

**AUDIT OF SBA'S
FY 2002 FINANCIAL STATEMENTS
MANAGEMENT LETTER**

AUDIT REPORT NUMBER 3-24

APRIL 14, 2003

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

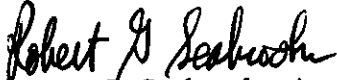
AUDIT REPORT

Issue Date: April 14, 2003

Number: 3-24

To: Hector V. Barreto
Administrator

Thomas A. Dumaresq
Chief Financial Officer (CFO)

From: 
Robert G. Seabrooks, Assistant Inspector General for Auditing

Subject: Audit of SBA's FY 2002 Financial Statements - Management Letter

Pursuant to the Chief Financial Officers Act of 1990, attached is Cotton & Company LLP's management letter. It identifies issues related to: (1) fund balance with Treasury differences, (2) foreclosed property records and valuation, (3) allotment detail, (4) administrative undelivered orders, (5) administrative costs, (6) sampling for erroneous payments, (7) intragovernmental reconciliations, (8) Federal Managers Financial Integrity Act reporting, (9) alignment of strategic goals with the Statement of Net Cost, (10) transactional detail for prior-year obligations, (11) funds control over administrative costs, (12) the general ledger account for loan sales, and (13) cash flow modeling.

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 on the recommendation(s) addressed to you within 30 days on the attached SBA Forms 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

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
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January 29, 2003

**MANAGEMENT LETTER
U.S. SMALL BUSINESS ADMINISTRATION
FINANCIAL STATEMENT AUDIT
FISCAL YEAR 2002**

Inspector General
U.S. Small Business Administration

We were engaged to audit the U.S. Small Business Administration's (SBA) financial statements as of September 30, 2002, and for the year then ended and have issued, under separate cover, our reports thereon dated January 29, 2003. Our reports included those on SBA's internal control and compliance with laws and regulations, with our compliance report including comments on the Federal Financial Management Improvement Act.

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

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

Very truly yours,

COTTON & COMPANY LLP



Charles Hayward, CPA, CISA, CFE

C&C
established 1981

**MANAGEMENT LETTER
U.S. SMALL BUSINESS ADMINISTRATION
FINANCIAL STATEMENT AUDIT
FISCAL YEAR 2002**

Certain nonreportable conditions came to our attention during the audit of the U.S. Small Business Administration's (SBA) Fiscal Year (FY) 2002 financial statements, and they are discussed in this report. All findings are related to SBA's internal control.

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

- **Foreclosed Property Records and Valuation**, reported below in finding No. 2.
- **Credit Card Use**, reported below in finding No. 5.
- **Personal Property and Equipment**, reported below in finding No. 5.

1. Improper Financial Presentation for Unreconciled Fund Balance with Treasury

Several line items included in SBA's financial statements were misstated at June 30, 2002, as a result of adjusting entries that improperly allocated un-reconciled Fund Balance with Treasury (FBWT) differences to clearing accounts. The posting of this "plug" entry to agree SBA's FBWT balance to Treasury's does not approximate the actual financial events that comprise the difference.

Generally accepted accounting principles (GAAP) require that recorded transactions represent economic events that actually occurred.

Each month SBA performs a FBWT reconciliation process, comparing its general ledger (GL) account balance by fund to Treasury's Financial Management Service (FMS) records (FMS 6654, *Undisbursed Appropriation Account Trial Balance*). Unreconciled differences identified by this process are reclassified by fund, via journal voucher (JV) entry (JV Type 623) in the Financial Reporting Information System (FRIS) consolidated general ledger (CGL), to ensure that SBA's GL account balance agrees to Treasury's records.

If Treasury's records indicate a greater balance than SBA's GL account balance at the fund level, then SBA records the following entries:

Account	Financial Statement	Associated F/S Line Item	Debit Amount	Credit Amount
1010: Fund Balance with Treasury	Balance Sheet	Fund Balance with Treasury	XXX	
2351: Unapplied Remittances	Balance Sheet	Other Liabilities Public, Other		XXX
7902: Expended Authority Paid	Statement of Budgetary Resources	Obligations Incurred and Outlays, Disbursements	XXX	
7510: Apportionments	Statement of Budgetary Resources	Unobligated Balances Available		XXX

If SBA's GL account balance indicates a balance greater than Treasury's records at the fund level, then SBA records the following entries:

Account	Financial Statement	Associated F/S Line Item	Debit Amount	Credit Amount
1010: Fund Balance with Treasury	Balance Sheet	Fund Balance with Treasury		XXX
1290: Miscellaneous Receivables	Balance Sheet	Balance Sheet; Accounts Receivable, Public	XXX	
7902: Expended Authority Paid	Statement of Budgetary Resources	Statement of Budgetary Resources; Obligations Incurred and Outlays, Disbursements		XXX
7510: Apportionments	Statement of Budgetary Resources	Statement of Budgetary Resources; Unobligated Balances Available	XXX	

The entries detailed above misstate various consolidated balance sheet and combined statement of budgetary resources line items based upon reclassification of unreconciled FBWT differences. For example, at June 30, 2002, SBA's unreconciled FBWT difference was approximately \$(23,000,000), indicating that at the consolidated level, SBA's GL FBWT account balance was greater than Treasury's records. Based upon differences by fund, this difference was reclassified for June 30, 2002, reporting as follows:

Account	Financial Statement	Associated F/S Line Item	Debit Amount	Credit Amount
1010: Fund Balance with Treasury	Balance Sheet	Fund Balance with Treasury		\$23,000,000
1290: Miscellaneous Receivables	Balance Sheet	Accounts Receivable, Public	\$39,000,000	
2351: Unapplied Remittances	Balance Sheet	Other Liabilities Public, Other		\$16,000,000
7902: Expended Authority Paid	Statement of Budgetary Resources	Obligations Incurred and Outlays, Disbursements		\$23,000,000
7510: Apportionments	Statement of Budgetary Resources	Unobligated Balances Available	\$23,000,000	

SBA does not have a basis to assert that the receivable, liability, and budgetary transactions created by these reclassification entries approximate the financial events that comprise the FBWT difference since the "plug" entry is not based upon a substantiated allocation methodology.

Instead of reclassifying FBWT differences to clearing accounts, as detailed above, SBA should reclassify the differences to the proper GL accounts that approximate the un-reconciled differences. This reclassification entry should be based upon an accrual methodology that has been tested for reasonableness.

Recommendations

To ensure that SBA does not misstate financial statement line items through FBWT reclassifications, we recommend that the Chief Financial Officer (CFO):

- 1A. Develop an accrual methodology to reclassify un-reconciled FBWT differences for financial reporting that will approximate the underlying valid economic events.
- 1B. Compare reclassification entries to actual clearing entries monthly, to ensure the accrual methodology is valid and identify areas to where the model's precision can be increased.

2. Foreclosed Property Records and Valuation

Property that SBA acquires through enforcing payment under secured loans is referred to as "collateral purchased" (Colpur), or foreclosed property inventory. We noted the following three deficiencies with SBA's Colpur accountability. Each deficiency caused an overstatement of SBA's consolidated balance sheet line item *Credit Program Receivables and Related Foreclosed Property, Net* as of September 30, 2002.

- SBA does not consistently remove Colpur items from the books upon partial sale. Denver Finance Center (DFC) staff sometimes does not reduce Colpur values when Colpur is partially disposed.

- SBA does not consistently and timely record disposition of Colpur on its books. We found \$2,800,000 of Colpur (corresponding with SBA's North Carolina District Office) that remained in SBA's foreclosed property inventory at September 30, 2002, even though SBA had completely disposed of such property.
- SBA's servicing offices do not consistently calculate the net realizable values (NRV) of Colpur items. We found \$300,000 of overstated NRV at September 30, 2002.

Regarding the first two points above, SBA's Standard Operating Procedure (SOP) 50 51 2A, *Loan Liquidation and Acquired Property*, Chapter 11, states:

Part II, of the electronic format SBA 297, is represented by the LLTS "S" screen and must identify whether the transaction was a partial or final sale of the Colpur.

Regarding the last point above, SOP 50 51 2A, Appendix 3, provides the following NRV computation guidelines:

Starting with the appraised value of the Colpur, an adjustment should be made to reduce this to liquidation value... In the absence of local information as to the appropriate size of this adjustment, use the following... If there is any, prior liens, taxes, CPC expenses, direct selling costs, and administrative expenses are subtracted from the liquidation value to reach NRV for the Colpur.

Recommendation

2A. We recommend that the CFO coordinate with the Offices of Capital Access (OCA) and Field Operations to dedicate the time and personnel to properly value SBA's Colpur account in accordance with existing policy and procedures, and Federal accounting standards.

3. Lack of Allotment Detail in the General Ledger

SBA does not record loan allotment transactions in the FRIS CGL. SBA's Office of Planning and Budget (OPB) records loan allotment transactions for loan guarantee and direct loans in the Loan Allotment Accounting (LAA) system based upon Office of Management and Budget (OMB) apportionments and SBA management allocations. LAA interfaces with the Loan Accounting System (LAS) to ensure that loan approvals (obligations) do not exceed allotments. LAA allotment data are not, however, uploaded into FRIS CGL via the monthly loan update process due to long standing subsidiary system (LAA) reconciliation problems. Consequently, SBA does not record the following accounting entry, for loan funds, as required by Treasury's Standard General Ledger:

4510 – Apportioned Funds	XXX
4610 – Allotted Funds	XXX

Although the absence of this entry has no effect on the financial statements (because SGL accounts 4510 and 4610 map to the same statement of budgetary resources line item: *Unobligated Balances Available, Apportioned, Currently Available*), SBA cannot analyze its use of funds via the FRIS CGL, and instead must revert to LAA to establish what amount of apportioned authority has been allotted for loan programs.

The Joint Federal Management Improvement Program's document titled *Core Financial System Requirements* states that "...all transactions to record financial events must post, either individually or in summary, to the general ledger, regardless of origin of the transaction."

Recommendation

3A. We recommend that the CFO work with the Office of Chief Information Officer (OCIO) to resolve subsidiary system problems impeding the upload of allotment data into the FRIS CGL. Once issues are resolved, OCFO should upload allotment data into the FRIS CGL monthly, or more frequently near the end of the fiscal year if required, to maintain proper budget-execution control.

4. Overstatement of Administrative Undelivered Orders

The combined statement of budgetary resources line item *Undelivered Orders* (UDOs) was overstated by a known amount of \$151,000 and a net projected amount of \$7,772,000 at September 30, 2002. This was the result of three errors we identified within SBA's Salaries and Expenses (S&E) appropriation. Generally accepted accounting principles require that:

- All economic events occurring in the current period are recorded in that period.
- Transactions should be recorded at correct amounts.

Our testing identified a small clerical error and two additional shortcomings:

- SBA failed to de-obligate an unneeded obligation of \$24,000 at 9/30/02, because it did not effectively monitor obligation activity during FY 2002.
- The improper cut-off of obligation liquidations caused the UDO balance to be overstated by \$127,000. SBA had no system to accrue for the goods or services received and not yet invoiced at September 30, 2002.

The following table outlines projected effects of these shortcomings (the effect on each line item was \$7,772,000):

Financial Statement	Line Item	Effect
Statement of Budgetary Resources	Undelivered Order, Unpaid	Overstated
Statement of Budgetary Resources	Accounts Payable	Understated
Statement of Net Cost	Gross Costs	Understated
Balance Sheet	Accounts Payable	Understated
Statement of Changes in Net Position	Appropriations Used/Cum. Results	Understated
Statement of Changes in Net Position	Appropriations Used, Unexpended Appropriations	Overstated

Recommendations

We recommend that the CFO:

4A. Coordinate with the Director of the Office of Procurement and Grants Management (OPGM) to develop stronger procedures to identify obligations with no activity, and process de-obligations in a timely manner.

4B. Develop cut-off procedures to ensure that transactions are recorded in the correct fiscal year.

5. Other Areas for Improvement, Administrative Costs

Our substantive testing identified the following known and projected overstatements of SBA's FY 2002 administrative expenses funded from its S&E appropriation:

Assertions	Number of Exceptions	Known Expense Overstatement	Projected Expense Overstatement
Validity	3	\$ 8,000	\$ 400,000
Cut-Off	11	62,000	2,400,000
Totals	14	\$70,000	\$2,800,000

This table refers to "assertions," a term used in the General Accounting Office (GAO), President's Council on Integrity & Efficiency (PCIE) *Financial Audit Manual*. This term refers to essential qualities that management represents are embodied in financial statements. These essential qualities are critical for management's financial statements to be free from material error. The validity assertion relates to whether accounting balances and activity have been executed with the proper legal and accounting treatment. The cut-off assertion relates to whether accounting balances and activity relate exclusively to the period or date covered in the financial statements.

Our testing indicated that SBA can improve its supervisory review and approval of administrative transactions, strengthen internal control over accountable-property, and enhance the transaction cutoffs between fiscal years.

Recommendations

We recommend that the CFO:

5A. Coordinate with the Office of Field Operations and stress the importance of supervisory review and approval of administrative transactions to ensure the validity and accuracy of recorded obligations and expenses. Areas of emphasis should include: travel authorization approvals, review of monthly credit card statements, and approval of time and attendance documentation.

5B. Work with the Offices of Administration and Field Operations to strengthen internal controls over accountable-property. Specifically, we recommend that SBA conduct annual inventory counts and evaluate the adequacy of its current accountable property system in meeting field office needs.

5C. Strengthen financial reporting internal control to ensure proper year-end cut-off.

6. Sampling for Erroneous Payments

SBA selects judgmental samples of loan payments and tests corresponding loan files to monitor "erroneous payments" for reporting in accordance with OMB Circular A-11, *Preparation, Submission,*

and Execution of the Budget, Section 57, Information on Erroneous Payments. Section 57 requires that estimates of erroneous payments reflect total erroneous payments for the program based either on a statistically valid sample projected to the universe of program payments or a 100-percent review of payments. Because SBA's sample selection is judgmental rather than statistical, it is unable to calculate valid projections of erroneous payments from its sample results.

Recommendation

6A. We recommend the CFO coordinate with OCA to select statistically-valid samples of program payments that will allow errors to be projected to the complete universe of payments.

7. Non-Fiduciary Intragovernmental Reconciliations

SBA did not fully reconcile intragovernmental assets and liabilities with non-fiduciary trading partners as of September 30, 2002. OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, provides that:

Reporting entities shall reconcile intragovernmental asset, liability and revenue amounts reported in the RSI (Required Supplementary Information) with their trading partners....

SBA did not effectively coordinate with non-fiduciary trading partners to fully reconcile intragovernmental balances. SBA's inability to fully reconcile non-fiduciary intragovernmental assets and liabilities, detailed in the table below, impairs Treasury's ability to reliably and accurately eliminate such activity in the Consolidated Financial Statements of the U.S. Government.

Account Category	Balance
Accounts Receivable	\$500,000
Advances	\$4,400,000
Accounts Payable	\$(24,800,000)
Other Liabilities	\$(940,700,000)

Recommendation

7A. We recommend that the CFO effectively coordinate with trading partners during SBA's quarterly reconciliations of intragovernmental assets, liabilities, and revenue. Effective coordination will entail SBA proactively working with trading partners rather than passively waiting for them to provide information and reconciliation detail.

8. Federal Managers Financial Integrity Act Reporting

SBA's FY 2002 Federal Managers Financial Integrity Act (FMFIA) report identified one material weakness (involving loan asset sale results and disaster loan modeling) based on SBA's FMFIA self-assessment. This material weakness was one of six reportable conditions identified in Cotton & Company's independent report on internal control, five of which were classified as material weaknesses. SBA did not report the following material weaknesses in its FY 2002 FMFIA report:

- Liability for loan guarantees and related accounts for pre-1992 loan commitments.
- Financial reporting process.
- Funds control weaknesses.
- Master reserve fund.

Under FMFIA, the definition of material weakness involves a deficiency that SBA's administrator judges to be sufficiently important to warrant reporting to the President and OMB. On the other hand, American Institute of Certified Public Accountants' (AICPA) standards employ a different definition of material weakness, as follows:

...a reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We believe the matters described in our report on internal control under the captions liability for loan guarantees and related accounts for pre-1992 loan commitments, financial reporting process, and funds control weaknesses should have been reported as material weaknesses under FMFIA because these matters fit the above-described definition and merit reporting to the President and OMB.

Recommendation

8A. We recommend that the administrator evaluate reportable conditions we reported and include in SBA's FY 2003 FMFIA report those judged to be sufficiently important to report to the President and OMB.

9. Alignment Between SBA Strategic Goals and Responsibility Segments in the Statement of Net Cost

OMB Bulletin No. 01-09 requires that major goals described in strategic and performance plans required by the Government Performance and Results Act, align directly with the statement of net cost responsibility segments. The following table presents SBA's current alignment of strategic goals and responsibility segments:

Strategic Goal (FY 2002 P&A Report)	Statement of Net Cost Responsibility Segments
Champion Small Business Interests	Business Programs
Empower Entrepreneurs	--
Help Businesses and Families Recover From Disasters	Disaster Assistance Programs
--	Costs not Assigned to Programs

This table demonstrates that SBA's three strategic goals in the FY 2002 Performance and Accountability Report are not directly aligned with SBA's statement of net cost responsibility segments and that alignment needs to be improved.

Recommendation

9A. We recommend that the CFO coordinate with the Chief Operating Officer to enhance alignment of SBA's major goals and outputs, described in its accountability report and strategic and performance plans, with the statement of net cost.

10. Incomplete Transactional Detail for Prior-Year Obligations

SBA did not maintain sufficient supporting transactional detail for prior year obligation adjustment transactions during FY 2002, contrary to OMB Circular A-127, *Financial Management Systems*, which provides that:

Transactional detail supporting SGL accounts shall be available in the financial management systems and directly traceable to specific SGL account codes.

SBA's administrative accounting system (Oracle) did not process prior-year obligation adjustment transactions in accordance with SGL criteria. To address this problem, SBA developed an ad-hoc procedure to capture prior-year obligation adjustment transactions outside Oracle and process them in accordance with SGL criteria. SBA did not, however, assure the data maintained outside Oracle were kept beyond 30 days and, in fact, the contractor purged these data after 30 days. Consequently, SBA was unable to support the audit trail of purged data.

Without transactional detail, SBA was not able to support SGL accounts 4871, Recoveries of Prior Year Obligations and 4881, Upward Adjustment of Prior Year Obligations for 11 out of 12 months during FY 2002.

Recommendation

10A. We recommend that the CFO maintain transactional detail for all prior year obligation adjustment transactions.

11. Funds Control Over Administrative Costs Needs Improvement

Several administrative procurement processing deficiencies in Oracle resulted in contra-balance UDOs (i.e., UDOs with debit balances) and UDOs with no transactional detail at September 30, 2002. These problems occurred because:

- Local travel was paid without establishing corresponding UDOs.
- Oracle was configured to process payments in excess of obligations as long as they did not exceed the initial obligation by ten percent.
- DFC users overrode funds controls to pay invoices that exceeded the previously-established obligations during the early part of FY 2002.
- "Direct Pay" invoices that did not reference a purchase order number.
- Credit card invoices could be paid in excess of established obligations during the early part of FY 2002.

These factors are indicative of weak funds control and resulted in a contra balance (debit) for UDOs of \$6,603,000, which SBA was unable to explain.

OMB Circular A-127 provides that:

The criteria for recording financial events in all financial management systems shall be consistent with accounting transaction definitions and processing rules defined in the SGL.

Transactional detail supporting SGL accounts shall be available in the financial management systems and directly traceable to specific SGL account codes.

In addition, OMB Circular A-11, Part 4, *Instructions on Budget Execution*, states that a funds control system should:

Restrict both obligations and expenditures from each appropriation or fund account to the lower of the amount apportioned by OMB or the amount available for obligation and/or expenditure in the appropriation or fund account.

Recommendations

We recommend that the CFO:

- 11A. Discontinue the use of funds control overrides to process procurement transactions.
 - 11B. Require all transactions processed in Oracle to pass procurement funds control edit checks.
 - 11C. Perform an analysis of contra balance UDOs to determine how to properly remove them from the general ledger detail.
 - 11D. Ensure that every UDO transaction is processed in accordance with SGL criteria and has sufficient supporting transactional detail.
12. **General Ledger Account 1990, Loan Sale Costs, Incorrectly Presented on Balance Sheet**

Account 1990, loan sale costs, is presented on SBA's balance sheet as part of the line item *Credit Program Receivables and Related Foreclosed Property, Net*. In FY 2001, there was no balance in this account; in FY 2002, however, \$23 million, after audit adjustments, remained. The account, as adjusted, accumulates prepaid costs corresponding with loan sales that must be matched against future loan sales. It should not be presented as part of the line item *Credit Program Receivables and Related Foreclosed Property, Net*. Instead, this amount should be reported on the other assets line item, in accord with OMB Bulletin No. 01-09, Section 3.3, *Assets*, which provides that prepayments or progress payments on work in process shall be presented as other assets.

This reporting error occurred because SBA has not developed, documented, implemented, and monitored an effective financial reporting process that includes adequate, detailed analysis of account balances, account mapping, and financial statement compliance with OMB Bulletin No. 01-09 and SGL requirements before year-end.

Recommendation

- 12A. We recommend that the CFO evaluate the crosswalk for account 1990, and assure the balance crosswalks to the correct financial statement line item, in accordance with OMB Bulletin No. 01-09 and SGL requirements.

13. Cash Flow Modeling

We continued to find errors in spreadsheets SBA used to support its loan program subsidy rate estimates and reestimates under the Federal Credit Reform Act. In FY 2002, these errors insignificantly affected cash flows. These errors were caused by ineffectual internal control procedures designed to check the reliability of SBA's cash flow modeling.

While our *Independent Auditor's Report on Internal Control* (January 29, 2003) did not address these errors (because they were not significant), we recommended that SBA's Office of Financial Analysis adhere to documentation requirements of *Federal Financial Accounting and Auditing Technical Release No. 3* for all significant loan programs. Once SBA implements this recommendation, modeling errors should be mitigated. Accordingly, we make no additional recommendation this year.

Management's Response

SBA management, Office of the Chief Financial Officer (OCFO), generally concurred with the findings in the draft report with certain exceptions. The following table summarizes management's responses, and our evaluations.

Management Response	Evaluation of Management Response
A number of recommendations in the report were addressed to OCFO without also addressing them to the office responsible for the applicable business process.	We agreed with management's comment and revised noted recommendations to include the coordination of other responsible offices. Even with the revision, we feel it is important that OCFO lead the coordination to implement the noted recommendations, since the CFO Act of 1990 states that the agency CFO shall "oversee all financial management activities relating to the programs and operations of the agency" and "provide for complete, reliable, consistent, and timely information."
Management commented that recommendations 1A and 1B, related to FBWT, should be revised to reflect the reality that there will be un-reconciled FBWT differences at year-end, and posting adjusting entries to "appropriate" general ledger accounts based upon historical analysis would be a feasible recommendation.	We agreed with management's comment and revised our finding and recommendations urging OCFO to develop an allocation methodology that would result in the reclassification of FBWT differences to proper general ledger accounts for financial reporting.
Management noted that recommendation 3A, related to the future inclusion of loan allotment data in the general ledger, was incorrectly addressed to OCFO, but should have been addressed to OCIO to ensure proper resources are allocated to the initiative.	We agree that OCIO should be involved in the initiative to include loan allotment data in the general ledger. We revised our recommendation to include coordination between OCFO and OCIO to resolve the finding. As noted above, OCFO should lead the initiative and coordinate with OCIO, since OCFO has stewardship of the agency's general ledger and is ultimately responsible for accurate financial reporting.

Management Response	Evaluation of Management Response
<p>Management noted that recommendation 4A and 4B in the draft management letter, related to the recordation of apportionments, were duplicate items that were already addressed in the <i>Independent Auditor's Report on Internal Control</i>.</p>	<p>We agree the inclusion of finding 4 and recommendations 4A and 4B in the management letter would be repetitive. We revised the management letter accordingly, removing the finding and related recommendations.</p>
<p>Management noted that recommendation 4A (formerly 5A), related to the timely processing of de-obligations, should be directed to OPGM in addition to OCFO.</p>	<p>We agree with management's comment and revised recommendation 4A (formerly 5A) to include OPGM in addition to OCFO.</p>
<p>Management paraphrased our recommendation 6A (formerly 7A) as follows "...[SBA should employ] statistically random samples, rather than "judgmental" samples." In addition, management stated that OCA requires at least one charged-off 7(a) guaranty purchase from each district office be selected as part of SBA's erroneous payment sampling. Management believes its current method is more appropriate to assure proper internal control.</p>	<p>We clarified our recommendation because management has not correctly paraphrased our draft recommendation. Randomly statistical samples are not synonymous with samples whose test results can be projected with statistical validity.</p> <p>In addition, we did not mean to convey that at least one charged-off 7(a) guaranty purchase from each district office should not be selected. A valid statistical sample can be developed while maintaining the integrity of OCA's requirement.</p> <p>Finally, because our recommendation (when implemented) will bring SBA into conformity with OMB Circular A-11, we do not agree that SBA's current method is more appropriate.</p>
<p>Management paraphrased our recommendation 8A (formerly 9A) to convey that SBA should consider Cotton & Company's FY 2002 internal control recommendations for inclusion in the FY 2003 FMFIA report. Management also stated that its FMFIA report's findings may legitimately differ from those that Cotton & Company is required to report under AICPA and GAO Yellow Book standards.</p>	<p>We agree that management's FMFIA results can differ from audit results. We wish to denote, however, that management should have reported several of our audit results within SBA's FY 2002 FMFIA report. OMB's current audit requirements specify that the auditor is authorized to report disagreements over reported FMFIA results within the report on compliance. Our recommendation was designed to avoid this reporting next year.</p>

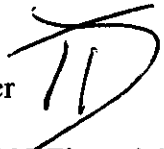


U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Attachment 1
Page 1 of 2

Date: April 3, 2003

To: Robert G. Seabrooks
Assistant Inspector General for Auditing

From: Thomas A. Dumaresq 
Chief Financial Officer

Subject: Audit of SBA's FY 2002 Financial Statements – Management Letter

The draft management letter for the FY 2002 financial statement audit dated March 7, 2003, provides the SBA 20 recommendations for 14 subject areas. This memo is to provide the SBA's comments to selected recommendations in the draft letter for your consideration in the final management letter.

A number of recommendations in your draft management letter have been addressed to the Office of the Chief Financial Officer (OCFO), without also addressing them to the office having responsibility for the applicable business process. These recommendations include the following (with the responsible office also indicated): 2A on loan collateral (Capital Access, Field Operations), 3A on loan allotment inclusion in the general ledger (OCFO), 6A on the supervisory review of administrative transactions (Field Operations), 6B on accountable property (Office of Administration, Field Operations), 6C on year-end cut-off procedures (Capital Access, Field Operations) and 7A on erroneous payments (Capital Access). In the past, similar recommendations have been made to the OCFO to coordinate activity with other Agency offices. We have found that the most successful way for us to involve these other offices in completing the action required is if you address these recommendations to the Agency office having responsibility over the business process, as well as addressing them to the OCFO.

Recommendations 1A and 1B on the Fund Balance with Treasury (FBWT) were discussed during the audit, but we still have only a partial agreement with Cotton & Co. on this issue. Cotton reported that the SBA has not reconciled the FBWT because it does not have documents identifying the appropriate general ledger processing of the disbursements and receipts items in the yearend cash reconciliation. The OCFO maintains, however, that it has reconciled its FBWT, and that it does identify the disbursement schedule or the deposit ticket number for items not processed in SBA's general ledger. We assert that it is not feasible to process all receipts and disbursements for inclusion in the general ledger as of September 30. There will always be unrecorded processing for disbursements not issued by Treasury and for deposits where the deposit detail has not been received from the Federal Reserve. The OCFO requests that items 1A

SBA IS AN EQUAL OPPORTUNITY EMPLOYER AND PROVIDER

and 1B in the draft management letter be revised to recognize this reality in the process to reconcile the FBWT. We do agree, however, to investigate the use of a yearend adjusting entry to record in the general ledger an estimate of the pro forma for cash reconciling items. This would use the results of historical experience to adjust the "appropriate" receivables and other general ledger accounts.

Recommendation 3A is to include loan allotment processing in the general ledger. The OCFO has been working on this initiative for 3 years, but OCIO has not been able to provide a file of data that reconciles with total allotments processed. As mentioned above, this recommendation should be addressed to the OCIO so that resources are allocated to this initiative.

Recommendations 4A and 4B in this draft management letter are identical to item 4C in the FY 2002 audit report. We suggest that you consider eliminating these duplicate items.

Recommendation 5A on the processing of deobligations should also be directed to the Office of Procurement and Grants Management, besides the OCFO. OPGM processes changes to procurements necessary to deobligate unliquidated obligations that are no longer needed.

Recommendation 7A on erroneous payments is to use statistically random samples, rather than "judgmental" samples. The Office of Capital Access, however, has determined that each district office should have at least one 7(a) guaranty purchase included in the samples in order to assure uniform compliance with SBA procedures, and that the purchases selected should consist of charged-off accounts so lender liquidation activities will be reviewed. Other than these requirements, the sample of 7(a) guarantee purchases is conducted in a statistically random manner. The SBA asserts that its current method is more appropriate to assure proper internal control for all of its purchase activity. As a result, I recommend that you drop this recommendation in your final management letter.

Recommendation 9A is to consider the auditor's FY 2002 internal control recommendations for inclusion in the FY 2003 report of internal control status required by the Federal Managers' Financial Integrity Act (FMFIA) and to include those "judged sufficiently important" in the report. Although we do not object to this recommendation as it is written, it is important that this is management's report of internal controls, and it may differ from the auditor's opinion.

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

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