

**General Principles Regarding Disclosure of Management's
Discussion and Analysis of Financial Condition and Results of
Operations**



OICU-IOSCO

**Report of the Technical Committee
of the
International Organization of Securities Commissions**

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The Technical Committee of the International Organization of Securities Commissions issued during its 17 and 18 February 2003 meeting the following guidance to regulators and issuers regarding general principles to be followed when preparing disclosure such as Operating and Financial Review, and Management's Discussion and Analysis:

The corporate collapses that have occurred around the world in recent years have highlighted the need for improved disclosure and transparency. In particular, attention worldwide has focused on the importance of greater transparency in disclosure of financial information, including both the financial statements and accompanying disclosure, often referred to as Operating and Financial Review (OFR) or as Management's Discussion and Analysis (MD&A). The term MD&A is used in this Statement to refer generally to this type of narrative explanation.

MD&A-type disclosure provides a context within which the financial results and financial position portrayed in the financial statements can be interpreted. It also provides material historical and prospective disclosure in the text of a document that enables investors and other users of information to assess the financial condition, changes in financial condition and results of operations of a public company, especially the company's prospects for the future. In the MD&A, issuers disclose the potential impact of currently known trends, events and uncertainties that are reasonably likely to have material effects on a company's financial condition or results of operations, such as a reduction in the company's product prices, erosion in the company's market share or demand, or changes in insurance coverage. Irrespective of the terminology used in different jurisdictions to describe this type of disclosure, this qualitative information about a company's operations and financial conditions is a critical component of information that public companies provide to the markets.

As underscored by the Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities that were recently published by the IOSCO Technical Committee, an issuer should provide all information that would be material to an investor's investment decision. This includes disclosures made in the MD&A.

In many IOSCO member jurisdictions, regulatory requirements, accounting standards or best practice guidance set forth the parameters for this narrative explanation of financial statement information. In some jurisdictions, MD&A-type disclosure is provided in an issuer's periodic reports, registration statements and proxy and information statements, while in others it is filed as a separate report with regulators as part of an issuer's continuous disclosure obligations. Although approaches may vary slightly among jurisdictions, under all of the approaches this disclosure is viewed as fulfilling several important objectives:

- First, MD&A-type disclosure enables investors to see the company “through the eyes of management.”
- Second, MD&A-type disclosure improves financial disclosure overall and provides the context within which financial statements should be analyzed.
- Third, MD&A-type disclosure provides information about the different components of earnings and cash flow and the extent to which they are recurring elements, thereby enabling investors to make a better prediction about the sustainability of earnings and cash flow in the future.
- Fourth, MD&A-type disclosure provides information about the risks to a company's earnings and cash flow.

The purpose of MD&A-type disclosure is to provide management's explanation of factors that have affected the company's financial condition and results of operations for the historical periods covered by the financial statements, and management's assessment of factors and trends which are anticipated to have a material effect on the company's financial condition and results of operations in the future. Companies should provide the information that is necessary for an investor's understanding of the company's financial condition, changes in financial condition and results of operation.

In the MD&A, a company should discuss its financial condition, changes in financial condition and results of operations for each year and interim period for which financial statements are required, including the causes of material changes from year to year in financial statement line items, to the extent

necessary for an understanding of the company's business as a whole. Information provided also shall relate to all separate segments of the company. In summary, through the disclosure provided in the MD&A, investors are better able to have an accurate and current view of the financial position of the company.

As a result of concerns raised about the adequacy of MD&A-type disclosure, regulators and accounting standard-setters in several IOSCO member jurisdictions, as well as international accounting standard-setters, have published statements, have recently proposed rule changes, or are otherwise working on projects to improve MD&A-type disclosure.

In light of the current regulatory focus internationally on MD&A-type disclosure, the Technical Committee has identified the following principles as useful guidance for issuers in preparing MD&A-type disclosure and for regulators in reviewing such disclosure:

- **MD&A-type disclosure should highlight the most relevant information.**
- **MD&A-type disclosure should be clear, concise and meaningful, and in plain language.**
- **MD&A-type disclosure should be presented in a format that will enhance the comprehensibility of the issuer's financial statements to investors, as well as to other users of this information, such as investment advisors and rating agencies.**
- **Irrespective of whether it is provided as a separate report or included as part of a periodic report, MD&A-type disclosure should be provided at the same time as the presentation of the relevant financial statements.**

The Technical Committee advises companies to take the following precautions when preparing MD&A-type disclosure in order to satisfy these objectives:

- **Care should be taken to avoid the use of boilerplate**

or stock language that appears to be in technical compliance with disclosure requirements, but that nonetheless fails to provide investors with appropriate information they need to make valuation and investment decisions.

- **MD&A-type disclosure should be properly crafted to address a company's specific situation. This will increase the overall quality of financial reporting, and assure material correctness and completeness of financial reporting regardless of the detailed accounting and financial requirements applied.**
- **MD&A-type disclosure should provide an objective analysis that may require the disclosure of information that could reflect negatively on the company's financial condition, changes in financial condition and results of operations.**

To illustrate how these general principles could be applied in practice, the Technical Committee provides the following examples. For instance, an issuer that engages in structured off-balance sheet financings could consider providing MD&A disclosure regarding arrangements, transactions and other relationships with unconsolidated entities or other parties that are reasonably likely to have a material effect on liquidity or the availability of or requirements for capital resources. An issuer that relies on financing or services from related parties could also consider providing MD&A disclosure about material related party transactions to the extent necessary for an understanding of an issuer's current and prospective financial position and operating results, especially when the transactions are not conducted at current market conditions. With respect to issuers whose financial statements contain a large number of accounting estimates, these issuers could consider providing MD&A disclosure about the critical accounting estimates that they make in applying their accounting policies, as well as disclosure concerning their initial adoption of an accounting policy. In addition, issuers that rely extensively on the granting of stock options as compensation could consider providing MD&A disclosure about the effect of stock option arrangements on an issuer's financial condition and results of operations.

Not only regulators, but also accounting standard-setters are focusing on the importance of disclosures contained in the MD&A. The authority of

MD&A guidance provided by these accounting standard-setters varies in each jurisdiction. Jurisdictions also vary in terms of the specific types of information that must be disclosed within the financial statements as opposed to the MD&A. For example, some of the information highlighted in the examples above may be contained in the financial statements in some jurisdictions.