

Management's Discussion and Analysis—Guidance on preparation and disclosure



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Management's Discussion and Analysis — Guidance on Preparation and Disclosure

Preface

It is quite clear that financial statements alone are not sufficient to communicate companies' overall performance. Senior management, boards of directors, audit committee members, investors, investor analysts, lenders and other creditors now turn to a broad array of information in order to understand and evaluate the overall performance and prospects of an organization. In particular, Management's Discussion and Analysis (MD&A) has become a core element of the communication package for external reporting purposes. In recognition of its importance, the Canadian Securities Administrators (CSA) set out rules for its preparation in National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102). There are also a number of Staff Notices available on the websites of the securities commissions on specific areas such as OSC Staff Notice 51-721 *Forward-Looking Information Disclosure*, Revised CSA Staff Notice 52-306 *Non-GAAP Financial Measures and Additional GAAP Measures* or OSC Staff Notice 52-722 *Report on Staff's Review of Non-GAAP Financial Measures and Additional GAAP Measures*.

Management's Discussion and Analysis: Guidance on Preparation and Disclosure is published by CPA Canada in recognition of the importance of MD&A as a financial reporting communications tool. It is hoped that this Guide will assist senior management and boards of directors by providing principles and a reporting framework when preparing and issuing MD&A reports. While the

guidance focuses on MD&A in annual and interim reporting, it should also be a useful resource when preparing MD&A in connection with an initial public offering.

Originally published in November 2002 and revised in 2004 and 2009, the 2014 revisions reflect changes in legislation, securities regulation, the economic environment, the transition of accounting standards to International Financial Reporting Standards and ongoing enhancements in best practices in MD&A reporting. While there has been much progress in reporting since 2002, reviews of published MD&A continue to demonstrate that more improvement is needed.

CPA Canada's involvement with *Management's Discussion and Analysis: Guidance on Preparation and Disclosure* has been through its Canadian Performance Reporting Board (CPRB). The CPRB's mandate is to advance the measurement and reporting of organizational performance. In fulfilling its mandate, the CPRB publishes guidance documents and awareness-raising reports.

The development process for the guidance included review by a working group of the CPRB and the CPRB's approval of this material. While representing views of the CPRB, this non-authoritative guidance is not a substitute for the securities regulators' materials. In particular, it should be noted that this guidance has not been reviewed by the CSA.

Management's Discussion and Analysis: Guidance on Preparation and Disclosure will be regularly updated to reflect regulatory and legislative changes as well as continuing evolution of best-practices reporting.

July 2014

Executive Summary

The purpose of this publication is to enable preparers, management, audit committee members, and boards of directors of all companies and other entities to prepare, present and review a useful MD&A in a way that maximizes value for primary users of a company's financial reports; namely, investors, investor analysts, lenders and other creditors.

Management is better positioned than outsiders to provide information about a company to capital markets. The MD&A can be a powerful tool for management to communicate how the company has created value and how it plans to continue doing so. The MD&A, in combination with the financial statements, provides the opportunity for a company to communicate the effectiveness of its stewardship of resources and to further progress towards its stated strategic objectives. While the MD&A provides material information about the company that users need to know, it is important to recognize the inherent limitations of the MD&A; namely, the MD&A is prepared at one point in time, and the MD&A does not necessarily contain all the material information about the company. There are other publicly-filed documents that contain information about the company, such as the Annual Information Form (AIF), Information Circular, press releases and material change reports.

The objectives of the MD&A are to:

- enable readers to view the company's performance, financial condition and future prospects through management's eyes
- provide material information to readers that may not be fully reflected in the financial statements
- supplement and complement the information in the financial statements by helping readers understand what the financial statements show and do not show

- outline key trends and risks that have affected or could affect the current and future financial statements
- provide discussion about the quality of earnings and cash flows and potential variability of the components within earnings and cash flows

To help achieve these objectives, the publication discusses in detail the six key general disclosure principles that should be considered by MD&A preparers and reviewers.

Furthermore, this publication provides a framework and discusses the five key elements of the disclosure framework to assist readers and preparers:

- core businesses
- objectives and strategy
- capability to deliver results—resources, risks and relationships
- results and outlook
- key performance measures and indicators

This framework is provided as a reporting tool and is not a template as different companies will have differing specific disclosure needs. Management should determine the best way to structure and frame their MD&A disclosures.

As a cornerstone of continuous disclosure, the MD&A should incorporate key information needed by readers that appears elsewhere. The interim MD&A should update previous disclosures about business strategy, performance measures and indicators, resources, risks, relationships and outlook but should avoid duplicating disclosure that has already been provided in the annual MD&A.

With respect to oversight, management and boards of directors need to ensure that they have the systems, controls and processes in place to assess whether all information for the MD&A is collected, summarized and communicated on an accurate and timely basis. As well, the guidance advocates disclosure of the responsibilities of each of management, the audit committee and the board of directors in producing the MD&A.

It is crucial for companies to prepare an MD&A in a way that is useful for primary readers of a company's financial reports. This publication provides principles and a framework to help preparers, management, audit committees and boards of directors prepare, organize and review the MD&A. For additional resources to help MD&A preparers, refer to CPA Canada's website at www.cpacanada.ca.

PART 1

Introduction

1.1 Purpose of MD&A

The purpose of the MD&A is to provide a narrative explanation, through the eyes of management, of how a company has performed in the past, its financial condition and its future prospects. In so doing, the MD&A provides investors, analysts, lenders and other creditors with information to help them make decisions and to decide whether to continue to invest in or provide loans to a company.

The MD&A should supplement and complement the information provided in the financial statements. Together, both reporting documents form the foundation for financial reporting.

The MD&A should be written primarily for current and prospective investors, analysts, lenders and other creditors, recognizing that others may rely on the MD&A. Companies should provide sufficient information to meet the needs of these primary users, organized and presented in language and formats to make the MD&A clear and straightforward.

1.2 Benefits of MD&A Disclosure

Management is better positioned than outsiders to provide useful information about a company to capital markets. The MD&A can be a powerful tool for management to communicate how the company has created value and how it plans to continue doing so. The better a company communicates with users, the better those readers can understand the company's underlying potential and prospects.

The MD&A, in combination with the financial statements, provides the opportunity for a company to communicate the effectiveness of its stewardship of resources and, further, progress towards its stated strategic objectives.

The MD&A can be used to integrate and accumulate, in one location, important information about the company that investors need to know. In addition to providing information for investors, many companies use the MD&A to help orient potential or new stakeholders and others interested in knowing about a company's performance and prospects.

The internal processes, systems and discipline required to prepare an effective MD&A can deliver significant benefits to companies by sharpening organizational focus, providing new insights into key performance measures and indicators, promoting accountability and control, and facilitating benchmarking of performance.

1.3 CPA Canada—Guidance on MD&A

The purpose of this guidance is to enable management, audit committee members and boards of directors of all companies to prepare, present and review the MD&A in a way that maximizes its usefulness for readers.

This publication provides principles and a framework to help preparers identify and organize information for their MD&A disclosures. The framework provides a structure for preparing a fact-based disclosure document that gives a reader the ability to look at the issuer “through the eyes of management.”

The review of the MD&A by the audit committee,¹ approval of the MD&A by the board of directors² and certification by the CEO and CFO are all important aspects of corporate governance. This guidance recognizes the importance of this responsibility and advocates disclosure in the MD&A of the role of the audit committee, the board of directors as well as the CEO and CFO with respect to the MD&A.

The MD&A disclosure framework recognizes that different companies have different specific disclosure obligations. Differences may arise, for example, because of industry-specific disclosure, or complexity or diversity of operations. Thus, this publication does not provide a standard checklist or template for preparation of MD&A disclosures.

1 National Instrument 52-110 *Audit Committees*.

2 National Instrument 51-102—The board of directors must approve the annual and interim financial statements and MD&A. However, the board of directors may delegate approval of the interim financial statements and MD&A to its audit committee.

Many parts of this document can be adapted and applied by public companies and not-for-profit organizations for effective communication about past and prospective performance.

Additional material to help MD&A preparers is available at CPA Canada's website at www.cpacanada.ca.

1.4 Structure of this Publication

The remainder of this publication is structured as follows:

- Part 2 presents general disclosure principles.
- Part 3 outlines a framework for organizing, preparing and communicating the information to be disclosed.
- Part 4 discusses MD&A reporting within the context of continuous disclosure.
- Part 5 provides guidance about ensuring the reliability and timeliness of MD&A disclosures.

The third, fourth and fifth parts include recommended practices.

PART 2

General Disclosure Principles

2.1 Principle 1: Through the Eyes of Management

A company should disclose information in the MD&A that enables readers to view it through the eyes of management.

This principle is consistent with Canadian securities regulations that state that the “MD&A is a narrative explanation, through the eyes of management, of how your company performed during the period covered by the financial statements, and of your company’s financial condition and future prospects.”³ The concept of “Through the Eyes of Management” is fundamental to MD&A reporting.

This principle requires disclosure of appropriate elements of the information used by management for internal purposes and recognizes the need to align internal and external reporting. The information that is relied on in managing the company, including that which forms the basis of presentations to the board of directors, is precisely the information investors need to view the company through the eyes of management.

In determining the nature and extent of internal information to be reported, companies need to balance the benefit of disclosure against competing demands, while recognizing that they have disclosure obligations under CSA rules. On the one hand, as noted, the better the disclosure, the better readers will understand potential and prospects. On the other hand, companies are reluctant to report confidential or commercially sensitive information that could be useful for competitors or that could affect the customer base.

³ Form 51-102F1 *Management’s Discussion & Analysis*.

While this principle calls for disclosures to reflect management's perspective, every reporting issuer's MD&A is subject to a review by the board of directors and/or audit committee to ensure completeness and balance.

2.2 Principle 2: Integration with Financial Statements

MD&A should complement, as well as supplement, the financial statements.

The MD&A and the financial statements are jointly relevant to understanding a company's financial performance. This principle reinforces securities regulations; namely, that the MD&A “complements and supplements your financial statements, but does not form part of your financial statements.”⁴ The MD&A supplements financial statements by providing analyses of the information it contains about financial position and performance. It complements financial statements by presenting contextual and prospective information that financial statements do not provide.

In supplementing financial statements, disclosure in the MD&A should: (1) explain the conditions and events that shaped the results reflected in the financial statements and (2) help in understanding how past conditions and events may give rise to future financial consequences.

In complementing financial statements, the MD&A should provide useful qualitative and quantitative information about the business and its performance that is not reported in financial statements but which is relevant to the evaluation of past results and assessment of future prospects.

As well, it should be noted that securities regulators' CEO and CFO certifications require a statement that the annual and interim filings have “no misrepresentations” and “fairly present” in all material respects the financial condition, financial performance and cash flows, without reference to IFRSs.

The MD&A must be a self-contained document that complements and supplements the financial statements. The MD&A must be capable of being read by itself and should not address any aspects of the story it tells by asking the readers to look to other documents. While ensuring the MD&A is integrated with the financial statements, it is important to note that cross-referencing is not an option.

4 *Ibid.*

Under its continuous disclosure review program, the Canadian Securities Administrators (CSA) periodically reviews various aspects of external reporting disclosures, including the MD&A. The results of the reviews undertaken in the year ended March 31, 2014 are summarized in CSA Staff Notice 51-341.

2.3 Principle 3: Completeness and Materiality

MD&A should be balanced, complete and fair as well as provide information that is material to the decision-making needs of users.

An MD&A should present faithfully the substance of what it purports to represent. It needs to be fair, avoiding promotional language and exaggeration. It is critical for management credibility that the MD&A be balanced in its disclosures, being free from deliberate or systemic bias, and openly reporting bad news as well as good news, thus avoiding the promotion of overly optimistic or pessimistic expectations. The MD&A should be transparent and discuss ranges of possibilities and possible outcomes.

Completeness calls for management to identify, address and communicate the qualitative and quantitative information necessary for users to understand and evaluate the company's strategy, business, results, financial condition, risks and prospects. This includes information about off-balance sheet arrangements such as obligations under certain guarantee contracts, retained or contingent interests in assets transferred to an unconsolidated entity, any obligation under certain derivative instruments or any obligation under a material variable interest in unconsolidated entity that provides financing, liquidity market risk or credit risk support to the company or engages in leasing, hedging or research and development activities with the company.⁵

Providing complete and balanced information includes disclosing information that is material to the decision-making needs of MD&A readers. As mentioned in the previous section, CEO and CFO certifications require a statement that the annual and interim filings have "no misrepresentations" and "fairly present" in all material respects the financial condition, financial performance and cash flows, without reference to IFRSs.

To enable readers to see the company through the eyes of management, all relevant information should be disclosed within the MD&A. Management can consider and opt to report certain information in the MD&A that is included

⁵ Form 51-102F1 *Management's Discussion & Analysis*.

in other documents such as the annual information form (AIF), website, press releases, material change reports, information circular, statement of executive compensation or business acquisition reports.

The MD&A should be free from material error and omission. Information is likely material if its omission or misstatement would be likely to influence or change the decision of a reasonable investor to invest or continue to invest in the company. Management's determination of materiality applies not only to financial statement disclosures but also to all information, qualitative as well as quantitative, prospective as well as historical, disclosed in the MD&A. Individual qualitative or quantitative items that in themselves may not be material may become so when considered as elements in the larger picture or when considered from the perspective of the company's future prospects. On the other hand, an item that may seem material in isolation may be immaterial when considered in the larger context. Materiality should always be assessed with regard to all aspects of the larger picture and relevance to future prospects. Management should avoid obscuring material disclosures with unnecessary disclosures of immaterial information.

If there is a time lapse between the date of the MD&A and its release, management should ensure that the information it contains is still materially complete, fair and balanced at the date of release. If there is some event that occurs after the reporting date but before the release of the MD&A, management should determine if the event is an adjusting event or a non-adjusting event. An adjusting event is an event that provides further evidence about conditions that existed at the end of the reporting period. For instance, the settlement of litigation for events that occurred before the end of the reporting period is considered an adjusting event. The financial statements and related MD&A discussion are adjusted for an adjusting event. In contrast, a non-adjusting event refers to conditions that transpired after the end of the reporting period. For instance, the initiation of a significant lawsuit against the company arising out of events that occurred after the reporting period is considered a non-adjusting event. In this case, material non-adjusting events require disclosure in the financial statements and MD&A.

Another area to consider in a broader sense is that of changes in the economic environment and related risks that occurred after the end of the reporting period, but before the release of the MD&A. Such changes may not necessarily result in adjustments to the financial statements; however, because of their impact on the company, the previous discussion in the MD&A may no longer be considered fair and balanced at the date of release. Management should review the MD&A before its release to ensure it is still fair and balanced.

2.4 Principle 4: Forward-Looking Orientation

A forward-looking orientation is fundamental to useful MD&A reporting.

A forward-looking orientation calls for the MD&A to explain past events, decisions, circumstances and performance in the context of whether they are reasonably likely to be indicative of, and have a material impact on, future prospects. It also calls for an MD&A to describe management's strategy and future events, decisions, circumstances, opportunities and risks that management considers likely to materially impact future prospects.

Forward-looking information is an important element of the forward-looking orientation. Forward-looking information is broadly defined by securities regulators as "disclosure regarding possible events, conditions or financial performance that is based on assumptions about future economic conditions and courses of action and includes future-oriented financial information with respect to prospective financial performance, financial position or cash flows that is presented either as a forecast or a projection."⁶

CSA regulations require that a company discuss known trends, risks or uncertainties that are reasonably likely to affect the company in the future but do not otherwise require disclosing forward-looking information. Nevertheless, many companies disclose forward-looking information of various kinds because primary users, such as investors, analysts and lenders, find this information useful. It should be noted that when forward-looking information is provided, it is subject to various CSA requirements.⁷ It should also be noted that forward-looking statements can be considered misleading if they are overly optimistic or lack objectivity.

There needs to be a reasonable basis for forward-looking information. In making this assessment, preparers should consider the reasonableness of the assumptions underlying the forward-looking information and the process followed in preparing and reviewing forward-looking information.⁸ They should disclose the relevant material factors and assumptions made, including, for example, their source, how the assumptions relate to actual past experience in the company and/or the industry, and the changes needed in the business for the assumptions to translate to actual experience. Typically, a reasonable basis

6 National Instrument 51-102 *Continuous Disclosure Obligations*

7 The CSA requirements for forward-looking information are set out in National Instrument 51-102, Parts 4A and 4B and section 5.8.

8 National Instrument 51-102 *Continuous Disclosure Obligations*.

for forward-looking information is more likely to exist when it relates to a company's continuing activities rather than to a new venture (for example, sales of a new product line).

When forward-looking information takes the form of quantified financial information, it should be limited to a period that can be reasonably estimated and should be based on assumptions that are reasonable in the circumstances. To provide a complete picture, management must provide an explanation if the company exceeds or falls short of previously disclosed future-oriented financial information (FOFI) or financial outlook.⁹

The diligence process followed with respect to the release of forward-looking information should also be considered. This includes, for example, the senior management members who are consulted about assumptions and risk factors, the controls around the completeness and accuracy of the gathering and computation of the information, and the approval process for disclosure. The audit committee and board of directors should consider reviewing and approving the initial forward-looking information disclosure, asking questions of management on the assumptions used to develop the forward-looking information, determining if updates are required and approving the targets before public disclosure occurs.

2.5 Principle 5: Strategic Perspective

The MD&A should explain management's strategy for achieving short-term and long-term objectives.

MD&A disclosure should provide the information that a reasonable investor would want to know in making an investment decision with a view to value accruing over time. This will involve integrating quantitative and qualitative information in a way that communicates the strategy for generating value for investors over time. To help investors understand the strategic direction of a company, management should consider disclosing objectives and the related strategies as well as indicating the resources available or to be obtained to help implement the action plans. The MD&A should discuss performance against milestones that show progress towards achievement of longer-term goals.

⁹ Financial outlook refers to forward-looking financial information that is not presented in the format of historical financial statements. Some examples of financial outlook could include, but are not limited to, projected earnings per share or earnings guidance or research and development spending. In contrast, FOFI is forward-looking information presented in the format of historical financial statements.

The nature of the industry will affect management's determination of an appropriate long-term perspective for MD&A reporting. In determining the time period that needs to be discussed, consideration will also need to be given to the time horizons of the company's longer-term investors.

2.6 Principle 6: Usefulness

To be useful, MD&A should be understandable, relevant, comparable, verifiable and timely.

Understandable

Management should provide commentary in a clear, concise and straightforward manner by:

- focusing on material information
- using plain language
- avoiding boilerplate disclosure

To be understandable, an MD&A should be written in plain language, with candour and without promotional language or exaggeration. Companies should consider using graphics and tables with explanatory narratives where these would enhance understanding. With respect to the MD&A format, companies have many options and are free to present the information in any order required and are not bound by traditional approaches to formatting. For an MD&A to be useful to a reader, the use of boilerplate language and carrying forward wording from the last MD&A should be avoided, as the discussion should be tailored to the specific company.

Relevant

Information is considered relevant if it has the capacity to make a difference in the decisions made by readers. Focusing on material information in the MD&A is an important aspect of providing relevant information in the MD&A. Regulators indicate when determining materiality, companies should consider if a reasonable investor's decision whether or not to buy, sell or hold securities in a company would likely be influenced or changed if the information was omitted or misstated.¹⁰ It is important to note that materiality will differ for each company and can change period to period.

¹⁰ Form 51-102F1 *Management's Discussion & Analysis*.

Information most important to MD&A readers should receive appropriate prominence. The MD&A should not be a list of every issue facing the company. It should focus on those matters that management perceives to be the most important in its specific business context, describing and explaining its approach to those matters.

Comparable

Information is comparable when sufficient commentary and disclosure have been provided so that similarities and differences between periods and between and within companies can be discerned and evaluated, including disclosures about accounting policies and changes therein. Comparability facilitates benchmarking among companies and business segments.

Comparability includes consistent reporting over successive reporting periods and enables trend identification and analysis. Any changes in matters being reported, or in their computation, should be explained unless irrelevant or immaterial. If the information is no longer relevant or material, why this is so should be explained. Companies should discuss and update previously raised issues in subsequent MD&A reports.

Verifiable

The use of verifiable information in the MD&A helps assure readers that the information faithfully represents what it purports to represent. Verifiability means that various knowledgeable and independent readers could reach a consensus, not necessarily full agreement, that a particular interpretation or portrayal is a faithful representation.

Timely

Timely disclosure of material information is important as it puts all current or potential investors in the market on an equal footing and ensures that information is available to users in time to be capable of influencing their decisions. It is important to note that the MD&A is prepared as at a point in time and provides only a snapshot of the company for the specified period. Consequently, for any occurrences happening that are considered material to the company between the issuances of interim reports, the company must issue and file a news release and, in some cases, a material change report.

PART 3

The Disclosure Framework

3.1 Introduction

This publication advocates that companies structure and integrate their MD&A disclosures within a broad reporting and disclosure framework.

The framework is presented as a reporting tool tailored to the context of a particular business, not a template. Management should determine the best way to use the framework to organize its MD&A disclosures and place information in a meaningful context. To assist readers, management may wish to provide a content map that shows how the various aspects of the framework have been addressed in the MD&A. Consideration should also be given to providing a table of contents for readers of the MD&A.

RECOMMENDED PRACTICE

The MD&A should communicate information that helps users understand past performance and future prospects. Five key elements of the disclosure framework to achieve this are:

- core business
- objectives and strategy
- capability to deliver results—resources, relationships and risk
- results and outlook
- key performance measures and indicators

Information should be presented as an integrated package, with emphasis given to linking relevant past performance to future prospects.

Consideration should be given to prefacing the MD&A with an executive summary that highlights key matters and helps frame and focus the MD&A. An effective executive summary provides a helpful overview of the company and its core businesses and discusses the highlights for the period. The executive summary should cross-reference the more detailed discussion in the body of the MD&A.

An MD&A that perfectly presents and analyzes historical information can be misleading if it fails to discuss known matters about future prospects that will affect results. Therefore, the recommended disclosure framework emphasizes a forward-looking orientation, even in the analysis of past performance. In particular, such analysis should focus on management's insights into the extent to which past performance is a predictor of future prospects. Whenever possible, historical analysis and prospective outlook should form a continuum of information in the MD&A, rather than being presented as stand-alone disclosures of distinct and unconnected data. Such a continuum explains the "linkages between past performance and future prospects."

While this guidance addresses forward-looking disclosure considerations in the outlook section of the disclosure framework, the same considerations apply in any area of the MD&A that contains forward-looking information.

The elements of the disclosure framework will be discussed as follows:

- 3.2 Core Businesses
- 3.3 Objectives and Strategy
- 3.4 Capability to Deliver Results—Resources, Relationships and Risk
- 3.5 Results and Outlook
- 3.6 Key Performance Measures and Indicators

3.2 Core Businesses

Readers of the MD&A need a clear understanding of what the company does, its core businesses and segments, and where it operates. Readers also need an overview of management's assessment of the significant factors, trends, strengths, weaknesses, opportunities and threats—in the external environment and within the organization—that shape the key strategies.

RECOMMENDED PRACTICE

The MD&A should disclose the company's core businesses, including all significant segments.

Disclosures typically include at least the following:

- a description of the company structure
- a description of each core business in which the company operates, including the total size of the business, its growth, and other relevant features
- a description of those aspects of each core business that are distinctive to the company, including the principal products produced and/or services rendered, the principal markets served and the methods of distribution, market share, major competitors and their market share, and appropriate business segment information
- a discussion about key aspects of the legal, regulatory and economic environment that affect how the business segment or company operates

Although the discussion focuses on the core businesses, management should also disclose material information about non-core businesses. If a company's non-core activity is going to be key for the future strategy of the company, this warrants discussion in the MD&A.

3.3 Objectives and Strategy

Management should disclose the appropriate level of information about the company's objectives and strategy to enable an investor to understand its priorities and how it plans to achieve those objectives. This should include information for the company as a whole and for each of its core businesses and significant segments:

- significant long-term business objectives, strategy, goals or targets and shorter-term priorities for each core business, including each significant segment, and for the company, as appropriate
- attitude to and tolerance for risk
- extent to which each core business is managed at the local level or through central oversight
- strategy for developing, maintaining or reducing productive capacity
- financing strategy, including considerations in determining the optimal capital structure, targeted debt-to-equity ratios and hedging strategies
- the strategic direction and financing implications behind acquisitions and dispositions
- outsourcing practices, strategic business relationships and related finance implications
- the company's focus regarding research and new product development
- marketing, distribution, pricing and customer credit arrangements

A clear picture of the company's past intentions compared to what the company achieved and what it wants to achieve in the future is essential to readers' understanding of the company. Accordingly, the strategy section should be integrated with other sections of the MD&A.

RECOMMENDED PRACTICE

MD&A should disclose the key features of the company's strategy, including the underlying rationale, context and factors considered by management in developing strategy. This rationale should relate to both internal and external factors, and to opportunities and risks. Disclosures of key assumptions upon which the strategy depends should indicate how changes in these assumptions could impact the implementation of strategy.

Readers of an MD&A need to understand not only the “what” but also the “why” and the “how” of the strategy. The “why” and the “how” should address the underlying rationale supporting the strategy, highlighting the key assumptions upon which implementation of the strategy depends. Management also needs to explain how it will measure its success in implementing strategies and achieving its objectives and should estimate the time over which the action plan will be achieved. Linking objectives, strategy, management actions and resources needed to achieve goals is useful to readers trying to understand the business and make investment decisions.

It is important to link information so that MD&A readers understand how internal and external events and/or activities may affect the company's performance in achieving its strategies and goals. For example, an external event such as climate change may impact business strategy and necessitate discussion of goals for greenhouse gas emission reductions. Disclosures of issues that may affect performance often benefit from including sensitivity analyses regarding the potential impacts of variations in the assumptions on which successfully implementing the strategy depends.

Information provided in the MD&A about strategy should be consistent with what is reviewed and approved by the board of directors in discharging its oversight and governance responsibilities.

3.4 Capability to Deliver Results—Resources, Relationships and Risk

Resources and Relationships

Readers of MD&A need to understand how well the company is equipped to execute strategy and achieve planned results. Capability refers to all the significant resources and relationships needed to deliver results and to the risks that can affect achieving these results. Resources include property, plant and equipment, intangible assets, working capital and other aspects of liquidity, capital structure, capital resources, leadership, general labour force, and systems and processes.

RECOMMENDED PRACTICE

The MD&A should describe the capability of the company as a whole and of each core business, including each significant segment, to execute its strategy, manage its key performance measures and indicators, and deliver results.

Disclosures about property, plant and equipment, and intangible assets should explain their relationship to the company's strategy; namely, management's strategy with regard to productive capacity,¹¹ focusing on changes in the period. For example, changes in property, plant and equipment, technologies, permits and patents, and systems and processes can be discussed in terms of their contribution to decreasing, maintaining or growing the company's productive capacity. This discussion should also address how plans for the future are expected to affect productive capacity.

Another example of capabilities discussed in the MD&A is the company's leadership. Investors often want to know the qualities of a company's leadership that distinguish it from its competitors. Although most of this type of information is included in the AIF and information circular, it can be beneficial for the company to consider disclosing some of the key aspects in the MD&A. For instance, the MD&A could communicate how the metrics for executive compensation support the company's strategy and performance drivers and how they relate to the company's key performance indicators.

¹¹ Productive capacity can be considered as a company's accumulated capital investment, and periodic changes therein, expressed not in monetary terms but in terms of the company's ability to convert inputs into outputs of goods and services that can be sold.

The need for other resources—such as research and development activities, or management systems and processes—should be discussed to the extent that they have a material effect on the company's ability to deliver results. Matters to address in this discussion include the nature of the resource, plans to maintain any unusual strengths and address any weaknesses.

Adequate liquidity is essential to a company's ability to deliver results. The MD&A should analyze changes in the period, including the reasons for changes in working capital and how seasonal, cyclical and volume changes affect the company's working capital requirements and its ability to generate sufficient cash and cash equivalents to meet the company's planned activities. The impact of non-operating items on liquidity should also be discussed. This may include the source of funding for debt repayments, capital expenditures, planned dividends and other planned distributions, and share repurchases.

A discussion of liquidity includes:

- the terms of and changes in credit facilities, debt covenants and debt repayments, including the effects of any non-compliance or anticipated non-compliance with terms
- risks associated with financial instruments and other sources of liquidity, including any terms that could trigger an additional funding requirement or early payment to counterparties; and circumstances that could impair the company's ability to undertake transactions considered essential to operations
- any legal restrictions on the ability of subsidiaries to transfer funds to the company and the impact on the company to meet obligations

This discussion should be supplemented with an analysis of the adequacy of the company's capital structure and resources, focusing on their ability to provide sufficient liquidity in the short-term and long-term, ability to make or continue to make dividend payments and describing how the company will address any working capital deficiencies. The analysis should address matters such as the timing for debt maturities, timing for the renegotiation of credit facilities, anticipated terms of any new debt, commitments for capital expenditures, other expenditures planned to maintain or grow capacity, and restrictions in accessing the net assets of subsidiaries.

Off-balance sheet arrangements should be discussed in the MD&A if they will have, or are reasonably likely to have, a current or future impact on the company's financial condition or financial performance, including liquidity and capital resources.

The MD&A should outline the nature and extent of financial instruments, risks associated with the financial instruments, how those risks are managed, the accounting treatment of the instruments and the methods used to determine their fair values.

Capabilities are often provided through supply chain relationships, outsourcing, strategic alliances, joint ventures and other types of business partnering. Companies also establish financing strategies that involve structured entities to finance their operations. The combined effect of all these relationships is referred to as the extended entity. When these relationships significantly impact the capabilities of the company, MD&A disclosures regarding extended-enterprise issues should address matters such as:

- nature, magnitude and reliability of the extended entity relationships, including strategic, operational, and financing relationships
- degree of management or board of director involvement in these relationships
- those relationships also considered to be “related parties”
- extent of economic dependency of the company on such relationships

Disclosure about these significant relationships helps readers understand how they impact performance and the value of the company as well as indicating if the relationship exposes the company to significant risk.

Risk

Risk encompasses exposure to negative consequences (“downside”) and the possibility that positive consequences (“opportunities”) will be missed. Risk can be viewed as the variability around an outcome where there is uncertainty about timing and the consequences if the risk materializes. For the most part, risk reporting in the MD&A tends to focus on the exposure to negative consequences, such as incurring losses or reduced revenues or profit.

The risk discussion in the MD&A typically includes:

- trends and risks that have impacted the financial statements
- trends and risks that are reasonably likely to affect the financial statements in the future
- information about the quality and potential variability of profit or loss and cash flow

RECOMMENDED PRACTICE

The MD&A should disclose risks that are material and company specific. The MD&A should provide an objective view and clearly define key risks that impact the company. Furthermore, the company should disclose company and segment-level risks when the company has diverse operations.

Here again, only material information needs to be disclosed. The company should assess whether an existing risk is reasonably anticipated to materially affect the company's current or future results when determining if it should be disclosed. Nevertheless, disclosure of a risk with a low incident rate but potential high impact should also be carefully considered. The key judgment involved in assessing materiality is—would an investor's decision to buy, sell or hold securities in the company likely be influenced or changed if the information was omitted or misstated? If yes, then generally the information is material and should be disclosed.

The risk discussion should focus on the risks that matter to the company rather than listing every conceivable risk. Dwelling on irrelevant or less important risks confuses readers who will likely not be able to easily distinguish the relative significance of the various risks. Companies should invest resources necessary to ensure that risks are being filtered and prioritized based on materiality, resulting in a focus on the principal risks. To accurately point out the key risks and engage the reader, boilerplate language should be avoided. The risk discussion should be sufficiently detailed to convey the significance of the risk to the company.

All discussions related to risk must be objective and factual. Readers turn to the MD&A for a balanced reporting of the company's activities and risks. The purpose of the risk section is to provide readers with an unbiased analysis of the things that could go wrong. This clear articulation of the risks gives the reader a better understanding of the company's risk analysis and management.

Companies with diverse segments covering various industries will provide readers a better grasp of risks by breaking down their risk discussion by segment.

RECOMMENDED PRACTICE

The MD&A should demonstrate and communicate the ability of the company to identify and respond to key risks affecting the company. Where possible, it should indicate the potential impacts of key risks.

In the CPRB's view, a company should not only discuss risks but also how the company manages those risks. Understanding the company's risks and risk management helps readers see the company through the eyes of management. Good risk disclosure allows readers to better appreciate how different risks impact various elements of the business. Assessing, monitoring and disclosing risk should result in the company having better stewardship and allocation of resources. In addition, the process of reporting on risk may help companies improve management of their risks.

A CPA Canada review of corporate risk reporting found that companies excelling at risk reporting took the discussion of risk management a step further by articulating what comprises a risk, how they assess risks, when they determine a risk to be material, and who is responsible for identifying and managing each risk. In addition, these top reporters provided specific (as compared to generic) details and action plans on how the company was mitigating each risk. While a full reporting of the risk management process helps readers assess the quality of the company's risk management, it is important to have balanced disclosure to ensure readers are not misled to believe a risk is fully mitigated or not ever likely to materialize. This disclosure must also be candid. Extensive risk mitigation disclosure could impede a company's defense in response to a legal action for misrepresentation in its continuous disclosure. Consequently, reporters need to carefully consider and determine their detailed risk mitigation disclosure.

Readers want to know the potential impact on results, operations or reputation if a specific risk materializes. Even though it is often not possible to quantify the impact of a risk's materialization, a qualitative discussion should address its nature (for example, the type of costs involved, assets affected or possible time horizon for the duration of any disruption).

RECOMMENDED PRACTICE

Risks should not be addressed in isolation—it is important to integrate risks throughout the MD&A.

While the AIF contains a detailed discussion of the risks, management can assess and discuss the key risks in the MD&A as well as the related risk management strategy. Risks impact many aspects of a company's operations and should not be addressed solely in a section devoted to risks. Addressing risk throughout the MD&A and having cohesive messaging in the annual report signal to readers that management understands the company's risks and manages them accordingly.

3.5 Results and Outlook

Readers of the MD&A need an analysis of past results to understand how management has performed with the resources at its disposal. An analysis of past results alone, however, can be misleading. In addition, readers need to understand the extent to which these results are indicative of future prospects and management's assessment of those prospects. Accordingly, this guidance document also calls for an outlook for the company.

Results

RECOMMENDED PRACTICE

The MD&A should provide a detailed, analytical and quantified discussion of the various factors that impact the results for items such as revenues and expenses.

The MD&A should discuss the results for the company as a whole as well as for each core business, including each significant segment, and provide an analysis of past results. This analysis, together with other information, should provide an indication of the extent to which past results will likely impact future prospects.

The analysis of past results should be an insightful explanation of the company's performance against its strategy and goals and of management's effectiveness in using the resources at its disposal. It should not be a boilerplate or line-by-line repetition of information that is contained in, or readily derived from, the accompanying financial statements. The past results analysis needs to provide further detail on some of the income statement line items to provide the necessary insight.

The analysis of past results should focus on explaining changes in financial and non-financial key performance indicators and their implications for the company's future prospects. Such an analysis should review trends in key performance indicators, discussing reasons for and changes in trends, including the impact of seasonal or cyclical fluctuations. The analysis should also be supplemented with information about known factors that, in management's opinion, will likely impact future prospects—factors such as significant conditions, demands, commitments, events, contingencies and risks or uncertainties.

Judgement should be used to determine how far into the past the analysis of past performance should extend. In some cases, it will be sufficient to present the analysis of past performance for the preceding year. In other cases, it may be necessary due to circumstances such as the industry cycle or the impact of non-recurring events for the analysis to cover additional comparative periods.

The analysis of results should focus on continuing operations, reconciling differences between results of continuing operations and reported financial results as a whole, including explanations of the basis on which any items have been eliminated. As well, management should distinguish and explain how continuing operations have been affected by:

- discontinued operations
- acquisitions and dispositions
- impairments

RECOMMENDED PRACTICE

The MD&A should report supplementary financial measures when management determines that they will be relevant to users. A supplementary financial measure is relevant to users when it is used by management, in the entity's industry or by investors. Supplementary financial measures should be accompanied by appropriate reconciliations, explanations and contextual disclosures.

Supplementary financial measures are those financial measures not specifically identified by the GAAP framework used by the company, such as Free Cash Flow or Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). They have become increasingly popular among preparers and investors who find they provide additional analytical insight into a company's performance and financial condition, expand on information provided by the financial statements, and are useful in communicating information that complements and supplements the financial statements.

A major issue with respect to supplementary financial measures is the lack of consistent definitions governing their calculation and disclosure, even among companies in the same industry. This lack of standard definitions is one reason that regulators have restricted the use of some measures in financial statements and require extensive disclosure and reconciliations with audited financial statement numbers when they are used elsewhere. However, the widespread use of such measures, even given such inconsistencies, indicates that

users believe they have value. Investors have indicated that, while they would prefer some degree of standardization in supplementary financial measures, they will likely continue to use non-standardized company-specific information.

CSA Staff Notice 52-306 (Revised) “*Non-GAAP Financial Measures and Additional GAAP Measures*” provides guidance to issuers that choose to disclose supplementary financial measures. Refer to the OSC Staff Notice 52-722 *Report on Staff’s Review of Non-GAAP Financial Measures and Additional GAAP Measures* to review the results of the OSC’s disclosure review in this area.

RECOMMENDED PRACTICE

The MD&A should highlight accounting policies and critical accounting estimates that are particularly important to understanding reported results and should explain how these policies and estimates impact reported results. In addition, the MD&A should address any changes in accounting policies and estimates, including those expected to be adopted after the period end.

When different accounting policies are used within an industry, the MD&A should highlight the policy adopted and the rationale for its selection. Readers also need to understand the effect of any changes in accounting policies.

Critical accounting estimates should be identified and described, including discussion around the methodology and range of assumptions used to determine the estimates as well as the trends, events or uncertainties that could impact the methodology or assumptions outlined.¹² Further disclosures required with respect to critical accounting estimates and changes in accounting policies are outlined in National Instrument 51-102F1.

RECOMMENDED PRACTICE

The MD&A should discuss the impact of fair value measurements on a company’s financial performance and on the carrying values of items on its statement of financial position, and should provide management’s perspectives on the fair value disclosures.

¹² Securities regulators prescribe various disclosures for critical accounting estimates at Form 51-102 F1, Item 1, section 1.12.

Investors need to understand how changes in fair value measurements have impacted a company's performance and its financial position. When performance is affected by fair value changes, the following suggestions should be considered for the MD&A discussion:

- Distinguish between components measured in different ways—the profit analysis should distinguish between historical cost or fair value amounts when these appear in the same financial statement line item.
- Discuss the additional factors that impact performance, for example, changes in the real and nominal interest rates, credit risk changes or timing of cash flows.
- Consider both realized and unrealized amounts, separately from the changes in valuation parameters. An analysis of changes to an item carried at fair value cannot be restricted to unrealized amounts. Consideration needs to be given to all the changes from period to period, including cash transactions that have affected the current carrying value.
- Discuss the extent to which fair value balances have changed for reasons other than market movements. The carrying value of assets held at fair value may change as a result of new investment and dispositions as well as changes from the passage of time and changes in the valuation parameters.

For further guidance in this area, refer to CPA Canada's publication, *Fair Value Discussions in the MD&A*.

Outlook—Forward-Looking Information

Forward-looking information is useful to readers such as investors, analysts, lenders and other creditors. However, it is also less reliable than historical information, and readers need to understand its limitations. Accordingly, forward-looking information needs to be clearly identified as forward-looking and accompanied by disclosure to help the reader understand its context and limitations so they do not mistake forward-looking information for historical information.

All elements of the MD&A disclosure framework contribute to historical and prospective analysis. The historical analysis serves to explain the past results in the context of the company's strategy, key performance measures and indicators, capabilities and risk management. Similarly, the outlook provides management's forward-looking assessments and judgements about future outcomes of strategy, key performance measures and indicators, capabilities and risk, taking into account historical performance. The recommended practices in Part 5, *Overseeing the Reliability and Timeliness of Disclosure*, are particularly important in relation to disclosures of the outlook.

RECOMMENDED PRACTICE

Companies are encouraged, but not required, to provide in the MD&A an outlook for the company as a whole as well as for each core business, including each significant segment. The outlook entails disclosure and discussion of significant business goals and objectives, and may also include targets as well as discussion of the current and anticipated environment, risks and trends that could impact the company. The nature, specificity and periods covered by such disclosure will vary depending on the industry, company and circumstances.

Disclosure of significant goals, objectives and targets is important to help readers see the company through the eyes of management. The significant goals, objectives and targets disclosed in the MD&A relate to operational issues and/or financial performance issues.

The extent to which a company's outlook reports quantitative as opposed to qualitative information will depend on the nature of the business, the reliability of the information, its susceptibility to revision and the general economic environment. General discussions of goals, objectives and targets, even though they do not include any quantification, nevertheless constitute forward-looking information.

Discussion of the company's outlook should be realistic and reflect outcomes considered reasonably likely by management. Goals, objectives and targets should reflect management's realistic assessment of the planned end result of executing strategy, utilizing resources and managing risk. Disclosures about a company's outlook should be produced through a fact-based analysis of the business and its environment and are consistent with plans and reports presented to the board of directors.

In disclosing significant goals, objectives or targets, quantified information should be based on reasonable assumptions and reflect realistic analysis and the best available information. Such disclosures should be accompanied by discussion of their potential for variability. Companies may find it useful to present quantified information in the form of ranges, which communicate the risk and the sensitivity of the numbers to assumptions and possible outcomes. To the extent management discloses forward-looking information, management must

provide an explanation /update in the MD&A if the actual results are reasonably likely to differ or have differed materially from previously disclosed material forward-looking information.¹³

If companies choose to provide information about goals, objectives or targets through media other than the MD&A, the information should also be disclosed and discussed in the MD&A. Such goals, objectives or targets should be discussed with respect to the long-term and short-term strategies and should provide a meaningful context for evaluating them.

RECOMMENDED PRACTICE

In addition to the disclosure of goals, objectives and targets, the MD&A should disclose other information that is considered by management to be relevant to assessing future prospects. Such other information should be based on management's assessment of known and reasonably likely future events, conditions and circumstances.

Securities regulations require disclosure of information about the potential variability of earnings and cash flows and known trends, commitments, events, risks or uncertainties that are reasonably likely to affect the company's business and future performance. Although not a requirement, the MD&A report should disclose goals, objectives and targets and also other information that is relevant to assessing future prospects. Such information would relate to matters whose future occurrence may be uncertain but which, in management's view, are reasonably likely and necessary to enable readers to view the company's future prospects through the eyes of management.

Securities regulations contain numerous requirements about forward-looking information. Companies should refer to National Instrument 51-102, Parts 4A and 4B and section 5.8, as well as the OSC Staff Notice 51-721 *Forward-Looking Information Disclosure*, which includes an appendix that summarizes the disclosure requirements for the initial disclosure of forward-looking information and the disclosures required relating to the ongoing obligations to update, compare to actual results and, if appropriate, withdraw previously disclosed forward-looking information.

¹³ National Instrument 51-102 under section 5.8(2)—updating forward-looking information in the interim or annual MD&A.

3.6 Key Performance Measures and Indicators

In addition to the supplementary financial measures already discussed in Section 3.5 of this publication, readers of an MD&A need to understand the key performance measures and indicators, internal and external, that are critical to managing the company and monitoring the company's progress towards its stated objectives. Performance measures are quantified measurements that impact a company's success. Performance indicators can be narrative evidence of how a business is managed or quantified measures that provide indirect evidence of performance. Disclosing performance measures and indicators helps users assess the extent of achievement towards company objectives.

RECOMMENDED PRACTICE

The MD&A should: (a) identify and define the key performance measures and indicators for the company, and each core business, including each significant segment; and (b) explain their significance to strategies and results.

Some key performance measures are external to the organization and largely outside management's direct control. Internal performance drivers, in contrast, are those activities, competencies and qualities for which superior performance and favourable results are essential to enable the company, core business or segment to achieve its strategic goals. Key performance measures and indicators may differ among companies, core businesses and segments.

Examples of external performance measures include:

- raw material prices
- foreign exchange rates
- market share
- interest rates

Examples of areas where internal performance can be measured could include:

- sales pricing
- overheads
- working capital
- research and development and new product development
- supply chain management
- cost containment and operating efficiency
- workforce—retention and turnover
- customer satisfaction
- leadership and governance
- capacity and utilization

- innovation
- technology
- reputation and brand equity
- financing
- safety
- key performance metrics on environmental, economic and social issues

A good MD&A identifies an organization's key performance measures and indicators and discusses how executive compensation arrangements support the key performance measures and indicators.

Financial statements are the cornerstones of financial reporting. In today's complex financial reporting environment, however, investors commonly focus on key performance measures and indicators when assessing performance and a company's future prospects. Some key performance measures and indicators are reported in the financial statements, other supplementary financial measures or indicators, or non-financial indicators are reported outside the financial statements.

Some key performance measures may be quantitative disclosures, such as production volumes, capital expenditures, debt/equity ratio, income tax rate, unit sales, revenues, gross margin, net income, free cash flow, or earnings per share or return on equity by business line. In other cases, the indicator may be more subjective. For example, where a motivated and productive workforce is identified as important to executing strategy, production rates and quality control data constitute key performance indicators.

Any change in the basis of the calculation of key performance measures or indicators from one year or period to another should be disclosed, with restatement of comparative amounts as appropriate.

PART 4

Continuous Disclosure and MD&A Reporting

4.1 Role of MD&A in Continuous Disclosure

As a cornerstone of continuous disclosure, the MD&A should incorporate key information needed by users, including what has been disclosed in other regulatory filings. Disclosing relevant information in the MD&A ensures that the information is distributed to users and is subjected to appropriate audit committee and board of director oversight.

RECOMMENDED PRACTICE

A company should use MD&A reporting, annual and interim, to gather, integrate and present information significant to users, including key information that has previously been communicated through other channels. In addition, companies should update, as necessary, previous disclosures about strategy, key performance measures and indicators, capabilities, risks and results. In this way, all significant information is disclosed and kept current through the MD&A.

A company distributes information to the capital markets via a number of channels, including regulatory filings, press releases and websites. Annual and interim MD&A together offer continuity of disclosure on a cumulative basis and integrate the separate information disclosures into one document. Websites communicate information, and readers may find financial reporting information on a company's website. Typically, an MD&A is placed on the investor relations section of a company's website at the time of its filing with securities regulators.

Many companies announce their financial results to the capital markets through press releases prior to publication of the MD&A. This delay in issuance of the MD&A means that investors make decisions without timely access to the more extensive disclosures provided in the MD&A. Accordingly, to the extent possible, a company should make its MD&A available at the same time as the release of its earnings or at the earliest opportunity thereafter.

4.2 Interim MD&A Reporting

Investors, lenders, analysts and other creditors want information about a company's performance more often than once a year. While the time covered by financial reports and the extent of information reported varies internationally, the accepted period for reporting in North America is quarterly, and this is reflected in securities regulations.

RECOMMENDED PRACTICE

A company should use its interim MD&A to update the company's annual MD&A disclosures and to provide the following:

- the current quarter and year-to-date results including a comparison of financial performance to the corresponding periods in the previous years
- a comparison of cash flows to the corresponding period in the previous year
- a discussion of any seasonal aspects of the business that impact the financial position, financial performance or cash flows
- a comparison of the interim financial condition to the company's financial condition as at the most recently completed financial year end

In addition, it should update, as necessary, previous disclosures about business strategy, key performance drivers, capabilities, risks, outlook and any related supporting rationale.

The securities regulators only require discussions comparing the current quarter to the corresponding period in the previous years. As an option, management should consider supplementing this disclosure by providing a comparison of the current quarter to the immediately preceding quarter.

IFRSs and Canadian securities law outline the requirements for the content of interim reports. By its nature, interim reporting is less fully defined than annual reporting, as the requirements are not as extensive as those applying to annual reporting. It is not necessary to duplicate in the interim MD&A disclosure provided

in the annual MD&A. Unless otherwise updated, information disclosed in the annual MD&A is assumed to still apply. The disclosure framework in this publication can be used to help determine the content of interim MD&A.

In its interim MD&A, a company presents its analysis of results and cash flow for the reporting period in question and year to date. The MD&A also discusses its financial condition at the end of the period and in comparison to the previous year end. In addition, it discusses any significant changes in the outlook presented in the annual MD&A or previous interim MD&A, as appropriate.

Companies report important information that occurs between MD&A filing dates in press releases and material change reports. Management should consider to what extent the information in these filings and communications should be reflected in the next MD&A to provide continuity of disclosure and integrate the information in one report.

Regulators do not require a separate fourth quarter MD&A (or related interim financial statements), and most companies do not file such a document because the costs and time required to prepare it exceed the likely benefits to readers. As an option, but not a requirement, companies could consider giving an expanded discussion of the fourth quarter results in the annual MD&A and/or press release as analysts have identified this as an area where there is an information gap.¹⁴

RECOMMENDED PRACTICE

The analysis of actual results in an interim MD&A should include a discussion of progress against previously disclosed goals, objectives or targets.

The discussion and analysis of actual results is given in the context of the longer-term strategies and relates to goals, objectives or targets disclosed in the annual MD&A. However, if shorter-term goals, objectives or targets have been previously disclosed, actual results against these should also be disclosed, while explaining their significance within the longer-term strategic context.

¹⁴ Refer to CPA Canada's publication *Interim Reporting Strategies—Discussion Brief* (2014) for further discussion in this area.

PART 5

Overseeing the Reliability and Timeliness of Disclosure

5.1 Introduction

Concern for the reliability and timeliness of corporate disclosures applies as much to an MD&A as to other disclosures, including financial statements. Management and boards of directors need to ensure that they have systems, controls and processes in place to ensure that all information needed for the MD&A is collected, summarized, and communicated on an accurate and timely basis.

Responsibility for disclosure in the secondary markets is recognized in secondary market civil liability legislation. Issuers and their officers and directors may be liable for misrepresentations in oral or written disclosures, including failure to make timely disclosure. Under secondary market civil liability legislation, for core documents such as the MD&A, there is no need for a plaintiff to prove reliance on either the company's misrepresentation or failure to make timely disclosure.

5.2 Responsibilities of Management

RECOMMENDED PRACTICE

Management should provide a statement about its responsibility for the reliability and timeliness of information disclosed in the MD&A.

Securities regulators require CEOs and CFOs to provide annual and interim certifications¹⁵ that financial statements and other financial information (where this applies to the MD&A) in filings are fairly presented and contain no material misrepresentations. Furthermore, such officers of non-venture issuers¹⁶ must certify about the establishment, design, maintenance and effectiveness of the issuer's disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR). These non-venture issuers must disclose each material weakness related to design of the ICFR, including description of the material weakness, impact of the weakness on the issuer's financial reporting and ICFR, and the issuer's remediation plans, if any, or action plans already taken to rectify the weakness. Issuers must also disclose if they have had a scope limitation and have excluded from the DC&P and ICFR review certain entities such as a newly acquired business,¹⁷ proportionately consolidated entity or special purpose entity in which the issuer has an interest.

Venture issuers must give certifications that financial statements and other financial information in filings are fairly presented and contain no material misrepresentations. However, venture issuers are not required to certify with respect to the establishment and maintenance of DC&P and ICFR. Venture issuer CEOs and CFOs are still responsible for ensuring processes are in place to provide them with sufficient knowledge to support the representations they are making in the certificate.

Management is responsible for the existence and effectiveness of systems, controls and procedures to ensure that information used internally by management and disclosed externally is reliable and timely.

15 For further guidance on disclosure and certification, refer to the following CPA Canada publications: *Guidance for Directors: Disclosure and Certification—What's at Stake?* and *Guidance for Management: Disclosure and Certification—What's at Stake?*

16 The venture issuer definition is provided in section 1.1 of NI 51-102. A "venture issuer" means a reporting issuer that, as at the applicable time, did not have any of its securities listed or quoted on any of:

- the Toronto Stock Exchange
- a U.S. marketplace
- a marketplace outside of Canada and the United States of America other than:
 - the Alternative Investment Market (AIM) of the London Stock Exchange or
 - the PLUS markets operated by PLUS Markets Group plc

where the "applicable time" in respect of: (a) Parts 4 and 5 of this Instrument and Form 51-102F1, is the end of the applicable financial period; (b) Parts 6 and 9 of this Instrument and Form 51-102F6, is the end of the most recently completed financial year; (c) Part 8 of this Instrument and Form 51-102F4, is the acquisition date; and (d) section 11.3 of this Instrument, is the date of the meeting of the securityholders

17 NI 52-109—Business acquired not more than 365 days before the issuer's financial year end.

RECOMMENDED PRACTICE

Management should provide a statement about its responsibility for effective systems, controls and processes, and should report in the MD&A the conclusions arising from its periodic evaluation of systems controls and procedures.

These systems, controls and procedures are important in ensuring that all necessary disclosures are made on a timely basis. They also enable management to satisfy regulatory certification requirements respecting such disclosure. Systems, controls and procedures apply to prospective as well as to historical information.

Disclosures regarding internal systems and processes should address their ability to provide reliable financial reporting information, including any limitations in the scope of the design of such systems and processes and changes which are reasonably likely to affect them. The MD&A should present management's conclusions from its periodic evaluations of the effectiveness of the systems, controls and procedures. This disclosure should include the basis on which management reached these conclusions; the impact of any material weaknesses on financial reporting and systems, controls and procedures; and the plans and actions taken to address any material weaknesses identified in management's periodic evaluations.

Management's statement of responsibility should include reference to any certifications filed about reported information and related systems, controls and procedures.

A disclosure committee is an essential element of a company's systems, controls and procedures for all aspects of a company's external financial reporting. Companies should have a written mandate for the disclosure committee that includes a description of the role of MD&A reporting, recognizing it as a basis for continuous disclosure in reporting key information needed by investors, regardless of whether that information has been reported in other regulatory filings.

The company's disclosure committee and culture are essential to the effectiveness of the company's systems, controls and procedures implemented by management to ensure the completeness, reliability and timeliness of MD&A disclosures.

RECOMMENDED PRACTICE

The mandate of a company's disclosure committee should include MD&A reporting and should address this as an integral component of the company's continuous disclosure policies and practices.

The composition of the disclosure committee will depend on the nature and complexity of the company and its financial reporting. In small single-business companies, the CFO and legal counsel often constitute the committee, while larger, more complex companies require a multi-functional, senior-executive-driven team, including representation from finance, the legal department, investor relations, internal audit and operating divisions.

External financial reports need to be filed with securities regulators within a specified number of days after the period end. The filing deadline varies depending on whether the company is a venture issuer and whether the issuer files in a foreign jurisdiction.¹⁸

Accordingly, the timetable for the financial reporting process needs to be carefully considered to ensure there is sufficient time for the disclosure committee, audit committee and, when appropriate, the board of directors to review the MD&A and provide feedback. When making changes to the format for the MD&A, it is important to seek the support of the disclosure committee and the audit committee at an early stage in the process.

5.3 Responsibilities of Boards of Directors

RECOMMENDED PRACTICE

Companies should provide a statement about the oversight role of the audit committee in reviewing the MD&A and the role of the board of directors in approving the MD&A.

¹⁸ The annual MD&A is required to be filed on or before the earlier of:

- the 90th day after the end of its most recently completed financial year for an issuer who is not a venture issuer or in the case of a venture issuer the 120th day
- the date of filing, in a foreign jurisdiction, annual financial statements for its most recently completed financial year

The interim MD&A is required to be filed on or before the earlier of:

- the 45th day after the end of the interim period for a reporting issuer who is not a venture issuer or in the case of a venture issuer the 60th day
- the date of filing, in a foreign jurisdiction, interim financial statements for a period ending on the last day of the interim period

Securities regulations require that the board of directors approve the annual and interim MD&A before it is filed. The board of directors can delegate approval of the interim MD&A to the audit committee but cannot delegate approval of the annual MD&A.¹⁹ National Instrument 52-110 *Audit Committees* requires that the audit committee review the company's interim and annual MD&A before a company publicly discloses this information. These activities are important elements of the due diligence process to ensure that the MD&A contains no misrepresentations.

While the MD&A should provide the view through management's eyes, it should be an objective analysis and provide a proper sense of events taking place in the company. Accordingly, the audit committee and board of directors must assess whether the MD&A is consistent with prior information they have received from management. They should pay particular attention to any information that has been omitted from the MD&A because of issues such as confidentiality.

The oversight role played by the audit committee and board of directors regarding the annual and interim MD&A should be disclosed. Audit committees and boards of directors need to ascertain whether, in preparing the MD&A, management has applied the general disclosure principles outlined in Part 2 of this document and has publicly disclosed all significant information. In addition, to discharge their responsibilities, they need to satisfy themselves that management has implemented the necessary systems, procedures and controls required to ensure the reliability and timeliness of MD&A disclosures.

These disclosures may be incorporated into a statement of oversight responsibilities for reported information as well as included in any other disclosures about corporate governance and the roles of audit committees and boards of directors.

¹⁹ National Instrument 51-102 *Continuous Disclosure Obligations*.

Final Thoughts

The MD&A can be a powerful tool for management to communicate how the company has created value and how it plans to continue doing so. The MD&A, in combination with the financial statements, provides the opportunity for a company to tell its story about the company's performance, financial condition and future prospects—to help readers understand where the company is at compared to past objectives, where they would like to be and how they plan to get there. The MD&A should complement and supplement the financial statement information and, in doing so, help readers better understand what the financial statements show or do not show and enable readers to make more informed investment or lending decisions.

This publication provides principles and a framework to help preparers, management, audit committees and boards of directors prepare, organize and review their MD&A. For additional resources to help MD&A preparers, refer to the CPA Canada's website at www.cpacanada.ca.



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