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ESG Innovation Research Note

Subject:	**Understanding the MD&A as a means to report on sustainability**
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Key Insights

- The Management Discussion and Analysis (MD&A), also referred to as the "Management Commentary," "Management Report," "Operating Financial Review," or "Strategic Report," is part of a public company's mandatory disclosures and is a narrative discussion of a company's operations and financial condition.
- Although it may vary in naming and structure from one jurisdiction to another, the content, purpose, audience, and reasoning of the MD&A are ultimately the same.
- Investors are the primary audience, as they use the MD&A to understand company performance and to make decisions to buy, sell, or hold securities.
- In the US, the MD&A is filed as part of the annual Form 10-K report to the US Securities and Exchange Commission (SEC) and included in annual reports sent to shareholders. In Canada, it is filed as a separate document to provincial securities administrators alongside financial statements (although there is currently a proposal to consolidate these documents). In Europe, the Management Commentary (hereafter referred to as the MD&A) can be filed as part of general financial statements or as a stand-alone report (this is also subject to change with the upcoming Corporate Sustainability Reporting Directive).
- While financial statements of companies must undergo an official audit by an independent auditor, the MD&A is not audited because it represents the thoughts and opinions of management (not verifiable facts).
- As regulators and standard-setters move towards requiring sustainability-related disclosures, the MD&A may well be the most suitable location for this information.

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Glossary of acronyms

- **CA:** Canada
- **CSA:** Canadian Securities Administrators
- **CSRD:** Corporate Sustainability Reporting Directive
- **ESRS:** European Sustainability Reporting Standards
- **FASB**: Financial Accounting Standards Board
- **IASB**: International Accounting Standards Board
- **IFRS:** International Financial Reporting Standards
- **ISSB:** International Sustainability Standards Board
- **IR:** Integrated reporting
- **MC:** Management Commentary
- **MD&A:** Management's Discussion and Analysis
- **NI**: National Instrument
- **OSC**: Ontario Securities Commission
- **SEC:** Securities Exchange Commission
- **US:** United States

Purpose of the MD&A

- The fundamental purpose of the MD&A across all jurisdictions is two-fold:
    1. **To allow a company's executives to contextualize reported financial data and explain any changes in company performance.** In the MD&A, executives present and explain information about the company's finances, compliance, risks, opportunities, challenges, goals, projects, and plans. The MD&A includes information on sales, specific risks, competition, and any other information that is helpful to understanding the company's past performance, financial condition, and future prospects[1].
    2. **To provide investors with a view of the company "through the eyes of management**." The MD&A is especially important for financial market participants (investors, creditors, lenders) as a way to assess the company's management performance and the ability of the company to generate value in the short and long term. The quality of MD&A disclosures has been shown to positively correlate with the forecast accuracy of reported corporate data[2]; with more material and robust context for financial data provided in the MD&A, investors can make clearer decisions on whether to finance or invest in a company.

MD&A disclosure requirements by jurisdiction

United States

- In the US, the MD&A is a mandatory section of the annual Form 10-K filing by public companies to the US Securities Exchange Commission (SEC). Companies must also include an updated MD&A in their quarterly Form 10-Q reporting to the SEC. The MD&A is also included in a company's annual report sent to shareholders (a less text-heavy report which is not mandated by the SEC but reflects information in the 10-K).
- The SEC describes the MD&A as a "principles-based" disclosure intended to provide management with the flexibility to describe the financial matters impacting the company, as well as enhance the usefulness of financial disclosures by **providing context for investors to decide to what extent past performance is indicative of future performance**.
- Requirements for the MD&A are outlined by the SEC in Regulation S-K Item 303[3], which was most recently amended in 2020. The amendments[4] clarified the purpose of the MD&A and streamlined and modernized reporting requirements for companies, aiming to provide better material financial information to investors by broadening the scope of information considered "material".

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[1] *CPA Canada 2014*

[2] *Pisano, S. and Alvino, F. 2015*

[3] *SEC 2022*

[4] *SEC 2020*

- The updated Item 303 states that the MD&A "must focus specifically on material events and uncertainties… that are reasonably likely to cause reported financial information not to be indicative of future operating results or financial condition…[or] have a material impact on future operations"[5]. The inclusion of the words "reasonably likely" is a notable change from the previous legislation, as it encourages forward-looking disclosures that consider what events *might* happen, and not only those management believes *will* happen[6].
- The Financial Accounting Standards Board (FASB)–the organization designated by the SEC to establish accounting and financial reporting standards for US public companies–also provides guidelines for the MD&A. Although the MD&A is not audited, FASB stipulates that it **must be company-specific, based on facts, and "provide a balanced presentation that includes both positive and negative information about the topics discussed"**[7].
- Despite some variability in presentation, all MD&As in the US must include information on liquidity and capital resources (including material cash requirements), results of operations (including known trends or uncertainties, net sales and revenues, inflation and price changes), and critical accounting estimates (CAE)[8].

Canada

- In Canada the MD&A is also a non-audited, fact-based document, but is filed as an independent document from financial statements both annually and quarterly to the company's provincial securities commissions. As a stand-alone document, the MD&A should complement the financial statements but must be readable on its own[9].
- The Canadian Securities Administrators[10] (CSA) defines the MD&A as "a narrative explanation… of how your company performed during the period covered by the financial statements, and of its financial condition and future prospects… [a] balanced discussion of your company's financial performance… openly reporting bad news as well as good news."[11]
- The CSA outlines requirements for the MD&A through National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102), first introduced in 2011 and harmonized (adopted and mandated) by provincial securities regulators.
- The legislation mandates that companies include key information in the MD&A: the date of the events covered in the report, overall performance, selected annual information,

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[5] *SEC 2020*
[6] *Kajunski, Daniel T., and Amanda Mei, "SEC Amends MD&A and Other Financial Disclosure Rules", 2021*
[7] *FASB 1999*
[8] *SEC 2017*
[9] *CPA Canada 2014*
[10] *In Canada, the CSA is an umbrella organization with representatives from each province and territory's securities agencies. The CSA coordinates and improves Canada's capital markets by developing national-level initiatives and electronic systems to streamline filing and viewing company reports. The CSA also creates National Instruments - regulations that are released by the CSA but written into law ("harmonized") at the provincial level - by individual province's regulatory agencies.*
[11] *OSC 2011*

discussion of operations, summary of quarterly results, liquidity, capital resources, off-balance sheet arrangements, transactions between related parties, fourth quarter information, proposed transactions, critical accounting estimates and changes in accounting policies including initial adoption, and financial and other instruments used.

- CPA Canada also stipulates that companies should address five key points in the MD&A:
    - Core business;
    - Objectives and strategy;
    - Capability to deliver results (resources, relationships and risks);
    - Results and outlook; and
    - Key performance indicators (KPIs).
- It also outlines key principles of disclosure for the MD&A (see Appendix A for more details), including:
    - Disclosing information "through the eyes of management;"
    - Integration with financial statements;
    - Completeness and materiality;
    - Forward-looking orientation;
    - Strategic perspective; and
    - Usefulness - information that is understandable, relevant, comparable, verifiable and timely.

Key proposed changes to the MD&A in Canada

- In May 2021, the CSA proposed amendments to NI 51-102 that include combining financial statements, the MD&A, and the Annual Information Form (AIF) into a single annual submission that would be called the "Annual Reporting Statement." The amendments would clarify and streamline disclosure requirements by removing the need to duplicate information across the three documents[12], which are currently filed separately to provincial regulators.
- As of September 2021, comments on the proposal have been received. The final amendment is expected to be published in September 2023 for adoption in December 2023.
- As proposed, the amendment would introduce the following key changes to the MD&A:
    - Eliminate the requirement to disclose information on Critical Accounting Estimates (CAE) to avoid duplicating data (as it is already included in financial statements under the Canadian GAAP);

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[12] *As of September 2021, the CSA has received comments on the proposal and is expected to publish a final version of the amendments in September 2023 (to be effective as of December 2023). See additional section below for more details on this proposed amendment.*

- Eliminate the requirement to disclose a summary of the eight most recently completed quarters (as this information is easy to locate in previous disclosures);
- Consolidate the MD&A requirement to discuss operations with the AIF requirement to discuss liquidity, capital resources, and information on R&D;
- Clarify that the discussion of financial condition, performance, and cash flows must include a comparison of the most recently completed financial year to the one prior;
- Require venture issuers to provide a description of their business; and
- **Remove materiality qualifiers for disclosed information such as "material", "significant", "critical," "major," and "fundamental,"–expanding what companies can consider material for disclosure**[13].

European Union

- In Europe, the MD&A is referred to as the "management commentary," "management report," "operating and financial review," or "strategic report." It is a mandatory document submitted by all EU publicly listed companies, required by EU law since 1978 (through Directive 78/660/EEC)[14] and harmonized by EU member states[15].
- This Directive states that companies must give a "fair review of the development of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces" as part of their annual financial reporting package. In 2003, the EU issued the Accounts Modernization Directive (2003/31/EC) which broadened the scope of the MD&A, provided more specific requirements of what information must be included, and confirmed the purpose of the MD&A.
- The Directive stipulates that the MD&A can be filed as a stand-alone report or part of a larger corporate report. In either case, **it must be balanced, comprehensive, and include financial and non-financial KPIs related to environmental and employee matters**[16]. Other, more specific requirements for the MD&A include that it must contain information on important events that ocurred since the end of the last financial year and the company's expected future developments, activities in R&D, acquisitions, information about branches of the company, and financial risk management and policies, as well as exposure to risks related to price, credit, liquidity, and cash.

[13] *CSA 2021*
[14] *European Commission 1978*
[15] *Pisano, S. and Alvino, F. 2015*
[16] *European Commission 2003*

- In 2010, the IFRS Practice Statement 1 *Management Commentary* provided non-mandatory guidance for drafting the MD&A[17]. Currently, there is work being done to amend the Practice Statement to clarify the purpose, key principles, and forward-looking nature of the MD&A (see the following section on the IFRS project to review the Management Commentary).

Comparison of mandatory reporting contents by jurisdiction

Reporting element	USA (Form 10-K)	CA (MD&A)	EU (MC)
Business	Business (overview of operations, products and services)[18]	Core business[19]	Business model[20] Branches of the company[21]
Risks	Risk factors[18]	Risks and relationships[22]	Financial risk management and policies; exposure to price, credit, liquidity and cash risk[20] Risks[21]
Selected financial data and performance	Selected financial data (past 5 years); financial statements and supplementary data[18]	Selected annual information; summary of quarterly results; financial and other instruments used and related risks[22]	Financial performance and position[21]
Strategy	Any material changes to previously disclosed business strategy[18]	Objectives & Strategy[19]	Management's strategy for sustainable business model, opportunities[21]
Liquidity	Ability to generate cash, historical cash flows[18]	Liquidity, contractual obligations[22]	*n.a.*
Capital resources and cash commitments	Material commitments of capital expenditures[18]	Off-balance sheet arrangements[22]	*n.a.*

[17] As of 2005, all publicly traded companies in the EU are mandated to comply with IFRS accounting standards for their financial reporting by the Eu law (EC 1606/2002 "IAS Regulation" issued in July 2002). However, companies do not have to comply with the non-mandatory guidelines for the MD&A, either in part or in full, to comply with the IFRS for financial reporting.
[18] SEC Regulation S-K
[19] CPA Canada disclosure framework
[20] IFRS Exposure Draft 2021 (ED/2021/6)
[21] EU law (Directive 78/660/EEC; Directive 2003/51/EC)
[22] Form 51-102F1

Results of operations, factors, and trends	Results of operations[18]	Overall performance, financial condition, and uncertainties; changes to operations[22] Discussion of operations (revenue by segment, COGS, profit, projected plans)[19]	Factors and trends[21]
Unusual or significant events	Unusual events[18]	Reportable event[22]	Important events[20]
Critical accounting estimates, accounting policies	CAE in accordance with GAAP and any relevant changes[18]	CAE, changes in accounting policies[22]	*n.a.*
Future prospects	*No explicit requirement as a section of the MD&A or 10-K. However, companies must explain how future performance may differ from past performance.*	Forward looking information[19] Results & outlook; future events, decisions, circumstances, opportunities and risks[19]	Expected future development of company[20]
Resources and relationships	*n.a.*	Transactions between related parties[22] Capability to deliver results - resources, relationships, and risks[22]	Resources and relationships[21]
Items subsequent to reporting year end	*n.a.*	Events and circumstances that occurred during the period to which the MD&A relates (usually greater than fiscal year)[22]	Important events that ocurred since the end of the last financial year[20]

Note: This tabular summary is intended for illustration purposes and may not be exhaustive. Gray shaded areas correspond to MD&A contents, illustrating that the content requirements of the Form 10-K (inclusive of its MD&A) for US listed companies closely match those of the MD&A for Canadian and European listed companies.

The role of the MD&A in sustainability reporting

- There are growing regulations pertaining to corporate sustainability reporting around the world.
- Increasingly, regulators and standard-setting organizations are recognizing the MD&A as the natural landing spot for corporate sustainability information. In the US, Canada, and the EU, there have been several moves to require inclusion of sustainability information in the MD&A (see Appendix C).
- Many companies in Europe currently use the MD&A to fulfill the requirement of the Non-Financial Reporting Directive (NFRD) to disclose how sustainability issues affect their performance, position, and development, and how the company impacts social and environmental issues[23].
- We believe that the trend towards including sustainability information in the MD&A is predicated on the structure, purpose, and composition of the MD&A. The very purpose of the MD&A makes it suitable to housing sustainability information, because 1) it's where information about the context for the business can be found, e.g., market drivers, business model, strategy, risks, management and performance explanations, and future prospects and 2) in attempting to integrate sustainability into business model and strategy, it makes sense to also integrate it into disclosures on business model and strategy.
- Key attributes of the MD&A that make it a natural home for sustainability information include:
    - **The contextual, narrative nature of the MD&A**. Environmental and social data is often both qualitative and quantitative in nature, and requires historical context and information to explain materiality. Indeed, determination of material issues is context-based, requiring information on geographic location of operations, the industry, and the specific nature of the company's activities.
    - **The discussion of business strategy in the MD&A**. Companies are ultimately being asked to integrate sustainability into their strategy and business model and articulate their corporate purpose.
    - **The discussion of key risks and opportunities in the MD&A**. Management and stakeholders alike are increasingly recognizing the risks for businesses associated with climate-change and other ESG-related considerations, and investors will increasingly expect sustainability-related issues to join the list of risks and opportunities discussed alongside other business issues in disclosures.
    - **The forward-looking nature of the MD&A**. Managing sustainability-related issues is not a backward-looking but a forward-looking exercise. The understanding that past performance may be a poor predictor of future performance is particularly

[23] *Under the NFRD, adopted in 2014, companies must report on how sustainability issues affect their performance, position, and development, and the impact of the company on people and the environment. For more information on the NFRD and its recent evolution to the coming CSRD, refer to the Novisto research note on the CSRD.*

applicable to sustainability-related performance, given i) the changing nature of system-level risk manifestations, ii) changing stakeholder expectations of appropriate corporate behaviour, and iii) growing expectations for companies not only to address and report on their impacts and dependencies, but to set targets for their key performance measures to achieve improved future outcomes.

- Emerging corporate reporting standards prescribe that sustainability information appear in general corporate disclosures.
    - The IFRS Sustainability Disclosures Standards (SDS) by the International Sustainability Standards Board (ISSB) are expected to require the inclusion of sustainability-related financial disclosures in a company's MD&A. This is established by the IFRS Exposure Draft S1 *General Requirements for Disclosure of Sustainability-related Financial Information*[24] published in March 2022.
    - The European Sustainability Reporting Standards (ESRS) developed by the European Financial Reporting Advisory Group (EFRAG) follow the IFRS definition of the MD&A as a complement to a company's financial statements. The ESRS - the first set of which was published in November 2022 and are mandated by the Corporate Sustainability Reporting Directive (CSRD) - will require that companies disclose material sustainability-related information as part of their management report, for the same period as financial information, essentially placing sustainability disclosures in general regulatory filings. The Draft ESRS 1 General Requirements (Appendix G) also specifies requirements for how sustainability information should be presented and identified as a single section in the MD&A[25].
- It is worth noting that any sustainability information included in the MD&A needs to comply with requirements of the MD&A. For instance, Canadian companies reporting ESG information in the MD&A will need this information to adhere to CPA Canada's six principles of disclosure for the MD&A (see Appendix A).

IFRS project to review the Management Commentary

- In 2005, the IFRS published a discussion paper *Management Commentary*[26] that looked at the state of the MD&A. It identified qualitative characteristics that the MD&A should have, and concluded that a company's reporting should be viewed as a package consisting of financial statements, accompanying notes, and the MD&A. However, it did not specify what information should be included in the MD&A or how it should be presented.
- Interestingly, the 2005 paper distinguished the primary audience of the MD&A (investors) from that of sustainability and CSR reports (a broader group of stakeholders)–emphasizing the financial-materiality perspective of the MD&A–but briefly mentioned that standardizing environmental risk measurement may benefit comparisons of company performance.

[24] *IFRS 2022*
[25] *EFRAG 2022*
[26] *IFRS 2005*

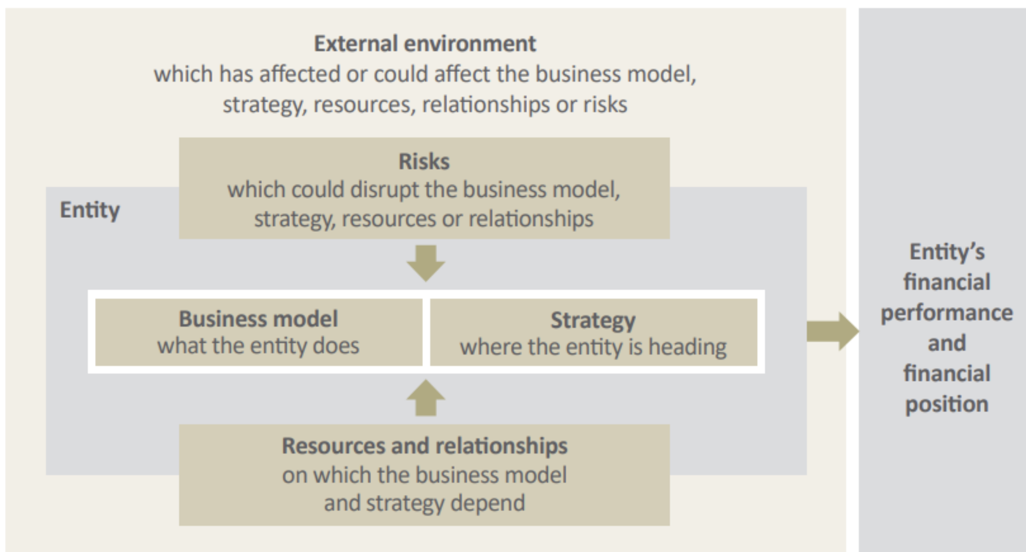
- In 2010, the IFRS released its [Practice Statement 1 *Management Commentary*] which provided a non-binding framework for companies drafting the MD&A[27] for financial statements prepared in accordance with the IFRS. The Practice Statement still did not specify what information the MD&A should include but stated that it should be clearly distinguished from other company information and **possess qualitative characteristics of comparability, verifiability, timelines, understandability, and materiality**. These principles parallel those in Canada laid out by CPA Canada, i.e., information presented through the eyes of management, integration with financial information, completeness and materiality, forward-looking orientation, strategic perspective, and usefulness (see Appendix A and B for more details).
- Companies do not need to comply with the Practice Statement for their general reporting to comply with the IFRS standards, but do need to disclose to what extent they followed the Practice Statement, if any. Despite its non-binding nature, the Practice Statement indicates the relevance of the MD&A to the IASB and thus to investors[28].
- In 2017, no doubt following the implementation of the NFRD in the EU, the IFRS launched a review of the 2010 Practice Statement, hoping to clarify the connection between financial and non-financial information, make the MD&A more useful to investors, and address identified gaps in current MD&A disclosures such as:
  - Lacking information on material challenges;
  - Too much boilerplate and generic information;
  - Overly short-term focus and lack of information on systemic risks and challenges;
  - Insufficient information about how intangible resources, relationships, and ESG matters affect the company's ability to create and preserve value;
  - Missing links between narrative and financial statements;
  - Information that is difficult to compare over time and to peers; and
  - Incomplete and unbalanced content.
- The work resulted in an [updated Practice Statement Exposure Draft *Management Commentary* (ED/2021/6)][29], published in May 2021 and open to a comment period until November of that year, which clarified the MD&A's purpose and defined key terms, including "material"[30]. It also provides an updated list of the attributes that the MD&A should

[27] IFRS 2010
[28] Pisano, S. and Alvino, F. 2015
[29] IFRS 2021
[30] The IFRS defines an issue as material if "...omitting, misstating or obscuring it could reasonably be expected to influence decisions that investors and creditors make on the basis of the management commentary and of the related financial statements." The view of materiality here is that of financial materiality - the impact on the company of creating or eroding value but not on other parties like customers, suppliers, employees, or society. Ultimately, it is up to management to decide whether information is material or not.

exemplify, including **completeness, balance, accuracy, clarity and conciseness, comparability, verifiability, and coherence**[31].

- The updated Practice Statement is meant to "overhaul" the existing one from 2010, and ultimately "enable an entity to bring together, in a single concise and coherent narrative, **information about financial, sustainability and other factors that have affected the entity in the reporting period or could affect the entity's prospects.**"
- It outlines the six "areas of content" that should be present in the MD&A:

Figure 1—Relationships between the six areas of content in management commentary

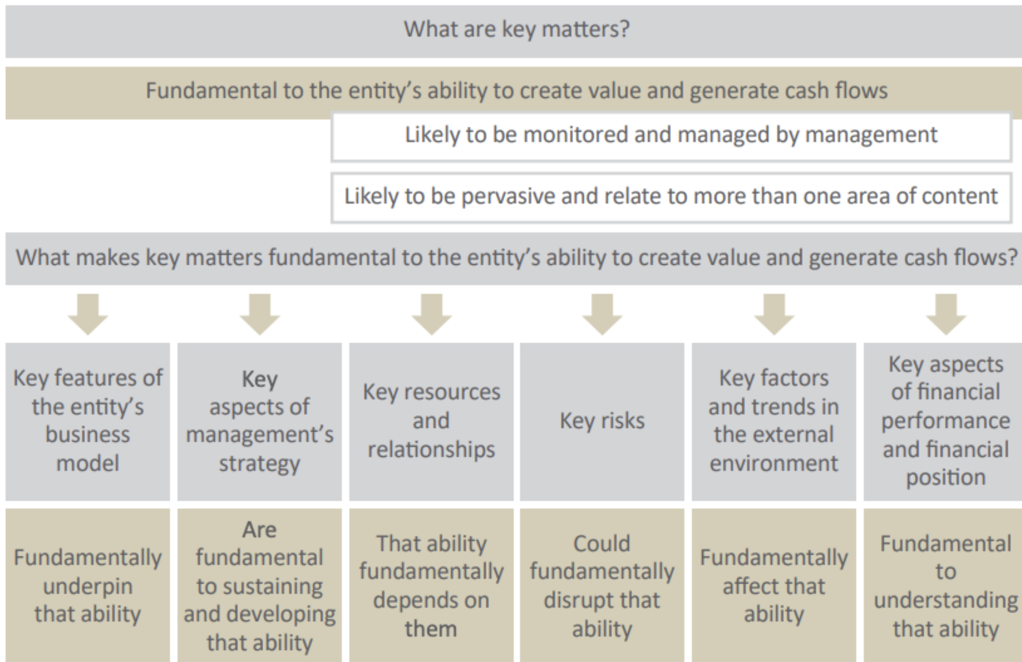


Source: [IFRS 2021]

- For each of these six areas of content, it further defines the "key matters" to be addressed by the MD&A, i.e. those "fundamental to the [company's] ability to create value and generate cash flows" across all time horizons:

[31] *IFRS 2021*

Figure 2—Descriptions and characteristics of key matters



Source: IFRS 2021

Digitization of narrative disclosures

- The IFRS project to review the management commentary coincides with efforts to digitize corporate disclosures, including qualitative narrative found in the MD&A, specifically with the attempt to align the 2021 Practice Statement Exposure Draft with the IFRS digital reporting XBRL taxonomy[32]. The intention is to break up the narrative MD&A into text-blocks based on the six key areas outlined above so that they can be tagged and extracted numerically, enabling users to analyze and compare textual information across periods and companies[33].
- This initiative aligns with global efforts to digitize sustainability disclosures to the same extent as financial disclosures. Indeed, digitization and XBRL tagging requirements can be found in the Corporate Sustainability Reporting Directive, and EFRAG has already begun work on the European Sustainability Reporting Standards (ESRS)'s XBRL taxonomy. For its part, the IFRS Foundation has released a draft XBRL taxonomy for its two Sustainability Disclosure Standards currently being finalized. Similar requirements are found in the US SEC's proposed rules for climate-related and cybersecurity-related disclosures.

[32] *IFRS Taxonomy 2021*
[33] *IFRS Agenda Paper 2021*

- In other words, just as we are witnessing the move towards incorporating sustainability disclosures into the MD&A, we are also witnessing the move towards the digitization of both sustainability disclosures and the contents of the MD&A.

IFRS project to align the MD&A with the Integrated Reporting (IR) Framework

- During its December 2022 meetings, the IFRS's ISSB agreed to prioritize four project proposals in its upcoming consultation on agenda priorities. One of these projects, **connectivity in reporting**, involves working with the IFRS's IASB to build on the MD&A guideline and the Integrated Reporting (IR) Framework, which is now "part of the materials" of the IFRS Foundation[34].
    - The Integrated Reporting Framework[35] aims to enable an entity to explain—primarily to investors and other capital market participants—how the entity creates, preserves, or erodes value over time by taking into consideration how the entity is affected and affects different financial, tangible, and intangible.
- This project would build on the work of the IASB to deliver a comprehensive overhaul of the 2010 IFRS Practice Statement 1 *Management Commentary* as described above—a project which at the time already referenced the work of the IR Framework—by specifically analyzing the feedback on the updated Exposure Draft in relation to the principles and concepts of the IR Framework[36].
- The objective of this work will be not only to facilitate the integration of sustainability disclosures into general purpose financial statements as per the requirements of the Exposure Draft IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*, but also to develop comprehensive disclosure requirements and guidance for companies to report **connected discussion and analysis of their financial statements and sustainability-related financial disclosures**.

[34] *Following the consolidation of the Value Reporting Foundation (VRF) into the IFRS Foundation in August 2022. The VRF comprised the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC).*
[35] *Integrated Reporting Framework 2021*
[36] *IFRS Staff Paper for ISSB Consultation on Agenda Priorities 2022*

Appendices

Appendix A: CPA Canada's general disclosure principles for the MD&A

- **Principle 1: Disclosing information "through the eyes of management" -** This principle requires disclosure of appropriate elements of the information used by management and therefore recognizes the need to align internal and external reporting. The information that is relied on to manage the company (including that presented to the company's board of directors) is the exact information investors need to truly view the company through the eyes of management. Companies need to balance the benefits of enhanced disclosure with the reluctance to report confidential or sensitive information that could affect the customer base or benefit competitors.
- **Principle 2: Integration with financial statements -** This principle reinforces the notion that the MD&A should complement and supplement, rather than form a part of, a company's financial statements. It should 1) provide an analysis of the financial position and performance and 2) present contextual and prospective information financial statements do not provide. To do so, the MD&A should be readable as a stand-alone document (not cross-referencing other documents) and explain the conditions and events that shaped financial results and how past conditions and events may impact future financial consequences using both qualitative and quantitative data.
- **Principle 3: Completeness and Materiality -** This principle reinforces that the MD&A must be written fairly, avoiding promotional language and exaggeration to ensure management credibility. The MD&A should transparently report good and bad news, without any systemic or deliberate bias, and disclose any information that is material to decision-making readers. A complete disclosure is one in which management identifies, addresses, and communicates qualitative and quantitative information necessary for users to understand and evaluate the company's strategy, risks, results, prospects, etc. Materiality should be assessed with regard to the "bigger picture" and relevance to future prospects. If events or changes to material information occur after the completion of the MD&A but before its release, management should assess whether the change is material enough to investors to update the MD&A needs to be adjusted - management should review the MD&A before the release to ensure that it is still balanced.
- **Principle 4: Forward-looking orientation -** This principle states that the MD&A should disclose forward-looking information and explain past events, decisions, circumstances, and performance in the context of whether they are likely indicative of future prospects. It also calls for management to describe strategy and future events, circumstances, opportunities, and risks likely to materially impact future prospects. However, any discussion of the future must be objective and not overly optimistic.
- **Principle 5: Strategic perspective -** This principle reinforces the purpose of the MD&A to provide information that a reasonable investor would want to know in making investment decisions. Management should disclose objectives and show progress towards achieving

milestones and long term goals (with time horizons based on industry specifications and longer-term investor needs).

- **Principle 6: Usefulness -** This principle stipulates that the MD&A be **understandable** (written in plain language that is not a repetition of previous MD&A, and with the use of graphics or explanatory narratives where appropriate to enhance understanding); **relevant** (presents material information that is relevant to the company with appropriate prominence); **comparable** (showing similarities and differences between other periods through consistent reporting over successive periods); **verifiable** (faithful in its representation); and **timely** (to put all current and potential investors on "equal footing")[37].

Appendix B: IFRS's specified attributes of MD&A contents (from the 2021 IFRS Practice Statement Exposure Draft *Management Commentary*)

- **Completeness -** Refers to providing a complete depiction of matters means providing all material information about the matter—not necessarily all information available to management—and includes all material information necessary for investors and creditors to understand the matter, including all material descriptions and explanations.
- **Balance -** Information is balanced if it is not slanted, weighted, emphasized, de-emphasised, or otherwise manipulated to make it more likely that investors and creditors will receive that information favorably or unfavorably. Achieving overall balance requires balance in the selection of matters to discuss as well as a discussion of both the aspirations and factors that could prevent management from achieving those aspirations.
- **Accuracy -** Information can be accurate without being perfectly precise in all respects. The degree of precision needed and attainable, and factors that make information accurate, depend on the nature of the information and the nature of the matters it addresses. For example, accuracy requires that: (a) factual information is free from material error; (b) descriptions are precise; (c) estimates, approximations and forecasts are clearly identified as such; (d) no material errors have been made in selecting and applying an appropriate process for developing an estimate, approximation or forecast, and the inputs to that process are reasonable and supportable; (e) assertions are reasonable and based on information of sufficient quality and quantity; and (f) information about management's judgements about the future faithfully reflects both those judgements and the information on which they are based.
- **Clarity and conciseness -** The MD&A needs to use plain language, and avoid jargon and unnecessary technical terminology. The clearest form of presentation depends on the nature of the information, and might sometimes include tables, graphs or diagrams in addition to narrative text. If graphs or diagrams are used, additional text or tables might be necessary to avoid obscuring material detail. Clarity might be further enhanced by distinguishing information about developments in the reporting period from 'standing'

[37] *CPA Canada 2014*

information that remains unchanged, or changes little, from one period to the next. For management commentary to be concise, it needs to: (a) avoid generic information, sometimes called ‘boilerplate’, that is not specific to the entity; (b) avoid duplication of information within management commentary, or unnecessary duplication of information also provided in the related financial statements; and (c) use simple, clear language and short, clearly structured sentences and paragraphs.

- **Comparability -** Information provided in the MD&A should be able to be compared with (a) information provided by the entity in previous periods; and (b) information provided by other entities, in particular those with similar activities or operating within the same industry. Accordingly, information in the MD&A shall be provided in a way that enhances comparability without omitting material information
- **Verifiability -** Information is verifiable if it is possible to corroborate either the information itself or the inputs used to derive it. Information in the MD&A shall be provided in a way that enhances its verifiability, including (a) sharing information that can be corroborated by comparing it with other information available to investors and creditors about the business, about other businesses or about the external environment; and (b) providing information about inputs and methods of calculation used to produce estimates or approximations. Some material information—for example, some explanations and forward looking information—might not be verifiable. Material information is included in the MD&A even if it is not verifiable. To help investors and creditors decide whether to use such information, the MD&A shall describe the underlying assumptions and methods of producing the information as well as other factors that help support it.
- **Coherence -** The completeness, clarity and comparability of information in the MD&A all rely on that information being presented as a well integrated, coherent whole. If a matter discussed for one area of content in the MD&A has implications for other areas of content, the MD&A shall include the information necessary for investors and creditors to assess those implications. Some information in the MD&A might be understood best in the context of information in another part of the management commentary, or in the context of information in the related financial statements. For management commentary to be coherent, such information shall be presented in a way that explains that context and the relationships between the related pieces of information[38].

Appendix C: Legislation in the US, Canada, and the EU about disclosing sustainability information in the MD&A

- In the US, the 2020 amendments to regulation S-K Item 303 specified that events that are “reasonably likely” to occur, such as those related to climate change, must be discussed in the MD&A. The amendment also introduced the requirement to disclose information about human capital resources, widely regarded as a major ESG issue, in the 10-K. Further, in

[38] *IFRS 2021*

March 2022, the US proposed regulation[39] that would require public companies to include climate-related disclosures when reporting on material impacts, risks, results of operations, financial conditions, metrics, and future plans of the company[40].

- In Canada, proposed amendments to NI 51-102 would not only consolidate the MD&A with other reporting requirements but also broaden and clarify what information is mandatory in the MD&A.
- In October 2021, the CSA proposed climate-related disclosure rules through its proposed NI 51-107 *Disclosure of Climate-related Matters*[41], which would apply to all reporting issuers and require companies to disclose climate-related information including scenario-analysis, GHG emissions data, and climate-related strategies and governance in their AIF or MD&A, in compliance with the TCFD recommendations. The CSA completed its consultation phase but has postponed issuing final disclosure rules, presumably until the new US SEC climate-related disclosure rules are finalized.
- In Europe, the coming CSRD will mandate that the MD&A include disclosures on how sustainability issues affect company performance, position, and development[42] and that these disclosures are aligned with the European Sustainability Reporting Standards (ESRS), the first set of which was released on November 15, 2022 by the European Financial Reporting Advisory Group (EFRAG). The standards provide details of how sustainability information should be presented as part of the MD&A and mandate that sustainability disclosures are included in an identifiable section of the MD&A. This section will be called the "sustainability statements" and will need to include information in four sections: general information, environmental information, social information, and governance information[43], as well as disclosures pursuant to Article 8 of the EU Taxonomy[44]. They will also require the audit (assurance) of reported information and require companies to produce a digitized report into a single European access point, with XBRL 'tags' to make their disclosures machine-readable.

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[39] *SEC 2021*

[40] *The proposed US regulation would have companies share information about scope 1, 2, and 3 emissions and the impact of climate-related events and risks (severe weather, regulatory changes, etc.) and link it directly to financial statement line items. Companies will also have to provide metrics and targets for any climate transition plans and information about parameters, assumptions, and strategies of any climate scenario analyses, similar to disclosures required by the TCFD and the GHG Protocol. Currently, the comment period on the proposal ended as of June 2022.*

[41] *OSC 2021*

[42] *The CSRD will mandate the MD&A as part of one larger submission by EU companies subject to the regulation and increase sustainability requirements for companies, including mandating disclosure by a larger subset of EU companies (nearly 50,000 companies compared to the current 11,600 companies that fall under the NFRD). Refer to the Novisto research note on the CSRD for further details on the CSRD and what companies it applies to.*

[43] *EFRAG 2022*

[44] *The EU taxonomy is a classification system of environmentally sustainable economic activities used as a tool to define the degree to which a company activity (or an investment in the activity) is environmentally sustainable under the EU Sustainable Finance Action Plan. Refer to the Novisto research note on the EU Taxonomy for further details.*

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