



Federal Accounting Standards Advisory Board

April 12, 2018

Memorandum

To: Members of the Board

*Robin M. Gilliam*

From: Robin Gilliam, Assistant Director

*Ross Simms*

Ross Simms, Assistant Director

*Wendy M. Payne*

Through: Wendy M. Payne, Executive Director

Subject: Management's Discussion and Analysis—**TAB F**<sup>1</sup>

**MEMBER ACTION REQUESTED:**

By **April 20, 2018**, please review the materials and provide a response to whether the Board agrees to create a new MD&A Statement that rescinds SFFAC 3 and SFFAS 15.

**OBJECTIVE**

The objective is to discuss an alternative for improving the management's discussion and analysis section of general purpose financial reports.

**BRIEFING MATERIALS**

The briefing material includes this memorandum.

**BACKGROUND**

Upon completing the development of Statement of Federal Financial Accounting Concepts (SFFAC) 8, *Federal Financial Reporting*, the Board began discussing the need to improve the content of financial reports. In May 2017, Board members reviewed

<sup>1</sup> 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.

financial reports and FASAB staff conducted round table discussions and noted several areas for improvement, including management's discussion and analysis (MD&A), required supplementary stewardship information (RSSI), other information, the overall reporting model, and certain financial statements and note disclosures. The Board was particularly concerned about the voluminous content of financial reports and, to address the concerns, the Board decided to use a two-phased approach. During the first phase, the Board will focus on areas that can be addressed in the near term and, in the second phase, consider areas to address over the long term.

The Board's near-term efforts involve MD&A and RSSI and, on July 20, 2017, staff engaged round table participants to discuss how the content of MD&A and RSSI might be improved. Although MD&A is intended to be concise, Board members and others noted MD&A is often broad and may overwhelm readers. In addition, with respect to RSSI, users can access the information from other sources, such as *Analytical Perspectives* and the *Budget of the United States Government*, ("the Budget"). Related performance information may also be presented in agency performance reports.

In August 2017, staff prepared a draft exposure draft (ED) and suggested that the Board eliminate RSSI. The ED proposed rescinding Statement of Federal Financial Accounting Standards (SFFAS) 8, *Stewardship Reporting*, in its entirety and noted that users do not review the information provided in financial reports. Instead, they refer to the Budget. However, the Board discussed the history and complexities of RSSI and noted that the draft ED needed to include a comprehensive discussion of the rationale for rescinding RSSI.

In addition, staff suggested that the Board eliminate the reporting requirement that addresses the reporting entity's vital performance goals, objectives, and results in MD&A. As an alternative, the Board could require reporting entities to inform readers where to obtain the entity's annual performance report (APR).

Members noted that conditions have changed since FASAB developed the MD&A reporting standards. Component reporting entities currently issue separate financial and performance reports and issue the reports at different times. In addition, the Board's concepts acknowledge that information that users need may not reside in a single report. Consequently, the Board could develop an ED to amend the existing MD&A reporting standards, explain the rationale for the proposal, and obtain comments from users, preparers, and auditors.

During the October 2017 meeting, the Board continued discussions on improving RSSI and MD&A. Staff presented a proposal that would permit flexibility in reporting the remaining item of RSSI, stewardship investments, and eliminate the RSSI category. Staff also presented a proposal that would permit management to refer users to more detailed performance reports when preparing MD&A. The discretion in reporting RSSI and MD&A would be responsive to input from preparers and auditors regarding users' access to and preference for other sources of information.

However, given the discretion, Board members were concerned that financial reports would not present information needed to achieve the reporting objectives. Board members noted that financial report users need information on expenses that provide long-term benefits, such as investments in human capital, research and development, and non-federal physical property. The information would help users assess the government's impact on the nation and the Board could consider how the reported information could be improved. In addition, users need information about the reporting entity's performance.

During the December 2017 meeting, the Board acknowledged that SFFAC 3, *Management's Discussion and Analysis*, provides guidance that preparers could consider. However, during the February 2018 meeting, the Board noted that the concepts discussed topics that have evolved. Rather than revisit SFFAC 3 topics, the Board agreed to develop implementation guidance to help improve the content of MD&As.

In addition, staff has been conducting research as part of the risk assumed project and noted concerns regarding MD&A. The risk assumed project staff met with users and preparers in round table discussions to understand the information that would be useful to them and participants expressed similar concerns as the research to improve MD&A. [See Tab E-April 2018-for a full discussion of the risk assumed round tables]. Due to the similarity of the issues, staff decided it would be more efficient and effective to combine efforts. Therefore, combined concerns and alternatives for improving the MD&A are presented below.

## **NEXT STEPS**

The next steps for the project will be determined during the meeting.

## **MEMBER FEEDBACK**

If you have any questions or comments, please contact both Mr. Simms and Ms. Gilliam by email at [simmsr@fasab.gov](mailto:simmsr@fasab.gov) and [gilliamr@fasab.gov](mailto:gilliamr@fasab.gov) with a cc to [paynew@fasab.gov](mailto:paynew@fasab.gov) by **Friday, April 20, 2018**

## Alternatives for Improving MD&A

### Overview of MD&A

MD&A is an integral part of general purpose federal financial reports (GPFFR) and MD&A is required supplementary information (RSI). FASAB developed generally accepted accounting principles (GAAP) for MD&A in 1999 and required that MD&A address several topics. Statement of Federal Financial Accounting Standards (SFFAS) 15, *Management's Discussion and Analysis*, requires MD&A to address the entity's:

- mission and organizational structure;
- performance goals, objectives, and results;
- financial statements; and
- systems, controls, and legal compliance.

In addition, MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known demands, risks, uncertainties, events, conditions and trends. MD&A may also include forward-looking information about the possible effects of anticipated future demands, events, conditions, and trends.[footnote omitted] Forward-looking information may comprise a separate section of MD&A or may be incorporated with the sections listed above.<sup>2</sup>

The Board believed that management should have great discretion regarding what to say about the topics. As a result, GAAP with respect to MD&A is not extremely prescriptive.<sup>3</sup>

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<sup>2</sup> SFFAS 15, pars. 2 and 3.

<sup>3</sup> SFFAS 15, par. 13.

## Concerns Regarding MD&A

### A Dense Presentation

Although MD&A is intended to be concise, Board members and others noted MD&A is often dense. For instance, the presentation may include detailed organizational charts which may not be linked to responsibility segments presented in the basic financial statements and detailed presentations of performance. This concern may result from the following:

- SFFAS 15 requires reporting entities to present topics in distinct sections of the MD&A. However, the topics are interrelated. For instance, information on the budgetary resources a reporting entity receives and uses is related to information on: the entity's mission and responsibility segments, costs incurred executing its mission, the adequacy of the systems and controls in place to account for the use of the resources, compliance with laws governing the use of the resources, and matters that could impact future resources. As a result, reporting entities may discuss the same information in different sections.
- SFFAS 15 permits management discretion. As a result, the boundaries of GAAP may not be clear and reporting entities may include information that the Board did not intend.
- Reporting entities may present information to comply with laws and administrative directives. For instance, to comply with the Reports Consolidation Act of 2000, a reporting entity may include a summary of the Inspector General's most serious management and performance challenges facing the entity.

Consequently, the significant amount of information in MD&A may burden potential users. Potential users may be overwhelmed and may not be able to access the information they need. In addition, users may likely go to the primary source, such as the annual performance report (APR), to review information.

### Duplicate Presentations

MD&A repeats required information presented in other sections of the financial report and other information presented in reporting entity presentations. FASAB developed the MD&A requirements when reporting entities primarily prepared printed reports that combined financial and detailed performance information in a single document. However, reporting entities have evolved to using electronic reporting and posting GPFFRs on their website. Electronic reporting on websites increases the potential user's access to information and the required information presented in the GPFFR is no longer as distinct from other information.

Accordingly, while accessing a reporting entity's information electronically, a potential user could readily access a range of other information about the entity, similar to the information required by GAAP. For instance, a potential user could review information on the reporting entity's mission and organizational structure presented in the following website locations:

1. MD&A of the GPFFR,
2. the first note disclosure of the GPFFR,
3. the reporting entity's "About" webpage,
4. summary performance and financial report, and
5. APR.

Consequently, potential users may not understand why similar information is presented in different locations and spend time scanning the reporting entity's website to determine what information is duplicated and what is missing.

### Lack of Information

Round table participants and other potential users noted that some MD&As did not present information they sought. For instance, potential users of risk assumed information sought a concise discussion of reporting entity programs in MD&A. They believed the concise presentation would address program performance, key risk factors, and forward-looking risk projections. The potential users would next seek granular data. Granular data allows them to analyze performance over time and the risk factors that may have impacted program performance. In addition, the cause of significant changes in financial statement amounts, such as changes in the net cost of operations, may not be explained. Because SFFAS 15 is not intended to be prescriptive, reporting entities may not be fully aware of the information that should be presented.

In addition, since the development of MD&A standards, reporting entities subsequently began presenting financial and performance information at different times and the reporting entity's actual performance information may not be available when reporting entities are required to prepare the MD&A.<sup>4</sup> Consequently, reporting entities may present estimated performance information in MD&A and subsequently report actual information in the entity's required APR. Some component reporting entities also noted that the performance information presented in MD&A is likely to be different from the information in the APR.

Users are likely to access the APR to address their performance information needs rather than the estimates presented in MD&A. Figure 1: Example of Reference to Annual Performance Report illustrates how a component reporting entity references the APR and Figure 2: Example of Presenting Preliminary Information illustrates how a component reporting entity presents preliminary performance information.

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<sup>4</sup> In addition, in some instances, the financial reporting period can be different from the program's performance period.

# FY 2017 PROGRAM PERFORMANCE

Detailed FY 2017 performance results will be presented in EPA's *FY 2017 APR*. EPA has chosen to produce an AFR and an APR, and will include its FY 2017 APR with its *FY 2019 Annual Performance Plan and Budget*. These reports, along with FY 2016 performance results are posted to the EPA internet at <http://www.epa.gov/planandbudget> concurrent with the publication of the FY 2019 President's Budget.

## A Framework for Performance Management

In compliance with GPRMA, EPA develops a *Strategic Plan*, which establishes long-term strategic goals, objectives, and measures to carry out the Agency's mission of protecting human health and the environment. To further its strategic goals and objectives, the agency has developed a performance management framework, which supports the analysis of annual performance results and progress toward longer-term strategic objectives as an integral part of formulating and justifying agency resource requests.



The Agency also develops *Data Quality Records* (DQRs) to present validation or verification information for selected performance measures and information systems, consistent with guidelines from OMB. The DQR documents the management controls, responsibilities, quality procedures, and other metadata associated with the data lifecycle for individual performance measures, and is intended to enhance the transparency, objectivity, and usefulness of the performance results.

Figure 1: Example of Reference to Annual Performance Report

## MARKETING AND REGULATORY PROGRAMS

Marketing and Regulatory Programs facilitate domestic and international marketing of U.S. agricultural products and ensures the health and care of animals and plants. MRP agencies are active participants in setting national and international standards.

Fiscal Year	2013 Actual	2014 Actual	2015 Actual	2016 Actual	2017 Target	2017 Preliminary
Cumulative number of biotechnology products deregulated by USDA based on scientific determinations that they do not pose a plant pest risk to agriculture	102	109	117	124	127	Meet

## NATURAL RESOURCES AND ENVIRONMENT

Natural Resources and Environment ensures the health of the land through sustainable management. Its agency works to prevent damage to natural resources and the environment, restore the resource base, and promote good land management.

Fiscal Year	2013 Actual	2014 Actual	2015 Actual	2016 Actual	2017 Target	2017 Preliminary
Annual acres of public and private forest lands restored or enhanced (millions of acres)	2.53	2.91	3.10	3.22	2.90	Meet
Volume of timber sold (billion board feet)	2.610	2.831	2.867	2.942	3.200	Meet
Percentage of National Forests and Grassland watersheds in properly (class 1 watersheds) functioning condition	52	52	52	53	53	Deferred <sup>10</sup>
Acres of Wildland Urban Interface hazardous fuels treated to reduce the risk of catastrophic wildfire (millions of acres)	1.737	1.725	1.577	2.016	1.80	Meet

<sup>10</sup> Results are not available for this measure until after the end of FY 2017.

**Figure 2: Example of Presenting Preliminary Information**

## Alternatives for Improving MD&A

As a result of the consolidated concerns noted above, the MD&A Improvement and Risk Assumed projects recommend creating a new Statement as an alternative to preparing implementation guidance. Financial reporting practices and the manner in which potential users access data has evolved since development of the MD&A concepts and standards. Consequently, a new Statement would rescind SFFAC 3 and SFFAS 15.

The following updates would help meet FASAB's goals of a concise, integrated, and transparent MD&A while taking advantage of presenting federal financial information in tandem with existing digital information:

### Agency Summary:

1. Maintain a short summary of the agency mission with a link to the agency website.
2. Update the information on organizational structure with an explanation of how information is presented in the statement of net cost. Also, include an explanation of changes from the prior period's structure.
3. Provide a link to the APR—source document for strategic goals and results—and its expected release date.
4. Update the requirement for information on systems, controls, and legal compliance.
5. Replace the general discussion about financial statements with information on financial performance as discussed below.

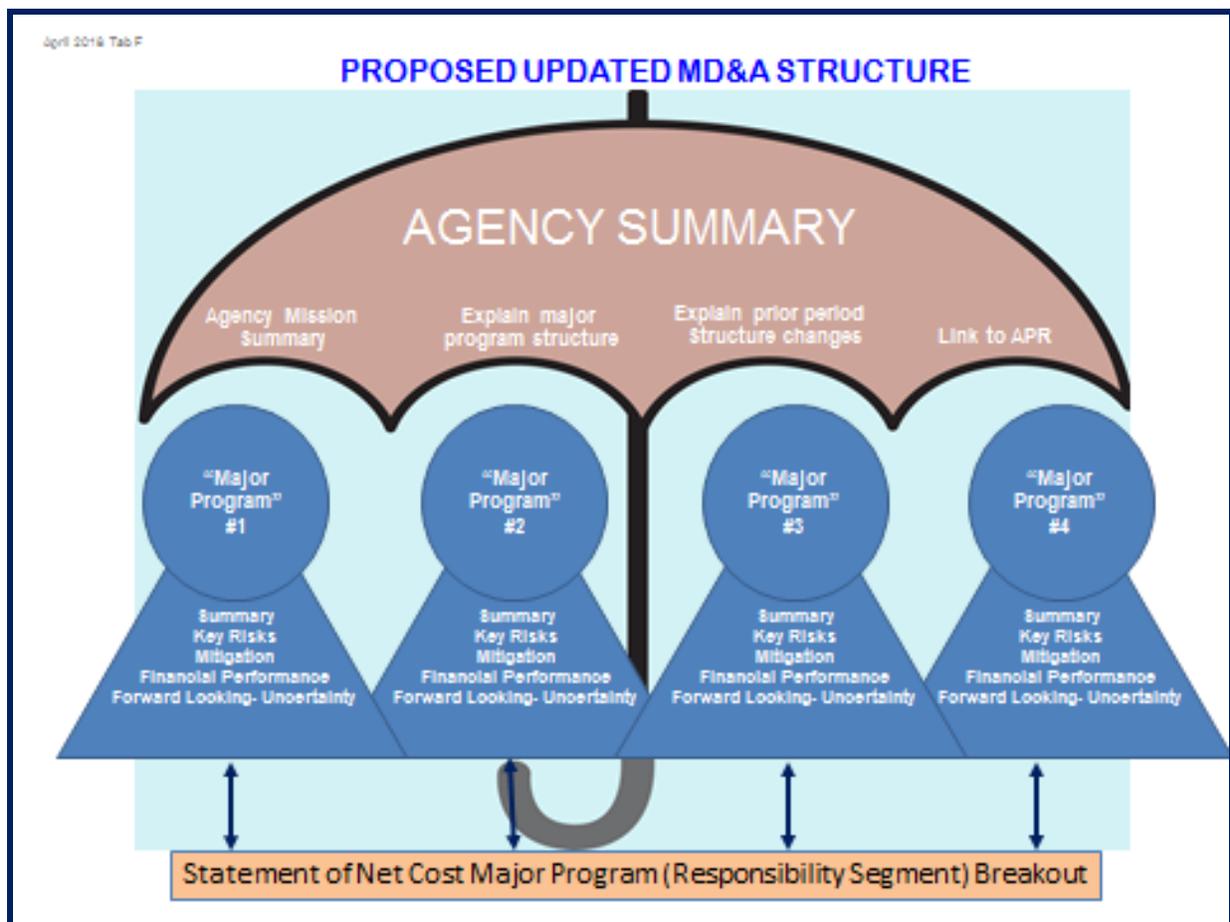
### Financial Performance Summary:

6. Structure financial performance information as it is presented in the statement of net cost, such as by “major programs”<sup>5</sup> as defined by management. For a concise, integrated discussion, each reporting entity should present the extent to which it has financially achieved its goals.

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<sup>5</sup> OMB A-136 II.4.4. Statement of Net Cost (SNC); II.4.4.1. Introduction; Major Programs: The SNC should show the reporting entity's net cost of operations as a whole and by major programs. The term “major program” may describe an agency's mission, strategic goals, functions, activities, services, projects, or processes, or other meaningful grouping. Program structure definition is at the entity's discretion.

7. A reporting entity should provide within each “major program”
  - a. a summary of the “major program” with an emphasis on financial performance measures and a concise explanation;
  - b. a general discussion about performance and a concise explanation for significant changes in financial amounts. For example, what caused a significant change in net cost? Was it due to a change in assumptions, risk event, other?
  - c. a forward-looking discussion about the potential financial impact of key risks identified by management, and mitigation strategies of those key risks; and
  - d. a discussion about uncertainty for potential impacts from future risks.



## Summary

A new Statement that would rescind SFFAC 3 and SFFAS 15 will help reporting entities provide a concise, integrated, and a financially focused discussion for users. This structure will remove redundant and incomplete information that is not timely due to the fiscal year end of the MD&A versus a calendar yearend for strategic reporting. Also, users will find a story about each “major program” as it maps to the Statement of Net Cost and related notes.

A single Statement regarding MD&A would also facilitate reporting entities’ understanding of the reporting requirements and enhance the efficiency of their search for guidance. Currently, the FASAB handbook provides separate concepts and standards for MD&A, causing reporting entities to consult different areas of the handbook and possibly confusing reporting entities on the information that should be presented in the MD&A.

**Question 1: Does the Board agree to create a new MD&A statement that rescinds SFFAC 3 and SFFAS 5?**