

FEDERAL MANAGERS FINANCIAL INTEGRITY ACT (FMFIA) ASSURANCE STATEMENT FY 2005

I am pleased to report that the Small Business Administration continued to strengthen the internal control over its programs and operations during FY 2005 and obtained a substantial improvement in SBA's audit result. Our auditor issued an "unqualified" opinion on SBA's FY 2005 financial statements with only one material weakness. This was a significant improvement over last year's "qualified" opinion with two material internal control weaknesses. This improvement was achieved even while SBA adhered, for the second year, to the accelerated deadline of November 15th for the issuance of audited financial statements and the FY 2005 Performance and Accountability Report (PAR).

More specifically, during FY 2005 our credit subsidy process improved significantly due to a number of quality assurance steps that eliminated last year's internal control weakness. Although the auditor continued to report a material internal control weakness in SBA's financial reporting process, great improvement was made here too through a number of quality assurance steps and adherence to a rigorous reporting and audit schedule. Also, the audit found internal control weaknesses in SBA's monitoring of disaster program obligations and information systems security. Action to improve SBA's internal controls is underway to address all the audit findings and recommendations.

The economic models used to forecast SBA's credit program costs have stabilized after a major rebuilding two years ago, and this year's audit did not find any discrepancies. During FY 2005, these models were again applied using the "Balances Approach" to reestimate the costs of SBA's business and disaster credit programs. Using this approach, the discounted present value of forecasted program cash flows are used to "true up" the loss allowance in our general ledger. The estimate of credit program costs is the most critical component of SBA's financial results, and the clean FY 2005 audit opinion confirms the validity of SBA's credit program cost determination. Difficulties experienced last year in the forecast methodology used in the models were overcome this year by a team effort committed to the timely delivery of reliable data.

The internal controls for SBA's program operations have continued to show improvement this year, and the system in place is basically sound. Agency managers have issued assertions as to the status of their FY 2005 internal controls, and these assertions are supported by checklists, reviews and other management activity. All managers attended training on the assertion requirements. Internal control improvement will continue to address business process, organization and resource issues and "Management Challenges" identified by SBA's management and auditors.

As reported in this PAR, SBA implemented improvements to address compliance with Federal Financial Management Improvement Act (FFMIA) accounting and systems standards. Although substantial improvement was made, because the SBA's independent auditor reported several instances of non-compliance with accounting and systems standards, I therefore cannot certify that SBA is in full compliance with FFMIA.

Overall, I am providing a "qualified" assurance that SBA's internal controls are achieving their intended objectives in accordance with the Office of Management and Budget Circular A-123 and the Federal

Managers Financial Integrity Act (FMFIA). I am qualifying this assurance because of the internal control weaknesses reported in the FY 2005 audit on SBA's financial reporting, Disaster program obligations, and information security.

We have substantially improved our reporting, obligations monitoring and information security, and we will make more progress in these areas in FY 2006. Also, we have begun work to substantially bolster internal control over FY 2006 financial reporting as required in the revised OMB Circular A-123. I am confident that these improvements will be reflected in improved SBA audit results in FY 2006. I will continue to take corrective action until all of the audit issues are resolved.



Hector V. Barreto
Administrator