

VOLUME 6B, CHAPTER 3: “*AGENCY FINANCIAL REPORT SECTIONS*”**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 *June 2024* is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
5.0	Removed Climate-Related Risks, pursuant to Secretary of Defense Memo, “Subject: Mission Focus of the Department of Defense,” dated March 17, 2025.	Deletion

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CHAPTER 3

AGENCY FINANCIAL REPORT SECTIONS

1.0 GENERAL

1.1 Purpose

This chapter prescribes requirements for Department of Defense (DoD) Tier 1 consolidation entities referenced in Chapter 1, section 4.1 that must prepare and submit an Agency Financial Report (AFR) to the OUSD(C). The AFR must include the Agency Head Transmittal Letter, Management's Discussion and Analysis (MD&A), Financial Section, and Other Information (OI). OUSD(C) prepares and submits the consolidated, Agency-wide AFR and a separate Annual Performance Report (APR). Subcomponents are not required to prepare an APR. If they decide to prepare an APR, subcomponents are not required to prepare OI, but may choose to do so using the format specified in this chapter.

1.2 Authoritative Guidance

The primary authoritative guidance for this chapter is Title 31, United States Code (U.S.C.), Section 3515, ([31 U.S.C. § 3515](#)) "Financial Statements of Agencies," Federal Accounting Standards Advisory Board's (FASAB's) Statement of Federal Financial Accounting Standard ([SFFAS](#)) [15](#), "Management's Discussion and Analysis," and Office of Management and Budget ([OMB](#)) [Circular A-136](#), "Financial Reporting Requirements."

Other guidance include FASAB's ([SFFAC](#)) [3](#), "Management's Discussion and Analysis," [SFFAC](#) [9](#), "Materiality: Amending Statement of Federal Financial Accounting Concepts (SFFAC) 1, Objectives of Federal Financial Reporting, and SFFAC 3, Management's Discussion and Analysis."

2.0 AGENCY HEAD TRANSMITTAL LETTER

An agency is required to include, toward the beginning of the report, a dated transmittal letter signed by the agency head. The date on the letter must match the due date prescribed in the OMB Circular A-136 to publish the AFR. The letter must include a brief message from the agency head containing an assessment of whether financial and performance data in the report are reliable and complete and, if not, describing any material inadequacies in the completeness and reliability of the data. The transmittal letter must also describe material internal control weaknesses and corrective actions the agency is taking to resolve these weaknesses. The transmittal letter may direct the reader to a more detailed section of the AFR instead of including the discussion in the transmittal letter.

3.0 MANAGEMENT'S DISCUSSION AND ANALYSIS

3.1 Purpose

To be useful, the MD&A should 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. 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, of 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

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 requirement that the information in the MD&A is not misleading to the reader. The MD&A provides management with a forum for communicating current and future insights about the entity, that increases the understandability of financial information, and also provides information about the entity, its operations, service levels, successes, and challenges. The preparer must develop and retain adequate documentation supporting the financial, statistical, and other information presented in the MD&A section.

3.3 Scope

The MD&A should be regarded as "required supplementary information" as that term is used in auditing standards and is an essential part of a complete general purpose federal financial report. 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. 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. Analysis of financial statements and stewardship information;
- 3.3.4. Analysis of systems, controls, and legal compliance;
- 3.3.5. Forward-looking information; and
- 3.3.6. Any additional information required by A-136, such as emergency funding.

3.4 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. The MD&A should:

3.4.1. Name the consolidation entity in a clear manner that leaves no doubt as to whether the consolidation entity is an entire organization or an activity or group of activities within an organization;

3.4.2. Identify the commercial functions (includes buying and leasing of real estate, providing insurance, making loans and loan guarantees, and other credit programs and any activity involving the provision of a service or thing for which a fee, royalty, rent, or other charge is imposed by an agency for services and things of value it provides) and the revolving, trust, and other fund accounts covered by the financial statements;

3.4.3. State the mission and major goals of the consolidation 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 consolidation 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

Pursuant to the Government Performance and Results Act (GPRA) Modernization Act of 2010 ([GPRAMA](#)), the APR is the primary document for comprehensive organizational performance reporting. The MD&A presentation should minimize duplicative reporting with the APR. Therefore, the discussion of performance goals, objectives, and results in the MD&A should include only a summary of non-financial performance information to provide context for the financial information presented.

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., consolidation 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

The MD&A should help users understand the entity's financial position, financial condition, and results of operations 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, financial condition, and results of operations to assist users in assessing whether the financial position has improved or deteriorated because of the year's activities. This section should also include a discussion of key financial-related measures emphasizing financial trends and assessing financial operations. Factors to consider in identifying major changes include likely public or congressional interest in the change, historical trends in the amount, and the relative size of the change. Additionally, the MD&A 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; and

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.

3.7 Analysis of Systems, Controls, and Legal Compliance

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 United States (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."

3.7.2.1. 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 [M-19-16](#), "Centralized Mission Support Capabilities for the Federal Government;"

OMB [M-13-09](#), “Fiscal Year 2013 PortfolioStat Guidance: Strengthening Federal IT Portfolio Management,” and OMB Circular A-123, Appendix D.

3.7.2.2. 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 FMFIA 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 24-01](#), “Audit Requirements for Federal Financial Statements,” which is updated annually. If there is a conflict between this Chapter and the annual update to OMB Bulletin 24-01, auditors must follow guidance in the annual update. 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

Forward-looking information includes information about the possible future effects of the most important existing performance and financial demands, events, conditions, and trends. Management should discuss important known and anticipated problems that need to be addressed and actions that have been planned or taken to address those 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

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

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, financial condition, and results of operations of the consolidation entity, pursuant to the requirements of [31 U.S.C. § 3515 \(b\)](#);

3.10.2. The statements are prepared from the books and records of the entity in accordance with Generally Accepted Accounting Principles and the formats prescribed by OMB. 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

The Financial Section of the AFR must contain the Auditor's Report, Financial Statements and Notes, and Required Supplementary Information. The financial statements are the responsibility of agency management. Although not a requirement, the consolidation entity may include a Chief Financial Officer letter summarizing planned time frames for major barriers to correct audit weaknesses and instances of non-compliance. The section should also discuss the process the entity followed in addressing previously reported audit weaknesses and instances of non-compliance. The guidance for the Financial Statements and Notes is in Chapters 4 through 10.

5.0 OTHER INFORMATION

The OI section of the AFR follows the Required Supplementary Information section of the statements and should contain the following, when appropriate and applicable:

5.1 Summary of Financial Statement Audit and Management Assurances

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 the information. The agency should list each material weakness 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.

5.2 Revenue Foregone

5.3 Tax Burden, Tax Gap, and Tax Expenditures

5.4 Management and Performance Challenges

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. The executive agency head may comment on, but not modify, the OIG statement. The executive agency head may append comments to the OIG's statement. Additional guidance is available in OMB Circular A-136, OI section.

5.5 Payment Integrity Information Act Reporting

The Act requires agencies to identify and review all programs and activities that may be susceptible to significant improper payments based on guidance from the OMB. Guidance for reporting improper payments is contained in Volume 4, Chapter 14 and OMB Circular A-136.

5.6 Other Agency-specific Statutorily Required Reports

Any reports required by statutes, not addressed in OMB Circular A-136 that pertain to financial or performance management, may be included in the AFR or PAR after consultation with OMB and Congress. The head of the agency must determine if inclusion of an agency-specific report will make the reported information more useful to decision makers. Consultation with Congress includes the Committee on Homeland Security and Governmental Affairs of the Senate, the Committee on Oversight and Reform of the House of Representatives, and any other committee of Congress having jurisdiction over the report being proposed for consolidation.

5.7 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 below and referenced in OMB Circular A-136.

Statutory Authority	Penalty Name & Description	Year Enacted	Latest year of adjustment (via statute or regulation)	Current Penalty (Dollar Amount or Range)	Bureau Name	Location for Penalty Update Details
XX U.S.C. XXX; XX CFR XXX.XXX [Insert statutory and regulatory citations.]	XYZ Act: Violation of [Specify statutory requirements that are subject to penalty.]		2022	Minimum: \$X Maximum: \$X		[Insert Federal Register citation(s) and hyperlink(s).]

5.8 Biennial Review of User Fees

Under [31 U.S.C. § 902](#), Chief Financial Officers are required to review on a biennial basis fees, royalties, rents and other charges imposed by the agency for services and things of value it provides and to make recommendations on revising those charges. The results of this review may be included in the AFR or PAR. See [OMB Circular A-25](#), User Charges, for more information.

5.9 Grant Programs

To promote the efficient administration of grants programs, significant consolidation entities with Federal grants programs must submit a brief high-level summary of expired, but not closed, Federal grants and cooperative agreements (awards), including:

5.9.1. A summary table (as shown below) of the total number of awards and balances for which closeout has not yet occurred, but for which the period of performance has elapsed by two years or more prior to September 30, 2022 (i.e., on or before September 30, 2020).

CATEGORY	2-3 Years	4-5 Years	More than 5 Years
Number of Grants/Cooperative Agreements with Zero Dollar Balances			
Number of Grants/Cooperative Agreements with Undisbursed Balances			
Total Amount of Undisbursed Balances			

5.9.2. A brief narrative of the progress made over the past year compared to the previous year's report, challenges preventing closeout of awards reported, and actions to be taken to close awards reported.

5.10 Agency Audit Resolution Reports

Entities required to produce reports from the Agency Head under [5 U.S.C.](#), Appendix 3, section 5(b) may include such reports in the AFR as provided by the Reports Consolidation Act ([31 U.S.C. § 3516](#)). Such entities are encouraged to do so if the AFR is the usual method for publishing the reports.

In addition, entities that provide a separate report to Congress under 5 U.S.C., Appendix 3, section 5(b) may include a summary of agency audit resolution in the AFR or PAR (either in the MD&A or as Other Information).