

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

AUDIT REPORT
Issue Date: July 11, 2000
Report Number: 0-20

TO: Joseph P. Loddo
Chief Financial Officer

FROM: Robert G. Seabrooks
Assistant Inspector General for Auditing

SUBJECT: Review of SBA's Financial Reporting Process

Attached is a copy of the report on SBA's Financial Reporting System issued by Cotton & Co., LLP. The report describes the systems and processes SBA uses to prepare its annual financial statements. The review was performed pursuant to the Conference Report on H.R. 3194, Consolidated Appropriations Act, 2000. The report includes two recommendations related to (1) preparing quarterly financial statements and (2) implementing an integrated standard general ledger. Your response to the draft report stated that it is a fair assessment of SBA's financial reporting over the last two years and describes the actions your office is taking to improve this process. A copy of your response is included as Attachment 2.

The findings included in this report are the conclusions of the Office of Inspector General's Auditing Division. **The findings and recommendations are subject to review, management decision, and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.** Please provide your proposed management decisions for the recommendations on the attached SBA Forms 1824, Recommendation Action Sheet, within 30 days. If you disagree with a recommendation, please provide your reasons in writing.

This report may contain proprietary information subject to the provisions of 18 USC 1905. Do not release to the public or another agency without permission of the Office of Inspector General. Should you or your staff have any questions, please contact Robert Hultberg, Director, Business Development Programs Group at (202) 205-7204.

Attachment

**INDEPENDENT ACCOUNTANT'S
REPORT ON THE PERFORMANCE AUDIT OF
SBA FINANCIAL REPORTING SYSTEM**

Performed by:

**Cotton & Company LLP
333 North Fairfax Street, Suite 401
Alexandria, Virginia 22314**

COTTON & COMPANY LLP

CERTIFIED PUBLIC ACCOUNTANTS

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

CHARLES HAYWARD, CPA, CFE, CISA
MATTHEW H. JOHNSON, CPA, CGFM

DWIGHT L. COTTON, CPA, CFE, CGFM
MICHAEL W. GILLESPIE, CPA, CFE
SANDRA A. HADLEY, CPA, CGFM

CATHERINE L. NOCERA, CPA
COLETTE Y. WILSON, CPA

June 7, 2000

U.S. Small Business Administration
Office of Inspector General

The Chief Financial Officers (CFO) Act and the Government Management Reform Act (GMRA) require SBA and other Federal agencies to prepare annual financial statements. These laws also require Inspectors General—or independent auditors under contract to Inspectors General—to audit and report on those statements by March 1 following the end of each fiscal year. SBA did not provide its Fiscal Year (FY) 1998 financial statements to the auditors until 3 months after the audit report was due. Because of significant errors and omissions in the FY 1998 statements, the auditors did not complete audit work and issue their report until September 1999—more than 6 months late.

Because SBA's financial statements and corresponding audit report were late, the Senate Appropriations Committee directed SBA's Office of Inspector General (OIG) to review the integrity of SBA's internal financial management systems, including an examination of its difficulties in completing annual financial statements and account balances. SBA's OIG engaged Cotton & Company, LLP to conduct this review.

We reviewed applicable standard operating procedures and results of the FYs 1998 and 1999 financial statement audits. We also interviewed individuals in the Offices of SBA's Chief Financial Officer (OCFO) and Chief Information Officer (OCIO). We conducted fieldwork from April to June 2000. The audit was conducted in accordance with Government Auditing Standards, except as described below.

FOLLOW-UP ON PRIOR AUDITS

The scope of our audit did not include following up on findings and recommendations from previous audit reports.

BACKGROUND

SBA's financial reporting system is complex and labor intensive. SBA faced additional challenges in FYs 1998 and 1999 that made preparation of its financial statements even more difficult. In FY 1998, full implementation of Office of Management and Budget (OMB) Bulletin 97-01 required preparation of three new statements. Although SBA developed a process to develop these new statements, they were submitted 5 months late due to the extensive work and complexity involved in this process. As a result, the auditors reported that SBA's financial reporting process was a material weakness¹. Specifically, the auditors found that:

- SBA lacked a detailed, comprehensive plan or methodology for preparing financial statements.

¹ Material weaknesses are reportable conditions in which the design or operation of one or more of the 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.

- SBA’s quality control process was only partially effective.
- SBA management did not dedicate enough resources to ensure timely completion of its financial statements.

In FY 1999, SBA moved its primary financial reporting activities from the Washington, DC, Central Office to the Denver Finance Center (DFC). Although SBA provided training to personnel assigned responsibility for financial statement preparation, FY 1999 was their first year to prepare these reports. Also, SBA held its first loan asset sale late in FY 1999, and this combined with the accounting complexities of such a sale, adversely affected FY 1999 financial statement preparation. Although the statements were prepared in time to meet the statutory deadline, the auditors again identified the financial reporting process as a material weakness.

Like other Federal agencies, SBA accounts for its activities using both budgetary and proprietary accounting. Budgetary accounting involves the processes, controls, monitoring, and reporting required to track execution of the budget laws of Congress. Proprietary accounting is similar to the process used in the private sector to account for assets, liabilities, investments, revenues, and expenses.

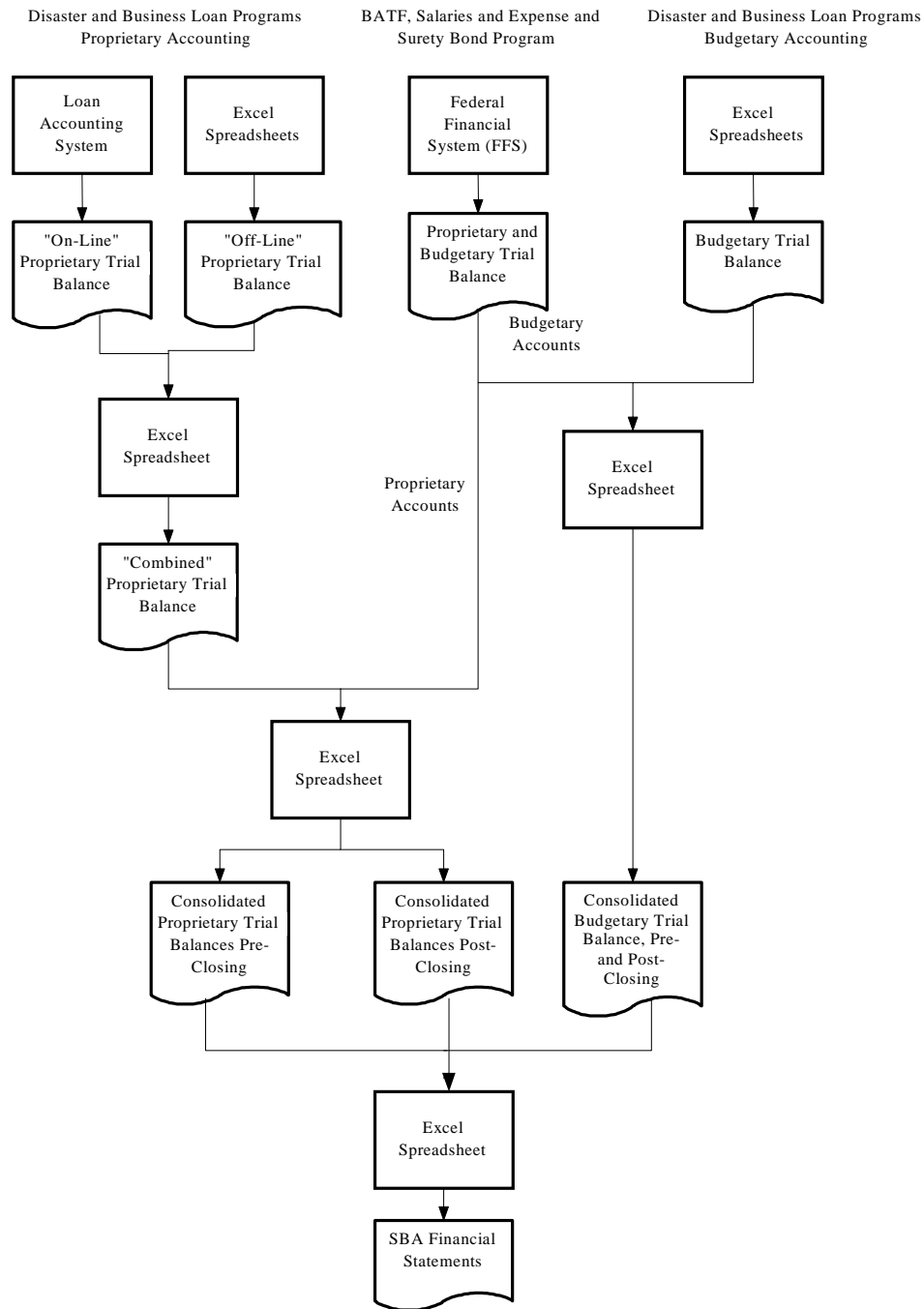
Both budgetary and proprietary accounting involve the use of funds. In federal accounting, the term “fund” means a Congressional appropriation of money or other budget authority directing an agency to incur obligations and make expenditures on behalf of the federal government. SBA accounts for its activities using 12 funds in five categories: Salaries and Expenses (S&E) – two funds, Surety Bond Guarantees (SBG), Disaster Loans (DL) – three funds, Business Loans (BL) – five funds, and the Business Assistance Trust Fund (BATF). SBA uses four systems to record and report on the transactions that occur in these funds:

1. Proprietary and budgetary accounting for S&E, SBG, and BATF transactions is performed using the Federal Financial System (FFS), an accounting package used by a number of other federal agencies. SBG transactions are recorded in a SBA-developed database system and loaded into FFS through an automated interface.
2. Proprietary accounting for BL and DL transactions is performed using the Loan Accounting System (LAS) and an array of Excel spreadsheets. There are eight funds associated with the loan programs. The DL program, for example, has a liquidating fund for pre-1992 loans, a program fund for appropriations on post-1991 loans, and a financing fund for cash flows on post-1991 loans. Accounting for these programs is further complicated by the Federal Credit Reform Act, which requires agencies to account for loans approved after 1991 by year of approval, or cohort. Because LAS does not fully support such requirements, SBA maintains an array of almost 70 separate Excel spreadsheet ledgers to perform the off-line portion of proprietary accounting for the financing and program funds of its post-Credit Reform loans. This number grows each year as new cohorts are added.
3. Budgetary accounting for the BL and DL programs is also performed on Excel spreadsheets. Because LAS does not support budgetary accounting, SBA has developed a process that involves querying hundreds of thousands of transactions processed in LAS. Through this process, SBA updates and maintains over 50 Excel spreadsheets, each containing over 150,000 cells of data, to determine budgetary account balances for the loan programs.
4. SBA uses these first three systems to produce pre-closing and post-closing trial balances² for each

² A pre-closing trial balance is a report of account balances before certain accounts are closed for the year. For example, revenue and expense accounts are closed (balance is brought to zero) at the beginning of each year; before these accounts are closed, a pre-closing trial balance is prepared. After these accounts are closed, a post-closing trial balance is prepared.

fund. Trial balances provide the data necessary to prepare the financial statements. Then the agency uses a fourth “consolidation” system to prepare its financial statements. The consolidation system involves another three Excel spreadsheets that combine the fund trial balances as follows: 1) a pre-closing trial balance for proprietary accounts, 2) a post-closing trial balance for proprietary accounts, and 3) a combined pre- and post- closing trial balance for budgetary accounts.

SBA’s financial reporting process is depicted below and described in detail in Attachment 1.



EVALUATION OF THE FINANCIAL REPORTING SYSTEM

SBA made improvements in FY 1999, most notably by submitting its financial statements to the auditors in January 2000, 5 months earlier than the prior year. Much, however, remains to be done. SBA's financial reporting system does not ensure that its financial statements will be prepared in a timely manner, free of material misstatements. Specifically, SBA:

- **Lacks a single integrated general ledger.** OMB Circular A-127 requires that each agency establish and maintain a single, integrated financial management system. SBA's system is not integrated. As a result, transactions are entered repeatedly in the process of preparing financial statements. In addition, the chart of accounts is not consistent among funds, which results in confusion, and the need for extensive conversion and data manipulation in the preparation of consolidated trial balances.
- **Relies on complex, error prone, manual processing.** LAS does not fully support the general ledger proprietary accounting requirements of SBA's loan programs and does not support budgetary accounting requirements at all. The systems that SBA has developed to address these shortcomings are cumbersome, labor intensive, and heavily reliant on manual keying and re-keying of data and account balances.
- **Lacks comprehensive plans and procedures for preparing financial statements.** During the FY 1998 audit, the auditors found that SBA's procedural documentation describing the requirements of and procedures for preparing financial statements was not sufficiently detailed. During FY 1999, that condition continued to exist. As a result of this and the extensive need for manual processing, SBA accountants responsible for the fund accounts do not process and record transactions in a consistent manner, which results in different reporting of similar transactions.

EFFECTS OF WEAKNESSES AND PROBLEMS

Financial management systems should enable program managers to operate their programs efficiently, effectively, and economically; facilitate accurate reporting to the President, Congress, program management and the public on a timely basis; and support efforts to deter fraud, waste, and mismanagement of federal resources.

Without a single, integrated financial management system to ensure timely and accurate financial reporting to the President, Congress, program management and the public, poor policy decisions may result; scarce resources are more likely to be directed toward collection of information rather than delivery of intended programs; and modifications to financial management systems necessary to keep pace with rapidly changing user requirements cannot be coordinated and managed properly.

In FYs 1998 and 1999, we found accounts incorrectly classified, errors in posting amounts, line items inconsistently labeled among funds, unusual and abnormal balances remaining undetected, preparation of trial balances and financial statements in an inconsistent manner among funds, and staff and management unfamiliar with accounting requirements. As a result, information to facilitate better decision-making is not routinely available to the SBA Administrator and program office heads to manage funds and link financial execution with program results.

CURRENT STATUS

Subsequent to the completion of the FY 1999 financial statement audit on February 29, 2000, the SBA began a significant project that will potentially address the weaknesses identified in this document. As of June, 2000, the SBA was working to complete a redesign and implementation of a new automated consolidation system for their financial reporting process. This redesign includes a consolidated general ledger; crosswalks to reflect activity in required SGL accounts; an automated journal voucher system which automates budgetary accounting entries and assures consistency; and feeder systems that eliminate most of the manual spreadsheet applications and re-keying of data. This new system also has automated quality checks to assure that the data entered is accurate and reliable. In addition, the SBA has recently hired a contractor to help assemble their documentation on reporting procedures into a comprehensive financial reporting plan. This contractor is also supposed to validate the logic and routines of the new consolidation system, validate proforma tables and SGL crosswalks, validate mapping models from the consolidated general ledger to the financial reports; and provide additional training to management and staff. SBA's new reporting system should enable the SBA to produce periodic reports during the upcoming fiscal year which will better prepare SBA for accurate and timely year-end reporting.

While this new system has yet to produce any financial statements for audit purposes, we are encouraged that if fully implemented, it may overcome the weaknesses we reported in the FY 1999 financial statement audit and in this document.

MANAGEMENT CONTROLS

The scope of our audit did not include assessing management controls, and thus we did not identify or test such controls.

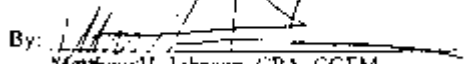
RECOMMENDATIONS

In addition to the recommendations we made in the FY 1999 Independent Auditors Report on Internal Controls involving resources, training, procedures, consistency, and automation, we recommend that the Chief Financial Officer (CFO):

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

MANAGEMENT RESPONSE

In response to the draft of this report SBA management agreed that it includes a fair assessment of SBA's financial reporting over the last two years. The response also describes some of the progress made toward improving this process and indicates a strong management commitment toward making further improvements. A copy of the response is provided on Attachment 2.

COTTON & COMPANY LLP
By: 
Matthew H. Johnson, CPA, CGFM

FINANCIAL REPORTING PROCESS U.S. SMALL BUSINESS ADMINISTRATION, FISCAL YEAR 1999

The U.S. Small Business Administration's (SBA's) financial reporting process is composed of the following four major components:

- Federal Financial System
- Loan Accounting System
- Budgetary Accounting
- Consolidation

FEDERAL FINANCIAL SYSTEM

Accounting for SBA's Salaries and Expenses Fund (S&E), Office of Inspector General Fund (OIG) and Business Assistance Trust Fund (BATF) is performed using the Federal Financial System (FFS), an automated accounting system owned and operated by the Department of Treasury's Financial Management Services (FMS). Through a memorandum of understanding with FMS, SBA administrative personnel at the Central Office and field offices use FFS to process travel, imprest fund and vendor payment transactions, and maintain accounting records. The Denver Finance Center (DFC) uses FFS for the same purposes plus payroll. FFS has a general ledger subsystem that provides an audit trail of transactions and data needed for generating accounting reports.

Transactions are recorded in FFS using transaction codes and transaction types. FFS is programmed to debit and credit appropriate accounts based upon transaction code and type. Additionally, year-end accruals, error corrections, and other adjustments are entered in FFS through the use of journal vouchers. FFS generates trial balances by fund and budget fiscal year. SBA does not, however, have access to an FFS reporting module, but instead orders individual reports from FMS and pays for each report ordered. SBA orders a detailed report every month in a text file and re-keys the data onto an Excel spreadsheet. Thus, it obtains financial summary information from Excel spreadsheets rather than directly from FFS.

The Surety Bond Program, used for recording activities under the Surety Bond Guarantees Revolving Fund (SBG), is also interfaced with FFS. After FFS has been updated with SBG data, trial balances are prepared in the same manner as described above.

For FY 1999, SBA obtained both pre- and post-closing trial balances from FFS. The trial balances were prepared by fund and by budget fiscal year. Thus, specific summary account balances by fund were not readily available, and SBA re-keyed the over-200-page trial balance onto an Excel spreadsheet and sorted the data by fund and general ledger account. Once sorted, SBA could obtain account balances; prepare trial balances for S&E, OIG, BATF, and SBG; and then prepare financial statements for these funds.

LOAN ACCOUNTING SYSTEM

Accounting for SBA's Business Loan (BL) and Disaster Loan (DL) Programs is conducted through the Loan Accounting System (LAS) – the online general ledger, and an array of Excel spreadsheets – the off-line general ledger. LAS is primarily used to track history and balances of specific loans, and the Excel spreadsheets are used to record transactions that do not impact a specific loan.

SBA personnel at the Central Office and at field offices enter transactions into LAS through transaction codes. The transaction codes adjust general ledger account balances at a loan-level basis. LAS is programmed to debit or credit specific accounts depending on the transaction code. Additionally, DFC personnel are able to adjust LAS balances through the use of journal vouchers. LAS generates trial balances by fund, the MARS 317 report.

Certain transactions are not, however, identifiable by loan number and are recorded off-line on Excel spreadsheets. These include year-end and month-end accruals of interest receivable, which is the interest from the most recent posting date to the cut-off reporting period; borrowings from Treasury in the financing funds; and appropriations received. These off-line general ledgers are maintained by fund for the eight funds: three each for financing funds and liquidating funds, and two for program funds,

Because accounting for the loans approved after FY 1991 must be in accordance with the Federal Credit Reform Act (FCRA), fund balances and transactions must be maintained at the cohort level (year of loan approval) for the financing funds and program funds. As a result, these funds must be accounted for by fiscal year of loan approval, going back to October 1st 1991. To comply with this requirement, SBA maintained its off-line general ledgers in FY 1999 on 68 separate Excel files. The number of files increases each year as new cohorts and annual funds are added.

Recording transactions onto Excel spreadsheets is done exclusively through the use of journal vouchers. FY 1999 accounting required the use of more than 3,000 journal entries to maintain the off-line general ledgers. Each of the 68 Excel files contains 14 spreadsheets, one for each of the 12 months in the year, one for making closing journal entries, and one for presenting the final trial balance.

The final trial balance sheet has rows that list all SBA general ledger accounts. Its 25 columns show transactions in the 12 months and the accumulated balance after each month's transaction. This final trial balance is linked with the 12 monthly sheets and the closing journal entry sheet and is thus automatically updated when journal vouchers are entered on the other spreadsheets. The 12 monthly spreadsheets are divided into 5 sections representing the 1000 to 5000 account series. Each journal entry made to an account is listed under the account as a debit or credit, and the journal voucher number is listed as reference.

One full-time staff member managed the off-line journal voucher system in FY 1999. Fund accountants prepared the journal vouchers and gave hardcopies to the staff member responsible for entering them onto the 68 Excel files.

After both the online trial balance (MARS 317) and off-line trial balance are complete, data are re-keyed onto another Excel spreadsheet that produces the combined trial balance. Account balances are entered onto an Excel spreadsheet by fund; each fund is linked to a summary spreadsheet, thus allowing for a combined trial balance for both the BL and DL Programs.

BUDGETARY ACCOUNTING

SBA uses two systems to track budgetary activities. It uses FFS to account for budgetary transactions within S&E, OIG, BATH, and SBG. SBA's Budget Office uses the Loan Accounting Allotment (LAA) system to monitor the budget for loan approvals. LAA is not, however, interfaced with LAS, which is used to account for SBA's BL and DL Programs. In this section, we describe SBA's budgetary accounting system for transactions associated with LAS.

To prepare off-line budgetary general ledgers, the Office of Chief Information Officer (OCIO) prepares a general ledger report, which is by transaction code and date from LAS; the Office of the Chief Financial Officer (OCFO) downloads the detailed general ledger report into an Access database. DFC

personnel then query reports by fund in Access. Budgetary account balances were computed based on a combination of transaction codes and General Ledger accounts.

The off-line general ledger system includes one Excel spreadsheet for each fund, cohort year (the loan-approval year), and one for each funding year (the year the appropriation was received). The BL Program (Fund 1154) and the DL Program (Fund 1152) receive annual and multi-year appropriations from Treasury. Thus, budgetary information for these funds is maintained by budget fiscal year, which is from FY 1992 (the first year of Credit Reform) to the current year. In addition, spreadsheets are maintained for each cohort year, also from FY 1992 to the current year. In total, 16 spreadsheets are kept for each of the two program funds; the number of files will increase each year as new cohorts and annual funds are added.

SBA also has three “financing funds:”

- Business Direct Loans (Fund 4148)
- Business Guaranteed Loans (Fund 4149)
- Disaster Direct Loans (Fund 4150)

Budgetary information for these financing funds must be maintained by cohort year. Thus, each of the eight business direct and guaranteed loan cohorts are maintained on separate spreadsheets; the DL Program is maintained on one spreadsheet with columns for each cohort year. In total, 17 spreadsheets are maintained for these financing funds. The number of these files will increase each year as new cohorts and annual funds are added.

SBA also has two “liquidating funds:”

- Disaster Loan Liquidating (Fund 4153)
- Business Loan Liquidating (Fund 4154)

These funds are pre-Credit Reform funds and, as such, do not require maintenance by cohort year. These two funds are maintained on separate spreadsheets.

In total, SBA updates and maintains over 50 spreadsheets for performing budgetary accounting of its BL and DL Programs. Each spreadsheet has more than 2,000 rows and 80 columns.

CONSOLIDATION

Consolidation is the final stage in the preparation of the financial statements. Account balances from each fund are re-keyed into the (1) pre-closing trial balance for proprietary accounts, (2) post-closing trial balance for proprietary accounts, and (3) combined pre- and post-closing trial balance for budgetary accounts. FFS and LAS do not use the same chart of accounts; thus, SBA prepares a crosswalk to properly classify accounts. Each of the three trial balances contains 13 spreadsheets: one for each of SBA’s 12 funds and one summary spreadsheet. They have the following characteristics:

- Each spreadsheet contains balances for more than 200 accounts, however, on some spreadsheets less than 50 accounts contain a balance.
- Each account has six columns:
 - On-line balance
 - Off-line balance
 - Adjustments

- Combined pre-audited trial balance (summarizing columns 1-3)
- Audit adjustment column
- Post-audited trial balance (summarizing columns 4-5)

When the consolidated trial balances are complete, SBA prepares its financial statements and footnotes following the guidance of Office of Management and Budget (OMB) Bulletin 97-01 SBA prepares the combined financial statements on five Excel spreadsheets, one for each of the following financial statements:

- Balance Sheet
- Consolidated Statement of Changes in Net Position
- Combined Statement of Budgetary Resources
- Combined Statement of Financing
- Combined Statement of Net Cost

With the exception of the Combined Statement of Net Cost, prepared only at the agency level, these statements are required for each of the following seven programs:

- Business Loan and Investment (Funds 1154, 4148, 4149, and 4154)
- Disaster Loan (Funds 1152, 4153, 4150)
- Surety Bond Guarantees (Fund 4156)
- Salaries and Expenses (Fund 0100).
- Business Assistance Trust Fund (Fund 8477)
- Pollution Control Equipment Fund Liquidating Account (Fund 4147)
- Office of Inspector General (Fund 0200)

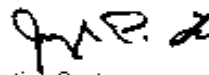
The consolidated statements are linked to other Excel spreadsheets, which are statements presented by program as discussed above. These spreadsheets have the following characteristics:

- Each spreadsheet is a financial statement with seven columns representing the seven programs.
- The financial statements for each program are prepared from the trial balance by following the SGL crosswalks to standard external reports, published by Financial Management Service.
- Line item amounts for the financial statements are obtained by matching or crosswalking to the proper general ledger account on the trial balances. For example, according to the SGL crosswalk, the loans receivable line item on the balance sheet statement is a summary of eight SGL account balances. Because LAS does not, however, follow SGL, 32 SBA general ledger accounts “crosswalk” to the 8 SGL accounts. SBA has three loan programs (Disaster Direct, Business Direct, and Business Guarantee) accounted for by seven funds. The 32 general ledger accounts must be manually added seven times to get the loans receivable balance for each fund. The fund balance is then summarized by program, and the program balances are combined to determine the final loans receivable balance for the entire agency.

Finally, each set of financial statements is combined to produce the consolidated financial statements.



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

Date: June 30, 2000
To: Robert G. Seabrooks, Assistant Inspector General for Auditing
From: Joseph P. Laddo, Chief Financial Officer 
Subject: Performance Audit of SBA Financial Reporting System

Thank you for the opportunity to respond to the June 7, 2000 revised draft report from Colton & Company entitled "Report on the Performance Audit of SBA Financial Reporting System." We want to first thank you for taking the extra time to visit and talk with the Denver Finance Center about the significant progress we have made in this area this fiscal year and for including this update in the revised draft that has been issued. We believe that our current plans will allow for this finding to be removed as a material weakness in the FY 2000 audit, and we are fully committed to executing the plan so that this can be assured. Also, we believe it is important to note that considering the complexity of SBA's financial reporting process and its related financial systems, it is a significant success that the SBA was the first credit agency to receive an unqualified opinion on its financial statements in FY 1996, and is the only credit agency to maintain an unqualified opinion for four consecutive years. This provides the ultimate assurance that SBA's financial house is in order.

Colton's report includes a fair assessment of SBA's financial reporting over the last two years. The SBA, along with a number of other agencies, was delinquent in submitting its financial statements three months late for FY 1998. As you know, this was principally caused by the addition of new reporting requirements that were rather extensive. This lateness prompted a Congressional request for the independent audit that is contained in this draft audit report. However, despite being late, the final audit report issued by the OIG in September 1999 contained an unqualified opinion - the highest rating available on an audit report.

Subsequent to the FY 1998 audit, on November 18, 1999, the SBA met with OMB, GAO and Treasury officials, as well as its independent auditor Colton & Co., to fully analyze the reasons for the lateness and to present detailed plans to all parties involved to ensure that the FY 1999 financial statements and OIG audit would be completed by the March 1st deadline. At this meeting, the SBA affirmed its commitment toward a timely submission for its FY 1999 reports, as well as its intention to maintain its unqualified opinion and improve upon its internal control status for its FY 1999 audit. SBA also announced its intentions to automate much of their manual systems at this meeting primarily through the implementation of the SBA's Systems Modernization Initiative (SMI). This initiative is a comprehensive and long-range plan that will replace and modernize SBA's current financial systems. The continual commitment by SBA toward this initiative and the continual provision of annual funding by the Congress for the SMI is essential to us meeting this objective.

Using a largely manual and extremely complex reporting system, the SBA provided its financial statements on time, and the SBA met the March 1st audit date. This audit provided SBA's fourth consecutive unqualified opinion and acknowledged the reduction of material internal control weaknesses from three items to two in this short time period since the September 1999 release of the FY 1998 audit.

The FY 1999 audit report still contained a material weakness related to SBA's financial reporting process. This weakness was due to: (1) The lack of a comprehensive reporting plan; (2) The need for a more effective quality review process; (3) The need for more resources in the reporting process; and, (4) The need for training related to the ongoing transfer of the statement preparation responsibility to the Denver Finance Center. We fully acknowledge these weaknesses.

In addition to our long range plans to correct most of these weaknesses through our SMI project, SBA decided to begin correction of these within its existing systems during FY 2000, so that the material weakness could be removed for FY 2000. Our goal is to achieve an unqualified opinion for FY 2000 with no material weaknesses.

You have worked closely with us as we developed our financial reporting plan for FY 2000, including our automation efforts to address the weaknesses. I am pleased to note that this revised draft report added the section entitled "Current Status" to capture this important information so that the Congress can see the significant efforts and progress that we have made toward this area. As described in this section, we are automating most of the previously manual reporting processes, building extensive quality assurance routines into a consolidated reporting system, and undertaking a major documentation project. Our new reporting process will have a single, Combined General Ledger (CGL) into which all SBA financial activity will be fed. This CGL is driven by a number of proforma tables, standard general ledger crosswalks and accounting proofs to ensure accuracy and consistency in our financial reporting process. In addition, to further address Cotton's FY 1999 recommendations, we have hired a contractor to assist with the validation of the system operation, tables, crosswalks and documentation over the next three months.

We are concerned that the language remaining in the revised draft report will be interpreted by the readers as being overly cautious regarding the ability of SBA's reporting plan to overcome the identified weaknesses. We are confident that, when fully executed, our plan will sufficiently address the weaknesses previously identified by Cotton, and we understand that they agree. If you or Cotton have any reservations about this, we would appreciate knowing the specifics of your concerns so that they can be addressed in the time remaining before the reports are produced for FY 2000.

Your revised draft report contains recommendations for the OCFO to 1) prepare quarterly financial statements to be better prepared for yearend reporting, and 2) to implement an integrated standard general ledger for all of SBA's program and administrative funds. Generally, we support these recommendations. As to the first recommendation, our new CGL system will be used to produce timely FY 2000 statements, and, once fully implemented, it will be able to produce quarterly (and even monthly) financial statement data for FY 2001. As to the second recommendation, we are working toward the Circular A-127 requirement to have a "single, integrated financial management system" that can be relied upon for accurate financial reporting. I believe our new CGL system will unify the various current reporting systems so that we will be in substantial compliance with the Circular this year. In addition, as mentioned above, the SBA is implementing the SMI, which will result in a fully integrated financial management system and processes for the SBA. We are currently in our final stage of planning to procure a new, integrated core financial system that will be implemented over the next two years. The administrative portion is planned to be fully operational by October 1, 2001, and all of loan accounting will be completed soon thereafter.

The SBA is committed to being a 21st century leading-edge institution. Part of this commitment is to maintain an unqualified opinion each year, and to fully eliminate any material weaknesses in our financial management processes. I believe that the actions underway at the SBA in both the financial reporting area and the system security area will allow us to achieve this goal. I am glad to answer any questions that you may have on this response and look forward to working closely with you throughout this process..

REPORT DISTRIBUTION

<u>Recipient</u>	<u>Copies</u>
Administrator	1
Deputy Administrator	1
Associate Deputy Administrator for Management & Administration	1
Associate Administrator for Field Operations	1
Assistant Administrator Office of Congressional & Legislative Affairs	1
Associate Administrator Office of Financial Assistance	1
Chief Information Officer	1
General Counsel	2
General Accounting Office	2