

VOLUME 6B, CHAPTER 3: “AGENCY HEAD MESSAGE, MANAGEMENT’S DISCUSSION AND ANALYSIS, PERFORMANCE SECTION, FINANCIAL SECTION, AND OTHER INFORMATION”

SUMMARY OF MAJOR CHANGES

All changes are denoted by [blue font](#).

Substantive revisions are denoted by an asterisk (*) symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by [bold, italic, blue, and underlined font](#).

The previous version dated [May 2012](#) is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
Multiple	Updated hyperlinks.	Revision
030102	Added “Authoritative Guidance” paragraph in accordance with current administrative instructions.	Addition
0302	Updated reference to Agency Head Message as an optional inclusion to the Agency Financial Report per Office of Management and Budget (OMB) Circular A-136.	Revision
030309	Added information on compliance assessment and assurance statement per OMB Circular A-136.	Addition
030604	Added paragraph on Fraud Reduction Report to comply with OMB Circular A-136.	Addition
030606	Added paragraph on Reduce the Footprint to comply with OMB Circular A-136.	Addition
030607	Added paragraph on Civil Monetary Penalty Adjustment for Inflation to comply with OMB Circular A-136.	Addition
030608	Added paragraph on Grants Oversight and New Efficiency Act Requirements to comply with OMB Circular A-136.	Addition

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CHAPTER 3

**AGENCY HEAD MESSAGE, MANAGEMENT'S DISCUSSION AND ANALYSIS,
PERFORMANCE SECTION, FINANCIAL SECTION, AND OTHER INFORMATION**

0301 GENERAL

030101. Purpose

The Agency Head Message, the Management's Discussion and Analysis (MD&A), the Performance Section, [the Financial Section](#), and Other Information (OI) are components of the Agency Financial Report (AFR) applicable to Office of Management and Budget (OMB) reporting entities [identified](#) in Chapter 1, paragraph 010401. Within the guidance of OMB Circular [A-11](#), "Preparation, Submission, and Execution of the Budget," and [OMB Circular A-136](#), "Financial Reporting Requirements," the Department of Defense (DoD) prepares and submits the AFR [and](#) a separate Annual Performance Report (APR). DoD reporting entities are required to prepare the AFR according to the policies prescribed by OMB Circular A-136 as implemented in this volume. These formats and instructions provide a framework within which individual agencies have flexibility to provide information useful to the Congress, agency managers, and the public. Subcomponents are not required to prepare an APR. Within the AFR framework, subcomponents are not required to prepare OI, but may choose to do so using the format specified in this chapter.

*030102. Authoritative Guidance

The primary authoritative guidance for this chapter is Title 31, United States Code (U.S.C.), [section 3515](#), "Financial Statements of Agencies," and OMB Circular A-136. Additional authoritative sources are referenced throughout the chapter.

*0302 AGENCY HEAD MESSAGE

[An agency has the option to include](#) a dated transmittal letter signed by the agency head to be located at the beginning of the report. [If included](#), it must include a brief message from the agency head highlighting:

- A. The agency's mission, goals, and accomplishments upholding the mission;
- B. An assessment of whether financial and performance data in the report is reliable and complete, identifying material internal control weaknesses and corrective actions the agency is taking to resolve them (the letter may reference a more detailed discussion of this topic elsewhere in the report); and
- C. An acknowledgement the agency is using an alternative to the Performance and Accountability Report (PAR). DoD prepares the AFR [and](#) APR, [but does not prepare the optional Summary of Performance and Financial Information](#).

0303 MD&A

030301. General

The MD&A should provide a clear and concise description of the reporting entity's performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems. To be useful, the MD&A must be concise, easy to read to a non-technical audience, and use visual references to present summary information. The MD&A should focus on the most important matters and provide a balanced analytical assessment of key program and financial performance that includes both positive and negative information. The MD&A should provide management's view of actual current performance and financial results, as well as expectations about the future. It should be grounded in facts and provide meaningful explanatory data to support an accurate assessment of agency performance by the audience. The MD&A should present a balanced discussion of negative as well as positive results, and it should relate financial results, especially costs, to performance and strategic goals.

030302. Highlights

The MD&A should include select highlights of key performance goals and results (shortfalls and successes) for the applicable year related to strategic goals. The agency should also provide a high-level discussion of selected key performance measures associated with the agency's goals. The high-level discussion need not provide a thorough detailed analysis and summary of performance results for the year, as this information will be provided in the APR to be issued in conjunction with the President's Budget. It should clearly delineate the details on when and where the APR will be available to the public.

030303. Purpose

The MD&A should serve as a brief overview of the entire annual financial report. Conformance to generally accepted accounting principles (GAAP) for federal entities requires the inclusion of the MD&A in the financial statements and related information. The MD&A should inform the reader, at a high level, on progress toward accomplishing the entity's mission and associated strategic goals. The discussion should deal with the most important matters that would likely affect the judgments and decisions of people who rely on the AFR as a key source of information. It should address most important matters that could:

- A. Lead to significant actions or proposals by senior management;
- B. Be significant to the managing, budgeting, and oversight functions of Congress and the Administration; or
- C. Significantly affect the judgment of stakeholders about the efficiency and effectiveness of the entity.

030304. Responsibility

Management is responsible for the content of the MD&A. Its preparation should be a joint effort of both the financial management office and program offices. Management has considerable discretion in preparing and presenting the MD&A, subject to the inclusion of the required components and the pervasive requirement that the MD&A not be misleading. The MD&A provides management with a vehicle for communicating insights about the entity, increasing the understandability of financial information, and providing information about the entity, its operations, service levels, successes, challenges, and the future. The preparer must develop and retain adequate documentation supporting the financial, statistical, and other information presented in the MD&A section.

030305. Scope

The MD&A is an integral part of the AFR and should be regarded as Required Supplementary Information (RSI). The [MD&A reporting](#) requirements are summarized in Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards ([SFFAS](#)) 15 and [Statement of Federal Financial Accounting Concepts 3](#). Pursuant to SFFAS 15, the MD&A may reference information in other discrete sections of the financial statement, or it may be based on information contained in reports separate from the financial statement. In addition, the MD&A must include a brief overview or executive summary explaining the MD&A. An overview section gives the reader a useful summary of what is to come. Some agencies include an overview or executive summary in the “Mission and Organizational Structure” section of the MD&A. At a minimum, the MD&A should address the entity’s:

- A. Mission and organizational structure;
- B. Performance goals, objectives, and results;
- C. Financial statements;
- D. Systems, controls, and legal compliance; and
- E. Forward-looking information about the possible effects of the most important existing performance and financial demands, events, conditions, and trends. Management should discuss important problems that need to be addressed and actions that have been planned or taken to address such problems. The actions that are needed, planned, and taken must be discussed within the sections listed in this paragraph or in a separate section of the MD&A.

030306. Mission and Organizational Structure

The MD&A should contain a brief description of the mission(s) of the entity and describe its related organizational structure, consistent with the entity's strategic plan. This section should:

- A. Name the reporting entity in a clear manner that leaves no doubt as to whether the reporting entity is an entire organization or an activity or group of activities within an organization;
- B. Identify the commercial functions and the revolving, trust, and other fund accounts covered by the financial statements;
- C. State the mission and major goals of the reporting entity, including reference to the entity's legislative mandate, if appropriate;
- D. Identify the type and provide information on the numbers of individuals and/or groups served by or benefiting from the entity's major program(s);
- E. Provide indicators of the size of the major program(s) (e.g., dollars expended, population served, and the numbers of military and civilian personnel employed in carrying out the major program(s));
- F. Describe the manner in which the reporting entity is organized to provide the major program(s), including information related to the geographic locations of the organization (e.g., numbers of local, district, state, and regional offices); and
- G. Include a discussion and analysis of those matters the entity's management believes could lead to significant actions or proposals by senior management or significantly affect the judgment of stakeholders about the effectiveness of the entity.

030307. **Performance Goals, Objectives, and Results**

The MD&A should highlight the "most important" performance goals and results (positive and negative) for the applicable year related to and consistent with goals and objectives in the entity's strategic and performance plans, including performance trend data. This applies to goals being evaluated by quantitative and descriptive criteria. For agencies producing an AFR and APR, the agency should provide a high-level discussion of key performance measures and goals. The high level discussion of performance information should include the most important performance matters that would likely affect the judgments and decisions of people who rely on the AFR as a key source of information. The MD&A should include a discussion and analysis of those matters that the entity's management believes could: 1) lead to significant actions or proposals by senior management; or 2) significantly affect the judgment of stakeholders about the effectiveness of the entity.

030308. **Analysis of Financial Statements and Stewardship Information**

The MD&A should help users understand the entity's financial results, position, and condition conveyed in the principal financial statements. The MD&A should include comparisons of the current year to the prior year and should provide an analysis of the agency's overall financial position and results of operations to assist users in assessing whether the financial position has improved or deteriorated as a result of the year's activities. This section should also include a

discussion of key financial related measures emphasizing financial trends and assessing financial operations. Additionally, it should give users the benefit of management's understanding of the following:

- A. Major changes in types or amounts of assets, liabilities, costs, revenues, obligations, and outlays (explaining the underlying causes of the changes);
- B. Relevance of particular balances and amounts shown in the principal financial statements, particularly if relevant to important financial management issues;
- C. Entity's stewardship information; and
- D. In addition, the following items may be useful to include in the financial statement analysis:
 1. Explanations for variances exceeding ten percent and are material to the agency;
 2. Significant issues qualitative in nature and relating to financial management; and
 3. Overall financial condition and financial management issues occurring since the previous reporting period that impact the agency's current financial status.

***030309. Analysis of Systems, Controls, and Legal Compliance**

A. Agencies are required to provide assurances to the status and effectiveness of the internal controls and financial management systems that support the preparation of the financial statements. Management should provide its assurances related to the Federal Managers' Financial Integrity Act of 1982 ([FMFIA](#)) and its compliance determination required by the Federal Financial Management Improvement Act of 1996 ([FFMIA](#)) in a separate section entitled "Management Assurances." The FMFIA assurance statement should:

1. Provide management's assessment of the effectiveness of the organization's internal controls to support effective and efficient programmatic operations, reliable financial reporting and compliance with applicable laws and regulations, and whether the financial management systems conform to relevant financial systems requirements;
2. Provide a separate assessment of the effectiveness of the internal controls over financial reporting as a subset of the overall FMFIA assurance statement; and
3. Include a summary of material weaknesses and non-compliance, a summary of assurance, and a summary of corrective actions to resolve the material weaknesses and non-compliance. Illustrative assurance statements and further guidance on corrective action plans can be found in [OMB Circular A-123](#), "Management's Responsibility for Enterprise Risk Management and Internal Control."

B. Management should include its FFMIA compliance assessment in this section. Management is required to provide its assessment of the organization's financial management systems compliance with the federal financial management systems requirements, standards promulgated by FASAB, and the U.S. [Standard General Ledger](#) at the transaction level. Financial management systems include both financial and financially-related (or mixed) systems. Further guidance on the financial systems requirement can be found in [OMB Circular A-123, Appendix D, "Compliance with the Federal Financial Management Improvement Act of 1996."](#) Briefly discuss the agency's financial management systems strategy and how it will achieve the goals of improving financial and budget management agency-wide. Include an overview of the agency's current and future financial management systems framework and a synopsis of critical projects currently underway or planned to achieve the target framework. For areas of FFMIA non-compliance, the agency must identify remediation activities that are planned and underway and include projected dates to achieve compliancy.

C. Management should also review its FMFIA assurance statements and its FFMIA compliance determination for consistency with the findings specified in the annual financial statement audit report(s). The Office of [the Inspector General \(OIG\)](#) or auditor [must](#) compare material weaknesses disclosed during the audit with those material weaknesses reported in the agency's FMFIA report and document any material weaknesses disclosed by audit that were not reported in the agency's assurance statements. The [financial](#) audit responsibilities are established in [OMB Bulletin 17-03](#), "Audit Requirements for Federal Financial Statements," Section 6. The reports may be different, but they should not be in direct conflict. When conflicting discrepancies exist, it is management's responsibility to ensure that outstanding issues are reported appropriately. [For material weaknesses related to an error requiring a restatement, if the agency asserted in its MD&A that it received an unmodified opinion on any previously issued financial statement, management should include a high-level discussion of the events that gave rise to the restatement, which should include the nature of the error.](#)

030310. Other Management Information, Initiatives, and Issues

Management has the discretion to include a summary in the MD&A of other information, initiatives, and issues it identifies. This could include [a summarization of entity progress towards implementation of key management initiatives and financial management systems framework.](#) The AFR should present an overview of the agency's current and future financial management systems framework and describe financial management systems critical to effective agency-wide financial management, financial reporting, or financial control. The AFR should include in the overview a synopsis of critical projects currently underway or planned to achieve the target framework per [OMB Memorandum M-13-08](#), "Improving Financial Systems Through Shared Services;" [OMB Memorandum M-13-09](#), "Fiscal Year 2013 PortfolioStat Guidance: Strengthening Federal IT Portfolio Management;" and [OMB Circular A-123, Appendix D](#). Identify FFMIA remediation activities that are planned and underway, describing target dates and offices responsible for bringing systems into substantial compliance with FFMIA.

030311. Limitations of the Financial Statements

The MD&A should include a section articulating the limitations of the principal financial statements. This section should state the following:

A. The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the legislative requirements of 31 USC § 3515 (b);

B. While the statements have been prepared from the books and records of the entity in accordance with GAAP for federal entities and the formats prescribed by OMB Circular A-136, the statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records; and

C. The statements should be read with the realization that they are for a Component of the U.S. Government, a sovereign entity.

0304 PERFORMANCE SECTION

DoD has chosen to produce an AFR and APR. The APR is included with the Congressional Budget Justification. [Additional guidance on the Performance Section](#) can be found in OMB Circular A-136, Section II.3.

0305 FINANCIAL SECTION

The [Financial](#) Section of the AFR [must](#) contain the Auditor's Report and Financial Statements [and Notes](#). The guidance for the Financial Statements and Notes is in Chapters 4 through 10.

0306 OI

The [OI](#) section of the AFR follows the RSI section of the statements and should contain the following, when appropriate and applicable:

030601. Management Challenges

OMB Circular A-136 states the PAR or AFR [must](#) include a statement prepared by the agency's [OIG](#) summarizing what the [OIG](#) considers the most serious management and performance challenges facing the agency and briefly assesses the agency's progress in addressing those challenges. This statement must be provided to the agency head at least 30 days before the AFR due date. These audit responsibilities are established in OMB [Bulletin 17-03](#), Section 12, paragraph 12.1. Comments by the agency head may be appended to the [OIG](#)'s statement. The agency head may comment on, but not modify the [OIG](#) statement. Additional guidance can be found in OMB Circular A-136, OI.

030602. Summary of Financial Statement Audit and Management Assurances

Components are required to prepare a Summary of Financial Statement Audit and a Summary of Management Assurances. OMB Circular A-136 requires agencies to include these summaries as OI or to explain how and why DoD uses an alternative method for reporting that information. Each material weakness should be listed using a unique, short, and easily understood name. These names should be kept constant, so that a weakness reported in FMFIA sections or by the auditor has the same name. To the extent possible, weakness names should also be kept constant from year to year. Significant deficiencies are not required to be reported. Refer to OMB Circular A-136 for additional guidance regarding format and content of the summary report.

030603. [Payment Integrity](#)

Guidance for reporting improper payments is contained in Volume 4, Chapter 14 and OMB Circular A-136, Section II.5.5.

*030604. [Fraud Reduction Report](#)

[Under the Fraud Reduction and Data Analytics Act of 2015 \(Public Law 114-186, Title 31 U.S.C., section 3321\)](#), each agency must include in its AFR or PAR a report on its fraud reduction efforts undertaken. This requirement became effective beginning with the final quarter of Fiscal Year (FY) 2016. The report must include information on the agency's progress in implementing financial and administrative controls established pursuant to the Act, the fraud risk principle in the Standards for Internal Control in the Government, and OMB Circular A-123 with respect to leading practices for managing fraud risk. The report must also include information on agency progress in identifying risks and vulnerabilities to fraud (including with respect to payroll, beneficiary payments, grants, large contracts, and purchase and travel cards) and agency progress on establishing strategies, procedures, and other steps to curb fraud.

030605. Other Supporting Statements for Foreign Military Sales (FMS) Reporting

DoD administers FMS programs on behalf of the Executive Office of the President. Principal statements must be prepared for all applicable FMS-related trust, general, and revolving funds. The Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Budgetary Resources will be reported as OI.

*030606. [Reduce the Footprint](#)

Consistent with Section 3 of the [OMB Memorandum M-12-12](#), "Promoting Efficient Spending to Support Agency Operations," and OMB Management Procedures Memorandum [2015-01](#) (the "Reduce the Footprint" policy implementing guidance), all Chief Financial Officers Act entities must set annual targets to reduce the total square footage of their domestic office and warehouse inventory compared to the FY 2015 baseline. Pursuant to the requirements in the "Reduce the Footprint" policy implementing guidance, agencies must:

A. Report the total square office and warehouse footage associated with the agency's assets subject to the "Reduce the Footprint" policy;

B. Report the annual operating costs as reported in the most recent Federal Real Property Profile submittal for owned and direct lease facilities (direct lease facilities does not include General Services Administration occupancy agreements) that are subject to the "Reduce the Footprint" policy; and

C. Provide a brief narrative highlighting actions the agency is taking to reduce its FY 2015 Reduce the Footprint office and warehouse baseline, the cost of its lease portfolio, and operation and maintenance costs of unneeded property. An illustrative table is provided for reference in OMB Circular A-136, Section II.5.8.

*030607. Civil Monetary Penalty Adjustment for Inflation

Under the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015, agencies must make annual inflation adjustments to civil monetary penalties and report on the adjustments in their AFR or PAR. Agencies are encouraged to include the illustrative table referenced in OMB Circular A-136, Section II.5.9.

*030608. Grants Oversight and New Efficiency (GONE) Act Requirements

A. All agencies must submit a brief high-level discussion on a subset of GONE Act information, including:

1. A summary table (as identified in OMB Circular A-136, Section II.5.10) of the total number of federal grant and cooperative agreement awards and balances for which closeout has not yet occurred but for which the period of performance has elapsed by more than two years; and

2. A brief narrative of the challenges leading to delays in grant and cooperative agreement award closeout and planned corrective actions to address these challenges.

B. If an agency is unable to submit all of the required information, it must explain why the information is not available or practical to collect, stating any shortcomings with and plans to improve existing grant systems, including financial management and payment data systems.