

**AUDIT OF SBA'S FY 2002
FINANCIAL STATEMENTS
AUDIT REPORT NUMBER 3-06
JANUARY 30, 2003**

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**U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416**

AUDIT REPORT
Issue Date: January 30, 2003
Report Number: 3-06

To: Hector V. Barreto, Administrator

Thomas A. Dumaresq, Chief Financial Officer

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

Subject: Audit of SBA's FY 2002 Financial Statements

Pursuant to the Chief Financial Officers Act of 1990, attached are the Independent Auditor's Report and accompanying reports on internal control and compliance with laws and regulations issued by Cotton & Company LLP. The auditors disclaimed an opinion on the FY 2002 and the restated FY 2001 financial statements. The auditors noted scope limitations on their work in the areas of disaster loan program modeling, pre-1992 loan guarantees, and the Master Reserve Fund. As a result, the auditors were unable to satisfy themselves as to certain financial statement and footnote amounts as described in the Independent Auditor's Report.

The Independent Auditor's Report on Internal Control discusses six matters considered to be reportable conditions, five of which the auditors considered to be material weaknesses. The five material weaknesses identified by the auditors were in the following areas: (1) SBA's disaster loan program modeling; (2) SBA's liability for loan guarantees and related accounts for pre-1992 loan commitments; (3) SBA's financial reporting process; (4) SBA's funds control procedures; and (5) accounting for the Master Reserve Fund. The reportable condition noted that SBA's information system control environment continues to contain areas for improvement. These reportable conditions are further described in the Independent Auditor's Report on Internal Control. The auditors found other management and internal control issues that will be communicated in a separate management letter.

The Independent Auditor's Report on Compliance with Laws and Regulations disclosed that SBA was not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) because of the following: (1) SBA's financial management systems did not substantially comply with FFMIA; (2) SBA is not in substantial compliance with federal accounting standards; and (3) SBA is not in substantial compliance with the United States Standard General Ledger at the transaction level. The auditors also noted that the funds control

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COTTON & COMPANY LLP

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Independent Auditor's Report

Inspector General
U.S. Small Business Administration

We were engaged to audit the accompanying consolidated balance sheets of the U.S. Small Business Administration (SBA) as of September 30, 2002, and 2001; the related consolidated statements of net cost, changes in net position, and financing; and the combined statements of budgetary resources for the years then ended. These financial statements are the responsibility of SBA management.

We were unable to satisfy ourselves with respect to certain of SBA's financial statement line items identified below (and related footnote disclosures), because SBA could not provide sufficient evidence to support the amounts reported and disclosures made in the consolidated and combined financial statements as of and for the years ended September 30, 2002, and 2001, thereby limiting the scope of the audit. Details follow under the next three captions.

Disaster Loan Program Model

As explained more fully in the accompanying Independent Auditor's Report on Internal Control, SBA's disaster loan modeling contains deficiencies, and is no longer adequate for determining the costs of disaster loans sold or reestimating the costs of loans not sold. SBA's existing modeling became inadequate when over \$5 billion of loans were sold in Fiscal Years 2000 through 2002. SBA is evaluating its loan models to identify and correct the modeling deficiencies. Once corrected, these deficiencies could materially impact amounts reported by SBA in the accompanying principal financial statements. Please see the table on the following page.

We were unable to satisfy ourselves that the amounts identified on the following table are fairly stated, because SBA has not completed its assessment of the disaster loan program model, and determined the effect of the modeling deficiencies.



Financial Statement Line Item	Financial Statement	Reported Amounts 2002 (thousands)	Reported Amounts 2001 (thousands)
Credit Program Receivables and Related Foreclosed Property, Net	BS	\$ 5,469,485	\$5,218,274
Other Liabilities	BS	56,416	148,332
Cumulative Results of Operations	BS	(1,451,573)	(879,335)
Intragovernmental Gross Costs (Disaster Assistance Program)	SNC	684,009	612,891
Gross Costs with the Public (Disaster Assistance Program)	SNC	330,940	404,767
Earned Revenue from the Public (Disaster Assistance Program)	SNC	257,708	128,340
Beginning Net Position	SCNP	(879,335)	(823,927)
Transfers In/Out Without Reimbursement	SCNP	(263,127)	(299,683)
Spending Authority From Offsetting Collections	SBR	2,961,112	3,428,503
Obligations Incurred	SBR, SF	5,084,400	4,413,660
Obligated Balance, Beginning of Period	SBR	1,177,283	863,982
Obligated Balance End of Period (Accounts Receivable)	SBR	(72,611)	(435,674)
Obligated Balance End of Period (Accounts Payable)	SBR	258,327	922,654
Transfers In (Out)	SF	(263,127)	(299,683)
Upward/Downward Reestimates of Credit Subsidy Expense	SF	542,065	(214,831)
Spending Authority From Offsetting Collections and Recoveries	SF	3,423,694	3,544,724

Pre-1992 Loan Guarantees

As explained more fully in the accompanying Independent Auditor's Report on Internal Control, SBA did not present future expected default costs of pre -1992 loan guarantees or determine the correct valuation of related line items in accordance with federal accounting standards. SBA made several adjusting entries to both FYs 2002 and 2001 financial statements in an effort to correct the presentation and related valuation of future expected default costs.

SBA did not, however, have a calculation methodology to determine its future expected default costs and related liability or to support adjustments made to its financial statements. Therefore, SBA could not provide sufficient documentary evidence to satisfy us that the financial statement line items identified on the following table are fairly stated.

Financial Statement Line Item	Financial Statement	Reported Amounts 2002 (thousands)	Reported Amounts 2001 (thousands)
Other Liabilities (Intragovernmental)	BS	\$ 947,039	\$1,479,295
Liabilities for Loan Guarantees	BS	1,525,038	1,436,997
Gross Costs with the Public (Business Programs)	SNC	1,004,517	(23,910)
Prior Period Adjustments	SCNP	557	(422,237)
Other, Current-Year Liquidating Equity Activity	SCNP	(204,976)	378,045
Other Financing Sources	SF	(204,976)	378,045
Change in Due to Treasury, Liquidating Funds	SF	204,976	(378,045)
Provision for Losses on Estimated Guarantees	SF	(242,945)	(219,267)

Master Reserve Fund (MRF) Residual Liability

As explained more fully in the accompanying Independent Auditor's Report on Internal Control, SBA's sampling of MRF activity for FYs 2002 and 2001 precluded SBA from ensuring that the projection of the MRF residual asset or liability is reliable. SBA's sampling methodology was based on small, judgmental samples of closed pools containing characteristics that differed in important respects from the total population of pools; thus the samples were not entirely representative. As a result, SBA did not sufficiently support the MRF's residual liability or asset disclosed in Note 4, Master Reserve Fund, or the estimated MRF residual asset, valued at \$68 million on SBA's September 30, 2001, balance sheet.

We were unable to satisfy ourselves that SBA's disclosures of the MRF residual liability for FY 2002 and asset for FY 2001 and the estimated residual asset valued at \$68 million on SBA's September 30, 2001, balance sheet, are fairly stated.

* * *

In our Independent Auditor's Report dated February 22, 2002, we expressed unqualified opinions on SBA's principal financial statements as of and for the years ended September 30, 2001 and 2000. This report updates our report dated February 22, 2002, with respect to SBA's September 30, 2001, financial statements and contains a disclaimer of opinion on such financial statements. The circumstances and events described in the preceding paragraphs, which impact the reliability of the financial statements as of and for the year ended September 30, 2001, caused us to issue a disclaimer on SBA's FY 2001 financial statements.

We were unable to apply other auditing procedures regarding the three scope limitations discussed above. Accordingly, we are not able to express, and we do not express, an opinion on these financial statements.

SBA restated its FY 2001 financial statements as explained in Note 1.V. to the financial statements. It was unable, however, to adequately support all necessary restatements with respect to pre-1992 loan guarantees. This matter contributed to our disclaimer of opinion, as explained above.

We noted one additional matter causing us reservations regarding the fair presentation of SBA's financial statements. As discussed in Note 1.V., SBA restated its FY 2001 financial statements to recognize subsidy expense at the time loans are disbursed rather than at the time loan commitments are made. The FY 2001 adjustments for the guaranteed loan program were made to the allowance for subsidy

account rather than the liability for loan guarantees account. Therefore, the FY 2001 Credit Program Receivables and Related Foreclosed Property, Net and the Liability for Loan Guarantees financial statement line items and related footnote disclosures (FY 2002 and FY 2001) are misstated by approximately \$95 million.

SBA management's discussion and analysis, required supplementary stewardship information, required supplementary information, and other accompanying information are not required parts of the financial statements, but are additional information required by the Federal Accounting Standards Advisory Board and OMB Bulletin No. 01-09, *Form and Content of Federal Financial Statements*. This information has not been subjected to auditing procedures; accordingly, we express no opinion on this information.

In accordance with *Government Auditing Standards*, we have also issued reports dated January 29, 2003, on our consideration of SBA's internal control and on its compliance with laws and regulations. Those reports, which disclose material weaknesses and a reportable condition in internal control and non-compliance with the Federal Financial Management Improvement Act, are integral parts of a report prepared in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our work.

COTTON & COMPANY LLP

A handwritten signature in black ink, appearing to read "Charles Hayward". The signature is written in a cursive, flowing style.

Charles Hayward, CPA

January 29, 2003
Alexandria, Virginia

COTTON & COMPANY LLP

auditors ♦ advisors

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Independent Auditor's Report on Internal Control

Inspector General
U.S. Small Business Administration

We were engaged to audit the financial statements of the U.S. Small Business Administration (SBA) as of and for the years ended September 30, 2002, and 2001, and have issued our report thereon dated January 29, 2003, in which we disclaimed an opinion on those financial statements. These financial statements are the responsibility of SBA's management.

In planning and performing our work, we considered SBA's internal control over financial reporting by obtaining an understanding of SBA's internal control, determining if internal control had been placed in operation, assessing control risk, and performing tests of control. We limited our internal control testing to those controls necessary to achieve objectives described in Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our work was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants (AICPA), reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect SBA's ability to record, process, summarize, and report financial data consistent with management assertions in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements, losses, or noncompliance may nevertheless occur and not be detected.

We noted six matters involving internal control and its operation that we consider to be reportable conditions. We consider the first five to be material weaknesses under standards established by AICPA and OMB Bulletin No. 01-02.



1. DISASTER LOAN PROGRAM MODELING

The cost of loans sold and re-estimates of the subsidy for remaining loans not sold cannot be determined for the disaster loan program, because, for instance, SBA's cash flow estimates for these purposes are based on broad historical averages and do not recognize important differences between characteristics of loans sold and remaining loans.

Loans under this program are made to businesses and individuals. The characteristics of these loans vary substantially, particularly in the term to maturity, which ranges from 5 to 30 years. SBA estimates the cost of the loans to businesses with a single proxy loan that has characteristics equal to overall averages of historical business loans. Similarly, SBA estimates the cost of loans to individuals with a proxy loan based on historical averages for household loans. The use of these proxies to represent a portfolio of substantially dissimilar loans became inadequate when over \$5 billion in loans were sold in FY 2000 through 2002.

Because characteristics of loans sold were different from remaining loans, historical averages ceased to fairly represent either group. Among other things, the original term of loans sold was several years longer than loans kept. Because the cost of such loans is directly related to the term to maturity (due to subsidized interest rates), the proxies understate the cost of loans sold (which have a relatively longer term) and overstate the cost of loans kept (which have a relatively shorter term). Additional differences between historical averages and characteristics of loans sold versus loans kept may arise in the assumptions affecting defaults, recoveries, and prepayments. Analysis is needed to determine if other dissimilarities exist between loans sold and loans kept that would affect estimates of their cost.

The inability to determine the book value of loans sold and to re-estimate the cost of loans not sold affects all of SBA's financial statements, including a number of line items on each statement and related footnote disclosures.

At September 30, 2002, and 2001, the disaster loan allowance for subsidy account had balances that increased the valuation of the disaster loan portfolio by over \$500 million and \$144 million, respectively. These values appear to understate the cost of loans held, because the present value of future cash flows of an interest-subsidized program, such as the disaster loan program, should be less than face value, not more.

Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, and SFFAS 18, *Amendments To Accounting Standards For Direct Loans and Loan Guarantees In Statement of Federal Financial Accounting Standards No. 2*, require credit program receivables to be stated at the present value of future cash flows. The adjustment to present value from face value is accomplished with the subsidy calculation and resulting allowance for subsidy account.

SFFAS No. 2 and No. 18 and OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, define the cost of loans sold (or pre-modification costs) as the present value of remaining cash flows of such loans in the most recent budget baseline. OMB Circular A-11 defines re-estimates as:

...revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and/or estimated changes in future cash flows of the cohort.

Finally, SBA does not maintain formal documentation and supporting material for preparing direct and guarantee loan subsidy estimates, in accordance with Federal Financial Accounting and Auditing Technical Release No. 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act of 1990*.

Recommendations

We recommend that SBA's Chief Financial Officer (CFO):

- 1A. Direct a coordinated effort among the Office of Financial Analysis and the Offices of Financial Reporting and Financial Administration to revise the approach to estimating cash flows for the disaster loan program. At a minimum, a new approach needs to:
 - Support separate estimation of cash flows associated with loans sold and remaining loans, taking into account original term to maturity and other characteristics that influence the cost of the loans.
 - Support a direct comparison between assumptions and actual experience regarding default costs and related recoveries, prepayments, and assets sold. The comparison should suggest ways to determine how well cash flow assumptions are borne out in each cohort and at what point the assumptions should be reexamined.
 - Ensure that historical data used to make assumptions about future cohorts are free of defects.
- 1B. Ensure that the Office of Financial Analysis adheres to documentation requirements of Federal Financial Accounting and Auditing Technical Release No. 3.

2. LIABILITY FOR LOAN GUARANTEES AND RELATED ACCOUNTS FOR PRE-1992 LOAN COMMITMENTS

We noted the following two matters regarding SBA's liability for loan guarantees and related accounts for pre-1992 loan commitments.

Invalid Undelivered Orders and Other Obligation Transactions

SFFAS No. 2 requires that:

...the liabilities of pre-1992 loan guarantees be recognized when it is more likely than not that the loan guarantees will require a future cash outflow to pay default claims.

The standard illustrates this recognition of cost via a proprietary liability and default expense.

SBA misinterpreted SFFAS No. 2 guidance and presented the liability for future default claims by establishing an undelivered order, as shown on the combined statement of budgetary resources. The liability for future default claims is unfunded and should not have a related undelivered order. Invalid recoveries of prior-year obligations were also reported on the draft financial statements, because of SBA's practice of estimating undelivered orders based on outstanding commitments and making downward adjustments to reflect expected future default costs.

As a result of our testing, SBA made correcting entries and posted adjustments to beginning obligated and unobligated balances on the combined statement of budgetary resources, removing invalid undelivered orders and recovery transactions.

Calculation Methodology to Estimate the Liability for Pre-1992 Loan Guarantees

SBA lacks a calculation methodology to estimate the liability related to future default payments for pre-1992 loan guarantees. To present the liability for loan guarantees on its FY 2002 and FY 2001 balance sheets, SBA recorded adjusting entries using the same amounts for which it had previously established undelivered orders. Thus, SBA could not provide sufficient documentation to support the valuation of resulting balances. In addition, SBA did not review resulting balances once the entries were made to assess their reasonableness as part of its quality control procedures.

SFFAS No. 2 states that the liability of pre-1992 loan guarantees should be “reestimated each year as of the date of the financial statements” utilizing “risk factors.” In addition, OMB Circular A-123, *Internal Control Systems*, states that “...documentation for transactions, management controls, and other significant events must be clear and readily available for examination.”

Because a calculation methodology was not used, we were unable to assess the reasonableness of the resulting liability of \$115 million for FY 2002 and \$354 million for FY 2001 (restated), which contributed to our disclaimer of opinion.

Recommendation

2. We recommend that the CFO develop a model to estimate the Pre-1992 guarantee loan default liability utilizing risk factors in accordance with SFFAS No. 2; maintain sufficient documentation to support the assumptions in the calculation model; and request the Office of Financial Administration to perform a thorough analysis to ensure that liquidating fund account balances and account activity are accounted for and presented in accordance with SFFAS No. 2.

3. FINANCIAL REPORTING PROCESS

SBA made efforts to improve its financial reporting process for FY 2002. SBA also made some progress in addressing FY 2001 recommendations to document all aspects of its financial reporting process and prepare a financial statement compilation manual. Although improvement was noted in these areas, SBA continued to experience widespread difficulties in producing complete, accurate, timely, and adequately supported draft and final financial statements (including related footnotes). Additional attention is needed to ensure a fully effective quality assurance process is documented and in place.

SBA’s difficulties with financial reporting may be attributable to devoting insufficient resources to the process, particularly regarding the quality control function.

For various internal reasons, SBA did not deliver its draft financial statements by the original agreed-upon date. Moreover, after being delivered late, we found that the draft statements and related footnotes contained numerous and significant errors and misclassifications. These matters are discussed below.

Late Delivery of Financial Statements

The Office of the Chief Financial Officer (OCFO) and Office of Inspector General (OIG) established dates at the beginning of fieldwork by which the financial statements would be provided. These dates were intended to ensure adequate review time and still allow SBA to meet OMB's reporting timeframe. OCFO was required to deliver draft and final financial statements to us on December 20, 2002, and on January 13, 2003, respectively. It delivered the draft financial statements and footnotes on December 23, 2002, but they contained excessive errors and misclassifications, many of which SBA did not correct until after submitting several subsequent drafts. While OCFO met the January 13 deadline, it needed to submit five subsequent versions before January 27, when we received the final version.

Financial Statement Errors and Misclassifications

We identified several material errors or potential misstatements within SBA's draft financial statements, some of which SBA was able to correct. Several examples are summarized below.

- A significant number of material adjustments were required to SBA's draft financial statements involving 14 proprietary and budgetary general ledger accounts in regard to SBA's practice of tracking loan sale administrative costs. SBA's accounting for these administrative costs was not in compliance with the United States Standard General Ledger (USSGL).
- SBA modified the Financial Reporting Information System (FRIS) during FY 2002, but did not detect an error in its budgetary crosswalk created during these modifications in a timely manner. Consequently, SBA processed direct loan transactions that did not post in accord with the USSGL. SBA corrected these posting errors after we brought these errors to its attention.
- The balance sheet line item "Other Liabilities Public" was understated by \$15,937,079, due to processing errors in the Joint Accounting and Administrative Management System (JAAMS). SBA was unable to determine why this error occurred and therefore could not correct it before finalizing its financial statements.
- SBA's draft financial statements showed several financial statement line items with material fluctuations between FY 2002 and 2001. Before it submitted draft financial statements, SBA did not evaluate whether such fluctuations were supported by substantive accounting activity or were caused by error. After we brought concerns to management's attention, SBA identified and corrected material errors in its draft financial statements.

For instance, SBA's offsetting receipts line items on its FY 2002 combined statement of budgetary resources and consolidated statement of financing were overstated, because SBA included inappropriate transactions in FY 2002 related to its interest on borrowings from Treasury. An analysis of the fluctuation between FY 2002 and FY 2001 should have identified this error.

- In the footnotes to its draft financial statements, SBA disclosed and discussed a book value adjustment made to the calculation of loan sale losses based on comments by General Accounting Office. We were unable to satisfy ourselves with respect to much of this draft information, because SBA did not have adequate documentation allowing us to test book value adjustments and total loan sale losses. SBA deleted this footnote disclosure in subsequent drafts.

Linkage Between Accounts and Financial Statements

As we reported last year, SBA's spreadsheet-based support for its financial statements crosswalks did not provide a clear audit trail to link general ledger account balances to financial statement line items. For example, SBA continued to use numerous mapping equations, many involving lengthy and in some cases complex formulae, without providing any written documentation of what the equations accomplished. This condition required us to review all formulae and perform some reconstruction to determine how general ledger accounts crosswalk to the financial statements before testing the statements. SBA prepared a "Mapping Documentation" spreadsheet, which may be a useful audit trail. We did not use or fully review this document as part of our audit, because it was not provided before testing ended.

OMB Circular A-123 states that "...documentation for transactions, management controls, and other significant events must be clear and readily available for examination."

Recommendations

- 3A. We recommend that SBA's Administrator assess whether SBA has devoted sufficient resources to adequately address its current financial reporting shortcomings and determine if the current process will need re-engineering and additional resources to enable SBA to meet accelerated financial reporting deadlines in future years.

We also recommend that SBA's CFO:

- 3B. Perform fluctuation analyses and determine reasons for all material changes in all financial statement account balances to permit inaccuracies that become obvious while performing such analyses to be corrected before submitting draft financial statements.
- 3C. Re-engineer and enhance its quality control process and continue to develop and document its financial reporting process in order to avoid submitting draft financial statements and related footnotes containing material and widespread errors and misclassifications.

4. FUNDS CONTROL WEAKNESSES

SBA maintained inadequate funds control with respect to the following conditions:

- SBA established invalid undelivered orders in liquidating funds during FY 2002 related to its misinterpretation of SFFAS No. 2.
- SBA did not return all unobligated balances in liquidating funds to the general fund at the end of the fiscal year.
- SBA incurred obligations against anticipated resources for several cohorts in the Business Loan Investment Fund (BLIF) financing funds and did not ensure that non-subsidy cost collections were only utilized to establish obligations in the cohort that generated the collections during FY 2002.
- SBA did not have adequate funds control over its loan programs' budgetary resources except for those allotted in the Loan Accounting and Allotment System and related disbursements in the Loan Accounting System. For instance, SBA did not have sufficient funds control in place to ensure that guarantee loan purchase transactions did not exceed apportioned authority or preclude obligations from being incurred against anticipated budgetary resources. In addition, SBA did not

have a mechanism to ensure that obligation transactions entered into FRIS by journal voucher were valid and did not exceed the lesser of apportioned authority or realized resources.

- SBA's Denver Finance Center (DFC) accountants record apportionments by journal voucher (JV) entry into the FRIS GL based on OMB-approved Standard Forms 132, *Apportionment and Reapportionment Schedule*, without controls designed to ensure that JV entries are reviewed by supervisors for accuracy before approving and posting.

These shortcomings increase the risk that SBA may violate the Antideficiency Act. OMB Circular A-11 defines a valid obligation as “a binding agreement that will result in outlays, immediately or in the future.” In addition, OMB Circular A-11 provides the following funds control requirements:

- “You (the agency) must transfer any unobligated balance remaining at the end of the fiscal year to the general fund” (citation relates to liquidating funds).”
- “...obligations should not be incurred against any anticipated budgetary resources, even if funds are apportioned” and “non-subsidy cost collections may be used only for the cohort that generated the collection.”
- “...the agency system of administrative control should be designed to keep obligations and expenditures from exceeding apportionments and allotments.”

Recommendations

We recommend that the CFO review SBA’s system of funds control to ensure compliance with OMB Circular A-11 and, at a minimum:

- 4A. Develop and implement procedures to review obligated and unobligated balances remaining in liquidating funds at the end of the fiscal year. De-obligate unneeded undelivered orders and return unobligated balances to the general fund at the end of each fiscal year.
- 4B. Develop and implement an integrated funds control system that allots the lesser of apportioned authority or realized resources at the fund and cohort level.
- 4C. Develop and implement a process to ensure that apportionment amounts are accurately recorded in SBA’s GL, which includes supervisory reviews by both DFC accountants and the Office of Administration, Accounting Liaison and Quality Assurance Branch. These reviews should compare the SF 132s by fund to apportionments recorded in the FRIS GL to ensure accuracy.

5. MASTER RESERVE FUND (MRF)

SBA’s fiscal and transfer agent maintains the MRF to facilitate operation of the 7(a) secondary market program. Borrowers with SBA-guaranteed loans make periodic payments to lenders who in turn submit payments to the MRF for loans sold on the secondary market.

Monthly payments to secondary market certificate holders are made from the MRF, and excess funds in the MRF are invested. Earnings on investments are used to fund shortages to certificate holders caused by timing differences between loans in the pool and the life of pool certificates. SBA owns any excess of earnings over payments to certificate holders.

SBA expended considerable effort during FY 2002 toward enhancing accounting disclosures of its MRF activity and in assessing the most appropriate financial statement treatment of that activity. We believe SBA made substantial improvement within the context of treating its MRF as a trust fund pursuant to SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*

In both FY 2002 and FY 2001, however, SBA used small, judgmental samples of closed pools to estimate the excess or deficiency of MRF investment earnings over payments to certificate holders. The characteristics of SBA's samples differed in important respects from the remaining population of pools. Although SBA considered its sample sizes sufficient, by using small and non-representative samples, SBA derived conclusions about the MRF excess or deficiency that were statistically unsound and may not be reliable, as required by Statement on Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, Paragraph 160, and Technical Release No. 3.

Recommendation

We recommend that the CFO develop a process for estimating SBA's ownership in earnings from the MRF that provides accurate, complete, and timely data for the financial statements. SBA's process should at least include a representative statistical sample to estimate the gain or loss on closed pools and an extrapolation of such results, taking into account any differences in characteristics between closed and open pools.

5. AGENCY-WIDE INFORMATION SYSTEMS CONTROL

SBA continued to improve internal control over its information system environment in certain areas. Specifically, it accomplished the following during FY 2002:

- Conducted certification and accreditation reviews for additional major applications.
- Implemented its JAAMS, a new financial and administrative system.
- Rolled out the Windows 2000 operating system.
- Implemented a new online back-up system.
- Selected and began implementing a new intrusion-detection tool.

These actions are essential elements for a sound information system control environment. Areas for improvements, however, continue to exist in each of the following six *Federal Information System Controls Audit Manual* (FISCAM) general control categories and the four FISCAM application control areas we tested:

General Control Categories

- Entity-wide security program control
- Access control
- Application software development and program change control
- System software control
- Segregation-of-duty control
- Service continuity control

Application Control Categories (Joint Accounting and Administrative Management System only)

- Authorization control
- Completeness control
- Integrity of processing and data file control
- Accuracy control

SBA's OIG will issue a separate report titled *Audit of SBA's Information System Controls, FY 2002* that will detail findings and recommendations in this area.

STATUS OF PRIOR-YEAR FINDINGS

As required by *Government Auditing Standards*, we provide the status of reportable conditions for the prior-year audit.

Description	Recommendation	Status
Financial Reporting Process	<ol style="list-style-type: none">1. Fully document the financial reporting process.2. Prepare compilation manual for financial reporting.3. Prepare quarterly agencywide financial statements.	<ol style="list-style-type: none">1. Some documentation provided; not fully implemented. See Recommendation 3C.2. Some documentation provided; not fully implemented. See Recommendation 3C.3. Implemented.
Subsidy Re-Estimates	<ol style="list-style-type: none">4. Upgrade cash flow modeling tool.5. Enhance quality of subsidy re-estimates.	<ol style="list-style-type: none">4. and 5. Progress made regarding prior year finding and recommendation. Reclassified to a management letter comment. However, see new recommendations 1A and 1B.
Master Reserve Fund	<ol style="list-style-type: none">6. Accurately estimate SBA's earnings within the MRF.	<ol style="list-style-type: none">6. Implementation in progress. See recommendation 5A.
Agencywide Information Systems Control	Please refer to separate report.	Unresolved. Updated in separate report.

In addition, we considered SBA's internal control over required supplementary stewardship information by obtaining an understanding of SBA's internal control, determining if internal control had been placed in operation, assessing control risk, and performing tests of control as required by OMB Bulletin No. 01-02. Our objectives were not to provide assurance on internal control; accordingly, we do not provide an opinion on such control.

Finally, with respect to internal control related to SBA performance measures, we obtained an understanding of the design of significant internal control relating to existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures; accordingly we do not provide an opinion on such control.

We also noted certain other matters involving internal control that we will report to SBA management in a separate letter.

This report is intended solely for the information and use of SBA management, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP

A handwritten signature in black ink, appearing to read "Charles Hayward". The signature is written in a cursive, flowing style.

Charles Hayward, CPA

January 29, 2003
Alexandria, Virginia

COTTON & COMPANY LLP

auditors ♦ advisors

DAVID L. COTTON, CPA, CFE, CGFM ♦ CHARLES HAYWARD, CPA, CFE, CISA ♦ MICHAEL W. GILLESPIE, CPA, CFE ♦ CATHERINE L. NOCERA, CPA, CISA
MATTHEW H. JOHNSON, CPA, CGFM ♦ SAM HADLEY, CPA, CGFM ♦ COLETTE Y. WILSON, CPA ♦ ALAN ROSENTHAL, CPA

Independent Auditor's Report on Compliance with Laws and Regulations

Inspector General
U.S. Small Business Administration

We were engaged to audit the financial statements of the U.S. Small Business Administration (SBA) as of and for the years ended September 30, 2002, and 2001, and have issued our report thereon dated January 29, 2003, in which we disclaimed an opinion on those financial statements.

SBA management is responsible for complying with laws and regulations applicable to the agency. We performed tests of SBA's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, including requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to SBA.

Under FFMIA, we are required to report whether SBA's financial management systems substantially complied with federal financial management system requirements, applicable federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. The results of our tests disclosed instances, described below, indicating that SBA's financial management systems did not substantially comply with federal financial management system requirements, applicable federal accounting standards, and the United States Government Standard General Ledger at the transaction level.

SBA is not in substantial compliance with federal financial management system requirements, as follows:

- SBA's core financial system is not able to provide complete, reliable, timely, and consistent financial management information on programs to enable management to fulfill its responsibility to the public and provide timely financial information for managing current operations.
- Access control, segregation-of-duty, and other general control weaknesses exist, which will be described in the Office of Inspector General report *Audit of SBA's Information System Controls, FY 2002*.



- Funds control deficiencies exist, discussed in our Independent Auditor's Report on Internal Control in the section titled Funds Control Weaknesses.

SBA is not in substantial compliance with federal accounting standards because it cannot support:

- The reliability of the reported cost of loans sold and reestimates of the subsidy for the loans not sold, as required by Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, and SFFAS 18, *Amendments To Accounting Standards For Direct Loans and Loan Guarantees In Statement of Federal Financial Accounting Standards No. 2*.
- Liabilities for loan guarantees committed before October 1, 1992, and related financial statement line items, as required by SFFAS No. 2.
- The reported future excess or deficit of earnings over payments in the Master Reserve Fund. SBA used small judgmental samples to estimate the excess or deficit of MRF investment earnings over payments to certificate holders from those earnings, contrary to Statement on Federal Financial Accounting Concept No. 1, *Objectives of Federal Financial Reporting*, paragraph 160, and Technical Release No. 3, *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act of 1990*.

SBA is not in substantial compliance with the United States Government Standard General Ledger at the transaction level, because it:

- Modified the Financial Reporting Information System (FRIS) during FY 2002, but did not detect an error in its budgetary crosswalk created during these modifications in a timely manner. Consequently, SBA processed direct loan transactions that did not post in accordance with the United States Government Standard General Ledger.
- Posted invalid recoveries of prior-year obligations and obligations incurred because of conversion problems from its Federal Financial System to its current Oracle-based administrative accounting system.

The Office of the Chief Financial Officer is responsible for financial management systems within SBA. SBA should assign priority to corrective actions for these FFMIA related-matters consistent with requirements of OMB Circular A-50, *Audit Followup*.

Results of our tests of compliance disclosed one additional instance of noncompliance with laws and regulations that is required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Our Independent Auditor's Report on Internal Control describes certain funds control shortcomings central to SBA's mission of guaranteeing loans and providing direct loans. These funds control shortcomings represent noncompliance with OMB Circular A-11 that we are required to report under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our work; accordingly, we do not express such an opinion.

This report is intended solely for the information and use of SBA management, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP

A handwritten signature in black ink, appearing to read "Charles Hayward". The signature is written in a cursive, flowing style.

Charles Hayward, CPA

January 29, 2003
Alexandria, Virginia



Financial Statements

of the

**U.S. Small Business
Administration**

for

Fiscal Year 2002

Introduction

This is the twelfth year that the SBA has issued Agencywide financial statements. The preparation of financial statements is a critical aspect of ensuring the accountability and stewardship for the public resources entrusted to the SBA. Preparation of these statements is also an important part of Agency financial management's goal of providing accurate and reliable information that may be used to assess performance and allocate resources.

These themes of accuracy and accountability resonate particularly strongly this year because in the course of our efforts, a critical longstanding issue was identified as undermining our ability to meet these core objectives in our financial accounting and reporting. Specifically, apparent inconsistencies and weaknesses in the budgeting and accounting for the SBA's loan Asset Sale program led our auditor to conclude that the SBA could not accurately state the impact of our loan sale program on the financial statements. Because of this issue, our auditor determined that the SBA would receive a "disclaimer" on its financial statements for FY 2002, and that it would withdraw its unqualified opinions of the previous two years. The SBA and our auditor spent much of the audit period conducting an in depth, but inconclusive, review of this issue.

The SBA is continuing to work vigorously to resolve the issue and has teamed with the Office of Management and Budget (OMB) and hired additional outside contract assistance to expedite the resolution process. The SBA is committed to taking responsibility for successfully resolving this discrepancy and restoring confidence to our accounting and budgeting processes and results.

Our independent auditor determined that the SBA did not furnish sufficient evidence to support statement lines and related notes with respect to two issues other than that of budgeting and accounting for asset sales. These were the calculation of a liability for guarantees for the pre-Federal Credit Reform business loan portfolio and the estimation of residual liability related to our Master Reserve Fund. The SBA intends to resolve both issues prior to restatement of its previous years' financial statements.

The responsibility for the accuracy and propriety of the information contained in the principal financial statements and the quality of internal controls rests with management. The financial statements have been prepared from the books and records of the Agency; however they differ from the financial reports used to monitor and control budget execution. Also, the Agency recognizes that it cannot liquidate liabilities not covered by budgetary resources without an enactment of an appropriation by the Congress and an apportionment by the OMB.

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with generally accepted accounting principals (GAAP) for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Balance Sheet

The Consolidated Balance Sheet summarizes the assets, liabilities, and net position as of the end of the fiscal year. For clarity in presentation, assets and liabilities have been differentiated between those resulting from transactions between Federal entities (intragovernmental) and those resulting from transactions between the Agency and non-Federal entities. Information for two years is presented for the purpose of comparison.

The SBA's total assets decreased \$882.3 million or 6% from \$14.3 billion as of September 30, 2001 to \$13.4 billion as of September 30, 2002. Credit program receivables and related foreclosed property increased by \$251.2 million due to an decrease in the allowance for subsidy. The SBA began selling pools of loans from its portfolios in 1999 instead of continuing to service the loans. A single sale was completed in 2000 and two sales were made in 2001 and 2002. Advances increased by \$126.1 million because of growth in the Small Business Investment Company program.

SBA's total liabilities decreased \$277.3 million or 2 percent from \$14.1 billion as of September 30, 2001 to \$13.9 billion as of September 30, 2002. Intragovernmental liabilities decreased by \$282.6 million due to a decrease in the amount owed to Treasury as a result of sales of loans from SBA's business and disaster loan portfolios. The decrease is also attributable to a decrease in the unfunded subsidy payable in both the business and disaster loan programs. Total other liabilities – public increased by \$5.3 million due to a increase in the loan guarantee liabilities of the business and pollution control programs.

Appendix A

SBA's net position consists of Unexpended Appropriations and Cumulative Results of Operations. Unexpended Appropriations reflects spending authority made available to the SBA by congressional appropriation. Cumulative Results of Operations reflects the net results of SBA's operations over time. As of September 30, 2002 SBA's Net Position decreased by \$605 million due to a decrease in Cumulative Results of Operations.

Statement of Net Cost

The Consolidated Statement of Net Cost 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 from gross cost.

In FY 2002, SBA's Net Cost of Operations was \$1.135 billion, a 147 percent increase from the FY 2001 cost of \$460.2 million. The net increase of \$675.3 million is the result of a \$771.49 million increase in Business program costs, a \$100.86 million decrease in costs for disaster assistance programs, and a \$4.64 million increase in costs not assigned to programs.

The \$771.49 million increase in net business program costs is due to an increase in both gross costs with the public and intragovernmental gross costs. The increase in gross costs with the public is primarily the result of two loan asset sales during FY 2002. The increase in intragovernmental gross costs is the result of an upward reestimate for loan subsidy in FY 2002.

The \$100.86 million decrease in the net cost of disaster assistance programs is due to a increase in earned revenue from the public, offset with a decrease in the gross costs with the public, and a decrease in intragovernmental gross costs. The decrease in gross costs with the public is the result of a reduction in SBA's loss allowance expense and fewer program expenses. These reductions are attributable to a smaller credit receivable portfolio. The increase in intragovernmental gross costs is the result of an upward reestimate for loan subsidy in FY 2002 while no reestimate was recorded in FY 2001.

FY 2002 costs were allocated between two major programs: Business programs for \$790.5 million or 69.6 percent, and disaster assistance programs for \$321.4 million or 28.3 percent. A small residual amount of \$23.7 million or 2.1 percent was attributable to a "Costs Not Assigned to Programs" category that included the costs of the SBA's Inspector General and local initiatives funded by Congress in SBA's budget.

Cost in Dollars

(in millions)

Fiscal Year	Business Intragovt.	Business Public	Business Total	Disaster Intragovt.	Disaster Public	Disaster Total	Not Assigned
2001	\$68.8	(\$49.9)	\$18.9	\$145.8	\$276.4	\$422.2	\$19.0
2002	(\$36.7)	\$827.2	\$790.5	\$248.1	\$73.2	\$321.4	\$23.7

Cost as Percentages

(in millions)

	2001	2002
Business	4.1%	69.6%
Disaster	91.8%	28.3%
Not Assigned	4.1%	2.1%
Total	100.0%	100%

Statement of Changes in Net Position

The Consolidated Statement of Changes in Net Position shows how SBA's net cost of operations was funded. The statement also shows the Agency's net position at the beginning of the fiscal year, the major components that caused the net position to change, and the ending net position (which is the same as "Total Net Position" shown on the Balance Sheet.) Changes were discussed in the analysis of the Consolidated Balance Sheet.

Budgetary Resources

The Combined Statement of Budgetary Resources provides information about the funding and availability of budgetary resources and the status at the end of the reporting period. It is the only financial statement from which data is derived exclusively from budgetary accounts in the general ledger.

Appendix A

Data on the Combined Statement of Budgetary Resources is consistent with budget execution information on the SF 133 Report on Budget Execution Budgetary Resources, with one exception. A line item, Offsetting Receipts, has been added to the Combined Statement of Budgetary Resources. Offsetting receipts are used to offset budgetary authority and outlays at the Agency level and are presented in this statement to reconcile outlay information in the Budget of the United States Government.

Total budgetary resources for SBA were \$11.82 billion, a decrease of \$31.99 million from FY 2001. The majority of SBA's funding was derived from the previous year's unobligated balance (63 percent) and offsetting collections (25 percent). Appropriations, borrowing authority, recoveries from prior year obligations, and non-available funding rounded out the balance of total budgetary resources.

Funding is further pro-rated between budgetary financing (18 percent) and non-budgetary financing (82 percent). The largest source of funding for the \$9.7 billion non-budgetary portion was from FY 2001 unobligated balances of \$6.1 billion. For the \$2.2 billion budgetary financing, the FY 2001 unobligated balance also provided the single greatest amount of \$1.3 billion.

The following tables show a comparison of the two most recent fiscal years of total budgetary resources available for use and the status of resources:

Budgetary Resources (Dollars in Billions)

	Budget Authority	Unobligated Balance (1 Oct)	Spending Authority from Offsetting Collections	Recoveries of Prior Year Obligations	Permanently not Available	Total Budgetary Resources
2001	\$2.21	\$7.21	\$3.43	\$0.12	(\$1.11)	\$11.86
2002	\$3.15	\$7.44	\$3.16	\$0.27	(\$2.20)	\$11.82

Status of Budgetary Resources (Dollars in Billions)

	Obligations Incurred	Unobligated Balances Available	Unobligated Balances Not Available	Total Status of Budgetary Resources
2001	\$4.41	\$2.55	\$4.90	\$11.86
2002	\$5.08	\$3.05	\$3.69	\$11.82

Statement of Financing

The Consolidated Statement of Financing shows the relationship between SBA's net obligations drawn from budgetary accounting and net cost of operations drawn from proprietary accounting by identifying key differences between the two amounts. The statement shows total resources used within the reporting period and adjustments to these resources based upon their usage to finance net obligations or net cost.

Budgetary resources obligated in FY 2002 were \$5.08 billion, a 15 percent increase from FY 2001 obligations of \$4.4 billion. Spending authority from offsetting collections and recoveries of \$3.42 billion was a decrease of 3 percent from the previous year's amount of \$3.54 billion. Both of these categories (less offsetting receipts), which sum to the net obligations, can be tied to amounts in the Combined Statement of Budgetary Resources. Net obligation, transfers in (out), and resources used to finance items not part of the net cost of operations result in the Total Resources Used to Finance the Net Cost of Operations.

Adjustments to the Total Resources Used to Finance the Net Cost of Operations created the Total Resources Used to Finance Net Cost of Operations of \$550.2 million, a decrease of 60 percent from the previous year's amount of \$1.38 billion. The major adjustment item was in the Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period, i.e., 'Upward/Downward re-estimates of Credit Subsidy Expense'. Net Cost of Operations is also shown on the Statement of Net Cost and the Statement of Net Position.

U. S. Small Business Administration
Consolidated Balance Sheet
as of September 30, 2002 and 2001

(Dollars in Thousands)

	2002	Restated 2001
ASSETS		
Intragovernmental Assets		
Fund Balances with Treasury (Note 2)	\$ 7,492,740	\$ 8,336,655
Accounts Receivable (Note 5)	529	369,313
Advances (Note 8)	4,428	2,496
Total Intragovernmental	7,497,697	8,708,464
Assets - Public and Other		
Cash (Note 3)	3,458	2,443
Interest Receivable (Note 4)		68,000
Accounts Receivable (Note 5)	76,974	57,188
Credit Program Receivables and Related Foreclosed Property, Net (Note 6)	5,469,485	5,218,274
General Property and Equipment, Net (Note 7)	6,828	8,518
Advances (Note 8)	379,856	253,708
Total Assets - Public	5,936,601	5,608,131
Total Assets	\$13,434,298	\$14,316,595
LIABILITIES		
Intragovernmental Liabilities		
Accounts Payable	\$ 27,992	\$ 698,190
Debt (Note 10)	11,138,280	10,218,415
Other (Note 12)	947,039	1,479,295
Total Intragovernmental	12,113,311	12,395,900
Other Liabilities - Public		
Accounts Payable	149,134	139,172
Liabilities for Loan Guarantees (Note 6)	1,525,038	1,436,997
FECA Actuarial Liability (Note 11)	31,487	32,255
Other (Note 12)	56,416	148,332
Total Other Liabilities - Public	1,762,075	1,756,756
Total Liabilities	\$ 13,875,386	\$14,152,656
NET POSITION		
Unexpended Appropriations	\$ 1,010,485	\$ 1,043,274
Cumulative Results of Operations	(1,451,573)	(879,335)
Total Net Position	\$ (441,088)	\$ 163,939
Total Liabilities and Net Position	\$ 13,434,298	\$14,316,595

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration
Consolidated Statement of Net Cost
for the periods ended September 30, 2002 and 2001

(Dollars in Thousands)

	2002	Restated 2001
PROGRAMS		
Business Programs		
Intragovernmental Gross Costs	\$ (4,551)	\$ 140,336
Less: Intragovernmental Earned Revenue	32,148	71,489
Intragovernmental - Net Costs	\$ (36,699)	\$ 68,847
Gross Costs with the Public	\$ 1,004,517	\$ (23,910)
Less: Earned Revenue from the Public	177,379	25,989
Net Costs with the Public	\$ 827,138	\$ (49,899)
Net Cost of Business Programs	\$ 790,439	\$ 18,948
Disaster Assistance Programs		
Intragovernmental Gross Costs	\$ 684,009	\$ 612,891
Less: Intragovernmental Earned Revenue	435,879	467,093
Intragovernmental - Net Costs	\$ 248,130	\$ 145,798
Gross Costs with the Public		\$ 404,767
Less: Earned Revenue from the Public	257,708	128,340
Net Costs with the Public	\$ 73,232	\$ 276,427
Net Cost of Disaster Assistance Programs	\$ 321,362	\$ 422,225
Cost not assigned to Programs	\$ 40,410	\$ 26,631
Less: Earned Revenue not attributed to Programs	16,752	7,611
Net Cost not assigned to Programs	\$ 23,658	\$ 19,020
Net Cost of Operations	\$ 1,135,459	\$ 460,193

(Note 13)

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration
Consolidated Statement of Changes in Net Position
for the periods ended September 30, 2002 and 2001

(Dollars in Thousands)

	2002			Restated 2001		
	Cumulative Results of Operations	Unexpended Appropriations	Total	Cumulative Results of Operations	Unexpended Appropriations	Total
Beginning Net Position - October 1	\$ (879,335)	\$ 1,043,274	\$ 163,939	\$ (823,927)	\$ 763,154	\$ (60,773)
Prior Period Adjustments	(1,399)	1,956	557	(541,451)	119,214	(422,237)
Beginning Net Position, as Adjusted	(880,734)	1,045,230	164,496	(1,365,378)	882,368	(483,010)
Budgetary Financing Sources						
Appropriations Received		1,013,208	1,013,208		969,117	969,117
Appropriations Transferred - in/out (+/-)					101,362	101,362
Rescissions		(5,985)	(5,985)		(31,972)	(31,972)
Adjustment - Cancelled Authority		(24,154)	(24,154)		(24,546)	(24,546)
Other Adjustments	273	(2,916)	(2,643)		(3,000)	(3,000)
Appropriations Used	1,014,898	(1,014,898)		850,055	(850,055)	
Donations of Cash and Cash Equivalents	132		132	78		78
Transfers - in/out Without Reimbursement (+/-)						
Other Financing Sources						
Transfers - in/out Without Reimbursement (+/-)	(263,127)		(263,127)	(299,683)		(299,683)
Imputed Financing from Costs Absorbed by Others	17,420		17,420	17,741		17,741
Other - Current Year Liquidating Equity Activity (+/-)	(204,976)		(204,976)	378,045		378,045
Total Financing Sources	\$ 564,620	\$ (34,745)	\$ 529,875	\$ 946,236	\$ 160,906	\$ 1,107,142
Net Cost of Operations	\$ 1,135,459	\$	\$ 1,135,459	\$ 460,193	\$	\$ 460,193
Ending Net Position	\$ (1,451,573)	\$ 1,010,485	\$ (441,088)	\$ (879,335)	\$ 1,043,274	\$ 163,939

(Note 14)

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration
Combined Statement of Budgetary Resources
for the periods ended September 30, 2002 and 2001

(Dollars in Thousands)

	2002			Restated 2001		
	Budgetary	Non-Budgetary Financing	Total	Budgetary	Non-Budgetary Financing	Total
BUDGETARY RESOURCES						
Budget Authority						
Appropriations Received	\$1,013,208	\$	\$1,013,208	\$969,117	\$	\$1,172,127
Borrowing Authority		2,168,244	2,168,244		1,172,127	1,172,127
Net Transfers (+/-)	(29,545)		(29,545)	72,910		72,910
Unobligated Balance						
Brought Forward October 1	1,306,034	6,136,976	7,443,010	1,349,649	6,045,141	7,394,790
Net Transfers (+/-)				(184,638)		(184,638)
Spending Authority from Offsetting Collections						
Earned	426,461	2,534,651	2,961,112	546,853	2,881,650	3,428,503
Change in Unfilled Customer Orders	55,074	140,913	195,987			
Recoveries of Prior Year Obligations Permanently Not Available	81,373 (691,455)	185,222 (1,502,472)	266,595 (2,193,927)	65,704 (297,931)	50,517 (814,429)	116,221 (1,112,360)
Total Budgetary Resources	\$ 2,161,150	\$9,663,534	\$11,824,684	\$ 2,521,664	\$9,335,006	\$11,856,670

(Dollars in Thousands)

	2002			2001		
	Budgetary	Non-Budgetary Financing	Total	Budgetary	Non-Budgetary Financing	Total
STATUS OF BUDGETARY RESOURCES						
Obligations Incurred	\$ 1,449,398	\$ 3,635,002	\$ 5,084,400	\$ 1,215,630	\$ 3,198,030	\$4,413,660
Unobligated Balances Available						
Apportioned - Currently Available	335,356	2,710,442	3,045,798	604,193	1,945,018	2,549,211
Exempt from Apportionment	104		104			
Unobligated Balances Not Available	376,292	3,318,090	3,694,382	701,841	4,191,958	4,893,799
Total Status of Budgetary Resources	\$ 2,161,150	\$ 9,663,534	\$11,824,684	\$ 2,521,664	\$ 9,335,006	11,856,670

	2002			2001		
	Budgetary	Non-Budgetary Financing	Total	Budgetary	Non-Budgetary Financing	Total
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS						
Obligated Balance, Beginning of Period	\$ 533,173	\$ 644,110	\$ 1,177,283	\$ 467,922	\$ 396,060	\$ 863,982
Obligated Balance, End of Period						
Accounts Receivable	(16,590)	(56,021)	(72,611)	(66,362)	(369,312)	(435,674)
Unfilled Customer Orders from Federal Sources		(140,913)	(140,913)		(166,763)	(166,763)
Undelivered Orders	464,984	242,667	707,651	457,541	399,525	857,066
Accounts Payable	75,641	182,686	258,327	141,994	780,660	922,654
Total Obligated Balance, End of Period	524,035	228,419	752,454	533,173	644,110	1,177,283
Outlays						
Disbursements	1,426,932	4,204,614	5,631,546	1,208,178	2,868,596	4,076,774
Collections	(531,307)	(3,014,707)	(3,546,014)	(670,435)	(2,850,778)	(3,521,213)
Subtotal	895,625	1,189,907	2,085,532	537,743	17,818	555,561
Less: Offsetting Receipts		403,861	403,861		1,106,679	1,106,679
Net Outlays	\$ 895,625	\$ 786,046	\$ 1,681,671	\$ 537,743	\$ (1,088,861)	\$ (551,118)

(Note 15)

The accompanying notes are an integral part of these statements.

Appendix A

U. S. Small Business Administration Consolidated Statement of Financing for the periods ended September 30, 2002 and 2001

(Dollars in Thousands)

	2002	Restated 2001
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred	\$5,084,400	\$4,413,660
Less: Spending Authority from Offsetting Collections and Recoveries	3,423,694	3,544,724
Obligations Net of Offsetting Collections and Recoveries	1,660,706	868,936
Less: Offsetting Receipts	403,861	1,106,679
Net Obligations	\$1,256,845	\$(237,743)
Other Resources		
Transfers In (Out)	(263,127)	(299,683)
Imputed Financing	17,420	17,741
Other Financing Sources	(204,976)	378,045
Net Other Resources Used to Finance Activities	\$(450,683)	\$ 96,103
Total Resources Used to Finance Activities	\$ 806,162	\$(141,640)
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in Undelivered Orders	270,531	(295,870)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	2,534,651	2,714,888
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(3,070,232)	(1,318,358)
Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	9,085	418,935
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	\$ (255,965)	\$1,519,595
Total Resources Used to Finance the Net Cost of Operations	\$550,197	\$1,377,955
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Periods		
Change in Annual Leave Liability	\$ 754	\$ 587
Increase in Unfunded Liability for Claims against SBA		800
Upward/ Downward reestimates of Credit Subsidy Expense	542,065	(214,831)
Change in Revenue Receivable from Public	64,399	(26,687)
Change in Due to Treasury - Liquidating Funds that is not an obligation	204,976	(378,045)
Provision for Losses on Estimated Guarantees	(242,945)	(219,267)
Unfunded Employee Benefits	(661)	1,670
Total Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period	\$ 568,588	\$ (835,773)
Components Not Requiring or Generating Resources		
Depreciation or Amortization	2,521	
Bad Debt Expense - Noncredit Reform	14,153	(81,989)
Total Components of Net Cost that will Not Require or Generate Resources	16,674	(81,989)
Total Components of Net Cost of Operations Not Requiring or Generating Resources in the Current Period	\$ 585,262	\$ (917,762)
Net Cost of Operations	\$ 1,135,459	\$ 460,193

(Note 16)

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration
Notes to Financial Statements
for the periods ended September 30, 2002 and 2001

(Dollars in Thousands)

NOTE 1. Significant Accounting Policies

A. Basis of Accounting and Presentation

These financial statements have been prepared to report the financial position and results of operations of the Small Business Administration (SBA), as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the SBA in accordance with generally accepted accounting principles (GAAP) of the United States and the form and content for entity financial statements specified by the Office of Management and Budget (OMB). The financial statements differ from financial reports that are prepared pursuant to OMB directives for the purpose of reviewing and controlling the SBA's use of budgetary resources.

The statements reflect transactions recorded on both a proprietary accrual accounting basis and a budgetary obligation basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when liabilities are incurred, without regard to receipt or payment of cash. Budgetary accounting recognizes legal obligation of funds often in advance of the proprietary accrual. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds.

Established under the terms of the Federal Advisory Committee Act (FACA), as amended, the Federal Accounting Standards Advisory Board (FASAB), after consideration, recommends Federal accounting concepts and standards to the Secretary of Treasury, the Director of OMB and Comptroller General of the General Accounting Office (GAO) co-principals of the FASAB. If the principals do not object, after ninety days the recommendation becomes authoritative.

On October 19, 1999 the Council of American Institute of Certified Public Accountants (AICPA) recognized the FASAB as the body designated to establish generally accepted accounting principals for Federal Governmental entities under Rule 203, "Accounting Principles", of the AICPA's Code of Professional Conduct. In April 2000, the AICPA through Statement on Auditing Standards (SAS) No. 91, Amendment to Statement on Auditing Standards No. 69, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles in the Independent Auditor's Report, established the generally accepted accounting principles hierarchy for Federal financial reporting entities. The Federal hierarchy is:

FASAB Statements and Interpretations, plus AICPA and Financial Accounting Standards Board (FASB) pronouncements if made applicable to Federal Governmental entities by FASAB Statements or Interpretations;

FASAB Technical Bulletins and the following pronouncements if specifically made applicable to Federal Governmental entities by the AICPA and cleared by the FASAB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position;

AICPA Accounting Standard Executive Committee Practice Bulletins if specifically made applicable to Federal Governmental entities and cleared by the FASAB, as well as Technical Releases of the Accounting and Auditing Policy Committee of the FASAB; or

Implementation guides published by the FASAB staff, as well as practices that are widely recognized and prevalent in the Federal Government.

B. Reporting Entity

The SBA was created as an independent Federal Agency by the Small Business Act of 1953. Its mission is to maintain and strengthen the Nation's economy by aiding, counseling, assisting, and protecting, the interests of small business, and to help businesses and families recover from disasters.

The SBA operates through the execution of its congressionally approved budget primarily with eight major programs. The SBA's budget consists of annual, multi-year and no-year appropriations covering salaries and expenses and various program and trust fund activities.

1. Major Programs Supporting SBA's Mission

Helping Business Succeed with Business Programs

The Business Loan program, through an assortment of guarantee and direct programs, is the SBA's largest financial assistance program. Banks and certain non-bank lenders make loans, which are guaranteed by the SBA, at percentages varying from 50 percent to 90 percent.

The Development Company program provides small business owners the means to expand, modernize and compete by providing long-term fixed asset financing through Certified Development Companies.

The Small Business Investment Company program addresses the need for venture capital by small and emerging enterprises through Small Business Investment Companies.

The Surety Bond Guarantees program assists small business contractors in obtaining the required bid, performance and payment bonds for construction, service, and supply contracts.

The Business Development program assists small disadvantaged businesses with marketing support, management and technical assistance.

The Government Contracting program ensures that small businesses receive a fair share of Government contracts and subcontracts.

The Entrepreneurial Development program provides assistance to small businesses in the form of training and counseling.

Helping Businesses and Families Recover from Disaster with Disaster Assistance Programs

The Disaster Loan program provides assistance to victims of physical disasters such as earthquakes, floods and hurricanes by extending direct loans to individuals and businesses.

2. Fund Accounting Structure

The SBA's financial activities are accounted for by the following fund types:

Trust Fund

The Business Assistance Trust Fund is funded by donations and used to provide services in support of carrying out the mission of counseling, assisting and protecting the interest of small businesses.

Program Funds

The Disaster Program Fund is funded by appropriations and provides resources to support subsidy and administration costs of disaster related loans.

The Business Program Fund is funded by appropriations and provides resources to support subsidy and administration costs of business related loans.

Administrative Funds

The Salaries and Expenses Fund is funded by appropriations which are used to support the administrative costs incurred in carrying out the missions and functions of the SBA.

The Office of Inspector General Fund is funded by appropriations which are used to support the operation of the Office of Inspector General in carrying out the missions and functions of the SBA.

Revolving Fund

The Surety Bond Guarantees Revolving Fund provides assistance to small business contractors in obtaining bid, performance and payment bonds for construction, service and supply contracts.

Liquidating Funds

The Pollution Control Equipment Contract Guarantee Fund supports the costs associated with the credit portfolio of pre-October, 1991, pollution control equipment loans and guarantees being liquidated by the Agency.

The Disaster Loan Liquidating Fund supports the costs associated with the credit portfolio of pre-October, 1991, disaster assistance loans being liquidated by the Agency.

A

The Business Loan Liquidating Fund supports the costs associated with the credit portfolio of pre-October, 1991, business loans and guarantees being liquidated by the Agency.

Financing Funds

The Business Direct Loan Financing Fund supports the credit costs associated with the portfolio of post-September, 1991, direct business loans which are funded by Treasury borrowings and subsidy received from the program fund.

The Business Guaranteed Loan Financing Fund supports the credit costs associated with the portfolio of post-September, 1991, guaranteed and defaulted business loans and receives subsidy from the program funds.

The Disaster Direct Loan Financing Fund supports the credit costs associated with the portfolio of post-September, 1991, direct disaster loans which are funded by Treasury borrowings and subsidy received from the program fund.

C. Budgets and Budgetary Accounting for Loan Programs

Each SBA loan disbursement is financed by a combination of two sources: one for the long term cost of the loan and another for the remaining non-subsidized portion of the loan. Congress provides one-year, multi-

year, and no-year appropriations to cover the estimated long term costs of SBA loans. The long term costs are defined as the net present value of the estimated cash outflows associated with the loans less the estimated cash inflows. The portion of each loan disbursement that does not represent long term cost is financed under a permanent indefinite authority to borrow funds from the U.S. Department of the Treasury. Congress also annually adopts an appropriation bill limiting the dollar amount of obligations that can be made for direct loans and loan guarantees.

A permanent indefinite appropriation is available to finance the costs of subsidy reestimates that occur after the year in which a loan is disbursed. Modification of loans or loan guarantees require that budget authority for the additional cost be appropriated, if not available from existing appropriations or other budgetary resources.

D. Intragovernmental Assets and Liabilities

The Consolidated Balance Sheet presentation distinguishes “intragovernmental” assets and liabilities from “other” assets and liabilities. Intragovernmental assets and liabilities are those that arise from transactions between Federal entities. Other assets and liabilities are either receivable from or payable to the public; or represent investments of the SBA in property, plant and equipment or other items.

E. Assets

The assets are resources which the SBA has authority to use in its operations. The authority to use funds in the SBA's operations means that the SBA management has the authority to decide how funds are used, or management is legally obligated to use funds to meet entity obligations.

F. Credit Program Receivable Sales

The SBA continued a program initiated in 1999 to sell pools of loans from its loan portfolio rather than servicing such loans itself. Sale two was held during FY 2000 with over 26,000 loans sold and an unpaid principal balance in excess of \$1.2 billion. During FY 2001, the SBA completed sales three and four selling 49,000 loans with unpaid principal balance of \$2.3 billion. During FY 2002, sales five and six were completed selling 59,000 loans with unpaid principal balance of \$1.25 billion.

Gains and losses from the sale of credit program receivables are recognized as cost of operations for the pre-1992 loans and reflected in the Liquidating Funds. For post-1991 loans the gains and losses are included in the adjustment for the subsidy allowance in the Financing Funds.

G. Fund Balances with Treasury and Cash

The SBA does not maintain cash in commercial bank accounts except for certain limited program activities that are not funds for the Government (See Note 1H). Cash receipts and disbursements are processed by the U.S. Department of the Treasury. Fund Balances with Treasury and cash are comprised primarily of appropriated, revolving and trust funds, which are available to make expenditures and pay liabilities. Amounts are included in Fund Balances which are unavailable for obligation because they relate to expired authority. (See Notes 2 & 3)

H. Interest Receivable-Master Reserve Fund

The 7(a) secondary market program, one of the Business Loans programs, is administered by an agent of the SBA. The agent receives collections from banks on 7(a) loans guaranteed by the SBA and makes payments to secondary holders who have investments in pools of 7(a) guaranteed loans. These payments flow through the Master Reserve Fund (MRF) and accumulated interest is the property of the SBA, but future payments, required to the holders of 7(a) secondary market securities, could exceed the principal amount of the investment. The interest, as well as the principal in the investment, is mostly invested in Treasury guaranteed securities. The SBA's policy, revised in FY 2001, was to record the residual portion of the interest as interest receivable and an offsetting deferred credit. In FY 2002 this policy was revised again according to SFFAS 7 requirements on trust funds to present the MRF results in a footnote to the

financial statement (see Note 4 for additional information) without recording MRF results on the face of the financial statements.

I. Accounts Receivable

Accounts Receivable - Intragovernmental is reimbursements due from other Federal agencies and funds. The SBA did not record an interest receivable from Treasury for FY 2002 because the interest due was received before the end of the fiscal year. The SBA records intrafund receivables and payables between program and financing funds for subsidy reestimates.

Accounts Receivable which are not intragovernmental primarily represent amounts due from participating financial institutions for guarantee fees, and advances from asset sale purchasers. The balance in the Salaries and Expenses fund represents receivables due from Agency employees or vendors for net credits from various transactions. See Note 5.

The SBA provides no allowance for uncollectible or unrecoverable accounts because of the historic immateriality of losses due to stringent collection policy and the ability to offset against the lender's share of collections, payments to employees, or payments to vendors.

J. Credit Program Receivables and Related Foreclosed Property

Accounting for Loan Assets Obligated Prior to FY 1992.

Loans, similar receivables, and related accrued interest are recorded at book value less an allowance for uncollectible amounts.

Accounting for Loan Assets Obligated After FY 1991.

Loans, similar receivables, and related accrued interest are recorded at book value. An allowance for subsidy is recorded to reduce the value of credit receivables and foreclosed property to net present value as required by the Federal Credit Reform Act of 1990 and Statement of Federal Financial Accounting Standards (SFFAS) #2. The allowance account is valued at the present value of subsidized costs described in note 6.

K. General Property and Equipment

The buildings in which the SBA operates are provided by the General Services Administration, which charges the SBA rent that approximates the commercial rental rates for similar properties. Equipment is capitalized at cost, if the initial unit acquisition cost is \$50,000 or more and service life is at least five years. Equipment with an acquisition cost of less than \$50,000 or less than five years of life is expensed when purchased. Equipment is depreciated using the straight-line method over five years. Computer related equipment is capitalized at cost, if the initial unit acquisition cost is \$50,000 or more and has a service life of at least three years. Computer related equipment and software with an acquisition cost of less than \$50,000 or less than three years of life is expensed when purchased. Computer related equipment and software is depreciated using the straight-line method over three years.

Software for internal use, whether internally developed, contractor developed, or commercial off-the-shelf (COTS), is capitalized at cost, if the initial unit acquisition cost is \$250,000 or more and has a service life of at least three years. For internally developed software, the capitalizable costs are the direct and indirect costs incurred after the SBA has completed all planning, designing, coding and testing activities that are necessary to establish that the software can meet design specifications up to the point of final acceptance. Internally developed, contractor developed, and COTS software with a development or acquisition cost of less than \$250,000 or less than three years of life is expensed when purchased or developed. Software for internal use is depreciated using the straight-line method over three years. Enhancements are capitalized when it is more likely than not that they will result in significant additional capabilities. Costs that do not meet the capitalization criteria are expensed when incurred.

L. Advances

Intragovernmental

The SBA advances payments semiannually to the Federal Financing Bank for loans guaranteed under Section 503 of the Small Business Act. The advances are liquidated by receipt of the next installment payments from state or local development companies. To the extent that those installments may not repay advances, balances remain collectible from the development companies.

Public

Advances are made to honor the SBA's timely payment requirement of principal and interest due for debentures in the SBA's Section 503, Section 504 and SBIC programs.

The Section 503 program was discontinued in 1986 and replaced by the Section 504 program which is a part of the Development Company program described Note 1.B.1.

The Section 504, Certified Development Company (CDC) program provides growing businesses with long-term, fixed-rate financing for major fixed assets, such as land and buildings. Typically, a 504 project includes a loan secured with a junior lien from the CDC, backed by a 100 percent SBA-guaranteed debenture, covering up to 40 percent of the project cost. The maximum SBA debenture generally is \$750,000 but may be as much as \$1,000,000 in some cases.

The Small Business Investment Company (SBIC) program provides long term loans and or venture capital to small firms. SBICs are privately owned and operated investment companies, which are licensed and regulated by the SBA. The SBA guarantees SBIC debentures and preferred securities sold to private investors. The SBA also guarantees non-voting preferred stock and participating securities.

M. Liabilities

Liabilities are the recognition of probable future outflow of resources that results from past transactions. If the transaction was between Federal entities, the liability is an Intragovernmental Liability.

Liabilities are recognized when incurred even if budgetary resources are not available to pay them. Liabilities must not be paid until budgetary resources become available. Liabilities funded by budgetary resources as of the reporting date are considered to be liabilities covered by budgetary resources, while liabilities not funded as of that date are considered to be liabilities not covered by budgetary resources. (See Note 9).

N. Debt

Borrowings payable to the Treasury result from loans provided by the Treasury to fund a portion of the Agency's credit reform financing accounts activity. The financing accounts are required to make periodic principal payments to Treasury based on the collections of loans receivable.

Borrowings payable to the Federal Financing Bank (FFB) result from a sale of loans to the FFB of loans from the Business Liquidating Account. As the FFB collects the principal of these loans the SBA's liability to FFB is reduced as well as an offsetting Loan Receivable. (See Note 10).

O. Liability for Loan Guarantees

There are two components to the Agency's liability for guaranteed loans: liabilities for losses on pre-1992 loans, and liabilities on post-1991 loans made under the Federal Credit Reform (FCR) legislation. For pre-1992 guarantees, the amount is an estimate of losses on guarantees outstanding based on historical experience. For post-1991 loans, the liability is based on the present value of future cash flows related to the guarantees, as described in Note 6-L.

P. Contingencies

The SBA is a party in various administrative proceedings, legal actions, environmental suits and claims brought against it. In the opinion of the SBA management and legal counsel, the ultimate resolution of these proceedings, actions, suits and claims will not materially affect the financial position or results of the SBA operations. The likelihood of loss to the SBA ranges from remote to probable for these litigation matters. (See Note 12).

Q. Annual, Sick and Other Leave

A liability for annual leave is accrued as it is earned and reduced as leave is taken. Each year, the balance in the accrued annual leave is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future appropriations.

Sick leave and other types of non-vested leave are expensed as taken.

R. Employee Health and Life Insurance Benefits

SBA employees are eligible to participate in contributory Federal Employees Health Benefit program (FEHB) and the Federal Employees Group Life Insurance program (FEGLI). The SBA matches employee contributions to each program. These contributions are recognized as current operating expenses.

S. Employee Pension Benefits

SBA employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). For employees participating in CSRS, 7.0 percent of their gross earnings was withheld and transferred to the Civil Service Retirement and Disability Fund. SBA contributes an additional 8.51 percent of the employee gross earnings to the CSRS Retirement and Disability Fund. For employees participating in FERS, SBA withholds .8 percent of gross earnings, and matches the withholding with a 10.7 percent employer contribution. This total is transferred to the Federal Employees' Retirement Fund.

The CSRS and FERS retirement funds are administered by the Office of Personnel Management (OPM). SBA contributions to the CSRS and FERS are recognized as current operating expenses. SBA's contribution for FY 2002 is \$7.8 million and for FY 2001 is \$7.4 million to CSRS and for FY 2002 \$14.7 million and for FY2001 \$13.2 million to FERS. The imputed cost for the two programs was \$6.4 million for FY 2002 and \$7.3 million for FY 2001.

FERS participants are also covered under the Federal Insurance Contribution Act (FICA) and are subject to FICA withholdings. The SBA makes matching contributions for FICA, recognized as operating expenses.

On April 1, 1987, the Federal Government initiated the Thrift Savings Plan (TSP), a defined contribution retirement savings and investment plan for employees covered by either CSRS or FERS. CSRS participants may contribute up to 7 percent of their gross pay (8 percent beginning October, 2002) to the TSP, but there is no Agency matching contribution. FERS participants may contribute up to 12 percent (13 percent beginning October, 2002) of their gross pay to the TSP. A primary feature of FERS is that it offers a savings plan to SBA employees which automatically contributes 1 percent of basic pay, matches any employee contributions dollar for dollar for the first 3 percent of pay, and for each dollar of the next 2 percent of pay contributions are matched 50 cents on the dollar. The SBA contributions to the TSP are recognized as current operating expenses. The maximum amount that either FERS or CSRS employees may contribute to the TSP is \$11,000 (\$12,000 beginning January, 2003). Employee and employer contributions to the TSP are transferred to the Federal Retirement Thrift Investment Board.

The SBA recognizes the full cost of providing future CSRS and FERS pension benefits to covered employees at the time the employees' services are rendered. The pension expense recognized in the financial statements equals the service cost for covered SBA employees, less amounts contributed by these

employees. Service cost represents the actuarial present value of benefits attributed to services rendered by covered employees during the accounting period. The measurement of service cost requires the use of actuarial cost methods to determine the percentage of the employees' basic compensation sufficient to fund their projected pension benefit. These percentages (cost factors) are provided by the OPM and applied by the SBA to the basic annual compensation of covered employees to arrive at the amount of total pension expense to be recognized in the SBA's financial statements.

The excess of total pension expense over the amount contributed by the Agency and by the SBA's employees represents the amount of pension expense which must be financed directly by the OPM. The SBA recognized as non-exchange revenue an imputed financing source equal to the excess amount. The SBA does not report in its financial statements FERS or CSRS assets, accumulated plan benefits or unfunded liabilities, if any, applicable to its employees.

T. Other Retirement Benefits

SBA employees eligible to participate in the FEHB and the FEGLI may continue to participate in these programs after their retirement. SBA recognizes a current operating expense for the future cost of these and other retirement benefits (ORB) at the time the employee's services are rendered. This ORB expense must be financed by the OPM, and is offset by the SBA through recognition of an imputed financing source. Using cost factors supplied by the OPM, the SBA recorded ORB expense and imputed financing sources of \$11.1 million for FY 2002 and \$9.8 million for FY 2001.

U. Revenues and Other Financing Sources

The SBA recognizes as revenues and other financing sources appropriations used, earned revenue, donations, imputed financing sources, and non-expenditure transfers.

The SBA receives the majority of the funding needed to support its operations through congressional appropriations. The Agency receives one year, multi-year and no year appropriations that may be used, within statutory limits, for operating expenditures. A financing source, appropriations are considered used when good or services financed by an appropriation are provided, regardless of when paid. This is reported in the Consolidated Statement of Changes in Net Position.

Earned revenue results from exchange transactions that benefit both parties. The SBA has earned revenues such as loan guarantee fees, interest on its loan portfolios, and interest on fund balances. These revenues are presented on the Consolidated Statement of Net Cost as reductions to operating cost.

Donations are treated as revenues and reported in the Consolidated Statement of Changes in Net Position.

Imputed financing sources are operating costs of the SBA which are paid for through funds appropriated to other Federal entities. These include items such as employee pension benefits and post-employment benefits for former employees. The imputed financing source is reported in the Consolidated Statement of Changes in Net Position while the associated cost is reflected in the Consolidated Statement of Net Cost.

Non-expenditure transfers of appropriated amounts or of assets without reimbursement included items such as transfers to Treasury of downward subsidy reestimates and unobligated balances from liquidating accounts. These transfers are included in the Consolidated Statement of changes in Net Position.

V. Accounting Changes

In FY 2002, SBA corrected an error for the recording of the subsidy expense associated with direct loans and loan guarantees. SBA had been recording subsidy expense at the time of commitment to make loans rather than the time loans were actually disbursed. Recognizing subsidy expense at the time loans are disbursed resulted in a prior period adjustment, to accurately state the beginning balances in the subsidy cost allowance account, a reduction of \$119 million for periods prior to FY 2001 and a reduction of \$41 million for FY 2001. The SBA follows SFFAS #21, Reporting Corrections of Errors and Changes in

Accounting Principles. In accordance with that guidance, the SBA has restated its FY 2001 financial statements. See Note 17.

For FY 2002, the new Oracle Financial accounting system allowed SBA to more accurately account for its reimbursable activity. This was a significant change in accounting practice from previous years. Due to this change in accounting practice, SBA began recording balances in a number of reimbursable accounts in FY 2002. Specifically, SBA began to use accounts such as Unfilled Orders With Advance, Reimbursements and Other Income Earned - Collected, Advances From Others, and Revenue From Services Provided. Thus 2002 financial statements reflect balances in these accounts, whereas previous years statements did not. In addition, a prior period adjustment of \$557,000 was made to reclassify Unexpended Appropriations balances that were determined to be reimbursable as Cumulative Results of Operations to reflect the reimbursable nature of the net position balance. The SBA did not restate its financial statements for this prior period adjustment.

The SBA had recorded, as valid obligations amounts that it expected to outlay for honoring guarantee agreements in its liquidating funds. This recordation as undelivered orders was incorrect. The recognition was changed to an unfunded guarantee liability. The effect of this change was \$354 million. The financial statements for FY 2001 have been restated to reflect this change.

SBA determined that the non-entity assets of \$1.8 billion included in prior balance sheets should be included in Treasury's statements instead of the SBA. The SBA has restated its 2001 fund balances with Treasury to reflect this change for purposes of comparative reporting.

NOTE 2. Fund Balances with Treasury

(Dollars in Thousands)

Fund Balances	FY 2002	FY 2001
Entity		
Trust Fund	\$ 278	\$ 214
Liquidating Funds	492,845	1,012,884
Financing Funds	6,256,952	6,497,449
Revolving Fund	26,706	26,089
Appropriated Funds	715,959	800,019
Total Fund Balances	\$ 7,492,740	\$ 8,336,655
Status of Fund Balances with Treasury		
Unobligated Balance		
Available	\$ 3,045,904	\$ 2,549,211
Unavailable	3,694,382	4,610,161
Obligated Balance Not Yet Disbursed	752,454	1,177,283
Total	\$ 7,492,740	\$ 8,336,655

NOTE 3. Cash

Cash held outside the U.S. Treasury consists of undeposited funds under the control of the SBA at field offices or lock boxes.

(Dollars in Thousands)

Cash	FY 2002	FY 2001
	Entity Assets	Entity Assets
At Field Offices	\$ 3,391	\$ 2,095
Lock boxes	67	348
	\$ 3,458	\$ 2,443

NOTE 4. Master Reserve Fund

The Small Business Secondary Market Improvements Act of 1984, P.L. 98-352 (Improvement Act) provided statutory authority for the 7(a) secondary market, and for the pooling of 7(a) loans, as well as the central registration of secondary market loans and improved disclosure of 7(a) secondary market loans. The Improvement Act also provided for SBA's regulation of brokers and dealers operating in the 7(a) secondary market and for reporting to Congress on secondary market results. The 7(a) secondary market has approximately \$12 billion of currently outstanding investments held by 7(a) secondary holders.

The Master Reserve Fund (MRF) is maintained by the SBA's fiscal agent as part of its administration of the 7(a) secondary market program. The intent of Congress in the Improvement Act was for the SBA to develop the MRF as a mechanism to fund the 7(a) secondary market pooling program at no cost to the Federal taxpayer. The MRF also provides for the pooling of loans having terms that vary within a range prescribed by the SBA, while the secondary investors have a fixed term for their investment that is the term of the longest loan in the pool. The MRF is funded by the timing of cashflows in the 7(a) secondary market program, including the principal portion of the borrower's first payment for pooled loans and float on borrower payments prior to payment to the secondary holders. It used to fund the SBA's guarantee of the timely payment of principal and interest owed to the 7(a) secondary market holders and to pay expenses of the MRF trustee and investment advisor.

The composition of the MRF at September 30, 2002 and September 30, 2001 is shown in the following table. A reconciliation of the change in MRF assets from September 30, 2002 and September 30, 2001 is also shown.

Master Reserve Fund

(Dollars in Thousands)

	09/30/02	09/30/01
Receivables		
Securities	\$ 218,000	\$ 228,630
Net Interest	13,183	12,338
Other Income		1,350
Interest Sold/Matured	12	528
Total Receivables	\$ 231,195	\$ 242,846
Payables	(12)	(57)
Government Bonds		
Treasury Bonds	166,835	102,582
Treasury Notes	644,537	691,811
Total Government Bonds	\$ 811,372	\$ 794,393
Cash Equivalents - Money Market Funds	27,444	20,490
Short Term Investments - Treasury Bills	143,384	136,978
Net Assets	\$ 1,213,383	\$ 1,194,650
 Master Reserve Fund	 \$ 1,213,383	 \$ 1,194,650

Reconciliation of MRF Assets

(Dollars in Thousands)

Beginning Net Assets - 09/30/01	\$ 1,194,650
Receipts	
Regular Loan Payments	1,181,896
Prepayments	1,194,960
Defaults from SBA or the Lender	561,200
Other Receipts	10,099
Earned Income	61,138
Net Realized Gain (Loss)	(2,708)
Total Receipts	\$ 3,006,585
Disbursements	
Regular Payments to Investors	1,229,997
Prepayments	1,194,960
Defaults	561,200
Expenses	1,695
Total Disbursements	\$ 2,987,852
Ending Net Assets - 09/30/02	\$ 1,213,383

A legal opinion has provided the SBA with the right to the interest earned by the MRF. At September 30, 2002 there was approximately \$551 million (compared to \$490 million for FY 2001) of interest earned by the MRF since its inception in 1986. This amount, however, has and will be reduced to fund the cost of providing timely payment of the amounts owed to secondary market investors. Currently the SBA estimates that there is a potential future deficit in the MRF in the range of zero to \$18.3 million required to liquidate the obligations in the 7(a) secondary market. This estimate is disclosed here, but not included in the SBA's financial statements as a contingent liability because the likelihood of the liability is remote. This potential deficit contrasts with FY 2001 where an estimated \$68 million of interest receivable was included in SBA's FY 2001 financial statements.

The SBA determined this estimate through an analysis of a representative sample of 50 closed MRF pools performed by the SBA's fiscal agent. Although the fiscal agent does not maintain an accounting of MRF funds on an individual pool basis, the actual mechanics of MRF activity were used by the fiscal agent to model the results of the 50 closed pools. The results of this analysis were extrapolated to the approximately 1000 closed pools, and then projected to the approximately 5000 open pools in the MRF to provide the estimate of the potential future deficit of

the MRF to meet 7(a) secondary market timely payment obligations. This estimate depends on future economic conditions that affect the MRF earnings and obligations.

The SBA, however, expects that changes that can be made to the 7(a) secondary market program will provide additional MRF income to eliminate the potential future deficit in the MRF should it become more imminent. Curing the cause of the deficit will meet the intent of Congress that the program should not create an additional cost or liability to the Government and that the SBA's secondary market pooling program should have no budgetary repercussions. However, since the SBA would be required to finance a future shortage in the MRF, in the remote circumstances that it would materialize, the SBA has agreed to work with the Office of Management and Budget to include the MRF under Federal Credit Reform reporting procedures in the future.

NOTE 5. Accounts Receivable

Accounts receivable are displayed by type. Additional information about the types of receivables is contained in Note 11.

Cash adjustments are Funds with Treasury transactions that Treasury has not applied as of the Balance Sheet date or Treasury transactions that SBA has not recorded due to timing differences.

	By Type			
	FY 2002		FY 2001	
	Intragovernmental	Public	Intragovernmental	Public
Subsidy Receivable from Program Fund to Financing Fund	\$ 1,129,078	\$	\$ 587,013	\$
Interest Receivable From Treasury	0		369,285	
Other Intrafund Receivables	72,610		66,361	
Overpayment to Secondary		578		340
Guarantee Fees Receivable		49,003		27,585
Examination Fees -SBIC		76		99
Administrative Receivables		617		268
Refunds		4,140		4,433
Revenue Receivable		1,001		
Receivable due from Banks		12,432		1,599
Cash Adjustments		8,990		21,641
Receivable due from Purchasers - Asset Sales		137		115
Reimbursables	529			
Miscellaneous		0	28	1,108
Sub-Total Before Eliminations	\$ 1,202,217	\$76,974	\$ 1,022,687	\$ 57,188
Eliminations -Intrafund Receivables	\$ (72,610)		\$ (66,361)	
Eliminations - Subsidy	(1,129,078)		(587,013)	
Balance Sheet Total	\$ 529	\$ 76,974	\$ 369,313	\$ 57,188

NOTE 6. Credit Program Receivables and Related Foreclosed Property

A. The SBA operates the following loan and loan guarantee programs:

- (1) Business, Direct
- (2) Disaster, Direct
- (3) Business, Guarantee
- (4) Pollution Control, Guarantee

Direct loan obligations and defaulted guarantee commitments made prior to 1992 are reported net of an allowance for estimated uncollectible loans or estimated losses. Loss allowances represent estimates of what the SBA does not expect to recover on its loans receivable obligated prior to FY 1992. These allowances are based upon historical

Appendix A

experience, current market conditions and an analysis of individual assets. They are unfunded and merely attempt to reflect the anticipated uncollectible 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

E. Subsidy Expense for Direct Loans by Program and Component Post-1991 Loans:
(Dollars in Thousands)

Subsidy Expense for New Direct Loans Disbursed FY 2002

Direct Loan Programs	Interest Differential	Defaults	Fees	Other	Total
	\$	\$			\$
(1) Business	2,005	142	\$	\$	2,147
(2) Disaster	109,905	110,274	(22,729)	16,790	214,240
	\$	\$	\$	\$	\$
Total	111,910	110,416	(22,729)	16,790	216,387

Subsidy Expense for New Direct Loans Disbursed FY 2001

Direct Loan Programs	Interest Differential	Defaults	Fees	Other	Total
(1) Business	\$ 3,262	\$ 48	\$	\$	\$ 3,310
(2) Disaster	105,155	40,847	(14,306)	9,903	141,599
Total	\$ 108,417	\$ 40,895	\$ (14,306)	\$ 9,903	\$ 144,909

Reestimates FY 2002

Loan Programs	Technical Reestimates	Total Reestimates
(1) Business	\$ 1,139	\$ 1,139
(2) Disaster	(78,210)	(78,210)
Total	\$ (77,071)	\$ (77,071)

Reestimates FY 2001

Loan Programs	Technical Reestimates	Total Reestimates
(1) Business	\$ (3,001)	\$ (3,001)
(2) Disaster	498,251	498,251
Total	\$ 495,250	\$ 495,250

The FY 2001 disaster reestimate of \$498 million was booked in 2001, but was never apportioned by OMB and has been netted with the FY 2002 reestimate of \$420 million for the FY 2002 net result of (\$78 million.)

Total Direct Loan Subsidy Expenses

FY 2002		FY 2001	
Loan Programs	Total	Loan Programs	Total
(1) Business	\$ 3,286	(1) Business	\$ 309
(2) Disaster	136,030	(2) Disaster	639,850
Total	\$ 139,316	Total	\$ 640,159

**F. Subsidy Rates for Direct Loans by Program and Component:
Budget Subsidy Rates for Direct Loans for the Current Year's Cohorts:**

(Dollars in Thousands)

FY 2002					
1. Direct Loans					
Loan Programs	Interest Supplements	Defaults	Fees	Other	Total
(1) Business	6.52%	0.26%	0.00%	0.00%	6.78%
(2) Disaster	6.88%	8.18%	-1.59%	1.20%	14.67%

G. Schedule for Reconciling Subsidy Cost Allowance Balances:

(Dollars in Thousands)

	(Post - 1991 Direct Business)		(Post - 1991 Direct Disaster)	
	FY 2002	FY 2001	FY 2002	FY 2001
Beginning balance of the subsidy cost allowance	\$ 23,748	\$ 34,108	\$ (144,283)	\$ 505,445
Add: subsidy expense for				
Direct loans disbursed during the reporting years by component:				
Interest rate differential costs	2,005	3,262	109,905	105,155
Default costs (net of recoveries)	142	48	110,274	40,847
Fees and other collections			(22,729)	(14,306)
Other Subsidy Costs			16,790	9,903
Total of the above subsidy expense components	2,147	3,310	214,240	141,599
Adjustments:				
Loans written off	(121)	(100)	(108,981)	(161,843)
Subsidy allowance amortization	(13,345)	(5,828)	(404,549)	(645,929)
Loss Allowance Adjustment		(712)		(414,175)
Subsidy Restatement		(4,028)		(67,631)
Ending balance of the subsidy cost allowance before reestimates	12,429	26,750	(443,573)	(642,534)
Add or subtract subsidy reestimates by component:				
(a) Interest rate reestimate				
(b) Technical/ default reestimate	1,139	(3,002)	(78,210)	498,251
Total of the above reestimate components	1,139	(3,002)	(78,210)	498,251
Ending balance of the subsidy cost allowance	\$ 13,568	\$ 23,748	\$ (521,783)	\$(144,283)

(Post - 1991 Guarantee Business)

	FY 2002	FY 2001
Beginning balance of the subsidy cost allowance	\$ 162,563	\$ 86,339
Adjustment related to the purchase of guaranteed loans	47,817	76,224
Other		0
Ending balance of the subsidy cost allowance before reestimates	\$ 210,380	\$ 162,563

H. Defaulted Guaranteed Loans from Pre-1992 Guarantees:*(Dollars in Thousands)*

Liquidating Loan Guarantee Programs	FY 2002					Defaulted Guaranteed Loans Receivable, Net
	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property		
(1) Business	\$ 323,576	\$ 8,942	\$ (116,212)	\$ 756	\$ 217,062	
(2) Pollution	48,702	415	(33,064)		\$16,053	
Total	\$ 372,278	\$ 9,357	\$ (149,276)	\$ 756	\$ 233,115	

I. Defaulted Guaranteed Loans from Post-1991 Guarantees:*(Dollars in Thousands)*

Credit Reform Loan Guarantee Program	FY 2002				Net Present Value of Assets Related to Defaulted Guaranteed Loans Receivable
	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Foreclosed Property	Allowance for Subsidy Cost (Present Value)	
(1) Business	\$ 1,458,966	\$ 5,947	\$ 13,387	\$ (210,380)	\$ 1,267,920

J. Guaranteed Loans:*(Dollars in Thousands)***Guaranteed Loans Outstanding:**

Loan Programs	FY 2002		FY 2001	
	Outstanding Principal, Guaranteed Loans Receivable, Face Value	Amount of Outstanding Principal Guaranteed By SBA	Outstanding Principal, Guaranteed Loans Receivable, Face Value	Amount of Outstanding Principal Guaranteed By SBA
(1) Business	\$ 50,089,639	\$ 40,440,908	\$ 46,605,001	\$ 37,452,750
(2) Pollution	12,207	12,207	15,921	15,921
Total	\$ 50,101,846	\$ 40,453,115	\$ 46,620,922	\$ 37,468,671

New Guaranteed Loans Disbursed:*(Dollars in Thousands)*

Loan Programs	FY 2002		FY 2001	
	Outstanding Principal, Guaranteed Loans Receivable, Face Value	Amount of Outstanding Principal Guaranteed By SBA	Outstanding Principal, Guaranteed Loans Receivable, Face Value	Amount of Outstanding Principal Guaranteed By SBA
(1) Business	\$12,904,326	\$10,308,950	\$11,298,036	\$8,899,482

K. Liability for Loan Guarantees:
(Dollars in Thousands)

Loan Programs	FY 2002		
	Liabilities for Loan Guarantees For Pre-1992 Guarantees	Liabilities for Loan Guarantees for Post-1991 Guarantees (Present Value)	Total Liabilities for Loan Guarantees
(1) Business	\$ 115,556	\$ 1,409,339	\$ 1,524,895
(2) Pollution			
(3) Disaster	143		143
Total	\$ 115,699	\$ 1,409,339	\$ 1,525,038

Loan Programs	FY 2001		
	Liabilities for Loan Guarantees For Pre-1992 Guarantees	Liabilities for Loan Guarantees for Post-1991 Guarantees (Present Value)	Total Liabilities for Loan Guarantees
(1) Business	\$ 359,746	\$ 1,076,583	\$ 1,436,329
(2) Pollution	525		525
(3) Disaster	143		143
Total	\$ 360,414	\$ 1,076,583	\$ 1,436,997

L. Subsidy Expense for Post-1991 Loan Guarantees:
(Dollars in Thousands)
Subsidy Expense for New Loan Guarantees

Loan Program	FY 2002			
	Defaults	Fees	Other	Total
Business	\$ 483,037	\$ (339,382)	\$ (21,288)	\$ 122,367

Loan Program	FY 2001			
	Defaults	Fees	Other	Total
Business	\$603,946	\$ (376,632)	\$ (72,457)	\$ 154,857

Loan Program	Reestimates FY 2002	
	Technical Reestimates	Total Reestimates
Business	\$ 412,001	\$ 412,001

Loan Programs	Reestimates FY 2001	
	Technical Reestimates	Total Reestimates
Business	\$ (282,874)	\$ (282,874)

Total Loan Guarantee Subsidy Expenses

Loan Program	FY 2002	FY 2001
	Total	Total
Business	\$ 534,368	\$ (128,017)

**M. Subsidy Rates for Loan Guarantees by Program and Component:
Budget Subsidy Rates for Loan Guarantees for the Current Year's Cohorts:**

FY 2002				
Loan Programs	Defaults	Fees	Other	Total
Business				
7(a) and NAFTA	4.38%	-3.23%	-0.08%	1.07%
7(a) Delta	5.04%	-3.23%	-0.08%	1.73%
504 Debentures	2.46%	-5.35%	2.89%	0.00%
504 Delta	2.83%	-5.31%	3.32%	0.84%
SBIC Debentures	9.04%	-3.00%	-6.04%	0.00%
SBIC Participating Securities	5.95%	-3.03%	-2.92%	0.00%
SBIC New Markets	14.74%	0.00%	0.00%	14.74%
Microloan	1.76%	0.00%	6.41%	8.17%

**N. Schedule for Reconciling Loan Guarantee Liability Balances:
(Post - 1991 Business Loan Guarantees)
(Dollars in Thousands)**

	FY 2002	FY 2001
Beginning balance of the loan guarantee liability	\$ 1,076,583	\$ 1,263,239
Add: subsidy expense for guarantee loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	483,037	603,945
Fees and other collections	(339,382)	(376,631)
Other Subsidy Costs	(21,288)	(72,456)
Total of the above subsidy expense components	122,367	154,858
Loans written off	(377,469)	(265,776)
Amortization of Subsidy	315,619	338,786
Loss Allowance Adjustment		(53,273)
Restatement Subsidy	(95,102)	
Adjustment related to the purchase of guaranteed loans	(47,816)	(76,225)
Other	3,157	(2,152)
Ending balance of the subsidy cost allowance before reestimates	997,339	1,359,457
Add or subtract subsidy reestimates by component:		
Technical / default reestimate	412,001	(282,874)
Total of the above reestimate components	412,001	(282,874)
Ending balance of the loan guarantee liability	\$ 1,409,340	\$ 1,076,583

O. Administrative Expense:
(Dollars in Thousands)

FY 2002			
Direct Loan Programs	Total	Loan Guarantees Program	Total
(1) Business	\$ 23,374	Business	\$ 93,498
(2) Disaster	93,307		
Total	\$ 116,681		

P. Summary of Note 6B, 6C, 6H and 6I

	FY 2002
Direct Loans Obligated Prior to FY 1992:	\$ 197,750
Direct Loans Obligated After FY1991:	3,770,700
Defaulted Guaranteed Loans from Pre-1992 Guarantees:	233,115
Defaulted Guaranteed Loans from Post-1991 Guarantees:	1,267,920
Credit Program Receivables and Related Foreclosed Property	\$ 5,469,485

Q. Other Information:

Part J of this note, for pre-1992 business loans, relates to outstanding gross amounts guaranteed for FY 2002 of \$1.1 billion and for FY 2001 of \$1.5 billion. Of this amount, the Agency's share for FY 2002 is \$939 million and for FY 2001 is \$1.5 billion. For Pollution Control Equipment Contract Guarantee Fund (PCECGF), the outstanding guarantees for FY 2002 total \$12.2 million and for FY 2001 total \$15.9 million. This amount is both gross and Agency share. For post-1991 loans, the gross amount guaranteed for business loans for FY 2002 is \$49 billion and for FY 2001 is \$45.1 billion. The Agency's share is \$39.5 billion for FY 2002 and \$36 billion for FY 2001.

The SBA has outstanding loan commitments of \$10.6 billion as of September 30, 2002, and \$9.3 billion as of September 30, 2001. These figures are comprised entirely of post-1991 commitments.

The FY 2002 foreclosed property referred to in Parts B, C, H, and I is comprised of \$21.03 million of real estate outstanding on 75 loans and \$919 thousand of other property outstanding on 17 loans. The average number of days for the outstanding foreclosed property was 532 days. The number of items in process as of September 30, 2002 was 16.

R. Credit Program Subsidy:

The subsidy rates disclosed pertain only to cohorts with outstanding balances in the current year. These rates cannot be applied to the direct loans and guarantee programs disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year could result from both current year cohorts and prior year's cohorts. The subsidy expense reported in the current year also includes reestimates.

The Federal Credit Reform Act of 1990 requires that all agencies budget for the cost of credit programs by measuring the net present value of cash flows to and from the Government. Loans originated during the same fiscal year are assigned to a "cohort" which is funded by appropriations for that year. Extensive amounts of transactional loan data and accounting data are used to model the cash flows for the SBA programs, culminating in the development of a subsidy rate. The terms below refer to definitions provided in OMB Circular A -11, which provides direction on the preparation of the estimates, which are also known as subsidy rates.

The credit subsidy rate represents the present value cost of a given program to the Government, expressed as a percentage of dollars of loan commitments of each loan or loan guarantee program. The process to develop subsidy rate calculations is lengthy and complex, requiring unique data collection techniques and analysis efforts for each program. The SBA develops its subsidy rates by creating models that incorporate data on loan maturity, borrowers' interest rates, fees, grace periods, interest subsidies (if appropriate), delinquencies, default or purchase rates, recoveries, prepayments and borrower characteristics. Loan receivable, net of the value of assets related to direct loans, is not the same as the proceeds that the SBA would expect to receive from selling loans.

After the initial estimate is made for budgetary purposes, the estimations are updated each year. These are known as reestimates. For scheduling purposes, the SBA conducts these reestimates using information as of June 30, which is then annualized. Changes in any subsidy rate after the cohort has been funded result in the submission of funds to or receipt from the U.S. Treasury under this reestimate.

Guarantee Programs

The 7(a) General Business Loan Guarantee Program

The following table shows the latest reestimate of subsidy rates for the 7(a) program for all cohorts originated under the requirements of the Federal Credit Reform Act. The total subsidy cost, presented on the left, is the sum of the components for the interest subsidy costs, default costs (net of recoveries), fees and other collections, and other costs. The SBA has prepared these estimates for cohorts in the current year's budget for the current and past years' cohorts. Each subsidy rate represents the cost, a percentage of the amount of guaranteed loans obligated in the cohort. Negative percentages indicate that the Government currently expects a positive cash flow for that cohort. (Note: sometimes components or their sums are rounded).

Cohort Year	Original	Current reestimate of			
	Subsidy Rate	Total	Interest	Default	Fee/Other
1992	4.85	1.62	0.00	3.15	(1.53)
1993	5.47	0.82	0.00	2.54	(1.72)
1994	2.15	0.81	0.00	2.69	(1.88)
1995	2.74	1.81	0.00	3.62	(1.81)
1996	2.74	0.40	0.00	3.55	(3.15)
1997	1.93	0.22	0.00	3.38	(3.16)
1998	2.14	0.41	0.00	3.69	(3.28)
1999	1.39	0.46	0.00	3.71	(3.25)
2000	1.16	0.28	0.00	3.75	(3.47)
2001	1.16	1.22	0.00	4.68	(3.46)
2002	1.07	0.04	0.00	4.06	(4.02)

7(a) loan performance is affected by economic conditions, legislation, credit origination and servicing policies. In order to more accurately forecast the costs of the program, the SBA intends to implement a new model next year which will use loan mix and economic conditions to adjust its cost estimates.

During 2002, default costs increased from prior estimates for the cohorts originating from FY 1993 through FY 1998. SBA's management has attributed this to the effect of the National economic cycle. The most recent cohorts, which remain volatile due to their lack of seasoning, experienced a fall in default costs resulting from updated projected default data.

Fee income rose slightly from the prior year. Fee income can be affected by many items, including the rate of prepayments, defaults and the mix in volumes. It appears that lower defaults in the past have increased the level of fees to date.

Appendix A

The SBA's subsidy account is entitled to 2 fees from loan guarantees: an upfront "guarantee fee" and an annual servicing fee. Since 1992, fees have increased as a result of changes in the statutory fee rates. Prior to the enactment of Credit Reform, the fee on loan guarantees was 1% on the SBA share of loans of \$75,000 or less and 2% on the remaining loans. In 1996, Congress changed this to a layered fee schedule referenced in 13 CFR 120. Under this regulation, fees on loans with a maturity of greater than 12 months increased to a minimum of 2% and a maximum of 3.875%. Under legislative mandate, for new loans made following December 2000, 25% of fees on smaller loans (those under \$150,000) may be retained by the originating lender. Additionally, the maximum rate was lowered to 3.5%.

In 1993, Congress enacted legislation mandating a servicing fee amounting to 40 basis points of the annual outstanding balance, accruing to the subsidy account, on the outstanding balance of all loans sold in the secondary market. In 1996, this was extended to all loans, and increased to 50 basis points. In general, this has caused rates to fall from the original projection.

In FY 2001, congress enacted legislation mandating a prepayment penalty for long term loans that prepay in the first 3 years after disbursement. To date, the Agency has collected less than \$1 million for this fee.

504 Loans – The Certified Development Program

The following table shows the latest reestimate of subsidy rates for the 504 program for all cohorts originated under the requirements of the Federal Credit Reform Act. The total subsidy cost is the sum of the components for the interest subsidy costs, default costs (net of recoveries), fees and other collections, and other costs. The SBA has prepared these estimates for loan guarantees in the current year's budget for the current and past years' cohorts. Each subsidy rate represents the cost, in the percentage of the guaranteed loans amount obligated in the cohort.

Cohort Year	Original	Current reestimate of			
	Subsidy Rate	Total	Interest	Default	Fee/ Other
1992	0.49	3.65	0.00	3.53	0.12
1993	0.54	2.27	0.00	2.35	(0.08)
1994	0.51	3.11	0.00	2.90	0.21
1995	0.57	2.98	0.00	3.66	(0.68)
1996	0.00	2.36	0.00	3.78	(1.42)
1997	0.00	(2.49)	0.00	4.45	(6.94)
1998	0.00	(2.07)	0.00	4.59	(6.66)
1999	0.00	(0.77)	0.00	5.48	(6.26)
2000	0.00	0.43	0.00	5.20	(4.77)
2001	0.00	0.49	0.00	5.91	(5.42)
2002	0.00	0.51	0.00	4.99	(4.48)

The performance of this loan guarantee program is affected by economic conditions, legislation, credit origination and servicing policies. For most of the cohorts, the current reestimated subsidy rates were higher than the previous year's reestimates. This was primarily due to higher actual defaults reported in FY 2002 reflecting in part the effects of the economic slowdown experienced during the year.

Small Business Investment Companies – The Debentures Program

The following table shows the latest reestimate of subsidy rates for the SBIC Debentures program for all cohorts originated under the requirements of the Federal Credit Reform Act. The total subsidy cost is the sum of the components for the interest subsidy costs, default costs (net of recoveries), fees and other collections, and other costs. The SBA has prepared these estimates for loan guarantees in the current year's budget for the current and past years' cohorts. Each subsidy rate represents the cost, in the percentage of the guaranteed loans amount obligated in the cohort.

Cohort Year	Original		Current reestimate of		
	Subsidy Rate		Subsidy Rate and Components		
	Total	Total	Interest	Default	Fee/Other
1992	14.29	16.01	0.00	16.92	(0.91)
1993	15.40	9.62	0.00	10.54	(0.92)
1994	16.25	0.37	0.00	1.79	(1.42)
1995	14.65	(0.34)	0.00	1.19	(1.53)
1996	15.46	1.35	0.00	2.89	(1.54)
1997	3.19	(4.23)	0.00	4.72	(8.95)
1998	1.94	(0.24)	0.00	9.89	(10.13)
1999	1.38	2.63	0.00	12.72	(10.09)
2000	0.00	(2.10)	0.00	8.76	(10.86)
2001	0.00	(2.02)	0.00	8.55	(10.57)
2002	0.00	(2.09)	0.00	9.03	(11.12)

The performance of this loan guarantee program is affected by economic conditions, legislation, credit origination and servicing policies. Overall, program costs arising from defaults remain covered by inflows generated from annual fees.

Small Business Investment Companies – The Participating Securities Program

The following table shows the latest reestimate of subsidy rates for the SBIC Participating Securities program for all cohorts originated under the requirements of the Federal Credit Reform Act. The total subsidy cost is the sum of the components for the interest subsidy costs, default costs (net of recoveries), fees and other collections, and other costs. The SBA has prepared these estimates for loan guarantees in the current year's budget for the current and past years' cohorts. Each subsidy rate represents the cost, in the percentage of the guaranteed loans amount obligated in the cohort.

Cohort Year	Original		Current reestimate of		
	Subsidy Rate		Subsidy Rate and Components		
	Total	Total	Interest	Default	Fee/ Other
1994	9.00	(15.19)	0.00	1.47	(16.66)
1995	8.90	(4.19)	0.00	6.13	(10.32)
1996	9.00	(6.68)	0.00	6.88	(13.56)
1997	3.29	5.11	0.00	12.64	(7.53)
1998	2.20	3.85	0.00	9.88	(6.03)
1999	2.19	10.60	0.00	8.96	1.64
2000	1.80	4.15	0.00	8.48	(4.33)
2001	1.31	(4.89)	0.00	7.04	(11.93)
2002	0.00	(4.24)	0.00	7.04	(11.28)

Participating Securities loan performance is affected by economic conditions, legislation, credit origination and servicing policies. Actual defaults increased mainly from forced redemptions on outstanding securities purchased by the program office in FY 2002.

Direct Loan Programs

The Disaster Loan Program

The following table shows the latest reestimate of subsidy rates for the Disaster Loan program for all cohorts originated under the requirements of the Federal Credit Reform Act. The total subsidy cost is the sum of the components for the interest subsidy costs, default costs (net of recoveries), and other collections, and other costs. The SBA has prepared these estimates for direct loans in the current year's budget for the current and past years' cohorts. Each subsidy rate represents the cost, in the percentage of the amount of direct loans obligated in the cohort.

Cohort Year	Original	Current reestimate of			
	Subsidy Rate	Total	Subsidy Rate and Components		Other
	Total	Total	Interest	Default	Other
1992	33.93	32.71	14.79	14.17	3.75
1993	20.58	25.10	13.08	8.65	3.38
1994	22.99	20.43	14.94	3.88	1.61
1995	31.54	21.62	15.21	5.00	1.42
1996	28.08	20.70	12.75	3.90	4.04
1997	20.02	19.92	12.16	2.18	5.57
1998	23.46	15.06	8.53	2.59	3.94
1999	22.36	17.89	10.26	7.72	(0.09)
2000	22.20	19.03	13.03	7.44	(1.43)
2001	17.46	12.29	6.49	6.18	(0.37)
2002	14.67				

The performance of this direct loan program is affected by economic conditions, legislation, credit origination and servicing policies. During 2002, several modifications to the data processing methodology were incorporated, which resulted in slight upward revisions in comparison to 2001. The 2002 reestimates also incorporate the impact of asset sales. For almost all cohorts, 2002 reestimates continue to be lower than original estimates. Since disaster loans are disbursed over a period of years, reestimates are delayed by one year. Therefore, the 2002 cohort has not been reestimated.

S. Loan Asset Sales:

In 1999, the SBA implemented a program to sell loans in bulk sales. Most of the loans sold to date have been disaster loans, for home and business borrowers. The remaining loans sold have been SBA business loans, including 7(a) loan guarantees and 504 CDC loan guarantees.

Two loan sales occurred in FY 2001. The SBA received \$1.54 billion for over 49,000 loans with unpaid principal balance of \$2.29 billion. A book loss occurred and was recognized in liquidating funds for Pre-1992 loans, and as a charge to the subsidy account for Federal Credit Reform loans.

Two loan sales occurred in FY 2002. SBA received \$861.7 million for approximately 58,700 loans with unpaid principal balance of \$1.25 billion. During FY 2002, the General Accounting Office (GAO) reviewed SBA's asset sales and concluded that the Book Value Adjustment for the Post-1991 credit reform disaster loans was incorrectly calculated because it did not include all subsidy factors affecting loan valuation. The SBA recomputed the Book Value Adjustment per GAO's recommendation. The recomputation affected no amounts presented herein, since book value adjustment plus loan sale loss, no matter how allocated, total to the difference between unpaid principal balance of the sold loans and the amount of net proceeds received for them and are both closed to the subsidy allowance account for credit reform funds, per SFFAS #2, Accounting for Direct Loans and Loan Guarantees.

NOTE 7. General Property and Equipment*(Dollars in Thousands)*

FY 2002			
Major Classes	Cost	Amortization	Net Book Value
Internal Use Software in Development	\$ 1,786		\$ 1,786
Internal Use Software	7,563	(2,521)	5,042
	<u>\$ 9,349</u>	<u>\$ (2,521)</u>	<u>\$ 6,828</u>

(Dollars in Thousands)

FY 2001			
Major Classes	Cost		Net Book Value
Internal Use Software in Development	\$ 8,518		\$ 8,518
	<u>\$ 8,518</u>		<u>\$ 8,518</u>

Software was not in service as of September 30, 2001, therefore it has not been amortized for FY 2001.

NOTE 8. Advances*(Dollars in Thousands)*

	FY 2002		FY 2001	
	Intragovernmental	Public	Intragovernmental	Public
Sec. 503 Debentures	\$ 4,428	\$	\$ 2,496	\$
Sec. 504 Debentures		11,881		7,507
SBIC		367,975		247,179
Advances from Program Funds	76,305			
Loss Allowance				(978)
Sub-Total before Eliminations	\$ 80,733	\$ 379,856	\$ 2,496	\$ 253,708
Eliminations	(76,305)			
Balance Sheet Total	\$ 4,428	\$ 379,856	\$ 2,496	\$ 253,708

When the SBA honors its guarantee agreement with an SBIC, any associated advances will be reclassified as receivables. It is estimated that the percentage of SBIC advances that may be reclassified as credit receivables to be approximately 20%. Of this percentage, only approximately 60% may be recoverable.

NOTE 9. Liabilities Not Covered by Budgetary Resources*(Dollars in Thousands)***Intragovernmental**

Accounts Payable	FY 2002	FY 2001
Business Loan and Investment Fund	\$ 667,979	\$ 88,762
Disaster Loan Fund	461,099	498,251
		\$
Sub-Total	\$ 1,129,078	587,013
Eliminations	(1,129,078)	(587,013)
Total	\$ 0	\$ 0

Accounts Payable is liability from Program Funds to Financing Funds for Subsidy Reestimates.

Appendix A

Other			
Business Loan and Investment Fund	\$	254,359	\$ 374,636
Disaster Loan Fund		41,057	0
Salaries and Expenses		5,470	5,363
Sub-Total	\$	300,886	\$ 379,999
Eliminations			
Total	\$	300,886	\$ 379,999

Intragovernmental Other for the Business Loan and Investment Fund and the Disaster Loan Fund is the downward subsidy reestimate liability to Treasury. The Salaries and Expenses amount is the FECA liability.

Total Intragovernmental	\$	300,886	\$379,999
Other Liabilities- Public Not Covered by Budgetary Resources			
FECA Actuarial Liability (Note 11)	\$	31,487	\$32,255
Other			
Business Loan and Investment Fund	\$	395	\$ 1,912
Disaster Loan Fund		226	44
Salaries and Expenses		21,244	20,490
Total	\$	21,865	\$ 22,446
Total Other Liabilities - Public Not Covered by Budgetary Resources	\$	53,352	\$ 54,701

Other for Business Loan and Investment Fund and Disaster Loan Fund is Prior Loans Outstanding on Acquired Collateral. The Salaries and Expenses amount is annual leave for all SBA employees.

NOTE 10. Debt
(Dollars in Thousands)

	Beginning Balance	FY 2002		Ending Balance
		New Borrowings	Repayments	
Intragovernmental Debt:				
Borrowing from the Treasury	\$ 10,086,452	\$ 2,451,887	\$ (1,502,479)	\$ 11,035,860
Borrowing from Federal Financing Bank	131,963		(29,543)	102,420
Total Intragovernmental Debt	\$ 10,218,415	\$ 2,451,887	\$ (1,532,022)	\$ 11,138,280

	Beginning Balance	FY 2001		Ending Balance
		New Borrowings	Repayments	
Intragovernmental Debt:				
Borrowing from the Treasury	\$ 10,012,391	\$ 888,485	\$ (814,424)	\$ 10,086,452
Borrowing from Federal Financing Bank	159,164		(27,201)	131,963
Total Intragovernmental Debt	\$ 10,171,555	\$ 888,485	\$ (841,625)	\$ 10,218,415

The FY 2002 new borrowings figure includes \$284 million of borrowing authority that was carried over from the prior fiscal year.

NOTE 11. FECA Actuarial Liability

The future workers' compensation estimates are generated from an application of actuarial procedures developed to estimate the liability for FECA benefits. The FECA actuarial liability includes the present value of the expected liability for employee death, disability, medical, and miscellaneous costs for approved compensation cases. It is estimated using the paid-losses extrapolation method calculated over the next 23 years. This method uses historical benefit payment patterns related to a specific incurred period to predict the entire payments related to that period. This is a non-current liability "non-intragovernmental" not covered by budgetary resources. FY 2002 liability is \$31.5 million and FY 2001 liability is \$32.3 million.

NOTE 12. Other Liabilities

(Dollars in Thousands)

	FY 2002		
	Non-Current Liabilities	Current Liabilities	Total Liabilities
1. Intragovernmental			
Payable to Special Receipt Fund	\$	\$ 295,416	\$ 295,416
Employment Taxes Payable		854	854
Unfunded FECA Liability		5,470	5,470
Due Federal Financing Bank	2,416		2,416
Net Assets of Liquidating Funds			
Due to Treasury	641,127		641,127
Advances from Other Agencies		1,756	1,756
Advances from Program Fund		76,305	76,305
Sub-Total before Eliminations	\$ 643,543	\$ 379,801	\$ 1,023,344
Eliminations		(76,305)	(76,305)
Total Intragovernmental Liabilities – Other	\$ 643,543	\$ 303,496	\$ 947,039
2. Liabilities – Public			
Accrued Funded Payroll Benefits	\$	\$ 6,207	\$ 6,207
Accrued Unfunded Annual Leave		21,244	21,244
Advances From Others		(15,937)	(15,937)
Cash Adjustments		27,972	27,972
Suspense Accounts		(2,241)	(2,241)
Prior liens on Real Estate	620		620
Deferred Credits – Interest Income	3,224		3,224
Contingent Liabilities	14,527	800	15,327
Total Public Liabilities – Other	\$ 18,371	\$ 38,045	\$ 56,416

	FY 2001		
	Non-Current Liabilities	Current Liabilities	Total Liabilities
1. Intragovernmental			
Payable to Special Receipt Fund	\$	\$ 374,636	\$ 374,636
Employment Taxes Payable		2,006	2,006
Unfunded FECA Liability		5,363	5,363
Due Federal Financing Bank	2,823		2,823
Net Assets of Liquidating Funds			0
Due to Treasury	1,094,467		1,094,467
Total Intragovernmental Liabilities – Other	\$ 1,097,290	\$ 382,005	\$ 1,479,295

Appendix A

2. Liabilities – Public

Accrued Funded Payroll Benefits	\$	\$	14,586	\$	14,586
Accrued Unfunded Annual Leave			20,490		20,490
Master Reserve Fund Liability	68,000				68,000
Cash Adjustments			26,564		26,564
Suspense Accounts			2,874		2,874
Prior liens on Real Estate	1,957				1,957
Deferred Credits – Interest Income	518				518
Contingent Liabilities	12,543		800		13,343
Total Public Liabilities – Other	\$	\$	65,314	\$	148,332

For FY 2001, the amount shown as “Public” under “Non-Current Liabilities” for BLIF consists primarily of a deferred credit of \$68 million related to the Master Reserve Fund discussed in Note 1H.

SBA recorded a contingent liability of \$800,000 for claims that were reasonably possible to be realized. The SBA has estimated that its ultimate losses for contingent liabilities for other claims related to various administrative proceedings, legal actions, environmental suits, and claims brought against it may range from zero to \$35 million.

The FY 2001 current liabilities were restated to exclude the Non-entity fund balance with Treasury.

NOTE 13. Statement of Net Cost

Federal cost accounting standards require the SBA to report operating costs by program activity. Full costs include all direct and indirect costs consumed by a program. Full costs are reduced by exchange (earned) revenues to arrive at net operating cost.

1. Operating Cost

The full and net operating costs of the SBA's major programs are presented in the Consolidated Statement of Net Cost. Full program costs are comprised of all direct costs consumed by the program and those indirect costs which can be reasonably assigned or allocated to the program, including employee pension and other retirement benefit costs paid by the OPM and imputed by the SBA.

2. Earned Revenue

Earned revenues arise from exchange transactions which occur through the provision of goods and services for a price, and are deducted from the full cost of the SBA's major programs to arrive at net program cost. Earned revenues are recognized by the SBA when reimbursements are payable from other Federal agencies and from the public, as a result of costs incurred or services performed on their behalf. A major source of earned revenue includes interest earned on the SBA's outstanding Business and Disaster loan portfolios.

3. Costs Not Assigned

Costs Not Assigned are costs the Agency has determined are not properly allocable to programs such as the Office of Inspector General, Congressional Initiatives, and some grants for FY 2002.

4. Earned Revenue Not Attributed to Programs

Earned Revenue Not Attributed to Programs are revenues the Agency has determined are not properly allocable to programs such as the Office of Inspector General.

Appendix A

(Dollars in Thousands)

	<u>2002</u>	<u>Eliminations</u>	<u>Consolidated</u>	<u>2001</u>
Business Programs				
Intragovernmental				
Gross Costs	\$ 112,321	\$ (116,872)	\$ (4,551)	\$ 140,336
Less: Earned Revenue	32,148		32,148	71,489
Net Costs	<u>\$ 80,173</u>	<u>\$ (116,872)</u>	<u>\$ (36,699)</u>	<u>\$ 68,847</u>
Public				
Gross Costs	\$ 1,004,517	\$	\$ 1,004,517	\$ (23,910)
Less: Earned Revenue	177,379		177,379	25,989
Net Costs	<u>\$ 827,138</u>	<u>\$</u>	<u>\$ 827,138</u>	<u>\$ (49,899)</u>
Net Cost of Business Programs	<u>\$ 907,311</u>	<u>\$ (116,872)</u>	<u>\$ 790,439</u>	<u>\$ 18,948</u>
Disaster Programs				
Intragovernmental				
Gross Costs	\$ 777,316	\$ (93,307)	\$ 684,009	\$ 612,891
Less: Earned Revenue	435,879		435,879	467,093
Net Costs	<u>\$ 341,437</u>	<u>\$ (93,307)</u>	<u>\$ 248,130</u>	<u>\$ 145,798</u>
Public				
Gross Costs	\$ 330,940	\$	\$ 330,940	\$ 404,767
Less: Earned Revenue	257,708		257,708	128,340
Net Costs	<u>\$ 73,232</u>	<u>\$</u>	<u>\$ 73,232</u>	<u>\$ 276,427</u>
Net Cost of Disaster Programs	<u>\$ 414,669</u>	<u>\$ (93,307)</u>	<u>\$ 321,362</u>	<u>\$ 422,225</u>
Cost not assigned to programs	\$ 40,410		\$ 40,410	\$ 26,631
Less: Earned revenue not attributed to programs	226,931	(210,179)	16,752	7,611
Net Cost not assigned to Programs	<u>\$ (186,521)</u>	<u>\$ 210,179</u>	<u>\$ 23,658</u>	<u>\$ 19,020</u>
Net Cost of Operations	<u><u>\$ 1,135,459</u></u>	<u><u>\$</u></u>	<u><u>\$ 1,135,459</u></u>	<u><u>\$ 460,193</u></u>

(Dollars in Thousands)

Functional Classification	FY 2002		
	<u>Gross Cost</u>	<u>Earned Revenue</u>	<u>Net Cost</u>
Commerce and Housing Credit	\$ 999,966	\$ 209,527	\$ 790,439
Community and Regional Development	1,055,359	710,339	345,020
Total	<u>\$ 2,055,325</u>	<u>\$ 919,866</u>	<u>\$ 1,135,459</u>

Functional Classification	FY 2001		
	<u>Gross Cost</u>	<u>Earned Revenue</u>	<u>Net Cost</u>
Commerce and Housing Credit	\$ 116,426	\$ 97,478	\$ 18,948
Community and Regional Development	1,044,289	603,044	441,245
Total	<u>\$ 1,160,715</u>	<u>\$ 700,522</u>	<u>\$ 460,193</u>

Appendix A

Business Programs	2002	2001
Business Loan Programs		
Intragovernmental		
Gross Costs	\$ (30,509)	\$ 96,417
Less: Earned Revenue	31,385	55,021
Net Costs	<u>\$ (61,894)</u>	<u>\$ 41,396</u>
Public		
Gross Costs	\$ 296,241	\$ (4,229)
Less: Earned Revenue	57,844	14,076
Net Costs	<u>\$ 238,397</u>	<u>\$ (18,305)</u>
Total Net Cost	<u>\$ 176,503</u>	<u>\$ 23,091</u>
Development Company Programs		
Intragovernmental		
Gross Costs	\$ 5,549	\$ 30,373
Less: Earned Revenue	314	1,638
Net Costs	<u>\$ 5,235</u>	<u>\$ 28,735</u>
Public		
Gross Costs	\$ 48,419	\$ (54,568)
Less: Earned Revenue	39,590	3,353
Net Costs	<u>\$ 8,829</u>	<u>\$ (57,921)</u>
Total Net Cost	<u>\$ 14,064</u>	<u>\$ (29,186)</u>
Small Business Investment Company (SBIC) Programs		
Intragovernmental		
Gross Costs	\$ (31,629)	\$ 13,546
Less: Earned Revenue	449	14,830
Net Costs	<u>\$ (32,078)</u>	<u>\$ (1,284)</u>
Public		
Gross Costs	\$ 435,419	\$ (14,401)
Less: Earned Revenue	79,941	5,913
Net Costs	<u>\$ 355,478</u>	<u>\$ (20,314)</u>
Total Net Cost	<u>\$ 323,400</u>	<u>\$ (21,598)</u>
Surety Bond Guarantees Programs		
Intragovernmental		
Gross Costs	\$ 888	\$
Less: Earned Revenue		
Net Costs	<u>\$ 888</u>	<u>\$</u>
Public		
Gross Costs	\$ 10,359	\$ (7,711)
Less: Earned Revenue	4	2,647
Net Costs	<u>\$ 10,355</u>	<u>\$ (10,358)</u>
Total Net Cost	<u>\$ 11,243</u>	<u>\$ (10,358)</u>

Appendix A

Business Development Programs

Intragovernmental			
Gross Costs	\$	12,359	
Less: Earned Revenue			
Net Costs	\$	12,359	
Public			
Gross Costs	\$	51,726	\$ 49,902
Less: Earned Revenue			
Net Costs	\$	51,726	\$ 49,902
Total Net Cost	\$	64,085	\$ 49,902

Government Contracting Programs

Intragovernmental			
Gross Costs	\$	5,104	\$
Less: Earned Revenue			
Net Costs	\$	5,104	
Public			
Gross Costs	\$	21,361	\$ 21,366
Less: Earned Revenue			
Net Costs	\$	21,361	\$ 21,366
Total Net Cost	\$	26,465	\$ 21,366

Entrepreneurial Development Programs

Intragovernmental			
Gross Costs	\$	30,997	
Less: Earned Revenue			
Net Costs	\$	30,997	
Public			
Gross Costs	\$	129,735	\$ 157,567
Less: Earned Revenue			
Net Costs	\$	129,735	\$ 157,567
Total Net Cost	\$	160,732	\$ 157,567

Improving Business Environment

Intragovernmental			
Gross Costs			
Office of Advocacy	\$	1,539	
National Advisory Council			
Ombudsman		588	
Office of Veterans' Affairs		438	
Women's Business Council		125	
Gross Costs	\$	2,690	
Less: Earned Revenue			
Net Costs	\$	2,690	
Public			
Gross Costs			
Office of Advocacy	\$	6,440	\$6,533
National Advisory Council			160
Ombudsman		2,461	954
Office of Veterans' Affairs		1,832	7,083
Women's Business Council		524	694
Gross Costs	\$	11,257	\$15,424
Less: Earned Revenue			
Net Costs	\$	11,257	\$15,424
Total Net Cost	\$	13,947	\$ 15,424
Business Programs			
Intragovernmental			
Gross Costs	\$	(4,551)	\$ 140,336
Less: Earned Revenue		32,148	71,489
Net Costs	\$	(36,699)	\$ 68,847
Public			
Gross Costs	\$	1,004,517	\$ (23,910)
Less: Earned Revenue		177,379	25,989
Net Costs	\$	827,138	\$ (49,899)
Total Net Cost	\$	790,439	\$ 18,948

The large increase in Net Costs for Development Company and Small Business Investment Company are due to subsidy reestimates. The large increase in the BLIF is due to subsidy reestimates and the change in accounting for guarantee liability.

NOTE 14. Disclosures Related to the Statement of Changes in Net Position

The SBA's net position, as of September 30, 2002, consisted of the following:

1. Unexpended Appropriations

Unexpended appropriations represent (1) unobligated amounts and (2) amounts for which orders for goods, services or benefits, have been placed, but not yet filled. Multi-year appropriations remain available to the SBA for obligation in future periods. Unobligated balances associated with appropriations that expire at the end of the fiscal year remain available for obligation adjustments, but not new obligations, until that account is closed, five years after the appropriations expire.

The SBA's unexpended appropriations beginning balance was restated on the FY 2001 statement by \$119.2 million to cover period adjustments for the years occurring prior to FY 2001, and on the FY 2002 statement, prior period adjustments of \$2 million were made for FY 2001. These prior period adjustments were made to reflect the change in accounting for the recording of subsidy expense and reimbursable activity.

2. Cumulative Results of Operations

Cumulative results of operations is the accumulated difference between expenses and financing sources since the inception of the SBA.

The SBA restated the Cumulative Results of Operations beginning balance by (\$541.5) million to cover prior period adjustments for the years occurring prior to FY 2001, and on the FY 2002 statement, prior period adjustments of (\$1.4) million were made for FY 2001. These prior period adjustments were made to reflect the change in accounting for the recording of probable defaults on pre-credit loan guarantees from undelivered orders and reimbursable activity.

NOTE 15. Disclosures Related to the Statement of Budgetary Resources

The Budget of the United States, the President's Budget, with actual numbers for the Fiscal Year 2002 has not yet been published. It is expected to be published February 4, 2003 and will be available via the internet at www.firstgov.gov or via written or telephone request to Office of Citizen Services and Communications, U.S. General Services Administration, 1800 F Street, NW Washington, DC 20405, 1-800-333-4636.

SBA had no borrowing or contract authority at the end of FY 2002. SBA had borrowing authority of \$284 million and no contract authority at the end of FY 2001. Repayments of borrowings are made annually from collections received through the SBA's credit reform portfolio. Borrowing repayments are calculated using the guidance provided by OMB. The SBA has access to permanent indefinite appropriations for liquidating fund obligations and upward subsidy reestimates.

The SBA incurred \$5.08 billion of direct obligations of which \$654.29 million was apportioned by fiscal quarters (type A apportionment) and the \$4.45 billion was apportioned by fiscal year for (type B apportionment). The SBA adjusted their undelivered orders by (\$31.7) million after the FACTS II revision period.

The large decrease in the offsetting receipts in the amount of \$702.8 million for FY 2002 was because of subsidy reestimates.

Explanation of Material Differences Between the Statement of Budgetary Resources and the Statement of Budget Execution

A reconciliation of budgetary resources, status of resources and outlays, as presented in the Combined Statement of Budgetary Resources, to the Statement of Budget Execution (SF133) for FY 2002 is shown below.

	Budgetary Resources	Status of Resources	Outlays
Consolidated Statement of Budgetary Resources	\$ 11,824,684	\$ 11,824,684	\$ 2,085,532
SF 133	11,858,316	11,858,316	2,083,531
Difference	\$ (33,632)	\$ (33,632)	\$ 2,001

The change is due to an erroneous entry in FACTS II during the revision period to correct the reporting of asset sales activity.

NOTE 16. Disclosures Related to the Statement of Financing

Imputed Financing includes an imputed cost of \$6.37 million for pension benefits, \$11.02 million for health benefits and \$37 thousand for life insurance.

The "Other" component of "Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period" are expenses to be funded in future periods.

The Balance Sheet reflects the account balances for liabilities not covered by budgetary resources as described in Note 9. The Statement of Financing reflects changes from period-to-period in those unfunded liabilities in the section titled “Components of the net cost of operations that will not require or generate resources in the current period.”

NOTE 17. Disclosure Related to Restatement of FY 2001 Financial Statements

Issue 1: Fund Balance with Treasury

The SBA determined that the non-entity assets in the amount of \$1.8 billion included on the SBA's 2001 Consolidated Balance Sheet should not have been reflected on its statements.

Issue 2: Subsidy Approval vs. Disbursed

The SBA corrected a longstanding problem caused by recording subsidy expense at the time of loan approval rather than disbursement.

Issue 3: Invalid Undelivered Orders Recorded in the Liquidating Funds

The SBA changed its recognition of probable defaults on loan guarantees from undelivered orders (funded) to a contingent liability (unfunded). This is result of reconsideration of SFFAS 2.

Issue 4: Federal / Nonfederal

The SBA restated some items from federal to nonfederal and vice versa.

Issue 5: Change in Reporting Line

The SBA changed the presentation of certain financial data to more accurately reflect the nature of the underlying activity according to our current understanding of OMB's Form and Content guidance.

Below is a summary of the items by principal statement that were restated for FY 2001. The issue number corresponds to the issue number directly above.

(Dollars in Thousands)

Balance Sheet	Issue	As Reported	Adjustment	Restated
Fund Balance with Treasury	1	\$ 10,169,491	\$ (1,832,836)	\$ 8,336,655
Accounts Receivable	2	376,087	(6,774)	369,313
Credit Program Receivables	2	5,051,123	167,151	5,218,274
Accounts Payable	2	(698,233)	43	(698,190)
Other Intragovernmental Liabilities	1	(1,832,836)	1,832,836	
Other Intragovernmental Liabilities	3	(1,833,486)	354,191	(1,479,295)
Total Other Intragovernmental Liabilities		(3,666,322)	2,187,027	(1,479,295)
Liabilities for Loan Guarantees	2		(354,191)	
Liabilities for Loan Guarantees	3		214	
Total Liabilities for Loan Guarantees		(1,083,020)	(353,977)	(1,436,997)
Unexpended Appropriations	2	882,641	160,633	1,043,274
Statement of Net Cost				
Business Programs				
Intragovernmental Gross Costs	4	\$ 2,933	\$ 137,403	\$ 140,336
Intragovernmental Earned Revenue	4	78,207	(6,718)	71,489
Gross Costs with the Public	2		(5,165)	
Gross Costs with the Public	3		(187,260)	
Gross Costs with the Public	4		(137,402)	
Total Gross Costs with the Public		305,917	(329,827)	(23,910)
Earned Revenue from the Public	4	19,272	6,717	25,989

Appendix A

Disaster Assistance Programs

Intragovernmental Gross Costs	4	838,565	(225,674)	612,891
Intragovernmental Earned Revenue	4	436,414	30,679	467,093
Gross Costs with the Public	2		(36,254)	
Gross Costs with the Public	4		225,674	
Total Gross Costs with the Public		215,347	189,420	404,767
Earned Revenue from the Public	4	159,018	(30,678)	128,340

Statement of Changes in Net Position

Prior Period Adjustments	2		\$ 119,214	
Prior Period Adjustments	3		(541,451)	
Total Prior Period Adjustments			(422,237)	(422,237)
Transfers – In/Out W/O Reimbursement	3	(275,827)	(23,856)	(299,683)
Other – Current Year Liquidating Equity Activity (+/-)	5		378,045	378,045
Net Cost of Operations	2		(41,418)	
Net Cost of Operations	3		(187,260)	
Total Net Cost of Operations		688,871	(228,678)	460,193

Statement of Budgetary Resources

Unobligated Balance Brought Forward	3	\$ 6,853,339	\$ 541,451	\$ 7,394,790
Recoveries of Prior Year Obligations	3	617,611	(501,390)	116,221
Obligations Incurred	3	4,727,794	(314,134)	4,413,660
Unobligated Balances Not Available	3	4,539,529	354,270	4,893,799
Obligated Balance, Beginning of Period	3	1,405,433	(541,451)	863,982
Accounts Receivable	2	(602,437)	166,763	(435,674)
Accounts Payable	2	1,082,682	(160,028)	922,654
Undelivered Orders, End of Period	2			
Undelivered Orders, End of Period	3		(354,192)	
Total Undelivered Orders, End of Period		1,051,229	(194,163)	857,066

Statement of Financing

Obligations Incurred	3	\$ 4,727,794	\$ (314,134)	\$ 4,413,660
Spending Authority from Offsetting Collections and Recoveries	3	4,046,114	(501,390)	3,544,724
Transfers In (Out)	3	(275,827)	(23,856)	(299,683)
Other Financing Sources	5		378,045	378,045
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	3	(115,344)	(180,526)	(295,870)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	5	3,988,329	(1,273,441)	2,714,888
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	5	(2,424,438)	1,106,080	(1,318,358)
Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	3	299,720	119,215	418,935
Change in Due to Treasury - Liquidating Funds	3	(23,856)	(354,189)	(378,045)
Provision for Losses on Estimated Guarantees	3	(32,007)	(187,260)	(219,267)



**Required Supplementary
Stewardship
Information**

**U.S. Small Business
Administration**

**for
Fiscal Year 2002**

U. S. Small Business Administration
Required Supplementary Stewardship Information
Stewardship Investments in Human Capital
for the periods ended September 30, 2002, 2001, 2000, 1999 and 1998

(Dollars in Thousands)

	2002	2001	2000	1999	1998
Office of Small Business Development Centers	\$ 98,721	\$ 98,583	\$ 88,162	\$ 79,078	\$79,735
Business Information Centers	13,816	16,015	11,719	7,832	8,023
Office of Women's Business Ownership	15,892	15,934	6,488	12,085	7,978
One Stop Capital Shops	0	8,114	8,495	5,137	2,052
Other Business Initiatives	11,870	6,050	4,900	4,254	4,943
Service Corps of Retired Executives	14,789	5,988	8,210	9,236	8,617
Office of International Trade	2,984	2,955		5,769	6,178
Business Linc	0	2,518			
Office of Native American Affairs	843	1,394	1,748	2,504	392
Welfare to Work	0	8	2,034	2,988	
Disability Initiative	130	8			
Electronic Government	649				
Egypt, Nigeria - Reimbursed Expenses	973				
BATF donations - Reimbursed Expenses	65				
Office of Veterans' Affairs ⁽¹⁾			2,776	2,862	1,566
Ombudsman ⁽¹⁾			1,507	3,396	
Women's Business Council ⁽¹⁾			1,106	693	
HubZones Program ⁽¹⁾			6,734	4,872	
Small Business Innovation and Research ⁽¹⁾				3,597	56
Total	\$ 160,732	\$ 157,567	\$ 143,879	\$ 144,303	\$ 119,540

Human Capital. Human Capital investments are expenses included in net cost for education and training programs that are intended to increase or maintain national economic productive capacity and that produce outputs and outcomes that provide evidence of maintaining or increasing national productive capacity. The definition excludes education and training expenses for Federal personnel.

A detailed description of the programs, outputs, and outcomes may be found in the Government Performance and Results Act (GPRA) Details portion of the Performance and Accountability Report.

Office of Small Business Development Centers delivers management and technical assistance, economic development and management training to existing and prospective small businesses through cooperative agreements with universities and colleges and government organizations.

Business Information Centers (BICs) provide a one-stop location where current and future small business owners can receive assistance and advice. Through partnerships with the public and private sector, BICs offer the latest computer technology, hardware and software, as well as extensive small business reference library of hard copy books and publications and current management videotapes for entrepreneurs. At a BIC they can plan their business, expand an existing business, or venture into new business areas. The use of software for a variety of business applications offers clients of all types a means for addressing diverse needs.

Office of Women's Business Ownership provides assistance to women business owners and acts as their advocate in the public and private sectors.

One Stop Capital Shops combines SBA resources and community partnerships to offer entrepreneurial development assistance to small businesses located in distressed inner cities and rural communities.

Other Business Initiatives include Youth Entrepreneurship, Classroom and e-commerce, and PRIME.

Service Corps of Retired Executives is a nonprofit organization which provides small business counseling and training under a grant from the U.S. Small Business Administration (SBA). SCORE members are successful, retired business men and women who volunteer their time to assist aspiring entrepreneurs and small business owners. There are SCORE chapters in every state.

Office of International Trade oversees and delivers SBA's business development and financing programs for small business exporters.

Business Linc On June 5, 1998 the BusinessLINC initiative was announced to encourage more private sector business-to-business linkages that enhance the economic vitality and competitive capacity of small businesses, particularly those located in economically distressed urban and rural areas. The name conveys the full range of business-to-business assistance programs. The LINC acronym stands for "Learning, Information, Networking, Collaboration." This is a joint effort between the Treasury and the SBA.

Office of Native American Affairs provides assistance to American Indian, Native Alaskan, and Native Hawaiian small business clients, tribally owned small businesses, and small businesses located in Native American communities.

Welfare to Work The SBA is helping small businesses gain access to a new pool of potential workers as well as helping former welfare recipients become entrepreneurs. The enactment of the Personal Responsibility and Work Opportunity Reconciliation Act (PL 104-193) of 1996 along with the President's Welfare to Work Initiative have made this possible.

Disability Initiative The SBA is helping small businesses gain access to a new pool of potential workers as well as assisting Americans with disabilities start small businesses.

(1) Office of Veterans' Affairs, Ombudsman, and Women's Business Council are now reported under "Improving Business Environment". **HubZones Program** is currently reported under "Business Development". **Small Business Innovation and Research** is reported under "Government Contracting".

U. S. Small Business Administration
Required Supplementary Stewardship Information
Stewardship Investments in Research and Development
for the periods ended September 30, 2002, 2001, 2000, 1999 and 1998

(Dollars in Thousands)

	2002	2001	2000	1999	1998
The Office of Technology	\$ 1,103	\$ 1,906	\$ 1,720	\$ 3,597	\$ 56

Research and Development. Research and Development investments are expenses included in net cost incurred to support the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits.

A detailed description of the programs, outputs, and outcomes may be found in the Government Performance and Results Act (GPRA) Details portion of the Performance and Accountability Report.



**Required Supplemental
Information**

**U.S. Small Business
Administration**

**for
Fiscal Year 2002**

U. S. Small Business Administration
Required Supplementary Information
Intragovernmental Assets and Liabilities
for the period ended September 30, 2002

(Dollars in Thousands)

Trading Partner	Fund Balance With Treasury	Accounts Receivable	Advances	Accounts Payable	Debt/Borrowings from Other Agencies	Other Liabilities
Department of Defense	\$	\$ 347	\$	\$	\$	\$
Federal Financing Bank			4,428	3,069	102,420	2,416
Agency for International Development		150				475
Department of Labor						5,470
Office of Personnel Management		8				854
Department of the Treasury	7,492,740			24,923	11,035,860	936,541
Other Agencies		24				1,283
Total	\$ 7,492,740	\$ 529	\$ 4,428	\$ 27,992	\$ 11,138,280	\$ 947,039

U. S. Small Business Administration
Required Supplementary Information
Intragovernmental Earned Revenues and Related Costs
for the period ended September 30, 2002

(Dollars in Thousands)

Trading Partner	Earned Revenue	Gross Cost
Department of the Treasury	\$ 468,027	\$ 800,400
Total	\$ 468,027	\$ 800,400
Budget Functional Classification	Earned Revenue	Gross Cost
Commerce and Housing Credit	\$ 32,148	\$ 685,515
Community and Regional Development	435,879	114,885
Total	\$ 468,027	\$ 800,400

The Intragovernmental Earned Revenues and Related Costs are for the SBA's Financing Accounts; therefore interest earned is an offset to cost of operations.

U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
for the period ended September 30, 2002

(Dollars in Thousands)

	BLIF		DLF		SBGRF
	Budgetary	Non-Budgetary Financing	Budgetary	Non-Budgetary Financing	Budgetary
BUDGETARY RESOURCES					
Budget Authority					
Appropriations Received	\$ 375,554	\$	\$ 284,714	\$	\$
Borrowing Authority		873,784		1,294,460	
Net Transfers (+/-)	(29,545)		(2,500)		
Unobligated Balance					
Brought Forward October 1	778,809	453,329	439,239	5,683,647	25,506
Net Transfers (+/-)					
Spending Authority from Offsetting Collections					
Earned	47,052	783,502	134,628	1,751,149	5,722
Change in Unfilled Customer Orders		102,777		38,136	
Recoveries of Prior Year Obligations	26,246	2,813	32,246	182,409	
Temporarily Not Available Pursuant to Public Law					
Permanently Not Available	(371,805)	(17,004)	(308,492)	(1,485,468)	
Total Budgetary Resources	\$ 826,311	\$ 2,199,201	\$ 579,835	\$ 7,464,333	\$ 31,228

U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
for the period ended September 30, 2002

(Dollars in Thousands)

STATUS OF BUDGETARY RESOURCES	BLIF		DLF		SBGRF
	Budgetary	Non-Budgetary Financing	Budgetary	Non-Budgetary Financing	Budgetary
Obligations Incurred	\$ 404,332	\$ 1,656,299	\$ 394,526	\$ 1,978,703	\$ 5,628
Unobligated Balances Available					
Apportioned - Currently Available	18,125	1,058,503	240,559	1,651,939	14,168
Exempt from Apportionment					
Unobligated Balances Not Yet Available	403,854	(515,601)	(55,250)	3,833,691	11,432
Total Status of Budgetary Resources	\$ 826,311	\$ 2,199,201	\$ 579,835	\$ 7,464,333	\$ 31,228

(Dollars in Thousands)

RELATIONSHIP OF OBLIGATIONS TO OUTLAYS	BLIF		DLF		SBGRF
	Budgetary	Non-Budgetary Financing	Budgetary	Non-Budgetary Financing	Budgetary
Obligated Balance, Beginning of Period	\$ 126,624	\$ 31,645	\$ 92,796	\$ 612,465	\$ 585
Obligated Balance, End of Period					
Accounts Receivable	(4,467)	(5,202)	(12,123)	(50,819)	
Unfilled Customer Orders from Federal Sources		(102,777)		(38,136)	
Undelivered Orders	139,117	25,680	38,217	216,987	
Accounts Payable	45,381	124,657	22,129	58,029	1,106
Total Obligated Balance, End of Period	180,031	42,358	48,223	186,061	1,106
Outlays					
Disbursements	386,573	1,695,343	394,729	2,509,271	5,106
Collections	(108,948)	(938,849)	(122,505)	(2,075,858)	(5,722)
Subtotal	\$ 277,625	\$ 756,494	\$ 272,224	\$ 433,413	\$ (616)
Less: Offsetting Receipts		389,382		14,479	
Net Outlays	\$ 277,625	\$ 367,112	\$ 272,224	\$ 418,934	\$ (616)

U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
for the period ended September 30, 2002

(Dollars in Thousands)

	<u>PCECGF</u>	<u>SE</u>	<u>OIG</u>	<u>BATF</u>	<u>TOTAL</u>	<u>TOTAL</u>	
BUDGETARY RESOURCES	Budgetary	Budgetary	Budgetary	Budgetary	Budgetary	Non-Budgetary Financing	Total
Budget Authority							
Appropriations Received	\$ 3,000	\$ 338,476	\$ 11,464		\$ 1,013,208	\$	\$ 1,013,208
Borrowing Authority						2,168,244	2,168,244
Net Transfers (+/-)		2,500			(29,545)		(29,545)
Unobligated Balance:							
Brought Forward October 1	2,897	58,622	756	205	1,306,034	6,136,976	7,443,010
Net Transfers (+/-)							
Spending Authority from Offsetting Collections							
Earned	209	238,432	285	133	426,461	2,534,651	2,961,112
Change in Unfilled Customer Orders		55,021	53		55,074	140,913	195,987
Recoveries of Prior Year Obligations		22,723	158		81,373	185,222	266,595
Temporarily Not Available Pursuant to Public Law							
Permanently Not Available	(2,898)	(8,254)	(6)		(691,455)	(1,502,472)	(2,193,927)
Total Budgetary Resources	\$ 3,208	\$ 707,520	\$ 12,710	338	\$ 2,161,150	\$ 9,663,534	\$11,824,684

**U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
for the period ended September 30, 2002**

<i>(Dollars in Thousands)</i> STATUS OF BUDGETARY RESOURCES	PCECGF Budgetary	SE Budgetary	OIG Budgetary	BATF Budgetary	TOTAL Budgetary	TOTAL Non-Budgetary Financing	Total
Obligations Incurred	\$ 0	\$ 632,733	\$ 12,104	\$ 75	\$ 449,398	\$ 3,635,002	\$ 5,084,400
Unobligated Balances Available Apportioned - Currently Available Exempt from Apportionment	3,041	59,007	336	120 104	335,356 104	2,710,442	3,045,798 104
Unobligated Balances Not Yet Available	167	5,780	270	39	376,292	3,318,090	3,694,382
Total Status of Budgetary Resources	\$ 3,208	\$ 707,520	\$ 12,710	\$ 338	\$ 2,161,150	\$ 9,663,534	\$ 1,824,684

U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
for the period ended September 30, 2002

<i>(Dollars in Thousands)</i>	PCECGF	SE	OIG	BATF	TOTAL	TOTAL	
RELATIONSHIP OF							
OBLIGATIONS TO OUTLAYS	Budgetary	Budgetary	Budgetary	Budgetary	Budgetary	Non-Budgetary Financing	Total
Obligated Balance, Beginning of Period	\$ 0	\$ 311,203	\$ 1,956	\$ 9	\$ 533,173	\$ 644,110	\$ 177,283
Obligated Balance - End of Period							
Accounts Receivable					(16,590)	(56,021)	(72,611)
Unfilled Customer Orders from Federal Sources						(140,913)	(140,913)
Undelivered Orders		286,899	737	14	464,984	242,667	707,651
Accounts Payable		6,872	153		75,641	182,686	258,327
Total Obligated Balance, End of Period	0	293,771	890	14	524,035	228,419	752,454
Outlays:							
Disbursements		627,442	13,013	69	1,426,932	4,204,614	5,631,546
Collections	(209)	(293,453)	(337)	(133)	(531,307)	(3,014,707)	(3,546,014)
Subtotal	\$ (209)	\$ 333,989	\$ 12,676	\$ (64)	\$ 895,625	\$ 1,189,907	\$ 2,085,532
Less: Offsetting Receipts						403,861	403,861
Net Outlays	\$ (209)	\$ 333,989	\$ 12,676	\$ (64)	\$ 895,625	\$ 786,046	\$ 1,681,671



**Other Accompanying
Information**

**U.S. Small Business
Administration**

for

Fiscal Year 2002

Appendix A

**U. S. Small Business Administration
Additional Accompanying Information
Consolidating Balance Sheet**
for the period ended September 30, 2002

(Dollars in Thousands)

ASSETS	BLIF	DLF	SBGRF	PCECGF	SE	OIG	BATF	Combined Total
Intragovernmental Assets								
Fund Balances with Treasury	\$ 1,187,270	\$ 5,905,223	\$ 26,706	\$ 3,209	\$ 368,558	\$ 1,496	\$ 278	\$ 7,492,740
Accounts Receivable	677,648	524,040			529			1,202,217
Advances	16,686	64,047						80,733
Total Intragovernmental	\$ 1,881,604	\$ 6,493,310	\$ 26,706	\$ 3,209	\$ 369,087	\$ 1,496	\$ 278	\$ 8,775,690
Assets - Public and Other								
Cash	3,458							3,458
Accounts Receivable	71,130	86	5,141		589	28		76,974
Credit Program Receivables and Related Foreclosed Property, Net	1,687,180	3,766,252		16,053				5,469,485
General Property and Equipment, Net					6,828			6,828
Advances	379,856							379,856
Total Assets - Public and Other	2,141,624	3,766,338	5,141	16,053	7,417	28	0	5,936,601
Total Assets	\$ 4,023,228	\$ 10,259,648	\$ 31,847	\$ 19,262	\$ 376,504	\$ 1,524	\$ 278	\$ 14,712,291
LIABILITIES								
Intragovernmental Liabilities								
Accounts Payable	\$ 759,322	\$ 470,358						\$ 1,229,680
Debt	1,396,087	9,742,193						11,138,280
Other	660,463			19,262	84,333	54		1,023,344
Total Intragovernmental	\$ 2,815,872	\$ 10,471,783	\$ 0	\$ 19,262	\$ 84,333	\$ 54	\$ 0	\$ 13,391,304
Other Liabilities -Public								
Accounts Payable	\$ 77,116	\$ 70,897	\$ 1,114		\$ 3	\$ 4		\$ 149,134
Liabilities for Loan Guarantees	1,524,895	143						1,525,038
FECA Actuarial Liability					31,487			31,487
Other	24,098	4,938	15,066		12,052	262		56,416
Total Other Liabilities -Public	1,626,109	75,978	16,180	0	43,542	266	0	1,762,075
Total Liabilities	\$ 4,441,981	\$ 10,547,761	\$ 16,180	\$ 19,262	\$ 127,875	\$ 320	\$ 0	\$ 15,153,379
NET POSITION								
Unexpended Appropriations	\$ 249,236	\$ 172,986	\$ 289,001		\$ 297,535	\$ 1,727		\$ 1,010,485
Cumulative Results of Operations	(667,989)	(461,099)	(273,334)		(48,906)	(523)	278	(1,451,573)
Total Net Position	\$ (418,753)	\$ (288,113)	\$ 15,667	\$ 0	\$ 248,629	\$ 1,204	\$ 278	\$ (441,088)
Total Liabilities and Net Position	\$ 4,023,228	\$ 10,259,648	\$ 31,847	\$ 19,262	\$ 376,504	\$ 1,524	\$ 278	\$ 14,712,291

**U. S. Small Business Administration
Additional Accompanying Information
Consolidating Balance Sheet**
for the period ended September 30, 2002

(Dollars in Thousands)

ASSETS	Eliminations	Consolidated TOTAL
Intragovernmental Assets		
Fund Balances with Treasury	\$	\$ 7,492,740
Accounts Receivable	(1,201,688)	529
Advances	(76,305)	4,428
Total Intragovernmental	\$ (1,277,993)	\$ 7,497,697
Other Assets -Public		
Cash		3,458
Accounts Receivable		76,974
Credit Program Receivables and Related Foreclosed Property, Net		5,469,485
General Property and Equipment, Net		6,828
Advances		379,856
Total Other Assets -Public	0	5,936,601
Total Assets	\$ (1,277,993)	\$ 13,434,298
LIABILITIES		
Intragovernmental Liabilities		
Accounts Payable	\$ (1,201,688)	\$ 27,992
Debt		11,138,280
Other	(76,305)	947,039
Total Intragovernmental	\$ (1,277,993)	\$ 12,113,311
Other Liabilities -Public		
Accounts Payable	\$	149,134
Liabilities for Loan Guarantees		1,525,038
FECA Actuarial Liability		31,487
Other		56,416
Total Other Liabilities -Public	0	1,762,075
Total Liabilities	\$ (1,277,993)	\$ 13,875,386
NET POSITION		
Unexpended Appropriations	\$	1,010,485
Cumulative Results of Operations		(1,451,573)
Total Net Position	\$ 0	\$ (441,088)
Total Liabilities and Net Position	\$ (1,277,993)	\$ 13,434,298

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Financing
for the period ended September 30, 2002

(Dollars in Thousands)

	BLIF	DLF	SBGRF	PCECGF	SE	OIG	BATF	Total
Resources Used to Finance Activities								
Budgetary Resources								
Obligated								
Obligations Incurred	\$2,060,631	\$ 2,373,229	\$ 5,628	\$ 0	\$ 632,733	\$ 12,104	\$ 75	\$ 5,084,400
Less: Spending Authority from Offsetting Collections and Recoveries	962,390	2,138,568	5,722	209	316,176	496	133	3,423,694
Obligations Net of Offsetting Collections and Recoveries	1,098,241	234,661	(94)	(209)	316,557	11,608	(58)	1,660,706
Less: Offsetting Receipts	389,382	14,479						403,861
Net Obligations	\$ 708,859	\$ 220,182	\$ (94)	\$ (209)	\$ 316,557	\$ 11,608	\$ (58)	\$ 1,256,845
Other Resources								
Transfers In (Out)	(224,352)	(38,775)						(263,127)
Imputed Financing					17,420			17,420
Other Financing Sources	(242,047)	37,821		(750)				(204,976)
Net Other Resources Used to Finance Activities	\$(466,399)	\$ (954)	\$ 0	\$ (750)	\$ 17,420	\$ 0	\$ 0	\$ (450,683)
Total Resources Used to Finance Activities	\$ 242,460	\$ 219,228	\$ (94)	\$ (959)	\$ 333,977	\$ 11,608	\$ (58)	\$ 806,162

**U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Financing**
for the period ended September 30, 2002

(Dollars in Thousands)

	BLIF	DLF	SBGRF	PCECGF	SE	OIG	BATF	Total
Resources Used to Finance Items not Part of the Net Cost of Operations								
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	\$ 57,944	\$ 148,588	\$	\$	\$ 63,274	\$ 730	\$ (5)	\$ 270,531
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	783,502	1,751,149						2,534,651
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(1,285,495)	(1,781,531)		145	(3,351)			(3,070,232)
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	(1,047)				9,894	106	132	9,085
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	\$ (445,096)	\$ 118,206	\$ 0	\$ 145	\$ 69,817	\$ 836	\$ 127	\$ (255,965)
Total Resources Used to Finance the Net Cost of Operations	\$ (202,636)	\$ 337,434	\$ (94)	\$ (814)	\$ 403,794	\$ 12,444	\$ 69	\$ 550,197

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Financing
for the period ended September 30, 2002

(Dollars in Thousands)

	BLIF	DLF	SBGRF	PCECGF	SE	OIG	BATF	Total
Components of the Net Cost of								
Operations that will not Require or								
Generate Resources in the Current								
Period								
Change in Annual Leave Liability					754			754
Increase in Unfunded Liability for Claims against SBA								
Upward/ Downward reestimates of Credit Subsidy Expense	579,218	(37,153)						542,065
Change in Revenue Receivable from Public	63,833	532	397	(15)	(320)	(28)		64,399
Change in Due to Treasury - Liquidating Funds that is not an obligation	242,047	(37,821)		750				204,976
Provision for Losses on Estimated Guarantees	(244,404)		1,985	(526)				(242,945)
Unfunded Employee Benefits					(661)			(661)
Components of the Net Cost of								

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Changes in Net Position
for the period ended September 30, 2002

(Dollars in Thousands)

	BLIF		DLF		SBGRF	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	\$ (88,761)	\$ 228,640	\$ (498,252)	\$ 198,318	\$ (275,375)	\$ 293,330
Prior Period Adjustments						
Beginning Balances, as Adjusted	(88,761)	228,640	(498,252)	198,318	(275,375)	293,330
Budgetary Financing Sources						
Appropriations Received		375,554		284,714		
Appropriations						
Transferred -in/out (+/-)				(2,500)		
Rescissions		(5,500)				
Adjustment -Cancelled Authority		(16,378)				
Other Adjustments						
Appropriations Used	333,080	(333,080)	307,546	(307,546)	4,329	(4,329)
Donations of Cash						
Transfers-in/out Without Reimbursement						
Other Financing Sources						
Transfers-in/out Without Reimbursement	(224,352)		(38,775)			
Imputed Financing from Costs Absorbed by Others						
Other - Current Year						
Liquidating Equity Activity (+/-)	(242,047)		37,821			
Total Financing Sources	\$ (133,319)	\$ 20,596	\$ 306,592	\$ (25,332)	\$ 4,329	\$ (4,329)
Less: Net Cost of Operations	\$ 445,909		\$ 269,439		\$ 2,288	
Net Position - End of Period	\$ (667,989)	\$ 249,236	\$ (461,099)	\$ 172,986	\$ (273,334)	\$ 289,001

On the Consolidated Statement of Net Costs, the costs are reported by major program using the SBA's cost accounting study, while on this statement the costs are reported by fund and are not allocated using the cost accounting study.

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Changes in Net Position
for the period ended September 30, 2002

(Dollars in Thousands)

	PCECGF		SE		OIG	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	\$ 0	\$ 0	\$ (16,638)	\$ 320,291	\$ (524)	\$ 2,695
Prior Period Adjustments			(1,399)	1,956		
Beginning Balances, as Adjusted	0	0	(18,037)	322,247	(524)	2,695
Budgetary Financing Sources						
Appropriations Received		3,000		338,476		11,464
Appropriations Transferred -in/out (+/-)				2,500		
Rescissions				(479)		(6)
Adjustment -Cancelled Authority				(7,776)		
Other Adjustments		(3,000)	273	93		(9)
Appropriations Used			357,526	(357,526)	12,417	(12,417)
Donations of Cash						
Transfers-in/out Without Reimbursement						
Other Financing Sources						
Transfers-in/out Without Reimbursement						
Imputed Financing from Costs Absorbed by Others			17,420			
Other - Current Year Liquidating Equity Activity (+/-)	(750)					
Total Financing Sources	\$ (750)	\$ 0	\$ 375,219	\$ (24,712)	\$ 12,417	\$ (968)
Less: Net Cost of Operations	\$ (750)		\$ 406,088		\$ 12,416	
Net Position - End of Period	\$ 0	\$ 0	\$ (48,906)	\$ 297,535	\$ (523)	\$ 1,727

On the Consolidated Statement of Net Costs, the costs are reported by major program using the SBA's cost accounting study, while on this statement the costs are reported by fund and are not allocated using the cost accounting study.

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Changes in Net Position
for the period ended September 30, 2002

(Dollars in Thousands)

	BATF		Eliminations		TOTAL		
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Total
Beginning Balances	\$ 215	\$ 0	\$ 0	\$ 0	\$ (879,335)	\$ 1,043,274	\$ 163,939
Prior Period Adjustments					(1,399)	1,956	557
Beginning Balances, as Adjusted	215	0	0	0	(880,734)	1,045,230	164,496
Budgetary Financing Sources							
Appropriations Received						1,013,208	1,013,208
Appropriations							
Transferred -in/out (+/-)							
Rescissions						(5,985)	(5,985)
Adjustment -Cancelled Authority						(24,154)	(24,154)
Other Adjustments					273	(2,916)	(2,643)
Appropriations Used					1,014,898	(1,014,898)	
Donations of Cash	132				132		132
Transfers-in/out Without Reimbursement							
Other Financing Sources							
Transfers-in/out Without Reimbursement					(263,127)		(263,127)
Imputed Financing from Costs Absorbed by Others					17,420		17,420
Other - Current Year Liquidating Equity Activity (+/-)					(204,976)		(204,976)
Total Financing Sources	\$ 132	\$ 0	\$ 0	\$ 0	\$ 564,620	\$ (34,745)	\$ 529,875
Less: Net Cost of Operations	\$ 69				\$ 1,135,459		\$ 1,135,459
Net Position - End of Period	\$ 278	\$ 0	\$ 0	\$ 0	\$ (1,451,573)	\$ 1,010,485	\$ (441,088)

On the Consolidated Statement of Net Costs, the costs are reported by major program using the SBA's cost accounting study, while on this statement the costs are reported by fund and are not allocated using the cost accounting study.



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

CFO Reply

DATE: January 30, 2003
TO: Robert Seabrooks, Assistant IG for Auditing
FROM: Thomas Dumaresq, Chief Financial Officer
SUBJECT: FY 2002 Financial Statement Audit Report

The Small Business Administration (SBA) is in receipt of the draft Independent Public Accountant (IPA) reports from Cotton and Company, LLP, that include the auditor's opinion and separate reports on internal controls and compliance with laws and regulations. As you know, the IPA audit of the Agency's financial statements and related processes is a core component of SBA's financial management program.

Unfortunately, the results of this year's audit process indicate that despite SBA's commitment to improved financial management, our efforts have not been sufficient to meet existing financial management standards. The IPA has indicated that it is unable to satisfy itself that the SBA's financial statements fairly present the financial position of SBA as of September 2002 and 2001. The IPA report cites three specific findings which have resulted in this disclaimed opinion: the Disaster loan program model; treatment of pre-1992 loan guarantees; and measurement and treatment of the Master Reserve Fund (MRF) residual liability.

Throughout the FY 2002 audit process, SBA worked closely with the IPA on the Disaster loan program modeling issue. SBA management acknowledges the depth and breadth of the impact that this issue has on the Agency's financial statements and therefore accepts the IPA's conclusion that a disclaimed audit opinion on SBA's financial statements is warranted given this issue. SBA is working aggressively with OMB and an outside contractor to resolve the issue as quickly as possible. We are conducting a very detailed review of the disaster budget models, the hold model, and the accounting methodologies used for this direct credit program. In addition, we are analyzing the interrelationships between these different models and procedures to ensure consistency in approaches, assumptions and results.

SBA also worked closely with the IPA on the MRF residual liability measurement and treatment during the FY 2002 audit process. While SBA made substantial progress in improving its capacity to estimate the MRF residual liability this year, we agree with the IPA's recommendation that additional analysis should be completed and we are committed to undertaking that analysis in the coming year. Nevertheless, because of the remote nature of this potential liability, we do not agree that potential changes in the residual liability estimate would be sufficient to materially change the financial statements. We believe classifying this as an issue that merits a disclaimer opinion on SBA's financial statements substantially overstates its importance.

The treatment of SBA's pre-1992 loan guarantees is an issue that was raised relatively late in the audit process and has received comparatively less review by SBA and the IPA than the MRF and asset sales issues. The IPA's concern is with a decline in our reserves for loan guarantees made prior to fiscal year 1992 and our inability to provide satisfactory reasons for that change. While we agree that more clarity and documentation regarding our methodology for this calculation is warranted, and we intend to provide it in subsequent years, we are not convinced that the issue merits such a grave assessment.

The IPA's Report on Internal Control identifies two material weaknesses in addition to those described above. The two items include the financial reporting process and funds control weaknesses. While SBA acknowledges that it still needs to make progress in all of these areas, we believe that we did make meaningful improvements this year and that overall the process is better and more rigorous than it has been in the past. In most cases, the "errors" identified by the IPA are things that SBA had treated in a similar manner in prior years with no objection from the IPA. While SBA agrees with the many theoretical accounting policy changes made this year, we believe that the IPA's decision to highlight so many of the items in their reports creates the false impression that our financial statements and reporting process are weaker than they have been in the past. In contrast, we see these results as evidence that our efforts and the audit process are achieving their intended objectives – improving the accuracy and reliability of our financial statements.

Moreover, we would note that the key issues that the IPA raised this year – the Disaster loan program model, and the MRF – have been elements of SBA's financial statements for several years now and only this year has the IPA determined that these issues merit a "disclaimed" opinion. It is not SBA's treatment of these issues that has changed, but rather the IPA's perspective in reviewing them. As discussed above, we concur with the IPA's recommendations on these issues. However, we think it is important to note that the changed audit opinion does not reflect a decline in the quality of our financial statements but rather a more in-depth assessment by the auditor of what has been in our financial statements for at least the past several years.

SBA's view is that bringing these important financial management and reporting issues to light so we can begin resolving them is a positive step forward for the Agency. SBA is strongly committed to addressing all of the issues raised by the IPA and resolving them during the coming year. We are committed to full compliance with all financial management laws, regulations, and policies.

We appreciate all of your efforts and those of your colleagues in the Office of the Inspector General as well as those of our IPA. While the audit process was very challenging this year, we believe our efforts and the assistance we received from you and the IPA resulted in substantial improvements in the quality of our financial statements and our financial management capacity, which is our most important objective. With the additional improvements we plan to achieve in the coming year, we believe we will be well positioned to achieve a “clean” audit opinion next year.

A handwritten signature in black ink, appearing to read "Thomas A. Dumaresq". The signature is written in a cursive style with a large, stylized initial 'T'.

Thomas A. Dumaresq
Chief Financial Officer

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