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HOW TO WRITE BAD MD&A

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There are plenty of articles about how to write good MD&A - referring of course to the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of your company's Form 10-K, Form 10-Q or Securities Act registration statement.

The purpose of this article is to give you concrete tips on how to write bad MD&A, section by section.

Let's get started.

MD&A Overview

Keep the overview section "spoiler free." That way, readers will go into the MD&A unburdened by any preconceived notions of what management or anyone else thinks is important about the company's financial model.

You don't want to give away the best parts of the story up front!

So, instead of drafting an overview that generally explains the company's financial model and highlights the most important information contained later in the MD&A, repeat verbatim the general overview description of the company's business from earlier in your filing - and include nothing else.

Critical Accounting Policies and Estimates

Import wholesale the "Significant Accounting Policies" disclosure from the financial statement footnotes with no additional discussion or analysis.

Alternatively, include boilerplate treatments of universally applicable and hard to understand accounting policies like Stock-Based Compensation, Fair Value of Financial Instruments and Impairment of Long-Lived Assets, for example, with no explanation of why management considers these accounting policies important, or how a change or error in management's judgments or estimates in applying these policies could cause the company's financial results to differ.

The goal here is to bore the reader to the point that he or she is numbed to the actual numbers that follow.

No Recent Accounting Pronouncement Left Behind

How recent is "recent"? Reasonable minds can differ on this point.

You should err on the side of inclusiveness, and allow your list of recent accounting pronouncements to grow into a majestic tapestry of boilerplate sure to repel even the most diligent reader. In particular, describe in detail all of the recent accounting pronouncements that management has reviewed and concluded have had no material impact on the company's financial statements.

Components of Results of Operations

Some companies include a helpful description of each line item of the company's income statement that details the particular revenues and expenses that comprise that line item.

Don't do this.

Comparison of Results of Operations

The comparison of results of operations between periods should be brief, capable of being written by anybody looking at the face of the company's financial statements, and limited to a rote recitation of reported results and the amount of the increases/decreases between periods.

If your legal counsel reminds you that the SEC requires a description of the trends driving the changes between periods, here are a few suggestions:

First, for each line item, copy and paste the applicable trends reported in your prior SEC filings without modification. The best place to start is the comparable periodic report for the prior year. The trends reported in more recent periodic reports, especially those from earlier in the current fiscal year, should be ignored.

Second, don't quantify trends. One of the great delights of public company reporting is the opportunity to respond to SEC Staff comments, and one of the most frequently issued Staff comments is to direct companies to disclose and quantify which individual trends caused changes in results between periods.

Third, don't include any forward-looking information. You could use the MD&A as a tool to explain management's perspective on how past results may or may not be indicative of future results, with all of the appropriate qualifiers and safe harbor liability protections. However, that's extra work, and it's easier just to issue a standard disclaimer that past results are not indicative of future results and leave it at that.

Liquidity and Capital Resources

As with the discussion of results of operations, the discussion of liquidity and capital resources should be limited to a simple recitation of reported amounts in the balance sheet and statement of cash flows - but make sure also to include a broad, unsupported statement that the company's cash-on-hand and expected sources of liquidity are expected to meet the company's cash flow needs for the next 12 months.

The statement of cash flows tends to be more difficult to understand than the statement of operations. Don't attempt to interfere with this natural harmony, such as by explaining the composition of item captions or tying such items to an interpretation of the overall financial functioning of the business.

If you have outstanding credit facilities, you should repeat verbatim the relevant disclosures of the technical fine points of those facilities from your financial statement footnotes (i.e., instead of a short cross-reference), because disclosures regarding these fine points are interesting and everyone will want to want to read them twice. Do not consider, much less disclose, any real risks associated with these credit facilities, such as prior non-compliance with covenants and lender waivers obtained minutes before the filing deadline.

Earnings Releases and Calls

Your company's investor relations function probably pays a lot of attention to earnings press releases and investor/analyst calls. Investor relations people (and CEOs and CFOs) understand that the stock will be punished if the company cannot tell a compelling and verifiable story about its earnings and future guidance that is comprehensible to analysts and sophisticated investors.

While preparing the MD&A, don't look at the earnings release for the same period or read the script or listen to the conference call. Hearing conference call Q&A is particularly dangerous to bad MD&A - you might hear what investors really care about and how the CEO or CFO think about those issues. The bad MD&A you have carefully drafted in accordance with these instructions might turn out to be fundamentally inconsistent with the company's actual story to Wall Street, and it's best to "see no evil" in this circumstance.

Moreover, because the SEC Staff routinely compares MD&A to earnings releases, doing this yourself can make the Staff attorneys and accountants feel undervalued. So let them find the obvious inconsistencies and issue comments to be addressed later.

Conclusion

Armed with these tools, your MD&A will be sure to disappoint and annoy your audit committee, board of directors, auditors, lawyers, investors, analysts and, potentially, the Staff examiners at the SEC Division of Corporation Finance.

Congratulations?

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