Chartered Accountants of Canada

20 Questions Directors Should Ask about **Management's Discussion and Analysis**

Second Edition

WRITTEN BY
Alan Willis, CA

20 QUESTIONS

How to use this publication

Each “20 Questions” briefing is designed to be a concise, easy to read introduction to an issue of importance to directors. The question format reflects the oversight role of directors, which includes asking management — and themselves — tough questions.

The comments that accompany the questions provide directors with a basis for critically assessing the answers they get and digging deeper as necessary. Each answer summarizes current thinking on the issues and, where appropriate, suggests some recommended practices. These are not intended to be comprehensive checklists, but rather a way to provide insight and stimulate discussion on important topics. Although the questions apply to most medium to large organizations, the answers will vary according to the size, complexity, sector of the economy and domestic or global presence of each individual entity.

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Preface

Investors and regulators increasingly scrutinize the effectiveness of boards of directors and audit committees in discharging their responsibilities, including their role in overseeing the integrity of financial reporting. Management's Discussion & Analysis (MD&A) is a core element of financial reporting, and for that reason demands the careful attention of directors. The enactment of statutory civil liability for misleading disclosures in secondary markets in several provinces reinforces the need for directors to carefully review these disclosures.

Directors can diligently carry out their oversight responsibilities by asking insightful, informed questions about the disclosures they are required to approve. This publication suggests 20 important questions that directors should ask about their company's MD&A before approving it. These should not be regarded, however, as the only questions for directors to ask—directors are encouraged to ask additional questions to obtain the information they feel is necessary for them to make informed decisions about their company's MD&A.

To help boards of directors and audit committees, the Risk Management and Governance Board (the Board) of the Canadian Institute of Chartered Accountants (CICA) commissioned this re-issue of its publication, *20 Questions Directors Should Ask about Management's Discussion and Analysis*. This edition has been updated to reflect changes in the legal and regulatory disclosure environment and related changes in disclosure oversight practices that have occurred since the first publication in 2003. It also includes relevant excerpts from *Management's Discussion & Analysis: Guidance on Preparation and Disclosure*, issued by the Canadian Performance Reporting Board of the CICA to help MD&A preparers.

This 20 Questions publication is provided to assist boards of small and large public companies, both venture and non-venture issuers. The exact manner in which boards of directors and audit committees discharge their oversight duties may vary among companies, subject to their compliance with securities regulators' rules regarding the audit committee's and board of directors' review and approval of MD&As. Throughout this publication, directors are referred to without distinguishing between individual directors, audit committees and boards as a whole unless otherwise indicated.

The Board acknowledges and thanks the members of the Directors Advisory Group, the Canadian Performance Reporting Board, and John Fraser, CA, for their invaluable advice, the author Alan Willis, CA, the CICA staff who provided support to the project, and Hugh Miller, who carried out the final editing.

Brian Ferguson, CA
Chair, Risk Management and Governance Board

What directors need to know about the MD&A

What is the purpose and nature of the MD&A?

The MD&A is a key element of the core business reporting package, which comprises the financial statements, the MD&A and the Annual Information Form (for non-venture issuers, such as those listed on the TSX). The importance of this reporting package is emphasized by the fact that the Canadian Securities Administrators' (CSA) CEO and CFO certification requirements apply to all three of these filings. CEOs and CFOs are required to certify that these filings do not contain any misrepresentations and collectively "fairly present in all material respects the financial condition, results of operations and cash flows" of the company. [1]

The MD&A's purpose is to give readers the ability to look at the company's performance and future prospects "through the eyes of management." It is intended to supplement and complement the company's financial statements. The CSA states:

> *Your objective when preparing the MD&A should be to improve your company's overall financial disclosure by giving a balanced discussion of your company's results of operations and financial condition... openly reporting bad news as well as good news. Your MD&A should*
>
> - *help current and prospective investors understand what the financial statements show and do not show;*
> - *discuss material information that may not be fully reflected in the financial statements, such as contingent liabilities, defaults under debt, off-balance sheet financing arrangements, or other contractual obligations;*
> - *discuss important trends and risks that have affected the financial statements, and trends and risks are reasonably likely to affect them in the future; and*
> - *provide information about the quality, and potential variability, of your company's earnings and cash flow, to assist investors in determining if past performance is indicative of future performance.* [2]

The CSA sets out the required content of the MD&A in National Instrument 51-102, *Continuous Disclosure Obligations*, and Form 51-102F1, *Management's Discussion & Analysis*[3]. In addition, disclosures about strategy, risk and risk management, key performance drivers and indicators and non-financial resources, including intangibles, are increasingly viewed by readers as providing useful and meaningful insights into a company's future prospects.

In practice, many investors and analysts are more interested in interim MD&As (and interim earnings releases) than annual MD&As. Since the latter are issued well after year end, they are viewed as confirming previously known information rather than offering new insights into the business for the year in question. Annual MD&As are, however, more helpful to investors and analysts when they are first learning about a particular company.

The annual MD&A can also be a useful orientation tool to help new directors acquire an enhanced understanding of the company's business and performance. Moreover, some companies acknowledge that there are other internal benefits when the process of preparing an MD&A involves key management members beyond the CFO and CEO.

Certain MD&A requirements are specific to particular industry sectors, namely mining, oil and gas companies, and to venture issuers without significant revenues.

As part of their oversight of continuous disclosure practices, the CSA member bodies periodically monitor, review and report on the quality and reliability of MD&A reporting and its consistency with other elements of corporate disclosure, such as financial statements, press releases, material change reports, AIFs and prior period MD&As. These reports are a useful source of hints for improving MD&A disclosures; risk disclosures, for example, are regularly mentioned as a topic on which companies' MD&As are found to be weak.

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1 NI 52-109 (formerly MI 52-109)

2 NI 51-102, Form 51-102F1 Management's Discussion & Analysis, Part 1 General Provisions, (a)

3 The CSA's purpose and objectives for MD&As are similar in principle to those of the US Securities and Exchange Commission (SEC); the CSA's requirements for MD&A disclosures, while also similar in many respects to those of the SEC, differ significantly in several respects.

Board oversight of the MD&A

Boards of directors and audit committees have significant responsibilities for overseeing the integrity of corporate disclosures. The CSA requires boards of directors to review and approve annual and interim MD&As (the approval of the interim MD&A may be delegated to the audit committee).[4] Audit committees are required to review the company's financial statements, MD&A and annual and interim earnings releases before these disclosures are made public.[5]

Directors have an obligation to exercise due diligence in reviewing and approving MD&As, which is accentuated by many provinces' statutory provisions regarding civil liability for disclosures in secondary markets.

Civil Liability for Secondary Market Disclosure

The advent of statutory provisions for civil liability for secondary market disclosures has significantly increased the consequences for failing to exercise due diligence to avoid making a misrepresentation in public disclosure documents. MD&As, financial statements and AIFs are "core documents" in which a plaintiff only has to prove that a misrepresentation occurred (i.e. there is no need for plaintiffs to prove that they relied on the misrepresentation to their detriment). Directors and officers are among the designated parties who may be sued by security holders.

There are defences available to defendants in respect of claims made pursuant to statutory civil liability for secondary market disclosure. Due diligence defenses are available to defendants who are able to show that they carried out a "reasonable investigation" prior to the release of a document. This has important implications regarding the way in which disclosure controls and procedures are designed and implemented since they can assist defendants in making a due diligence defence.

Securities regulators expect MD&As to assist readers in assessing matters such as trends, risks, events, commitments and uncertainties that management considers reasonably likely to affect a company's business or future performance. In other words, a forward-looking orientation is encouraged. However, by its nature, forward-looking information is less reliable than historic information. For this reason, statutory provisions for civil liability for secondary market disclosure contain a "safe harbour" defense with respect to disclosure of forward-looking information.

This "safe harbour" defence is available where the forward-looking information is accompanied by cautionary language which identifies the forward-looking information and the material factors which may cause actual results to differ and by the disclosure of material factors and assumptions that were considered in making the disclosure. There must also be a reasonable basis for the conclusions, forecasts or projections set out in the forward-looking information.

The regulators have adopted a common definition of "forward-looking information" that includes all disclosure about possible events, conditions or results including future-oriented financial information presented as a forecast or projection (which are not normally provided in MD&As). This broad definition captures much of what is typically disclosed in MD&As, including items the CSA requires and those that management discloses voluntarily in the spirit of the regulators' stated purpose and objectives for MD&As.

Given the complexity of the civil liability legislation, directors may wish to obtain legal advice in balancing the need for MD&As to provide a useful forward-looking orientation with the appropriate cautionary language required to meet the requirements of the statutory defense against liability. Legal counsel may also advise directors on the obligation to update previously disclosed material forward-looking information contained in the prior MD&A or other public disclosure documents. [6]

[4] NI 51-102, Part 5 Management's Discussion & Analysis, Part 5, 5.5
[5] MI 52-110, Part 2, 2.3 (5)
[6] NI 51-102, s. 5.8

What directors need to know about the CICA guidance on MD&A

The CICA's Canadian Performance Reporting Board (CPRB) issued *Management's Discussion and Analysis: Guidance on Preparation and Disclosure* in May, 2004 (the CICA guidance), as well as related guidance publications to help management prepare and present effective MD&As.

In some respects, the CICA's recommended MD&A disclosure practices go beyond the letter of existing securities regulations; in other areas, the guidance highlights aspects of the regulations that are not always implemented effectively.

The CICA guidance is applicable to reporting issuers of all sizes that are subject to Canadian securities regulation, however companies subject to US MD&A requirements may also find the guidance helpful. Reporting issuers may choose to use the guidance in its entirety or adopt parts of it, while following applicable regulatory requirements. The CICA has also issued guidance for smaller issuers, which includes practical hints for building a better MD&A[7] and guidance on risk disclosures.[8]

The CICA guidance emphasizes that effective MD&As integrate historical and prospective information with financial and business analyses so they, together with the financial statements, impart useful knowledge to investors and other readers.

The MD&A, like financial statements, also provides companies with the opportunity to demonstrate their accountability to investors for effective stewardship of resources and meeting stated strategic objectives.

The key features of the CICA guidance are set out below as additional background and context to assist directors in addressing the 20 questions contained in this publication. The guidance provides six general disclosure principles and a five-part framework for enhancing the usefulness of MD&A disclosures.

[7] Building a Better MD&A: A Guide for Smaller Issuers, CICA — Canadian Performance Reporting Board, 2007

[8] Building a Better MD&A: A Guide on Risk Disclosures — Canadian Performance Reporting Board, 2008

General disclosure principles

Six principles provide the foundation of MD&A disclosures. The first emphasizes the MD&A's traditional regulatory purpose — to enable readers to view the company through the eyes of management. The other five principles are that MD&As should:

- complement as well as supplement financial statements;
- be reliable, complete, fair and balanced, and provide material information that is important to investors, acting reasonably, in making decisions about investing in the company;
- have a forward-looking orientation;
- focus on management's strategy for generating value for investors over time; and
- be written in plain language, with candour and without exaggeration, and embody the qualities of understandability, relevance, comparability and consistency over reporting periods.

These disclosure principles are aligned with the requirements set out in CSA National Instrument 51-102 and Form 51-102F1 regarding the MD&A, although they place a greater emphasis on the usefulness of a forward-looking orientation and a focus on strategy for generating value over time.

The disclosure framework

The CICA guidance recommends that companies structure and integrate their MD&A disclosures within a broad disclosure framework. This approach is not required under existing regulations. Much of the information called for under this approach may already be available within a company, but is rarely presented in a single, succinct disclosure document.

The CICA guidance recommends that the analysis of past results and discussion of future prospects be framed within the context of five key elements:

- the company's vision, core businesses and strategy;
- key performance drivers;
- capabilities (capital and other resources) to achieve desired results;
- results — historical and prospective analysis; and
- the principal risks the company faces, the strategies to manage them, and how those risks may affect the achievement of results.

Recommended disclosure practices are provided under each of these headings.

The CICA guidance points out that useful MD&As explain the "why" behind past performance and future prospects by "connecting the dots" between otherwise separate pieces of internal and external information.

MD&As communicate not only financial information but also relevant and material non-financial information. Any disclosure and discussion of targets is best presented within a longer term strategic context and, in subsequent periods, with comparison to actual results achieved.

Continuous disclosure and MD&A reporting

The CICA guidance indicates that MD&As are integral elements of the continuous disclosure regimen. Companies use MD&A reporting to gather, integrate, update and present significant information to investors, including that which has previously been communicated elsewhere.

Overseeing the reliability and timeliness of disclosure

The CICA guidance recommends that reporting issuers provide statements about the:

- responsibility of management for the existence of appropriate information systems, procedures and controls to ensure the reliability and timeliness of information used internally and disclosed externally, and
- the oversight role of the board of directors and audit committee in ensuring the reliability and timeliness of information reported in the MD&A and the financial statements.

Such statements are increasingly common in practice.

The CICA guidance is accessible on the CICA web site, www.cica.ca/cpr.

The questions directors should ask about MD&A

The following questions address matters directors will need to reach judgements about in order to carry out their responsibility for reviewing and approving the MD&A. There may also be other matters that should be considered, depending on the company and its circumstances.

For most questions, management will need to provide directors with information, explanations and representations in order for them to be able to form a judgement. For a few broad overall questions, either the audit committee or the board will need to consider both the entirety and the specifics of the information, explanations and representations provided by management in order to reach a comprehensive judgement about the integrity and usefulness of the MD&A and its role in achieving fair presentation.

The process directors adopt for obtaining, evaluating, recording answers and judgements related to the questions, and documentation of that process, will be important aspects of exercising and demonstrating due diligence.

The first two questions are, perhaps, the most fundamental ones for directors to ask since they focus on more than just matters of regulatory compliance — they address the essence of MD&As as a source of meaningful, useful and reliable disclosure to investors. If either question raises concerns about a given MD&A, that should be a signal to directors to obtain sufficient information on which to base a reasonable judgement about those concerns.

1. Does the MD&A provide a complete and integrated view of the company's historical results, financial condition and future prospects, explaining the "why" behind performance and prospects, such as strategy, risks and key performance drivers?

2. Is the MD&A written in clear, plain language and does it present with candour and without exaggeration a fair and balanced picture, including "bad news" as well as "good news"?

Next, directors are encouraged to consider the following questions.

3. Do the MD&A disclosures comply with regulatory requirements?

This question is essentially one of fact. Certain regulatory requirements, however, call for management to make subjective judgements, such as those concerning critical accounting estimates, in order to decide on appropriate disclosure.

Beginning in 2011, Canadian reporting issuers will be required to follow International Financial Reporting Standards (IFRS) instead of GAAP. Most issuers will at least plan and even begin to transition from GAAP to IFRS before 2011. Disclosures about expected and actual changes in accounting policies and their impact on financial statements arising from the transition will be important considerations for reporting periods leading up to the transition, and in the actual period when the transition is completed. It will be advisable for reporting issuers to consult regulators' notices and CICA guidance about MD&A disclosures on the changeover to IFRS in preparing these disclosures.

Management of non-venture issuers may also have to make judgements about the materiality of weaknesses in internal control over financial reporting and the need to include control-related disclosures in the MD&A, as required under the CSA's regulations related to the CEO's and CFO's certification of the annual and interim filings. Management should be asked to indicate when and where these judgements have been made and explain its rationale for the form and extent of the disclosure.

Management may have asked legal counsel to review the MD&A for compliance with regulatory disclosure requirements. Question 17 addresses comments offered by legal counsel in reviewing the MD&A.

4. To what extent has the CICA Guidance on MD&A been followed in preparing the MD&A? If any significant aspects of that guidance have not been followed, are we satisfied with the reasons provided?

Management may chose to follow the CICA's guidance in whole or in part, depending on the company's corporate disclosure policy (approved by the board), and its goals for relations with capital markets and providers of finance. Management should explain its decision regarding the use of the CICA guidance to the audit committee. The audit committee and board may also want to enquire about the extent to which regulators encourage or expect reporting issuers to follow the CICA guidance.

5. How has management satisfied itself as to the reliability of the information on which the MD&A is based?

Management is responsible for designing, implementing and periodically evaluating the systems, controls and procedures that underpin the reliability of the information in the MD&A.

Management should provide the audit committee with a description of how it has satisfied itself as to the integrity and reliability of the systems and processes supporting the MD&A disclosures, including the internal auditors' summary reports on any related work and findings.

An important topic for enquiry by the audit committee is the nature and effectiveness of disclosure controls and procedures, including the mandate, composition and work of the disclosure committee, if such a committee exists. If disclosure controls and procedures (DC&P) and/or internal control over financial reporting (ICFR) have been the subject of engagements carried out by the external auditor, the reports from these engagements would be reviewed with the audit committee.

Information about the processes the CEO and CFO of non-venture issuers have undertaken to fulfill the CSA certification requirements related to DC&P and ICFR are another useful input for the audit committee to consider regarding the reliability and integrity of MD&A disclosures.

The certification-related MD&A disclosures by non-venture issuers[9] about DC&P and ICFR made to address the CEO/CFO certification requirements should be consistent with the audit committee's understanding of the condition of these controls. In reviewing these disclosures, the audit committee should satisfy itself about the adequacy of management's actions to address identified ICFR deficiencies or its reasons for not taking such actions. [10]

MD&A disclosures of performance measures and key performance indicators that are not derived from the accounting systems underlying the financial statements should be based on operational measurement and reporting systems appropriate for the subject matter in question. The basis for factual MD&A disclosures should be the management information systems used to provide operational information for reports to management and for management's reports to the board of directors or to external authorities.

It is also important to consider the processes used to track the consistency and comparability of MD&A disclosures from period to period.

6. What has been management's approach to determining materiality in preparing the MD&A?

Management's determination of materiality applies not only to financial results but also to all of the qualitative and quantitative information disclosed in the MD&A.

The CSA instructions for the MD&A and the CICA guidance both advocate a test based on significance to investor decision making when considering the materiality of quantitative or qualitative matters to be disclosed in the MD&A. The impact on market prices, it is argued, follows investor decision making based upon what is disclosed to them.

[9] The CSA's continuous disclosure reviews have found that some reporting issuers do not make the required MD&A disclosures regarding management's evaluation of DC&P and changes in ICFR in the most recent reporting period.

[10] Further guidance on these topics is provided in these CICA publications: Internal Control 2006: The Next Wave of Certification - Guidance for Directors; Internal Control 2006: The Next Wave of Certification - Guidance for Management; and Internal Control 2006: The Next Wave of Certification. Helping Smaller Companies with Certification and Disclosure about Design of Internal Control over Financial Reporting.

The CICA guidance states: "To be reliable, MD&As should be complete, fair and balanced, and provide information that is material to the decision-making needs of users."

The CICA guidance states that information is material if it would be considered important by investors, acting reasonably, in making decisions about investing in the company. Individual items that may not be material in themselves may be material when considered as elements in the larger picture. Management should resolve any doubt about materiality in favour of disclosure.

Management should, therefore, be asked to explain the basis upon which materiality has been judged, and indicate and explain any instances where there were doubts about materiality and how they were resolved. If it would be helpful to readers, the MD&A should disclose how materiality has been determined.

7. Are disclosures of a forward-looking nature in the MD&A reasonable and supportable, as well as useful to investors?

The CSA's MD&A requirements often call for disclosures that are inherently forward-looking in nature. For example, in its analysis of a company's operations for the most recent period, management is asked to discuss "commitments, events, risks or uncertainties that you reasonably believe will materially affect your company's future performance including net sales, total revenue and income or loss…"[11] Likewise, in discussing overall performance, management is asked to address "known trends, demands, commitments, events or uncertainties that are reasonably likely to have an effect on your company's business."[12] The discussion of liquidity is to be accompanied by a tabular summary of the contractual obligations including payments for each of the next five years and thereafter.

The CICA guidance also calls for disclosures intended to provide meaningful insights into a company's future prospects. It states that "a forward-looking orientation is fundamental to useful MD&A reporting" and "the focus in MD&As should be on management's strategy for generating value for investors over time." For example, the guidance recommends that a company's MD&A disclose information about its:

- vision, strategy and goals or targets,
- key performance drivers for creating value,
- resources (financial and non-financial) needed and available in the future for achieving strategic objectives, and
- principal business risks and risk management strategies.

Disclosures of a forward-looking nature must be fact-based, reasonable and supportable. The CSA's National Instrument 51-102 prohibits the disclosure of forward-looking information unless the issuer has a reasonable basis for it. Forward-looking disclosures must be based on management's best judgement and reflect the facts, risk assessments and assumptions based on which management is running the business. They should be consistent with the plans, reports and other materials presented to and discussed with the board of directors.

With the introduction of civil liability for secondary market disclosure and the broad statutory definition of forward-looking information, care must be exercised in presenting MD&A disclosures that have a forward-looking orientation. (See the discussion of "Civil Liability for Secondary Market Disclosure" above).

Additional guidance about forward-looking information in MD&As is provided in a CICA publication[13].

[11] Form 51-102F1 Management's Discussion & Analysis, 1.4 (g)
[12] Form 51-102F1 Management's Discussion & Analysis, 1.2
[13] CFO Beyond-GAAP Briefing: Forward Looking Information —CICA, 2008

8. **Is there any information that management has omitted from the MD&A due to competitive concerns? If so, what is management's rationale for such omission and do we, as directors, agree?**

FOR MORE INFORMATION,
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20 QUESTIONS DIRECTORS SHOULD ASK ABOUT STRATEGY

Companies should disclose an appropriate level of strategic information to enable investors to make informed investment decisions. Some companies may hesitate to disclose significant strategic information due to concerns about maintaining competitive advantage. Others may be concerned that disclosing information, such as profitability, may upset customers or compromise ongoing discussions with government agencies.

The CICA guidance recommends challenging and carefully evaluating any concerns about the impact of disclosures on competitive advantage. These concerns may be valid and justifiable for companies in certain circumstances and industries, including those that are regulated. Often however, experience has shown that such concerns are not only unjustified, but that more rather than less disclosure is most effective in building marketplace understanding of and confidence in a company's future prospects.

Management should, therefore, be asked to explain its reasons for not disclosing any information that would otherwise be significant and useful to investors on the grounds of competitive concerns. Careful consideration should be given to what action would best serve the interests of shareholders: disclosure for the sake of transparency and more informed investment decisions at the risk that some of the information disclosed may be helpful to competitors versus withholding, to protect the company's competitive position, information which would have been useful to shareholders in making decisions about the company.

In particular, information must be disclosed if its omission would result in a misrepresentation (i.e. a failure to state something necessary to ensure that other statements are not misleading) and if the disclosure is necessary to enable the CEO and CFO to certify that the filings fairly present in all material respects the company's financial condition, results of operations and cash flows.

9. **Are there any disclosures presented or matters addressed in previous periods' MD&As that are not addressed in this MD&A, and if so, why?**

Securities regulators require MD&As to provide any necessary update of material forward-looking information that has been previously released by a company, including previous MD&As. MD&As are also required to disclose and explain instances where previously issued material forward-looking information has subsequently been withdrawn[14]. Although MD&As do not typically provide future oriented financial information, they usually provide disclosures that regulators define as financial outlook and other general (non-financial) forward-looking information.

Management should be asked whether any forward-looking disclosures made in prior periods' MD&As are not addressed in the current MD&A, and if so, to indicate what those disclosures were and explain why they are not being addressed in the current MD&A.

The CICA guidance similarly points out: "To be consistent over reporting periods, significant information, once disclosed in an MD&A report, should be updated and explained unless it becomes irrelevant or inappropriate. If the information is no longer relevant or appropriate, why this is so should be explained. Companies should not avoid discussion and update of a previously raised issue by simply omitting it from a subsequent MD&A report."

Consistency in reporting also enhances comparability. The CICA guidance states that "comparable information is information about which sufficient commentary and disclosure has been provided so that similarities and differences among time periods and/or companies can be discerned and evaluated."

[14] NI 51-102 s. 5.8

10. Do the risk disclosures in the MD&A focus on the principal business risks facing the company? Are these consistent with the business risks that management has reviewed with us for carrying out our oversight of strategy and risk?

FOR MORE INFORMATION,
PLEASE SEE THE CICA PUBLICATION
20 QUESTIONS DIRECTORS SHOULD ASK ABOUT RISK

Boards of directors are expected to consider business risks and opportunities as part of their mandate. Risk disclosures in the MD&A should, therefore, be consistent with what management has previously presented to and reviewed with the board regarding business risks and their implications for strategy and results.

If anything, the MD&A should focus attention on risks faced by the company that are different from those of other companies in the same industry because of their nature, potential impact or manner in which they are managed. For example, risks and related risk management strategies associated with the potential financial impact of climate change issues and related government regulations often differ from one company to another, since the companies in a given sector may be impacted in different ways and adopt different strategies to address such issues.

A more extensive listing of risks faced by the company may be provided in the AIF (for non-venture issuers), where disclosure of specified types of risk is required. Risks disclosed in the MD&A do not need to be repeated in the AIF, provided that the AIF references the MD&A's risk disclosures. However, MD&A risk disclosure requirements may not be satisfied by merely referencing the AIF risk disclosures.

The CICA guidance recommends the following:

> A company should disclose its principal risks and describe related risk management systems to enable MD&A report readers to understand and evaluate the company's risks and its decisions regarding the management of such risks. Such disclosure should include:
>
> - the principal risks and uncertainties facing the company and its core businesses and segments, as appropriate;
> - the strategies and processes employed for managing these risks;
> - the potential specific impact of these risks on results and capabilities, including capital resources and liquidity.

"There should be continuity and consistency from one period to another regarding risk disclosures and how the risks impact on results." [15]

[15] To assist MD&A preparers, the CICA has published "Building a Better MD&A: A Guide on Risk Disclosures" (2008).

11. Have previous disclosures to the markets in any form (websites, press releases, conference calls) been reviewed in the light of intervening events and disclosed or updated as necessary in the current MD&A, to ensure that investors are not misled by omission of information that should be disclosed also in the MD&A?

MD&As are a key part of Canada's continuous disclosure system. Disclosure controls and procedures, including disclosure committees where they have been implemented, play an important role in providing timely and complete reporting in interim and annual filings, such as the MD&A. Particular attention should be paid to the content of interim MD&As if earnings press releases are issued before the MD&A for the same interim period.

The CICA guidance points out that: "where a company has determined that a change has occurred and has disclosed this to the marketplace and/or regulators, its subsequent MD&A report (annual or interim) should incorporate and reflect that disclosure and provide appropriate further analysis, as necessary, as to the effect of the change on the company's view going forward."

These recommendations are all intended to help ensure that the MD&A is used effectively in integrating disclosures to the market, and that earlier disclosures to the market are updated as necessary in subsequent MD&As.

12. Are there any ways in which the MD&A disclosures are inconsistent with information provided in the financial statements or other materials included in the reporting package and continuous disclosure filings?

The CICA guidance states: "MD&As should complement as well as supplement financial statements."

"In supplementing financial statements, disclosure in the MD&A should (1) explain the conditions and events that shaped the information contained in the financial statements and (2) help in understanding how past conditions and events may give rise to future financial consequences. MD&As should provide insight as to the quality of management stewardship. MD&As should not simply make statements that are obvious from reading the financial statements, including the notes thereto, or consist only of discussion of line item disclosures in the financial statements."

The CICA Guidance also states that "In complementing financial statements, the principle of providing information 'to give a reader the ability to look at the issuer through the eyes of management' should drive disclosure. The MD&A should provide useful quantitative and qualitative 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. In this way, it is expected that MD&As will impart knowledge, as well as communicate information and data."

The external auditors have a responsibility to ensure that information provided in reports, including the MD&A, that contain financial statements upon which they are expressing an opinion is not inconsistent with those financial statements or the knowledge they obtained in the course of their audit.

At a broader level, this question focuses on the consistency of the MD&A within the company's overall corporate disclosure policy, annual report and other continuous disclosure filings. The MD&A disclosures should not be inconsistent with those contained in other reports, such as the CEO's letter to shareholders, components of the Compensation Discussion and Analysis, or the AIF.

13. If alternative (non-GAAP) financial performance measures have been disclosed, have relevant CSA Staff Notices and CICA Releases about such measures been followed?

One common example of alternative financial performance measures is "EBITDA" (earnings before interest, taxes, depreciation and amortization), for which there is no GAAP accounting standard. Income trusts often make disclosures about "Distributable Cash," a term not defined under GAAP. The CSA has issued specific notices about their expectations regarding disclosures of non-GAAP financial measures.

The CICA guidance states: "Where management determines that the disclosure of non-GAAP financial measures is useful to readers in understanding reported results (and future prospects), care should be taken to ensure that all necessary explanations are provided, such as those concerning the purpose and relevance of such measures and how they reconcile to GAAP financial measures."

Management uses its judgement in deciding the most useful way of communicating results to the marketplace. Investors are entitled, however, to understand how alternative financial performance measures relate to GAAP financial statements and why such alternative measures are relevant to an adequate understanding of the company's performance and prospects. If the board uses alternative financial measures in its evaluation of the company's performance, consideration should be given to whether the same information would also be useful to investors and should, therefore, be disclosed.

The CICA's CPRB periodically issues guidance about the definition, measurement and disclosure of non-GAAP financial measures, such as distributable cash, EBITDA and Free Cash Flow.[16] Reporting issuers may wish to consider that guidance in addition to the applicable CSA notices.

[16] See CICA guidance "Improved Communication with Non-GAAP Financial Measures—General Principles and Guidance for Reporting EBITDA and Free Cash Flow".

14. How does the company's MD&A compare with MD&As of other companies within the same industry sector and/or other relevant benchmarks?

In making their investment decisions, users will read and compare the MD&As of different companies, so there are benefits to companies in comparing their MD&As with those of other companies, especially competitors, in the same sector.

Directors may wish to see whether other companies' MD&As include disclosures and discussions about additional topics that they may then wish to consider for inclusion in their own company's MD&A. Conversely, directors may find their own company discloses and discusses topics that are not presented in other similar companies' MD&As, in which case the directors may wish to assess the pros and cons of their company's disclosure of these matters. Management should be asked about the extent of its review of the content and comparability of other companies' MD&As and what insights have been gained and acted upon.

Through its review of other companies' MD&As, it may also be possible for management to obtain ideas to help in more effectively formatting and presenting information in the MD&A. Further, members of audit committees and boards of directors may be able to bring the benefit of their own knowledge of reporting practices in other companies.

15. What feedback, if any, has been received from regulators about the adequacy of the company's MD&A and/or other disclosures such as press releases and financial statements? What action has management taken in response to any such feedback?

Securities regulators monitor companies' financial statements and the other filings they make under the continuous disclosure system, including how those filings compare with press releases, webcasts, etc. Sometimes, companies receive communications from regulators regarding a concern about a particular filing, which, on occasion, may include a call for the financial statements and/or MD&A to be revised and re-filed.

Management should be required to inform directors about any such communications received from regulatory bodies, including the action taken or proposed in response, and where the matter currently stands. Audit committees may wish to review the letters received from the regulators about disclosure concerns and deficiencies, as well as management's written responses.

16. What feedback, if any, has been received from institutional or other significant investors or their proxies about the adequacy of the company's MD&A and other disclosures? Has management sought such feedback? What has been learned and what action has been taken in response to any feedback?

Management should be required to bring to the board's attention any significant communication from institutional or other investors or analysts (as proxies for investors) about the MD&A. This may include questions and comments from analysts' calls and "road shows." This is especially important if there have been concerns or misunderstandings about an MD&A report or other disclosure. Management should explain how significant the concern is, any action taken or proposed in response, and where the matter currently stands.

17. Have legal counsel reviewed the MD&A and offered any comments on it? If so, what has been management's response to such comments, and why?

Legal counsel often reviews a company's MD&A before release, usually in order to advise management regarding the appropriateness of all proposed disclosures, including any forward-looking information and related cautionary language, and also to identify any disclosures that have implications regarding potential harm to the company's competitive advantage. Legal counsel may also advise management about known, expected or possible future legal and regulatory matters that may significantly affect the company in terms of its strategy and/or risks, which should, therefore, be disclosed and discussed in the MD&A.

Many companies' in-house counsel have an appropriate knowledge of securities law and practice to review MD&As, while other companies may need to retain external counsel for such purposes. In the latter case, counsel's comments will normally be provided to management in writing. Depending upon the nature of the comments and whether any serious reservations have been expressed, the audit committee may wish to meet with the counsel, as well as reviewing their written comments.

Having the MD&A reviewed by legal counsel may also be important in making a defence to a civil liability claim based on a misrepresentation in the MD&A.

18. What comments, if any, have the external auditors offered regarding the MD&A in the normal course of their duties to audit the financial statements? Is there any reason for us to engage the external auditors to carry out any specific additional procedures regarding the MD&A or parts thereof?

External auditors read MD&As published in reports that contain the financial statements upon which they are expressing an audit opinion, in order to assess whether any information in the MD&A appears to be inconsistent with the knowledge they acquired during their examination of the financial statements.

Although there are no legal or regulatory requirements for the external auditor to review or express an opinion on the MD&A, audit committees may consider engaging the external auditor to carry out agreed-upon audit procedures regarding particular parts of the MD&A to help the committee satisfy itself about the reliability of those MD&A disclosures.

In deciding whether the external auditor should review the MD&A and, if so, the nature of that review, the audit committee should take into account current legal and regulatory requirements regarding its role and responsibilities and those of management regarding corporate reporting, disclosure systems and controls, and ICFR, especially if there are unremediated ICFR weaknesses at the end of the reporting period.

19. Is the information contained in the MD&A consistent with that which has been previously presented by management to the audit committee and board of directors in the normal course of our oversight duties?

This question is similar to but broader than question 10, which specifically addresses risk disclosures. Management provides directors with a wide range of information about matters including strategic direction, availability of resources, company performance and evaluation of management performance.

In reviewing the MD&A, directors should individually and collectively review and consider the information previously provided to them, and assess whether any inconsistencies exist between that information and any part of the MD&A or the MD&A as a whole. A review of the minutes of previous audit committee and board meetings should be a part of this process.

If the directors detect or suspect any inconsistency, management should be asked to confirm or explain the matter and, if necessary, adjust the MD&A.

20. Does the MD&A include all significant issues that management has previously raised with us? If not, what is missing and why?

This question is similar to question 19, except the focus is on "errors of omission" rather than inconsistencies between actual information in the MD&A compared to earlier presentations of the same information. A review of the minutes of previous audit committee and board meetings should also be part of this process.

Again, if the directors detect or suspect that information has been omitted about an issue that would be significant to an investor, management should be asked to confirm or explain the matter and, if necessary, adjust the MD&A.

The focus of these reviews should be on ensuring fair presentation in all material respects, including the completeness of disclosures.

Where to find more information

Canadian Institute of Chartered Accountants publications

THE 20 QUESTIONS SERIES*

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20 Questions Directors Should Ask about Building a Board

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Management's Discussion & Analysis: Guidance on Preparation and Disclosure

Standardized Distributable Cash in Income Trusts and Other Flow-Through Entities: Management's Discussion and Analysis — Guidance on Preparation and Disclosure

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About the author

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Alan Willis, Chartered Accountant, is an independent consultant in the fields of corporate governance, performance measurement and business reporting, with a particular focus on the linkages of these topics with sustainable development and the business value of stakeholder relations. He directed the development of CICA's guidance on MD&A preparation and disclosure and wrote the related briefing "20 Questions Directors Should Ask About Management's Discussion and Analysis." He co-authored CICA's publication "Learning about Risk: Choices, Connections and Competencies." His first foray into the realm of corporate governance was writing a guidance booklet for audit committees and creating a documentary film about corporate directors in 1971. He observes that both would still be remarkably relevant today. As a member of the International Corporate Governance Network, he serves on its Non-financial Business Reporting Committee. He has worked extensively with Canadian and international initiatives to develop performance indicators and reporting guidelines relevant to corporate management of and disclosure about climate change impacts, environmental performance and corporate social responsibility. He is currently engaged in a multi-disciplinary North American project on the design of a new corporate governance model for the 21st century. He and Jim Goodfellow co-authored the CICA's September 2006 publications, "Internal Control 2006: The Next Wave of Certification."

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