

Memorandum

MD&A

July 21, 2021

To: Members of the Board
From: Robin M. Gilliam, Assistant Director
Thru: Monica R. Valentine, Executive Director
Subject: **MD&A Proposed Standards** (Topic A)

INTRODUCTION

Staff proposes standards to assist management in creating a balanced, integrated, and concise discussion in a streamlined MD&A. Staff's analysis, and recommendations for proposed standards are included in Attachment 1.

REQUEST FOR FEEDBACK BY August 4, 2021

Please review the attached staff recommendations and analyses and respond to the questions by **August 4, 2021**.

For additional information, questions, or suggestions, please contact us as early as possible at gilliamr@fasab.gov with a cc to Monica Valentine at valentinem@fasab.gov.

NEXT STEPS

Prepare draft exposure draft.

ATTACHMENTS

- #1. Staff Analysis
- #2. MD&A Vision Framework and Objectives

Staff Analysis

MD&A

Attachment 1

CONTEXT

At the June 2021 Board meeting, members began to review nine proposed standards for MD&A. Members reviewed proposed standards #1 and #2 with the following results.

Proposed standard #1:

The Board agreed to include the following in the *Scope* section of the exposure draft instead of as a proposed standard.

MD&A should provide a balanced, integrated, and concise financial and non-financial discussion and analysis about the reporting's entity's financial position and condition and its current actions and plans to improve performance.

Proposed standard #2:

The Board tentatively agreed to the following proposed standard.

MD&A should summarize the entity's mission, organizational structure, and key performance challenges and achievements.

The Board agreed to the following definition for **financial position** based on the traditional definition which focuses on the balance sheet:

Financial position: *The status of a reporting entity's assets, liabilities, net position, and budgetary resources as of the date of the financial statements.*

The Board tentatively agreed to the following definition.

Financial condition *is a broad, forward-looking, financial and nonfinancial discussion and analysis about how the reporting entity's operations and performance has and will contribute to the nation's current and future well-being.*

RECOMMENDATIONS AND ANALYSES

During this meeting members will review the remaining seven proposed MD&A standards.

Staff has updated the remaining proposed standards based on email responses received in preparation for the June 2021 Board meeting, and member due process at the June 22, 2021, Board meeting. For example, staff updated the wording of the proposed standards to reflect the MD&A objectives and included the related MD&A objectives in the analysis. In addition, staff also included comments/questions that may help management to implement these broad, principle-based proposed standards. This explanatory information may be included as an appendix in the exposure draft, in implementation guidance, and/or in training material.

PROPOSED MD&A STANDARDS

I. RECOMMENDATION

Proposed MD&A Standard #3:

*MD&A should summarize the reporting entity's operating performance as it relates to its **financial position** by*

- 1) concisely explaining key performance challenges and achievements that caused significant changes in assets, liabilities, costs, revenues, and budgetary/financing resources from the prior reporting period,*
- 2) any significant cost trends from prior reporting periods, and*
- 3) the current actions taken and short and long-term actions planned to address the key performance challenges and achievements.*

ANALYSIS

Understanding how performance impacts assets, liabilities, costs, revenues and budgetary/financial resources is a big challenge for reporting entities yet one of the most important issues that the Board wants to address with updated MD&A standards. This proposed standard should help reporting entities to understand what they are expected to report in the MD&A in relation to performance and its impact on financial statement balances.

The following provides information that supports this proposed standard.

A. Proposed standard stems from the following MD&A objective(s):

- BI-2 MD&A should concisely explain why significant changes in budgetary and/or financing resources were needed during the reporting period.

- OP-2 MD&A should concisely explain reasons for significant changes in net cost from the prior year and any significant trends cost over multiple years.
- OP-4 MD&A should provide a concise/balanced discussion/summary of significant financial and non-financial operating performance information, including electronic references to legislative performance framework documents, such as GPRAMA reporting, for the entity's major program investments and the entity as a whole.
- ST-1 MD&A should concisely explain reasons for significant changes in assets, liabilities, costs, and/or revenues from the prior year and any significant trends.
- ST-2 MD&A should concisely describe planned agency actions to address current and prospective mission-related issues, challenges, and/or risks that could significantly affect assets, liabilities, costs, revenues, and budgetary resources.

B. Proposed standard stems from the MD&A vision framework content:

- The essential few matters causing significant changes to the entity's (1) financial statement amounts during the current reporting period, and (2) financial, budgetary and key performance trends over past reporting periods.
- The current and planned actions that will address the essential few opportunities, challenges, and risks that could significantly affect financial statement amounts and key performance results in the future.

C. Pilot findings

Users found the MD&A samples that summarized each financial statement provided the most helpful information in understanding the reporting entity's financial position and condition.

Users found that trend information over a period of years that showed changes in dollars and percentages was very useful information. Users also emphasized that a qualitative summary about a trend chart helped them to understand what key drivers were behind the changes and how management's decisions were affected by the trends.

Pilot agency preparers were challenged with understanding how many years to report in the past for a trend and noted that the time period for a trend would vary depending on the program or issue. For example, information related to COVID-19 is only a year old, where storm information could go back many decades.

D. Additional Information

During the June 2021 meeting, a number of members requested additional explanatory information to help management with these broad, principle-based standards. The following could be included with the standard, in basis for conclusions, in implementation guidance, and/or in training materials.

E. Comments/Questions that might help management

- Management should understand why financial statement balances significantly changed from the prior period.
- Management should understand what key performance challenges or achievements occurred that significantly increased or decreased assets, liabilities, costs, revenues and/or budgeting/financing resources?
- Management should understand and be able to discuss and analyze significant cost trends going back multiple reporting periods.
- What action is management taking to support key performance achievements?
- What actions will management take in the next 12-24 months to meet the budget allocated to meet key performance goals?
- What actions will management take beyond 24 months to meet the budget allocated to meet key performance goals?

Question #1 for the Board:

Do members have any technical edits for the following proposed standard?

*MD&A should summarize the reporting entity's operating performance as it relates to its **financial position** by*

- 1) concisely explaining key performance challenges and achievements that caused significant changes in assets, liabilities, costs, revenues, and budgetary/financing resources from the prior reporting period,*
- 2) any significant cost trends from prior reporting periods, and*
- 3) the current actions taken and short and long-term actions planned to address the key performance challenges and achievements.*

II. RECOMMENDATION

Proposed MD&A Standard #4:

MD&A should summarize the reporting entity's financial condition if it materially contributes to the financial condition of the United States Government as a whole.

ANALYSIS

At the June 2021 meeting, members agreed that not all reporting entities can or should discuss financial condition. Only those reporting entities that materially impact the financial condition of the government-wide consolidated financial report (CFR). For example, reporting entities that report on social insurance.

The following provides information that supports this proposed standard.

A. There are no MD&A objective(s) to support this proposed standard.

B. Proposed standard stems from the following MD&A vision framework statement:

MD&A should summarize information about the financial position and condition of the reporting entity by discussing the entity's mission, organization, and key financial and performance results to inform users of its financial health and sustainability of major programs.

C. Comments/Questions that might help management:

- Do any programs materially impact the government-wide CFR?
- Does your reporting entity provide social insurance programs?

Question #2 for the Board:

Do members have any technical edits for the following proposed standard?

MD&A should summarize the reporting entity's financial condition if it materially contributes to the financial condition of the United States Government as a whole.

III. RECOMMENDATION

Proposed MD&A Standard #5:

*MD&A should summarize key **opportunities***

- 1) *that could potentially have a positive significant effect on*
 - a. *assets,*
 - b. *liabilities,*
 - c. *cost and revenues,*
 - d. *budgetary and financial resources, and*
 - e. *key performance outcomes in the future; and*
- 2) *the current actions taken, and*
- 3) *the short and long-term actions planned to take advantage of these key opportunities.*

ANALYSIS

There are two sides of risk management that the reporting entity management should be aware of in making performance decisions— opportunities and risk. An opportunity refers to the possibility that an event will occur and positively affect the achievement of performance and the related financial statement balances.

Staff recommends providing one proposed standard for opportunity and one for risk to help users understand that management is making performance decisions based on forward looking information about opportunities and risks.

The following provides information that supports the proposed standard for opportunities.

A. Proposed standard stems from the following MD&A objective(s):

ST-2 MD&A should concisely describe planned agency actions to address current and prospective mission-related issues, challenges, and/or risks that could significantly affect assets, liabilities, costs, revenues, and budgetary resources.

B. Proposed standard stems from the following MD&A vision framework content:

The current and planned actions that will address the essential few opportunities, challenges, and risks that could significantly affect financial statement amounts and key performance results in the future.

C. Comments/Questions that might help management

- What opportunities can management take advantage of to support performance achievements?
- What key performance opportunities could cause a significantly positive impact on future financial statement balances?
 - For example, significantly:
 - Increase the assets or revenues
 - decrease the liabilities or cost
- What action(s) is management taking now to address key opportunities that could significantly impact financial statement balances and key performance outcomes?
- What action(s) will management take in the next 12-24 months to address key opportunities that could have a significantly positive impact on financial statement balances and key performance outcomes?
- What action(s) will management take beyond 24 months to address key opportunities that could have a significantly positive impact on financial statement balances and key performance outcomes?

Question #3 for the Board:

Do members have any technical edits for the following proposed standard?

*MD&A should summarize key **opportunities***

- 1) *that could potentially have a positive significant effect on:*
 - a. *assets,*
 - b. *liabilities,*
 - c. *cost and revenues,*
 - d. *budgetary and financial resources, and*
 - e. *key performance outcomes in the future; and*
- 2) *the current actions taken, and*
- 3) *the short and long-term actions planned to take advantage of these key opportunities.*

IV. RECOMMENDATION

Proposed MD&A Standard #6:

*MD&A should summarize key **risks***

- 1) *that could potentially have a negative significant effect on*
 - a. *assets,*
 - b. *liabilities,*
 - c. *cost and revenues,*
 - d. *budgetary and financial resources, and*
 - e. *key performance outcomes in the future; and*
- 2) *the current actions taken, and*

- 3) *the short and long-term actions planned to take to mitigate these key risks.*

ANALYSIS

There are two sides of risk management that the reporting entity management should be aware of in making performance decisions— opportunities and risk. A risk refers to the possibility that an event will occur and negatively affect the achievement of performance and the related financial statement balances.

Staff recommends providing one proposed standard for opportunity and one for risk to help users understand that management is making performance decisions based on forward looking information about opportunities and risks.

The following provides information that supports the proposed standard for risks.

A. Proposed standard stems from the following MD&A objective(s):

ST-2 MD&A should concisely describe planned agency actions to address current and prospective mission-related issues, challenges, and/or risks that could significantly affect assets, liabilities, costs, revenues, and budgetary resources.

B. Proposed standard stems from the following MD&A vision framework content:

The current and planned actions that will address the essential few opportunities, challenges, and risks that could significantly affect financial statement amounts and key performance results in the future.

C. Pilot findings

Users want to understand key risks that could impact the financial statements and key performance outcomes.

Pilot agencies want to understand how to talk about key risk and what key risks could have a financial impact.

Pilot agencies were also challenged with understanding how to discuss and analyze long-term actions to mitigate key risks. They do a great job discussing current plans for mitigating key risks in the next reporting period, but most fall short with a looking forward analysis.

D. Comments/Questions that might help management

- What key risks could have a significantly negative impact on financial statement balances and key performance outcomes in the future?
 - For example, significantly:
 - decrease assets or revenues
 - increase liabilities or cost
- What action(s) is management taking now to mitigate key risks that could have a significantly negative impact on financial statement balances and key performance outcomes?
- What action(s) will management take in the next 12-24 months to mitigate key risks that could have a significantly negative impact on financial statement balances and key performance outcomes?
- What action(s) will management take beyond 24 months to mitigate key risks that could have a significantly negative impact to financial statement balances and key performance outcomes?

Question #4 for the Board:

Do members have any technical edits for the following proposed standard?

MD&A should summarize key risks

- 1) *that could potentially have a negative significant effect on*
 - f. assets,*
 - g. liabilities,*
 - h. cost and revenues,*
 - i. budgetary and financial resources, and*
 - j. key performance outcomes in the future; and*
- 2) *the current actions taken, and*
- 3) *the short and long-term actions planned to take to mitigate these key risks.*

V. RECOMMENDATION

Proposed MD&A Standard #7:

MD&A may include well labeled visual aids, such as charts, tables, or graphs and a qualitative summary.

ANALYSIS

The following provides information that supports this proposed standard.

A. Proposed standard was not derived from MD&A objectives or the MD&A vision framework

B. Proposed standard stems from pilot findings

Users found visual aids very helpful in making quantitative information more useful and understandable. However, users stated that the summary should include an explanation of what the user was viewing in the visual aide.

Pilot agencies made an effort to include easy to read visual aids because they believed the aids helped users better understand the financial information.

Question #5 for the Board:

Do members have any technical edits for the following proposed standard?

MD&A may include well labeled visual aids, such as charts, tables, or graphs and a qualitative summary.

VI. RECOMMENDATION

Proposed MD&A Standard #8:

MD&A should identify

- 1) *key drivers related to systems and controls that could affect the entity's ability to produce reliable financial information, and*
- 2) *current actions taken and short and long-term actions planned to address non-compliance and control weaknesses that may hinder producing reliable financial information.*

ANALYSIS

The following provides information that supports this proposed standard.

A. Proposed standard stems from the following MD&A objective(s):

- S&C-1 MD&A should concisely describe the conditions of data, systems, and controls that affect the ability to produce reliable financial information. June 2020
- S&C NOTE A number of members recommended that MD&A should also include a summary discussion about ongoing and planned actions to address non-compliance and control weaknesses that may be causing material weaknesses. This includes references to other sections that have a more in depth discussion of those items.

B. Proposed standard stems from the following MD&A vision framework content:

The essential few conditions related to systems and controls that could affect the entity's ability to produce reliable financial information.

C. Pilot findings

Pilot agencies and users preferred the term 'key drivers' over "essential few conditions."

Question #6 for the Board:

Do members have any technical edits for the following proposed standard?

MD&A should identify

- 1) *key drivers related to systems and controls that could affect the entity's ability to produce reliable financial information, and*
- 2) *current actions taken and short and long-term actions planned to address non-compliance and control weaknesses that may hinder producing reliable financial information.*

VII. RECOMMENDATION

Proposed MD&A Standard #9:

Management should include references to websites or other areas of the agency financial report to provide additional information, where applicable.

ANALYSIS

The following provides information that supports this proposed standard.

A. Proposed standard stems from the following MD&A objective(s):

OP-4 MD&A should provide a concise/balanced discussion/summary of significant financial and non-financial operating performance information, including electronic references to legislative performance framework documents, such as GPRAMA reporting, for the entity's major program investments and the entity as a whole.

B. Proposed standard stems from the following MD&A vision framework content:

MD&A may also include references to websites or other areas of the agency financial report that provide additional information when applicable.

C. Pilot findings

Users appreciated the references and the ability to find more details elsewhere.

Including references removed the additional burden from Pilot agencies of duplicating information.

Question #7 for the Board:

Do members have any technical edits for this proposed standard?

Management should include references to websites or other areas of the agency financial report to provide additional information, where applicable.

VIII. RECOMMENDATION [Repeated from June 2021 Briefing Material for MD&A]

Rescind Statement of Federal Financial Accounting Standards (SFFAS) 15
Management's Discussions and Analysis in its Entirety

Staff recommends rescinding SFFAS 15 in its entirety because the content and structure of those standards do not support an integrated, balanced, and concise discussion and analysis by management about the reporting entity's financial position, condition, and related key performance outcomes.

ANALYSIS

The following provides information that supports the proposal to rescind SFFAS 15 in its entirety:

1. On June 8, 1999, FASAB published the Statement of Federal Financial Accounting Concepts (SFFAC) 3, *Management's Discussion and Analysis*, as part of the initial federal financial framework. However, these concepts were written as standards. Despite the standards-based language, as a concept statement, SFFAC 3 could not require MD&A as part of the agency financial reports. Therefore, on August 12, 1999, FASAB published an outline of SFFAC 3 as standards in SFFAS 15, *Management's Discussions and Analysis*. The Board expected agencies to use SFFAC 3 in conjunction with SFFAS 15 to prepare MD&As. However, agencies have only used SFFAS 15 for preparing MD&As, and the standards-based language in SFFAC 3 was ignored.
2. In 2017, staff conducted an on-line survey and round-tables to identify the challenges users had with the financial reports and MD&A. These outreach activities revealed that MD&A was very dense with duplicative information making it very hard for a user to understand the financial position and condition

of the agency. One reason noted as a cause for the density and duplication, was the section requirements in SFFAS 15, paragraph 2.

SFFAS 15, paragraph 2 states:

MD&A should contain sections that address the entity's:

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

3. As a result of the SFFAS 15 section requirements, agencies repeat the same information throughout the MD&A in different sections to make sure they are providing enough information in each section. This requirement has created duplicative and dense information in the MD&A for a user to decipher.
4. Another cause for dense information in the MD&A are the titles of some sections.
 - a. ***“mission and organizational structure”***

The term “structure” has led agencies to include organizational charts and other information not related to financial position and condition.

The proposed standards will not include the term “structure” and will encourage references to more detailed information.

b. ***“performance goals, objectives, and results”***

The section “performance goals, objectives, and result” is GPRA-MA terminology. As a result, agencies report performance by percentages achieved instead of how performance relates to the financial position and condition. In addition, OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, Part 6, requires GPRA-MA reports be submitted in February with the budget submission instead of at the end of the fiscal year. This timing difference adds to preparer burden by forcing agencies to prepare two sets of performance reports – one for GPRA-MA and one for financial reporting.

The proposed standards will provide better guidance on integrating financial position, condition, and performance outcomes.

c. ***“systems, controls, and legal compliance”***

The term “compliance” in SFFAS 15 has led to OMB circulars, such as OMB Circular A-136, *Financial Reporting Requirements*, to require compliance reporting, in the MD&A¹ which does not support a balanced, integrated, or

¹ There are other required supplemental information sections, aside from MD&A, in the agency financial report where A-136 compliance information may be housed.

concise discussion and analysis about a reporting entity's financial position and condition.

The proposed standards do not include the word "compliance."

5. The Board added the MD&A project to its agenda in June 2019. The MD&A project merged the Risk Reporting and Reporting Model-Phase I: MD&A and the Stewardship Investments Improvements projects that was addressing the previously mentioned issues identified by the on-line survey and round-tables.
6. The current MD&A project proposes to consolidate the standards-based language from SFFAC 3 and SFFAS 15 to provide updated standards for MD&A.

Based on the above reasons, staff recommends SFFAS 15 be rescinded.

Question #8 for the Board:

Do members agree to rescind SFFAS 15 in its entirety?

MD&A
Objectives & Vision Framework
Attachment 2

MD&A Objectives

Developed August 2019 – June 2019 based on general (G), the four reporting objectives in SFFAC 1, *Objectives of Federal Financial Reporting*: budgetary integrity (BI); operating performance (OP); stewardship (ST); and systems and controls (S&C), and review of SFFAC 3, *Management's Discussion and Analysis*.

1. G-1 MD&A should concisely explain—in plain language—any budget and financial terms used, such as but not limited to, unfunded, unobligated, and net cost of operations. Aug 2019
2. BI-1 MD&A should concisely explain financing resources and the sources and status of budgetary resources. Aug 2019
3. BI-2 MD&A should concisely explain why significant changes in budgetary and/or financing resources were needed during the reporting period. Aug 2019
4. OP-1 MD&A should concisely explain if significant costs contributed to agency performance. Oct 2019
5. OP-2 MD&A should concisely explain reasons for significant changes in net cost from the prior year and any significant trends cost over multiple years. Oct 2019
6. OP-3 MD&A should provide an integrated discussion and analysis of the entity's mission, organization, budget, cost, and performance, for the entity's significant major program investments and the entity as a whole, including what types of resources the entity used and what the entity achieved during the reporting period. Feb 2020
7. OP-4 MD&A should provide a concise/balanced discussion/summary of significant financial and non-financial operating performance information, including electronic references to legislative performance framework documents, such as GPRAMA reporting, for the entity's major program investments and the entity as a whole. Feb 2020
8. ST-1 MD&A should concisely explain reasons for significant changes in assets, liabilities, costs, and/or revenues from the prior year and any significant trends. June 2020
9. ST-2 MD&A should concisely describe planned agency actions to address current and prospective mission-related issues, challenges, and/or risks that

could significantly affect assets, liabilities, costs, revenues, and budgetary resources. June 2020

10. S&C-1 MD&A should concisely describe the conditions of data, systems, and controls that affect the ability to produce reliable financial information. June 2020
11. S&C NOTE A number of members recommended that MD&A should also include a summary discussion about ongoing and planned actions to address non-compliance and control weaknesses that may be causing material weaknesses. This includes references to other sections that have a more in depth discussion of those items.

MD&A Vision Statement: MD&A should summarize information about the financial position and condition of the reporting entity by discussing the entity's mission, organization, and key financial and performance results to inform users of its financial health and sustainability of major programs.

Therefore, MD&A should be an objective, concise, and easily readable summary analysis of:

- I. The essential few matters causing significant changes to the entity's (1) financial statement amounts during the current reporting period, and (2) financial, budgetary and key performance trends over past reporting periods.
- II. The current and planned actions that will address the essential few opportunities, challenges, and risks that could significantly affect financial statement amounts and key performance results in the future.
- III. The essential few conditions related to systems and controls that could affect the entity's ability to produce reliable financial information.

MD&A may also include references to websites or other areas of the agency financial report that provide additional information when applicable.