

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

SUMMARY OF MAJOR CHANGES

Changes are identified in this table and also 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 **January 2018** is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
Multiple	Updated hyperlinks.	Revision
All	Deleted multiple instances of redundant/duplicative information throughout the chapter.	Deletion
All	Deleted the Performance Section and all references to the Performance Section per Office of Management and Budget (OMB) Circular A-136, dated June 28, 2019. Previous version of paragraph 0304 was entirely deleted.	Deletion
All	Changed title of Agency Head Message to Agency Head Transmittal Letter per OMB Circular A-136, section II.1.1, dated June 28, 2019.	Revision
1.1 (030101)	Added reference to Tier 1 entities per Deputy Chief Financial Officer Memorandum, “Annual List of Department of Defense Reporting Entities (FPM 19-08),” dated August 29, 2019.	Revision
1.2 (030102)	Clarified that annual updates to OMB Circular A-136 are on the OMB website.	Revision
2.0 (0302)	Updated reference to the Agency Head Transmittal Letter as a required inclusion to the Agency Financial Report, per OMB Circular A-136, dated June 28, 2019, and deleted information no longer required by OMB Circular A-136.	Revision
3.1 (030301); (030302 & 030303) (Deleted)	Combined into a single paragraph (030301) by deleting redundant information.	Deletion

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
3.2 (030302)	Added language regarding offices responsible for performance reporting in accordance with OMB Circular A-136, section II.2.2, dated June 28, 2019.	Revision
3.3 (030303)	Clarified that a brief overview or executive summary explaining the Management Discussion & Analysis (MD&A) may be included but is not required by OMB Circular A-136, dated June 28, 2019.	Revision
030306.G (Deleted)	Deleted subparagraph 030306.G as being redundant to information in paragraph 030301.	Deletion
3.5 (030305)	Added language explaining detailed information to include in the performance discussion of the MD&A section of the annual financial report per OMB Circular A-136, section II.2.5, dated June 28, 2019.	Revision
3.6.4.4. (030306.D.4)	Added reference to an illustrative table of key measures which may be included in the financial statement analysis section of the MD&A per OMB Circular A-136, dated June 28, 2019.	Revision
3.7.2. (030307.B)	Added information on OMB memorandums, located in previous version of paragraph 030310, for better alignment of information.	Revision
3.7.3. (030307.C)	Added a note that OMB Bulletin 19-03, "Audit Requirements for Federal Financial Statements," is updated annually.	Revision
3.8 (030308)	Created a new paragraph from information in previous version of paragraph 030305, for consistency in presentation, by moving explanation of forward-looking information.	Revision
3.10 (030310) (Previous Version)	Streamlined paragraph by moving some information to paragraph 030307, for consistency in presentation, and by deleting redundant information.	Revision
3.10 (030310)	Added language clarifying that this paragraph refers to federal entities.	Revision
3.4 (0304)	Added language clarifying responsibility for preparation of the Financial Section and the location of additional clarifying guidance per OMB Circular A-136, section II.3, dated June 28, 2019.	Revision
5.1 (030501), 5.2 (030502)	Added language clarifying this section applies specifically to executive agencies per OMB Circular A-136, dated June 28, 2019.	Revision

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
030605 (Deleted)	Deleted paragraph on Foreign Military Sales after removal from the Agency Financial Report based upon Department of Defense interpretation of Statement of Federal Financial Accounting Standards 47, "Reporting Entity."	Deletion
030608 (Deleted)	Deleted Grants Oversight and New Efficiency Act section due to expiration of statutory reporting requirement.	Deletion

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CHAPTER 3

AGENCY HEAD TRANSMITTAL LETTER, MANAGEMENT'S DISCUSSION AND ANALYSIS, FINANCIAL SECTION, AND OTHER INFORMATION

1.0 GENERAL (0301)

*1.1 Purpose (030101)

The Agency Head [Transmittal Letter](#), the Management's Discussion and Analysis (MD&A), the Financial Section, and Other Information (OI) are components of the Agency Financial Report (AFR) applicable to [Tier 1](#) reporting entities [referenced](#) in Chapter 1, section 0104. Within the guidance of the Office of Management and Budget ([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. Finally, DoD does not prepare the optional Summary of Performance and Financial Information.

1.2 Authoritative Guidance (030102)

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. [Annual updates to Circular A-136 are on the \[OMB\]\(#\) website.](#)

*2.0 AGENCY HEAD TRANSMITTAL LETTER (0302)

An agency [is required](#) to include a dated transmittal letter signed by the agency head to be located at the beginning of the report. It must include a brief message from the agency head highlighting 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).

3.0 MD&A (0303)

*3.1 Purpose (030301)

The MD&A should serve as a brief overview of the entire annual financial report. 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. 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:

3.1.1. Lead to significant actions or proposals by senior management;

3.1.2. Be significant to the managing, budgeting, and oversight functions of Congress and the Administration; or

3.1.3. Significantly affect the judgment of stakeholders about the efficiency and effectiveness of the entity.

*3.2. Responsibility (030302)

Management is responsible for the content of the MD&A. Its preparation should be a joint effort of the financial management office, program offices, and offices responsible for performance reporting. Management has considerable discretion in preparing and presenting the MD&A, subject to the inclusion of the required content 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.

*3.3 Scope (030303)

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 15](#) and [Statement of Federal Financial Accounting Concepts 3](#). The MD&A may reference information in other discrete sections of the AFR, or it may be based on information contained in reports separate from the AFR. In addition, the MD&A may 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. The MD&A should clearly delineate the details on when and where the APR will be available to the public. At a minimum, the MD&A should address the entity's:

3.3.1. Mission and organizational structure;

3.3.2. Performance goals, objectives, and results;

- 3.3.3. Financial statements;
- 3.3.4. Systems, controls, and legal compliance; and
- 3.3.5. Forward-looking information.

3.4 Mission and Organizational Structure (030304)

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. The MD&A should:

3.4.1. 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;

3.4.2. Identify the commercial functions and the revolving, trust, and other fund accounts covered by the financial statements;

3.4.3. State the mission and major goals of the reporting entity, including reference to the entity's legislative mandate, if appropriate;

3.4.4. 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);

3.4.5. 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)); and

3.4.6. 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).

*3.5 Performance Goals, Objectives, and Results (030305)

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. The performance discussion should help the reader assess the relative efficiency and effectiveness of programs. The MD&A should:

3.5.1. Provide a concise assessment of the entity's overall progress toward major program goals, linking goals to cost categories or responsibility segments in the Statement of Net Cost or related notes, if possible;

3.5.2. Summarize overall (e.g., reporting entity) performance in the context of historical trends;

3.5.3. Summarize the strategies and resources the entity used to achieve its goals;

3.5.4. Summarize any significant underlying factors that may have affected the reported performance, including factors that are substantially outside the entity's control, factors over which the entity has significant control, and any anticipated or unanticipated risks;

3.5.5. Summarize plans to improve performance; and

3.5.6. Summarize the procedures management has designed and followed to provide reasonable assurance that reported performance information is relevant and reliable.

***3.6 Analysis of Financial Statements and Stewardship Information (030306)**

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:

3.6.1. Major changes in types or amounts of assets, liabilities, costs, revenues, obligations, and outlays (explaining the underlying causes of the changes);

3.6.2. Relevance of particular balances and amounts shown in the principal financial statements, particularly if relevant to important financial management issues;

3.6.3. Entity's stewardship information; and

3.6.4. In addition, the following items may be useful to include in the financial statement analysis:

3.6.4.1. Explanations for variances exceeding ten percent and are material to the agency;

3.6.4.2. Significant issues qualitative in nature and relating to financial management;

3.6.4.3. Overall financial condition and financial management issues occurring since the previous reporting period that impact the agency's current financial status; and

* 3.6.4.4. A table of information based upon the Illustrative Table of Key Measures identified in OMB Circular A-136, Section II.2.6.

*3.7 Analysis of Systems, Controls, and Legal Compliance (030307)

3.7.1. 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:

3.7.1.1. 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;

3.7.1.2. Provide a separate assessment of the effectiveness of the internal controls over financial reporting as a subset of the overall FMFIA assurance statement; and

3.7.1.3. 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."

* 3.7.2. 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, per OMB Memorandum [M-19-16](#), "Centralized Mission Support Capabilities for the Federal Government;" OMB Memorandum [M-13-09](#), "Fiscal Year 2013 PortfolioStat Guidance: Strengthening Federal IT Portfolio Management;" and [OMB Circular A-123](#), Appendix D. For areas of FFMIA non-compliance, the agency must identify remediation activities that are planned and underway and include projected dates to achieve compliance.

* 3.7.3. 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 the “Scope of the Audit” section of OMB Bulletin 19-03, “[Audit Requirements](#) for Federal Financial Statements,” which is updated annually. 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.

*3.8 Forward-looking Information (030308)

Forward-looking information includes 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.

3.9 Other Management Information, Initiatives, and Issues (030309)

Management has the discretion to include a summary in the MD&A of other information, initiatives, and issues it identifies.

*3.10 Limitations of the Financial Statements (030310)

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

3.10.1. The principal financial statements are prepared to report the financial position and results of operations of the reporting entity, pursuant to the requirements of 31 USC § 3515 (b);

3.10.2. The statements are prepared from the books and records of the entity in accordance with [Federal Generally Accepted Accounting Principles](#) and the formats prescribed by [OMB Circular A-136](#). Reports used to monitor and control budgetary resources are prepared from the same books and records; and

3.10.3. The statements should be read with the realization that they are for a Component of the U.S. Government.

*4.0 FINANCIAL SECTION (0304)

The Financial Section of the AFR must contain the Auditor’s Report and Financial Statements and Notes. The financial statements are the responsibility of agency management. The reporting entity may include a Chief Financial Officer letter summarizing planned time frames for and major impediments to correcting audit weaknesses and instances of non-compliance and the process made in addressing previously reported audit weaknesses and instances and

non-compliance. Refer to OMB Circular A-136, Section II.3.1 for additional guidance on the financial section. The guidance for the Financial Statements and Notes is in Chapters 4 through 10.

5.0 OI (0305)

The OI section of the AFR follows the RSI section of the statements and should contain the following, when appropriate and applicable.

*5.1 Management Challenges (030501)

OMB Circular A-136 states the [Performance Accountability Report \(PAR\)](#) or AFR must include a statement prepared by an [executive](#) agency's OIG summarizing what the OIG considers the most serious management and performance challenges facing an [executive](#) agency and briefly assessing the [executive](#) agency's progress in addressing those challenges. This statement must be provided to the [executive](#) agency head at least 30 days before the AFR due date. Comments by the [executive](#) agency head may be appended to the OIG's statement. The [executive](#) agency head may comment on, but not modify, the OIG statement. Additional guidance can be found in OMB Circular A-136, OI.

*5.2 Summary of Financial Statement Audit and Management Assurances (030502)

[Executive agencies](#) are required to prepare a Summary of Financial Statement Audit and a Summary of Management Assurances. [OMB Circular A-136](#) requires [executive](#) 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.

5.3 Payment Integrity (030503)

Guidance for reporting improper payments is contained in Volume 4, Chapter 14 and OMB Circular A-136, Section II.4.5.

5.4 Fraud Reduction Report (030504)

Under the Fraud Reduction and Data Analytics Act of 2015 (Public Law 114-186, Title 31 U.S.C., [§ 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.

5.5 Reduce the Footprint (030505)

Consistent with Section 3 of the [OMB Memorandum M-12-12](#), “Promoting Efficient Spending to Support Agency Operations,” and [OMB Memorandum M-17-08](#), “Amending OMB Memorandum M-12-12, Promoting Efficient Spending to Support Agency Operations,” 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:

5.5.1. Report the total square office and warehouse footage associated with the agency’s assets subject to the “Reduce the Footprint” policy;

5.5.2. 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

5.5.3. 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.4.8.

5.6 Civil Monetary Penalty Adjustment for Inflation (030506)

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.4.9.