



Federal Accounting Standards Advisory Board

August 7, 2009

Memorandum

To: Members of the Board

From: Richard Fontenrose, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: TAB J, Staff Analysis Regarding Management's Discussion and Analysis¹

MEETING OBJECTIVES

The objective for this meeting is to update the members on the status of the work on Management's Discussion and Analysis ("MD&A").

BACKGROUND

The objective of the MD&A work has been to identify areas for improvement. The MD&A in federal reports has been criticized for failing to effectively summarize and communicate entity performance and financial results. Current MD&A seems to provide excessive narrative description rather than analysis.

The MD&A project seeks to (1) determine whether there is a problem with current MD&A and, if so, (2) identify the source of that problem and recommend improvements. The problem might be the Federal Accounting Standards Advisory Board ("FASAB") standards, Office of Management and Budget ("OMB") guidance, or agency execution – or a combination of these.

The staff prepared a "white paper" (see Attachment 1) giving the background for the work and framing the issues. It surveys current federal MD&A reporting requirements and discusses recent AGA studies of federal reporting. The staff also established a task group (see Attachment 2) to discuss the issues and possible recommendations.

The task group met on July 9, 2009 (see Attachment 3 for meeting notes). The group discussed current concepts, standards, and guidance for MD&A and the assertions that there is a problem with MD&A.

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

The group agreed that:

1. Questions needing study are:
 - a. What is the purpose of MD&A;
 - b. What content would achieve that purpose; and
 - c. Who is the audience for MD&A?
2. SFFAS 15, *Management's Discussion and Analysis*, is satisfactory. The guidance should continue to be flexible.
3. A "best practices" guide would be useful that illustrates specific topics, for example, loans, grants, and contracts; and/or, that illustrates reporting of performance goals and results, analysis of financial statements, and forward-looking information.
4. OMB Circular A-136 *Financial Reporting Requirements*, should be reviewed with the goal of improving the MD&A presentations.

Other areas of consensus are as follows:

1. MD&A may be too long but the complexity of the federal reporting environment makes generalization difficult.
2. MD&A should provide SFFAS 15-required information and explain succinctly and candidly why such information is important. Candor is especially valued.
3. OMB's receptivity to candid discussion of forward-looking information depends on how the MD&A is worded and on the individual budget examiner.
4. MD&A generally is constrained by the relationship or lack thereof among the finance, budget, and program offices.
5. Agency management would not have difficulty identifying the "vital few" subjects for discussion, as required by SFFAS 15.
6. MD&A should link (especially hyper-link) to more detailed information.
7. Setting a fixed number of pages for the MD&A is not feasible – at least not via FASAB standards.

NEXT STEPS

Since the task group concluded that SFFAS 15 is satisfactory and that a "best practices" guide would be useful, the next step is for the Board to discuss initiating an Accounting and Auditing Policy Committee project to that end.

With respect to a reconsideration of the purpose, content, and audience for MD&A, the FASAB's reporting model project affords an opportunity to analyze such fundamentals.

TAB J – Attachment 1 – MD&A White Paper

MD&A White Paper

6/2/2009

Executive Summary

Many Federal Accounting Standards Advisory Board (FASAB) members believe that management's discussion and analyses (MD&As) in federal agency financial reports do not meet expectations established in Statement of Federal Financial Accounting Concepts (SFFAC) 3 and Statement of Federal Financial Accounting Standards (SFFAS) 15. They believe that federal agency MD&As fail to effectively summarize and communicate entity performance and financial results.

Current MD&A has been criticized for providing excessive narrative description rather than analysis. For example, they provide program vignettes and the financial analysis merely describes changes in account balances during the reporting period, which is fairly obvious on the face of the financial statements, rather than providing the reasons balances changed. On the other hand, there is evidence that federal agencies have made substantial progress in financial reporting over the past decade and a half.

The federal government is not alone in questioning the decision-usefulness of financial reports. Much has been written about the need to improve decision usefulness, especially regarding forward-looking information. There is a general call for concise reports with less reiteration of data and more discussion about the future.

The objectives of this project are to determine whether there is a problem with current MD&A reporting and, if so, what is the source of the problem, and to recommend how to improve the MD&A. If there is a problem, it may involve the FASAB concepts and standards, Office of Management and Budget guidance, the federal entities' execution of the standards and guidance, or a combination of these.

The staff plans to convene a task group to assist with the analysis and recommendations. The purpose of the group is to substantiate the problem and to assist in the development of recommendations.

This paper provides background for the project. It surveys current federal MD&A reporting requirements and discusses recent Association of Government Accountants studies of federal financial reporting.

Table of Contents

Section I – The Problem	5
Current Federal Financial Reporting.....	5
The Pilot Program	6
Financial Report of the US Government	7
Section II – Current MD&A Concepts and Standards	8
FASAB Standards	8
OMB Circular A-136	10
Circular A-136 MD&A Provisions	10
Circular A-136 MD&A Performance Reporting.....	11
Circular A-136 MD&A Financial Statement Analysis.....	12
Circular A-136 MD&A Systems and Controls.....	12
Circular A-136 MD&A Other Provisions	14
Circular A-136 Non-MD&A PAR Sections	14
Other MD&A Standards	14
Securities and Exchange Commission.....	14
SEC Advisory Committee on Improvements to Financial Reporting	17
Government Accounting Standards Board.....	19
Section III – AGA Studies of MD&A	23
Section IV – FASAB MD&A Task Group.....	27

1 **Section I – The Problem**
2

- 3 1. Many FASAB members believe that management’s discussion and analyses
4 (MD&A) in federal agency financial reports do not meet expectations established
5 in Statement of Federal Financial Accounting Concepts (SFFAC) 3 and
6 Statement of Federal Financial Accounting Standards (SFFAS) 15. They
7 believe that federal agency MD&A fail to effectively summarize entity
8 performance and financial results. Current MD&A seem to provide excessive
9 narrative description rather than analysis. For example, they provide program
10 vignettes and the financial analysis merely describes changes in account
11 balances during the reporting period, which is fairly obvious on the face of the
12 financial statements, rather than also providing the reasons the balances
13 changed.
14
- 15 2. On the other hand, there is evidence that federal agencies have made
16 remarkable progress in financial reporting over the past decade and a half. All
17 24 CFO Act agencies issue their audited financial statements within 45 days
18 after the end of the fiscal year.² Twenty-one of the 24 CFO Act agencies
19 representing more than 75% of all Federal outlays achieved a clean audit
20 opinion in FY 2008. This represents the highest number of clean audit opinions
21 achieved in the past 6 years.
22
- 23 3. The federal government is not alone in questioning the decision-usefulness of
24 financial reports. Much has been written about the need to improve the decision
25 usefulness of financial reports, especially regarding forward-looking
26 information.³ There is a general call for more concise reports with more
27 discussion about the future. The focus of the task group will be on MD&A; other
28 FASAB projects are addressing the overall reporting model.
29
- 30 4. The objective of this project is to determine whether there is a problem with
31 current MD&A reporting and, if so, to make recommendations regarding how to
32 improve. This paper begins by providing background for the project. It surveys
33 current reporting requirements and MD&A standards.

34 Current Federal Financial Reporting
35

- 36 5. Current reporting requirements involve the Performance and Accountability
37 Report (PAR). The PAR requires the following:
38
- 39 1) Agency head’s message
 - 40 2) MD&A
 - 41 3) Performance Section

² OMB, *Federal Management Report 2009*, Jan. 7, 2009 (“*OMB Management Report*”), page 2.

³ See Eccles, Robert G., Robert H. Herz, E. Mary Keegan, and David M. H. Phillips, *The Value Reporting Revolution*, John Wiley and Sons, 2001; and CFO Europe Research Services, *The Story Behind the Numbers: CFOs Are Under Pressure To Provide Insight and Analysis in Financial Reporting*, December 2007.

TAB J – Attachment 1 – MD&A White Paper – Section I – The Problem

- 1 4) Financial Section
- 2 5) Other accompanying information
- 3
- 4 6. The Reports Consolidation Act of 2000 (RCA) permits agencies to submit
- 5 combined reports for financial and performance management. These reports are
- 6 combined in the PAR, which consists of the Annual Performance Report
- 7 required by the Government Performance and Results Act of 1994 (GPRA), the
- 8 annual financial statements, and other reports such as assurances regarding
- 9 internal control. PARs provide financial and performance information that
- 10 enables the President, the Congress, and the public to assess the performance
- 11 of an agency relative to its mission and to demonstrate accountability.⁴

12 The Pilot Program

- 13
- 14 7. In FY 2007, the Office of Management and Budget (OMB) conducted a pilot to
- 15 try to streamline PAR reporting using an alternative reporting format. Eleven
- 16 agencies participated. The FY 2007 pilot resulted in many best practices for
- 17 providing accessible and useful performance and financial information to agency
- 18 stakeholders. One of the more successful products of the pilot was a
- 19 “Highlights” document that contained performance and financial information in a
- 20 brief, user-friendly format.
- 21
- 22 8. In FY 2008, OMB made further improvements to the pilot. There is now a three-
- 23 tiered drill down reporting structure that allowed agencies to provide easily
- 24 accessible information to readers and stakeholders. The structure includes:
- 25
- 26 1) a 2-page “Budget, Performance and Financial Snapshot” that provides
- 27 the reader with a quick picture of agency mission, organization,
- 28 performance and financial results, and plans for the future;
- 29 2) a 25-page “Citizens’ Report” (called the “Highlights” report in FY 2007)
- 30 that summarizes the agency’s mission, key goals, spending,
- 31 performance, and planned actions; and
- 32 3) a comprehensive Agency Financial Report (AFR) and Annual
- 33 Performance Report (APR).⁵
- 34
- 35 9. The goals of the pilot were to allow agencies to explore different formats to
- 36 enhance the presentation of financial and performance information, make this
- 37 information more meaningful and transparent to the public, and allow Congress,
- 38 stakeholders, and the public to make informed decisions about agencies’
- 39 performance.
- 40
- 41 10. Although the pilot was successful, some agencies continue to achieve enhanced
- 42 presentation of financial and performance information in the consolidated PAR.
- 43

⁴ OMB Circular A-136, June 29, 2007, page 12.

⁵ *OMB Management Report*, pp. 14-15.

TAB J – Attachment 1 – MD&A White Paper – Section I – The Problem

1 11. For FY 2009, agencies may choose either to produce a consolidated PAR or a
2 separate AFR and APR (see Circular A-11 for detailed guidance on developing
3 APRs). In addition, all CFO Act Agencies will be required to produce a summary
4 of performance and financial information. Non-CFO Act agencies that produce
5 an APR and AFR will be required to produce a summary of performance and
6 financial information. Suggested formats for the summary of performance and
7 financial information include the following:

- 8
9 1) A 3-8 page high level summary,
10 2) A 25-30 page more detailed summary , or
11 3) An MD&A that integrates performance and financial information in a
12 concise, easy to read format and that can easily be extracted from the
13 PAR or AFR and issued as an independent summary report.
14

15 12. Whether an agency elects to produce a PAR or the pilot reports, each is
16 required to present an MD&A under the same standards: SFFAS 15.

17 Financial Report of the US Government
18

19 13. In addition to entity reports, the Treasury Department prepares the *Financial*
20 *Report of the U.S. Government (Financial Report)*. The *Financial Report*
21 contains the consolidated financial statements of the Government as a whole
22 and an MD&A. The 2008 *Financial Report* was published on December 15,
23 2008. In February 2008 [and 2009], the Treasury and OMB, in coordination with
24 GAO, released the first-ever summaries of the *Financial Report* entitled, *The*
25 *Government's Financial Health: A Citizen's Guide to the 2007 [and 2008]*
26 *Financial Report of the United States Government*. The 8-page Guide is a user-
27 friendly overview of the U.S. Government's short-term and long-term financial
28 position.
29

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1

2 Section II – Current MD&A Concepts and Standards

3 FASAB Standards

4

5 14. Current MD&A standards and concepts provide guidance and establish
6 minimum requirements.⁶ SFFAC 3 provides the basic MD&A concepts while
7 SFFAS 15 establishes the requirement that an entity present an MD&A with
8 required components in its general purpose federal financial report (GPFFR).

9

10 15. SFFAC 3 provides that MD&A should address the entity's program and financial
11 performance measures, financial statements, systems and controls, compliance
12 with laws and regulations, and actions taken or planned to address problems.
13 The discussion and analysis of these subjects may be based partly on
14 information contained in reports other than the GPFFR. In addition, MD&A also
15 should address significant events, conditions, trends, and contingencies that
16 may affect future operations.⁷

17

18 16. SFFAC 3 notes that financial reports have two key roles: feedback and
19 prediction. Managers have the knowledge and should explain what the report is
20 communicating. MD&A makes the GPFFR understandable.⁸ Due to the
21 complexity of the federal government and the lack of user familiarity with federal
22 financial and performance concepts, MD&A may be more important in the
23 federal government than in the private sector.⁹ A third key role is that financial
24 reports require the accumulation and compilation of auditable and therefore
25 reliable information, which agencies would not otherwise do, and which results
26 in the agency personnel gaining an understanding of their agency's financial
27 condition and operations that they would not otherwise have.¹⁰

28

29 17. SFFAC 3 lists five subjects an MD&A should address¹¹:

30

- 31 1) the entity's structure, mission, goals, and objectives, with indicators of its
32 performance;
33 2) actions taken or planned to improve performance, when appropriate;
34 3) the financial statements;
35 4) systems, internal controls and legal compliance, including corrective
36 action taken or planned; and

⁶ The table in Appendix A provides a comparison of MD&A concepts, standards, and requirements from SFFAC 3, SFFAS 15, and Circular A-136, and shows the similarities and differences between these documents. It illustrates the brevity of SFFAS 15.

⁷ SFFAC 3, par. 1.

⁸ SFFAC 3, pars. 3-5.

⁹ SFFAC 3, par. 7.

¹⁰ SFFAC 3, par. 17.

¹¹ SFFAC 3, par. 9.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1 5) the future effects of existing, currently-known demands, risks,
2 uncertainties, events, conditions and trends. MD&A may also address
3 the possible future effects of anticipated future demands, events,
4 conditions, trends, etc. that management believes would be important to
5 the reader of the report. MD&A should explain future effects if there is a
6 reasonable prospect of occurrence.¹² “Future effects” should be
7 quantified, if possible, and ranges are useful in discussing future
8 effects.¹³

9
10 SFFAS 15, the FASAB’s MD&A standard, establishes the basic requirements for
11 an MD&A and requires that each of the above subjects be addressed.¹⁴

12
13 18. In addition, SFFAC 3 explains that the MD&A should discuss each topic even if
14 basic information on that topic is in a non-GPFFR report. The MD&A concepts
15 included referencing such material.

16
17 19. Regarding financial statement analysis – item c. in paragraph 17 above –
18 SFFAC 3, the MD&A concepts, provides that management should give readers
19 the benefit of its understanding from both a short- and long-term perspective.
20 Management should discuss the significance and potential effect of variations in
21 assets, liabilities, costs, revenues, obligations, and outlays; of particular
22 balances and amounts in the financial statements; and of stewardship
23 information.¹⁵ The MD&A should explain significant variations from prior years,
24 from the budget, and from plans, and the potential effect of these factors, of
25 changed circumstances, and of expected future trends.¹⁶ The discussion should
26 include only those variations of potential interest to readers who are not part of
27 agency management.

28
29 20. Not all material changes are sufficiently important to be included in MD&A.
30 Thus, the MD&A should summarize the most important items, explain the
31 relevant causes and efforts, and place them in context.¹⁷

32
33 21. Regarding performance, SFFAC 3 calls for the entity to explain what it does and
34 how well it is doing it. The MD&A should provide information readers need to
35 gauge success. It should explain how the entity measures success and what the
36 measures show.¹⁸

37
38 22. To assess a government entity’s performance, readers need to know more than
39 simple financial information.¹⁹ Reporting performance in government is different

¹² SFFAC 3, par. 34.

¹³ SFFAC 3, par. 35-36.

¹⁴ SFFAS 15, pars. 2-4.

¹⁵ SFFAC 3, 26-7.

¹⁶ SFFAC 3, par. 14.

¹⁷ SFFAC 3, 26-7.

¹⁸ SFFAC 3, par. 11.

¹⁹ SFFAC 3, par. 13.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1 than in the private sector.²⁰ The financial statement analysis should answer
2 questions such as: What is the entity’s financial position and condition? How did
3 this come about? MD&A should relate the strategic plan to the entity’s results,
4 include both positive and negative results, explain what needs to be done and
5 what is planned, and note the limitations of performance reporting.²¹

6
7 23. Regarding systems and controls, the MD&A should tell the reader whether the
8 internal accounting and administrative controls are adequate.²² The GPFFR
9 may include summaries of information about systems, internal legal compliance
10 from other reports, e.g., FMFIA and FFMIA reports or incorporate them by
11 reference. The MD&A, in turn, should discuss the most important aspects of this
12 information.²³

13 OMB Circular A-136

14
15 24. OMB Circular A-136, *Financial Reporting Requirements*, defines the form and
16 content for the federal agency PARs and Pilot Program reports required to be
17 submitted to the OMB and the Congress.²⁴ Circular A-136 provides a framework
18 within which individual agencies have flexibility to provide information useful to
19 the Congress, agency managers, and the public.²⁵

20 **Circular A-136 MD&A Provisions**

21
22
23 25. The MD&A provisions of Circular A-136 cite SFFAC 3 and SFFAS 15. Thus, the
24 Circular A-136 requires MD&A sections wherein the entity is to discuss and
25 analyze:

- 26
27 1) mission and organizational structure
28 2) performance goals, objectives, and results
29 3) financial statements and stewardship information
30 4) systems, controls and legal compliance.²⁶

31
32 26. Also as in SFFAS 15 (par. 3), Circular A-136 includes the requirement for
33 forward-looking information.

²⁰ SFFAC 3, par. 42.

²¹ SFFAC 3, par. 45-9.

²² SFFAC 3, par. 15.

²³ SFFAC 3, pars. 18-22.

²⁴ See the Chief Financial Officers Act of 1990 (“CFO Act”) (Pub. L. 101 – 576), as amended by the Reports Consolidation Act of 2000 (Pub. L. 106-531); the Accountability of Tax Dollars Act of 2002 (“ATDA”) (Pub. L. 107–289); and Annual Management Reports under the Government Corporations Control Act (31 U.S.C. § 9101 et seq.). The PARs and AFRs are in addition to the reports submitted to OMB for purposes of monitoring budget execution.

²⁵ See Circular A-136, Section I.1, *Guide to the Circular*.

²⁶ Circular A-136, Section II.2.4, Scope.

Circular A-136 MD&A Performance Reporting

27. In addition, Circular A-136 includes extensive MD&A instructions with respect to performance reporting. The Circular provides that the MD&A should include (in no specific order) highlights of performance goals and results (positive and negative) related to and consistent with major goals and objectives in the entity's strategic and performance plans, including trend data where available. These performance highlights should:

- 1) provide a clear, objective picture of the entity's program results compared to its goals and objectives;
- 2) indicate the extent to which its programs are achieving their intended goals and objectives, and explain performance trends;
- 3) discuss the strategies and resources the entity uses to achieve its performance goals;
- 4) evaluate the significance of underlying factors that may have affected the reported performance. These may include information about factors that are substantially outside the entity's control as well as information about factors over which the entity has significant control;
- 5) include an explanation of plans and timelines to improve performance where targets were not met;
- 6) summarize the procedures management has designed and followed to provide reasonable assurance that reported performance information is relevant and reliable; and
- 7) discuss important limitations and difficulties associated with performance measurement and reporting should be noted to the extent relevant.²⁷

28. Circular A-136 encourages entities to provide information in the PAR that helps the reader assess the relative efficiency and effectiveness of entity programs/operations. Efficiency is defined as the ratio of an "effective or useful" outcome or output to the total input resources of a system. Effectiveness means having an intended or expected effect.²⁸

29. Entities are instructed to strive to articulate efficiency and effectiveness by developing and reporting objective measures that, to the extent possible, indicate results achieved and relate major goals and objectives in their strategic plan to cost categories (i.e., responsibility segments) presented in the entity's statement of net cost. Entities should be engaged in strategic management, including recognizing that the dual objectives of and the occasional trade-offs between efficiency and effectiveness (e.g., the most effective solution or process is not always the most efficient, nor is the most efficient always the most effective). Entities should focus on tracking and reporting the most

²⁷ A-136, Section II.2.6, *Performance Goals, Objectives, and Results*.

²⁸ *Ibid.*

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1 appropriate and meaningful measures that show program effectiveness,
2 efficiency, and results.

3
4 **Circular A-136 MD&A Financial Statement Analysis**

5
6 30. With respect to financial statement analysis, Circular A-136 incorporates SFFAS
7 15 paragraphs.²⁹ Thus, MD&A should help users understand the entity's
8 financial results, position and condition conveyed in the principal financial
9 statements. The MD&A should include comparisons of the current year to the
10 prior year and should provide an analysis of the agency's overall financial
11 position and results of operations to assist users in assessing whether that
12 financial position has improved or deteriorated as a result of the year's activities.
13 It should give users the benefit of management's understanding of the:

- 14
15 1) Major changes in types or amounts of assets, liabilities, costs, revenues,
16 obligations, and outlays;
17 2) Relevance of particular balances and amounts shown in the principal
18 financial statements, particularly if relevant to important financial
19 management issues; and
20 3) Entity's stewardship information.

21
22 This section should also include a discussion of key financial-related measures
23 emphasizing financial trends and assess financial operations.
24

25 **Circular A-136 MD&A Systems and Controls**

26
27 31. Circular A-136 requires agencies to provide assurances related to the Federal
28 Managers' Financial Integrity Act (FMFIA) and the Federal Financial
29 Management Improvement Act (FFMIA)³⁰ in a separate section of the MD&A
30 entitled "Management Assurances." The Circular instructs the agencies that the
31 FMFIA assurance statement should:

- 32
33 1) Provide management's assessment of the effectiveness of the
34 organization's internal controls to support effective and efficient
35 programmatic operations, reliable financial reporting, and compliance
36 with applicable laws and regulations (FMFIA § 2); and whether the
37 financial management systems conform to financial systems
38 requirements (FMFIA § 4).
39 2) Provide a separate assessment of the effectiveness of the internal
40 controls over financial reporting as a subset of the overall FMFIA
41 assurance statement (i.e., separate paragraph within the FMFIA
42 Assurance Statement).

²⁹ OMB Circular A-136, Section II.2.7, "Analysis of the Entity's Financial Statements and Stewardship Information."

³⁰ Pub.L.No.104-208.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

- 1 3) Include a summary of material weaknesses (FMFIA § 2) and non-
2 conformances (FMFIA § 4), and a summary of corrective actions to
3 resolve the material weaknesses and non-conformances. Illustrative
4 assurance statements and further guidance on corrective action plans
5 can be found in the CFOC Implementation Guide, Management’s
6 Responsibility for Internal Control, Appendix A, Internal Control over
7 Financial Reporting located at:
8 ([http://www.cfoc.gov/documents/Implementation_Guide_for](http://www.cfoc.gov/documents/Implementation_Guide_for_OMB_Circular_A-123.pdf)
9 [OMB_Circular_A-123.pdf](http://www.cfoc.gov/documents/Implementation_Guide_for_OMB_Circular_A-123.pdf)).
- 10
- 11 32. Management is also directed to include its FFMIA compliance assessment in
12 this section. FFMIA requires management to assess the organization’s
13 compliance with Federal financial management systems requirements,
14 standards promulgated by FASAB, and the U.S. Standard General Ledger
15 (USSGL) at the transaction level. Further guidance on the financial systems
16 requirements can be found in OMB Circular No. A-127, *Financial Management*
17 *Systems*. Circular A-11, Part 2, Section 52, *Information on Financial*
18 *Management* outlines requirements for agency’s plans for bringing its systems
19 into substantial compliance.
- 20
- 21 33. Management is to review its FMFIA assurance statements and its FFMIA
22 compliance determination for consistency with the findings specified in the
23 annual financial statement audit report(s). The Office of Inspector General or
24 auditor is to compare material weaknesses disclosed during the audit with those
25 material weaknesses reported in the agency’s FMFIA report and document any
26 differences. The reports could, in fact be different, but they should not be in
27 direct conflict. When conflicting discrepancies exist, it is management’s
28 responsibility to ensure that outstanding issues are appropriately reported.
- 29
- 30 34. A review of agency reporting reveals some noteworthy aspects of FMFIA
31 reporting. What appears to be happening is that management reports material
32 weaknesses in internal control using criteria different than the auditors use to
33 determine material weaknesses and system non-conformances in the
34 accounting and financial reporting systems. The result is that some of the
35 management-determined material weaknesses are different than what the
36 auditor reports and some are the same. However, no instances were found
37 where the auditor reported that a material weakness in internal control in
38 financial systems that management did not report.
- 39
- 40 35. The review found different results for FFMIA than for FMFIA. Several instances
41 were found where the auditor reported non-compliance with the FFMIA but
42 management felt that the agency complied. Management frequently tried to
43 justify its position rather than state what it will do to remove the auditor’s finding.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29

Circular A-136 MD&A Other Provisions

36. In addition, Circular A-136 affords management the discretion to include a summary in the MD&A of other information, initiatives, and issues it identifies. This could include summarizing entity progress in implementing key administration management initiatives.³¹
37. Circular A-136 requires the MD&A to include a section articulating the limitations of the principal financial statements, and provides the specific wording.³²

Circular A-136 Non-MD&A PAR Sections

38. Circular A-136 directs that Sections 2, 3 and 4 of the PAR be for performance reporting, financial statements, and other accompanying information, respectively. The instructions for performance reporting in Circular A-136 is taken from Circular A-11, Section 230, *Preparing and submitting the annual Performance Report, the Performance Portion of a Performance and Accountability Report*. Circular A-11 takes precedent if there is any inconsistency between Circulars A-11 and A-136.³³ Agencies are instructed to refer to Circular No. A-11 for a comprehensive discussion on performance. The annual performance report required by GPRA provides information on an agency's actual performance and progress in achieving the goals in its strategic plan and performance budget.
39. Agencies prepare one annual performance report for a fiscal year. For most agencies, this is the "Performance Section" of its PAR. For those agencies participating in the pilot, the APR is to accompany the Congressional Budget Justification (CBJ).

Other MD&A Standards

Securities and Exchange Commission

40. Although an MD&A section is not required by FASB, the Securities and Exchange Commission (SEC) requires an MD&A when companies file financial statements.³⁴ SEC guidance is intended to elicit meaningful disclosure in MD&A in a number of areas, including the overall presentation and focus of MD&A, with

³¹ OMB Circular A-136, Section II.2.9.

³² OMB Circular A-136, Section II.2.10.

³³ OMB Circular A-136, Section II.3.1, General, fn. 20.

³⁴ The MD&A is required by Item 303 of Regulation S-K, Items 303(b) and (c) of Regulation S-B, Item 5 of Form 20-F and Paragraph 11 of General Instruction B of Form 40-F. The basic requirement is in Item 303 but you have to go to financial reporting releases and staff accounting bulletins to get specific guidance. Industry guides and EITF releases also create "requirements."

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1 general emphasis on the discussion and analysis of known trends, demands,
2 commitments, events and uncertainties, and specific guidance on disclosures
3 about liquidity, capital resources and critical accounting estimates.³⁵ The SEC
4 states that management's most important responsibilities include
5 communicating with investors in a clear and straightforward manner, and that
6 MD&A is a critical component of that communication. The SEC has said that if
7 shareholders could read only one item in the annual report, it should be the
8 MD&A.

9
10 41. There is a key difference between a private company's MD&A and a
11 government entity's MD&A. In the private sector, the emphasis is on financial
12 matters since MD&A is to help investors assess the size, sources, and likelihood
13 of future cash flows. In government, the MD&A serves two purposes. It is a
14 summary of the entire report; and it also discusses matters not in other parts of
15 the report in an attempt to give readers an understanding of the agency's
16 performance and its management of resources.

17
18 42. Through its rules, enforcement actions and interpretive processes, the SEC has
19 sought to elicit MD&A that not only meets technical disclosure requirements but
20 generally is informative and transparent. Frequently companies resist providing
21 this information.

22
23 43. The move to MD&A started in 1968. Sandy Burton, the SEC's chief accountant
24 at the time, wrote rules requiring narrative explanations of comparative income
25 statement line items changing 10% or more. Companies complied in a very
26 perfunctory manner so that Burton's goal was not achieved.

27
28 44. In 1980, Rule 303 of Regulation S-K was created and has remained basically
29 unchanged, although it has been extensively interpreted. A three-pronged
30 approach was developed to frame the MD&A discussion: liquidity, capital
31 resources, and results of operations. The focus is on the results of operations;
32 line item analysis was de-emphasized by Item 303. The goal is to have
33 management explain "why what happened happened," and is what happened
34 going to continue to happen. Companies filing with the SEC tend to want to
35 comply with the "why what happened happened," which involves historical
36 information, but not the second element, which involves predictive information.
37 Companies see legal jeopardy in predicting the future. However, the SEC has
38 viewed predictive information as much more important.

39
40 45. The SEC took its first MD&A enforcement action in April 1992 against Caterpillar
41 Tractor. SEC alleged a 1989 filing by Caterpillar was intentionally misleading.
42 Three deficiencies were cited. Caterpillar failed to explain the nature of its
43 reported income and, mostly importantly, omitted prospective information about

³⁵ See SEC *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, December 19, 2003, <http://www.sec.gov/rules/interp/33-8350.htm>.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

- 1 a change in government and devaluation affecting its very substantial Brazilian
2 operations.
3
- 4 46. SEC wants known facts, conditions, trends, commitments, uncertainties to be
5 discussed if they will impact the results of operations. Materiality is gauged not
6 on line items but on results of operations.
7
- 8 47. The big problem has been with “known uncertainty.” For example, if a company
9 files with the SEC in March and has labor contract negotiations in April, does it
10 address the uncertainty? If a company operates in a city that has experienced
11 earthquakes, does it address possibility of earthquake?
12
- 13 48. The SEC developed a “probability/materiality” test for this purpose. First, is it
14 probable a future event will not happen (probable means more likely than not)?
15 If the answer is affirmative, then do not discuss it. Second, if it happens, would it
16 have a material effect on future results of operations or liquidity? If not, do not
17 discuss it.
18
- 19 49. Regarding the discussion of results of operations, anything management knows
20 that will make the future look different than the past should be disclosed. If there
21 is a new accounting statement that has been issued but is not yet effective both
22 MD&A and footnotes must discuss its projected impact, even if the impact is not
23 material.
24
- 25 50. The December 2003 SEC interpretative release regarding MD&A stated that the
26 purpose of MD&A is to provide readers information necessary to an
27 understanding of an entity’s financial condition, changes in financial condition
28 and results of operations. The MD&A requirements are intended to satisfy three
29 principal objectives:
30
- 31 1) to provide a narrative explanation of an entity’s financial statements that
32 enables investors to see the company through the eyes of management;
 - 33 2) to enhance the overall financial disclosure and provide the context within
34 which financial information should be analyzed; and
 - 35 3) to provide information about the quality of, and potential variability of, an
36 entity’s earnings and cash flow, so that investors can ascertain the
37 likelihood that past performance is indicative of future performance.
38
- 39 51. The SEC states that management should discuss and analyze the entity’s
40 activity as seen through the eyes of its managers. The SEC believes that
41 managers have a unique perspective on the entity’s activities that only it can
42 present. The MD&A should not be a recitation of financial statements in
43 narrative form or an otherwise uninformative series of technical responses to
44 MD&A requirements, neither of which provides this important management
45 perspective. The SEC encourages early top-level involvement by a company’s
46 managers in identifying the key MD&A discussion points.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44

52. Based on its experience with many entities' disclosures in MD&A, the SEC believes there are a number of general ways for companies to enhance their MD&A. An Interpretative Release provided additional guidance.

53. In the Release, the SEC emphasized the following points regarding overall presentation:

- 1) entities should present their disclosure so that the most important information is most prominent;
- 2) entities should avoid unnecessary duplicative disclosure that can tend to overwhelm readers and act as an obstacle to identifying and understanding material matters; and
- 3) many entities would benefit from starting their MD&A with a section that provides an executive-level overview that provides context for the remainder of the discussion.

54. The Release also emphasized the following points regarding focus and content:

- 1) in deciding on the content of MD&A, entities should focus on material information and eliminate immaterial information that does not promote understanding of entities' financial condition, liquidity and capital resources, changes in financial condition and results of operations;
- 2) entities should identify and discuss key performance indicators, including non-financial performance indicators, that their management uses to manage the business and that would be material to investors;
- 3) entities must identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance; and
- 4) entities should explain management's view of the implications and significance of information and satisfy the objectives of MD&A.

55. With respect to MD&A in the government sector, it is well to keep in mind that a corporate MD&A is part of a legal document, is subject to scrutiny by the SEC, and must be "truthful." The PARs and AFRs are prepared under the purview of political appointees in a political environment. There is a great reluctance to discuss problems, challenges, negative issues, etc. in a government agency's MD&A (as well as in the agency head's message).

SEC Advisory Committee on Improvements to Financial Reporting

56. The SEC Advisory Committee on Improvements to Financial Reporting is encouraging the private sector to develop "key performance indicators" (KPI).³⁶ The Committee's objective is to capture important aspects of a company's

³⁶ *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission*, August 1, 2008, (*Improvements to Reporting*) p. 4.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1 activities that may not be fully reflected in its financial statements or may be
2 non-financial measures. While recognizing that the most appropriate KPI may
3 be dependent on the activities of the particular company, the Committee wants
4 the private sector to develop consistent definitions and methodologies for KPI,
5 by activity and industry, as appropriate, in order to facilitate comparisons across
6 companies and through time.

7
8 57. An issue for the MD&A task group and the FASAB is: what are KPI for activities
9 within the federal government. Some argue that the Federal government already
10 has KPI. They are called performance measures and they are already the most
11 important part of a GPFFR.

12
13 58. The Committee is recommending³⁷ that the SEC encourage private sector
14 initiatives targeted at best practice development of company use of KPI in their
15 business reports. The process would involve dialogue among preparers,
16 investors, analysts, and other interested parties to generate understandable,
17 consistent, relevant, and comparable KPI. The Committee recommends that the
18 SEC encourage companies to provide, explain, and consistently disclose period-
19 to-period company-specific KPI. The Committee recommended that the SEC
20 “consider reiterating and expanding its interpretative guidance regarding
21 disclosures of KPI in MD&A and other company disclosures.”³⁸

22
23 59. The Committee explains that enhanced business reporting and KPI are
24 disclosures about the aspects of a company’s business that provide significant
25 insight into the sources of its value. Citing the Enhanced Business Reporting
26 Consortium,³⁹ the Committee notes that a company’s “value drivers” may be
27 quantitative or qualitative such as opportunities, risks, strategies and plans – all
28 of which permit assessment of the quality, sustainability and variability of a
29 company’s cash flows and earnings. This emphasizes that the purpose of a
30 private company’s reporting is on the financial results and the things that drive
31 those results. By contrast, the purpose of a federal agency’s reporting is to
32 disclose the results achieved from the services provided and the costs of those
33 services.

34
35 60. The Committee notes that financial reports provide an accounting of past events
36 and a current view of the financial condition of the entity. The financials are not
37 necessarily forward-looking indicators. The Committee believes users are
38 interested in information about the fundamental drivers of the entity’s activity
39 and metrics used to give evidence as to how the entity is being managed.
40 Financial reporting captures some aspects of this but not all, and financial

³⁷ *Improvements to Reporting*, Recommendation 4.3, p. 109.

³⁸ *Improvements to Reporting*, p. 110.

³⁹ The Enhanced Business Reporting Consortium founded by the AICPA, Grant Thornton LLP, Microsoft, and PriceWaterhouseCoopers LLP; and see Eccles, Robert G., Robert H. Herz, E. Mary Keegan and David M. H. Phillips, *The Value Reporting Revolution*, New York: John Wiley and Sons, 2001.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1 statements are not currently designed to provide a picture of the entity and its
2 operations. From a preparer standpoint, management uses KPI as key metrics
3 with which to direct the entity as part of the strategic planning process both in
4 terms of goal setting and as a way to provide analysis and feedback. Thus, KPI
5 should increase the transparency of the entity to non-management users of the
6 reports.⁴⁰ To recognize this, the Committee noted that the SEC encourages
7 extensive discussion of the condition of the entity in the MD&A.⁴¹

8
9 61. The Committee noted that some companies are already reporting company-
10 specific KPI in the SEC filings. However, they may not be consistent from
11 period-to-period, or well-defined, or commonly used by other companies, which
12 would make comparative analysis impossible.

13
14 62. The Committee noted that various groups are developing KPI and
15 recommended that, for KPI reporting to be effective and improve user
16 understanding, entities should consider the following to improve voluntary KPI
17 disclosure:

- 18
19 1) Standard definitions, to make the KPI understandable.⁴²
- 20 2) Consistent reporting from period to period.⁴³
- 21 3) Relevancy. KPI that are important to an understanding and tracking of
22 responsibility segments and their activity and align with how the entity is
23 operated.⁴⁴
- 24 4) Presentability. KPI should be disclosed in a separate KPI section in the
25 MD&A or subsections of parts of the MD&A. Reporting KPI by segments
26 could be useful.
- 27 5) Comparable. Industry- or activity-defined KPI.

28
29 63. The Committee's recommendation is not unique or new. Some have called for
30 radical improvements in corporate reporting. To make sound, long-term
31 investment decisions, investors need to know how an entity creates value. They
32 especially need information about market dynamics, corporate strategy, and
33 non-financial value drivers that are leading indicators of a company's future
34 financial performance and stock price.⁴⁵

35 36 **Government Accounting Standards Board**

37
38 64. The Government Accounting Standards Board (GASB) established MD&A
39 requirements for state and local governments in Statement 34, *Basic Financial*
40 *Statements – and Management's Discussion and Analysis – for State and Local*

⁴⁰ *Improvements to Reporting*, p. 111.

⁴¹ *Ibid.*

⁴² *Improvements to Reporting*, p. 112

⁴³ *Ibid.*

⁴⁴ *Improvements to Reporting*, p. 113

⁴⁵ See Eccles, Robert G., Robert H. Herz, E. Mary Keegan and David M. H. Phillips, *The Value Reporting Revolution*, New York: John Wiley and Sons, 2001.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1 *Governments.*⁴⁶ According to Statement 34, MD&A is an opportunity for
2 management to present both short- and long-term analysis of the government's
3 activities.⁴⁷ The MD&A should:

- 4
- 5 1) be an objective and easily readable analysis of the government's
6 financial activities based on currently known facts, decisions, or
7 conditions;
- 8 2) provide an analysis of the government's overall financial position and
9 results of operations and changes therein;⁴⁸
- 10 3) compare the current year to the prior year based on the government-
11 wide information, and include both positive and negative aspects;⁴⁹
- 12 4) analyze significant changes that occur in funds and significant budget
13 variances and include the reasons therefore, and not simply the amounts
14 or percentage of the change;⁵⁰
- 15 5) analyze significant variations between original and final budget amounts
16 and between final budget amounts and actual budget results, including
17 any "currently known reasons for those variations that are expected to
18 have a significant effect on future services or liquidity;"⁵¹
- 19 6) describe capital asset and long-term debt activity during the year,⁵² and
20 7) conclude with a description of currently known facts, decisions, or
21 conditions that are expected to have a significant effect on financial
22 position or results of operations.⁵³
- 23

24 65. State and local governments' focus their MD&A on the financial condition and
25 results of the government operations. The federal MD&A is broader, perhaps
26 because of the broader Objectives for Federal Financial Reporting. Financial
27 analysis is only one part of the federal MD&A.; it also addresses mission,
28 organization, program performance, systems and controls, and future-oriented
29 matters.

30

31 66. In addition to MD&A standards, the GASB has promulgated concepts regarding
32 reporting service efforts and accomplishments (SEA). For the GASB, SEA
33 reporting refers to the communication of selected measures of a government's
34 performance results. This includes the public reporting of key service
35 performance indicators that provide decision-useful information about the
36 government's actual accomplishments achieved in pursuit of its goals and
37 objectives. GASB notes that traditional financial statements provide financial
38 performance information about a government's fiscal and operational
39 accountability, but they do not provide all of the information needed to determine

⁴⁶ June 1999.

⁴⁷ GASB Statement 34, par. 8.

⁴⁸ GASB Statement 34, par. 11c.

⁴⁹ GASB Statement 34, par. 9.

⁵⁰ GASB Statement 34, par. 11d.

⁵¹ GASB Statement 34, par. 11e.

⁵² GASB Statement 34, par. 11f.

⁵³ GASB Statement 34, par. 11h.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

1 the degree to which the government was successful. SEA performance
2 information makes it possible to know how much government services were
3 provided, how efficiently they were provided, and how effective those services
4 were. GASB's SEA efforts have focused on helping governments communicate
5 their most important accomplishments to constituents. The GASB's research
6 efforts reveal that SEA reporting provides important information that can help
7 citizens and their elected representatives better assess how well their
8 government is achieving its public policy mission.

9
10 67. Since the beginning of 2007, the GASB has been working on a project focused
11 on SEA reporting with two objectives: (1) to update GASB Concepts Statement
12 No. 2, *Service Efforts and Accomplishments Reporting*, to reflect what has been
13 learned since 1994 from the research of the GASB and others; and (2) to
14 consider the development of suggested guidelines for governments that choose
15 to voluntarily report on their SEA performance.

16
17 68. In November 2008, the GASB published Concepts Statement 5, *Service Efforts*
18 *and Accomplishments Reporting*, updating Concepts Statement 2 and
19 eliminating the entire section of Concepts Statement 2 titled "Developing
20 Standards for Reporting SEA Information." The GASB needed to allay fears and
21 make clear that Concepts Statement 5 and GASB do not:

- 22
- 23 1) develop the goals and objectives of state and local government
24 services;
- 25 2) develop specific non-financial measures or indicators of service
26 performance; or
- 27 3) set standards of or benchmarks for service performance.⁵⁴
- 28

29 69. The GASB notes that SEA attempts to provide insight into government
30 performance. Governmental services are diverse and often complex and
31 therefore SEA is an important part of general purpose external financial
32 reporting. The GASB notes that Concepts Statement 1 recognizes that general
33 purpose external financial reporting provides information to assess
34 accountability and to make economic, social, and political decisions.⁵⁵

35
36 70. SEA information should measure service efforts and accomplishments and
37 relate service efforts to accomplishments. GASB defines "efforts" as the amount
38 of financial and non-financial resources that are applied to a service.

39
40 71. Measures of service efforts include ratios that compare financial and non-
41 financial resources with other information, e.g., general population, service
42 population, or lane-miles of road. "Measures of service accomplishments" report
43 what was provided and achieved with the resources used.

44

⁵⁴ GASB Concepts Statement 5, *Service Efforts and Accomplishments Reporting*, par. 4.

⁵⁵ GASB Concepts Statement 5, par. 5.

TAB J – Attachment 1 – MD&A White Paper – Section II – Current MD&A Concepts and Standards

- 1 72. In addition, SEA performance information should include related quantitative
2 and narrative information. Such information can help provide the context for
3 users to understand reported SEA performance measures, assess the entity's
4 SEA performance, and evaluate the significance of underlying factors that may
5 have affected the reported SEA performance. The entity does this by providing
6 comparisons, e.g., with prior years, entity-established targets, comparable
7 entities, and other benchmarks. In addition, information on unintended effects,
8 demand for services, and factors that influence results are informative.⁵⁶
9
- 10 73. Finally, the GASB recommends a frank discussion of the limitations of SEA
11 performance information and how to enhance its usefulness.⁵⁷

⁵⁶ Ibid.

⁵⁷ GASBN Concepts Statement 5, pars. 9-10.

1 **Section III – AGA Studies of MD&A**

2
3 74. The AGA’s Certificate of Excellence in Accountability Reporting program has
4 been reviewing agency PAR and their predecessor Accountability Reports for
5 the past 12 years. The AGA also reviewed the new AFR portion of the pilot
6 program as part of a Performance Coalition project. The AGA review included
7 nine of the 11 pilot agencies’ AFR. In addition, the Mercatus Center, a member
8 of the Performance Coalition, reviewed the APRs and Citizens’ Reports. The
9 AGA review asserted that since many of its findings are applicable to both the
10 PAR and AFR, most of its recommendations are equally appropriate for both.

11
12 75. Regarding the MD&A, the AGA review commented that guidance for the MD&A
13 is as necessary for an AFR as it is for the PAR. The review noted that SFFAS
14 15, the MD&A standard, is applicable to both AFR and PAR. The review
15 recommended expanding the MD&A guidance to help assure the MD&A provide
16 complete meaningful, readily understandable information that enable the
17 readers to obtain an understanding of the efficiency and effectiveness of the
18 agencies’ performance and management of resources.⁵⁸

19
20 76. The AGA review recommended that the guidance specify the size of both the
21 entire report and the MD&A. It found wide size variations among PAR and AFR.
22 Also, many agencies present MD&A-type information in other report sections.
23 The group recommended that the size of the MD&A in the PAR and AFR should
24 relate to the size and scope of the agency and should be specified. Moreover,
25 agencies should be reminded not to circumvent size limits by placing information
26 intended for the MD&A in other sections of the PAR and AFR. The review
27 suggested that OMB should work with any agencies that exceed the size limits
28 to eliminate the problem.⁵⁹

29
30 77. The AGA review also suggested that since an AFR does not contain a
31 Performance Section, more performance information might be needed in the
32 MD&A of the AFR. The group stated that this would not only provide
33 performance information but assure internal control in the performance
34 measurement systems and drive management improvements. The review found
35 that most of the AFR MD&A presented program vignettes that might be
36 interesting but that do not give a sense of the agency’s overall performance.⁶⁰

37
38 78. The AGA review recommended that the MD&A include overall and year-to-year
39 results for each strategic goal, and individual results for a small number of the
40 most important performance goals, even if estimated, and including both
41 positive and negative results. This would demonstrate that the agencies have

⁵⁸ Steinberg, Harold I., *You’ve Come A Long Way Baby, An Evaluation of the Federal Agencies’ Annual Financial Reporting (AGA Evaluation)*, pp. 1-2.

⁵⁹ *AGA Evaluation*, p. 6-7.

⁶⁰ *AGA Evaluation*, p. 7.

TAB J – Attachment 1 – MD&A White Paper – Section III – AGA Studies of MD&A

1 accumulated data soon enough after year-end to be useful in the budget
2 process and to illustrate performance trends.
3

4 79. The review also stated that the best approach regarding assuring reliability for
5 the performance information would be to return to the practice of requiring the
6 auditor to (1) review the existence and completeness of the assertions
7 pertaining to performance measures included in the MD&A and (2) report
8 internal controls that have not been properly designed and placed in operation.⁶¹
9

10 80. The AGA review found that, with few exceptions, the AFR and PAR (and the
11 Citizens' or Highlights Reports) did not relate performance to financial results. It
12 felt agencies should be required to identify the resources associated with each
13 strategic goal – budget appropriations, budget obligations, expenditures, and/or
14 net cost. This would enable readers to understand the amount of resources
15 devoted to each strategic goal and how much performance is costing. It also
16 would drive the agencies that currently cannot present this information to
17 establish cost accounting systems, which are critical to the effective
18 management of resources.
19

20 81. The AGA review said cost information is likely to stimulate interest in
21 determining where resources are going or will have to go in the future.
22

23 82. In addition, agencies should be required to present one or more measures of
24 efficiency and effectiveness. Such measures relate outputs or outcomes to
25 inputs. This would help stakeholders evaluate whether the results accomplished
26 are worth the inputs required.⁶²
27

28 83. The AGA review said that OMB Circular A-136, should unambiguously direct
29 federal agencies to present the costs of each strategic goal. It said that the
30 directions for FY 2007 in this regard were unclear, and many agencies
31 presented financial information for what they consider to be their programs,
32 which have no relationship to their strategic goals. However, for FY 2008, the
33 Circular A-136 instructions were clarified to direct federal agencies to show the
34 net cost of operations for the entity as a whole and by major program, which
35 should be related to major goal(s) and output(s) described in the entity's
36 strategic and performance plans as required by GPRA.⁶³
37

38 84. The AGA review noted a weakness in the Circular A-136 directions for financial
39 statement analysis. Circular A-136 requires agencies to present the major
40 changes in balances before presenting the relevance of the balances. The AGA
41 review would reverse that presentation. It said that readers would understand
42 the changes better if they already knew the nature of what was changed. In
43 addition, instead of just explaining what an account is, e.g., Fund Balance with

⁶¹ AGA *Evaluation*, p. 9.

⁶² AGA *Evaluation*, pp. 9-10.

⁶³ AGA *Evaluation*, p. 10.

1 Treasury, which is common to most federal agencies, it said agencies should be
2 directed to explain the relevance of accounts that are unique to the agency's
3 operations.

4
5 85. In addition, the A-136 guidance requires the agencies to identify the major
6 changes in types or amounts of assets, liabilities, etc.; but the AGA review said
7 it should require them to explain the reasons for the changes, not just the
8 amounts of the changes. If it did, users could obtain maximum insight into the
9 agency's financial position and results of operations and whether that position
10 has improved or deteriorated. In other words, identifying the line item that
11 changed is not explaining the reason for the change or the underlying cause
12 thereof. The review said that providing illustrations in Circular A-136 of effective
13 analysis would probably help to improve the quality of the analysis.⁶⁴

14
15 86. The AGA review also was critical of the Circular A-136 guidance for forward-
16 looking information. The guidance follows the SFFAS 15 format: and lists the
17 sections the MD&A should contain – mission and organizational structure;
18 performance goals, objectives, and results; analysis of financial statements;
19 and, systems, controls, and legal compliance⁶⁵ – followed by a paragraph
20 requiring forward-looking information. The latter involves the “possible future
21 effects of the most important existing currently-know demands, risks,
22 uncertainties, events, conditions and trends,” and allows forward-looking
23 information about possible future effects of “anticipated future demands, events,
24 conditions, and trends.”⁶⁶ Circular A-136 also follows SFFAS 15 in requiring that
25 the entity discuss “important problems that need to be addressed, and actions
26 that have been taken or planned.”⁶⁷ SFFAS 15 provides that the forward-looking
27 information and the discussion of important problems may be a separate section
28 of the MD&A or incorporated in the sections listed in SFFAS 15, paragraph 2,
29 regarding performance, financial analysis, etc.⁶⁸

30
31 87. The AGA review states that forward-looking information and information about
32 what the entity plans to do to address known and possible significant demands,
33 events, conditions and trends could well be the most important information for
34 the report to convey.⁶⁹ However, Circular A-136 splits the guidance for an
35 MD&A in an AFR into two sections: Section II.1.3, which overviews what an AFR
36 should contain and Section II.2 which provides an outline of the required
37 information. The AGA review concluded that one result of this bifurcation is a
38 de-emphasis of management's analysis of future challenges. It noted that only
39 five of the 11 pilot agencies presented information that concerned future
40 challenges. And of those, one entity presented its past actions as forward-
41 looking information. A second assumed it had to describe its strategies for

⁶⁴ AGA *Evaluation*, pp. 10-11.

⁶⁵ SFFAS 15, par. 2.

⁶⁶ SFFAS 15, par. 3.

⁶⁷ SFFAS 15, par. 4.

⁶⁸ SFFAS 15, par. 3-4.

⁶⁹ AGA *Evaluation*, p. 12.

TAB J – Attachment 1 – MD&A White Paper – Section III – AGA Studies of MD&A

1 addressing the most serious management and performance challenges
2 identified by the IG and GAO and did not even address an extremely significant
3 existing and future condition facing the nation in which the department has a
4 major role.⁷⁰

5
6 88. The AGA review also comments on the manner in which the summaries of the
7 most important challenges identified by the IG were presented in the MD&A. All
8 nine pilot agencies presented the summaries, accompanied by the IG's
9 assessment of the agencies' progress addressing the challenges. However, in
10 five instances management presented its own description of progress in addition
11 to the IG's assessment, which added to the length of the MD&A. The AGA
12 review recommended having Circular A-136 remind the agencies that the
13 assessments of progress should be presented by the IG, not management,
14 although the latter should work with the IG to ensure completeness. The AGA
15 review said that this would eliminate inconsistencies and avoid having
16 management appear defensive. Finally, the review recommended that the IG
17 focus on the challenges to the agency rather than the IG's past, present and
18 planned work on the challenges.⁷¹

19
20 89. The review also made recommendations with respect to how information about
21 improper payments ought to be summarized in the MD&A.⁷²

22
23 90. The AGA review recommended that OMB encourage agencies to have their
24 reports reviewed for quality by the external groups that are willing to do so. The
25 AGA review noted that although OMB requires the agencies' reports 10 days
26 before the official issue date, the review OMB conducts is primarily for assuring
27 an absence of inconsistency with Administration policies. OMB does not have
28 the resources to review the reports for usefulness and quality. The AGA and the
29 Mercatus Center, on the other hand, have programs that review the reporting.
30 OMB should seek to benefit from these studies.

31
32 91. Finally, the study found that the MD&A were lengthy, averaging 42 pages and
33 ranging from 15 to 108 pages.
34

⁷⁰ Ibid.38

⁷¹ AGA 38*Evaluation*, p. 13.

⁷² Ibid.34

TAB J – Attachment 1 – MD&A White Paper – Section IV – FASAB MD&A Task Group

1

2 Section IV – FASAB MD&A Task Group

3

4 92. The staff plans to convene a task group to assist with the analysis of MD&A
5 reporting. The group will help to substantiate the problem and develop
6 recommendations.

7

8 93. The task group will include representatives of users, preparers, auditors, and the
9 central financial agencies (OMB, Treasury, and GAO). The task group will
10 consider FY 2008 MD&As and discuss current FASAB MD&A standards and
11 OMB guidance, issues, and opportunities for improvement. The objective is to
12 consider whether, in the judgment of the group, the MD&A standards and
13 guidance are satisfactory, and whether MD&A that purportedly is prepared in
14 accordance with such standards and guidance does in fact comply.

15

16 94. An early draft of this paper proposed to limit the scope of the discussion to
17 management's discussion and analysis of performance, believing that that held
18 the most promise for improving MD&A in the shorter run. However, after further
19 review, it was decided not to limit the scope in this way but rather to cover the
20 MD&A in its entirety.

21

22 95. The questions for consideration include current MD&A reporting concisely
23 explain the entity's (1) performance, both positive and negative;⁷³ and, (2)
24 financial statements, its assets, liabilities, revenue and costs, and why the
25 amounts reported changed during the reporting period?⁷⁴

26

27 96. Beyond these questions, the staff proposes that the task group consider
28 performance evaluation, which involves analysis of information that managers
29 use to manage the entity. Staff notes that one preparer, the Treasury
30 Department, used the term "performance cost" in its FY 2008 MD&A, which
31 Treasury created because, in Treasury's view, it more accurately reflects the
32 total cost to achieve an outcome than "net cost."⁷⁵ Other agencies presumably
33 have used similar terms. This is an area the task group could explore. The
34 concept of "performance cost" or other concepts that capture a unit cost of

⁷³ See SFFAC 3, pars. 45-6.

⁷⁴ See SFFAC 3, pars. 14 and 26.

⁷⁵ Treasury's FY 2008 Annual Performance Report, Part II, Introduction. "For instance, while the Net Cost to manufacture coins and currency for non-appropriated bureaus such as the U.S. Mint and the Bureau of Engraving and Printing is zero because they are essentially self-funded, the real cost of operating these organizations is over \$2 billion once all imputed costs, depreciation, losses and other expenses are included. While performance cost is more than Net Cost, it is less than the Gross Cost reported on the Statement of Net Cost because it excludes accounts that do contribute to the cost of achieving performance for the agency, such as the Exchange Stabilization Fund and the Federal Financing Bank. Fiscal year 2008 is the second year that Treasury has included this information."

TAB J – Attachment 1 – MD&A White Paper – Section IV – FASAB MD&A Task Group

- 1 performance might be developed by the task group and ultimately the Board for
- 2 comparative analysis in federal MD&A.

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

SFFAC 3	SFFAS 15	A-136
MD&A – General		
SFFAC 3	SFFAS 15	A-136 (Section II.2.1)
<p>Each GPFFR should include a section devoted to MD&A. MD&A should address the entity’s</p> <ul style="list-style-type: none"> • program and financial performance measures • financial statements • systems, controls and compliance with laws and regulations and • actions taken or planned to address problems <p>The discussion and analysis may be based partly on information contained in reports other than the GPFFR. MD&A should also address significant events, conditions, trends and contingencies that may affect future operations. (SFFAC 3, par. 1)</p> <p>A typical GPFFR is a highly summarized profile of a complex entity based on conditions that exist and events that have occurred. It shows what happened but not why. (SFFAC 3, par. 2)</p> <p>Financial reports have two roles: feedback for evaluation and predictive for forms expectations about the future.</p>	<p>A report in conformance with federal GAAP should include MD&A of the financial statements and related information. MD&A should be a clear and concise description of the entity and its mission, activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition. MD&A should be balanced and include both positive and negative information. MD&A should be regarded as RSI. (SFFAS 15, par. 1)</p> <p>Because MD&A must be concise to be useful, mgt. must select the most important matters to discuss. Thus, some material items might not be discussed in MD&A. (SFFAS 15, par. 5)</p> <p>MD&A should deal with the “vital few” matters, i.e., the most important</p>	<p>A PAR must contain a section entitled MD&A as Section 1 and should follow the Agency Head letter. The MD&A should provide a clear and concise description of the reporting entity’s</p> <ul style="list-style-type: none"> • performance measures, • financial statements, • systems and controls, compliance with laws and regulations, and • actions taken or planned to address problems (cites SFFAS 15, par. 1). <p>To be useful, MD&A must be concise and readable to a non-technical audience, focus on the most important matters (cites SFFAS 15, par. 5) and provide a balanced analytical assessment of program and financial performance that includes both positive and negative information (cites SFFAS 15, par. 1). Not all material items in the basic statements, notes, performance section, and other sections of the PAR need to be discussed in MD&A. (A-136, Section II.2.1)</p> <p>MD&A should be a brief overview of the entire PAR. It includes most important matters that could:</p> <ul style="list-style-type: none"> • lead to significant actions or proposals by top management of the reporting unit • be significant to the managing, budgeting, and oversight functions of Congress and the Administration or

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

SFFAC 3	SFFAS 15	A-136
<p>(SFFAC 3, par. 3)</p> <p>The entity’s managers have detailed knowledge and have informed expectations regarding the future. Managers should explain the significance of key financial and nonfinancial information, the entity’s strategies, and the implications. (SFFAC 3, par. 4)</p> <p>The GPFFR should be understandable to a wide audience. It should be accompanied by a concise narrative discussion and analysis. (SFFAC 3, par. 5)</p> <p>MD&A may be even more important for federal reporting entities than for those in the private sector and may need to be more extensive in scope. SFFAC 3, par. 6)</p>	<p>matters that will probably affect the judgments and decisions of people who rely on GPFFR as a source of information. (The specific topics mentioned in SFFAC 3 are examples.) Mgt. should discuss and analyze matters that it’s reasonable to assume could:</p> <ul style="list-style-type: none"> • lead to significant actions or proposals by top management of the reporting unit • be significant to the managing, budgeting, and oversight functions of Congress and the Admin. or • significantly affect the judgment of citizens about the efficiency and effectiveness of their Federal Government <p>(SFFAS 15, par. 6) Management of the reporting unit is responsible for the content of the MD&A. (SFFAS 15, par. 7)</p>	<ul style="list-style-type: none"> • significantly affect the judgment of citizens about the efficiency and effectiveness of their Federal Government. Conformance to U.S. GAAP for federal entities requires the inclusion of an MD&A. <p>(A-136, Section II.2.2)</p> <p>The content of MD&A is the responsibility of management. Its preparation should be a joint effort of both the CFO’s office and program offices, and offices responsible for performance reporting, if applicable. Management has considerable discretion with respect to the presentation, subject to the required components and the pervasive requirement that MD&A not be misleading (cites SFFAS 15, par. 13) MD&A provides management with a vehicle for communicating insights about the entity, increasing the understandability of financial information, and providing information about the entity, its operations, service levels, successes, challenges, and future (cites SFFAC 3, Executive Summary). (A-136, Section II.2.3)</p>

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Scope		
SFFAC 3	SFFAS 15	A-136 (Section II.2.4)
<p>MD&A should address the entity’s</p> <ul style="list-style-type: none"> • structure, mission, goals, and objectives, with indicators of its performance • actions taken or planned to improve performance • the financial statements • systems, internal controls, and legal compliance, including corrective actions taken or planned and • the future effects of existing, currently-known demands, risks, uncertainties etc. and • may also address possible future effects of anticipated future demands, events, conditions, trends, etc. <p>(SFFAC 3, par. 9)</p> <p>MD&A should address these subjects even if separate documents report much of the information in more detail. (SFFAC 3, par. 10)</p> <p><u>Understanding Financial Reporting</u> MD&A should answer questions such as: What is the entity’s fin. position and condition and how did this come about? What were the</p>	<p>MD&A should contain sections that address the entity’s:</p> <ul style="list-style-type: none"> • mission and organizational structure • performance goals, objectives and results • financial statements • systems, controls, and legal compliance (SFFAS 15, par. 2) <p>MD&A should include forward-looking information re possible future effects of <u>existing</u>, currently-known demands, risks, uncertainties, events, conditions and trends. It may also include info. regarding <u>anticipated</u> future events, conditions, and trends. (SFFAS 15, par. 3)</p> <p>MD&A should discuss important problems that</p>	<p>MD&A is an integral part of the annual PAR as RSI. The scope section is a summary of SFFAC 3 and SFFAS 15. Pursuant to SFFAS 15, MD&A may reference information in other discrete sections of the PAR or it may be based on information contained in reports separate from the PAR.</p> <p>At a minimum, the MD&A should address the entity’s:</p> <ul style="list-style-type: none"> • mission & organ. structure • performance goals, objectives, & results • fin. stmts; & systems, controls, & legal compliance <p>MD&A should also include forward-looking information about the possible effects of the most important existing (cites SFFAS 15, par. 3) and anticipated performance and financial demands, events, conditions, and trends. Management should discuss important problems that need to be addressed, and actions that have been planned or taken to address those problems. Actions needed, planned, and taken may be discussed within the sections listed above or in a separate section of the MD&A. (A-136, Section II.2.4)</p>

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Scope		
SFFAC 3	SFFAS 15	A-136 (Section II.2.4)
<p>significant variations from prior years, from the budget, from plans? What is the potential effect of current and future events? (SFFAC 3, par. 14)</p>	<p>need to be addressed, and actions taken or planned to address them. (SFFAS 15, par. 4)</p> <p>MD&A should deal with the “vital few” matters, i.e., the most important matters that will probably affect the judgments and decisions of people who rely on GPFFR as a source of information. (SFFAS 15, par. 6)</p>	

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Mission and Organizational Structure		
SFFAC 3	SFFAS 15	A-136 (Section II.2.5)
<p>MD&A should address the entity’s</p> <ul style="list-style-type: none"> • structure, mission, goals, and objectives, with indicators of its performance ... <p>(SFFAC 3, par. 9)</p> <p>To understand performance, systems, controls, and compliance, it’s necessary to understand the entity’s organizational structure, mission, and strategic plan. (SFFAC 3, par. 12)</p> <p>MD&A should contain a brief description of the mission(s) of the entity and describe its related organizational structure. (SFFAC 3, par. 25)</p>	<p>MD&A should contain sections that address the entity’s:</p> <ul style="list-style-type: none"> • mission and organizational structure ... <p>(SFFAS 15, par. 2)</p> <p>MD&A should include forward-looking information re possible future effects of <u>existing</u>, currently-known demands, risks, uncertainties, events, conditions and trends. It may also include info. regarding <u>anticipated</u> future events, conditions, and trends. (SFFAS 15, par. 3, is also applicable here.)</p>	<p>MD&A should contain a brief description of the mission(s) of the entity and describe its related organizational structure, consistent with the entity’s strategic plan. (A-136, Section II.2.5)</p>

MD&A – Financial Statements		
SFFAC 3	SFFAS 15	A-136 (Section II.2.7)
<p>Mgt should discuss & analyze <u>financial results, position, and condition</u>. Help readers understand financial results & position &</p>	<p>MD&A should contain sections that address the entity’s:</p>	<p>MD&A should help users understand the entity’s financial results, position and condition conveyed in the principal financial statements. MD&A should include:</p>

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Financial Statements		
SFFAC 3	SFFAS 15	A-136 (Section II.2.7)
<p>entity’s effect on the financial position & condition of the govt. Give readers the benefit of mgt’s understanding of the significance & potential effect of changes in financial stmt. Elements; of particular account balances; of RSSI. (SFFAC 3, par. 26)</p> <p>Discuss only those variations, balances & amounts of potential interest to readers. Not all changes should be included. (SFFAC 3, par. 27)</p> <p><u>Budget Integrity</u> Discuss <u>budgetary</u> resources & how such resources related to costs of operations. Explain when major support for a program or activity is provided outside the reporting entity’s budget; and discuss the major financing arrangements. (SFFAC 3, par. 28)</p> <p>Explain major changes to original budget, major failures to comply with legis., etc., including:</p> <ul style="list-style-type: none"> • unfunded liabilities • assets that could be sold • payments not matched with oblig. • anticipated increase in costs. 	<ul style="list-style-type: none"> • ... financial statements ... (SFFAS 15, par. 2) <p>MD&A should include forward-looking information re possible future effects of <u>existing</u>, currently-known demands, risks, uncertainties, events, conditions and trends. It may also include info. regarding <u>anticipated</u> future events, conditions, and trends. (SFFAS 15, par. 3, is also applicable here)</p> <p>MD&A should discuss important problems that need to be addressed, and actions taken or planned to address them. (SFFAS 15, par. 4)</p>	<ul style="list-style-type: none"> • comparisons of the current year to the prior year and • an analysis of the agency’s overall financial position and results of operations to assist users in assessing whether that financial position has improved or deteriorated as a result of the year’s activities. It should give users the benefit of management’s understanding of the: <ul style="list-style-type: none"> • major changes in types or amounts of assets, liabilities, costs, revenues, obligations, and outlays • relevance of particular balances and amounts shown in the principal financial statements, particularly if relevant to important financial management issues and • entity’s stewardship information. <p>This section should also include a discussion of key financial-related measures emphasizing financial trends and assess financial operations. (A-136, Section II.2.7)</p>

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Financial Statements		
SFFAC 3	SFFAS 15	A-136 (Section II.2.7)
<p>(SFFAC 3, par. 29)</p> <p><u>Use of Estimates</u> Discuss the use of estimates where that’s important to understand issues, e.g., major risks and uncertainties or key forward-looking info. (SFFAC 3, par. 30)</p> <p><u>Current Demands, Risks, Uncertainties etc.</u> Describe existing, currently-known demands, risks, uncertainties, events, conditions and trends—both favorable & unfavorable. (SFFAC 3, par. 31)</p> <p><u>Future Effects of Current Demands, Risks, Uncertainties etc.</u> Go beyond mere description of existing conditions to include possible effects. (SFFAC 3, par. 32)</p> <p><u>Future Effects of Anticipated Future Events, Conditions, and Trends</u> Discuss possible future effects of anticipated future events, conditions, and trends, e.g., anticipated cost & demographic trends. (SFFAC 3, par. 33)</p> <p>If there is a reasonable prospect of a major effect due to an anticipated condition,</p>		

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Financial Statements		
SFFAC 3	SFFAS 15	A-136 (Section II.2.7)
<p>discuss that. (SFFAC 3, par. 34)</p> <p>The discussion of existing and anticipated factors should include quantitative forecasts or projections. (SFFAC 3, par. 35)</p> <p>MD&A should make the financial stmts. Understandable to a wide audience. Mgt should try to identify sources of misunderstanding, e.g., budget vs. accrued cost, & explain. (SFFAC 3, par. 37)</p> <p>Emphasis given to certain costs in the fin. stmts may need to be explained. When MD&A itself discusses the cost of program outcomes, the problems of associating costs with outcomes may need to be discussed. (SFFAC 3, par. 38)</p> <p>The auditors report should be mentioned. (SFFAC 3, par. 39)</p>		

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Systems, Controls and Legal Compliance		
SFFAC 3	SFFAS 15	A-136 (Section II.2.8)
<p>MD&A should tell the reader whether internal controls are adequate. (SFFAC 3, par. 15).</p> <p>Information on mgt systems is important. (SFFAC 3, par. 16)</p> <p>The ability to prepare auditable fin. stmts is a positive signal. (SFFAC 3, par. 17)</p> <p>GPFRR includes a discrete section reporting on the status of the entity’s mgt systems and internal controls that support (1) fin. stmt. preparation and performance info. & (2) the entity’s compliance with laws; & also problems revealed by audits or otherwise. (SFFAC 3, par. 40)</p> <p>Management should discuss the results of audit and actions taken or planned to address issues. (SFFAC 3, par. 41)</p>	<p>MD&A should contain sections that address the entity’s:</p> <ul style="list-style-type: none"> • ... systems, controls, and legal compliance <p>(SFFAS 15, par. 2)</p> <p>MD&A should discuss important problems that need to be addressed, and actions taken or planned to address them. (SFFAS 15, par. 4, is also applicable here)</p>	<p>Management Assurances required under the Federal Managers Financial Integrity Act (FMFIA) (Pub. L. No. 97-255) and OMB Circular No. A-123, <i>Management’s Responsibility for Internal Control</i> must be separately identified within the MD&A as part of the information provided in accordance with Section II.2.8 Analysis of the Entity’s Systems, Controls and Legal Compliance. (A-136, General, Section 1.2 and 1.3)</p> <p>Agencies are required to provide assurances related to the FMFIA and FFMIA in a separate section entitled “Management Assurances.”</p> <p>The FMFIA assurance statement should:</p> <ul style="list-style-type: none"> • Provide management’s assessment of the effectiveness of the organization’s internal controls to support effective and efficient programmatic operations ... (FMFIA § 2); and ... financial systems requirements (FMFIA § 4). • Provide a separate assessment of the effectiveness of the internal controls over financial reporting as a subset of the overall FMFIA assurance statement (i.e., separate paragraph within the FMFIA Assurance Statement). • Include a summary of material weaknesses (FMFIA § 2) and non-conformances (FMFIA § 4), and a summary of corrective actions to resolve the material weaknesses and non-conformances. <p>Management should also include its FFMIA compliance assessment in this section. Management is required to</p>

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Systems, Controls and Legal Compliance		
SFFAC 3	SFFAS 15	A-136 (Section II.2.8)
		<p>provide its assessment of the organization’s compliance with Federal financial management systems requirements, standards promulgated by FASAB, and the USSGL at the transaction level. ...Management should review its assurance statements (FMFIA) and its compliance determination (FFMIA) for consistency with the findings specified in the annual financial statement audit report(s). The OIG or auditor will compare material weaknesses disclosed during the audit with those material weaknesses reported in the agency’s FMFIA report and document any material weaknesses disclosed by audit that were not reported in the agency’s FMFIA report. Management should perform the same due diligence when preparing its final assurance statements. The reports could, in fact be different, but they should not be in direct conflict. When conflicting discrepancies exist, it is management’s responsibility to ensure that outstanding issues are appropriately reported.</p> <p>The agency assurance statement is required to be signed by the agency head.</p> <p>All agencies are required to prepare Table 1 in OAI Section II.5.6 of this document. For agencies reporting material weaknesses, summary information is required to be reported in Table 2, also in Section II.5.6. (A-136, Section II.2.8)</p>

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Performance		
SFFAC 3	SFFAS 15	A-136 (Section II.2.6)
<p>MD&A should inform the reader how well the entity is doing; it should tell the reader what the entity has accomplished and how well it's managed. It ought to answer questions such as: what do we need to know to gauge operating success, how do we measure success? (SFFAC 3, par. 11)</p> <p>To assess performance, people need to info. on the consequences of activities. For govt., expense reflects efforts but indicators other than net income usually are needed to gauge accomplishments. (SFFAC 3, par. 13)</p> <p>The objectives & needs of the fed. govt. are markedly different from non-govt. The needs of federal financial report users are different, too. In particular, reporting on performance of govt. programs organs., and activities requires info. going beyond changes in net assets and, indeed, beyond fin. info. (SFFAC 3, par. 42)</p> <p>The actual outcomes, accomplishments, or degree to which predetermined objectives are met provide indicators or measures of some aspects of effectiveness. MD&A should objectively discuss the entity's</p>	<p>MD&A should contain sections that address the entity's:</p> <ul style="list-style-type: none"> • ... performance goals, objectives, and results ... (SFFAS 15, par. 2) <p>MD&A should include forward-looking information re possible future effects of <u>existing</u>, currently-known demands, risks, uncertainties, events, conditions and trends. It may also include info. regarding <u>anticipated</u> future events, conditions, and trends. (SFFAS 15, par. 3, is also applicable here)</p> <p>MD&A should discuss important problems that need to be addressed, and actions taken or planned to address them. (SFFAS 15, par. 4, is also applicable here)</p>	<p>MD&A should Inform the reader re how well the entity is doing, e.g., explain what how to gauge success, how to measure accomplishments, & what the measurements show (cites SFFAC 3, par. 11).</p> <p>Since govt. entities mostly focus on services and products rather than making a profit, the interests of the diverse groups affected by the govt's activities lie as much in efforts & accomplishments as in financial results. Thus, the discussing performance using indicators other than revenue is particularly critical (cites SFFAC, par. 13).</p> <p>MD&A should include highlights of performance goals and results (positive and negative) for the applicable year related to and consistent with major goals and objectives in the entity's strategic & performance plans, including trend data where available (this applies to goals being evaluated by quantitative and descriptive criteria). Effective for FY 2007 [emphasis in original], if material to the mission, reflect results of services performed through allocation transfers in which the financial statements do not include the amounts received. These performance highlights should:</p> <ul style="list-style-type: none"> • Provide a clear, objective picture of the entity's program results compared to its goals and objectives • Indicate the extent to which its programs are achieving their intended goals and objectives, and explain performance trends • Discuss the strategies and resources the entity uses to achieve its performance goals • Evaluate underlying factors that may have affected the reported performance

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Performance		
SFFAC 3	SFFAS 15	A-136 (Section II.2.6)
<p>program results. Efficiency and effectiveness are important elements of performance measurement, and measuring cost is an integral part of assessing efficiency and effectiveness. Relating outputs to inputs provides an indicator or measure of one aspect of efficiency. Information regarding effectiveness is often combined with cost information to help assess “cost effectiveness.” (SFFAC 3, par. 43)</p> <p>Financial and non-financial performance ought to be summarized to provide indicators of its operations. (SFFAC 3, par. 44)</p> <p>The discussion of performance ought to relate major goals and objectives from the strategic plan to indicators reported per GPRA. It should explain what the key performance indicators say. The summary of performance should:</p> <ul style="list-style-type: none"> • discuss strategies & resources used to achieve goals • clearly explain planned & actual performance • explain how management is able to be ensure that performance info. is 		<ul style="list-style-type: none"> • Explain plans and timelines to improve performance where targets were not met • Summarize management’s design to provide reasonable assurance that performance information is relevant and reliable and • Discuss important limitations and difficulties associated with performance measurement and reporting <p>Entities are encouraged to provide information in the PAR to help the reader assess the relative efficiency and effectiveness of entity programs/operations. Efficiency is defined as the ratio of an “effective or useful” outcome or output to the total input resources of a system; effectiveness is having an intended or expected effect (for efficiency measures, A-136 cites http://www.whitehouse.gov/omb/part/fy2007_guidance_final.pdf, pages 9-11, 41-43, 58, and 78-81) .</p> <p>Entities should discuss efficiency and effectiveness via objective measures that indicate results achieved and relate major goals and objectives in their strategic plan to cost categories (i.e., responsibility segments) presented in the entity’s SNC. (A-136, Section II.2.6)</p>

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Performance		
SFFAC 3	SFFAS 15	A-136 (Section II.2.6)
<p>relevant and reliable. (SFFAC 3, par. 45)</p> <p>The discussion ought to:</p> <ul style="list-style-type: none"> • include positives and negatives • present historical and future trends • use charts and graphs • explain trends • compare actual to goals or benchmarks • explain variations from goals and plans • provide any info. mgt. thinks is necessary for an understanding of results <p>(SFFAC 3, par. 46)</p> <p><u>Understanding Performance Reporting</u> Limitations and difficulties of performance measurement & reporting ought to be noted, e.g.,</p> <ul style="list-style-type: none"> • performance usually can't be fully described by a single indicator • indicators by themselves don't say why performance is at a certain level • focus on quantities can sometime be 		

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Performance		
SFFAC 3	SFFAS 15	A-136 (Section II.2.6)
misleading (SFFAC 3, par. 48) Thus, performance indicators usually need to be explained. (SFFAC 3, par. 49)		

TAB J – Attachment 1 – MD&A White Paper – Standards Matrix

MD&A – Other Information		
SFFAC 3	SFFAS 15	A-136
		<p>Management has the discretion to include a summary in MD&A of other information, initiatives, and issues it identifies. This could include summarizing entity progress in implementing key administration management initiatives. (A-136, Section II.2.10)</p> <p>Limitations of the Financial Statements MD&A should include a section articulating the limitations of the principal financial statements. This section should state the following: “The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.” (A-136, Section II.2.11)</p>

TAB J – Attachment 2 – MD&A Task Group Members

Attachment 2 – MD&A Task Group Members

MD&A TASK GROUP MEMBERS July 2009	
Name	Affiliation
Hal Steinberg	Member, Federal Accounting Standards Advisory Board. Retired partner, KPMG, and former Deputy Controller of the Office of Federal Financial Management at OMB. Leader of AGA's Certificate of Excellence in Accountability Reporting program.
Scott Bell	Treasury Department, Office of Fiscal Service
Terry Bowie	DCFO, National Air and Space Administration (NASA)
Linda Casias represented by Julie Tao	CFO, Commerce Department Director for Internal Controls, Commerce Department
Tom Cooley	CFO, National Science Foundation (NSF)
Mortimer Downey	Chairman, Pb Consult, Inc. and former Deputy Secretary, U.S. Department of Transportation (DOT), former Assistant Secretary for Budget and Programs, DOT; Budget Priorities Analyst, Committee on the Budget, U.S. House of Representatives.
Mathew Johnson	Cotton and Company LLP
Regina Kearney	Office of Management and Budget (OMB), Financial Standards and Grants Branch
Kathy Newcomer	Director, School of Public Policy and Public Administration, The George Washington University
Sue Piyapongroj	Government Accountability Office (GAO)
Robert Shea	Director, Global Public Sector, Grant Thornton LLP Former positions with OMB: Associate Director for Administration and Government Performance, Associate Director for Management, Counsel to the Controller. Former Counsel, Senate Committee on Governmental Affairs, U.S. Senate; Legislative Director, Office of Representative Pete Sessions; Special Assistant/Professional Staff Member, House Committee on Government Reform and Oversight, U.S. House of Representatives.
Dave Smith	Defense Department (DoD); former Acting DCFO, DoD
Kathleen Turco	CFO, General Services Administration (GSA)
Sheila Weinberg	Founder and CEO, Institute for Truth in Accounting
Richard Fontenrose	Assistant Director, FASAB

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

Observers and Others	
Gordon Alston	Commerce
Donjette Gilmore	Defense Department
John Lynsky	NSF
Alethea Mack	NASA
Diane Marston	Commerce
Sharnell Monthomery	Grant Thornton LLP
Diane McKay	NSF
Martha Rubenstein	NSF
Shirl Ruffin	NSF
Ralf Seiffe	Institute for Truth in Accounting
Michael Sieverts	NSF
Shirley Watt	NSF

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

Attendees:

Hal Steinberg, FASAB
Scott Bell, Treasury
Terry Bowie, NASA
Julie Tao, Commerce
Tom Cooley, NSF
Mort Downey, Pb Consult, Inc.
Regina Kearney, OMB
Kathy Newcomer, GWU
Sue Piyapongroj, GAO (on the phone from Atlanta)
Bob Shea, Grant Thornton LLP
Dave Smith, DoD
Kathleen Turco, GSA
Sheila Weinberg, Institute for Truth in Accounting
Wendy Payne, FASAB
Richard Fontenrose, FASAB
Donjette Gilmore, DoD
Sharnell Monthomery, Grant Thornton LLP

Summary

The group discussed current concepts, standards, and guidance for management's discussion and analysis ("MD&A"), and assertions that there is a problem with MD&A.

The group agreed that:

- There are several open questions (1) what is the purpose of MD&A, (2) what MD&A content would achieve that purpose, and (3) who is the audience, which should be studied.
- SFFAS 15 is satisfactory. The guidance should continue to be flexible.
- A "best practices" guide that illustrates specific topics, for example, loans, grants, and contracts would be useful; or, instead of loans, grants, and contracts, one member prefers that the guide illustrate reporting of performance goals and results, analysis of financial statements, and forward-looking information.
- Circular A-136 should be reviewed with the goal of improving the MD&A presentations.

Other areas of consensus are as follows:

- It is possible that many MD&A are too long but the complexity of the federal reporting environment prevents generalization.
- The MD&A should provide SFFAS 15-required information and explain succinctly and candidly why it is important. Candor is especially valued.

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

- OMB’s receptivity to candid discussion of forward-looking information would depend on how the MD&A was worded and on the individual budget examiner.
- The relationship among the finance, budget, and program offices generally is a constraint for MD&A.
- Agency management would not have difficult identifying the “vital few” subjects for discussion.
- MD&A should link (especially hyper-link) to more detailed information.
- Setting a fixed number of pages for the MD&A is not feasible due to the varying complexities of organization and operation across Federal entities and agencies – at least not via Federal Accounting Standards Advisory Board (“FASAB”) standards.

Are MD&A Too Long?

Regarding the nature of the problem, the agenda listed certain questions for consideration starting with “Is the MD&A too long,” e.g., is there too much of the obvious, or a lack of focus on the “vital few” topics, or too much focus on responding to Inspector General-identified challenges.

Some task group members felt that many MD&A sections are redundant, verbose, and irrelevant. One member stated that in some cases this would be due simply to writing styles; in short, some MD&A are poorly written.

The consensus of the group was that it is possible that many MD&A are too long but generalization is not possible. The complexity and number of issues with which the entity must deal impact the length of the MD&A.

The group discussed the possibility of requiring MD&A to be a fixed number of pages to limit its length, which is something an Association of Government Accountants (“AGA”) review (“AGA Review”) had suggested.⁷⁶ The Office of Management and Budget (“OMB”) had in fact required a fixed number of pages with respect to its performance and accountability report (“PAR”) pilot program.

One member noted the OMB PAR pilot program was a promising mechanism to limit the length of financial reports. It was noted that some numerical page limit would be useful in order to contain individuals’ natural tendency to want to their programs mentioned, but the number of pages allowed should depend on the complexity of the issues. The consensus of the group was that setting a fixed number of pages for the MD&A, was not feasible – at least not via Federal Accounting Standards Advisory Board (“FASAB”) standards.

Auditors’ Effect

One member mentioned that auditors can affect the length of the MD&A. For example, if the auditors are “a strict constructionists” regarding SFFAS 15, for example, they may employ an excessive checklist approach, which can lead them, as a practical matter, to demand more in

⁷⁶ See FASAB staff’s *MD&A White Paper*, June 2, 2009, paragraph 76.

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

the MD&A than management would put there; or require things in MD&A that management would or could put in other parts of the document. Because MD&A is “required supplementary information” (“RSI”) rather than “basic information,”⁷⁷ the auditors’ negative comments on the MD&A would not effect the auditor’s opinion on the financial statements per se, management normally works to prevent having to publish negative comments by the auditor.

A member mentioned that, as a practical matter, auditors affect what management includes in the MD&A. Negotiating with the auditors about MD&A language consumes critical time as the required reporting date approaches and management would tend to comply to avoid delay. In addition, if preparers include analytics, auditors want to audit it. To meet the 45-day reporting deadline and write the MD&A, preparers tend to keep the MD&A at a very high level and/or include the simple and obvious. This also applies to the performance section of the MD&A.

On the other hand, a member noted that auditors to whom he has spoken do not consider RSI something about which they would make demands. They do not give RSI as much attention as the basic information. He noted also that that would vary among audit firms.

Several members mentioned that more auditor participation on the MD&A group would be beneficial, and participating auditors should have experience reviewing agencies’ MD&A.

Fundamental Questions

A member noted that the question of the length of the document may be better addressed after more fundamental questions are answered, for example, what are the objectives, who are users and stakeholders, and what information do they need. If a document is being written for Congress, then one type of information is needed; if it is for the general public, then other types of information are needed; OMB wants other information; accountants other information.

A member said the objective is a transparent and candid assessment of the entity’s strategy and performance. Too much detail and/or “check the box” approaches produce poor results. A member mentioned that FASAB standards focus on general purpose information for citizens, managers and other decision-makers who do not have access to the data, etc.

The OMB’s recent PAR pilot was mentioned as a positive initiative. The PAR pilot resulted from agencies’ concern that, putting performance information in the financial report can lead to excessive emphasis on auditing that information.

A member mentioned that, in response to the audit difficulties, OMB created the “Citizens’ Report,” which is a mechanism for agencies to provide summary information to the public. Also, it was noted that OMB put in the page limit because it was getting hundred-page MD&A that nobody could read. The Citizens’ Report is a high level of data that was hyper-linked to other levels of data.

⁷⁷ See OMB Bulletin) 07-04, *Audit Requirements for Federal Financial Statements*, August 24, 2008, as revised, especially paragraphs 7.9-7.11.

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

A member mentioned that an advantage of the FASAB standards versus the Citizens' Report approach is that information can be required by FASAB standards whereas the Citizens' Report requirement could and in fact has changed. For example, now agencies have the option of providing the summary as a separate document or in MD&A.⁷⁸ [It was noted that having options means OMB now has to review the results, be it MD&A or another approach, to determine if it meets the requirement and revisit the matter for the next Circular A-136 revision.]

The group discussed whether anyone reads general purpose financial reports. One member said they were not used and noted by contrast that the Web site recovery.com receives many visits or "hits." This was due, presumably, to the user-friendly way the information is presented in the latter.

The group discussed the question of "who is the audience" for general-purpose financial reports. It was asserted that the only time a general-purpose financial report is read (at least by Congress) is when a clean opinion is lost. A member mentioned that the different levels of interest may be due to the different publicity afforded them. Several members asserted that such reports are not used for decision-making at federal agencies. A member mentioned that annual and quarterly general-purpose financial reports are less important than monthly cash flow and budget reports.

⁷⁸ During FY 2007 and FY 2008 OMB conducted a pilot in which agencies were permitted to produce an alternative to the consolidated PAR. The pilot had 3 required components: 1) an Agency Financial Report (AFR), 2) an Annual Performance Report (APR) with detailed performance information that meets GPRA requirements and is transmitted with the Congressional Budget Justification (CBJ), and 3) a Citizens' Report that summarized the AFR and APR in a brief, user friendly format.

The goals of the pilot were to allow agencies to explore different formats to enhance the presentation of financial and performance information, make this information more meaningful and transparent to the public, and allow Congress, stakeholders, and the public to make informed decisions about agencies' performance. Results from the pilot identified some advantages to separating the APR from the AFR and to producing a Citizens' Report. For example: Including the APR along with the annual performance plan in the CBJ allowed agencies to discuss future programmatic resources directed at improving performance more fully; and

Creating a Citizens' Report increased the focus on the public as a stakeholder in program outcomes, providing an easy to read summarization of agencies' performance and financial information.

Although the pilot was successful, some agencies continue to achieve enhanced presentation of financial and performance information in the consolidated PAR.

For FY 2009, agencies may continue to choose either to produce a consolidated PAR or to produce a separate AFR and APR. In addition, all CFO Act Agencies will be required to produce a summary of performance and financial information. Suggested formats for the summary of performance and financial information include the following:

- A 3-8 page high level summary,
- A 25-30 page more detailed summary, or
- An MD&A that integrates performance and financial information in a concise, easy to read format and that can easily be extracted from the PAR or AFR and issued as an independent summary report. (Note: the MD&A is a required component of the PAR or AFR regardless if it is or is not used as the summary of performance and financial information.) OMB Circular A-136, June 10, 2009, pp. 12-13

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

The group discussed the purpose of general-purpose financial reports. A member said the group might want to consider why we have MD&A; and, before that, why we have financial statements. The member thought they were exclusively for accountability and to improve the accounting process. Another member thought such reports were also intended to provide useful information.

There was a consensus that general-purpose reports were needed for accountability and had improved the reporting process at federal agencies.

A member said, based on her research regarding “users,” that the audience for financial reports cannot be “citizens.” “Citizen” is too broad a category. Marketing to such a category is impossible. There needs to be a massive study of who should care, what would they care about, what is important to them, what should the message be, and how should it be delivered. The MD&A work needs this foundation.

A member noted that federal financial reporting had evolved. It had started with financial statements and separate performance report. The performance and financial reports were combined into the PAR, and now are starting to be broken out again, which he agreed with because it reflects a different-reports-for-different-purposes approach. A general-purpose report for the average citizen may be too general. He thought the financial section is a compliance report and the performance section is separate. He asserted that the MD&A should be focused on the compliance piece, the basic blocking and tackling, and the major challenges down the road. He thought current general reports have gotten large trying to cover too much.

A member asked whether the report had gotten too general and too broad because no one within the agency wanted to tackle the tough issues or because they were following the “checklist.”

The member responded that his agency was following the “checklist” but everyone wants to participate, which results in a collage, which forces the “reader” to wade through it. He thought segmentation into distinct pieces – for example, performance and compliance – might overcome the no-one-reads-it issue. He suggested that perhaps no one needs to read the financial statements, that all they need to know is that the data has been independently reviewed and deemed reasonable; and therefore the data in other reports can be relied on, because it is produced from the same system.

On the subject of the purpose of the MD&A, a member mentioned the difficulty of communicating financial statement information that might not be too interesting. He thought that the original developers of the financial statements had recognized that no one is going to read financial statements. Instead, readers want to know what the organization is trying to do, how it is organized, what it has accomplished. He said originally there had been an “overview” for the financial statements, which became the FASAB’s MD&A. The FASAB added a few things to the “overview,” for example, the need to discuss systems and controls, analysis of financial statements and changes therein, and forward-looking information and the risks. He noted that FASAB had not added the current requirement regarding internal management challenges, discussion of which can be found in the IG’s statement, but which many agencies include in

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

their MD&A. Essentially, this is what SFFAS 15 required. He said ultimately the MD&A task group might decide the MD&A is more important than the financial statements, and that is what the task group ought to work on. He thought the task group should develop recommendation for the Board for the best MD&A possible.

A member responded that SFFAS 15 outlines the critical information and therefore the guidance exists; and, if the goal is not being achieved, then something else is wrong. The member thought that it goes back to everyone in the agency wanting to have their say, which results in a large, confusing presentation. You have the 45-day time constraint. You have a lot of people reviewing the MD&A, from different angles, which again results in the inclusion of a lot of marginal information. Unless these underlying problems are dealt with, even the best MD&A guidance ever will be ineffectual.

A member suggested going back to first principles and stripping away from the MD&A the reporting that has accreted over time that does not contribute to achieving the purpose of the MD&A. The member asserted that MD&A is trying to serve too many masters – accountability, performance, etc. Another member agreed and added that the easy way to deal with new requirements is to simply add pages to the report. Under time and resource constraints, it is often easy just to follow the path of least resistance.

A member asserted that critiques by the AGA's Certificate of Excellence in Accounting and Report ("CEAR") review ("AGA Review") and Mercatus programs had also resulted in more pages being added to the financial report. A document that should be 30 pages has become 90 pages. He suggested that the nature of reporting has changed in fundamental ways, that effective reporting is now via the Web. The initial Web page engages the users and links to more detail if so desired, and with auditor assurances about the data.

Another member spoke about the "chilling effect" of reporting requirements. She said really effective performance reporting generally is hard to do; for example, linking costs to strategic goals is hard. It is easier to merely "feed the OMB beast" enough to comply but not do any really inspired reporting. No one really learns anything via that kind of reporting. In addition, she noted that program managers and analysts are going to be overly cautious when providing information for the accountants. She was not sure you can ever really have a meshing of something that is perceived to be "feeding the beast" about financial accountability but at the same time learn about performance.

A member said her office tries very hard not to ask the program office for information. They try to gather information during the year and then go back with a completed analysis for the program offices to review. Continually asking program offices for information generates ill will.

A member said that generally you have two environments in which you have learning cultures. There is the programmatic side of the house and the administrative side. The program side of the house is more than happy to say the audited financial statements are the administrative side's responsibility; do not ask questions of the program side because they do not want to deal with the auditors. On the other hand, when you go out to the community you serve and ask them what information is important to them you discover some very interesting things. They

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

found that the information the users wanted was already available in the system. It was a learning process; it takes time.

A member returned to the question of why the MD&A is done and why do we care if the financials are read if everyone only cares about the clean opinion. What Congress and The People want to know is how much money did you get – the budget – and what did you do with it – performance. A tremendous amount of resources are used each year to develop the budget and the budget justification. The reason every program manager wants to give the financial officers something for the MD&A is not because they care about the financials; it's because they want their programs funded. If what we are trying to report is how much money did you get and what did you do with it, then put some accountability and transparency into the whole budget process; the budgeteers have the information, so make them provide information on whether they accomplished what they said they would for the MD&A. Accountants cannot get that information from program managers. The threat to the clean opinion is an indirect tool, at best, that makes the finance office the villain. He suggested making the future budget funding depend on whether performance information was provided.

A member said that at her agency the CFO office is responsible for reporting on performance. Also, the problem of everybody wanting to add something to the MD&A does not exist at her agency because the CFO office cuts it out. The issue of the auditor wanting to verify information is addressed by keeping the MD&A at a high level. The difficult part at her agency is the link between financial side and the budget over performance measures and the validity of the measures, and the cost accounting that needs to be done in that regard, which has been discussed in the Chief Financial Officers' Council.

She concluded with the observation that she did not see a problem with current MD&A. She said the MD&A reflects the quality and the analytics that go into them. She said her agency's MD&A may have become too generic and perhaps more was needed.

Regarding analytics in the MD&A, a member said his agency values a 5-year historical trend more than any prognostication for the out years. Every year's budget is subject to the vagaries of the budget formulation and appropriations process. A projection published in the MD&A on November 15 has almost no chance of being accurate. The out-years received from OMB are almost never sustained.

A member mentioned the usefulness of a survey of users that another member had undertaken. First decide who we want the audience to be and then go to that audience and ask what information and formats they want.

Another member added that the FASAB standard would not determine that but rather each agency would survey its stakeholders.

A member suggested that the performance report should be a stand-alone document depending upon the agency's mission. For example, explain what the agency is supposed to do and whether it has done it. Another member added that such a performance report would speak very

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

directly to the stakeholders; they are the people who care. The agency should not assume without asking that it knows what the stakeholders want.

A member added that effective reporting would constitute a Web page offering daily updates to the entity's finances, for example, as of October 1, its appropriations and plans and then daily updates as to how the money is spent. For example, you can show compliance with spending and other laws and also provide the taxpayers some reasonable assurance that the money was actually spent as originally intended. Another member added that a final step would be to show what the outcome was, what you got for the money.

A member mentioned that these suggestions touched on another on-going FASAB project on the reporting model. The project would be looking at reports by the agencies and by the federal government.

There was a consensus that the MD&A is supposed to be an introduction to this information, with links to more detailed information.

The group discussed the fact that the budget offices at OMB and on the Hill do not pay attention to the financials. Several members agreed that more attention is paid to the congressional budget justification than to the financial report. A member added that the appropriators ask just one question: did you get a clean opinion? If the answer is "yes", they are done. He said the authorizers ask about the IG management challenges and what the agency is doing about it.

A member responded that the management challenges generally are more on the programmatic side. The finance office is held accountable for some challenges, usually involving internal controls or program operations, and there is a bit of a breakdown in the remedial process there. The finance office usually cannot solve those problems. They are inherent problems or problems within the program areas, and yet the critics are pointing at the finance office.

It was suggested that the management challenges be placed in a bigger performance report. The group discussed whether the financial and performance reporting had to be together by law.

A member gave background on the Reports Consolidation Act. He said the Social Security Administration report had been the model for the legislation, which was negotiated between the Hill and OMB. The law says the agency may consolidate the financial and the performance reports into a single report, which is to be called the performance and accountability report ("PAR"). In its "cover letter" the agency has to attest to the quality of the performance data. In addition, the agency can consolidate any annual report into the PAR, all of which was designed to put in one location financial, performance, and management information and make it easier for the agency to report. He said the pilot resulted from feedback from the performance management community that it needed some flexibility in how it would accomplish this reporting.

He agreed that hardcopy reports are not really useful to more than a few people. The agency needs to provide information in a variety of tailored formats that are useful to a number of people.

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

A member mentioned that the Reports Consolidation Act requires performance information in the financial report – which includes the MD&A – if the financial and performance reports are separate. OMB guidance requires performance information in MD&A because that is where it was before and because SFFAS 15 requires the entity to address performance in the MD&A. The member noted that a question arose when the OMB pilot was started about where the MD&A should go if financial and performance information was separated. She noted that the separation eliminates the audit scrutiny of the performance report, which she felt is desirable.

Another member added that one of the reasons his agency signed up for the pilot is because the program managers were having difficulty meeting the 45-day reporting requirement for the financial statements. The 4th quarter data was estimated, which caused problems with the auditors. He thought having the Citizens' Report come out in January with the final performance data while publishing the financial report in November within the 45-day requirement really helped the value of the information.

It was noted that a Mercatus study had concluded that even though under the PAR pilot, the agencies had more time to do the performance report, the additional time did not result in enhanced reporting.

Performance Reporting

It was noted that budget and performance divisions within agencies are reluctant to devote time to performance reporting for the financial report. They focus on the budget and, for example, do not want to disclose information or simply do not want to spare the time to develop it. The group generally agreed that the financial report's dependence on budget offices for performance information is a constraint.

The group discussed performance reporting at large agencies with multiple divisions and multiple goals. The group agreed that agency leadership decides what are the "vital few" areas to discuss in the MD&A. Generally, the vital few areas would be commonly understood within an agency.

The Labor Department report was cited as an example of excellent reporting. The Labor report is succinct and candid and provides useful information. There was a consensus that candor is a valuable element of good reporting.

MD&A in filings with the Securities and Exchange Commission were contrasted with those in federal reports. The latter were characterized as "political documents" as opposed to documents for investors.

The group discussed the desirability of teamwork when developing the MD&A. The team would include the program, budget, and finance offices.

The group discussed whether OMB would allow candid discussion of future financing issues in the MD&A. The group discussed the two divisions within OMB, the budget side and the

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

management side. A member said that, in his experience, every time his agency includes candid discussion of future financing challenges, OMB tells them to take it out. Another member said it would depend on how the agency says it. The agency does not have to discuss the problem in terms of dollars. For example, deferred maintenance can be discussed as something that needs to be replaced without being quantified in dollars. Another member said that his agency had always been able to say in public documents that there are not enough dollars to do something; another member had the opposite experience.

The group generally agreed that even imminent and dire funding problems are sometimes not mentioned in the MD&A. Recent reporting deficiencies regarding the Unemployment and Highway Trust Funds were mentioned as examples. A member noted that the auditors do not check for forward-looking information; they look at the historical record. If there is a budget impact to what is being reported, the budget side will give it attention.

There was a consensus that OMB's receptivity to candid discussion of forward-looking information would depend on how the MD&A was worded and on the individual budget examiner. The group also discussed the OMB clearance process as a possible source of revisions.

The group discussed the relationship between SFFAS 15 and Circular A-136. It was noted that Circular A-136 incorporates SFFAS 15 and SFFAC 3 and also requires additional information about management assertions. [See FASAB staff *MD&A White Paper*, June 2, 2009, paragraphs 24-39.] It was explained that OMB has current initiatives looking at updating the reporting requirements of A-136, which would include the MD&A. It has been a few years since the reporting requirements have been reviewed. [The next OMB update of A-136 would be in early 2010.]

The group discussed a recommendation of the AGA Review that agencies could improve their reporting by having it reviewed by external parties. Ideally this would be OMB, but OMB probably is not going to have the resources to do it. Thus, groups like the AGA and Mercatus might be enlisted.

A member mentioned that OMB was considering using the A-136 Subcommittee to allow agencies to review each other's MD&A and benchmark. A member mentioned that the A-136 Subcommittee did not have any budget or program people on it.

The group discussed the possibility of recommending that the FASAB create "best practices" guidance via the FASAB's Accounting and Auditing Policy Committee. There was a consensus that such guidance would be beneficial, given that SFFAS 15 appeared to be satisfactory. A member noted that such guidance should address specific types of MD&A reporting, for example, best practice regarding loans, grants, contracts, etc. One member prefers that the guide highlight performance goals and results, analysis of financial statements, and forward-looking information instead of reporting for loans, grants, and contracts. A member questioned whether the subcommittee would know who a particular agency's stakeholders are.

TAB J – Attachment 3 – MD&A Task Group Meeting July 9, 2009, Notes on

The group discussed the need to improve how the government communicates. For example, Web pages are much more effective than paper documents. Also, publicity is necessary. Various current electronic communication mechanisms were discussed that would improve – or actually begin – the flow of information to potential users.

The group discussed the issue of the reliability of data published on a Web page. Having unreliable information become public is a major concern to the agency. Some currently popular federal Web pages do not contain information that has been independently reviewed.