U.S. Small Business Administration

SBA

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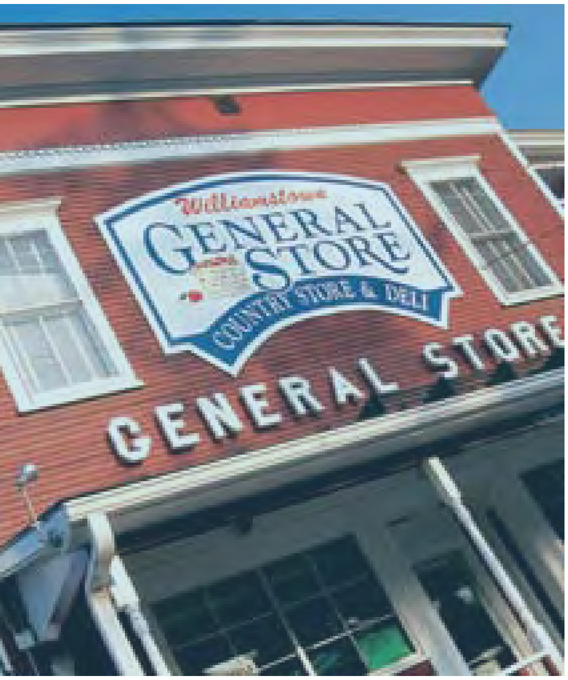

FINANCIAL REPORTING

Message from the Chief Financial Officer

November 15, 2009

In compliance with the Reports Consolidation Act, I am pleased to submit the U.S. Small Business Administration's Agency Financial Report for FY 2009.

FY 2009 was a challenging year for the SBA. In February, Congress passed the American Reinvestment and Recovery Act, and the SBA was responsible for assisting with the stabilization of the U.S. economy. This responsibility introduced new financial management and reporting challenges as the SBA rushed to provide a quick response to the economic downturn. The SBA tracked both its regular appropriations dollars and its Recovery Act funding to provide accountable, transparent reports to the President, the Congress, and the public. To develop tracking process and tools for the Recovery Act, the SBA engaged its employees and promoted internal cross-collaboration and innovation.

Despite these demanding circumstances, an independent audit has earned the SBA an unqualified opinion, with one material weakness, while improving the quality of the financial processes, data, and statements. The material weakness finding was in the development and review of the alignment entry which adjusts the net receivables for defaulted loan guaranties and liability for loan guaranties to their net present value. This error was immediately corrected and the SBA is instituting a process to ensure that this does not recur.

SBA's credit subsidy reestimate and Recovery Act models and processes demonstrate the application of high quality financial analysis to the unique current economic climate. All of our reestimates and quality assurance reviews were completed on time and SBA's numerous reviews and the auditor's review of the subsidy estimates yielded only a few findings and concerns which we were able to address in a timely manner.

In financial management and reporting, the SBA managed two key initiatives this year. First, the SBA engineered and expanded its financial processes and analysis to include implementation of the Recovery Act. All of SBA's existing financial systems and processes had to be augmented, and new tools had to be developed to meet the Executive Branch's high standard for monitoring and reporting.

Second, the SBA continued to make progress on the development of its LMAS project, which will re-engineer SBA's loan management accounting systems and align them with our lender oversight and customer service systems. In FY 2009, the SBA completed the project blueprints and proof of concept, purchased the necessary Oracle licenses, and finalized the project plans. The implementation phase began in October 2009.

Since late FY 2004, the SBA has had an independent Audit and Financial Management Advisory Committee. During FY 2009, the committee was highly engaged in the financial reporting process and audit cycle, providing advice and counsel and making recommendations for our financial statement footnotes and reporting on the Recovery Act. 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. We appreciate their support and dedication to our continued improvement.

The SBA is actively participating in the Office of Management and Budget's High Priority Goals initiative, which is expected to shape the new administration's agenda. The SBA has submitted its goals for review and is in the process of developing teams to implement OMB's recommendations.

The SBA also continued to make important strides in budget and performance integration. Because of Recovery Act projects and cross-collaboration, budget and performance staff have developed stronger relationships and a deeper understanding of how they can promote efficiency and performance at the Agency. Together, these offices are developing a new Operational Plan template for headquarters. The template more closely aligns spending with results. In another result of this close relationship, the SBA is laying the groundwork for the development of its new Agency strategic plan, which will be completed in FY 2010.

Finally, the SBA continued to garner value from improved internal control reviews and process analyses. Engaging program office staff to understand the requirements and to take advantage of the opportunities associated with internal controls continues to be a primary office objective. The SBA continued to pursue the development of a strong risk management culture.

In summary, FY 2009 was a rewarding year that posed many challenges in financial management. Achieving an unqualified opinion has been our objective since the SBA lost its prior unqualified opinion. Now that we have achieved our goal and met the challenges set by the Recovery Act, we will concentrate our efforts on maintaining our high quality financial management processes and on expanding the quality and use of our financial data for decision making.

Thank you for your interest in our FY 2009 Agency Financial Report.

Jonathan I. Carver
Chief Financial Officer

Audit and Financial Management Advisory Committee's Report

The Audit and Financial Management Advisory Committee assists the Administrator in overseeing the U.S. Small Business Administration'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, 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 2009 financial management and reporting. During 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 2009 AFR.

Edward J. Mazur

Edward J. Mazur
Chairman
Audit and Financial Management Advisory Committee

Inspector General's Audit Report

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

AUDIT REPORT
Issue Date: November 13, 2009
Number: 10-04

To: Jonathan I. Carver
Chief Financial Officer

Debra S. Ritt

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Audit of SBA's FY 2009 Financial Statements

Pursuant to the Chief Financial Officer's Act of 1990, attached is a copy of the *Independent Auditors' Report* issued by KPMG LLP on the Small Business Administration's financial statements for the fiscal year ended September 30, 2009. 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, 2009 and 2008. 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 controls, KPMG reported a material weakness over financial reporting, and continued to report a significant deficiency related to Information Technology security controls. Details regarding the matters that led to the auditor's conclusion on internal controls are further discussed in Exhibits I and II of the *Independent Auditors' Report.* KPMG's test for compliance with certain laws, regulations, contracts and grant agreements determined that the Agency did not fully comply with the Debt Collection Improvement Act of 1996 because SBA did not consistently follow Treasury guidelines for referring delinquent debts for collection. Details regarding the auditor's conclusion are included in the "Compliance and Other Matters" section of the *Independent Auditors' Report.* The auditors did not report any other instances or matters regarding noncompliance.

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 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.

Attachment

Independent Auditors' Report on FY 2009 Financial Statements

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, 2009 and 2008, and the related consolidated statements of net cost and 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 2009 audit, we also considered SBA's internal control 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, 2009 and 2008, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

Our opinion emphasized SBA's implementation of Statement of Federal Financial Accounting Standards (SFFAS) No. 31, *Accounting for Fiduciary Activities*.

Our consideration of internal control over financial reporting resulted in identifying a certain deficiency that we consider to be a material weakness, item number 1, and other deficiencies that we consider to be a significant deficiency, item number 2, as follows:

1 Improvement Needed in Internal Controls over Financial Reporting
2 Improvement Needed in Information Technology (IT) Security Controls

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed one instance of noncompliance that is required to be reported herein under *Government Auditing Standards* and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

3 Noncompliance with the Debt Collection Improvement Act

The following sections discuss our opinion on the SBA's consolidated financial statements; our consideration of the 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, 2009 and 2008 and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources for the years then ended.

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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, 2009 and 2008 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 stated in Note 4 to the financial statements, SBA implemented the requirements of SFFAS No. 31 in fiscal year 2009.

The information in the Management's 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. 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 was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses.

A deficiency in internal control 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 and correct misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

In our fiscal year 2009 audit, we identified a deficiency in internal control over financial reporting that we consider a material weakness, as described in Exhibit I, and other deficiencies that we consider to be a significant deficiency, as described in Exhibit II. Exhibit III presents the status of the prior year significant deficiency.

We noted certain additional matters that we have reported to management of SBA in a separate letter dated November 13, 2009.

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 one instance of noncompliance that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

As stated in its Federal Managers' Financial Integrity Act (FMFIA) Assurance Statement, SBA management reported the agency was noncompliant with the Debt Collection Improvement Act in fiscal year 2009 due to instances where it did not refer a substantial number of charged off loans to Treasury for offset and cross servicing.

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

* * * * * * *

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 2009 and 2008 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. Those standards and OMB Bulletin No. 07-04, 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; and
- 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 2009 audit, we considered SBA's internal control over financial reporting by obtaining an understanding of 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 controls relevant to operating objectives, as broadly defined by the FMFIA. 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 SBA's internal control over financial reporting.

As part of obtaining reasonable assurance about whether SBA's fiscal year 2009 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 the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in

KPMG

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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.

SBA's response to the findings identified in our audit 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 13, 2009

Exhibit I

U.S. Small Business Administration

Material Weakness

Introduction

Exhibit I herein describes the material weakness and Exhibit II describes the control deficiencies, which collectively resulted in a significant deficiency, for the year ended September 30, 2009, and our recommendations. The status of the prior year significant deficiency is reported in Exhibit III, and SBA management's response is presented in Exhibit IV.

Material Weakness

The material weakness we identified for the year ended September 30, 2009, is summarized below.

(1) Improvement Needed Surrounding Controls Over the Financial Reporting Process

SBA has various reconciliation and data quality improvement procedures between and within its various systems and departments to ensure that the agency's financial statements are reasonable and fairly presented. The purpose of these procedures is to improve the overall quality of the data SBA uses internally to monitor operations and loan portfolio performance as well as to periodically report to its various stakeholders, such as the U.S. Department of Treasury and the Office of Management and Budget (OMB). However, these procedures need to be strengthened to improve the quality and accuracy of the quarterly and year-end financial reporting process.

SBA did not timely identify a $346.6 million overstatement in its financial statements concerning its liability for loan guaranties and defaulted loan guaranty receivable balances. The error was due to a lack of effective process controls over SBA's Return on Assets (ROA) calculation. The ROA calculation is used to record an alignment entry which adjusts the net defaulted loan guaranty receivable and the liability for loan guaranty balances to net present value (NPV) in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*. One of the main inputs of this calculation is the NPVs generated by the Credit Subsidy Calculator 2 (CSC2). For cohorts reestimated using projected disbursements SBA did not properly reduce the NPV amounts on a prorata basis to reflect the NPV based on actual disbursements to date.

Additionally, we noted that the ROA adjusting entry was improperly posted before all loan guaranty transactions were posted to the general ledger. As a result, the defaulted loan guaranty and liability for loan guaranty balances were overstated by $32.7 million.

The lack of process controls resulted in cumulative misstatements totaling $379.3 million related to the defaulted loan guaranties and liability for loan guaranty balances at September 30, 2009. SBA subsequently recalculated the alignment entry and reposted the transactions to correct the balances in error.

OMB Circular A-123, *Management's Responsibility for Internal Controls*, states: "management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Management shall consistently apply the internal control standards to meet each of the internal control objectives and to assess internal control effectiveness."

Exhibit I

U.S. Small Business Administration

Material Weakness

Recommendations

We recommend that the Chief Financial Officer:

1. Implement a reconciliation procedure in which a staff member traces and agrees the NPV in the ROA calculation to the outputs generated by the CSC2 prior to posting the alignment entry in the general ledger.

2. Develop policies and procedures to ensure the ROA alignment entry is made after all credit reform loan guaranty activity has been posted to the general ledger.

3. Enhance SBA's procedures related to its in-depth analysis of the valuation of the liability for loan guaranties and defaulted loan guaranty receivable balances to ensure the balances are properly presented at the NPV in accordance with SFFAS No. 2.

Exhibit II

U.S. Small Business Administration

Significant Deficiency

The significant deficiency identified for the year ended September 30, 2009, is summarized below:

(2) Improvement Needed in Information Technology (IT) Security Controls

During fiscal year 2009, we noted that SBA made progress in several areas in its efforts to address prior year IT internal control deficiencies. Despite these improvements, we also noted that deficiencies continued to exist in the areas of security access controls, software program changes, patch management, and end-user computing.

Security Access Controls

Integral to an organization's security program management efforts, technical security access controls for systems and applications should provide reasonable assurance that IT resources, such as data files, application programs, and IT-related facilities/equipment, are protected against unauthorized modification, disclosure, loss, or impairment.

A summary of the security access control deficiencies we identified during the fiscal year 2009 SBA financial statement audit follows:

- We noted several [FO1A Exemption 2] vulnerabilities, with [FO1A Exemption 2] hosted by SBA's [FO1A Exemption 2] service provider. Details are not provided in this report due to their sensitivity, but have been provided to SBA management. Many of these issues were tracked by the internal [FO1A Exemption 2] support team; however, the issues were not appropriately tracked and prioritized by the Plan of Action and Milestones (POA&M) in which the Office of Chief Information Officer (OCIO) provides oversight and management.

- We noted security vulnerabilities with [FO1A Exemption 2] hosted in the [FO1A Exemption 2]. Details are not provided in this report due to their sensitivity, but have been provided to SBA management. Although we noted improvement in this area since fiscal year 2008, consistent and periodic completion of vulnerability scans would have helped SBA reduce the number of vulnerabilities.

- We identified access control weaknesses through our technical vulnerability testwork [FO1A Exemption 2].

- Validation of physical access to the data center at [FO1A Exemption 2] is not performed in accordance with SBA Standard Operating Procedure (SOP) 90-47.2, *Automated Information Systems Security Program*, which requires that a listing of authorized personnel for SBA computer facilities (e.g., server rooms) be maintained, and access be revalidated at least quarterly. In addition, we noted that visitor logs at [FO1A Exemption 2] were not fully completed.

- OCIO management was unable to provide reasonable assurance that electronic media is sufficiently sanitized prior to disposal, in accordance with SOP 90-47.2. The SOP requires that (1) media must be sanitized prior to disposal by using one of the three approved methods: overwriting, degaussing, or destruction, and (2) a log of who completed the sanitation action must be maintained.

- OCIO management was unable to provide reasonable assurance that user access to the [FO1A Exemption 2] system was appropriately authorized and approved, in accordance with National Institute of Standards and

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Exhibit II

U.S. Small Business Administration

Significant Deficiency

Technology (NIST) Special Publication 800-53, *Recommended Security Controls for Federal Information Systems*, Section AC-2.

- OCIO management does not enforce a process for monitoring, reviewing, and signing-off on the audit logs [FO1A Exemption 2].
.

The majority of the above issues are consistent with findings identified by the Office of Inspector General (OIG) in past years. In fact, the OIG has identified IT security as a significant SBA management challenge since at least fiscal year 2000.

<u>Recommendations – Security Access Controls:</u>

We recommend that the Chief Information Officer (CIO) coordinate with SBA program offices to:

4. Improve the vulnerability tracking and monitoring process to include unresolved [FO1A Exemption 2] vulnerabilities in the [FO1A Exemption 2] POA&M.

5. [FO1A Exemption 2]

6. Develop a more thorough approach to track and mitigate patch management and configuration management vulnerabilities identified during [FO1A Exemption 2] scans.

7. Prevent users from [FO1A Exemption 2] by developing and implementing procedures for ensuring mandatory [FO1A Exemption 2].

8. Implement controls to comply with SOP 90-47.2 regarding the validation of [FO1A Exemption 2] to the data center.

9. Implement procedures to control the process for requesting and granting access to the [FO1A Exemption 2] system, and implement procedures to retain the appropriate approval evidence for tracking and validation.

10. Implement a process to monitor the audit logs of all [FO1A Exemption 2] on a regular basis.

Software Program Changes

The primary focus of an organization's software change controls (which also encompasses patch management and configuration management efforts) is on controlling the software changes made to systems and applications in operation. Without such controls, there is a risk that security features could be inadvertently or deliberately omitted or turned off, or that processing irregularities or malicious code could be introduced into the IT environment.

Exhibit II

U.S. Small Business Administration

Significant Deficiency

A summary of the software program change control deficiencies we identified during the fiscal year 2009 SBA financial statement audit follow:

- An agency-wide change control process has not been implemented, and the Enterprise Change Control Board (ECCB) charter is in draft form. In fiscal year 2008, the Office of the Chief Information Officer (OCIO) stated that the ECCB charter would be implemented and that it would adhere to the IT Infrastructure Library.
- The OCIO was unable to provide evidence that (1) testing and approvals were performed for six of eight selected LAN\WAN operating system changes, (2) testing and approvals were performed for eight of eight selected Financial Reporting Information System (FRIS) operating system changes, and (3) the listing of JAAMS operating system changes was complete and accurate.
- The OCIO was unable to provide evidence that changes to the LAN/WAN were appropriately tracked, approved, and implemented for the selected sample of seven application changes.
- Change controls to management LAN/WAN emergency changes were not sufficient. The OCIO was unable to provide testing results and approvals for two of the three selected emergency changes.
- The Office of the Chief Financial Officer (OCFO) was unable to provide evidence that the software change requests were consistently completed for JAAMS and the FRIS.
- The OCIO was unable to provide evidence that baseline configurations for LAS were updated in a timely manner. Documented baseline configurations enable the process of tracking and controlling software changes, especially as system security settings are changed.

Recommendations – Software Program Changes:

We recommend the CIO:

11. Oversee the development of a finalized ECCB charter that is supported by a promulgated SOP.
12. Implement procedures for documenting operating system, software, and emergency change testing results, testing approvals, and final approvals. Specifically, such procedures and controls need to be applied for the LAN\WAN.

We recommend the CFO:

13. Implement a process to capture all change requests for JAAMS.
14. Ensure consistent application of procedures for documenting operating system change testing results, testing approvals, and final approvals. Specifically, such procedures and controls need to be applied for the FRIS.

Exhibit II

U.S. Small Business Administration

Significant Deficiency

End-user Computing

End-user computing tools/programs (e.g., spreadsheets and other user-developed programs) present the need for a unique set of general control procedures within an organization. By its nature, end-user computing brings the development and processing of information systems closer to the user. End-user computing capabilities typically include access to any end-user developed programs or objects, such as spreadsheets that contain critical data/information. Critical data/information could include personally identifiable information (PII) and financial data. While this environment may not typically be subjected to the same level of rigor and structure as an IT general controls environment, policies and procedures in this area are important to the overall IT environment. During our follow-up on this prior year deficiency, we noted that the policy and procedure has been drafted, but, had yet to be finalized, approved, and implemented in the SBA environment.

Recommendations – End-user Computing:

15. We recommend the Senior Policy Analyst in the Office of the Administrator coordinate with program offices using end-user programs containing sensitive data, such as PII and financial data, to implement end-user computing procedures in accordance with the guidance provided by the OCIO.

Exhibit III

U.S. Small Business Administration

Status of Prior Year Significant Deficiency

Fiscal Year 2008 Finding	**Fiscal Year 2009 Status of Finding**
1. Improvement needed in management information technology security controls	During our review of SBA's information technology (IT) general and application controls, we noted improvements in remote access authorizations, security vulnerabilities over Disaster Credit Management System, sanitization over sensitive media, and user account recertification for the Loan Accounting System and the LAN/WAN. However, we continued to identify opportunities for SBA to improve its internal controls. The control deficiencies that continue to exist are in the following areas: security access controls, software program changes, and end-user computing. This year, we also noted weaknesses in port security and the monitoring of system audit logs. Therefore, in fiscal year 2009, the presentation of the issue was modified to reflect current year operations, and we continue to report a significant deficiency in internal controls as it relates to IT systems and their impact on the consolidated financial statements. See Exhibit I for additional information.

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CFO Response to Draft Audit Report on FY 2009 Financial Statements

Exhibit IV

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

DATE: November 13, 2009

TO: Debra Ritt, Assistant IG for Auditing

FROM: Jonathan Carver, Chief Financial Officer

SUBJECT: Draft Audit Report on FY 2009 Financial Statements

The Small Business Administration is in receipt of the draft Independent Auditors' Report from KPMG that includes the auditor's opinion on the financial statements and review of the Agency's internal control over financial reporting and compliance with laws and regulations. The independent audit of the Agency's financial statements and related processes is a core component of SBA's financial management program.

We are delighted that the SBA has again received an unqualified audit opinion from the independent auditor. We believe these results accurately reflect the quality of the Agency's financial statements and our improved accounting, budgeting and reporting processes. As you know, the SBA has worked hard over the past several years to address the findings from our independent auditors. Our core financial reporting data and processes have improved substantially and we are proud that the results of our efforts have been confirmed by the independent auditor. The draft audit report contains a material weakness concerning controls around the Liability for Loan Guaranties (LLG) and the Return On Assets (ROA). This calculation is performed once a year under severe time constraints. The SBA has procedures in place for this calculation; however due to time constraints the procedure was not completely followed. SBA will improve the process controls around Loan Liability Guaranties (LLG) and Return On Assets (ROA) in order to mitigate the significant time constraints during the audit. It is notable that this error was corrected within hours upon notification by the auditors.

The audit report includes a continuing significant deficiency in the SBA's information technology controls. As the auditors noted in their report on the 2009 financial statements, the SBA made substantial progress in resolving IT deficiencies. The SBA will continue to improve the Agency's IT security during the upcoming fiscal year. The SBA is developing plans to track, monitor, and aggressively mitigate vulnerabilities in all agency systems. Furthermore, the SBA will clarify and strengthen detailed procedures

Exhibit IV

required to ensure security access controls are in place to protect SBA data from unauthorized modification, disclosure, and loss.

The audit report contains one instance of non-compliance with applicable laws and regulations as of September 30, 2009 that the SBA identified. During FY 2009, the SBA did not refer a substantial number of loans to the Treasury Department for cross-servicing or for the Treasury offset. The SBA management team established a Debt Collection Improvement Act (DCIA) team to tackle the problem comprised of members from the Offices of Capital Access, Chief Financial Officer and Chief Information Officer. The root of this error was identified as a system coding error. The error has since been corrected and additional resources have been allocated to refer these loans to the Treasury within the next six months. A mitigation plan is in place to ensure that this error does not occur in the future.

We appreciate all of your efforts and those of your colleagues in the Office of the Inspector General as well as those of KPMG. The independent audit process continues to provide us with new insights and valuable recommendations that will further enhance SBA's financial management practices. We continue to be committed to excellence in financial management and look forward to making more progress in the coming year.

Financial Statements and Notes

The U.S. Small Business Administration prepares its financial statements as a critical aspect of ensuring the accountability and stewardship for the public resources entrusted to the SBA. Preparation of these statements is also an important part of SBA's financial management goal of providing accurate and reliable information that may be used to assess performance and allocate resources.

SBA's management is responsible for the accuracy and propriety of the information contained in the principal financial statements and the quality of internal controls. The statements are, in addition to other financial reports, used to monitor and control budgetary resources. The SBA prepares these financial statements from its books and records in accordance with the accounting principles generally accepted in the United States for federal entities and the formats prescribed by the Office of Management and Budget.

The **Consolidated Balance Sheet** summarizes the assets, liabilities and net position by major category as of the reporting date. Intragovernmental assets and liabilities resulting from transactions between federal agencies are presented separately from assets and liabilities resulting from transactions with the public.

The **Consolidated Statement of Net Cost** shows, by strategic goal, the net cost of operations for the reporting period. Net cost of operations consists of full program costs incurred by the SBA less the exchange revenues earned by those programs.

The **Consolidated Statement of Changes in Net Position** presents SBA's beginning and ending net position by two components - Cumulative Results of Operations and Unexpended Appropriations. It summarizes the change in net position by major transaction category. The ending balances of both components of net position are also reported on the Balance Sheet.

The **Combined Statement of Budgetary Resources** provides information about funding and availability of budgetary resources and the status of those resources at the end of the reporting period. Data on the Combined Statement of Budgetary Resources is consistent with information reflected on the Report on Budget Execution and Budgetary Resources (SF 133), with the one exception of offsetting receipts. Offsetting receipts offset budget authority and outlays at the agency level in the Budget of the United States Government, but are not reflected in the SF 133. The SBA included offsetting receipts in this statement for the purpose of reconciling outlay information presented to the Budget of the United States Government.

The **Required Supplementary Information** presents a Combining Statement of Budgetary Resources report by principal functional area.

The **Required Supplementary Stewardship Information** provides information on SBA's investment in human capital.

U. S. Small Business Administration

Consolidated Balance Sheet

as of September 30, 2009 and 2008

(Dollars in Thousands)

	2009	2008
ASSETS		
Intragovernmental Assets		
Fund Balance with Treasury (Note 2)	$ 3,469,465	$ 3,880,755
Total Intragovernmental Assets	3,469,465	3,880,755
Assets - Public and Other		
Cash (Note 3)	2,662	3,972
Accounts Receivable, Net (Note 5)	16,081	34,528
Credit Program Receivables and Related Foreclosed Property, Net (Note 6)	9,128,496	8,522,941
General Property and Equipment, Net (Note 7)	8,535	4,417
Advances	1,220	1,602
Total Assets - Public and Other	9,156,994	8,567,460
Total Assets	**$ 12,626,459**	**$ 12,448,215**
LIABILITIES		
Intragovernmental Liabilities		
Interest Payable	$ 2,143	$ 3,430
Debt (Note 9)	10,878,283	9,473,227
Net Assets of Liquidating Funds Due to Treasury (Note 10)	78,584	104,789
Downward Reestimate Payable to Treasury (Note 1, Note 13)	64,875	466,887
Other (Note 8, Note 11)	16,062	19,554
Total Intragovernmental Liabilities	11,039,947	10,067,887
Other Liabilities - Public		
Accounts Payable (Note 1)	129,807	69,184
Accrued Grant Liability (Note 1)	59,000	60,000
Liability for Loan Guaranties (Note 6)	3,994,636	1,825,551
Federal Employee Compensation Act Actuarial Liability (Note 1, Note 8)	29,640	27,061
Surety Bond Guarantee Program Future Claims (Note 8)	20,817	24,764
Other (Note 8, Note 11)	41,212	39,638
Total Other Liabilities - Public	4,275,112	2,046,198
Total Liabilities	**15,315,059**	**12,114,085**
NET POSITION		
Unexpended Appropriations (Note 1)	1,983,504	1,696,866
Cumulative Results of Operations (Note 1)	(4,672,104)	(1,362,736)
Total Net Position	**(2,688,600)**	**334,130**
Total Liabilities and Net Position	**$ 12,626,459**	**$ 12,448,215**

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration

Consolidated Statement of Net Cost

For the years ended September 30, 2009 and 2008

(Dollars in Thousands)

	2009	2008
STRATEGIC GOAL 1:		
Expand America's Ownership Society, Particularly in Underserved Markets		
Gross Cost	$ 5,409,931	$ 995,731
Less: Earned Revenue	166,343	149,322
Net Cost of Strategic Goal 1	**5,243,588**	**846,409**
STRATEGIC GOAL 2:		
Provide Timely Financial Assistance to Homeowners, Renters, Nonprofit Organizations and Businesses Affected by Disaster		
Gross Cost	1,081,232	1,053,030
Less: Earned Revenue	405,904	468,168
Net Cost of Strategic Goal 2	**675,328**	**584,862**
STRATEGIC GOAL 3:		
Improve Economic Environment for Small Business		
Gross Cost	14,506	14,114
Net Cost of Strategic Goal 3	**14,506**	**14,114**
COST NOT ASSIGNED TO STRATEGIC GOALS		
Gross Cost	62,294	119,931
Net Cost Not Assigned to Strategic Goals	**62,294**	**119,931**
Net Cost of Operations	**$ 5,995,716**	**$ 1,565,316**

Note 12, Note 14

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration

Consolidated Statement of Changes in Net Position

For the years ended September 30, 2009 and 2008

(Dollars in Thousands)

	2009	2008
Beginning Cumulative Results of Operations	**$ (1,362,736)**	**$ (571,343)**
Budgetary Financing Sources		
Appropriations Used	2,748,961	1,317,809
Donations of Cash and Cash Equivalents	25	–
Other Financing Sources		
Imputed Financing from Costs Absorbed by Others	25,549	24,014
Other - Current Year Liquidating Equity Activity	(863)	(4,502)
Other - Non-entity Activity	(87,324)	(563,398)
Total Financing Sources	**2,686,348**	**773,923**
Less: Net Cost of Operations	**5,995,716**	**1,565,316**
Ending Cumulative Results of Operations	**$ (4,672,104)**	**$ (1,362,736)**
Beginning Unexpended Appropriations	**$ 1,696,866**	**$ 974,211**
Budgetary Financing Sources		
Appropriations Received	3,050,068	2,060,201
Appropriations Transferred In	2,953	–
Adjustment - Cancelled Authority	(11,777)	(8,446)
Other Adjustments	(5,645)	(11,291)
Appropriations Used	(2,748,961)	(1,317,809)
Total Budgetary Financing Sources	**286,638**	**722,655**
Ending Unexpended Appropriations	**$ 1,983,504**	**$ 1,696,866**
Ending Net Position	**$ (2,688,600)**	**$ 334,130**

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration

Combined Statement of Budgetary Resources

For the years ended September 30, 2009 and 2008

(Dollars in Thousands)

	September 30, 2009		
	Budgetary	Nonbudgetary Financing	Total
BUDGETARY RESOURCES			
Unobligated Balance			
Brought Forward October 1	$ 1,429,754	$ 1,547,065	$ 2,976,819
Recoveries of Prior Year Obligations	64,639	220,652	285,291
Budget Authority			
Appropriations Received	3,050,068	–	3,050,068
Borrowing Authority	–	3,455,566	3,455,566
Spending Authority from Offsetting Collections			
Earned	429,412	4,042,183	4,471,595
Change in Unfilled Customer Orders	32,755	157,011	189,766
Total Budget Authority	3,512,235	7,654,760	11,166,995
Nonexpenditure Transfers, Net			
Budget Authority	2,953	–	2,953
Permanently Not Available	(49,302)	(2,045,701)	(2,095,003)
Total Budgetary Resources	**$ 4,960,279**	**$ 7,376,776**	**$ 12,337,055**
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred, Net			
Direct	$ 2,602,745	$ 6,181,465	$ 8,784,210
Reimbursable	850,922	–	850,922
Total Obligations Incurred, Net	3,453,667	6,181,465	9,635,132
Unobligated Balances, Available	537,389	889,666	1,427,055
Unobligated Balances, Not Available	969,223	305,645	1,274,868
Total Status of Budgetary Resources	**$ 4,960,279**	**$ 7,376,776**	**$ 12,337,055**
CHANGE IN OBLIGATED BALANCES			
Obligated Balance Brought Forward, Net October 1			
Unpaid Obligations Brought Forward	$ 421,630	$ 561,165	$ 982,795
Uncollected Customer Payments from Federal Sources Brought Forward	–	(78,863)	(78,863)
Total Obligated Balance Brought Forward, Net	421,630	482,302	903,932
Obligations Incurred	3,453,667	6,181,465	9,635,132
Gross Outlays	(3,197,180)	(6,132,044)	(9,329,224)
Recoveries of Prior Year Unpaid Obligations	(64,639)	(220,652)	(285,291)
Change in Uncollected Customer Payments from Federal Sources	–	(157,011)	(157,011)
Obligated Balance, Net, End of Period			
Unpaid Obligations	613,478	389,934	1,003,412
Uncollected Customer Payments from Federal Sources	–	(235,874)	(235,874)
Total Obligated Balance, Net, End of Period	**$ 613,478**	**$ 154,060**	**$ 767,538**
NET OUTLAYS			
Gross Outlays	$ 3,197,180	$ 6,132,044	$ 9,329,224
Offsetting Collections	(462,167)	(4,042,183)	(4,504,350)
Net Outlays Before Offsetting Receipts	2,735,013	2,089,861	4,824,874
Offsetting Receipts	(59)	(489,336)	(489,395)
Net Outlays	**$ 2,734,954**	**$ 1,600,525**	**$ 4,335,479**

Note 15

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration

Combined Statement of Budgetary Resources

For the years ended September 30, 2009 and 2008

(Dollars in Thousands)

	September 30, 2008		
	Budgetary	Nonbudgetary Financing	Total
BUDGETARY RESOURCES			
Unobligated Balance			
Brought Forward October 1	$ 622,764	$ 4,678,380	$ 5,301,144
Recoveries of Prior Year Obligations	101,875	476,638	578,513
Budget Authority			
Appropriations Received	2,060,201	–	2,060,201
Borrowing Authority	–	1,346,805	1,346,805
Spending Authority from Offsetting Collections			
Earned	399,344	3,558,120	3,957,464
Change in Unfilled Customer Orders	(103,640)	(98,469)	(202,109)
Total Budget Authority	2,355,905	4,806,456	7,162,361
Nonexpenditure Transfers, Net			
Budget Authority	–	–	–
Permanently Not Available	(62,668)	(3,869,296)	(3,931,964)
Total Budgetary Resources	**$ 3,017,876**	**$ 6,092,178**	**$ 9,110,054**
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred, Net			
Direct	$ 973,991	$ 4,545,113	$ 5,519,104
Reimbursable	614,131	–	614,131
Total Obligations Incurred, Net	1,588,122	4,545,113	6,133,235
Unobligated Balances, Available	210,390	1,152,426	1,362,816
Unobligated Balances, Not Available	1,219,364	394,639	1,614,003
Total Status of Budgetary Resources	**$ 3,017,876**	**$ 6,092,178**	**$ 9,110,054**
CHANGE IN OBLIGATED BALANCES			
Obligated Balance Brought Forward, Net October 1			
Unpaid Obligations Brought Forward	$ 501,180	$ 1,090,147	$ 1,591,327
Uncollected Customer Payments from Federal Sources Brought Forward	–	(177,332)	(177,332)
Total Obligated Balance Brought Forward, Net	501,180	912,815	1,413,995
Obligations Incurred	1,588,122	4,545,113	6,133,235
Gross Outlays	(1,565,797)	(4,597,457)	(6,163,254)
Recoveries of Prior Year Unpaid Obligations	(101,875)	(476,638)	(578,513)
Change in Uncollected Customer Payments from Federal Sources	–	98,469	98,469
Obligated Balance, Net, End of Period			
Unpaid Obligations	421,630	561,165	982,795
Uncollected Customer Payments from Federal Sources	–	(78,863)	(78,863)
Total Obligated Balance, Net, End of Period	**$ 421,630**	**$ 482,302**	**$ 903,932**
NET OUTLAYS			
Gross Outlays	$ 1,565,797	$ 4,597,457	$ 6,163,254
Offsetting Collections	(295,703)	(3,558,120)	(3,853,823)
Net Outlays Before Offsetting Receipts	1,270,094	1,039,337	2,309,431
Offsetting Receipts	(240)	(742,338)	(742,578)
Net Outlays	**$ 1,269,854**	**$ 296,999**	**$ 1,566,853**

Note 15

The accompanying notes are an integral part of these statements.

NOTE 1. Significant Accounting Policies

(Dollars in Thousands, except as noted)

Reporting Entity

The Small Business Act of 1953 created the Small Business Administration as an independent federal agency. SBA's mission is to maintain and strengthen the nation's economy by aiding, counseling, assisting and protecting the interests of small businesses and to help businesses and families recover from disasters. The SBA operates through the execution of a congressionally approved budget that funds its programs.

Basis of Accounting and Presentation

The SBA prepares financial statements reporting its financial position and results of its operations as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. The financial statements are prepared from the Agency's records in accordance with generally accepted accounting principles in the United States of America and the formats prescribed by the Office of Management and Budget. The statements are in addition to other financial reports used to monitor and control budgetary resources. As a federal agency, the SBA cannot incur obligations without authority from the Congress and an apportionment by the OMB.

These financial statements reflect transactions recorded on both a proprietary accrual accounting basis and a budgetary obligation basis, in accordance with concepts and guidance provided by the OMB, the Federal Accounting Standards Advisory Board, and the Department of the Treasury. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting recognizes the legal obligation or restriction of funds in advance of the proprietary accruals and facilitates compliance with legal constraints and controls over the use of federal funds.

Beginning in FY 2009, fiduciary activities are required by SFFAS 31 to be disclosed in the notes to the financial statements. Fiduciary assets are not assets of the SBA and are not recognized on the Balance Sheet. SBA's fiduciary activities include the Master Reserve Fund and Master Reserve Account. See Note 4 for disclosure of the SBA's fiduciary activities.

Use of Estimates

SBA's management makes assumptions and estimates to prepare the financial statements based upon the facts that exist when the statements are prepared. Actual results may differ from those estimates and the differences may be significant. The most significant differences between actual results and SBA's estimates may occur in the valuation of credit program receivables and liabilities for loan guaranties under the Federal Credit Reform Act of 1990 guidelines. The SBA recognizes the sensitivity of credit reform modeling to slight changes in some model assumptions and uses continual review of model factors, statistical modeling and annual reestimates to reflect the most accurate cost of the credit programs to the U. S. government.

Budgets and Budgetary Accounting for Loan Programs

SBA's loan disbursements are financed by appropriations for long-term loan subsidy cost and borrowings from the Treasury for the remaining non-subsidized portion of the loans. The Congress may provide one year, multi-year or no year appropriations to cover the estimated long-term costs of the loan programs. The non-subsidized portion of each loan disbursement, financed initially under permanent indefinite authority to borrow funds from the Treasury, is repaid from collections of loan fees, repayments and default recoveries. The Congress limits the dollar amount of obligations that can be made for direct loans and loan guaranties in its annual appropriation bill.

A permanent indefinite authority is available to fund any reestimated increase of subsidy costs that occurs after the year in which a loan is disbursed. Reestimated reductions of subsidy costs are returned to the Treasury and are unavailable to the SBA. As required by the Federal Credit Reform Act of 1990, the SBA uses budgetary "program accounts" to account for appropriations in its credit programs and nonbudgetary "financing accounts" to account for credit program cash flow. Estimates and reestimates of credit program subsidy expenses are recorded in SBA's program accounts. Financing accounts are used to account for the Treasury borrowings and the collection of loan fees, repayments, default recoveries and disbursement of loans.

Accounts Payable

Accounts Payable are amounts due to public entities that will be liquidated during the next operating cycle. Included in the liability are payables to lender banks for the bank share of loan collections and to vendors for goods and services.

Accrued Grant Liability

Disbursements of grant funds are recognized as expenses at the time of disbursement. However, some grant recipients incur expenditures prior to initiating a request for disbursement based on the nature of the expenditures. The SBA accrues a liability for expenditures incurred by grantees prior to receiving grant funds for the expenditures. The amount to be accrued is determined through an analysis of historic grant expenditures. The Small Business Development Center program and several other grant programs are subjected to this treatment.

Contingencies

The SBA is a party in various administrative proceedings, legal actions, environmental suits and claims brought against the Agency. In the opinion of SBA's management and legal counsel, the ultimate resolution of these proceedings, actions, suits and claims will not materially affect the financial position or results of SBA's operations. The likelihood of loss to the SBA ranges from remote to a reasonably possible amount of $1.2 million, and the likelihood of loss on one action has not been determined where the loss amount could exceed $1.2 million. These activities will be monitored and recognized if a loss becomes probable.

Cumulative Results of Operations

Cumulative Results of Operations, presented on the Balance Sheet and on the Statement of Changes in Net Position, is the accumulated difference between expenditures and financing sources since the inception of the Agency. Unfunded expenses do not yet have a financing source and thus increase the loss the SBA reports as Cumulative Results of Operations. The largest category of unfunded expenses at the SBA is year-end reestimates which are funded in the following year. The majority of the Cumulative Results of Operations reported results from these unfunded reestimates.

Unexpended Appropriations

Unexpended Appropriations is the portion of SBA's appropriations received which are either undelivered or unobligated. Delivered orders result in expended appropriations and reduce the total reported as Unexpended Appropriations. Undelivered orders are the amount of orders of goods or services which have not been actually or constructively received.

Employee Benefits

LEAVE

A liability for employee annual leave is accrued as it is earned and reduced as leave is taken. Each year the balance of accrued annual leave is adjusted to reflect current pay rates as well as forfeited "use or lose" leave. Amounts are reported as unfunded to the extent current or prior year appropriations are not available to fund annual leave earned but not taken. Sick leave and other types of non-vested leave are expensed as taken.

EMPLOYEE HEALTH AND LIFE INSURANCE BENEFITS

SBA employees may choose to participate in the contributory Federal Employees Health Benefit and the Federal Employees Group Life Insurance Programs. The SBA matches a portion of the employee contributions to each program. Matching contributions are recognized as current operating expenses.

EMPLOYEE PENSION BENEFITS

SBA employees participate in either the Civil Service Retirement System or the Federal Employees' Retirement System and Social Security. These systems provide benefits upon retirement and in the event of death, disability or other termination of employment and may also provide pre-retirement benefits. They may also include benefits to survivors and their dependents, and they may contain early retirement or other special features. SBA's contributions to both retirement plans, as well as to the government-wide Federal Insurance Contribution Act, administered by the Social Security Administration, are recognized on the Consolidated Statement of Net Cost as current operating expenses.

Federal employee benefits also include the Thrift Savings Plan. For FERS employees the SBA matches employee contributions to the plan, subject to limitations. The matching contributions are recognized as current operating expenses.

IMPUTED FINANCING COSTS

The SBA recognizes the full cost of providing all employee and future retirement benefits, including life and health insurance, at the time employee services are rendered. Eligible retired SBA employees can continue to participate in health and life insurance plans. The cost is funded through Agency contributions, employee compensation to the extent withheld from employee and retiree pay, from matching of employee withholding for Thrift Savings Plan and FICA, and by the Office of Personnel Management which administers the retirement programs for SBA employees.

The OPM calculates imputed costs as the actuarial present value of future benefits attributed to services rendered by covered employees and eligible retired SBA employees during the accounting period, net of the amounts contributed by employees, retirees, and the Agency. The SBA recognizes the imputed costs as current operating expense in the Statement of Net Cost and as a part of net cost funded by an imputed financing source included in determining SBA's net position.

FEDERAL EMPLOYEES COMPENSATION ACT

The Federal Employees Compensation Act provides income and medical cost protection to covered federal civilian employees injured on the job and to beneficiaries of employees whose deaths are attributable to job-related injury or disease. The FECA program is administered by the Department of Labor. Labor pays valid claims as they occur, which are billed to the SBA annually and funded and paid approximately 15 months later. Labor also calculates an estimated actuarial liability for future benefits based upon historical experience and other economic variables. Projected annual benefit payments are then discounted to present value using the forecasted interest rates for 10-year Treasury notes and bonds published by the OMB in its economic assumptions for the federal budget. The SBA recognizes a current unfunded cost for the actual claims paid and the change in the FECA actuarial liability each year.

NOTE 2. Fund Balance with Treasury

The Department of the Treasury processes cash receipts and disbursements on SBA's behalf to pay liabilities and finance loan program costs. SBA's cash receipts are deposited to accounts at the Treasury. SBA's fund balances with the Treasury are available to make expenditures to liquidate allowable obligations, except for Non-entity Fund Balance which is not available to the SBA to obligate or expend. Separate records are maintained for SBA's program, financing, liquidating and other accounts. Fund balances at the Treasury include expired year amounts, which are unavailable for obligation, as well as amounts currently available for new obligations.

(Dollars in Thousands)

AS OF SEPTEMBER 30,		**2009**		**2008**
Appropriated Funds	$	2,052,859	$	1,781,718
Financing Funds		1,349,371		2,029,367
Liquidating Funds		17,527		38,394
Revolving Fund		49,415		30,994
Trust Fund		289		278
Total Entity Fund Balance with Treasury		**3,469,461**		**3,880,751**
Non-entity Fund Balance		**4**		**4**
Total Fund Balance with Treasury	**$**	**$3,469,465**	**$**	**$3,880,755**
Status of Fund Balance with Treasury				
Unobligated Balance Available	$	$1,427,055	$	$1,362,816
Unobligated Balance Unavailable		1,274,868		1,614,003
Obligated Balance Not Yet Disbursed		767,538		903,932
Non Budgetary		4		4
Total Fund Balance with Treasury	**$**	**$3,469,465**	**$**	**$3,880,755**

Unobligated balances become available when apportioned by the OMB for obligation in the current fiscal year. Obligated balances not yet disbursed include unpaid obligations offset by uncollected customer payments from other federal government accounts. The unobligated and obligated balances are reflected on the Statement of Budgetary Resources.

NOTE 3. Cash

The SBA field offices deposit collections from borrowers in Treasury General Accounts at financial institutions for credit to SBA's account at the Treasury. At the end of the fiscal year, collections temporarily held by SBA field offices pending deposit are recorded as Undeposited Collections – Cash in Transit and total $2.6 million and $ 3.9 million at September 30, 2009 and 2008.

NOTE 4. Fiduciary Activities: Master Reserve Fund and Master Reserve Account

Fiduciary activities are the receipt, management, protection, accounting, investment and disposition by the federal government of cash or other assets in which non-federal entities have an ownership interest that the federal government must uphold. Fiduciary cash and other assets are not assets of the government, and are not recognized on SBA's proprietary statements, but they are required to be disclosed in the notes to SBA's financial statements. Fiduciary balances may be on deposit with the Treasury or commercial banks. Beginning in FY 2009, federal agencies are required to comply with SFFAS 31 (Accounting for Fiduciary Activities) and the note disclosure guidance in OMB Circular A-136, Note 40.

The SFFAS 31 requires schedules disclosing the status of fiduciary net assets and activity for the reporting period. The SBA has disclosed these schedules for the Master Reserve Fund in prior years' reporting (in advance of the SFFAS 31 requirement) and is adding the Master Reserve Account information in FY 2009 in compliance with the new standard. In accordance with federal guidelines the SBA has not restated FY 2008 fiduciary activities.

SBA's fiduciary activities include the Master Reserve Fund and Master Reserve Account both administered by SBA's fiscal agent, Colson Inc. The MRF and MRA are maintained in commercial bank accounts (not the Treasury). The balances in the MRF and MRA are invested according to the SBA policy entirely in Treasury securities and repurchase agreements that are backed by Treasury securities. The MRF is an integral part of SBA's 7(a) secondary market program. The MRF was authorized by the Small Business Secondary Market Improvement Act of 1984 to facilitate the pooling of 7(a) guarantied loans that are purchased by secondary market investors. The 7(a) secondary market program includes the SBA's guaranty of timely payment, as well as a default guaranty, to 7(a) secondary market investors. The program encompassed $14.7 billion and $14.9 billion of outstanding trust certificate principal at September 30, 2009 and 2008.

The MRA facilitates the operation of the 504 development company secondary market program. The MRA was authorized by Section 505 of the Small Business Investment Act of 1958 as a vehicle to receive, temporarily hold and distribute 504 program cash flows. The MRA receives monthly payments from the 504 borrowers, and retains the payments until a semi-annual debenture payment is due to the secondary market investors. The 504 secondary market program includes SBA's guaranty of timely payment, as well as a default guaranty, to 504 secondary market investors. The program encompassed $23.0 billion and $21.8 billion of debentures outstanding at September 30, 2009 and 2008.

The composition of the MRF and MRA and a reconciliation of the changes in the assets are included in the following table:

(Dollars in Thousands)

FIDUCIARY ASSETS

AS OF SEPTEMBER 30,	2009	2008
Short Term Securities		
Money Market Funds	$ 27,473	$ 9,300
Treasury Bills	47,979	193,354
Repurchase Agreements	667,766	222,078
Total Short Term Securities	**743,218**	**424,732**
Long Term Securities		
Treasury Notes Including Interest	1,643,277	1,467,158
Total Long Term Securities	**1,643,277**	**1,467,158**
Net Assets	**$ 2,386,495**	**$ 1,891,890**

RECONCILIATION OF FIDUCIARY ASSETS

FOR THE YEARS ENDING SEPTEMBER 30,	2009	2008
Beginning Net Assets	**$ 2,370,628**	**$ 1,881,933**
Receipts		
Earned Income	65,219	72,757
Contributions	7,250,815	4,396,830
Net Realized Gain (Loss)	(109)	4,204
Total Receipts	**7,315,925**	**4,473,791**
Less Disbursements		
Payments to Investors	7,298,452	4,461,084
Expenses	1,606	2,750
Total Disbursements	**7,300,058**	**4,463,834**
Ending Net Assets	**$ 2,386,495**	**$ 1,891,890**

NOTE 5. Accounts Receivable

Accounts receivable include amounts owed by the public for guaranty fees in SBA's loan and surety bond programs, refunds due from employees and others, as well as other amounts owed by lenders on guarantied loans purchased by the SBA. An Allowance for Loss on uncollectible surety bond guaranty fees is based on an analysis of delinquent balance aging. The uncollectible or unrecoverable amounts for Guaranty Fees Receivable, Refunds and Other accounts receivable are not significant and no allowance is provided.

The American Recovery and Reinvestment Act of 2009 temporarily eliminated certain loan guaranty fees after February 17, 2009, which substantially reduced the outstanding Guaranty Fees Receivable at year end. Also, the Allowance for Loss decreased in FY 2009 as uncollectible surety bond guaranty fees were written off.

(Dollars in Thousands)

AS OF SEPTEMBER 30,	2009	2008
Public		
Guaranty Fees Receivable	$ 1,474	$ 21,620
Refunds	229	4,486
Other	14,461	11,284
Total Public	**16,164**	**37,390**
Allowance For Loss	(83)	(2,862)
Net Public	**$ 16,081**	**$ 34,528**

NOTE 6. Credit Program Receivables and Liability for Loan Guaranties

A. Loan Program Descriptions and Cost Determinations

LOAN PROGRAM DESCRIPTIONS

The SBA administers guarantied and direct loan programs that help small businesses obtain financing, and a direct loan program that assists homeowners, renters and businesses to recover from disasters.

MAJOR DIRECT LOAN AND LOAN GUARANTY PROGRAMS

Program group	Program type	Program
Disaster	Direct	Disaster Assistance Loans
Business	Guarantied	7(a) Loan Guaranty
Business	Guarantied	America's Recovery Capital Loan
Business	Direct	7(m) Microloan
Business	Guarantied	504 Certified Development Company
Business	Guarantied	Small Business Investment Company Debenture
Business	Guarantied	Small Business Investment Company Participating Securities
Business	Guarantied	Secondary Market Guaranty

SBA's Disaster Assistance Loan Program makes direct loans to disaster victims under four categories: (1) loans for homes and personal property, (2) physical disaster loans to businesses of any size, (3) economic injury loans to small businesses without credit available elsewhere and (4) economic injury loans to eligible businesses affected by essential employees called up to active duty in the military reserves. The maximum interest rate is four percent for home loan applicants without credit available elsewhere and eight percent for applicants with credit available elsewhere.

SBA's business loan programs include its flagship 7(a) Loan Guaranty Program in which the SBA guarantees up to 90 percent of the principal amount of loans made by banks and other lending institutions to small businesses not able to obtain credit elsewhere. The Section 504 Certified Development Company program guarantees 100 percent of the principal and interest payments on debentures issued by development companies that make small business loans secured primarily by real estate. The Small Business Investment Company Debentures and Participating Securities programs guarantee principal and interest payments on securities issued by investment capital firms, which in turn make investments in small business. The 7(m) Microloan program provides direct loans to nonprofit intermediaries, which use these funds to make loans up to $35,000 to eligible small businesses. See Note 4 for further discussion of the secondary market guaranty. American's Recovery Capital Loan program is a new temporary guarantied loan program authorized by the American Recovery and Reinvestment Act of 2009 (ARRA or Recovery Act). ARC Loans are deferred payment loans of up to $35,000 available through SBA's 7(a) participating lenders. ARC Loans are interest free to the borrower, 100 percent guaranteed by the SBA to the lender, and have no fees associated with them.

CREDIT PROGRAM RECEIVABLES AND LIABILITIES FOR LOAN GUARANTIES

The Federal Credit Reform Act of 1990 governs direct loans made after FY 1991. FCRA loans are valued at the present value of expected future cash flows, discounted at the interest rate of marketable Treasury securities. The subsidy allowance account represents the difference between the outstanding loans receivables balance and the net present value of the estimated cash flows of the loans over their remaining term. The subsidy allowance is subtracted from the outstanding loans receivable balance to obtain the net loan receivables balance. FCRA also governs loan guaranties made after FY 1991. A liability for outstanding guaranties is included on SBA's balance sheet. The liability is determined by calculating the net present value of expected future cash flows for outstanding guaranties in a manner similar to that used to determine the subsidy allowance for direct loans. Guarantied loans purchased by the SBA upon borrower default are established as loan receivables and are valued in a similar manner as direct loans under FCRA.

Direct loans made prior to FCRA are recorded at cost with an allowance for uncollectible amounts calculated using historical loss experience. For loan guaranties made prior to FCRA, a liability for expected future losses on outstanding guaranties is established based on historical experience. Guarantied loans purchased upon borrower default are established as loan receivables with an allowance for losses based on historical loss experience.

The SBA advances payments semiannually to the Federal Financing Bank for loans guarantied under Section 503 of the Small Business Act. The advances are liquidated by receipt of the installment payments on loans made by state and local development companies. To the extent that those installments may not repay advances, balances from development companies that remain collectible are reported as credit program receivables.

Advances are similarly made to honor SBA's timely payment requirement of principal and interest due for debentures in SBA's Section 504 Certified Development Company and Small Business Investment Company programs. These advances are also reported as credit program receivables.

SUBSIDY FUNDING UNDER FEDERAL CREDIT REFORM

FCRA requires that the credit subsidy costs of direct loans and loan guaranties be expensed in the year loans are disbursed. The credit subsidy cost is the net present value of expected cash inflows and outflows over the life of a guarantied loan, or the difference between the net present value of expected cash flows and the face value of a direct loan. The cost expressed as a percentage of loans approved is termed the subsidy rate. The SBA receives appropriations annually to fund its credit programs based on the subsidy rate that applies to the credit program level approved by Congress. Then, when loans are disbursed, the SBA records subsidy expense. In accordance with FCRA, subsidy costs are reestimated annually.

FCRA also requires that changes made to Agency loan programs that affect the costs of outstanding loans or guaranties be treated as a "modification" under credit reform guidelines. A modification is a government action that differs from actions assumed in the baseline estimate of cash flows in the budget, and changes the estimated cost of an outstanding direct loan or an outstanding loan guaranty. A modification requires a government action (either new legislation or administrative action). The SBA recorded cost modification of $13.2 million in the 7(a) and 504 programs reflecting fees paid between February 17th and March 15th that were refunded back to the borrowers in accordance with the passage of the American Recovery and Reinvestment Act legislation.

INTEREST RECEIVABLE

Interest receivable is comprised of accrued interest on loans receivable and purchased interest related to defaulted guarantied loans. Interest income is accrued at the contractual rate on the outstanding principal amount and is reduced by the amount of interest income accrued on non-performing loans in excess of 90 days delinquent. Purchased interest is carried at cost. A 100 percent loss allowance is established for all purchased interest on non-performing loans made prior to FY 1992.

FORECLOSED PROPERTY

Foreclosed property is comprised of real and business-related property acquired through foreclosure on loans and defaulted loan guaranties. Properties acquired as a result of defaulted loans committed after FY 1991 are shown at recoverable value which is adjusted to the present value of expected future cash flows for financial statement presentation through the allowance for subsidy. Other foreclosed property is shown at the appraised value. SBA's foreclosed property inventory increased during FY 2009 due to the economic conditions. At September 30, 2009 SBA's foreclosed property was $41.7 million related to 80 loans. The properties had been held for an average of 1,266 days. At September 30, 2008 foreclosed property was $24.3 million related to 71 loans. The properties had been held for an average of 1,076 days.

VALUATION METHODOLOGY FOR POST-1991 DIRECT LOANS AND LOAN GUARANTIES

Direct and guarantied loans committed after FY 1991 are based on the net present value of their expected future cash flow. The SBA estimates future cash flows for guarantied and direct loans using economic and financial credit subsidy models. The SBA has developed a customized credit subsidy model for each of its major loan guaranty and direct loan programs.