CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

# Reporting Alert

## CORPORATE REPORTING

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# Preparing MD&A Discussion of Liquidity and Capital Resources

To make sound decisions about investing in a company, investors need information about its liquidity and related risks, and about its capital resources. Canadian securities laws require a public company to provide full disclosure of material information about such aspects of its business within Management's Discussion and Analysis (MD&A). The principal requirements for annual and interim disclosures are set out in the Canadian Securities Administrators' National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102) and accompanying Form 51-102F1 *Management's Discussion & Analysis* (NI 51-102F1).[1]

The CPA Canada publication *Management's Discussion and Analysis — Guidance on preparation and disclosure*[2] (the MD&A Guide) provides general guidance for developing MD&A disclosure. The MD&A Guide introduces its discussion of capital resources, liquidity and other matters as follows:

1 The complete texts of NI 51-102 and NI 51-102F1 are available at **www.albertasecurities.com/industry/securities-law-and-policy/_layouts/Regulatory-Instruments/RegulatoryInstrumentDispForm.aspx?List=c425783b%2D0214%2D41e1%2Dbc6a%2D66e6766ff3aa&ID=114&Web=729da164%2D5e70%2D47a7%2Dbdea%2D6a26546e92e3**

2 Available at **www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/mdanda-and-other-financial-reporting/publications/guidance-for-MDA-preparation-and-disclosure**

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

This *Reporting Alert* provides important considerations to aid preparers in developing disclosures about liquidity and capital resources in their company's MD&A. It does not, however, attempt to provide advice on how to comply with securities regulations. Whether MD&A disclosures comply with applicable securities requirements is ultimately a legal matter and should be considered carefully. The information included in this *Reporting Alert* is for general information purposes only and should not be used as a substitute for consultation with professional advisors.

## Important Considerations for Preparers

2015 was challenging for many companies. Falling commodity prices, currency volatility and concerns about global growth prospects have added to current economic uncertainties causing companies to reassess their expectations and business plans, with obvious consequences for their disclosures about liquidity and capital resources. However, these disclosures can be equally or even more important when the risks are less apparent and the impact on liquidity is more subtle and incremental. In the latter circumstances, it may be particularly challenging to convey all the strengths, weaknesses and related sensitivities of an entity's current liquidity position, and to convey how these might evolve in subsequent periods.

This *Reporting Alert* presents a series of questions and factors for preparers of MD&A to consider as they develop their disclosures around liquidity and capital resources. The following questions and considerations are not intended to be comprehensive or cover matters relevant to every entity. The nature and extent of disclosures about liquidity and capital resources required in practice will vary greatly from one entity to another depending on its circumstances.

### 1. Does your disclosure tie into the company's business and financial plans?

Readers need context to understand the company's current and prospective liquidity and ability to fund its stated strategy. In developing disclosures about liquidity and capital resources, it is important that preparers seek and consider input from all relevant sources in the organization to ensure a complete understanding of the company's financial condition, objectives and business plans and the implications for such disclosure. Input can be sought from the chief executive officer, senior management, legal counsel, operational management and others, depending on the circumstances.

## 2. Does your disclosure address the company's current and anticipated sources of and needs for cash as well as its capital resources?

Readers need to understand a company's cash needs and sources of cash and how the company uses its capital resources to satisfy those needs. In determining a company's cash needs and sources of cash, factors to consider include:

***Cash needs***

- current obligations, budgets and plans in the short and long term
- cash requirements to maintain the company's operating capacity, meet planned growth and fund development activities
- impact of non-operating items, including the need to fund debt repayments and share repurchases
- ability to continue to pay dividends at current payout ratios
- impact of commitments, whether or not disclosed in the financial statements (e.g., approved and announced capital spending budgets, contractual obligations to make exploration or development expenditures)
- existing debt and equity instruments and associated servicing costs, bringing out important distinctions between short- and long-term instruments

***Sources of cash***

- resources available to satisfy cash needs in the short and long term (e.g., operating cash flows, lines of credit, debt or equity financing)
- impact of non-operating items, including cash inflows from items such as asset sales, debt and equity issuances
- flexibility in cash management (e.g., discretion to make capital expenditures)

## 3. Does your disclosure address market conditions and risks impacting liquidity?

Readers need to understand the threats to solvency and liquidity and how the prevailing external environment affects the company's ability to maintain or expand current operations, fund capital projects, meet obligations as they come due and raise capital in the future. Balanced disclosure in this area is important and should also consider how the company is responding or plans to respond to the risks and circumstances identified. Factors to consider include:

- effects of current market conditions on the company's ability to generate future cash flows from operating and financing sources (e.g., reductions in cash flows from operating activities, inability to roll over or renew existing lines of credit, difficult market conditions for offering new shares to the public)
- difficulties affecting the company's industry and competitors (e.g., liquidity challenges, debt covenant compliance issues)
- ability in the short and long term to satisfy debt covenants
- risks associated with financial instruments, including the collectability of accounts receivable, and other sources of liquidity
- extent to which the company is hedged against market fluctuations and will continue to be hedged in future periods

- events that could impact future liquidity (e.g., commodity price changes, loss of customers or contracts)
- terms of and changes in credit facilities, debt covenants and debt repayments, including their effects on operations
- legal restrictions on the ability of subsidiaries to transfer funds to the company and their impact on the company's ability to meet its obligations
- consequences of defaults under current financing agreements, which may involve uncertainty about the company's ability to continue as a going concern

### 4. Does your disclosure address significant changes in balance sheet conditions, income and cash flow items during the reporting period covered by the MD&A?

Readers need to understand the reasons for changes in cash flows including how changes in balance sheet conditions and net income materially affected cash flows. This analysis is important when assessing trends and variability in cash flows. This analysis might consider:

- sources of cash during the reporting period and the period-end cash position
- working capital position at period end and the effects of changes during the reporting period in non-cash working capital balances
- net income (loss) and how it affected liquidity during the reporting period
- reductions in cash flows from operating activities
- significant net cash outflows in the current period or a succession of net cash outflows over several periods
- increases in long-term indebtedness over several periods

### 5. Is your MD&A disclosure consistent with information reported in other external communications (e.g., company websites, investor presentations etc.)?

Management may discuss events and trends during earnings calls or on a company website. It is important to review such information for consistency with what is disclosed in the MD&A. Improved connectivity among sources of information provides readers with a coherent picture of the company's performance, financial condition and future prospects.

Comments on this *Reporting Alert* or suggestions for future *Reporting Alerts* should be sent to:

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