

Updated information for Report No. 2-04

Subsequent Independent Auditor's Action Affecting Reliance on SBA's Audited Financial Statements for FY 2000 and 2001

The Small Business Administration (SBA) was notified on December 20, 2002 by its independent auditor that SBA's financial statements for fiscal years 2000 and 2001, and the auditor's reports thereon, should no longer be relied on. SBA has indicated it is committed to resolving the discrepancies which involve its disaster loan cost models and the related accounting as quickly as possible and will be issuing revised financial statements and audit reports upon completion of an analysis underway to assess the impact of the discrepancies. A copy of the letter dated January 6, 2003, notifying one of the various Congressional oversight Committees is attached along with the notification from the independent auditor.



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

JAN 6 2003

The Honorable John Kerry
Chairman
Committee on Small Business and Entrepreneurship
United States Senate
Washington, DC 20510

Dear Chairman Kerry:

The purpose of this letter is to make you aware that the U.S. Small Business Administration (SBA) has been advised by its independent auditor, Cotton & Company LLP (Cotton), "...that SBA's financial statements for fiscal years 2000 and 2001, and Cotton & Company's audit reports thereon, should no longer be relied upon." According to Cotton, those financial statements may need "material adjustments for...disaster loans sold, disaster loan subsidy expense, and other directly-related accounts and footnotes corresponding with the SBA's disaster loan program."

Current senior SBA management (including the new Chief Financial Officer team put in place by Administrator Barreto) became aware of this issue and was working to solve it prior to receiving Cotton's determination. SBA is closely examining its disaster loan subsidy cost calculation and is making every effort to resolve the issue by the end of March 2003. In addition to employing all available SBA staff, the Agency is contracting for assistance from outside experts to review and verify SBA's analysis. It is also important to recognize that the issue is limited solely to the disaster loan subsidy estimates and SBA's disaster loan sale results.

In short, at issue is the consistency and precision of SBA's methods for valuing its disaster loans sold through the asset sales program and those that are retained in the Agency's loan portfolio. SBA followed all of the guidance available in developing its cost models and validated that the models were consistent and satisfactory prior to beginning the sales program. However, over time the results have revealed inconsistencies between the model used to determine the loan "value to government" for sale purposes and the model required for measuring the program's budget and accounting cost under the Federal Credit Reform Act. The model used for disaster loan sales has shown a substantial gain while the model used for budgeting purposes has shown a loss. In addition, the models appear to lack the precision necessary for accurately valuing the impact of the asset sales on the disaster loan portfolio.

It is important to note that SBA's FY 2000 and FY 2001 financial statements both disclosed the accounting book losses associated with SBA's disaster loan sales.

SBA IS AN EQUAL OPPORTUNITY EMPLOYER AND PROVIDER

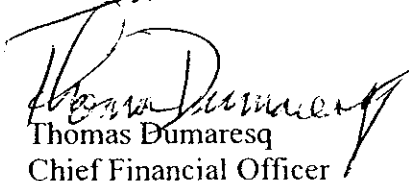


Furthermore, throughout the asset sales program, SBA has followed the budgeting and accounting guidance issued by the Office of Management and Budget and Financial Accounting Standards Advisory Board and sought outside experts to help develop the program and cost models.

SBA is committed to resolve the discrepancies as quickly as possible. The impact of our efforts to revise our disaster loan cost models and the related accounting, however, may affect the required appropriations for SBA's disaster loan program and the cost of SBA's disaster loan asset sales. Revised financial statements and audit reports will be issued upon completion, if necessary and appropriate.

If you have any questions or require any additional information, please do not hesitate to contact me at 202-205 6449.

Sincerely,



Thomas Dumaesq
Chief Financial Officer

COTTON & COMPANY LLP

auditors ♦ advisors

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

December 20, 2002

Mr. Thomas Dumaresq
Chief Financial Officer
U.S. Small Business Administration
409 Third Street, SW
Washington, DC 20416

Dear Mr. Dumaresq:

As required by auditing standards issued by the American Institute of Certified Public Accountants, this letter will advise you to notify all persons known to be relying or likely to rely upon SBA's FY 2000 and 2001 financial statements and related Cotton & Company audit reports that:

- Those financial statements and reports should no longer be relied on, because of the possibility that material adjustments may be necessary for disaster loans sold, disaster loan subsidy expense, and other directly-related accounts and footnotes corresponding with SBA's disaster loan program.
- Revised financial statements and audit reports will be issued upon completion and subject to the results of your investigation.

Before SBA makes its notification, please assure that you discuss with appropriate regulatory agencies the disclosure to be made or other measures to be taken in the circumstances.

Please refer to auditing standard AU 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report, for criteria governing our responsibilities. Cotton & Company will work with you to ensure that requirements are understood and met as they apply to this matter.

Very truly yours,

COTTON & COMPANY LLP



Charles Hayward, CPA

cc: Mr. Peter McClintock
Acting Inspector General


established 1981

**AUDIT OF SBA'S FY 2001
FINANCIAL STATEMENTS
AUDIT REPORT NUMBER 2-04
FEBRUARY 27, 2002**

This report may contain proprietary information subject to the provisions of 18 USC 1905 and must not be released to the public or another agency without permission of the Office of Inspector General.

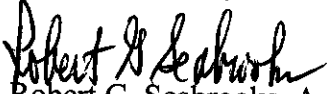


U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416

AUDIT REPORT

Issue Date: February 27, 2002

Number: 2-04

To: Joseph P. Loddo, Chief Financial Officer
From: 
Robert G. Seabrooks, Assistant Inspector General for Auditing
Subject: Audit of SBA's FY 2001 Financial Statements

Pursuant to the Chief Financial Officers Act of 1990, attached is the Independent Auditors' Report issued by Cotton & Company LLP. The auditors concluded that the financial statements present fairly, in all material respects, the financial position of SBA as of September 30, 2001, and 2000, and its net costs for the years then ended, and the changes in net position, budgetary resources, and financing for the year ended September 30, 2001, in conformity with generally accepted accounting principles.

The Independent Auditors' Report on Internal Control discusses four matters considered to be reportable conditions. The reportable condition related to the financial reporting process was deemed a material weakness as SBA continued to experience difficulties in producing complete, accurate, and timely financial statements. The other three reportable conditions include: (1) SBA's cash flow models used for determining subsidy re-estimates continue to contain errors that remain undetected by SBA; (2) SBA used a small non-representative sample to estimate the amount of excess of the Master Reserve Fund investment earnings over payments to certificate holders from those earnings; and (3) SBA's information system control environment continues to contain areas for improvements. The auditors found other management and internal control issues that will be communicated in a separate management letter.

The Independent Auditors' Report on Compliance with Laws and Regulations discusses that SBA was not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA). SBA's financial management systems did not substantially comply with FFMIA because (1) SBA's core financial system is not able to provide complete, reliable, timely, and consistent financial management information for external reporting and managing current operations, and (2) significant errors and misstatements were made in SBA's initial financial statements.

SBA management generally agreed with the auditors' findings and recommendations and stated that they believe the auditors' assessment of SBA's financial reporting process and internal control activities is fair. **The findings in this report are based on the auditors' 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 Robert G. Hultberg, Director, Business Development Programs Group at (202) 205-7577.

Attachments

AUDIT OF SBA'S FY 2001 FINANCIAL STATEMENTS

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COTTON & COMPANY LLP

auditors ♦ advisors

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

Inspector General
United States Small Business Administration

Independent Auditors' Report

We have audited the Balance Sheets of the U.S. Small Business Administration (SBA) as of September 30, 2001, and 2000, and the related Statements of Net Cost for the years then ended; we have also audited the related Statements of Changes in Net Position, Budgetary Resources, and Financing for the year ended September 30, 2001. These financial statements are the responsibility of SBA management and were prepared in accordance with Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with *Government Auditing Standards*, auditing standards generally accepted in the United States of America, and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures relating to 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SBA as of September 30, 2001, and 2000, and its net costs for the years then ended, and the changes in net position, budgetary resources, and financing for the year ended September 30, 2001, in conformity with generally accepted accounting principles.

As discussed in Note 5 to the financial statements, SBA changed its Fiscal Year (FY) 2001 presentation of assets for the Master Reserve Fund and restated the presentation of FY 2000 financial statements for consistency.

Our audits were conducted to form an opinion on SBA's financial statements taken as a whole. Information in the accompanying sections titled Management's Discussion and Analysis, Required Supplementary Information, Required Supplementary Stewardship Information, Other Accompanying Information, and Supplemental Financial Statements is not a required part of the financial statements, but is other information provided for additional analysis in accordance with OMB Bulletin No. 01-09. We did not audit the information in these sections and, therefore, express no opinion on them. We performed selected tests of this information, such as comparing it for consistency with the financial statements and footnotes.

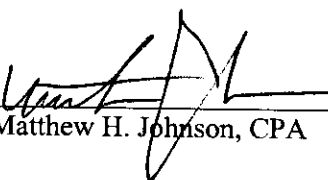


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In accordance with *Government Auditing Standards*, we issued separate reports dated February 20, 2002, on SBA's internal control and compliance with laws and regulations. Our reports on internal control and compliance are an integral part of an audit conducted in accordance with *Government Auditing Standards* and, in considering the results of the audits, those reports should be read together with this report.

COTTON & COMPANY LLP

By: 
Matthew H. Johnson, CPA

February 20, 2002
Alexandria, Virginia

COTTON & COMPANY LLP

auditors ♦ advisors

DAVID L. COTTON, CPA, CFE, CGFM ♦ CHARLES HAYWARD, CPA, CFE, CISA ♦ MICHAEL W. GILLESPIE, CPA, CFE ♦ CATHERINE L. NOCERA, CPA
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Inspector General
United States Small Business Administration

Independent Auditors' Report on Internal Control

We have audited the Balance Sheets of the U.S. Small Business Administration (SBA) as of September 30, 2001, and 2000, and the related Statements of Net Cost for the years then ended; we have also audited the related Statements of Changes in Net Position, Budgetary Resources, and Financing for the year ended September 30, 2001. We have issued our report thereon dated February 20, 2002. We conducted our audit in accordance with *Government Auditing Standards*, auditing standards generally accepted in the United States of America, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered SBA's internal control over financial reporting by obtaining an understanding of the agency's internal control, determining whether internal controls had been placed in operation, assessing the control risk, and performing tests of controls to determine auditing procedures for the purpose of expressing an opinion on the financial statements. We limited our internal control testing to 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 (FMFIA) of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect an agency'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 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. Because of inherent limitations in internal control, misstatements, losses, or noncompliance may nevertheless occur and not be detected.

We noted four matters involving internal control and its operation that we consider to be reportable conditions; we consider the first of these to be a material weakness. We will communicate non-reportable conditions to SBA in a separate management letter.



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A. FINANCIAL REPORTING PROCESS

SBA made efforts to improve its financial reporting process for fiscal year (FY) 2001. Even with improvements, SBA continued to experience difficulties in producing complete, accurate, and timely financial statements. In our report on internal control for FY 2000, we reported that the financial reporting process and procedures were not adequately documented, and a fully effective quality assurance process was not in place. During the FY 2001 audit, we found that documentation had improved, but the overall process had worsened.

For various internal reasons, SBA did not deliver its financial statements to the auditors by original agreed-upon dates, and these statements contained numerous errors and misclassifications. Further, in SBA's efforts to automate the financial reporting process, it created a mapping process that links account balances to financial statement line items; the audit trail, however, was not always clear and precise.

Late Delivery of Financial Statements

The Office of the Chief Financial Officer (OCFO) and Office of Inspector General (OIG) established dates at the beginning of fieldwork by which the financial statements would be provided to the auditors. These dates were intended to ensure adequate time for review and to allow SBA to meet OMB's reporting time frame. OCFO notified us on December 19, 2001, that it would be unable to meet original delivery dates. It then provided revised dates extending delivery of financial statements and supporting documentation by 11 to 21 days. We agreed to work within the revised schedule and complete the audit on schedule.

Errors and Misclassifications in Financial Statements

Some examples of the financial statement errors and misclassifications identified by the auditors are summarized below.

- Overstating accounts receivable and advances by approximately \$30 million on the Balance Sheet.
- Reporting nearly \$350 million in gross costs in the wrong line item on the Statement of Net Cost.
- Underreporting obligations incurred by approximately \$50 million on the Statement of Budgetary Resources (SBR) and the Statement of Financing.
- Excluding the reporting of \$1.1 billion of Offsetting Receipts on the Statement of Financing when the correct amount had already been reported on the SBR.

Further, we also identified inadequate and incomplete disclosures that resulted in significant changes to the financial statement notes. Although some of the changes were subjective improvements, many were simply errors and omissions. Neither SBA's process for preparing the statements nor its quality assurance process identified these errors prior to submission to the auditors.

Linkage Between Accounts and Financial Statements Was Unclear

In FY 2000, SBA significantly improved the labor-intensive process for preparing its financial statements by automating much of what had previously been accomplished through spreadsheets. The process did not, however, provide a clear audit trail to link account balances to financial statement line items. For example, to determine the composition of the line item "Borrowing Authority" on the SBR for the business loan program, it was necessary to trace the following mapping equation:

$$\text{=TRUNC}(\text{SUM}(\text{IF}(\text{((Data!T1:T8887="BudgetaryResources")}*(\text{Data!F1:F8887="1b"})) * (\text{Data!G1:G8887}=\{"X4148", "X4149"})), \text{Data!H1:H8887}))/1000))$$

Although this equation provided accurate results for the line item, it did not provide a clear trail for auditors or management attempting to determine the line item composition.

OMB Circular A-123, *Management Accountability and Control*, states:

[T]ransactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination.

Additionally, federal financial system requirements mandate that an agency's financial system provide the capability to prepare complete, reliable, timely and consistent consolidated financial statements as required by OMB.

Recommendations

1. We repeat our recommendation from last year that the Chief Financial Officer (CFO) continue SBA's efforts to improve the financial reporting process by completing documentation for all aspects of the financial reporting process, including preparing journal vouchers; calculating loss allowances; preparing and updating trial balances; preparing financial statements and footnotes; and updating the chart of accounts, transaction descriptions, Standard Operating Procedures, and guidance for conducting quality assurance reviews.
2. We recommend that the CFO prepare a compilation manual to assist in financial statement and footnote preparation. The manual should specifically identify the sources for all financial statement line items. Further, the manual should incorporate timelines, milestones, and controls to ensure that quality assurance reviews for technical and clerical accuracy are accomplished.
3. We also repeat our recommendation from FY 2000 that the CFO prepare consolidated agency-wide financial statements on a quarterly basis. OMB Bulletin No. 01-09 requires the preparation of March 31, 2002, semi-annual statements and quarterly statements beginning in FY 2003. We believe, however, that SBA should prepare quarterly statements in FY 2002 as well. This will allow SBA to identify and resolve issues and problems prior to year-end as well as meet Federal Financial Management Improvement Act requirements to provide reliable and timely financial information for managing current operations.

B. SUBSIDY RE-ESTIMATES

SBA's cash flow models used for determining subsidy re-estimates continue to contain errors that remain undetected by SBA. In FY 2000, we reported that SBA's quality control process over cash flow models used for budget estimates and financial statement re-estimates, as required under Credit Reform, was not completely effective. In FY 2001, we found similar errors, including data input and cell reference mistakes. These errors resulted in significant inaccuracies in the cash flow estimates and necessitated corrections to the Disaster, 7(a), and Small Business Investment Companies (SBIC) subsidy re-estimates.

To re-estimate subsidy rates for its 7(a), SBIC, and 504 business loan programs, SBA uses cash flow models developed within Excel spreadsheets. The results of these cash flow models are uploaded into OMB's subsidy rate calculator, which is used to calculate a subsidy rate. For the disaster loan program, sophisticated programming within SAS software is used to model cash flows, the results of which are then entered into a spreadsheet for uploading into the OMB calculator. The Director of the Office of Financial Analysis (OFA) developed procedures for review of cash flow worksheets but the procedures were not fully implemented.

SBA cannot assure that a simple key stroke error will not result in a significant error in the cash flow model and subsequent subsidy rate re-estimate. As such, even with procedures in place, accuracy over these spreadsheets can only be achieved through an extensive cell-by-cell review of the entire spreadsheet. SBA does not, however, conduct this type of review, because it would be inefficient.

Recommendations

4. We recommend that the CFO request the Director of OFA to develop, document, test, and implement an automated methodology or other alternative for accumulating cash flows necessary for subsidy rate calculations for each significant loan program at SBA. Until such time as a methodology is developed, SBA should verify the cash flow spreadsheet for each program on a cell-by-cell basis.
5. We recommend that the Director of OFA fully implement quality assurance procedures over the subsidy re-estimation process.

C. MASTER RESERVE FUND

In FY 2001, SBA changed the way it presents its ownership in earnings from the Master Reserve Fund (MRF). The change, an improvement over past practices, requires estimates of future liabilities that SBA was not sufficiently prepared to calculate.

SBA's fiscal transfer agent maintains the MRF to facilitate operation of the 7(a) secondary market program. Borrowers with SBA-guaranteed loans make periodic payments to lenders, who in turn submit payments to the MRF for loans sold on the secondary market. Payments to the secondary market certificate holders are made from the MRF on a monthly basis, and excess funds in the MRF are invested. Earnings on investments are used to fund shortages to certificate holders caused by timing differences between loans in the pool and the life of pool certificates. SBA owns any excess of earnings over payments to certificate holders.

In FY 2001, SBA used a small non-representative sample to estimate the amount of excess of the MRF investment earnings over payments to certificate holders from those earnings. Although we do not think that SBA's estimate is materially misstated, its estimation process could be improved.

Recommendation

6. We recommend that the CFO develop a process for estimating SBA's ownership in earnings from the MRF that provides accurate, complete, and timely data for the financial statements.

D. AGENCY-WIDE INFORMATION SYSTEMS CONTROLS

SBA continued to improve internal control over its information system environment in certain areas. Specifically, it accomplished the following during FY 2001:

- Conducted certification and accreditation reviews for additional major applications.
- Established an online security awareness-training program to instruct SBA Information Resources Management personnel and network system administrators.
- Continued implementation of a System Development Lifecycle Methodology to improve control over new system development, system enhancements, and program changes.

These actions are essential elements for a sound information system control environment. Areas for improvements do, however, continue to exist in each of the six control categories reviewed:

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

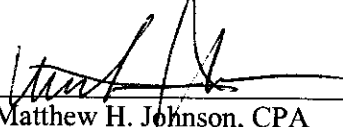
SBA's OIG will issue a separate report titled *Audit of SBA's Information System Controls, FY 2001*, that will detail our findings and recommendations in these six control categories.

In addition, we considered SBA's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the agency'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 and 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 performance measures reported in Management's Discussion and Analysis, Performance Goals and Results, we obtained an understanding of the design of significant internal control relating to existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

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

By: 
Matthew H. Johnson, CPA

February 20, 2002
Alexandria, Virginia

COTTON & COMPANY LLP

auditors ♦ advisors

DAVID L. COTTON, CPA, CFE, CGFM ♦ CHARLES HAYWARD, CPA, CFE, CISA ♦ MICHAEL W. GILLESPIE, CPA, CFE ♦ CATHERINE L. NOCERA, CPA
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Inspector General
United States Small Business Administration

Independent Auditors' Report on Compliance with Laws and Regulations

We have audited the Balance Sheets of the U.S. Small Business Administration (SBA) as of September 30, 2001, and 2000, and the related Statements of Net Cost for the years then ended; we have also audited the related Statements of Changes in Net Position, Budgetary Resources, and Financing for the year ended September 30, 2001. We have issued our report thereon dated February 20, 2002. We conducted our audit in accordance with *Government Auditing Standards*, auditing standards generally accepted in the United States of America, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

SBA management is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether its financial statements are free of material misstatement, we performed tests of SBA's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 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 we did not test compliance with all laws and regulations applicable to SBA.

The results of our tests of compliance disclosed no instances of noncompliance with laws and regulations discussed in the preceding paragraph, exclusive of FFMIA, that we are required to report under *Government Auditing Standards* or OMB Bulletin No. 01-02.

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

Results of our tests disclosed two instances, described below, in which SBA's financial management systems did not substantially comply with federal financial management system requirements and federal accounting standards.



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SBA's core financial system is not able to provide complete, reliable, timely and consistent financial management information on operations to enable management to fulfill its responsibility of being accountable to the public and provide timely financial information for managing current operations.

SBA is not in substantial compliance with federal accounting standards because of significant errors and misstatements in its initial financial statements prepared in accordance with the OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*.

Specific conditions attributable to these areas of noncompliance, as well as SBA's lack of adequate compensating internal control over its financial reporting process, and specific recommendations to address the problems identified are more fully described in our report on internal control dated February 20, 2002. SBA's Office of Chief Financial Officer is responsible for the financial management systems within SBA.

Results of our tests disclosed no instances in which SBA's financial management systems did not substantially comply with the U.S. Government Standard General Ledger requirements at the transaction level.

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

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

COTTON & COMPANY LLP

By: 

Matthew H. Johnson, CPA

February 20, 2002
Alexandria, Virginia



Financial Statements

of the

**U.S. Small Business
Administration**

for

Fiscal Year 2001

U. S. Small Business Administration
Consolidated Balance Sheet
as of September 30, 2001 and 2000

	(Dollars in Thousands)	
	2001	2000
ASSETS		
Intragovernmental Assets		
Fund Balances with Treasury (Note 2 and Note 3)	\$ 10,169,491	\$ 9,760,608
Accounts Receivable (Note 6)	376,087	386,870
Advances (Note 9)	2,496	3,074
Total Intragovernmental	10,548,074	10,150,552
Other Assets -Public		
Cash (Note 4)	2,443	3,458
Interest Receivable (Note 5)	68,000	58,000
Accounts Receivable (Note 6)	57,188	68,787
Credit Program Receivables and Related Foreclosed Property, Net (Note 7)	5,051,123	6,822,505
General Property and Equipment, Net (Note 8)	8,518	
Advances (Note 9)	253,708	162,077
Total Other Assets -Public	5,440,980	7,114,827
Total Assets	\$ 15,989,054	\$17,265,379
LIABILITIES (Note 10)		
Intragovernmental Liabilities		
Accounts Payable (Note 11)	\$ 698,233	\$ 741,300
Debt (Note 12)	10,218,415	10,171,555
Other (Note 14)	3,666,322	4,501,364
Total Intragovernmental	14,582,970	15,414,219
Other Liabilities -Public		
Accounts Payable (Note 11)	139,172	70,107
Liabilities for Loan Guarantees (Note 7)	1,083,020	1,279,184
FECA Actuarial Liability (Note 13)	32,255	30,746
Other (Note 14)	148,331	531,896
Total Other Liabilities -Public	1,402,778	1,911,933
Total Liabilities	\$ 15,985,748	\$17,326,152
NET POSITION		
Unexpended Appropriations	\$ 882,641	\$ 763,155
Cumulative Results of Operations	(879,335)	(823,928)
Total Net Position	\$ 3,306	\$ (60,773)
Total Liabilities and Net Position	\$ 15,989,054	\$17,265,379

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration
Consolidated Statement of Net Cost
for the periods ended September 30, 2001 and 2000

PROGRAMS	<i>(Dollars in Thousands)</i>	
	<u>2001</u>	<u>2000</u>
Business Programs		
Intragovernmental Gross Costs	\$ 2,933	\$ (133,828)
Less: Intragovernmental Earned Revenue	78,207	70,771
Intragovernmental - Net Costs	<u>\$ (75,274)</u>	<u>\$ (204,599)</u>
Gross Costs with the Public	\$ 305,917	\$ 257,176
Less: Earned Revenue from the Public	19,272	24,159
Net Costs with the Public	<u>\$ 286,645</u>	<u>\$ 233,017</u>
Net Cost of Business Programs	<u>\$ 211,371</u>	<u>\$ 28,418</u>
Disaster Assistance Programs		
Intragovernmental Gross Costs	\$ 838,565	\$ 1,050,416
Less: Intragovernmental Earned Revenue	436,414	491,997
Intragovernmental - Net Costs	<u>\$ 402,151</u>	<u>\$ 558,419</u>
Gross Costs with the Public	\$ 215,347	\$ 299,879
Less: Earned Revenue from the Public	159,018	274,145
Net Costs with the Public	<u>\$ 56,329</u>	<u>\$ 25,734</u>
Net Cost of Disaster Assistance Programs	<u>\$ 458,480</u>	<u>\$ 584,153</u>
Cost not assigned to Programs	\$ 26,631	\$ 38,947
Less: Earned Revenue not attributed to Programs	7,611	16,092
Net Cost of Operations	<u>\$ 688,871</u>	<u>\$ 635,426</u>
(Note 16)		

The accompanying notes are an integral part of these statements.

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

(Dollars in Thousands)

	<u>Cumulative Results of Operations</u>	<u>Unexpended Appropriations</u>	<u>Total</u>
Beginning Net Position - October 1	\$ (823,927)	\$ 763,154	\$ (60,773)
Prior Period Adjustments			
Beginning Net Position, as Adjusted	<u>(823,927)</u>	<u>763,154</u>	<u>(60,773)</u>
Budgetary Financing Sources			
Appropriations Received		969,117	969,117
Appropriations Transferred - in/out (+/-)		101,362	101,362
Rescissions		(31,972)	(31,972)
Adjustment - Cancelled Authority		(24,546)	(24,546)
Other Adjustments		(3,001)	(3,001)
Appropriations Used	891,473	(891,473)	
Donations of Cash and Cash Equivalents	77		77
Other Financing Sources			
Transfers - in/out Without Reimbursement (+/-)	(275,828)		(275,828)
Imputed Financing from Costs Absorbed by Others	17,741		17,741
Total Financing Sources	<u>\$ 633,463</u>	<u>\$ 119,487</u>	<u>\$ 752,950</u>
Net Cost of Operations	<u>\$ 688,871</u>	<u>\$</u>	<u>\$ 688,871</u>
Ending Net Position - September 30 (Note 17)	<u>\$ (879,335)</u>	<u>\$ 882,641</u>	<u>\$ 3,306</u>

The accompanying notes are an integral part of these statements.

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

	(Dollars in Thousands)		
	Budgetary	Non-Budgetary Financing	Total
BUDGETARY RESOURCES			
Budget Authority			
Appropriations Received	\$ 969,117	\$	\$ 969,117
Borrowing Authority		1,172,127	1,172,127
Net Transfers (+/-)	72,910		72,910
Unobligated Balance			
Brought Forward October 1	808,198	6,045,141	6,853,339
Net Transfers, Actual (+/-)	(184,638)		(184,638)
Spending Authority from Offsetting			
Collections	546,853	2,881,650	3,428,503
Recoveries of Prior Year Obligations	567,095	50,516	617,611
Permanently Not Available	(298,013)	(814,422)	(1,112,435)
Total Budgetary Resources	\$ 2,481,522	\$ 9,335,012	\$ 11,816,534
STATUS OF BUDGETARY RESOURCES			
	Budgetary	Non-Budgetary Financing	Total
Obligations Incurred	\$ 1,529,758	\$ 3,198,036	\$ 4,727,794
Unobligated Balances Available	604,193	1,945,018	2,549,211
Unobligated Balances Not Available	347,571	4,191,958	4,539,529
Total Status of Budgetary Resources	\$ 2,481,522	\$ 9,335,012	\$ 11,816,534
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS			
	Budgetary	Non-Budgetary Financing	Total
Obligated Balance, Beginning of Period	\$ 1,009,373	\$ 396,060	\$ 1,405,433
Obligated Balance, End of Period			
Accounts Receivable	(66,362)	(536,075)	(602,437)
Undelivered Orders	651,100	400,129	1,051,229
Accounts Payable	302,624	780,058	1,082,682
Total Obligated Balance, End of Period	887,363	644,112	1,531,475
Outlays			
Disbursements	1,208,178	2,868,596	4,076,774
Collections	(670,435)	(2,850,778)	(3,521,213)
Subtotal	537,743	17,818	555,561
Less: Offsetting Receipts		(1,106,679)	(1,106,679)
Net Outlays (Note 18)	\$ 537,743	\$ (1,088,861)	\$ (551,118)

The accompanying notes are an integral part of these statements.

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

	<i>(Dollars in Thousands)</i>
Resources Used to Finance Activities	
Budgetary Resources Obligated	
Obligations Incurred	\$ 4,727,794
Less: Spending Authority from Offsetting Collections and Recoveries	<u>4,046,114</u>
Obligations Net of Offsetting Collections and Recoveries	681,680
Less: Offsetting Receipts	<u>1,106,679</u>
Net Obligations	\$ (424,999)
Other Resources	
Transfers In (Out)	(275,827)
Imputed Financing	<u>17,741</u>
Net Other Resources Used to Finance Activities	\$ (258,086)
Total Resources Used to Finance Activities	\$ (683,085)
Resources Used to Finance Items not Part of the Net Cost of Operations	
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	(115,344)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	3,988,329
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(2,424,438)
Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	<u>299,720</u>
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	\$ 1,748,267
Total Resources Used to Finance the Net Cost of Operations	\$ 1,065,182

The accompanying notes are an integral part of these statements.

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

	<u>(Dollars in Thousands)</u>
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period	
Change in Annual Leave Liability	\$ 587
Increase in Unfunded Liability for Claims against SBA	800
Upward/ Downward reestimates of Credit Subsidy Expense	(214,831)
Change in Revenue Receivable from Public	(26,685)
Change in Due to Treasury - Liquidating Funds	(23,856)
Provision for Losses on Estimated Guarantees	(32,007)
Unfunded Employee Benefits	1,670
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period	<u>\$ (294,322)</u>
Components Not Requiring or Generating Resources	
Bad Debt Expense - Noncredit Reform	<u>(81,989)</u>
Total Components of Net Cost that will Not Require or Generate Resources	<u>(\$81,989)</u>
Total Components of Net Cost of Operations Not Requiring or Generating Resources in the Current Period	<u>\$ (376,311)</u>
Net Cost of Operations	<u>\$ 688,871</u>
(Note 19)	

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration
Notes to Principal Statements
for the periods ended September 30, 2001 and 2000

(Dollars in Thousands)

NOTE 1. Significant Accounting Policies:

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Small Business Administration (SBA) as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the SBA in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin No. 01-09 and the SBA's accounting policies which are summarized in this note. The financial statements differ from financial reports that are prepared pursuant to OMB directives for the purpose of reviewing and controlling the SBA's use of budgetary resources.

B. Reporting Entity

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

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

1. Major Programs Supporting SBA's Mission

Help Business Succeed

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

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

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

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

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

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

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

Help Businesses and Families Recover from Disaster

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

2. Fund Accounting Structure

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

Trust Fund

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

Program Funds

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

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

Administrative Funds

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

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

Revolving Fund

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

Liquidating Funds

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

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

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

Financing Funds

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

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

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

Non-Entity Funds

Interest Advances to SBA holds interest transferred to the Treasury until Treasury sweeps the account after fiscal year end.

Interest Received from Credit Reform Financing Accounts holds interest transferred collected by the SBA and transferred to the Treasury until Treasury sweeps the account after fiscal year end.

Disaster Loan Program, Downward Reestimates of Subsidies holds downward reestimates of disaster subsidy transferred to Treasury until Treasury sweeps the account after fiscal year end.

Business Loan Program, Downward Reestimates of Subsidies holds downward reestimates of business subsidy transferred to Treasury until Treasury sweeps the account after fiscal year end.

Collections of Receivables from Cancelled Accounts holds collections of receivables from cancelled accounts transferred to Treasury until Treasury sweeps the account after year end.

Collections of Receivables Not otherwise classified holds other collections transferred to Treasury until Treasury sweeps the account after year end.

General Fund Proprietary Receipts, Not Otherwise Classified, All Other holds other collections transferred to Treasury until Treasury sweeps the account after year end.

Withheld State and Local Taxes holds taxes due.

C. Basis of Accounting

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

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

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

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

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

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

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

D. Budgets and Budgetary Accounting for Loan Programs

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

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

E. Intragovernmental Assets and Liabilities

Balance Sheet classification of Assets and Liabilities: The Consolidated Balance Sheet presentation distinguishes "intragovernmental" assets and liabilities from "other" assets and liabilities. Intragovernmental assets and liabilities are assets and liabilities that arise from transactions among Federal entities and are claims of the SBA against other Federal entities or their claims against the SBA. They include the fund balances with Treasury, receivables from Treasury and payables to Treasury and other agencies.

F. Assets

Combination of entity and non-entity assets: The Balance Sheet combines entity assets and non-entity assets as required by OMB 01-09 beginning with FY 2001 and restated for FY 2000 for comparison. Entity assets are assets the SBA has authority to use in its operations. The authority to use funds in the SBA's operations means that SBA management has the authority to decide how funds are used, or management is legally obligated to use funds to meet entity obligations. Non-entity assets are assets that are held by the SBA but are not available.

G. Credit Program Receivable Sales

The SBA continued a program initiated in 1999 to sell pools of loans from its loan portfolio rather than servicing such loans itself. Sale two was held during FY 2000 with over 26,000 loans sold and an unpaid principle balance in excess of \$1.2 billion. During FY 2001, the SBA completed sales three and four selling 49,000 loans with unpaid principal balance of \$2.3 billion. It is expected that the loan sales program will continue to result in a greater net present value of cash flow for the SBA than would result from the Agency

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

H. Fund Balances with Treasury and Cash

The SBA does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Department of the Treasury. Fund Balances with Treasury and cash are comprised primarily of appropriated, revolving and trust funds, which are available to make expenditures and pay liabilities. It also contains amounts that relate to expired authority and amounts held by the SBA that are not available for its use.

I. Interest Receivable

The 7(a) secondary market program, one of the Business Loans programs, is administered by an agent of the SBA. The agent receives collections from banks on 7(a) loans guaranteed by the SBA and makes payments to secondary holders who have investments in pools of 7(a) guaranteed loans. This accumulated interest is the property of the SBA, but future payments, required to the holders of 7(a) secondary market securities, could exceed the principal amount of the investment. The interest, as well as the principal in the investment, is mostly invested in Treasury guaranteed repurchase agreements. The SBA's policy, revised in FY 2001, is to record the residual interest as interest receivable and an offsetting deferred credit. (See Note 5 for additional

J. Accounts Receivable

Accounts Receivable - Intragovernmental represent reimbursements from other Federal agencies and funds. The amounts shown for the Business Loan and Investment Fund (BLIF) and the Disaster Loan Fund (DLF) are comprised of interest due from Treasury and Intrafund receivables not subject to elimination.

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

Based upon the immateriality of losses from historical experience, collection policy and the ability to offset against a participant's share of loan collections, no allowance for unrecoverable accounts is provided. No allowance for uncollectable guarantee fees is required because the uncollectable amounts are immaterial. No allowance for uncollectable accounts for administrative activity is necessary, because employee accounts may be recovered through an offset process and vendor receivables are generally offset against disbursements made to the vendor.

K. Credit Programs Receivable and Related Foreclosed Property

Loans, direct and guarantee purchases, are accounted for as credit program receivables at the time funds are disbursed. For loans obligated prior to October 1, 1991, loans receivable are reduced by an allowance for estimated uncollectable amounts. The allowance is estimated using methodology involving historical experience and an analysis of outstanding balances. For loans obligated on or after October 1, 1991, the loans receivable are reduced by an allowance equal to the present value of the subsidy costs (due to the interest rate differential between the loans and Treasury borrowing, the estimated delinquencies and defaults net of recoveries, the offset from fees, sale of foreclosed property and other estimated cash flows) associated with

Foreclosed Property is recorded at the bid sale price and adjusted to appraised value if lower. If a property is held beyond one year it is reevaluated prior to fiscal year end.

L. General Property and Equipment

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

Software for internal use, whether internally developed, contractor developed, or commercial off-the-shelf (COTS), is capitalized at cost, if the initial unit acquisition cost is \$250,000 or more and has a service life of three years or more. For internally developed software, following guidance in Statement of Federal Financial Accounting Standard Number 10, the capitalizable costs are the direct and indirect costs incurred after the SBA has completed all planning, designing, coding and testing activities that are necessary to establish that the software can meet design specifications up to the point of final acceptance. Internally developed, contractor developed and COTS software with a development or acquisition cost of less than \$250,000 or less than three years of life is expensed when purchased or developed. Software for internal use is depreciated using the straight-line method over three years. Enhancements are capitalized when it is more likely than not that they will result in significant additional capabilities. Costs that do not meet the capitalization criteria are expensed.

M. Advances

Intragovernmental

SBA advances payment semiannually to the Federal Financing Bank for loans guaranteed under Section 503 of the Small Business Act. When a full installment has not been received by the SBA from the state or local development companies, it is recorded as an advance.

Public

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

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

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

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

N. Liabilities

Liabilities are the recognition of probable future outflow of resources that results from past transactions. If the transaction was between Federal entities, the liability is an Intragovernmental Liability. Liabilities are considered to be current if the payment will be made during the next fiscal year. Non-current liabilities will be liquidated at a point in time beyond the next fiscal year.

Liabilities are recognized when incurred even if budgetary resources are not available to pay them. They must not be paid until budgetary resources become available. Liabilities funded by budgetary resources as of the reporting date are considered to be liabilities covered by budgetary resources, while liabilities not funded as of that date are considered to be liabilities not covered by budgetary resources. Previous presentation in the SBA's financial statements distinguished liabilities covered by budgetary resources from those not covered by budgetary resources in the Balance Sheet. For the fiscal year ended September 30, 2001, the SBA has followed the guidance contained in OMB's bulletin 01-09. To improve the readability of the Balance Sheet, the guidance requires that budgetary resource coverage information be disclosed in a note. The September 30, 2000 Balance Sheet has been restated for the purpose of comparison.

O. Debt

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

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

P. Liability for Loan Guarantees

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

Q. Contingencies

The SBA is a party in various administrative proceedings, legal actions, environmental suits and claims brought against it. In the opinion of the SBA management and legal counsel, the ultimate resolution of these proceedings, actions, suits and claims will not materially affect the financial position or results of the SBA operations. The likelihood of loss to the SBA ranges from remote to probable for these litigation matters. (See Note 14).

R. Annual, Sick and Other Leave

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

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

S. Federal Employees' Compensation Act

The future workers' compensation estimates are generated from an application of actuarial procedures developed to estimate the liability for Federal Employees' Compensation Act (FECA) benefits. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases. The liability is determined using the paid losses extrapolation method calculated over the next 23 years. This method uses historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These annual benefit payments have been discounted to present value.

T. Employee Health and Life Insurance Benefits

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

U. Employee Pension Benefits

The SBA employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). For employees participating in CSRS, 7.40% of their gross earnings was withheld and transferred to the Civil Service Retirement and Disability Fund through 2000. In 2001, the CSRS rate decreased to 7.0%. The SBA contributes an additional 8.51% of the employee gross earnings to the CSRS Retirement and Disability Fund. For employees participating in FERS, the SBA withholds .8% of gross earnings and matches the withholding with a 10.7% employer contribution. The FERS rate decreased to .8% in FY 2001 from 1.2%. This total is transferred to the Federal Employees' Retirement Fund.

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

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

On April 1, 1987, the Federal Government initiated the Thrift Savings Plan (TSP), a defined contribution retirement savings and investment plan for employees covered by either CSRS or FERS. CSRS participants may contribute up to 6% of their gross pay (7% beginning January, 2002) to the TSP, but there is no Agency matching contribution. FERS participants may contribute up to 11% of their gross pay (12% beginning January, 2002) to the TSP. A primary feature of FERS is that it offers a savings plan to SBA employees which automatically contributes 1% of basic pay, matches any employee contributions dollar for dollar for the first 3% of pay, and for each dollar of the next 2% of pay contributions are matched 50 cents on the dollar. The SBA contributions to the TSP are recognized as current operating expenses. The maximum amount that either FERS or CSRS employees may contribute to the TSP is \$10,500 (\$11,000 beginning January, 2002). Employee and employer contributions to the TSP are transferred to the Federal Retirement Thrift Investment Board.

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

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

V. Other Retirement Benefits

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

W. Revenues and Other Financing Sources

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

The SBA receives the majority of the funding needed to support its operations through congressional appropriations. The Agency receives one year, multi-year and no year appropriations that may be used, within statutory limits, for operating expenditures. A financing source, appropriations used is recognized to the extent that expenses are accrued. This is reported in the Consolidated Statement of Changes in Net Position.

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

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

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

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

X. Changes to Form and Content

Consolidated Balance Sheet - SBA implemented OMB's Form and Content Bulletin 01-09 for FY 2001 reporting and restated its FY 2000 balance sheet presentation for comparative purposes. The new format provides a streamlined look and relegates detailed information to the notes. A major change in presentation is that liabilities covered by budgetary resources and not covered by budgetary resources are combined in the balance sheet and the detail is disclosed in the notes to the statements. The consolidated statement reflects an elimination of intra-agency offsets. For example, financing fund subsidy receivables are offset with program fund subsidy payables.

Consolidated Statement of Net Cost - SBA implemented the Form and Content required by OMB 01-09 for FY 2001 and restated FY 2000 Statement of Net Cost presentation for comparative purposes. The new format subtracts "Intragovernmental earned revenue" from "Intragovernmental gross costs" to subtotal "Intragovernmental net costs" and subtracts "Earned revenue from the public" from "Gross costs with the public" with a subtotal of "Net costs with the public", then totals Net Cost from the two subtotals. The SBA has also moved the detail of the various programs to the notes to the financial statements in order to improve readability and provide a clearer relationship between the net cost statement and the SBA's major goals of helping small business succeed through business programs and helping citizens recover from disasters through disaster assistance programs. The SBA's consolidated statement offsets or eliminates revenue recognized in the Administrative Funds and an offsetting cost in the program funds to eliminate duplications that would be present in a combined statement.

Consolidated Statement of Changes in Net Position - The SBA opted for early implementation of changes in Form and Content required by OMB 01-09 for FY 2002 for the Statement of Changes in Net Position. Net position is affected by changes to its two components: Cumulative Results of Operations and Unexpended Appropriations. The statement format is designed to display both components of net position separately to enable the user to better understand the nature of changes to net position as a whole. The SBA has not restated, nor is it required to, its FY 2000 Statement of Changes in Net Position, so no comparative information is presented. The Statement of Changes in Net Position is presented on a consolidated basis consistent with OMB Bulletin 01-09.

Combined Statement of Budgetary Resources - The SBA opted for early implementation of changes in Form and Content required by OMB 01-09 for FY 2002 for the Statement of Budgetary Resources. The new format is consistent with the Report on Budget Execution and Budgetary Resources (SF133). The Statement of Budgetary Resources using the new format aggregates account-level information reported to Treasury and OMB on the SF133 via FACTS II reporting. The SBA has not, nor is it required, to restate its FY 2000 Statement of Budgetary Resources so no comparative information is presented. The Statement of Budgetary Resources is presented on a combined not a consolidated basis consistent with OMB Bulletin 01-09. Prevailing accounting theory and OMB Bulletin 01-09 precludes eliminations and concludes that combined balances provide the most useful information.

Consolidated Statement of Financing - The SBA opted for early implementation of changes in Form and Content from OMB 01-09 required by OMB 01-09 for FY 2002 for the Statement of Financing. The Statement of Financing is the bridge between an entity's budgetary and financial (proprietary) accounting. The Statement of Financing articulates the relationship between net obligations derived from an entity's budgetary accounts and net cost of operations derived from the entity's proprietary accounts by identifying and explaining key differences between the two numbers. The Consolidated Statement of Financing reconciles the Combined Statement of Budgetary Resources, "combined" because no budgetary eliminations are allowed, and Consolidated Statement of Net Cost, "consolidated" because eliminations are required. The SBA has not restated, nor is it required to, its FY 2000 Statement of Financing so no comparative information is presented.

NOTE 2. Non-Entity Assets:

(Dollars in Thousands)

Intragovernmental	<u>FY 2001</u>	<u>FY 2000</u>
Fund Balance with Treasury	\$ 1,832,836	\$ 1,505,290

Non-Entity Assets are assets that are held by the SBA, but are not available to the Agency. In 2001, non-entity assets consist primarily of downward reestimates (\$1,106.7 million), interest due to Treasury from liquidating funds (\$75.1 million) and interest due to Treasury from financing funds (\$651.0 million).

NOTE 3. Fund Balances with Treasury:

(Dollars in Thousands)

Fund Balances	<u>FY 2001</u>	<u>FY 2000</u>
Entity		
Trust Fund	\$ 214	\$ 234
Liquidating Funds	1,012,884	1,152,108
Financing Funds	6,497,449	6,441,202
Revolving Fund	26,089	33,339
Appropriated Funds	800,019	628,435
Total Entity	<u>\$ 8,336,655</u>	<u>\$ 8,255,318</u>
Non-Entity	1,832,836	1,505,290
Total Fund Balances	<u>\$ 10,169,491</u>	<u>\$ 9,760,608</u>
Unobligated Balance		
Available	\$ 2,265,651	\$ 1,576,388
Unavailable*	6,372,365	5,957,669
Obligated Balance Not Yet Disbursed		
Total	<u>1,531,475</u>	<u>2,226,551</u>
	<u>\$ 10,169,491</u>	<u>\$ 9,760,608</u>

* Unobligated Balance Unavailable includes Non-entity assets. Non-entity assets are not subject to the budgetary process, so that even though the balance is due to Treasury it is not treated as an obligation.

The FY 2000 fund balance with Treasury was restated to include the Non-entity fund balance with Treasury.

NOTE 4. Cash:

Cash held outside the U.S. Treasury are funds under the control of the SBA at field offices or lock boxes that are not yet deposited.

(Dollars in Thousands)

Cash	<u>FY 2001</u>	<u>FY 2000</u>
	Entity Assets	Entity Assets
At Field Offices	\$ 2,095	\$ 3,331
Lock boxes	348	127
	<u>\$ 2,443</u>	<u>\$ 3,458</u>

NOTE 5. Interest Receivable:

The SBA has revised its treatment of assets related to the Master Reserve Fund (MRF). A more conservative approach now reports only residual accrued interest as a Balance Sheet item. This has resulted in a change from \$418 million reported as Investments for FY 2000 to \$68 million reported as Interest Receivable for FY 2001.

The MRF is maintained by the SBA's fiscal agent to facilitate the operation of the 7(a) secondary market program. The 7(a) secondary market has approximately \$11 billion of currently outstanding investments held by 7(a) secondary holders. The MRF is funded by the timing of cashflows in the 7(a) secondary market program. It is used to provide the timely payment of principal and interest to the 7(a) secondary market holders and to pay expenses of the MRF trustee and investment advisor. The MRF balance was approximately \$1.2 billion at September 30, 2001. This balance is invested in Government guaranteed securities by the trustee.

A legal opinion has provided the SBA with the right to the interest earned by the MRF. At September 30, 2001, this amount was approximately \$490 million (compared to \$418 million for FY 2000). The estimated residual amount of the accrued interest that will become available to the SBA in the future is \$68 million. The SBA determined this estimate through an analysis of closed MRF pools. The composition of this estimated amount is as follows:

MRF ACCRUED INTEREST

(Dollars in Thousands)

	Closed MRF	Open MRF	Total MRF
	Pools	Pools	Pools
Accrued Interest Used to Date	\$ 42,226	\$ 211,128	\$ 253,354
Accrued Interest to be Used		168,902	168,902
Residual Accrued Interest	6,800	61,200	68,000
Total Accrued Interest	\$ 49,026	\$ 441,230	\$ 490,256

The SBA is recognizing the \$68 million of residual accrued interest as interest receivable. It will recognize this interest as earned revenue when it receives payment. Until that point, a deferred credit is used to record the unearned nature of the revenue.

NOTE 6. Accounts Receivable:

Accounts receivable are displayed by fund and by type. Additional information about the types of receivables is contained in Note 1J.

Unapplied cash adjustments are Funds with Treasury transactions that Treasury has not applied as of the Balance Sheet date or Treasury transactions that SBA has not recorded.

	By Fund			
	FY 2001		FY 2000	
	Intragovern- mental	Public	Intragovern- mental	Public
<i>(Dollars in Thousands)</i>				
Business Loan and Investment Fund	\$ 315,672	\$ 51,277	\$ 368,444	\$ 61,375
Disaster Loan Fund	873,779	103	360,624	133
Surety Bond Guaranty Program		5,540		6,907
Salaries and Expenses		268	58	372
Sub-Total	\$ 1,189,451	\$ 57,188	\$ 729,126	\$ 68,787
Eliminations - between Program Funds	\$ (66,361)		\$ (189,866)	
Eliminations - Subsidy	(747,003)		(152,390)	
Balance Sheet Total	\$ 376,087	\$ 57,188	\$ 386,870	\$ 68,787

	By Type			
	FY 2001		FY 2000	
	Intragovern- mental	Public	Intragovern- mental	Public
Subsidy Receivable from Program Fund to Financing Fund	\$ 753,776	\$	\$ 158,235	\$
Interest Receivable From Treasury	369,285		380,976	
Other Intrafund Receivables	66,361		189,866	
Overpayment to Secondary Guarantee Fees Receivable		340		787
Examination Fees -SBIC		27,585		32,498
Administrative Receivables		99		99
Refunds		268		2,208
Receivable due from Banks		4,433		5,018
Unapplied Cash Adjustments		1,599		1,419
Receivable due from Purchasers		21,641		26,511
- Asset Sales		115		
Miscellaneous	29	1,108	49	247
Sub-Total Before Eliminations	\$ 1,189,451	\$ 57,188	\$ 729,126	\$ 68,787
Eliminations - between Program Funds	\$ (66,361)		\$ (189,866)	
Eliminations - Subsidy	(747,003)		(152,390)	
Balance Sheet Total	\$ 376,087	\$ 57,188	\$ 386,870	\$ 68,787

NOTE 7. Credit Program Receivables and Related Foreclosed Property:

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

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

Direct loans or loan guarantee commitments made prior to 1992 are reported net of an allowance for estimated uncollectable loans or estimated losses. Loss allowances represent estimates of what the SBA does not expect to recover on its loans receivable obligated prior to FY 1992. These allowances are based upon historical experience, current market conditions and an analysis of individual assets. They are unfunded and merely attempt to reflect the anticipated uncollectable loans receivable.

Direct loan obligations or loan guarantee commitments made after FY 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act. The Act provides that the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, estimated delinquencies and defaults, fee offsets, and other cash flows) associated with direct loans and loan guarantees be recognized as a cost in the year the loan or loan guarantee is made.

An analysis of loans receivable, loan guarantees, liability for loan guarantees, and the nature and amounts of the subsidy and administrative costs associated with the loans and loan guarantees is provided in the following sections.

During FY 2001 the SBA changed its method for calculating the allowance of loan loss for pre-credit reform loans. The new method uses information from the Combined General Ledger and the charge-off / recovery reports.

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. A 100% allowance is established for all purchased interest on non-performing loans.

B. Direct Loans Obligated Prior to FY 1992:

(Dollars in Thousands)

Liquidating Loan Programs	FY 2001					Value of Assets Related to Direct Loans
	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property		
(1) Business	\$ 130,830	\$ 4,592	\$ (88,896)	\$ 7,441	\$	53,967
(2) Disaster	266,043	2,196	(11,838)	357		256,758
Total	\$ 396,873	\$ 6,788	\$ (100,734)	\$ 7,798	\$	310,725

C. Direct Loans Obligated After FY1991:

(Dollars in Thousands)

Credit Reform Programs	FY 2001					Net Present Value of Assets Related to Direct Loans
	Loans Receivable, Gross	Interest Receivable	Foreclosed Property	Allowance for Subsidy Cost (Present Value)		
(1) Business	\$ 108,810	\$ 1,298	\$ 280	\$ (27,776)	\$	82,612
(2) Disaster	3,293,470	23,289	848	76,650		3,394,257
Total	\$ 3,402,280	\$ 24,587	\$ 1,128	\$ 48,874	\$	3,476,869

D. Total Amount of Direct Loans Disbursed (Post-1991):

(Dollars in Thousands)

Credit Reform Programs	FY 2001	FY 2000
	(1) Business	\$ 24,983
(2) Disaster	585,774	766,295
Total	\$ 610,757	\$ 781,536

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

Subsidy Expense for New Direct Loans Disbursed FY 2001

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

Subsidy Expense for New Direct Loans Disbursed FY 2000

Direct Loan Programs	Interest Differential	Defaults	Fees	Other	Total
(1) Business	\$ 2,098	\$ 171	\$	\$	\$ 2,269
(2) Disaster	134,351	47,012	22,773	(43,463)	160,673
Total	\$ 136,449	\$ 47,183	\$ 22,773	\$ (43,463)	\$ 162,942

Reestimates FY 2001

Loan Programs	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
(1) Business	\$	\$ (3,001)	\$ (3,001)
(2) Disaster		498,251	498,251
Total	\$ 0	\$ 495,250	\$ 495,250

Reestimates FY 2000

Loan Programs	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
(1) Business		\$ 881	\$ 881
(2) Disaster		(376,602)	(376,602)
Total	\$ 0	\$ (375,721)	\$ (375,721)

Total Direct Loan Subsidy Expenses

Loan Programs	FY 2001		FY 2000	
	Total		Loan Programs	Total
(1) Business	\$ 309		(1) Business	\$ 3,150
(2) Disaster	639,850		(2) Disaster	(215,929)
Total	\$ 640,159		Total	\$ (212,779)

F. Subsidy Rates for Direct Loans by Program and Component:
Budget Subsidy Rates for Direct Loans for the Current Year's Cohorts:
(Dollars in Thousands)

FY 2001

1. Direct Loans

<u>Loan Programs</u>	<u>Interest Supplements</u>	<u>Defaults</u>	<u>Fees</u>	<u>Other</u>	<u>Total</u>
(1) Business	8.48%	0.47%	0.00%	0.00%	8.95%
(2) Disaster	12.89%	5.13%	-1.75%	1.20%	17.47%

G. Schedule for Reconciling Subsidy Cost Allowance Balances:
(Dollars in Thousands)

	<u>(Post - 1991 Direct Business)</u>		<u>(Post - 1991 Direct Disaster)</u>	
	<u>FY 2001</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2000</u>
Beginning balance of the subsidy cost allowance	\$ 34,108	\$ 31,161	\$ 505,445	\$ 929,356
Add: subsidy expense for Direct loans disbursed during the reporting years by component:				
Interest rate differential costs	3,262	2,097	105,155	134,350
Default costs (net of recoveries)	48	171	40,847	47,011
Fees and other collections			(14,306)	22,773
Other Subsidy Costs			9,903	(43,462)
Total of the above subsidy expense				
components	3,310	2,268	141,599	160,672
Adjustments:				
Loans written off	(100)	(1,189)	(161,843)	(133,670)
Subsidy allowance amortization	(5,828)	286	(645,928)	(488,486)
Loss Allowance Adjustment	(712)	712	(414,175)	414,175
Other		(11)		

Ending balance of the subsidy cost allowance before reestimates	30,778	33,227	(574,902)	882,047
Add or subtract subsidy reestimates				
by component:				
(a) Interest rate reestimate				
(b) Technical/ default reestimate	(3,001)	881	498,251	(376,602)
Total of the above reestimate components	(3,001)	881	498,251	(376,602)
Ending balance of the subsidy cost allowance	\$ 27,777	\$ 34,108	\$ (76,651)	\$ 505,445

(Post - 1991 Guarantee Business)

	<u>FY 2001</u>	<u>FY 2000</u>
Beginning balance of the subsidy cost allowance	\$ 86,339	\$ 160,635
Adjustments:		
Adjustment related to the purchase of guaranteed loans	76,224	(74,296)
Other		
Ending balance of the subsidy cost allowance before reestimates	\$ 162,563	\$ 86,339

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

Liquidating Loan Guarantee Programs	FY 2001				
	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Defaulted Guaranteed Loans Receivable, Net
(1) Business	\$ 366,203	\$ 7,670	\$ (59,107)	\$ 5,397	\$ 320,163
(2) Pollution	48,847	398	(33,209)		\$16,036
Total	\$ 415,050	\$ 8,068	\$ (92,316)	\$ 5,397	\$ 336,199

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

FY 2001					
Credit Reform Loan Guarantee Program	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Foreclosed Property	Allowance for Subsidy Cost (Present Value)	Net Present Value of Assets Related to Defaulted Guaranteed Loans Receivable
(1) Business	\$ 1,070,363	\$ 3,727	\$ 15,803	\$ (162,563)	\$ 927,330

J. Guaranteed Loans:
(Dollars in Thousands)

Guaranteed Loans Outstanding:

Loan Programs	FY 2001		FY 2000	
	Outstanding Principal, Guaranteed Loans Receivable, Face Value	Amount of Outstanding Principal Guaranteed By SBA	Outstanding Principal, Guaranteed Loans Receivable, Face Value	Amount of Outstanding Principal Guaranteed By SBA
(1) Business	\$ 46,605,001	\$ 37,452,750	\$ 43,748,774	\$ 35,045,270
(2) Pollution	15,921	15,921	33,105	33,105
Total	\$ 46,620,922	\$ 37,468,671	\$ 43,781,879	\$ 35,078,375

New Guaranteed Loans Disbursed:
(Dollars in Thousands)

Loan Programs	FY 2001		FY 2000	
	Outstanding Principal, Guaranteed Loans Receivable, Face Value	Amount of Outstanding Principal Guaranteed By SBA	Outstanding Principal, Guaranteed Loans Receivable, Face Value	Amount of Outstanding Principal Guaranteed By SBA
(1) Business	\$11,298,036	\$8,899,482	\$12,149,785	\$9,406,621

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

Loan Programs	FY 2001		
	Liabilities for Loan Guarantees For Pre-1992 Guarantees	Liabilities for Loan Guarantees for Post-1991 Guarantees (Present)	Total Liabilities for Loan Guarantees
(1) Business	\$ 5,912	\$ 1,076,583	\$ 1,082,495
(2) Pollution	525		525
Total	\$ 6,437	\$ 1,076,583	\$ 1,083,020

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

Subsidy Expense for New Loan Guarantees

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

Loan Program	FY 2000			
	Defaults	Fees	Other	Total
Business	\$ 537,011	\$ (392,130)	\$ (18,951)	\$ 125,930

The negative fees amount is due to loan cancellations in prior year cohorts.

Reestimates FY 2001

Loan Program	Technical Reestimates	Total Reestimates
Business	\$ (282,874)	\$ (282,874)

Reestimates FY 2000

Loan Programs	Technical Reestimates	Total Reestimates
Business	\$ (677,143)	\$ (677,143)

Total Loan Guarantee Subsidy Expenses

Loan Program	FY 2001 Total	FY 2000 Total
Business	\$ (128,017)	\$ (551,213)

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

FY 2001				
<u>Loan Programs</u> Business	<u>Defaults</u>	<u>Fees</u>	<u>Other</u>	<u>Total</u>
7(a) and NAFTA	4.59%	-3.30%	-0.13%	1.16%
7(a) Delta	5.29%	-3.30%	-0.12%	1.87%
504 Debentures	3.62%	-5.67%	2.05%	0.00%
504 Delta	4.17%	-5.62%	2.35%	0.90%
SBIC Debentures	8.99%	-3.00%	-5.99%	0.00%
SBIC Participating Securities	5.77%	-3.04%	-1.42%	1.31%
SBIC New Markets	14.44%	0.00%	0.00%	14.44%
Microloan	1.68%	0.00%	6.27%	7.95%

N. Schedule for Reconciling Loan Guarantee Liability Balances:

(Post - 1991 Business Loan Guarantees)

(Dollars in Thousands)

	<u>FY 2001</u>	<u>FY 2000</u>
Beginning balance of the loan guarantee liability	\$ 1,263,239	\$ 1,380,126
Add: subsidy expense for direct loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	603,945	526,882
Fees and other collections	(376,631)	(378,891)
Other Subsidy Costs	<u>(72,456)</u>	<u>(22,060)</u>
Total of the above subsidy expense components	154,858	125,931
Adjustments:		
Loans written off	(265,776)	(227,415)
Claim Payment to Lenders	338,786	537,976
Loss Allowance Adjustment	(53,273)	53,273
Adjustment related to the purchase of guaranteed loans	(76,225)	74,296
Other	<u>(2,152)</u>	<u>(3,805)</u>
Ending balance of the subsidy cost allowance before reestimates	1,359,457	1,940,382
Add or subtract subsidy reestimates by component:		
Technical / default reestimate	<u>(282,874)</u>	<u>(677,143)</u>
Total of the above reestimate components	<u>(282,874)</u>	<u>(677,143)</u>
Ending balance of the loan guarantee liability	<u>\$ 1,076,583</u>	<u>\$ 1,263,239</u>

O. Administrative Expense:

(Dollars in Thousands)

FY 2001

Direct Loan Programs	Total	Loan Guarantee Program	Total
(1) Business	\$ 25,755	Business	\$ 103,009
(2) Disaster	131,615		
Total	<u>\$ 157,370</u>		

Summary of Note B, C, H and I

	<u>FY 2001</u>	<u>FY 2000</u>
Direct Loans Obligated Prior to FY 1992:	\$ 310,725	\$ 755,968
Direct Loans Obligated After FY1991:	3,476,869	4,918,955
Defaulted Guaranteed Loans from Pre-1992 Guarantees:	336,199	335,529
Defaulted Guaranteed Loans from Post-1991 Guarantees:	927,330	812,053
Credit Program Receivables and Related Foreclosed Property	<u>\$ 5,051,123</u>	<u>\$ 6,822,505</u>

P. Other Information:

The liability in Part J of this note, for pre-1992 business loans, relates to outstanding gross amounts guaranteed for FY 2001 of \$1.4 billion and for FY 2000 of \$2.0 billion. Of this amount, the Agency's share for FY 2001 is \$1.4 billion and for FY 2000 is \$1.8 billion. For Pollution Control Equipment Contract Guarantee Fund (PCECGF), the outstanding guarantees for FY 2001 total \$16 million and for FY 2000 total \$33 million. This amount is both gross and Agency share. For post-1991 loans, the gross amount guaranteed for business loans for FY 2001 is \$45.2 billion and for FY 2000 is \$41.7 billion. The Agency's share is \$36.1 billion for FY 2001 and \$33.3 billion for FY 2000.

The SBA has outstanding loan commitments of \$9.3 billion as of September 30, 2001 and \$7.3 billion as of September 30, 2000. These figures are comprised entirely of post-1991 commitments.

The FY 2001 Foreclosed Property referred to in Parts B, C, H and I is comprised of \$28.3 million of Real Estate outstanding on 173 loans and \$1.8 million of Other Property outstanding on 27 loans. The average number of days for the outstanding COLPUR was 1,041 days. The number of items in process as of September 30, 2001 was 32.

In 1999, the SBA began to sell loans in bulk sales. Most of the loans sold to date have been disaster loans for homes and businesses. The remaining loans sold have been SBA business loans, including 7(a) loan guarantees and 504 CDC loan guarantees. The business loans sold included SBA direct loans and defaulted guaranteed loans purchased by the SBA. In 1999, the SBA sold \$332 million of primarily business loans.

For FY 2002 and the future, additional sales have been planned and are being executed. The financial effect of all sales is being factored into the future calculations of the subsidy expense and allowance.

Q. Credit Program Subsidy:

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

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

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

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

Guarantee Programs

The 7(a) General Business Loan Guarantee Program

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

Cohort Year	Original	Current reestimate of			
	Subsidy Rate	Subsidy Rate and Components			
	Total	Total	Interest	Default	Fee/Other
1992	4.85	1.64	0.00	3.17	(1.53)
1993	5.47	0.76	0.00	2.47	(1.71)
1994	2.15	0.74	0.00	2.65	(1.91)
1995	2.74	1.52	0.00	3.52	(2.00)
1996	2.74	0.20	0.00	3.38	(3.18)
1997	1.93	(0.36)	0.00	3.17	(3.53)
1998	2.14	0.24	0.00	3.43	(3.19)
1999	1.39	0.59	0.00	3.93	(3.34)
2000	1.16	1.18	0.00	4.44	(3.26)
2001	1.16	0.71	0.00	4.59	(3.88)

7(a) loan performance is affected by economic conditions, legislation, credit origination and servicing policies, and various subsidy estimation methodologies and assumptions. During 2001, default costs were lower than previously estimated. The SBA's management has attributed this to the continued effect of the national economic growth cycle as well as improved underwriting and servicing practices.

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

The SBA conducted a study during 2001 and discovered that, for cohorts prior to 1997, the original estimates of upfront fee income were too high because guarantee volumes under one year in maturity were overestimated. Because these cohorts are now fully disbursed, no adjustments to the subsidy rate should occur in the future.

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

504 Loans - The Certified Development Program

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

Cohort Year	Original	Current reestimate of			
	Subsidy Rate	Subsidy Rate and Components			
	Total	Total	Interest	Default	Fee/ Other
1992	0.49	3.14	0.00	3.00	0.14
1993	0.54	2.04	0.00	2.09	(0.05)
1994	0.51	2.76	0.00	2.52	0.24
1995	0.57	2.20	0.00	2.90	(0.70)
1996	0.00	1.44	0.00	3.01	(1.57)
1997	0.00	(3.94)	0.00	3.36	(7.30)
1998	0.00	(3.66)	0.00	3.27	(6.93)
1999	0.00	(2.53)	0.00	3.78	(6.31)
2000	0.00	1.47	0.00	4.08	(2.61)
2001	0.00	2.50	0.00	4.21	(1.71)

The performance of this loan guarantee program is affected by economic conditions, legislation, credit origination and servicing policies, and various subsidy estimation methodologies and assumptions. For most of the cohorts, the current reestimated subsidy rates were lower than the previous year's reestimates. This was primarily due to lower actual defaults reported in FY 2001 as well as a lower assumed default curve for the outyears. The SBA's management has attributed this to the continued effect of the national economic growth cycle as well as improved underwriting and servicing practices.

Small Business Investment Companies – The Debentures Program

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

Cohort Year	Original	Current reestimate of			
	Subsidy Rate	Subsidy Rate and Components			
	Total	Total	Interest	Default	Fee/Other
1992	14.29	15.94	(0.18)	17.03	(0.91)
1993	15.40	3.90	(0.20)	5.01	(0.91)
1994	16.25	1.54	(0.89)	3.85	(1.42)
1995	14.65	1.00	(1.36)	3.90	(1.54)
1996	15.46	(1.25)	(1.99)	2.28	(1.54)
1997	3.19	(2.16)	(6.28)	6.82	(2.70)
1998	1.97	3.37	(3.49)	10.15	(3.29)
1999	1.38	5.59	(2.36)	11.35	(3.40)
2000	0.00	(5.58)	(12.80)	11.41	(4.19)
2001	0.00	(13.10)	(19.08)	12.15	(6.17)

The performance of this loan guarantee program is affected by economic conditions, legislation, credit origination and, various subsidy rate estimation methodologies and assumptions.

In 2001, legislation was enacted allowing the fee on this program to adjust every year in order to reach a subsidy rate of zero. In addition, default costs were lower than previously estimated because there were fewer defaults than previously estimated. During 2001, fees were significantly higher than originally projected. Additionally, several modifications to the data processing methodology were incorporated, which resulted in many of the cohorts either reflecting an upward or downward adjustment.

Small Business Investment Companies – The Participating Securities Program

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

Cohort Year	Original	Current reestimate of			
	Subsidy Rate	Subsidy Rate and Components			
	Total	Total	Interest	Default	Fee/ Other
1994	9.00	(10.67)	0.00	11.24	(21.91)
1995	8.90	(12.99)	0.00	3.98	(16.97)
1996	9.00	(9.55)	0.00	6.08	(15.63)
1997	3.29	(6.21)	0.00	3.29	(9.50)
1998	2.20	(6.96)	0.00	3.27	(10.23)
1999	2.19	(0.96)	0.00	1.34	(2.30)
2000	1.80	0.02	0.00	6.29	(6.27)
2001	1.31	(4.13)	0.00	9.77	(13.90)

Participating Securities loan performance is affected by economic conditions, legislation, credit origination and various subsidy estimation methodologies and assumptions. During 2001, default costs were lower than previously estimated. Future expected profits were estimated slightly higher in comparison to 2000. This was attributed to the method in which redemption payments were previously recorded.

Direct Loan Programs

The Disaster Loan Program

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

Cohort Year	Original	Current reestimate of			
	Subsidy Rate	Subsidy Rate and Components			
	Total	Total	Interest	Default	Other
1992	33.93	32.73	14.79	14.32	3.61
1993	20.58	26.90	13.08	10.51	3.32
1994	22.99	20.64	14.94	3.95	1.75
1995	31.54	21.65	15.21	4.99	1.44
1996	28.08	21.04	12.75	4.39	3.90
1997	20.02	20.97	12.16	2.70	6.10
1998	23.46	16.98	8.53	4.46	3.99
1999	22.36	17.92	10.27	8.21	(0.56)
2000	22.20	17.87	12.98	6.55	(1.65)
2001	17.46				

The performance of this direct loan program is affected by economic conditions, legislation, credit origination and servicing policies, and various subsidy estimation methodologies and assumptions. During 2001, several modifications to the data processing methodology were incorporated, which resulted in slight upward revisions in comparison to 2000. Additionally, the 2001 reestimates for the first time incorporate the impact of asset sales. For almost all cohorts, 2001 reestimates continue to be significantly lower than original estimates. Disaster reestimates are delayed by one year in order to ensure that loans that do not pay are true defaults. Therefore, the 2001 cohort has not been reestimated.

R. Loan Asset Sales:

In 1999, SBA implemented a program to sell loans in bulk sales. Most of the loans sold to date have been disaster loans, for home and business borrowers. In FY 2000, one loan sale of 26,285 loans was held which yielded \$477 million net of expenses. The unpaid principal balance of the sold loans totaled \$1,200 million, and a book loss was recognized. The SBA was expected to recover less than \$477 million by continuing to hold and service the loans. The sale was authorized by OMB. An accounting entry was made to recognize the portion of the book loss occurring in Post-1991 credit reform loan funds as subsidy expense, thus replenishing the subsidy reserve allowance for the remaining loans.

Two loan sales occurred in FY 2001. The SBA received \$1,535 million for over 49,000 loans with unpaid principal balance of \$2,291 million. A book loss occurred and was recognized in liquidating funds for Pre-1992 loans. The reestimate process was re-modeled, specifically reflecting the reduced future cash flows expected as a result of the sale. Econometric analysis continues to support the loan sale process by showing present value of future cash flows to be improved by bulk sales at these profitability levels. The SBA believes the Federal Credit Reform process will result in corrections to estimates over time due to timing differences and other naturally-occurring anomalies in the cash flows.

The SBA expects that the proceeds received in future sales will continue to be different from the unpaid principal balance, but due to the newness of the operation, cannot predict the long term differences between these two valuations. At such time as sufficient data is available, the SBA will factor the expected financial effect of loan asset sales into future subsidy estimates.

Since FY 1997 the SBA's budget submissions have included a statement showing the SBA's intention of selling loan assets in this manner. Since the SBA could not predict the effect of the loan asset sales, its baseline estimates assumed that there would be no difference in cashflows due to the loan asset sales. In 2001, it requested funding for advance costs of loan asset sales this year. The SBA has determined, in consultation with OMB, that the sale of loan assets is consistent with Agency policy as presented in its budget submissions to Congress since FY 1997. Therefore, the SBA does not treat loan sales as a modification and as such, any effects on subsidy cost brought about by the loan sales are included in its annual reestimates.

NOTE 8. General Property and Equipment:

(Dollars in Thousands)

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

Software was not in service as of September 30, 2001, therefore it has not been amortized for FY 01.

NOTE 9. Advances:

(Dollars in Thousands)

	FY 2001		FY 2000	
	Intragovern- mental	Public	Intragovern- mental	Public
Sec. 503 Debentures	\$ 2,496	\$	\$ 3,074	\$
Sec. 504 Debentures		7,507		5,822
SBIC		247,179		149,090
8(a) Program Subcontractors				8,123
Travel Advances				20
Loss Allowance		(978)		(978)
Total	\$ 2,496	\$ 253,708	\$ 3,074	\$ 162,077

If SBA honors its guarantee agreement with an SBIC, any associated advances will be reclassified as receivables.

NOTE 10. Liabilities Not Covered by Budgetary Resources:

(Dollars in Thousands)

Intragovernmental

Accounts Payable	FY 2001	FY 2000
Business Loan and Investment Fund	\$ 88,761	\$ 33,998
Disaster Loan Fund	498,251	
Sub-Total	\$ 587,012	\$ 33,998
Eliminations	(587,012)	(33,998)
Total	\$ 0	\$ 0

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

Other

Business Loan and Investment Fund	\$ 374,636	\$ 710,259
Disaster Loan Fund		378,046
Salaries and Expenses	5,363	5,260
Sub-Total	\$ 379,999	\$ 1,093,565
Eliminations		
Total	\$ 379,999	\$ 1,093,565

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

Total Intragovernmental	\$ 379,999	\$ 1,093,565
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Other Liabilities- Public Not Covered by Budgetary Resources

FECA Actuarial Liability (Note 13)	\$ 32,255	\$ 30,746
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Other

Business Loan and Investment Fund	\$ 1,912	\$ 1,965
Disaster Loan Fund	44	312
Salaries and Expenses	<u>20,490</u>	<u>19,903</u>
Sub-Total	\$ 22,446	\$ 22,180
Eliminations		
Total	\$ 22,446	\$ 22,180

Total Other Liabilities - Public Not Covered

by Budgetary Resources	\$ 54,701	\$ 52,926
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Other for Business Loan and Investment Fund and Disaster Loan Fund is Prior Loans Outstanding on Acquired Collateral. The Salaries and Expenses amount is annual leave for all SBA employees.

NOTE 11. Accounts Payable:

(Dollars in Thousands)

Liabilities	FY 2001		FY 2000	
	Intragovern- mental	Public	Intragovern- mental	Public
Business Loan and Investment	\$ 318,303	\$ 114,831	\$ 376,225	\$ 67,493
Disaster Loan Fund	1,193,294	23,757	707,274	1,255
Surety Bond Guaranty Program		584		1,351
Salaries and Expenses			57	
Office of Inspector General				8
Sub-Total	\$ 1,511,597	\$ 139,172	\$ 1,083,556	\$ 70,107
Eliminations - between Program Funds	\$ (66,361)		\$ (189,866)	
Eliminations - Unfunded Subsidy	(587,012)		(33,998)	
Eliminations - Subsidy	(159,991)		(118,392)	
Eliminations	(813,364)		(342,256)	
Total	\$ 698,233	\$ 139,172	\$ 741,300	\$ 70,107

The amounts shown as "Accounts Payable - Intragovernmental" include interest payable to Treasury in the amount of \$23.0 million for the BLIF and \$22.5 million for the DLF, interest expense due to Treasury on borrowing in the amount of \$42.4 million for the BLIF and \$590.4 million for the DLF. Additionally, these amounts include a payable of subsidy to the financing fund in the amount of \$181.1 million for the BLIF and \$565.9 million for the DLF. Liquidating account subsidy due Treasury is \$1.5 million for BLIF and \$14.5 million for DLF. There is an intrafund payable in the BLIF funds of \$66.3 million. Lastly, a payable in BLIF for \$4.0 million is due to FFB for accrued interest.

The amounts shown as "Accounts Payable - Public" include asset sale related payables in the amount of \$50.3 million for the BLIF and \$23.6 million for the DLF. Additionally, payables not related to asset sales in the amount of \$46.4 represent amounts due to participating banks for the BLIF and the balance of \$18.8 is miscellaneous payables.

The difference between the intrafund payables / receivables of \$6.8 million is due to lapsed funds.

NOTE 12. Debt:

(Dollars in Thousands)

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

	FY 2000			
	Beginning Balance	New Borrowings	Repayments	Ending Balance
Intragovernmental Debt:				
Borrowing from the Treasury	\$ 9,825,781	\$ 1,031,297	\$ (844,687)	\$ 10,012,391
Borrowing from Federal Financing Bank	193,863		(34,699)	159,164
Total Intragovernmental Debt	\$ 10,019,644	\$ 1,031,297	\$ (879,386)	\$ 10,171,555

The FY 2001 new borrowings figure includes \$125 million of borrowing authority that was carried over from the prior fiscal year.

NOTE 13. FECA Actuarial Liability:

The FECA actuarial liability includes the expected liability for employee death, disability, medical and other approved costs. It is estimated using the paid-loss extrapolation method. This method uses historical benefit payment patterns related to a specific incurred period to predict the entire payments related to that period. The payments are discounted to present value. This is a non-current liability "non-intragovernmental" not covered by budgetary resources. For FY 2001 the liability is \$32.3 million and \$30.7 million for FY 2000.

NOTE 14. Other Liabilities:

(Dollars in Thousands)

	By Fund		
	FY 2001		
	Non-Current Liabilities	Current Liabilities	Total Liabilities
I. Intragovernmental			
(1) Business Loan and Investment Fund	\$ 868,441	\$ 374,636	\$ 1,243,077
(2) Disaster Loan Fund	564,631		564,631
(3) Pollution Control Guarantee Fund	18,409		18,409
(4) Salaries and Expenses		7,289	7,289
(5) Office of Inspector General		80	80
(6) Non-Entity Due Treasury		1,832,836	1,832,836
Total Intragovernmental Liabilities	\$ 1,451,481	\$ 2,214,841	\$ 3,666,322

2. Liabilities - Public

(1) Business Loan and Investment Fund	\$ 70,010	\$ 23,551	\$ 93,561
(2) Disaster Loan Fund	465	5,339	5,804
(3) Surety Bond Guaranty Program	12,542	548	13,090
(4) Salaries and Expenses		35,415	35,415
(5) Office of Inspector General		461	461
Total Public	\$ 83,017	\$ 65,314	\$ 148,331

The amount shown as Salaries and Expenses includes \$20.5 million as unfunded annual leave liability for all SBA employees, \$14.1 million as accrued funded leave and payroll and \$.8 million as a contingent liability.

By Type

	FY 2001		
	Non-Current Liabilities	Current Liabilities	Total Liabilities
1. Intragovernmental			
Payable to Special Receipt Fund			
	\$	\$ 374,636	\$ 374,636
Employment Taxes Payable		2,006	2,006
Unfunded FECA Liability		5,363	5,363
Due Federal Financing Bank	2,823		2,823
Net Assets of Liquidating Funds			
Due to Treasury	1,448,658		1,448,658
Non-Entity - Due to Treasury		1,832,836	1,832,836
Total Intragovernmental Liabilities	\$ 1,451,481	\$ 2,214,841	\$ 3,666,322
2. Liabilities - Public			
Accrued Funded Payroll			
Benefits	\$	\$ 14,586	\$ 14,586
Accrued Unfunded Annual Leave		20,490	20,490
Master Reserve Fund Liability	68,000		68,000
Unapplied Cash Adjustments		26,564	26,564
Suspense Accounts		2,874	2,874
Prior liens on Real Estate	1,957		1,957
Deferred Credits - Interest Income	518		518
Contingent Liabilities	12,542	800	13,342
Total Public Liabilities	\$ 83,017	\$ 65,314	\$ 148,331

	By Fund		
	FY 2000		
	Non-Current Liabilities	Current Liabilities	Total Liabilities
1. Intragovernmental			
(1) Business Loan and Investment Fund	\$ 1,002,512	\$ 710,259	\$ 1,712,771
(2) Disaster Loan Fund	884,736	378,047	1,262,783
(3) Pollution Control Guarantee Fund	13,289		13,289
(4) Salaries and Expenses		7,152	7,152
(5) Office of Inspector General		78	78
(6) Non-Entity Due Treasury		1,505,291	1,505,291
Total Intragovernmental Liabilities	\$ 1,900,537	\$ 2,600,827	\$ 4,501,364
2. Liabilities - Public			
(1) Business Loan and Investment Fund	\$ 71,418	\$ 274,502	\$ 345,920
(2) Disaster Loan Fund	24,076	92,735	116,811
(3) Surety Bond Guarantee	34,956	597	35,553
(4) Salaries and Expenses		33,186	33,186
(5) Office of Inspector General		426	426
Total Public Liabilities	\$ 130,450	\$ 401,446	\$ 531,896

	By Type		
	FY 2000		
	Non-Current Liabilities	Current Liabilities	Total Liabilities
1. Intragovernmental			
Payable to Special Receipt Fund	\$	\$ 1,088,306	\$ 1,088,306
Employment Taxes Payable		1,969	1,969
Unfunded FECA Liability		5,261	5,261
Due Federal Financing Bank	3,641		3,641
Net Assets of Liquidating Funds			
Due to Treasury	1,896,896		1,896,896
Non-Entity - Due to Treasury		1,505,291	1,505,291
Total Intragovernmental Liabilities	\$ 1,900,537	\$ 2,600,827	\$ 4,501,364
2. Liabilities - Public			
Accrued Funded Payroll Benefits	\$	\$ 13,709	\$ 13,709
Accrued Unfunded Annual Leave		19,903	\$ 19,903
Master Reserve Fund Liability	58,000		58,000
Unapplied Cash Adjustments		35,178	35,178
Suspense Accounts		332,656	332,656
Prior liens on Real Estate	2,278		2,278
Deferred Credits - Interest Income	35,216		35,216
Contingent Liabilities	34,956		34,956
Total Public Liabilities	\$ 130,450	\$ 401,446	\$ 531,896

For FY 2001, the amount shown as "Public" under "Non-Current Liabilities" for BLIF consists primarily of a deferred credit of \$68 million related to the Master Reserve Fund discussed in Note 5.

The SBA recorded a contingent liability of \$800 thousand for claims that were reasonably possible to be realized. The SBA has estimated that its ultimate losses for contingent liabilities for other claims related to various administrative proceedings, legal actions, environmental suits and claims brought against it may range from zero to \$50 million.

NOTE 15. Subsequent Events:

The SBA discloses significant subsequent events that could impact the Agency in future years. The first event was the implementation of a new administrative accounting system beginning on October 1, 2001. The SBA converted from the Federal Financial System (FFS) to Oracle Financials.

The second event which also occurred in October 2001, was a disbursement in excess of \$44 million. A Small Business Investment Corporation (SBIC) confirmed its insolvency, leading the SBA to honor the guarantee agreement in that amount. The administrative status of this SBIC has been changed from "regular servicing" to "in liquidation".

A third event was the Agency's response to the terrorist activities of September 11, 2001. Based on language in the Defense Appropriations Act of 2002, \$4.5 billion was provided to implement measures known as the "Supplemental Terrorist Activity Relief" (STAR). This includes a reduction of the monthly servicing fee for qualifying 7(a) STAR loans from 50 to 25 basis points for the life of the loan. In addition, the disaster loan program was modified to increase the limit for Economic Injury Disaster Loans (EIDL) from \$1.5 million to \$10 million and provided for two-year deferments on principal and interest for EIDLs in the declared disaster areas.

The possible future impact of these events is currently unknown. However, we do not expect these events to adversely affect the Agency's operations.

NOTE 16. Statement of Net Cost:

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

1. Operating Cost

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

2. Earned Revenue

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

3. Costs Not Assigned

Costs Not Assigned are costs the Agency has determined are not properly allocable to programs such as the Office of Inspector General, Congressional Initiatives and some grants for FY 2001. In prior years the costs from Pollution Control Equipment Contract Guarantee Fund (PCECGF) had been included in Costs Not Assigned.

For FY 2001 PCECGF negative costs of \$3.814 million were included in Gross Costs - Public under Business Programs. For FY 2000 PCECGF negative costs of \$1.408 million were included in Costs Not Assigned.

4. Earned Revenue Not Attributed to Programs

Earned Revenue Not Attributed to Programs are revenues the Agency has determined are not properly allocable to programs such as the Office of Inspector General for FY 2001. In prior years the revenues from Pollution Control Equipment Contract Guarantee Fund (PCECGF) had been included in Revenue Not Attributed to Programs.

For FY 2001 PCECGF \$91 thousand Earned Revenue - Public were included under Business Programs. For FY 2000 PCECGF \$89 thousand were included in revenue not assigned.

(Dollars in Thousands)

	<u>2001</u>	<u>Eliminations</u>	<u>Consolidated</u>	<u>2000</u>
Business Programs				
Intragovernmental				
Gross Costs	\$ 131,697	\$ (128,764)	\$ 2,933	\$ (133,828)
Less: Earned Revenue	<u>78,207</u>		<u>78,207</u>	<u>70,771</u>
Net Costs	\$ 53,490	\$ (128,764)	\$ (75,274)	\$ (204,599)
Public				
Gross Costs	\$ 305,917	\$	\$ 305,917	\$ 257,176
Less: Earned Revenue	<u>19,272</u>		<u>19,272</u>	<u>24,159</u>
Net Costs	\$ 286,645	\$	\$ 286,645	\$ 233,017
Net Cost of Business Programs	<u>\$ 340,135</u>	<u>\$ (128,764)</u>	<u>\$ 211,371</u>	<u>\$ 28,418</u>

Disaster Programs

Intragovernmental				
Gross Costs	\$ 970,180	\$ (131,615)	\$ 838,565	\$ 1,050,416
Less: Earned Revenue	436,414		436,414	491,997
Net Costs	<u>\$ 533,766</u>	<u>\$ (131,615)</u>	<u>\$ 402,151</u>	<u>\$ 558,419</u>
Public				
Gross Costs	\$ 215,347	\$	\$ 215,347	\$ 299,879
Less: Earned Revenue	159,018		159,018	274,145
Net Costs	<u>\$ 56,329</u>	<u>\$</u>	<u>\$ 56,329</u>	<u>\$ 25,734</u>
Net Cost of Disaster Programs	\$ 590,095	\$ (131,615)	\$ 458,480	\$ 584,153
Cost not assigned to programs	\$ 26,631		\$ 26,631	\$ 38,947
Less: Earned revenue not attributed to programs	267,990	(260,379)	7,611	16,092
Net Cost of Operations	<u>\$ 688,871</u>	<u>\$</u>	<u>\$ 688,871</u>	<u>\$ 635,426</u>

(Dollars in Thousands)

<u>Functional Classification</u>	<u>FY 2001</u>		
	<u>Gross Cost</u>	<u>Earned Revenue</u>	<u>Net Cost</u>
Commerce and Housing Credit	\$ 308,850	\$ 97,479	\$ 211,371
Community and Regional Development	1,080,543	603,043	477,500
Total	<u>\$ 1,389,393</u>	<u>\$ 700,522</u>	<u>\$ 688,871</u>
<u>Functional Classification</u>	<u>FY 2000</u>		
	<u>Gross Cost</u>	<u>Earned Revenue</u>	<u>Net Cost</u>
Commerce and Housing Credit	\$ 123,348	\$ (94,930)	\$ 28,418
Community and Regional Development	1,389,242	(782,234)	607,008
Total	<u>\$ 1,512,590</u>	<u>\$ (877,164)</u>	<u>\$ 635,426</u>

Business Programs

	<u>2001</u>	<u>2000</u>
Business Loan Programs		
Intragovernmental		
Gross Costs	\$ 19,415	\$ 127,990
Less: Earned Revenue	<u>59,891</u>	<u>62,295</u>
Net Costs	\$ (40,476)	\$ 65,695
Public		
Gross Costs	\$ 67,625	\$ 147,097
Less: Earned Revenue	<u>9,208</u>	<u>9,578</u>
Net Costs	\$ 58,417	\$ 137,519
Total Net Cost	<u>\$ 17,941</u>	<u>\$ 203,214</u>
Development Company Programs		
Intragovernmental		
Gross Costs	\$ (42,566)	\$ (85,233)
Less: Earned Revenue	<u>1,614</u>	<u>4,931</u>
Net Costs	\$ (44,180)	\$ (90,164)
Public		
Gross Costs	\$ 18,303	\$ 14,725
Less: Earned Revenue	<u>3,377</u>	<u>10,317</u>
Net Costs	\$ 14,926	\$ 4,408
Total Net Cost	<u>\$ (29,254)</u>	<u>\$ (85,756)</u>
Small Business Investment Company (SBIC) Programs		
Intragovernmental		
Gross Costs	\$ 26,084	\$ (176,585)
Less: Earned Revenue	<u>16,702</u>	<u>3,545</u>
Net Costs	\$ 9,382	\$ (180,130)
Public		
Gross Costs	\$ (16,560)	\$ (135,004)
Less: Earned Revenue	<u>4,040</u>	<u>858</u>
Net Costs	\$ (20,600)	\$ (135,862)
Total Net Cost	<u>\$ (11,218)</u>	<u>\$ (315,992)</u>

Surety Bond Guarantees Programs

Public			
Gross Costs	\$	(7,711)	\$ 10,182
Less: Earned Revenue		2,647	3,407
Net Costs	\$	<u>(10,358)</u>	\$ <u>6,775</u>
Total Net Cost	\$	<u>(10,358)</u>	\$ <u>6,775</u>

Business Development Programs

Public			
Gross Costs	\$	49,902	\$ 49,941
Less: Earned Revenue			
Net Costs	\$	<u>49,902</u>	\$ <u>49,941</u>
Total Net Cost	\$	<u>49,902</u>	\$ <u>49,941</u>

Government Contracting Programs

Public			
Gross Costs	\$	21,366	\$ 26,356
Less: Earned Revenue			
Net Costs	\$	<u>21,366</u>	\$ <u>26,356</u>
Total Net Cost	\$	<u>21,366</u>	\$ <u>26,356</u>

Entrepreneurial Development Programs

Public			
Gross Costs	\$	157,567	\$ 143,879
Less: Earned Revenue			
Net Costs	\$	<u>157,567</u>	\$ <u>143,879</u>
Total Net Cost	\$	<u>157,567</u>	\$ <u>143,879</u>

Improving Business Environment *

Public

Gross Costs	
Office of Advocacy	\$ 6,533
National Advisory Council	160
Ombudsman	954
Office of Veterans' Affairs	7,083
Women's Business Council	694
Gross Costs	\$ 15,424
Less: Earned Revenue	
Net Costs	\$ 15,424
Total Net Cost	\$ 15,424

* New category for FY 2001. Costs included in other categories in prior years.

Business Programs

Intragovernmental

Gross Costs	\$ 2,933	\$ (133,828)
Less: Earned Revenue	78,207	70,772
Net Costs	\$ (75,274)	\$ (204,600)

Public

Gross Costs	\$ 305,916	\$ 257,176
Less: Earned Revenue	19,272	24,159
Net Costs	\$ 286,644	\$ 233,017
Total Net Cost	\$ 211,370	\$ 28,417

The large credit balances in the Net Program Section for Development Company and Small Business Investment Company are due to subsidy reestimates. The Consolidated Statement of Net Cost has been reformatted to group by program to make the statement more readable. FY 2000 is restated to make it comparable to FY 2001.

NOTE 17. Disclosures Related to the Statement of Net Position:

The SBA's net position, as of September 30, 2001, consisted of the following:

1. Unexpended Appropriations

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

2. Cumulative Results of Operations

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

NOTE 18. Disclosures Related to the Statement of Budgetary Resources:

The SBA incurred \$4.7 billion of direct obligations of which \$.8 billion was apportioned by fiscal quarters (type A apportionment's) and the \$3.9 billion was not apportioned by fiscal quarter (type B apportionment).

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

Authority permanently not available pursuant to Public Law 107-20 is \$22 million for the New Markets Venture Capital Program which was not authorized.

Several line items on the SBA's Statement of Budgetary Resources (SBR) were different from comparable line items on the Budget of the United States Government (BUSG). The SBA had not accumulated all of the information it needed prior to the submission deadline of BUSG data. Missing from the SBA's BUSG submission was some of the data for the August 2001 loan asset sale, the final subsidy reestimates figures, and the final Agency cost data. Also, the SBA recognized \$123 million as collections in its business program fund on its SBR, while the BUSG did not. Additional differences were the result of gathering data from different sources. The SBR was prepared using data from the Agency's general ledger, while some of the BUSG data was obtained from internal cost reports. Lastly, the SBA's SBR splits its unobligated balances between "Available" and "Not Yet Available" and the BUSG does not.

The SBA restated the beginning balance of obligations from \$1.8 billion to \$1.4 billion reducing it by \$.4 billion in order to reflect a change in accounting for unapplied remittances. The beginning unobligated balance increased by a corresponding \$0.4 billion.

NOTE 19. Disclosures Related to the Statement of Financing:

Imputed Financing includes an imputed cost of \$7.3 million for pension benefits, \$9.8 million for health benefits, \$36 thousand for life insurance and \$609 thousand for a payment by the Judgement Fund.

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



**Required Supplementary
Stewardship
Information**

**U.S. Small Business
Administration**

**for
Fiscal Year 2001**

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

(Dollars in Thousands)

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

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

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

The SBA is only presenting four years of data because FY 98 was the first year that data was compiled.

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

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

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

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

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

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

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

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

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

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

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

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

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

(Dollars in Thousands)

	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
The Office of Technology	\$ 1,906	\$ 1,720	\$ 3,597	\$ 56

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

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

The SBA is only presenting four years of data because FY 98 was the first year that data was compiled.



**Required Supplemental
Information**

**U.S. Small Business
Administration**

**for
Fiscal Year 2001**

U. S. Small Business Administration
Required Supplementary Information
Intragovernmental Assets and Liabilities
for the period ended September 30, 2001

(Dollars in Thousands)

	Fund Balance With Treasury	Accounts Receivable	Advances	Accounts Payable	Debt/Borrowings from Other Agencies	Other Liabilities
Trading Partner						
Federal Financing Bank	\$		\$ 2,496		\$ 131,963	\$ 2,823
Department of the Treasury	10,169,491	376,087		698,233	10,086,452	3,656,130
Office of Personnel Management						2,006
Department of Labor						5,363
Total	\$ 10,169,491	\$ 376,087	\$ 2,496	\$ 698,233	\$ 10,218,415	\$ 3,666,322

U. S. Small Business Administration
Required Supplementary Information
Intragovernmental Earned Revenues and Related Costs
for the period ended September 30, 2001

(Dollars in Thousands)

Trading Partner	<u>Earned Revenue</u>	<u>Gross Cost</u>
Department of the Treasury	\$ 514,622	\$ (362,593)
Total	<u><u>\$ 514,622</u></u>	<u><u>\$ (362,593)</u></u>
Budget Functional Classification		
Commerce and Housing Credit	\$ 78,207	\$ 227,841
Community and Regional Development	436,415	\$ (590,434)
Total	<u><u>\$ 514,622</u></u>	<u><u>\$ (362,593)</u></u>

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, 2001

	BLIF		DLF		SBGRF
	Budgetary	Non-Budgetary Financing	Budgetary	Non-Budgetary Financing	
<i>(Dollars in Thousands)</i>					
BUDGETARY RESOURCES					
Budget Authority					
Appropriations Received	\$ 329,035	\$	\$ 184,494	\$	\$
Borrowing Authority		27,142		1,144,985	
Net Transfers (+/-)	(26,872)		95,100		
Other					
Unobligated Balance					
Brought Forward October 1	374,058	1,394,240	367,793	4,650,901	31,979
Net Transfers, Actual (+/-)	(184,638)				
Spending Authority from Offsetting Collections	(68,958)	673,873	341,082	2,207,777	6,187
Recoveries of Prior Year Obligations	526,363	445	11,013	50,071	
Temporarily Not Available Pursuant to Public Law					
Permanently Not Available	(8,177)	(20,734)	(240,111)	(793,688)	
Total Budgetary Resources	\$ 940,811	\$ 2,074,966	\$ 759,371	\$ 7,260,046	\$ 38,166

U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
for the period ended September 30, 2001

<i>(Dollars in Thousands)</i> STATUS OF BUDGETARY RESOURCES	BLIF		DLF		SBGRF
	Budgetary	Non-Budgetary Financing	Budgetary	Non-Budgetary Financing	Budgetary
Obligations Incurred	\$ 516,049	\$ 1,621,637	\$ 320,275	\$ 1,576,399	\$ 12,740
Unobligated Balances Available	82,695	243,259	468,211	1,701,759	7,439
Unobligated Balances Not Yet Available	342,067	210,070	(29,115)	3,981,888	17,987
Total Status of Budgetary Resources	\$ 940,811	\$ 2,074,966	\$ 759,371	\$ 7,260,046	\$ 38,166

(Dollars in Thousands)
RELATIONSHIP OF
OBLIGATIONS TO OUTLAYS

	BLIF		DLF		SBGRF
	Budgetary	Non-Budgetary Financing	Budgetary	Non-Budgetary Financing	
Obligated Balance, Beginning of Period	\$ 681,101	\$ (25,490)	\$ 75,432	\$ 421,550	\$ 1,360
Obligated Balance, End of Period	(66,362)	(160,548)		(375,527)	
Accounts Receivable					
Unfilled Customer Orders from Federal Sources	354,382	38,141	144	361,988	
Undelivered Orders	192,649	154,054	92,798	626,004	585
Accounts Payable					
Total Obligated Balance, End of Period	480,669	31,647	92,942	612,465	585
Outlays					
Disbursements	313,621	1,548,086	291,753	1,320,510	13,515
Collections	(54,545)	(657,904)	(341,082)	(2,192,874)	(6,266)
Subtotal	\$ 259,076	\$ 890,182	\$ (49,329)	\$ (872,364)	\$ 7,249
Less: Offsetting Receipts		(722,361)		(384,318)	
Net Outlays	\$ 259,076	\$ 167,821	\$ (49,329)	\$ (1,256,682)	\$ 7,249

U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
for the period ended September 30, 2001

	PCECGF		SE		OIG		BATF		TOTAL		TOTAL	
	Budgetary		Budgetary		Budgetary		Budgetary		Budgetary	Financing		Total
BUDGETARY RESOURCES												
Budget Authority												
Appropriations Received	\$ 3,000	\$	440,635	\$	11,953	\$	969,117	\$	969,117	\$	969,117	\$
Borrowing Authority										1,172,127		1,172,127
Net Transfers (+/-)			4,682				72,910		72,910			72,910
Other												
Unobligated Balance:												
Brought Forward October 1	1,784		31,651		736		808,198		808,198	6,045,141		6,853,339
Net Transfers, Actual (+/-)							(184,638)		(184,638)			(184,638)
Spending Authority from Offsetting Collections	273		267,692		500		546,853		546,853	2,881,650		3,428,503
Recoveries of Prior Year Obligations			28,936		783		567,095		567,095	50,516		617,611
Temporarily Not Available Pursuant to Public Law												
Permanently Not Available	(1,785)		(47,914)		(26)		(298,013)		(298,013)	(814,422)		(1,112,435)
Total Budgetary Resources	\$ 3,272	\$	725,682	\$	13,946	\$	2,481,522	\$	2,481,522	\$ 9,335,012	\$	11,816,534

U. S. Small Business Administration
Required Supplementary Information
Combining Statement of Budgetary Resources
 for the period ended September 30, 2001

<i>(Dollars in Thousands)</i>	PCECGF		SE		OIG		BATF		TOTAL			
	Budgetary		Budgetary		Budgetary		Budgetary		Budgetary	Non-Budgetary Financing		
STATUS OF BUDGETARY RESOURCES												
Obligations Incurred	\$ 375	\$	667,060	\$	13,190	\$	69	\$	1,529,758	\$	3,198,036	\$ 4,727,794
Unobligated Balances Available	2,651		42,408		584		205		604,193		1,945,018	2,549,211
Unobligated Balances Not Yet Available	246		16,214		172				347,571		4,191,958	4,539,529
Total Status of Budgetary Resources	\$ 3,272	\$	725,682	\$	13,946	\$	274	\$	2,481,522	\$	9,335,012	\$ 11,816,534

(Dollars in Thousands)
RELATIONSHIP OF

OBLIGATIONS TO OUTLAYS

	PCECGF		SE		OIG		BATF		TOTAL		TOTAL	
	Budgetary		Budgetary		Budgetary		Budgetary		Budgetary		Financing	Total
Obligated Balance, Beginning of Period		\$	249,682	\$	1,763	\$	36	\$	1,009,374	\$	396,060	\$ 1,405,434
Obligated Balance - End of Period											(66,362)	(602,437)
Accounts Receivable												
Unfilled Customer Orders from Federal Sources												
Undelivered Orders			295,152		1,413		9		651,100		400,129	1,051,229
Accounts Payable			16,050		543				302,625		780,058	1,082,683
Total Obligated Balance - End of Period			311,202		1,956		9		887,363		644,112	1,531,474
Outlays:												
Disbursements	375		576,604		12,214		96		1,208,178		2,868,596	4,076,774
Collections	(273)		(267,692)		(500)		(77)		(670,435)		(2,850,778)	(3,521,213)
Subtotal	102	\$	308,912	\$	11,714	\$	19	\$	537,743	\$	17,818	\$ 555,561
Less: Offsetting Receipts											(1,106,679)	(1,106,679)
Net Outlays	102	\$	308,912	\$	11,714	\$	19	\$	537,743	\$	(1,088,861)	\$ (551,118)

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Balance Sheet
for the period ended September 30, 2001

	BLIF	DLF	SBGRF	PCECGF	SE	OIG	BATF	Total Entity
ASSETS								
<i>(Dollars in Thousands)</i>								
Intragovernmental Assets								
Fund Balances with Treasury	\$ 1,390,412	\$ 6,544,504	\$ 26,089	\$ 2,897	\$ 369,826	\$ 2,712	\$ 215	\$ 8,336,655
Accounts Receivable	315,672	873,779						1,189,451
Advances	2,496							2,496
Total Intragovernmental	\$ 1,708,580	\$ 7,418,283	\$ 26,089	\$ 2,897	\$ 369,826	\$ 2,712	\$ 215	\$ 9,528,602
Other Assets -Public								
Cash	2,443							2,443
Interest Receivable	68,000							68,000
Accounts Receivable	51,277	103	5,540		268			57,188
Credit Program Receivables and Related								
Foreclosed Property, Net	1,384,076	3,651,010		16,037	8,518			5,051,123
General Property and Equipment, Net								8,518
Advances	253,708							253,708
Total Other Assets -Public	1,759,504	3,651,113	5,540	16,037	8,786	0	0	5,440,980
Total Assets	\$ 3,468,084	\$ 11,069,396	\$ 31,629	\$ 18,934	\$ 378,612	\$ 2,712	\$ 215	\$ 14,969,582
LIABILITIES								
Intragovernmental Liabilities								
Accounts Payable	\$ 318,303	\$ 1,193,294	\$	\$	\$	\$	\$	\$ 1,511,597
Debt	568,856	9,649,559						10,218,415
Other	1,243,077	564,631		18,409	7,289	80		1,833,486
Total Intragovernmental	\$ 2,130,236	\$ 11,407,484	\$	\$ 18,409	\$ 7,289	\$ 80	\$	\$ 13,563,498
Other Liabilities -Public								
Accounts Payable	\$ 114,831	\$ 23,757	\$ 584	\$	\$	\$	\$	\$ 139,172
Liabilities for Loan Guarantees	1,082,495			525				1,083,020
FECA Actuarial Liability					32,255			32,255
Other	93,561	5,804	13,090		35,415	461		148,331
Total Other Liabilities -Public	1,290,887	29,561	13,674	525	67,670	461	0	1,402,778
Total Liabilities	\$ 3,421,123	\$ 11,437,045	\$ 13,674	\$ 18,934	\$ 74,959	\$ 541	\$ 0	\$ 14,966,276
NET POSITION								
Unexpended Appropriations	\$ 135,721	\$ 130,604	\$ 293,330	\$	\$ 320,291	\$ 2,695	\$	\$ 882,641
Cumulative Results of Operations	(88,761)	(498,252)	(275,375)		(16,638)	(524)	215	(879,335)
Total Net Position	\$ 46,960	\$ (367,648)	\$ 17,955	\$ 0	\$ 303,653	\$ 2,171	\$ 215	\$ 3,306
Total Liabilities and Net Position	\$ 3,468,084	\$ 11,069,396	\$ 31,629	\$ 18,934	\$ 378,612	\$ 2,712	\$ 215	\$ 14,969,582

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Balance Sheet
for the period ended September 30, 2001

<i>(Dollars in Thousands)</i>	Non-Entity	Eliminations	Consolidated TOTAL
ASSETS			
Intragovernmental Assets			
Fund Balances with Treasury	\$ 1,832,836		\$ 10,169,491
Accounts Receivable		(813,364)	376,087
Advances			2,496
Total Intragovernmental	\$ 1,832,836	\$ (813,364)	\$ 10,548,074
Other Assets -Public			
Cash			2,443
Investments			68,000
Accounts Receivable			57,188
Credit Program Receivables and Related			
Foreclosed Property, Net			5,051,123
General Property and Equipment, Net			8,518
Advances			253,708
Total Other Assets -Public	0	0	5,440,980
Total Assets	\$ 1,832,836	\$ (813,364)	\$ 15,989,054
LIABILITIES			
Intragovernmental Liabilities			
Accounts Payable		(813,364)	698,233
Debt			10,218,415
Other	1,832,836		3,666,322
Total Intragovernmental	\$ 1,832,836	\$ (813,364)	\$ 14,582,970
Other Liabilities -Public			
Accounts Payable			139,172
Liabilities for Loan Guarantees			1,083,020
FECA Actuarial Liability			32,255
Other			148,331
Total Other Liabilities -Public	0	0	1,402,778
Total Liabilities	\$ 1,832,836	\$ (813,364)	\$ 15,985,748
NET POSITION			
Unexpended Appropriations			882,641
Cumulative Results of Operations			(879,335)
Total Net Position	\$	\$	\$ 3,306
Total Liabilities and Net Position	\$ 1,832,836	\$ (813,364)	\$ 15,989,054



**Other Accompanying
Information**

**U.S. Small Business
Administration**

**for
Fiscal Year 2001**

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Changes in Net Position
for the period ended September 30, 2001

(Dollars in Thousands)

	BLIF		DLF		SBGRF	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	\$ (87,984)	\$ 103,549	\$ (414,175)	\$ 121,630	\$ (299,851)	\$ 303,193
Prior Period Adjustments						
Beginning Balances, as Adjusted	(87,984)	103,549	(414,175)	121,630	(299,851)	303,193
Budgetary Financing Sources						
Appropriations Received		329,035		184,494		
Transferred -in/out (+/-)		1,580		95,100		
Rescissions		(647)		(405)		
Adjustment -Cancelled Authority		(7,528)				
Other Adjustments						
Appropriations Used	290,268	(290,268)	270,215	(270,215)	9,863	(9,863)
Donations of Cash						
Other Financing Sources						
Transfers-in/out Without Reimbursement	(352,321)		80,398			
Imputed Financing from Costs Absorbed by Others						
Total Financing Sources	\$ (62,053)	\$ 32,172	\$ 350,613	\$ 8,974	\$ 9,863	\$ (9,863)
Less: Net Cost of Operations	\$ (61,276)	\$	\$ 434,690	\$	\$ (14,613)	\$
Net Position - End of Period	\$ (88,761)	\$ 135,721	\$ (498,252)	\$ 130,604	\$ (275,375)	\$ 293,330

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

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Changes in Net Position
for the period ended September 30, 2001

(Dollars in Thousands)

	PCECGF		SE		OIG	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	\$	\$	(22,085)	\$ 232,729	\$	\$ 2,053
Prior Period Adjustments						
Beginning Balances, as Adjusted	9	0	(22,085)	232,729	(66)	2,053
Budgetary Financing Sources						
Appropriations Received		3,000		440,635		11,953
Appropriations				4,682		(26)
Transferred -in/out (+/-)				(30,894)		
Rescissions				(17,018)		
Adjustment -Cancelled Authority				(1)		
Other Adjustments		(3,000)		(309,842)		(11,285)
Appropriations Used			309,842		11,285	
Donations of Cash						
Other Financing Sources						
Transfers-in/out Without Reimbursement	(3,905)		17,741			
Imputed Financing from Costs Absorbed by Others						
Total Financing Sources	\$ (3,905)	\$ 0	\$ 327,583	\$ 87,562	\$ 11,285	\$ 642
Less: Net Cost of Operations	\$ (3,905)	\$	\$ 322,136	\$	\$ 11,743	
Net Position - End of Period	\$ 0	\$ 0	\$ (16,638)	\$ 320,291	\$ (524)	\$ 2,695

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

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Changes in Net Position
for the period ended September 30, 2001

(Dollars in Thousands)

	BAAF		Eliminations		TOTAL	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	\$ 234	\$	\$	\$	(823,927)	\$ 763,154
Prior Period Adjustments						
Beginning Balances, as Adjusted	234	0	0	0	(823,927)	763,154
Budgetary Financing Sources						
Appropriations Received						969,117
Appropriations						101,362
Transferred -in/out (+/-)						(31,972)
Rescissions						(24,546)
Adjustment -Cancelled Authority					891,473	(3,001)
Other Adjustments						(891,473)
Appropriations Used						
Donations of Cash	77				77	
Other Financing Sources						
Transfers-in/out Without Reimbursement					(275,828)	
Imputed Financing from Costs Absorbed by Others					17,741	
Total Financing Sources	\$ 77	\$ 0	\$ 0	\$ 0	\$ 633,463	\$ 119,487
Less: Net Cost of Operations	\$ 96				\$ 688,871	\$ 688,871
Net Position - End of Period	\$ 215	\$ 0	\$ 0	\$ 0	\$ (879,335)	\$ 882,641
						\$ 3,306

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

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Financing
for the period ended September 30, 2001

(Dollars in Thousands)

	BLIF	DLF	SBGRF	PCECGF	SE	OIG	BAIF	Total
<i>Resources Used to Finance Activities</i>								
Budgetary Resources Obligated								
Obligations Incurred	\$ 2,137,686	\$ 1,896,674	\$ 12,740	\$ 375	\$ 667,060	\$ 13,190	\$ 69	\$ 4,727,794
Less: Spending Authority from Offsetting Collections and Recoveries	1,131,723	2,609,943	6,187	273	296,628	1,283	77	4,046,114
Obligations Net of Offsetting Collections and Recoveries	1,005,963	(713,269)	6,553	102	370,432	11,907	(8)	681,680
Less: Offsetting Receipts	722,361	384,318						1,106,679
Net Obligations	\$ 283,602	\$ (1,097,587)	\$ 6,553	\$ 102	\$ 370,432	\$ 11,907	\$ (8)	\$ (424,999)
Other Resources								
Transfers In (Out) Imputed Financing	(352,320)	80,398		(3,905)	17,741			(275,827)
Net Other Resources Used to Finance Activities	\$ (352,320)	\$ 80,398	\$ 0	\$ (3,905)	\$ 17,741	\$ 0	\$ 0	\$ (258,086)
Total Resources Used to Finance Activities	\$ (68,718)	\$ (1,017,189)	\$ 6,553	\$ (3,803)	\$ 388,173	\$ 11,907	\$ (8)	\$ (683,085)

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Financing
for the period ended September 30, 2001

(Dollars in Thousands)

	BLIF	DIF	SEGRF	PCBCGF	SE	OIG	BAIF	Total
Resources Used to Finance								
Items not Part of the Net								
Cost of Operations								
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	\$ 184,172	\$ (238,760)	\$ 9	\$	\$ (60,628)	\$ (164)	\$ 27	(115,344)
Financing Sources that Fund								
Expenses Recognized in Prior Periods								
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	1,396,234	2,592,095						3,988,329
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(1,536,393)	(879,363)		(164)	(8,518)			(2,424,438)
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	299,683		(40)				77	299,720
Total Resources Used to								
Finance Items Not Part of								
the Net Cost of Operations	\$ 343,696	\$ 1,473,972	\$ (31)	\$ (164)	\$ (69,146)	\$ (164)	\$ 104	\$ 1,748,267
Total Resources Used to								
Finance the Net Cost of								
Operations	\$ 274,978	\$ 456,783	\$ 6,522	\$ (3,967)	\$ 319,027	\$ 11,743	\$ 96	\$ 1,065,182

U. S. Small Business Administration
Additional Accompanying Information
Consolidating Statement of Financing
for the period ended September 30, 2001

<i>(Dollars in Thousands)</i>	BLIF	DLF	SBCRF	PCECGF	SE	OIG	BATF	Total
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period								
Change in Annual Leave Liability					587			587
Increase in Unfunded Liability for Claims against SBA					800			800
Upward/ Downward reestimates of Credit Subsidy Expense	(298,907)	84,076						(214,831)
Change in Revenue Receivable from Public	(47,277)	19,203	1,365	(28)	52			(26,685)
Change in Due to Treasury - Liquidating Funds	52,637	(80,398)		3,905				(23,856)
Provision for Losses on Estimated Guarantees Unfunded Employee Benefits	(5,525)		(22,500)	(3,982)				(32,007)
					1,670			1,670
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period								
	\$ (299,072)	\$ 22,881	\$ (21,135)	\$ (105)	\$ 3,109	\$ 0	\$ 0	\$ (294,322)
Components Not Requiring or Generating Resources								
Depreciation or Amortization								
Revaluation of Assets and Liabilities								
Bad Debt Expense - Noncredit Reform	(37,182)	(44,974)		167				(81,989)
Total Components of Net Cost that Will Not Require or Generate Resources	(37,182)	(44,974)	167					(81,989)

Total Components of Net
Cost of Operations Not
Requiring or Generating
Resources in the Current
Period
Net Cost of Operations

\$	(336,254)	\$	(22,093)	\$	(21,135)	\$	62	\$	3,109	\$	0	\$	0	\$	(376,311)
\$	(61,276)	\$	434,690	\$	(14,613)	\$	(3,905)	\$	322,136	\$	11,743	\$	96	\$	688,871



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

DATE: February 25, 2002
TO: Robert Seabrooks
Assistant IG for Auditing
FROM: Joe Loddo *JL*
CFO
SUBJECT: FY 2001 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 are aware, the financial statement reporting process and the conduct of an IPA audit are integral to the SBA's financial management program. As such, increased attention and resources have been provided to this area, resulting in the achievement of 5 previous unqualified opinions. This FY 2001 financial statement IPA opinion provides our 6th straight "clean" opinion.

The SBA has enjoyed a continually improving working relationship with the Office of Inspector General and the IPA, sharing the same goals and objectives for improved financial management at the Agency. This relationship was further enhanced this year through regular meetings of our audit committee and open and honest dialogue as we jointly addressed various financial challenges in our reporting and internal control processes. We look forward to the continuation of this relationship and wish to express our sincere appreciation for your support of SBA's efforts in this area.

The SBA faced several significant challenges during FY 2001 in preparing its financial statements, and in other areas related to financial management, and these are reflected in the IPA reports: (1) We had to further accelerate the reporting timeline, moving toward a November 15 final date for FY 2004 reporting; (2) We had to begin implementation of yet another set of revised "form and content" changes issued by OMB in their Bulletin 01-09; (3) We are still working with financial systems that require additional modernization to ensure their full integration, requiring continued use of "bridge" applications to create these necessary linkages; (4) We have the added complexity of being a major Federal credit Agency, and the subsidy rate calculations add a dimension to the financial reporting process that is extremely complex; and (5) We are operating with limited resources, both staff and funding, in an environment of increasing demands in all operational areas, including financial management and information technology. This limits our ability to make forward progress as rapidly as we and others would like.

All said, we believe that the IPA assessment of our financial reporting process and internal control activities is fair. Specifically, I offer the following comments relative to the IPA reports.

Independent Auditor's Report:

- We agree and accept the unqualified "clean" opinion, including the reference to the Master Reserve Fund (MRF) restatement of FY's 2000 and 2001. We have no comments on this report.

Independent Auditor's Report on Internal Control:

- We agree and accept the four reportable conditions, with one being material relative to our financial reporting process.
- For the material weakness on the financial statement reporting process, the following comments are provided:
 - We agree that continued attention needs to be provided to the quality and timeliness of our financial statement reporting process. SBA is committed to developing and fully implementing an improved financial statement reporting process this year, including using individuals and/or firms in a quality review capacity that can take a more objective and critical view toward these statements and footnotes—allowing errors to be identified and corrected prior to submission to the IPA.
 - SBA is also committed to improving its quarterly financial statement reporting process to increase the timeliness and accuracy of our annual statements, by identifying issues and problems early-on in the year and correcting these prior to the yearend statements.
 - We fully agree that the Financial Reporting Information System (FRIS) that SBA developed to assist in the integration of our financial data from disparate systems creates complexities in mappings and audit trails. However, this system that is essentially the same as was used for the FY 2000 reporting process, provides SBA a necessary automated “bridge” between our various general ledgers. As noted by the IPA last year, this was an effective interim improvement step taken by SBA. Additional documentation of this system will continue, especially as we introduce changes, such as those contained in OMB Bulletin 01-09.
- For the non-material reportable condition on Subsidy Re-estimates, we agree that additional quality control measures need to be taken over this extremely complex process, and provide the following comments on this section of the report.
 - As noted in our regular meetings on this year's audit process, the principal problems with our work in this general area are two-fold: First, the subsidy rate process is extremely complex, and this complexity grows each year due to the addition of cohorts, program and legislative changes, and our desire to make continuous improvements in the analytics to improve accuracy of forecasting. Second, the process that is used to calculate the rates is extremely cumbersome relying on Excel spreadsheets with thousands of cells and references, and a high degree of manual intervention to update the information annually. This process is prone to the introduction of cell reference or other errors and only limited improvement is possible with the current methodologies.

As you are aware, we have begun a modernization effort in this area with the disaster model using SAS programming. We have contracted with the Office of Federal Housing Enterprise Oversight (OFHEO) to develop an automated model for 7(a) for FY 2004, and one for the 504 program for FY 2005. We plan to continue this automation effort which, over time, will further mitigate these weaknesses in the process. However, there is no adequate substitute to continual quality assurance,

including the use of independent validation, and we will also continue this oversight as well.

- We agree that the quality assurance measures developed by our office were not fully implemented for the FY 2001 reporting processes. This was a direct result of two factors: (1) delays in the finalization of the models because of difficulty in receiving our necessary clearances; (2) delays in awarding a contract to our independent validation firm due to limited funding available to SBA in its operating budget this year, and the delay in our appropriation, that was not approved until November 28.
- For the non-material reportable condition on MRF, we agree that additional analysis of the MRF is needed, and as we have previously discussed, we are committed to accomplishing this analysis during FY 2002 in time for next year's financial statement reporting. An additional comment on this section is:
 - Recommendation #2 is for us to consider additional disclosure using SFFAS No.7 as a guide, as referenced above. We are uncertain what this implies and need further discussion with the IPA regarding this recommendation before we can take a formal position on it.
- For the non-material reportable condition on SBA's Agency-wide Security Program, we agree that continual and additional attention to this area is needed, and as we have previously discussed, we are committed to this during FY 2002 in time for next year's audit cycle. We appreciate the comments recognizing the good progress we have made in this area to date. We await the receipt of the separate IPA report on our systems controls, and as indicated to you previously, we have already dedicated significant additional resources to this area again this fiscal year, and are aggressively making the agreed-upon improvements in all areas that are viewed to be weaknesses.

Independent Auditor's Report on Compliance with Laws and Regulations:

- This IPA report principally references the audit work accomplished in response to the Federal Financial Management Improvement Act (FFMIA). The overall assessment in this area is that, while SBA was determined to be substantially compliant with FFMIA last year, the same determination is not made for FY 2001. I understand that this is a direct reflection on the previously-referenced material weakness on our financial statement reporting process that did not allow us to be both timely and fully accurate in our initial delivery of statements to the IPA. OMB's guidance to the audit community in this area includes this as a criteria for the compliance assertion. This however, is not a negative reflection on the significant progress that we made in this area prior to FY 2001 that allowed us to receive the compliance assessment last year, including remaining in substantial compliance with the U.S. Standard General Ledger. We agree with this assessment solely due to the OMB guidance that the IPA must follow.

Thank you for the opportunity to comment on these DRAFT reports, and I'm happy to respond to any questions that you may have on these comments. Additionally, I look forward to working with your staff and the IPA as we prepare for the challenges that we will face in further accelerating the statements for FY 2002 and beyond.

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