Federal Accounting Standards Advisory Board

October 4, 2018

Memorandum

MEMBER ACTIONS REQUESTED:

By October 11, 2018, please review the materials and provide answers to the questions on page 13.

To: Members of the Board

From: *Ross Simms*
Ross Simms, Assistant Director

Wendy M. Payne
Through: Wendy M. Payne, Executive Director

Subj: Management's Discussion and Analysis–**TAB D**[1]

OBJECTIVE

The objective is to determine the FASAB actions that might improve management's discussion and analysis (MD&A).

BRIEFING MATERIALS

The briefing material includes this memorandum and the following:

Attachment I: Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, provides the text for the four reporting objectives.

Attachment II: SFFAC 3, *Management's Discussion and Analysis*, presents the conceptual guidance for 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.

Attachment III: Statement of Federal Financial Accounting Standards (SFFAS) 15, *Management's Discussion and Analysis*, shows the current standards for MD&A.

Attachment IV: Stewardship Investments presents the stewardship investment section of the *Financial Report of the U.S. Government FY 2010*.

BACKGROUND

During the August 2018 meeting, the Board discussed the discussion and analysis of the financial statements section within MD&A. While the discussion and analysis of financial statements may be central to MD&A, the Board expressed concern that component reporting entities were not explaining the reason for significant changes in financial statement line items or totals.

FASAB members agreed that a single set of guidance should be prepared for both the government-wide and component reporting entities. Members noted that similar information would be needed from both the government-wide and component reporting entities and the discussion and analysis would not necessarily need to focus on addressing a particular reporting objective, such as operating performance. Also, the Board believed that guidance for the discussion and analysis should be principles-based, providing flexibility.

In addition, the Board requested that staff prepare an analysis to determine:

- What do SFFAS 15 and SFFAC 3 require to meet the reporting objectives?
- How are reporting entities applying those requirements?
- What are the gaps in the requirements or their application that warrant changing standards or providing guidance?

NEXT STEPS

The next steps will be determined during the meeting.

MEMBER FEEDBACK

If you have any questions or comments, please contact Mr. Simms by email at simmsr@fasab.gov with a cc to paynew@fasab.gov by October 11, 2018.

Objective

To determine FASAB actions that might improve MD&A practices.

Overview

At this meeting, we are addressing two issues – the SFFAS 15 requirement for sections and the SFFAS 8, *Supplementary Stewardship Reporting*, requirement for stewardship investment information. At future meetings, we will explore other improvements to MD&A guidance.

The SFFAS 15 requirement for sections should be rescinded because it unnecessarily constrains management. Eliminating the section requirement may facilitate an integrated MD&A and reduce the overall length of MD&A.

The SFFAS 8 requirement for stewardship investment information should be rescinded because:

1. Users prefer the investment information presented in the President's Budget (this information differs from stewardship investment information presented as required supplementary information (RSI) in at least two respects – it is budgetary rather than expenses based data and the investment definition is broader)

2. MD&A will address such investments when the information is relevant to the entity's goals and objectives and will frame the discussion in the context of those goals and objectives (for example, safety or commerce goals rather than "stewardship investments")

Methodology

Staff compared the four financial reporting objectives to the existing MD&A concepts and standards. Also, in May 2017, Board members reviewed FY 2016 financial reports and FASAB staff conducted roundtable discussions to provide insights on existing practices and areas of concern.[2] Staff also conducted additional roundtables during January and March 2018 to determine concerns in risk assumed reporting practices[3] and, during the June 2018 meeting, the Board determined that stewardship investments should be presented in MD&A.[4] Consequently, the Board and roundtable participants noted the following practice concerns:

1. Performance information appears too voluminous.
2. Performance and financial information are not linked where appropriate.

[2] FASAB staff memo, *Federal Financial Reporting: Streamlining Management's Discussion and Analysis and Required Supplementary Stewardship*, August 18, 2017.
[3] FASAB staff memo, *Risk Assumed*, April 12, 2018.
[4] FASAB Minutes, June 28, 2018.

3. Component reporting entities include information not relevant to the financial statements or the most important issues.
4. Component reporting entities may not discuss information in required supplementary information.
5. Details to understand the component reporting entity, information on systems and controls, and applicable laws could be hyperlinked and users could obtain the information from other sources.
6. MD&A needs to better help users understand the financial performance of programs, including risks.
7. MD&A topics need to be integrated rather than discussed in sections.
8. MD&A needs to better discuss the rationale for changes in financial statement line items and totals.
9. MD&A should present information on stewardship investments.

Staff compared the list of practice concerns to existing MD&A concepts and standards.

Results

Current MD&A concepts and standards address each of the financial reporting objectives. SFFAS 15 provides principles for MD&A and SFFAC 3 provides specific suggestions for MD&A content.[5] Both Statements address budgetary integrity, operating performance, stewardship, and systems and controls. Table 1: Comparison of Reporting Objectives to MD&A Concepts and Standards provides references to the concepts and standards that address each reporting objective. Also, Attachment I provides the text of each reporting objective and Attachments II & III provide the full text of SFFAC 3 and SFFAS 15, respectively.

Reporting Objective and Practice Concern	Addressed in SFFAC 3	Addressed in SFFAS 15
1. Budgetary Integrity	Yes Pars. 28 and 29	Yes Par.2
2. Operating Performance	Yes Pars. 11-12, 25, and 42-49	Yes Par.2
3. Stewardship	Yes Pars. 26-36	Yes Par. 2
4. Systems and Control	Yes Pars. 40-41	Yes Par.2

Table 1: Comparison of Reporting Objectives to MD&A Concepts and Standards

Regarding the practice concerns, Board members and roundtable participants expected linkage among the information presented in MD&A, especially between performance and

[5] SFFAC 3, par. 24.

financial information (concern nos. 2 and 7). During a roundtable discussion on improving MD&A, roundtable participants agreed that the performance section of MD&A was not achieving its intended purpose and a participant noted,

> …ideally, users could see the cost of achieving certain outcomes, form an opinion about the value of those outcomes, and speak to their politician about the program.[6]

Although SFFAC 3 and SFFAS 15 provide guidance that addresses performance and financial information, SFFAS 15 requires separate discussions and analyses.

In addition, SFFAC 3 and SFFAS 15 are based on the notion that component reporting entities prepare performance information concurrently with the financial statements. However, this is not necessarily the case. Chief Financial Officer (CFO) Act reporting entities prepare agency performance reports (APR) months after preparing their financial statements. Consequently, management prepares and presents performance information twice—first to conform to SFFAS 15 requirements and second to comply with Office of Management and Budget (OMB) Circular A-11 requirements for the APR. This means that MD&A users receive information that may be less useful than the information presented in the APR.

Also, with respect to stewardship investment information, SFFAS 15 does not explicitly require stewardship investment information. The Statement requires management to address the entity's performance goals and results, and financial statements. In addition, SFFAC 3 provides flexibility and notes that management should only discuss stewardship matters of interest to potential users.[7] Table 2: Comparison of Practice Concerns with MD&A Concepts and Standards summarizes the comparison between the practice concerns and SFFAC 3 and SFFAS 15 and shows the paragraph reference that addresses each concern.

[6] FASAB staff memo, *Federal Financial Reporting: Streamlining Management's Discussion and Analysis and Required Supplementary Stewardship*, August 18, 2017.
[7] SFFAC 3, par. 27.

Practice Concern	Addressed in SFFAC 3	Addressed in SFFAS 15
1. Performance information appears too voluminous.	Yes Pars. 5 and 13	Yes Pars. 5 and 6[8]
2. Performance and financial information are not linked where appropriate.	No	No
3. Component reporting entities include information not relevant to the financial statements or the most important issues	Yes Par. 5	Yes Pars. 5 and 6
4. Component reporting entities may not discuss information in required supplementary information	Yes Par. 13	Implicit Pars. 2-4
5. Details to understand the component reporting entity, information on systems and controls, and applicable laws could be hyperlinked and users could obtain the information from other sources.	Yes Par. 5	Yes Pars. 5 and 6
6. MD&A needs to better help users understand the financial performance of programs, including risks.	Yes Par. 31-36, 44-46	Yes Pars 2-4
7. MD&A topics need to be integrated rather than discussed in sections.	No	No
8. MD&A needs to better discuss the rationale for changes in financial statement line items and totals.	Yes Pars. 14, 26-39	Yes Pars. 1 and 2
9. MD&A should present information on stewardship investments.	No	No

Table 2: Comparison of Practice Concerns with MD&A Concepts and Standards

Staff Recommendations

1. Eliminate the Requirement for Sections within MD&A

Staff suggests that the Board eliminate the requirement for sections within MD&A and note that preparers have discretion in how to address the following:

- the entity's mission and organizational structure
- the entity's performance goals and results
- the entity's financial statements
- the entity's systems, controls, and legal compliance
- the future effects on the entity of existing, currently-known demands, risks, uncertainties, events, conditions and trends

The Board has noted the need to allow flexibility in presenting information in MD&A. For example, the Board's social insurance exposure draft required a table of key measures in the financial statement analysis section of MD&A. However, when respondents noted that the proposed MD&A requirements would be too prescriptive, the Board decided to allow

[8] SFFAS 15, paragraph 6 states, "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 the GPFFR as a source of information."

discretion in where the table should be placed. The Board stated that the preparer is best positioned to decide where the information would be most effective in MD&A.[9]

Also, the Board has noted that narrative presentations should integrate information to help users in assessing information presented in basic financial statements and disclosures. For instance, when proposing guidance for long-term fiscal projections, the Board stated that a comprehensive package was needed. The comprehensive package should include a narrative to 'integrate' and explain information provided through a basic financial statement and disclosures.[10]

Eliminating the requirement for sections in MD&A will allow reporting entities to connect various sources of data and ultimately help users understand how well the reporting entity is doing. While prospects for future cash flows may be the focus of private sector MD&A, users of government MD&A are primarily concerned about performance[11] and the topic of performance has multiple aspects. SFFAC 1 states that users seek answers to questions such as the following:

- How much do various programs cost?
- What outputs and outcomes were achieved?
- How were the important assets managed?
- What liabilities arose and how will they be liquidated?
- Did the government's financial condition improve or deteriorate?
- What provisions are being made for the future?[12]

Accordingly, reporting entities could discuss performance in terms of trends in financial and nonfinancial data.

The focus on trends could help address the challenge of reporting performance information in MD&A. Reporting entities could discuss the actual performance trends in prior period APRs and, because SFFAS 15 provides principles, OMB form and content guidance could provide specific requirements for discussing performance trends.

Permitting integration of information in MD&A would require amending SFFAS 15 because the standard is explicit regarding the need for sections. SFFAS 15 states

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[9] SFFAS 37, *Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements*, par. A66.
[10] Exposure Draft, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*, September 2, 2008.
[11] SFFAC 3, par. 44.
[12] SFFAC 1, par. 11.

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

- mission and organizational structure
- performance goals, objectives, and results
- financial statements
- systems, controls, and legal compliance.[13]

Thus, developing an interpretation or technical release to SFFAS 15 may confuse management rather than clarifying the Board's intent. Also, although the Board discussed the possibility of eliminating the requirement for sections in MD&A, a determination was not made.

> **Question 1**: To help users understand how well the reporting entity is doing, a reporting entity may need the flexibility to connect financial and non-financial performance information and avoid redundant discussions. However, SFFAS 15 requires separate discussions and analyses, including separate discussions and analyses on performance results and financial statements. Does the Board agree that the requirement for specific sections of information in MD&A should be eliminated?

2. Rescind Reporting of Information in terms of Stewardship Investments

Staff suggests that the Board rescind reporting of information in terms of stewardship investments. With respect to reporting information in MD&A, SFFAS 15 states that the matters to be discussed in MD&A are those that management believe could

- 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
- significantly affect the judgment of citizens about the efficiency and effectiveness of their federal government.[14]

These principles recognize that establishing the reporting entity's goals and objectives is a function of management[15] and the matters discussed in MD&A should be relevant to those goals and objectives. In addition, users are interested in the reporting entity's performance and will expect the discussion and analysis to address the entity's goals and objectives. Thus, reporting entities frame their discussions and analyses according to the performance goals and objectives acted upon during the period.

For example, the Department of Transportation (Transportation) invested over $56 billion in non-federal physical property during FY 2017 or about 70 percent of its gross cost of operations.[16] However, management set "safety" as its priority for the period and, in MD&A, framed the discussion and analysis of performance in terms of reducing transportation-

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[13] SFFAS 15, par. 2.
[14] SFFAS 15, par. 6.
[15] SFFAC 1, par. 193
[16] Department of Transportation, *Agency Financial Report FY 2017*.

related fatalities and injuries rather than “stewardship investments.”[17] Transportation also presented detailed measures regarding safety and the condition of highways, bridges, and runways in its APR.[18] Because reducing transportation-related fatalities and injuries includes investing in highways, bridges, runways, etc., another discussion and analysis or section of the general purpose federal financial report (GPFFR) framed in terms of stewardship investments may appear repetitive.

The National Aeronautics and Space Administration (NASA) provides another example. NASA’s mission is to

> Drive advances in science, technology, aeronautics, and space exploration to enhance knowledge, education, innovation, economic vitality, and stewardship of earth.[19]

Also, each of NASA’s three strategic goals included investing in research and development (R&D) that comprised 56 percent of the reporting entity’s FY 2017 gross cost of operations.[20] Because NASA framed its discussion and analysis in terms of its mission and strategic goals, adding another discussion in MD&A or GPFFR categorized as stewardship investments would appear redundant.

Addressing the Board’s Concern

The Board has discussed providing flexibility in reporting stewardship investments and expressed concern that financial reports would lack information needed to achieve the reporting objectives. Members believed that permitting flexibility would not ensure that reporting entities provide information about provisions being made for the nation’s future. Also, the government-wide reporting entity relies on component reporting entity data to prepare the stewardship investments section of the consolidated financial report of the U.S. government (CFR).[21]

However, component reporting entities such as Transportation and NASA categorize financial and non-financial information according to their goals and objectives and discussed and analyzed provisions for the nation’s future without explicitly referencing “stewardship investments” or framing the discussion in those terms. Table 3: References to "Stewardship Investments" in MD&A provides examples of language and data from component reporting entities’ MD&A that informs users of provisions being made for the nation’s future.

[17] Department of Transportation, *Agency Financial Report FY 2017*.
[18] Department of Transportation, *Fiscal Year 2016 Annual Performance Report/Fiscal Year 2018 Annual Performance Plan*, p.6.
[19] NASA, *Agency Financial Report FY 2017*.
[20] NASA, *Agency Financial Report FY 2017*.
[21] FASAB Minutes, October 25-26, 2017.

Stewardship Investment Type	Language Regarding "Stewardship Investments" in the Mission Section of MD&A	Language Regarding "Stewardship Investments" in the Performance Section of MD&A	Language Regarding "Stewardship Investment" in the Financial Statement Analysis Section of MD&A
Non-Federal Physical Property	The Department's mission is to serve the United States by ensuring a fast, safe, efficient, accessible, and convenient transportation system that meets our vital national interests and enhances the quality of life of the American people, today and into the future.	The department's top priority was safety[22] and MD&A discussed performance in reducing transportation-related fatalities and injuries. However, the reporting entity's APR did include performance measures regarding the state of highways, bridges, and runways.	Investments decreased by $12 billion as HTF [Highway Trust Fund] expenditures exceeded excise tax collections. Surface transportation program costs represent the largest investment for the Department at 77.5 percent of the net cost of operations. Air transportation is the next largest investment at 20.9 percent of total net cost of operations.
Human Capital	To foster, promote, and develop the welfare of the wage earners, job seekers, and retirees of the United States; improve working conditions; advance opportunities for profitable employment; and assure work-related benefits and rights.	…provides employment assistance, labor market information, and job training…for adults, youth, dislocated workers, and other targeted populations. …committed to meeting the employment and training needs of veterans, transitioning service members, and eligible spouses	Employment and training costs were $6.1 billion in FY 2017, a decrease of 3.2% from FY 2016.
Human Capital and Research & Development	…conducts health and social science research with the largest source of funding for medical research in the world, while creating hundreds of thousands of high-quality jobs for scientists in universities and research institutions in every state across America and around the globe	Since 1980, CDC [Centers for Disease Control] has developed FETPs [International Field Epidemiology Training Programs] that have graduated over 3,700 epidemiologists in over 70 countries. In FY 2016,[23] there were 470 new residents of the FETP program, exceeding CDC's target for new residents by 40. On average, over 80 percent of FETP graduates work within their Ministry of Health after graduation and many assume key leadership positions…	The entity presented a three-year trend in cost by major budget function. The trend included the costs for Education, Training, and Social Services.
Research & Development	Drive advances in science, technology, aeronautics, and space exploration to enhance knowledge, education, innovation, economic vitality, and stewardship of Earth.	Each strategic goal included research and development. The following were the entity's strategic goals: 1. Expand the frontiers of knowledge, capability, and opportunity in space. 2. Advance understanding of Earth and develop technologies to improve the quality of life on our home planet. 3. Serve the American public and accomplish our Mission by effectively managing our people, technical capabilities, and infrastructure.	MD&A referred users to the RSSI section of the GPFFR. The RSSI section provides a five-year trend of research and development costs by strategic goal.

Table 3: References to "Stewardship Investments" in MD&A

In addition, MD&A of the Financial Report of the U.S. Government (CFR) discusses significant government-wide financial matters and provisions being made for the nation's future. For example, in 2009, Congress passed laws to stimulate the economy and create

[22] The reporting entity reimburses states for physical property construction costs.
[23] Results for FY 2017 were pending.

jobs and the CFR MD&A discussed those laws, including the American Recovery and Reinvestment Act of 2009 (ARRA). ARRA was a $787 billion spending package and Congress devoted approximately one-third of the package to “investments to create jobs, spur economic activity, and lay the foundation for future sustained growth.”[24] While the discussion of the government’s net costs noted the increase in costs due to economic recovery efforts, ARRA efforts were not distinguished as stewardship investments in MD&A or the stewardship investment section of the CFR.

Also, the stewardship investments section of the CFR provides the government-wide trend in stewardship investments and, over the past 10 years, stewardship investments have remained around $290 billion. However, it is not clear what this means – are we investing enough, too little, or too much? Targets are not set for stewardship investments, the trade-offs between consumption and investment spending are not discussed, and accomplishments are not provided to assist users in assessing the trend. Figure 1: Stewardship Investments Trend shows the stewardship investment trend for the past 10 years and Attachment IV provides the text for the stewardship investments section of the CFR.

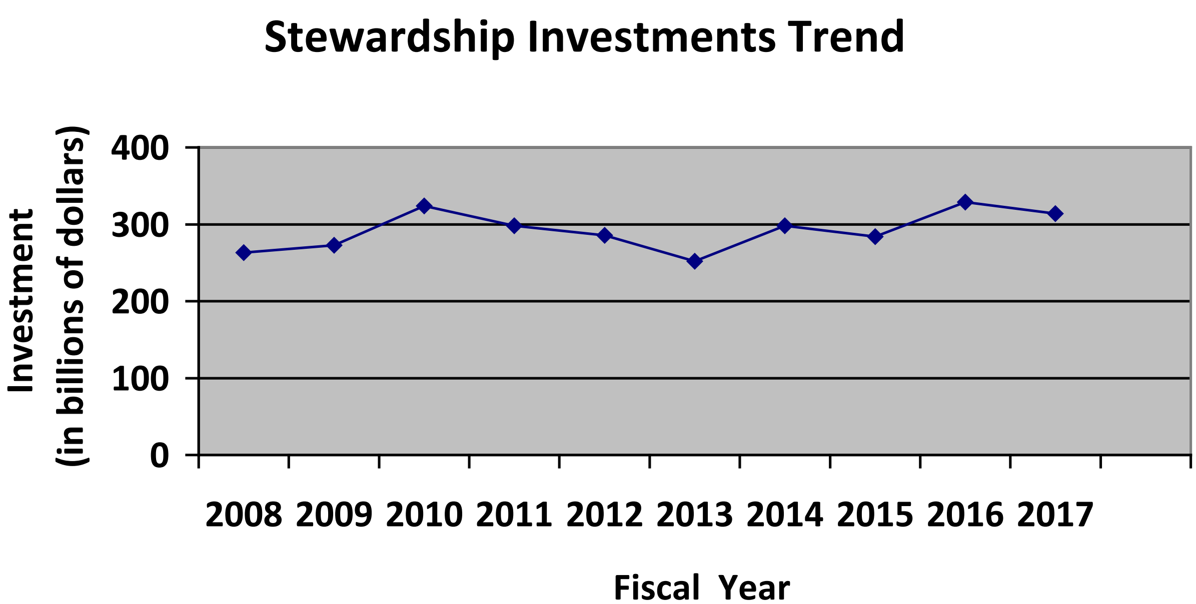

Figure 1: Stewardship Investments Trend

Thus, the reporting entity’s goals and objectives inform users on the provisions being made for the nation’s future. The current requirement to categorize and report expenses as stewardship investments is not the basis for existing MD&A content and – based on input from preparers, auditors, and potential users – is not used. Users access the *Budget of the*

[24] CFR FY 2010.

U.S. Government when seeking government-wide data on the provisions being made for the nation's future. [25]

Question 2: Establishing entity goals and objectives is a function of management and management may frame its discussions and analyses based on those goals and objectives. Although an entity's goals and objectives include language regarding provisions for the nation's future, the discussion may not reference the term, "stewardship investments." Management frames the discussion in terms used to manage entity activities during the period. Does the Board believe that, in addition to the discussion and analysis on the entity's goals and objectives, a distinct stewardship investments discussion and analysis is needed to inform users of provisions being made for the nation's future?

Question 3: If the Board does not believe that a distinct stewardship investments discussion is needed to inform users of provisions being made for the nation's future, should the requirement for stewardship investments be rescinded? Rescinding the additional category for reporting financial information in terms of stewardship investments would minimize the likelihood of redundant information in GPFFR.

[25] FASAB Staff memo, *Federal Financial Reporting: Streamlining Management's Discussion and Analysis and Required Supplementary Stewardship Information*, August 18, 2017.

Questions for the Board

1. To help users understand how well the reporting entity is doing, a reporting entity may need the flexibility to connect financial and non-financial performance information and avoid redundant discussions. However, SFFAS 15 requires separate discussions and analyses, including separate discussions and analyses on performance results and financial statements. Does the Board agree that the requirement for specific sections of information in MD&A should be eliminated?

2. Establishing entity goals and objectives is a function of management and management may frame its discussions and analyses based on those goals and objectives. Although an entity's goals and objectives include language regarding provisions for the nation's future, the discussion may not reference the term, "stewardship investments." Management frames the discussion in terms used to manage entity activities during the period. Does the Board believe that, in addition to the discussion and analysis on the entity's goals and objectives, a distinct stewardship investments discussion and analysis is needed to inform users of provisions being made for the nation's future?

3. If the Board does not believe that a distinct stewardship investments discussion and analysis is needed to inform users of provisions being made for the nation's future, should the requirement for stewardship investments be rescinded? Rescinding the additional category for reporting financial information in terms of stewardship investments would minimize the likelihood of redundant information in GPFFR.

Budgetary Integrity

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations. Federal financial reporting should provide information that helps the reader to determine

- how budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization,
- the status of budgetary resources, and
- how information on the use of budgetary resources relates to information on the costs of programs operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

Operating Performance

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity;1 the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine

- the costs of providing specific programs and activities and the composition of, and changes in, these costs;
- the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
- the efficiency and effectiveness of the government's management of its assets and liabilities.

Stewardship

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

Federal financial reporting should provide information that helps the reader to determine whether

- the government's financial position improved or deteriorated over the period,
- future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- government operations have contributed to the nation's current and future well-being.

Systems and Controls

Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that

- transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purpose authorized, and are recorded in accordance with federal accounting standards;
- assets are properly safeguarded to deter fraud, waste, and abuse; and
- performance measurement information is adequately supported.

Statement of Federal Financial Accounting Concepts 3: Management's Discussion and Analysis

Status

Issued	June 8, 1999
Interpretations and Technical Releases	
Affects	SFFAC 1, paragraph 181, by providing guidance on MD&A
Affected by	SFFAS 27, paragraph 39, amends paragraph 26

See pages 6-7 for the preamble to Statements of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.pdf).

Summary

This document describes the concepts on which the Board relied in recommending standards for Management's Discussion and Analysis (MD&A) to be included in general purpose federal financial reports (GPFFR).[1] Concepts Statements are not authoritative in the sense that they do not establish standards or principles. Preparers may find them useful, but these concepts are not "prescribed guidelines" for required supplementary information as discussed in section 558 of the *Codification of Statements on Auditing Standards* published by the American Institute of Certified Public Accountants. No standards or prescribed guidelines for MD&A are presented in this statement of concepts.

MD&A is an important vehicle for (1) communicating managers' insights about the reporting entity, (2) increasing the understandability and usefulness of the GPFFR, and (3) providing accessible information about the entity and its operations, service levels, successes, challenges, and future. Some federal agencies also refer to MD&A as the "overview."

The basic concept that underlies the standards for MD&A is:

> Each general purpose federal financial report (GPFFR) should include a section devoted to management's discussion and analysis (MD&A). It should address the reporting entity's performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems. The discussion and analysis of these subjects may be based partly on information contained in reports other than the GPFFR. MD&A also should address significant events, conditions, trends and contingencies that may affect future operations.

[1]The term general purpose financial report, abbreviated "GPFFR," is used as a generic term to refer to the report that contains the entity's financial statements that are prepared pursuant to federal accounting principles.

A separate document titled *Standards for Management's Discussion and Analysis* presents the standards for MD&A. The standards for MD&A say that MD&A should address:

- the entity's mission and organizational structure;
- the entity's performance goals and results;
- the entity's financial statements;
- the entity's systems, controls, and legal compliance; and
- the possible future effects on the entity of existing, currently-known demands, risks, uncertainties, events, conditions and trends.

The discussion and analysis of these subjects may be based on information in other discrete sections of the GPFFR or it may be based on reports separate from the GPFFR. The standards require MD&A to be included in each GPFFR as required supplementary information (RSI).

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Statement Of Concepts

Basic Concept

1. Each general purpose federal financial report (GPFFR, see figure 1 on 7) should include a section devoted to management's discussion and analysis (MD&A).[1] MD&A should address the reporting entity's program and financial performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems. The discussion and analysis of these subjects may be based partly on information contained in reports other than the GPFFR. MD&A also should address significant events, conditions, trends and contingencies that may affect future operations.

Discussion and Rationale

2. A typical GPFFR is a highly summarized profile of a complex entity. It is based on conditions that exist at the reporting date and events that occurred in the preceding period. It shows what has happened, but it does not explain why it happened or what may reasonably be expected to happen in the future.

3. Financial reports have two key roles. One is a feedback role to provide information used for evaluating past decisions, expectations, and trends. Another is a predictive role to provide information used for formulating expectations and making decisions about the future. Both roles can be enhanced by insights and interpretations from an entity's management.

4. The managers of an entity have detailed knowledge of the transactions, events, and conditions reflected in the entity's financial report and of the policies that govern the entity's operations. The managers also have informed expectations regarding the future based on that knowledge. As a part of their stewardship responsibility, managers should explain the significance of key financial and nonfinancial information shown in the report, the strategies

[1]The term general purpose federal financial report, abbreviated "GPFFR," is used as a generic term to refer to the report that contains the entity's financial statements that are prepared and audited pursuant to the CFO Act of 1990, as amended. entities may refer to these reports using different terms, such as "Annual Report," "Accountability Report," "Financial Management report," etc. Paragraphs 54-112 and Appendix 1 of Statement of Federal Financial Accounting Concepts 2, *Entity and Display*, describe and illustrate the contents of the GPFFR. For more information on the "Accountability Report" see paragraph 59 and the glossary. (Other words defined in the glossary are marked with an asterisk.) See also *Toward a Report to Citizens on the State of their Nation and the Performance of Their Government: proceedings of the AGA Task Force on a Report to Citizens on the State of the Nation*, Association of Government Accountants, 1994.

that led to the results reported, and the implications for future operations of events that have occurred or are likely to occur. The distinction between “financial” and “nonfinancial” information is arbitrary and often tenuous, but in this context “nonfinancial information” can include information on systems, controls, compliance with laws and regulations, and performance.

5. A Federal reporting entity’s GPFFR should be understandable and useful to a wide audience, not just members of the entity’s management and specialized analysts working for special interest groups, corporations, and other entities affected by the Government’s actions. Therefore, the report should be accompanied by a concise narrative discussion and analysis. Even insiders and specialized analysts often need such a discussion and analysis to understand the report. Communication with a wide audience may require effective use of colors, graphs, photographs, and charts. Reporting understandable, accessible information on the Government’s actions and the effects of its actions helps assure accountability and provides a more “level playing field” on which the public interest can best be served.

Background

6. The Securities and Exchange Commission (SEC) has for many years recognized the importance of such a narrative discussion of the financial statements. To serve the interests of investors and creditors, the SEC requires such a narrative discussion and analysis from management of companies under its purview. The SEC wants MD&A to help readers understand the entity’s financial position and results of operations with the benefit of management’s understanding and perspective. The SEC also wants MD&A to go beyond the basic financial statements, to include relevant forward-looking information. Research on MD&A for companies registered with the SEC shows that MD&A adds value to the financial statements. Forward-looking information, for example, can be an important contribution.[2]

7. Several factors suggest that 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. These factors include the complexity of Federal operations, the myriad objectives they pursue, and the diverse nature of the groups affected by and interested in the Government’s activities. Fundamentally, the Government’s objective is to provide for the common defense and to promote the general welfare, not to earn a profit. Therefore, reporting on performance and other matters in a way that is understandable to diverse audiences is

[2]Research on MD&A in private sector financial reporting suggests that forward-looking information in MD&A, in particular, is a significant source of added value for financial analysts. See Stephen H. Bryan, “Incremental Information Content of Required Disclosures Contained in Management Discussion and Analysis,” *The Accounting Review* Vol. 72 No. 2, (April 1997), pp. 285-301.

important. For these reasons, both SFFAC 1, *Objectives of Federal Financial Reporting*, and SFFAC 2, *Entity and Display*, refer to MD&A in concept as part of the general purpose federal financial report.

8. Page 7 presents a schematic diagram of a sample GPFFR. It is schematic because the information called for by the statements of federal financial accounting standards should be located in the report in a logical sequence, not necessarily in the order shown. MD&A for the reporting entity as a whole normally will be located immediately after the agency head's letter. Reporting entities that organize their GPFFR by responsibility segment may combine MD&A regarding each segment; alternatively, they may have MD&A for each responsibility segment located separately in each of the respective subsections of the report. Preparers have flexibility to structure their report in the manner most appropriate under the circumstances. This diagram, the entire statement of concepts, and the accompanying standards for MD&A are intentionally written in general terms, in light of the evolving practice of performance reporting and accountability reporting in the federal government. The standards for MD&A define in general terms required supplementary information that should accompany financial statements prepared in conformance with federal accounting principles.

FIGURE 1: Schematic Diagram of a Sample General Purpose Federal Financial Report

Agency Head's Letter					
Management's Discussion and Analysis (RSI)					
<----- Other Elements of the General Purpose Federal Financial Report ----->					
1. Basic financial statements and notes, with auditor's report if audited	2. Required Supplementary Stewardship Information (RSSI)	3. Required Supplementary Information (RSI)	4. Performance Information	5. Other Accompanying Information (OAI)	6. Management's assertions and reports on controls, compliance, and corrective actions under FMFIA and FFMIA (or portions of these assertions and reports)

The GPFFR is represented by MD&A plus columns 1-6 of the diagram. (The agency head's letter is part of the GPFFR by general practice, though it is not required by federal accounting principles.) This is not a literal depiction of the organization of a report. Information should be presented in a logical arrangement. MD&A will address major issues that are typically reported in more detail in the discrete sections of the GPFFR or in other publicly available reports that the GPFFR incorporates by reference. Incorporating another report by reference does not, by itself, mean that the separate report is subject to audit.

Unless law or managerial action requires more extensive audit review or examination of the material incorporated by reference, the FASAB expects that the auditor of the financial statements will treat the material incorporated by reference as other accompanying information, although it does not physically accompany the GPFFR. OMB has authority to provide specific guidance on the auditor's minimum responsibility regarding this material. OMB may, for example, direct auditors to treat the material incorporated by reference as if it were other accompanying information in an auditor-submitted document.

SFFAC 2 (paragraphs 106-111 and Appendix 1-F) calls for a "Statement of Performance Measures" as part of the GPFFR, but FASAB has not yet recommended standards for it. Other titles may be used for this section of the GPFFR. Performance indicators included in the GPFFR will either be those in the entity's annual performance report under the Government Performance and Results Act of 1993 (GPRA or the Results Act) or a subset of them.

Alternatively, that report may be incorporated by reference. Until further guidance is available, the agency should select the indicators to report in consultation with OMB.

The assertions and report on control called for by the Federal Managers Financial Integrity Act (FMFIA or Integrity Act) would not be stated in full in MD&A. They would be reported in a discrete section of the GPFFR or incorporated in the GPFFR by reference. They are within the scope of MD&A because highly important aspects of systems, compliance, and internal controls should be discussed in MD&A. "Highly important" in this context may imply a higher threshold than "materiality" for the financial statements.

If the report also includes financial statements for component entities (bureaus, responsibility segments, etc.), management should use its judgment in organizing the report. The component entities' financial statements may be discussed in separate sections of the report or as subsections of MD&A of the consolidated entity.

9. MD&A should address:

   - the entity's structure, mission, goals, and objectives, with indicators[3] of its performance;
   - actions taken or planned to improve performance, when appropriate;
   - the financial statements;
   - systems, internal controls*[4] and legal compliance, including corrective action taken or planned; and
   - the future effects of existing, currently- known demands, risks, uncertainties, events, conditions and trends. MD&A may also address the possible future effects of anticipated* future demands, events, conditions, trends, etc. that management believes would be important to the reader of the report.

10. MD&A should address these subjects even if, as will be true for many Federal reporting entities, separate documents report much of the information in more detail. Information about these subjects is essential to address the objectives of federal financial reporting regarding performance, stewardship, budgetary integrity, and systems and controls.

    The following paragraphs explain the implications of this.

11. Regarding the entity's mission and performance, MD&A should inform the reader how well the reporting entity is doing. This means that it should tell the reader what the reporting entity and its programs have accomplished, and how well the entity is managing its programs. To do this, MD&A should answer such questions as:

    - What do we need to know to gauge operating success?
    - How do we measure what we accomplished?
    - What do the measurements show?

12. To understand the information on performance, systems, controls, and legal compliance, it typically is necessary to understand something about the reporting entity's organizational structure, mission, and strategic plan. Accordingly, MD&A should concisely inform the reader about these topics.

13. Reporting information that helps people assess the performance of the Government's programs and organizations is an important objective of Federal financial reporting. For

[3]This document uses the terms "performance measure" and "performance indicator" synonymously. Some people use the term "performance indicator" instead of "performance measure" because the performance of government programs typically involves several factors or dimensions, and many of these dimensions of performance cannot be measured precisely.

[4]Words marked with * are defined in the glossary.

governmental entities, in contrast to profit-seeking entities, the financial result of governmental-type activities is rarely an adequate indicator of performance. (For a few governmental entities, mainly those that conduct primarily business-type instead of governmental-type activities, the financial results of operations may be an important, albeit rarely sufficient, performance indicator.) To assess performance, people need additional information on the consequences of the Government's activities. For a competitive, profit-seeking entity, the value of its products or services is measured by the amount of money customers are willing voluntarily to pay for them. In such a situation, the traditional income statement reports on both the efforts (measured by expenses incurred) and the accomplishments (measured by revenue earned) of the entity. For government, expense reflects efforts, as it does in the private sector, but indicators other than revenue must be used to report on accomplishments. A discrete section of the GPFFR therefore presents indicators of accomplishments (such as indicators of outputs and outcomes) and other indicators of performance. Alternatively, the GPFFR incorporates performance indicators by reference to a separate report such as the Annual Performance Report required by the Results Act. Either way, performance information is an integral part of the GPFFR and should be discussed in MD&A. Management's discussion and analysis should therefore address the most important facets of performance as well as the financial statements and supplementary information.

14. Regarding the financial statements, MD&A should answer questions such as the following, to the extent that they are relevant and important for the entity:

- What is the entity's financial position? What is its financial condition?[5] How did this come about?
- What were the significant variations:
  - from prior years?
  - from the budget?[6]
  - from performance plans, long-term plans, or other relevant plans in addition to the budget?
- What is the potential effect of these factors, of changed circumstances, and of expected future trends? In other words, to the extent that it is feasible to project the effects of these factors, will future financial position, condition, and results, as reflected in future financial statements, probably be different from this year's and, if yes, why? (Any such discussion should acknowledge that the future is unpredictable and will be

[5]The traditional concepts of "financial position" and "financial condition" are typically applicable to revolving funds, Government corporations, and other reporting entities that are intended to be self-financing. The concepts may be less relevant, or may require some qualification or modification, for other kinds of Federal reporting entities.

[6]Management should use its judgment to decide what variances are relevant for MD&A. It will not always be essential or appropriate to discuss all variances.

influenced by factors outside the reporting entity's control, including actions by Congress.)

15. Regarding systems and controls, MD&A should tell the reader whether internal accounting and administrative controls (some authorities prefer the term "management controls") are adequate to ensure that:

- transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards;
- assets are properly acquired and used, safeguarded to deter theft, accidental loss or unauthorized disposition, and fraud; and
- performance measurement information is adequately supported.

16. Reporting information that helps people assess the condition of the entity's management systems and of the relevant internal controls is an important objective of Federal financial reporting. The relevant internal controls for this purpose are those that support reporting on financial and operating performance and reporting on compliance with applicable laws.[7] The great diversity of people (often with competing interests) affected by governmental action, and the fact that governments function within and by means of a framework of laws, mean that more attention to these matters is necessary than in financial reports for profit-seeking entities.

17. An entity's ability to prepare auditable financial statements and other reliable reports for management from the entity's books and records is a positive signal about the finance-related systems and controls of that entity. By themselves, however, the financial statements of a governmental entity do not provide adequate information about the status of the entity's management systems and internal controls that support reporting on financial and operating performance and reporting on compliance with applicable laws. For these reasons, the GPFFR of a Federal reporting entity should include information about systems, internal controls, and legal compliance, in addition to the basic financial statements. This information—like the information on performance—is presented in a discrete section of the GPFFR; alternatively it may be incorporated in the GPFFR by reference to separate reports such as those required by the Integrity Act. MD&A should therefore address the most important facets of this information on systems, controls and legal compliance, as well as the financial statements, supplementary information, and performance information.

[7]Internal controls are also relevant to other objectives. For example, controls help management assure efficient and effective use of resources for the purpose intended. They also support preparation of performance reports pursuant to GPRA. See, for example, paragraph 40.

Relationship to Other Reports

18. The information in the GPFFR about systems, internal controls, and legal compliance (column 6 in figure 1) may include the assertions and a summary of the reports on controls, legal compliance, and corrective actions pursuant to the Integrity Act and the Federal Financial Management Improvement Act (FFMIA), or those reports may be incorporated by reference. This information should be presented in conformance with guidelines published by OMB. MD&A, in turn, should discuss the most important aspects of the information on these topics. Referring to separately-issued reports on systems and controls does not eliminate the need to discuss these topics in MD&A.[8]

19. The performance information (column 4 in figure 1) may include the indicators in an entity's performance report pursuant to the Results Act or a selection of the most important performance indicators. Alternatively, a separate performance report may be incorporated by reference. This information should be presented in conformance with guidelines published by OMB. MD&A, in turn, will discuss the most important aspects of the performance information. Reference to a separately-issued performance report does not eliminate the need to discuss performance in MD&A.

20. The performance reports required by the Results Act may be voluminous for some agencies. In such cases, it may not be desirable to include all this information in the GPFFR. It is necessary to include at least some information about performance with the financial statements, however, so that people who use the GPFFR can understand why the costs reported in the financial statements were incurred and the consequences of doing so.

21. In the same way, the GPFFR by itself may not provide a comprehensive report on systems, controls and legal compliance. There may be voluminous reports from management and auditors on these topics. It is necessary to include at least some information about these topics, however, so that users of the GPFFR can understand whether the resources on which it reports were properly safeguarded and used for the purposes intended, whether reliable reports can be prepared, and whether the other objectives of internal controls are being met. This information is important both to provide a basis for understanding the financial statements themselves and to address the objectives of federal financial reporting.

22. Combining information on these topics adds value by putting the information about performance, internal controls, and systems in the context of audited financial statements. For example, the quality of information on the cost of outputs and outcomes of programs is

[8]Note that the purpose of the pilot Accountability Reports is to eliminate the need for numerous separate reports and to include the information required by those reports in a single report. For example, the Integrity Act requires an assertion on controls by the agency head. Pilot agencies are including this assertion in the Accountability Report.

enhanced by linking these indicators to the audited Statement of Net Cost. This is true even though the Statement of Net Cost may be too highly aggregated to identify separately all the programs reported on for the Results Act. Similarly, the auditor's tests of transactions and controls in connection with the audit of the financial statements provide information about the condition of the systems and controls used to safeguard resources and to assure that they are used for the intended purposes, in conformance with law. (Paragraphs 15 and 40-49 say more about the discussion and analysis of systems, controls, and performance.)

Authoritative Status of Accounting Concepts

23. This Statement of Federal Financial Accounting Concepts describes ideas and goals to guide the Board in its work. Concepts are not authoritative in the sense that they do not constitute accounting standards or principles for federal reporting entities. In particular, they are not "prescribed guidelines" for required supplementary information as discussed in section 558 of the Codification of Statements on Auditing Standards published by the American Institute of Certified Public Accountants.

Topics For MD&A

24. This section provides specific suggestions for the content of MD&A. Like the other sections of this document, this material does not constitute accounting standards or principles for federal reporting entities. Except to the extent that OMB may issue supplementary mandatory guidance regarding the content of MD&A, the following items should be read as suggestions to be considered, not as prescriptive rules that must be followed.

Mission and Organizational Structure

25. MD&A should contain a brief description of the mission(s) of the entity and describe its related organizational structure.

Discussion and Analysis of the Financial Statements

26. Financial Results, Position and Condition[9]—MD&A should help those who read it to understand the entity's financial results and financial position and the entity's effect on the financial position and condition of the Government.[10] It should give readers the benefit of management's understanding of the significance and potential effect from both a short- and a long-term perspective of:

    - the variations discussed in paragraph 14 in terms of major changes in types or amounts of assets, liabilities, costs, revenues, obligations and outlays;
    - particular balances and amounts shown in the basic financial statements, including the notes, such as those dealing with funds from dedicated collections, if relevant to important financial management issues and concerns; and
    - the entity's required supplementary stewardship information (because RSSI describes economic conditions that cannot be expressed in the basic financial statements).

27. Only those variations, balances and amounts, and stewardship matters of potential interest to readers who are not part of agency management should be discussed. Not all changes that are material to the GPFFR are sufficiently important to be included in MD&A. A line-by-line analysis of the financial statements is not generally appropriate. Instead, MD&A should summarize the most important items, explain the relevant causes and effects, and place them in context.

28. Budgetary Integrity—MD&A should concisely explain how budgetary resources have been obtained and used, instances in which their acquisition and use were not in accordance with legal authorization, the status of budgetary resources, and how information on the use of budgetary resources relates to information on the cost of program operations. MD&A should explain when major support for cost of a program or activity is provided outside the reporting entity's budget and when the entity's budget supports a program primarily reported by another entity. The discussion should describe major financing arrangements, guarantees, and lines of credit, including those not recognized in the basic financial statements.

[9]For many readers program performance information is more important than the financial statements. The order in which topics are discussed in this document does not imply that performance information is of secondary importance. See paragraphs 43 and following.

[10]Materiality of effects to be discussed should be evaluated in the context of the specific reporting entity, not the Government as a whole.

29. MD&A should explain major changes during the period to the budget originally approved, major failures to comply with finance-related laws, and other matters management believes necessary. These could include:

- unfunded liabilities that may require appropriations;
- assets that could be sold to augment future budgetary resources;
- amounts of payments that have not been matched with obligations;
- anticipated increases in the cost to complete long-term projects in progress that may require additional obligations or appropriations.

30. Use of Estimates—MD&A should concisely explain the use of estimates where that is important to understand issues discussed in MD&A, such as the major risks and uncertainties mentioned in paragraph 31 or the key forward-looking information discussed in paragraph 32. For example, the future expenses and the long term obligations[11] associated with major social insurance programs such as Social Security and Medicare should be discussed in MD&A of the financial report of the relevant reporting entities. These estimates are inherently imprecise and sensitive to several assumptions. Such factors would, therefore, be worthy of discussion in MD&A.

31. Current Demands, Risks, Uncertainties, Events, Conditions, and Trends—MD&A should describe important existing, currently-known demands, risks, uncertainties, events, conditions and trends--both favorable and unfavorable--that affect the amounts reported in the financial statements and supplementary information. The information called for by this paragraph and paragraph 32 is closely related. Preparers should combine the presentation of this information in whatever fashion is appropriate under the circumstances that apply to the reporting entity.

32. Future Effects of Current Demands, Risks, Uncertainties, Events, Conditions and Trends—The discussion of these current factors should go beyond a mere description of existing conditions, such as demographic characteristics, claims, deferred maintenance, commitments[12] undertaken, and major unfunded liabilities, to include a discussion of the possible future effect of those factors. (This discussion of possible future effect of existing, currently-known factors is required pursuant to the standards in *Standards for Management's Discussion and Analysis*.)

33. Future Effects of Anticipated Future Events, Conditions, and Trends—To the extent feasible and appropriate, the discussion should also encompass the possible future effects of

[11]The term "obligations" is used here in the customary sense, not as it is used in budgetary accounting.

[12]The term "commitments" is used here in the customary sense, not as it is used in budgetary accounting.

anticipated future events, conditions, and trends, although this additional information is not required by the standards for MD&A.[13] For example, MD&A might discuss the possible future effect of anticipated trends in the cost of inputs that may significantly affect future output costs. Other examples include the future effect of anticipated demographic trends, such as declining mortality rates, and the future effects of potential changes in behavior that may be caused by changes in Government programs. Such behavioral changes can greatly affect the future cost of some Governmental programs. For example, such effects can arise if subsidized insurance encourages the people or entities most at risk to participate in insurance programs (“adverse selection”) or encourages risky behavior (“moral hazard”).

34. An anticipated condition such as a prospective demographic trend or potential behavioral change may not, in itself, constitute a contingency or assumed risk that must be recognized, disclosed, or reported pursuant to SFFAS 5. Likewise, it may not be something that must be discussed in MD&A pursuant to the *Standards for Management’s Discussion and Analysis*. Even so, if there is a reasonable prospect of a major effect on the reporting entity due to the anticipated condition, then MD&A should include this information to the extent feasible.

35. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts* or projections*. Such forecasts or projections can show the implications of existing policies and conditions in light of anticipated or reasonably possible future conditions. For example, for MD&A of the Government-wide financial statements, long-term projections of the deficit or surplus may be important indicators of financial condition and sustainability. For insurance programs, this kind of projection—which actuaries sometimes call “dynamic analysis”—would consider possible interactions among current assets, reserves, policies in force, expected future business or populations covered by the insurance, and potential behavioral changes such as adverse selection and moral hazard, if appropriate. Some programs are inter-related among themselves and/or with conditions in the private sector. For example, flood insurance programs and disaster assistance programs may be related to such an extent that analysis of programs individually would not provide a good idea of their potential impact on the Government. To the extent feasible, projections should consider the potential implications of such relationships.

36. The future implications of current or anticipated factors often can better be expressed as a range of possible outcomes and associated probabilities than as a single point estimate. Sometimes the implications may best be discussed in nonfinancial as well as financial

[13] Some projections that could involve consideration of anticipated factors would be presented as required supplementary stewardship information pursuant to the standards exposed for comment in FASAB’s exposure draft Accounting for Social Insurance, February, 1998.

terms. Forward-looking information can be highly useful, but management should avoid turning this part of MD&A into mere “lobbying” for more budgetary authority.

37. Understanding Financial Reporting—MD&A should make federal financial statements understandable to a wide audience, not just to users who are specialized analysts or members of the entity’s management. There may be many potential sources of misunderstanding. Management should try to identify those sources of misunderstanding that may be important and deal with them in MD&A. Some of these are general and pervasive, such as those that may arise in the minds of new users of federal financial statements. New users may have been budget-oriented rather than accrual-accounting oriented, or may be accustomed to seeing financial statements prepared on the basis of private sector accounting standards. A general discussion and reference to the Statement of Financing and the basis of accounting footnote may be sufficient for such users, although more specific treatment may be appropriate where the resulting differences in the reported amounts may be important to the understanding of users.

38. Emphasis that may be given in the financial statements to the costs of suborganizations and programs may require cautionary discussion of the relevance and utility of cost information. When MD&A itself discusses the cost of program outcomes, the problems of associating costs with outcomes may need to be discussed. In addition, the possible imprecision of cost information should be mentioned when it could be relevant to users’ understanding. Similarly, any account-level discussion in MD&A of variations, balances, and amounts in the basic and stewardship information made in response to paragraphs 26 and 27 may require mention of the imprecision of amounts cited.

39. Exceptions and disclaimers in the auditor’s report should be mentioned in MD&A, and management should respect the auditor’s professional judgment if management expresses disagreement with auditor’s findings. (This does not mean that management must refrain from stating views that differ from the auditor’s; e.g., different views as to whether a weakness in control is material.) There may be other sources of misunderstanding. Management should be sensitive to them and guide the user to a better understanding when the problem could significantly affect the conclusions and judgments of substantial numbers of users.

Discussion and Analysis of Systems, Controls and Legal Compliance

40. The schematic diagram of a sample GPFFR on page 7 includes a discrete section that reports on the status of the entity’s management systems and internal controls that support (1) preparation of financial statements and performance information in accordance with Federal Accounting Standards and management’s criteria, respectively, and (2) the entity’s

compliance with applicable laws.[14] That section also describes material problems revealed by audits or otherwise known to management, and the corrective actions taken or planned regarding material problems.

41. Where relevant, management should discuss the results of audits of non-Federal entities such as those pursuant to the Single Audit Act as amended and OMB Circular A-133. MD&A should also discuss actions taken, in progress, or planned to address systemic problems in program design that contributed to the audit findings. Where relevant, management should describe the methods used to limit, detect, and recover improper payments; to assure that grantees and other nonfederal recipients of Federal funds use the funds as intended; and to assure that Federal and nonfederal entities comply with finance-related laws and regulations. MD&A should include a concise description of any major problems in these areas and of the corrective action taken or planned.

Discussion and Analysis of Performance

42. Performance Measurement—The objectives and needs of the Federal Government are markedly different from the objectives and needs of non-governmental organizations. This difference extends to the needs of those who use financial statements of governmental organizations. Their needs are different in many ways from the needs of investors, which the SEC's requirements address. In particular, reporting on the performance of governmental programs, organizations, and activities requires information that goes beyond the change in net assets and, indeed, beyond financial information.

[14]These responsibilities are defined in numerous laws and administrative requirements, including the Federal Financial Management Improvement Act, OMB Circulars A-123 and A-127, and OMB Bulletin 98-08. A law of special importance in this connections is the Federal Managers' Financial Integrity Act of 1982 (FMFIA or the Integrity Act). The Integrity Act requires, in part, that "internal accounting and administrative controls of each executive agency shall be established.. and shall provide reasonable assurance that --
(i) obligations and costs are in compliance with applicable law;
(ii) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
(iii) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

43. The actual outcomes, accomplishments, or degree to which predetermined objectives are met provide indicators or measures of some aspects of effectiveness.[15] MD&A should objectively discuss the entity's program results and indicate the extent to which its programs are achieving their intended objectives.[16] Efficiency and effectiveness are important elements of performance measurement, and measuring cost is an integral part of assessing the efficiency and effectiveness of programs. Relating outputs (the quantity of services provided) to inputs (the cost incurred to provide the services) provides an indicator or measure of one aspect of efficiency. Information about effectiveness is often combined with cost information to help assess "cost effectiveness."

44. The entity's financial performance should be summarized to provide significant indicators of its financial operations for the reporting period. Indicators of financial performance are presented in notes and supplementary information as well as on the face of the principal financial statements, e.g., information about management of loans and accounts receivable. Financial performance is only one aspect of performance for governmental entities. Financial performance should be discussed to the extent relevant for the entity, in a way that appropriately balances the discussion of financial and nonfinancial performance relevant to the program or other reporting entity.

45. The discussion of performance should relate to major goals and objectives from the agency's strategic plan and to the indicators reported pursuant to the Results Act. It should explain what key performance indicators say about program performance. The summary discussion of performance in MD&A should:

- discuss the strategies and resources the agency uses to achieve its performance goals;
- provide a clear picture of actual and planned performance across the agency; and
- explain the procedures that management has designed and followed to provide reasonable assurance that the reported performance information is relevant and reliable.

46. The discussion of performance should:

[15]SFFAC 1, paragraph 206 notes that, to the extent feasible and practical, effectiveness evaluation should focus on program results or effects in the sense of "impacts*," i.e., the difference between what actually occurred and what would have occurred in the absence of the program. Assessing impacts of Governmental action in this sense typically requires program evaluations or other techniques that transcend annual performance reporting, although these techniques often will avail of information i the annual performance reports. Valid and reliable evaluations of program impacts are not feasible for some programs. When they are conducted, they often require several years of data, are expensive, and typically are not performed on an annual basis for a given program.

[16]Paragraphs 106-111 and Appendix 1-F of Statements of Federal Financial Accounting Concepts 2, *Entity and Display*, discuss and illustrate reporting on performance in the GPFFR.

- include both positive and negative results;
- present historical and future trends, if relevant (see paragraphs 31-36 regarding projections of the financial effects of known and anticipated demands, commitments, events, risks, uncertainties or trends for which a material financial effect is reasonably possible);
- be illustrated with charts and graphs, whenever helpful, for easy identification of trends;
- explain the significance of the trends;
- provide comparison of actual results to goals or benchmarks;
- explain variations from goals and plans; and
- provide other explanatory information that management believes readers will need to understand the significance of the indicators, the results, and any variations from goals or plans.

47. To further enhance the usefulness of the information, agencies should include an explanation of what needs to be done and what they plan to do to improve program performance.

48. Understanding Performance Reporting—Important limitations and difficulties associated with performance measurement and reporting should be noted to the extent relevant to the vital performance indicators discussed in MD&A. The relevant limitations will vary from program to program, but some common factors that may need to be discussed include the following:

- performance usually cannot be fully described by a single indicator;
- indicators of performance do not, by themselves, say why performance is at the level reported; and
- focusing exclusively on quantifiable indicators can sometimes have unintended consequences.

49. For these and other reasons, performance indicators generally need to be accompanied by suitable explanatory information. Explanatory information helps report users understand reported indicators, assess the reporting entity’s performance, and evaluate the significance of underlying factors that may have affected the reported performance. Explanatory information may include, for example, information about factors substantially outside the entity’s control, as well as information about factors over which the entity has significant control.

This Statement of Recommended Concepts was adopted unanimously by the eight members of the Federal Accounting Standards Advisory Board serving on the Board in April 1999.

Appendix A: Basis For Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Background and Project History

50. The Board identified MD&A as a topic for its agenda shortly after the Board's inception. The Board deferred work on this topic, however, until it completed recommendations for an initial set of basic accounting standards. FASAB published an initial exposure draft on MD&A in January, 1997. The Board received comment letters on the initial exposure draft from the following sources:

	Federal (internal)	Nonfederal (external)	Total
Users, Academics and Others[17]		4	**4**
Auditors	7	3	**10**
Preparers and Financial Managers	16		**16**
Total	**23**	**7**	**30**

51. The basic rationale for MD&A has not changed since the initial exposure draft. As a result of its deliberations after receiving comments on the 1997 exposure draft, however, the Board made certain changes. The more significant changes are discussed below.

Concepts and Standards

52. The initial exposure draft was presented as a statement of recommended concepts. The Board proposed that it would deal with MD&A conceptually, with the understanding that OMB would provide authoritative guidance on MD&A to implement the concepts. This approach would have been similar to the one used to deal with the topics of entity and

[17]This category include representational organizations, retired federal employees, federal employees responding as individuals, and federal contractors, as well as academics and other GPFFR users.

display. The Board dealt with those topics conceptually in SFFAC 2. OMB then provided authoritative guidance in its Bulletin on Form and Content. The 1997 exposure draft asked respondents whether all or part of its provisions should be issued as recommended standards rather than recommended concepts. Responses were mixed; most of those who commented on this question favored concepts, but a significant number expressed the view that standards would be appropriate.

53. The Board concluded that, given the importance of MD&A as an integral part of the GPFFR, it would be appropriate to recommend standards for MD&A. At the same time, however, the Board concluded that for now this information should be treated as required supplementary information. The Board also agreed that no detailed requirements or guidelines for MD&A should be incorporated in federal accounting standards at this time beyond those proposed in the subsequent exposure draft (discussed below) titled *Standards for Management's Discussion and Analysis*. In other words, the Board agreed, a discussion and analysis that addresses the topics listed in the proposed standards should be an essential part of a complete GPFFR. At the same time, management should have great discretion about what to say regarding those topics, subject only to the criteria proposed in the exposure draft *Standards for Management's Discussion and Analysis* and the pervasive requirement that MD&A not be misleading. Because of this change, the Board decided to expose separately for further comment the proposed new standards and concepts. The exposure drafts were issued in October 1998; responses were requested by January 1999.

Responses to Second Exposure Draft

54. The Board received comment letters on the second exposure draft from the following sources:

	Federal (internal)	**Nonfederal (external)**	**Total**
Citizens, Users, Academics and Others		3	**3**
Auditors[18]	3	3	**6**
Preparers and Financial Managers	11		**11**
Total	**14**	**6**	**20**

[18]Includes the AICPA's Federal Accounting and Auditing Subcommittee and the Comptroller General's Advisory Council on Government Audit Standards.

55. Most comments were generally favorable, but comments were mixed regarding some points. A few auditors and preparers expressed some concern about requiring forward-looking information as RSI. Others expressed support for doing so. After considering these responses, the Board agreed to defer the recommended implementation date of the standard by one year and to make minor editorial changes to the standards and concepts that were exposed for comment.

Incorporation of Guidance in OMB Bulletin 97-01

56. This document, like both exposure drafts, integrates some of the guidance in OMB Bulletin 97-01 for preparing the "Overview" of the financial report with some of the guidance proposed in FASAB's initial exposure draft for MD&A. Some portions of the guidance regarding performance measurement in 97-01's discussion of the "Overview" have been omitted. As an interim step prior to implementation of the Results Act, OMB and many agencies used the Overview as a major vehicle for reporting on performance, not just as a summary and analysis. With the full implementation of the Results Act in FY 1999, however, it will be appropriate to implement the financial reporting model contemplated in SFFAC 2. This contemplates a discrete section of the GPFFR focused on performance. Alternatively, performance information may be incorporated in the GPFFR by reference to another report or reports.

Management's Assertions

57. Senior management of the reporting unit is responsible for the content of the GPFFR, including MD&A. Consistent with that, the initial exposure draft included the following paragraph:

> MD&A should include a discrete section with management's explicit assertions that it is responsible for maintaining internal accounting and administrative controls that are adequate to ensure that
>
> - transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards;
> - assets are properly safeguarded to deter fraud, waste, and abuse; and
> - performance measurement information is adequately supported. [footnote omitted]

58. This paragraph, which was based on the language of objective four in SFFAC 1, was modified after the first exposure. The Board concluded that such assertions should be

presented in a separate section of the GPFFR, not in MD&A. Alternatively, management's assertions about internal control and related information about systems, controls, and compliance may be incorporated in the GPFFR by reference to another report or reports. (As noted previously, pilot agencies are including these assertions in their accountability reports.) FASAB expects to consider whether a new statement of standards is needed to assure that Federal financial reports adequately address objective four of Federal financial reporting, "Systems and Controls." As noted in paragraph 41, MD&A should include a description of any major deficiencies in the management systems and internal controls designed to provide reasonable assurance that management responsibilities are satisfactorily carried out. It also should describe the corrective action planned.

Accountability Reports

59. The Board notes that the concept and practice of the "Accountability Report" continue to evolve through the pilot project voluntarily undertaken by several agencies. The Board supports this evolution and encourages agencies to participate in the pilot project. The concepts and standards FASAB recommends are intended to be applicable to the GPFFR of Federal entities, whether those reports are prepared pursuant to the Chief Financial Officers Act, the Government Management Reform Act, or some future law that might establish a statutory basis for Accountability Reports. In the event of such future legislation, OMB will need to resolve any questions about how to apply existing Federal accounting standards in the context of new legislative requirements.

Incorporation by Reference

60. Some respondents were disturbed by the notion of providing program performance information through reference. Some were concerned that, if readers are merely directed to other reports for this information, the GPFFR will become irrelevant. They believe that the GPFFR should contain information about program performance, systems, and controls, not only in MD&A but also in discrete sections, such as the Statement of Program Performance discussed and illustrated in SFFAC 2, paragraphs 106-111 and Appendix 1-F.

61. The Board agrees that, as is stated in paragraph 20, "it is necessary to include at least some information about performance with the financial statements . . . so that people who use the GPFFR can understand why the costs reported in the financial statements were incurred and the consequences of doing so."

62. The Board acknowledges that SFFAC 2 calls for and illustrates a Statement of Program Performance Measures. (Footnote 13 in SFFAC 2 explains that this statement is not "basic" information as that term is used in audit standards: "The Statement of program performance

measures is not a basic financial statement. Nevertheless, it is an important component of the financial reports.") The Board continues to believe that performance information is a vital, integral part of general purpose financial reporting. It should be noted, however, that SFFAC 1 and SFFAC 2 were issued before the performance planning and reporting requirements of GPRA became effective. The Results Act creates an elaborate new planning and reporting environment that is still evolving. Some details of the reporting model that were envisioned conceptually in SFFAC 2 may accordingly need to be revised slightly.

63. This statement of concepts is intended to be consistent with the previously stated goals and concepts of the Board, while recognizing that some details of how best to achieve those goals in the new context still need to be defined. OMB will play a key role in this process; FASAB may also provide further guidance in future projects. FASAB agrees that the GPFFR should not address performance, systems, and controls only by means of reference to other reports. The standards for MD&A require that MD&A do more than refer to other documents.

64. Others expressed concern that, if MD&A is to be regarded as RSI, audit problems might arise from "incorporation by reference" in MD&A of information drawn from other sources that might not be subject to audit or review as basic or required supplementary information, and for which authoritative guidance had not been provided by a standard setter. The Board noted that most of those who commented, including most auditors, did not appear to be greatly concerned about this potential problem. The Board concluded, therefore, that any such problems were not likely to be insurmountable. The Board did, however, agree to defer by one year the implementation date of the standard to allow OMB and GAO time to resolve any audit issues that may arise.

Appendix B: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary.”

Statement of Federal Financial Accounting Standards 15: Management's Discussions and Analysis

Status

Issued	August 12, 1999
Effective Date	For fiscal periods beginning after September 30, 1999
Interpretations and Technical Releases	
Affects	None.
Affected by	None.

Summary

This document establishes standards for preparing Management's Discussion and Analysis (MD&A). MD&A is an important vehicle for (1) communicating managers' insights about the reporting entity, (2) increasing the understandability and usefulness of the general purpose federal financial report (GPFFR),[1] and (3) providing understandable and accessible information about the entity and its operations, service levels, successes, challenges, and future. Some federal agencies also refer to MD&A as the "overview."

The basic concept that underlies the standards for MD&A is:

> Each general purpose federal financial report (GPFFR) should include a section devoted to management's discussion and analysis (MD&A). It should address the reporting entity's performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems. The discussion and analysis of these subjects may be based partly on information contained in reports other than the GPFFR. MD&A also should address significant events, conditions, trends and contingencies that may affect future operations.

A separate document titled *Concepts for Management's Discussion and Analysis* explains the conceptual basis for the role and importance of MD&A, the general content of the GPFFR, and the elements of MD&A. The concepts provide a foundation for the standards presented in this document. The concepts include suggestions about the contents of MD&A, but those suggestions are not accounting standards or principles for federal reporting entities. In particular,

[1] The term "general purpose federal financial report," abbreviated GPFFR, is used as a generic term to refer to the report that contains the entity's financial statements that are prepared and audited pursuant to the CFO Act of 1990, as amended. Entities may refer to these reports using different terms, such as "Annual Report," "Accountability Report," "Financial Management Report," etc. Paragraphs 54-112 and Appendix 1 of Statement of Federal Financial Accounting Concepts 2, Entity and Display, describe and illustrate the contents of the GPFFR.

the concepts are not “prescribed guidelines” for required supplementary information as discussed in section 558 of the *Codification of Statements on Auditing Standards* published by the American Institute of Certified Public Accountants (AICPA). The only standards and prescribed guidelines for MD&A are in paragraphs 1-8 of this document.

The standards require MD&A to be included in each GPFFR as required supplementary information (RSI). MD&A should address:

- the entity’s mission and organizational structure;
- the entity’s performance goals and results;
- the entity’s financial statements;
- the entity’s systems, controls, and legal compliance; and
- the future effects on the entity of existing, currently-known demands, risks, uncertainties, events, conditions and trends.

The discussion and analysis of these subjects may be based on information in other discrete sections of the GPFFR or it may be based on reports separate from the GPFFR. The standards are effective for reporting periods that begin after September 30, 1999.

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Management’s Discussion And Analysis

Statement Of Standards

1. A report that presents a Federal reporting entity’s financial statements in conformance with Federal accounting principles should include management’s discussion and analysis (MD&A) of the financial statements and related information. MD&A should provide a clear and concise description of the reporting entity and its mission, activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition. MD&A should provide a balanced presentation that includes both positive and negative information about these topics. MD&A should be regarded as “required supplementary information” as that term is used in auditing standards.[2]

2. 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. 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

[2]See section 558, “Required Supplementary Information,” in *Codification of Statements on Auditing Standards*, American Institute of Certified Public Accountants (AICPA)

possible effects of anticipated future demands, events, conditions, and trends.[3] Forward-looking information may comprise a separate section of MD&A or may be incorporated with the sections listed above.

4. MD&A should discuss important problems that need to be addressed, and actions that have been taken or planned. Actions needed, taken, and planned may be discussed within the sections listed above or in a separate section of MD&A.

5. Because MD&A must be concise if it is to be useful, management must select the most important matters to discuss. This means that some items that are material to the financial statements, notes, and other sections of the GPFFR may not be discussed in MD&A.

6. 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 the GPFFR as a source of information. (The specific topics mentioned in *Concepts for Management’s Discussion and Analysis* are examples of items that might be relevant for MD&A of a given entity.) Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

   - 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
   - significantly affect the judgment of citizens about the efficiency and effectiveness of their Federal Government.

7. Management of the reporting unit is responsible for the content MD&A.

8. The standards are effective for reporting periods that begin after September 30, 1999.

[3]The word “anticipated” is used in a broad, generic sense in this document. In this context the term may encompass both “probable” losses arising from events that have occurred, which should be recognized on the face of the basic or “principal” financial statements, as well as “reasonably possible” losses arising from events that have occurred, which should be disclosed in notes to those statements. “Anticipated” may include the effects of future events that are deemed probable, for which a financial forecast would be appropriate. The term may also encompass hypothetical future trends or events that are not necessarily deemed probable, for which financial projections may be appropriate. Such information about the possible effects of anticipated future demands, events, conditions and trends, if presented, should include the term or label “projected” or “projection,” and the key hypothetical underlying assumptions should be explained. As with other information presented in MD&A, no examination of this information by the auditor is now routinely included within the scope of an audit of a federal entity’s financial statements; however, preparers and auditors may find useful background information in the AICPA’s Statements on Standards for Attestation Engagements Nos. 1 and 4, codified as section 200, “Financial Forecasts and Projections,” of the AICPA’s *Codification of Statements on Standards for Attestation Engagements.*

This Statement of Recommended Standards was adopted unanimously by the eight members of the Federal Accounting Standards Advisory Board serving on the Board in April 1999.

Appendix A: Basis For Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Background, Rationale, and Project History

9. The Board identified MD&A as a topic for its agenda shortly after the Board's inception. The Board deferred work on this topic, however, until it completed recommendations for an initial set of basic accounting standards.

10. FASAB published an initial exposure draft on MD&A in January, 1997. It was presented as a statement of recommended concepts rather than standards. The Board proposed that it would deal with MD&A conceptually, with the understanding that OMB would provide authoritative guidance on MD&A to implement the concepts. This approach would have been similar to the one used to deal with the topics of entity and display. The Board dealt with those topics conceptually in SFFAC 2. OMB then provided authoritative guidance in its Bulletin on Form and Content.

11. The Board received comment letters on the initial exposure draft from the following sources:

	Federal (internal)	Nonfederal (external)	Total
Citizens, users, academics and others[4]		4	4
Auditors	7	3	10
Preparers and financial managers	16		16
Totals	23	7	30

[4]This category includes representational organizations, retired federal employees, federal employees responding as individuals, and federal contractors, as well as academics and other GPFFR users.

Concepts and Standards

12. The first exposure draft asked respondents whether all or part of the exposure draft’s provisions should be issued as recommended standards rather than recommended concepts. Responses were mixed; most of those who commented on this question favored concepts, but a significant number expressed the view that standards would be appropriate. The Board concluded that, given the importance of MD&A as an integral part of the GPFFR, it would be appropriate for federal accounting principles to include standards for MD&A.

13. At the same time, the Board concluded that MD&A should be treated as required supplementary information. The Board agreed that it would recommend no detailed requirements or guidelines for MD&A at this time, beyond those in paragraphs 1-8. In other words, a discussion and analysis by management that addresses the listed topics should be required, because it is an essential part of a complete GPFFR. At the same time, management should have great discretion regarding what to say about those topics, subject only to the criteria in paragraphs 1-8 and the pervasive requirement that MD&A not be misleading. The standard itself, therefore, is not extremely prescriptive.

14. Because of this change from what was originally exposed for comment, the Board decided to expose separately the proposed standards and concepts for further comment. The exposure drafts were issued in October, 1998; responses were requested by January 1999. The proposed standard, like the final recommended standard, would require the auditor to note the omission of MD&A or the failure to address the specified topics. At the same time, RSI status for MD&A—coupled with the lack of specific, detailed, prescriptive standards for the content of MD&A—would minimize the requirement for the auditor to scrutinize MD&A. This, the Board believed, would provide the flexibility appropriate for dealing with topics such as performance measurement at this point in the evolution of federal financial reporting.

Responses to Second Exposure Draft

15. The Board received comment letters on the second exposure draft from the following sources:

	Federal (internal)	Nonfederal (external)	Total
Citizens, users, academics and others		3	3
Auditors[5]	3	3	6
Preparers and financial managers	11		11
Totals	14	6	20

16. Most comments were generally favorable, but comments were mixed regarding some points. A few auditors and preparers expressed some concern about requiring forward-looking information as RSI. Others expressed support for doing so. After considering these responses, the Board agreed to defer the recommended implementation date of the standard by one year and to make minor editorial changes to the standards and concepts that were exposed for comment.

17. Although the resulting standard differs from private sector standards, the Board expects that, in practice, the effect on auditors will not be greatly different.[6] In the private sector, corporations frequently include with their annual financial report the MD&A that they are required to file with the SEC. Because it is required by the SEC rather than by accounting standards, the auditor engaged to audit the corporation's financial statements normally treats MD&A as "accompanying information" that is not audited in the context of the audit of the financial statements. The auditor also may review the submission to the SEC and may have certain responsibilities in that regard, but the auditor's usual role regarding MD&A is, nevertheless, fairly limited.

18. Because this standard defines MD&A for federal reporting entities as RSI, auditors will have certain responsibilities regarding it; however, both the accounting standards specified here and the auditing standards specified by the AICPA (and incorporated in Government Audit Standards) for RSI are rather general. Therefore, the Board does not expect that this standard will cause the auditor to be deeply involved in reviewing the contents of MD&A.

[5]Includes the AICPA's Federal Accounting and Auditing Subcommittee and the Comptroller General's Advisory Council on Government Audit Standards.

[6]The standard itself differs from the SEC's guidance for MD&A in ways that reflect the unique federal reporting environment. This will affect what financial statement preparers must do to comply with the standard. For example, reporting on performance of governmental programs requires measures in addition to net income or net cost.

19. More specific requirements regarding the content of MD&A may be added later by OMB acting on its own authority or pursuant to future FASAB recommendations. For example, OMB might at some time in the future require preparers to address certain of the suggested items in Concepts for Management's Discussion and Analysis. OMB also may provide more specific guidance regarding the auditor's responsibility for MD&A. That guidance may call for more extensive review of all or parts of MD&A than the minimum contemplated by this accounting standard in the context of current auditing standards. For example, OMB might at some time in the future decide that the minimum scope of engagements to audit federal financial statements should be expanded to include a review or examination of all or parts of MD&A, consistent with attestation guidelines published by the AICPA.[7]

Accountability Reports

20. The Board notes that the concept and practice of the "Accountability Report" continue to evolve through the pilot project voluntarily undertaken by several agencies.[8] The Board supports this evolution and encourages agencies to participate in the pilot project. The concepts and standards FASAB recommends are intended to be applicable to the GPFFR of Federal entities, whether those reports are prepared pursuant to the Chief Financial Officers Act, the Government Management Reform Act, or some future law that might establish a statutory basis for Accountability Reports. In the event of such future legislation, OMB will need to resolve any questions about how to apply existing Federal accounting standards in the context of new legislative requirements.

Forward-looking Information

21. MD&A should include forward-looking information regarding the future effects of existing, currently-known demands, risks, uncertainties, events, conditions and trends. This kind of

[7]See Statement on Standards for Attestation Engagements No. 8, *Management's Discussion and Analysis,* issued by the Auditing Standards Board of the AICPA, March 1998.

[8]Accountability reports are broader in scope than traditional general purpose financial reports. As explained by OMB: "Six pilot agencies volunteered to produce an 'Accountability Report' for FY 1995 to provide more useful information to decision makers by linking together information required by several management statutes... Accountability Reports integrate the following information: the FMFIA report, the CFOs Act Annual Report (including audited financial statements); management's Report on Final Action as required by the IG Act; Civil Monetary Penalty and Prompt Payment Act reports; and available information on agency performance compared with its stated goals and objectives, in preparation for implementation of GPRA." *Federal Financial Management Status Report and Five Year Plan,* June 1996, pp. 33-34. Twelve agencies produced accountability reports for FY 1997; eighteen plan to do so for FY 1998; the number will increase to 23 for FY 2000. (The requirement to include Civil Monetary Penalty and Prompt Payment Act reports has been deleted.)

forward-looking information is required when management believes it would be important to people who read the financial report. Though not required, MD&A may also include forward-looking information about the possible effects of <u>anticipated</u> future demands, events, conditions, and trends. FASAB encourages management to include forward-looking information about the possible effects of <u>anticipated</u> future demands, events, conditions, and trends to the extent management believes such information would be useful and relevant. This information can be highly useful, but management should avoid turning this part of MD&A into mere “lobbying” for more budgetary authority.

Incorporation by Reference

22. Some respondents expressed concern that, if MD&A is to be regarded as RSI, audit problems might arise from “incorporation by reference” in MD&A of information drawn from other sources that might not have been subject to audit or review as basic or required supplementary information, and for which authoritative guidance had not been provided by a standard setter. The Board noted that most of those who commented, including most auditors, did not appear to be greatly concerned about this potential problem. The Board concluded, therefore, that any such problems were not likely to be insurmountable. The Board did, however, agree to defer by one year the implementation date of the standard to allow OMB and GAO time to resolve any audit issues that may arise.

United States Government Stewardship Information (Unaudited) for the Years Ended September 30, 2010, and 2009

Stewardship Investments

Stewardship investments focus on Government programs aimed at providing long-term benefits by improving the Nation's productivity and enhancing economic growth. These investments can be provided through direct Federal spending or grants to State and local governments for certain education and training programs, research and development, and federally financed but not Federally-owned property, such as bridges and roads. When incurred, these investments are included as expenses in determining the net cost of operations. Stewardship investments for the current year and for the immediately preceding 4 years are shown below in Table 11.

Table 11
Stewardship Investments
for the Years Ended September 30

(In billions of dollars)	Fiscal Year 2010	Fiscal Year 2009	Fiscal Year 2008	Fiscal Year 2007	Fiscal Year 2006
Investments in non-Federal physical property	66.7	65.1	57.8	56.2	54.4
Investments in human capital	122.3	60.3	77.2	76.1	107.4
Research and development:					
Investments in basic research	31.5	27.4	27.6	26.5	25.2
Investments in applied research	26.2	19.1	21.4	22.2	21.7
Investments in development	77.3	101.0	79.2	66.3	52.1
Total investments	324.0	272.9	263.2	247.3	260.8

Non-Federal Physical Property

The Government makes grants and provides funds for the purchase, construction, and/or major renovation of State and local government physical properties. Cost for non-Federal physical property programs are included as expenses in the Statements of Net Cost and are reported as investments in Table 11. They are measured on the same accrual basis of accounting used in the *Financial Report* statements. DOT, HUD, and DOD had $55.2 billion (83 percent), $5.7 billion (9 percent), and $2.1 billion (3 percent), respectively, of the total non-Federal physical property investments in fiscal year 2010 as shown in Table 11. Within DOT, the Federal Highway Administration invested $41.5 billion during fiscal year 2010, primarily via reimbursement from the Highway Trust Fund, for States' construction costs of interstate and national highways. The States' contribution is 10 percent for the Interstate System and 20 percent for most other programs.

Human Capital

The Government runs several programs that invest in human capital. Those investments go toward increasing and maintaining a healthy economy by educating and training the general public. Costs do not include training expenses for Federal workers.

Education, DOL, and VA had $99.5 billion (81 percent), $7.7 billion (6 percent), and $9.5 billion (8 percent), respectively, of the total human capital investments in fiscal year 2010 as shown in Table 11. In comparison over the past 5 years, Education had an increase in fiscal years 2006 and 2010, due to an increase in Federal Family Education Loan and Direct Loan subsidy re-estimates and subsidy transfers due to increased loan consolidation activity; while VA increased in fiscal year 2010 due to implementation of the Post 9/11 GI Bill. Education administers a wide variety of programs related to general public education and training programs that are intended to increase or maintain national economic productive capacity. The Office of Federal Student Aid administers need-based financial assistance programs for students pursuing postsecondary education and makes available federal grants, direct loans, and work-study funding to eligible undergraduate and graduate students.

The significant human capital programs administered by DOL relate to grants for job training and employment programs. The significant human capital programs administered by VA also relate to grants for job training and rehabilitation programs for veterans.

Research and Development

Federal investments in Research and Development (R&D) comprise those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other future benefits.

- Investments in basic research are for systematic studies to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind.
- Investments in applied research are for systematic studies to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met.
- Investments in development are the systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.

With regard to basic and applied research, HHS had $19.1 billion (61 percent) and $13.0 billion (50 percent), of the total basic and applied research investments, respectively, in fiscal year 2010 as shown in Table 11. HHS also had similar R&D investment amounts (and percentage contributions) in each of the preceding 4 years.

Within HHS, the National Institutes of Health (NIH) conducts almost all (98 percent) of the Department's basic and applied research. The NIH Research Program includes all aspects of the medical research continuum, including basic and disease-oriented research, observational and population-based research, behavioral research, and clinical research, including research to understand both health and disease states, to move laboratory findings into medical applications, to assess new treatments or compare different treatment approaches, and health services research.

The NIH regards the expeditious transfer of the results of its medical research for further development and commercialization of products of immediate benefit to improved health as an important mandate.

With regard to development, the DOD and NASA had $65.3 billion (84 percent) and $9.1 billion (12 percent), respectively, of total development investments in fiscal year 2010, as shown in Table 11. Development is comprised of five stages: advanced technology development, advanced component development and prototypes, system development and demonstration, management support, and operational systems development. Major outputs of DOD development are:

- Hardware and software components, and complete weapon systems ready for operational and developmental testing and field use, and
- Weapon systems finalized for complete operational and developmental testing.

NASA development programs include activities to extend our knowledge of Earth, its space environment, and the universe, and to invest in new aeronautics and advanced space transportation technologies that support the development and application of technologies critical to the economic, scientific, and technical competiveness of the United States. Some outcomes and future outcomes of this development are:

- The Earth Science Research Program improves the capability to document the global distribution of a range of important environmental parameters related to the Earth's atmosphere, hydrosphere, biosphere, cryosphere, and land surface; to understand the processes that drive and connect them; and to improve our capability to predict the future evolution of the Earth system, including climate, weather, and natural hazards.
- Earth Systematic Missions provide Earth observing satellites that contribute to the provision of long-term environmental data sets that can be used to study the evolution of the Earth system on a range of temporal scales. This information is used to analyze, model, and improve understanding of the Earth system.
- The Mars Exploration program has been developed to conduct a rigorous, incremental, discovery-driven exploration of Mars to determine the planet's physical, dynamic, and geological characteristics, investigate the Martian climate in the context of understanding habitability, and investigate whether Mars ever had the potential to develop and harbor any kind of life.
- The Cosmic Origins missions explore how the expanding universe grew into a grand, cosmic web of galaxies; how stars and planets formed within the galaxies; how stars created the heavy elements, such as carbon, that are essential for life. Major breakthroughs in our knowledge of the cosmos have already been made with the current suite of missions.

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