

Management Discussion & Analysis (MD&A)

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Agenda

- Purpose
- Requirements
- 8 Elements of the MD&A
- MD&A vs. Letter of Transmittal (CAFR's)
- Common Deficiencies
- MD&A in an audit
- Exercises
- Best Practices

Purpose

■ Purpose

- To provide an *objective and easily readable analysis* of the entity's F/S (short & long-term)
- Should summarize, rather than repeat, the detailed information presented in the notes.
- Both positive and negative aspects
- Based on currently known facts, decisions, and conditions as of date of auditor's report
- Basically, tell a story!

Requirements

■ Requirements

- Required for GAAP Basis F/S. Optional for GASB 34 Look-a-like F/S (However, everyone is doing it). Do not report under Regulatory Basis F/S
- Specific requirements are both the minimum and maximum – Up to 8 separate elements
- “Required Supplemental Information” presented prior to the Basic Financial Statements

Requirements

■ Requirements (cont.)

- Discussion must be factual, no “what if” scenarios
- Discussion must provide not only **WHAT** changed but **WHY** it changed (Standard requirement)
- Focus on the primary government
 - But will include discussion on individual Major Funds and the Budgetary Statement for the General Fund.

8 Elements

- Element #1 Discussion of the basic financial statements. Overview of items in summary reconciliation between governmental fund financials and government-wide financials.
 - Example: Why did Cash increase? Why did Taxes decrease?
- Element #2 Condensed comparative data from the F/S for governmental and business-type activities
 - Statement of activities general revenue – property taxes in total instead of by levy
 - Short vs. long-term
 - Comparative statements/information, not only charts/graphs (can be used to help present the data)
 - NOTE-if comparative F/S are presented, MD&A should cover 3 years of information/analysis

Condensed Comparative Data

Explanation: The condensed data should include:

- Total assets (distinguishing between capital assets and other assets);
- Total liabilities (distinguishing between long-term liabilities and other liabilities);
- Total net position (distinguishing *net investment in capital assets*, *restricted net position*, and *unrestricted net position*);
- Program revenues (by major source);
- General revenues (by major source);
- Total revenues;
- Program expenses (at least by function);
- Total expenses;
- Excess or deficiency (before any contributions to term and permanent endowments, contributions to permanent fund principal, special items, extraordinary items, and transfers);
- Contributions;
- Special and extraordinary items;
- Transfers;
- Change in net position;
- Ending net position from the statement of activities.

8 Elements, con't

- Element #3 Overall financial position and results of operation at the Entity-Wide Level – improving or deteriorating and the reasons “why”
- Element #4 Balances and transactions of individual major funds (governmental and enterprise)
 - recommended for anything significant occurring within non-major funds

8 Elements, con't

- Element #5 Significant budgetary variances – General Fund Only
 - Original vs Final
 - Final vs Actual
 - Both Revenue and Expenditures
 - What and “why” for the variances
 - Purpose of the Original was to primarily hold entities responsible for their initial budgeting

8 Elements, con't

- Element #6 Description of significant Capital Assets and Long-Term Debt activity
 - Major purchases/disposal or debt issuances
 - Any changes in credit ratings or significant changes in debt limits that could effect future financing
 - Exclude Special Assessment Debt where there is NO entity obligation, unless used for capital assets of the entity
 - Including references to applicable Note Disclosures for further information
- Element #7 Discussion on infrastructure (if the modified approach his used). Rare in Ohio.

Element #7 - Requirements

- Infrastructure – modified approach
 - Option of reporting qualified networks or subsystems of infrastructure
 - Eliminates reporting of depreciation expense
 - Discussion points:
 - Significant changes in condition level;
 - Current condition level vs. target level;
 - And significant differences between amount estimated to be necessary for maintaining at target condition level vs. actual expenses.

8 Elements, con't

- Element #8 Current, Significant Economic Factors – Discussion of *currently know facts, conditions and decisions* that will impact future operations (May not even have any). Examples:
 - New/Lost tax levy
 - Fiscal Watch/Emergency
 - Lawsuit settlement
 - Building loss (fire or other)
 - Issuance of debt
 - Covers items through the Auditor's Opinion Date

Examples of Currently Known Facts - MD&A

Explanation: "Currently known facts, conditions, or decisions" are those known by management as of the date of the independent auditor's report. Examples of items that meet the criteria and should be discussed in MD&A include:

- *The award and acceptance of a major grant;*
- *The adjudication of a significant lawsuit;*
- *The reassessment of taxable property;*
- *The completion of an agreement to locate a major manufacturing plant in the government's boundaries;*
- *A renegotiated labor contract with employees;*
- *A flood that caused significant damage to a government's infrastructure.*

The emphasis is on things that have actually happened rather than those that might happen (e.g., the possible award of a grant, the potential for the location of a major business within the government's boundaries).

Who Prepares MD&A?

- Government's Fiscal Officer (traditionally)
- Even if prepared by a Independent Account/compilation team, still the responsibility of the government
 - This is true for everything the audit opinion covers actually, even though the MD&A is technically not “audited”

MD&A vs. Letter of Transmittal

- LoT – Reported in CAFR's only
- Avoid duplication of information
- MD&A – limited to what happened
- LoT – more subjective, such as potential events

Common Deficiencies

- Common deficiencies in the MD&A
 - Financial Highlights incomplete
 - Inaccurate financial data vs F/S, including after audit adjustments
 - Prior year amounts within tables not updated or not updated for any restatements
 - Discussion only provides **WHAT** changed and not **WHY** it changed
 - Fund analysis excludes a major fund
 - Lack of discussion for the General Fund budget variances

Common Deficiencies

- Common deficiencies in the MD&A, continued
 - Lack of description of significant capital asset “activity” during the year (GAAP Basis Reporting only)
 - Too often we see “C/A increased due to additions exceeding depreciation expense”. However, there was a major project.
 - Lack of description of significant long-term debt “activity” during the year
 - New Debt issued or a debt refunding

Relation to Audit

- Unaudited
- Auditor performs limited procedures:
 - Inquiry of management
 - Comparison of relevant information and/or support
 - Included in the written management representations (ie the Management Representation letter you provide at end of an audit)

Exercises

- Which of the following statements would qualify as “*analysis*”?
 - A. Sales tax revenues decreased by five percent during the period.
 - B. Sales tax revenues decreased more sharply than revenues from fees and charges during the period.
 - C. Sales tax revenues decreased because of a substantial decline in motor vehicles sales at local car dealerships.
 - D. All of the above.

Exercises

- What is the required focus of the analysis of balances and transactions in the individual funds section?
 - A. The general fund
 - B. Major governmental funds
 - C. Major enterprise funds
 - D. All of the above

Exercises

- What is the required focus of the analysis of budgetary variances?
 - A. The general fund
 - B. Major special revenue funds
 - C. All governmental funds
 - D. Both A and B

Exercises

- The analysis of budgetary variances should address:
 - A. Differences between original budgets and the final amended budget
 - B. Differences between the final amended budget and actual amounts
 - C. Differences between the original budgets and actual amounts
 - D. Both A and B
 - E. All of the above

Exercises

- Which of the following might properly be addressed in MD&A that satisfies the 8th Element?
 - A. The potential award of a major grant.
 - B. Negotiations to attract a new employer.
 - C. Plans to raise the local option sales tax.
 - D. All of the above.
 - E. None of the above.

Exercises

- Which of the following best describes the proper use of graphs and charts?
 - A. Can be used to supplement the presentation of condensed financial information.
 - B. Can be used as a replacement for the presentation of condensed financial information.
 - C. Both A and B
 - D. None of the above.

MD&A Best Practices

- Begin updating accrual work papers to include comments as to why accrued amounts changed from a PY
- Keep a list of large one time events that occur during the year (major purchase, debt issuance, etc.)
- Set up F/S shells with extra tabs. Copy over prior year info and link current year info and add some formulas of variances, % changes, ratios, etc for common discussions items within the MD&A
- Add graphs and charts to your MD&A to make it more reader friendly



QUESTIONS?

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