single customer or the failure to retain an existing customer.

Consolidation in the industries we serve may adversely affect our ability to sell our products and services.

Mergers, acquisitions and personnel changes at retailers and electronic funds transfer networks may adversely affect our business, financial condition and results of operations. The grocery store and supermarket industry continues to consolidate, causing the number of grocery stores and supermarkets to decline. This consolidation could cause us to lose:

- current and potential customers; and

- market share if an entity resulting from a combination of our customers determines that it is more efficient to develop in-house products and services similar to ours or to use our competitors' products and services.

ITEM 1B. Unresolved Staff Comments

None.

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ITEM 2. Properties

Office Space. As of May 31, 2007, we leased office space containing approximately 18,550 square feet of floor space for our operations. Our principal facilities include:

Location	Approximate Square Feet	Lease Expiration Date	Description
Wichita, Kansas	10,000	December, 2008	Primary/Secondary Collection operations
Scottsdale, Arizona	5,000	January, 2011	Data Center Operations
Phoenix, Arizona	150	June, 2009	Data Center Operations
Vancouver, British Columbia	3,400	September, 2008	Administration

Our corporate headquarters are located in Vancouver, British Columbia, Canada.

During the fiscal year ended March 31, 2007, we elected to not renew leases for approximately 11,500 square feet of leased space for facilities in Dallas, Texas that were being utilized for primary collection operations. We made the decision to not renew the leases for those facilities, which expired in November 2006, as part of a plan that we implemented in fiscal 2007 to combine the operations of our primary check collections business located in Dallas, Texas with our secondary check collections business located in Wichita, Kansas.

We consider our current facilities (including our current primary and secondary collections facilities in Wichita, Kansas) to be adequate for our current needs and believe that suitable additional space will be available, as needed, to accommodate further physical expansion of corporate, data center processing and primary and secondary check collections operations and for additional sales and service.

ITEM 3. Legal Proceedings

On July 14, 2004 we filed suit in the U.S. District Court for the District of Delaware against four companies who provide equipment, systems and services that convert paper checks presented at the point-of-sale into electronic transactions. In the suit, we alleged that these four companies infringed certain of our U.S. patents and sought damages and injunctive and other relief for the alleged willful infringement of these patents. A federal judge had set a trial date of April 17, 2006 in this matter. In September 2004, one of the defendants filed a counterclaim for declaratory relief. The defendant was seeking a declaratory judgment that each of the patents-in-suit was invalid, unenforceable, not infringed by the defendant and that the court determine that this was an extraordinary and exceptional case and award the defendant it’s attorney’s fees and litigation expenses.

In July 2005, Telecheck International Inc., an affiliate of one of the defendants in the Delaware litigation, filed a complaint for patent infringement in the United States District Court for the Eastern District of Texas Marshall Division against us in an action styled Telecheck International Inc. as plaintiff vs. LML Payment Systems Inc. and LML Payment Systems Corp. In the suit, Telecheck International Inc. alleged that we infringed U.S. Patent Nos. 5,679,938 and 5,679,940 and sought damages, injunctive and other relief.

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In April 2006, we settled our litigation with the defendants in the Delaware case. We granted licenses to the defendants in exchange for cash consideration that, in one case, involved a release fee of $400,000 for past transactions, a $200,000 standstill fee and an ongoing running royalty on future transactions with future royalty payments by this licensee being contingent upon the number of transactions conducted in the future. In other cases, the cash consideration we received was for a fully-paid up license to certain of our patents and was based on our receiving a lump-sum payment for past and future transactions. The lump-sum payment was based upon our estimation of each defendant's past transactions and our estimation of the number of transactions each defendant would conduct over the remaining lifetime of our patents, less a discounted cash flow adjustment as a result of receiving all funds for estimated future transactions immediately. The total amount received for fully-paid up licenses was $15,400,000.

In April 2006 we also settled the litigation filed against us for patent infringement by Telecheck International Inc., an affiliate of one of the defendants in the Delaware litigation. As part of the settlement we granted a fully paid-up license to certain of our patents and we received a fully-paid up license to certain of the Telecheck International Inc. patents and to certain other patents owned by First Data Corp.

As part of our strategy to enforce our intellectual property rights with respect to our patent portfolio, we entered into a special fee arrangement with our legal counsel, Kirkland and Ellis, LLP, who represented us both as plaintiffs in the Delaware litigation and as defendants in the Telecheck International Inc. litigation in Texas. Under the terms of our special fee arrangement, we paid $7,100,000 to Kirkland and Ellis LLP.

In March 2006, a former employee of ours filed a complaint against us for breach of contract and wrongful termination in the Superior Court of the State of Arizona in and for the County of Maricopa. In the suit, the former employee alleged that we wrongfully reduced the former employee's salary without requisite notice under an employment agreement between the former employee and us and wrongfully terminated the former employee without requisite notice and for acts that do not constitute cause under the aforementioned employment agreement. In May 2007, we entered into a settlement agreement with respect to this complaint. Pursuant to the terms of the settlement agreement we paid the former employee the sum of $22,500 and the former employee's legal counsel the sum of $22,500 in full settlement and release of all claims.

On March 6, 2007 we received notification that we were named in a class-action lawsuit filed in the United States District Court, Eastern District, Marshall Division, Texas, alleging that numerous defendants violated the Driver's Privacy Protection Act of Texas regulating the use of personal information such as driver's license numbers and home addresses contained in motor vehicle records held by motor vehicle departments, by not having a permissible use in obtaining the State of Texas' entire database of names, addresses and other personal information. We believe that these allegations are without merit and we do not expect them to have a material adverse effect on our results of operations, financial position or liquidity.

Other than as described herein, we are not currently involved in any material legal proceedings. However, we are party from time to time to additional ordinary litigation incidental to our business, none of which is expected to have a material adverse effect on the results of our operations, financial position or liquidity.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

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PART II

ITEM 5. Market For Registrant's Common Equity and Related Stockholder Security Matters

Our common stock is traded on The NASDAQ Stock Market's Capital Market, which is the principal market for our common stock, and trades under the symbol "LMLP". Our common stock is neither listed nor traded on any foreign trading market. The following table sets forth the range of high and low prices for our common stock during the fiscal periods indicated. The prices set forth below represent quotations between dealers and do not include retail markups, markdowns or commissions and may not represent actual transactions.

Fiscal Year Ended March 31:		High	Low
2007	1Q	$ 12.21	$ 3.76
	2Q	5.33	2.89
	3Q	4.12	2.57
	4Q	3.93	3.00
2006	1Q	5.80	4.05
	2Q	7.79	3.92
	3Q	8.35	5.35
	4Q	8.82	6.05

The prices set forth above are not necessarily indicative of liquidity of the trading market for our common stock. Trading in our common stock is limited and sporadic.

Our common stock price is volatile.

The market price of our common stock has been volatile in the past and may change rapidly in the future. The following factors, among others, may cause significant volatility in our stock price:

- Actual or anticipated fluctuations in our operating results;
- Financial or business announcements by us, our competitors or our customers;
- Announcements of the introduction of new or enhanced products and services by us or our competitors;
- Announcements of mergers, joint development efforts or corporate partnerships in the electronic commerce market;

- Market conditions in the banking, telecommunications, technology and emerging growth sectors;
- Rumors relating to our competitors or us; and
- General market or economic conditions.

In addition, the U.S. stock markets have experienced significant price and volume fluctuations, which have particularly affected the trading price of equity securities of many technology companies.

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Holders of Common Stock

As of May 31, 2007, there were approximately 376 record holders of our common stock, with approximately 20,207,094 shares outstanding. The number of holders of record is based on the actual number of holders registered on the books of our transfer agent and does not reflect holders of shares in "street name" or persons, partnerships, associations, corporations or other entities identified in security position listings maintained by depository trust companies.

Dividend Policy

We have not paid any dividends on our common stock in the past and have no current plan to pay dividends in the future. We intend to devote all funds to the operation of our businesses.

Canadian Federal Tax Considerations

General

There are no foreign or currency controls in Canada, and there are no exchange restrictions on borrowing from abroad, on the repatriation of capital, or the ability to remit dividends, profits, interests, royalties, or other payments to non-resident holders of our common stock. However, any such remittance to a resident of the U.S. is subject to a reduced withholding tax pursuant to various Articles of the Canada-U.S. Income Tax Convention, 1980 (the “Treaty”) between Canada and the U.S.

Dividends

Generally, dividends that are paid or credited by Canadian corporations to non-resident shareholders are subject to a nonresident tax of 25%. However, the Treaty provides that dividends paid by a Canadian corporation to a corporation resident of the U.S. with no permanent establishment in Canada, which owns at least 10% of our voting stock paying the dividend, are subject to the Canadian non-resident withholding tax of 5%. In all other cases, when a dividend is paid by a Canadian corporation to the beneficial owner resident in the U.S., the Canadian non-resident withholding tax is 15% of the amount of the dividend.

The reduced withholding tax rates do not apply if the beneficial owner of the shares carries on business through a permanent establishment in Canada and the stock holding in respect of which the dividends are paid is effectively connected with such permanent establishment. In such a case, the dividends are taxable in Canada as general business profits at rates that may exceed the 5% or 15% rates applicable to dividends that are not effectively connected with a Canadian permanent establishment.

The Treaty permits Canada to apply its domestic law rules for differentiating dividends from interest and other disbursements. Stock dividends are subject to the normal Canadian non-resident withholding tax rules on the amount of the dividend. The amount of a stock dividend is equal to the increase in our paid-up capital by virtue of the dividend.

Interest

Generally, interest paid or credited to a non-resident is subject to a 25% Canadian withholding tax. If, at a time when interest has accrued but is not yet payable, the holder of the debt transfers it to a Canadian resident or, in certain circumstances, a non-resident who carries on business in Canada, part of the proceeds of the disposition may be considered to be interest for Canadian income tax purposes. Under the Treaty, the rate of withholding tax on interest paid to a U.S. resident is 10%. For Treaty purposes, interest means interest as defined by domestic Canadian income tax rules. The withholding tax applies to the gross amount of the interest payment.

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Capital Gains

Non-residents are subject to Canadian income tax on dispositions of "taxable Canadian property." Taxable Canadian property includes shares of a publicly traded Canadian corporation if, at any time during the preceding five years, the non-resident and persons with whom the non-resident did not deal at arm's length owned at least 25% of the issued and outstanding shares of any class of stock.

The applicable tax rate on capital gains realized by a non-resident is 18.06% for corporations and 21.46% for individuals. Under the Treaty, capital gains realized by a U.S. resident on the disposition of shares of a Canadian corporation are exempt from Canadian income tax, unless (i) the value of the shares is derived principally from Canadian real property, or (ii) the shares are effectively connected with a permanent Canadian establishment of such non-resident, the capital gains are attributable to such permanent establishment, and the gains are realized not later than twelve months after the termination of such permanent establishment.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of March 31, 2007 about our common stock that may be issued upon the exercise of options, warrants and rights under all of our existing equity compensation plans, including the 1996 Stock Option Plan and the 1998 Stock Incentive Plan:

PLAN CATEGORY	(A) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(B) Weighted-average exercise price of outstanding options, warrants and rights	(C) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (A))
Equity compensation plans approved by security holders[1]	2,225,500	$ 4.59	1,657,967

Stock Performance Graph

The graph set forth below compares the cumulative total shareholder return on our common stock between March 31, 2002 and March 31, 2007 with the cumulative return of (i) the NASDAQ Stock Market Index (US) and (ii) the NASDAQ Computer and Data Processing Index (US and Foreign), over the same period. This graph assumes the investment of $100 on March 31, 2002 in our common stock, the NASDAQ Stock Market Index (US) and the NASDAQ Computer and Data Processing Index (US and Foreign), and assumes the reinvestment of dividends, if any.

The comparisons shown in the graph below are based upon historical data. We caution that the share price performance shown in the graph below is not indicative of, nor intended to forecast, the potential future performance of the LML Shares. Information used in the graph was obtained from the Center for Research in Security Prices, Graduate School of Business, The University of Chicago, a source believed to be reliable but we are not responsible for any errors or omissions in such information.

Notwithstanding anything to the contrary set forth in any of our previous or future filings under the Securities Act of 1933 or the Securities Exchange Act of 1934 that might incorporate this Annual Report or future filings made by us under those statutes, the stock price performance graph is not considered "soliciting material," is not deemed "filed" with the SEC and is not deemed to be incorporated by reference into any of those prior filings or into any future filings made by us under those statues.

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[1] These plans consist of: (i) the 1996 Stock Option Plan, and (ii) the 1998 Stock Incentive Plan

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ITEM 6. Selected Financial Data

The selected financial data set forth below should be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and related notes. We have derived the statement of operations data for the fiscal years ended March 31, 2005, 2006 and 2007 and the balance sheet data as at March 31, 2006 and 2007 from the audited financial statements included elsewhere in this document. The statement of operations data for the fiscal years ended March 31, 2003 and 2004 and the balance sheet data as at March 31, 2003, 2004 and 2005 were derived from audited financial statements that are not included in this document. Historical results are not necessarily indicative of results to be expected for future periods.

Table of Selected Financial Data[1]
Year Ended March 31
(Presented under Canadian GAAP)
(Amounts in thousands, except per share data)

	2007	2006	2005	2004	2003
Statement of operations data:					
Revenue	$ 6,554	$ 5,458	$ 6,658	$ 8,740	$ 8,560
Loss from continuing operations[2]	(1,073)	(4,647)	(4,150)	(2,316)	(2,963)
Discontinued operations[3]	-	-	-	588	(85)
Net loss[2 and 4]	(1,073)	(4,647)	(4,150)	(1,728)	(3,048)
Loss from continuing operations per share – basic	(.05)	(.23)	(.21)	(.12)	(.15)
Loss from continuing operations per share - diluted	(.05)	(.23)	(.21)	(.12)	(.15)
Net loss per share – basic	(.05)	(.23)	(.21)	(.09)	(.16)
Net loss per share – diluted	(.05)	(.23)	(.21)	(.09)	(.16)
Weighted average number of common shares outstanding – basic	20,206	20,164	20,012	19,606	19,495
Weighted average number of common shares outstanding – diluted	20,206	20,164	20,012	19,606	19,495

Balance sheet data:					
Current assets	$ 11,148	$ 4,753	$ 7,318	$ 6,713	$ 4,908
Total assets[5]	13,679	6,078	9,070	9,759	11,553
Current liabilities	2,860	1,725	1,204	1,076	1,346
Long-term debt, less current portion	727	-	23	56	-

[1] The financial information set forth in this table for the fiscal years ended March 31, 2003, 2004, 2005, 2006 and 2007 includes our accounts on a consolidated basis.

[2] Loss from continuing operations and net loss for the fiscal years ended March 31, 2007, 2006 and 2005 include stock based compensation expenses of approximately $877,000, $904,000 and $1.5 million, respectively, resulting from our adoption of new accounting standards in fiscal 2004 requiring fair value accounting for all stock options issued during the year.

[3] During the fiscal year ended March 31, 2004 we sold the Wildwood Estates property for gross proceeds of approximately $2.4 million. The decision to discontinue operations of this business segment resulted from an opportunity to sell the property and consequently remove a business segment no longer consistent with our business strategy. The results of these discontinued operations have been reclassified in the statements of operations and deficit and cash flows for the years ended March 31, 2003 and 2004.

[4] Under Canadian generally accepted accounting principals ("Canadian GAAP"), goodwill impairment of approximately $6.4 million is recorded as an adjustment to opening retained earnings as of the beginning of the fiscal year ended March 31, 2003, while under U.S. generally accepted accounting principles ("U.S. GAAP"), the impairment is reflected as a cumulative effect of an accounting change and included in net loss for the fiscal year ended March 31, 2003.

[5] The total assets for the fiscal year ended March 31, 2003 are reflective of a one-time non-cash charge of approximately $6.4 million to write-off the carrying value of our goodwill.

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Table of Selected Financial Data[1]
Year Ended March 31
(Reconciliation As Adjusted for U.S. GAAP)
(Amounts in thousands, except per share data)

	2007	2006	2005	2004	2003
Statement of operations data:					
Revenue	$ 6,554	$ 5,458	$ 6,658	$ 8,740	$ 8,560
Loss from continuing operations[2]	(1,073)	(4,647)	(4,150)	(2,316)	(2,963)
Discontinued operations[3]	-	-	-	588	(85)
Net loss before cumulative effect of accounting change	(1,073)	(4,647)	(4,150)	(1,728)	(3,048)
Loss from continuing operations per share basis	(.05)	(.23)	(.21)	(.12)	(.15)
Loss from continuing operations per share diluted	(.05)	(.23)	(.21)	(.12)	(.15)
Net loss before cumulative effect of accounting change per share – basic	(.05)	(.23)	(.21)	(.09)	(.16)
Net loss before cumulative effect of accounting change per share – diluted	(.05)	(.23)	(.21)	(.09)	(.16)
Cumulative effect of accounting change	-	-	-	-	(6,434)
Per share – basic	-	-	-	-	(.33)
Per share – diluted	-	-	-	-	(.33)
Net loss[2 and 4]	(1,073)	(4,647)	(4,150)	(1,728)	(9,482)
Per share – basic	(.05)	(.23)	(.21)	(.09)	(.49)
Per share – diluted	(.05)	(.23)	(.21)	(.09)	(.49)
Weighted average number of common shares outstanding – basic	20,206	20,164	20,012	19,606	19,495
Weighted average number of common shares outstanding – diluted	20,206	20,164	20,012	19,606	19,495
Balance sheet data:					
Current assets	$ 11,148	$ 4,753	$ 7,318	$ 6,713	$ 4,908

Total assets[5]	13,679	6,078	9,070	9,759	11,553
Current liabilities	2,860	1,725	1,204	1,076	1,346
Long-term debt, less current portion	727	-	23	56	-

[1] The financial information set forth in this table for the fiscal years ended March 31, 2003, 2004, 2005, 2006 and 2007 includes our accounts on a consolidated basis.

[2] Loss from continuing operations and net loss for the fiscal years ended March 31, 2007, 2006 and 2005 include stock based compensation expenses of approximately $877,000, $904,000 and $1.5 million, respectively, resulting from our adoption of new accounting standards in fiscal 2004 requiring fair value accounting for all stock options issued during the year.

[3] During the fiscal year ended March 31, 2004 we sold the Wildwood Estates property for gross proceeds of approximately $2.4 million. The decision to discontinue operations of this business segment resulted from an opportunity to sell the property and consequently remove a business segment no longer consistent with our business strategy. The results of these discontinued operations have been reclassified in the statements of operations and deficit and cash flows for the years ended March 31, 2003 and 2004.

[4] Under Canadian generally accepted accounting principals ("Canadian GAAP"), goodwill impairment of approximately $6.4 million is recorded as an adjustment to opening retained earnings as of the beginning of the fiscal year ended March 31, 2003, while under U.S. generally accepted accounting principles ("U.S. GAAP"), the impairment is reflected as a cumulative effect of an accounting change and included in net loss for the fiscal year ended March 31, 2003.

[5] The total assets for the fiscal year ended March 31, 2003 are reflective of a one-time non-cash charge of approximately $6.4 million to write-off the carrying value of our goodwill.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in this Form 10-K. See Item 8. "Financial Statements." This information is not necessarily indicative of future operating results.The Consolidated Financial Statements and Notes thereto have been prepared in accordance with Canadian GAAP.

Forward Looking Information

All statements other than statements of historical fact contained in this Annual Report on Form 10-K are forward-looking statements. Forward-looking statements generally are accompanied by words such as "anticipate," "believe," "estimate," "intend," "project," "potential" or "expect" or similar statements. The forward-looking statements were prepared on the basis of certain assumptions which relate, among other things, to the demand for and cost of marketing our services, the volume and total value of transactions processed by merchants utilizing our services, the technological adaptation of electronic check conversion end-users, the renewal of material contracts in our business, our ability to anticipate and respond to technological changes, particularly with respect to financial payments and e-commerce, in a highly competitive industry characterized by rapid technological change and rapid rates of product obsolescence, our ability to develop and market new product enhancements and new products and services that respond to technological change or evolving industry standards, no unanticipated developments relating to previously disclosed lawsuits against us, and the cost of protecting our intellectual property. Even if the assumptions on which the forward-looking statements are based prove accurate and appropriate, the actual results of our operations in the future may vary widely due to technological changes, increased competition, new government regulation or intervention in the industry, general economic conditions and other risks described elsewhere in this Annual Report on Form 10-K. See Part I, Item 1A – "Risk Factors". Accordingly, the actual results of our operations in the future may vary widely from the forward-looking statements included herein. All forward-looking statements included herein are expressly qualified in their entirety by the cautionary statements in this paragraph.

Overview

LML Payment Systems Inc. is a financial payment processor. We provide check risk services such as electronic check authorization, electronic check processing services such as electronic check conversion and return check management such as traditional and electronic recovery services to retail clients. We also provide mainframe payment processing software modules and rights to use our patented intellectual property to retailers and other payment processors.

When we provide return check management services, we typically receive revenue when we are successful at recovering the principal amount of the original transaction on behalf of the client. In some instances we also earn a percentage of the principal amount and in some other instances our secondary recovery services provide for us to earn additional fees when legal action is required.

When we provide check authorization and electronic check conversion services we typically earn revenue based upon the number of transactions we process through our data center.

When we provide mainframe based payment software modules to clients who are of sufficient size and possess the technical capability to process financial transactions in-house, or through their own data center, we typically earn revenue by way of a fixed software license fee. In some instances we also earn revenue by way of royalties that are typically based upon a fixed sale price or on a usage or transaction basis.

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When we provide clients licenses to our intellectual property estate (which includes four U.S. patents describing electronic check processing methods), we typically earn revenue or other income from release fees for potential past infringement and ongoing royalty fees. In some instances we also earn revenue from license agreements that provide for the payment of contractually determined paid-up license fees to us in consideration for the grant of a non-exclusive, retroactive and future license to our intellectual property estate and in other instances, where license agreements include multiple element arrangements, we may defer this revenue and recognize the revenue ratably over the license term.

We provide our financial payment processing services from our office locations and facilities in Scottsdale, Arizona, and Wichita, Kansas.

Recent Developments

Subsequent to the end of our 2007 fiscal year, we signed a definitive agreement to acquire all of the outstanding capital stock of Beanstream for a purchase price of approximately CDN$19.5 million. The purchase price consists of up to CDN$9.3 million in cash, CDN$5.0 million in two-year promissory notes and CDN$5.2 million in our common stock. Beanstream could also receive up to an additional CDN$2.0 million in our common stock if certain revenue milestones are reached by the first anniversary of the closing. See Part I, Item 1 – "Business – Beanstream Acquisition."

If completed, we believe that the Beanstream acquisition could have a significant positive impact in future periods on our results of operations, financial condition, and liquidity and capital resources. However, the Beanstream acquisition is subject to a number of closing conditions, including the approval by the shareholders of Beanstream, and no assurances can be made that such conditions will be satisfied or that the transaction will close by the targeted closing date, if at all.

In addition, because the purchase price payable by us under the Arrangement Agreement with Beanstream is denominated in Canadian dollars, to pay the cash portion of the closing date purchase price we must generate the amount of cash in U.S dollars (which is the functional currency of our operations) that, when exchanged at the then-prevailing U.S./Canadian currency exchange rate, will equal CDN $9.3 million. At the time we executed the Arrangement Agreement on April 30, 2007, the amount of U.S. dollars necessary to pay CDN $9.3 million was U.S. $8.3 million. Given recent and unexpected fluctuations in the U.S./Canadian currency exchange rate, that amount has increased as of the date this Annual Report on Form 10-K is being filed from U.S. $8.3 million to approximately U.S. $8.7 million. Further significant changes in the U.S./Canadian currency exchange rate could have a significant adverse impact on our current liquidity and capital resources and could also have an adverse impact on our profitability and results of operations for our fiscal year ending March 31, 2008. See Part I, Item 1A – "Risk Factors – Risks related to the pending Beanstream acquisition."

Results of Operations

Fiscal year 2007 compared to Fiscal year 2006

Revenue

Total revenue for fiscal year 2007 was approximately $6.6 million, an increase of approximately 20% from total revenue of approximately $5.5 million for fiscal year 2006. This increase is primarily attributable to an increase in revenue from licensing our patented intellectual property.

Revenue from electronic check verification was approximately $730,000 for fiscal year 2007, approximately a 33.6% decrease from revenue from electronic check verification of approximately $1.1 million for fiscal year 2006. This decrease is primarily attributable to certain existing customers negotiating a reduction in the per transaction pricing of our enhanced electronic check verification services when they entered into contract renewals with us during the first quarter of our fiscal year 2007.

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Revenue from our primary check collections business decreased approximately 22.1% from approximately $1.0 million for fiscal year 2006 to approximately $779,000 for fiscal year 2007. The reduction in revenue from our primary check collections business was primarily attributable to an overall reduction of approximately 28% in new returned check volume provided to us for primary collection services. We believe this reduction may be attributable to better check verification services we are providing to some of our customers and fewer paper checks being processed by some of our customers. In light of trending decreases in revenue from our primary check collections business, during the fiscal year 2007, we implemented a plan to combine the operations of our primary check collections business located in Dallas, Texas with our secondary check collections business located in Wichita, Kansas. This combination of operations coincided with the expiration of our property leases for our Dallas facilities. The total one-time cost associated with this combination of operations was approximately $68,000. We believe this combination will produce new operating efficiencies, including a significant reduction in our future primary check collection costs of operations without significantly impacting our existing revenue from our primary check collections business.

Revenue from our secondary check collections business increased approximately 13.6% from approximately $2.2 million for fiscal year 2006 to approximately $2.5 million for fiscal year 2007. The increase in revenue from our secondary check collections business was primarily attributable to an increase in collections of the principal amount and related fees of returned checks assigned for secondary recovery.

Revenue from our licensing of certain payment software modules was nil for fiscal year 2007 compared to approximately $162,000 for fiscal year 2006.

Revenue from royalties received from CheckFree Corporation pertaining to their marketing of the PEP+ reACH™ product was approximately $363,000 for fiscal year 2007, versus approximately $413,000 for fiscal year 2006. We believe future royalties are dependent upon the continued successful marketing by CheckFree Corporation of the PEP+ reACH™ product.

Revenue from licensing our patented intellectual property increased by approximately $1.6 million from approximately $147,000 for fiscal year 2006 to approximately $1.7 million for fiscal year 2007. The licensing revenue of approximately $1.7 million consists of: (i) approximately $143,000, net of legal fees, pertaining to one granted license; (ii) approximately $1.2 million, net of legal fees, representing the recognized current period portion of deferred revenue from a second granted license; and (iii) approximately $352,000 related to aggregate licenses providing running royalties (see Part I, Item 3 – “Legal Proceedings”).

Recently released statistics from the National Automated Clearing House Association ("NACHA") show that the transaction volume for point-of-purchase ("POP") check conversion during 2006 was over 269 million, an increase of approximately 61% over the transaction volume for the same period in 2005. We believe that this growing trend may have a positive impact on our patented intellectual property licensing activities.

Costs of operations

Costs of operations were approximately $4.8 million for fiscal year 2007 as compared to approximately $4.6 million for fiscal year 2006. Costs of operations consist of transaction processing costs, personnel costs, equipment related costs and telecommunication costs. For fiscal year 2007, costs of operations as a percentage of revenue decreased to approximately 72.7% compared to approximately 83.6% for fiscal year 2006. In fiscal year 2007, costs of operations were approximately $1.3 million in the first quarter, approximately $1.2 million in the second quarter, approximately $1.2 million in the third quarter and approximately $1.1 million in the fourth quarter.

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Sales, general and administrative expenses

Sales, general and administrative expenses consist primarily of stock-based compensation expense, personnel costs, commissions, office facilities, travel, promotional events such as trade shows, seminars and technical conferences, public relations and professional service fees, which include legal fees, audit fees, SEC compliance costs and costs related to compliance with the Sarbanes-Oxley Act of 2002. Sales, general and administrative expenses decreased to approximately $3.0 million from approximately $4.8 million for the fiscal year 2007 and 2006, respectively, a decrease of approximately $1.8 million or approximately 37.5%. The decrease in sales, general and administrative expense is primarily attributable to a decrease in legal fees of approximately $1.4 million from approximately $1.5 million for fiscal year 2006 to approximately $52,000 for fiscal year 2007. This decrease is attributable to the settlement of the patent infringement suit we filed in fiscal 2005 and settled in the first quarter of fiscal 2007.

Amortization and depreciation

Amortization on intangibles increased to approximately $164,000 for fiscal year 2007 from approximately $157,000 for fiscal year 2006. Depreciation expenses relating to our system software and other software decreased to approximately $40,000 for fiscal year 2007 from approximately $247,000 for fiscal year 2006. Depreciation expense for capital assets decreased to approximately $132,000 for fiscal year 2007 from approximately $213,000 for fiscal year 2006. The decreases in depreciation expenses were primarily attributable to certain capital assets becoming fully depreciated during fiscal year 2007.

Other income (expenses), net

During the fiscal year 2007 we had net other income of approximately $621,000 compared to net other expenses of approximately $5,700 for the fiscal year 2006. Net other income for fiscal year 2007 consists primarily of (i) approximately $377,000, net of legal fees, attributable to specific release provisions contained in two of the license agreements we entered into in April 2006, (ii) approximately $43,000, net of legal fees, attributable to the recognized current period portion of deferred other income from a certain standstill agreement contained in one of these licenses, and (iii) approximately $208,000 related to a State sales tax refund resulting from the conclusion of a State sales tax audit performed during our fiscal year 2007.

Settlement expenses

Settlement expenses for fiscal year 2007 decreased to approximately $45,000 from approximately $236,000 for fiscal year 2006. Settlement expenses for fiscal year 2007 consist of the settlement of the complaint filed by a former employee against us. See also Part I, Item 3 – "Legal Proceedings". Settlement expenses for fiscal year 2006 consist of costs of approximately $227,000 attributable to an arbitrator's decision to award a former consultant of ours damages, interest and certain arbitration costs.

Due diligence expenses

Due diligence expenses for fiscal year 2007 were approximately $568,000 compared to nil for fiscal year 2006. As part of our continuing efforts to maximize shareholder value and solidify our financial and operational foundation, we explored several potential acquisitions and merger opportunities during the fiscal year 2007. The due diligence process involved in these activities resulted in us incurring certain related costs, namely professional services fees which primarily included legal fees, as well as other travel, meetings and related expenditures. We did not enter into any definitive agreements related to these costs; therefore, during the fiscal year 2007, we expensed approximately $568,000 of costs attributable to these efforts.

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Interest income, net

Interest income for fiscal year 2007 increased to approximately $475,000 from approximately $142,000 for fiscal year 2006. The increase in interest income was primarily attributable to an increase in interest bearing cash investments resulting from the net consideration we received from the three settlement and license agreements we entered into in April 2006. Interest expense increased to approximately $13,000 in fiscal year 2007 compared to approximately $10,000 in fiscal year 2006.

Income Taxes

We regularly evaluate the realizability of our future tax assets given the nature of our operations and given the tax jurisdictions in which we operate. At this time, we consider it more likely than not that the future tax assets will not be realized through future taxable income. Accordingly, a valuation allowance of 100% has been provided against these future tax assets at March 31, 2007 and 2006.

Net Loss

Net loss was approximately $1.1 million for fiscal year 2007 and approximately $4.6 million for fiscal year 2006. Net loss per both basic and diluted shares was approximately ($0.05) for fiscal year 2007, as compared to approximately ($0.23) for fiscal year 2006.

Results of Operations

Fiscal year 2006 compared to Fiscal year 2005

Revenue

Total revenue for fiscal year 2006 was approximately $5.5 million, approximately a 17.9% decrease over total revenue of approximately $6.7 million for fiscal year 2005. This decrease was primarily attributable to a decrease in revenue associated with our primary and secondary check collection business.

Revenue from electronic check verification increased approximately 10% from approximately $1.0 million for fiscal year 2005 to approximately $1.1 million for fiscal year 2006. This increase was primarily attributable to an increase in existing customers utilizing our enhanced electronic check verification services. Our enhanced electronic check verification services provide customers with access to additional check databases for a higher per transaction fee.

Revenue from our primary check collections business decreased approximately 50% from approximately $2.0 million for fiscal year 2005 to approximately $1.0 million for fiscal year 2006. The reduction in revenue from our primary check collections business was primarily attributable to us no longer providing check recovery services to 7-Eleven, formerly our largest customer which was responsible for approximately 20% of revenue from our primary check collections business for the fiscal year 2005. Revenue from our secondary check collections business decreased approximately 18.5% from approximately $2.7 million for fiscal year 2005 to approximately $2.2 million for fiscal year 2006. The decrease in revenue from our secondary check collections business was partially attributable to a decrease in collections of the principal amount and related fees of returned checks assigned for secondary recovery and partially attributable to a reduction in new returned check volume assigned for secondary recovery of approximately 27.4% for fiscal year 2006 as compared to fiscal year 2005.

Revenue from our licensing of certain payment software modules was approximately $162,000 for fiscal year 2006, compared to approximately $105,000 for fiscal year 2005.

Revenue from royalties received from Checkfree pertaining to their marketing of the PEP+ reACH™ product was approximately $413,000 for fiscal year 2006, compared to approximately $267,000 for fiscal year 2005.

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Revenue from licensing our patented intellectual property increased by approximately 22.5% from approximately $120,000 for fiscal year 2005 to approximately $147,000 for fiscal year 2006.

Costs of operations

Costs of operations consist of transaction processing costs, transaction processing personnel, equipment related costs and telecommunication costs. Costs of operations decreased from approximately $5.3 million in fiscal year 2005 to approximately $4.6 million in fiscal year 2006, a decrease of approximately 13.2%. The decrease was primarily attributable to certain cost reductions such as transaction processing costs, transaction processing personnel and telecommunication costs associated with us no longer providing check authorization and recovery services to 7-Eleven, our former largest customer. For fiscal year 2006, costs of operations as a percentage of revenue increased to approximately 83.6% compared to approximately 79.1% for fiscal year 2005. During the fiscal year 2006, costs of operations were approximately $1.1 million in the first quarter, approximately $1.1 million in the second quarter, approximately $1.2 million in the third quarter and approximately $1.2 million in the fourth quarter.

Sales, general and administrative expenses

Sales, general and administrative expenses consist primarily of professional service fees, which include legal fees, audit fees, SEC compliance costs and costs related to compliance with the Sarbanes-Oxley Act of 2002, stock-based compensation expense, personnel costs, commissions, office facilities, travel, promotional events such as trade shows, seminars and technical conferences, and public relations. Sales, general and administrative expenses increased to approximately $4.8 million from approximately $4.0 million for the fiscal year 2006 and 2005, respectively, an increase of approximately $800,000 or approximately 20%. The increase in sales, general and administrative expenses was primarily attributable to an increase in legal fees of approximately $1.4 million from approximately $381,000 for fiscal year 2005 to approximately $1.8 million for fiscal year 2006. The increase in legal fees was primarily attributable to an increase in costs associated with the patent infringement suit we filed during fiscal year 2005 of approximately $1.3 million from approximately $176,000 for fiscal year 2005 to approximately $1.5 million for fiscal year 2006, and partially attributable to costs associated with the legal fees related to the arbitration proceedings between us and a former consultant and other legal fees associated with ordinary legal matters incidental to our business. The increase in sales, general and administrative expenses was partially offset by a decrease in stock-based compensation expense of approximately $600,000 from approximately $1.5 million for fiscal year 2005 to approximately $904,000 for fiscal year 2006.

Amortization and depreciation

Amortization on intangibles increased to approximately $157,000 for fiscal year 2006 from approximately $147,000 for fiscal year 2005. Depreciation expenses relating to our system software and other software decreased to approximately $247,000 for fiscal year 2006 from approximately $1.0 million for fiscal year 2005. Depreciation expense for capital assets decreased to approximately $213,000 for fiscal year 2006 from approximately $263,000 for fiscal year 2005. The decreases in depreciation expenses were primarily attributable to certain capital assets becoming fully depreciated during fiscal year 2006.

Other income (expenses), net

During the fiscal year 2006 we had other expenses of approximately $241,000 compared to approximately $4,000 for fiscal year 2005. The increase in other expenses was primarily attributable to the costs associated with an arbitrator's decision to award a former consultant of ours approximately $156,000 in damages plus interest of approximately $61,000 for an alleged breach of ours in failing to issue additional common shares as part of our former consultant's finders fees with respect to certain acquisitions made by us in the fiscal years ended March 31, 2000 and March 31, 2001. The arbitrator's decision also included reimbursing certain arbitration costs to our former consultant totaling approximately $10,000.

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Interest income, net

Interest expense increased to approximately $10,000 in fiscal year 2006 compared to approximately $8,000 in fiscal year 2005. Interest income for fiscal year 2006 increased to approximately $142,000 from approximately $90,000 for fiscal year 2005. The increase in interest income was primarily attributed to an increase in interest rates from an average of approximately 1.74% in fiscal year 2005 to approximately 3.00% in fiscal year 2006.

Income Taxes

We regularly evaluate the realizability of our future tax assets given the nature of our operations and given the tax jurisdictions in which we operate. At this time, we consider it more likely than not that the future tax assets will not be realized through future taxable income. Accordingly, a valuation allowance of 100% has been provided against these future tax assets at March 31, 2006 and 2005.

Net Loss

Net loss was approximately $4.6 million for fiscal year 2006 and approximately $4.2 million for fiscal year 2005. Net loss per both basic and diluted shares was approximately ($0.23) for fiscal year 2006, as compared to approximately ($0.21) for fiscal year 2005.

Liquidity and Capital Resources

Our liquidity and financial position consisted of approximately $8.3 million in working capital as of March 31, 2007 compared to approximately $3.0 million in working capital as of March 31, 2006. The increase in working capital was primarily attributable to cash flows provided by operating activities of approximately $7.5 million. Cash provided by operating activities increased approximately $9.9 million from cash used in operating activities of approximately $2.4 million for fiscal year 2006 to cash provided by operating activities of approximately $7.5 million for fiscal year 2007. The increase in cash provided by operating activities was primarily attributable to consideration we received of approximately $16.0 million (less special fee arrangements we paid Kirkland & Ellis of approximately $7.1 million) resulting from the three settlement and license agreements we entered into during the fiscal year 2007. Cash used in investing activities was approximately $969,000 for fiscal year 2007 as compared to approximately $200,000 for fiscal year 2006, an increase in cash used in investing activities of approximately $769,000. The increase in cash used in investing activities was primarily attributed to expenditures related to our due diligence efforts from our consideration of potential acquisitions and merger opportunities, including professional services fees, which included legal fees, travel, meetings and other related expenditures and partially attributable to an amount we paid pursuant to the engagement of a corporate financial advisor. Cash used in financing activities was approximately $18,000 for fiscal year 2007 as compared to cash provided by financing activities of approximately $184,000 for fiscal year 2006. The decrease in cash provided by financing activities was primarily due to the reduction in proceeds from exercise of options of our common stock of approximately $169,000 from approximately $233,000 for fiscal year 2006 to approximately $64,000 for fiscal year 2007.

We anticipate positive cash flows from our operating activities in fiscal 2008.

In light of our strategic objective of acquiring electronic payment volume across all our financial payment processing services and strengthening our position as a financial payment processor, our long-term plans may include the potential to strategically acquire complementary businesses, products or technologies and may also include instituting actions against other entities who we believe are infringing our intellectual property. We believe that existing cash and cash equivalent balances and potential cash flows from operations should satisfy our long-term cash requirements, however, we may elect to raise additional funds for these purposes, either through equity or debt financing, as appropriate. There can be no assurance that such financing would be available on acceptable terms, if at all.

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Contingencies

On March 6, 2007 we received notification that we were named in a class-action lawsuit filed in the United States District Court, Eastern District, Marshall Division, Texas, alleging that numerous defendants violated the Driver's Privacy Protection Act of Texas regulating the use of personal information such as driver's license numbers and home addresses contained in motor vehicle records held by motor vehicle departments, by not having a permissible use in obtaining the State of Texas' entire database of names, addresses and other personal information. We believe that these allegations are without merit and we do not expect them to have a material adverse effect on our results of operations, financial position or liquidity.

Contractual Obligations

During the fiscal year ended March 31, 2007, we entered into a three year lease agreement with IBM Credit LLC to finance two IBM Mainframe hardware purchases totaling $1.1 million. Also during the fiscal year 2007, we entered into a three year financing arrangement with Xerox Canada Ltd. to finance an equipment purchase. In our prior fiscal year 2005, we entered into a two year financing arrangement with De Lage Financial Services Canada Inc. for funding a software enhancement renewal fee.

The following table summarizes our significant contractual obligations and commitments as of March 31, 2007 (in thousands):

	Payments due by: (in thousands)				
	Total	Less than 1 year	1 to 3 years	4 to 5 years	More than 5 years
Capital Lease Obligations	$ 1,200	$ 423	$ 777	$ -	$ -
Operating Lease Obligations	862	347	515	-	-
Purchase Obligations	172	172	-	-	-
Total	$ 2,234	$ 942	$ 1,292	$ -	$ -

Critical Accounting Policies and Estimates

Our financial statements have been prepared in accordance with accounting principles generally accepted in Canada and form the basis for the following discussion and analysis of critical accounting policies and estimates. We make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities during the course of preparing these financial statements. On a regular basis, we evaluate our estimates and assumptions including those related to the recognition of revenues, valuation of other long-lived assets and stock-based compensation.

We base our estimates on historical experience and on various other assumptions that we believe to be reasonable. These estimates form the basis of our judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from those estimates.

The following critical accounting policies reflect the more significant estimates and assumptions we have used in the preparation of our financial statements.

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Revenue Recognition

Transaction processing and service fees are recognized in the period these services are performed. These services consist of processing our clients' electronic check authorization and conversion transactions. These fees are charged on a per transactions basis and depend upon the contractual agreement with the client.

Check recovery fees are recognized in the period when cash is received for the services performed. These services typically consist of recovering the face amount of the original transaction and a service or collection fee. We are typically paid the service fee only when we are successful in the recovery of the face amount of the original transaction on behalf of our client.

In cases where our clients are of sufficient size and possess the technical capability to process transactions on their own, we license certain elements of our modules of our electronic payment processing software. We are typically paid either a fixed license fee that is recognized in accordance with Statement of Position ("SOP") 97-2, "Software Revenue Recognition" or in some cases a fee per transaction processed by the client whereupon revenue is recognized at the time the transactions are processed, provided the fee is fixed and determinable and collectability is reasonably assured.

License fees regarding the licensing of the technology embodied within our four U.S. patents regarding electronic check processing are recognized in accordance with Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") 101 "Revenue Recognition" ("SAB 101") and further guidance provided by the Canadian Institute of Chartered Accountants ("CICA") Emerging Issues Committee ("EIC") abstract-142 ("EIC 142") and Emerging Issues Task Force ("EITF") issue 00-21; "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"). In some instances, our licensees have paid an up-front fee to obtain a license, and in such cases the up-front fee is treated as deferred revenue and is recognized over the life of the agreement. In other cases, our licensees have paid a fee for a release regarding potential past infringements of our four U.S. patents and, in such cases, the fee is recognized as revenue when the release is granted and the amount is reasonably determinable. Running royalties earned from electronic check transactions processed by the licensee are recognized on a monthly basis based on the volume of transactions processed.

Valuation of Other Long-Lived Assets

We regularly evaluate whether events and circumstances have occurred that indicate the carrying amounts of our other long-lived assets, primarily our patents and our transaction processing software, equipment and other intangible assets, may warrant revision or may not be recoverable. When there are indications that such assets should be evaluated for possible impairment, we perform an impairment test in accordance with CICA Section 3063 and SFAS No. 144: “Accounting for the Impairment or Disposal of Long-Lived Assets”. In the opinion of management, our long-lived assets are appropriately valued as of March 31, 2007 and 2006.

Stock Based Compensation

We issue stock options to our employees and directors under the terms of our 1996 Stock Option Plan and our 1998 Stock Incentive Plan. Canadian GAAP previously provided two alternative methods of accounting for stock options under the terms and conditions we typically issue such options. Alternative one was to estimate the fair value of the stock option on the date of grant and recognize that value as an expense to operations over the stock option’s vesting period (“Alternative One”). Alternative two was to estimate the fair value of the stock option on the date of grant but only reflect the impact in a pro-forma disclosure setting forth compensation expense as if the fair value method was used in the Corporation’s financial statements and forego adjusting the consolidated statements of operations (“Alternative Two”). During the fiscal year 2004, CICA released revised transitional provisions for voluntary adoption of Alternative One. These provisions permit a prospective application of the Alternative One recognition provisions to accounting for stock options not previously accounted for at fair value, provided we elect to apply the Alternative One method to those stock options granted starting for our fiscal year 2004. We adopted these transitional provisions during our fiscal year 2004 and, therefore, stock options granted during the fiscal years 2004, 2005, 2006 and 2007 have been recognized under Alternative One and presented as stock based compensation expense in our consolidated statements of operations. Stock options granted in previous fiscal years have continued to be accounted for under the Alternative Two method with stock based compensation expense reflected in a pro-forma disclosure. Stock options granted in future fiscal years will be accounted for under the Alternative One method with stock based compensation recognized as an expense to operations over the stock options’ vesting period.

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We determine the assumptions used in computing the fair value of the stock options by estimating the expected useful lives, giving consideration to the vesting periods, contractual lives, actual employee forfeitures and the relationship between the exercise price and the historical market value of our common stock, among other factors. The risk-free interest rate is the federal government zero-coupon bond rate for the relevant expected life. The fair value of the stock options are estimated on the date of grant using the Black-Scholes option-pricing model.

Future Income Taxes and Valuation Allowance

Future income taxes reflect the net tax effects of temporary differences between the carrying amount of our assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We assess the likelihood that our future tax assets will be recovered from our future taxable income, and to the extent we believe that recovery is not likely, we establish a valuation allowance. We consider historical taxable income, estimates of future taxable income and ongoing prudent and feasible tax planning strategies in assessing the amount of the valuation allowance. Based on various factors, including our cumulative losses for the past years and estimates of future profitability, we recorded a valuation allowance for the full amount of our net future tax assets. We will continue to monitor our estimate of future profitability and the likelihood of realizing our net future tax assets based on evolving business conditions.

Off-Balance Sheet Arrangements

We do not currently have any off-balance sheet arrangements as such term is defined in Item 303(a) (4) of Regulation S-K.

Summary Quarterly Financial Data (Unaudited)

The following summarizes our unaudited quarterly financial results for the fiscal years ended March 31, 2007 and March 31, 2006 (in thousands, except share data):

	Year Ended March 31, 2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenue	$ 1,796	$ 1,651	$ 1,516	$ 1,592
Net income (loss)	184	(419)	(924)	86
Basic net income (loss) per common share	.01	(.02)	(.05)	.01
Diluted net income (loss) per common share	.01	(.02)	(.05)	.01

	Year Ended March 31, 2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenue	$ 1,560	$ 1,158	$ 1,206	$ 1,534
Net loss	(1,078)	(1,964)	(1,100)	(505)
Basic net loss per common share	(.05)	(.10)	(.05)	(.03)
Diluted net loss per common share	(.05)	(.10)	(.05)	(.03)

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ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk from changes in marketable securities (which consist of money market and commercial paper). At March 31, 2007, our marketable securities were recorded at a fair value of approximately $1.1 million, with an overall weighted average return of 5.3% and an overall weighted average life of less than three months. Our marketable securities have exposure to price risk, which is estimated as the potential loss in fair value due to a hypothetical change of 50 basis points (9% of our overall average return on marketable securities) in quoted market prices. This hypothetical change would have an immaterial effect on the recorded value of the marketable securities.

We are not exposed to material future earnings or cash flow fluctuations from changes in interest rates on long-term debt since 100% of our long-term debt is at a fixed rate as of March 31, 2007. The fair value of our debt approximates its carrying value. To date, we have not entered into any derivative financial instruments to manage interest rate risk and are currently not evaluating the future use of any such financial instruments.

We have immaterial exposure to foreign currency transaction gains or losses. To date, we have not entered into any derivative financial instrument to manage foreign currency risk and are currently not evaluating the future use of any such financial instruments.

ITEM 8. Financial Statements and Supplementary Data

Information called for by this item is set forth in our Consolidated Financial Statements contained in this report. Our Consolidated Financial Statements begin at page F-1.

ITEM 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosures

Not applicable

ITEM 9A. Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based on their evaluation, the Chief Executive Officer and Chief Accounting Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

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MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in the Exchange Act Rules 13a-15(f) and 15d-15(f). Those rules define internal control over financial reporting as a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Generally Accepted Accounting Principles ("GAAP"). It includes policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of management and directors; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company’s internal control over financial reporting as of March 31, 2007, based on the criteria set forth in the *Internal Control-Integrated Framework* by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on this assessment and those criteria, management believes that the Company maintained effective internal control over financial reporting as of March 31, 2007.

Management’s assessment of the effectiveness of our internal control over financial reporting as of March 31, 2007 has been audited by Grant Thornton, LLP, an Independent Registered Chartered Accounting Firm, as stated in their report, which is included elsewhere herein.

Changes in Internal Control over Financial Reporting

Based on the evaluation conducted by management, including the Chief

Executive Officer and the Chief Accounting Officer, there were no changes in our internal controls during the fourth quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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REPORT OF INDEPENDENT REGISTERED CHARTERED ACCOUNTING FIRM

Board of Directors and Shareholders of LML Payment Systems Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting appearing under Item 9A, that LML Payment Systems Inc. and subsidiaries (together, the "Corporation") maintained effective internal control over financial reporting as of March 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that LML Payment Systems Inc. and subsidiaries maintained effective internal control over financial reporting as of March 31, 2007, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, LML Payment Systems Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of March 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of LML Payment Systems Inc. and subsidiaries as of March 31, 2007 and 2006 and the consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended March 31, 2007 and our report dated June 11, 2007 expresses an unqualified opinion on those financial statements.

Vancouver, Canada /s/ GRANT THORNTON LLP
June 11, 2007 Chartered Accountants

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ITEM 9B. **Other Information**

Not applicable.

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PART III

ITEM 10. Directors, Executive Officers and Corporate Governance

Information on our directors, executive officers, and audit committee, compliance with Section 16(a) of the Exchange Act and our code of ethics applicable to our Chief Executive Officer and Chief Accounting Officer will be contained in our Proxy Statement for our 2007 Annual and Special Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2007, and is incorporated herein by reference.

We have adopted a Code of Ethics applicable to our principal executive officer, principal financial officer, controller and others performing similar functions. Our Code of Ethics also applies to all of our other employees and to our directors. Our Code of Ethics is available on our website located at www.lmlpayment.com under the heading "Investor Relations; Corporate Governance". We intend to satisfy any disclosure requirements pursuant to Item 5.05 of Form 8-K regarding any amendment to, or a waiver from, certain provisions of our Code of Ethics by posting such information on our website (unless we are otherwise required to file a Form 8-K under the rules and regulations of The NASDAQ Stock Market).

There were no material changes to the procedures by which our stockholders may recommend nominees to our Board of Directors implemented during fiscal 2007.

ITEM 11. Executive Compensation

Information on compensation of our directors and executive officers will be contained in our Proxy Statement for our 2007 Annual and Special Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2007, and is incorporated herein by reference.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Security Matters

Information on the securities ownership of certain beneficial owners and our management will be contained in our Proxy Statement for our 2007 Annual and Special Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2007, and is incorporated herein by reference.

Information required by Item 201(d) of Regulation S-K is set forth under Item 5. "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities".

ITEM 13. Certain Relationships and Related Transactions

Information on certain relationships and related transactions will be contained in our Proxy Statement for our 2007 Annual and Special Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2007, and is incorporated herein by reference.

ITEM 14. Principal Accountant Fees and Services

Information regarding principal accountant fees and services will be contained in our Proxy Statement for our 2007 Annual and Special Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2007, and is incorporated herein by reference.

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PART IV

ITEM 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this report:

(1) Consolidated Financial Statements

All other schedules are omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or Notes thereto.

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(b) Exhibits:

Exhibit Number	Description of Document
2.1	Arrangement Agreement dated as of April 30, 2007, between LML Payment Systems Inc. and Beanstream Internet Commerce Inc. and the schedules thereto (incorporated by reference to Exhibit 2.1 to the Form 8-K dated April 30, 2007 of LML (file No. 0-13959)).
2.2	Amending Agreement between LML Payment Systems Inc. and Beanstream Internet Commerce Inc. dated as of May 24, 2007 (incorporated by reference to Exhibit 99.2 to the Form 8-K dated June 4, 2007 of LML (file No. 0-13959)).
3.1	Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K for the period ended March 31, 2006 of LML (File No. 0-13959)).
3.2	Bylaws of LML, as amended (incorporated by reference to Exhibit 3.2 to the Annual Report on Form 10-K for the period ended March 31, 2006 of LML (File No. 0-13959)).
10.1	Form of employment agreement between Robert E. Peyton and Phoenix EPS, Inc. dated July 9, 2000 (incorporated by reference to Exhibit 10.1 to the Annual Report on Form 10-K for the period ended March 31, 2003 of LML (File No. 0-13959)).
10.2	Settlement and License Agreement between LML Payment Systems Inc. LML Patent Corp., and LML Payment Systems Corp. and TeleCheck Services, Inc., TeleCheck International, Inc. and First Data Corp. (incorporated by reference to Exhibit 10.1 to the Form 8-K dated April 3, 2006 of LML (file No. 0-13959)).
21	Subsidiaries of LML (incorporated by reference to Exhibit 21 to the Annual Report on Form 10-K for the period ended March 31, 2006 of LML (File No. 0-13959)).
23.1*	Consent of Grant Thornton LLP

31.1*	Rule 13a-14(a) Certification of Principal Executive Officer.
31.2*	Rule 13a-14(a) Certification of Principal Financial Officer.
32*	Section 1350 Certification of Principal Executive Officer and Principal Financial Officer.

* filed herewith

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LML PAYMENT SYSTEMS INC.

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LML PAYMENT SYSTEMS INC.

/s/ Patrick H. Gaines
Patrick H. Gaines
Chairman of the Board, Chief Executive Officer and President

Date: June 13, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated and on the dates indicated below.

	Title	Date
/s/ Patrick H. Gaines Patrick H. Gaines	Chairman of the Board, Chief Executive Officer, President and Director (Principal Executive Officer)	June 13, 2007
/s/ Richard R. Schulz Richard R. Schulz	Controller and Chief Accounting Officer (Principal Financial and Accounting Officer)	June 13, 2007
/s/ L. William Seidman L. William Seidman	Director	June 13, 2007
/s/ Jacqueline Pace Jacqueline Pace	Director	June 13, 2007
/s/ Greg A. MacRae	Director	June 13, 2007

Greg A.
MacRae

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REPORT OF INDEPENDENT REGISTERED CHARTERED ACCOUNTING FIRM

To the Shareholders
LML Payment Systems Inc.

We have audited the accompanying consolidated balance sheets of LML Payment Systems Inc. and subsidiaries (together, the “Corporation”) as of March 31, 2007 and 2006 and the related consolidated statements of operations, shareholders’ equity and cash flows for each of the three years in the period ended March 31, 2007. These consolidated financial statements are the responsibility of the Corporation’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of LML Payment Systems Inc. and subsidiaries as of March 31, 2007 and 2006 and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2007 in accordance with Canadian generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of LML Payment Systems Inc. and subsidiaries’ internal control over financial reporting as of March 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated June 11, 2007 expressed an unqualified opinion on management’s assessment of the effectiveness of the Corporation’s internal control over financial reporting and an unqualified opinion on the effectiveness of the

Corporation's internal control over financial reporting.

Canadian generally accepted accounting principles vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 15 to the consolidated financial statements.

Vancouver, Canada	/s/ GRANT THORNTON LLP
June 11, 2007	Chartered Accountants

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LML PAYMENT SYSTEMS INC.

CONSOLIDATED BALANCE SHEETS
(In U.S. Dollars)

	March 31	
	2007	2006
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 10,163,008	$ 3,691,632
Restricted cash (Note 4(a))	250,000	250,000
Accounts receivable, less allowance of $23,388 (2006: $46,145)	330,055	436,475
Prepaid expenses	405,213	374,887
Total current assets	11,148,276	4,752,994
PROPERTY AND EQUIPMENT (Notes 5 and 7)	1,362,003	201,036
PATENTS (Note 6)	943,985	1,093,392
OTHER ASSETS (Note 13)	224,263	30,102
Total assets	13,678,527	6,077,524
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable	659,111	1,104,034
Accrued liabilities	309,677	338,527
Current portion of obligations under capital lease (Note 7)	360,179	22,458
Current portion of deferred revenue	1,531,260	260,121
Total current liabilities	2,860,227	1,725,140
OBLIGATIONS UNDER CAPITAL LEASE (Note 7)	726,806	-
DEFERRED REVENUE	5,859,628	10,985
Total liabilities	9,446,661	1,736,125
COMMITMENTS AND CONTINGENCIES (Note 12)		
SHAREHOLDERS' EQUITY		

CAPITAL STOCK		
Class A, preferred stock, $1.00 CDN par value, 150,000,000 shares authorized, issuable in series, none issued or outstanding	-	-
Class B, preferred stock, $1.00 CDN par value, 150,000,000 shares authorized, issuable in series, none issued or outstanding	-	-
Common shares, no par value, 100,000,000 shares authorized, 20,207,094 issued and outstanding (2006: 20,194,094)	32,774,368	32,710,018
CONTRIBUTED SURPLUS (Note 3)	3,443,292	2,544,312
DEFICIT	(31,985,794)	(30,912,931)
Total shareholders’ equity	4,231,866	4,341,399
Total liabilities and shareholders’ equity	13,678,527	6,077,524

SUBSEQUENT EVENT (Note 13)

See accompanying notes to the consolidated financial statements.

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LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In U.S. Dollars, except share data)

	Years ended March 31,		
	2007	2006	2005
REVENUE	$ 6,554,191	$ 5,458,029	$ 6,658,103
COSTS AND EXPENSES			
Cost of operations	4,757,053	4,600,766	5,339,080
Sales, general and administrative expenses (includes stock-based compensation expense of $877,334 (2006-$903,778; 2005-$1,485,475))	2,967,132	4,752,718	4,049,430
Amortization and depreciation	335,555	616,592	1,415,712
LOSS BEFORE OTHER INCOME (EXPENSES) AND INCOME TAXES	(1,505,549)	(4,512,047)	(4,146,119)
Other income (expenses), net	621,026	(5,675)	(3,681)
Settlement expenses	(45,000)	(235,778)	-
Due diligence expenses	(567,562)	-	-
Interest income, net	462,668	132,270	81,730
LOSS BEFORE INCOME TAXES	(1,034,417)	(4,621,230)	(4,068,070)
Income taxes (Note 11)	38,446	25,863	82,036
NET LOSS	(1,072,863)	(4,647,093)	(4,150,106)
NET LOSS PER SHARE, basic and diluted	(0.05)	(0.23)	(0.21)
WEIGHTED AVERAGE SHARES OUTSTANDING, basic and diluted (Note 8)	20,206,412	20,164,279	20,012,286

See accompanying notes to the consolidated financial statements.

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LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In U.S. Dollars)

	Common Shares	Amount	Contributed Surplus	Deficit	Total
Balance as at March 31, 2004	19,659,851	$ 30,656,471	$ 85,918	$ (22,115,732)	$ 8,626,657
Exercise of stock options	485,743	1,820,222	-	-	1,820,222
Stock-based compensation (Note 3)	-	-	1,485,475	-	1,485,475
Stock-based compensation – future income taxes	-	-	60,078	-	60,078
Net loss	-	-	-	(4,150,106)	(4,150,106)
Balance as at March 31, 2005	20,145,594	32,476,693	1,631,471	(26,265,838)	7,842,326
Exercise of stock options	48,500	233,325	-	-	233,325
Stock-based compensation (Note 3)	-	-	903,778	-	903,778
Stock-based compensation – future income taxes	-	-	9,063	-	9,063
Net loss	-	-	-	(4,647,093)	(4,647,093)
Balance as at March 31, 2006	20,194,094	32,710,018	2,544,312	(30,912,931)	4,341,399
Exercise of stock options	13,000	64,350	-	-	64,350
Stock-based	-	-	877,334	-	877,334

compensation (Note 3)					
Stock-based compensation – future income taxes	-	-	21,646	-	21,646
Net loss	-	-	-	(1,072,863)	(1,072,863)
Balance as at March 31, 2007	20,207,094	32,774,368	3,443,292	(31,985,794)	4,231,866

See accompanying notes to the consolidated financial statements

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LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In U.S. Dollars)

	Years ended March 31,		
	2007	2006	2005
OPERATING ACTIVITIES:			
Net loss	$ (1,072,863)	$ (4,647,093)	$ (4,150,106)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities			
Provisions for losses on accounts receivable	37,347	14,989	24,034
Amortization and depreciation	335,555	616,592	1,415,712
Stock-based compensation	877,334	903,778	1,485,475
Stock-based compensation – future income taxes	21,646	9,063	60,078
Due diligence expenses	567,562	-	-
Other	(7,252)	-	(33,669)
Changes in operating assets and liabilities			
Restricted cash	-	-	50,000
Accounts receivable	69,073	57,161	271,980
Prepaid expenses	(30,326)	122,526	(33,926)
Accounts payable and accrued liabilities	(473,773)	530,263	100,832
Other assets	14,447	10,953	14,048
Deferred revenue	7,119,782	27,439	17,938
Net cash provided by (used in) operating activities	7,458,532	(2,354,329)	(777,604)
INVESTING ACTIVITIES:			
Other assets	(776,170)	-	-
Short term investments	-	-	183,561
Proceeds from disposal of capital assets	7,252	-	12,606
Acquisition of property and equipment	(185,886)	(152,096)	(104,836)
Patents	(14,341)	(47,755)	(31,679)
Net cash (used in) provided by investing activities	(969,145)	(199,851)	59,652
FINANCING ACTIVITIES:			
Payments on capital leases	(79,588)	(38,874)	(34,028)
Payments on long-term	(2,773)	(10,460)	(10,399)

borrowing			
Proceeds from long-term borrowing	-	-	22,635
Proceeds from exercise of stock options	64,350	233,325	1,820,222
Net cash (used in) provided by financing activities	(18,011)	183,991	1,798,430
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	6,471,376	(2,370,189)	1,080,478
Cash and cash equivalents, beginning of year	3,691,632	6,061,821	4,981,343
Cash and cash equivalents, end of year	10,163,008	3,691,632	6,061,821
Cash and cash equivalents consist of:			
Cash	9,041,704	1,176,900	2,148,315
Money market fund	1,121,304	-	-
Commercial paper	-	2,514,732	3,913,506
	10,163,008	3,691,632	6,061,821
Supplemental disclosure of cash flow information:			
Interest paid	12,700	10,041	8,346
Taxes paid	16,800	16,800	21,958
Non-cash investing and financing transactions not included in cash flows:			
Property and equipment acquired through capital leases	1,146,473	-	-

See accompanying notes to the consolidated financial statements.

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LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

1. NATURE OF OPERATIONS

LML Payment Systems Inc. (a Yukon Territory corporation) and its subsidiaries (the "Corporation"), see Note 2(a), is a financial payment processor providing check processing solutions including electronic check authorization, electronic check conversion (ECC) and primary and secondary check collection including electronic check re-presentment (RCK) to retailers in the United States of America (U.S.). The Corporation also provides selective routing of debit, credit and electronic benefit transfer (EBT) transactions to third party processors and banks in the U.S. for authorization and settlement.

The Corporation’s intellectual property estate, owned by subsidiary LML Patent Corp., includes U.S. Patent No. 6,354,491, No. 6,283,366, No. 6,164,528 and No. 5,484,988, which describe electronic check processing methods.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). Except as disclosed in Note 14, these principles do not differ materially from generally accepted accounting principles in the U.S. (“U.S. GAAP”).

These consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries as set out below. All significant inter-company balances and transactions have been eliminated on consolidation.

CANADA
Legacy Promotions Inc.

UNITED STATES
LHTW Properties Inc.
LML Corp.
LML Patent Corp.
LML Payment Systems Corp.

(b) Use of Estimates and Measurement Uncertainty

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to, among others, the allowance for doubtful accounts, determination of impairment of assets, determination of stock-based compensation expense, useful lives for depreciation and amortization and future income taxes. Actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and all highly liquid debt instruments purchased with a maturity of three months or less at the date of purchase.

(d) Accounts Receivable

Accounts receivable are stated net of allowances for uncollectible accounts. Management develops the estimate of the allowance based on the Corporation's experience with specific customers, its understanding of their current economic circumstances and its own judgment as to the likelihood of their ultimate payment. Management also considers the Corporation's collection experience with the balance of its receivables portfolio and makes estimates regarding collectability based on trends in aging.

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LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Property and Equipment

Property and equipment are recorded at cost less accumulated depreciation. A straight-line method is used to depreciate assets over their estimated useful lives as follows:

Computer equipment	3 – 5 years
Computer software	3 – 5 years
Furniture and fixtures	3 years
Leasehold improvements	Lesser of the life of the lease or the useful life of the leasehold improvement
Office equipment	5 years
System and software	5 years
Vehicles	4 years
Website & trademarks	5 years

(f) Patents

Patent costs are amortized using the straight-line method over the estimated useful life of 15 years.

(g) Long-lived Assets

Long-lived assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from undiscounted cash flows estimated to be earned from future operations. An impairment charge, if any, is recorded in the statement of operations based on the difference between the asset’s book value and its fair value.

(h) Revenue Recognition

Revenue consists primarily of transaction charges from the Corporation's primary and secondary check collection business, including electronic check re-presentment, electronic check authorization and electronic check conversion business, software license sales, royalty fees and maintenance fees. Revenue is recognized in accordance with Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3400, "Revenue" ("CICA 3400") and with the corresponding U.S. guidance, Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") 104, "Revenue Recognition".

Revenue from the Corporation's electronic check authorization and electronic check conversion business is recognized at the time the transactions are processed by the merchant, provided the fee is fixed and determinable and collectability is reasonably assured. Fees associated with the Corporation's primary and secondary check collection business, including electronic check re-presentment, are contingent on successful recovery; accordingly, revenue is recognized as cash is received.

In accordance with the American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 97-2, as amended by SOP 98-9, "Software Revenue Recognition," the Corporation recognizes software license revenue when all of the following criteria are met: execution of a written agreement; delivery has occurred; the fee is fixed and determinable; collectibility of the proceeds is probable; and vendor-specific objective evidence exists to allocate the total fee to elements of multiple-element arrangements, including post contract customer support. Vendor-specific objective evidence is based on the price charged when an element is sold separately. If the Corporation does not have sufficient evidence of the fair value of undelivered elements, revenue is recognized ratably over the support period when the only undelivered element is post-contract customer support. Any cash consideration received prior to meeting revenue recognition criteria is recorded as deferred revenue.

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LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Income Taxes

The liability method is used in accounting for income taxes. Under this method, income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are provided against net deferred tax assets when it is more likely than not those assets may not be realized.

(j) Loss Per Common Share

Basic loss per common share is calculated based on net loss divided by the weighted-average number of common shares outstanding during the period. Diluted loss per share includes the dilutive effect of stock options granted using the treasury stock method.

(k) Stock-based Compensation Plans

The Corporation has two stock-based compensation plans, described more fully in Note 9. Effective April 1, 2003, the Corporation adopted the fair value accounting provisions of CICA Handbook Section 3870 “Stock-based compensation and other stock-based payments” (“CICA 3870”) which corresponds to the fair value recognition provisions under the Financial Accounting Standard Board’s (“FASB”) Statement of Financial Accounting Standards No. 123, (“SFAS 123”), as amended by SFAS No. 148, “Accounting for Stock-Based Compensation - Transition and Disclosure” (“SFAS 148”) for all stock-based compensation granted after April 1. Subsequent to SFAS 148, the Corporation has adopted Statement of Financial Accounting Standards No. 123(R) (“SFAS 123(R)”), “Share-Based Payment” (see Note 14), which also corresponds to CICA Section 3870. Under this method, the fair value of the stock options at the date of grant is recognized and is amortized to the Consolidated Statement of Operations over the shorter of the remaining employee service period or the vesting period with the offsetting credit to contributed surplus. Upon the exercise of these options, any amounts originally credited to contributed surplus are or will be credited to capital stock.

Any consideration paid by directors, officers and employees on the exercise of stock options or purchase of stock is credited to share capital.

(l) Foreign Exchange

The functional currency of the Corporation is the U.S. dollar. The Corporation follows the temporal method of accounting for the translation of foreign currency amounts into U.S. dollars. Under this method, monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities are translated at exchange rates prevailing at the historical transaction date. Revenue and expense items are translated at average exchange rates prevailing during the year. Foreign exchange gains or losses (that have been immaterial for fiscal 2007, 2006 and 2005) are reflected in the results of operations.

(m) Financial Instruments

The Corporation's financial instruments consist of cash and cash equivalents, restricted cash, short term investments, accounts receivable, accounts payable, and obligations under capital lease, the fair values of which approximate their carrying values. From time to time the Corporation purchases short-term investments including commercial paper. The principal objective of the Corporation's investment activities is to provide maximum levels of interest income while maintaining acceptable levels of interest rate and liquidity risk and facilitating the funding needs of the Corporation.

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LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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3. CHANGE IN ACCOUNTING POLICIES

Stock-based Compensation

As described in Note 2(k), effective April 1, 2003, the Corporation prospectively early adopted CICA 3870 which corresponds to SFAS 123, as amended by SFAS 148, which requires fair value accounting for all stock options issued during the year. Subsequent to SFAS 148, the Corporation has adopted Statement of Financial Accounting Standards No. 123(R) ("SFAS 123(R)"), "Share-Based Payment" (see Note 14), which also corresponds to CICA Section 3870. Prior to the adoption of the new accounting standard, the Corporation did not record the fair value of stock options issued, rather, it provided pro-forma disclosure of the effect of applying the fair value based method to stock options issued to directors, officers and employees.

The 760,000 stock options granted in the fiscal year ended March 31, 2007 (see Note 9), have a weighted average fair value of a range from a low of $1.46 to a high of $1.82.

The total fair value stock compensation is amortized over the vesting period resulting in a stock compensation expense of $877,334 for the fiscal year ended March 31, 2007 (2006 - $903,778; 2005: $1,485,475). The fair value for the 2007 stock option grants was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate of 3.84% to 4.42%;

Expected volatility of 60.2% to 65.5%;

Expected life of the stock option of 4 years; and

No dividend yields.

The 250,000 stock options granted in the fiscal year ended March 31, 2006, have a weighted average fair value of $2.35.

The total fair value stock compensation is amortized over the vesting period resulting in a stock compensation expense of $903,778 for the fiscal year ended March 31, 2006 (2005 - $1,485,475). The fair value for the 2006 stock option grants was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate of 3.12%;

Expected volatility of 65.5%;

Expected life of the stock options of 4 years; and

No dividend yields.

The 635,000 stock options granted in the fiscal year ended March 31, 2005, have a weighted average fair value of a range from a low of $3.07 to a high of $4.44.

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LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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3. CHANGE IN ACCOUNTING POLICIES (Continued)

The total fair value stock compensation is amortized over the vesting period resulting in a stock compensation expense of $1,485,475 for the fiscal year ended March 31, 2005. The fair value for the 2005 stock option grants was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate of 4.07% for 560,000 of the stock option grants and 4.35% for 75,000 of the stock option grants;

Expected volatility of 78.9% to 79.6%;

Expected life of the 560,000 stock option grants of 4 years and 6 years for the 75,000 stock option grants; and

No dividend yields.

The pro-forma disclosure below relates to stock options granted prior to April 1, 2003, which have vested in 2005.

	2007	2006	2005
Net loss, as reported	$ (1,072,863)	$ (4,647,093)	$ (4,150,106)
Add: Stock-based compensation expense included in reported net loss, including related tax effects	898,980	912,841	1,545,553
Less: Total stock-based compensation expense determined under fair value method for all awards, including related tax effects	(898,980)	(912,841)	(2,304,799)
Pro forma net loss:	(1,072,863)	(4,647,093)	(4,909,352)
Basic and diluted loss per common share:			
As reported	(0.05)	(0.23)	(0.21)
Pro forma	(0.05)	(0.23)	(0.25)

4. FINANCIAL INSTRUMENTS

(a) Restricted Cash

Under the terms of the processing agreement with one of the Corporation's processing banks, the Corporation has pledged a deposit of $250,000 (2006-$250,000) against charge back losses.

(b) Concentrations of Credit Risk and Economic Dependence

During the fiscal year ended March 31, 2007, revenue from the Corporation's two largest customers amounted to approximately 34% of total revenue for one customer (2006 - 29%; 2005 – 21%) and 19% for the second customer (2006 - 0%; 2005 – 0%). The amount of actual revenue from these customers amounted to approximately $2,265,963 for one customer (2006-$1,553,567; 2005-$1,390,162) and $1,222,224 for the second customer (2006 - $0; 2005 - $0).

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LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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5. PROPERTY AND EQUIPMENT

2007

	Cost	Accumulated Amortization and Depreciation	Net Book Value
Computer equipment	$ 2,528,848	$ 1,307,677	$ 1,221,171
Computer software	1,060,510	1,022,816	37,694
Furniture and fixtures	289,209	288,721	488
Leasehold improvements	257,872	255,372	2,500
Office equipment	661,553	587,391	74,162
Vehicles	75,277	67,468	7,809
Website & trademarks	38,186	35,425	2,761
System & software	6,800,841	6,785,423	15,418
Total cost	11,712,296	10,350,293	1,362,003

2006

	Cost	Accumulated Amortization and Depreciation	Net Book Value
Computer equipment	$ 1,275,997	$ 1,217,452	$ 58,545
Computer software	1,042,288	990,351	51,937
Furniture and fixtures	288,692	288,692	-
Leasehold improvements	254,873	231,115	23,758
Office equipment	603,368	575,213	28,155
Vehicles	75,277	64,541	10,736
Website & trademarks	38,186	34,031	4,155
System & software	6,800,841	6,777,091	23,750
Total cost	10,379,522	10,178,486	201,036

Depreciation expense on property and equipment totaled $171,807 in 2007, $460,041 in 2006 and $1,269,079 in 2005. Property and equipment include $1,146,473 of assets that are financed under various capital leases for the year ended March 31, 2007 and $409,271 for the year ended March 31, 2006. Accumulated amortization on these assets totals $449,316 and $409,271 for the years ended March 31, 2007 and 2006, respectively. Amortization of assets under capital lease is included in depreciation expense.

6. PATENTS

	2007	2006
Cost	$ 2,034,911	$ 2,020,570
Less: accumulated amortization	1,090,926	927,178
Net book value	943,985	1,093,392

Amortization expense totaled $163,748 in 2007, $156,551 in 2006 and $146,632 in 2005.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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6. PATENTS (continued)

Estimated aggregate amortization expense for each of the five succeeding fiscal years is as follows:

Years ending March 31	
2008	$ 165,950
2009	165,950
2010	165,950
2011	165,950
2012	165,950

7. OBLIGATIONS UNDER CAPITAL LEASE

In August, 2006, the Corporation entered into a lease agreement with Xerox Canada Ltd. to finance an equipment purchase of $7,367. Lease payments are due quarterly under the lease term of thirty-six (36) months. Title to the equipment will transfer to the Corporation at the expiration of the lease. Accordingly these amounts have been recorded as a capital lease.

In February, 2007, the Corporation entered into a lease agreement with IBM Credit LLC to finance two IBM Mainframe hardware purchases totaling $1,139,106. Lease payments are due on the last day of each month under the lease term of thirty-six (36) months. Title to the equipment will transfer to the Corporation at the expiration of the lease. Accordingly these amounts have been recorded as a capital lease.

	2007	2006
Future minimum payments due		
2007	$ -	$ 22,963
2008	423,934	-
2009	423,934	-
2010	351,852	-
Less amount representing interest (7%-8%)	(112,735)	(505)
Net principal balance	1,086,985	22,458
Less current portion	(360,179)	(22,458)
	726,806	-

The lease is collateralized by the equipment under capital lease.

8. (LOSS) EARNINGS PER COMMON SHARE

As a result of the net losses incurred for 2007, 2006 and 2005, the effect of dilutive securities would have been anti-dilutive to the diluted loss per common share computations and were thus excluded. Dilutive securities that would have otherwise been included in the determination of the weighted-average number of common shares outstanding for the purposes of computing diluted earnings per common share included 660,000 for 2007, 1,174,500 for 2006 and 958,000 for 2005, issuable under stock options.

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LML PAYMENT SYSTEMS INC.

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9. COMMON STOCK OPTIONS

The Corporation maintains two stock option plans; the 1996 Stock Option Plan (the "1996 Plan") and the 1998 Stock Incentive Plan (the "1998 Plan"). The number of shares that may be granted under the 1996 Plan is a total of 3 million shares and the number of shares that may be granted under the 1998 Plan is a total of 3 million shares. All director, officer and employee stock options are granted under the Corporation's 1996 Plan or the 1998 Plan with the exception of 80,000 stock options granted to a former consultant, vesting over a one year period, which were not granted under the 1996 Plan or the 1998 Plan. The exercise price of stock options granted under the 1996 Plan and the 1998 Plan is 100% of the fair market value on the date the stock option is granted. Stock options granted to directors, officers and employees are normally vested over a three-year period. Stock options are typically exercisable for a period of five years from the date of grant. Stock options previously granted will be forfeited upon leaving the employment of the Corporation.

At March 31, 2007 there are stock options outstanding and exercisable to issue 2,255,500 common shares of the Corporation (2006 – 1,629,500). The price of these stock options range from $2.95 to $6.25 and their expiry dates range from September 4, 2007 to October 5, 2011. At March 31, 2007, 1,657,967 common shares were reserved for issuance pursuant to the 1996 Plan and 1998 Plan. This amount reflects the limit of shares collectively to be granted pursuant to the 1996 Plan and 1998 Plan less (i) the number of shares which have been granted and are still outstanding (ii) the number of shares which have been granted and exercised and (iii) the number of shares that have been granted and have expired without being exercised.

The following table summarizes information about the stock options outstanding:

	Options outstanding			Options exercisable		
Range	Total # of Shares	Weighted average exercise price	Weighted average contract life remaining (years)	Total # of Shares	Weighted average exercise price	Weighted average contract life remaining (years)

$	2.95	585,000	$ 2.95	4.52	171,250	$ 2.95	4.52
	3.62	175,000	3.62	4.42	100,000	3.62	4.42
	4.52-4.74	255,000	4.55	3.17	255,000	4.55	3.17
	5.00-5.90	785,500	5.10	0.77	775,500	5.10	0.75
	6.25	455,000	6.25	2.34	425,000	6.25	2.22
		2,225,500	4.59	2.64	1,726,750	5.00	2.06

Stock option activity for the three preceding years is as follows:

	2007		2006		2005	
	Total # of Shares	Weighted average exercise price	Total # of Shares	Weighted average exercise price	Total # of Shares	Weighted average exercise price
Stock options outstanding, beginning of year	1,629,500	$ 5.32	1,903,000	$ 6.65	2,068,210	$ 6.15
Granted	760,000	3.10	250,000	4.52	635,000	5.99
Forfeited	(151,000)	4.89	(475,000)	10.30	(314,467)	6.47
Exercised	(13,000)	4.95	(48,500)	4.81	(485,743)	3.75
Stock options outstanding, end of year	2,225,500	4.59	1,629,500	5.32	1,903,000	6.65

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10. EMPLOYEE BENEFIT PLAN

The Corporation has a defined contribution 401 (k) plan (the "Plan") for eligible employees. The Plan requires that the Corporation match 50% of eligible employees' contributions, up to 6% of their compensation. The Corporation recorded matching contribution expenses for the years ended March 31, 2007, 2006 and 2005 of $24,018, $17,779 and $14,054 respectively.

11. INCOME TAXES

At March 31, 2007, the Corporation has Canadian non-capital loss carry-forwards for income tax purposes of approximately $10,900,000 and U.S. federal net operating loss carry-forwards of $11,889,000. Due to Canadian and U.S. tax "change of ownership" rules, the loss carry-forwards are restricted in their use. These losses expire in 2008 to 2027.

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Corporation's future tax assets as of March 31, 2007 and 2006 are as follows:

	2007	2006
Future tax assets:		
Excess of tax value over the net book value for capital assets	$ 317,000	$ 317,000
Stock-based compensation	1,275,000	396,000
Canadian non-capital loss carry-forwards	3,719,000	3,759,000
U.S. federal net operating loss carry-forwards	4,472,000	5,268,000
Total future tax assets	9,783,000	9,740,000
Valuation allowance for future tax assets	(9,783,000)	(9,740,000)
Net future tax assets	-	-

The potential income tax benefits related to these future tax assets have not been recognized in the accounts as their realization did not meet the requirements of "more likely than not" under the liability method of tax allocation due to the Corporation's history of losses. Accordingly, no future tax assets have been recognized in the financial statements as at March 31, 2007.

The reconciliation of income tax attributable to operations computed at the statutory tax rates to income tax expense (recovery), using a 34.12% statutory tax rate at March 31, 2007, a 34.12% statutory tax rate at March 31, 2006 and a 35.62% statutory tax rate at March 31, 2005 is as follows:

	2007	**2006**	**2005**
Income taxes at statutory rates	$ (366,000)	$ (1,586,000)	$ (1,478,000)
State income taxes	16,800	16,800	21,958
Stock-based compensation – future income taxes	21,646	9,063	60,078
Stock-based compensation	307,000	311,000	551,000
Effect of U.S. tax rates	16,000	(21,000)	6,000
Increase in valuation allowance	43,000	1,296,000	921,000
	38,446	25,863	82,036

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LML PAYMENT SYSTEMS INC.

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12. COMMITMENTS AND CONTINGENCIES

(a) During the fiscal year ended March 31, 2007, a subsidiary of the Corporation settled its suit, originally filed on June 14, 2004 in the U.S. District Court for the District of Delaware, against four companies who provide equipment, systems and services that convert paper checks presented at the point-of-sale into electronic transactions and entered into a separate settlement and license agreement with each of them. The provisions of each of the three settlement and license agreements included providing a license to the patents owned by the subsidiary of the Corporation in exchange for consideration in the form of a release fee for a release from any and all causes of action related to the subsidiary of the Corporation's licensed patents as well as consideration in the form of either a lump sum payment or a running royalty fee covering a term through to the expiration of the licensed patents owned by the subsidiary of the Corporation. The consideration received by the subsidiary of the Corporation for these three settlement and license agreements was $16,000,000.

The three settlement and license agreements contained a number of elements that have been recorded in these consolidated financial statements as follows:

- Under the terms of two of the agreements, in exchange for a release fee consideration, the subsidiary of the Corporation has agreed to release these licensees from any and all causes of action related to its patents which may have arisen prior to the effective date of the licenses. Due to the specific nature of the releases, these release fees totaling $377,000, net of legal fees, have been recorded as other income in the fiscal year ended March 31, 2007.

- The subsidiary of the Corporation has entered into a standstill agreement with one of the licensees, whereby both have promised to refrain from filing certain types of litigation against each other until April 1, 2009. The consideration received related to the standstill agreement totaling $130,000, net of legal fees, has been deferred and will be recognized as other income ratably over the standstill period. For ther fiscal year ended March 31, 2007 $43,333 has been recognized as other income and the deferred balance was $86,667.

- Under the terms of one agreement, the subsidiary of the Corporation agreed to provide licensing rights for use of existing patents. As these rights have been delivered, payment has been received and the subsidiary of the Corporation has no future obligations under the agreement, this revenue, totaling $143,000, net of legal fees, has been recognized in the fiscal year ended March 31, 2007.

- Under the terms of one agreement, a portion of the consideration received is comprised of license fees for past and future use of the subject patents and for use of any future patents to be developed, acquired or obtained by the Corporation. The components of this portion of the agreement are considered multiple element arrangements that do not qualify for separate units of accounting, therefore, these license fees, totaling $8,250,000, net of legal fees, have been deferred and will be recognized ratably over the remaining term of the license agreement, which expires on January 16, 2013. For the fiscal year ended March 31, 2007, $1,222,222 has been recognized as revenue and the deferred balance was $7,027,778.

- One agreement also included running royalties for certain future transactions completed by the licensee. These running royalties will be recorded by the subsidiary of the Corporation as revenue in the period in which they are earned.

    - The Corporation has a special fee arrangement with its legal firm, Kirkland and Ellis LLP, that resulted in a $7,100,000 fee for the legal firm's services in connection with the foregoing settlement and licensing agreements. The special fee was paid in April 2006 and has been offset against the $16,000,000 consideration.

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LML PAYMENT SYSTEMS INC.

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12. COMMITMENTS AND CONTINGENCIES (continued)

In conjunction with one of the agreements above, during the fiscal year ended March 31, 2007, the Corporation and the Corporation's subsidiary, LML Payment Systems Corp., settled the complaint for patent infringement originally filed on June 22, 2005 by Telecheck International Inc. in the United States District Court for the Eastern District of Texas, Marshall Division. The provisions of the settlement agreement included providing the Corporation and the Corporation's subsidiary, LML Payment Systems Corp., with a license to certain patents owned by Telecheck International Inc. and certain other future patents owned by First Data Corp. and Telecheck related to the Corporation's current products or services.

(b) During the prior fiscal year ended March 31, 2006, a former employee of a subsidiary of the Corporation filed a complaint against the Corporation's subsidiary, LML Payment Systems Corp. for breach of contract and wrongful termination in the Superior Court of the State of Arizona in and for the County of Maricopa. In the suit, the former employee alleges that the subsidiary of the Corporation wrongfully reduced the former employee's salary without requisite notice under the employment agreement between the former employee and the Corporation's subsidiary, LML Payment Systems Corp. and wrongfully terminated the former employee without requisite notice and for acts that do not constitute cause under the aforementioned employment agreement.

Subsequent to the fiscal year ended March 31, 2007, the subsidiary of the Corporation settled the complaint. Pursuant to the terms of the settlement, the subsidiary of the Corporation has agreed to pay the former employee the sum of $22,500 and the former employee's legal counsel the sum of $22,500. The amounts have been included in accrued liabilities at March 31, 2007 and recorded and reported as "settlement expenses" in the Consolidated Statements of Operations and Deficit for the fiscal year ended March 31, 2007.

(c) During the fiscal year ended March 31, 2007 a subsidiary of the Corporation received notification that it had been named in a class-action lawsuit filed in the United States District Court, Eastern District, Marshall Division, Texas, alleging that numerous defendants, including the subsidiary of the Corporation, violated the Driver's Privacy Protection Act regulating the use of personal information such as driver's license numbers and home addresses contained in motor vehicle records held by motor vehicle departments, by not having a permissible use in obtaining the State of Texas' entire database of names, addresses and other personal information. The subsidiary of the Corporation believes that these allegations are without merit and does not expect them to have a material adverse effect on its results of operations, financial position or liquidity.

(d) The Corporation is a party to additional ordinary litigation incidental to its business, none of which is expected to have a material adverse effect on results of operations, financial position or liquidity of the Corporation.

(e) Operating lease obligations

Future minimum lease payments for obligations under operating leases, including premises, are as follows:

2008	$ 519,169
2009	300,491
2010	131,807
2011	82,715
2012	-
	1,034,182

The Corporation's rent expense totaled $415,609 in 2007, $360,599 in 2006, and $351,166 in 2005.

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13. SUBSEQUENT EVENT

Subsequent to the fiscal year ended March 31, 2007, the Corporation signed a significant definitive agreement to acquire all of the outstanding capital stock of Beanstream Internet Commerce Inc. for a purchase price of $17.5 million. The purchase price consists of up to $8.3 million in cash, $4.5 million in a two-year promissory note and $4.7 million in the Corporation's common stock. Beanstream Internet Commerce Inc. could also receive up to an additional $1.8 million in the Corporation's common stock if certain revenue milestones are reached by the first anniversary of the closing.

14. RECONCILIATION OF CANADIAN TO UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

These financial statements are prepared using Canadian GAAP, which does not differ materially from U.S. GAAP with respect to the accounting policies and disclosures in these financial statements except as set out below:

(a) Under U.S. GAAP, the Corporation could not effect the reduction in deficit of $22,901,744 by reducing the stated capital of the shares of the Corporation's common stock.

(b) On April 1, 2006, the Corporation adopted SFAS 123(R) which requires the expensing of all options issued, modified or settled based on the grant date fair value over the period during which an employee is required to provide service (vesting period).

The Corporation adopted SFAS 123(R) using the modified prospective approach, which requires application of the standard to all awards granted, modified, repurchased or cancelled on or after April 1, 2006, and to all awards for which the requisite service has not been rendered as at such date. Since April 1, 2003, the Corporation has been following the fair value based approach prescribed by SFAS 123, as amended by SFAS 148, for stock option awards granted, modified or settled on or after such date. As such, the application of SFAS 123(R) on April 1, 2006 to all awards granted prior to its adoption did not have an impact on the financial statements. In accordance with the modified prospective approach, prior period financial statements have not been restated to reflect the impact of SFAS 123(R). The prospective adoption of this new U.S. GAAP policy creates no differences with the Corporation's stock compensation expense reported under Canadian GAAP.

Previously under U.S. GAAP, the Corporation accounted for its 1996 Stock Option Plan and 1998 Stock Incentive Plan under the principles of Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees and Related Interpretations" ("APB 25"). No compensation expense was recognized under APB 25 because the exercise price of the Corporation's stock options equals the market price of the underlying stock on the date of the grant.

(c) Other Comprehensive Income

U.S. GAAP requires that a statement of comprehensive income be displayed with the same prominence as other financial statements and that the aggregate amount of comprehensive income excluding the deficit be disclosed separately in shareholders' equity. Comprehensive income, which incorporates the net income (loss), includes all changes in shareholders' equity during a period except those resulting from investments by and distributions to owners. Net income (loss) for the Corporation is the same as comprehensive income. There is currently no requirement to disclose comprehensive income under Canadian GAAP.

Under U.S. GAAP there are no adjustments that resulted in changes to the Consolidated Statements of Operations and Deficit, Consolidated Statements of Cash Flows or the Consolidated Balance Sheets of the Corporation, except that under U.S. GAAP the stated capital of the Corporation's shares would be $22,901,744 higher, as would the Corporation's deficit due to the reporting difference disclosed under note 14(a).

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15. RECENT ACCOUNTING PRONOUNCEMENTS

Canadian GAAP

Recent accounting pronouncements affecting the Corporation's financial reporting under Canadian GAAP are summarized below:

(i) Convergence with International Financial Reporting Standards

In 2006, Canada's Accounting Standards Board ratified a strategic plan that will result in Canadian GAAP, as used by public companies, being converged with International Financial Reporting Standards over a transitional period currently expected to be approximately five years. The precise timing of convergence will depend on an Accounting Standards Board progress review to be undertaken by early 2008. Canadian GAAP will be converged with International Financial Reporting Standards through a combination of two methods: as current joint-convergence projects of the United States' Financial Accounting Standards Board and the International Accounting Standards Board are agreed upon, they will be adopted by Canada's Accounting Standards Board and may be introduced in Canada before the complete changeover to International Financial Reporting Standards; and standards not subject to a joint-convergence project will be exposed in an omnibus manner. As this convergence initiative is very much in its infancy as of the date of these consolidated financial statements, it would be premature to currently assess the impact of the initiative, if any, on the Corporation.

(ii) Comprehensive income

Commencing with the Corporation's 2008 fiscal year, the new recommendations of the CICA for accounting for comprehensive income (CICA Handbook Section 1530), for the recognition and measurement of financial instruments (CICA Handbook Section 3855) and for hedges (CICA Handbook Section 3865) will apply to the Corporation. In the Corporation's specific instance, the transitional rules for these sections require prospective implementation at the beginning of a fiscal year (the exception being in respect of the cumulative foreign currency translation adjustment, which is retroactively adjusted for at the beginning of the fiscal year of adoption). Currently, net income (loss) for the Corporation is the same as comprehensive income

(iii) Accounting changes

Commencing with the Corporation's 2008 fiscal year, the new recommendations of the CICA for accounting changes (CICA Handbook Section 1506) will apply to the Corporation. Most significantly, the new recommendations stipulate that voluntary changes in accounting policy are made only if they result in the financial statements providing reliable and more relevant information and that new disclosures are required in respect of changes in accounting policies, changes in accounting estimates and correction of errors. The Corporation is not currently materially affected by the new recommendations.

(iv) Business combinations

Possibly commencing in the Corporation's 2008 fiscal year, the proposed amended recommendations of the CICA for accounting for business combinations will apply to the Corporation's business combinations, if any, with an acquisition date subsequent to the amended recommendations coming into force. Whether the Corporation would be materially affected by the proposed amended recommendations would depend upon the specific facts of the business combinations, if any, occurring subsequent to the amended recommendations coming into force. Generally, the proposed recommendations will result in measuring business acquisitions at the fair value of the acquired entities and a prospectively applied shift from a parent company conceptual view of consolidation theory (which results in the parent company recording the book values attributable to non-controlling interests) to an entity conceptual view (which results in the parent company recording the fair values attributable to non-controlling interests).

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15. RECENT ACCOUNTING PRONOUNCEMENTS (continued)

(v) Financial instruments – disclosure and presentation

Commencing with the Corporation's 2009 fiscal year, the new recommendations of the CICA for financial instrument disclosures and presentation (CICA Handbook Section 3862) will apply to the Corporation. The new recommendations will result in incremental disclosures, relative to those currently, with an emphasis on risks associated with both recognized and unrecognized financial instruments to which an entity is exposed during the period and at the balance sheet date, and how an entity manages those risks. The Corporation is assessing how it will be affected by these new recommendations.

(vi) Earnings per share

Amendments were proposed to the recommendations of the CICA for the calculation and disclosure of earnings per share (CICA Handbook Section 3500); such amendments had progressed to the typescript stage. In July 2006, the typescript with the proposed amendments, which would have applied to the Corporation, was withdrawn and an announcement was made indicating that an International Financial Reporting Standards-based exposure draft from Canada's Accounting Standards Board would be issued at a later date, now expected in the first half of 2007.

U.S. GAAP.

Recent accounting pronouncements affecting the Corporation's financial reporting under U.S. GAAP are summarized below.

(i) In June 2006, FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), effective for fiscal years beginning after December 15, 2006. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes," including the recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Corporation plans to adopt FIN 48 on April 1, 2007, as required. The Corporation is currently evaluating the impact, if any, the adoption of FIN 48 will have on its consolidated financial statements.

(ii) In June 2006, FASB ratified the consensus reached by the Emerging Issues Task Force in Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That is, Gross Versus Net Presentation)." Issue No. 06-3 requires disclosure of an entity's accounting policy regarding the presentation of taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer, including sales, use, value added and some excise taxes. The adoption of Issue No. 06-3, which is effective for interim and annual reporting periods beginning after December 15, 2006, did not have an impact on the Corporation's consolidated financial statements.

(iii) In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 was issued to provide consistency between how registrants quantify financial statement misstatements. Historically, there have been two widely-used methods for quantifying the effects of financial statement misstatements. These methods are referred to as the "roll-over" and "iron curtain" method. The roll-over method quantifies the amount by which the current year income statement is misstated. Exclusive reliance on an income statement approach can result in the accumulation of errors on the balance sheet that may not have been material to any individual income statement, but which may misstate one or more balance sheet accounts.

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15. RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

The iron curtain method quantifies the error as the cumulative amount by which the current year balance sheet is misstated. Exclusive reliance on a balance sheet approach can result in disregarding the effects of errors in the current year income statement that results from the correction of an error existing in previously issued financial statements. The Corporation currently uses the roll-over method for quantifying identified financial statement misstatements. SAB 108 established an approach that requires quantification of financial statement misstatements based on the effects of the misstatement on each of the company's financial statements and the related financial statement disclosures. This approach is commonly referred to as the "dual approach" because it requires quantification of errors under both the roll-over and iron curtain methods. SAB 108 allows registrants to initially apply the dual approach either by (1) retroactively adjusting prior financial statements as if the dual approach had always been used or by (2) recording the cumulative effect of initially applying the dual approach as adjustments to the carrying values of assets and liabilities as of April 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Use of this "cumulative effect" transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose. The Corporation applied SAB 108 using the retroactive method in connection with the preparation of its annual financial statements for the year ending March 31, 2007. The adoption of SAB 108 did not result in any adjustment to the Corporation's consolidated financial statements.

(iv) In September 2006, FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS No. 157 is effective for fiscal years beginning after December 15, 2007. The Corporation plans to adopt SFAS No. 157 beginning in the first quarter of fiscal 2009. The Corporation is currently assessing the potential impact that adoption of SFAS No. 157 will have on its consolidated financial statements.

(v) In February 2007, the FASB issued FASB Statement No. 159, "The Fair

Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. FASB has indicated it believes that SFAS No. 159 helps to mitigate this type of accounting- induced volatility by enabling companies to report related assets and liabilities at fair value, which would likely reduce the need for companies to comply with detailed rules for hedge accounting. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. For example, SFAS No. 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. SFAS No. 159 does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statement No. 157, "Fair Value Measurements" (SFAS No. 157), and FASB Statement No. 107, "Disclosures about Fair Value of Financial Instruments" (SFAS No. 107). SFAS No. 159 is effective as of the beginning of a company's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the company makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. The Corporation has not yet completed its evaluation of the Interpretation, but does not currently believe that adoption will have a material impact on its results of operations, financial position or cash flows.

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