

AUDIT OF SBA'S FY 2000 FINANCIAL STATEMENTS

MANAGEMENT LETTER

AUDIT REPORT NO. 1-15

AUGUST 15, 2001

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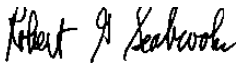
U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416

AUDIT REPORT
Issue Date: August 15, 2001
Number: 1-15

To: Joseph P. Loddo
Chief Financial Officer

Jane P. Butler
Associate Administrator, Office of Financial Assistance

Cory Whitehead
Acting Assistant Administrator for Administration

From: 
Robert G. Seabrooks
Assistant Inspector General for Auditing

Subject: Audit of SBA's FY 2000 Financial Statements – Management Letter

Pursuant to the Chief Financial Officer's Act of 1990, attached is the Independent Auditor's Management Letter issued by Cotton & Company LLP. The letter identifies conditions related to (1) subsidy models for budget estimates and financial statement re-estimates, (2) personal property and equipment, (3) expired appropriations, (4) foreclosed property records and valuation, and (5) loan accounting records and servicing. The conditions were identified during the audit of SBA's Fiscal Year 2000 financial statements, but were not required to be included in the Auditor's Report. Also attached is your response to the draft report, in which you generally agreed with the findings and recommendations.

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 audit follow-up and resolution. Please provide your management decisions for the recommendations within 30 days using 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) 205-7204.

Attachment

COTTON & COMPANY LLP

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February 28, 2001

MANAGEMENT LETTER COMMENTS INDEPENDENT AUDIT OF FISCAL YEAR 2000 PRINCIPAL FINANCIAL STATEMENTS

Inspector General
U.S. Small Business Administration

We have audited the U.S. Small Business Administration's (SBA) principal financial statements as of September 30, 2000, and for the year then ended, and have issued our reports, dated February 28, 2001, to SBA under separate cover. These documents included our reports on SBA's internal control structure and compliance with laws and regulations.


The purpose of this management letter is to communicate five nonreportable findings 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

By 
Matthew H. Johnson, CPA.

**INDEPENDENT AUDIT OF FISCAL YEAR 2000
PRINCIPAL FINANCIAL STATEMENTS
U.S. SMALL BUSINESS ADMINISTRATION
NONREPORTABLE FINDINGS**

Certain nonreportable findings came to our attention during the audit of the U.S. Small Business Administration's (SBA) Fiscal Year (FY) 2000 principal financial statements, and they are discussed in this report. Finding 1 was also reported in our FY 1999 management letter, and Finding 2 expands on a finding related to computer equipment that was also reported in the FY 1999 management letter. All findings are related to SBA's internal control.

1. Subsidy Models for Budget Estimates and Financial Statement Re-Estimates

SBA's quality control process over subsidy models used for budget estimates and financial statement re-estimates, as required under credit reform, while much improved, is not completely effective. In response to our FY 1999 management letter, SBA developed comprehensive policies and procedures for preparing subsidy estimates and re-estimates. SBA also improved its quality assurance process to include peer review by an analyst not responsible for preparing the re-estimate as well as a supervisory review.

Even with these improvements, errors continued. Complete and thorough documentation had not been fully developed, and the quality control process was not fully effective. In our review of the cash flow models for SBA's business loan program, disaster loan program, and the Certified Development Company (CDC) loan program, we found several formula errors and numerous incorrect cell references. As a result of these findings, SBA was required to recalculate its re-estimates for each of the three programs.

To ensure that these types of errors do not continue, we recommend that the Chief Financial Officer (CFO) request the Director of the Office of Financial Analysis to:

- Complete development, implementation, and documentation of review procedures over the credit reform cash flow worksheets and update the documentation annually.
- Develop a checklist to guide both preparer and reviewer through all steps of the subsidy model preparation for budget estimates and financial statement re-estimates.

2. Personal Property and Equipment

In our FY 1999 management letter, we reported deficiencies in the safeguarding of computer equipment and recommended that the CFO:

- Develop written procedures and policies for tracking and disposing of computer equipment.
- Establish a centralized inventory database.
- Perform periodic inventories of computer equipment and compare results to the inventory database.

- Establish disposal procedures for computer equipment that include sanitizing data remaining on hard drives of surplus equipment.

SBA responded by stating:

- It has an inventory control system, the Fixed Asset Accounting System (FAAS), that safeguards computer equipment against material loss.
- The Office of the Chief Information Officer (OCIO) conducts inventories of computer equipment several times a year.
- Office information technology personnel also maintain inventories of their computer equipment.
- SBA will implement improvements to its current process, such as an asset tracking system possibly using bar codes.
- SBA will develop procedures for disposal of computer equipment that sanitize data on hard drives for obsolete equipment.

In following-up on our recommendations and SBA's response, we identified two related issues in FY 2000 that apply to all personal property and equipment, including computer equipment.

Specifically, we found that SBA field offices do not consistently conduct annual physical inventories of personal property and equipment. In addition, SBA's property accountability system, FAAS, does not fully meet the needs of all field offices. As a result, much of the information the system contains is duplicated in ad-hoc systems or is not being used at all.

For example, personnel at one Disaster Area Office (DAO) informed us that FAAS could not provide the information it needs when establishing disaster site offices. In response, it had developed its own system to meet its unique needs. Thus, much of the computer property had two property labels attached—one for FAAS and one for the ad-hoc system.

Field offices are required to maintain property records on FAAS and conduct annual physical inventories of that property (SBA's standard operating procedure, SOP 00 13 4). Agencies also must establish physical control to secure and safeguard vulnerable assets, and such assets should be periodically counted and compared to control records (General Accounting Office's *Standards for Internal Control in the Federal Government*).

SBA's field offices do not always conduct inventories and may maintain inadequate or duplicate records in some locations. Thus, decisions about property may be made with inadequate or incorrect information, resulting in either excess or insufficient property and equipment.

We recommend that the Acting Assistant Administrator for Administration in coordination with the CFO and CIO:

- Notify all field offices of the need for and importance of conducting annual physical inventories.

- Evaluate the adequacy of the FAAS to meet field office needs, and modify the system as appropriate.

3. Expired Appropriations

SBA included FYs 1994 and 1995 funds in its reported Fund Balance with Treasury balance on the FY 2000 financial statements.

An appropriation is to be canceled 5 years from its appropriation period [Office of Management and Budget (OMB) Circular No. A-34, Instructions on Budget Execution]. Thus, SBA should not have included appropriations for these years in its FY 2000 financial statements.

Also, an entity's Fund Balance with Treasury is to be reduced by cancellation of expired appropriations (Statement of Federal Financial Accounting Standards, SFFAS, No. 1). Because SBA did not cancel these appropriations, the Fund Balance with Treasury was overstated by \$13.7 million. This required an audit adjustment to correct the FY 2000 financial statements.

We recommend that the CFO develop a checklist for preparing financial statements that would include a review for expired appropriations and update the checklist annually to ensure that it reflects the most recent federal regulations.

4. 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. COLPUR-related transactions, such as sales and purchases, should be recorded in SBA's Liquidation/Litigation Tracking System (LLTS) and Loan Accounting System (LAS) in a timely manner. Additionally, agencies are required to record property acquired on loans approved before 1992 at cost; adjust for the lower of cost or net realizable value; and carry any difference in a valuation allowance (SFFAS No. 3, paragraph 81). SFFAS No. 3 also requires property acquired on loans approved from 1992 forward to be valued at the net present value of projected future cash flows associated with the property. Agencies also are required to maintain comprehensive inventory records of all foreclosed property (OMB Circular A-129, Policies for Federal Credit Programs and Non-Tax Receivables, Appendix A, Chapter III, Section A.3.d).

We noted three sold COLPUR items not removed from LLTS and LAS as of September 30, 2000, even though sold prior to year-end. As a result, COLPUR was overstated. Also, we found a property with a current net realizable value of \$318,495 that was still valued at the full \$450,000 note balance, thereby overstating the value of COLPUR by another \$131,505.

We recommend that the CFO coordinate with the Office of Capital Access and the Office of Field Operations to:

- Record COLPUR-related transactions in LLTS and LAS within one month from the dates the transactions occurred.
- Ensure that all field office liquidation staff receive training and guidance on requirements for valuing foreclosed property and entering complete and accurate data into LLTS and LAS.

- Periodically reconcile field office property documentation and LLTS and LAS entries to ensure that property is properly valued and accurately entered in LLTS and LAS.

5. Loan Accounting Records and Servicing

SBA's loan accounting system does not always reflect current borrower information. We mailed 288 loan confirmations to SBA borrowers as part of our FY 2000 financial statement audit. SBA provided the addresses from LAS. Of the 288 confirmations sent, 22, or about 8 percent, were returned with incorrect addresses. Confirmations with incorrect addresses were generally associated with non-performing loans, which require substantially more servicing by SBA or the servicing bank than performing loans. We identified one loan for which payment had not been received for 2 years; neither the loan officer nor the servicing bank had performed servicing on the loan during the past 2 years and could not obtain contact information for the borrower.

Accurate and complete loan file information is critical to providing proper service to the debtor, pursuing collection of delinquent debt, and, in the case of guaranteed loans, obtaining claim payment (OMB Circular No. A-129).

We recommend that the Associate Administrator, Office of Financial Assistance establish procedures to periodically validate borrower information to ensure that addresses and other personal information are accurate and current.

Management's Response

SBA management concurred with the findings in this letter and provided corrective actions (see the attachment). In general, we think that these actions, when fully implemented, will adequately address all findings.



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

DATE: JUL 2001
TO: Robert Seabrooks
Assistant Inspector General for Auditing
FROM: Joseph Loddo *J. Loddo*
Chief Financial Officer
SUBJECT: FY 2000 Financial Audit-DRAFT Management Letter

Thank you for the opportunity to provide comments on the FY 2000 Financial Audit-DRAFT Management Letter (the Letter.) In general, we agree with the findings in the Letter. We are pleased that you note some of the corrective actions that the SBA has taken, especially in the area of subsidy rates and computer equipment. I also want to extend my thanks to your auditing firm, Cotton and Company, LLP, for their effective cooperation during this past year's audit process.

Since the Letter is being issued 4 months after the issuance of the FY 2000 Audit Report, there have been additional corrective actions taken by SBA to address the issues in the Letter. I believe that the good progress by SBA on these non-reportable findings should be mentioned. These and other actions we have planned should resolve all of the Letter findings in time for the FY 2001 audit.

Our corrective actions taken on the findings in the Letter are as follows.

1. Subsidy Modeling and Re-Estimation Process

In order to place the findings on this item into the proper context, we believe it is appropriate to note that while some inconsistencies were found, they were not material and were not included in the audit report. This area was considered a reportable material internal control weakness in the FY 1998 audit, and was entirely eliminated from the audit report in FY 1999 and FY 2000 through the good work to improve this process.

As you indicate in the Letter, SBA had already developed comprehensive policies and procedures and improved its quality assurance process. However, these were not yet fully implemented in time for the FY 2000 audit process. We have been testing and training under these new policies and procedures throughout the year. We fully expect that the level of inconsistencies identified in the FY 2000 audit will be minimized leading to their total elimination.

The documentation of the subsidy rate process has been further updated this year. We have centralized all quality control documents from peer and supervisory reviews with the internal control representative. We are completing the checklist and will use this in the review of the FY 2003 budget process models, which include the FY 2001 subsidy re-estimates.

2. Personal Property and Equipment

We have accomplished the following actions:

- We have drafted an SBA Notice that will be issued shortly to all employees reminding them of the SOP requirement that all property valued at \$50.00 or more must be inventoried annually.
- We have already published a Policy Notice providing Agency guidance on sanitizing/degaussing procedures for hard drives on excess computers.
- We have recently modified the Fixed Asset Accounting System (FAAS) to better meet the needs of the field & Headquarters for personal property and equipment.
- We are currently working with the Office of Disaster Assistance and the Chief Information Officer to address additional modifications that may be needed.

3. Expired Appropriation

The SBA's report staff already had a checklist for preparing the yearend financial statements and it has been modified to include this issue and to ensure the correct years are included in the reportable Fund Balance with Treasury. We will update this checklist annually to ensure that it reflects any changes to Federal regulations and guidelines regarding financial reporting.

4. Foreclosed Property Records and Valuation

The timely and accurate recordation of purchased collateral has long been an issue of the SBA. We understand the importance of this activity and agree to continue to stress this to our field and center employees through regular SBA Notice reminders. We also conduct on-going training of personnel in our policies and procedures regarding liquidation of loans, that includes the appropriate use of the Liquidation and Litigation Tracking System and Loan Accounting System to record activity on foreclosed property. In addition, as recommended, we will conduct periodic reviews of the information recorded in our systems.

5. Loan Accounting Records and Servicing

We will continue to stress the importance of timely and accurate recording of borrower information in our systems, and we will regularly remind our employees of this requirement. This issue will be lessened significantly in the future as SBA moves towards electronic processing of loans. Borrowers' electronic data will be updated directly to SBA's systems by the lenders, removing a step where mistakes can occur. Further, Lender updates of borrower data will likewise be input to SBA's systems

directly. Lenders have a variety of “drop down boxes” that allow for a wider range of options to provide more specific information and lessen the chance for error.

The SBA is committed to utilizing the very best technology to improve its service to America’s Small Business Community. Part of this commitment is the prompt, effective attention to all financial management issues. We will continue to dedicate the time and resources necessary to correct any weakness in our financial management and reporting.

We look forward to working with you and your external auditor to correct any areas of concern. I will be glad to answer any questions that you may have.

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