

**AUDIT OF SBA'S FY 2004  
FINANCIAL STATEMENTS  
MANAGEMENT LETTER  
AUDIT REPORT NUMBER 5-13  
FEBRUARY 23, 2005**

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

<b>AUDIT REPORT</b>
<b>Issue Date: February 23, 2005</b>
<b>Number: 5-13</b>

**To:** 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 - Management Letter

Pursuant to the Chief Financial Officers Act of 1990, attached is Cotton & Company LLP's management letter. The purpose of the management letter is to communicate "non-reportable conditions" to SBA management that came to Cotton & Company's attention during their engagement to audit the U.S. Small Business Administration's (SBA) Fiscal Year (FY) 2004 financial statements. The following areas, which were reported last year, are repeated in this report because the conditions, as well as the need for implementing enhanced controls, continue to exist.

- Accountable Property Controls.
- Disaster Area Office Centrally Billed Account.
- Master Reserve Fund (MRF), Cash Held Outside of Treasury.
- Recordation of Allotment Transactions.
- Entry to Align Statement of Financing with Statement of Net Cost.

The management letter also noted areas for improvement in the areas of: 1) Retention of Documentation to Support Colson Data Validation; 2) Surety Bond Guarantee (SBG) Liability Documentation; 3) Monitoring of the Small Business Investment Company (SBIC) Participating Securities Reimbursement Assumption; 4) Separation of Duties within the Office of the Chief Information Officer (OCIO); 5) Loan Accrual Methodology; 6) Activity-Based Costing (ABC) Model; 7) Enhancements top Footnote Disclosures; 8) Performance and Accountability Report; 9) Budget Briefing Book; 10) Disaster Loan Program Cohort 1996 Loan Data; and 11) Section 504 Credit Subsidy Cash Flow Model.

SBA management generally agreed with the auditors' findings and recommendations, but requested more information on the specifics of several findings that had not been previously communicated to CFO personnel. Management also questioned whether several findings should be included in the report or could be better presented in the report.

**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

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

JAN 26 2005

Date:

To: Robert G. Seabrooks  
Assistant Inspector General for Auditing

From: Thomas A. Dumaresq [FOIA Ex. 6]  
Chief Financial Officer

Subject: Audit of SBA's FY 2004 Financial Statements – Draft Management Letter

The FY 2004 draft management letter in your memo to me dated December 28, 2004 contains 23 recommendations to improve the SBA's financial management. The following comments are for your consideration in developing the final management letter.

As we discussed in our "lessons learned" meeting on January 13, 2005, we have questions regarding several of the findings. I would ask that you consider whether these findings and recommendations should be included in the final management letter, or possibly whether the findings could be better presented in the report. Recommendations 1A, 2A, 2C, 10A, 11A, 12A and 15A in the draft management letter are included in this suggestion.

Also, as we discussed in this meeting, we would like to have additional information on the specifics of the findings from Cotton's work papers for a couple of the findings (3A and 7A.) This is because this information was not communicated to CFO personnel during the audit.

Thank you for the opportunity to provide comments to the draft management letter. I will be glad to answer any questions that you may have on this response.

SBA IS AN EQUAL OPPORTUNITY EMPLOYER AND PROVIDER

# COTTON & COMPANY LLP

auditors • advisors

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## MANAGEMENT LETTER REPORT U.S. SMALL BUSINESS ADMINISTRATION FISCAL YEAR 2004 FINANCIAL STATEMENT AUDIT

Inspector General  
U.S. Small Business Administration

Cotton & Company LLP audited the financial statements of the U.S. Small Business Administration (SBA) as of September 30, 2004, and for the year then ended and has issued, under separate cover, our reports thereon dated November 15, 2004. Our reports included those on SBA's internal control and compliance with laws and regulations, with our compliance report including comments on the Federal Financial Management Improvement Act.

The purpose of this management letter is to communicate "non-reportable conditions" to SBA management. This letter is intended solely for the information and use of SBA management.

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

Very truly yours,

COTTON & COMPANY LLP

[FOIA Ex 6]

Charles Hayward, CPA  
November 15, 2004

**MANAGEMENT LETTER REPORT**  
**U.S. SMALL BUSINESS ADMINISTRATION**  
**FISCAL YEAR 2004 FINANCIAL STATEMENT AUDIT**

Cotton & Company LLP audited the financial statements of the U.S. Small Business Administration (SBA) for Fiscal Year (FY) 2004. This document discusses matters we noted involving internal control that warrant management attention.

We noted 16 areas for improvement. The following five areas, which were reported last year, are repeated this year because the conditions, as well as the need for implementing enhanced control, continue to exist.

- Accountable Property Controls.
- Disaster Area Office Centrally Billed Account.
- Master Reserve Fund (MRF), Cash Held Outside of Treasury.
- Recordation of Allotment Transactions.
- Entry to Align Statement of Financing with Statement of Net Cost.

In addition, we noted the following areas for improvement that were not reported last year:

- Retention of Documentation to Support Colson Data Validation.
- Surety Bond Guarantee (SBG) Liability Documentation.
- Monitoring of the Small Business Investment Company (SBIC) Participating Securities Reimbursement Assumption.
- Separation of Duties within the Office of the Chief Information Officer (OCIO)
- Loan Accrual Methodology.
- Activity-Based Costing (ABC) Model.
- Enhancements to Footnote Disclosures.
- Performance and Accountability Report.
- Budget Briefing Book.
- Disaster Loan Program Cohort 1996 Loan Data.
- Section 504 Credit Subsidy Cash Flow Model.

**1. Accountable Property Controls**

Our testing at field and headquarters locations indicated that SBA could strengthen internal control over accountable property. We noted the following exceptions related to accountable property tracking:

Out of 45 property items selected randomly from the accountable property system:

- 12 could not be located in SBA's office locations.
- 15 were either not assigned a location within the accountable property system or had a location that differed from the assigned location within the accountable property system.
- 12 contained bar code numbers that differed from the bar code numbers assigned within the accountable property system.

Out of 45 property items selected randomly from SBA's office locations:

- 9 were not tracked in SBA's accountable property system although they met SBA's criteria for accountable property tracking.
- 13 had a location that differed from the assigned location within the accountable property system.
- 9 contained bar code numbers that differed from the bar code numbers assigned within the accountable property system.

## **Recommendation**

We recommend that the Chief Financial Officer (CFO):

- 1A. Coordinate with the Office of Administration (OA) and Office of Field Operations (OFO) to strengthen internal control over accountable property. Specifically, we recommend that SBA conduct annual inventory counts and evaluate the adequacy of its current accountable property system in meeting the Agency's responsibility for safeguarding assets.

## **2. Disaster Area Office Centrally Billed Account**

Disaster Area Offices (DAOs) use the Centrally Billed Account (CBA) mainly to purchase airline tickets for disaster assistance-related travel. During our FY 2003 audit, we noted that DAOs did not obligate travel funds paid through the CBA account until they received the monthly credit account statement, thus incurring travel expenses before obligations were recorded. This accounting treatment increases the risk of violating provisions of the Antideficiency Act because valid obligations were not recorded in a timely manner.

In response to our FY 2003 Management Letter recommendation, SBA developed a Travel Authorization and Obligation Procedures Memorandum for the CBA account. However, the DAOs are not fully complying with the procedures set forth in this memorandum, as evidenced by two instances we noted during our FY 2004 audit in which the travel expense was incurred prior to recording the obligation.

The GAO *Red Book*, Principles of Federal Appropriations Law, Volume II, Chapter 7 states that:

*[if a transaction meets the criteria for recording an obligation]...the agency not only may but must at that point record the transaction as an obligation. While 31 U.S.C. 1501 does not explicitly state that obligations must be recorded as they arise or are incurred, it follows logically from an agency's responsibility to comply with the Antideficiency Act.*

## **Recommendation**

We recommend that the CFO coordinate with the Office of Disaster Assistance (ODA) to:

- 2A. Incorporate the guidance provided in the Travel Authorization and Obligations Procedures Memorandum in a Standard Operating Procedure (SOP) for administering the CBA and ensure this guidance is fully implemented by the DAOs so that proper controls are in place for recording and liquidating travel obligations in a timely manner.



### 3. Master Reserve Fund (MRF), Cash Held Outside of Treasury

SBA's fiscal and transfer agent (FTA) maintains the MRF (cash held outside of Treasury) to facilitate operation of the section 7(a) Secondary Market Guarantee (SMG) program. SBA discloses information related to MRF cash activity in its financial statement footnotes (as required by Statements of Federal Financial Account Standards No. 7, *Accounting for Revenue and Other Financing Sources*), but does not record MRF cash activity in its general ledger or report MRF transactions to Treasury.

Treasury Financial Manual (TFM) 2-3400 provides guidance for reporting activity on cash held outside the government on the SF-224, *Statements of Transactions*. TFM 2-3435.10 (Cash Held Outside the Government) requires that, effective January 1, 2003:

*Agencies that deposit, hold, and/or invest funds outside of the U.S. Treasury must record those transactions to specific US SGL accounts and report these amounts in their audited financial statements. In addition, agencies must submit those amounts in the ATBs [Adjusted Trial-Balance] to Treasury.*

#### Recommendation

We recommend that the CFO:

- 3A. Work with Treasury and OMB to obtain Treasury account symbols for the MRF and begin reporting the MRF activity to Treasury monthly on the SF-224 and in the general ledger.

### 4. Recordation of Allotment Transactions

SBA's Office of Planning and Budget (OPB) records loan allotment transactions for loan guarantee and direct loans in the Loan Allotment and Accounting (LAA) system based on Office of Management and Budget (OMB) apportionments and SBA allocations. LAA interfaces with the Loan Accounting System (LAS) to ensure that loan approvals (obligations) do not exceed allotments. In response to our FY 2003 Management Letter recommendation, SBA began uploading allotment activity monthly from LAA into its Financial Reporting Information System (FRIS) Consolidated General Ledger (CGL). These transactions are reflected in the FRIS CGL as memorandum account 6000, Outstanding Loan Approvals. However, SBA did not update its budget proforma to record the budgetary transactions in its CGL based on the allotment activity in this memorandum account. As a result, SBA is not recording the following entry in its CGL to record allotment of authority:

4510 Apportionments  
4610 Allotments – Realized Resources

Although the absence of this entry has no effect on the financial statements (because SGL accounts 4510 and 4610 map to the same Statement of Budgetary Resources line item, *Unobligated Balances Available, Apportioned, Currently Available*), SBA cannot analyze its use of funds via the FRIS CGL and instead must revert to LAA to determine the loan program allotment balances.

The Joint Federal Management Improvement Program's *Core Financial System Requirements* state that:

*All transactions to record financial events must post, either individually or in summary, to the general ledger, regardless of origin of the transaction.*

## **Recommendation**

- 4A. We recommend that the CFO coordinate with the Denver Finance Center (DFC) to ensure the budget proforma posting logic is extended to include the recordation of allotment transactions based on underlying memorandum transactions in conformity with U.S. Standard General Ledger criteria.

## **5. Entry to Align Statement of Financing with Statement of Net Cost**

As required by OMB Bulletin 01-09, SBA prepares the consolidated Statement of Financing to:

*Articulate the relationship between net obligations derived from an entity's budgetary accounts and the net cost of operations derived from the entity's proprietary accounts by identifying and explaining key differences between the two numbers.*

SBA could not fully reconcile net obligations to net cost of operations. Therefore, it used an unsupported entry to ensure that the Net Cost of Operations line items on the consolidated Statement of Financing and the consolidated Statement of Net Cost equaled. The amount of the entry was \$1,316,522.

## **Recommendation**

- 5A. We recommend that the CFO fully reconcile net obligations to net costs of operations as part of the consolidated Statement of Financing compilation process and discontinue using unsupported entries.

## **6. Retention of Documentation to Support Colson Data Validation**

Colson Services Corporation, SBA's FTA, provides certain loan and loan pool data for use in the SMG credit subsidy cash flow model. Prior to submitting the data, the FTA purportedly performs validation procedures to ensure completeness and accuracy of the data. The FTA did not, however, retain adequate documentation to support its validation process and the results. As a result, we relied on inquiries of the FTA and SBA management to gain assurance as to the procedures performed.

OMB Circular No.A-123, *Management Accountability and Control*, states:

*Documentation for transactions, management controls, and other significant events must be clear and readily available for examination.*

## **Recommendations**

We recommend that the CFO:

- 6A. Coordinate with the FTA to ensure that adequate documentation supporting the validation of the SMG loan and pool data is prepared and retained by the FTA.
- 6B. Include the FTA documentation in its SMG re-estimate binder. Perform a quality review of the data validation process and results as part of the four-person internal control review process of the SMG cash flow model and resulting re-estimate.

## **7. Surety Bond Guarantee (SBG) Liability Documentation**

SBA estimates the long-term liability for potential losses related to outstanding surety bond guarantees annually for financial reporting purposes. The liability is estimated using a model that projects future losses net of recoveries based upon historical averages.

In response to our FY 2003 Management Letter recommendation, SBA developed documentation to fully explain the estimate's calculation methodology and underlying assumptions. However, during our audit, we noted that the actual calculation of the Breakdown of Losses was inconsistent with the documented methodology. Based on discussions with SBA, we determined that the documented methodology contained errors. In addition, we noted instances in which the loss rates used in the model were either omitted or incorrectly calculated and one instance in which the amount for guarantees issued used in the model did not agree to the amount per the supporting SBG report.

The omission of loss rates and use of incorrect loss rates in conjunction with the usage of incorrect guarantees issued resulted in a \$1,824,122 overstatement of the FY 2004 SBG liability and related expense. SBA corrected these errors and the inconsistencies in model documentation when we brought them to its attention and provided us with the corrected calculation and supporting documentation.

OMB Circular No.A-123, *Management Accountability and Control*, states:

*Management controls are the organization, policies, and procedures used by agencies to reasonably ensure that... reliable and timely information is obtained, maintained, reported and used for decision making.*

## **Recommendations**

We recommend that the CFO coordinate with OPB to:

- 7A. Ensure the documentation explaining the estimate's calculation methodology and underlying assumptions is consistent with and accurately reflects the method by which the SBG liability and related expense are estimated.
- 7B. Enhance the existing quality control and review process to ensure that amounts and calculations contained in the SBG estimated liability calculation are accurate.

## **8. Monitoring of the Small Business Investment Company (SBIC) Participating Securities Reimbursement Assumption**

The cash flow model utilized by SBA to forecast future cash flows related to the SBIC Participating Securities program uses cumulative outstanding leverage as a base for estimating future advances of prioritized payments made by SBA on behalf of the SBIC. The model reduces cumulative outstanding leverage by defaults that already occurred and were recorded in the accounting system as well as program office estimates of defaults to occur within the next two years. Thus, the model appropriately does not forecast future advances for defaulted SBICs or those estimated to default.

The model forecasts future reimbursements based on cumulative advances, to include forecasted advances. Because the model is not forecasting the future advances for defaulted SBICs, it is also not forecasting future reimbursements on those advances. However, the model does not remove the advances already made on behalf of defaulted SBICs or those estimated to default by the program office from the cumulative advances on which future reimbursements are calculated. As a result, the model is forecasting

future reimbursements of advances already made, even though the SBIC has defaulted or is estimated to default.

As a result, SBA may be overstating its estimated cash inflows related to reimbursements of advanced prioritized payments under the SBIC Participating Securities program. Although the total percentage of advances expected to be reimbursed based on the FY 2004 cash flow model is reasonable given actual program experience and expectations, it is unlikely that SBA will be reimbursed advances already made on behalf of a defaulted SBIC.

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*, states that:

*...cash flow models should be tested for reliability by comparing estimated cash flows to actual cash flows and assessing the model's ability to replicate the credit program's performance.*

#### **Recommendation**

- 8A. We recommend that the CFO, in conjunction with the Office of Financial Analysis (OFA), continually monitor the reimbursement of advanced prioritized payments assumption in the SBIC Participating Securities model to ensure that future reimbursements estimated by the model are reasonable given actual program experience and expectations.
9. **Separation of Duties within the Office of the Chief Information Officer (OCIO)**

FOIA Ex. 2

The Government Accountability Office publication, *Standards for Internal Control in the Federal Government*, provides that:

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<sup>1</sup> Inventory refers to the category "inventory held in reserve for future use." See Statement of Federal Financial Accounting Standards No. 3, *Accounting for Inventory and Related Property*.

*Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets.*

The Joint Financial Management Improvement Program publication, Inventory System Requirements, requires both physical inventory controls and controls to reconcile physical inventory counts with corresponding inventory listings.

**Recommendations**

9A. We recommend that the CFO, in coordination with the OCIO,  
[FOIA Ex. 2]

9B. We also recommend that the OCIO  
[FOIA Ex. 2]

**10. Loan Accrual Methodology**

SBA's FY 2004 loan accrual methodology identified liquidation activity at the Herndon Liquidation Center and SBIC loan charge-off activity as potential year-end accruals. The methodology stated that activity in these areas would be reviewed at year end to determine if it warranted year-end accrual treatment. We noted that SBA did not record accruals to reflect this activity.

SBA does not have sufficient documentation to fully explain and support the rationale for its decision not to accrue certain types of loan-related activity, such as liquidations and charge-offs. We had to rely on inquiry and SBA's responses to determine why these accruals were not made.

Lack of sufficient documentation to fully explain the rationales for decisions made increases the risk of errors or material misstatements in estimates and can undermine effective quality review and audit processes.

OMB Circular No.A-123, *Management Accountability and Control*, states:

*Documentation for transactions, management controls, and other significant events must be clear and readily available for examination.*

**Recommendation**

We recommend that the CFO, in coordination with the Herndon Liquidation Center and Office of SBIC Liquidations:

10A. Document thoroughly, and have readily available for examination, the rationale supporting the decision to either accrue or not accrue certain loan related activity. Specifically, we recommend documenting the rationale for not accruing liquidation activity at the Herndon Liquidation Center and SBIC loan charge off activity at the Office of Liquidations within Investment Division.

## 11. Activity-Based Costing (ABC) Model

SBA uses an ABC model to assign administrative indirect costs to its programs. The cost data extracted from FRIS for this model incorrectly contained costs recorded in two of SBA's unreported funds (X0600DA and X6275DA), as well as Surety Bond Guaranty program costs (fund X4156DA). In contrast, the model did not include necessary non-program fiduciary costs, such as imputed financing and FECA costs.

The use of inappropriate costs and the omission of costs that should have been included in the model cause the misstatement of the net cost percentage table, resulting in the improper distribution of the September 30, 2004, administrative indirect costs.

Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, discusses activity based costing:

*“The full cost of resources that directly or indirectly contribute to the production of outputs should be assigned to outputs through costing methodologies or cost finding techniques that are most appropriate to the segment’s operating environment and should be followed consistently.”*

### Recommendation

- 11A. We recommend that the CFO coordinate with DFC to ensure that the FRIS cost data used to develop the net cost percentage table contains all appropriate costs.

## 12. Enhancements to Footnote Disclosures

SBA's footnote disclosures lack useful information about the nature and magnitude of costs and revenues included in each line item component of its Statement of Net Costs, such as the amount of salary, benefits, grant expense, interest expense and interest revenue.

OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, states:

*An agency's Statement of Net Cost may display highly aggregated program information, and the programs may have clearly distinguishable segments. Information on the net cost of the segments should be disclosed in the footnotes. Supporting schedules similar to the illustration in Exhibit 9E should be included in the notes to the financial statements and present detailed cost and revenue information supporting the summary information presented in the Statement of Net Cost.*

OMB Bulletin 01-09 does not require that expenses be broken out by nature or budget object class. As a result, users of SBA's financial statements cannot determine what levels or types of costs or revenues SBA incurs or generates.

### Recommendation

- 12A. We recommend that the CFO, in coordination with DFC, develop additional footnote disclosures that itemize and describe the costs and revenues included in each of its Statement of Net Costs line item components.

### 13. Performance and Accountability Report (PAR)

OMB Bulletin 01-02 requires that we read the PAR to ensure consistency with the financial statements and audit results and perform minimal additional testing. During our work, we noted that SBA's PAR contained information that was inconsistent with the information in the financial statements and our audit results. We found no evidence that SBA management maintained effective control over ensuring that the information presented in the PAR is consistent with the information presented in the financial statements.

In addition, SBA's PAR, at 474 pages, is substantially larger than any of the other federal credit agencies (Agriculture, Education, Housing and Urban Development, and Veterans Affairs), whose PARs average just over 300 pages. SBA's PAR is also more than three times the size of the government-wide PAR, which is 146 pages.

SBA's PAR is comprised of the following principal sections:

Section	Pages
MD&A	70
Performance Report	174
Financial Report	124
Appendixes	106

In accord with SFFAS No. 15, *Management's Discussion and Analysis*, the MD&A should:

*deal with the "vital few" matters; i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the [General Purpose Federal Financial Report, or GPFFR] as a source of information.*

Also,

*Because MD&A must be concise if it is to be useful, management must select the most important matters to discuss. This means that some items that are material to the financial statements, notes, and other sections of the GPFFR may not be discussed in MD&A.*

According to OMB Bulletin 01-09:

*"...measures in the MD&A should be limited to the entity's most significant program and financial measures." Also, "To be useful, the MD&A must be concise and readable to a non-technical audience."*

We believe the spirit of the above criteria should be applied beyond the MD&A; to the PAR on the whole. The large size of SBA's PAR indicates the OCFO has not ensured equilibrium between program managers' desire to report non-key information and the need to present information on only the few vital programs.

## Recommendations

We recommend that the CFO, in coordination with program personnel:

- 13A. Assign personnel to compare the financial and non-financial information in the PAR to ensure consistency between the two.
- 13B. Substantially limit the information reported in the PAR, in conformity with the criteria above.

### 14. Budget Briefing Book

SBA prepares a budget briefing book that contains budget formulation and execution information related to the various loan program cash flow models and outputs, such as the original and re-estimated subsidy rates, as well as re-estimates for each program and cohort, key assumptions, and external and internal factors affecting the execution rates developed as part of budget formulation. We utilize the information in the budget briefing book during our audit. We noted that the budget briefing book supporting the FY 2005 budget formulation process was not complete for all programs and contained incorrect re-estimate amounts. Accordingly, we were not able to rely on this information as part of the audit.

OMB Circular No.A-123, *Management Accountability and Control*, states:

*“Management controls are the organization, policies, and procedures used to reasonably ensure that ... reliable and timely information is obtained, maintained, reported and used for decision making.”*

### Recommendation

- 14A. We recommend that the CFO ensure that the information in its budget briefing book is accurate and complete so that it can be useful to SBA management and used as evidential matter in support of our audit conclusions.

### 15. Disaster Loan Program Cohort 1996 Loan Data

SBA noted in its Disaster Loan Program re-estimate documentation that the 1996 Cohort loan data in the “findata” file was defective and unusable. SBA stated that the reason for the defect and its resolution were under investigation. As a result, SBA used an earlier version of “findata” and applied off-line procedures in preparing its 1996 Cohort re-estimate. Such off-line procedures were not well-documented and could not be validated by SBA’s Independent Verification and Validation contractor or Cotton & Company.

Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees*, states that:

*“the effort to make accurate projections should begin with establishing and using reliable records of historical credit performance data.”*

### Recommendation

- 15A. We recommend that the CFO, in coordination with OFA, complete its analysis of the 1996 Cohort data, identify the cause for the defective data and either resolve the condition or develop a “workaround” that is clearly documented and can be independently validated to ensure and support the reasonableness of the 1996 Cohort re-estimates.



## 16. Section 504 Credit Subsidy Cash Flow Model

Our review of SBA's 504 cash flow model disclosed that the model and documentation appear to be carefully and objectively prepared, according to sound statistical and econometric principles and practice. However, the model documentation could be enhanced by:

- Clearly stating the model version and history.
- Showing the computed default and prepayment conditional probabilities resulting from the default and prepayment model components.
- Explaining the way in which the conditional probabilities are used in the cash flow projections.
- Including the developers' tables summarizing model selection, utilizing the Schwarz criterion, to support how the models were chosen.

In addition, we experienced difficulty in replicating the final run of the model, using the model and documentation as delivered, which could be prevented with relatively minor changes.

FASAB's Technical Release No. 6 states that agencies should:

*Document the agency's cash flow model(s) used, the rationale for selecting the specific methodologies, and the degree of calibration within the model(s).*

### Recommendation

16A. We recommend that the CFO consider enhancing the 504 model documentation by including the items noted above and clarifying the documentation to enable an independent programmer to effectively and efficiently replicate the model run.