

# Financial Reporting

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## MESSAGE FROM THE CHIEF FINANCIAL OFFICER

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November 17, 2008

I am pleased to submit the U.S. Small Business Administration's Agency Financial Report for FY 2008. This report provides the SBA's financial results as required by the Reports Consolidation Act.

The SBA's financial management program continued to excel during FY 2008. We successfully met our objective to support the Agency's programs to assist small business and provide disaster relief. The SBA's independent auditor issued an unqualified opinion on the accuracy of SBA's FY 2008 financial reports, the fourth year in a row for this achievement. Also, the FY 2008 audit reported no material weaknesses in SBA's financial reporting for the second year in a row. This continued success in SBA's financial management is the culmination of our progress over the last five years to improve the quality of the SBA's financial processes, data, and reports. Based on this progress, the SBA maintained a "green" for status and progress on the President's Management Agenda scorecard for Improved Financial Management during each quarter of FY 2008.

Our credit subsidy models are a key element in SBA's financial management because they estimate the cost of our credit programs. The SBA's credit programs generate most of our financial activity and results. Therefore, maintaining strong internal controls over our cost modeling as well as maintaining high quality, state of the art models is a top priority for us. We are proud to report that the independent auditor's review of our cost models did not find any significant discrepancies that affected their accuracy.

Another important element of SBA's financial management program is the review of our internal controls over financial reporting that we have conducted for three years now in compliance with OMB Circular A-123 Appendix A requirements. During FY 2008 we continued to engage SBA program offices in the review of the financial controls over their program operations. Our goal is to institute a strong risk management culture within the SBA.

We completed two major financial management initiatives in FY 2008. First, we completed a project that we began last year to account for disaster loan increases as if they were new loans in the current year consistent with the requirements of the Federal Credit Reform Act. SBA's accounting system did not have this capability in the past, but the financial impact had never been material until FY 2007 when there was \$529 million of loan increases on loans originally made the previous year to the victims of hurricanes Katrina, Rita and Wilma. The cost impact of these loans is a continuing factor, and our financial systems staff successfully completed this initiative in FY 2008.

Second, we completed the procurement for a major project to develop and implement a new Loan Management and Accounting System. SBA's legacy loan accounting system is over 40 years old and needs replacement. Our work during FY 2008 on this procurement has provided us the resources and development plan needed for this multiyear project that has now begun. Our objective is to develop and implement a new Oracle based general ledger and receivables management system for SBA's credit programs, and I am confident that we have developed a sound approach to this important project.

Since late FY 2004, SBA has had an independent Audit and Financial Management Advisory Committee (AFMAC). During FY 2008, the Committee was well engaged in the financial reporting process and audit cycle, providing oversight of activities and making recommendations for our financial statement footnotes and the AFR. We are proud to have one of the few independent audit

committees within the government and appreciate the opportunity to have such an esteemed group of professionals advising us. I thank them for their support and dedication to our continued improvement.

The SBA also continued to make important strides in budget and performance integration this year. Our ongoing efforts were reflected in our “green” status again in the President’s Management Agenda throughout FY 2008. In addition, our Performance Management Office worked successfully with SBA’s program offices during FY 2008 on a number of the Administrator’s initiatives to improve the Agency’s programs and operations.

In summary, FY 2008 was a rewarding year in financial management at the SBA. We obtained an unqualified opinion with no material weaknesses for the second year in a row. We will continue to dedicate ourselves to maintaining the high quality financial management processes we have put in place and to expand the quality and use of our financial data for decision making. Our continued participation in this “pilot” Agency Financial Report reflects our desire to improve the effectiveness of our external reports.

Thank you for your interest in SBA’s FY 2008 Agency Financial Report.



Jennifer E. Main

Chief Financial Officer

## AUDIT AND FINANCIAL MANAGEMENT ADVISORY COMMITTEE'S REPORT

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November 17, 2008

The Audit and Financial Management Advisory Committee (the Committee) assists the Administrator in overseeing the U.S. Small Business Administration's (SBA's) financial operations. As part of that responsibility, the Committee meets with Agency management, the Agency's Inspector General, and its external auditors to review and discuss SBA's external financial audit coverage, the effectiveness of SBA's internal controls over its financial operations, and its compliance with certain laws and regulations that could materially impact SBA's financial statements. SBA's external auditors are responsible for expressing an opinion on the conformity of SBA's audited financial statements with the U.S. generally accepted accounting principles. The Committee reviews the findings of the Inspector General and external auditors, and SBA's responses to those findings, to ensure that SBA's plan for corrective action includes appropriate and timely follow-up measures. In addition, the Committee reviews the draft Agency Financial Report (AFR), including its financial statements, and provides comments to management who has primary responsibility for the AFR. The Committee met three times during the year with respect to these responsibilities on FY 2008 financial management and reporting. During two of these sessions, the Committee met with the Inspector General and external auditors without SBA management being present and discussed with the external auditors the matters that are required to be discussed by generally accepted auditing standards. Nothing came to our attention as a result of these discussions to indicate changes were needed to the financial statements and notes thereto that are included in the FY 2008 AFR.



Edward J. Mazur  
Chairman  
Audit and Financial Management Advisory Committee

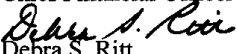


**U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
AUDITING DIVISION**

<b>AUDIT REPORT</b>
<b>Issue Date: November 14, 2008</b>
<b>Number: 9-03</b>

**To:** Sandy K. Baruah  
Acting Administrator

Jennifer Main  
Chief Financial Officer

**From:**   
Debra S. Ritt  
Assistant Inspector General for Auditing

**Subject:** Audit of SBA's FY 2008 Financial Statements

Pursuant to the Chief Financial Officer's Act of 1990, attached are *the Independent Auditors' Report* and accompanying reports on internal control and compliance with laws and regulations issued by KPMG LLP for the fiscal year ending September 30, 2008. The audit was performed under a contract with the Office of Inspector General (OIG) and in accordance with *Generally Accepted Government Auditing Standards*; Office of Management and Budget's (OMB) Bulletin 07-04, *Audit Requirements for Federal Financial Statements*, as amended; the Government Accountability Office (GAO)/President's Council on Integrity and Efficiency (PCIE) *Financial Audit Manual*; and GAO's *Federal Information System Controls Audit Manual*.

The KPMG report concluded that SBA's consolidated financial statements presented fairly, in all material respects, the financial position of SBA as of and for the years ended September 30, 2008 and 2007. It also presented fairly, in all material respects, SBA's net costs, changes in net position, and combined statements of budgetary resources for the years then ended.

With respect to internal control over financial reporting, KPMG continued to report a significant deficiency related to Information Technology controls; but did not consider this deficiency to be a material weakness. KPMG noted that SBA made progress in several areas in its efforts to address prior year Information Technology internal control deficiencies. However, despite these improvements, deficiencies continue to exist for security access controls, software program changes, and end-user computing. Details regarding this significant deficiency are discussed more in Exhibit 1 of the *Independent Auditors' Report*.

KPMG's test for compliance with certain laws, regulations, contracts and grant agreements disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, and Bulletin 07-04, as amended.

We provided a draft of KPMG's report to SBA's Chief Financial Officer (CFO), who concurred with its findings and recommendations and agreed to implement the recommendations. The CFO is delighted that SBA has again received an unqualified audit opinion with no reported material weaknesses and believes these results accurately reflect the quality of the Agency's financial statements and its improved accounting, budgeting and reporting processes.

We reviewed a copy of KPMG's report and related documentation and made necessary inquiries of their respective representatives. Our review was not intended to enable us to express, and we do not express, an opinion on the SBA's financial statements, KPMG's conclusions about the effectiveness of internal control, or its conclusions about SBA's compliance with laws and regulations. However, our review disclosed no instances where KPMG did not comply, in all material respects, with *Generally Accepted Government Auditing Standards*.

We appreciate the cooperation and assistance of SBA and KPMG. Should you or your staff have any questions, please contact me at (202) 205-7390 or Jeffrey R. Brindle, Director, Information Technology and Financial Management Group at (202) 205-7490.

Attachments



KPMG LLP  
2001 M Street, NW  
Washington, DC 20036

## Independent Auditors' Report

Office of Inspector General  
U.S. Small Business Administration:

We have audited the accompanying consolidated balance sheets of the U.S. Small Business Administration (SBA) as of September 30, 2008 and 2007, and the related consolidated statements of net cost, changes in net position, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these consolidated financial statements. In connection with our fiscal year 2008 audit, we also considered SBA's internal controls over financial reporting and tested SBA's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these consolidated financial statements.

### SUMMARY

As stated in our opinion on the consolidated financial statements, we concluded that SBA's consolidated financial statements as of and for the years ended September 30, 2008 and 2007, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

Our opinion emphasized that the current economic conditions give rise to risks associated with the uncertainty of future events and actual losses to the agency will be dependent upon future economic and market conditions.

Our consideration of internal control over financial reporting resulted in the following condition being identified as a significant deficiency:

- Improvement Needed in Information Technology (IT) Controls

However, we did not consider this significant deficiency to be a material weakness.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

The following sections discuss our opinion on SBA's consolidated financial statements; our consideration of SBA's internal control over financial reporting; our tests of SBA's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; and management's and our responsibilities.





## OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of SBA as of September 30, 2008 and 2007, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources for the years then ended.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SBA as of September 30, 2008 and 2007, and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in note 17 to SBA's financial statements, SBA continues to evaluate the risks posed by the current market downturn on its direct loan and loan guaranty portfolios, but the impact of such future risks cannot be reasonably estimated at this time. Actual losses, if any, will largely depend on future economic and market conditions and could differ materially from SBA's current estimates.

The information in the Management Discussion and Analysis, Required Supplementary Information and Required Supplementary Stewardship Information sections is not a required part of the consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information, and accordingly, we express no opinion on it.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and would not necessarily disclose all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects SBA's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of SBA's consolidated financial statements that is more than inconsequential will not be prevented or detected by SBA's internal control over financial reporting. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by SBA's internal control.

In our fiscal year 2008 audit, we consider the deficiency described in Exhibit I to be a significant deficiency in internal control over financial reporting; however, we do not believe the significant deficiency described in Exhibit I is a material weakness. A summary of the status of the prior year significant deficiency, and management's response to our findings, is included as Exhibits III and IV, respectively.

We also noted certain additional matters that we reported to SBA's management in a separate letter dated November 14, 2008.



## COMPLIANCE AND OTHER MATTERS

The results of our tests of compliance described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended.

The results of our tests of FFMIA disclosed no instances in which SBA's financial management systems did not substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

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## RESPONSIBILITIES

**Management's Responsibilities.** Management is responsible for the consolidated financial statements; establishing and maintaining effective internal control; and complying with laws, regulations, contracts, and grant agreements applicable to SBA.

**Auditors' Responsibilities.** Our responsibility is to express an opinion on the fiscal year 2008 and 2007 consolidated financial statements of SBA based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04, as amended. Those standards and OMB Bulletin No. 07-04, as amended, require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SBA's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements
- Assessing the accounting principles used and significant estimates made by management
- Evaluating the overall consolidated financial statement presentation.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2008 audit, we considered SBA's internal control over financial reporting by obtaining an understanding of the SBA's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to express an opinion on the effectiveness of SBA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the SBA's internal control over financial reporting.



As part of obtaining reasonable assurance about whether SBA's fiscal year 2008 consolidated financial statements are free of material misstatement, we performed tests of SBA's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of SBA financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the provisions referred to in Section 803 (a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to SBA. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit, and accordingly, we do not express such an opinion.

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SBA's response to the findings identified in our audit report is presented in Exhibit IV. We did not audit SBA's response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of SBA's management, SBA's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

*KPMG LLP*

November 14, 2008