



Enhancing the Effectiveness of
Management's Discussion and Analysis
(MD&A)

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Session Outline

- Required supplementary information (RSI)
- MD&A basics/required elements
- Auditing MD&A
- Common problems to avoid
- Telling your government's story
- Best practices / examples

Types of Financial Reporting

Type of Reporting	Users	Contents
Internal	Management	Determined by management
External (special purpose)	Those in a position to set their own reporting requirements (grantors and regulators)	Determined by party that requires reporting
External (general purpose)	Citizens, legislative and oversight bodies, investors, and creditors	Determined by GAAP

GASB Concepts Statement 3

Communication Methods

- Four communication methods:
 - Display (recognition in basic financial statements)
 - Disclosure (inclusion in notes to basic financial statements)
 - Required supplementary information (RSI)
 - Supplementary information (SI)

GASB Concepts Statement 3

Communication Methods

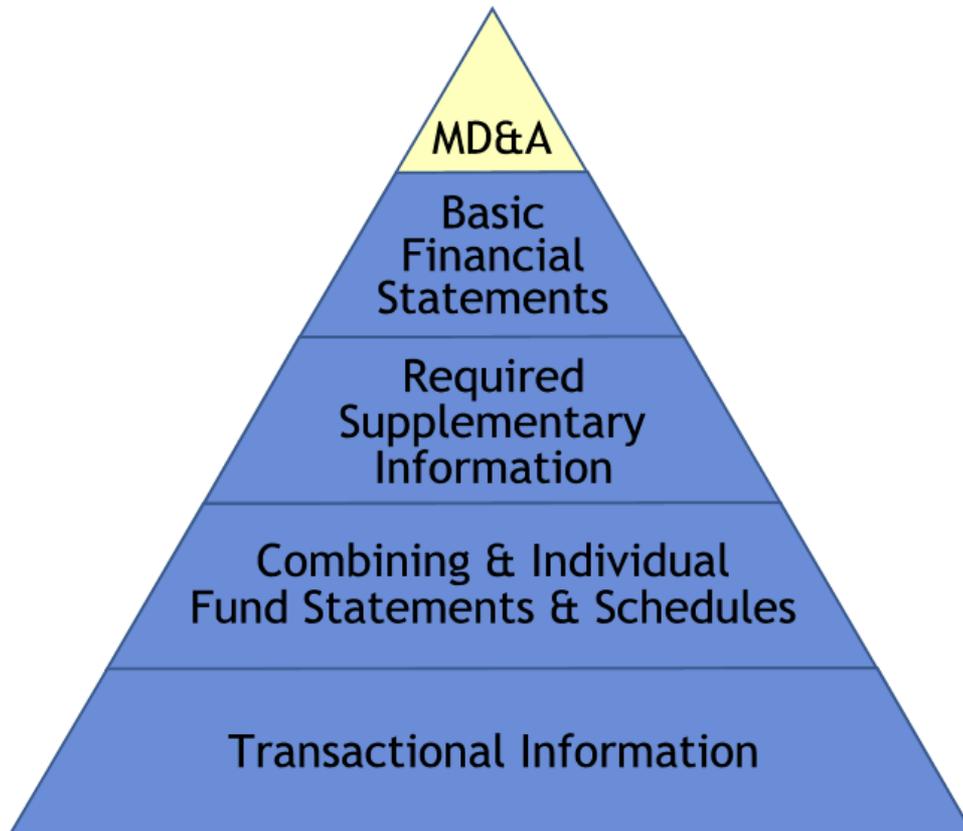
- Required supplementary information (RSI)
 - Supporting information that the GASB has concluded is *essential* for placing basic financial statements and notes to basic financial statements in an appropriate operational, economic, or historical context
 - Has a clear and demonstrable relationship to information in the BFS to which it pertains

GASB Concepts Statement 3

Communication Methods

- Required supplementary information (RSI)
 - Does not include (a) subjective assessments of the effects of reported information on the reporting unit's future financial position, (b) predictions about the effects of future events on future financial position, or (c) information unrelated to the financial statements

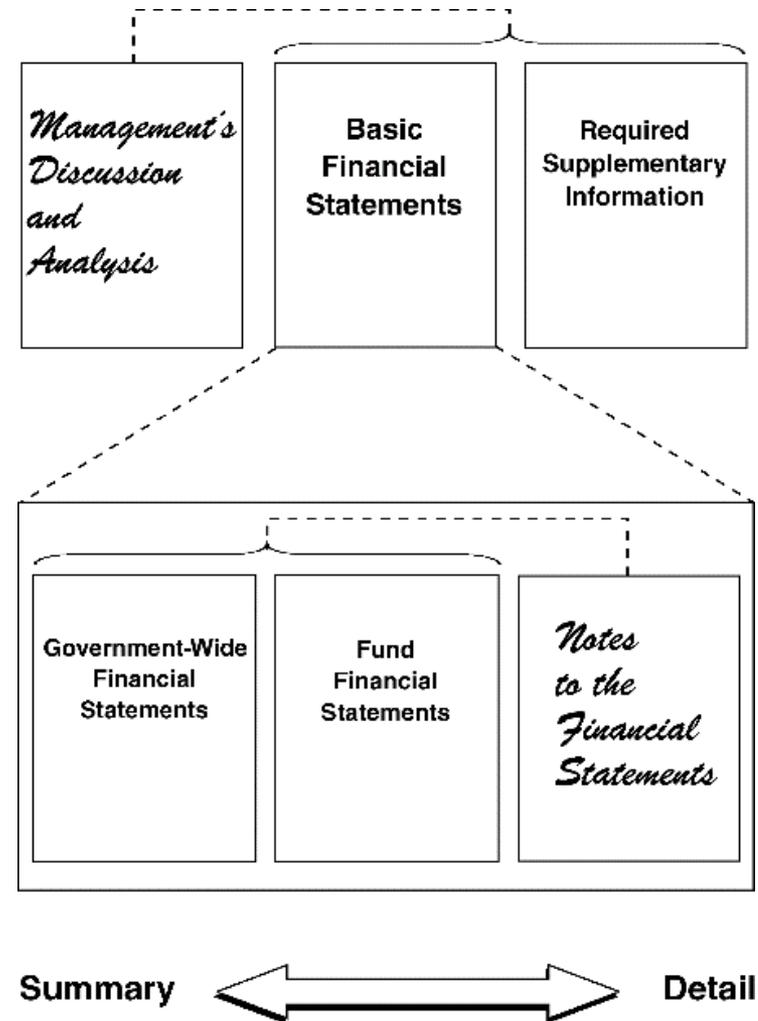
Financial Reporting Pyramid



- Management's Discussion and Analysis:
 - Objective analysis of financial activities
 - Comparison to prior year
 - Focus on primary government

MD&A in Relation to Other Components

- Graphic from sample MD&A found in the original GASB 34 implementation guide



MD&A Basics

- GASBS 34, ¶18:
 - The basic financial statements should be preceded by MD&A, which is required supplementary information (RSI). MD&A should provide an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions, or conditions.

MD&A Basics

- GASBS 34, ¶18:
 - The financial managers of governments are knowledgeable about the transactions, events, and conditions that are reflected in the government's financial report and of the fiscal policies that govern its operations. MD&A provides financial managers with the opportunity to present both a short- and a long-term analysis of the government's activities.

MD&A Basics

- GASBS 34, ¶19:
 - MD&A should discuss the current-year results in comparison with the prior year, with emphasis on the current year. This fact-based analysis should discuss the positive and negative aspects of the comparison with the prior year. The use of charts, graphs, and tables is encouraged to enhance the understandability of the information.

MD&A Basics

- GASBS 34, ¶10:
 - MD&A should focus on the primary government. Comments in MD&A should distinguish between information pertaining to the primary government and that of its component units. Determining whether to discuss matters related to a component unit is a matter of professional judgment...

MD&A Basics

- GASBS 34, ¶10:
 - ...and should be based on the individual component unit's significance to the total of all discretely presented component units and that component unit's relationship with the primary government. When appropriate, the reporting entity's MD&A should refer readers to the component unit's separately issued financial statements.

MD&A Basics

- GASBS 34, ¶11 (as amended):
 - MD&A requirements established by this section are discussed below in general rather than specific terms to encourage financial managers to effectively report only the most relevant information and to avoid "boilerplate" discussion. The information presented should be confined to the topics discussed in a through h, below.

MD&A Required Elements

- a. A brief discussion of the basic financial statements, including the relationships of the statements to each other, and the significant differences in the information they provide.

MD&A Required Elements

- b. Condensed financial information derived from government-wide financial statements comparing the current year to the prior year. Governments should present the information needed to support their analysis of financial position and results of operations required in c, below.

MD&A Required Elements

- b. Condensed financial information:
 1. Total assets, distinguishing between capital and other assets
 2. Total liabilities, distinguishing between long-term liabilities and other liabilities
 3. Total net assets, distinguishing among amounts invested in capital assets, net of related debt; restricted amounts; and unrestricted amounts

MD&A Required Elements

- b. Condensed financial information:
 - 4. Program revenues, by major source
 - 5. General revenues, by major source
 - 6. Total revenues
 - 7. Program expenses, at a minimum by function
 - 8. Total expenses

MD&A Required Elements

b. Condensed financial information:

9. Excess (deficiency) before contributions to term and permanent endowments or permanent fund principal, special and extraordinary items, and transfers

10. Contributions

11. Special and extraordinary items

MD&A Required Elements

- b. Condensed financial information:
 - 12. Transfers
 - 13. Change in net assets
 - 14. Ending net assets

MD&A Required Elements

- c. An analysis of the government's overall financial position and results of operations to assist users in assessing whether financial position has improved or deteriorated as a result of the year's operations.

MD&A Required Elements

c. An analysis... (continued)

The analysis should address both governmental and business-type activities as reported in the government-wide financial statements and should include reasons for significant changes from the prior year, not simply the amounts or percentages of change.

MD&A Required Elements

- d. An analysis of balances and transactions of individual funds.

The analysis should address the reasons for significant changes in fund balances or fund net position and whether restrictions, commitments, or other limitations significantly affect the availability of fund resources for future use.

MD&A Required Elements

- e. An analysis of significant variations between original and final budget amounts and between final budget amounts and actual budget results for the general fund (or its equivalent).

The analysis should include any currently known reasons for those variations that are expected to have a significant effect on future services or liquidity.

MD&A Required Elements

- f. A description of significant capital asset and long-term debt activity during the year, including a discussion of commitments made for capital expenditures, changes in credit ratings, and debt limitations that may affect the financing of planned facilities or services.

MD&A Required Elements

- g. A description of currently known facts, decisions, or conditions that are expected to have a significant effect on financial position (net position) or results of operations (revenues, expenses, and other changes in net position).

MD&A FAQ

- How should a government with comparative (2-year) financial statements present MD&A?
 - MD&A is required to address both years presented in the comparative financial statements
 - There should be three years of comparative data—the current year, the prior year, and the year preceding the prior year (with related analysis)

MD&A FAQ

- Are governments permitted to discuss other issues, not included in the requirements of paragraph 11, in MD&A?
 - No. Because MD&A is regarded as RSI, the information presented should be limited to the areas required in subparagraphs a–h, as amended.

(cont...)

MD&A FAQ

...Some governments will provide only minimal information to meet each requirement, whereas others will provide additional analytical or descriptive data. There is no limit (other than perhaps readability) to the information that may be provided *if it provides additional details about the required elements in those subparagraphs.*

MD&A FAQ

- Can the comparison of condensed financial information be provided with charts and graphs?
 - No. The information required by paragraph 11(b) should be presented in the form of *condensed financial statements*. Charts and graphs may be used to supplement, or elaborate on, information in the condensed statements, but should not be used *in place of them*.

MD&A FAQ

- In the discussion of significant general fund budget variances, is it sufficient to state that the original budget was increased to cover higher-than-expected expenditures?
 - No. MD&A is required to provide an analysis of significant budget variances. The analysis should discuss reasons for those variances.

MD&A FAQ

- What are “currently known facts, decisions, or conditions” that may need to be discussed in MD&A?
 - “Currently known” means to have been aware of as of the date of the auditor's report. This discussion should be based on events or decisions that have already occurred or have been enacted, adopted, agreed upon, or contracted. Governments should not discuss in MD&A the *possible* effect of events that *might* happen.

Additional Considerations

- MD&A is categorized by GAAP as “required supplementary information”
 - Frequently not actually “required” in the traditional sense (by bankers, OMB, etc.)
 - Auditors do not actually opine on MD&A
 - Omitting MD&A will not result in an opinion modification, but will be reported

Auditor Responsibility for RSI

- Auditor's perform limited procedures on RSI:
 - Inquire of management about the methods of preparing the RSI and its presentation
 - Compare the RSI with the audited FS and other knowledge obtained for consistency
 - Obtain written representations from management

Auditor Responsibility for RSI

- Auditor include an explanatory paragraph in the auditor's report on RSI:
 - Identify who requires the RSI, and that it is not part of the basic financial statements
 - Either that the auditor performed limited procedures on the RSI, or that it was omitted
 - Indicate that the auditor does not express an opinion or provide any assurance on the RSI

Auditor Responsibility for RSI

Auditor's Opinion (excerpt)

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on page XX be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be **an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.** (cont...)

Auditor Responsibility for RSI

We have applied certain **limited procedures** to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of **inquiries of management** about the methods of preparing the information and **comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements.** We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Telling Your Government's Story

- Potential users of general purpose external financial statements
 - Legislators
 - Investors/creditors
 - Grantor agencies
 - Citizens

Telling Your Government's Story

- To many people, governmental financial statements read like a phone book
- MD&A is your opportunity to present an “easily readable analysis” that they can actually understand
- Avoid accountant-speak

Telling Your Government's Story

1. Are we better off or worse off than last year?
2. What are the biggest financial threats to our government?
3. Are we cheating our kids?
4. Are we maintaining our infrastructure?
5. Is the story as complete as possible?

Common Problems to Avoid

- Having your auditors prepare it for you (aka: AD&A)
- Summarizing data from the basic financial statements without explaining it (aka: MD&_)
- Including items not prescribed by GAAP (who puts the “R” in “RSI”?)

Common Problems to Avoid

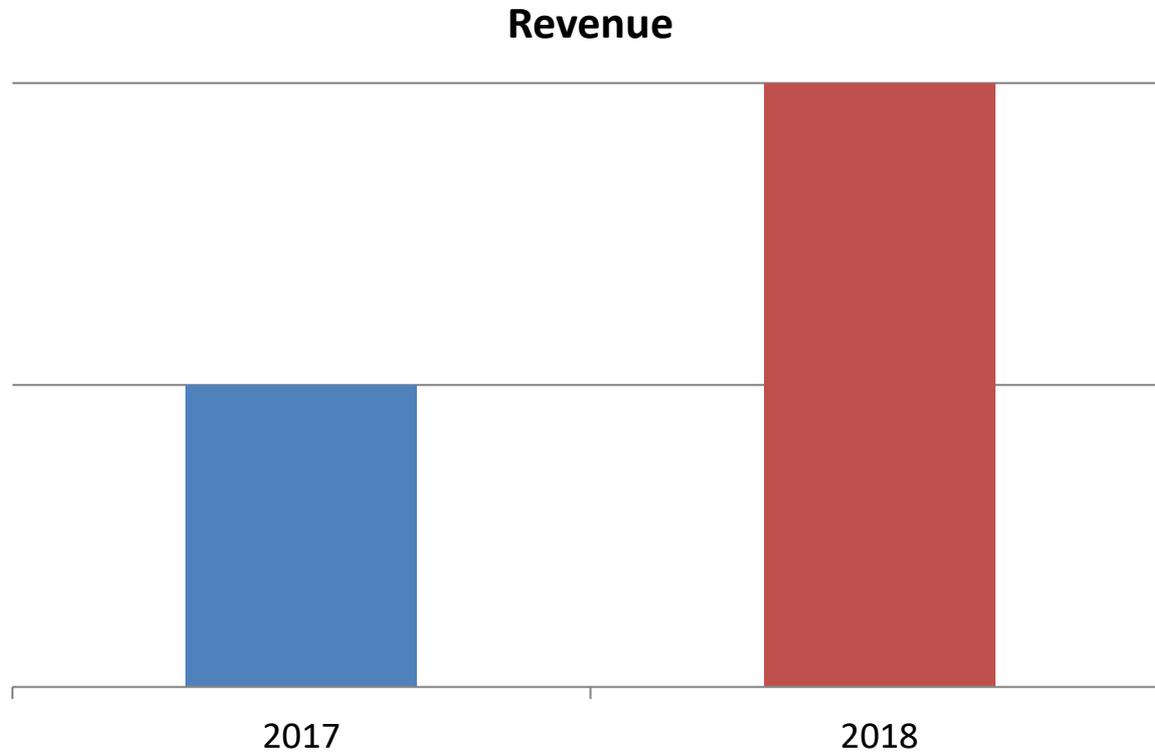
- Wrong level of detail on summary F/S
 - Capital vs. other assets
 - Long-term vs. other liabilities
- Boiler-plate language
- “Elevator analysis”
- Explanations that are illogical

Common Problems to Avoid

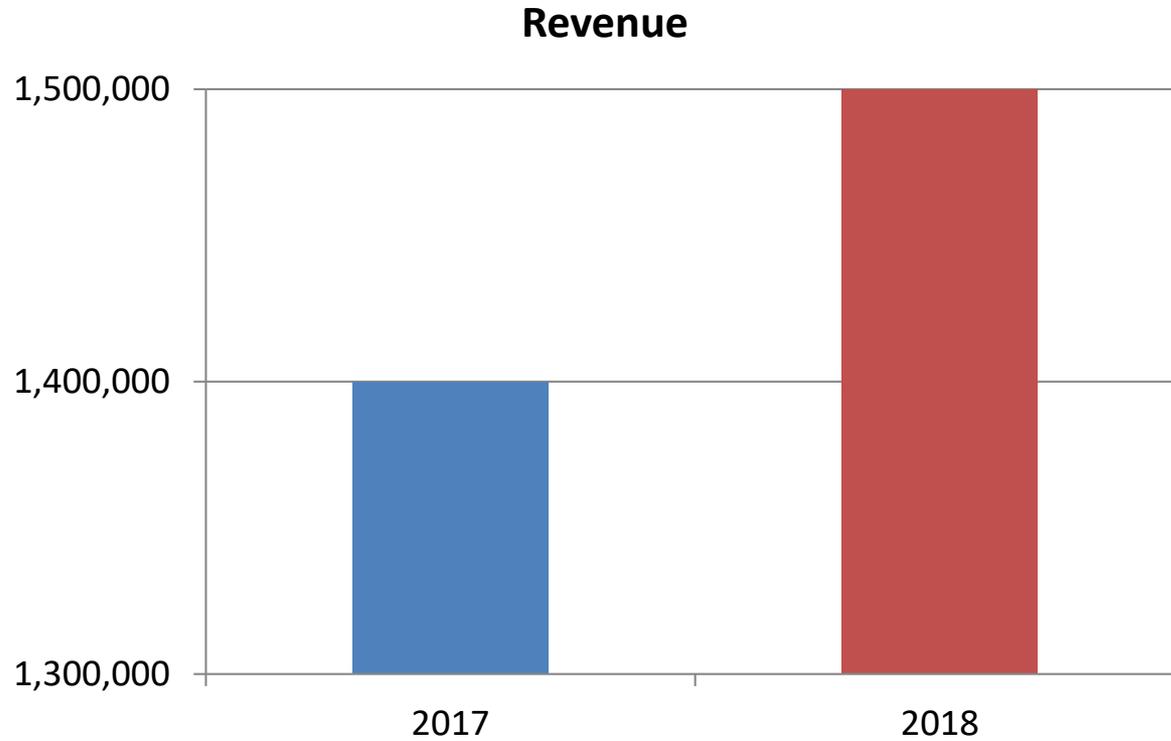
- Misleading charts and graphs
 - Attribute bias
 - 3-D perspective

*“There are three kinds of lies:
lies, damned lies, and statistics.” - Mark Twain*

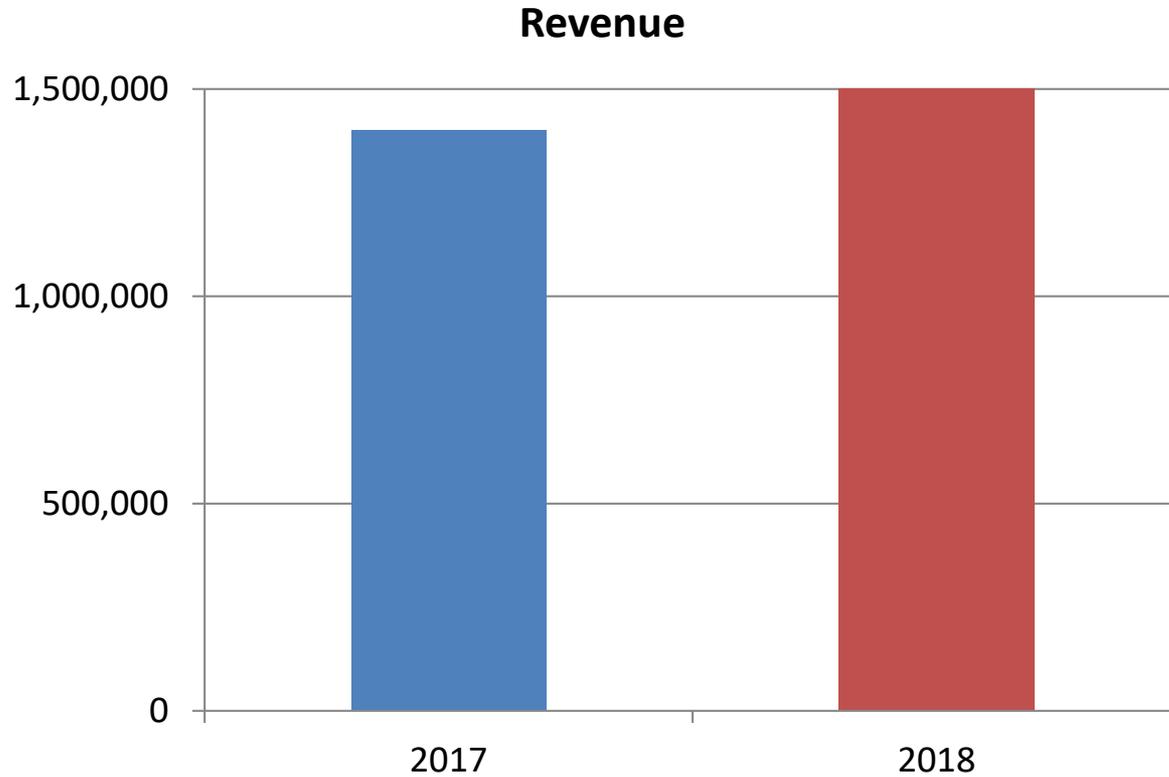
Attribute Bias



Attribute Bias

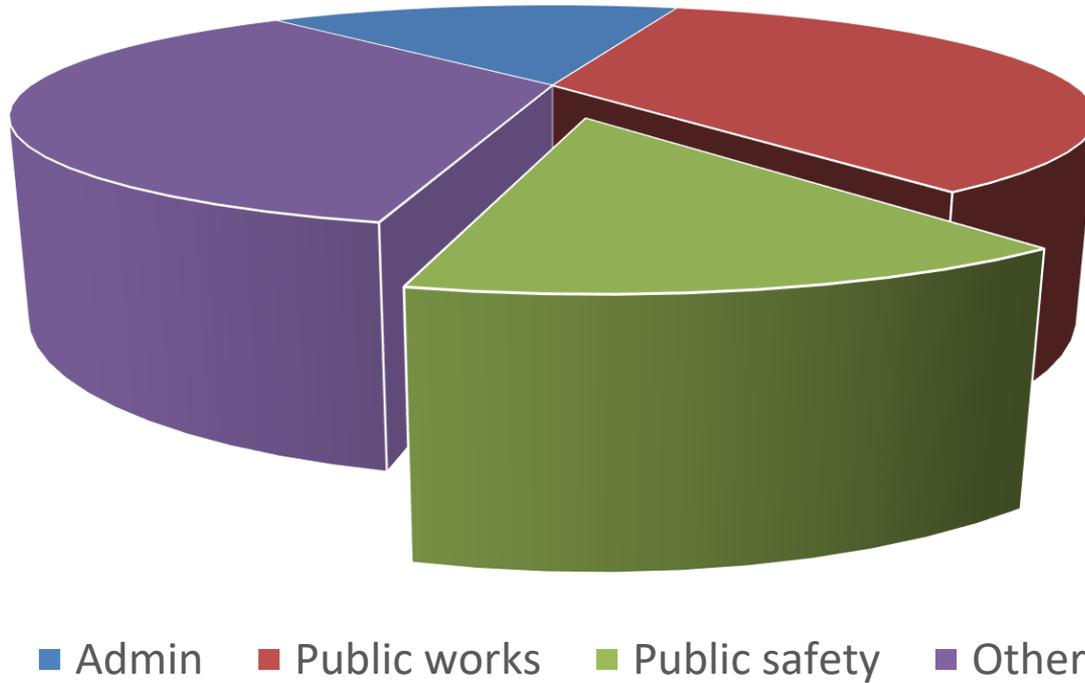


Attribute Bias



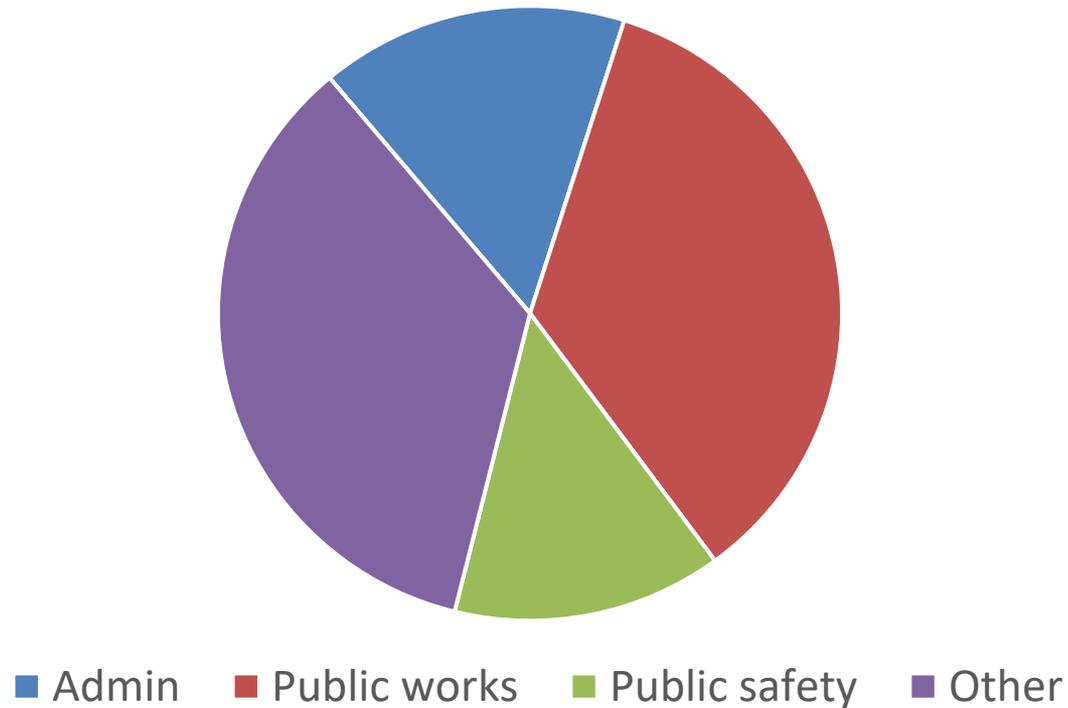
3-D Perspective

Expenditures

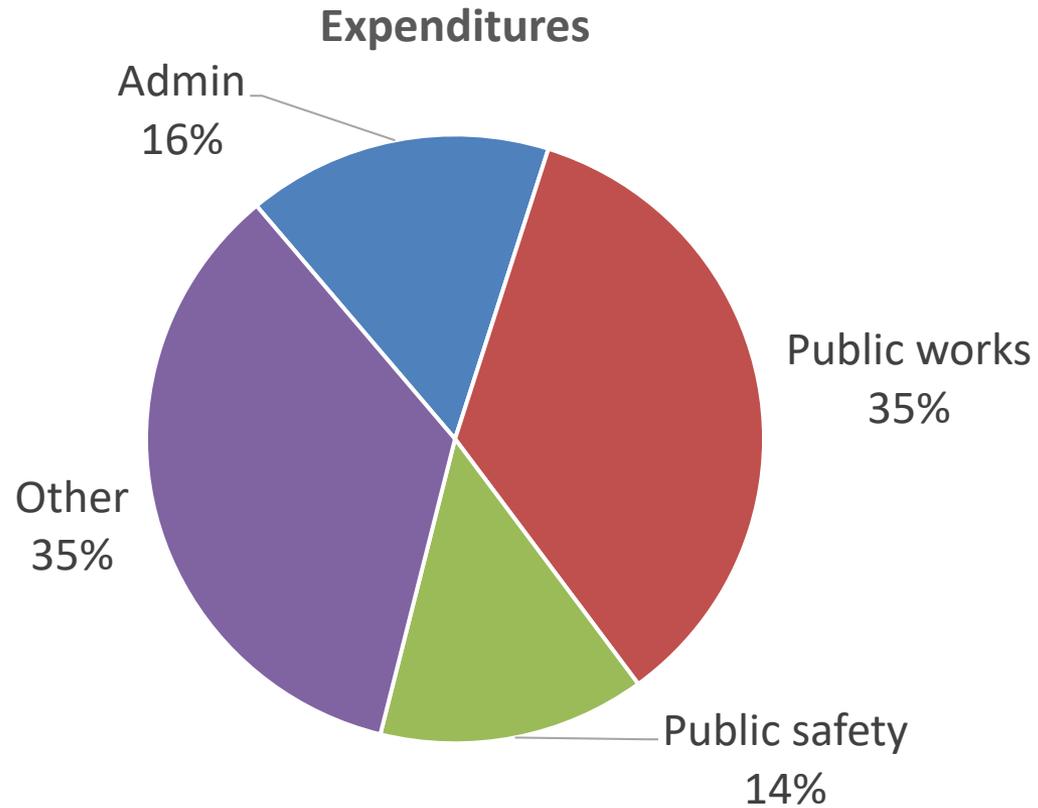


3-D Perspective

Expenditures



3-D Perspective



GFOA Recommendations

- Issues from the CAFR Certificate Program
 - Missing the analysis
 - Reasons for significant changes in fund balance/fund net position – not just dollar amount or percentage of changes
 - Any restrictions, commitments, or other limitations significantly affect fund resources for future use
 - Not addressing all major funds with significant changes in fund balance/net position

GFOA Recommendations

- Issues from the CAFR Certificate Program
 - Deferred outflows and inflows are separate elements (don't combine/net)
 - Condensed statement of activities - include the ending net position
 - Amounts in MD&A should agree with amounts reported in financial statements

Sample MD&A

- MD&A examples
 - GASB implementation guide 2015-1 (App. B7-1)
Illustration A: Municipal Government
 - GFOA Blue Book Appendix D
http://gfoa.org/sites/default/files/u2/AppendixD_final2012.pdf

Questions?



For more information...



CPAs & Consultants • Wealth Advisors • Corporate Investigation



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