

APPENDIX B

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) DEFICIENCIES

As in prior years, deficiencies were noted in the MD&A disclosure. As stated in Part 1(a) of Form 51-102F1 *Management's Discussion and Analysis* of National Instrument 51-102 *Continuous disclosure obligations (Form 51-102F1)*, the MD&A should include balanced discussions of the issuer's financial performance and financial condition, including, without limitation, such considerations as liquidity and capital resources. The MD&A should help current and prospective investors to understand what the financial statements show and do not show. It should also discuss material information that may not be fully reflected in the financial statements.

There are three important areas of the MD&A where deficient disclosures were noted: 1) liquidity; 2) discussion of operations; and 3) related party transactions. For each area, we have provided examples of deficient disclosure contrasted against more robust entity-specific disclosure.

1. Liquidity

Many smaller issuers focus their resources on completing a project or on expanding their operations. In accordance with section 1.6 of Form 51-102F1, the MD&A should focus on the issuer's ability to generate sufficient liquidity in the short term and in the long term to fund development activities or to meet planned growth. Moreover, the MD&A should explain how an issuer will meet its obligations as they become due and how they will address working capital deficiencies. We often find issuers reproduce in their MD&A information that is readily available from the financial statements without ensuring compliance with section 1.6 of Form 51-102F1.

<i>Example of deficient disclosure</i>			
<i>Liquidity</i>			
Year ended	December 31, 2012	December 31, 2011	Difference
	\$	\$	\$
Cash flows from operating activities	(270,000)	102,000	(372,000)
Cash flows from investing activities	(350,000)	(340,000)	(10,000)
Cash flows from financing activities	520,000	425,000	95,000
Increase (decrease) of cash flows	(100,000)	187,000	(287,000)
<i>Operating activities</i>			
<i>The cash flows used in operating activities totalled \$270,000. For the same period last year, the cash flow from operating totalled \$102,000.</i>			

Investing activities

The cash flows used in investing activities increased by \$10,000.

Example of deficient disclosure (continued)

Financing activities

The cash flows from financing activities totalled \$520,000. For the same period last year, the cash flows from financing totalled \$425,000.

	December 31, 2012	December 31, 2011	Increase (decrease in working capital)
	\$	\$	\$
Cash	51,000	151,000	(100,000)
Accounts receivable	789,000	852,000	(63,000)
Inventory	800,000	942,000	(142,000)
Prepaid expenses	30,000	28,000	2,000
Bank indebtedness	350,000	0	(350,000)
Loan – Investment tax credits	120,000	0	(120,000)
Accounts payable	1,035,000	877,000	(158,000)
Current portion of long term debt	150,000	100,000	(50,000)
Total working capital	15,000	996,000	(981,000)

The company's working capital decreased by \$981,000.

Example of entity-specific disclosure

At the end of fiscal 2012, the Company had \$51,000 of cash on hand and working capital of \$15,000.

Given the various projects the Company is handling in the short and medium terms, management still considers the current cash balance and forecast net cash flows from operating activities for the next 12 months to be below the \$300,000 desirable for its planned business development activities.

The success of development projects depends greatly on the Company's ability to generate sufficient cash to meet its needs. In fiscal 2012, the Company renegotiated the terms of its financing agreement with its financial institution and obtained an operating line of credit of \$500,000 to continue development of its X products distribution activities and to finance growth. As at the end of fiscal 2012, \$150,000 was available on the line of credit. Also in 2012, the Company contracted new financing of \$120,000, secured by investment tax credits, to continue research and development work on its Y project. This financing was used at the end of fiscal 2012.

Hence, as of the end of fiscal 2012, management was still considering various sources of financing available on the market to increase the Company's liquidity. At year end, management was negotiating a private placement of \$500,000 that was completed after year end.

2. Discussion of operations

An MD&A should explain what factors contributed to changes in an issuer's operations. Issuers often reproduce information from the statement of profit or loss and other comprehensive income in their MD&A, without explaining what caused the changes.

In accordance with section 1.4 of Form 51-102F1, the revenue analysis included in an issuer's MD&A should discuss any change caused by selling prices, volume or quantity of goods or services being sold, or the introduction of new products or services. It is useful to investors if the issuer quantifies each of these elements. If other elements affected revenue, such as the introduction of a new competitor, the issuer's MD&A should also address these factors. If an issuer's financial statements present information from more than one reportable segment, the issuer must discuss the results of each segment in its MD&A.

Example of deficient disclosure

The Company reported revenue of \$7,666,000 for the year ended December 31, 2012, compared with \$7,098,000 a year earlier, an increase of 8%. The growth is mainly due to the sales of L products.

Example of entity-specific disclosure

During fiscal 2012, the Company's sales increased by 8%. The Company undertook a new activity, namely the distribution of L product in the Canadian manufacturing sector. As at year end, because of a delay in the manufacturing of L products, this activity had not yet reached the level that management had anticipated. The sales of L products increased sales by 7%.

Since 30% of sales are made in US dollars, the depreciation of the Canadian dollar had a positive impact on sales. This impact was a 3% increase in sales.

Despite the positive effect of the introduction of L product and of the exchange rate, the arrival of a new competitor forced the Company to decrease its sale price on product V. With this decrease, the Company was able to maintain the sale volume of product V. Due to the quality reputation of product V, management believes that no other decrease of the sale price will be necessary to maintain the sale volume of product V in the future. The decrease in the sale price caused a 2% decrease in sales.

3. Related party transactions

Under section 1.9 of Form 51-102F1, issuers are required to identify the related person or entities, to discuss the business purpose of the transaction, to describe the measurement basis used and to discuss ongoing commitments resulting from the transaction. It is common for issuers to reproduce the related party transactions note provided in their financial statements or to simply refer to that note. However, IAS 24 *Related Party Disclosures* does not require the same level of information as section 1.9 of Form 51-102F1.

Example of deficient disclosure

The Company paid \$150,000 to a company controlled by a director for consulting services.

Example of entity-specific disclosure

During the year, the Company paid \$150,000 to Orange Inc., which is controlled by Mr. Smith, Chief Executive Officer and director of the Company. The \$150,000 fee was paid for programming services relating to the implementation of new inventory software. The fee is based on what Orange Inc. usually charges its regular clients less a 10% discount. The Company expects to continue to use Orange Inc.'s programming services until the implementation of the new inventory software is completed.