



U.S. Small Business Administration
Washington, D.C. 20416

**OFFICE OF
INSPECTOR GENERAL**

AUDIT REPORT
Issue Date: December 16, 1999
Number: 0-02

To: Joseph P. Loddo
Acting Chief Financial Officer

Robert G. Seabrooks

From: Robert G. Seabrooks
Assistant Inspector General for Auditing

Subject: Audit of SBA's FY 1998 Financial Statements – Management Letter

Pursuant to the Chief Financial Officers Act of 1990, attached is the Independent Auditor's Management Letter (Attachment 1) issued by Cotton & Co., CPAs. The Management Letter includes conditions related to the (1) transfer of funds from one fiscal year to another, and (2) inventory of capitalized property. The conditions were identified during the audit of SBA's Fiscal Year 1998 financial statements but were not required to be included in the Auditor's Report. SBA officials agreed with the findings and recommendation. **The findings in this report are subject to review, management decision, and action by your office in accordance with existing Agency procedures for audit follow-up and resolution.** Please provide your management decisions on SBA Form 1824, Recommendation Action Sheet, also attached, within 30 days.

Should you or your staff have any questions, please contact Victor R. Ruiz, Director, Business Development Programs, on (202) 205-7204.

Attachment

COTTON & COMPANY LLP

CERTIFIED PUBLIC ACCOUNTANTS

333 NORTH FAIRFAX STREET • SUITE 401 • ALEXANDRIA, VIRGINIA 22314

DAVID L. COTTON, CPA, CFE
CHARLES HAYWARD, CPA, CPE

MICHAEL W. GILLESPIE, CPA, CFE
CATHERINE L. NOCERA, CPA

ELLEN P. REED, CPA
MATTHEW H. JOHNSON, CPA

August 13, 1999

**MANAGEMENT LETTER COMMENTS
INDEPENDENT AUDIT OF FISCAL YEAR 1998
PRINCIPAL FINANCIAL STATEMENTS**

Inspector General
Small Business Administration

We have audited the Small Business Administration's (SBA) principal financial statements as of September 30, 1998, and for the year then ended and have issued our reports on SBA's internal control structure and compliance with laws and regulations dated August 13, 1999, to SBA under separate cover.

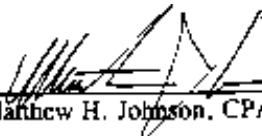
The purpose of this management letter is to communicate two non-reportable findings to SBA management.

This letter is intended solely for the information and use of SBA management.

We would like to express our appreciation to the SBA representatives who assisted us in completing our audit. They were always courteous, helpful, and professional.

Very truly yours,

COTTON & COMPANY, LLP

By: 
Matthew H. Johnson, CPA, CGFM

**INDEPENDENT AUDIT OF FISCAL YEAR 1998
PRINCIPAL FINANCIAL STATEMENTS
U.S. SMALL BUSINESS ADMINISTRATION
NONREPORTABLE FINDINGS**

Certain nonreportable findings came to our attention during the audit of the Small Business Administration's (SBA) Fiscal Year (FY) 1998 principal financial statements. The first finding pertains to compliance with laws and regulations and the second to the SBA's internal control structure. These are discussed below.

1. Small Business Development Center Cooperative Agreements

The Small Business Development Center (SBDC) Program is a partnership between SBA and host organizations to provide small businesses with quality assistance to promote growth, expansion, innovation, productivity, and management improvement. SBA funds SBDCs through cooperative agreements that link Federal, state, and local governments resources with those of colleges, universities, and the private sector. To qualify for assistance, an SBDC must provide matching funds equal to the total amount of SBA funding.

SBA receives annual appropriations for fundign the SBDC program. These appropriations state that the SBDC may use the funds over a 2-year period. Payments are made to an SBDC by the letter-of-credit system when they present a "request for funds." SBDC funds are usually awarded for a 12-month period, and costs incurred in a specific budget period must be charged to that period even if funds remain from the previous period. Under certain circumstances, an SBDC may request approval to "carryover" a Federal unobligated balance to the next budget period to make it available for spending during the next period. Carryover of unexpended funds is permissible, however, only if these leftover funds are used for a non-recurring project or activity within the scope of the original grant. Approved carryover requests require the issuance of a revised Notice of Award.

During our audit of SBA's 1997 financial statements, we noted that the Denver Finance Center (DFC) did not record SBDC disbursements to the correct grants. DFC officials stated that grantees did not always identify grant numbers. We recommended that SBDCs be required to identify grant numbers on disbursements, and that DFC reconcile each grant with the final financial status report.

During the reconciliation process in FY 1998, SBA found that a significant amount of funds (\$5.3 million) were unexpended by the SBDCs from prior years (including FYs 1997 and 1998). The then Chief Financial Officer directed DFC to transfer FY 1998 and 1999 drawdowns to the FYs 1997 and 1998 accounts of some SBDCs, thereby freeing up FYs 1998 and 1999 funds. The transfer was made without any request from the SBDCs, to carry over funds and without amending the Notice of Awards. 31 United States Code (USC) 150(a)(5), Grants and Subsidies, requires that "there must be documentary evidence of the commitment" and "award terms must be communicated to the grantee and where the grantee is required to comply with certain prerequisites, such as matching funds, the award must be accepted by the grantee during the period

of availability of the grant funds.” SBA did, upon questioning by the auditors, move the drawdowns back to the FYs 1998 and 1999 appropriation by reversing the accounting transactions.

The effect of transferring the FY 1998 drawdowns created the appearance that funds from the FY 1998 appropriation were still available for obligation. If the transfer of funds had not been corrected, SBA could potentially have exceeded its FY 1998 obligation authority by the \$5.3 million that was transferred.

2. Capitalized Property

The Office of the Chief Financial Officer (OCFO), Denver Finance Center (DFC), is responsible for maintaining capitalized property records for SBA. Specifically, DFC maintains records of capitalized property on the Administrative Accountable Property (AAP) system and SBA’s general ledger control accounts in the Federal Financial System (FFS). DFC also is responsible for reconciling the FFS control accounts to the AAP system. Property officers in headquarters and field offices are responsible for physical inventory of capitalized property.

In conducting our audit of SBA’s 1998 financial statements, we found that SBA does not perform periodic inventories of its capitalized property. Further, we found that the disposal of capitalized property is not always recorded. Because SBA does not perform periodic inventories, it cannot assure itself that capitalize property is accurately reported on it financial statements. This problem is compounded by the inconsistent recording of disposals on SBA property records.

For FY 1998, SBA conducted a “Record to Floor” physical inventory of its capitalized property, tracing property as recorded on the AAP system (Record) to the actual physical item (Floor). It did not, however, attempt to inventory property that actually exists but may not be recorded on the AAP system, or “Floor to Record.” This inventory thus resulted in significant adjustments to SBA’s property accounts. We commend SBA on this effort and encourage it to conduct the “Record to Floor” inventory as well as a “Floor to Record” inventory on a periodic basis.

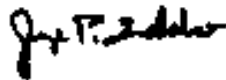
SBA’s Standard Operating Procedure (SOP) 20-13-3, Capitalized Property Accounting, requires that items of property on hand be periodically verified. Specifically, it states that capitalized property be inventoried at least once a year. The cut-off date for the annual physical inventory is September 30 of each calendar year. The SOP further requires that DFC remove excess personal property that has been disposed of from the AAP system.

We recommend that the Director of DFC request responsible personnel to adhere to the requirements of SOP 20-13-3.



United States Government
SMALL BUSINESS ADMINISTRATION

Date: December 14, 1999

From: Joseph P. Laddo, Acting Chief Financial Officer 

To: Robert G. Seabrooks, Assistant Inspector General for Auditing

Subject: Audit of SBA's FY 1998 Financial Statements - Management Letter

We have reviewed the draft Management Letter submitted by Cotton & Company (Cotton) for SBA's FY 1998 financial audit. Cotton has identified only two non-reportable items - Small Business Development Center Cooperative Agreements and Capitalized Property. While we accept the auditors' findings, we are pleased to note that this is significantly fewer items than identified in prior years, and that we have already corrected one item and substantially corrected the second.

Small Business Development Center Cooperative Agreements

The FY 1997 audit contained a recommendation to improve the disbursement process for SBDCs - specifically, to require disbursement requests to identify the proper grant year. An SBA Notice was issued as well as a letter to all SBDCs notifying them of this requirement. Also resulting from this audit item, the Denver Finance Center (DFC) undertook a comprehensive reconciliation of all SBDC grant activity for all years during FY 1998. As identified by the auditors, some transactions were identified as questionable, and immediately corrected.

Resulting from that FY 1998 reconciliation experience, the DFC worked with the Office of SBDC and the Office of General Counsel to document the correct disbursement procedures. Now, as noted in the current Management Letter, all drawdown activity has been reconciled and recorded in the proper fiscal year. Therefore, this item has been corrected.

Capitalized Property

During the planning phase for the FY 1998 audit, Cotton identified capitalized property as a potential issue. In response to that "heads-up," a comprehensive review of all capitalized property recorded in the agency's tracking system was undertaken during the summer of 1998. Listings of all property were sent out to field offices for physical inspection. And, resulting from that review, a number of adjustments were made to reconcile the capitalized property system. Cotton describes this effort as a "Record to Floor" review.

Due to the recency of the FY 1998 reconciliation, we took a different approach during FY 1999. Transactions exceeding the \$5,000 threshold were downloaded from the agency's accounting system. Historically, only certain BOCs such as 3110, 3115, 3120, 3125 have resulted in capitalized property - items such as copy machines, file storage units, phone systems and computer file servers. These transactions were reviewed and those items which met the capitalized property criteria were added to the tracking system. Although not initiated at the field office level, Cotton describes this effort as a "Floor to Record" review. This method yielded better information than other approaches from a tracking standpoint as to the location and current disposition of the property.

Based on these efforts, the only remaining area of concern is validation of the tracking system for pre-FY 1998 acquisitions. In order to address this area for final resolution, DFC will do the following during FY 2000:

- Issue an SBA Notice (already drafted) reminding the field offices of their responsibility regarding the acquisition, tracking and disposal of capitalized property as contained in SOP 20-13-3.
- This Notice will also instruct office to conduct a comprehensive "Floor to Record" review of capitalized property, focussing on pre-FY 1998 acquisitions.

- DFC will continue to validate the capitalized property tracking system on an annual basis with a "Record to Floor" review with field offices.

The OCFO will respond to the SBA Form 1824, concerning capitalized property, once received. The item regarding the SBDC activity is completed. If you have any additional questions for us or wish to discuss these matters further, please let me know.