Certified General Accountants Association of Canada

Issue in Focus

MD&A – Counterpart to or Distraction from Financial Reporting

By Kevin Girdharry, Elena Simonova, and Rock Lefebvre

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ISSN 1925-1548

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January 2011

Executive Summary

The purpose of the Management Discussion & Analysis (MD&A) is to complement and supplement the information provided through financial statements by affording balanced discussions of company's operating results and financial conditions. Currently, Canadian public companies adhere to requirements prescribed by the Canadian Securities Administrators (CSA) when preparing MD&A components; however, discretion of structure and style is essentially left to management. MD&A content has been an ongoing topic of recent debate with the views divided on the impact that regulated content has on the quality of the MD&A. Complexity has simply amplified as a result of emerging issues of particular importance to investors such as transition to International Financial Reporting Standards (IFRS), the environment and executive compensation. To better understand whether following CSA requirements positively influences the quality of the MD&A, CGA-Canada examined companies' compliance with CSA requirements for MD&A disclosures. As the following pages reveal, it can be reasonably contended that:

> ***Overall, companies provide quality information to investors as MD&A disclosures meet, and often exceed CSA requirements.*** Compliance with MD&A regulation provisions seem to encourage companies to prepare higher quality MD&As. The level and quality of MD&A compliance tend to be industry specific with utilities companies scoring the highest in all categories of reporting.
>
> ***Environmental and executive compensation disclosures are two areas that are currently underrepresented in the MD&A.*** The lack of clearly set requirements to the structure of the MD&A may provide companies with an opportunity to expand their analysis, and better project financial outcomes by including environmental and executive remuneration factors.
>
> ***Companies are well positioned to closely follow principles and the framework of the IFRS Practice Statement on Management Commentary*** recently released by the International Accounting Standards Board (IASB). However, minor improvements to the MD&A may be desired in the future.
>
> ***Incorporating marketing elements in the MD&A is sometimes present.*** Some companies tend to use the MD&A not only to provide information that may be useful to financial professionals and potential investors, but also to serve the interests of marketing strategies. A combination of limited disclosure information and emphasis of positive results may mislead the reader; essentially infringing on the spirit of the MD&A. Establishing clearer formal rules in this area may also be desired.

Overall, our analysis shows that regulations are a driving force in MD&A quality assurance. Encouraging companies to meet MD&A requirements ensures that relevant business activities are being disclosed effectively.

Introduction

The MD&A is an important component of a company's reporting obligation. Intended to provide investors with more comprehensive elucidation of financial outcomes, MD&A permits greater opportunity to present both short and long-term analysis. A study published by Contemporary Accounting Research[1] indicated that there is a strong relationship between MD&A content and the accuracy of financial projections, suggesting that the quality of the MD&A is vital in this relationship. As such, the effectiveness of the MD&A greatly depends on the quality of its explicit content.

Attention directed to the quality and importance of the MD&A particularly intensified once such large cases as those of Enron and WorldCom became public. In response to uncovered malpractices, securities regulators strengthened disclosure rules for publicly traded companies and toughened enforcement practices. The course was set by the CSA through National Instrument (NI) 44-101 – *Short Form Prospectus Distributions and Related Documents*, specifically Form 2, which specified content requirements for the MD&A. Revisions to content requirements were further made in the following year by Ontario Securities Commission's (OSC) Rule 51-501[2] that established content requirements for interim documents. In 2004, in an effort to expand and standardize disclosure rules across all provinces as well as raise the quality of content, the CSA implemented NI 51-102 – *Continuous Disclosure Obligations* with specific MD&A requirements identified in Form 1.

MD&A content has been an ongoing topic of debate in recent years. Management's concern is primarily related to the impact of regulated content on the quality of the MD&A and its usefulness to investors. Anecdotally, it is suggested that regulators and not investors are increasingly becoming the MD&A's target audience. Regulators, in turn, continue to be preoccupied with the fact that financial statements are not sufficiently informative for investors to determine whether past results are indicative of future performance.

1 Clarkson, P., Kao, J., and Richardson, G. (1999). *Evidence that Management Discussion and Analysis (MD&A) is a Part of a Firm's Overall Disclosure Package.*

2 Later rescinded and replaced with Rule 51-801 – *Implementing National Instrument 51-102 Continuous Disclosures Obligations.*

Added complexity is brought by emerging issues of particular importance to investors. Transition to International Financial Reporting Standards (IFRS) for public companies has arrived. With increasing global concerns of how business practices affect the environment, companies are becoming more accountable for their carbon footprint. Concurrently, executive compensation disclosure can be an important factor for investment decisions as it may be an effective measure of corporate governance and sustainability.

The adoption of IFRS further convolutes preparers' decisions when it comes to defining the structure and content of the MD&A. The International Accounting Standards Board (IASB), which is responsible for development and harmonization of IFRS, published the IFRS Practice Statement on Management Commentary, a broad, non-binding framework for the presentation of narrative reporting – an equivalent of MD&A – to accompany financial statements prepared in accordance with IFRSs. Canadian publicly traded companies will continue to be required to comply with CSA requirements regarding the MD&A, but now also have an option of greater alignment with the IASB guidance as a way of applying best practices.

Given the described challenges and importance of the MD&A, CGA-Canada deems it timely to examine companies' compliance with CSA requirements for MD&A disclosures and to analyse whether change in these requirements could influence the quality of the MD&A. To that end, this paper begins with a brief overview of the requirements and other principles important in preparing a high quality MD&A. This is followed by a qualitative analysis of companies' MD&As which is further extended to more specific topics that are of a particular interest in today's business environment – conversion to IFRS, the environment and executive compensation disclosures. This analysis is supplemented by examining the MD&A in accordance with the elements identified in the IFRS Practice Statement. The report concludes with highlights of the more salient aspects of our contentions.

MD&A – An Overview

The MD&A is a narrative explanation of how the company performed during the period covered by the financial statements, the company's financial conditions, and its future prospects. The MD&A aims to improve overall financial disclosure by providing a balanced discussion of company results and financial conditions. Moreover, the MD&A not only discloses changes in financial conditions, but also enables the reader to understand trends, events and transactions.

Current regulations set by the CSA specify relatively few clearly stated requirements regarding the structure of the MD&A. Among the required sections of the MD&A are company's overall performance, selected annual information, results of operations, summary or quarterly results, analysis of company's liquidity and capital resources, off-balance sheet arrangements, transactions with related parties, critical accounting estimates, changes in accounting policies, and discussion of financial instruments.

Publicly traded companies file their MD&A together with their financial statements. The responsibility for preparing the MD&A rests with the management of the company. Similarly to financial statements, the MD&A of publicly traded companies are signed off by the CEO and CFO, and approved by the board (or, in the case of interim reporting, the audit committee); certifying that provided information accurately reflects the state of the company.[3]

The MD&A is an interim and annual document. The interim MD&A builds on past MD&As and therefore should contain the most current information. Often, analysts and investors show more interest in the interim MD&A as it provides renewed insight and revised company information. The annual MD&A discloses financial year end information and often confirms what investors already know. Additionally, CSA regulations state that the interim MD&A must update the annual MD&A for all required sections in addition to providing analysis of current quarter and year to date results, changes in operations, and any seasonal aspects that may affect financial conditions.

An important but often overlooked characteristic of the MD&A relates to its level of complexity. Many contend that it is important that information be presented in a way that is understandable to individuals who may not have an extensive financial background. Financial jargon should be thoroughly explained or be integrated intermittently. Most well written MD&As include a glossary or explanation summary that identifies financial, company or industry terms used throughout the document. The style in which an MD&A is written influences its effectiveness as a main reference point for readers interested in the company.

In addition to the MD&A requirements set by the CSA, companies reporting under IFRS may choose to apply the framework presented in the IFRS Practice Statement on Management Commentary. Although entities applying IFRSs are not required to comply with the Practice Statement, it may still be viewed as a compilation of best practices in the area of the MD&A as it was developed with an active participation of the international accounting community.

3 Canadian Securities Administrators (CSA). (2007). *Certification of Disclosure in Issuers' Annual and Interim Filings.* National Instrument Form 52-109.

The IFRS Practice Statement identifies two notions – presenting management's view, and supplementing and complementing financial statements – as two key principles that allow the MD&A to be decision-useful and assist users of the financial statements in assessing the performance of the entity. Moreover, MD&A prepared in accordance with the IFRS Practice Statement should also include forward-looking information.[4]

The MD&A should provide management's view of the company's performance, position and progress. Management has access to full company information and therefore can provide an analysis of the company from a unique perspective. This type of analysis enhances the information already disclosed in the financial statements and may enhance investors' understanding of a company's strategy. However, companies still need to use discretion when disclosing information. For instance, disclosing proprietary information may jeopardize a company's competitive edge; whereas the potential impact of the MD&A on partnered companies or government entities should also be considered.

The MD&A should supplement and complement financial statements, but not form part of the financial statements. The MD&A should complement financial statements by integrating financial information with managerial discussions about the business that is not evident in the financial statements. For example, a manufacturing company may disclose new employee safety expenditures under its operating expenses with a follow-up discussion on the actual safety measure and its future benefits. The MD&A also supplements financial statements by providing additional information about reported information in financial statements through the explanation of events or decisions. For example, a farming company can present its quarterly earnings which show better than expected growth. As an explanation, the company may mention that this unexpected growth is expected to plateau in the near future, thereafter perhaps normalizing back to projected activity and profit levels.

A forward looking MD&A communicates management's objectives for the entity and strategies in pursuing those objectives. It also discusses known trends or uncertainties that may affect company business. Disclosed information needs to be clearly defined as being forward looking. In addition, factors that are subject to changing the outcome of disclosed forward looking information need to be identified through material assumptions, appropriate risk disclosures, and use of cautionary language.

4 IFRS Foundation. (2010). *Management Commentary – A Framework for Presentation*. Practice Statement, p. 8-10.

MD&A – Analysis

The analysis of the quality of MD&A disclosures was based on the review of 124 publicly traded companies operating in four industries – utilities, financial services, consumer product and retail, and oil and gas suppliers. Within each industry, a mix of smaller, medium-sized and larger companies were examined.

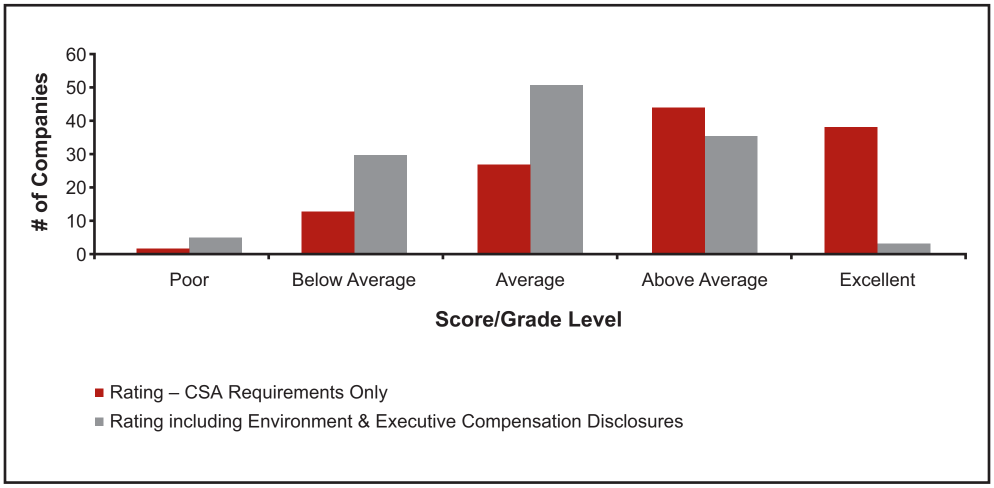
The objective of the MD&A analysis was to assess the quality of the MD&A as it pertains to CSA requirements and guidance presented in the IFRS Practice Statement. To that end, the examination comprised of three parts: (i) evaluation of selected MD&A sections against CSA requirements, (ii) evaluation of the disclosure of three specific topics of interest – transition to IFRS, the environment and executive compensation disclosures, and (iii) evaluation of selected MD&A sections against the IFRS Practice Statement that lays out principles for management commentary. The paragraphs that follow discuss the results of the analysis at a greater length, whereas the methodology of the analysis is presented in Annex A.

MD&A and CSA requirements

The review of the MD&As found that 88% of companies are at least satisfactorily meeting requirements according to all our measured elements. As seen in Figure 1, the majority of companies earned at least an "average" rating or higher. Some 31% of measured companies exceeded requirements, earning an "excellent" rating, where 35% earned an "above average" rating. Main factors that significantly influenced results were discussions on performance indicators, quarterly results and risk factors. The majority of companies addressed performance indicators and discussed quarterly results; however, a significant number of companies disclosed only general risk factor information.

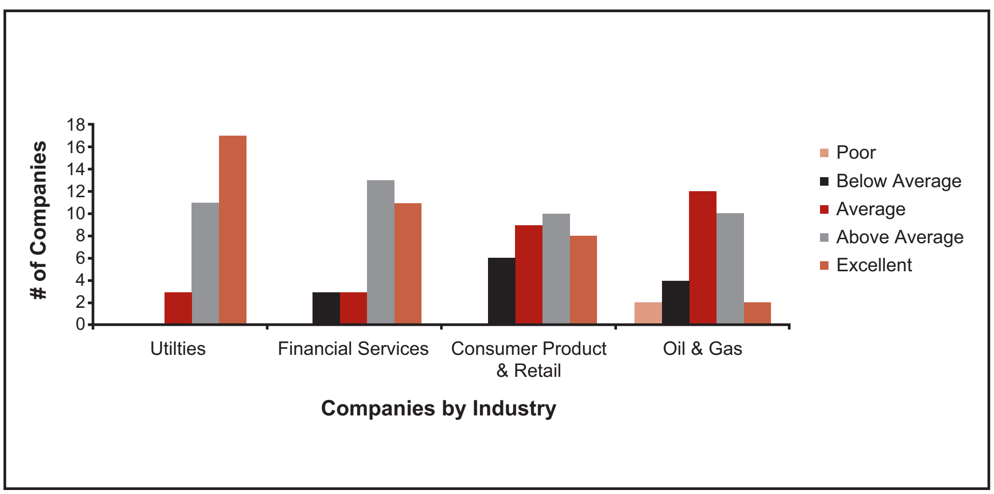
As previously mentioned, environmental factors and executive compensation disclosures are deemed important in today's business environment even though these issues are currently not directly required for MD&A disclosure. To examine the impact that the quality of these disclosures could potentially have on the overall quality of the MD&A, we assessed the disclosure of environmental factors and executive compensation and combined this score with overall MD&A scores. The combined results were significantly lower where the majority of companies slipped into the "average" category as opposed to "above average" and "excellent" categories that were prevailing for scoring based on CSA requirements only (Figure 1). This shows that companies tend to side-step the provision of unrequired information and elect therefore to potentially overlook the opportunity to increase the reporting quality. This further suggests the strong relationship between requirements compliance and overall quality of the MD&A.

Figure 1 – MD&A Ratings — All Companies



Among the different industries, utilities and financial services companies scored noticeably higher (Figure 2). The utilities industry had the largest proportion of companies that scored "excellent" compared to other industries. Unlike the utilities and financial industries, some companies in consumer product and retail, and oil and gas supplier industries scored "below average" or "poor". Boilerplate style language and very little follow-up information were found in various sections of their MD&As.

Figure 2 – MD&A Ratings by Industry



A number of specific elements of the MD&A are noteworthy. Key performance indicators (KPI) for example, were recognized as a strength for a number of companies. Whether they were company or industry specific, KPI disclosures identified company accomplishments and setbacks. A common KPI found was the Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). This KPI can be used to compare profitability among like firms. Companies can be compared without the constraints of various financial and accounting decisions. This comparison definitely has a vanity appeal; however EBITDA is not recognized as a GAAP or IFRS measure of cash flow. An interesting example of an industry specific KPI – retail sales by square foot – was identified in the MD&A of a consumer product and retail company. Retail sales by square foot reveal approximate sales flowing through each of the company's franchises and may provide management perspective on possible trends.

Discussion of risk factors in various sections received mixed reviews, which as indicated earlier impacted the overall scoring. A number of companies were on either side of the spectrum, either providing extensive details or providing general boilerplate style details. Risk disclosures ranged from discussions of specific company risk factors for newly acquired capital resources to current economic condition uncertainties, to general description of business risks.

The style and level of complexity of the document were deemed as appropriate to the general reader. Most companies integrated suitable language when conveying information. In many cases, financial or industry terms were explained using a glossary. It was observed that larger companies tend to present their MD&A with a greater aesthetic appeal.

IFRS disclosures

In accordance with the Accounting Standards Board (AcSB) and the CSA, the conversion from Generally Accepted Accounting Principles (GAAP) to IFRS is compulsory for publicly traded companies. As such, all publicly traded companies are required to prepare their financial statements in accordance with IFRS standards for fiscal years beginning on or after January 1, 2011.

The decision to convert to IFRS was made by the AcSB in early 2006 with the objective of moving to a more global set of accepted accounting and assurance standards. With the support of multiple constituents including CGA-Canada, the AcSB deemed the international standards as practical for Canada's financial reporting future. Adoption of IFRS may enable Canadian publicly traded companies to enjoy improved access to capital in global markets. With the growing credibility and acceptance of IFRS worldwide, and the increasing convergence of the IASB and the Financial Accounting Standards Board (FASB) standards, this strategy is both reasonable and indispensable.[5] The adoption of IFRS by the European Union (2005), Australia (2005) and

5 Certified General Accountants Association of Canada. (2005). *Exposure Draft – Accounting Standards in Canada: Future Directions Draft Strategic Plan.*

Hong Kong[6] (2005) in addition to over 100 other countries are prime indicators of the significance of international standards in global accounting. As such, we considered it important to review the quality of IFRS transition disclosures within the MD&A.

The focus of the analysis was to assess IFRS transition disclosure details in terms of the CSA timelines and regulations as well as determine the types of companies that were conforming. The analysis, though, did not aim to examine the actual preparedness for IFRS conversion. Auditing committees and/or top level management are better positioned to provide the best credible assessment.

Our review found that companies are effective in their disclosures of transitioning toward IFRS with an overall scoring of "above average" in this area. Companies that earned "excellent" ratings for their transition disclosures were the same companies that achieved "excellent" ratings in other areas of their MD&A.

Utilities companies had the strongest disclosures, discussing in depth, the impacts of conversion on business activities and financial reports. Set milestones and objectives were clearly identified for the transition process through timelines and graphs. Additionally, discussions of key differences between current and new accounting policies under IFRS identified potential changes to bottom line results as well as served as an educative guide for readers. It is interesting to note that the majority of utilities companies do have reporting obligations prescribed by their respective provincial governments that need to be submitted well in advance. Such enhanced reporting obligations may create a strong basis for surpassing CSA requirements.

Similar to utilities companies, financial services companies also had strong disclosures, providing detailed transition information.

Companies in the oil and gas supplier industry averaged an "above average" rating. These companies had additional adjustments to consider when incorporating IFRS. The accounting standard *IFRS 6 – Exploration and Evaluation of Mineral Resources* only allows companies to capitalize costs for exploration and evaluation activities, which means that firms will have to account for all other costs on a comparable basis. Companies also have the option to exercise exemptions from *IFRS 1 – First-time Application of IFRSs* that allow them to measure environment and evaluation assets as well as oil and gas assets under development using Canadian GAAP rules. These changes were understandably identified by most companies and therefore considered when determining their rating.

6 The Hong Kong Financial Reporting Standards (HKFRS) are equivalent to IFRS with the exception of IAS 32 and IAS 39.

The consumer product and retail industry rounded out the group with a solid "average" rating. A number of companies did, however, option exceptions from CSA Form 51-102F1 Section 1.13, indicating that they could not reasonably estimate effects on financial statements. In the year leading up to conversion, companies may be expected to be further enough along to provide an estimate. An issuer will generally be able to provide more detailed information about the expected effects of IFRS on its specific circumstances in its MD&A for interim and annual periods of the year before the issuer's changeover date.[7] Disclosure details are needed to inform readers that the company is not at risk of missing the conversion deadline.

A study undertaken by the CSA[8] came to a similar conclusion noting a general improvement in quantity and quality of IFRS disclosures; however, also indicating that room for further development exists.

It may be of interest to mention that IFRS transition disclosures of larger companies tended to contain promotional dimensions in addition to information that may be deemed as valuable for decision-making. This phenomenon was less present in disclosures of smaller companies. Overall, this raises a concern that the MD&A may in some instances be seen as a marketing medium where communication is nevertheless afforded for the purpose of providing investors with information useful for decision-making.

Environmental disclosures

Environmental matters are not a direct requirement for the MD&A and therefore technically not required. However, environmental information has become pertinent to the financial world, and therefore germane to investment decisions. Moreover, according to National Instrument Form 51-102 Part 1 (f), information is classified as material if an investor's investment decision is influenced or changed when that information is omitted or misstated. Consequently, environmental matters may be required to be included in the MD&A when classified as material under certain circumstances. The results of analyzing environmental disclosures in the interim MD&A were below satisfactory. As such, annual reports were reviewed but showed only marginal improvements. Overall, companies that did disclose environmental issues in their MD&A (interim or annual) were the same companies that earned high ratings for their compliance with CSA requirements for the MD&A. From an industry perspective, utilities companies showed the highest ratings. Environmental disclosures were relatively non-existent for companies in the financial sector as well as the consumer product and retail sectors. Oil and gas companies tended to disclose boilerplate information rather than a substantive analysis despite being part of an industry wherein environmental issues appear to be highly relevant.

7 Canadian Securities Administrators (CSA). (2008). *Disclosure of Expected Changes in Accounting Policies Relating to Changeover to International Financial Reporting Standards.* Staff Notice 52-320. Section 1.1.2.
8 Canadian Securities Administrators (CSA). (2010). *IFRS Transition Disclosure Review.* Staff Notice 52-326.

OSC Staff Notice 51-716 – *Environmental Reporting* prepared in February 2008 found similar results indicating that although companies were reporting on environmental issues, information was nonspecific and ultimately ineffective. Interestingly enough, the OSC analysis also discovered that companies disclosed environmental issues on their websites, but noted that it is insufficient to discuss such matters solely there.

Similar to the phenomenon identified for IFRS disclosures, larger companies that disclosed environmental information tended to accompany it with information that may be interpreted, at least in part, as promotional.

Environmental disasters are never desired, however disclosing information that projects liabilities, indicates compliance and discusses contingency plans communicates company preparedness. The environment will continue to become an increasingly important factor in the financial world with investors seeking discussions on financial liabilities in regards to the environment, asset retirement obligations, effects of environmental policies and protection requirements on operations, and environmental risk factors when determining investment strategies.[9] It may be in the best interest of companies to adopt environmental factors in their MD&A as best practice.

Executive compensation disclosures

Understanding how a company makes decisions regarding its compensation to Named Executive Officers (NEOs) may provide useful insights to investors regarding company's control and governance. Although information relevant to making investment decisions may already be available through other sources, disclosure in the MD&A further develops one's viewpoint. For instance, the CSA introduced the *Statement of Executive Compensation* (Form 51-102F6) with the objective of gaining additional insight on overall company direction through executive compensation disclosures. Due to its direct relevance to understanding company governance and execution, disclosure of executive compensation may be an important component of the MD&A.

Our study included the review of compensation disclosures through statements of executive compensation and MD&As to see if companies presented this material. The results of the analysis were less than satisfying as only a small group of companies disclosed information regarding compensation for NEOs. Furthermore, a number of these disclosures were nonspecific or incomplete and only a few companies did include effective executive remuneration information. These companies tended to be the same companies as those that had above average or excellent rating in other areas of the MD&A.

9 Ontario Securities Commission (OSC). (2008). *Environmental Reporting.* Staff Notice 51-716, p. 8.

MD&A and IFRS Practice Statement on Management Commentary

Our analysis showed that 83% of the reviewed MD&As were well aligned with the key elements and content structure suggested in the IFRS Practice Statement. Specifically, 27% of measured companies scored an "average" rating, 45% earned an "above average" rating, and 11% earned an "excellent" rating. However, minor improvements may be desired in the future.

Similar to our findings regarding the compliance with CSA requirements, the MD&As scored well against the IFRS Practice Statement in reporting performance indicators and discussing financial results. The insufficient disclosure of risk factors once again negatively impacted scores.

As the financial crisis recovery continues to represent a global challenge, the IFRS Practice Statement calls for emphasis on the disclosure of risk factors with good reason. According to the IFRS Practice Statement, risk factors need to be thoroughly disclosed in every aspect of the business. Investors need to understand the principal risk exposures and the plans for mitigating them. Additionally, risks need to be identified when discussing related party transactions as well as when discussing future objectives that may significantly change business operations. These elements were often absent in the management discussions reviewed during the analysis.

The IFRS Practice Statement also emphasises the provision of a detailed overview of the business and the environment it operates in. Although MD&As of a significant number of reviewed companies responded well to this guidance, larger companies tended to discuss quarterly results rather than expanding information on the entity's external environment and the nature of their businesses.

The IFRS Practice Statement recognizes the management commentary as an intricate piece of financial reporting that helps readers place related financial statements in context. For the management commentary to fulfil that purpose, it should not only describe the entity's performance, but also provide management's view and analysis of causes of the events and their implications for the entity's future.[10]

The MD&As reviewed during our examination were well aligned with the "management's view" principle as management's perspective was evident throughout all MD&As. Disclosures of financial results and performance indicators are examples of discussions where management most often used the opportunity to provide a unique perspective. Similarly, management's objectives for the entity and the strategies for achieving those objectives were also well presented in the reviewed MD&As.

10 IFRS Foundation. (2010). *Management Commentary – A Framework for Presentation.* Practice Statement, p. 8.

Closing Comments

The results of the analysis presented in this paper compel us to highlight a number of points. First, companies that meet or exceed MD&A requirements also tend to provide additional quality information furthering the discussion in their disclosure. As such, compliance with MD&A regulation requirements seem to encourage companies to prepare higher quality MD&As. Moreover, it is evident that companies use their own unique style to organize and present information in their MD&A even though certain formal MD&A requirements exist.

Second, the level and quality of MD&A compliance tend to be industry specific as differences in ranking across industries were consistent for reviewed sections and specific topics of the MD&A. Moreover, companies in the same industry had fairly similar results which may suggest the presence of informal, industry specific standards formed by competitive forces.

Third, environmental and executive compensation disclosures are two areas that are currently underrepresented in the MD&A as the majority of companies do not include disclosures of either.

Fourth, MD&As prepared based on CSA requirements also align well with principles presented in the IFRS Practice Statement on Management Commentary. Canadian publicly traded companies are well positioned to closely follow best practices set out in the Practice Statement.

Fifth, in a number of cases, companies tended to use the MD&A not only to present information that may be useful to financial professionals and potential investors, but also to incorporate some marketing elements.

The outlined weaknesses may also present opportunities. The lack of clearly set requirements to the structure of the MD&A provides companies with an opportunity to expand their analysis, and better project financial outcomes by including environmental issues and executive compensation disclosures. With the MD&A being generated quarterly, companies can update investors more frequently on new environmental developments or changes to corporate policy. The recent failures of financial giants as well as environmental disasters blamed on corporate negligence are examples of why these issues are important to investors.

Another opportunity may lie in a more balanced approach to combining MD&A compliance requirements and marketing strategies. A combination of limited disclosure information and emphasis of positive results may mislead the reader; essentially infringing on the spirit of the MD&A. Establishing clearer formal rules in this area may also be desired.

There have been discussions regarding the effectiveness of the requirements of the MD&A between executive management and securities regulators. Management has voiced concerns that the requirements do not satisfy the needs of investors, but add time and costs to companies unnecessarily increasing the length and complexity of the MD&A. More discretion and less regulation have thus been advocated by management. Our analysis though shows that regulations are the driving force in MD&A quality assurance. Encouraging companies to meet MD&A requirements ensures that all relevant business activities are being disclosed effectively.

Annex A – Methodology of the Study

For the purpose of this examination, the list of companies that file public securities documents through the System for Electronic Document Analysis and Retrieval (SEDAR) was relied upon as a source of our sample. Four industries – utilities, financial services, consumer product and retail, and oil and gas suppliers were considered. Within each industry, companies were further grouped into three subgroups based on the size of their assets:

a) Smaller companies – those with an asset value of less than $100 million.
b) Medium-sized companies – those with an asset value greater than $100 million but less than $500 million.
c) Larger companies – those with an asset value over $500 million.

Within each subgroup, companies were randomly selected to form a total sample of 124 companies.

The analysis of the MD&A comprised of three parts: (i) evaluation of selected MD&A sections against CSA requirements, (ii) evaluation of the disclosure of three specific topics of interest – transition to IFRS, the environment and executive compensation disclosures, and (iii) evaluation of selected MD&A sections against the IFRS Practice Statement on Management Commentary. The evaluation of the selected sections was based on the interim MD&A from the second quarter of 2010 whereas the evaluation of the specific topics of interest was based on interim and the latest annual MD&A as well as other specific financial reporting documents.

Evaluation of the MD&A sections against CSA requirements

Evaluation of the MD&A sections aimed to assess the level of compliance with CSA requirements and the overall quality of information. Each of the sections outlined below was assessed and assigned a score ranging from "poor" to "excellent" and these scores were then averaged to obtain a final rating of the company. Figure 3 lists sections of the MD&A examined and a brief description of requirements set by the CSA; Figure 4, in turn, outlines the scorecard, indicating scale and measurement characteristics.

Figure 3 – MD&A Sections Examined and CSA Requirements to Their Content

Section of MD&A	Requirement	Topics Discussed & Analysed
Date	Date must be no earlier than the date of the auditor's report on financial statements of most recent financial year	• Specified and easily identified
Overall Performance	Analysis of financial conditions, results of operations and cash flows, including discussion on trends, commitments, events and uncertainties	• Key Performance Indicators (KPIs) • Net Cash flows • Changes in financial conditions • Industry and economic factors affecting performance • The effect of discontinued operations • Legal or other restrictions on the flow of funds
Results of Operations	Discuss the analysis of company operations for the most recently completed financial quarter or year	• Selling prices, volume, quantity of goods/services, new products/services • Cost of sales or gross profit • New projects affecting total revenues • Other factors affecting costs and revenues • Commitments, events, risk factors or uncertainties that will affect future performance • The use of company proceeds and explanation of any variances that may affect company objectives or milestones
Summary of Quarterly Statements	Provide in summary form from financial statements, for each of the eight most recently completed quarters	• Net sales or total revenues • Income or loss before discontinued operations and extraordinary items in total and on a per-share basis
Liquidity	Provide a summary of cash flows in the short and long run, identifying risks associated with financial instruments, defaults or arrears (actual or anticipated).	• Generation of sufficient cash flows and equivalents to maintain company capacity and meet planned growth • Trends or expected fluctuations • Risk factors in terms of liquidity • Effects of balance sheet conditions on liquidity • Defaults or arrears
Capital Resources	Provide an analysis of commitments for capital expenditures, known trends in capital resources and sources of financing that have been confirmed but not yet applied.	• Details of capital expenditure commitments including the amount, date, purpose, nature, and expected sources • Trends or expected fluctuations for capital resources • Sources of arranged funding
Critical Accounting Estimates	Identify and describe each critical accounting estimate used	• Description, methodology, assumptions, trends and reasoning of the used accounting estimate
Changes in Accounting Policies including Initial Adoption	Discuss and analyze any changes in company's accounting policies, including any policies have been adopted or expected to be adopted.	• All IFRS conversions - transition progression
Financial Instruments and Other Instruments	Discuss the nature and extent of use of instruments.	• The nature and use of instruments for business purposes • Risks associated with these instruments • Assumptions made in determining the fair value of financial instruments

Source: Canadian Security Administrators (CSA). (2004). *National Instrument 51-102 – Continuous Disclosure Obligations, Form 1.*

Evaluation of the disclosure of specific topics of interest

Evaluation of the disclosure of specific topics of interest focused on IFRS transition, environmental issues and executive compensation disclosure. The selection of the specific topics was driven by a number of considerations. First, the changeover to IFRS has taken place and is germane to all publicly traded companies. As such, this part of the MD&A was thought as having particular importance to investors' ability to make decisions. Second, the effects of business practices on the environment have increasingly become a social and financial concern and, as such, addressing such concerns through the MD&A may be essential. And thirdly, providing disclosure of compensation for Named Executive Officers may be an essential element in demonstrating company stewardship to investors.

The analysis of IFRS transition disclosures was based on the scorecard presented in Figure 4 whereas the analysis of environmental issues and executive compensation disclosures were primarily based on their presence / absence and content in MD&As and other related reporting documents.

Figure 4 – Scorecard Used for MD&A Sections Analysis

Score Rating	Explanation
Poor – (1 point)	Absolutely no mention or little discussion of the topic. Disclosure clearly does not meet requirements.
Below Average – (2 points)	Fulfills minimum CSA requirements. General discussion is present, but value of the information is unclear for decision-making. Various degrees of "boilerplate" information seem present.
Average – (3 points)	Fulfills CSA requirements with adequate information to generate a general understanding of the company, its performance and conditions. Some material may require further explanation, where other material may be difficult to follow and its relevance is questionable.
Above Average – (4 points)	Fulfills CSA requirements and provides additional information and explanations as per guidelines. Quality of information allows reader to grasp a better understanding of the company, its performance and conditions. Specific components may need further details.
Excellent – (5 points)	Exceeds requirements by including thorough explanations of the company, its performance and conditions. Additional information is provided through charts and graphs, which assists the reader in better understanding of the material. The information is of high quality and may be useful in making investment decisions.

Evaluation of selected MD&A sections against the IFRS Practice Statement

Evaluation of selected MD&A sections against the IFRS Practice Statement was based on the number of key elements presented in the Practice Statement. Figure 5 presents the content elements that were measured, identifying their specific characteristics.

Figure 5 – Content Elements and Characteristics of the IFRS Practice Statement

Content Element	Characteristic
Nature of the Business	• Discussion of the industry • The competitive position within the market • Legal & regulatory features that influence company operations • Discussion of the company's main products, services, and processes • Company structure and economic model
Objectives and Strategies	• Addresses market trends, threats and opportunities • Defines company goals and objectives, providing plans for achievement
Resources	• Identifying the major resources used in achieving objectives (financial & non-financial)
Risks	• Identifies principle risk exposures • Discusses plans to mitigate risks
Relationships	• Identifies relationships with related or third party clients or customers • Discuss how these relationships affect performance (risks & benefits)
Results	• Identify financial results • Provide comparison of results to forecast, previous year and previous period results • Discussion and analysis of any changes in financial condition and liquidities
Prospects	• Discuss future goals and objectives • Identify potential risks associated with these objectives
Performance Measures and Indicators	• Describe indicators that demonstrate company's progress • Define the indicators used • Discussion of the relevance of the indicators used

Source: IFRS Foundation. (2010). *Management Commentary – A Framework for Presentation.* Practice Statement

An alternative scorecard was developed to cater to the fact that MD&As are prepared in accordance with CSA requirements rather than the IFRS Practice Statement. Each of the characteristics presented in Figure 5 was assigned a score of 1 to 3 where 1 stood for “not discussed”, 2 stood for “somewhat discussed”, and 3 stood for “thoroughly discussed”. A “somewhat discussed” score implied the characteristics were described in general terms. A “thoroughly discussed” score implied the characteristics were described in detail and further supplemented with the discussion and analysis identifying possible implications for the company.

Overall, a company could receive a maximum score of 60 as 20 characteristics were assessed. The following scorecard was used to determine a company’s ranking:

Ranking	Score Range
Poor	0 – 28
Below Average	29 – 39
Average	40 – 45
Above Average	46 – 51
Excellent	52 – 60

The “Excellent” rating was assigned if a company was able to score a “thoroughly discussed” score in at least 80% of the analyzed elements, where the “Poor” rating was assigned if a company scored a “not discussed” score in at least 80% of the analyzed elements.

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