**AUDIT OF SBA'S FY 2004**

**FINANCIAL STATEMENTS**

**AUDIT REPORT NUMBER 5-05**

**NOVEMBER 15, 2004**

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

| **AUDIT REPORT** |
|---|
| **Issue Date: November 15, 2004** |
| **umber: 5-05** |

**To:** Hector V. Barreto,
Administrator

Tom Dumaresq,
Chief Financial Officer

/S/original signed
**From:** Robert G. Seabrooks,
Assistant Inspector General for Auditing

**Subject:** Audit of SBA's FY 2004 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 auditor issued an unqualified opinion on the Fiscal Year (FY) 2004 combined statement of budgetary resources and the FY 2003 consolidated balance sheet (as restated); issued a qualified opinion on the FY 2004 consolidated balance sheet and statements of net costs, changes in net position, and financing. As agreed upon between the Office of the Chief Financial Officer and the Office of the Inspector General, the auditor did not apply all necessary auditing procedures in accordance with generally accepted auditing procedures to express an opinion on SBA's FY 2003 consolidated statements of net cost, changes in net position, and financing and the combined statement of budgetary resources, which previously received a disclaimed opinion from the auditors in FY 2003. A summary of FY 2004 audit results is outlined below.

**Summary of FY 2004 Audit Results**

| **Statement:** | **FY 2004** | **FY 2003** |
|---|---|---|
| Balance Sheet | Qualified | Unqualified |
| Statement of Net Cost | Qualified | Disclaimed |
| Statement of Changes in Net Position | Qualified | Disclaimed |
| Statement of Budgetary Resources | Unqualified | Disclaimed |
| Statement of Financing | Qualified | Disclaimed |

The auditor's qualification stemmed from their inability to satisfy themselves as to the reasonableness of (1) SBA's FY 2004 subsidy re-estimates pertaining to its Section 7(a), 504, Small Business Investment Company (SBIC) Participating Securities, and SBIC Debenture programs, (2) the value of Credit Program Receivables and Related Foreclosed Property, and (3) the value of Liabilities for Loan Guarantees for these four programs.

The Independent Auditor's Report on Internal Control discusses three matters considered reportable conditions: (1) Financial Management and Reporting Controls; (2) Credit Reform Controls; and (3) Agency-Wide Information System Controls. The auditors further considered combined matters described in the first two areas to be material weaknesses under the standards established by the American Institute of Certified Public Accountants and the Office of Management and Budget Bulletin No. 01-02. The auditor 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 is not in substantial compliance with federal financial system requirements; (2) SBA financial system 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. As discussed in more detail in the Independent Auditor's Report on Internal Control, the auditor also noted instances of noncompliance with the Anti-Deficiency Act and the Federal Credit Reform Act.

SBA management generally agreed with the auditors' findings and recommendations and noted that meeting the accelerated reporting date of November 15th was a major accomplishment for SBA, the Inspector General and the Independent Public Accountant this year and could not have done it without the coordinated effort made by all parties involved. SBA is proud of the work it did in establishing an aggressive but realistic set of milestones and working cooperatively with Cotton & Company to ensure they received timely and accurate materials. SBA management is also pleased that the SBA has received an improved audit opinion from the independent auditor compared to the previous three years and believe it accurately reflects a substantial improvement in the quality of the Agency's financial statements. SBA management saw the audit results as a particularly strong accomplishment given the shortened reporting cycle.

**The findings in this report are based on the auditor's conclusions and the report recommendations are subject to review, management decision and action by your office, in accordance with existing Agency procedures for follow-up and resolution.** Please provide us your proposed management decisions within 30 days on the attached SBA Form 1824, Recommendation Action Sheet.

Should you or your staff have any questions, please contact Jeff Brindle, Director, Information Technology and Financial Management Group at (202) 205-[FOIA Ex. 2].

Attachments

**AUDIT OF SBA'S FY 2004 FINANCIAL STATEMENTS**

**TABLE OF CONTENTS**

COTTON & COMPANY LLP
auditors ◆ advisors
333 North Fairfax Street ◆ Suite 401 ◆ Alexandria, Virginia 22314 ◆ 703/836/6701 ◆ fax 703/836/0941 ◆ www.cottoncpa.com

# INDEPENDENT AUDITOR'S REPORT

Inspector General
U.S. Small Business Administration

We audited the accompanying consolidated balance sheets of the U.S. Small Business Administration (SBA) as of September 30, 2004, and 2003 (restated); related consolidated statements of net cost, changes in net position, and financing; and combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of SBA management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as explained in the following four paragraphs, we conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The scope of our examination for the Fiscal Year (FY) 2003 financial statements was limited, because SBA was late in completing development and testing of certain credit program subsidy models, completing its credit program subsidy re-estimates, and preparing its financial statements. As a result, adequate time did not remain to obtain sufficient, competent evidential matter, apply auditing procedures necessary to conduct an audit in accordance with generally accepted auditing standards and generally accepted government auditing standards, and form a reasonable basis for an opinion on the financial statements by the January 30, 2004, reporting deadline specified by the Office of Management and Budget (OMB) Memorandum titled Fiscal Year (FY) 2003 Financial and Performance Reporting (August 13, 2003.)

SBA restated its FY 2003 financial statements during FY 2004. The scope of our examination of the September 30, 2003, restated balance sheet included applying auditing procedures sufficient to enable us to express an opinion thereon. The scope of our examination did not include additional auditing procedures sufficient to enable us to express an opinion on the restated consolidated statements of net cost, changes in net position, and financing and the combined statement of budgetary resources for the year ended September 30, 2003.

Because we did not apply all necessary auditing procedures to conduct an audit in accordance with generally accepted auditing standards or dispose of all reservations identified during our work conducted as part of the FY 2003 audit, we are not able to express, and we do not express, an opinion on SBA's FY 2003 restated consolidated statements of net cost, changes in net position, and financing and combined statement of budgetary resources.

We were not able to satisfy ourselves as to the reasonableness of SBA's FY 2004 subsidy re-estimates pertaining to its Section 7(a), 504, Small Business Investment Company (SBIC) Participating Securities, and SBIC Debenture programs or to the value of SBA's Credit Program Receivables and Related Foreclosed Property, Net and Liabilities for Loan Guarantees for these four programs. SBA forecasted its cash flow activity, including purchases for defaulted loans, recoveries on defaults, interest transactions on estimated cash balances, and other collection and disbursement activities for the second half of FY 2004. SBA consistently overestimated purchase activity, which in turn affected projections of other cash flow components. We were not able to determine the impact of this material over-estimate of purchase activities on the re-estimates of subsidy costs. In addition, the material over-estimate of purchase activities directly affects SBA's valuation of its Credit Program Receivables and Related Foreclosed Property and Liabilities for Loan Guarantees, because SBA makes adjustments between these two financial statement line items based on estimates of activity for the second half of FY 2004.

In our opinion, the consolidated balance sheet as of September 30, 2003, and the combined statement of budgetary resources for the period ended September 30, 2004, present fairly, in all material respects, the financial position of SBA as of September 30, 2003, and its budgetary resources for the period ended September 30, 2004. Except for the effects of such adjustments, if any, that might have been determined to be necessary had we been able to examine additional evidence related to the re-estimates and financial statement line items explained in the previous paragraph, the consolidated balance sheet as of September 30, 2004, and statements of net cost, changes in net position, and financing for the period ended September 30, 2004, present fairly in all material respects, the financial position of SBA as of September 30, 2004, and the results of operations, changes in net position, and reconciliation of net costs to budgetary obligations for the period ended September 30, 2004.

SBA presented its net costs of operations in FY 2004, consistent with its strategic goals. As discussed in Note 1.S and Note 15, to the financial statements, SBA restructured its strategic goals during FY 2004 and presented its FY 2003 net costs of operations in summary without costs matching current-year goals.

During the conduct of our FY 2003 audit (OIG Report No. 4-10, *Audit of SBA's Fiscal Year 2003 Financial Statements*, January 28, 2004) Cotton & Company identified certain matters causing us reservations regarding whether particular FY 2003 financial statement amounts and disclosures were presented fairly in accordance with prevailing federal accounting standards. We were not able to apply all auditing procedures that may have allowed us to resolve our reservations before the due date for audited financial statements. As noted above, during the conduct of our FY 2004 audit, we did not apply audit procedures to enable us to express an opinion on the restated FY 2003 consolidated statements of net cost, changes in net position, and financing and the combined statement of budgetary resources. Accordingly, we were not able to resolve the reservation related to the gain or loss on asset sales, and we identified one new matter causing us reservations regarding the consolidated statement of net cost for the period ended September 30, 2003.

**Restated Gain or Loss on Asset Sales**

SBA conducted an analysis to calculate revised gain/loss on loans sold during FYs 1999 through 2003. SBA computed a revised net book value using various assumptions depending on the program and available data. The revised net book value was subtracted from the loan sale proceeds to calculate a revised gain/loss. We have concerns with the data used in this analysis for the Section 7(a) and 504 guaranteed business loan programs and communicated them to management. SBA did not respond to our concerns in time for us to complete our review of the revised gain/loss calculation. SBA disclosed a $163 million and $126 million changes between previously reported losses and revised gains in its Section 7(a) and 504 credit programs, respectively. We did not apply additional auditing procedures during the FY 2004 to resolve this reservation.

**Consolidated Statement of Net Cost**

As described in Notes 1.S and 15, to the financial statements, SBA reported its net costs of operations consistent with the agency's strategic goals. SBA restructured its strategic goals during FY 2004 and added a new goal, the costs of which are allocable to all other strategic goals. As the result of this restructuring, SBA presented its FY 2003 net costs of operations in total, rather than by strategic goal. As a result, the consolidated statements of net costs for FYs 2003 and 2004 are not comparable. OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, states that the financial statements and related footnotes should present balances and amounts for current and prior years for comparative purposes. In addition, its states that the statement of net cost should present responsibility segments that align directly with the major goals and outputs described in an entity's strategic and performance plan, required by the Government Performance and Results Act (GPRA).

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. Information presented in SBA's Performance and Accountability Report (PAR), including management's discussion and analysis, required supplementary stewardship information, required supplementary information, and other accompanying information are not required parts of the basic financial statements, but are additional information required by the Federal Accounting Standards Advisory Board and OMB Bulletin No. 01-09. We applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it. Our limited procedures raised doubts, however, that we were unable to resolve regarding whether material modification should be made to the information for it to conform to OMB Bulletin No. 01-09.

In accordance with *Government Auditing Standards*, we have also issued reports dated November 15, 2004, on our consideration of SBA's internal control and on its compliance with laws and regulations. Those reports, which disclose material weaknesses and reportable conditions in internal control and non-compliance with certain laws and regulations and 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

[FOIA Ex. 6]

Charles Hayward, CPA

November 15, 2004
Alexandria, Virginia

COTTON & COMPANY LLP
auditors ◆ advisors
333 North Fairfax Street ◆ Suite 401 ◆ Alexandria, Virginia 22314 ◆ 703/836/6701 ◆ fax 703/836/0941 ◆ www.cottoncpa.com

# INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

Inspector General
U.S. Small Business Administration

We audited the consolidated balance sheets of the U.S. Small Business Administration (SBA) as of September 30, 2004, and 2003 (restated); related consolidated statements of net cost, changes in net position, and financing; and combined statements of budgetary resources for the fiscal years then ended and have issued our report thereon, dated November 15, 2004. In that report, we issued an unqualified opinion on the Fiscal Year (FY) 2004 combined statement of budgetary resources and the FY 2003 consolidated balance sheet (as restated); issued a qualified opinion on the FY 2004 consolidated balance sheet and statements of net costs, changes in net position, and financing; and disclaimed an opinion on the FY 2003 consolidated statements of net cost, changes in net position, and financing and the combined statement of budgetary resources.

Except as described in our November 15, 2004, Independent Auditor's Report referred to above, we conducted our audits in accordance with auditing standards generally accepted in the United States; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statement*.

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

Our consideration of internal controls over financial reporting would not necessarily disclose all matters in internal controls over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants (AICPA) and OMB Bulletin No. 01-02, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal controls 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 matters involving internal controls and its operation in the following three areas that we consider to be reportable conditions:

1. Financial Management and Reporting Controls
2. Credit Reform Controls
3. Agency-Wide Information System Controls

We consider combined matters described in the first two areas to be material weaknesses under standards established by AICPA and OMB Bulletin No. 01-02, as discussed below.

## 1. FINANCIAL MANAGEMENT AND REPORTING CONTROLS

SBA's internal control and quality assurance procedures over financial management and reporting continue to need improvement in the following areas:

- Financial Statement Preparation and Quality Assurance
- Financial Accounting Transactions and Review of Account Balances
- Funds Control Management
- Anti-Deficiency Act Compliance
- Intra-Governmental Transactions

SBA made substantial improvements during FY 2004 and was able to provide its FY 2004 interim and final draft financial statements and footnotes, supporting trial balances, and key audit evidence in accordance with agreed-upon milestone dates. SBA's quality control procedures, however, continue to need improvement to ensure that financial reports and audit evidence are accurate, reliable, and provided in a timely manner. The FY 2004 audit plan contained key milestone dates that were negotiated based on what SBA could realistically accomplish during its first year operating under an accelerated audit schedule. Some of these key milestone dates should ideally be accelerated further to ensure adequate time to complete the audit in accordance with generally accepted auditing standards, resolve audit issues, and prepare the Performance and Accountability Report. To accomplish this, SBA must continue to refine its resource management controls and critical-path approach for completing reconciliations; calculating and reviewing accruals, re-estimates, and other manual adjustments; closing the general ledger; preparing complete and accurate financial statements and footnotes; and performing appropriate analytical procedures and evaluation of account balances.

We discuss SBA's control weaknesses and areas needing improvement on the following pages under their respective captions.

### FINANCIAL STATEMENT PREPARATION AND QUALITY ASSURANCE

SBA maintained insufficient and sometimes ineffective quality control over its interim and final draft financial statements, related footnote disclosures, and other sections of the Performance and Accountability Report, including the Management Discussion and Analysis (MD&A) and the Performance Report sections. The reports contained numerous, pervasive, and obvious errors, including inconsistencies among the principal financial statements, footnote disclosures, and MD&A and Performance Report sections.  This resulted in a significant number of auditor comments on each version of the draft financial statement packages. For example:

- Footnotes contained many factual inaccuracies and grammatical errors.

- Footnote schedules did not sum properly, digits were omitted from amounts presented in the schedules, and footnote amounts did not tie to the applicable financial statement line item or other related footnotes.

- SBA omitted essential disclosures in its footnotes, such as discussion about its use of significant estimates in the financial statements, the agreed-upon accounting treatment for additional interest on subsidy re-estimates resulting from changes in discount rates for interest income and expense transactions with Treasury, and the time period for which actual data were used for developing the FY 2004 re-estimates and its methodology for annualizing such data.

- SBA mischaracterized a reduction in new borrowing authority as a repayment of borrowings. As a result, Footnote No. 11, Debt, showed borrowings in excess of borrowing authority. This was not identified during SBA's quality review process.

- Footnote No. 6, Credit Program Receivables and Related Foreclosed Property and Liability for Loan Guarantees, showed an increase in guaranteed loans outstanding in FY 2004 that exceeded new guaranteed loans disbursed resulting from a $10 billion misstatement of FY 2003 guaranteed loans outstanding. SBA did not identify this illogical condition during its internal control review process.

- Footnote No. 4, Master Reserve Fund, contained an incorrect amount carried forward from financial statements published for FY 2003 that was related to the FY 2002 restatement of subsidy re-estimates.

- SBA's August 2004 statement of budgetary resources did not tie to the trial balance, because one line item contained a "hard coded" number from June that was not deleted when preparing the August statement.

- Expected relationships among the financial statements and between the financial statements and footnotes were incorrect.

- The draft MD&A and Performance Measures sections were missing information in some key areas. In addition, some of the data and text presented either were not supported by the underlying documentation or were inconsistent with our audit results. We noted that management did not ensure that the final MD&A was materially consistent with the final principal financial statements and audit results. For instance, management did not update the Analysis of Financial Results section of the MD&A so that it agreed with the final financial statements.

OMB Circular A-127, *Financial Management Systems,* states:

> *The agency financial management system shall be able to provide financial information in a timely and useful fashion to…comply with internal and external reporting requirements, including, as necessary, the requirements for financial statements prepared in accordance with the form and content prescribed by OMB and reporting requirements prescribed by Treasury.*

Also, Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting,* states:

> *Financial reporting is the means of communicating with those who use financial information. For this communication to be effective, information in financial reports must have these basic characteristics:*

*understandability, reliability, relevance, timeliness, consistency, and comparability.*

SBA corrected the majority of the errors and inconsistencies identified with the draft financial statements submitted throughout the audit period.

In addition, SBA did not prepare its consolidated statement of financing in accordance with the most recent guidance available to facilitate the implementation of Statement of Federal Financial Accounting Standards (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources*. Specifically, SBA included its interest transactions with the public and Treasury in the section titled Resources Used to Finance Items Not Part of the Net Cost of Operations, although interest transactions were reported on the net cost of operations. In addition, SBA did not include its amortization of the allowance for subsidy in the section titled Components Not Requiring or Generating Resources.

According to SFFAS No. 7, the purpose of the statement of financing is to explain the relationship between a reporting entity's budgetary resources and its net cost of operations. Through reconciliation, the statement provides information necessary for understanding how budgetary resources finance the net cost of operations and affect assets and liabilities of the reporting entity. The SFFAS No. 7 Implementation Guide (April 2002) explains concepts and standards to aid in understanding and implementing SFFAS No. 7.

**Recommendation:**

1.A We recommend that the CFO continue to develop new quality assurance review procedures and enhance existing procedures to ensure that all financial transactions are properly reflected in the financial statements, and that footnote disclosures are accurate and logical and contain comprehensive information essential to the fair presentation of SBA's financial condition. We recommend the following:

- Performing additional analytical procedures monthly or quarterly.
- Developing and completing additional checklists.
- Performing studies of best practices.
- Having an independent review conducted by individuals not associated with SBA's daily financial management and reporting responsibilities, such as an outside peer reviewer.

## FINANCIAL ACCOUNTING TRANSACTIONS AND REVIEW OF ACCOUNT BALANCES

SBA's quality assurance process did not detect all instances in which its accounting practices were not United States Standard General Ledger (SGL) compliant or for which accounting transactions were not recorded, processed, summarized, and reported in compliance with OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and federal accounting standards. We noted the following matters.

### Improper Accounting Treatment for Appropriation Transfer

SBA incorrectly treated an appropriation transfer from the Department of Homeland Security for Disaster Loan Program administrative expenses, as reimbursable activity rather than appropriated funds. This transfer was received in September 2004 to provide emergency funding for disasters occurring in Florida. SBA treated the appropriation transfer as reimbursable activity to accommodate immediate obligation and disbursement needs associated with emergency funding.

Within its accounting system, SBA had already established separate account symbols for its salary and expense fund to distinguish transactions incurred under reimbursable activities from direct activities. SBA's Disaster Loan Program administrative appropriations are typically received in the loan program funds and advanced to the salary and expense fund reimbursable account where the expenditures are obligated and paid. The apportionment to advance money from the program funds and receive the spending authority from offsetting collections in the salary and expense fund is included on the Standard Form (SF) 132, Apportionment and Reapportionment Schedule, and approved by OMB. Because the Disaster Loan Program account classification information was already set up in the reimbursable account, SBA also treated the appropriation transfer received in its salary and expense fund as reimbursable activity, similar to its other Disaster Loan Program administrative appropriations.

This treatment was not appropriate, because both the salary and expense direct and reimbursable funds are apportioned as one fund. Therefore, the transfer received in the salary and expense fund was not apportioned as spending authority from offsetting collections, and it was not apportioned to be advanced to the salary and expense reimbursable account.

By adopting such treatment, SBA created the erroneous intra-fund transactions identified below:

| Financial Statement | Financial Statement Line Item | General Ledger Account | Misstatement |
|---|---|---|---|
| Statement of Budgetary Resources and Statement of Financing | Obligations Incurred and Outlays-Collections | 480201, Unexpended Obligations - Prepaid/Advanced | $22,579,915 Overstated |
| | | 490201, Delivered Orders - Obligations, Paid | $7,420,085 Overstated |
| | Spending Authority from Offsetting Collections-Unfilled Customer Orders and Outlays-Disbursements | 422201, Unfilled Customer Orders With Advance | $22,579,915 Overstated |
| | | 425201, Reimbursements and other Income Earned - Collected | $7,420,085 Overstated |
| Balance Sheet | Advances | 141001, Advances to Others | $22,579,915 Overstated |
| | Other Liabilities | 231001, Advances from Others | $22,579,915 Overstated |
| Statement of Net Cost | Intragovernmental Earned Revenues | 520001, Revenue from Services Provided | $7,420,085 Overstated |
| | Gross Costs with Public | 610001, Operating Expenses | $7,420,085 Overstated |

SBA made correcting entries after we brought this matter to its attention.

Statement of Federal Financial Accounting Standard No. 7 states that unexpended appropriations should be adjusted for other changes in budgetary resources, such as rescissions and transfers.

**Improper Assignment of Disaster Administrative Expense to Strategic Goals**

SBA allocated indirect salary and expense costs to its strategic goals for purposes of reporting net costs of operations consistent with its goals. It used a cost study to calculate percentages assigned to each goal. It assigned 100 percent of Disaster Loan Program administrative expenses received in the program fund to Goal C, Restore Home and Businesses Affected by Disaster. As noted previously, in September 2004, SBA received an appropriation transfer in its salary and expense fund from the Department of Homeland Security to cover Disaster Loan Program administrative expenses. Because the transfer appropriation was received in the salary and expense fund, it was allocated to each of SBA's strategic goals rather than being assigned 100 percent to Goal C. This resulted in understating costs assigned to Strategic Goal C by about $5.7 million and overstating other strategic goals by the same amount.

SBA was aware of this condition but did not have a process in place to correct the misstatement of net cost of operations at the strategic-goal level.

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, states that in principle, costs should be assigned to outputs by directly tracing costs, assigning costs on a cause and effect basis or allocating costs on a reasonable and consistent basis. Direct tracing applies to specific resources that are dedicated to particular outputs.

**Subsidy Realignment Entry**

SBA recorded an offline journal entry to properly align the present value of future cash flows between the Liabilities for Loan Guarantees and Credit Program Receivables and Related Foreclosed Property, Net, balance sheet line items. During FY 2004, SBA developed a revised methodology for determining the amount of the alignment entry. The methodology identifies the estimated present value of future cash flows for loans with a guarantee still in force from the subsidy re-estimate models. The balance in General Ledger Account 2180, Liability for Loan Guarantee, is then "aligned" with this estimate. We noted two exceptions with SBA's alignment entry.

SBA did not segregate the present value of future cash flows for its Small Business Investment Company (SBIC) Participating Securities Program between those related to guarantees still in force and those related to SBICs that have already defaulted. SBA aligned General Ledger Account 2180 to the unsegregated present value of future cash flows from the subsidy re-estimate model, causing it to be understated and General Ledger Account 1399 to be overstated. As a result of our audit inquiries, SBA determined that an audit adjustment was necessary and posted an adjusting entry to correct the following misstatements:

<table>
<tr><th colspan="4">Fiscal Year 2004 Financial Statements</th></tr>
<tr><th>Financial Statement</th><th>Financial Statement Line Item</th><th>General Ledger Account</th><th>Misstatement</th></tr>
<tr><td rowspan="2">Balance Sheet</td><td>Credit Program Receivables and Related Foreclosed Property, Net</td><td>1399, Allowance for Subsidy</td><td>$343,287,839 Overstated</td></tr>
<tr><td>Liability for Loan Guarantees</td><td>2180, Loan Guarantee Liability</td><td>$343,287,839 Understated</td></tr>
<tr><th colspan="4">Fiscal Year 2003 Financial Statements</th></tr>
<tr><td rowspan="2">Balance Sheet</td><td>Credit Program Receivables and Related Foreclosed Property, Net</td><td>1399, Allowance for Subsidy</td><td>$222,136,726 Overstated</td></tr>
<tr><td>Liability for Loan Guarantees</td><td>2180, Loan Guarantee Liability</td><td>$222,136,726 Understated</td></tr>
</table>

Second, SBA recorded the FY 2003 alignment entry and validated that the resulting General Ledger Account 2180 balance agreed to the estimated present value of future cash flows for guarantees in force per the subsidy re-estimate models. Subsequent to this, SBA posted another transaction that affected the General Ledger Account 2180 balance. As a result, the account balance no longer agreed to the target amount per the re-estimate models. SBA did not identify this condition during its quality assurance review process of the September 30, 2004, draft financials statements. Upon audit inquiry, SBA determined why the balance did not align and made an audit adjustment to correct the following misstatements:

| Fiscal Year 2003 Financial Statements | | | |
|---|---|---|---|
| **Financial Statement** | **Financial Statement Line Item** | **General Ledger Account** | **Misstatement** |
| Balance Sheet | Credit Program Receivables and Related Foreclosed Property, Net | 1399, Allowance for Subsidy | $33,063,756 Understated |
| | Liability for Loan Guarantees | 2180, Loan Guarantee Liability | $33,063,756 Overstated |

**Secondary Market Guarantee Re-estimate Accounting Entry**

SBA's Secondary Market Guarantee re-estimate was improperly recorded in the general ledger, resulting in misstatements in the following general ledger account balances:

| Financial Statement | Financial Statement Line Item | General Ledger Account | Misstatement |
|---|---|---|---|
| Balance Sheet | Accounts Payable | 2005U, Payable Subsidy to Financing Fund (Unfunded) | $6,736,325 Overstated |
| | Accounts Receivable | 1101U, Receivable Subsidy from Program Fund (Unfunded) | $6,736,325 Overstated |
| | Liabilities for Loan Guarantees | 2180, Loan Guarantee Liability | $6,736,325 Overstated |
| Statement of Net Cost | Gross Costs with Public | 5013U, Interest Expense on Subsidy Reestimate | $2,143,411 Overstated |
| | | 5105U, Subsidy Expense (Unfunded) | $4,592,914 Overstated |
| | | 5119U, Interest Expense (Unfunded) | $2,143,411 Overstated |
| | Earned revenue from Public | 4034, Interest Income Subsidy Reestimate | $2,143,411 Overstated |

SBA's quality assurance review procedures were inadequate and did not detect these errors either before or after the re-estimate transactions were posted in the accounting system. SBA corrected the errors after we brought them to its attention.

**Net Position Balances**

SBA did not have a process in place to routinely validate the propriety of its net position balances. We identified several funds that had potentially invalid cumulative results of operations and unexpended appropriations balances and asked SBA to review them to determine validity.

SBA determined that the balances were misstated. The misstatements were most likely attributable to use of improperly recorded prior-year appropriations. SBA posted the following correcting entries:

| Financial Statement | Financial Statement Line Item | General Ledger Account | Fund | Misstatement |
|---|---|---|---|---|
| Balance Sheet and Statement of Changes in Net Position | Unexpended Appropriations | 3100, Unexpended Appropriations | X4156 | $273,500,000 Overstated |
| | | | X0100DA | $5,355,698 Understated |
| | | | 30100DA | $477,663 Understated |
| | | | X0200DA | $523,317 Overstated |
| | | | 10100DA | $509,444 Understated |
| | | | 20100DA | $842,581 Understated |
| | | | 900100DA | $1,301,103 Overstated |
| | Cumulative Results of Operations | 3310, Cumulative Results of Operations | X4156 | $273,500,000 Understated |
| | | | X0100DA | $5,355,698 Overstated |
| | | | 30100DA | $477,663 Overstated |
| | | | X0200DA | $523,317 Understated |
| | | | 10100DA | $509,444 Overstated |
| | | | 20100DA | $842,581 Overstated |
| | | | 900100DA | $1,301,103 Understated |

**Disaster Loan Program Interest Transactions with Treasury**

SBA developed a component of its Disaster Loan Program interest on subsidy re-estimates to correct for shortfalls in Disaster Program financing fund balances resulting from:

- Inconsistencies among various credit reform tools and schemes for calculating and applying cohort weighted average and single effective interest rates. In accordance with OMB guidance, SBA calculated interest transactions with Treasury using budget assumptions for the Disaster Loan Program 2002 cohort until it was 90-percent disbursed; SBA's adjustment corrected for differences between those assumptions and actual discount rates that became known once the cohort was 90-percent disbursed.

- Misallocation of borrowings between Disaster Loan Program and World Trade Center/Pentagon (WTCP) Program and commingling Disaster Loan Program and WTCP Program net cash balances in its calculation of interest transactions with Treasury prior to FY 2004. This resulted in the improper use of program and cohort discount rates for calculating interest transactions with Treasury.

SBA overlooked the additional interest on subsidy re-estimates when posting its FY 2004 and restated FY 2003 re-estimates for inclusion in its August 2004 draft financial statements. In addition, when the entry was posted, it was posted as a FY 2004 transaction; the portion related to SBA's failure to separately calculate interest transactions for the WTCP Program should have been recorded as a FY 2003 restatement, because the errors related to FY 2003 and prior accounting periods. SBA did not separately calculate the effects of the two conditions noted above. The correcting entry affected the following financial statement line items:

| Financial Statement | Financial Statement Line Item | General Ledger Account | Misstatement |
|---|---|---|---|
| Balance Sheet | Accounts Receivable | 1101U, Receivable Subsidy from Program Fund (Unfunded) | $25,626,197 Understated |
| | Credit Program Receivables and Related Foreclosed Property | 1399, Allowance for Subsidy | $3,565,585 Understated |
| | Accounts Payable | 2005U, Payable Subsidy to Financing Fund (Unfunded) | $25,626,197 Understated |
| | Other Liabilities | 2012U, Payable to Special Receipt Fund (Unfunded) | $22,060,612 Understated |
| Statement of Net Cost | Earned Revenue from Public | 4033, Interest Income (Non Federal) | $3,565,585 Overstated |
| | | 4034, Interest Income Subsidy Reestimate | $25,626,197 Understated |
| | Intragovenmental Gross Costs | 5034U, Interest Expense-Subsidy Reestimate (Unfunded) | $22,060,612 Understated |
| Statement of Net Cost and Statement of Financing | Gross Costs with Public and Upward/Downward Reestimates | 5013U, Interest Expense on Subsidy Reestimate (Unfunded) | $25,626,197 Understated |

The Federal Credit Reform Act of 1990 requires that the rate of interest charged by the Secretary of Treasury on lending to financing accounts or paid to financing accounts on uninvested funds be the same as the discount rate used in estimating net present values.

**Recommendation:**

1.B. We recommend that the CFO continue to develop new quality control procedures and tools and enhance existing procedures and tools to prevent and detect errors or misstatements in amounts recorded in SBA's financial accounting systems or in the accounting treatment and presentation of economic events and to ensure that underlying transactions in the financial statements are accurate, complete, and presented in conformity with federal accounting standards and principles. We recommend that procedures be included for:

- Assigning sufficient human resources to perform financial management and quality assurance functions.
- Providing appropriate training and ensuring knowledge transfer among accountants and analysts responsible for recording, reviewing, and approving accounting transactions.
- Developing appropriate skill sets to enable efficient, complete, and accurate analysis of detailed and summarized financial data.

**FUNDS CONTROL MANAGEMENT**

SBA's funds control management improved significantly since FY 2003, but continues to have weaknesses, as discussed below.

**Invalid Budgetary Proforma Entries**

SBA used an application called Budget Proforma to record budgetary accounting entries in its Financial Reporting Information System (FRIS) consolidated general ledger based upon proprietary and memorandum transactions occurring in the Loan Accounting System (LAS), because LAS does not include budgetary accounting transactions. We noted the following misstatements on the combined statement of budgetary resources related to SBA's budgetary proformas:

- During FY 2004, SBA corrected invalid proforma posting logic for Transaction Codes 311 and 320. It did not, however, make retroactive adjustments to correct the effects from the invalid logic. As a result, Spending Authority from Offsetting Collections and Obligations Incurred were understated by $313,057.

- SBA posted a manual journal voucher to correct year-to-date effects from invalid budgetary posting logic for Transaction Code 462. This entry did not result in the correct budgetary balances. As a result, Spending Authority from Offsetting Collections and Obligations Incurred were understated by $14,546,294.

SBA did not reconcile its proprietary and related budgetary account balances to ensure that the results of its budgetary proforma posting logic were correct. In addition, SBA's quality assurance process did not detect account balance errors. SBA corrected these misstatements after we brought them to its attention.

Substantial compliance with the SGL at the transaction level, as mandated by the Federal Financial Management Improvement Act (FFMIA), requires that SBA record financial events consistent with applicable posting models/attributes reflected in the SGL. Generally accepted accounting principles require that transactions be recorded based upon events that actually occurred.

**Monitoring Undelivered Orders**

SBA did not adequately monitor undelivered orders, as discussed below:

**Invalid Loan Program Undelivered Orders:** During FY 2003, we noted that SBA maintained invalid loan program undelivered orders. In response to our recommendation, SBA developed two reports to aid disaster assistance and servicing offices in identifying invalid Disaster Program undelivered orders resulting from duplicate loan approvals or based on the age of the undelivered order. Although SBA made significant improvement in identifying and de-obligating invalid or unneeded Disaster Program undelivered orders, we noted the following during FY 2004 testing:

- 3 instances of duplicate loan approvals.

- 35 instances of invalid posting logic at Transaction Code 212, which reestablished an undelivered order when a loan disbursement check was returned after the loan was cancelled.

In addition, we noted 12 instances in which SBA failed to de-obligate unneeded undelivered orders for its Business Direct Loan Program in a timely manner.

This condition resulted in the following misstatements on the combined statement of budgetary resources:

| Financial Statement | Financial Statement Line Item | General Ledger Account | Known Misstatement | Projected Misstatement |
|---|---|---|---|---|
| Statement of Budgetary Resources and Statement of Financing | Undelivered Orders and Obligations Incurred | 7801B, Undelivered Orders-Unpaid-Loans | $3,390,202 Overstated | $31,872,616 Overstated |
| | Unobligated Balances Available | 7610, Allotments-Realized Resources | $3,390,202 Understated | $31,872,616 Understated |

During FY 2004, SBA corrected $1,259,595 of the known misstatements once we brought them to its attention.

OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, defines a valid obligation as a binding agreement that will result in outlays immediately or in the future. The undelivered orders detailed above will not result in future outlays and should have been de-obligated.

**Administrative Undelivered Orders:** During sample testing of administrative undelivered orders, we identified a $1.5 million undelivered order for a grant for which the performance period had expired on August 31, 2003. SBA stated that a verbal extension of the grant period had been authorized, but it had not prepared and signed a written modification to the grant agreement as of September 30, 2004. Accordingly, SBA could not provide support to substantiate the need for this undelivered order nor could we determine its propriety without discussion with the Office of Procurement and Grants Management (OPGM).

Part 31 U.S.C. Section 1501 (a) (5) requires an obligation to be supported by documentary evidence of a grant payable under an agreement authorized by law.

**Recommendation:**

We recommend that the CFO:

1.C. Continue to refine the review process implemented during FY 2004 to identify invalid or unneeded Disaster Program undelivered orders and develop a similar review process for the Business Direct Loan Program.

1.D. Coordinate with the Director of OPGM to ensure that a written grant amendment is issued to extend the performance period for the grant identified above.

1.E. Coordinate with OPGM to implement a control to ensure that all future administrative undelivered orders are supported by valid obligating documents.

**ANTI-DEFICIENCY ACT COMPLIANCE**

SBA did not have sufficient funds control to ensure that activity affecting expired salary and expense funds was valid and did not result in Anti-Deficiency Act violations. For example, it recorded $7.1 million of obligation activity in expired funds during FY 2004 that SBA management could not readily explain as appropriate upward adjustments.

OMB Circular A-11, Section 20-13, Period of Availability for Making Disbursements, states that budget authority is not available for new obligations during the expired phase of a fund. Agencies may, however, use expired budget authority to make certain adjustments to obligations incurred before budget authority expiration.

Because SBA did not routinely review these obligations to ensure Anti-Deficiency Act compliance, it was unable to assure us that its FY 2004 obligation activity in expired funds met OMB Circular A-11 criteria.

**Recommendation:**

1.F. We recommend that CFO implement procedures to require senior management review and approval of all obligation activity in expired funds and maintain sufficient documentation to substantiate its validity and compliance with OMB Circular A-11 and the Anti-Deficiency Act.

**INTRA-GOVERMENTAL TRANSACTIONS**

While SBA strengthened its process for reconciling intra-governmental activity and balances with trading partners, it was unable to reconcile a significant amount of intra-governmental activity through September 30, 2004. In some instances, SBA did not fully capture the requisite trading partner data, such as agency location code, in its accounting system. In addition, SBA's contacts with a significant trading partner, Office of Personnel Management, failed to resolve large differences noted by Treasury. Further, SBA's attempts to contact another significant trading partner, General Services Administration, were not reciprocated.

*Treasury Financial Manual*, 2-4700, Agency Reporting Requirements for the Financial Report of the United States Government (May 28, 2004), requires agencies to capture trading partner information in their accounting systems and fully reconcile differences with trading partners on a quarterly basis. Additionally, according to *Treasury's Federal Intragovernmental Transactions Accounting Policies Guide* (September 24, 2004), the responsibility for reconciliation of an agency's activity and balances is with the agency regardless of the trading partner's involvement with the transaction.

**Recommendation:**

1.G. We recommend that the CFO strengthen internal controls to ensure that all requisite trading partner data are fully captured in SBA's accounting system, and that all trading partners are contacted quarterly to reconcile differences. In addition, we recommend that CFO seek assistance from OMB to enhance cooperation from non-responsive trading partners.

## 2. CREDIT REFORM CONTROLS

SBA developed and implemented draft standard operating procedures for calculating re-estimates and established an internal review and documentation process for all of its credit re-estimate activities during FY 2004. This process covered the following elements:

- Ensuring version control and security over model input data.
- Verifying program structure and documenting technical changes to the model.
- Updating model assumptions and accounting data.
- Reviewing cash flows generated from the model for reasonableness.
- Ensuring completion of interest rate re-estimates when required.
- Ensuring use of appropriate discount rates.
- Reviewing accuracy of data used in the credit subsidy calculator or balances approach re-estimate calculator.

Standard operating procedures provided for a four-person review process. The preparer and first- and second-level reviewers ensured that each of the procedures was executed correctly and was sufficiently documented to support SBA's re-estimate calculations. The fourth individual, an SBA contractor with expertise in econometrics and statistical analyses, then performed an independent verification and validation exercise.

The existence of and adherence to a set of standard operating procedures for calculating re-estimates, along with more meaningful and standardized documentation of the process and results, and an effective internal review process were critical to SBA's success in meeting key milestone dates. They also were essential to completing the audit process within an accelerated financial reporting timeframe.

Although much substantial and noteworthy progress was made, additional improvements are warranted to ensure that reasonable estimates can be produced and audited in a timely manner in the future. We noted conditions during testing of the credit subsidy re-estimate process in the following areas:

- Program-Level Accounting Data
- Historical Accounting Data in Cash Flow Models
- Discount Rates for Re-Estimates and Interest Transactions
- Projected Cash Balances
- Actual Cash Flows for Analytical Procedures

### PROGRAM-LEVEL ACCOUNTING DATA

SBA prepared re-estimates for its loan-related activities at the program level, such as the 7a guarantee program versus the SBIC Participating Securities Program or Disaster Loan Program. SBA accounted for over 25 programs within its 3 financing funds. The accounting system did not, however, have a unique data element to identify the program. Instead, SBA used a "point break" data element within the accounting system and manually assigned multiple point breaks to each program. Therefore, SBA was able to accumulate and analyze data at the program level outside of the accounting system.

The proper segregation and integrity of data at the program level is essential for computing re-estimates using the balances approach and performing other program-level analytical procedures, such as comparing actual to estimated cash flows and validating data used in the re-estimate models and cash-flow outputs produced by the models.

This process of accumulating data at the program level is labor intensive and subject to human error and interpretation. Financial data are used by many individuals, including credit analysts, accountants, program personnel, and auditors. While SBA made progress in identifying which point breaks should be assigned to which programs, we noted some inconsistencies in program classification among various analyses prepared by SBA. In addition, SBA had to manually prepare and review data each time it was used. This was often time consuming and hindered SBA's ability to efficiently complete its analyses and our ability to perform our audit.

OMB Circular A-127 states:

> *The design of the financial management systems shall reflect an agency-wide financial information classification structure that is consistent with the U. S. Government Standard General Ledger, provides for tracking of specific program expenditures, and covers financial and financially related information. This structure will minimize data redundancy, ensure that consistent information is collected for similar transactions throughout the agency, encourage consistent formats for entering data directly into the financial management systems, and ensure that consistent information is readily available and provided to internal managers at all levels within the organization.*

**Recommendation:**

2.A. We recommend that the CFO investigate the feasibility of enhancing the agency's accounting data structure to include a program code within the financial reporting information system and update this new program code data element for existing financial records. If this is not feasible, we recommend that the CFO maintain an authoritative crosswalk between point breaks and programs and develop procedures to ensure accurate and consistent summarization of data at the program level.

## HISTORICAL ACCOUNTING DATA IN CASH FLOW MODELS

The conditions we noted related to SBA's development of its subsidy re-estimates are discussed below.

### Incorrect Estimated Disbursements

SBA calculated a re-estimate for a 2004 cohort under its 7a Supplementary Terrorist Assistance Relief (STAR) program, although no new obligations were incurred or disbursements made beyond the 2003 cohort. SBA forecasted second half of FY 2004 program demand for all cohorts to project its September 30, 2004, cash balances. Because no disbursements were made in the first half of the year for the 2004 cohort, the forecast model used loans from the second half of FY 2003 to project disbursement activity for the second half of FY 2004.

SBA's quality assurance process did not detect that a re-estimate had been completed for a cohort for which no budget authority existed. This resulted in a $143 million overstatement of forecasted disbursements in the 2004 cohort, which produced an erroneous $1 million downward re-estimate.

**Incorrect Unpaid Principal Balances**

SBA's 7a model used unpaid principal balance (UPB) at the beginning of each quarter to forecast cash flows in subsequent periods. Actual cash flow activity records for the period ended March 31, 2004, for loans in 1996 and 1997 cohorts were missing certain data elements, including one that designated the loan status as either active or inactive. Loans with missing data were dropped from the data set, and the UPB was understated for 1996 and 1997 cohorts. SBA estimated that the FY 2004 re-estimates were understated by approximately $4.2 million as a result.

**Incorrect Disaster Loan Program Borrowing**

Beginning in FY 2003, SBA established new disaster loan point breaks to account for WTCP physical and economic injury disaster loans. For a direct loan program, the unsubsidized portion of the loan disbursement is funded by borrowing from Treasury. SBA did not, however, have any borrowing transactions in its WTCP point breaks, because all borrowing was erroneously attributed to the Disaster Loan Program point break codes. As a result, WTCP point breaks showed a substantial amount of negative cash, and the Disaster Loan Program showed too much cash.

In addition, SBA did not segregate its net cash balances between its Disaster Loan Program and WTCP Program when computing and recording interest expense or income transactions with Treasury during FYs 2002 and 2003. As a result, the cumulative net cash balances (uninvested funds less debt owed to Treasury) for both programs were misstated in the accounting system. SBA needed to manually reconstruct its net cash balances in order to use the balances approach for re-estimating these programs.

SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, states:

> *The efforts to make accurate projections should begin with establishing and using reliable records of historical credit performance data….*

SBA made accounting adjustments during FY 2004 totaling about $500 million to realign its borrowing activity between WTCP and regular disaster point breaks and calculated an additional component to its re-estimate to cover the effects of failing to separately calculate and record interest transactions with Treasury in its WTCP Program in prior years.

**Incomplete Historical Data**

SBA used incomplete disbursement and default data when developing its historical average default and principal repayment assumption curves for its SBIC Participating Securities Program cash flow model. These errors resulted in overstating subsidy re-estimates by approximately $2 million.

The Federal Accounting Standards Advisory Board's (FASAB) Credit Reform Task Force (Accounting and Auditing Policy Committee), Technical Release No. 6, Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act, requires agencies to compare budgeted to actual cash flows to ensure that cash flow models reflect actual cash flows from the accounting records. Additionally, Technical Release No. 6 requires budget and accounting offices to ensure that cash flow models are updated to reflect actual cash flows and terms of the loan program recorded in the accounting records.

**Recommendation:**

2.B. We recommend that CFO continue to improve its quality assurance and review process to ensure that historical accounting data used in cash flow models are complete and accurate based on underlying accounting records.

**DISCOUNT RATES FOR RE-ESTIMATES AND INTEREST TRANSACTIONS**

To compute interest transactions with Treasury, SBA used discount rates that were inconsistent with discount rates used to estimate the present value of future cash flows, which should be the cohort weighted average or single effective discount rates set once a cohort becomes 90-percent disbursed. This inconsistency likely stemmed from two circumstances.

First, the OMB Consolidated Credit Tool (c-credit tool) and Interest Calculator for Credit Financing Accounts each compute the cohort weighted average discount rate based on yearly disbursement amounts entered by the preparer. If different disbursement amounts are entered into each tool, different discount rates will result and be used by the respective tool. Second, the single effective discount rates (used for 2001 cohort and later) must be manually entered in the tools. SBA did not have a procedure in place to make sure that single effective discount rates used for interest transactions were the actual cohort discount rate when the cohort became 90-percent disbursed.

We noted that SBA did not maintain an official list or database of the cohort weighted average or single effective discount rates that were set when the interest rate re-estimates were performed. SBA was required to retrieve subsidy re-estimate files from previous years, which were not always available, to ensure that the appropriate discount rate was used in the current re-estimate. A similar exercise was not performed when the interest transactions were calculated, and different individuals were responsible for preparing the re-estimates and calculating the interest transactions with Treasury.

The use of discount rates other than those set when the cohort became 90 percent disbursed resulted in a net error of approximately $5 million.

The Federal Credit Reform Act of 1990 requires that the rate of interest charged by the Secretary of Treasury on lending to financing accounts or paid to financing accounts on uninvested funds be the same as the discount rate used in estimating net present values.

**Recommendation:**

2.C. We recommend that the CFO develop and implement procedures for ensuring consistency and a clear audit trail between the discount rate resulting from the interest rate re-estimate and discount rates used for both subsequent technical re-estimates and calculations of interest income and expense transactions with Treasury.

## PROJECTED CASH BALANCES

SBA used the “balances approach” for calculating its FYs 2004 and 2003 restated re-estimates. This approach compares actual cash balances less debt owed to Treasury in the accounting system with forecasted cash flows projected by the subsidy re-estimate models. Any excess or deficiency in net cash balances results in a re-estimate under this approach. SBA began preparing its re-estimates in the spring of 2004 and was able to use September 30, 2003, actual cash balances to calculate the FY 2003 restated re-estimate. Starting with the March 2004 actual net cash balance, SBA projected the second half of FY 2004 cash activity, such as purchases, collections, and FY 2004 interest income and expense transactions with Treasury.

SBA’s original projections for its non-disaster programs assumed that, as part of interest transactions with Treasury, it would earn or pay interest for one-half of a year on the change between the FY 2003 funded and FY 2003 restated re-estimates. Because the change will not be funded until FY 2005, SBA should have calculated an additional amount of “interest on re-estimate” for its FY 2003 restatements. SBA’s quality assurance procedures did not detect this condition. SBA revised its FY 2004 re-estimates after we brought this to its attention.

The effect of this error did not change the total combined FY 2003 and FY 2004 re-estimates and would not have occurred had SBA not needed to restate its FY 2003 re-estimates. Because of the error, however, amounts recorded as subsidy re-estimate versus interest on re-estimates during FY 2004 were misstated, impacting the consolidated statements of net cost and financing. The effects ranged from $0.8 million to $6 million depending on the program and totaled approximately $19 million.

In addition, SBA used an incorrect recovery curve to estimate recovery activity for the second half of FY 2004 under the SBIC Debentures program. As a result, estimated balances on deposit with Treasury as of September 30, 2004, were overstated, and the re-estimate was understated by $442,574.

**Recommendation:**

2.D. We recommend that CFO continue to refine its quality review procedures to ensure that it correctly applies procedures necessitated by the use of the balances approach, if restatements are required in the future.

## ACTUAL CASH FLOWS FOR ANALYTICAL PROCEDURES

SBA prepared a cash flow component analysis of actual plus forecasted cash flows over the cohort life for its SBIC Participating Securities Program. It included this analysis in supporting documentation provided with the model as part of its quality assurance process. This analysis was intended to be used to evaluate the reasonableness of the cash flow forecasts. It did not contain explanations describing procedures performed or conclusions reached. In addition, we noted instances in which the actual cash flows for FYs 1994 through 2003 did not agree with LAS, and forecasted cash flows did not agree with the model output. To be reliable and effective, the analysis should be accurate and demonstrate the test performed, test results, and conclusions reached.

We noted that SBA did not perform a similar analysis of cohort-specific actual plus forecasted cash flows for its other guaranteed loan programs. Unlike the traditional approach for re-estimating, the balances approach does not require actual cash flow amounts to be included in the cash flow spreadsheets. Although not required, an analysis of actual plus forecasted cash flow streams over the life of the cohort, to determine if proper and intuitive relationships among cash flow components exist, would be useful in explaining trends and substantiating the reasonableness of cash flow projections.

In addition, SBA used March 31, 2004, cash balances annualized to September 30, 2004, to establish its net cash balances with Treasury for its balances approach re-estimates. SBA forecasted cash flow activity for the second half of the year, including purchases for defaulted loans, recoveries on defaults, interest transactions on estimated cash balances, and other collection and disbursement activities. At year-end, SBA compared its projections with actual activity for the second half of FY 2004, and noted that it had consistently overestimated purchase activity, which in turn affected projections of other cash flow components. The accelerated audit schedule did not allow sufficient time to effectively analyze the cause of some differences or develop an auditable approach to measuring the effects of such differences on projected re-estimates and resulting account balances. While SBA had some features in place to study and measure the impacts caused by such differences, it recognized that additional analytical procedures and tools may be useful.

As noted in our Independent Auditor's Report, we were not able to satisfy ourselves as to the reasonableness of SBA's FY 2004 subsidy re-estimates for the Section 7(a), 504, SBIC Participating Securities, and SBIC Debenture Programs or its Credit Program Receivables and Related Foreclosed Property and Liabilities for Loan Guarantees account balances for these four programs.

**Recommendation:**

2.E. We recommend that the CFO continue to develop and refine existing analytical tools and analyses to substantiate the reasonableness of forecasted cash flows and subsidy re-estimates produced by its models, including analytical analyses of actual plus projected cash flows over the cohort life, statistical methods for establishing the degree of uncertainty inherent in the subsidy models, and procedures to determine model quality.

2.F. We recommend that the CFO develop and test an approach for quantifying the impact on re-estimates and account balances caused by differences between actual and projected cash flows if SBA continues to use interim data for computing its re-estimates.

## 3. AGENCY-WIDE INFORMATION SYSTEMS CONTROLS

SBA continued to improve internal control over its information system environment in certain areas during FY 2004. Specifically, SBA:

- Conducted certification and accreditation (C&A) reviews for additional major applications.

- Continued to implement the Windows 2000 operating system at various field locations.

- Conducted a disaster recovery exercise.

While these accomplishments are important and noteworthy, SBA continues to have serious weaknesses in its information systems control environment, as discussed below:

- OCIO did not have an adequate information technology training program in place for personnel who administer or oversee SBA's IT resources.

- Management had not corrected known deficiencies. Specifically, 14 of 26 recommendations for 13 findings noted in FY 2003 were not adequately addressed.

- Duties within financial applications were not adequately segregated. SBA's Joint Accounting and Administrative Management System (JAAMS) security administration and user account administration privileges have been granted to several individuals. In addition, we identified one user with both financial- and IT incompatible duties within JAAMS.

- Policies and procedures for the administration of the SBA's network operating system have not been developed.

- No minimally-acceptable baseline configuration existed for SBA's network operating system, general support computer operating systems, and database management system. In addition, we found several weaknesses within the security configurations of these platforms when compared to federal guidance and industry best practices promulgated by the Center for Internet Security, National Institute for Standards and Technology, and National Security Agency.

- Access authorization and restriction controls to the SBA network, JAAMS, LAS, and the Sybase general support systems were not adequate. Access authorization forms documenting approval of access and privileges granted were not required for the network, Sybase, and LAS. Although JAAMS did require access authorization forms, not all forms could be located for review.

- Emergency access authorizations to SBA's Network, JAAMS, LAS, and the Sybase general support system were not adequately documented.

- Network, JAAMS, and LAS password controls were weak.

- SBA did not review inactive accounts on the network, LAS, or the Sybase general support system.

- Logging and monitoring of security events within SBA general support systems and JAAMS were inadequate.

- Business resumption plans have not been completed and fully incorporated into SBA's Continuity of Operations Plan (COOP)

- Several vulnerabilities continued to exist on the SBA network.

SBA's OIG will issue a separate report titled *Audit of SBA's Information System Controls, FY 2004,* that will provide additional detail of our scope of work, findings, and recommendations in the following categories:

**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 (Oracle administrative accounting system)**

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

## STATUS OF PRIOR-YEAR FINDINGS

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

## OTHER MATTERS

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. We concluded that SBA's control over performance measures did not ensure accuracy and reliability as required by OMB Bulletin 01-09 and prevailing FASAB standards. 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

[FOIA Ex.6]

Charles Hayward, CPA
Partner

November 15, 2004
Alexandria, Virginia

## APPENDIX

## STATUS OF FY 2003 AUDIT FINDINGS

| Description | Recommendation | Status |
|---|---|---|
| Credit Reform Controls | Develop a comprehensive SOP detailing the subsidy re-estimate process, including related internal controls, that reflects SBA's current re-estimate preparation processes and any proposed improvements. Update the SOP at least annually to capture significant changes such that it reflects the current operating process. (1A) | Implemented |
| | Complete the Section 7(a) model documentation in accordance with Tech Release No. 3 and assure that the identified shortcomings are addressed by the documentation. Perform and document the likelihood ratio test and comparison of predicted versus actual default and prepayment probabilities for subgroups of the population. (1B) | Implemented |
| | Direct a coordinated effort among OCFO and Investment Division to fully document the SBIC program models in accordance with Tech Release No. 3. (1C) | Implemented |
| | Clearly define which programs (program codes) should be included in the Section 7(a) re-estimate actuals. (1D) | Implemented |
| | Develop a quality assurance system to ensure that data extracted from LAS for inclusion in the Disaster and 7(a) subsidy re-estimate models are complete and accurate. (1E) | Implemented |
| | Develop, as an interim measure, an internal control procedure to reconcile the Investment Division SBIC Participating Securities and Debenture transaction data to LAS at the cohort and activity-year level; research and fully explain all variances; and determine if Investment Division data are appropriate for use in subsidy re-estimates. (1F) | Implemented |
| | Begin recording all SBIC transactions in the proper fiscal year and cohort and add SBIC-specific transaction codes to LAS, as necessary, to better identify SBIC activity, so that SBIC subsidy re-estimate actuals can be derived from LAS in the future. (1G) | Implemented |
| | Develop, document, and implement data quality assurance procedures to establish the completeness and accuracy of data provided by SBA's fiscal and transfer agent for Secondary Market Guarantee estimation purposes. (1H) | Partially Implemented |
| | Determine if selection and development of the SBIC Participating Securities model's forecast assumptions are consistent with program guidelines and are reasonable in light of historical experience and current economic conditions and document the basis for such assumptions. (1I) | Implemented |

| Description | Recommendation | Status |
|---|---|---|
| | Develop a quality assurance review process to minimize errors in calculating re-estimates and/or ensure that errors that do occur are detected and corrected in a timely manner. (1J) | Implemented |
| | Direct a coordinated effort among applicable OCFO branches to identify potential disconnects between the agency's subsidy models and accounting records and make refinements to subsidy models and post correcting entries to the general ledger as appropriate. (1K) | Implemented |
| | Implement a system of internal control in which the Office of Financial Analysis and the Office of Financial Administration monitor the direct loan subsidy allowance account balance and the liability for loan guarantees account balance as compared to the outstanding balances of loans and/or guarantees, at the program and cohort levels monthly. Maintain documentation that explains unusual fluctuations determined to be appropriate, supports any adjusting entries to the general ledger and details revisions made to subsidy models and/or assumptions. (1L) | Implemented |
| | Ensure that the FRIS general ledger and subsidiary feeder systems are properly accounting for credit reform activities at the program and cohort levels in accordance with SFFAS No. 2. (1M) | Implemented |
| Financial Management and Reporting Controls | Assess whether SBA has devoted sufficient and qualified resources to adequately address its current financial reporting shortcomings and determine if the current process is in need of re-engineering to meet accelerated financial reporting deadlines in future years. (2A) | Implemented |
| | Develop a comprehensive plan with firm milestone dates to meet the FY 2004 accelerated financial reporting date of November 15th. (2B) | Implemented |
| | Design specific procedures to identify accounts requiring estimation or other adjustment in a timely manner to achieve proper valuation in the financial statements. (2C) | Implemented |
| | Lead a collaborative effort between the Office of Financial Administration accountants and the Office of Financial Analysis analysts, such that sufficient knowledge transfer is achieved to enable SBA to design and implement comprehensive and effective analyses and review processes regarding estimates and other accounting adjustments. (2D) | Implemented |
| | Complete the document titled *Checklist for Reports Prepared Under the CFO Act--Revised 2003*, as issued jointly by the General Accounting Office and the President's Council on Integrity and Efficiency, before submitting financial statements to help ensure the adequacy of financial statement presentation and disclosure. (2E) | Implemented |

| Description | Recommendation | Status |
|---|---|---|
| | Correct known budgetary proforma errors and perform a complete analysis of posting logic to ensure compliance with the SGL at the transaction level. (2F) | Implemented |
| | Coordinate with the Office of Disaster Assistance to develop and implement procedures to review and determine the validity of outstanding disaster Loan UDOs quarterly. Invalid UDOs should be de-obligated to ensure efficient use of funds. (2G) | Implemented |
| | Coordinate with the Director of the Office of Procurement and Grants Management to develop additional or strengthen existing internal controls to identify administrative obligations with no activity and process de-obligations in a timely manner. (2H) | Implemented |
| | Develop procedures to ensure proper cut-off to ensure completeness of administrative transactions for financial reporting. (2I) | Implemented |
| | Ensure that adequate supporting documentation is maintained to substantiate recorded administrative obligations. (2J) | Not Implemented |
| | Continue to review obligation activity posted against expired funds in FY 2003 and make a determination if the Antideficiency Act was violated. Maintain sufficient documentation to ensure a clear audit trail during FY 2004. (2K) | Not Implemented |
| | Develop control techniques to ensure that only valid obligation activity is posted against expired funds and review transactional detail monthly to ensure no invalid activity was posted. (2L) | Partially Implemented |
| | Investigate the possibility of implementing automated funds controls within the Loan Accounting System that allot the lesser of apportioned authority or realized resources at the fund level. (2M) | Implemented |
| | Enhance the cash management tracking system by implementing a control technique to ensure that obligations incurred transactions entered via journal voucher do not exceed the lesser of apportioned authority or realized resources. (2N) | Implemented |
| | Calculate and pay all interest due to immediate pay vendors for late payments in prior fiscal years and begin paying Prompt Payment Act interest to these vendors on future late payments. (2O) | Implemented |
| | Perform a thorough account analysis at the fund level to identify account and posting anomalies, such as accounts with unnatural balances. Any anomalies detected should be researched and subsequently corrected to ensure compliance with SGL posting logic and federal accounting standards. (2P) | Implemented |

| Description | Recommendation | Status |
| --- | --- | --- |
| Agency-wide Information Systems Control | Please refer to SBA's OIG report titled *Audit of SBA's Information System Controls, FY 2003*. | Unresolved. Updated in SBA's OIG report titled *Audit of SBA's Information System Controls, FY 2004*. |

COTTON & COMPANY LLP
auditors • advisors
333 North Fairfax Street • Suite 401 • Alexandria, Virginia 22314 • 703/836/6701 • fax 703/836/0941 • www.cottoncpa.com

# INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Inspector General
U.S. Small Business Administration

We audited the consolidated balance sheets of the U.S. Small Business Administration (SBA) as of September 30, 2004, and 2003 (restated); the related consolidated statements of net cost, changes in net position, and financing; and the combined statements of budgetary resources for the fiscal years then ended and have issued our report thereon, dated November 15, 2004. In that report, we issued an unqualified opinion on the Fiscal Year (FY) 2004 combined statement of budgetary resources and the FY 2003 consolidated balance sheet (as restated); issued a qualified opinion on the FY 2004 consolidated balance sheet and statements of net costs, changes in net position and financing; and disclaimed an opinion on the FY 2003 consolidated statements of net cost, changes in net position, and financing and the combined statement of budgetary resources.

Except as described in our November 15, 2004, Independent Auditor's Report referred to above, we conducted our audits in accordance with auditing standards generally accepted in the United States; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

SBA management is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether SBA's financial statements are free of material misstatement, we performed tests of agency 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 OMB Bulletin 01-02, including requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and did not test compliance with all laws and regulations applicable to SBA.

Our Independent Auditor's Report on Internal Control states that SBA had $8.7 million of obligation activity in expired funds during FY 2004 (see the section in that report titled Anti-Deficiency Act Compliance), which could not be readily explained as appropriate upward adjustments by SBA management. Accordingly, we were not able to conclude whether or not SBA violated the Anti-Deficiency Act.

The results of our tests of compliance with the laws and regulations described in the third paragraph above, exclusive of FFMIA, disclosed the following instance of noncompliance, which is required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

**Anti-Deficiency Act**

During FY 2004, SBA's Office of General Counsel (OGC) ruled that SBA improperly augmented its appropriations by allowing its fiscal and transfer agent to retain the float interest earned on fees collected on SBA's behalf as compensation. Additionally, OGC determined that this practice constituted a violation of the Anti-Deficiency Act. SBA has notified OMB about this violation and is in the process of preparing an anti-deficiency letter required by the Act.

Also, SBA calculated the amount of float interest for each fiscal year during which this interest was earned and identified the appropriate fiscal year funding source for these amounts. OMB approved a $1.1 million reapportionment for SBA's business loan guarantee financing account to reflect spending authority from offsetting collections from federal sources. SBA recorded an adjusting entry to move this amount from various salary and expense accounts to the financing account.

Under FFMIA, we are required to report whether SBA's financial management systems substantially comply with federal financial management system requirements, federal accounting standards, and the United States Government Standard General Ledger (SGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. 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, federal accounting standards, and the United States SGL at the transaction level.

Please see our Independent Auditor's Report on Internal Control (applicable section cited) for details regarding each of the matters discussed below.

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

- Access control, segregation-of-duty, and other general-control weaknesses existed, which are described in the Office of Inspector General report titled *Audit of SBA's Information System Controls, FY 2004*. (3. Agency-Wide Information System Controls)

- Security weaknesses and non-conformances with OMB Circular A-130, *Management of Federal Information Resources*, continued to exist in certain major applications and general support systems. (3. Agency-Wide Information System Controls)

- SBA maintained insufficient funds control over obligation activity in expired salary and expense funds. (1. Financial Management and Reporting Controls, Anti-Deficiency Act Compliance)

- SBA's accounting system did not accumulate data at the program level to ensure that consistent financial information was collected and readily available for management at all levels of the organization, as required by OMB Circular No. A-127, *Financial Management Systems*. (2. Credit Reform Controls, Program-Level Accounting Data)

SBA was not in substantial compliance with federal accounting standards, because it:

- Incorrectly recorded borrowing transactions attributable to its World Trade Center/Pentagon (WTCP) Program to its Disaster Loan Program and commingled the net cash balances in its calculation of interest transactions with Treasury for FYs 2002 and 2003. (2. Credit Reform Controls, Incorrect Disaster Loan Program Borrowing)

- Used incorrect discount rates to calculate its interest income and expense transactions with Treasury. (2. Credit Reform Controls, Discount Rates for Interest Transactions)

- Submitted draft financial statements, related footnote disclosures, and other sections of the Performance and Accountability report, such as the Management Discussions and Analysis (MD&A) and Performance Report sections, that contained numerous, pervasive, and obvious errors including inconsistencies among the principal financial statements, footnotes, and MD&A and Performance Report sections. (1. Financial Management and Reporting Controls, Financial Statement Preparation and Quality Assurance)

- Did not assign disaster loan administrative expenses covered by an appropriation transfer to the proper strategic goal. (1. Financial Management and Reporting Controls, Improper Assignment of Disaster Administrative Expense to Strategic Goals)

- Did not segregate the present value of future cash flows for its Small Business Investment Company (SBIC) Participating Securities Program between the Liability for Loan Guarantees and Credit Program Receivables and Related Foreclosed Property. (1. Financial Management and Reporting Controls, Subsidy Realignment Entry)

- Recorded additional interest on re-estimates to the wrong accounting period. (1. Financial Management and Reporting Controls, Disaster Loan Program Interest Transactions with Treasury)

- Overstated loan undelivered orders because it failed to deobligate unneeded obligations. (1. Financial Management and Reporting Controls, Invalid Loan Program Undelivered Orders)

- Incorrectly treated an appropriation transfer from another agency as reimbursable activity rather than appropriated funds. (1. Financial Management and Reporting Controls, Improper Accounting Treatment for Appropriation Transfer)

- Presented its FY 2003 net costs of operations in total, rather than by strategic goal. (Independent Auditor's Report)

SBA was not in substantial compliance with the United States Government SGL at the transaction level, because:

- SBA misstated unexpended appropriations and cumulative results of operations account balances in several funds. (1. Financial Management and Reporting Controls, Net Position Balances)

- SBA recorded invalid spending authority from offsetting collections and obligations incurred due to improper budget pro-forma posting logic. (1. Financial Management and Reporting Controls, Invalid Budgetary Proforma Entries)

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

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

[FOIA Ex. 6]

Charles Hayward, CPA

November 15, 2004
Alexandria, Virginia

 aa

# U.S. Small Business Administration

## Fiscal Year 2004 and 2003
## Financial Statements

## Introduction

This is the fourteenth year the Small Business Administration (SBA) has issued agency-wide financial statements. 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 the Agency financial management goal of providing accurate and reliable information that may be used to assess performance and allocate resources.

Extensive improvements were made to the financial statements in Fiscal Years (FY) 2003 and 2004. In FY 2003 the SBA addressed critical longstanding issues on the cost of the Disaster Program and the sale of Disaster loans as part of SBA's Loan Asset Sale Program. During FY 2003 inconsistencies and weaknesses in the budgeting and accounting for the SBA's Loan Asset Sale Program were substantially corrected. A new subsidy model was built to forecast Disaster Program costs and the FY 2003 financial statements (as restated) and footnotes accurately include the cost of the Disaster Program. During FY 2004 the SBA conducted extensive analysis of its Disaster Program account balances to verify the accuracy of its overall Disaster Program cost. This was done as part of the "balances approach" to reestimate the Disaster Program subsidy during FY 2004. This analysis resulted in restatements to the FY 2003 financial statements published in January 2004.

During FY 2003 the SBA also updated its 7(a) econometric model first used for the FY 2003 budget. In addition, during FY 2003 the Agency updated assumptions used for defaults and recoveries in its Small Business Investment Company (SBIC) Program models and built a new model for its 504 Development Company Program used for the FY 2005 budget. SBA completed this work through an aggressive approach that employed Agency as well as outside modeling experts, consultation with the Office Management and Budget (OMB) and extensive review and quality assurance by outside modeling experts. During FY 2004 substantial analysis was conducted to verify the accuracy of 7(a) and 504 Program subsidy accounts and costs in preparation for the use of the "balances approach" for FY 2004 subsidy reestimates (including restatement of FY 2003 subsidy costs and related account balances). Also during FY 2004 the SBIC subsidy cost estimates were improved through an extensive data "cleanup" and a review of the subsidy reestimate model assumptions to assure consistency with SBIC Program projections.

During FY 2003 SBA also built a new model to estimate the sufficiency of the Master Reserve Fund (MRF) to fund the Secondary Market Guarantee (SMG) to investors in 7(a) securities. Also during FY 2003 the Agency developed a new procedure to estimate the liability for guarantees for the pre-Federal Credit Reform business loan portfolio. During FY 2004 documentation of the internal controls over the MRF data was improved and the reestimate of the cost of the SMG was further refined, resulting in a restatement of the FY 2003 financial statements.

In the FY 2003 audit, our independent auditor determined that the SBA did not furnish sufficient evidence in a timely manner to support the accuracy of the Agency's credit program costs. In addition the delayed delivery of the SBA's financial statements did not leave sufficient time for the SBA's auditor to verify the final submission of the SBA's financial statements. As a result, a "disclaimed" opinion was issued on the SBA's FY 2003 financial statements. For FY 2004 the

SBA has adhered to an accelerated schedule for the development and review of its financial statements. In addition SBA has improved the quality of its FY 2004 financial statements. It has provided improved documentation of the process and internal controls used in its accounting and reporting of its program and administrative costs.

The responsibility for the accuracy and propriety of the information contained in the principal financial statements and the quality of internal controls rests with SBA's management. The statements are, in addition to other financial reports, used to monitor and control budgetary resources. The financial statements have been prepared from the books and records of the Agency in accordance with generally accepted accounting principals (GAAP) for Federal agencies and the formats prescribed by OMB. The Agency recognizes it cannot liquidate liabilities not covered by budgetary resources without an enactment of an appropriation by Congress and an apportionment by OMB.

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 agencies (intragovernmental) and those resulting from transactions with non-Federal entities. Information for two years is presented for the purpose of comparison.

SBA's net position consists of Unexpended Appropriations and Cumulative Results of Operations. Unexpended Appropriations reflects spending authority made available to SBA by congressional appropriation. Cumulative Results of Operations reflects the net results of SBA's operations over time.

## Statement of Net Cost

The Consolidated Statement of Net Cost shows, by strategic goal, how much it cost SBA to provide its services for the fiscal year. Net cost is calculated by subtracting earned revenues from gross costs. SBA did not present a detailed comparative Statement of Net Cost since its strategic goals changed from FY 2003 to FY 2004.

## Statement of Changes in Net Position

The Consolidated Statement of Changes in Net Position shows SBA's beginning and ending net position by two major components - Cumulative Results of Operations and Unexpended Appropriations - both of which are shown under Net Position on the Balance Sheet. The Statement of Changes in Net Position summarizes the major categories of transactions that caused the net position to change during the year.

## Statement of 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.

Data on the Combined Statement of Budgetary Resources is consistent with budget execution information on the Standard Form (SF) – 133 Report on Budget Execution and 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 for the purpose of reconciling outlay information in the Budget of the United States Government.

## Statement of Financing

The Consolidated Statement of Financing shows the relationship between SBA's net obligations and net cost of operations.  Net obligations are drawn from budgetary accounting, and net cost of operations are 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.

**U. S. Small Business Administration**
## Consolidated Balance Sheet
as of September 30, 2004 and September 30, 2003

| *(Dollars in Thousands)* | **2004** | **Restated 2003** |
|---|---|---|
| **ASSETS** | | |
| Intragovernmental Assets | | |
| Fund Balances with Treasury (Note 2) | **$ 7,072,582** | $ 2,798,677 |
| Accounts Receivable (Note 5) | | 12,650 |
| Advances (Note 8) | | |
| Total Intragovernmental Assets | **7,072,582** | 2,811,327 |
| Assets - Public and Other | | |
| Cash (Note 3) | **22,510** | 5,331 |
| Accounts Receivable (Note 5) | **39,457** | 35,472 |
| Credit Program Receivables and Related Foreclosed Property, Net (Note 6) | **3,413,244** | 3,532,595 |
| Equipment and Internal Use Software (Note 7) | **19,789** | 8,522 |
| Total Assets - Public and Other | **3,495,000** | 3,581,920 |
| **Total Assets** | **$ 10,567,582** | $ 6,393,247 |
| **LIABILITIES** | | |
| Intragovernmental Liabilities | | |
| Accounts Payable (Note 10) | **$ 10,297** | $ 13,739 |
| Debt (Note 11) | **8,603,974** | 6,706,379 |
| Net Assets of Liquidating Funds Due to Treasury (Note 12) | **299,516** | 407,109 |
| Other (Note 14) | **567,073** | 652,299 |
| Total Intragovernmental Liabilities | **9,480,860** | 7,779,526 |
| Other Liabilities - Public | | |
| Accounts Payable (Note 10) | **33,894** | 49,648 |

| | | |
|---|---|---|
| Liabilities for Loan Guarantees (Note 4 and 6) | **2,524,052** | 2,541,530 |
| FECA Actuarial Liability (Note 13) | **28,436** | 31,822 |
| Other (Note 14) | **102,615** | 108,091 |
| Total Other Liabilities - Public | **2,688,997** | 2,731,091 |
| **Total Liabilities** | **$ 12,169,857** | $ 10,510,617 |
| | | |
| **NET POSITION** | | |
| | | |
| Unexpended Appropriations | **$ 540,894** | $ 573,974 |
| Cumulative Results of Operations | **(2,143,169)** | (4,691,344) |
| **Total Net Position** | **$ (1,602,275)** | $ (4,117,370) |
| | | |
| **Total Liabilities and Net Position** | **$ 10,567,582** | $ 6,393,247 |

The accompanying notes are an integral part of these statements.

See Note 19 for additional information related to restatement of 2003.

**U. S. Small Business Administration**

## Consolidated Statement of Net Cost

for the periods ended September 30, 2004 and September 30, 2003

| *(Dollars in Thousands)* | 2004 | | Restated 2003 | |
|---|---|---|---|---|
| **PROGRAMS** | | | | |
| **Strategic Goal 1: Improve Economic Environment for Small Business** | | | | |
| Intragovernmental Gross Costs | $ | 11,633 | | |
| Less: Intragovernmental Earned Revenue | | | | |
| Intragovernmental - Net Costs | $ | 11,633 | $ | |
| Gross Costs with the Public | $ | 38,991 | | |
| Less: Earned Revenue from the Public | | | | |
| Net Costs with the Public | $ | 38,991 | $ | |
| **Net Cost of Strategic Goal 1** | $ | 50,624 | $ | |
| **Strategic Goal 2: Increase Small Business Success by Bridging Competitive Opportunity Gaps** | | | | |
| Intragovernmental Gross Costs | $ | 292,582 | | |
| Less: Intragovernmental Earned Revenue | | 136,746 | | |
| Intragovernmental - Net Costs | $ | 155,836 | $ | |
| Gross Costs with the Public | $ | 1,483,911 | | |
| Less: Earned Revenue from the Public | | 282,748 | | |
| Net Costs with the Public | $ | 1,201,163 | $ | |
| **Net Cost of Strategic Goal 2** | $ | 1,356,999 | $ | |
| **Strategic Goal 3: Restore Homes and Businesses Affected by Disaster** | | | | |
| Intragovernmental Gross Costs | $ | 399,300 | | |
| Less: Intragovernmental Earned Revenue | | 166,096 | | |
| Intragovernmental - Net Costs | $ | 233,204 | $ | |
| Gross Costs with the Public | $ | 268,676 | | |
| Less: Earned Revenue from the Public | | 204,658 | | |
| Net Costs with the Public | $ | 64,018 | $ | |
| **Net Cost of Strategic Goal 3** | $ | 297,222 | $ | |
| **Costs Not Assigned to Strategic Goals** | | | | |
| Intragovernmental Gross Costs | $ | 9,810 | | |
| Less: Intragovernmental Earned Revenue | | | | |
| Intragovernmental - Net Costs | $ | 9,810 | $ | |
| Gross Costs with the Public | $ | 32,882 | | |
| Less: Earned Revenue from the Public | | | | |
| Net Costs with the Public | $ | 32,882 | $ | |
| **Net Costs Not Assigned to Strategic Goals** | $ | 42,692 | $ | |
| **Net Cost of Operations** | $ | 1,747,537 | $ | 3,949,258 |

**Note 15**

The accompanying notes are an integral part of these statements.

See Note 19 for additional information related to restatement of 2003.

**U. S. Small Business Administration**

## Consolidated Statement of Changes in Net Position

for the periods ended September 30, 2004 and September 30, 2003

*(Dollars in Thousands)*

| | 2004 | | | Restated 2003 | | |
|---|---|---|---|---|---|---|
| | **Cumulative Results of Operations** | **Unexpended Appropriations** | **Total** | **Cumulative Results of Operations** | **Unexpended Appropriations** | **Total** |
| **Beginning Net Position As Previously Restated** | | | | $ (2,697,964) | $ 954,633 | $ (1,743,331) |
| Prior Period Adjustments | | | | 425,075 | (273,500) | 151,575 |
| **Beginning Net Position, as Adjusted** | **$ (4,691,344)** | **$ 573,974** | **$ (4,117,370)** | $ (2,272,889) | $ 681,133 | $ (1,591,756) |
| **Budgetary Financing Sources** | | | | | | |
| Appropriations Received | | **4,430,112** | **4,430,112** | | 1,982,908 | 1,982,908 |
| Appropriations Transferred - In/Out (+/-) | | **30,000** | **30,000** | | (9,000) | (9,000) |
| Rescissions | | **(8,040)** | **(8,040)** | | (29,369) | (29,369) |
| Adjustment - Cancelled Authority | | **(6,353)** | **(6,353)** | | (5,978) | (5,978) |
| Other Adjustments | **(1,253)** | **(101,756)** | **(103,009)** | | (30,581) | (30,581) |
| Appropriations Used | **4,377,043** | **(4,377,043)** | | 2,015,139 | (2,015,139) | |
| Donations of Cash and Cash Equivalents | **426** | | **426** | 207 | | 207 |
| **Other Financing Sources** | | | | | | |
| Transfers - In/Out Without Reimbursement (+/-) | **(102,741)** | | **(102,741)** | (496,728) | | (496,728) |
| Imputed Financing from Costs Absorbed by Others | **17,858** | | **17,858** | 19,063 | | 19,063 |
| Other - Current Year Liquidating Equity Activity (+/-) | **4,379** | | **4,379** | (6,878) | | (6,878) |
| **Total Financing Sources** | **$ 4,295,712** | **$ (33,080)** | **$ 4,262,632** | $ 1,530,803 | $ (107,159) | $ 1,423,644 |
| **Less: Net Cost of Operations** | **$ 1,747,537** | | **$ 1,747,537** | $ 3,949,258 | | $ 3,949,258 |
| **Ending Net Position** | **$ (2,143,169)** | **$ 540,894** | **$ (1,602,275)** | $ (4,691,344) | $ 573,974 | $ (4,117,370) |

**Note 16**

The accompanying notes are an integral part of these statements.

See Note 19 for additional information related to restatement of 2003.

**U. S. Small Business Administration**

## Combined Statement of Budgetary Resources

for the periods ended September 30, 2004 and September 30, 2003

*(Dollars in Thousands)*

| | 2004 | | | 2003 | | |
|---|---|---|---|---|---|---|
| | **Budgetary** | **Non-Budgetary Financing** | **Total** | **Budgetary** | **Non-Budgetary Financing** | **Total** |
| **BUDGETARY RESOURCES** | | | | | | |
| Budget Authority | | | | | | |
| Appropriations Received | **$ 4,430,112** | **$** | **$ 4,430,112** | $ 1,982,908 | $ | $ 1,982,908 |
| Borrowing Authority | | **2,203,099** | **2,203,099** | | 1,158,196 | 1,158,196 |
| Net Transfers (+/-) | **30,000** | | **30,000** | | | |
| Other | | | | | | |
| Unobligated Balance | | | | | | |
| Brought Forward October 1 | **415,697** | **1,769,202** | **2,184,899** | 711,921 | 6,049,860 | 6,761,781 |
| Net Transfers (+/-) | | | | (9,000) | | (9,000) |
| Spending Authority from Offsetting Collections | | | | | | |
| Earned | **365,014** | **5,222,293** | **5,587,307** | 487,232 | 2,963,617 | 3,450,849 |
| Change in Unfilled Customer Orders | **(15,294)** | **(21,251)** | **(36,545)** | (8,898) | (12,930) | (21,828) |
| Recoveries of Prior Year Obligations | **42,994** | **108,998** | **151,992** | 125,914 | 85,615 | 211,529 |
| Permanently Not Available | **(241,346)** | **(284,147)** | **(525,493)** | (461,404) | (5,567,309) | (6,028,713) |
| **Total Budgetary Resources** | **$ 5,027,177** | **$ 8,998,194** | **$ 14,025,371** | $ 2,828,673 | $ 4,677,049 | $ 7,505,722 |

*(Dollars in Thousands)*

| | 2004 | | | 2003 | | |
|---|---|---|---|---|---|---|
| | **Budgetary** | **Non-Budgetary Financing** | **Total** | **Budgetary** | **Non-Budgetary Financing** | **Total** |
| **STATUS OF BUDGETARY RESOURCES** | | | | | | |
| Obligations Incurred | **$ 4,639,787** | **$ 3,009,311** | **$ 7,649,098** | $ 2,412,968 | $ 2,907,847 | $ 5,320,815 |
| Unobligated Balances, Available | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Apportioned - Currently Available | **185,675** | **2,457,091** | **2,642,766** | 287,327 | 1,236,696 | 1,524,023 |
| Exempt from Apportionment | | | | 365 | | 365 |
| Unobligated Balances, Not Available | **201,715** | **3,531,792** | **3,733,507** | 128,013 | 532,506 | 660,519 |
| **Total Status of Budgetary Resources** | **$ 5,027,177** | **$ 8,998,194** | **$ 14,025,371** | $ 2,828,673 | $ 4,677,049 | $ 7,505,722 |

| **RELATIONSHIP OF OBLIGATIONS TO OUTLAYS** | **Budgetary** | **Non-Budgetary Financing** | **Total** | **Budgetary** | **Non-Budgetary Financing** | **Total** |
|---|---|---|---|---|---|---|
| Obligated Balance, Beginning of Period | **$ 473,939** | **$ 139,831** | **$ 613,770** | $ 523,869 | $ 207,090 | $ 730,959 |
| Obligated Balance, End of Period | | | | | | |
| Accounts Receivable | | | | (3,264) | (34,862) | (38,126) |
| Unfilled Customer Orders from Federal Sources | **(233)** | **(106,732)** | **(106,965)** | (233) | (127,983) | (128,216) |
| Undelivered Orders | **336,242** | **366,232** | **702,474** | 382,886 | 261,053 | 643,939 |
| Accounts Payable | **77,207** | **23,593** | **100,800** | 94,550 | 41,623 | 136,173 |
| Total Obligated Balance, End of Period | **413,216** | **283,093** | **696,309** | 473,939 | 139,831 | 613,770 |
| Outlays | | | | | | |
| Disbursements | **4,660,782** | **2,813,163** | **7,473,945** | 2,350,241 | 2,923,581 | 5,273,822 |
| Collections | **(352,982)** | **(5,257,156)** | **(5,610,138)** | (491,596) | (2,984,774) | (3,476,370) |
| Subtotal | **4,307,800** | **(2,443,993)** | **1,863,807** | 1,858,645 | (61,193) | 1,797,452 |
| Less: Offsetting Receipts | | **230,309** | **230,309** | | 299,819 | 299,819 |
| **Net Outlays** | **$ 4,307,800** | **$ (2,674,302)** | **$ 1,633,498** | $ 1,858,645 | $ (361,012) | $ 1,497,633 |

**Note 17**

The accompanying notes are an integral part of these statements.

**U. S. Small Business Administration**

## Consolidated Statement of Financing

for the periods ended September 30, 2004 and September 30, 2003

| *(Dollars in Thousands)* | **2004** | **Restated 2003** |
|---|---|---|
| ***Resources Used to Finance Activities*** | | |
| **Budgetary Resources Obligated** | | |
| Obligations Incurred | **$ 7,649,098** | $ 5,320,815 |
| Less: Spending Authority from Offsetting Collections and Recoveries | **5,702,754** | 3,640,550 |
| Obligations Net of Offsetting Collections and Recoveries | **1,946,344** | 1,680,265 |
| Less: Offsetting Receipts | **230,309** | 299,819 |
| **Net Obligations** | **$ 1,716,035** | $ 1,380,446 |
| **Other Resources** | | |
| Transfers In (Out) | **(102,741)** | (496,728) |
| Imputed Financing | **17,858** | 19,063 |
| Other Financing Sources | **4,379** | (6,878) |
| **Net Other Resources Used to Finance Activities** | **$ (80,504)** | $ (484,543) |
| **Total Resources Used to Finance Activities** | **$ 1,635,531** | $ 895,903 |
| ***Resources Used to Finance Items not Part of the Net Cost of Operations*** | | |
| Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered But Not Yet Provided | **$ (80,641)** | $ 12,025 |
| Resources that Fund Expenses Recognized in Prior Periods | **667** | |
| Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations | | |
| Credit Program Collections | **5,221,793** | 2,963,617 |
| Offsetting Receipts | **230,309** | 299,819 |
| Resources that Finance the Acquisition of Assets or Liquidation of Liabilities | **(2,751,423)** | (2,691,952) |
| Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations | **1,749** | 1,323 |
| **Total Resources Used to Finance Items Not Part of the Net Cost of Operations** | **$ 2,622,454** | $ 584,832 |
| **Total Resources Used to Finance the Net Cost of Operations** | **$ 4,257,985** | $ 1,480,735 |
| ***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 | **$ (568)** | $ 650 |
| Change in Contingent Liability | **(800)** | |
| Upward/ Downward Reestimates of Credit Subsidy Expense | **(2,527,704)** | 2,418,283 |
| Change in Revenue Receivable from Public | **1,618** | 7,963 |
| Other - Current Year Liquidating Equity Activity (+/-) | **(4,379)** | 6,878 |
| Provision for Losses on Estimated Guarantees | **1,736** | 10,092 |
| Change in Unfunded Employee Benefits | **(3,605)** | 671 |
| **Total Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period** | **$ (2,533,702)** | $ 2,444,537 |
| **Components Not Requiring or Generating Resources** | | |
| Depreciation or Amortization | **3,074** | 3,018 |
| Bad Debt Expense - Noncredit Reform | **20,180** | 20,968 |
| **Total Components of Net Cost that will Not Require or Generate Resources** | **$ 23,254** | $ 23,986 |
| **Total Components of Net Cost of Operations Not Requiring or Generating Resources in the Current Period** | **$ (2,510,448)** | $ 2,468,523 |
| **Net Cost of Operations** | **$ 1,747,537** | $ 3,949,258 |

**Note 18**

The accompanying notes are an integral part of these statements.

See Note 19 for additional information related to restatement of 2003.

# Note 1.  Significant Accounting Policies

## A. Basis of Accounting and Presentation

These consolidated financial statements have been prepared to report the financial position, net cost of operations, changes in net position, budgetary resources and reconciliation between net budgetary expenditures and net costs of the U.S. Small Business Administration (SBA).  These statements are required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994.  They have been prepared from the accounting records of SBA maintained in accordance with generally accepted accounting principles (GAAP) of the United States Government as promulgated by the Federal Accounting Standards Advisory Board (FASAB).

The statements reflect transactions recorded on both a proprietary accrual accounting basis, and a budgetary obligation basis, in accordance with concepts and guidance provided by the Office of Management and Budget (OMB) in Circular A-11, "Preparation, Submission, and Execution of the Budget."  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, and facilitates compliance with legal constraints and controls over the use of Federal funds.

## B. Use of Estimates

The preparation of the financial statements in accordance with GAAP of the United States Government requires Agency management to make assumptions and estimates directly affecting the amounts reported in the financial statements.  Actual results may differ from those estimates.

Estimates for credit program receivables and liabilities contain assumptions of future results that have a significant impact on the financial statements.  These assumptions include loan disbursement, repayment, delinquency, default and recovery rates.  Actual rates in the future may differ significantly from the assumptions made at the time the financial statements were prepared.  Minor adjustments to any of these assumptions may create significant changes to the estimate.

The Agency recognizes the sensitivity of the changes in assumptions and the impact that the projections can have on estimates.  Econometric modeling is used for the 7(a) and 504 Programs to improve the statistical accuracy of the projection of future cash flows.  Near term cash flows for the Small Business Investment Company (SBIC) Program reflect the best available estimates, at this time, of defaults and recoveries.  Disaster loan models utilize individual loan data to optimize the models forecasting.  The assumptions used for current year and prior year statements are based on the best information available at the time the estimates were prepared. In addition, all models and assumptions are updated periodically to reflect changing conditions.

Reestimates included in these financial statements may differ from the reestimates submitted with the President's budget in February, 2005. These may differ because the reestimates in the budget include the President's most recent economic assumptions, which are not available in time for these financial statements. The revised economic assumptions include economic factors such as gross domestic product (GDP) and unemployment rates that are included in the 7(a) and 504 models. The changed factors could affect 7(a) and 504 default and prepayment forecasts. In addition, changes in interest rate forecasts could affect SMG earnings forecast. The revised economic assumptions will also include the interest rate used for the present value discount calculation for cohorts for which an interest rate reestimate is being completed this year. Although these factors could result in different subsidy costs, the direction and magnitude of these changes are not known at this time. Finally, the estimates for the financial statements were based on annualized cash flows through September 30, 2004. Reestimates for the budget will include actual cash flows for FY 2004.

## C. Reporting Entity

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 7 (a) Business Loan, 504 Development Company and SBIC Programs are SBA's major credit programs to assist small business. SBA's non-credit programs providing small business assistance include Surety Bond Guarantees (SBG), Business Development for minority firms, Government Contracting assistance and Entrepreneurial Development assistance to counsel and train small business entrepreneurs. In addition, SBA's Advocacy Program promotes the interests of small business in government legislative and regulatory forums. SBA's Disaster Loan Program provides assistance to victims of physical and economic disasters such as earthquakes, floods and hurricanes by extending direct loans to individuals and businesses.

SBA operates through the execution of a congressionally approved budget that funds its programs. SBA's budget consists of annual, multi-year and no-year appropriations which fund salaries and expenses and the various program activities.

Under the aegis of the Federal Credit Reform Act of 1990 (FCRA), as amended, SBA utilizes program and financing accounts to record events for its business direct and guaranteed loans and disaster loans, and utilizes Liquidating Accounts for its Pollution Control Equipment Guarantees and pre-FY 1992 business and disaster loans. A revolving fund is used to record SBG accounting events and administrative funds are used to account for salaries and expenses of the Agency and its Inspector General.

Finally a trust fund, funded by donations made by non-Federal entities, is used to record accounting events for business assistance.

## D. Budgets and Budgetary Accounting for Loan Programs

SBA's loan disbursements are financed by a combination of two sources - one for the long term cost of the loan (subsidy cost) 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 loan programs. 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 permanent indefinite authority to borrow funds from the U.S. Department of Treasury (Treasury). Congress also limits the dollar amount of obligations that can be made for direct loans and loan guarantees in its annual appropriation bill.

A permanent indefinite appropriation is available to finance any increase in the estimated subsidy costs (reestimates) that occurs after the year in which a loan is disbursed. Reductions in the estimated long term subsidy cost arising from reestimates are returned to Treasury and are unavailable to the Agency. Modification of direct loans or loan guarantees requires budget authority be appropriated for the additional cost if not available from existing appropriations or other budgetary resources.

## E. Fund Balances with Treasury and Cash

Fund Balances with Treasury and cash consist of appropriated, financing, liquidating, revolving and trust funds. These funds are available to make expenditures and pay liabilities. Fund balances also include expired year amounts which are unavailable for obligation. Cash receipts and disbursements are processed by Treasury (See Notes 2 & 3).

## F. Accounts Receivable

Accounts Receivable - Intragovernmental are reimbursements due from other Federal agencies and funds. In addition, SBA records interfund receivables and payables between its program and financing funds for its subsidy reestimates that are eliminated in its consolidated statements.

Accounts Receivable that are not intragovernmental primarily represent amounts due from participating financial institutions for guarantee fees. 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).

SBA has determined uncollectible or unrecoverable accounts receivable are not significant and does not provide an allowance. The historic immateriality of losses is due to stringent collection policies and the ability to offset against the lender's share of collections, payments to employees and payments to vendors.

## G. Credit Program Receivables and Related Foreclosed Property

Reporting requirements for direct loan obligations made after FY 1991 are governed by the FCRA. The FCRA requires the subsidy costs be reported on a present value basis. The subsidy cost is the present value of the estimated cash outflows over the life of the loans minus the present value of the estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term. The FCRA also requires the present value of subsidy cost be recognized as a cost in the year that the loan is disbursed. Direct loans are reported net of an allowance for subsidy at the present value.

Loans obligated prior to the FCRA are recorded at book value with an allowance for uncollectible amounts.

SBA also guarantees loans made by participating lenders in its Business Loan, 504 Development Company and Small Business Investment Company programs. Upon default, these guaranteed loans are purchased by SBA and treated as loan receivables. The reporting requirements for these loan receivables are also governed by the FCRA and they are reported net of an allowance for subsidy determined in a similar manner as SBA’s direct loans (See Note 6).

SBA advances payments semiannually to the Federal Financing Bank (FFB) for loans guaranteed under Section 503 of the Small Business Act. The advances are liquidated by receipt of the installment payments on loans made by state and local development companies. To the extent that those installments may not repay advances, balances from development companies that remain collectible are reported as credit programs.

Advances are similarly made to honor SBA’s timely payment requirement of principal and interest due for debentures in SBA’s Section 504 and SBIC Programs. These advances are reported as credit program receivables.

Foreclosed property acquired as a result of defaulted loans or guarantees is valued at the net realizable value. The net realizable value is reevaluated annually by SBA field managers. For loans made after FY 1991 under FCRA, the estimated losses on the sale of collateral are included in the forecasted cash flow used to determine the credit subsidy allowance.

## H. Equipment and Internal Use Software

Computer-related equipment and other equipment (non computer-related) are capitalized at full cost, if the initial unit acquisition cost is $50,000 or more and service life is at least two years; otherwise, it is expensed when purchased. Computer-related equipment is depreciated using the straight-line method over three years. Other equipment is depreciated using the straight-line method over five years.

Software for internal use, whether it is internally developed, contractor developed, or commercial off-the-shelf (COTS), is capitalized at cost provided that the initial unit acquisition cost is $250,000 or more and the service life is at least two years. The costs subject to capitalization are all the direct and indirect costs incurred (whether SBA or contractor developed or COTS purchased), including overhead. Software development begins after the planning phase of the system project when management has decided to go ahead with software implementation. Data conversion costs during implementation and post implementation costs for operation and maintenance of the system are not included in software development costs to be capitalized. Software for internal use is depreciated using the straight-line method over its useful life, not to exceed five years. The depreciation of capitalized costs begins when the system is put into operation. The costs of enhancements are capitalized when it is more likely than not that the enhancements will result in significant additional capabilities. Costs that do not meet the capitalization criteria are expensed when incurred (See Note 7).

## I. Accounts Payable

Accounts Payable – Intragovernmental are payables due to other Federal agencies and funds that will be liquidated during the next operating cycle. SBA records interfund receivables and payables between program and financing funds for its subsidy reestimates. Additionally, SBA recognizes as accounts payable unpaid amounts to Federal vendors for goods and services provided as of the balance sheet date.

Accounts Payable – Public are payables due to non-Federal entities that will be liquidated during the next operating cycle. Included in this liability are payables to banks and vendors (See Note 10).

## J. Debt

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

Borrowings payable to FFB are the result of its financing of SBA Section 503 Debentures issued prior to 1988. SBA, as the servicing agent, collects on the underlying loan receivables and repays its debt to FFB (See Note 11).

## K. Net Assets of Liquidating Fund Due to Treasury

Net Assets of Liquidating Funds Due to Treasury is the residual of the book value of assets less liabilities of the Liquidating Funds.  SBA returns to Treasury each year the portion of this balance that has been converted to cash (See Note 12).

## L. Liability for Loan Guarantees

There are two components to the Agency's liability for guaranteed loans: liabilities for losses on pre-FY 1992 loans; and liabilities on post-FY1991 loans made under the FCRA legislation.  For pre-FY 1992 loans, the amount is an estimate of losses on guarantees outstanding based on historical experience.  For post-FY1991 loans, the liability is based on the present value of future cash flows related to the guarantees in force as of year end (See Note 6-L).

## M. Contingencies

SBA is a party in various administrative proceedings, legal actions, environmental suits and claims brought against the Agency.  In the opinion of 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 SBA operations.  The likelihood of loss to SBA ranges from remote to a reasonably possible amount of $4.2 million.  These activities will be monitored and recognized if a loss becomes probable.

## N. Leave

A liability for employee annual leave is accrued as it is earned and reduced as leave is taken.  Each year the balance of accrued annual leave is adjusted to reflect current pay rates as well as forfeited "use or lose" leave.  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.

## O. Employee Health and Life Insurance Benefits

SBA employees are eligible to participate in the contributory Federal Employees Health Benefit (FEHB) and the Federal Employees Group Life Insurance (FEGLI) programs. SBA matches a portion of the employee contributions to each program.  SBA's matching contributions are recognized as current operating expenses.

## P. Employee Pension Benefits

SBA employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). Most employees hired after December 31, 1983 are covered by FERS. These systems provide benefits upon retirement and in the event of death, disability, or other termination of employment, and may also provide pre-retirement benefits. They may also include benefits to survivors and dependents, and they may contain early retirement or other special features. The CSRS and FERS retirement funds are administered by the Office of Personnel Management (OPM).

For CSRS, SBA contributes 7.0% of the employee's gross earnings in addition to the 7.0% withheld from the employee. For FERS, SBA withholds .8% of gross earnings and matches the withholding with a 10.7% employer contribution. SBA contributions to CSRS and FERS are recognized as current operating expenses. FERS participants are also covered under the Federal Insurance Contribution Act (FICA) and are subject to FICA withholdings. SBA makes matching contributions for FICA, which are recognized as current operating expenses.

Federal employee benefits also include the Thrift Savings Plan (TSP) where CSRS participants may contribute up to 9.0% of their gross pay to the TSP without any Agency matching contribution. FERS participants may contribute up to 14% of their gross pay to the TSP. For FERS participants, SBA contributes 1.0% of basic pay and matches any employee contributions dollar for dollar for the first 3.0% of pay, and 50 cents on the dollar for the next 2.0% of pay. The maximum limit that either FERS or CSRS employees may contribute to the TSP is $13,000 annually. SBA contributions to the TSP are recognized as current operating expenses.

SBA recognizes the full cost of providing future CSRS and FERS pension benefits at the time the employees' services are rendered. The cost of pension benefits represents the actuarial present value of future benefits attributed to services rendered by covered employees during the accounting period, net of the amounts contributed by these employees. In addition, OPM finances the excess of total pension expense over the amount contributed by the Agency and its employees. SBA recognizes the amount financed by OPM as current year operating expenses and an imputed financing source. SBA does not report in its financial statements FERS or CSRS assets, accumulated plan benefits or unfunded liabilities, if any, applicable to its employees.

## Q. 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 is financed by OPM; SBA recognizes the amount financed by OPM as current year operating expense and an imputed financing source.

## R. Revenues and Other Financing Sources

SBA's revenues and other financing sources include appropriations used, earned revenue, donations, imputed financing sources and non-expenditure transfers.

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 and program expenditures. Appropriations are considered used when goods or services financed by an appropriation are provided, regardless of when paid. Appropriations received and used are reported in the Consolidated Statement of Changes in Net Position.

Earned revenue results from exchange transactions that benefit both parties. SBA has earned revenues such as 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 costs.

Donations are treated as non-exchange revenue and reported in the Consolidated Statement of Changes in Net Position.

Imputed financing sources are operating costs of SBA which are paid through funds appropriated to other Federal entities. These include items such as additional charges by OPM for 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 assets without reimbursement include 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.

## S. Accounting Changes

SBA accrues interest receivable (and recognizes revenue) as of the report date for loans not delinquent and loans delinquent less than 91 days. Prior to FY 2004, for Credit Reform loans, SBA would record a deferral of accrued interest for loans delinquent 1 to 90 days in a deferred interest account, with a corresponding decrease in interest revenue. This treatment was based on Federal accounting guidance provided years ago in a "case study." Per SBA's review of the most recent case studies, there was not any justification to continue this treatment. In FY 2004 SBA stopped deferring interest delinquent 1 to 90 days for Credit Reform loans and the prior year statements were restated.

SBA reports its costs consistent with the Agency's goals. The strategic goals this year were restructured from the strategic goals in the prior year. In FY 2004 Procurement Assistance programs have been included in the economic environment goal and another goal was added (Goal 4).  As a result, the Statement of Net Cost for the current year is not comparable to the prior year and the prior year costs are presented in summary without the subtotals for the prior year strategic goals.

## Note 2. Fund Balance with Treasury

(Dollars in Thousands)

Fund Balances with Treasury at the end of FY 2004 and 2003 consisted of the following:

| | FY 2004 | FY 2003 |
|---|---|---|
| **Entity Fund Balances** | | |
| Trust Fund | $488 | $440 |
| Liquidating Funds | 174,936 | 245,606 |
| Financing Funds | 6,271,977 | 1,909,033 |
| Revolving Funds | 22,948 | 22,978 |
| Appropriated Funds | 602,233 | 620,620 |
| **Total Fund Balance** | **$7,072,582** | **$2,798,677** |
| **Status of Fund Balances with Treasury** | | |
| Unobligated Balance | | |
| Available | $2,642,766 | $1,524,388 |
| Unavailable | 3,733,507 | 660,519 |
| Obligated Balance Not Yet Disbursed | 696,309 | 613,770 |
| **Total Fund Balance** | **$7,072,582** | **$2,798,677** |

Fund Balance with Treasury is an entity asset maintained with Treasury. The monies are available to pay current liabilities and finance loan programs. SBA has the authority to disburse funds through Treasury, which processes cash receipts and disbursements on the Agency's behalf.

Available unobligated balances represent amounts that are apportioned for obligation in the current fiscal year. Unavailable unobligated balances represent amounts not apportioned for obligation during the current fiscal year and expired appropriations no longer available for new obligations. Obligated balances not yet disbursed include reimbursements, other income earned, undelivered orders and expended authority-unpaid.

An immaterial difference exists between SBA's recorded Fund Balances with Treasury and Treasury's records. Normally it is the Agency's practice to adjust its records to agree with Treasury's balances at the end of the fiscal year. The adjustments are reversed at the beginning of the following fiscal year.

## Note 3. Cash

(Dollars in Thousands)

Cash at the end of FY 2004 and 2003 consisted of the following:

**Cash**

| | FY 2004 Entity Assets | FY 2003 Entity Assets |
|---|---|---|
| Cash in Transit | $3,328 | $5,331 |
| Undeposited Collections | 19,182 | |
| **Total** | **$22,510** | **$5,331** |

Undeposited collections are amounts under the control of the SBA at field offices. Cash in Transit are collections held by SBA's fiscal agents, such as lockboxes or Colson Services, at the reporting date.

## Note 4.  Master Reserve Fund

The Small Business Secondary Market Improvement Act of 1984, P.L. 98-352 (Improvement Act) provided statutory authority for the 7(a) secondary market, the pooling of 7(a) loans, 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 on secondary market results to Congress.  The 7(a) secondary market has approximately $14 billion of outstanding investments held by 7(a) secondary holders in FY 2004 compared to $13 billion in FY 2003.

It was the intent of Congress in the Improvement Act that the 7(a) secondary market pooling program operate at no cost to the Federal taxpayer.  The Master Reserve Fund (MRF), maintained by SBA's fiscal agent as part of its administration of the 7(a) secondary market program, was created to fulfill this intent.  In order for the 7(a) secondary market pooling program to have no cost to the Federal taxpayer, the collections from the underlying loans and the earnings of the MRF must be adequate to fund SBA's guarantee of timely payment of principal and interest to the 7(a) secondary market investors throughout the portfolio liquidation period and to pay expenses of the MRF trustee and investment advisor.  If the MRF is not sufficient, SBA is liable to secondary market investors.  With this in mind, in November 2002, SBA agreed with the OMB to include the MRF under the requirements of the FCRA of 1990, beginning with the FY 2005 budget.  Since then, the program has been referred to as the Secondary Market Guarantee Program (SMG Program).  SBA also agreed to reestimate the cost of the SMG Program annually beginning in FY 2003 (for the FY 2005 budget).  SBA will account for the SMG Program within its Business Loan Program and Business Guarantee Financing Accounts, and will begin cohort accounting in FY 2005.

The secondary market program provides for the pooling of loans having terms that vary within a range prescribed by SBA and the sale of the pools to secondary market investors.  The pool's investments have fixed terms, equivalent to the term of the longest loan in the pool.  Various factors influence SMG adequacy, including the interest rate paid to investors, the "spread" of maturities in the loan pools, the occurrence of loan prepayments and delinquencies, the amount of interest earned on the float on monthly loan payments and prepayments, the holdback of the principal portion of the first loan payment, the pattern of liquidation of investments in 7(a) secondary market pools, and the earnings rate on MRF short and long term investments.  Approximately 30 percent of the MRF is invested in short-term (6 month) Treasury securities and repurchase agreements and 70 percent in long-term Treasury securities and Treasury-guaranteed money market funds.

During FY 2004 and FY 2003, SBA conducted a thorough analysis of the SMG adequacy.  This analysis concluded the SMG will not be sufficient after 2017 to liquidate the secondary market portfolio that existed at FY 2004 and FY 2003 yearend.  Based on this analysis, a subsidy of $189 million was needed to fully liquidate the portfolio as of

September 30, 2003. The analysis showed $123 million was attributed to FY 2002 and prior years and $66 million was attributed to FY 2003 as restated. As of FY 2004 yearend, SBA estimates that a reduction in SMG subsidy of $4 million is appropriate to properly value the SMG liability. SBA recognized these amounts as FY 2004 and FY 2003 subsidy expense on its Consolidated Statement of Net Costs and established a liability for Secondary Market Guarantee on its FY 2004 and FY 2003 Consolidated Balance Sheet. In addition the SBA recognized $4.6 million of interest on the FY 2003 reestimate as subsidy expense in FY 2004.

SBA expects to make changes to the 7(a) SMG Program which will provide additional SMG income resulting in a zero subsidy rate. These include the pass-through of partial prepayments and the principal portion of the first payment on new loans. These changes will be effective with FY 2005 processing of new 7(a) pools for sale in the secondary market. This will satisfy the Congressional intent that the program should not impose any additional cost to the Federal taxpayers or liability on the government.

The composition of the MRF for FY 2004 and FY 2003 is shown in the following table. A reconciliation of the change in MRF assets during FY 2004 and FY 2003 is also shown.

**Master Reserve Fund Assets**
(Dollars in Thousands)

| | FY 2004 | FY 2003 |
|---|---|---|
| **Short Term Securities** | | |
| Treasury Bills | $155,312 | $155,616 |
| Repurchase Agreements | 287,511 | 231,000 |
| **Total Short Term Securities** | **$442,823** | **$386,616** |
| | | |
| **Long Term Securities** | | |
| Money Market Funds | $ 27,577 | $26,848 |
| Treasury Bonds | 184,961 | 123,719 |
| Treasury Notes | 757,109 | 709,935 |
| Net Interest | 13,219 | 12,672 |
| **Total Long Term Securities** | **$ 982,866** | **$873,174** |
| | | |
| **Net Assets** | **$1,425,689** | **$1,259,790** |

**Reconciliation of MRF Assets FY 2004**
(Dollars in Thousands)

| | FY 2004 | FY 2003 |
|---|---|---|
| **Beginning Net Assets** | **$1,259,790** | **$1,213,383** |
| **Receipts** | | |
| Regular Loan Payments | 1,296,744 | 1,219,237 |
| Loan Prepayments | 1,275,835 | 961,202 |
| Payments Received to Cover Defaults | 535,900 | 564,800 |
| Other Receipts | | (9,850) |
| Earned Income | 55,064 | 55,246 |
| Net Realized Gain (Loss) | 309 | (1,028) |
| **Total Receipts** | **$3,163,852** | **$2,789,607** |
| | | |
| **Disbursements** | | |
| Regular Payments to Investors | $1,184,360 | $1,215,445 |
| Loan Prepayments | 1,275,835 | 961,202 |
| Defaults | 535,900 | 564,800 |
| Expenses | 1,858 | 1,753 |
| **Total Disbursements** | **$2,997,953** | **$2,743,200** |
| | | |
| **Ending Net Assets** | **$1,425,689** | **$1,259,790** |

## Note 5. Accounts Receivable

(Dollars in Thousands)

Accounts receivable are displayed by type and consisted of the following at the end of FY 2004 and 2003:

| | FY 2004 | | Restated FY 2003 | |
|---|---|---|---|---|
| | **Intra-governmental** | **Public** | **Intra-governmental** | **Public** |
| Subsidy Receivable from Program Fund | $2,114,474 | $ | $4,642,178 | $ |
| Interest Receivable from Treasury | | | 12,643 | |
| Other Interfund Receivables | | | 25,880 | |
| Overpayment to Secondary | | 1,747 | | 401 |
| Guarantee Fees Receivable | | 31,080 | | 26,702 |
| Examination Fees – SBIC | | 76 | | 76 |
| Administrative Receivables | | 79 | | 81 |
| Refunds | | 3,621 | | 4,288 |
| Revenue Receivable | | 1,038 | | 1,587 |
| Receivables Due from Lenders | | 1,786 | | 2,288 |
| Receivable Due from Purchasers Asset Sales | | 30 | | 49 |
| Reimbursable | | | 1,687 | |
| **Sub Total Before Eliminations** | **$2,114,474** | **$39,457** | **$4,682,388** | **$35,472** |
| Eliminations –Subsidy Receivable | (2,114,474) | | (4,642,178) | |
| Eliminations – Interfund Receivable | | | (27,560) | |
| **Balance Sheet Total** | **$** | **$39,457** | **$12,650** | **$35,472** |

Other interfund receivables result from adjustments to cash balances for individual year's appropriations in the Agency's credit programs. SBA's credit program appropriations are received on an annual, multiyear and no-year basis, but the Agency's loan accounting system does not separately account for the use of these appropriation types as new loans and guarantees are processed. Adjustments to general ledger cash balances are therefore made as part of the monthly accounting cycle in order to properly record the use of annual, multi year and no-year appropriations. These amounts are eliminated in the consolidated statements as the adjustments effect interagency fund activity and balances.

SBA has determined uncollectible or unrecoverable accounts receivable are not significant and does not provide an allowance. The historic immateriality of losses is due to stringent collection policies and the ability to offset against the lender's share of collections, payments to employees or vendors.

# Note 6. Credit Program Receivables and Related Foreclosed Property

## A. Loan Program Descriptions

The SBA operates the following loan and loan guarantee program funds:

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

SBA administers several loan guarantee and direct lending programs providing small businesses with financial assistance not otherwise available in the financial markets. Under its business loan guarantee programs, SBA guarantees loans made by banks and other lending institutions to small businesses. These loan guarantee programs include the 7(a) General Business Loan Guarantee Program, the Section 504 Certified Development Company Debentures Loan Guarantee Program, the Small Business Investment Company Debentures and Participating Securities programs and the Microloan Guarantee Program. The original Pollution Control Loan Guarantee Program ceased guaranteeing new loans in 1988; since 1989, those loans have been guaranteed under the 7(a) Program.

SBA's primary direct loan program is the Disaster Program, which makes direct loans to disaster victims under five categories: (1) loans for homes and personal property, (2) physical disaster loans to businesses of any size, (3) pre-mitigation disaster loans to businesses, (4) economic injury loans to small businesses without credit available elsewhere, and (5) economic injury loans to eligible businesses affected by essential employees called up to active duty in the military reserves. The maximum interest rate is 4 percent for applicants without credit available elsewhere and 8 percent for applicants with credit available elsewhere. The Microloan Program provides direct loans to nonprofit intermediaries, who use these funds to make loans up to $35,000 to eligible small businesses.

The FCRA requires all agencies budget for the credit subsidy cost of credit programs by estimating net present value of cash flows discounted at the government's cost of borrowing. OMB Circular A-11 provides direction on the preparation of credit program cost estimates. Loans originated during the same fiscal year are assigned to a "cohort", the credit subsidy cost of which is funded by appropriations for that year.

Using special data collection techniques and analyses, SBA analyzes loan, accounting and other data to estimate the cash flows used in the calculation of the subsidy cost for each program. SBA has created estimation models that incorporate actual and estimated data on loan maturity, fees, grace periods, interest rate differentials, delinquencies, default or purchase rates, recoveries, prepayments, borrower characteristics and macroeconomic variables.

The credit subsidy rate is the credit subsidy cost expressed as a percent of the dollar amount of loans expected to be disbursed or loan guarantees committed for that cohort year. It consists of the sum of the components for the interest subsidy costs, default costs (net of recoveries), fees and other offsetting collections and other costs. The credit subsidy rate may be affected by actual and expected economic conditions, new legislation, changes in credit origination and servicing practices, and particular estimation methodologies and assumptions because it reflects anticipated loan performance for each cohort in each program.

Direct loan obligations or loan guarantee commitments made after FY 1991 are governed by FCRA and reported as credit reform loans. FCRA provides the credit subsidy cost, equal to the credit subsidy rate multiplied by the loan disbursements, be recognized and reported as an expense in the year in which the direct loans or loan guarantees are disbursed. Subsidy costs are reestimated annually after disbursement. Reestimates that increase subsidy expenses result in SBA receiving additional funds from the Treasury; reestimates that decrease subsidy expenses result in SBA transferring funds to the Treasury. For scheduling purposes, SBA may prepare these reestimates using information available as of March 31, annualized to September 30.

Direct loan obligations and guarantee loan commitments made prior to FY 1992 are reported as liquidating loans (i.e., pre-credit reform loans). The related credit program receivables for direct and defaulted guaranteed loans are reported net of an allowance for loan losses, which reflect estimates of what the Agency does not expect to collect or recover. These allowances are unfunded. They are based upon historical experience, current market conditions and, in some circumstances, an analysis of individual assets. SBA establishes a 100% allowance for liquidating loans past due more than 180 days.

Interest receivable is comprised of accrued interest on accounts and loans receivable, and purchased interest related to defaulted guaranteed loans. Interest income is accrued at the contractual rate on the outstanding principal amount and is reduced by the amount of interest income accrued to non-performing loans (those in excess of 90 days delinquent). Purchased interest is carried at cost; however, a 100% loss allowance is established for all purchased interest on non-performing liquidating loans.

Foreclosed property is comprised of real and business-related property acquired through foreclosure on loans and defaulted loan guarantees. Property held in inventory is appraised every year and reported at the appraised value.

Information pertaining to loans receivable, loan guarantees, liability for loan guarantees, credit subsidy costs, and administrative costs associated with the loans and loan guarantees is provided for liquidating and credit reform loans in the following sections.

## B. Direct Loans Obligated Prior to FY 1992

(Dollars in Thousands)

Direct Liquidating Loans Receivables net are as follows:

| FY 2004 | | | |
|---|---|---|---|
| **Liquidating Loan Program** | **Business** | **Disaster** | **Total** |
| Loans Receivable, Gross | $32,149 | $42,674 | **$74,823** |
| Interest Receivable | 12,951 | 339 | **13,290** |
| Allowance for Loan Losses | (15,385) | (5,082) | **(20,467)** |
| Foreclosed Property | 5,392 | | **5,392** |
| **Value of Assets Related to Direct Loans** | **$35,107** | **$37,931** | **$73,038** |

## C. Direct Loans Obligated After FY 1991

(Dollars in Thousands)

Direct Credit Reform Loans Receivables net are as follows:

| FY 2004 | | | |
|---|---|---|---|
| **Credit Reform Program** | **Business** | **Disaster** | **Total** |
| Loans Receivable, Gross | $133,299 | $3,037,809 | **$3,171,108** |
| Interest Receivable | 1,532 | 18,241 | **19,773** |
| Foreclosed Property | | 863 | **863** |
| Allowance for Subsidy Cost (Present Value) | (42,959) | (613,278) | **(656,237)** |
| **Net Present Value of Assets Related to Direct Loans** | **$91,872** | **$2,443,635** | **$2,535,507** |

## D. Total Amount of Direct Loans Disbursed Post-1991

(Dollars in Thousands)

Total Direct Credit Reform Loans disbursed by program in the current year and the prior year are as follows:

| | FY 2004 | FY 2003 |
|---|---|---|
| **Credit Reform Programs** | | |
| (1) Business | $20,595 | $23,123 |
| (2) Disaster | 465,152 | 686,149 |
| **Total** | **$485,747** | **$709,272** |

Disaster program disbursements are extremely irregular due to the variability of disaster activity.

## E. Subsidy Expense for Direct Loans by Program and Component (Credit Reform Loans)

(Dollars in Thousands)

Total credit subsidy expense consists of the credit subsidy expense of direct loans disbursed during the year plus the reestimate of the credit subsidy cost. The following tables show total direct loan subsidy expense by program and component for direct loans disbursed in FY 2004 and FY 2003 and for reestimates of loans disbursed in prior years.

| Direct Loan Program | Subsidy Expense for New Direct Loans Disbursed in FY 2004 | | | | | Reestimates FY 2004 | Total Direct Loan Subsidy Expense FY 2004 |
|---|---|---|---|---|---|---|---|
| | **Interest** | **Defaults** | **Fees** | **Other** | **Total Subsidy Expense** | **Technical Reestimate** | |
| (1)Business | $ 2,233 | $ 55 | $ | $ | $ 2,288 | $ 27,935 | $ 30,223 |
| (2)Disaster | 19,457 | 39,169 | (283) | (504) | 57,839 | 55,474 | 113,313 |
| **Total** | $21,690 | **$ 39,224** | **$ (283)** | **$ (504)** | **$ 60,127** | **$83,409** | **$ 143,536** |

| Direct Loan Program | Subsidy Expense for New Direct Loans Disbursed in FY 2003 | | | | | Restated Reestimates FY 2003 | Total Direct Loan Subsidy Expense FY 2003 |
|---|---|---|---|---|---|---|---|
| | **Interest** | **Defaults** | **Fees** | **Other** | **Total Subsidy Expense** | **Technical Reestimate** | |
| (1)Business | $ 2,281 | $ 74 | $ | $ | $ 2,355 | $ 1,393 | $ 3,748 |
| (2)Disaster | 47,955 | 60,693 | (6,711) | 5,640 | 107,577 | 363,283 | 470,860 |
| **Total** | **$50,236** | **$60,767** | **$(6,711)** | **$ 5,640** | **$ 109,932** | **$ 364,676** | **$ 474,608** |

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

The Disaster loan program comprised the lion's share of SBA's direct loans approved and disbursed in FY 2004. The cost of the Disaster direct loan program is affected by the original terms of the loan, such as below-market interest rates, grace periods and average loan size, as well as deviations from the original terms caused by estimated prepayments, defaults, delinquencies, charge-offs, and recoveries. The Disaster loan default rate is 8.56% of dollars disbursed and recoveries are expected to be 39.0% of the default dollars.

**FY 2004**

| Loan Program | Interest Differential | Defaults | Fees | Other | Total |
|---|---|---|---|---|---|
| (1) Business | 9.34% | 0.21% | 0.00% | 0.00% | **9.55%** |
| (2) Disaster | 3.29% | 8.56% | 0.00% | (0.13%) | **11.72%** |

## G. Schedule for Reconciling Subsidy Cost Allowance Balances

(Dollars in Thousands)

The following reconciles the subsidy cost allowance for direct loans and loan guarantees.

| | (Post-1991 Direct Business) | | (Post-1991 Direct Disaster) | |
|---|---|---|---|---|
| | FY 2004 | Restated FY 2003 | FY 2004 | Restated FY 2003 |
| Beginning Balance of the Subsidy Cost Allowance | $14,504 | $12,493 | $630,907 | $446,318 |
| Add: Current Year Subsidy Expense by Component | | | | |
| Interest Rate Differential Cost | 2,233 | 2,281 | 19,457 | 47,955 |
| Default Costs (Net of Recoveries) | 55 | 74 | 39,169 | 60,693 |
| Fees and Other Collections | | | (283) | (6,711) |
| Other Subsidy Costs | | | (504) | 5,640 |
| **Total of the Above Subsidy Expense Components** | 2,288 | 2,355 | 57,839 | 107,577 |
| Adjustments: | | | | |
| Loans Written Off | (106) | (331) | (53,441) | (143,195) |
| Subsidy Allowance Amortization | (1,663) | (3,662) | (77,500) | (152,180) |
| Other Adjustments: | | | | |
| Deferred Interest Adjustment | | 1,181 | | 5,837 |
| Restatement Subsidy Prior Period Adjustment | | 1,075 | | 3,267 |
| **Balance of the Subsidy Cost Allowance Before Reestimates** | 15,023 | 13,111 | 557,805 | 267,624 |
| Add or Subtract Subsidy Reestimates by Component: | | | | |
| (a) Interest Rate Reestimate | | | | |
| (b) Technical/default Reestimate | 27,935 | 1,393 | 55,474 | 363,283 |
| Total of the Above Reestimate Components | 27,935 | 1,393 | 55,474 | 363,283 |
| **Ending Balance of the Subsidy Cost Allowance** | **$42,958** | **$14,504** | **$613,279** | **$630,907** |

| | (Post – 1991 Guarantee Business) | |
|---|---|---|
| | **FY 2004** | **Restated FY 2003** |
| Beginning Balance of the Subsidy Cost Allowance | $1,791,958 | $526,444 |
| Adjustment Related to the Purchase of Guaranteed Loans | 1,054,774 | 1,265,514 |
| **Ending Balance of the Subsidy Cost Allowance Before Reestimates** | **$2,846,732** | **$1,791,958** |

## H. Defaulted Guaranteed Loans from Pre-1992 Guarantees

(Dollars in Thousands)

The Liquidating Loan Guarantee Receivables net consist of the following:

**FY 2004**

| **Liquidating Loan Guarantee Programs:** | **Business** | **Pollution** | **Total** |
|---|---|---|---|
| Defaulted Guaranteed Loans Receivable Gross | $199,753 | $48,232 | **$247,985** |
| Interest Receivable | (2,366) | 459 | **(1,907)** |
| Allowance for Loan Losses | (61,268) | (32,598) | **(93,866)** |
| Foreclosed Property | 825 | | **825** |
| **Defaulted Guaranteed Loans Receivable, Net** | **$136,944** | **$16,093** | **$153,037** |

## I. Defaulted Guaranteed Loans from Post-1991 Guarantees

(Dollars in Thousands)

The Credit Reform Loan Guarantee Receivables net consist of the following:

**FY 2004**

| **Credit Reform Loan Guarantee Program** | **Business** |
|---|---|
| Defaulted Guaranteed Loans Receivable, Gross | $2,925,127 |
| Advances | 554,977 |
| Interest Receivable | 11,996 |
| Foreclosed Property | 6,294 |
| Allowance for Subsidy Cost (Present Value) | (2,846,732) |
| **Net Present Value of Assets Related to Defaulted Guaranteed Loans Receivable** | **$651,662** |

## J. Credit Program Receivables and Related Foreclosed Property

(Dollars in Thousands)

The following is a Summary of Notes 6B, 6C, 6H and 6I for the current FY:

| | FY 2004 |
|---|---|
| Direct Loans Obligated Prior to FY 1992 | $73,038 |
| Direct Loans Obligated After FY 1991 | 2,535,507 |
| Defaulted Guaranteed Loans from Pre-1992 Guarantees | 153,037 |
| Defaulted Guaranteed Loans from Post 1991 Guarantees | 651,662 |
| **Credit Program Receivables and Related Foreclosed Property** | **$3,413,244** |

The FY 2004 foreclosed property referred to in Parts B, C, H, and I is comprised of $13 million of real estate on 48 loans and $418 thousand of other property on 10 loans. The average number of days the foreclosed property was held by the SBA was 723 days. For FY 2003 there was $19.9 million of real estate outstanding on 65 loans and $1.2 million of other property outstanding on 18 loans.

## K. Guaranteed Loans

(Dollars in Thousands)

The SBA maintains records of the amount of guaranteed loans outstanding as of the reporting date. The amount of SBA's 7(a) guaranteed loans outstanding, however, is obtained from reports submitted by participating lenders as of the end of the prior month (August 2004). The amount of 7(a) guarantees reported is $49.6 billion of the total guarantees of $67.5 billion at September 30, 2004. Guaranteed loans outstanding and the share guaranteed by SBA follow:

### Guaranteed Loans Outstanding

| | FY 2004 | | |
|---|---|---|---|
| **Loan Programs** | **Business** | **Pollution** | **Total** |
| Outstanding Principal, Guaranteed Loans Receivable, Face Value | $67,493,467 | 5,803 | $67,499,270 |
| Amount of Outstanding Principal Guaranteed by SBA | $56,441,604 | 5,803 | $56,447,407 |

| | Restated FY 2003 | | |
|---|---|---|---|
| **Loan Programs** | **Business** | **Pollution** | **Total** |
| Outstanding Principal, Guaranteed Loans Receivable, Face Value | $63,641,745 | 9,874 | $63,651,619 |
| Amount of Outstanding Principal Guaranteed by SBA | $53,376,310 | 9,874 | $53,386,184 |

Guaranteed loans disbursed and the share guaranteed by SBA follows:

### New Guarantee Loans Disbursed

| | FY 2004 | FY 2003 |
|---|---|---|
| | **Business** | **Business** |
| Outstanding Disbursed Principal, Guaranteed Loans Receivable, Face Value | $15,267,177 | $13,182,813 |
| Amount of Outstanding Disbursed Principal Guaranteed by SBA | $12,128,578 | $10,493,400 |

## L. Liability for Loan Guarantees:

(Dollars in Thousands)

The liability for post-1991 loan guarantees represents the present value of future estimated cash outflows from SBA, net of inflows, such as fees.

The liability for pre-1992 loan guarantees represents the estimated loss for loans that are projected to default.

| | Business Loan Programs | |
|---|---|---|
| | **FY 2004** | **Restated FY 2003** |
| Liabilities for Loan Guarantees for Pre-1992 Guarantees | $6,324 | $5,465 |
| Liabilities for Loan Guarantees for Post-1991 Guarantees (Present Value) | $2,517,728 | $2,536,065 |
| **Total Liabilities for Loan Guarantees** | **$2,524,052** | **$2,541,530** |

## M. Subsidy Expense for Post-1991 Loan Guarantees by Program and Component

(Dollars in Thousands)

Total credit subsidy expense consists of the credit subsidy expense of guaranteed loans disbursed during the year plus the reestimate of the credit subsidy cost of guaranteed loans committed and disbursed in prior years. The following tables show total loan guarantee subsidy expense by program and component for guarantee loans disbursed in FY 2004 and FY 2003 and for reestimates of guaranteed loans committed in prior years.

| Loan Guarantee Program | Subsidy Expense for New Loan Guarantees Disbursed in FY 2004 | | | | Reestimates FY 2004 | Total Loan Guarantee Subsidy Expense FY 2004 |
|---|---|---|---|---|---|---|
| | Defaults | Fees | Other | Total Subsidy Expense | Technical Reestimate | |
| **Business** | $420,817 | $(309,146) | $(5,077) | $106,594 | $744,547 | $ 851,141 |

| Loan Guarantee Program | Subsidy Expense for New Loan Guarantees Disbursed in FY 2003 | | | | Restated Reestimates FY 2003 | Total Loan Guarantee Subsidy Expense FY 2003 |
|---|---|---|---|---|---|---|
| | Defaults | Fees | Other | Total Subsidy Expense | Technical Reestimate | |
| **Business** | $398,266 | $(275,806) | $(8,644) | $113,816 | $2,551,215 | $ 2,665,031 |

## N. Subsidy Rates for Loan Guarantees by Program and Component Budget Subsidy Rates for Loan Guarantee for the Current Year's Cohorts

The following table shows the credit subsidy rates by component and by program for loan guarantees committed in the FY 2004 cohort.

The subsidy rate for the several 7(a) programs is principally affected by estimated fees, defaults or purchases, and recoveries. The annual fee was raised and other program changes were made on April 5, 2004, which lowered the subsidy rate for the program for the remainder of the year.

In 2001 legislation was enacted allowing the fee on the SBIC Participating Securities program and the SBIC Debentures program to adjust every year in order to reach a subsidy rate of zero. Once established, these fees remain the same for the life of each cohort. In the SBIC Participating Securities program, SBA pays the interest to the holders of securities during the term of the security.

Per OMB requirements, subsidy rates are established during the budget formulation period which is about one year prior to budget execution. Subsequent information that may impact the estimates, such as changes in forecast defaults and recoveries, is incorporated through the reestimate process. Since the establishment of the FY 2004 subsidy rates at the end of FY 2002, SBA has substantially revised its expectations for defaults, recoveries, and other cash flows for the SBIC Participating Securities program. Therefore, the reestimated subsidy rate for the FY 2004 cohort is substantially higher than the execution rate shown below. Each year SBA will continue to update its subsidy cost estimates by incorporating actual program performance and the latest available forecast information.

**FY 2004**

| Loan Guarantee Program | Interest Supplements | Defaults | Fees | Other | Total |
|---|---|---|---|---|---|
| **Business** | | | | | |
| 7(a) | | 3.46% | (2.40%) | | 1.06% |
| 7(a) (eff. 04/05/04) | | 3.44% | (2.86%) | | 0.58% |
| 7(a) NAFTA (CAIP) | | 3.46% | (2.40%) | | 1.06% |
| 7(a) Star | | 3.46% | (2.40%) | | 1.06% |
| 7(a) Delta | | 3.96% | (2.40%) | | 1.56% |
| 504 Debentures | | 2.54% | (5.53%) | 2.99% | 0.00% |
| 504 Delta | | 2.92% | (5.50%) | 3.44% | 0.86% |
| SBIC Debentures | | 9.60% | (3.08%) | (6.52%) | 0.00% |
| SBIC Participating Securities Program | | 6.82% | (3.07%) | (3.75%) | 0.00% |
| SBIC New Markets | | 16.05% | | 0.00% | 16.05% |
| Microloan | | 1.87% | | 6.79% | 8.66% |

## O. Schedule for Reconciling Loan Guarantee Liability Balances (Post – 1991 Business Loan Guarantees)

(Dollars in Thousands)

The following reconciles the liability for Credit Reform Loan Guarantees:

| | FY 2004 | Restated FY 2003 |
|---|---|---|
| Beginning Balance of the Loan Guarantee Liability | $2,536,065 | $1,233,403 |
| Add: Subsidy Expense for Guarantee Loans Disbursed During the Reporting Years by Component: | | |
| Default Costs (net of recoveries) | 420,817 | 398,266 |
| Fees and Other Collections | (309,146) | (275,806) |
| Other Subsidy Costs | (5,077) | (8,644) |
| **Total of the Above Subsidy Expense Components** | **106,594** | **113,816** |
| Loans Written Off | (413,074) | (521,742) |
| Amortization of Subsidy | 592,323 | 576,762 |
| Restatement Subsidy | | (175,937) |
| Adjustment Related to the Purchase of Guarantee Loans | (1,054,773) | (1,265,515) |
| Deferred Interest Accounting Adjustment | | 25,178 |
| Other | 6,046 | (1,115) |
| **Ending Balance of the Loan Guarantee Liability Before Reestimates** | 1,773,181 | (15,150) |
| Add or Subtract Subsidy Reestimate by Component: | | |
| Technical / Default Reestimate | 744,547 | 2,551,215 |
| **Ending Balance of the Loan Guarantee Liability** | **$2,517,728** | **$2,536,065** |

## P. Administrative Expense

(Dollars in Thousands)

Administrative expenses for direct business and disaster loans, and business loan guarantees are as follows:

| FY 2004 | | | |
|---|---|---|---|
| **Direct Loan Programs** | **Total** | **Loan Guarantee Program** | **Total** |
| (1) Business | $26,073 | (1) Business | **$104,291** |
| (2) Disaster | 124,425 | | |
| **Total** | **$150,498** | | |

## Q. Other Information

For pre-1992 business loans, SBA's share of outstanding gross amounts guaranteed is $466.9 million of $531.2 million for the current year and $653.7 million of $742.5 million for the prior year.  For Pollution Control Equipment Contract Guarantee Fund, the outstanding guarantees total $5.8 million for the current year and $9.9 million for the prior year.  This amount is both gross and Agency share.  For post-1991 loans, the gross amount guaranteed for business loans is $66.9 billion for the current year and $62.9 billion for the prior year.  The Agency's share is $55.9 billion for the current year and $52.7 billion for the prior year.

The SBA has outstanding loan commitments of $15.4 billion for the current year, and $10.5 billion for the prior year end.  These figures are comprised entirely of post-1991 commitments.

## R. Credit Program Subsidy Reestimates

The purpose of credit subsidy reestimates is to match the net resources for each loan cohort in the financing account with the remaining discounted expected cash flows of that cohort. Credit subsidy reestimates result from: (1) variations between actual and estimated cash flows during the year, including prepayments, defaults or purchases, and recoveries; (2) changes in expectations about future cash flows; (3) changes in the estimated discount rate; and (4) changes in the financial modeling techniques used to approximate the expected performance of a loan cohort. In addition, reestimates may be affected by the approach used to develop them.

OMB Circular A-11, which guides the credit subsidy reestimate process, authorizes agencies to use either the "traditional approach" or the "balances approach" to reestimates. The traditional approach bases reestimates on both actual past and estimated future loan cash flows, whereas the balances approach compares the balances of resources in the financing account (cash, other assets and liabilities) with estimated future loan cash flows to assess whether resources are insufficient (requiring an upward reestimate) or in excess (requiring a downward reestimate). Thus the balances approach goes one step beyond the traditional approach by incorporating cohort-level account balance, in addition to loan-level transactional data, directly into the reestimate calculation. The SBA has historically used the traditional approach to develop credit subsidy reestimates. This year, SBA used the balances approach to prepare the FY 2004 reestimates and restate the FY 2003 reestimates.

Both reestimate approaches will yield similar results, so long as the balance of resources in each program cohort is consistent with actual past loan cash flows for that program cohort, including Treasury interest, and all assumptions in the subsidy models match the actual transactions in the account. For many of SBA's earlier cohorts, however, the balance of resources was not consistent with past activity, due to incorrect recordation of transactions across sub-programs in the early years of credit reform. For these cohorts, the balances approach reestimates have adjusted the balance of resources to correct for these past recordation errors. These recordation errors affected the recording of activity at the sub-program and cohort level only; they did not affect the recording of activity at the loan transaction level or the fund level.

The balances approach also corrected for discrepancies in the interest transactions with Treasury that affected the fund level. Unlike the traditional approach, the balances approach adjusts for differences between estimated and actual interest paid to or earned from Treasury.

Because the reestimate approach has changed since last year and eliminates previous discrepancies that affected the fund level, the FY 2003 financial statements have been restated for the revised reestimates.

### Guarantee Loan Programs

The following table shows the credit subsidy reestimates for SBA's guaranteed loans by program in FY 2004 and as restated in FY 2003.

**Guaranteed Loan Programs Subsidy Reestimates**

(Dollars in Thousands)

| Guaranteed Loan Programs | 2004 Reestimates | 2003 Reestimates Restated |
|---|---|---|
| 7(a) | $41,413 | $344,317 |
| 7(a) STAR | (130) | (30,905) |
| 504 Debentures | (112,278) | 132,510 |
| SBIC Debentures | 56,521 | 41,077 |
| SBIC Participating Securities | 718,953 | 1,978,701 |
| Secondary Market Guarantees | (4,287) | 188,863 |
| **Total** | **$700,192** | **$2,654,563** |

The largest reestimate in FY 2004 and FY 2003 was for the SBIC Participating Securities Program. This program provides equity financing to the venture capital industry, which has experienced a substantial economic downturn in recent years. The downturn has increased actual and expected defaults and reduced actual and expected recoveries in this program. The SBIC Debentures Program, which finances less risky subordinated debt to the venture capital industry, was also impacted by the downturn in this industry but to a lesser extent. FY 2003 results have been restated for the revised reestimates using these revised assumptions with the balances approach.

The reestimate in the 7(a) Program reflects program changes as well as a model correction, which increased the estimated purchase of accrued interest net of recoveries. This new model was used for both the FY 2004 and the restated FY 2003 reestimates with the balances approach. The continued growth in the volume of SBA 7(a) Express loans, which have a lower default risk, is the primary program change that also impacted the FY 2004 and FY 2003 reestimates restated.

In FY 2004 SBA created a new econometric model for estimating and reestimating subsidy costs in the 504 Debentures Program. It also increased the estimated recovery rate for this program. This new model was used for both the FY 2004 and the restated FY 2003 reestimates with the balances approach.

The reestimate for the Secondary Market Guarantee Program is primarily affected by differences in the actual versus the estimated spread between the Treasury Rates and the prime rate. The FY 2003 reestimate has been restated using a revised model that more accurately reflects estimated short-term interest earnings. Both the FY 2004 and the restated FY 2003 reestimates used the balances approach.

**Direct Loan Programs**

The following table shows the credit subsidy reestimates for SBA's Disaster Loan Programs in FY 2004 and as restated in FY 2003.

**Disaster Direct Loan Subsidy Reestimates**

(Dollars in Thousands)

| Direct Loan Programs | 2004 Reestimates | 2003 Reestimates Restated |
|---|---|---|
| Disaster | $62,001 | $1,205,946 |
| Disaster - WTCP | (19,296) | |
| **Total** | **$42,705** | **$1,205,946** |

In FY 2003 SBA implemented a new micro-simulation model to reestimate the subsidy cost of its Disaster Loan Program. In addition, SBA separately modeled the World Trade Center Program (WTCP) Disaster loans and regular Disaster Assistance loans to account for substantial differences in the terms under which loans were made.

The FY 2003 restatement includes updated reestimates for all cohorts of regular Disaster Assistance loans, mainly for the effect of model changes on loan activity prior to FY 2004. FY 2003 reestimates were not made for the WTCP loans; an FY 2003 restatement was not prepared because that model has not changed since last year.

The FY 2004 reestimates show the effect of activity in FY 2004. For Regular Disaster Assistance loans, the total amount of reestimates is due mainly to the initial reestimate of the FY 2003 cohort and a correction for the interest charged during FY 2002 and FY 2003. The interest correction is to reimburse Regular Disaster for interest that should have been charged to WTCP and to adjust the interest rate used in disbursement of the FY 2002 Regular Disaster cohort. For WTCP loans, reestimates of the 2002 and 2003 cohorts were made for the first time in FY 2004. FY 2004 reestimates do not include the FY 2004 cohort because sufficient data about the loan characteristics was not available at the time reestimates were made. Disaster loan installment repayment is deferred six months after disbursement, resulting in a lack of repayment activity for the current year cohort. WTCP reestimates also include a correction for the interest not charged during FY 2002 and FY 2003 (that was improperly charged to Regular Disaster), and also to adjust the interest rate used in disbursement of the FY 2002 WTCP cohort.

Reestimates for these programs used the balances approach.

## S. Loan Asset Sales

From FY 1999 to FY 2003 SBA completed seven loan asset sales. An additional sale (Sale #8) was planned but was subsequently cancelled. Disaster, 7(a), 504, and other loans were sold over the course of the program. Through the completion of Asset Sale #7 in early FY 2003, SBA's cost models showed that the asset sales resulted in a net gain to the government. However, during FY 2003, SBA determined that its previous estimation methodology was not accurate. A new loan sale model was developed, which found Asset Sale #7 resulted in an estimated loss to the government of $81 million. The new model showed that SBA had incurred losses on its previous six loan sales as well. Based on these findings, Asset Sale #8 was cancelled, but $17 million in expenses had already been incurred. These expenses were applied as a reduction in proceeds on Asset Sale #7. No asset sales have been planned or executed since Sale #8 was cancelled.

**Gain/Loss by Asset Sale**
**In FY 2003**
(Dollars in Millions)

| | **Sale 7 Dec-02** | **Sale 8 (expenses)** | **FY 2003 Total** |
|---|---|---|---|
| **7a** | $(7) | $(1) | **$(8)** |
| **Disaster** | (79) | (15) | **(94)** |
| **504** | 5 | (1) | **4** |
| **Total** | **$(81)** | **$(17)** | **$(98)** |

## Note 7. Equipment and Internal Use Software

(Dollars in Thousands)

Capitalized Internal Use Software consisted of the following at the end of FY 2004 and 2003:

**FY 2004**

| Major Classes | Cost | Amortization | Net Book Value |
|---|---|---|---|
| Internal Use Software in Development | $18,829 | $ | $18,829 |
| Internal Use Software | 9,573 | (8,613) | 960 |
| **Total** | **$28,402** | **$(8,613)** | **$19,789** |

**FY 2003**

| Major Classes | Cost | Amortization | Net Book Value |
|---|---|---|---|
| Internal Use Software in Development | $4,870 | $ | $4,870 |
| Internal Use Software | 9,191 | (5,539) | 3,652 |
| **Total** | **$14,061** | **$(5,539)** | **$8,522** |

Statement of Federal Financial Accounting Standard No. 6 defines property, plant and equipment (PP&E) as tangible assets that (1) have an estimated useful life of 2 or more years, (2) are not intended for sale in the ordinary course of the business, and (3) are intended to be used or available for use by the entity.

The SBA has established an individual item threshold amount of $50,000 for PP&E. The SBA does not own any PP&E that meets this capitalization threshold.

The SBA does not have any restrictions on the use of its capitalized internal use software. The SBA's threshold for internal use software capitalization is $250,000 per item with a useful life of more than 2 years.

# Note 8.  Advances

(Dollars in Thousands)

Advances consisted of the following at the end of FY 2004 and 2003:

| | FY 2004 Intragovernmental | FY 2003 Intragovernmental |
|---|---|---|
| Advances to Salary & Expense Fund | $34,115 | $49,476 |
| Eliminations | (34,115) | (49,476) |
| **Balance Sheet Total** | **$** | **$** |

Advances from program funds are used to reimburse Salaries and Expenses as they are incurred.  These advances from the Business and Disaster Program funds are offset by similar amounts in the Salaries and Expense Fund.  These amounts are eliminated in the preparation of consolidated statements.

In FY 2003 SBA reclassified amounts previously considered advances to credit program receivables.  These include Advances to Federal Financing Bank - Section 503 Debentures, Advances to Holders of Delinquent Payments - Section 504 Debentures, Advances to Private Investors - Small Business Investment Company (SBIC) Debentures, Advances to Receivers - SBIC Debentures and Loans and Advances Outstanding - SBIC Participating Securities.

## Note 9. Liabilities Not Covered by Budgetary Resources

(Dollars in Thousands)

Liabilities not covered by Budgetary Resources at the end of FY 2004 and 2003 consisted of the following:

| | | Restated |
|---|---|---|
| **Intragovernmental Liabilities, not Covered by Budgetary Resources** | **FY 2004** | **FY 2003** |
| **Other** | | |
| Unfunded FECA Liability (Note 13) | $5,488 | $5,707 |
| **Total Intragovernmental** | $5,488 | $5,707 |
| | | |
| **Other Liabilities – Public, Not Covered by Budgetary Resources** | | |
| FECA Actuarial Liability (Note 13) | $28,436 | $31,822 |
| **Other** | | |
| Prior Liens on Real Estate (Note 14) | $186 | $1,708 |
| Accrued Unfunded Annual Leave | 21,326 | 21,894 |
| Surety Bond Guarantees | 20,032 | 19,154 |
| Contingent Liability | | 800 |
| **Total Other** | **$41,544** | **$43,556** |
| | | |
| **Total Other Liabilities – Public, Not Covered By Budgetary Resources** | **$69,980** | **$75,378** |

The liability for Prior Liens on Real Estate is attributable to acquired collateral in the Business Loan and Investment and Disaster Loan Funds

The liability for Surety Bond Guarantees is an estimate of the requirement for future claims in the SBG Program for guarantees outstanding at year end.

## Note 10. Accounts Payable

(Dollars in Thousands)

Accounts Payable, displayed by type, consisted of the following at the end of FY 2004 and 2003:

| | FY 2004 | | Restated FY 2003 | |
|---|---|---|---|---|
| | Intra-governmental | Public | Intra-governmental | Public |
| Disbursements in Transit | $ | $6,893 | $23 | $11,750 |
| Accrued Interest Payable | 10,297 | | 13,700 | |
| Subsidy Payable to Financing | 2,114,474 | | 4,642,178 | |
| Other Interfund Payables | | | 27,560 | |
| Refunds Due Borrowers | | 222 | | 388 |
| Due Subcontractors | | 160 | | 565 |
| Due Lenders | | 14,519 | | 15,578 |
| Miscellaneous Payable | | 12,100 | 16 | 21,367 |
| **Sub Total Before Eliminations** | $2,124,771 | $33,894 | $4,683,477 | $49,648 |
| Eliminations – Subsidy Payable | (2,114,474) | | (4,642,178) | |
| Eliminations – Interfund Payables | | | (27,560) | |
| **Balance Sheet Total** | **$10,297** | **$33,894** | **$13,739** | **$49,648** |

Other interfund payables result from adjustments to cash balances for individual year's appropriations in the Agency's credit programs. SBA's credit program appropriations are received on an annual, multiyear and no-year basis, but the Agency's loan accounting system does not separately account for the use of these appropriation types as new loans and guarantees are processed. Adjustments to general ledger cash balances are therefore made as part of the monthly accounting cycle in order to properly record the use of annual, multi year and no-year appropriations. These amounts are eliminated in the consolidated statements as the adjustments effect intra-agency fund activity and balances.

# Note 11. Debt

(Dollars in Thousands)

Treasury and Federal Financing Bank intragovernmental debt consisted of the following at the end of FY 2004 and 2003:

**FY 2004**
**Intragovernmental Debt**

| | Treasury | Federal Financing Bank | Total Intragovernmental Debt |
|---|---|---|---|
| **Beginning Balance** | $6,626,749 | $79,630 | $6,706,379 |
| **New Borrowings** | 2,203,099 | | 2,203,099 |
| **Repayments** | (284,147) | (20,740) | (304,887) |
| **Change in Interest Payable** | | (617) | (617) |
| **Ending Balance** | **$8,545,701** | **$58,273** | **$8,603,974** |

**FY 2003**
**Intragovernmental Debt**

| | Treasury | Federal Financing Bank | Total Intragovernmental Debt |
|---|---|---|---|
| **Beginning Balance** | $11,035,897 | $105,487 | $11,141,384 |
| **New Borrowings** | 1,158,196 | | 1,158,196 |
| **Repayments** | (5,567,308) | (25,106) | (5,592,414) |
| **Change in Interest Payable** | (36) | (751) | (787) |
| **Ending Balance** | **$6,626,749** | **$79,630** | **$6,706,379** |

Interest payable on debt and receivable on uninvested funds held at Treasury (net) is included in the beginning and ending balances of debt outstanding.  The change in net interest payable is shown to obtain the ending debt balance.

Repayment of Treasury borrowings was deferred until 2005 for the Disaster and Business Guarantee funds.

## Note 12. Net Assets of Liquidating Funds Due to Treasury

(Dollars in Thousands)

The Net Assets of Liquidating Funds Due to Treasury consisted of the following at the end of FY 2004 and 2003:

| | FY 2004 | Restated FY 2003 |
|---|---|---|
| **Liquidating Funds** | | |
| Pollution Control Equipment Contract Guarantee Fund | $19,425 | $19,330 |
| Disaster Loan Fund | 98,713 | 105,614 |
| Business Loan and Investment Fund | 181,378 | 282,165 |
| **Total Due Treasury** | **$299,516** | **$407,109** |

Net Assets of Liquidating Funds Due to Treasury are funds returned to Treasury comprised of net assets less liabilities. For FY 2003 the amount due Treasury was included as “Other – Intragovernmental Liabilities” however for FY 2004 SBA is showing the amount as a separate item on the Balance Sheet.

# Note 13. Federal Employee Compensation Act (FECA) Actuarial Liability

The Federal Employees Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (Labor), which pays valid claims and subsequently seeks reimbursement from the Agency for these paid claims.

The FECA liability consists of two components. The first component is based on actual claims paid by Labor but not yet reimbursed by the Agency. There is generally a two to three year time period between payment by Labor and reimbursement to Labor by the Agency. As a result, the Agency accrues an expense and recognizes a liability for the actual claims paid by Labor that have not been reimbursed by the Agency.

The second component is the estimated actuarial liability for future benefit payments as a result of past events. This liability includes death, disability, medical and miscellaneous costs. Labor determines this component annually, as of September 30, using a method that considers historical benefit payment patterns and a number of economic variables. The projected annual benefit payments are discounted to present value using OMB's economic assumptions including the effects of inflation on the liability. Finally, Labor evaluates the estimated projections to ensure that they are consistent with historical payment patterns and the prior projection of the liability. The FY 2004 liability is $28.4 million and the FY 2003 liability was $31.8 million.

## Note 14. Other Liabilities

(Dollars in Thousands)

Other liabilities consisted of the following at the end of FY 2004 and 2003:

……

| | FY 2004 | | |
|---|---|---|---|
| | Non-Current Liabilities | Current Liabilities | Total Liabilities |
| **1. Intragovernmental Liabilities-Other** | | | |
| Payable to Special Receipt Fund | $ | $556,249 | $556,249 |
| Employment Taxes Payable | | 1,248 | 1,248 |
| Unfunded FECA Liability | 5,488 | | 5,488 |
| Due Federal Financing Bank | 1,575 | | 1,575 |
| Advances from Other Agencies | | 2,513 | 2,513 |
| Advances from Program Funds | | 34,115 | 34,115 |
| **Sub Total before Eliminations** | **$7,063** | **$594,125** | **$601,188** |
| Eliminations | | (34,115) | (34,115) |
| **Total Intragovernmental Liabilities – Other** | **$7,063** | **$560,010** | **$567,073** |
| **2. Public Liabilities – Other** | | | |
| Accrued Funded Payroll Benefits | $ | $11,192 | $11,192 |
| Accrued Grants | | 46,520 | 46,520 |
| Accrued Unfunded Annual Leave | | 21,326 | 21,326 |
| Suspense Accounts | | 3,359 | 3,359 |
| Prior Liens on Real Estate | 186 | | 186 |
| Contingent Liabilities-Public | 20,032 | | 20,032 |
| **Total Other Liabilities – Other** | **$20,218** | **$82,397** | **$102,615** |

| | Restated FY 2003 | | |
|---|---|---|---|
| | Non-Current Liabilities | Current Liabilities | Total Liabilities |
| **1. Intragovernmental Liabilities – Other** | | | |
| Payable to Special Receipt Fund | $ | $642,596 | $642,596 |
| Employment Taxes Payable | | 196 | 196 |
| Unfunded FECA Liability | 5,707 | | 5,707 |
| Due Federal Financing Bank | 1,855 | | 1,855 |
| Advances from Other Agencies | | 1,945 | 1,945 |
| Advances from Program Fund | | 49,476 | 49,476 |
| **Sub Total before Eliminations** | **$7,562** | **$694,213** | **$701,775** |
| Eliminations | | (49,476) | (49,476) |
| **Total Intragovernmental Liabilities – Other** | **$7,562** | **$644,737** | **$652,299** |

| | Non-Current Liabilities | Current Liabilities | Total Liabilities |
|---|---|---|---|
| **2. Public Liabilities – Other** | | | |
| Accrued Funded Payroll Benefits | $ | $8,909 | $8,909 |
| Accrued Grants | | 39,700 | 39,700 |
| Accrued Unfunded Annual Leave | | 21,894 | 21,894 |
| Employment Taxes Payable | | 2,244 | 2,244 |
| Advances From Others | | 502 | 502 |
| Cash Adjustments | | 18,178 | 18,178 |
| Suspense Accounts | | (4,998) | (4,998) |
| Prior Liens on Real Estate | 1,708 | | 1,708 |
| Surety Bond Guarantee Future Claims | 19,154 | | 19,154 |
| Contingent Liabilities | | 800 | 800 |
| **Total Public Liabilities – Other** | **$20,862** | **$87,229** | **$108,091** |

The payable to special receipt fund is related to downward subsidy restatements.

Other liabilities include current liabilities for contractual services and grants, contingent liabilities, and the liability for accrued unfunded annual leave. Additionally, the non-current liabilities include unfunded accrued FECA.

The SBA has recorded a non-current contingent liability for future claims in its Surety Bond Guarantee Program in the amount of $20.0 million for FY 2004 and $19.2 million for FY 2003. This liability is an estimate of the future claims for outstanding contracts as of the reporting dates.

## Note 15. Statement of Net Cost

Federal cost accounting standards require SBA to report operating costs by program activity. Full costs include all direct and indirect costs for 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 SBA's major programs are presented in the Consolidated Statement of Net Cost. Full program costs are comprised of all direct costs for 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 OPM and charged to 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 SBA's major programs to arrive at net program cost. Earned revenues are recognized by 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 SBA's outstanding Business and Disaster loan portfolios and interest earned on uninvested funds in the credit reform financing account.

**3. Reporting by Goals**

SBA reports its costs consistent with the Agency's strategic goals. The strategic goals this year were restructured from those of the prior year. In FY 2004 Procurement Assistance programs are not included in Goal 1 Improve Economic Environment. Because of this restructuring, the Statement of Net Cost for the current year is not comparable to the prior year. Thus, the cost for FY 2003 is presented in summary without the subtotals matching to the current year goals.

For FY 2004, SBA developed a new strategic Goal 4 – "Ensure that SBA programs operate at maximum efficiency and effectiveness by providing them with high quality executive leadership." The costs of this goal, however, are fully allocated to the other strategic goals. The amount of Goal 4 is estimated to be $83 million in FY 2004. "Costs Not Assigned to Strategic Goals," such as Congressionally mandated grant programs, costs of the Office of the Inspector General and costs associated with SBA's management of USDA's Rural Business Investment Program are included the Net Cost Statement

**4. Eliminations**

The purpose of eliminations is to eliminate the offsetting presentation of assets, liabilities, revenue and costs that is created by the activities within a reporting entity such as the SBA. The SBA receives a portion of its funding for operating expenses in the Disaster and Business Program funds.

(Dollars in Thousands)

| | FY 2004 | Eliminations | Consolidated | Restated FY 2003 |
|---|---|---|---|---|
| **Strategic Goal 1: Improve Economic Environment for Small Businesses** | | | | |
| Intragovernmental | | | | |
| Gross Costs | $11,633 | | $11,633 | |
| Less: Earned Revenue | | | | |
| Net Costs | $11,633 | | $11,633 | |
| Public | | | | |
| Gross Costs | $38,991 | | $38,991 | |
| Less: Earned Revenue | | | | |
| Net Costs | $38,991 | | $38,991 | |
| **Net Cost Strategic Goal 1** | **$50,624** | | **$50,624** | |
| **Strategic Goal 2 Increase Small Business Success by Bridging Competitive Opportunity Gaps Facing Entrepreneurs** | | | | |
| Intragovernmental | | | | |
| Gross Costs | $422,946 | $(130,364) | $292,582 | |
| Less: Earned Revenue | 267,110 | (130,364) | 136,746 | |
| Net Costs | $155,836 | $ | $155,836 | |
| Public | | | | |
| Gross Costs | $1,483,911 | | $1,483,911 | |
| Less: Earned Revenue | 282,748 | | 282,748 | |
| Net Costs | $1,201,163 | | $1,201,163 | |
| **Net Cost Strategic Goal 2** | **$1,356,999** | | **$1,356,999** | |
| **Strategic Goal 3: Restore Homes and Businesses Affected by Disaster** | | | | |
| Intragovernmental | | | | |
| Gross Costs | $523,725 | $(124,425) | $399,300 | |
| Less: Earned Revenue | 290,521 | (124,425) | 166,096 | |
| Net Costs | $233,204 | $ | $233,204 | |
| Public | | | | |
| Gross Costs | $268,676 | | $268,676 | |
| Less: Earned Revenue | 204,658 | | 204,658 | |
| Net Cost | $64,018 | | $64,018 | |

| | | | |
|---|---|---|---|
| **Net Cost Strategic Goal 3** | **$297,222** | **$297,222** | |
| **Costs Not Assigned to Strategic Goals** | | | |
| Intragovernmental | | | |
| Gross Cost | $9,810 | $9,810 | |
| Less: Earned Revenue | | | |
| Net Costs | $9,810 | $9,810 | |
| Public | | | |
| Gross Costs | $32,882 | $32,882 | |
| Less: Earned Revenue | | | |
| Net Costs | $32,882 | $32,882 | |
| **Net Cost Not Assigned** | **$42,692** | **$42,692** | |
| **Net Cost of Operations** | **$1,747,537** | **$1,747,537** | **$3,949,258** |

**Functional Classification**
(Dollars in Thousands)

| | FY 2004 | | |
|---|---|---|---|
| | **Gross Cost** | **Earned Revenue** | **Net Cost** |
| Commerce and Housing Credit | | | |
| Strategic Goal 1 | $50,624 | $ | $50,624 |
| Strategic Goal 2 | 1,776,493 | 419,494 | 1,356,999 |
| Costs Not Assigned | 42,692 | | 42,692 |
| **Total Commerce and Housing Credit** | **$1,869,809** | **$419,494** | **$1,450,315** |
| Community and Regional Development | | | |
| Strategic Goal 3 | $667,976 | $370,754 | $297,222 |
| **Total Community and Regional Development** | **$667,976** | **$370,754** | **$297,222** |
| **Total** | **$2,537,785** | **$790,248** | **$1,747,537** |

| Functional Classification | Restated FY 2003 Gross Cost | Restated FY 2003 Earned Revenue | Restated FY 2003 Net Cost |
|---|---|---|---|
| Commerce and Housing Credit | $4,181,322 | $924,023 | $3,257,299 |
| Community and Regional Development | 1,214,223 | 522,264 | 691,959 |
| **Total** | **$5,395,545** | **$1,446,287** | **$3,949,258** |

| Intragovernmental Revenue | FY 2004 | Restated 2003 |
|---|---|---|
| **Functional Classification** | | |
| Commerce and Housing Credit | $136,746 | $53,335 |
| Community and Regional Development | 166,096 | 283,994 |
| **Total** | **$302,842** | **$337,329** |

# Note 16. Statement of Changes in Net Position

The SBA's net position consisted of the following as of the end of FY 2004 and 2003:

1. Unexpended Appropriations

Unexpended appropriations represent unobligated amounts and amounts for which orders for goods, services or benefits have been placed but not yet filled. Multi-year appropriations remain available to SBA for obligation in future periods. Unobligated balances associated with appropriations expiring 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 restated the FY 2003 Unexpended Appropriations beginning balance by $273.5 million to cover prior period adjustments to the Surety Bond Guaranty Fund (SBG).

The prior period adjustment is separately stated for FY 2003 because FY 2002 has not been restated.

2. Cumulative Results of Operations

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

The SBA restated the FY 2003 Cumulative Results of Operations beginning balance by $425.1 million to cover prior period adjustments. These prior period adjustments were made to reflect the changes to the Cumulative Results of Operations for the SBG Fund and the Modification Adjustment Transfer.

The prior period adjustment is separately stated for FY 2003 because FY 2002 has not been restated.

3. Imputed Financing

The Statement of Changes in Net Position recognized an imputed financing source of $17.9 million for the year ended September 30, 2004 and $19.1 million for the year ended September 30, 2003. Corresponding imputed post-employment benefit expenses are recognized on the Statement of Net Cost as Intragovernmental Gross Costs and are allocated to all programs.

4. Current Year Liquidating Fund Equity Activity

The agency recognizes a liability to Treasury for the amount of net assets in the liquidating funds. The amount reflected as a financing source on the Statement of Changes in Net Position is the change in this liability for the current reporting period.

# Note 17. Statement of Budgetary Resources

**Budget Authority**

SBA has access to permanent indefinite appropriations for liquidating fund obligations and upward reestimates of credit subsidy cost in its Business and Disaster financing accounts. SBA used all of its borrowing authority in FY 2004 and FY 2003.

Under the SBA's appropriation act a portion of the administrative expenses in its Salary and Expense (S&E) and Office of Inspector General (OIG) funds are funded by amounts advanced from its Business and Disaster program funds. The use of these advances in the S&E and OIG funds creates a parallel set of budgetary entries in the SBA's general ledger for the Business and Disaster funds program funds and the S&E and OIG funds. Under current Federal accounting standards these parallel entries are not eliminated in the Combined Statement of Budgetary Resources (SBR), with the end result of duplicating the obligations in the SBR. The amount of this duplication was $240.9 million and $252.0 million for FY 2004 and FY 2003 respectively.

**Obligations Incurred**

During FY 2004, SBA incurred $7,649 million of direct and reimbursable obligations of which $192 million was apportioned by fiscal quarters for category A apportionment and $7,457 million was apportioned by fiscal year for category B apportionment. Category A apportionments are those for resources that can be obligated without restriction on the purpose of the obligation, other than to be in compliance with legislation underlying programs for which the resources were made available. Category B apportionments are restricted by purpose for which obligations can be incurred.

**Reconciliation of the SBR to the Presidents Budget (FY 2003)**

Because the Budget of the United States Government (the President's Budget) with actual amounts for FY 2004 has not yet been published, SBA compared FY 2003 Statement of Budgetary Resources to the actual amounts reported in the President's Budget for FY 2003. This comparison indicated certain differences for which SBA had not accumulated all of the information it needed prior to the submission of the President's Budget for FY 2003. The differences reflect several accounting adjustments to correct the FY 2003 Statement of Budgetary Resources but were not incorporated into the President's Budget for FY 2003 as follows:

- $55 million asset sales activity due to a change in budgetary accounting for various transactions types.
- $(48) million adjustment for recording other Federal receivables.
- $17 million upward adjustment due to a change in the accounting treatment used in recording of prior year undelivered orders.
- $22 million additional interest due Treasury on SBA borrowings.

- $21 million budgetary accounting change in recording the disallowed purchased interest liability.
- $29 million adjustment for Federal Financing Bank transactions.
- $20 million adjustment for recording the suspense allocation.

SBA incurred additional differences due to the methodology used in gathering financial data from different sources. SBA prepared the Statement of Budgetary Resources using data from the general ledger, while some of the President's Budget data was obtained from internal cost reports. Furthermore, SBA reported expired unobligated balances in the Statement of Budgetary Resources which were not included in the President's Budget.

## Note 18. Statement of Financing

The Statement of Financing provides information on the total resources used by an agency, both those received through budgetary resources and those received through other means during the reporting period. The statement reconciles these resources with the net cost of operations by removing resources that do not fund net cost of operations and including components of net cost of operations that did not generate or use resources during the year.

The Statement of Financing is presented as a consolidated statement for the Agency and its major programs. Net interagency eliminations are presented for proprietary amounts. The budgetary amounts are reported on a combined basis as presented in the SBR. Accordingly, net interagency eliminations for budget amounts are not presented.
The relationship between the amounts reported as liabilities not covered by budgetary resources on the balance sheet and amounts reported as components requiring or generating resources in future periods on the statement of financing were analyzed. The differences are primarily due to credit program collections offset by resources that financed acquisitions of assets or liquidation of liabilities and reestimates of credit subsidy expense.

# Note 19. Disclosure Related to Restatement of FY 2003 Financial Statements

Restatement No 1: Subsidy Reestimates

SBA restated its FY 2003 Financial Statements to reflect reestimates as of September 30 2003 using a new subsidy model methodology. This new methodology known as the “balances approach” (See Footnote 6R), provides an improved estimate of the cost of SBA’s credit programs.

Restatement No 2: Deferred Interest

SBA determined it was recording its noncurrent interest incorrectly (See Footnote 1 S). The FY 2003 financial statements have been adjusted to reflect the change.

Restatement No 3: Change in Presentation – Offsetting Collections / Receipts

SBA changed the presentation of "Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations” on its Statement of Financing to more closely agree with Treasury’s Standard General Ledger crosswalk. For FY 2003, receipts in Treasury’s special fund for downward subsidy reestimates were recorded on line 15 “Resources that Finance the Acquisition of Assets or Liquidation of Liabilities.” For FY 2004, they are recorded on line 14b “Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations, Offsetting Receipts.”

Restatement No 4: Modification Adjustment Transfer

During FY 2004 it was determined that the Modification Adjustment Transfer (MAT) related to SBA’s sale of Business and Disaster loans in FY 2003 was unneeded because the original Treasury interest discount rates, not current market rates, were used to determine the cost of SBA’s loan sale program.

Restatement No 5: Cumulative Results of Operation

SBA determined its cumulative results of operations and unexpended appropriation balances were incorrect in the Surety Bond Guaranty Program due to a longstanding incorrect closing entry. These balances were therefore previously misreported, although total equity was not misstated. SBA recorded a prior period adjustment and restated FY 2003 and correctly reported FY 2004 results in this report.

Restatement No 6: Net Assets of Liquidating Funds Due Treasury

SBA determined its net assets of its liquidating funds due Treasury should be disclosed separately due to the materiality of this item. Previously it was included with Other Intragovernmental Liabilities. The FY 2003 Balance Sheet has been restated to show this new line on the statement.

## U. S. Small Business Administration
## Consolidated Balance Sheet
Note 19

| (Dollars in Thousands) | | FY 2003 | Adjustment | Restated FY 2003 |
|---|---|---|---|---|
| **Assets** | | | | |
| Assets – Public and Other | | | | |
| Credit Program Receivables and Related Foreclosed Property, Net | **Restatement #1** | $ | $(760,719) | $ |
| Credit Program Receivables and Related Foreclosed Property, Net | **Restatement #2** | 4,300,333 | (7,019) | 3,532,595 |
| **Liabilities** | | | | |
| Intragovernmental Liabilities | | | | |
| Accounts Payable | **Restatement #1** | 13,737 | 2 | 13,739 |
| Net Assets of Liquidating Funds Due to Treasury | **Restatement #6** | | 407,109 | 407,109 |
| Other | **Restatement #1** | | 433,764 | |
| Other | **Restatement #4** | | (214,752) | |
| Other | **Restatement #6** | 840,396 | (407,109) | 652,299 |
| **Other Liabilities – Public** | | | | |
| Liabilities for Loan Guarantees | **Restatement #1** | | (32,611) | |
| Liabilities for Loan Guarantees | **Restatement #2** | 2,548,963 | 25,178 | 2,541,530 |
| Other | **Restatement #2** | 140,288 | (32,197) | 108,091 |
| **Net Position** | | | | |
| Unexpended Appropriations | **Restatement #5** | 847,474 | (273,500) | 573,974 |
| Cumulative Results of Operations | **Restatement #1** | | (1,161,874) | |
| Cumulative Results of Operations | **Restatement #4** | | 214,752 | |
| Cumulative Results of Operations | **Restatement #5** | (4,017,722) | 273,500 | (4,691,344) |

# U. S. Small Business Administration
# Consolidated Statement of Changes in Net Position

Note 19

(Dollars in Thousands)

| | | FY 2003 | | Adjustment | | Restated FY 2003 | |
|---|---|---|---|---|---|---|---|
| | | **Cumulative Results of Operations** | **Unexpended Appropriations** | **Cumulative Results of Operations** | **Unexpended Appropriations** | **Cumulative Results of Operations** | **Unexpended Appropriations** |
| Beginning Net Position As Adjusted | **Restatement #4** | $ | $ | $151,575 | $ | $ | $ |
| Beginning Net Position As Adjusted | **Restatement #5** | (2,697,964) | 954,633 | 273,500 | (273,500) | (2,272,889) | 681,133 |
| Other Financing Sources | | | | | | | |
| Transfers – In/Out Without Reimbursement | **Restatement #1** | (175,608) | | (321,120) | | (496,728) | |
| Net Cost of Operations | **Restatement #1** | | | 840,754 | | | |
| Net Cost of Operations | **Restatement #4** | 3,171,681 | | (63,177) | | 3,949,258 | |

**U. S. Small Business Administration**
**Consolidated Statement of Net Cost**
Note 19

| (Dollars in Thousands) | | FY 2003 | Adjustment | Restated FY 2003 |
|---|---|---|---|---|
| **Net Cost of Operations** | **Restatement #1** | $ | $840,754 | $ |
| **Net Cost of Operations** | **Restatement #4** | 3,171,681 | (63,177) | 3,949,258 |

## U. S. Small Business Administration
## Consolidated Statement of Financing
Note 19

(Dollars in Thousands)

| | | FY 2003 | Adjustment | Restated FY 2003 |
|---|---|---|---|---|
| **Resources Used to Finance Activities** | | | | |
| **Other Resources** | | | | |
| Transfers In (Out) | **Restatement#1** | $(175,608) | $(321,120) | $(496,728) |
| **Resources Used to Finance Items not Part of the Net Cost of Operations** | | | | |
| Offsetting Receipts | **Restatement#3** | | 299,819 | 299,819 |
| Resources that Finance the Acquisition of Assets or Liquidation of Liabilities | **Restatement#3** | (2,392,133) | (299,819) | (2,691,952) |
| Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations | **Restatement#1** | 1,320 | 3 | 1,323 |
| **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** | | | | |
| Upward/Downward Reestimates of Credit Subsidy Expense | **Restatement#1** | | 1,161,873 | |
| Upward/Downward Reestimates of Credit Subsidy Expense | **Restatement#4** | 1,319,587 | (63,177) | 2,418,283 |

**U. S. Small Business Administration**

## Required Supplementary Stewardship Information

## Stewardship Investments in Human Capital

For the periods ended September 30, 2004, 2003, 2002, 2001 and 2000

(Dollars in Thousands)

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Small Business Development Centers | $97,250 | $99,293 | $100,276 | $98,583 | $88,162 |
| Women's Business Centers | 19,218 | 15,361 | 16,141 | 15,934 | 6,488 |
| Service Corps of Retired Executives | 17,993 | 10,305 | 15,021 | 5,988 | 8,210 |
| Business Information Centers | 9,480 | 8,426 | 14,033 | 16,015 | 11,719 |
| Native American Outreach | 2,064 | 194 | 856 | 1,394 | 1,748 |
| Small Business Training Network | 1,483 | | | | |
| 7(j) Program | 1,483 | | | | |
| National Education Center | 1,483 | 259 | | | |
| Microloans Technical Assistance | 1,354 | | | | |
| Other Business Assistance | 903 | 12,639 | 12,057 | 6,050 | 4,900 |
| Counseling & Training | | 12,315 | | | |
| US Export Assistance Centers | | 3,500 | 2,174 | | |
| Co Sponsorships | | 1,102 | | | |
| Electronic Government | | 259 | 659 | | |
| Disabilities Initiative | | 65 | 132 | 8 | |
| BATF donations - Reimbursed Expenses | | 65 | 66 | | |
| One Stop Capital Shops | | | | 8,114 | 8,495 |
| Business LINC | | | | 2,518 | |
| Welfare to Work | | | | 8 | 2,034 |
| Office of International Trade | | | | 2,955 | |
| Office of Veterans' Affairs[1] | | | | | 2,776 |
| Ombudsman[1] | | | | | 1,507 |
| Woman's Business Council[1] | | | | | 1,106 |
| HubZones Program[1] | | | | | 6,734 |
| **Total** | **$152,711** | **$163,783** | **$161,415** | **$157,567** | **$143,879** |

**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.

**Small Business Development Centers** deliver 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.

**Women's Business Centers** provide assistance to women business owners and acts a
the public and private sectors in a number of locations around the U.S.

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

**Business Information Centers (BIC)** provide a one-stop location where current and
business owners can receive assistance and advice. Through partnerships with the put
sector, BIC offer the latest computer technology, hardware and software, as well as ex
business reference library of hard copy books and publications and current manageme
entrepreneurs. At a BIC they can plan their business, expand an existing business, or
business areas. The use of software for a variety of business applications offers client
means for addressing diverse needs.

**Native American Outreach** provides assistance to American Indian, Native Alaskan,
Hawaiian small business clients, tribally owned small businesses, and small businesse
American communities.

**Small Business Training Network** is an online training program designed to fill smal
educational gaps. It serves as a virtual SBA campus.

**7(j) Program** provides assistance such as accounting; marketing and preparation of bu
proposals (Add Definition), as well as industry-specific technical assistance and entrep
to small business people to startup, run and expand their business.

**National Education Center** was added as new activity in FY 2003 to provide a forum
of small business people from a centralized location in Florida.

**Microloans Technical Assistance** is provided to microloan intermediaries to fund mai
technical assistance to small business receiving microloan financial assistance.

**Other Business Assistance** includes Drug Free Workplace, International Visitors Prog

**Counseling & Training** was separately categorized in FY 2003 to identify the cost of
business assistance to small business.

**US Export Assistance Centers** provide assistance to small business entrepreneurs in tl
on how to conduct business activities to export goods and services. This is a new categ

**Co Sponsorships** was added as a category in FY 2003 to include the educational assist
small business by SBA in partnership with non government organizations.

**Electronic Government** was added as a category in FY 2003 for services provided to
through electronic processing activity and electronic information.

**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.

**BATF donations – Reimbursed Expenses** are used by SBA to provide assistance to small business in the form of educational services.

**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. SBA funding for this program was discontinued in FY 2002.

**Business LINC** On June 5, 1998 the Business LINC 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. This program was improperly categorized as Human Capital enhancement in FY 2001.

**Welfare to Work** The SBA helped small businesses gain access to a new pool of potential workers as well as helping former welfare recipients become entrepreneurs. This program ended effectively in FY 2000.

**Office of International Trade** provides assistance to small businesses obtain financing for export activity. This activity was improperly reported as a stewardship investment in human capital for several years in the past.

[1]**The Office of Veterans Affairs, Ombudsman, Women's Business Council, HubZones Program,** these SBA programs were reclassified to other cost categories after FY 2000.

A description of the major programs, outputs, and outcomes may be found in this Performance and Accountability Report.

**U. S. Small Business Administration**

# Required Supplementary Stewardship Information

## Stewardship Investments in Research and Development

For the periods ended September 30, 2004, 2003, 2002, 2001, and 2000

(Dollars in Thousands)

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| The Office of Technology | $ | $778 | $1,103 | $1,906 | $1,720 |

**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.

As of the 2004 reporting year the SBA is no longer capturing the costs associated with research and development.

**U. S. Small Business Administration**

**Required Supplementary Information**

**Intragovernmental Assets and Liabilities**

for the period ended September 30, 2004

*(Dollars in Thousands)*

| Trading Partner | Fund Balance With Treasury | Accounts Payable | Debt/Borrowings from Other Agencies | Net Assets of Liquidating Funds Due to Treasury | Other Liabilities |
|---|---|---|---|---|---|
| Federal Financing Bank | $ | | $ 58,273 | $ | $ 1,575 |
| Agency for International Development | | | | | 31 |
| Department of Labor | | | | | 5,488 |
| Office of Personnel Management | | | | | 1,193 |
| Department of the Treasury | 7,072,582 | 10,297 | 8,545,701 | 299,516 | 556,249 |
| Other Agencies | | | | | 2,537 |
| **Total** | **$ 7,072,582** | **$ 10,297** | **$ 8,603,974** | **$ 299,516** | **$ 567,073** |

**U. S. Small Business Administration**

## Required Supplementary Information

## Intragovernmental Earned Revenues and Related Costs

for the period ended September 30, 2004

*(Dollars in Thousands)*

| | Earned Revenue | Gross Cost |
|---|---|---|
| **Trading Partner** | | |
| Department of the Treasury | $ 302,842 | $ 547,191 |
| **Total** | **$ 302,842** | **$ 547,191** |
| **Budget Functional Classification** | | |
| Commerce and Housing Credit | $ 136,746 | $ 362,111 |
| Community and Regional Development | 166,096 | 185,080 |
| **Total** | **$ 302,842** | **$ 547,191** |

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, 2004

| *(Dollars in Thousands)* | BLIF | | DLF | | SBGRF |
|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | Budgetary | Non-Budgetary Financing | Budgetary | Non-Budgetary Financing | Budgetary |
| Budget Authority | | | | | |
| Appropriations Received | $ 2,693,380 | $ | $ 1,349,082 | $ | $ |
| Borrowing Authority | | 1,421,542 | | 781,557 | |
| Net Transfers (+/-) | | | | | |
| Other | | | | | |
| Unobligated Balance | | | | | |
| Brought Forward October 1 | 256,913 | 564,091 | 97,216 | 1,205,111 | 22,641 |
| Net Transfers (+/-) | | | | | |
| Spending Authority from Offsetting Collections | | | | | |
| Earned | 79,062 | 3,460,595 | 14,909 | 1,761,698 | 7,723 |
| Change in Unfilled Customer Orders | | (28,061) | | 6,810 | |
| Recoveries of Prior Year Obligations | 7,314 | 1,917 | 13,936 | 107,081 | |
| Permanently Not Available | (166,412) | (284,145) | (61,910) | (2) | |
| **Total Budgetary Resources** | $ 2,870,257 | $ 5,135,939 | $ 1,413,233 | $ 3,862,255 | $ 30,364 |

U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
for the period ended September 30, 2004

| (Dollars in Thousands) STATUS OF BUDGETARY RESOURCES | BLIF Budgetary | BLIF Non-Budgetary Financing | DLF Budgetary | DLF Non-Budgetary Financing | SBGRF Budgetary |
|---|---|---|---|---|---|
| Obligations Incurred | $ 2,673,355 | $ 1,991,168 | $ 1,323,785 | $ 1,018,143 | $ 8,028 |
| Unobligated Balances, Available Apportioned - Currently Available Exempt from Apportionment | 104,734 | 1,928,395 | 30,677 | 528,696 | 2,708 |
| Unobligated Balances, Not Available | 92,168 | 1,216,376 | 58,771 | 2,315,416 | 19,628 |
| **Total Status of Budgetary Resources** | $ 2,870,257 | $ 5,135,939 | $ 1,413,233 | $ 3,862,255 | $ 30,364 |

| (Dollars in Thousands) RELATIONSHIP OF OBLIGATIONS TO OUTLAYS | BLIF Budgetary | BLIF Non-Budgetary Financing | DLF Budgetary | DLF Non-Budgetary Financing | SBGRF Budgetary |
|---|---|---|---|---|---|
| Obligated Balance, Beginning of Period | $ 120,700 | $ (40,256) | $ 40,183 | $ 180,087 | $ 337 |
| Obligated Balance, End of Period | | | | | |
| Accounts Receivable | | | | | |
| Unfilled Customer Orders from Federal Sources | | (63,557) | | (43,175) | |
| Undelivered Orders | 62,550 | 31,798 | 43,217 | 334,434 | |
| Accounts Payable | 15,131 | 21,400 | 2,506 | 2,193 | 611 |
| Total Obligated Balance, End of Period | 77,681 | (10,359) | 45,723 | 293,452 | 611 |
| Outlays | | | | | |
| Disbursements | 2,712,235 | 2,005,722 | 1,304,399 | 807,441 | 7,753 |
| Collections | (82,236) | (3,478,904) | (14,999) | (1,778,252) | (7,723) |
| Subtotal | $ 2,629,999 | $ (1,473,182) | $ 1,289,400 | $ (970,811) | $ 30 |
| Less: Offsetting Receipts | | 227,933 | | 2,376 | |
| Net Outlays | $ 2,629,999 | $ (1,701,115) | $ 1,289,400 | $ (973,187) | $ 30 |

U. S. Small Business Administration
## Required Supplementary Information
## Combining Statement of Budgetary Resources
for the period ended September 30, 2004

*(Dollars in Thousands)*

| | PCECGF | SE | OIG | BATF | TOTAL | TOTAL | |
|---|---|---|---|---|---|---|---|
| | Budgetary | Budgetary | Budgetary | Budgetary | Budgetary | Financing | Total |
| **BUDGETARY RESOURCES** | | | | | | | |
| Budget Authority | | | | | | | |
| Appropriations Received | $ 3,000 | $ 371,650 | $ 13,000 | $ | $ 4,430,112 | $ | $ 4,430,112 |
| Borrowing Authority | | | | | | 2,203,099 | 2,203,099 |
| Net Transfers (+/-) | | 30,000 | | | 30,000 | | 30,000 |
| Other | | | | | | | |
| Unobligated Balance: | | | | | | | |
| Brought Forward October 1 | 3,262 | 34,585 | 662 | 418 | 415,697 | 1,769,202 | 2,184,899 |
| Net Transfers (+/-) | | | | | | | |
| Spending Authority from Offsetting Collections | | | | | | | |
| Earned | 333 | 262,098 | 463 | 426 | 365,014 | 5,222,293 | 5,587,307 |
| Change in Unfilled Customer Orders | | (15,328) | 34 | | (15,294) | (21,251) | (36,545) |
| Recoveries of Prior Year Obligations | | 21,675 | 67 | 2 | 42,994 | 108,998 | 151,992 |
| Permanently Not Available | (3,262) | (9,559) | (203) | | (241,346) | (284,147) | (525,493) |
| **Total Budgetary Resources** | $ 3,333 | $ 695,121 | $ 14,023 | $ 846 | $ 5,027,177 | $ 8,998,194 | $ 14,025,371 |

U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
for the period ended September 30, 2004

| *(Dollars in Thousands)* STATUS OF BUDGETARY RESOURCES | PCECGF Budgetary | SE Budgetary | OIG Budgetary | BATF Budgetary | TOTAL Budgetary | TOTAL Non-Budgetary Financing | Total |
|---|---|---|---|---|---|---|---|
| Obligations Incurred | $ | $ 620,703 | $ 13,505 | $ 411 | $ 4,639,787 | $ 3,009,311 | $ 7,649,098 |
| Unobligated Balances Available | | | | | | | |
| Apportioned - Currently Available Exempt from Apportionment | 3,333 | 43,614 | 189 | 420 | 185,675 | 2,457,091 | 2,642,766 |
| Unobligated Balances, Not Available | | 30,804 | 329 | 15 | 201,715 | 3,531,792 | 3,733,507 |
| **Total Status of Budgetary Resources** | $ 3,333 | $ 695,121 | $ 14,023 | $ 846 | $ 5,027,177 | $ 8,998,194 | $ 14,025,371 |

| *(Dollars in Thousands)* RELATIONSHIP OF OBLIGATIONS TO OUTLAYS | PCECGF Budgetary | SE Budgetary | OIG Budgetary | BATF Budgetary | TOTAL Budgetary | TOTAL Non-Budgetary Financing | Total |
|---|---|---|---|---|---|---|---|
| Obligated Balance, Beginning of Period | $ | $ 311,059 | $ 1,639 | $ 21 | $ 473,939 | $ 139,831 | $ 613,770 |
| Obligated Balance - End of Period | | | | | | | |
| Accounts Receivable | | | | | | | |
| Unfilled Customer Orders from Federal Sources | | (233) | | | (233) | (106,732) | (106,965) |
| Undelivered Orders | | 229,287 | 1,134 | 54 | 336,242 | 366,232 | 702,474 |
| Accounts Payable | | 58,376 | 583 | | 77,207 | 23,593 | 100,800 |
| Total Obligated Balance, End of Period | | 287,430 | 1,717 | 54 | 413,216 | 283,093 | 696,309 |
| Outlays | | | | | | | |
| Disbursements | | 622,658 | 13,359 | 378 | 4,660,782 | 2,813,163 | 7,473,945 |
| Collections | (333) | (246,769) | (496) | (426) | (352,982) | (5,257,156) | (5,610,138) |
| Subtotal | $ (333) | $ 375,889 | $ 12,863 | $ (48) | $ 4,307,800 | $ (2,443,993) | $ 1,863,807 |
| Less: Offsetting Receipts | | | | | | 230,309 | 230,309 |
| Net Outlays | $ (333) | $ 375,889 | $ 12,863 | $ (48) | $ 4,307,800 | $ (2,674,302) | $ 1,633,498 |

U. S. Small Business Administration

## Additional Accompanying Information

## Consolidating Balance Sheet

as of September 30, 2004

*(Dollars in Thousands)*

| | BLIF | DLF | SBGRF | PCECGF | SE | OIG | BATF | Combined Total |
|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | |
| Intragovernmental Assets | | | | | | | | |
| Fund Balances with Treasury | $ 3,408,995 | $ 3,272,735 | $ 22,948 | $ 3,333 | $ 361,847 | $ 2,236 | $ 488 | $ 7,072,582 |
| Accounts Receivable | 1,762,555 | 351,919 | | | | | | 2,114,474 |
| Advances | 651 | 33,464 | | | | | | 34,115 |
| Total Intragovernmental Assets | $ 5,172,201 | $ 3,658,118 | $ 22,948 | $ 3,333 | $ 361,847 | $ 2,236 | $ 488 | $ 9,221,171 |
| Assets - Public and Other | | | | | | | | |
| Cash | 22,510 | | | | | | | 22,510 |
| Accounts Receivable | 34,695 | 24 | 4,659 | | 79 | | | 39,457 |
| Credit Program Receivables and Related Foreclosed Property, Net | 915,586 | 2,481,566 | | 16,092 | | | | 3,413,244 |
| Equipment and Internal Use Software | | | | | 19,789 | | | 19,789 |
| Total Assets - Public and Other | 972,791 | 2,481,590 | 4,659 | 16,092 | 19,868 | | | 3,495,000 |
| Total Assets | $ 6,144,992 | $ 6,139,708 | $ 27,607 | $ 19,425 | $ 381,715 | $ 2,236 | $ 488 | $ 12,716,171 |
| **LIABILITIES** | | | | | | | | |
| Intragovernmental Liabilities | | | | | | | | |
| Accounts Payable | $ 1,770,486 | $ 354,285 | $ | $ | $ | $ | $ | $ 2,124,771 |
| Debt | 2,741,515 | 5,862,459 | | | | | | 8,603,974 |
| Net Assets of Liquidating Funds Due to Treasury | 181,378 | 98,713 | | 19,425 | | | | 299,516 |
| Other | 489,352 | 68,472 | | | 43,098 | 266 | | 601,188 |
| Total Intragovernmental Liabilities | $ 5,182,731 | $ 6,383,929 | $ | $ 19,425 | $ 43,098 | $ 266 | $ | $ 11,629,449 |
| Other Liabilities - Public | | | | | | | | |
| Accounts Payable | $ 30,874 | $ 2,402 | $ 618 | $ | $ | $ | $ | $ 33,894 |
| Liabilities for Loan Guarantees | 2,524,052 | | | | | | | 2,524,052 |
| FECA Actuarial Liability | | | | | 28,436 | | | 28,436 |
| Other | 2,930 | 49 | 20,599 | | 78,509 | 528 | | 102,615 |
| Total Other Liabilities - Public | 2,557,856 | 2,451 | 21,217 | | 106,945 | 528 | | 2,688,997 |
| Total Liabilities | $ 7,740,587 | $ 6,386,380 | $ 21,217 | $ 19,425 | $ 150,043 | $ 794 | $ | $ 14,318,446 |
| **NET POSITION** | | | | | | | | |
| Unexpended Appropriations | $ 166,960 | $ 105,247 | $ 764 | $ | $ 266,481 | $ 1,442 | $ | $ 540,894 |
| Cumulative Results of Operations | (1,762,555) | (351,919) | 5,626 | | (34,809) | | 488 | (2,143,169) |
| Total Net Position | $ (1,595,595) | $ (246,672) | $ 6,390 | $ 0 | $ 231,672 | $ 1,442 | $ 488 | $ (1,602,275) |
| Total Liabilities and Net Position | $ 6,144,992 | $ 6,139,708 | $ 27,607 | $ 19,425 | $ 381,715 | $ 2,236 | $ 488 | $ 12,716,171 |

U. S. Small Business Administration

## Additional Accompanying Information

## Consolidating Balance Sheet

for the period ended September 30, 2004

*(Dollars in Thousands)*

| ASSETS | Eliminations | Consolidated TOTAL |
|---|---|---|
| Intragovernmental Assets | | |
| Fund Balances with Treasury | $ | $ 7,072,582 |
| Accounts Receivable | (2,114,474) | |
| Advances | (34,115) | |
| Total Intragovernmental Assets | $ (2,148,589) | $ 7,072,582 |
| Assets - Public and Other | | |
| Cash | $ | $ 22,510 |
| Accounts Receivable | | 39,457 |
| Credit Program Receivables and Related Foreclosed Property, Net | | 3,413,244 |
| Equipment and Internal Use Software | | 19,789 |
| Total Assets - Public and Other | | 3,495,000 |
| Total Assets | $ (2,148,589) | $ 10,567,582 |
| **LIABILITIES** | | |
| Intragovernmental Liabilities | | |
| Accounts Payable | $ (2,114,474) | $ 10,297 |
| Debt | | 8,603,974 |
| Net Assets of Liquidating Funds Due to Treasury | | 299,516 |
| Other | (34,115) | 567,073 |
| Total Intragovernmental Liabilities | $ (2,148,589) | $ 9,480,860 |
| Other Liabilities -Public | | |
| Accounts Payable | $ | $ 33,894 |
| Liabilities for Loan Guarantees | | 2,524,052 |
| FECA Actuarial Liability | | 28,436 |
| Other | | 102,615 |
| Total Other Liabilities -Public | | 2,688,997 |
| **Total Liabilities** | $ (2,148,589) | $ 12,169,857 |
| **NET POSITION** | | |
| Unexpended Appropriations | $ | $ 540,894 |
| Cumulative Results of Operations | | (2,143,169) |
| **Total Net Position** | $ | $ (1,602,275) |
| **Total Liabilities and Net Position** | $ (2,148,589) | $ 10,567,582 |

U. S. Small Business Administration
## Additional Accompanying Information
## Consolidating Statement of Financing
for the period ended September 30, 2004

*(Dollars in Thousands)*

| | BLIF | DLF | SBGRF | PCECGF | SE | OIG | BATF | Total |
|---|---|---|---|---|---|---|---|---|
| ***Resources Used to Finance Activities*** | | | | | | | | |
| **Budgetary Resources** | | | | | | | | |
| **Obligated** | | | | | | | | |
| Obligations Incurred | $ 4,664,523 | $ 2,341,928 | $ 8,028 | $ | $ 620,703 | $ 13,505 | $ 411 | $ 7,649,098 |
| Less: Spending Authority from Offsetting Collections and Recoveries | 3,520,827 | 1,904,434 | 7,723 | 333 | 268,445 | 564 | 428 | 5,702,754 |
| Obligations Net of Offsetting Collections and Recoveries | 1,143,696 | 437,494 | 305 | (333) | 352,258 | 12,941 | (17) | 1,946,344 |
| Less: Offsetting Receipts | 227,933 | 2,376 | | | | | | 230,309 |
| **Net Obligations** | $ 915,763 | $ 435,118 | $ 305 | $ (333) | $ 352,258 | $ 12,941 | $ (17) | $ 1,716,035 |
| **Other Resources** | | | | | | | | |
| Transfers In (Out) | (97,824) | (4,917) | | | | | | (102,741) |
| Imputed Financing | | | | | 17,858 | | | 17,858 |
| Other Financing Sources | 7,435 | (2,698) | | (358) | | | | 4,379 |
| **Net Other Resources Used to Finance Activities** | $ (90,389) | $ (7,615) | $ | $ (358) | $ 17,858 | $ | $ | $ (80,504) |
| **Total Resources Used to Finance Activities** | $ 825,374 | $ 427,503 | $ 305 | $ (691) | $ 370,116 | $ 12,941 | $ (17) | $ 1,635,531 |

**U. S. Small Business Administration**

## Additional Accompanying Information

## Consolidating Statement of Financing

for the period ended September 30, 2004

*(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 Budgetary Resources Obligated for | | | | | | | | |
| Goods, Services and Benefits Ordered But Not Yet Provided | $ (2,408) | $ (93,975) | $ | $ | $ 15,470 | $ 304 | $ (32) | $ (80,641) |
| Resources that Fund Expenses Recognized in Prior Periods | | | 667 | | | | | 667 |
| Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations | | | | | | | | |
| Credit Program Collections | 3,460,095 | 1,761,698 | | | | | | 5,221,793 |
| Offsetting Receipts | 227,933 | 2,376 | | | | | | 230,309 |
| Resources that Finance the Acquisition of Assets or Liquidation of Liabilities | (1,935,935) | (801,418) | | 271 | (14,341) | | | (2,751,423) |
| That Do Not Affect Net Cost of Operations | 2 | 1,317 | 2 | | 1 | | 427 | 1,749 |
| **Total Resources Used to Finance Items Not Part of the Net Cost of Operations** | $ 1,749,687 | $ 869,998 | $ 669 | $ 271 | $ 1,130 | $ 304 | $ 395 | $ 2,622,454 |
| **Total Resources Used to Finance the Net Cost of Operations** | $ 2,575,061 | $ 1,297,501 | $ 974 | $ (420) | $ 371,246 | $ 13,245 | $ 378 | $ 4,257,985 |

U. S. Small Business Administration

## Additional Accompanying Information

## Consolidating Statement of Financing

for the period ended September 30, 2004

*(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** | | | | | | | | |
| **Components Requiring or Generating Resources in Future Periods** | | | | | | | | |
| Change in Annual Leave Liability | | | | | (568) | | | (568) |
| Change in Contingent Liability | | | | | (800) | | | (800) |
| Upward/ Downward Reestimates of Credit Subsidy Expense | (1,495,586) | (1,032,118) | | | | | | (2,527,704) |
| Change in Revenue Receivable from Public | 1,096 | (2) | 550 | (26) | | | | 1,618 |
| Other - Current Year Liquidating Equity Activity (+/-) | (7,435) | 2,698 | | 358 | | | | (4,379) |
| Provision for Losses on Estimated Guarantees | 859 | | 877 | | | | | 1,736 |
| Change in Unfunded Employee Benefits | | | | | (3,605) | | | (3,605) |
| **Total Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period** | $ (1,501,066) | $ (1,029,422) | $ 1,427 | $ 332 | $ (4,973) | $ | $ | $ (2,533,702) |
| **Components Not Requiring or Generating Resources** | | | | | | | | |
| Depreciation or Amortization | | | | | 3,074 | | | 3,074 |
| Bad Debt Expense - Noncredit Reform | 17,001 | 2,982 | | (270) | 467 | | | 20,180 |
| **Total Components of Net Cost that Will Not Require or Generate Resources** | $ 17,001 | $ 2,982 | $ | $ (270) | $ 3,541 | $ | $ | $ 23,254 |
| **Total Components of Net** | | | | | | | | |
| **Cost of Operations Not Requiring or Generating Resources in the Current Period** | $ (1,484,065) | $ (1,026,440) | $ 1,427 | $ 62 | $ (1,432) | $ | $ | $ (2,510,448) |
| Net Cost of Operations | $ 1,090,996 | $ 271,061 | $ 2,401 | $ (358) | $ 369,814 | $ 13,245 | $ 378 | $ 1,747,537 |

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

**CFO Reply**

**DATE:** November 15, 2004

**TO:** Robert Seabrooks, Assistant IG for Auditing

**FROM:** Thomas Dumaresq, Chief Financial Officer

**SUBJECT:** FY 2004 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.

Meeting the accelerated reporting date of November 15th was a major accomplishment for SBA, the IG and the IPA this year and we could not have done it without the coordinated effort made by all parties involved. SBA is proud of the work it did in establishing an aggressive but realistic set of milestones and working cooperatively with Cotton & Co. to ensure they received timely and accurate materials.

Overall we are pleased that the SBA has received an improved audit opinion from the independent auditor compared to the previous three years and believe it accurately reflects a substantial improvement in the quality of the Agency's financial statements. We see this as a particularly strong accomplishment given the shortened reporting cycle. Nevertheless, we are disappointed not to have reached a "clean" audit opinion since that was our objective. Although we were able to successfully resolve essentially all of the FY 2003 audit findings, the accelerated schedule presented new challenges that we were not able to overcome in the available time. However, given all that we have accomplished in the past several years and our experience meeting the accelerated reporting timeframe this year, we are confident that we can resolve the issues identified in the audit in the coming year.

The IPA's Report on Internal Control retains the two material weaknesses included in the FY 2003 report: the financial management and reporting controls and credit reform controls. While we are disappointed that all of the progress we feel we have made in these areas did not result in reducing these to reportable conditions, we understand that additional improvements need to be made and we are committed to maintaining the strong momentum we have established to improve the Agency's financial management processes and results. The IPA's Report on Internal Control recommends that SBA continue to refine and accelerate its reporting processes in light of the 45-day reporting schedule. We agree that we can make further progress in this area, including the production of the PAR document itself. We note that we were able to correct the inconsistencies you reported between the PAR draft document and the final financial statements before the final publication of the PAR, but we recognize additional work is needed to ensure this complex process is completed accurately in the shortened timeframe. In addition, we request that your office continue to work with the IPA to identify opportunities for further improving the audit process and resource availability to ensure SBA also receives adequate time to understand and respond to audit findings.

We appreciate all of your efforts and those of your colleagues in the Office of the Inspector General as well as those of Cotton & Co. While the audit process was again challenging this year, we believe our efforts and the assistance we received from you and Cotton & Co. resulted in substantial improvements in the quality of our financial statements. Overall we feel our financial management capacity has improved considerably this year and we are proud of what we have accomplished. We continue to be committed to excellence in financial management and look forward to making more progress in the coming year.

## REPORT DISTRIBUTION

| Recipient | No. of Copies |
|---|---|
| Chief Operating Officer | 1 |
| Associate Administrator<br>Office of Congressional & Legislative Affairs | 1 |
| Associate Deputy Administrator<br>Office of Capital Access | 1 |
| Associate Deputy Administrator<br>Office of Management and Administration | 1 |
| Associate Administrator<br>Office of Disaster Assistance | 1 |
| Chief Information Officer | 1 |
| Chief Financial Officer<br>Attn: Jeff Brown | 1 |
| General Counsel | 3 |
| Government Accountability Office | 2 |