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Disclosure Examples

Corporate Finance Branch

October 23, 2012

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Going Concern

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Going Concern

Observations

Financial fundamentals, such as a working capital deficiency, an excessive cash burn rate and milestone challenges, suggest liquidity concerns that may cast doubt on the company's ability to continue operations, however a going concern note is absent

Why Important

A going concern note provides warnings about the significant risks being faced by the company and identifies concerns regarding its future viability, both of which will ultimately impact investment decisions

Management needs to assess the company's ability to continue as a going concern for at least 12 months from the end of the reporting period

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Going Concern
Example of Boilerplate Disclosure

Unclear if this is meant to highlight a material uncertainty

The company is considered to be in the development stage and is currently exploring mineral properties in Central America. While these financial statements have been prepared on a going concern basis, the company continues to remain dependent on its ability to obtain sufficient funding to sustain operations and complete its current exploration projects.

While the company has been successful in raising financing in the past, there can be no assurance that it will be able to do so in the future.

Missing clear disclosures of material uncertainties that cast significant doubt

If the going concern assumption was not appropriate, then adjustments might be necessary to the financial statements.

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Going Concern
Example of Entity-Specific Disclosure

The company is considered to be in the development stage and is currently exploring mineral properties in Central America. The financial statements were prepared on a going concern basis. The going concern basis assumes that the company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

Specific disclosure of the material uncertainties that cast significant doubt

During the year ended December 31, 2011, the company had a net loss of $2 million, negative cash flow from operations of $800,000, and positive working capital of $3.2 million. The positive working capital balance was mainly due to having a cash balance of $5.5 million. Given the company maintained positive working capital, it believes that it will have sufficient capital to operate over the next 12 months, however additional funding will be necessary to complete its bulk sampling program by the 14 month requirement date.

Going Concern
Example of Entity-Specific Disclosure (cont'd)

Explicit link between disclosed uncertainties and ability to continue as going concern

Historically the company has had operating losses, negative cash flows from operations, and working capital deficiencies. Whether, and when, the company can attain profitability and positive cash flows from operations is uncertain. The company is also uncertain whether it can obtain financing to complete clinical trials for Wonder Drug. These uncertainties cast significant doubt upon the company's ability to continue as a going concern.

The company will need to raise capital in order to fund its operations. This need may be adversely impacted by: uncertain market conditions, approval by regulatory bodies, and adverse results from clinical trials. To address its financing requirements, the company will seek financing through debt and equity financings, asset sales, and rights offerings to existing shareholders. The outcome of these matters cannot be predicted at this time.

Discussion of Operations

Discussion of Operations

Observations

Discussion of operations is boilerplate and does not provide entity-specific disclosure about changes in revenues and cost of sales

Why Important

Investors require meaningful discussion of operations so that they can better understand the reasons why there have been changes

Provide analysis of operations by discussing why revenues and costs have changed

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Discussion of Operations
Example of Boilerplate Disclosure

Repetition from financial statements

No discussion of variances

Revenue increased from $900,000 to $1,080,000, a 20% increase. Gross profit increased from $400,000 to $408,000, a 2% increase.

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Discussion of Operations
Example of Entity-Specific Disclosure

Discussion of variances

Quantification of factors

Relationship with gross profit

Revenue increased from $900,000 to $1,080,000, a 20% increase. Gross profit increased from $400,000 to $408,000, a 2% increase. Three factors caused revenue to increase by $180,000:

- increased sales volume of Product X-$60,000;
- decreased unit price of Product X-($30,000); and
- the introduction of a new product during the fourth quarter, Product Y-$150,000.

In late 2011, we anticipated new competition entering our market, so we discounted our remaining Product X units to encourage their sale and to allow us to focus on its replacement, Product Y. Discounts on Product X caused the reduced gross profit percentage. We expect to continue discounting Product X in the first quarter, but expect our gross profit to improve as Product Y replaces Product X.

Liquidity and Capital Resources

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Liquidity and Capital Resources

Observations

A meaningful analysis of the company's ability to generate sufficient cash, address its working capital requirements and its ability to access financing to meet its committed expenditures is not always provided

Why Important

Investors need to clearly understand any anticipated funding shortfalls and financing resources available to meet a company`s operating needs, obligations and fund any future planned growth

Companies should explain their current liquidity position and how they will fund upcoming operating commitments and other obligations

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Liquidity and Capital Resources
Example of Boilerplate Disclosure

- Identifies working capital deficiency
- No explanation of how deficiency will be remedied
- No explanation of how will meet obligations

As at year-end, the company had cash of $100,000 and accounts receivable of $50,000. Current assets amounted to $150,000 with current liabilities of $400,000 resulting in a working capital deficit of $250,000. The company believes that it has sufficient capital on hand to satisfy working capital requirements for the next 12 months.

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Liquidity and Capital Resources
Example of Entity-Specific Disclosure

Ability to generate cash

Working capital requirements

As at year-end, the company had cash of $100,000 and accounts receivable of $50,000. Current assets amounted to $150,000 with current liabilities of $400,000 resulting in a working capital deficit of $250,000. Working capital was impacted by the slowdown in operations experienced in Q3 and Q4 as a result of the labour stoppage in our Calgary plant, which resulted in insufficient inventory levels of Product Z to meet orders. Since the labour agreement was renegotiated in December, subsequent to year end operations have resumed to prior period levels. The company's working capital requirements for the next 12 months are estimated to be $300,000.

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Liquidity and Capital Resources
Example of Entity-Specific Disclosure (cont'd)

Expected sources of funds

Subsequent to year end:

- January 2012 - the company negotiated a credit facility with Lender ABC for an amount up to $300,000.
- February 2012 - the company received a significant order from Customer DEF for the purchase of 50,000 units of Product Z to be delivered in stages by the end of fiscal 2012.

Ability to meet working capital obligations

As Calgary operations have been resumed and with the receipt of this significant order, the company believes it will have sufficient funds to meet current and future working capital requirements. In addition, the company will also have funds available through the credit facility.

Capex requirements

Expected sources of funds

We estimate that the company will need $500,000 over the next two years to invest in machinery to produce Product X. The company plans to raise additional financing through a share issuance in fiscal 2013 in order to fund this project. The company will not proceed with this project until sufficient funds are raised to fund it.

Risks and Uncertainties

Risks and Uncertainties

Observations

Disclosure of risks and uncertainties is often boilerplate in nature and the potential impact of how the risks may affect the company is rarely disclosed

Why Important

Investors need to understand the entity-specific risks and how those risks may impact the company and its business, both of which may affect an investment decision or the value of their investment should the risks be realized

Throughout each section of the MD&A, companies should disclose risks and uncertainties that are material and entity-specific

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Risk and Uncertainties
Example of Boilerplate Disclosure

General and not specific to company

Potential impact is not disclosed

Competition Risk

Our industry is very competitive. We face significant competition from other software companies in all aspects of our business. Our competitors are larger in size, well established, international in scope and have significant financial resources. We continue to actively monitor the activities of our competitors with a view to ensuring that we will be able to effectively compete in the marketplace and attract new customers.

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Risk and Uncertainties
Example of Entity-Specific Disclosure

Entity-specific

Potential impact

Risk management

Competition risk

We face significant competition from other manufacturers in Canada and Country ABC. Our competitors include Company Calao and Company Lagos. These competitors are well established, international in scope and have significant financial resources that permit them to develop new products, modify existing products, use proprietary software and market products on a global basis. Competition is based mainly on price, quality of product and efficiency of production. The increased competition may affect our sales, cash flow and financial condition. To mitigate competition risk, our strategies include creating long-term value for our customers and implementing efficient processes to manufacture our main product TopProgram.

Transactions Between Related Parties

Transactions Between Related Parties

Observations

The business purpose and economic substance of related party transactions (RPTs) is sometimes not disclosed

Why Important

By virtue of their nature, related party transactions lack the independence inherent in arm's length transactions. Investors need to understand the business purpose and economic substance of RPTs, so they can understand the rationale for transactions and impact on the business

Companies should clearly discuss ALL related party transactions, including the identity of the parties and their relationship to the company, as well as the business purpose and economic substance of each transaction

Transactions between Related Parties Example of Boilerplate Disclosure

Lacks detail on the transaction and the identity of the related party

During the year, the company paid $300,000 to a director for consulting services and interest on a loan.

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Transactions between Related Parties Example of Entity-Specific Disclosure

Relationship/ identity Business purpose and amount Measurement basis used	During the year, the company paid $300,000 to Steven Jones, a director who is a geologist. The company paid $20,000 to Mr. Jones for the use of office space he provided, and $80,000 for his geological services in connection with Phase 1 of the exploration program on the ABC option. The office space and geological services, which were both provided in the normal course of operations at rates comparable to what would have been paid to unrelated parties, were measured at the exchange amount.
Business purpose and amount	The company also paid Mr. Jones $200,000 in interest on a loan he provided in the principal amount of $2,000,000. The unsecured loan bears interest at 10% per annum, and matures in five years with an option by the company to extinguish the debt at any time without penalty. The company entered into this related party transaction because alternate sources of financing were unavailable due to the company's limited operating history, lack of collateral and limited access to public financing due to current market conditions.

Forward-Looking Information

Forward-Looking Information

Observations

Companies that choose to disclose forward-looking information (FLI) fail to label it as such. They provide non-entity specific disclosure of assumptions and do not update previously disclosed FLI

Why Important

FLI allows investors to see how well the company has forecasted results and how it is progressing towards the achievement of these results

If a company chooses to provide FLI, it should provide information that allows readers to understand the company's future prospects. This information should be updated on a timely basis

Forward-Looking Information (cont'd)

- Must be reasonable basis for all FLI disclosed
- Material FLI must include disclosure that:
  - identifies it as FLI
  - cautions users that actual results may vary from FLI and identifies risk factors that could cause results to vary
  - states assumptions used to develop FLI
  - describes company's policy for updating FLI
  - is limited to a reasonable period

For more information, see:
- *National Instrument 51-102, Part 4A*
- *Appendix E*

Forward-Looking Information
Example of Boilerplate Disclosure

FLI not identified

No assumptions provided

In fiscal 2012, the Company anticipates meeting the following targets:

- Total revenues expected to be between $15 - $20 million
- Introduce new high margin product
- Cash EPS expected to be between $0.25 - $0.35
- Adjusted Cash Flow from Operations > $12 million

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Forward-Looking Information
Example of Entity-Specific Disclosure

Identification of FLI

Assumptions

The following represents forward-looking information and users are cautioned that actual results may vary. In fiscal 2012, the company expects total sales to increase by 5.0% to 6.0%. This expectation is based on the introduction of our new product AmazeInvention. It is expected that AmazeInvention will contribute to the increase in sales and will be offset by increased competition from other firms and the retirement of legacy products. Key performance indicator for the company includes pre-orders of 3 million units. As discussed under risk factors, new products developed by other firms may erode or reduce expected sales.

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Forward-Looking Information
Example of Updating Previously Disclosed FLI

2011 objectives	Accomplishments in 2011
Sales growth of 3-4%	<u>Sales growth of 10.5%</u> The increase in sales growth achieved during fiscal 2011 was due to the introduction of product XX in Q4 which resulted in a growth of 6% of sales, reduction of the selling price of product Y which resulted in the increase in sales volume of 75%.
Litigation expenditure $12-13 million	<u>Litigation expenditure of $20 million.</u> Spending was $7-8 million higher than originally anticipated due to outstanding matters with Litigus Co. The suit alleges that the company infringed on various patents owned by Litigus Co. as disclosed in Discussion of Operations.

Non-GAAP Financial Measures

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Non-GAAP Financial Measures

Observations

Many companies disclose non-GAAP financial measures, such as EBITDA, however they often do not explain why these measures provide useful information to investors. As well, these measures are not always reconciled to the most directly comparable GAAP measure.

Why Important

Since non-GAAP financial measures do not form part of IFRS and as such do not have a standardized meaning or calculation, it is critical that companies explain the composition of the measure and its relevance so that investors and analysts are fully informed

When providing non-GAAP financial information, companies have an obligation not to mislead investors or obscure the company's GAAP results

For more information, see:

- *CSA Staff Notice 52-306*

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Non-GAAP Financial Measures
Example of Boilerplate Disclosure

- No explanation of why useful
- No reconciliation provided
- Standardized language missing

Our operating income before specific items rose 31%, reaching a new peak of $101 million.

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Non-GAAP Financial Measures
Example of Entity-Specific Disclosure

Our profit for the fiscal year was $50 million compared to $31 million in the previous fiscal year. Operating income before specific items (OIBI) rose 31%, reaching a new peak of $101 million. OIBI of the previous fiscal year was $77 million.

Highlights that there is no standardized meaning

OIBI is a non-GAAP measure and is mainly derived from the consolidated financial statements but does not have any standardized meaning prescribed by IFRS. Therefore it is unlikely to be comparable to similar measures presented by other companies.

Why useful

OIBI is used by management to evaluate the performance of its operations based on a comparable basis which excludes specific items that are non-recurring. When a specific item occurs in more than two consecutive fiscal years, it is no longer considered to be non-recurring by management.

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Non-GAAP Financial Measures
Example of Entity-Specific Disclosure (cont'd)

Why useful

We believe that a significant number of users of our MD&A analyze our results based on OIBI since it is a yearly comparable measure of the performance of the Company.

Presented with equal prominence to IFRS

Reconciliation of OIBI to profit in thousands of dollars:

Quantitative reconciliation

OIBI	$101	$77
Restructuring of distribution network	($6)	$0
Relocation of production	$0	($9)
Gross income as per financial statements	$95	$68
Sales and administrative expenses.	$23	$19
Financial expenses	$12	$9
Tax expenses	$10	$9
Net income as per financial statements	$50	$31