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Report to the Chairman, Committee on Small Business, U. S. Senate

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FINANCIAL MANAGEMENT

Status of Financial Management Issues at the Small Business Administration

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United States General Accounting Office
Washington, D.C. 20548

Accounting and Information Management Division

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The Honorable Christopher S. Bond
Chairman, Committee on Small Business
United States Senate

Dear Mr. Chairman:

You asked that we assist you in your monitoring and oversight efforts by performing a body of work that would provide you with an assessment of the Small Business Administration's (SBA) ability to effectively achieve its mission of serving the small business sector of the economy and helping businesses and families recover from disasters. Your request identified several programmatic and operational areas you wished us to review in that regard, including financial management at SBA.

Despite receiving an unqualified audit opinion on its fiscal year 1999 financial statements, SBA faces several challenges before it will be able to provide useful, relevant, reliable day-to-day financial information to support ongoing management and accountability. To address your concerns about the status of financial management at SBA, this report provides information on the following questions:

1. What useful information can Congress obtain from SBA's fiscal year 1999 financial statements?

2. What were the major internal control deficiencies identified in SBA's fiscal year 1999 financial statement audit and what are the major causes and implications of these deficiencies?

3. What are the ramifications of SBA's lack of substantial compliance with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA)?[1]

[1]FFMIA requires auditors for each of the 24 major departments and agencies named in the Chief Financial Officers (CFO) Act to include in the audit report on the agencies' annual financial statements information to indicate whether the agencies' financial management systems comply substantially with three requirements: (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the *U.S. Government Standard General Ledger* (SGL) at the transaction level.

Results in Brief

SBA's unqualified audit opinion on its fiscal year 1999 financial statements means that the information contained in those statements is fairly stated and therefore can be used as a tool for congressional oversight of the agency. Among other things, properly prepared and audited financial statements that include information on the status of budgetary resources, obligations, and outlays help provide some assurance of the reliability of numbers reported in the President's Budget as actual amounts. These actual amounts show how the resources provided were spent and can be helpful in evaluating the need for future funding. For a credit agency such as SBA, in which 75 percent of total appropriations for fiscal year 1999 related to credit programs, the audit of financial statements is essential to assessing the reliability of the estimated cost of credit programs and can provide additional information that can be used by decisionmakers to supplement credit cost information included in the budget. In addition, the financial statements provide valuable information on SBA's activities and, ultimately, in conjunction with measurements of the agency's outputs, will provide the means to address the agency's performance in terms of what the taxpayers got for their money.

Despite receiving an unqualified opinion, SBA faces major challenges before it can fully achieve financial accountability. There were two material internal control weaknesses identified in SBA's fiscal year 1999 financial statement audit: (1) SBA's financial reporting process did not ensure that its financial statements would be free of material misstatements and (2) general computer control weaknesses in SBA's information systems did not ensure that unauthorized activities, such as the modification of data or software, would be prevented or detected.

SBA's lack of an integrated general ledger for recording its transactions during the year contributed to the deficiencies in SBA's financial reporting process. SBA used three separate accounting systems to record various types of transactions. In addition, SBA relied on multiple, nonintegrated spreadsheets as well as complex and error-prone manual processes for recording financial data. This resulted in an overly complex process for preparing financial statements and a lack of assurance about the reliability of the data. In addition, SBA lacked comprehensive plans and procedures for preparing its financial statements. Therefore, an extensive amount of manual processing and significant adjustments to the financial statements were required to enable SBA to achieve an unqualified opinion. SBA is currently undertaking steps to address the identified weakness in the financial reporting process.

Although SBA took significant, positive steps in fiscal year 1999 toward improving the general computer controls[2] over its information systems, the results of the audit showed that significant security deficiencies continued to exist in its information systems. SBA's auditors found deficiencies in all six of the general computer control categories that are included in the audit process. General computer controls have an impact on the overall effectiveness and security of computer operations rather than specific computer applications. In addition, they create the environment in which application systems and controls operate. SBA's control weaknesses increased the risk of unauthorized modification of data and software and reduced assurance that the unauthorized activities would be prevented or detected.

The deficiencies in SBA's financial reporting process, coupled with its general computer control deficiencies, resulted in SBA's lack of substantial compliance with FFMIA. FFMIA is a measure of an agency's ability to incorporate into its financial management systems the accounting standards and reporting objectives established for the federal government, so that all assets, liabilities, revenues, expenses, and the full costs of programs and activities can be consistently and accurately recorded, monitored, and uniformly reported. Substantial noncompliance with FFMIA is one of the factors that indicate that agency financial management systems do not routinely provide reliable, useful, and timely financial information to manage on a day-to-day basis. SBA agreed with the auditor's findings of noncompliance with FFMIA and developed a remediation plan which the Office of Management and Budget (OMB) has approved.

SBA's overall strategy to resolve all FFMIA noncompliance hinges on its Systems Modernization Initiative (SMI). This initiative is a three-phase, long-range, comprehensive, overall systems modernization program that will replace and modernize SBA's current financial systems. Phase I focuses on systems for lender monitoring and oversight, Phase II on financial management systems and disaster loan processing, and Phase III on

[2]General computer controls are the policies, procedures, and technical controls that apply to all or a large segment of an entity's information systems and help ensure their proper operation. GAO has issued the *Federal Information System Controls Audit Manual* (FISCAM) to provide guidance to auditors in reviewing general computer controls. The FISCAM identifies six major categories of general computer controls: (1) entitywide security program planning and management, (2) access controls, (3) application software development and program change controls, (4) system software controls, (5) segregation of duties controls, and (6) service continuity controls.

information technology infrastructure improvements and additional application support systems.

Phase II will be the primary project that addresses FFMIA noncompliance. Preliminary planning for Phase II started in late fiscal year 1998. Many of SBA's policies and procedures for managing information technology are currently in the early stages of development or not yet developed. Thus, it is too early to tell whether SBA's system modernization effort will resolve SBA's noncompliance.

SBA's achievement of a clean audit opinion is an important milestone along the road to financial accountability. However, until SBA improves financial reporting and information system controls, it will not be in a position to provide reliable, timely information on a day-to-day basis, an ultimate goal of financial management initiatives in the federal government. Implementation of a fully integrated financial management system is key to these improvements. However, SBA has several steps it needs to take to be in a position to effectively undertake such an effort.

Background

Laws and Standards That Guide the Preparation of Financial Statements

The Chief Financial Officers (CFO) Act of 1990 laid the legislative foundation for requiring federal agencies to provide taxpayers, Congress, and agency program managers with reliable financial information through audited financial statements. In addition to requiring annual audited financial statements, the CFO Act sets expectations for agencies to build effective financial management organizations and systems and to routinely produce sound cost and operating performance information throughout the year. Additionally, the Government Performance and Results Act of 1993 (GPRA) requires agencies to establish missions, goals, and performance measures for assessing the effectiveness and efficiency of agency programs and services.

Under the CFO Act some of the government's 24 major agencies, including SBA, started preparing annual financial statements, beginning with those for fiscal year 1991.[3] The agency financial statements are subjected to independent audit. These audits (1) determine the reliability of financial information reported, (2) provide information on the adequacy of systems and controls used to ensure accurate financial reports and safeguard assets, and (3) report on agencies' compliance with laws and regulations.

In an effort to improve the integrity of financial information reported by federal agencies, in 1990 the OMB, the Department of the Treasury (Treasury), and GAO established the Federal Accounting Standards Advisory Board (FASAB) to develop accounting standards for the federal government. In 1999, the American Institute of Certified Public Accountants recognized the standards developed by FASAB as being generally accepted accounting principles (GAAP) for the federal government.

Because SBA is a credit agency, it has been required to estimate the cost of its loan programs in accordance with the Federal Credit Reform Act of 1990 (FCRA)[4] and FASAB's accounting standard for credit reform, Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees,* as amended, since fiscal years 1992 and 1994, respectively. The FASAB standard established guidance for estimating the cost of direct and guaranteed loan programs, as well as for recording direct loans and the liability for loan guarantees for financial reporting purposes. SFFAS No. 2 states that actual and expected costs of federal credit programs should be fully recognized in both budgetary and financial reporting. To accomplish this, agencies first predict or estimate the future performance of direct and guaranteed loans when preparing their annual budgets. The data used for these budgetary estimates are generally updated after the fiscal year-end to reflect any changes in loan performance since the budget was prepared as well as any expected changes in future loan performance. This reestimated data is then used in financial reporting in calculating the allowance for subsidy on direct loans, the liability for loan guarantees, and the net cost of the program. In the

[3]Under the CFO Act as expanded in 1994, beginning with fiscal year 1996 all of the government's 24 major agencies are required to prepare annual financial statements.

[4]FCRA changed the budgetary treatment of credit programs so that their costs could be compared more appropriately with each other and with other federal spending. FCRA requires that the agencies have budget authority in advance to cover the program's cost to the government. The agencies are required to estimate the cost of extending or guaranteeing credit over the life of the loan.

financial statements, the actual and expected costs of direct loans disbursed and guaranteed loans committed as part of a credit program are recorded as “Program Cost” on SBA’s Statement of Net Costs.

How Audit Opinions Are Determined

In an audit of an agency’s basic financial statements, the auditor must consider the results of all audit procedures to determine whether an opinion can be expressed on the fairness of the information presented and, if so, what type of opinion. In this regard, there are four possibilities:

Table 1: Types of Audit Opinions

Type of audit opinion	What it means
Unqualified opinion	• Basic statements and the accompanying notes are fairly stated in accordance with GAAP.
Qualified opinion	• Overall the financial statements are fairly stated. • However, one of the following conditions exist for one or more major accounts: 1. limitation on audit scope 2. failure to follow GAAP 3. uncertainty over whether certain information was fairly presented.
Disclaimer of opinion	• The auditor is unable to obtain satisfaction that the financial statements are fairly presented and does not express an opinion. • Possible causes: 1. severe limitation on the audit scope 2. material uncertainties about amounts or outcomes.
Adverse	• Financial statements are materially misstated and do not fairly present financial position.

While unqualified audit opinions are essential to providing an annual public scorecard, they do not guarantee that agencies have the financial systems needed to dependably produce reliable financial information. Modern systems and good internal controls are essential to reach the end goal of useful, relevant, reliable day-to-day financial information to support ongoing management and accountability.

Internal Control Over Financial Information

The study and evaluation of the system of internal control over financial reporting are important to the auditor and are specifically included as part of the financial statement audit under generally accepted auditing standards. GAO's *Standards for Internal Control in the Federal Government*[5] defines internal control as an integral component of an agency's management that provides reasonable assurance that the following objectives are being achieved: (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations. Internal control serves as the first line of defense in safeguarding assets and in preventing and detecting errors and fraud. As federal policymakers and program managers continually seek to better achieve agencies' missions and program results, they seek ways to improve accountability. A key factor in achieving these outcomes and minimizing operational problems is the implementation of appropriate internal control.

Internal control over financial information is evaluated during the audit, and professional auditing standards require the auditor to communicate to the agency any condition that represents a significant deficiency in internal controls – referred to as a reportable condition.[6] A material internal control weakness is a reportable condition that does not reduce to a relatively low level the risk that errors, fraud, or noncompliance involving significant amounts may occur and not be detected in a timely manner by employees in the normal course of performing their assigned functions.

Scope and Methodology

To assess financial management issues at SBA, we reviewed reports prepared by SBA's Independent Public Accountant (IPA) under the direction of SBA's Office of Inspector General (OIG) concerning (1) SBA's fiscal year 1999 financial statement audit, (2) SBA's financial reporting system performance, and (3) SBA's information system security. We coordinated with representatives and analyzed workpapers and documents from the independent auditor relating to these reports. In addition, we met

[5] *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, Nov. 1999)

[6] A reportable condition is a significant deficiency in the design or operation of internal controls that could adversely affect the organization's ability to provide reasonable assurance on the reliability of its financial reporting, performance reporting, and compliance with laws and regulations.

with officials from SBA's Office of the CFO and OIG to obtain more information about issues raised in the reports and to gain a better understanding of the audit work performed and its results. We assessed SBA's financial management systems and financial reporting with regard to the agency's adherence to federal standards including the CFO Act; GPRA; FFMIA; OMB Circular No. A-127, *Financial Management Systems;* OMB Bulletin 97-01, *Form and Content of Agency Financial Statements;* FASAB Statements of Federal Financial Accounting Concepts and Statements of Federal Financial Accounting Standards; and GAO's *Federal Information System Controls Audit Manual* (FISCAM).

To determine the extent that SBA's financial statements provide some assurance over the amounts reported in the President's Budget, we compared budgetary figures in SBA's financial statements with corresponding accounts in the President's Budget and identified any significant differences. For the two largest credit programs, we determined whether the cash flow models and assumptions used to estimate the cost of SBA's loan programs for financial statement purposes were also used to calculate SBA's budget estimate.

To identify useful information in SBA's fiscal year 1999 financial statements, we reviewed applicable accounting standards and described what type of information is included in each of the financial statements and the accompanying notes and how that information could be useful to Congress. To assess the status of SBA's noncompliance with FFMIA, we obtained and reviewed information about the current status of SBA's remediation plan to resolve its noncompliance with FFMIA.

Our work was conducted in Washington, D.C., from March to June 2000 in accordance with generally accepted government auditing standards. We requested written comments on a draft of this report from the Administrator of Small Business or her designee. The Chief Financial Officer provided us with written comments that are reprinted in appendix II and discussed in the "Agency Comments" section of this report.

SBA's Financial Statements Are a Valuable Tool for Congressional Oversight

SBA's unqualified audit opinion on its fiscal year 1999 financial statements means that the information contained in those statements is fairly stated and, therefore, can be used as a tool for congressional oversight of the agency. Among other things, properly prepared and audited financial statements that include information on the status of budgetary resources, obligations, and outlays help provide some assurance on the reliability of numbers that are reported in the President's Budget as actual amounts. These actual amounts show how the resources provided were spent and can be helpful in evaluating the need for future funding. For a credit agency, such as SBA, where 75 percent of its total appropriations for fiscal year 1999 related to credit programs, the audit of its financial statements is essential for assessing the reliability of the estimated cost of credit programs and can provide additional information on the cost of credit programs that can be used to supplement credit cost information included in the budget. Additionally, the financial statements provide valuable information on SBA's activities and, ultimately, in conjunction with measurements of the agency's outputs will provide the means to address the agency's performance in terms of what the taxpayers got for their money. In addition to the discussion that follows, in appendix I, we have reproduced portions of SBA's financial statements and explained the information that can be obtained about SBA's operations from each component of the financial statements.

Testing the Reliability of Budgetary Amounts

Assurances over the reliability of SBA's actual amounts included in the President's Budget are provided through the Statement of Budgetary Resources (SBR). The SBR provides information on the status of budgetary resources at the fiscal year-end and the obligations and outlays during the year. Preparation of the SBR requires agencies to reconcile obligations recorded in budgetary records with their cash outlays.

Because SBA's SBR was subjected to the rigors of a financial audit and received an unqualified opinion, information contained in SBA's SBR provides useful information for congressional oversight. For example, the outlay information in SBA's SBR is the same as the outlay amounts reported in the President's Budget. Certain other amounts reported in SBA's SBR differ from actual amounts reported in the President's Budget. The identified differences were generally due to timing or other justifiable reasons.[7] Notwithstanding these differences, the audit provides some level of assurance over the actual amounts presented in the President's Budget.

Reliable reports of actual amounts reported in the President's Budget are important not only for demonstrating accountability over resources provided, but also for assisting in evaluating the amount of funding needed in the future. By providing some assurance that funds were spent for the purposes for which they were appropriated, the audit helps decisionmakers know how much was actually spent on a particular program during the fiscal year. In addition, since obligated and unobligated balances are reviewed as part of a financial statement audit, the audit can help determine whether obligated funds are properly recorded and whether there has been a buildup of unobligated balances. These, plus other relevant factors, can contribute to decisions about the appropriate amounts of funding for an agency's programs in the future.

In addition to the assurance it provides over actual amounts in the President's Budget, the audit's validation of SBA's compliance with credit reform in preparing its financial statements provides some additional assurance on the reliability of budgeted amounts for credit program cost estimates. This is particularly important at SBA, because such a significant portion of SBA's total appropriations relate to credit programs. When FASAB developed accounting standards for loan programs, it recognized that financial accounting should support the budget and that accounting standards for credit reform should be consistent with budgeting under credit reform. This mirroring helps provide for integrity in the budget process through the financial statement audit. As part of the fiscal year 1999 SBA financial statement audit, the cash flow models and assumptions used to estimate the cost of SBA's loan programs were reviewed by the auditors and found to be reasonable. Assuming that these same models were used for budgetary purposes, the results of the financial statement audit can be extended to the budget process.

[7]Because the President's Budget and the SBR are prepared using separate reporting systems and the President's Budget is required to be submitted several months before the SBR, differences in the amounts reported often occur.

To determine whether SBA used the same cash flow models to calculate its fiscal year 2001[8] budget estimates, we compared the cash flow assumptions in the budget estimate to the assumptions in the financial statement estimate for the two largest credit programs [Disaster Loan Program and 7(a) General Business Loan Program] at SBA. Although we found some differences between the cash flow assumptions in the budget model and the audited assumptions in the financial statement model, these differences had little or no budgetary impact. This general consistency between the budget and financial statement model helps provide assurance to Congress that the loan program cost estimates included in the fiscal year 2001 President's Budget are reasonable.

Since SBA is a large federal lender, providing reasonable credit program cost estimates based on reliable data is critical to effective program stewardship and accountability. Because economic and other conditions that affect loan programs can change rapidly, SBA and other federal credit agencies are required to update or "reestimate" loan program costs periodically for differences between (1) estimated loan performance and related cost and (2) the actual program cost recorded in the accounting records, as well as for expected changes in future economic performance. Because of the timing of the preparation and audit of these reestimates, SBA's fiscal year 1999 reestimates were included in the financial statements but not in the actual amounts in the budget. Thus, the financial statements included additional information on the cost of credit programs that can be used by decisionmakers to supplement credit cost information included in the budget.

When the loan program costs were updated for fiscal year 1999, SBA's revised estimate showed the programs costing less than previously anticipated for direct loans and guaranteed loans. This is referred to as a downward reestimate. The downward reestimates, which relate to all previously disbursed and committed loans and which are disclosed in the notes to SBA's financial statements, totaled $360 million. The notes show that the downward reestimates of loan program cost for prior years more than offset the subsidy expense recognized for the current year

[8]Because the President's Budget is prepared 2 years in advance, the fiscal year 2001 budget estimates of loan program costs were prepared during the same time period as the fiscal year 1999 financial statement estimates of loan program costs, generally using the same data.

disbursements.[9] SBA's downward reestimates were primarily the result of changes in economic activity and program performance as well as refinements in the credit subsidy modeling process. Over time as agencies improve their ability to forecast costs through better modeling and more and better historical data, it is anticipated that the variability in the subsidy rate will diminish. However, some level of variability will continue to exist.

Focusing on Key Activities of the Fiscal Year

In addition to helping provide assurance over certain amounts in the President's Budget, SBA's audited financial statements provide useful information on the agency's activities during the fiscal year. For example, SBA held a pilot loan sale in fiscal year 1999. The notes inform the reader that SBA expects to sell the majority of its loan portfolio within the next 3 or 4 years.

According to the information in SBA's notes, SBA's fiscal year 2001 budget request for subsidy costs did not include the results of the pilot sale. However, the notes do let the reader know that the effect of the pilot sale, as well as the other sales planned, will be factored into the calculations of SBA's subsidy costs for the fiscal year 2002 budget request.[10] Thus, since the amount of money SBA receives for its loans from the loan sales will most likely continue to differ from the amount SBA expected to receive by holding and servicing the loans, inclusion of the effect of the loan sales in the 2002 budget request can be expected to affect future subsidy costs. Whether future subsidy costs increase or decrease will depend on the actual cash SBA ultimately ends up receiving on these loan sales.

Reliable Cost Information Will Help Assess Agency Performance

In the 1990s Congress and the federal government laid out a statutory and management framework that provides the foundation for strengthening government management and accountability. GPRA requires agencies to establish missions, goals, and performance measures for assessing the effectiveness and efficiency of agency programs and services. Previously, the CFO Act had established a structure for more businesslike management

[9]For a more detailed discussion of the costs of SBA's loan programs, see appendix I.

[10]Subsequent to the issuance of the fiscal year 1999 financial statements, SBA's asset sales schedule changed. As a result, SBA officials stated that the results of the pilot sale and the one sale currently planned for fiscal year 2000 do not provide the predictive data or reliability needed to include the results of the sale in the subsidy calculation for its budget request.

and reporting of the government's finances. The effective implementation of the statutory framework, although important, is not an end in itself. Rather, the implementation of the framework is the means to an end—improved federal performance through enhanced agency and congressional decision-making and oversight.

The first step towards this goal is to have reliable cost information. SBA has achieved, by virtue of its unqualified opinion, basic accountability over the fiscal year end amounts reported in its financial statements. The next step will be to link financial information to performance measures. For example, one of SBA's performance goals is to increase opportunities for small business success. A number of performance indicators, such as increasing the numbers of business loans approved and increasing the number of start-up businesses, are associated with this goal. Ultimately, SBA should be able to determine not only if the goal was achieved but also the cost associated with achievement of the goal. Certain of SBA's performance indicators, such as the default rate on its loans, are currently reviewed for reasonableness as part of the financial statement audit. Once SBA has fully developed the ability to link costs to outcomes, taxpayers can be better apprised of what they receive for their money.

Despite Unqualified Opinion, SBA's Audit Report Discloses Significant Financial Management Deficiencies

Although SBA has realized an important objective in obtaining a timely, unqualified opinion on its financial statements, financial accountability goes well beyond an unqualified opinion. The key to financial accountability is to improve internal controls and underlying financial and management information systems to the point where timely, accurate, and useful information is generated on an ongoing basis, not just at the end of the fiscal year. Strong financial management systems and internal control are essential to ensure the end goal of useful, relevant, reliable day-to-day financial information to support ongoing management and accountability. SBA's auditors identified two material internal control deficiencies that indicated that SBA had yet to fully achieve financial accountability: (1) SBA's financial reporting process did not ensure that its financial statements would be free of material misstatements and (2) general computer control weaknesses in SBA's information systems did not ensure that unauthorized activities, such as the modification of data or software, would be prevented or detected. Because of these weaknesses, an extensive amount of manual processing and significant adjustments to the financial statements were required.

Weakness in the Financial Reporting Process

SBA's financial reporting system did not ensure that SBA's financial management activities were consistently and accurately recorded, and timely and uniformly reported. Specifically, SBA did not have a single integrated general ledger. Rather, it relied heavily on complex, error prone manual processes and lacked comprehensive plans and procedures for preparing financial statements. Without changing its current processes, SBA will continue to experience difficulties in preparing timely, accurate financial information. SBA is currently undertaking steps to address the identified weaknesses in the financial reporting process.

OMB Circular A-127 requires that each federal agency have an integrated financial management system designed to provide for effective and efficient interrelationships between software, hardware, and personnel. Ideally, each transaction would be entered into a financial management system once, and all records and reports would accurately reflect the impact of the transaction. This was not the case at SBA because it did not have an integrated general ledger system but instead used three separate accounting systems to record transactions. Consequently, transactions had to be entered into more than one system in order to prepare financial statements. For example, a loan disbursement would be entered into the loan accounting system when the loan was disbursed. Summarized transactions from the loan accounting system would also be manually entered onto an Excel spreadsheet to reflect the impact on budgetary accounting. In addition, the general ledger balances affected by the loan disbursement transaction would be rekeyed several times into various spreadsheets prior to the preparation of the financial statements.

FFMIA, as well as OMB Circular A-127, requires agencies to comply with the *U.S. Government Standard General Ledger* (SGL) [11] at the transaction level. Although SBA's system did not follow the SGL, SBA had developed a crosswalk to it. In order to prepare its consolidated trial balances, SBA combined data from all of its funds.[12] However, SBA's chart of accounts was not consistent among funds. This inconsistency resulted in the need for conversion and data manipulation in the preparation of the consolidated

[11]The SGL provides a standard chart of accounts that agencies are to use in their financial statements.

[12]SBA's financial statements involve funds in seven categories: salary and expenses, surety bond guarantees, disaster loans, business loans, the Business Assistance Trust Fund, the Pollution Control Equipment Fund Liquidating Account, and the Office of the Inspector General.

trial balances. The inconsistency stems from the fact that although progress has resulted in a number of SBA's funds using SGL-based accounts, the remaining funds do not. The additional manipulation of the data not only took time but also increased the likelihood of error in the consolidated trial balances.

Because of its multiple systems for recording financial data and its extensive manual recording, SBA's process for preparing its financial statements was overly complex. It also lacked sufficiently detailed documentation of these complex procedures. For example, SBA's budget office used a system to monitor the budget authority for new loans. This system, however, was not completely linked with the accounting system. Therefore, SBA had developed a separate process to include the activity for loans made in prior years when determining budgetary account balances. For fiscal year 1999, SBA updated and maintained more than 50 spreadsheets, each containing over 150,000 cells of data, to determine the budgetary account balances for its loan programs. The complex processes that SBA had developed were cumbersome, labor intensive, and heavily reliant on manual keying and rekeying of data and account balances, which increased the risk of errors.

Additionally, during fiscal year 1999, SBA moved its primary financial reporting responsibilities from Washington, D. C., to Denver, Colorado. Fiscal year 1999 was the first year that Denver staff was given responsibility for preparing the financial statements. This change created challenges since SBA's financial reporting process was complex and the procedures for preparation of its financial statements were not sufficiently detailed. Also, SBA held its first loan asset sale in fiscal year 1999 and this, combined with the accounting complexities of the sale, affected the financial statement preparation.

All of these factors led to the identification of problems in SBA's financial reporting process during the fiscal year 1999 audit. Therefore, in conjunction with the audit process, SBA made numerous adjustments to the year-end financial statements. These adjustments were necessary to remedy problems identified by the auditors such as amounts incorrectly classified, line items that were not labeled consistently between funds, unusual and abnormal balances that were undetected, and trial balances and financial statements that were not prepared consistently between funds.

To address these issues, the Inspector General (IG) included the following recommendations, with which we concur, in its audit report on the fiscal year 1999 financial statements:

- Ensure that adequate resources are provided to implement an effective internal control system over the financial reporting processes.
- Provide additional training to both staff and management responsible for the financial reporting process.
- Develop detailed procedures for activities, such as preparing journal vouchers, calculating loss allowances, preparing and updating trial balances, and preparing financial statements and notes.
- Require each fund accountant to process and maintain trial balances and reports in a consistent manner.
- Reduce the manual rekeying of data through automation. To the extent possible, automate the roll-up of data from the off-line and on-line trial balances to the combined and consolidated trial balances and the resulting financial statements.

In addition to performing the audit of the fiscal year 1999 financial statements, the IPA was engaged by SBA's OIG to review the integrity of SBA's internal financial management systems. In conjunction with this review, the auditors made the following recommendations, with which we concur:

- Require preparation of quarterly consolidated agencywide financial statements. With quarterly financial statements, SBA will be better prepared for an accurate and timely year-end consolidation process.
- Implement an integrated standard general ledger to account for and report on all SBA fund transactions.

According to the IPA's report, SBA has undertaken a significant system project that, if fully implemented, may overcome the identified weaknesses in the financial reporting process. As of June 2000, SBA was working to complete a redesign and implementation of a new automated financial reporting consolidation system. This redesign was to include a consolidated general ledger, crosswalks to activity in the SGL accounts, and feeder systems that would eliminate most of the manual applications and rekeying. In addition, SBA has hired a contractor to help assemble documentation on reporting procedures into a comprehensive reporting plan.

While implementation of the recommendations should improve SBA's year-end financial reporting process, the lack of an integrated financial management system hinders SBA from generating complete, reliable, consistent, timely, and useful financial management information on its day-to-day operations. Achieving this goal would require that SBA implement an integrated financial management system designed to provide effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the system. SBA's efforts toward developing such a system are discussed later in this report.

Weaknesses in Information Systems Controls

The other major internal control weakness identified in SBA's fiscal year 1999 *Independent Auditor's Report on Internal Control* is in SBA's information systems controls. While SBA took several steps during fiscal year 1999 to improve its general computer controls, many of its initiatives were in the initial stages of implementation and development. Weaknesses were reported in all six categories of general computer controls (general computer controls create the environment in which application systems and controls operate).

During a financial statement audit, the auditor focuses on general controls for the agency's major computer facilities and systems supporting a number of different computer applications, such as major data processing installations or local area networks. If general computer controls are weak, they severely diminish the reliability of controls associated with individual applications. The IPA, under contract with SBA's OIG, used GAO's FISCAM to guide the review of SBA's computer information systems environment for the financial statement audit. The following section discusses each of the six categories of general computer controls, examples of the weaknesses identified by SBA's IPA in each category, and the impact those weaknesses have on SBA's general computer controls.

- **Entitywide security program planning and management** provide a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of computer-related controls. These are the fundamental activities that allow an organization to manage its information security risks cost effectively, rather than react to individual problems only after a violation has been detected or an audit finding has been reported.

  SBA has established a senior management group responsible for developing and implementing an ongoing agencywide information systems security program. However, the basic requirements related to general computer controls were either not in place or not fully effective at the time of the fiscal year 1999 audit. For example, formal agencywide security policies and procedures had not been established. A draft standard operating procedure for information system security was in clearance but not yet established as official agency policy. Also, security plans with acceptable risk levels and rules for each system had not been developed and security awareness training had not been provided.

Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, and improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

- **Access controls** limit or detect access to computer resources such as data files, application programs, and computer-related facilities and equipment. Access controls should provide reasonable assurance that these computer resources are protected against unauthorized modification, disclosure, loss, or impairment. Such controls include physical controls, such as keeping computers in locked rooms to limit physical access, and logical controls, such as security software programs designed to prevent or detect unauthorized access to sensitive files.

  Audit testing conducted by the IPA revealed that 11 percent (199 out of 1,819) of active users' accounts in SBA systems were for employees and contractor personnel no longer employed by the agency. These user accounts were not inactivated promptly upon the termination or transfer of an employee. Also, a network server for the Office of General Counsel was not physically secured. Both examples demonstrate SBA's lack of adequate access controls.

  Without adequate access controls, unauthorized individuals, including outside intruders or terminated employees, can read and copy sensitive data and make undetected changes or deletions for malicious purposes or personal gain. In addition, authorized users can unintentionally modify or delete data or execute changes that are outside their authority.

- **Application software development and program change controls** prevent implementation of unauthorized programs or modification to existing programs. Key aspects of such controls are ensuring that (1) software changes are properly authorized by the managers responsible for the agency program or operations that the applications support, (2) new and modified software programs are tested and approved prior to their implementation, and (3) approved software programs are maintained in carefully controlled libraries to protect them from unauthorized changes and to ensure that different versions are properly labeled.

  Application control weaknesses were noted by the IPA in several of SBA's systems. For example, SBA's Automated Loan Control System (ALCS) [13] controls did not ensure that all program changes were authorized, tested, and reviewed before being placed into production. In addition, no procedures were developed to ensure that server-based programs developed by and for various field and program offices followed system development and program change control procedures. This situation existed because SBA had not implemented controls to restrict and monitor programmer access and had not developed the criteria necessary to assess and justify access needs for application software development and program change. Application software development and program change control procedures are critical to ensure that the applications and programs work as intended and provide accurate and reliable information for decision-making and reporting purposes. Consequently, SBA could not be assured that programmers were performing only authorized activities.

  Application software development and program change control focuses on controlling the changes that are made to software systems in operation. This is an important area because operational systems produce the financial statements, and the majority of program changes are made to maintain operational systems. Without proper controls, there is a risk that security features could be inadvertently or deliberately omitted or turned off or that processing irregularities or malicious code could be introduced.

[13] ALCS is a minicomputer system maintained and operated at each of SBA's four Disaster Area Offices. ALCS is used to track and process disaster loan applications.

- **System software**[14] **controls** limit and monitor access to powerful programs and sensitive files that (1) control computer hardware and (2) secure applications supported by the system. Controls over access to and modification of system software are essential in providing reasonable assurance that operating system-based security controls are not compromised or impaired. Control concerns for system software are similar to the access control issues and the application software change controls issues discussed earlier. However, because of the high level of risk associated with system software activities, a separate set of control procedures apply to them.

  As part of the audit, the IPA reviewed and tested the highest-level system software privileges for one of SBA's systems. These privileges provide access that allows programmers to shut down the system or run unauthorized programs. Audit testing conducted by the IPA identified 12 user accounts that did not have documentation showing security officer approval, 24 unnecessary accounts, 15 users that had multiple accounts, 6 accounts that belonged to unknown individuals, and 3 accounts that belonged to a previous vendor. Procedures and criteria were not in place to ensure on an ongoing basis that access to system software was properly restricted. Because system software programmers are often more technically qualified than other data processing personnel (thus, having a greater ability to perform unauthorized actions if controls in this area are weak), adequate system software controls are essential.

  Inadequate controls in this area could lead to unauthorized individuals using system software to circumvent security controls to read, modify, or delete critical or sensitive information and programs. Inadequate controls could also provide the opportunity for authorized users of the system to gain unauthorized privileges to conduct unauthorized actions and for systems software to be used to circumvent edits and other controls built into application programs. Such weaknesses seriously diminish the reliability of information produced by all of the applications supported by the computer system and increase the risk of fraud and sabotage.

[14] A set of programs designed to operate and control the processing activities of computer equipment. These programs help control and coordinate the input, processing, output, and data storage associated with all of the applications that run on a system.

- **Segregation-of-duty controls** provide policies, procedures, and an organizational structure to prevent a single individual from controlling key aspects of computer-related operations and thereby conducting unauthorized actions or gaining unauthorized access to assets or records without being detected. Key areas of concern involve the segregation of duties between major operating and programming activities, including duties performed by users, application programmers, and data center staff. Policies outlining the responsibilities of these groups and related individuals should be documented, communicated, and enforced.

  To help reduce the potential for unauthorized activities, SBA has a Rule of Two policy that requires two individuals to sign certain documents and approve certain transactions or perform specific transactions within a computer application. Although SBA has acted on a fiscal year 1998 audit recommendation that it enforce the Rule of Two, it is important to note that SBA has assessed only one of the critical system functions and access controls to identify incompatible duties. User privileges in the other systems have not been reviewed and assessed. For example, programmers at the Office of the CFO had access to both financial data records and software that provide the ability to initiate transactions. The primary reason that users were provided with these system privileges was lack of training. Security administrators and supervisory personnel at SBA lacked understanding of the activities associated with certain privileges and were not provided system-specific training.

  Although segregation of duties, alone, will not ensure that only authorized activities occur, inadequately segregated duties increase the risk that erroneous or fraudulent transactions could be processed, improper program changes could be implemented, and computer resources could be damaged or destroyed.

- **Service continuity controls** ensure that when unexpected events occur, critical operations continue without interruption or are promptly resumed and critical and sensitive data are protected. SBA had a disaster recovery plan in place for one of the accounting systems. However, further work was needed. The IPA audit found that the Denver Finance Center (among its responsibilities is processing and maintaining disbursement and collection records for SBA) and each SBA Disaster Area Office had only partial plans in place, and the plans had not been tested. This reduced SBA's assurance that it would be able to provide congressionally mandated services to disaster victims and the small business community if a significant disruption occurred.

While SBA took several steps during fiscal year 1999 to improve its general computer controls, many of its initiatives were in the initial stages of implementation and development. SBA took the following actions:

- A senior management group, the Information System Control Committee (ISCC), was established composed of the Chief Information Officer (CIO), the CFO, and the Associate Administrator for Disaster Assistance responsible for addressing the issue of information system security. This committee will oversee the agency's efforts to address the OIG audit recommendations.
- A draft certification and accreditation (C&A) handbook[15] and a schedule for conducting C&A reviews were developed.
- Guidelines for software development and program change controls were improved.
- Disaster recovery tests for the Loan Accounting System were conducted.
- A risk assessment of the Federal Financial System (FFS) access privileges was conducted to reduce exposure and strengthen segregation-of-duty controls; system development and program change control procedures and a security plan were drafted.
- New procedures for conducting inventories of existing systems and applications were issued, system development controls were improved, and a security plan was drafted.
- Funding to increase the security administration staff and obtain contractor support was provided.

To address the remaining information systems control issues, the OIG made the following recommendations, with which we concur, in its audit report on the fiscal year 1999 financial statements: (1) that SBA continue its efforts toward implementing an agencywide information systems security program and (2) that SBA establish responsibilities and milestones for developing and implementing policies and procedures to:

[15]The C&A handbook is an agencywide certification and accreditation effort that focuses on a process for management review and approval to ensure that adequate controls are provided for applications that process sensitive or classified data.

- assign responsibility for the security of each major application to a management official knowledgeable in the nature of the program supported by the application;
- provide annual security training for all SBA employees and contractor personnel on their information system security responsibilities;
- notify security administrators of changes in the employment status of all personnel, promptly eliminate unnecessary user accounts, and notify security administrators in advance when personnel are being discharged under adverse conditions;
- develop a consolidated listing of all user accounts and privileges granted for all SBA employees and contractor personnel;
- revise position descriptions for personnel with security administration responsibilities to include specific responsibilities, technical requirements, and appropriate performance measures in their annual performance plans;
- ensure the use of Office of the CIO approved System Development Life Cycle standards and techniques for all new systems, system enhancements, and program changes;
- perform quality control for all test plans and results for new systems, system enhancements, and program changes to ensure that results are documented, the system operates as intended, and test-support documentation is retained;
- limit and monitor programmer access to operating systems, system utilities, application software, and production data;
- assess critical system functions and access controls to identify incompatible duties and enforce SBA's Rule of Two;
- complete the agency's disaster recovery and business continuity plans and perform annual testing of major portions of the plans;
- obtain approval by senior management and program officials of security plans and risk assessments.

Implementation of these recommendations should improve SBA's general controls over its information systems by assuring that (1) data is safeguarded, (2) computer application programs are protected, (3) unauthorized access to system software is prevented, and (4) continued computer operations are ensured in case of unexpected interruptions.

Lack of Compliance With FFMIA Further Indicates Accountability Challenges

SBA's financial management systems in fiscal year 1999 did not substantially comply with (1) federal financial management systems requirements, (2) federal accounting standards, or (3) the U.S. government SGL at the transaction level as required by FFMIA. One of the purposes of FFMIA is to ensure that agency financial management systems can routinely provide reliable, useful, and timely financial information. As noted previously, causes of FFMIA noncompliance at SBA were attributed to its material weakness in information systems controls (federal financial management systems requirement) and its material weakness in the financial reporting process (federal accounting standards and the SGL requirements).

Federal Financial Management Systems

In conducting the fiscal year 1999 audit, the IPA found that for federal management systems requirements, SBA did not provide security over financial information in accordance with OMB Circular A-130, *Management of Federal Information Resources*, appendix 3, "Security of Federal Automated Information Resources." As previously discussed, general computer control weaknesses in SBA's financial management systems were reported in a variety of areas.

Federal Accounting Standards

The IPA also concluded that SBA's financial management systems did not substantially comply with federal accounting standards. According to OMB Bulletin 98-08, appendix D, "The Federal Financial Management Improvement Act of 1996, OMB Implementation Guidance for CFOs and IGs," an indicator of substantial compliance with federal accounting standards is that the audit disclosed no material weaknesses in internal controls that affect the agency's ability to prepare auditable financial statements and disclosures. As previously discussed, SBA had a material weakness in its financial reporting process since it did not ensure that financial statements would be free of material misstatements. Consequently, the IPA concluded that SBA was not in substantial compliance with this element.

U.S. Government Standard General Ledger at the Transaction Level

Finally, the IPA discovered that SBA's financial systems did not capture information using the same description and posting rules as those contained in the SGL. FFMIA requires agencies to comply with the SGL at the transaction level.[16] As previously mentioned, SBA does not have an integrated general ledger system but instead uses three separate accounting systems to record transactions. SBA's chart of accounts was not consistent across funds as a result of progress made toward the implementation of SGL-based accounting. A number of SBA's funds use the SGL, and the remainder will do so as systems are revised.

SBA's Plan for Resolving FFMIA Noncompliance

FFMIA requires that in addition to auditors reporting on FFMIA compliance in their financial statement audits, the head of each agency must determine whether the agency's financial management systems comply with FFMIA based on a review of the audit results and any other applicable information. If the agency agrees with the auditor's findings of noncompliance, a remediation plan must be developed in consultation with OMB. The IG is required to report on agency progress in achieving compliance.

According to OMB guidance, remediation plans should contain corrective actions and target dates and the resources necessary to implement those actions and achieve substantial compliance with FFMIA within 3 years of the date noncompliance is determined. If, with the concurrence of the Director of OMB, the agency head determines that substantial compliance cannot be reached within 3 years, the remediation plan must specify the most feasible date by which the agency will achieve compliance and designate an official responsible for effecting the necessary corrective actions. SBA agreed with the auditor's findings of noncompliance for FFMIA and developed a remediation plan that OMB has approved.

SBA's overall strategy to resolve all FFMIA noncompliance hinges on its Systems Modernization Initiative (SMI). This initiative is a three-phase, long-range, comprehensive, overall systems modernization program that will replace and modernize SBA's current financial systems. SMI was originally estimated to cost approximately $40 million, to begin in fiscal year 1998, and to take 5 years to complete. Phase I focuses on the systems

[16] An agency's core financial system general ledger management function should be in full compliance with the SGL chart of accounts descriptions and posting rules. This means that transactions from feeder systems are summarized and fed into the core financial system's general ledger following SGL requirements through an interface (automated or manual). The detail supporting the interface transactions can be traced back to the source transactions in the feeder systems, and the feeder systems process transactions that are consistent with SGL account descriptions and posting.

for lender monitoring and oversight, Phase II focuses on financial management and accounting systems and paperless disaster loan processing, and Phase III on information technology infrastructure improvements and additional application support systems. While SBA's efforts during fiscal years 1998 and 1999 have been focused on Phase I, preliminary planning for Phase II started in late fiscal year 1998.

Although SBA has begun to undertake another project to redesign and implement a new automated consolidation system for their financial reporting process, Phase II will be the primary project that addresses FFMIA noncompliance. This phase of the project involves modernizing SBA's financial management and administrative activities, including information technology; procurement and grants management; human resources; and financial functions, especially accounting, budget reporting, and financial operations.

The main purpose of Phase II is to migrate to a new Core Accounting System (CAS) that will serve as the central repository for all of SBA's general ledger activity and consolidated reporting. SBA officials stated that this system will be effective for fiscal year 2002. One of the primary goals of SBA's SMI is to replace its existing outdated systems. As previously mentioned, SBA's systems are not effectively integrated and thus provide limited information sharing. SBA hopes to begin to rectify this problem by implementing a new CAS. SBA envisions that this new CAS will be one of the basic building blocks for a fully integrated financial management system.

However, according to our recently completed evaluation of SBA's management of information technology (IT),[17] many of SBA's policies and procedures for managing information technology are currently in the early stages of development or not yet developed. To improve SBA's IT management, we made several recommendations in this report, with which SBA concurred. Therefore, because SBA's strategy to resolve FFMIA noncompliance depends on the successful completion of the SMI, until the recommendations are implemented it is too early to tell whether SBA's system modernization effort will resolve its noncompliance. We recognize that it will take time, investment, and sustained emphasis on correcting deficiencies to improve SBA's financial management systems to the level

[17] *Information Technology Management: SBA Needs to Establish Policies and Procedures for Key IT Processes* (GAO/AIMD-00-170, May 2000).

required by FFMIA and necessary for effectively managing government funds.

Conclusion

SBA's achievement of a clean audit opinion is an important milestone along the road to financial accountability. However, until SBA improves financial reporting and information system controls, it will not be in a position to provide reliable, timely information on a day-to-day basis, an ultimate goal of financial management initiatives in the federal government. Implementation of a fully integrated financial management system is key to these improvements. However, SBA needs to take several steps to be in a position to effectively undertake such an effort.

Agency Comments

We obtained oral comments on a draft of this report from SBA officials and incorporated the comments where appropriate. We also received written comments from SBA's Chief Financial Officer which are reprinted in appendix II. SBA generally agreed with the findings in our report, and the comments provided further details on the progress that SBA has made in improving its financial management. For example, SBA indicates that it has now reassigned two personnel to the financial reporting team and staff, and management responsible for the financial reporting process have completed training in specific technical aspects of report preparation. In addition, SBA has engaged a contractor to document its accounting and reporting processes. However, these, as well as the other efforts discussed by SBA in its comments, generally occurred after the end of our fieldwork or are currently in process, and thus we have not evaluated these actions.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the date of this letter. At that time we will send copies to Senator John Kerry, Ranking Minority Member of your Committee and the Honorable Aida Alvarez, Administrator, Small Business Administration. Copies will also be made available to others upon request.

Please contact me at (202) 512-9508 if you or your staff have any questions concerning this report. Key contributors to this assignment were Shirley Abel, Julia Duquette, Doris Yanger, Carol Browder, and Maria Zacharias.

Sincerely yours,

Linda M. Calbom
Director, Resources, Community, and Economic Development
Accounting and Financial Management Issues

Analysis of SBA's Financial Statement Components

This appendix provides an analysis of each component of the financial statements with a general discussion of its purpose, followed by a reproduction of the component taken from SBA's fiscal year 1999 *Accountability Report* and an explanation of the information that can be obtained about SBA's operations from it.

Components of a Federal Agency's Financial Statements

The first component of an agency's financial statements is the balance sheet. The balance sheet summarizes the assets and liabilities of a federal agency as of a specific point in time, usually the end of the fiscal year. Assets and liabilities shown on the balance sheet are classified as either intragovernmental (transactions among federal entities) or governmental (transactions of the federal government with nonfederal entities). Also, the balance sheet separates those liabilities for which funds have been appropriated (liabilities covered by budgetary resources) from those that have not yet been funded (liabilities not covered by budgetary resources). Figure 1 shows SBA's balance sheet as of the end of fiscal year 1999.

Figure 1: Balance Sheet

U.S. Small Business Administration

Balance Sheet

as of September 30, 1999

(Rounded to the Thousands)

ASSETS		
Intragovernmental Assets:		
Fund Balances with Treasury (Note 2)	$8,223,656	A
Accounts Receivable, Net (Note 5)	343,894	
Advances (Note 6)	3,629	
Governmental Assets:		
Investments (Note 4)	350,586	
Accounts Receivable, Net (Note 5)	27,860	
Credit Program Receivables and Related Foreclosed Property, Net (Note 7)	7,086,451	B
Cash (Note 3)	2,677	
General Property and Equipment, Net (Note 8)	740	
Advances (Note 6)	129,218	
Total Entity Assets	**$16,168,711**	
Total Non-Entity Assets	**$0**	
Total Assets	**$16,168,711**	
LIABILITIES		
Liabilities Covered by Budgetary Resources:		
Intragovernmental Liabilities:		
Accounts Payable (Note 10)	$1,532,415	C
Debt (Note 9)	10,019,644	D
Other (Note 10)	2,326,987	
Governmental Liabilities:		
Accounts Payable (Note 10)	52,322	
Liabilities for Loan Guarantees (Note 7)	1,404,688	E
Other (Note 10)	400,254	
Total Liabilities Covered by Budgetary Resources	**$15,736,309**	
Liabilities Not Covered by Budgetary Resources:		
Intragovernmental Liabilities:		
Debt (Note 9)	$0	
Other (Note 10)	16,585	
Governmental Liabilities:		
Other (Note 10)	27,498	
Total Liabilities Not Covered by Budgetary Resources	**$44,083**	
Total Liabilities	**$15,780,392**	
NET POSITION		
Unexpended Appropriations (Note 11)	$671,527	
Cumulative Results of Operations	(283,208)	
Total Net Position	**$388,319**	
Total Liabilities and Net Position	**$16,168,711**	

The accompanying notes are an integral part of this statement.

The components of this amount appear in Note 7

This same amount appears in Note 7

This same amount appears on the Statement of Changes in Net Position

SBA provides guaranteed loans to small businesses unable to secure financing in the commercial market without SBA's guarantee and direct loans to victims of federally declared disasters. Thus, the assets and liabilities on SBA's **Balance Sheet** are mostly the result of its credit program activities.

Instead of maintaining cash in a commercial bank account, SBA, like most federal agencies, uses the Department of Treasury to process its cash receipts and disbursements. SBA's **fund balances with Treasury** (see item A in figure 1), which totaled $8.2 billion at the end of fiscal year 1999, are obtained through appropriations as well as borrowings from Treasury and receipts from SBA's program and administrative activities. Fund balances with Treasury are used to make disbursements of direct loans, to purchase defaulted loan guarantees, to pay SBA's expense of servicing and liquidating loan receivables, and to administer credit and business assistance programs.

Loans and defaulted guaranteed loans are accounted for as **credit program receivables** (see item B in figure 1) at the time SBA disburses the funds. As of September 30, 1999, SBA had $7.1 billion in credit program receivables. This amount represents the ultimate amount of cash the government expects to collect on SBA loans—primarily repayments of loan principal and interest less an allowance for the estimated long-term cost to the government of the outstanding loans. As discussed below, more detailed information about SBA's credit program receivables can be found in note 7 (see figure 7) to SBA's financial statements.

SBA is required to estimate the net cost of extending or guaranteeing credit, called subsidy cost. The subsidy cost is measured as the present value[1] of estimated net cash flows, excluding administrative costs. In estimating cash flows, SBA and other credit agencies are required to predict borrower behavior—how many borrowers will pay early, pay late, or default on their loans and at what point in time. The subsidy costs are financed with appropriated funds. The portion of SBA's disaster and other direct loans that SBA predicts will ultimately be collected is financed by borrowings from Treasury. For example, a hypothetical disaster loan of $100 may have a subsidy cost of $20 (the amount SBA expects to lose),

[1]Present value is the worth of the future stream of returns or costs in terms of money paid immediately. In calculating present value, prevailing interest rates provide the basis for converting future amounts into their "money now" equivalents.

which is financed with appropriated funds, and the remaining $80 is financed by Treasury borrowings (the amount SBA expects to be repaid). These Treasury borrowings are labeled as **debt** on the balance sheet (see item D in figure 1). At approximately $10 billion, this debt owed to Treasury at the end of fiscal year 1999 is the largest liability on SBA's balance sheet. **Accounts payable** (see item C in figure 1) is primarily interest owed on Treasury debt which is payable in the upcoming year.

Liabilities for loan guarantees (see item E in figure 1) represents the amount estimated to be payable in the future to the holders of defaulted SBA guaranteed loans. This primarily includes payments SBA estimates it will make on defaulted guaranteed loans less estimated fees paid to SBA for providing the guarantee. As with the credit program receivables, more detailed information about SBA's loan guarantees can be found in note 7 (see figure 7) to SBA's financial statements.

The **Statement of Net Cost** (see figure 2) shows, by major program, how much it cost SBA to provide its services for the fiscal year. Net cost is calculated by subtracting any earned revenues, such as guarantee or user fees, from gross cost, including program cost as well as administrative costs such as payroll, health, and retirement benefits. The "bottom line"(net cost of operations) discloses to the reader, at a summary level, what it cost taxpayers to operate the agency's programs for the fiscal year.

Figure 2: Consolidated Statement of Net Cost

U.S. Small Business Administration

Consolidated Statement of Net Cost

for the period ended September 30, 1999

(Rounded to the Thousands)

PROGRAMS	
Business Loans	$154,685
Development Company	(84,242) F
Disaster Loans	194,996
Small Business Investment Company	4,918
Surety Bond Guarantees	9,470
Minority Enterprise Development	71,485
Government Contracting	19,685
Entrepreneurial Development	144,311
Total Program Costs	**$515,308**
Cost not assigned to programs	12,351
Less: Earned revenue not attributed to programs	(12,713)
Net Cost of Operations (Note 12)	**$514,946**

The accompanying notes are an integral part of this statement.

This same amount appears on the Statement of Financing

The net costs shown on SBA's statement include the gross cost of each of the identified programs, including any subsidy costs and administrative costs, less any earned revenues. SBA's net cost of operations for fiscal year 1999 was $515 million. The largest portions of SBA's net costs are related to disaster and business loans. SBA's net cost in fiscal year 1999 for the **Development Company Program** (see item F in figure 2) reflects a negative cost due to an update in program cost for previously disbursed and committed loans. SBA is required to periodically update or "reestimate" loan program costs for differences between (1) estimated loan performance and related cost and (2) the actual program cost recorded in the accounting records, as well as expected changes in future economic performance. When the loan program cost for the Development Company Program were updated, SBA's revised estimate showed the programs costing less than previously anticipated.[2] The other costs associated with this program were not enough to offset this downward reestimate.

[2]This is generally referred to as a downward reestimate.

Additional information about the subsidy costs of SBA's business and disaster programs can be found in note 7 of the financial statements (see figure 7). In addition, note 12 shows SBA's net cost of operations by budget functional classification[3] and also shows the breakout of gross cost and earned revenue for these budget classifications (see figure 8).

The **Statement of Changes in Net Position** (see figure 3) shows how the agency's net cost of operations was funded. It also shows the agency's net position at the beginning of the fiscal year, the major inflows and outflows of funds that caused the net position to change during the year, and the ending net position. The ending net position, the last line of the statement, discloses to the reader, at a summary level, the current amount of funding available[4] to that agency at the end of the audited year for future operations. This amount is the same as the "Total Net Position" on the Balance Sheet.

[3]The budget functional classification presents costs in terms of the national needs being addressed, in much the same way as the President's Budget, i.e., commerce and housing credit, or community and regional development.

[4]Funds available may include unobligated funds as well as unliquidated obligations (i.e., undelivered orders).

Figure 3: Consolidated Statement of Changes in Net Position

U.S. Small Business Administration

Consolidated Statement of Changes in Net Position

for the period ended September 30, 1999

(Rounded to the Thousands)

Net Cost of Operations	**$514,946**
Financing Sources:	
Appropriations Used	1,213,781
Changes to Resources Payable to Treasury	(64,027)
Donations	131
Imputed Financing	17,328
Transfers-out	(637,102) G
Net Results of Operations	**$15,165**
Prior Period Adjustments	0
Net Change in Cumulative Results of Operations	**$15,165**
Increase (Decrease) in Unexpended Appropriation	348,741 H
Change in Net Position	**$363,906**
Net Position - Beginning of the Period	24,413
Net Position - End of Period	**$388,319**

The accompanying notes are an integral part of this statement.

This same amount appears on the Statement of Financing

This same amount appears on the Balance Sheet

As can be seen from SBA's Statement of Changes in Net Position, SBA receives the majority of the funding needed to support its programs through appropriations. The $637 million **transfers-out** (see item G in figure 3) is the return of money to Treasury as a result of a downward reestimate of the cost of SBA's loan programs during fiscal year 1999. When the loan program costs were updated, SBA's revised estimate showed the programs costing less than previously anticipated. Therefore, the excess was returned to Treasury. In addition, SBA's Statement of Changes in Net Position shows that SBA's net position increased during fiscal year 1999 due to an increase in SBA's **unexpended appropriations** (see item H in figure 3).

The **Statement of Budgetary Resources** (SBR) (see figure 4) is a relatively new addition to the federal financial statements, having been required starting with fiscal year 1998. It provides a link between actual amounts reported in the President's Budget for SBA and the audited financial statements, thus exposing the budgetary actuals to the rigors of a financial audit. SBA's SBR is presented on a consolidated basis, unlike the statements that appear in the President's Budget which are presented by account. Figure 4 shows SBA's SBR for fiscal year 1999.[5]

The SBR provides detailed information on the status of budgetary resources at the fiscal year-end and obligations and outlays during the year. Preparation of the SBR requires agencies to reconcile obligations recorded in budgetary records with their cash outlays.

Because the President's Budget and the SBR are prepared using separate reporting systems and the President's Budget is required to be submitted several months before the SBR, differences in the amounts reported often occur. These differences may be because of timing or other justifiable reasons. For example, adjustments made to amounts reflected on the SBR may be based on information available only after the President's Budget has been submitted.

In the Statement of Budgetary Resources, the caption **Status of Budgetary Resources, Category A, Direct** refers to funds that are apportioned for each calendar quarter in the fiscal year and **Category B, Direct** refers to funds that are apportioned on a basis other than calendar quarters. In general, Category A includes funds related to Salaries and Expenses and the Office of the Inspector General, and Category B includes funds related to SBA programs such as the Business Loan and Investment Fund and the Disaster Loan Fund.

[5]In addition to this SBR, SBA's financial statements also include a consolidating SBR that provides a breakout of amounts by fund (e.g., the Business Loan and Investment Fund and the Disaster Loan Fund).

Figure 4: Combined Statement of Budgetary Resources

U.S. Small Business Administration

Combined Statement of Budgetary Resources (Note 13)

for the period ended September 30, 1999

(Rounded to the Thousands)

BUDGETARY RESOURCES	
Budget Authority:	
Appropriations	$1,207,872
Borrowing Authority	915,742
Net Transfers, Current Year Authority	(20,905)
Unobligated Balance:	
Brought Forward October 1	6,699,756
Spending Authority from Offsetting Collections:	
Earned	
Collected	3,457,975
Receivable from Federal Sources	(161,624)
Adjustments:	
Recoveries of Prior Year Obligations	189,359
Permanently Not Available	
Cancellations of Expired and No Year Accounts	(10,699)
Enacted Rescissions of Prior Year Balances	(6,000)
Capital Transfers and Redemption of Debt	(1,006,976)
Total Budgetary Resources	**$11,264,500**
STATUS OF BUDGETARY RESOURCES	
Obligations Incurred:	
Category A, Direct	$648,346
Category B, Direct	3,332,559
Direct, Not Subject to Apportionment	240,750
Reimbursable	1,642
Unobligated Balances Available:	
Apportioned	21,341
Other	16,708
Unobligated Balances Not Yet Available:	
Apportioned for Subsequent Periods	500
Other	7,002,654
Total, Status of Budgetary Resources	**$11,264,500**

The accompanying notes are an integral part of this statement.

Each amount appears on the Statement of Financing

The sum of these three numbers, $4,221,655, appears on the Statement of Financing

(The Combined Statement of Budgetary Resources continues on the next page)

Figure 4 (continued)

U.S. Small Business Administration

Combined Statement of Budgetary Resources (Note 13)

for the period ended September 30, 1999

(Rounded to the Thousands)

OUTLAYS	
Obligations Incurred:	
Category A, Direct	$648,345
Category B, Direct	3,332,559
Direct, Not Subject to Apportionment	240,750
Reimbursable	1,643
Less: Spending Authority from Offsetting Collections and Adjustments:	
Earned	
Collected	3,457,974
Receivable from Federal Sources	(161,624)
Actual Recoveries of Prior Year Obligations	189,359
Obligated Balance, Net – Beginning of the Period:	1,492,712
Less: Obligated Balance, Net - End of Period:	
Accounts Receivable	(1,294,656)
Undelivered Orders	881,405
Accounts Payable	1,730,763
Total Outlays	**$912,788**
Disbursements	$4,370,762
Collections	($3,457,974)

The accompanying notes are an integral part of this statement.

For fiscal year 1999, certain amounts reported in SBA's SBR differed from actual amounts for SBA reported in the President's Budget. However, because the identified differences are justifiable, as explained below, the audit provides some level of assurance over the actual amounts presented in the President's Budget. Additionally, because of the timing of the preparation and audit of credit program cost reestimates, SBA's fiscal year 1999 reestimates were included in the financial statements but not in the actual amounts in the President's Budget. Thus, the financial statements include additional information on the cost of credit programs that can be used by decision makers to supplement credit cost information included in the budget.

Differences in SBA's actual amounts recorded in the President's Budget and the same items reflected in the SBR can be attributed to audit adjustments and inconsistencies in account classifications between the financial and budget offices. For example, actual figures related to budget authority, obligations, and outlays for the preceding fiscal year are submitted to OMB from November to January for inclusion in the President's Budget for the upcoming fiscal year. At the time that these figures are submitted, many end-of-year audit adjustments that will be reflected in the SBR when the financial statements are issued several months later are not available. In other cases, differences between amounts reported in SBA's SBR and the President's Budget exist because the instructions for preparing the SBR require that balances for expired accounts[6] are included, while the President's Budget includes only actual year information. Other differences are attributable to credit subsidy reestimates and end-of-year loan sales figures that were not available until after the budget submission. Notwithstanding these types of differences, preparation and audit of the SBR provides for the first time a mechanism for determining the reasonableness of agency actual amounts presented in the President's Budget.

The primary purpose of the **Statement of Financing** (see figure 5) is to explain the difference between obligations of budget authority, as reported in the President's Budget and the SBR, and the net cost of operations as shown in the Statement of Net Cost. It clarifies the relationship between budgetary accounting, where obligations are recorded when goods and services are ordered, and financial accounting, where expenses are recorded when goods and services are received. Various amounts in the Statement of Financing can be linked to amounts reported in other components of the financial statements. Since a number of the significant amounts contained in the Statement of Financing can be obtained from other statements, one of the real benefits of the statement is that it demonstrates that the budgetary and financial accounting information in an agency's financial management systems are commensurate with each other.

[6]Expired accounts are an appropriation or fund account in which the balance is no longer available for incurring new obligations because the time available for incurring such obligations has expired.

Figure 5: Combined Statement of Financing

U.S. Small Business Administration

Combined Statement of Financing

for the period ended September 30, 1999

(Rounded to the Thousands)

Resources Used to Finance Activities:	
Budgetary	
Budgetary resources obligated for orders and services to be received or benefits to be provided to others	$4,221,655
Less: Offsetting collections, recoveries of prior-year authority	
Earned reimbursements	
Collected	3,457,974
Receivable from Federal sources	(161,624)
Transfers from Trust Funds	(1,643)
Recoveries of prior-year obligations	189,359
Net budgetary resources used to finance activities	**$737,589**
Non-Budgetary	
Costs incurred by others for the entity without reimbursement	$17,328
Net non-budgetary resources used to finance activities	**$17,328**
Total resources used to finance activities	**$754,917**
Relationship of total resources to net cost of operations:	
Deduct resources used to fund items not part of the net cost of operations	
Increase in budgetary resources obligated to order goods and services not yet received or benefits not yet provided	177,471
Budgetary offsetting collections that do not increase exchange revenue or decrease expenses	
Collections that decrease assets unrelated to exchange revenue	1,338,376
Credit program collections that increase liabilities for loan guarantees or allowances for subsidy	473,051
Other	343,320
Adjustments other than collections made to compute net budgetary resources that do not affect net cost of operations	
Recoveries of prior-year authority	28,890
Resources that fund expenses recognized in prior periods	14,020
Resources that finance the acquisition of assets or liquidation of liabilities	
General property, plant and equipment	196
Loans Receivable	1,143,178
Collateral Acquired	(4,974)
Other resources used to fund items not part of the net cost of operations	(518,049)
Total resources used to fund items not part of the net cost of operations	**($1,371,795)**
Resources used to finance the net cost of operations	**$2,126,712**

The accompanying notes are an integral part of this statement.

The components of this amount appear on the Statement of Budgetary Resources

Each of these amounts appears on the Statement of Budgetary Resources

This same amount appears on the Statement of Changes in Net Position

(The Combined Statement of Financing continues on the next page.)

Figure 5 (continued)

U.S. Small Business Administration

Combined Statement of Financing

for the period ended September 30, 1999

(Rounded to the Thousands)

Components of net cost of operations that do not require or generate resources during the reporting period	
Expenses or exchange revenue related to the disposition of assets or liabilities, or allocation of their costs over time:	
Expenses related to the use of assets	$413
Gains or (losses) from revaluation of assets and liabilities	(7,167)
Decrease in exchange revenue receivable from the public	(46,806)
Interest revenue from amortization of credit program allowance for subsidy	(206,416)
Other	(847,665)
Subtotal	**($1,107,641)**
Expenses that will be financed with budgetary resources recognized in future periods	
Other	($1,556)
Subtotal	**($1,556)**
Other net cost components that do not require or generate resources during the reporting period	(502,568)
Total components of net cost of operations that do not require or generate resources during the reporting period	**($1,611,765)**
Net cost of operations	**$514,946**

The accompanying notes are an integral part of this statement.

This same amount appears on the Statement of Net Cost

The fact that SBA was able to prepare the Statement of Financing and received an unqualified opinion gives the reader comfort that SBA was able to reconcile its budgetary and financial accounting information. The reader can also link amounts reported in the Statement of Financing back to other components. For example, the $4.2 billion in **budgetary resources obligated for orders and services to be received or benefits to be provided to others** is the sum of the first three amounts in the SBR "Status of Budgetary Resources" section. The last number on the Statement of Financing is the net cost of operations which is the same as the **net cost of operations** on the Statement of Net Costs.

Footnotes are used at the end of financial statements to offer a fuller understanding of the information presented. Footnotes may be used to identify accounting methods used for major expenses and other transactions or to provide supplementary information and details about significant assets and liabilities.

For example, note 1, Significant Accounting Policies (see figure 6), describes SBA's accounting methods and also discloses that SBA initiated a pilot program in fiscal year 1999 to sell rather than service loans from its portfolio. SBA also indicates that its fiscal year 2001 budget request for subsidy allowance did not reflect any cash flow or gains or losses from the pilot sale.

Figure 6: Footnotes to Principal Financial Statements, Note 1

U.S. Small Business Administration

Footnotes to Principal Financial Statements

September 30, 1999

NOTE 1. Significant Accounting Policies

* * *

I. Asset Sales

During fiscal year 1999, the SBA initiated a pilot program to sell pools of loans from its loan portfolio rather than servicing such loan itself. It is expected that if the program results in additional funds received by the Agency over the amounts expected to be received if such loans were serviced by the SBA and held to maturity, the loan sale program will continue.

Gains and losses loan-by-loan were recognized as cost of operations for the pre-1992 loans in the sale.

This year, calculation of the budget request for loan subsidy allowance for FY 2001 7(a) and direct loans, did not reflect any cash flows or gains and losses from this pilot sale. OMB granted the SBA permission to calculate its expected cash flows from loans using only the first 3 quarters of the fiscal year, for timeliness concerns, rather than a full year. The loan sale occurred in the 4th quarter, and any cash flow changes requiring additional subsidy or reducing future subsidy, which would be reflected in the subsidy expense for the year, were not determinable at year-end. Showing this completely neutral effect upon future cash receipts and disbursements is a more conservative approach than speculation about positive future sale results based upon one pilot sale.

* * *

Further details on the loan sale, as well as an abundance of other information, are disclosed in note 7, Loans and Loan Guarantees, Non-Federal Borrowers, which is presented in figure 7 under part K.

Figure 7: Footnotes to Principal Financial Statements, Note 7

NOTE 7. Loans and Loan Guarantees, Non-Federal Borrowers:

A. SBA operates the following loan and/or loan guarantee programs:

(1) Business, Direct

(2) Business, Guarantee

(3) Disaster, Direct

(4) Pollution Control, Guarantee

Direct loan obligations or loan guarantee commitments made prior to FY 1992, and the resulting direct loans or loan guarantees, are reported net of an allowance for estimated uncollectible loans or estimated losses. Loss allowances represent estimates of what SBA does not expect to recover on its loans receivable obligated prior to FY 1992. These allowances are based upon historical experience, current market conditions and an analysis of individual assets. They are non-funded and merely attempt to reflect the anticipated unrecoverable loans receivable.

Direct loan obligations or loan guarantee commitments made after FY 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act. The Act provides that the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, estimated delinquencies and defaults, fee offsets, and other cash flows) associated with direct loans and loan guarantees be recognized as a cost in the year the loan or loan guarantee is made.

An analysis of loans receivable, loan guarantees, liability for loan guarantees, and the nature and amounts of the subsidy and administrative costs associated with the loans and loan guarantees is provided in the following sections.

B. Direct Loans Obligated Prior to FY 1992:

Liquidating Loan Programs	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Direct Loans
(1) Business	$332,501,401	$1,870,879	($62,863,703)	$10,313,436	$281,822,013
(2) Disaster	1,116,446,128	17,687,237	(80,000,757)	589,035	1,054,721,644
Total	**$1,448,947,529**	**$19,558,116**	**($142,864,460)**	**$10,902,471**	**$1,336,543,657**

C. Direct Loans Obligated After FY 1991:

Credit Reform Programs	Loans Receivable, Gross	Interest Receivable	Foreclosed Property	Allowance for Subsidy Cost (Present Value)	Net Present Value of Assets Related to Direct Loans
(1) Business	$118,453,746	$2,356,534	$250,654	($31,160,445)	$89,900,489
(2) Disaster	5,658,607,878	38,808,366	1,032,638	(929,356,794)	4,769,092,088
Total	**$5,777,061,624**	**$41,164,900**	**$1,283,292**	**($960,517,239)**	**$4,858,992,577**

D. Defaults on Pre-1992 Guaranteed Loans:

Liquidating Loan Guarantee Programs	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Defaulted Guaranteed Loans Receivable, Net
(1) Business	$671,897,499	$44,056,753	($323,599,891)	$11,180,537	$403,534,898
(2) Pollution	47,405,266	342,935	(32,016,345)	0	15,731,856
Total	**$719,302,765**	**$44,399,688**	**($355,616,236)**	**$11,180,537**	**$419,266,754**

(Note 7 continues on the next page.)

Figure 7 (continued)

E. Defaults on Post-1991 Guaranteed Loans:

Credit Reform Loan Guarantee Program	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Foreclosed Property	Allowance for Subsidy Cost (Present Value)	Net Present Value of Assets Related to Defaulted Guarantee Loans Receivable
Business	$592,349,812	$20,774,168	$19,159,378	($160,635,766)	$471,647,592

F. Guaranteed Loans Outstanding:

Loan Programs	Outstanding Principal, Guaranteed Loans Receivable, Gross	Amount of Outstanding Principal Guaranteed
(1) Business	$39,551,704,489	$31,924,382,912
(2) Pollution	45,140,146	45,140,146
Total	**$39,596,844,635**	**$31,969,523,058**

G. Liability for Loan Guarantees:

Loan Programs	Liabilities for Losses on Pre-1992 Guarantees Liquidating	Liabilities for Loan Guarantees for Post-1991 Guarantees (Present Value)	Total Liabilities for Loan Guarantees
(1) Business	$17,621,222	$1,380,126,393	$1,397,747,615
(2) Pollution	6,940,886	0	$6,940,886
Total	**$24,562,108**	**$1,380,126,393**	**$1,404,688,501**

This same amount appears on the Balance Sheet

H. Subsidy Expense for Post-1991 Loans:

1. Current Year's Direct Loans

Loan Programs	Interest Differential	Defaults	Fees	Other	Total
(1) Business	$1,128,798	($55,694)	$1,326	($21,371)	$1,053,060
(2) Disaster	94,900,742	64,337,989	(66,591)	(7,981,489)	151,190,651
Total	**$96,029,540**	**$64,282,295**	**($65,265)**	**($8,002,860)**	**$152,243,712**

2. Direct Loan Modification and Re-estimates

Loan Programs	Modifications	Re-estimates	Total
(1) Business	$0	$0	$0
(2) Disaster	0	(152,690,680)	(152,690,680)
Total	**$0**	**($152,690,680)**	**($152,690,680)**

3. Total Direct Loan Subsidy Expenses

Loan Program	Total
(1) Business	$1,053,060
(2) Disaster	(1,500,029)
Total	**($446,969)**

I. Subsidy Expense for Post-1991 Loans Guarantees:

1. Current Year's Loan Guarantees

Loan Program	Interest Supplement	Defaults	Fees	Other	Total
Business	$0	$455,956,442	($292,584,272)	($36,129,792)	$127,242,378

(Note 7 continues on the next page.)

Figure 7 (continued)

2. Loan Guarantee Modifications and Re-estimates

Loan Program	Modifications	Re-estimates	Total
Business	$0	($206,909,581)	($206,909,581)

3. Total Loan Guarantee Subsidy Expenses

Loan Program	Total
Business	($79,667,202)

J. Administrative Expense:

Direct Loans Loan Programs	Total
(1) Business	$18,800,000
(2) Disaster	146,750,000
Total	**$165,550,000**

Loan Guarantees Loan Program	Total
Business	$96,966,563

K. Other Information:

The liability in Part G of this note, for pre-1992 business loans, relates to outstanding gross amounts guaranteed of $2,585,509,735. Of this amount, the Agency's share is $2,262,737,540. For Pollution Control Equipment Contract Guarantees, the outstanding guarantees total $45,140,146. This amount is both gross and Agency share. For post-1991 loans, the gross amount guaranteed for business loans is $36,966,194,754. The Agency's share is $29,661,645,372.

The Foreclosed Property referred to in Parts B through E is comprised of $38,574,920 of Real Estate outstanding on 261 loans and $3,950,758 of Other Property outstanding on 50 loans.

The majority of loans sold in FY 1999 were from the 7(a) program. Under this program, the SBA guarantees a percentage of business loans which are actually made and disbursed by participating banks. Loans with unpaid principal balances totaling $332 million were sold to two successful bidders for $195 million before costs. Since SBA expected to net less than $195 million by holding and servicing the loans itself, the sale was deemed successful. Book value of the loans after consideration of various subsidy allowances and allowances for doubtful accounts totaled $270 million.

For FY 2000, additional sales have been planned. About $1.5 billion of SBA's loan portfolio, to include disaster loans, is expected to be sold in each of the future anticipated sales. The effect of the smaller pilot loan sale in FY 1999, and the effects of the two larger sales planned, will be factored into the calculations of the subsidy expense and allowance next year. At that point, we will determine what the impact may be from future asset sales. If there is no future positive impact to the agency, loan sales will not continue. However, based upon the positive impact of the first sale, we expect to sell the bulk of the SBA's loan portfolio within the next three or four years.

Figure 8: Footnotes to Principal Financial Statements, Note 12

NOTE 12. Gross Cost and Earned Revenue by Budget Functional Classification:

Functional Classification	Gross Cost	Earned Revenue	Net Cost
Commerce and Housing Credit	$478,472,183	($176,773,834)	$301,698,350
Community and Regional Development	957,875,950	(744,628,667)	213,247,283
Total	**$1,436,348,133**	**($921,402,501)**	**$514,945,633**

Figure 9: Summary of Part B Through Part E in SBA's Note 7

(In thousands of dollars)

Direct loans	**Loans receivable**	**Interest receivable**	**Foreclosed property**	**Gross total assets**	**Subsidy qllowance**	**Net direct loan assets**
Pre-1992 direct loans	1,448,947	19,558	10,902	1,479,407	(142,864)	1,336,543
Post-1991 direct loans	5,777,062	41,165	1,283	5,819,510	(960,517)	4,858,993
Acquired pre-1992 direct loans	719,303	44,400	11,181	774,884	(355,616)	419,268
Acquired post-1991 direct loans	592,350	20,774	19,159	632,283	(160,636)	471,647
Total	8,537,662	125,897	42,525	8,706,084	(1,619,633)	7,086,451

This same amount appears on the Balance Sheet

Part A of note 7 (see figure 7) lists the loan and loan guarantee programs operated by SBA and explains the basic method of accounting for them. Parts B through E display the assets related to direct loans and defaulted guaranteed loans.[7] Although only the net amount of credit reform receivables was reported in SBA's balance sheet, a reader can calculate the gross amount of loans receivable and the allowance by adding the numbers in Parts B through E, as shown in figure 9. The gross amount of loans receivable is useful to know because it shows the total amount of loans outstanding, and the allowance shows the long-term cost to the

[7]When a borrower defaults on a guaranteed loan, SBA purchases the loan from the lending institution. At this point the loan is recorded on SBA's financial statement as part of credit program receivables.

government of those outstanding loans. The gross amount of loans receivable as of September 30, 1999, was approximately $8.7 billion and the subsidy allowance was about $1.6 billion. By subtracting the subsidy allowance from the gross amount of loans receivable of $8.7 billion, we calculate the net amount of loan assets of approximately $7.1 billion, which agrees with the amount reported on the balance sheet.

Parts F and G (see figure 7) of the footnote provide data on SBA's guaranteed loans outstanding and liability for loan guarantees. Part F shows that the total amount or face value of guaranteed loans outstanding as of September 30, 1999, was approximately $39.6 billion. Of that amount almost $32 billion or approximately 80 percent is guaranteed by SBA, i.e., represents a risk to the government. Part G shows that the liability for loan guarantees is $1.4 billion, which is the amount reported on SBA's balance sheet. It is based on estimated defaults on guaranteed loans and therefore represents the estimated cost to the government of the guaranteed loans.

The subsidy expenses reported by SBA in parts H and I (see figure 7) represent the estimated losses for the direct and guaranteed loans disbursed during the current reporting year.[8] The Federal Credit Reform Act of 1990 requires that these estimates be based on the present value of projected net cash flows over the life of the direct and guaranteed loans, taking into account interest subsidies, projected defaults, fee receipts, and all other factors that may affect the cash flows. The subsidy expenses are subjected to reestimates on an annual basis.

For direct loans disbursed in fiscal year 1999, SBA incurred a subsidy expense of $152 million, as shown in part H. Of that amount, $96 million was due to interest subsidy costs and $64 million was due to the costs of projected defaults. For guaranteed loans disbursed in fiscal year 1999, SBA incurred a subsidy expense of $127 million, as shown in part I. The expense equals the costs of the estimated defaults of $456 million, minus projected fee receipts and other offsets of $329 million.

In fiscal year 1999, SBA made downward reestimates for the subsidy allowance for direct loans and the liability for loan guarantees, as shown in figure 10. For direct loans, the downward reestimate was $153 million. For

[8]This differs from the subsidy estimate made for budgetary purposes, which includes the estimated cost for loans and guarantees for a particular fiscal year, regardless of the year in which they are disbursed.

loan guarantees, the downward reestimate was $207 million. In total, the downward reestimates, which relate to loans disbursed and committed in prior years, more than offset the expenses recognized for the loans disbursed and committed in the current year. As a result, SBA reported a negative expense of $80 million for its direct loans and loan guarantees for fiscal year 1999. In the Statement of Net Costs these amounts offset other loan program costs, such as administrative expenses.

Figure 10: Subsidy Expense and Reestimates

(In thousands of dollars)

	Expense for loans disbursed in 1999	Reestimates	Total
Direct loans	152,244	(152,691)	(447)
Loan guarantees	127,242	(206,910)	(79,668)
Total	279,486	(359,601)	(80,115)

Part J (see figure 7) of the footnote provides data on administrative expenses[9] for direct loans and loan guarantees. The total administrative expense was $263 million. Of that amount, $166 million was for direct loans and $97 million was for loan guarantees.

Finally, SBA provides information on its loan sale in part K (see figure 7). SBA held its first loan sale in fiscal year 1999, and the majority of the loans sold were from the 7(a) program. SBA expects to sell the majority of its loan portfolio within the next 3 or 4 years. Additional sales have been planned for fiscal year 2000, and these sales will include disaster loans. About $1.5 billion of loans is expected to be sold in each of the future sales.

As stated previously, note 1 (see figure 6) informed the reader that SBA's fiscal year 2001 budget request for subsidy allowance did not include the results of the loan sale. In note 7 (see part K in figure 7), it is noted that the effect of the small sale in fiscal year 1999 and the planned sales in fiscal

[9]Costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes are administrative costs. Administrative costs are not included in calculating subsidy costs.

year 2000 will be factored into the subsidy expense and allowance calculations included in the fiscal year 2000 financial statements.[10]

These are just a few examples of the types of detailed information included in the footnotes to the financial statements that provide insight into the agency's activities.

[10]According to agency officials, SBA's asset sale schedule has changed and only one sale will be held during fiscal year 2000. Due to the lateness of this sale in the fiscal year, and the financial transactions related to it, SBA officials have indicated that fiscal year 2000 financial statements will only include the results of the pilot sale held in fiscal year 1999.

Comments From the Small Business Administration

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

AUG 4 2000

Jeffrey C. Steinhoff
Assistant Comptroller General
Government Accounting Office

Dear Mr. Steinhoff:

Thank you for the opportunity to respond to the General Accounting Office (GAO) draft report *"Status of Financial Management Issues at the Small Business Administration."* We especially appreciated the cooperation of your staff in working closely with us during the course of the review to ensure the report was both accurate and balanced. The SBA welcomes the opportunity to identify and discuss with the GAO and the Congress the challenges we, as well as the rest of the Federal government, face in the improvement of our financial management. We are extremely proud of the tremendous progress that we have made in this regard. As an example, the SBA was the first credit agency to receive an unqualified opinion (in 1996), and is the only credit agency to maintain its unqualified opinion for four consecutive years.

As discussed in your report, and as identified in the FY 1999 audit report submitted by our Independent Public Accountant (IPA), further improvement to SBA's financial management is needed. On November 18, 1999, the SBA met with high level representatives of the OMB, GAO, Treasury, our Inspector General's (IG) office, as well as SBA's IPA, Cotton & Company. In this meeting we discussed the challenges that we have faced in our financial reporting, our commitment to timely reporting of FY 1999 results and finally the improvements that we had planned for FY 2000 reporting. Despite changes to reporting requirements and the addition of three substantive statements in 1998, the SBA, with much hard work using a largely manual reporting system, did submit its FY 1999 financial statements on time with an unqualified audit opinion. At the November meeting, the SBA also discussed its plan to launch a major automation effort during FY 2000 to improve SBA's financial reporting and to eliminate this as a material weakness in the auditor's FY 2000 report. Much of the work on this effort to automate and improve our financial reporting process has been completed and we appreciate the recognition of this progress included in your draft report. With these improvements, and those planned for the balance of this year, we fully expect to have financial reporting removed as a weakness in our audit report for FY 2000.

We are submitting the comments below to further clarify the progress that SBA has made in improving its financial management and to ensure the accuracy of your report. The following specific comments are aligned with the pages in your report.

Now on p. 16.
See comment 1.

1. On Page # 20, the report addressed the recommendations from the IG/IPA audit report for fiscal year 1999. The SBA believes our corrective actions should be included in the report, reflecting the current status of SBA's efforts to address each of the audit recommendations.

- Ensure that adequate resources are provided to implement an effective internal control system over the financial reporting processes. **Current Status**: ***Completed by the reassignment of two personnel into the reporting team and the addition of contract assistance, where and when needed.***
- Provide additional training to both staff and management responsible for the financial reporting process. **Current Status**: ***Training for reporting team in specific technical aspects of report preparation has been completed.***
- Develop detailed procedures for activities, such as preparing journal vouchers, calculating loss allowances, preparing and updating trial balances, and preparing financial statements and notes. **Current Status**: ***We have engaged a contractor to assist us with preparing the necessary documentation, and we will use the preferred documentation format recommended by our IPA to document our accounting and reporting processes.***
- Require each fund accountant to process and maintain trial balances and reports in a consistent manner. **Current Status:** ***We have developed and are setting up a standard layout of the accounts, both budgetary and general, into a template to be used in the reporting process. Also, our automation of financial reporting will apply uniformity to the process (see next item).***
- Reduce the manual re-keying of data through automation. To the extent possible, automate the roll-up of data from the off-line and on-line trial balances to the combined and consolidated trial balances and the resulting financial statements. **Current Status:** ***Using our in-house information technology staff, we have identified several initiatives where report preparation can be further automated and have established a detailed action plan to automate these functions and reports in a deliberate manner for the balance of the year. We have made significant progress against this plan to date, with the balance to be fully completed by the end of the reporting period. We view this initiative as a temporary solution, but it fully addresses the weakness. Our optimal solution is to fully automate all of our general ledger accounting and reporting through the installation of an integrated core accounting system that is being procured through our Systems Modernization Initiative. This long-term solution should be in place for FY 2002, and further refined in the future.***

Now on p. 16.
See comment 1.

2. On page #21 at the top of the page the report references: "With quarterly financial statements….." SBA has clarified this recommendation of the IPA and offers the results of that discussion. ***The SBA has agreed to provide quarterly reports in FY 2001 of financial results, as this will help ensure the accuracy of financial data during the year. The SBA has clarified this recommendation of the IPA to mean that the yearend adjusting and closing entries will not be made in the quarterly reports as this is not appropriate for record keeping purposes.***

Now on p. 16.
See comment 1.

3. Also on page 21 for the paragraph beginning "According to the Independent Public Accountant (IPA) report, SBA has undertaken a significant project that should help address the identified weakness in the financial reporting process." The SBA would like to add a citation from the referenced IPA report as a footnote to this paragraph in the draft report. **Footnote:** ***Matthew H. Johnson, CPA, CGFM, IPA stated; "While this new system has yet to produce any financial statements for audit purposes, we are encouraged that if fully implemented, it may overcome the weaknesses we reported in the FY 1999 financial statement audit..."***

We would appreciate your adoption of the above comments/changes into the body of your report, and the inclusion of this entire response in the report. We appreciate the Committee's interest in improving government wide financial management, and the assessment of SBA in this regard. The recent statutes passed by the Congress to improve financial management have presented daunting challenges for financial management officials and Federal managers. In the end, we believe the American taxpayer deserves the level of accountability expected through the full implementation of these statutes within each Federal agency.

We firmly believe that SBA is committed to fully implementing these statutes and has visibly demonstrated this commitment through its continuing financial management improvements that have been identified in the annual financial audits and other reviews of SBA's activities. There is always room for improvements and we welcome the identification of potential improvements, as this supports the SBA's strategic goal to become a leading-edge 21st century institution. We are well on our way to this goal in the SBA's strategic plan under the Government Performance and Results Act.

Joseph P. Loddo
Chief Financial Officer

The following is GAO's comment on the Small Business Administration's letter dated August 4, 2000.

GAO Comment

1. See “Agency Comments” section.

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