

From Cook to Chef

Improving the Quality and Usefulness of
MD&A

Session Objectives

- Provide background regarding M D & A requirements in GASB 34 and Implementation Guide
- Discuss limitations and pitfalls of many current M D & A presentations
- Discuss ideas for making M D & A more substantive and understandable
- Discuss ideas for making M D & A more appealing to read

This Just In...

- More useful information can be gained by simply “googling” the entity than by reading the MD&A
- As part of their reexamination of the financial reporting model, GASB held a series of roundtables around the country with disappointment in the MD&A, and limited usefulness of the MD&A being recurring themes.
- This session will discuss:
 - **What went wrong?**
 - **How do we fix it?**

What Went Wrong?

Two Distinct Approaches

- Cook/Assembler
 - Follows the recipe to the letter
 - Does not adjust well to changing circumstances
 - Does not adjust recipe for the tastes of those dining
- Chef
 - Always looking for ways to improve existing dishes
 - Uses their brain power, experience and creativity to create their dishes
 - Improvises when circumstances change
 - Reacts well to special requests

Most of us are Cooks

- As a brand new and very different requirement, MD&A was intimidating.
- We were implementing all of GASB 34 simultaneously and typically left MD&A to the end when we were both tired and facing deadlines.
- An over one page long paragraph of requirements in laundry list format did not help stimulate creativity.
- Implementation guide question (can only provide what is required and nothing else) took creativity from life support to DOA.
- Our response as preparers was to retreat to the safe haven by following the example provided in GASB 34 to the letter.
- Twelve years later most are following the exact same template

Problems With Rigidly Following GASB 34 Example

- Example in GASB 34 was never intended to be all-inclusive
- Governments vary too much for one example to work best for all situations
- GASB 34 Appendix C states:
 - **“This illustration is not intended to serve as a template or blueprint for MD&A but rather to provide a frame of reference for preparers to use while giving consideration to their own particular circumstances”**

Problems With Rigidly Following GASB 34 Example

- GASB 34 encourages use of charts, graphs and tables but the example does not include any.
- Appendix C readily admits that the illustration exceeds the minimum requirements to show how MD&A might be “embellished” to improve readability.

The Infamous Implementation Guide Question

- Question 7.5.7: “Are governments allowed to discuss other issues, not included in the requirements of *GASB 34* paragraph 11, in MD&A? ”
- Answer: No, with two long paragraphs of explanation.
- Many preparers have focused on the “No” and ignored the two paragraphs of explanation.
- The first paragraph of 7.5.7 states “There is no limit to the information that may be provided if it provides additional details about the required elements...”

The Infamous Implementation Guide Question

- Paragraph 11 is over a page long and is quite inclusive covering virtually any financial transaction including explanations of changes at both the entity wide and fund level financial statements.
- Paragraph 11 h. also requires disclosure of “currently known facts, decisions or conditions that are expected to have a significant effect on financial position or results of operations.”

“Currently Known”

- Footnote 6 to Paragraph 11 h states:
 - **“For purpose of MD&A, currently known facts are information the management is aware of as of the date of the auditor’s report”**
- This footnote represents a huge change from past practice and a significant responsibility for management
- We do not usually date the MD&A but if we did, the date would be the date of the auditor’s report.

“Currently Known”

- Implementation Guide Question 7.5.13:
 - Events or decisions that have already occurred or have been enacted, adopted, agreed upon or contracted.
- Examples of Currently Known:
 - Award of a major grant.
 - Adjudication of a significant law suit
 - A significant change in the property tax base
 - Infrastructure damaged from a flood event
 - Agreement to build Manufacturing Plant
 - Change/Increase in Sales Tax Rate or University Tuition
 - Flood causing significant infrastructure damage
 - Renegotiated Labor Contract

“Currently Known”

- Examples of Not Currently Known
 - How much sales tax a planned shopping mall may generate
 - That planned technology improvements “will pay for themselves”
- If “known fact” also meets criteria for subsequent event or contingency, MD&A should highlight but not duplicate footnote information.

“Currently Known”

- Given the wide range of information sources available about our governments, we must be diligent to include all significant, relevant information from:
 - Council work sessions & other communications
 - Newspaper articles
 - Bond rating presentations
 - Accounting & other management reports
 - Budget cuts or under performance of budgeted revenues since year end

Other Implementation Guide Guidance

- Separate MD&A for each year when comparative statements provided?-No
- Analysis on non-major funds required?-focus should be on major but non-major information is also allowed
- Can charts or graphs be used instead of the condensed financial statements?-No
- Should discussion of “currently known facts” include impacts on both BTA and GTA separately?-yes

Other Pitfalls

- Explaining the change and not the underlying reason for the change.
 - Net Assets decreased for the year due to expenses exceeding revenues.
- Too narrow a focus on financial statements lead to excluding information relevant to financial statement users.
- Too glowing and one sided-must be objective and balanced.

Other Pitfalls

- Required level of detail not met
 - Condensed financial information should be for current and prior year
 - Capital assets not reported separately as non- current
 - No separate lines for contributions, transfers, special items etc. (net stuff approach)
 - Only including percentage or dollar amount changes and not the underlying number
- Governmental and Business Type activities not discussed separately

How Do We Fix It?

Just Like the Old Joke...

How many Psychiatrists does it take to change a light bulb?

One, but the bulb must want to change.

- We must decide that we want to invest the time to make our MD&A better:
 - Pick the slowest week of the year and commit to rewrite MD &A
 - Before that week spend a few hours looking at other government's MD&A one good example-City of Largo, FL
 - For your MD&A-ask yourself:
 - Does it tell the financial story of my government?
 - Have I addressed the biggest financial threats?
 - Have I identified my fastest growing expenditures?
 - Can the reader identify the financial priorities of the government?
 - Would it put someone who just drank five Red Bulls to sleep?

Review your previous year's MD&A

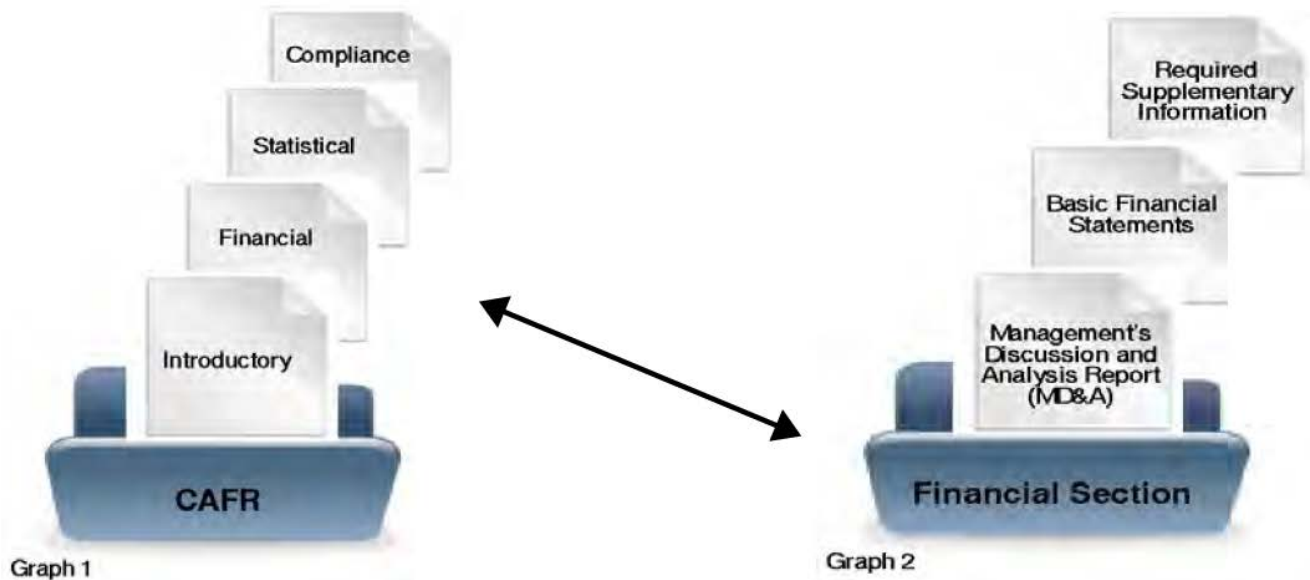
- Financial Highlights section
 - Is it less than ½ a page and no more than 3 to 4 bulleted items?
 - Can I name it something else?
- Overview of the Financial Statements
 - Can I reduce this section given
 - That the standard says “brief”
 - The description in the notes already spends several pages on financial statement presentation
 - The standard has been in place for twelve years
- Financial Analysis
 - Is the required level of condensed financial information provided?
 - Can I break this up with charts or graphs to illustrate key areas?
 - Is a “chart du jour” needed this year? i.e. a chart that will only appear in the current year

Review your previous year's MD&A

- **Financial Analysis (cont.)**
 - Are there specific areas that merit a separate section due materiality, volatility, financial risk to the entity, newness, or financial impact on the entity?
 - Pensions and/or OPEB
 - Bankruptcy filing/debt restructuring
 - Use of Capital Appreciation Bonds
 - State Law changes
 - New Accounting Standards
 - Can I add a chart or graph to supplement this discussion?
 - Are there items included last year that no longer warrant inclusion?

Example- Illustrating Reporting Structure

As shown in Graph 1, the CAFR is organized into four main sections. The Financial Section is the CAFR's main section and is organized into three sub-sections, as shown in Graph 2.



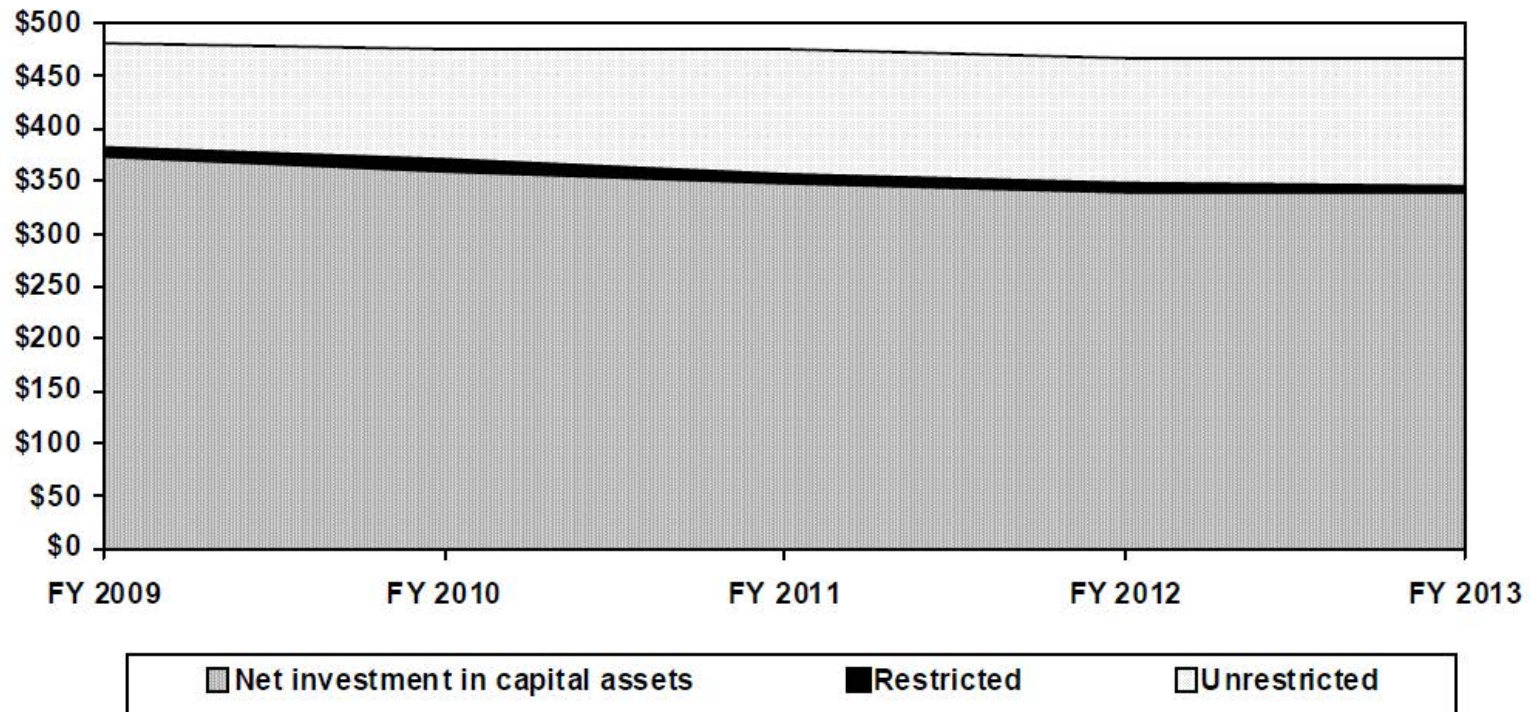
Example-Explaining Reporting Structure

Fund Statements

	<u>Government-wide Statements</u>	<u>Governmental Funds</u>	<u>Proprietary Funds</u>	<u>Fiduciary Funds</u>
Scope	Entire City government (except fiduciary funds)	The activities of the City that are not proprietary or fiduciary, such as police, fire, and parks.	Activities the City operates similar to private business, such as the water and sewer system	Instances in which the city is the trustee or agent for someone else's resources, such as the retirement plan for City employees
Required financial statements	<ul style="list-style-type: none"> • Statement of Net Position • Statement of Activities 	<ul style="list-style-type: none"> • Balance Sheet • Statement of Revenues, Expenditures, and Changes in Fund Balance 	<ul style="list-style-type: none"> • Statement of Net Position • Statement of Revenues, Expenses, and Changes in Net Position • Statement of Cash Flows 	<ul style="list-style-type: none"> • Statement of Fiduciary Net Position • Statement of Changes in Fiduciary Net Position
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, and short-term and long-term	Current assets and liabilities that come due during the year or soon thereafter; no capital assets included	All assets and liabilities, both financial and capital, and short-term and long-term	All assets and liabilities, both short-term and long-term; can include capital assets
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and payment is due	All revenues and expenses during year, regardless of when cash is received or paid	All revenues and expenses during year, regardless of when cash is received or paid

Example Chart-Condensed Financial Information

Total Net Assets
Governmental and Business-Type Activities
(in millions)

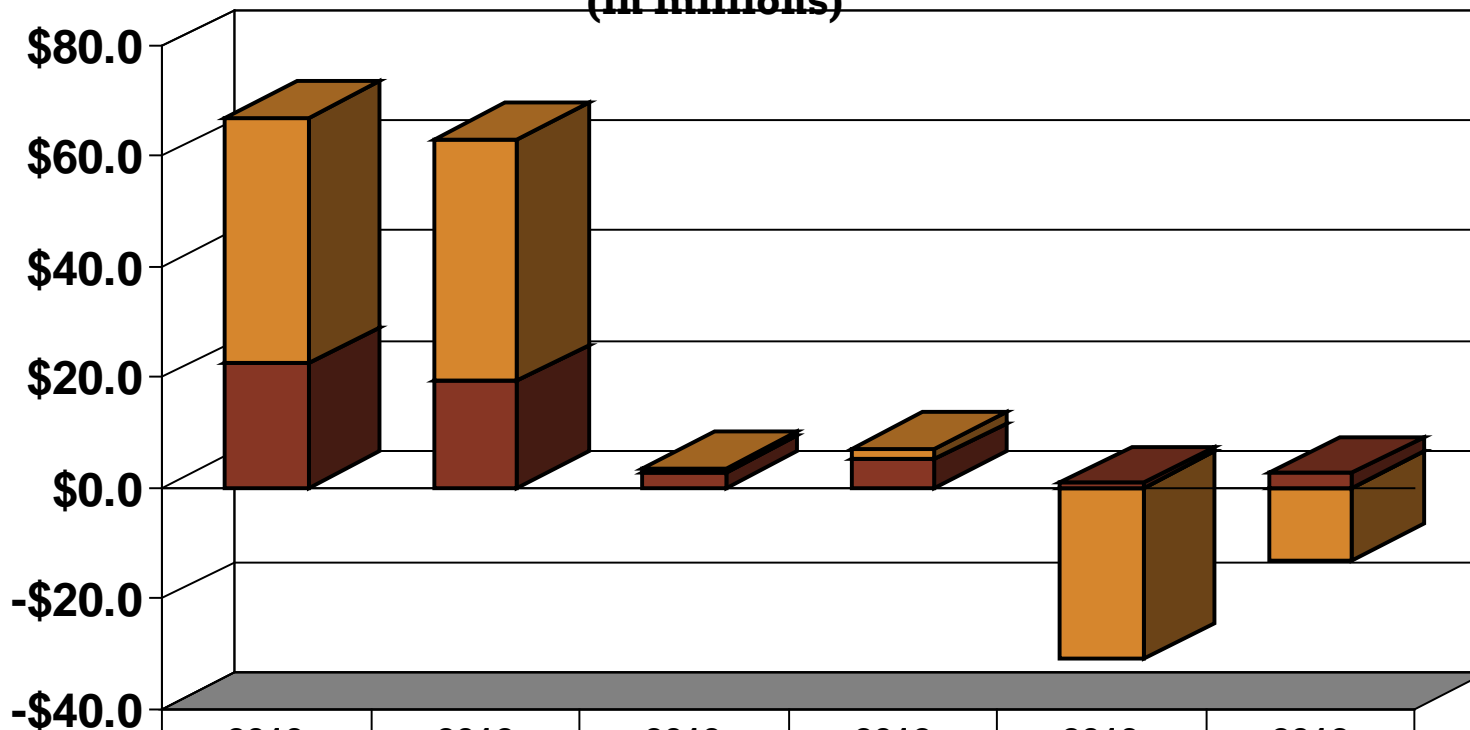




Example-Condensed Financial Information

Net Position

for the Fiscal Year Ended September 30, 2013 and 2012

(in millions)



 Governmental	\$44.5	\$43.7	\$0.8	\$2.0	(\$31.0)	(\$13.1)
 Business-type	\$22.5	\$19.3	\$2.8	\$5.1	\$0.8	\$2.7

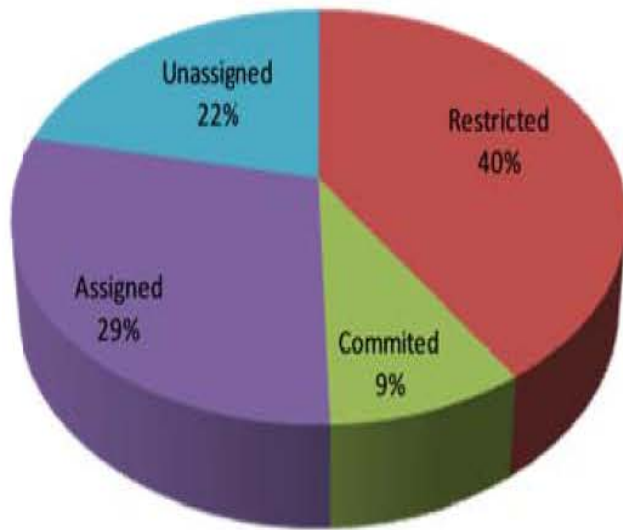
**Investment in
Capital**

Restricted

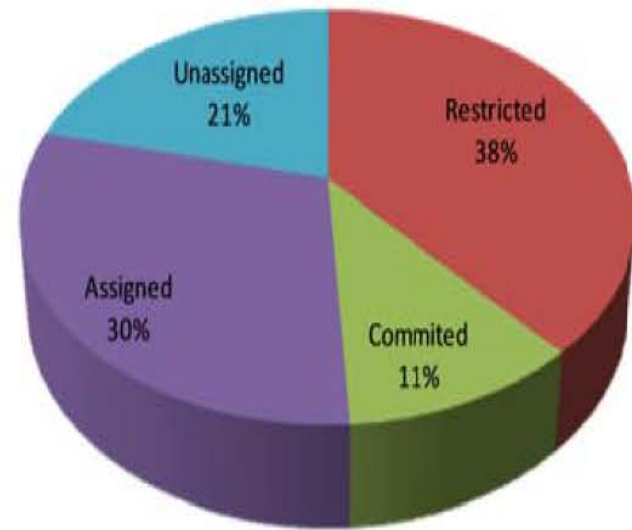
Unrestricted

New Fund Balance Standard

FY 2012



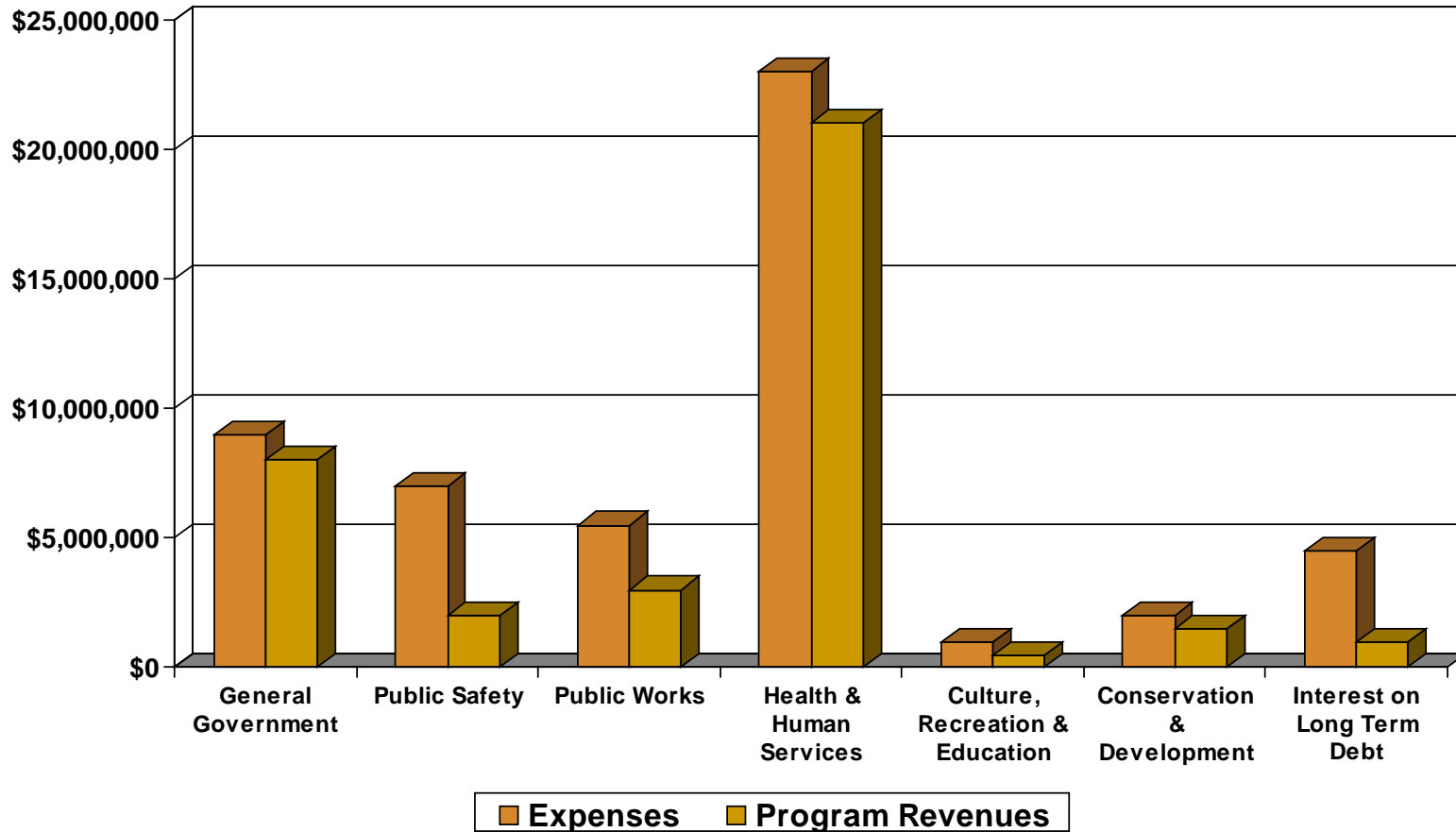
FY 2013



Example-Condensed Financial Information

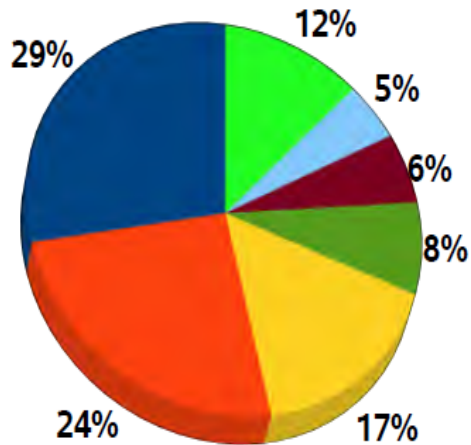
Expenses and Program Revenues

Governmental Activities

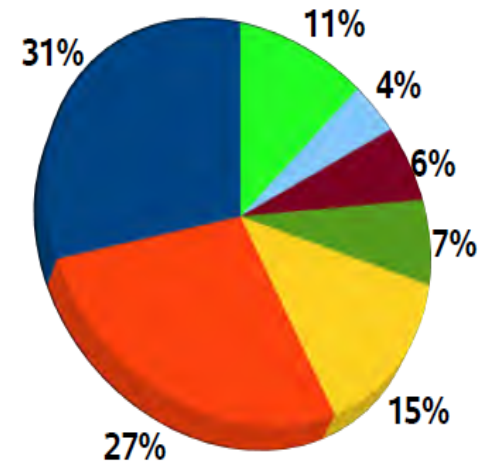


Example- “Snapshot” Trend Information

FY 2004
Total Expenditures
& Encumbrances



FY 2013
Total Expenditures &
Encumbrances

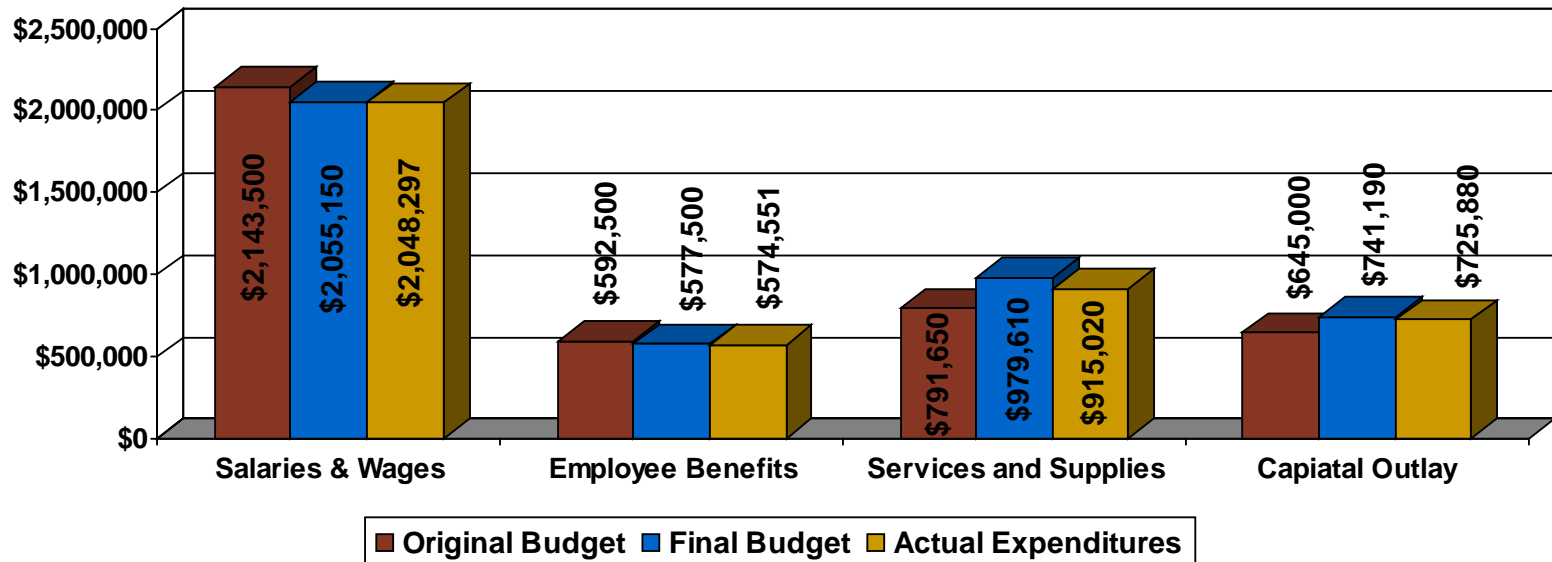


Example-Narrative Explanation

General Fund Budgetary Highlights

The original fiscal year 2013 final budget was approved May 31, 2012. State regulations require budget controls to be exercised at the function level. Although function-level controls are required, management exercises control at the lower object level. Transfers at the object level were made during the current fiscal year and the Board of Trustees was notified of these changes. Transfers were necessary to reflect the higher than anticipated expenditures associated with the operations of the new library and the savings associated with staffing vacancies.

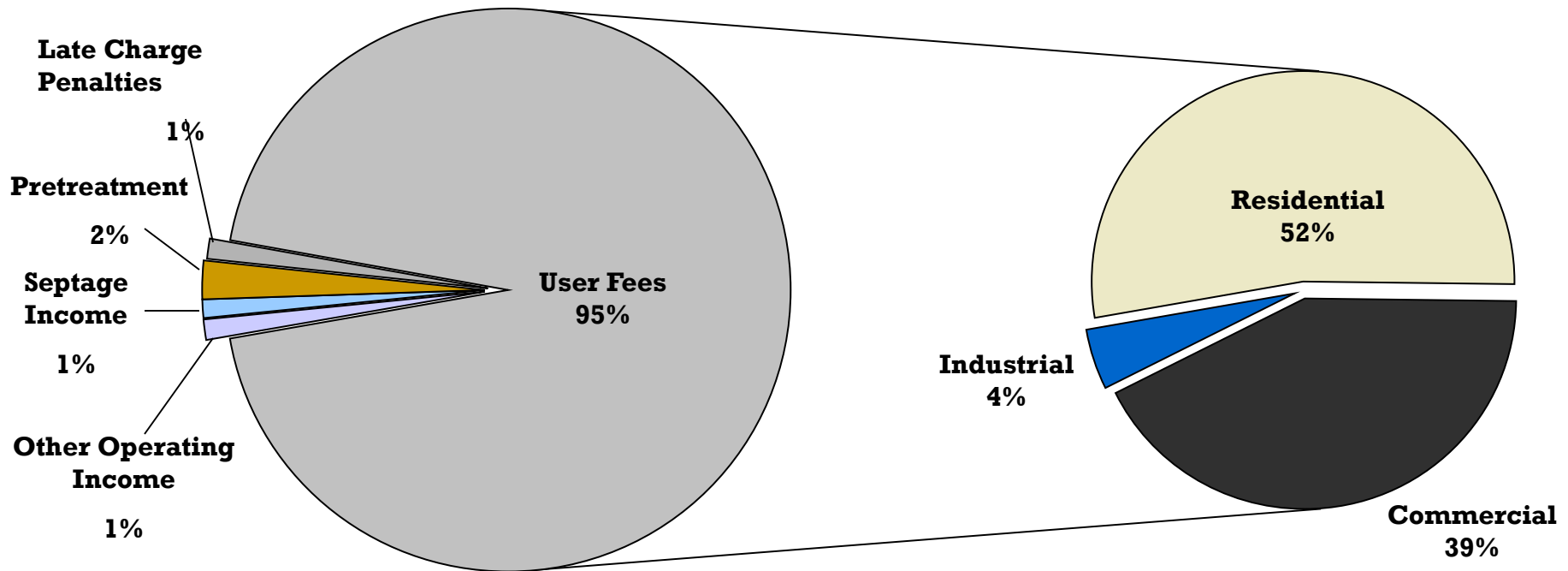
In addition to the transfers, the original budget was amended to include \$186,800 in grant awards and associated expenditures. The following table illustrates the total changes in the final budget and the actual expenditures.



Example-Multiple Perspectives

User fees are NBC's primary source of revenue, representing approximately 95% of total operating revenues. Fiscal year 2004 user fee revenue was \$47,873,355. This is \$5,879,393 more or 14% higher than the prior year as a result of a June 30, 2003 rate increase approved by the PUC. Fiscal year 2004 reflects an entire year of revenue at the increased rates.

Operating Revenues



Example-Current Issue Affecting the Government

■ *Drought surcharges* constituted 6% of 2013 water revenue. They were imposed by the Board effective November 1, 2012, as a temporary measure designed to reduce consumption. A tap surcharge was effective September 16, 2012, which is based on 20% of the scheduled system development charge (“SDC”). Proceeds from the tap surcharge are used for conservation rebates. Tap surcharges amounted to \$1.2 million of the \$7.4 million total surcharges for the year ended December 31, 2013. The tap surcharges were terminated on June 26, 2013 and the rate surcharges began to be phased out on June 30, 2013 as reservoirs reached the 80% full level. They were ended July 31, 2013.

Example –Referencing the Notes

PENSIONS AND RETIREE HEALTHCARE

Pensions and retiree health care continue to receive negative media attention as governments around the nation struggle to fund these commitments. The City is committed to providing programs in these areas that are fair to both employees and taxpayers and that can be sustained over the long term.

Pension funded status has increased five years in a row and is currently 95% funded for the December 31, 2012 valuation. However, as discussed in footnote 7 on pages 46-49, subsequent to year end, the Texas Municipal Retirement system adopted significant changes to the plan that will affect future actuarial values. While, the overall affect should be positive in the long term, the City is expecting a net reduction in funded status based on these changes for the December 31, 2013 valuation.

Final Questions to Ask

- Does the MD&A cover all the requirements listed in paragraph 11?
- Have I updated MD&A as of the date of the audit opinion?
- Does MD&A truly explain rather than just list changes?
- Have all material and relevant facts been included?
- Is the format more a function of what was needed rather than what was done last year?
- Would a bond analyst or elected official find it useful?
- Did I use “plain English” and are all charts sufficiently labeled?
- Is the MD&A visually appealing?

Questions or Ideas?

