

MANAGEMENT DISCUSSION AND ANALYSIS

BETTER PRACTICE GUIDELINE

JUNE 2007

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Introduction

What's New?

As part of the 2006-07 Budget the ACT Government announced a number of changes to the cash management framework for departments commencing from 1 July 2006, to ensure cash balances are used effectively and cash management is performed in a transparent and accountable manner.

Features of the cash management reforms include:

- minimisation of agencies' cash balances, with appropriation provided on a 'just-in-time' basis;
- cessation of departments earning interest revenue, except where specific conditions apply (examples include monies that must be separately accounted for under an agreement with the Commonwealth Government and monies raised through public fund raising activities); and
- establishment of an appropriate cash buffer for each department to suit operational circumstances and working capital needs.

The above reforms impact information previously required in the Management Discussion and Analysis (MD&A), specifically:

- Liquidity: Information regarding liquidity was previously required by all Territory agencies. Only Territory authorities are now required to provide this information.

Purpose

The purpose of this "better practice" guideline is to provide assistance to agencies with the preparation of Management Discussion and Analysis (MD&A) information. This guideline applies to all ACT departments and Territory authorities. It updates, and replaces, earlier memoranda issued by the Department of Treasury, namely Finance Memorandum 2003/10 *Better Practice Guideline - Management Discussion and Analysis Reporting in Annual Reports*.

The purpose of the MD&A is to enhance financial reporting, mainly in the Annual Report, by providing a high level overview of the financial results and health of an agency. The MD&A is "information that accompanies financial statements as part of an entity's financial reporting. It explains the main trends and factors underlying the development, performance and position of the entity's business during the period covered by the financial statements. It also explains the main trends and factors that are likely to affect the entity's future development, performance and position."¹

¹ DISCUSSION PAPER - *Management Commentary, A paper prepared for the IASB by staff of its partner standard-setters and others*, page 15

The MD&A should provide “a historical and prospective analysis of the reporting entity, through the eyes of management”². The management of an agency should be in a position to explain the significance of key financial information contained in the financial statements, the strategies that led to the results reported, and the implications of financial trends for future services / operations of the agency.

Provision of this information assists users of financial reports to more completely understand the information presented. The MD&A should be understandable and useful to a wide audience, including the Legislative Assembly, which predominantly consists of non-accountants.

The MD&A precedes the audited financial statements in the Annual Report, but does not form part of the financial report. As the MD&A does not form part of the financial report, the MD&A information is not directly subject to audit. However, in accordance with Auditing Standard 212 *Other Information in Documents Containing Audited Financial Statements*, the ACT Auditor-General’s Office will review the MD&A information for consistency with information contained in the financial report.

² Accounting Standards Board (ASB) *Statement “Operating and Financial Review”* (Revised Statement issued January 2003), UK.

Model MD&A

To assist agencies with improving the content and format of the MD&A, two model MD&As have been prepared, one for departments and the other for Territory authorities. The information contained in the model MD&As is for illustrative purposes only and is not representative of any Territory agency.

The models cover the essential components of the MD&A and should be tailored to suit an agency's particular financial composition. As the analysis is an overview, it needs to be concise and needs to convey the main financial messages without becoming engrossed in detail. It is recommended that the maximum length of the MD&A be limited to ten pages.

Use of graphs / charts can be an effective means for communicating financial information and can assist with minimisation of text. Where possible, the MD&A should utilise both graphs / charts and brief tables in conjunction with text, as some readers grasp visual information more readily as opposed to financial text.

The model framework is as follows:

a. General Overview

- Objectives
- Changes to Administrative Structure (*to be included where a department has a change to its administrative structure due to a transfer of functions between agencies*)
- Risk Management

b. Financial Performance

- Net Cost of Services
- Total Expenditure
- Total Own Source Revenue

c. Financial Position

- Total Assets
- Total Liabilities
- Liquidity – for Territory authorities only

d. Territorial Statement of Revenues and Expenses

- Total Income
- Total Expenditure

e. Other Disclosures

General Overview

- *Objectives*
 - State the agency’s major objectives (this information can be found in the agency’s strategic plan).
- *Changes to Administrative Structure*
 - Provide a brief description of the functions that have been gained or lost as a result of a transfer of functions between agencies.
- *Risk Management*
 - The MD&A should concisely explain the major risks and uncertainties associated with the agency, for example, future expenses and long-term obligations.
 - Once the risk / uncertainty has been identified, discuss the agency’s strategy to address the risk / uncertainty.

Financial Performance

- *Net Cost of Services*
 - Insert a table illustrating the total expenditure, total own source revenue and the net cost of services for the prior financial year, the current budget year and the current financial year. Provide a brief explanation as to what the table is depicting. It is recommended that additional tables be provided as attachments to:
 1. explain the movement from original budget to amended budget³ for total income, total expenditure, total assets and total liabilities; and
 2. provide a detailed comparison of net cost of services to budget, with variances being explained in the relevant section of the MD&A.
- *Total Expenditure*
 - Provide a graph / chart depicting the total expenses for the current year, together with a brief discussion as to what the graph is illustrating. This will assist the reader with interpretation of the information.
 - Provide the variance of the current year’s expenditure from the 2006-07 amended Budget, where the budget was amended. Department and Territory authority budgets can be amended by supplementary budgets in accordance with section 13A of the FMA⁴. It is recommended that a table be provided in the body of the MD&A showing any changes in expenditure from the amended budget for any structural changes that have occurred subsequent to a supplementary appropriation(s), that is, AAO’s. The variance explanation should focus on key operational reasons.

³ Note that for 2006-07 the amended budget is the original budget as there were no supplementary appropriations.

⁴ Note that in the previous model, budgets could also be amended by virtue of section 19F of the FMA. This section has been deleted from the FMA as it will become redundant under the AASB’s proposed changes to public sector financial reporting as part of the GAAP/GFS convergence project.

- Provide the variance of the current year’s expenditure from the previous year’s expenditure. Again, provide a brief explanation describing the major reason(s) for the variance.
- Provide brief commentary on the expected increases / decreases over the next four years and reasons for significant expected changes in expenditure. (Refer to your agency chapter in Budget Paper 4.)

➤ *Total Own Source Revenue*

- Provide a graph / chart to illustrate the components of own source revenue for the current year, together with a brief discussion as to what the graph is illustrating to assist readers with interpretation of the information.
- Provide explanations for **significant** variations of total own source revenue for the current year from the 2006-07 amended Budget, **and** from the previous year.
- Once again a line-by-line analysis is not generally appropriate. The MD&A should provide a summary of the most important variances, explaining the relevant causes and effects.
- Provide brief commentary on the expected increases / decreases over the next four years and reasons for significant expected changes. (Refer to your agency chapter in Budget Paper 4.)

Financial Position

➤ *Total Assets*

- Provide a graph / chart to illustrate the components of total assets for the current year, together with a brief discussion as to what the graph is illustrating to assist readers with interpretation of the information.
- Identify the change in the total assets value from the 2006-07 amended Budget. It is recommended that a table be provided in the body of the MD&A showing any changes in total assets from the amended budget for any additional changes that have occurred subsequent to a supplementary appropriation(s), for example, AAO’s, and other asset transfers. The variance explanation should focus on key operational reasons.
- Identify the change in the total assets value from the previous year and comment on reasons for the change, identifying the major line items that effected the variation.
- *Departments* are required to provide a breakdown of cash and investments for the current year as provided in the model. Comment on reasons for the change from the 2006-07 amended Budget and the prior year.
- *Territory authorities* are required to provide a table of the current ratio for the previous year, budget, current year, and forward years. The current ratio (current assets divided by current liabilities) is a common indicator of liquidity. Comment on the reasons for any material change from budgeted and previous year ratios and comment on the adequacy of the agency’s liquidity position.

➤ *Total Liabilities*

- Provide a graph / chart to illustrate the components of total liabilities for the current year, together with a brief discussion as to what the graph is illustrating to assist readers with interpretation of the information.
- Identify the change in the total liabilities from the 2006-07 amended Budget and the prior year and comment on reasons for the change, identifying the major line items that effected the variation.

Territorial Statement of Revenue and Expenses

➤ *Total Income and Total Expenditure*

- Provide graphs / charts to illustrate the components of territorial income and expenditure for the current year.
- Provide explanations for **significant** variations for the current year from the 2006-07 amended Budget **and** from the previous year.
- A line-by-line analysis is not generally appropriate. The MD&A should provide a summary of the most important items, explaining the relevant causes and effects.
- Provide brief commentary on the expected increases / decreases over the forward years and reasons for significant expected changes. (Refer to your agency chapter in Budget Paper 4.)

Other Disclosures

- Where the audit report includes either a qualification or ‘Matter of Emphasis’, the MD&A should either advise of the proposed remedial action, or comment on why the agency’s adopted treatment(s) is to be continued.

It is important to remember that the model is to be used as a guide only, providing minimum reporting requirements. Agencies are not operationally identical and have diverse financial issues. Agencies will need to adapt the model to suit individual requirements.

Checklist

Better Practice Checklist	√
a. General Overview	
- Translate the vision of the agency into clear objectives .	<input type="checkbox"/>
- Where applicable, outline changes to the administrative structure of the department.	<input type="checkbox"/>
- Identify clearly the risks the agency may encounter in the future.	<input type="checkbox"/>
b. Financial Performance	
- Review the financial performance of the agency highlighting significant variations from the budget / amended budget and the previous year.	<input type="checkbox"/>
- Analyse the expected financial performance for the forward years and provide brief commentary on future trends.	<input type="checkbox"/>
- Provide a table / graph depicting the total expenditure, total own source revenue and net cost of services of the agency for the previous, current and forward years and provide brief commentary on what the graph / table is illustrating.	<input type="checkbox"/>
- Provide a graph / chart to illustrate the components of total expenditure for the current year.	<input type="checkbox"/>
- Provide explanations for significant variations of the total expenditure for the current year from the budget / amended budget, and from the previous year.	<input type="checkbox"/>
- Provide a graph / chart to illustrate the components of total own source revenue for the current year.	<input type="checkbox"/>
- Provide explanations for significant variations of the total own source revenue for the current year from the budget / amended budget, and from the previous year.	<input type="checkbox"/>
c. Financial Position	
- Provide a graph / chart depicting the agency's total assets . Provide a brief discussion as to what the graph / chart is illustrating.	<input type="checkbox"/>
- Provide a graph / chart depicting the agency's total liabilities . Provide a brief discussion as to what the graph / chart is illustrating.	<input type="checkbox"/>
- Provide the cash and investments table with commentary. (For Departments only)	<input type="checkbox"/>
- Provide the current ratio table with commentary. (For Territory authorities only)	<input type="checkbox"/>
d. Territorial Statement of Revenues and Expenses (For Departments only)	
- Provide a graph / chart to illustrate the components of total territorial income for the current year.	<input type="checkbox"/>
- Provide explanations for significant variations of total territorial income for the current year from the budget / amended budget, and from the previous year.	<input type="checkbox"/>
- Provide a graph / chart to illustrate the components of total territorial expenditure for the current year.	<input type="checkbox"/>
- Provide explanations for significant variations of total territorial expenditure for the current year from the budget / amended budget, and from the previous year.	<input type="checkbox"/>
e. Other Disclosures	
- Discuss the Audit Report , where the opinion was qualified or contained matters of emphasis.	<input type="checkbox"/>