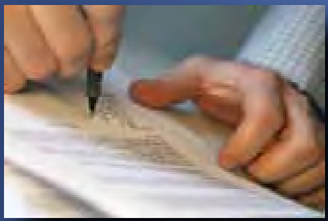

Contracting



Capital

Counseling

Disasters

*U.S. Small Business Administration*

# Agency Financial Report

## Fiscal Year 2011

Giving Small Businesses the Tools
They Need to Grow and Create Jobs

# ABOUT THIS REPORT

The U.S. Small Business Administration's (SBA) Agency Financial Report (AFR) for FY 2011 provides an overview of the Agency's financial and performance data to help Congress, the President, and the public assess SBA's stewardship over the resources entrusted to it. The AFR is the first in a series of three annual financial and performance reports for federal agencies choosing to produce a separate AFR. An Annual Performance Report (APR), and a Summary of Performance and Financial Information (SPFI) make up the other two reports. The FY 2011 APR, included as part of the FY 2013 Congressional Budget Justification (CBJ), which is the Agency's budget request to Congress, will be issued February 6, 2012; and the FY 2011 SPFI, which brings together in summary fashion the financial, performance and budgetary information presented in the AFR and the CBJ/APR, is to be released February 15, 2012.

# FY 2011 HIGHLIGHTS

| *(Dollars in Thousands)* | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|
| **Loan Portfolio[1]** | **$ 88,095,765** | **$ 90,451,263** | **$ 93,339,844** | **$ 99,203,933** |
| Regular FTE Employees | 2,094 | 2,098 | 2,135 | 2,175 |
| Disaster Employees | 1,436 | 1,743 | 1,120 | 1,141 |
| Total Employees | 3,530 | 3,841 | 3,255 | 3,316 |
| Total Assets | $ 12,448,215 | $ 12,626,459 | $ 15,230,476 | $ 16,882,801 |
| Total Liabilities | $ 12,114,085 | $ 15,315,059 | $ 16,765,021 | $ 17,191,824 |
| Total Net Position | $ 344,130 | $ (2,688,600) | $ (1,534,545) | $ (309,023) |
| Total Net Cost of Operations | $ 1,565,316 | $ 5,995,716 | $ 5,277,197 | $ 3,460,562 |
| Total Budgetary Resources | $ 9,110,054 | $ 12,337,055 | $ 18,340,769 | $ 19,277,292 |

[1] The total portfolio consists of guarantied loans outstanding, defaulted guarantied business loans receivable, direct disaster loans, and direct business loans receivable.

# FOR MORE INFORMATION

Information about SBA's programs is available at: www.sba.gov

SBA's plans and reports are available at: www.sba.gov/performance

Para información acerca de los programas de la SBA: www.sba.gov →"Translate" →"Select Language"

Requests for printed copies, or questions and comments regarding the content, presentation and usefulness of this report are welcome and may be addressed to: performancereports@SBA.gov

Or, you may write to:

U.S. Small Business Administration
Office of Performance Management
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## SBA's Mission

*The mission of the U.S. Small Business Administration is to maintain and strengthen the nation's economy by enabling the establishment and vitality of small businesses and by assisting in the economic recovery of communities after disasters.*

*Success Story*

**Bringing Advanced Medical Care to Underserved Communities**

Mobile Medical International Corporation, St. Johnsbury, Vermont

Rick Cochran had a dream – to bring advanced medical care to underserved areas in the U.S. and around the globe. Bolstered by his dream, in the early 1980s he combined his experience working at an advanced medical equipment provider with unshakable determination and founded Outpatient Services of America, Inc., a consulting firm specializing in planning and developing ambulatory surgery centers. Recently, the Vermont manufacturer was named 2011 National Small Business Person of the Year by SBA Administrator Karen Mills.

By 1994, OSA had evolved into Mobile Medical International Corporation, manufacturing state-of-the-art mobile healthcare units and military shelter systems for commercial, military, and emergency response applications worldwide. To date, MMIC has 22 mobile healthcare units in its commercial product line, as well as Mobile Breast Care Centers, Mobile Intensive Care, Mobile Laboratory/Pharmacy, Mobile CT Scan/Dental/Ophthalmology, Mobile Ophthalmology and Mobile Endoscopy Units.

Rick started MMIC with five employees working in the basement of his home in Walden, Vermont. Today, with financing support from several SBA-guarantied loans, MMIC has a staff of 54. Gross revenues for 2010 amounted to $14 million, and net profits rose from $9,835 in 2008 to $1.68 million in 2010. Rick encourages MMIC employees to participate in community events and frequently lends a hand either personally or through a donation to ensure the success of worthy local charitable causes.

# Message from the Administrator

November 15, 2011

I am pleased to present the U.S. Small Business Administration's (SBA) FY 2011 Agency Financial Report. The SBA has chosen to produce the Agency Financial Report as an alternative to the consolidated Performance and Accountability Report (PAR).

The SBA is committed to helping America's entrepreneurs and small business owners as they build their businesses and create jobs. This report details SBA's efforts in its mission to strengthen the nation's economy by enabling the establishment and vitality of small businesses and by assisting in the economic recovery of communities after disasters. The Agency continues to move forward with goals in areas such as access to capital, opportunities in government contracting, entrepreneurial development, and disaster assistance.

Key SBA accomplishments in FY 2011 include:

**Record in SBA lending:** The SBA increased overall lending supported from $22.4 billion in FY 2010 to $30.5 billion in FY 2011. This reflected the highest ever SBA lending year in the 60-year history of the Agency.

**Record in growth capital program:** Due to a reduction in licensing times and attraction of new funds in the Small Business Investment Company program, the SBA supported nearly $2.6 billion in overall financings to "high-growth" small businesses that drive net new job creation, a 63-percent increase from FY 2010.

**Increase in small business contracting in the federal government:** Through stronger efforts to coordinate and reach out to other federal agencies, the SBA worked with government agencies to increase the percentage of contracts going to small business from 21.9 percent (FY 2009) to 22.7 percent (FY 2010), just shy of the goal of 23 percent. (FY 2011 numbers are still coming in.)

**Increase in entrepreneurial education resources:** SBA's grant-funded resource partners continued to experience high demand for counseling and mentoring from entrepreneurs and small business owners, with over 1 million clients served in FY 2011.

**Optimized disaster assistance in record year:** The SBA quickly responded to over 300 disasters, a record number of SBA-declared disasters that included devastating tornadoes (Alabama and Missouri), floods (North Dakota), and hurricanes (Irene). The SBA approved over $700 million in loans to businesses and homeowners. Turnaround time on SBA disaster loan applications averaged less than 10 days.

I am pleased to provide an assurance that SBA's financial and performance data in this report are reliable and complete. SBA's auditor issued an unqualified opinion on our FY 2011 financial statements. The auditor did not note any material internal control weaknesses.

Sincerely,

Karen G. Mills

Karen G. Mills
Administrator

The Association of Government Accountants has awarded the U.S. SMALL BUSINESS ADMINISTRATION

## The Certificate of Excellence in Accountability Reporting

*In recognition of SBA's outstanding efforts in preparing its*

### Performance and Accountability Report
### or
### Agency Financial Report

for the fiscal years ended September 30, 2006, 2007, 2008, 2009, and 2010

2006

2007


2008

2009


2010

# Management's Discussion & Analysis

# Primer of SBA's Principal Programs

## Access to Capital (www.sba.gov/financialassistance)

*The SBA has a portfolio of $83.6 billion in the following programs:*

**7(a) Loan Guaranties** — The SBA offers government guaranties on loans (up to $5 million) made by commercial lenders to help expand access to capital for business owners who face challenges in getting approved for financing. The SBA guarantees a portion of 7(a) loans made and administered by commercial lending institutions. Loans can be guaranteed for a variety of general business purposes.

**504 CDC Loan Guaranties** — These are long-term, fixed-rate loans (up to $5.5 million) for major assets such as real estate and heavy equipment. Loans are delivered by certified development companies (CDC) which are private, non-profit corporations. CDCs work with the SBA and private lenders to provide the financing. The SBA guarantees a portion of these loans.

**Microloans** — These loans (up to $50,000) are designed for small businesses needing small scale financing and technical assistance for start-up or expansion. They are delivered through intermediary lenders, which are nonprofit community-based organizations with experience in lending and technical assistance.

**Surety Bonds** — A surety bond is a type of insurance that guarantees performance of a contract. If one party does not fulfill its end of the bargain, then the surety bond provides financial compensation to the other party. The SBA guarantees bonds issued by a surety company in order to encourage the surety company to provide bonds to small businesses.

## Opportunities in Contracting (www.sba.gov/contracting)

*The SBA leads federal efforts to deliver 23 percent of contracts to small business through the following programs:*

Procurement Assistance to Small Businesses — Small business contracts represent the largest form of direct monetary support for small business in the federal government. Within this goal are four sub-goals:

> **8(a) Business Development** — This program provides assistance to businesses owned and controlled by socially and economically disadvantaged individuals. Over the course of nine years, a firm is assisted in gaining resources to compete for federal contracts as well as in the private sector.
>
> **HUBZone** — This program provides sole-source and set-aside contracting for firms located in economically disadvantaged geographical areas.
>
> **Service-Disabled Veteran-Owned Small Businesses** — This program allows federal agencies to set-aside contracts for competition only among service-disabled veteran-owned small businesses.
>
> **Women-Owned Small Businesses** — This program allows federal agencies to set-aside certain contracts for competition only among small businesses owned and controlled by women.

## Access to Counseling and Training (www.sba.gov/training)

*The SBA and its 14,000 partners serve over 1 million small business clients a year through the following programs:*

**Small Business Development Centers** — SBDCs deliver an array of services to small businesses and prospective business owners using an extensive network of 63 lead centers managing more than 900 service delivery points throughout the U.S. and the insular territories. SBDCs deliver professional counseling and training in key management areas to more than 600,000 clients annually.

**Women's Business Centers** — WBCs provide counseling and training through 110 educational centers across the nation. They provide services on a vast array of topics, from how to write a business plan to programs specifically for veterans. Many WBCs provide multilingual services, and a number offer flexible hours allowing for mothers with children to attend training classes.

**SCORE** — SCORE is a non-profit association comprised of over 12,000 volunteer business counselors that serve entrepreneurs with in-person mentoring and local training workshops. As the largest volunteer business advisor network in the federal government, SCORE adapts its structure and services to meet the needs of the small business.

**Regional Innovation Clusters** — SBA offices and resource partners help lead regional innovation and jobs accelerator initiatives.

## High-growth Small Businesses (www.sba.gov/inv and www.sba.gov/oit)

*The SBA supports small businesses that drive net new job growth:*

**SBIR** — The Small Business Innovation Research program is a highly competitive program that stimulates high-tech innovation by reserving a specific percentage of federal R&D funds for small business. SBIR protects the small business and enables it to compete on the same level as larger businesses. (www.sbir.gov)

**SBIC** — Small Business Investment Companies are privately owned and managed investment funds that use their own capital plus funds borrowed with an SBA guaranty to make equity and debt investments in qualifying small businesses. (www.sba.gov/sbic)

**Exporting** — The SBA, through its staff, lending and resource partners, leads federal efforts to support small U.S. exporters through its international trade loans and counseling programs. (www.sba.gov/exporting)

## Disaster Assistance (www.sba.gov/disaster)

*The SBA has a portfolio of $7.5 billion in direct disaster loans to businesses, homeowners, and renters.*

**Disaster** — The SBA is the federal government's primary source of financing for the long term repair and rebuilding of disaster-damaged private property for homeowners, renters, businesses of all sizes, and private nonprofit organizations affected by disasters. It is the only form of SBA assistance not limited to small businesses.

*Success Story*

## Uniforms for the Troops!

Pentaq Manufacturing Corporation, Sabana Grande, Puerto Rico

Oscar Quiles cut his teeth in the military and occupational uniform manufacturing business during almost a decade working for his family's business, Caribbean Needlepoint, Inc. In 2003, after gaining support from the Puerto Rico Industrial Development Company, Quiles bought a company that was about to close, keeping all 50 employees on the payroll. In 2004, the company became Pentaq Manufacturing, specializing in commercial military clothing, military uniforms and related products. Today, the company has 160 employees and $3.2 million in revenues.

Pentaq is certified in the SBA's 8(a) Business Development program and its clients include the Department of Defense and the Coast Guard. The Department of Defense awarded Pentaq a $3.2 million contract to manufacture uniforms and tents for U.S. troops, and the company later produced universal uniforms that U.S. forces are now wearing in Afghanistan. The Coast Guard and DoD recently awarded $17.7 million in contracts to Pentaq to manufacture coats, shirts, trousers, bed nets and bags.

In October Oscar Quiles was named the National Minority Small Business Person of the Year by the SBA during the 29th annual Minority Enterprise Development (MED) Week conference in Washington, D.C. "We are honoring Oscar for his commitment to excellence in government contracting, for creating jobs and providing work incentives for his employees, and for manufacturing uniforms and tents for our men and women in the armed services, including the new universal uniforms our troops are now wearing in Afghanistan," said SBA Administrator Karen G. Mills. "Oscar's story is a true testimony of all that small businesses do for our nation and its economy."

*Did you know*

**The answers you need start here. SBA Direct gives you information and services based on your unique business needs. Find local resources, explore your programs and services, and achieve your business goals.**

**For more information, go to www.sba.gov/sba-direct.**

# Executive Summary

The U.S. Small Business Administration's (SBA) efforts to assist entrepreneurs and small business owners are critical as the U.S. economy continues to recover and grow. Throughout America's history, small businesses have played the leading role in job creation. More than half of working Americans own or work for a small business and small businesses are responsible for two out of every three net new private sector jobs created over the past decade.

The SBA helps strengthen America's economy by providing tools to help grow businesses and create jobs. These tools include access to capital; opportunities in federal contracting; access to entrepreneurial education and counseling; and disaster assistance for business owners, homeowners, and renters.

FY 2011 was the first year of a five-year Strategic Plan focused on three overarching goals:

1. *Growing businesses and creating jobs*
2. *Building an SBA that meets the needs of today's and tomorrow's small businesses*
3. *Serving as the voice for small business*

FY 2011 exhibited the highest ever SBA loan volume in the Agency's history. The SBA exhausted virtually all of its loan authority in FY 2011 ($24.5 billion in loans approved[1] or $30.5 billion in overall lending supported), attaining a 45 percent increase from FY 2010. Under the Small Business Jobs Act, over $10 billion was approved in the first quarter. Other drivers of lending volume included a larger number of new and returning SBA lenders, higher loan limits of $5 million, and increased size standards.

Notably, FY 2011 also reflected a record year for Small Business Investment Companies, a zero subsidy guaranty debenture program targeted at high-growth firms. Nearly $2.6 billion in overall debenture financings were supported, a 63 percent increase from FY 2010.

In FY 2011, the Agency continued to identify and fill critical gaps in the marketplace, such as smaller loans and loans to underserved communities, through the introduction of key access-to-capital initiatives such as Community Advantage, a 7(a) loan product, and others. Detailed analysis and modeling played a key role in ensuring that such efforts would help meet key policy goals while not adversely affecting financial performance. Simultaneously, the SBA aggressively worked to streamline and simplify lending and other Agency operations in order to improve financial performance while better serving SBA's partners and end customers, the most important of whom are entrepreneurs and small business owners.

## Financial Results

***(in-depth analysis found in Analysis of Financial Results section)***

For FY 2011, SBA's total budgetary resources, used for staffing and operations and subsidy costs, were $7.9 billion as well as nonbudgetary resources used to purchase guarantied loans in default and to make direct loans of $11.4 billion for loan financing. SBA's guarantied portion of the outstanding loan principal balance rose 8.7 percent in FY 2011 to $70 billion. The overall outstanding principal balance for loans made under SBA programs grew at 6.3 percent in FY 2011 to a new high of $99.2 billion. Growth in SBA's portion occurred primarily as a result of the popularity of the Small Business Jobs Act's temporary higher guaranty limits (90 percent) and fee reductions as well as its permanent provisions for higher loan size limits. Purchase rates and amounts for guarantied loans dropped significantly in FY 2011, falling from $5 billion to $3.4 billion. This encouraging trend is expected to continue in upcoming years as the country moves further into economic recovery. The credit program receivables portion of the SBA portfolio declined from $9.1 billion to $8.4 billion in FY 2011. Direct disaster loans accounted for $463 million of this decrease while an additional $256 million came from a net reduction from defaulted guarantied business loans. There were not any major disbursements of new direct disaster loans in FY 2011 resulting in the

1 "Loans approved" does not include the bank-approved portion (50%) of the 504 loans. "Lending supported" does.

decrease in disaster loan receivables in FY 2011. However, approvals of disaster loans increased towards the end of FY 2011 due to the spring floods in North Dakota and the tornadoes in Alabama and Missouri which will impact the receivables for FY 2012 when these loans are disbursed.

## Program Results

***(in-depth analysis found in SBA's Annual Performance Plan, to be released in February 2012)***

The *SBA by the Numbers* table (see following page) reflects increases across nearly all Agency programs in FY 2011. This includes:

- over 60,000 loans delivered to small businesses through its top two programs – 7(a) and 504;
- increases across other capital access programs, ranging from microloans that serve underserved businesses to small business investment companies that target high-growth small businesses;
- nearly $100 billion in federal contracts to small businesses (projected);
- service to over 1 million small businesses through SBA resource partners; and
- providing over $700 million in direct disaster loans to small businesses and homeowners.

## Management Results

In addition, the SBA achieved significant successes across its four High Priority Performance Goals, which were effective for FY 2010 and FY 2011:

1. **Increase number of active lenders 15 percent above FY 2008 and FY 2009 average to 3,000:** The SBA exceeded this goal, drawing 3,537 active bank, financial institution, and other approved lenders into its 7(a) loan guaranty program.
2. **Increase small business participation in federal government contracting to meet the statutory goal of 23 percent and reduce participation by ineligible firms:** FY 2010 continued an upward trend to 22.7 percent. Final results for FY 2011 will not be available until 3rd or 4th quarter FY 2012. However, based on preliminary data, the SBA expects to achieve its internal target for contracting, awarding 67.5 percent of all its contracts in FY 2011 to small businesses.
3. **Process 85 percent of home disaster loan applications within 14 days and 85 percent of business disaster loan applications within 18 days:** SBA's Office of Disaster Assistance exceeded this goal with 98 percent for home and 99 percent for business applications within these processing windows.
4. **Improve the Small Business Innovation Research (SBIR) program:** The SBA consolidated SBIR opportunities across 11 federal agencies by launching an interactive website for the program, www.SBIR.gov. The SBA also established a performance metric database for measures such as firm commercialization rate.

**Did you know**

What can SBA do for your small business? Meet the SBA 100. SBA 100 features one hundred businesses that have created at least 100 jobs since receiving SBA assistance. The 100 companies are from across America and do business in a variety of industries, from manufacturing, to food and beverage, to shipping. Each business received SBA support in the form of capital, counseling or investment before going on to create at least 100 jobs. Please take a look and check out the companies that together have created over 10,000 jobs since receiving SBA assistance at www.sba.gov/sba-100.

# SBA By The Numbers

| *(Dollars in Millions)* | | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|
| **Total Portfolio**[1] | **Outstanding Principal Balance** | **$ 88,096** | **$ 90,451** | **$ 93,340** | **$ 99,204** |
| **Capital**[2] | | | | | |
| 7(a) Loans | Dollars of Gross Loans Approved | $ 12,671 | $ 9,191 | $ 12,407 | $ 19,638 |
| | Numbers of Gross Loans Approved | 69,434 | 41,289 | 47,000 | 53,706 |
| 504 Loans | Dollars of Gross Loans Approved [3] | $ 5,290 | $ 3,834 | $ 4,433 | $ 4,845 |
| | Number of Gross Loans Approved | 8,883 | 6,608 | 7,833 | 7,983 |
| Microloans | Dollars of Gross Loans Approved for Micro borrowers | $ 31 | $ 35 | $ 45 | $ 47 |
| | Number of Gross Loans Approved for Micro borrowers | 2,682 | 2,727 | 3,795 | 3,991 |
| Surety Bond | Number of Bid and Final Bonds Guarantied | 6,055 | 6,135 | 8,348 | 8,638 |
| **Contracting**[4] | | | | | |
| Prime Contracting | Dollars of Annual Federal Contracts Awarded to Small Businesses | $ 93,306 | $ 96,834 | $ 97,947 | N/A |
| Prime Contracting (%)[5] | Percentage of Federal Contracts Awarded to Small Businesses | 21.5% | 21.9% | 22.7% | N/A |
| HUBZone | Dollars of HUBZone Contracts | $ 10,157 | $ 12,413 | $ 11,969 | N/A |
| 8(a) Program | Dollars of 8(a) Contracts | $ 16,173 | $ 18,670 | $ 18,466 | N/A |
| **Counseling and Training** | | | | | |
| SCORE | Number of Small Businesses Assisted | 360,559 | 380,357 | 407,240 | 356,837 |
| SBDC | Number of Small Businesses Assisted | 558,487 | 583,770 | 589,352 | 557,698 |
| WBC | Number of Small Businesses Assisted | 159,879 | 155,383 | 160,735 | 138,923 |
| **Disaster Assistance**[1] [2] | | | | | |
| | Dollars of Gross Loans Approved | $ 826 | $ 1,130 | $ 574 | $ 739 |
| | Number of Gross Loans Approved | 15,128 | 21,780 | 15,356 | 13,643 |
| **High-growth Small Businesses** | | | | | |
| SBIC | Dollars of Gross Financings Invested in Small Businesses[6] | $ 2,427 | $ 1,856 | $ 2,047 | $ 2,833 |
| | Number of Small Businesses Financed | 1,905 | 1,481 | 1,331 | 1,339 |

(1) The total portfolio consists of guarantied loans outstanding, defaulted guarantied business loans receivable, direct distaster loans, and direct business loans receivable.

(2) There are three basic ways to present loan data: Gross Loans Approved (the total loans approved); Net Loans Approved (gross loans approved plus any loan increases minus any cancellations); and, Disbursed Loans (the amount that is actually given to the borrower). Gross Loans Approved is presented in the Capital and Disaster Assistance part of the chart because it is the only loan data that remains constant.

(3) Lending Supported for 504 loans includes the SBA share and third party loans that are made by commercial lenders as part of the funding package. In FY 2011 gross approvals of $4.84 billion supported $10.9 billion in small business lending under the 504 Certified Development Company loan program.

(4) Federal agencies have not yet certified their FY 2011 data. The SBA expects to receive the FY 2011 certified data in the 3rd or 4th quarter of FY 2012.

(5) Currently, the federal goal is to give small businesses at least 23 percent of all government-wide contract dollars. The SBA negotiates the goals annually with each federal agency on an individual basis.

(6) This reflects totals for alll SBICs, including those that are no longer approving new funds (i.e., participating securities and specialized SBICs) but that have funds still actively investing.

# Management Information

## SBA's History and Organization

In 1953, Congress created the U.S. Small Business Administration to "aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns." SBA's headquarters is located in Washington, D.C. while its business products and services are delivered with the help of field personnel and a vast network of private sector and nonprofit partners in each U.S. state and territory. Major SBA offices fall under one of three Agency-wide strategic goals, as outlined in SBA's long-term Strategic Plan: [2]

***The SBA plays a vital role in enabling America's entrepreneurs and has stamped its mark on many small businesses that have grown to become household names and leaders in their fields. These firms include Nike, Staples, Apple, Federal Express, Hewlett Packard, and a host of others.***

### STRATEGIC GOAL ONE — GROWING BUSINESSES AND CREATING JOBS

*The Office of Capital Access* assists small businesses in obtaining capital via the 7(a), 504 and Microloan programs through an extensive lending network.

*The Office of Investments and Innovation* assists high-growth small businesses through the Small Business Investment Company program, the Small Business Innovation Research program, and other tailored programs that drive innovation and competitiveness.

*The Office of Government Contracting and Business Development* (GCBD) provides assistance to small businesses in competing for federal contracting opportunities through the government-wide prime and subcontracting programs. This includes HUBZone, 8(a), women-owned and veteran-owned small businesses. GCBD also sets size standards for small businesses which determine the size a business must be to be considered a small business.

*The Office of Entrepreneurial Development* provides business counseling and training through its resource partner network composed of small business development centers, women's business centers and SCORE, as well as through online training at SBA's website. In addition to coordinating connections between SBA resource partners and local small business communities, SBA's district offices provide business development services and support through the 8(a) program which complements and builds upon the assistance provided by SBA resource partners.

*The Office of Disaster Assistance* provides affordable, timely and accessible financial assistance to homeowners, renters and businesses following a disaster. The Disaster loan program is the only form of SBA assistance that is not limited to small businesses.

*The Office of International Trade* enhances the ability of small businesses to export and compete in the global marketplace by facilitating access to capital, providing technical assistance, ensuring the interests of small business are considered and reflected in trade negotiations, and supporting and contributing to the U.S. government's international commercial and economic agenda.

Across all of these offices is a focus on reaching underserved communities, which is a particular focus of the *Office of Veterans Business Development*, the *Office of Native American Affairs,* and the *Center for Faith-Based and Neighborhood Partnerships*.

### STRATEGIC GOAL TWO — BUILDING AN SBA THAT MEETS THE NEEDS OF TODAY'S AND TOMORROW'S SMALL BUSINESSES

SBA's management offices support Strategic Goal Two:

*The Office of Performance Management and the Chief Financial Officer* provides financial and performance data and information that is useful, relevant, timely and accurate and which assists the SBA and its executive team in maximizing program performance and accountability to taxpayers.

2 See CD - Supplementary Information.

*The Office of Credit Risk Management* focuses on mitigation of risk to taxpayers through ever-improving risk management and oversight of SBA lending programs.

*The Office of the Chief Information Officer* provides information technology leadership, product services, and operational support for the SBA in order to maximize internal efficiency and responsiveness to small businesses.

*The Office of Field Operations* works as the front line operating team for the SBA. Most SBA programs and services are executed when small businesses connect with their regional, district and branch field offices located in each state and territory.

*The Office of Communications and Public Liaison* communicates the Agency's programs and priorities to small businesses, their partners, and the public at large by working with media outlets, developing social media content, creating user-friendly online resources, crafting high quality marketing materials, organizing events to gain feedback from small businesses, and coordinating strategic partnerships.

Other offices include the *Office of Management and Administration, Congressional and Legislative Affairs*, the *Office of General Counsel*, the *Office of Hearings and Appeals*, the *Office of Human Capital Management*, and the *Office of Equal Employment Opportunity.*

### STRATEGIC GOAL THREE — SERVING AS THE VOICE FOR SMALL BUSINESS

All of SBA's management and program offices work together to support increasing interagency collaboration; reducing burdens on small business; and, providing current, accurate data statistics on small business to inform top level strategic decision-making.

Interagency Collaboration — To ensure effective delivery of programs and services, the SBA has made collaboration with other federal agencies a top priority. The SBA is the leading participant in interagency collaborations that focus on small business job creation including: access to capital; entrepreneurial education; innovation; government contracting; exporting; and entrepreneurship among underserved communities including women, minorities, veterans and others.

Reducing Burdens — The SBA works across the federal government to increase responsiveness to and opportunities for small businesses while also reducing regulatory burdens and excessive/unnecessary enforcement. The SBA fulfills these functions through an array of listening sessions and strategic partnerships as well as the *Office of the National Ombudsman*, which receives complaints and comments from small businesses and acts as a "trouble shooter" between small businesses and federal agencies.

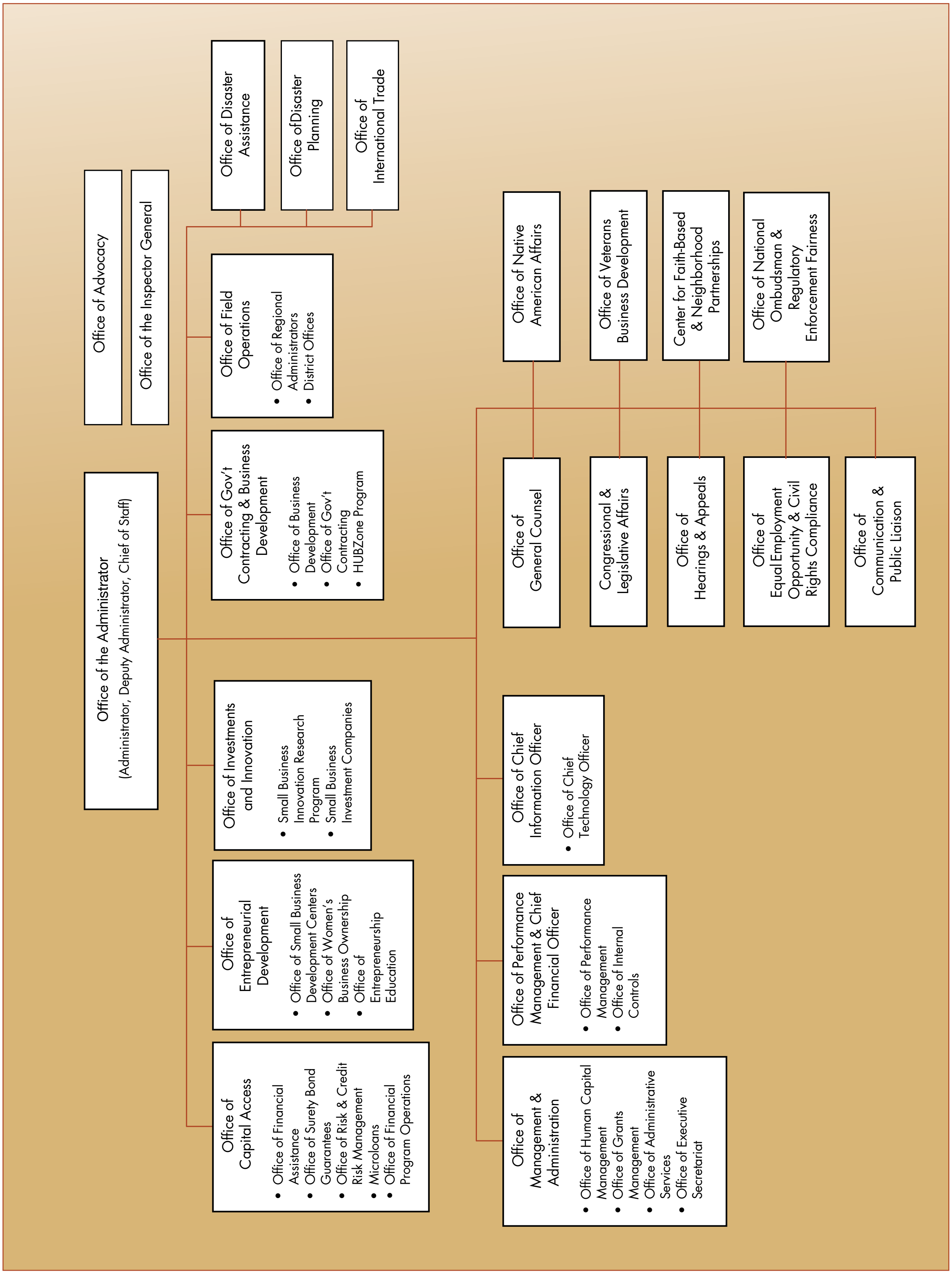
Statistics on Small Business — SBA's policy analysts are responsible for collecting data and statistics to help evaluate existing policies and programs of the SBA. They translate economic, social and demographic trends that have an impact on small business job creation into policy prescriptions that will allow the Agency to be as proactive as possible in anticipating and addressing the needs of small business.

**Did you know**

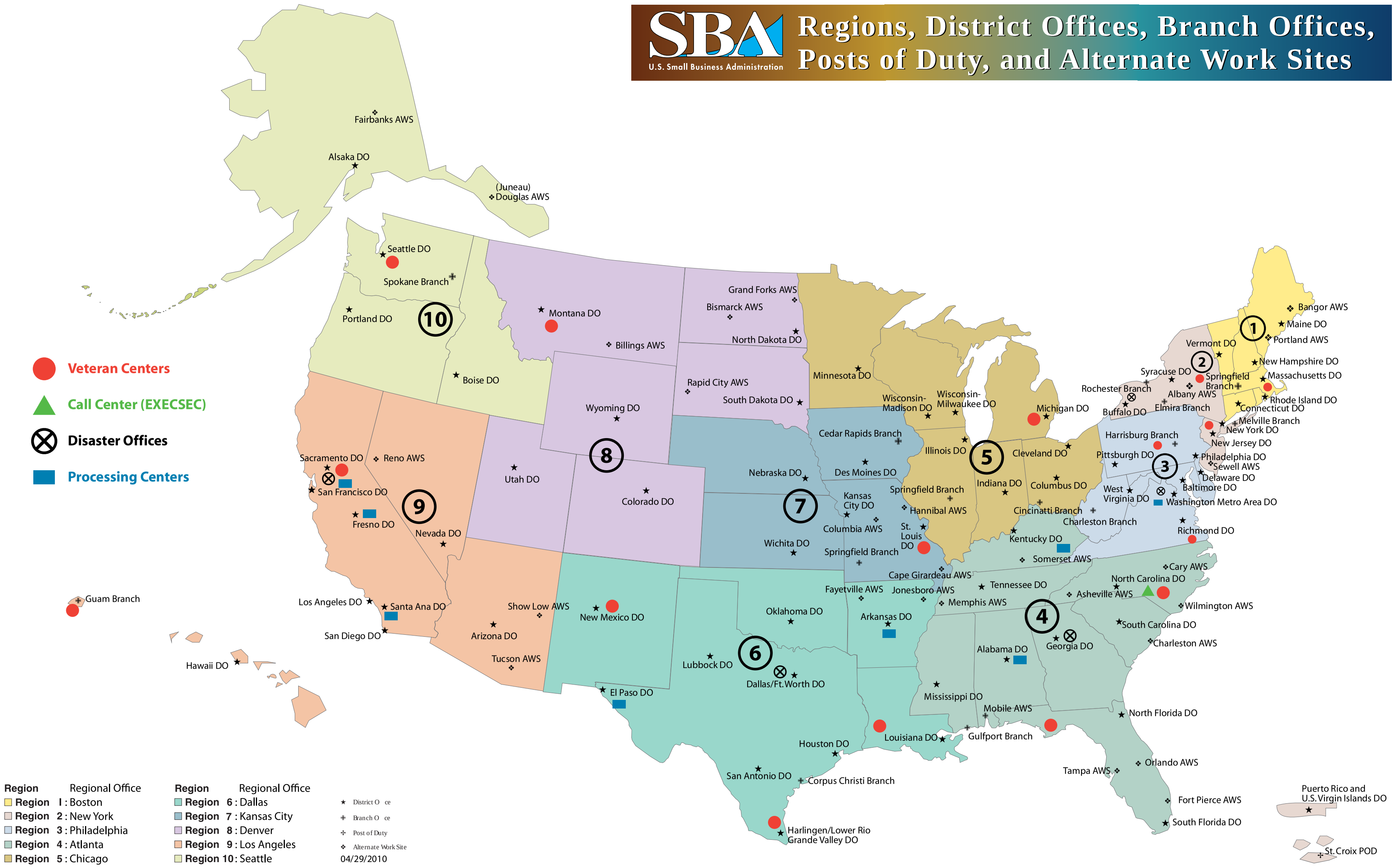
The *Export Business Planner* is a free, customizable tool for small business owners who are exploring exporting. Using the planner, you can work through the critical processes of export readiness and planning via a ready-made, easily accessible document that can be updated and referenced time and again as your export business grows.

For more information, go to www.sba.gov/exportbusinessplanner.

## SBA'S ORGANIZATION CHART



# Regions, District Offices, Branch Offices, Posts of Duty, and Alternate Work Sites

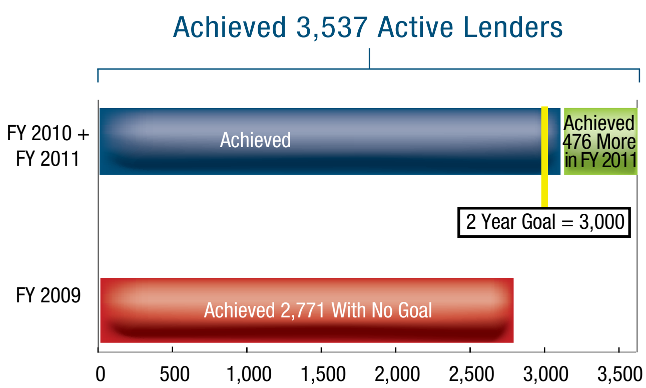


# Summary Performance Information

## HIGH PRIORITY PERFORMANCE GOALS

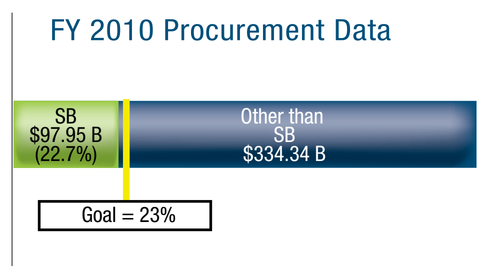
The SBA identified four performance goals that reflect the high priorities of SBA leadership and the Administration, and are critical to success in the strategic focus areas. These goals reflect the breadth and depth of SBA's commitment both to taxpayers and to the small business community. By actively pursuing these goals, the SBA strengthened its national contributions to entrepreneurship, innovation, and competitiveness. These were two-year goals measuring program efficacy for FY 2010 and FY 2011.

**HIGH PRIORITY PERFORMANCE GOAL #1** Expand access to capital by increasing the number of active SBA lending partners for the 7(a) loan program to 3,000 by September 30, 2011, a 15 percent increase over the FY 2008 and FY 2009 average. *The following chart shows that the SBA exceeded the two year goal by 18 percent.*



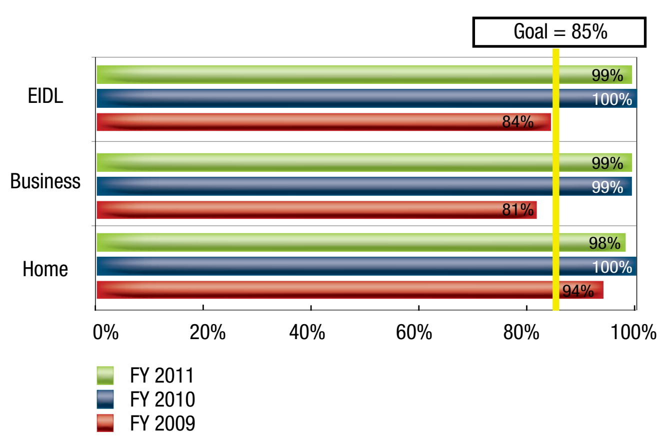

✓ ACHIEVED GOAL

**HIGH PRIORITY PERFORMANCE GOAL #2** Increase small business participation in federal government contracting to meet the statutory goals and reduce participation by ineligible firms. *The following chart shows that out of $432 billion of government contracts, small businesses received $98 billion or 22.7 percent of the federal goal. FY 2010 data show significant progress toward the 23 percent contracting goal.*




✓ SUBSTANTIALLY ACHIEVED

**HIGH PRIORITY PERFORMANCE GOAL #3** Process 85 percent of disaster loan applications for home and businesses within standard. *The following chart shows that the SBA in FY 2010 and FY 2011, unlike FY 2009, met and exceeded all disaster goals.*




✓ ACHIEVED GOAL

**HIGH PRIORITY PERFORMANCE GOAL #4** Improve the Small Business Innovation Research program (SBIR) by (1) deploying an improved data collection and reporting system, including implementing performance metrics, (2) implementing more systematic monitoring for fraud, waste and abuse, and (3) improving commercialization from existing program awards.

The SBIR is a high profile and highly effective program. It is a catalyst for long-term job growth by providing opportunities for innovative companies with high-growth potential and ensures that the nation's small, high tech, innovative businesses are a significant part of the federal government's research and development efforts. All milestones for this High Priority Performance Goal have been achieved on target. The creation of these four performance indicators was one of the milestones: (1) Commercialization Rate for SBIR Awardees (%); (2) Number of Patents; (3) Additional outside Investment Received; and (4) Small Businesses Assisted in Underserved Markets. These indicators are excellent first steps to measuring and tracking the accomplishments of this progressive cutting-edge program.

✓ ACHIEVED GOAL

## PERFORMANCE INFORMATION ON KEY SBA PROGRAMS

The following table presents key SBA FY 2011 performance data from **Strategic Goal 1 - Growing businesses and creating jobs**. Although the SBA has three Strategic Goals, an analysis has determined that 98 percent of all SBA costs are associated with Strategic Goal 1. Therefore, only Strategic Goal 1 performance indicators are presented here. The presentation of the performance indicators is by Strategic Objectives which follows SBA's Strategic Plan adopted in FY 2011. Detailed performance information on all SBA programs will be presented, and all variances explained, in the FY 2013 Congressional Budget Justification and FY 2011 Annual Performance Report which will be submitted February 6, 2012.

**Strategic Objective 1.1 – Expand Access to capital through SBA's extensive lending network.**

### Capital

| Program | Performance Indicator[1] | Type of Indicator | FY 2007 Actual | FY 2008 Actual | FY 2009 Actual | FY 2010 Actual | FY 2011 Target | FY 2011 Actual | FY 2011 Variance |
|---|---|---|---|---|---|---|---|---|---|
| 7(a) and 504 | Lending Supported ($ Billions)[1] | Output | $28.5 | $24.6 | $17.8 | $22.4 | $23.5 | $30.5 | 30% G |
| 7(a), 504, Microloan, and SBG | Jobs Supported[2] | Outcome | 918,061 | 713,574 | 514,035 | 583,737 | 583,800 | 700,746 | 20% G |

(1) Lending Supported includes gross approvals in the 7(a) loan program, gross approvals in the 504 loan program, and third party loans that are made by commercial lenders as part of the 504 funding package.
(2) Job supported numbers are self-reported by the borrower and appear in the SBA loan application form. A filter was applied to reduce outliers and jobs associated with cancelled loans.

**Strategic Objective 1.2 - Ensure federal contracting goals are met or exceeded by collaborating across the federal government to expand opportunities for small businesses and strengthen the integrity of the federal contracting certification process and data.**

### Contracting

| Program | Performance Indicator[3] | Type of Indicator | FY 2007 Actual | FY 2008 Actual | FY 2009 Actual | FY 2010 Target | FY 2010 Actual | FY 2010 Variance |
|---|---|---|---|---|---|---|---|---|
| Prime Contracting | Percent of Federal Contract Dollars Awarded to Small Businesses | Outcome | 22.0% | 21.5% | 21.9% | 23.0% | 22.7% | -1% Y |

(3) The data supporting these indicators are not finalized until the 3rd or 4th quarter of the next year. Therefore, prior year numbers are reported.

**Strategic Objective 1.3 - Strengthen SBA's entrepreneurial education, counseling and training resources to help create new businesses and support the needs of existing businesses by successfully focusing on core program resources and ensuring these resources are aligned with the needs of both Main Street and high-growth small businesses.**

### Counseling and Training

| Program | Performance Indicator | Type of Indicator | FY 2007 Actual | FY 2008 Actual | FY 2009 Actual | FY 2010 Actual | FY 2011 Target | FY 2011 Actual | FY 2011 Variance |
|---|---|---|---|---|---|---|---|---|---|
| SBDC, WBC, and SCORE | Small Businesses Assisted (#)[4] | Output | 1,083,904 | 1,078,925 | 1,119,510 | 1,157,327 | N/A | 1,053,458 | N/A |
| SBDC, WBC, and SCORE | Small Businesses Created (#) | Outcome | 9,031 | 14,400 | 14,201 | 15,831 | 14,200 | 15,181 | 7% G |

(4) SBDCs do not have a target for small businesses assisted.

**Strategic Objective 1.4 - Ensure that SBA's disaster assistance resources for businesses, non-profit organizations, homeowners, and renters can be deployed quickly, effectively and efficiently in order to preserve jobs and help return small businesses to operation.**

### Disaster Assistance

| Program | Performance Indicator | Type of Indicator | FY 2007 Actual | FY 2008 Actual | FY 2009 Actual | FY 2010 Actual | FY 2011 Target | FY 2011 Actual | FY 2011 Variance |
|---|---|---|---|---|---|---|---|---|---|
| Disaster | Average Processing Days for Business Applications | Output | 11 | 11 | 14 | 10 | 18 | 10 | 44% G |
| Disaster | Average Processing Days for Home Applications | Output | 7 | 6 | 6 | 8 | 14 | 8 | 43% G |
| Disaster | Customer Satisfaction Rate for Approvals (%) | Outcome | 66% | 65% | 72% | 74% | 71% | 80% | 13% G |

**Strategic Objective 1.5 – Strengthen SBA's relevance to high-growth entrepreneurs and small businesses to more effectively drive innovation and job creation through both the Agency's existing programs as well as new initiatives.**

### High-growth Small Businesses

| Program | Performance Indicator | Type of Indicator | FY 2007 Actual | FY 2008 Actual | FY 2009 Actual | FY 2010 Actual | FY 2011 Target | FY 2011 Actual | FY 2011 Variance |
|---|---|---|---|---|---|---|---|---|---|
| SBIC | Debentures Deployed by SBA ($ Millions) | Output | $708 | $1,029 | $788 | $1,165 | $1,352 | $1,827 | 35% G |

G — The Actual result meets or exceeds target.
Y — The Actual result is within 10% or less of the target.
Y — The Actual result is less than 90% of target.

# Analysis and Highlights of Financial Statements and Results

## Highlights of Financial Results (September 2011)

*(Dollars in Thousands)*

| At End of Fiscal Year | FY 2011 | FY 2010 | % Change |
|---|---|---|---|
| **CONDENSED BALANCE SHEET DATA** | | | |
| Fund Balance with Treasury | $ 8,469,322 | $ 6,116,325 | 38.47% |
| Credit Program Receivables | 8,354,739 | 9,076,679 | -7.95% |
| All Other Assets | 58,740 | 37,472 | 56.76% |
| **Total Assets** | **$ 16,882,801** | **$ 15,230,476** | **10.85%** |
| Liability for Loan Guaranties | 4,741,442 | 4,467,006 | 6.14% |
| Debt with Treasury | 11,190,279 | 11,753,781 | -4.79% |
| Downward Reestimate Payable to Treasury | 911,765 | 130,993 | 596.04% |
| All Other Liabilities | 348,338 | 413,241 | -15.71% |
| **Total Liabilities** | **17,191,824** | **16,765,021** | **2.55%** |
| Unexpended Appropriations | 1,537,185 | 2,295,070 | -33.02% |
| Cumulative Results of Operations | (1,846,208) | (3,829,615) | 51.79% |
| **Total Net Position** | **(309,023)** | **(1,534,545)** | **79.86%** |
| **Total Liabilities and Net Position** | **$ 16,882,801** | **$ 15,230,476** | **10.85%** |
| | | | |
| **For the Fiscal Year** | | | |
| **STATEMENT OF NET COST BY STRATEGIC GOAL** | | | |
| Goal 1: Growing Businesses and Creating Jobs | | | |
| Loan Subsidy Cost Including Reestimates | $ 2,559,524 | $ 4,402,085 | -41.86% |
| All Other Costs Net of Revenue | 744,627 | 771,611 | -3.50% |
| Goal 2: Building an SBA that Meets the Needs of Today's and Tomorrow's Small Business | 6,132 | 5,343 | 14.77% |
| Goal 3: Serving as the Voice for Small Business | 13,454 | 12,738 | 5.62% |
| Costs Not Assigned | 136,825 | 85,420 | 60.18% |
| **Total Net Cost of Operations** | **$ 3,460,562** | **$ 5,277,197** | **-34.42%** |
| | | | |
| **CONDENSED STATEMENT OF NET POSITION** | | | |
| Beginning Cumulative Results of Operations | $ (3,829,615) | $ (4,672,104) | 18.03% |
| Total Financing Sources | 5,443,969 | 6,119,686 | -11.04% |
| Less: Net Cost of Operations | 3,460,562 | 5,277,197 | -34.42% |
| **Ending Cumulative Results** | **(1,846,208)** | **(3,829,615)** | **51.79%** |
| Beginning Unexpended Appropriations | 2,295,070 | 1,983,504 | 15.71% |
| Total Budgetary Financing Sources | (757,885) | 311,566 | -343.25% |
| **Ending Unexpended Appropriations** | **1,537,185** | **2,295,070** | **-33.02%** |
| **Ending Net Position** | **$ (309,023)** | **$ (1,534,545)** | **79.86%** |
| | | | |
| **CONDENSED STATEMENT OF BUDGETARY RESOURCES** | | | |
| Net Appropriations & Budget Authority Received, Budgetary | $ 5,611,644 | $ 6,554,119 | -14.38% |
| Spending Authority from Offsetting Collections | 8,768,637 | 8,218,384 | 6.70% |
| Unobligated Balances Forward | 5,226,984 | 2,701,923 | 93.45% |
| Borrowing Authority | 1,078,132 | 2,737,959 | -60.62% |
| Other Budgetary Resources, Net | (1,408,105) | (1,871,616) | -24.77% |
| **Total Budgetary Resources** | **$ 19,277,292** | **$ 18,340,769** | **5.11%** |
| Obligations Incurred, Budgetary | $ 6,919,443 | $ 6,598,610 | 4.86% |
| Obligations Incurred, Nonbudgetary | 4,973,564 | 6,515,175 | -23.66% |
| Unobligated Balances, Available and Unavailable | 7,384,285 | 5,226,984 | 41.27% |
| **Total Status of Budgetary Resources** | **$ 19,277,292** | **$ 18,340,769** | **5.11%** |

## Analysis of Financial Results

The SBA prepares its financial statements as a critical aspect of ensuring accountability and stewardship for the public resources with which it is entrusted. The financial statements are prepared in accordance with guidance issued by the Office of Management and Budget pursuant to the Chief Financial Officers Act of 1990. While these statements have been prepared from SBA's books and records in accordance with generally accepted accounting principles for federal entities and the formats prescribed by OMB, they are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities presented herein cannot be liquidated without the enactment of appropriations, and ongoing operations are subject to the enactment of future appropriations.

This analysis is intended to help readers understand the Agency's financial results, position and condition as portrayed in the principal financial statements and notes. It explains major changes in assets, liabilities, costs, and budgetary resources; includes comparisons of the current year to the prior year; and discusses the relevance of particular balances and amounts reflected in the principal financial statements and notes. This section also depicts trends via the use of charts and graphs to further understanding of the financial condition and results of the Agency. The SBA is primarily a credit agency and therefore the trends and financial condition of credit program receivables and reestimates are emphasized in this analysis. The Highlights of Financial Results table provides a condensed summary of the balances in the financial statements for the current and prior year and the percentage change.

The Operational Portfolio Analysis section in this MD&A discusses in some detail the major trends impacting SBA's portfolio of loan guaranties and receivables. The purpose of this section is to provide an operational analysis of SBA's credit programs rather than a financial statement analysis. As a result, the definitions of the loan and guaranty balances in the Portfolio Analysis section may differ somewhat from the balances used in this Analysis of Financial Results. For example, for the 7(a) program the total amount of guarantied loans is used in the Portfolio Analysis, where only SBA's guarantied portion is used in the Analysis of Financial Results, as it ties to balances in the financial statements.

### BACKGROUND

Most of SBA's available budgetary resources are devoted to its credit programs. For FY 2011 SBA's budgetary resources were $7.9 billion, and nonbudgetary resources in the loan financing funds were $11.4 billion making total resources $19.3 billion. The apportioned budgetary resources are the amounts available to enter into new obligations and to liquidate them. Budgetary resources are made up of new budget authority and unobligated balances of budget authority provided in previous years. The loan financing funds are nonbudgetary accounts that record all the cash flow activity resulting from post 1991 direct loans and loan guaranties. This activity in the financing account is reported separately in the Budget of the United States Government and is excluded from the budget surplus/deficit totals.

The portion of the outstanding principal guaranteed by the SBA as of September 30, 2011 was $70 billion. This amount is up 8.66 percent from the $64.4 billion guaranteed at September 30, 2010, increasing the portfolio. New guaranties disbursed by SBA participating banks during FY 2011 were up 26.12 percent compared to FY 2010 (see Note 6C in the financial statements for further detail on loans disbursed and outstanding at year-end). **Chart I** depicts the increase in guarantied loans disbursed during FY 2011 to a record level. The American Recovery and Reinvestment Act provided for SBA guarantied loans having reduced fees and increased guaranty percentages. On September 27, 2010, the President signed the Small Business Jobs Act of 2010 that provided $505 million of additional appropriations to temporarily extend the Recovery Act fee relief and guaranty percentage provisions. The Small

Business Jobs Act also raised the maximum loan amounts under several SBA programs. For example, for the 7(a) loan program the limit increased from $2 million to $5 million. These efforts, combined with SBA outreach to increase the strength and number of SBA lenders overall, resulted in $30.5 billion of SBA lending support during FY 2011, an all-time record level for SBA lending in the history of the Agency. This upward trend of guarantied loans disbursed (as a result of increased loan approval volume) since FY 2009 is reflected in Chart I. **Chart II** depicts the monthly disbursements of guarantied loans during FY 2011. As reflected in the chart, there is an increase in the beginning of FY 2011 and also in September 2011. The funding for fee relief and higher percentage guaranties provided by the Small Business Jobs Act enhancements ended as the calendar year closed, and therefore the highest volume of loans disbursed were in the early part of 2011. Loans disbursed continued at a high monthly pace throughout the year, even after funds expired.

**CHART I GUARANTIED LOANS DISBURSED**

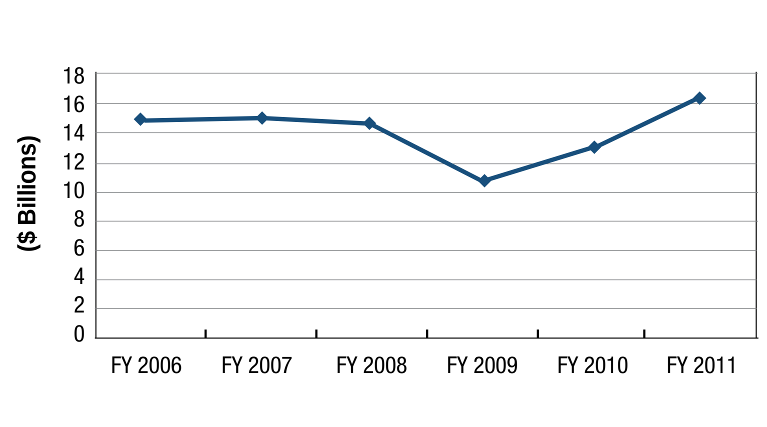
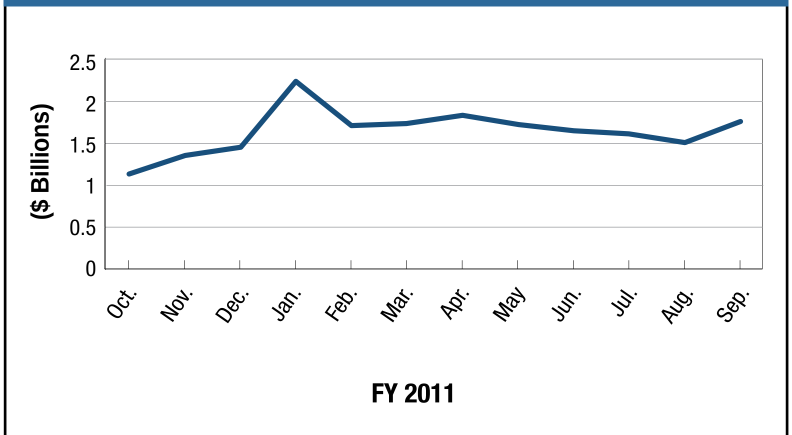


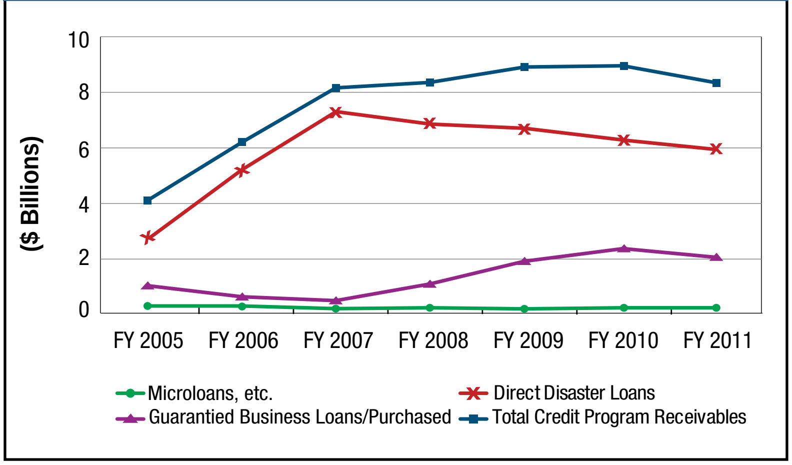

**CHART II GUARANTIED LOANS DISBURSED MONTHLY**




SBA's total portfolio of loan guaranties and receivables continued to grow in FY 2011 due primarily to increases in the record guarantied loan approval volume as well as continued high purchases of guarantied business loans. The total portfolio consists of guarantied loans outstanding, purchased guarantied business loans receivable, direct disaster loans, microloans and other direct business loans receivable.

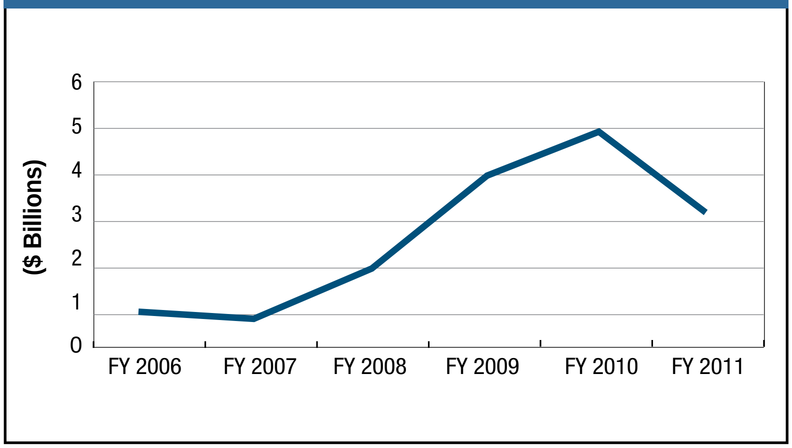
Credit program receivables for the SBA are comprised of business and disaster direct loans and guarantied business loans purchased per the terms of SBA's loan guaranty programs which are offset by an allowance for subsidy. These credit program receivables were valued at $8.4 billion in FY 2011, which was a decrease from FY 2010. As reflected in **Chart III**, the biggest changes in the credit program receivables included a reduction in the direct disaster loans of $463 million as well as a decrease in the purchased guarantied business loans of $258 million. The credit program receivables decreased in direct disaster loans because there were no major recent disasters for which the SBA is currently disbursing new loans. However, at the end of FY 2011 there was a significant increase in approvals of disaster loans (reflected in Note 6C, outstanding loan obligations Disaster loan program) that increased the outstanding loan obligations from $217.5 million to $427.2 million. This increase was due to the flooding disasters in North Dakota, South Dakota and other parts of the country and also to the tornadoes in Alabama and Missouri. In FY 2012 the SBA expects to see an increase in the disbursement activity for these loans and an increase in the credit program receivables. The credit program receivables for purchased guarantied loans, net of the allowance, decreased because even though the purchased business loans receivable increased $448 million (due to net increase in purchases offset by collections and write offs) the allowance/offset against these receivables increased $706 million.

**CHART III** TOTAL CREDIT PROGRAM RECEIVABLES




As reflected in **Chart IV**, the increase in purchased guarantied business loans receivable was due to the continued effect of the economic recession. However, purchases of SBA's share of guarantied loans decreased from $4.9 billion in FY 2010 to $3.4 billion in FY 2011, reflecting an improvement in current economic conditions. The SBA expects this downward trend in purchases to continue into FY 2012.

**CHART IV** PURCHASES OF GUARANTIED LOANS




SBA's assets and liabilities result primarily from its credit program activities. They consist of Fund Balance with Treasury, credit program receivables, liabilities for loan guaranties, and Debt with Treasury. SBA's loans and guaranties are financed by a combination of subsidy appropriations, fees charged to lenders and borrowers, and borrowings from Treasury. Congress provides appropriations to cover the estimated long-term costs of SBA's disaster and direct business loans, while SBA's guarantied business loan program costs are largely financed through fees. These costs are defined as the net present value of the estimated cash outflows and inflows associated with the loans. The remaining portion of each new direct loan disbursed is financed by borrowings from Treasury's Bureau of the Public Debt. Borrowings are repaid to Treasury as loans are repaid to the SBA.

## FINANCIAL POSITION

### Assets

The SBA had total assets of $16.9 billion at the end of FY 2011, up 10.9 percent from FY 2010. Assets increased primarily due to a $2.4 billion increase in the Fund Balance with Treasury partially offset by a $722 million decrease in Credit Program Receivables. The Fund Balance with Treasury increased primarily in the Loan Guaranty Financing Fund ($2.9 billion). This increase consisted primarily of the collection of the prior year upward subsidy reestimate as well as FY 2011 subsidy ($5.2 billion), collection of fees ($628 million), and collections on loans of $1 billion. This increase was partially offset by purchases of guarantied loans in FY 2011 ($3.4 billion). The decrease in the Credit Program Receivables is due to the reduction in the Direct Disaster loans portfolio as well as the Purchased

Guarantied Business Loans previously discussed. Per the provisions of the Federal Credit Reform Act of 1990, credit program receivables are valued at the present value of expected future cash flows.

### Liabilities

The SBA had total liabilities of $17.2 billion at the end of FY 2011, up 2.6 percent from FY 2010. Liabilities consist primarily of the Liability for Loan Guaranties, Downward Reestimate Payable to Treasury, and Debt with Treasury. The Liability for Loan Guaranties is defined as the estimate of the net present value of the future amount the SBA will pay, net of fee collections, to liquidate expected purchases of guarantied loans under its guarantied loan programs. The Liability for Loan Guaranties increased $274.4 million primarily due to the year-end reestimate as well as subsidy and fees collected (offset partially by claim payments). There was a net upward re-estimate of $1.8 billion for the loan guaranty programs at September 30, 2011. Reference the following Results of Operations section which discusses the impact of the reestimates and the chart in Note 6E of the financial statements which reconciles this account.

The Downward Reestimate Payable to Treasury increased $780.8 million primarily due to the year-end accrual of the SBIC Participating Securities downward reestimate. Reestimates are revisions of the subsidy cost estimate based on information about the actual performance and/or estimated changes in future cash flows of the cohort. A downward reestimate indicates that too much subsidy had been paid to the financing account and this will be returned to Treasury the following year. The SBIC Participating Securities downward reestimate was mostly due to lower than projected purchases and higher than projected recoveries during FY 2011, as well as a decrease in projected purchases and an increase in projected recoveries for the remaining years within the cohorts. Lower than average purchases during FY 2011 decreased the overall purchase curve, in turn decreasing purchase projections in future years and contributing to a downward reestimate for FY 2011.

Debt with Treasury decreased $563.5 million as SBA's repayments of borrowings were greater than the borrowings in FY 2011 (in FY 2010 the SBA borrowed funds to cover purchases of defaulted guarantied loans due to an unexpected surge in purchases as a result of the continued effect of the economic recession). Please refer to Note 9.

### Net Position

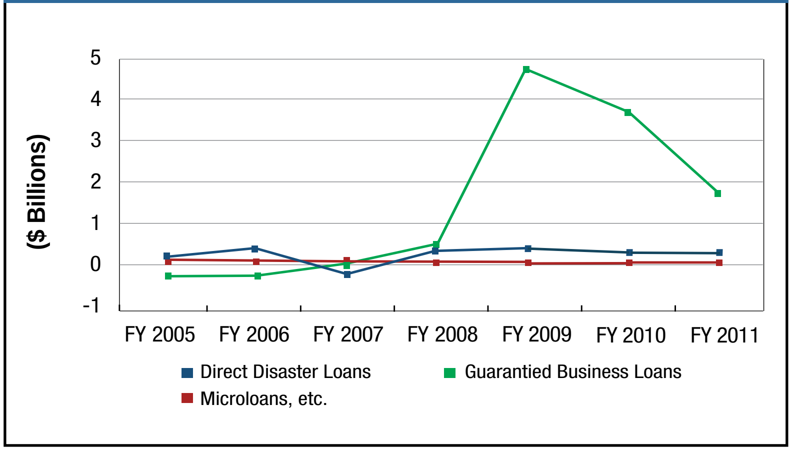
Net position, which is the sum of Unexpended Appropriations and Cumulative Results of Operations, increased in FY 2011 to a $309 million credit. Cumulative Results of Operations is the accumulated difference between expenditures and financing sources since the inception of the Agency. The loss shown as Cumulative Results of Operations decreased to $1.85 billion at the end of FY 2011, from $3.83 billion in FY 2010 due to a decrease in unfunded upward subsidy reestimates in FY 2011 on the 7(a) loan guaranty, 504, and the SBIC participating securities programs. These unfunded upward reestimate expenses do not yet have a financing source at year-end and are funded in the following year. They increase the loss that the SBA reports in the Cumulative Results of Operations.

Unexpended Appropriations decreased $757.9 million this year because the appropriations used were greater than the appropriations received in FY 2011. This is primarily due to funding in the Small Business Jobs Act on September 27, 2010 that provided $697.5 million of additional appropriations to the SBA. These funds were appropriated in FY 2010 but not disbursed until FY 2011, increasing FY 2010 Unexpended Appropriations balance.

### Results of Operations

The Results of Operations primarily reflects the costs of SBA credit programs from subsidy expenses during the year for new loans and subsidy reestimates at year-end. The credit subsidy cost is the net present value of expected cash inflows and outflows over the life of a guarantied loan, or the

**CHART V** CREDIT PROGRAM SUBSIDY REESTIMATES




difference between the net present value of expected cash flows and the face value of a direct loan. The SBA receives appropriations annually to fund its credit programs. When loans are disbursed, the SBA records subsidy expense. In accordance with the Federal Credit Reform Act, the subsidy costs are reestimated annually. Reestimates update original loan program cost estimates to reflect actual experience and changes in forecasts of future cash flows. Increased reestimated costs are funded in the following year by permanent indefinite authority, while decreased costs are returned by the SBA to a Treasury general fund. During FY 2011, the net upward reestimated costs for the 7(a) and 504 programs decreased, and there was a change from a net upward reestimate to a net downward in the SBIC participating security program compared to FY 2010. Those decreases were the largest components of the change (net decrease) in the Agency's net cost. **Chart V** reflects the decreases in the reestimates for the Disaster direct programs as well as the guarantied business loan program from FY 2010 to FY 2011.

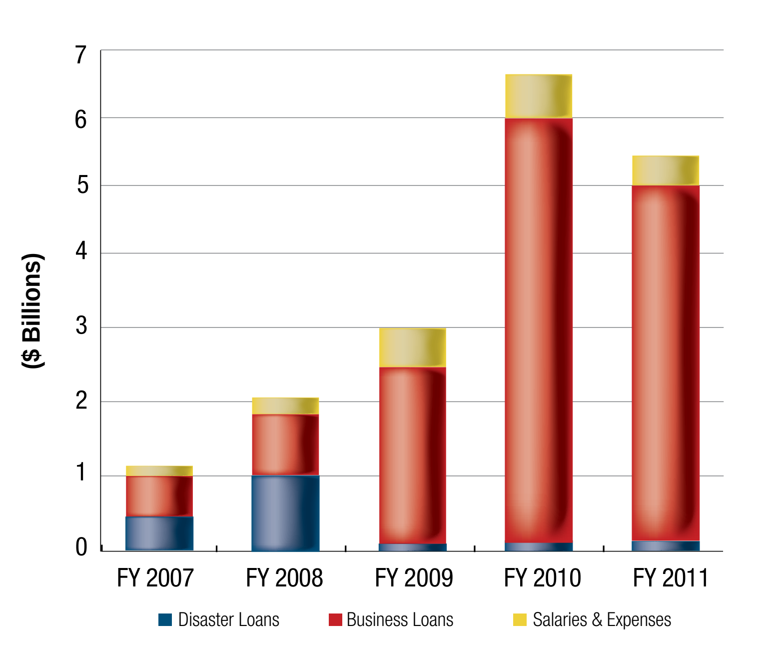
While there were still significant upward reestimates in both of those programs (composing the majority of the FY 2011 Net Cost), the upward reestimates were less than in FY 2010. Strategic Goal 1 includes significant upward reestimates in the 7(a) loan guaranty program and the 504 CDC program, as well as a significant downward reestimate in the SBIC participating securities program.

The 7(a) loan guaranty program, SBA's flagship and largest program, had a net upward reestimate in FY 2011 of $1,235.7 million. A significant portion of the reestimate is due to updated model assumptions, which resulted in increased purchase projections for the remaining years within the cohorts. The remainder of the reestimate is due to the difference between the actual and forecasted performance during FY 2011.

Similarly, the 504 CDC program had a net upward reestimate of $1,063.8 million. While the 2009 and 2010 cohorts performed better than expected in FY 2011, many earlier cohorts performed worse. The majority of the reestimate was due to updated model assumptions, which will allow for more accurate projections of future cash flows. These updated assumptions resulted in increased purchase projections for the remaining years within the cohorts. The remainder of the reestimate was mostly due to higher than projected purchases in FY 2011, in particular for cohorts 2006 and 2007.

The SBIC Participating Securities program had a net downward reestimate of $757.5 million. The reestimate was mostly due to lower than projected purchases and higher than projected recoveries during FY 2011. The remaining reestimate amount was due to a decrease in projected purchases and an increase in projected recoveries for the remaining years within the cohorts. Poor economic conditions in recent years, as well as SBA's decision to liquidate poor performing SBICs in an expedited manner, caused an increase in purchases in FY 2009 and FY 2010 that led to upward reestimates in those years. The increase in purchases in FY 2009 and FY 2010 also increased projections of purchases in future years. Furthermore, funds that were adversely impacted by the weak economy were liquidated during FY 2009 and FY 2010, and fewer poor performers were remaining during FY 2011. This caused purchases to be lower than projected, contributing to the downward reestimate for FY 2011.

CHART VI APPROPRIATIONS RECEIVED




## Budgetary Resources

Total Budgetary Resources increased $937 million from FY 2010 to FY 2011. This increase consists of increases in Spending Authority from Offsetting Collections and Unobligated Balance Forward offset by decreases in Appropriations Received and Borrowing Authority. Spending Authority increased $550 million from FY 2010 to FY 2011. The increase in Spending Authority is primarily in the loan guaranty financing fund and is due to the increase in collection of fees and loan collections. In FY 2010 fees were waived as part of the Recovery Act and fee collections were low. In FY 2011, after the Jobs Act fee reductions ended in December 2010, fee collections increased (and the guaranty accounts receivables correspondingly increased). Unobligated Balance Forward increased $2.5 billion from FY 2010 to FY 2011. The increase of the Unobligated Balance Forward reflects that the ending unobligated balance of FY 2010 is higher than the ending unobligated balance of FY 2009. The SBA received Jobs Act funding in September 2010 and received funding for the FY 2009 subsidy upward reestimates during FY 2010, resulting in a higher ending unobligated balance at the end of FY 2010.

Borrowing Authority decreased $1.7 billion from FY 2010 to FY 2011. Borrowings were unusually high in FY 2010 to fund high levels of default claims in FY 2010 (consistent with higher amount of purchases in FY 2010). This decrease in borrowing authority in FY 2011 is consistent with the decrease in purchases and obligations incurred in the guaranty financing fund.

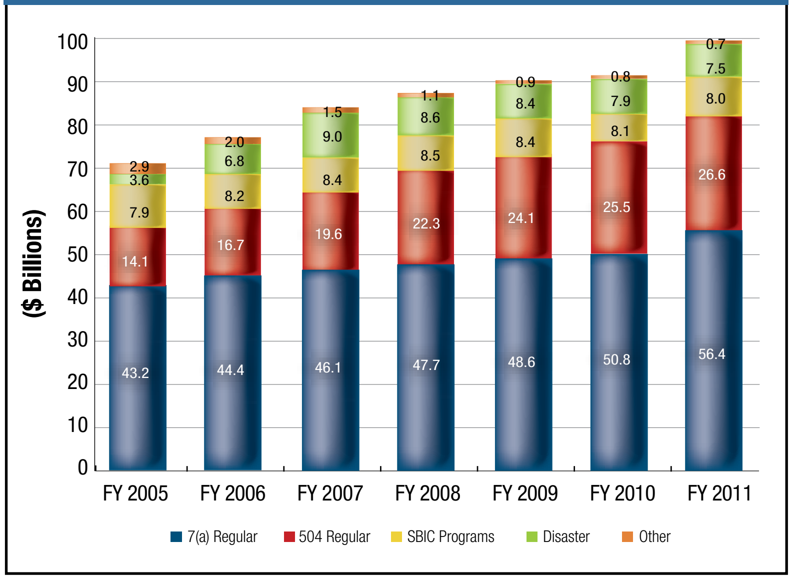
Appropriations Received decreased $942 million from FY 2010 to FY 2011. The decrease is due to the Small Business Jobs Act of 2010 funding of $697 million that was received in FY 2010 and increased the budgetary resources in FY 2010. **Chart VI** depicts that the substantial decrease in Appropriations Received is for business loans due to the passage of the Jobs Act in FY 2010.

## Status of Budgetary Resources

Total Status of Budgetary Resources increased $937 million from FY 2010 to FY 2011. This increase consisted of an increase in unobligated balance of $2.16 billion partially offset by a decrease in obligations incurred of $1.22 billion. Obligations decreased in the nonbudgetary financing funds $1.5 billion. This is primarily due to a decrease in default claims paid (purchases) of $1.6 billion in the loan guaranty financing fund offset partially by an increase in obligations in the disaster financing fund. The decrease of default claims is consistent with the drop in purchases of defaulted loans in FY 2011. The increase in the obligations in the direct loan financing fund is due primarily to the flooding disaster in North Dakota in FY 2011 which resulted in an increase in approvals towards the end of FY 2011.

Unobligated balances at September 30, 2011 and 2010 are $7.4 billion and $5.2 billion which include $5.3 billion and $3 billion of unavailable unobligated balances. These balances are unavailable because they are unapportioned by OMB. The SBA accumulates the majority of unobligated balances in its nonbudgetary financing accounts ($6.4 billion in FY 2011 and $3.5 billion in FY 2010) from reestimates that are used primarily to pay default claims in future years.

**CHART VII SBA OUTSTANDING LOAN PORTFOLIO OVER THE PAST 7 YEARS**




## Operational Portfolio Analysis

The SBA is the taxpayers' custodian of a small business loan portfolio of $99.2 billion, as shown in **Chart VII.** This portfolio of outstanding principal loan amounts includes guarantied loans – 7(a), 504, and SBIC; direct disaster loans; and microloans. SBA's two flagship guaranty business loan programs, 7(a) and 504, have accounted for practically all growth of the portfolio size, $25.7 billion since FY 2005. They currently comprise 84 percent of the portfolio. The direct disaster loan portfolio shrunk from a high of $9 billion in FY 2007 to the current $7.5 billion, mostly due to the absence of another catastrophic disaster on the scale of Hurricane Katrina in 2005. Much like the Recovery Act and its extensions drove loan growth in the portfolio in FY 2009 and FY 2010, provisions in the Small Business Jobs Act of 2010 (signed into law three days before FY 2011 began) drove growth in the portfolio over the past fiscal year. The 38.8 percent growth in the portfolio since 2005 amid a stagnation of conventional small business lending over the same time period[3] implies that the SBA has filled a gap in the small business lending marketplace while achieving greater market penetration among small business lenders.

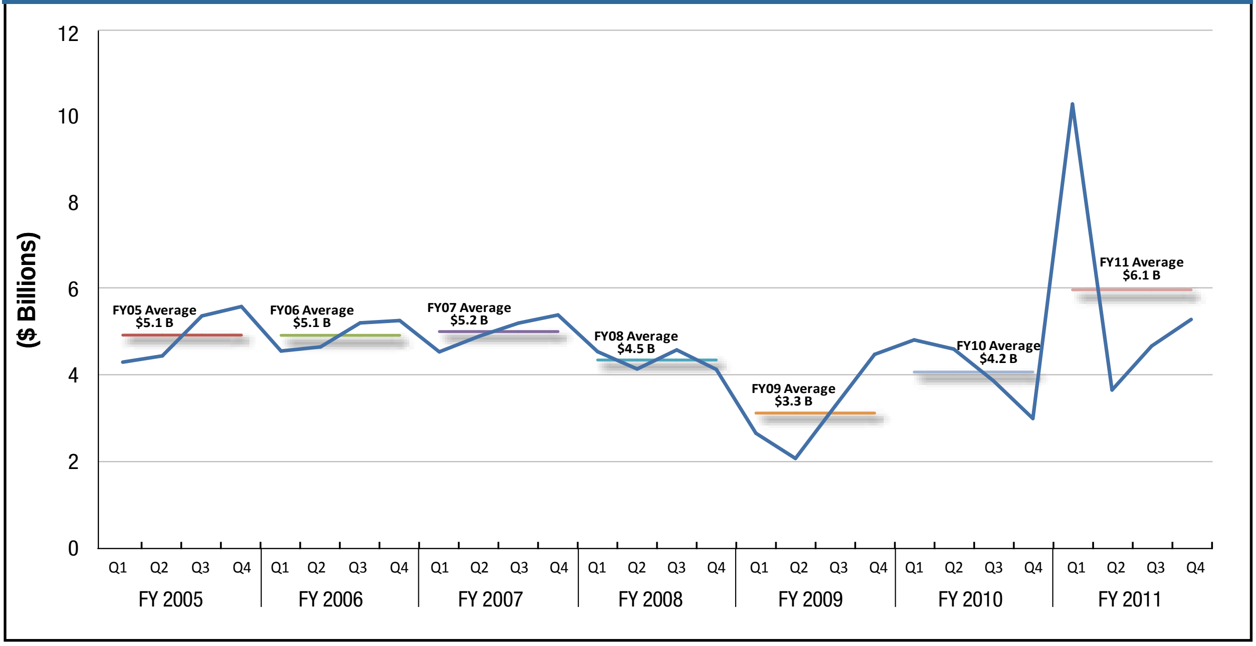
### Jobs Act Incentives Led to Record SBA Loan Approval Volume

As **Chart VIII** shows, loan volumes spiked considerably in FY 2011, with the $10.4 billion approved in the first quarter significantly raising the FY 2011 quarterly average to $6.1 billion. The spike occurred as lenders took advantage of the Jobs Act enhanced loan provisions of a 90 percent guaranty and reduced fees. While the higher guaranty and reduced fees ended when the special subsidy ran out in the first quarter, the Jobs Act also made some permanent changes to SBA's flagship loan programs.

Most notably, the Jobs Act permanently raised the 7(a) and 504 limits from $2 million to $5 million (up to $5.5 million for manufacturers in the 504 loan program) and established alternative size standards for the 7(a) and 504 loan programs by which small businesses with less that $15 million in net worth and $5 million in average net income would be eligible for a loan in those programs. This alternative standard meant increased lending opportunities for the small business community. In FY 2011, nearly 1,500 7(a) loans totaling $4.6 billion were made that utilized these higher limits. For the 504 program, 300 loans totaling over $860 million were

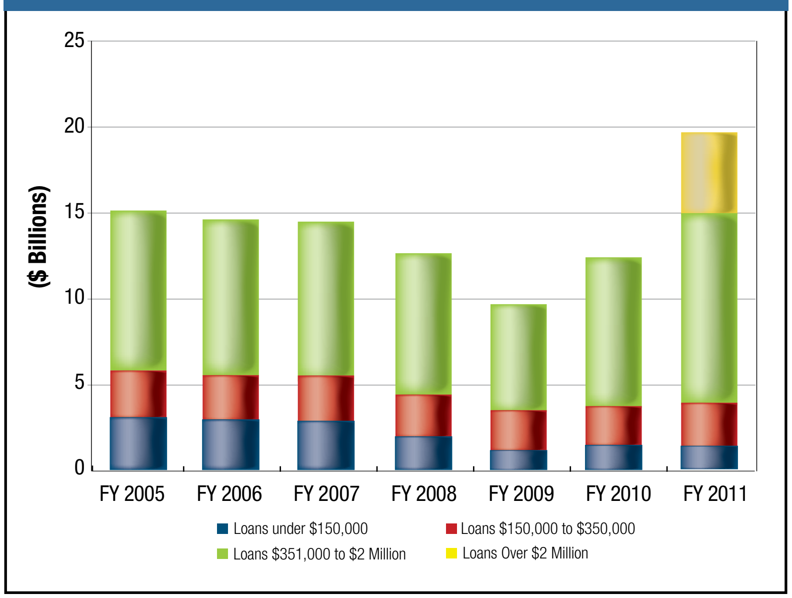
3 www2.fdic.gov/qbp/timeseries/SmallBusiness&FarmLoans.xls FDIC data show outstanding small business loans (<$1 million) of $665 billion in 2005 increasing to only $673 billion in June 2011.

**CHART VIII** QUARTERLY GROSS 7(A) AND 504 LOAN APPROVALS




made that are greater than could be awarded previously. Also, the Jobs Act's temporary maximum size increase from $350,000 to $1 million for quick turnaround SBA Express loans yielded over 1,500 loans totaling more than $910 million.

**CHART IX** 7(A) LOAN APPROVALS BY LOAN SIZES




## Loan Sizes and Access to Capital

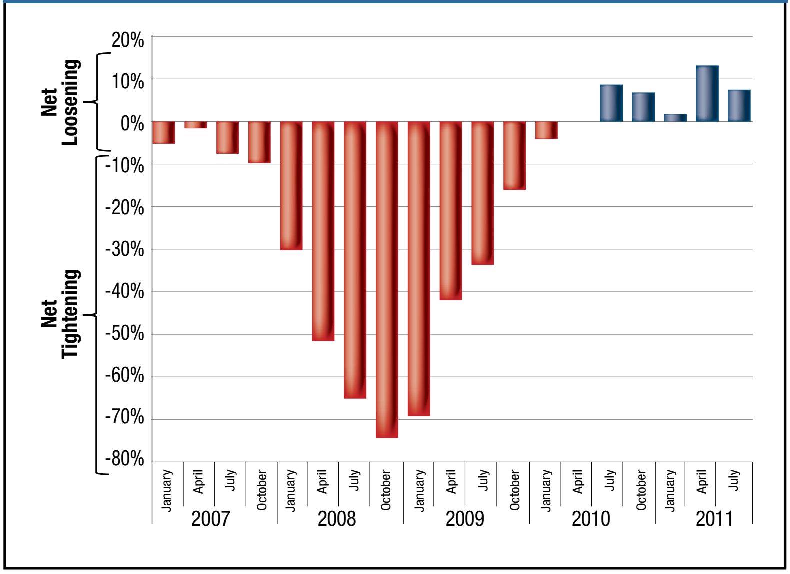
Overall, while the nation's outstanding small business loan portfolio has declined 14 percent since the peak in June 2008[4], SBA guarantied loans have grown over 18 percent since FY 2008; premiums for securitized bundles of SBA guarantied loans in the secondary market remain at record highs; increasing number of lenders are active in SBA programs; and, SBIC debentures garner record amounts. As SBA lending levels continue to rebound to pre-recession levels, the Agency will work through new programs to fill the gaps created in the marketplace.

As seen in **Chart IX**, the SBA has generally seen increases across all loan size categories over the past two years. While the Agency is pleased to see increased overall loan volume as well as higher creditworthiness among its borrowers, a gap still exists in smaller dollar small business loans. Loans under $150,000, in particular, have not returned to pre-recession volumes. These smaller

4 www2.fdic.gov/qbp/timeseries/SmallBusiness&FarmLoans.xls

loans have been shown to disproportionately help small businesses in underserved markets, and the SBA took several steps to start filling this gap in FY 2011.

**CHART X SENIOR LOAN OFFICERS REPORTING ON CREDIT STANDARDS FOR SMALL BUSINESSES**




First, SBA's High Priority Performance Goal to increase the number of active lenders resulted in significantly more and stronger partnerships among community lenders and credit unions which are much more likely to make smaller-dollar loans. Through increased outreach efforts coupled with the enhanced provisions in the Recovery Act and Jobs Act, over 1,000 lenders who had not made an SBA loan since 2007 came back to SBA lending.

Second, the SBA introduced two new 7(a) loan initiatives with streamlined applications – Community Advantage and Small Loan Advantage – to encourage current and prospective SBA lenders to make more lower-dollar loans (under $250,000). So far, 53 lenders have participated in these programs, and significant efforts are underway to increase this number in FY 2012.

In addition, SBA's Microloan program became a stronger tool for low-dollar loans with a new maximum loan size of $50,000. In FY 2011, of the $46.5 million in microloans approved, 223 microloans totaling $10.5 million were made by leveraging this higher ceiling.

One cause for the decrease in volume of the smallest 7(a) loans since FY 2007 is tightening of credit standards by banks following the financial crisis. The Federal Reserve's Quarterly Senior Loan Officer Survey[5] reveals the dramatic tightening of credit standards for small businesses during the financial crisis as shown in **Chart X**. Businesses with higher credit scores on average receive larger loans and larger banks typically lend to businesses with higher scores. Also, multiple mergers among large U.S. lenders has given significant control to relatively few banks, providing them greater leverage to establish uniformly tight lending standards across the marketplace. One report found that the four largest U.S. banks in 2011 had been 37 separate banks back in the early 1990s[6], and the Federal Reserve noted that the top 10 largest banks in 2009 controlled over 54 percent of assets.[7]

## SBIC Has Record Year

Notable improvements have been made in the SBIC program that are not reflected in Chart VII. Importantly, the SBA has wound down the participating securities function of SBIC in favor of the debenture program. This lowers the risk for the SBA and taxpayers because equity is not at stake and the guaranty only comes into play when the SBIC has difficulty repaying the debenture to the financing bank. The debenture portion of the SBIC portfolio has risen from 26 percent in FY 2005 to 57 percent in FY 2011. A strong effort to reduce licensing times for SBICs, from 13.2 months in FY 2009 to 5.5 months in FY 2011, allowed 22 new debenture SBICs to be licensed and a record $2.59 billion in overall financings

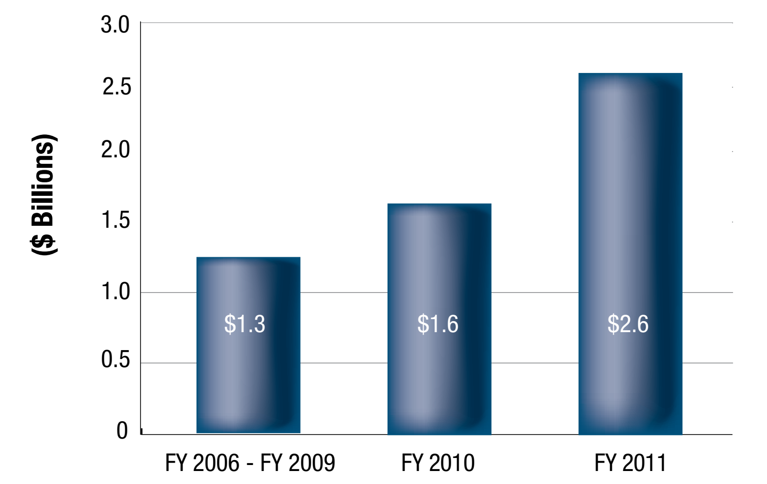
5 www.federalreserve.gov/boarddocs/snloansurvey/201108/fullreport.pdf

6 http://motherjones.com/politics/2010/01/bank-merger-history

7 www.federalreserve.gov/pubs/bulletin/2010/pdf/bankprofits10.pdf

(including both SBA support and private sector matching funds) to small businesses in FY 2011 as seen in **Chart XI**. The composition of the SBIC portfolio will continue to reflect a stronger emphasis on SBIC debentures, and the overall size of the portfolio will likely increase. This is critical because SBICs invest in small businesses with high-growth potential, and these businesses create a disproportionate number of new jobs.[8]

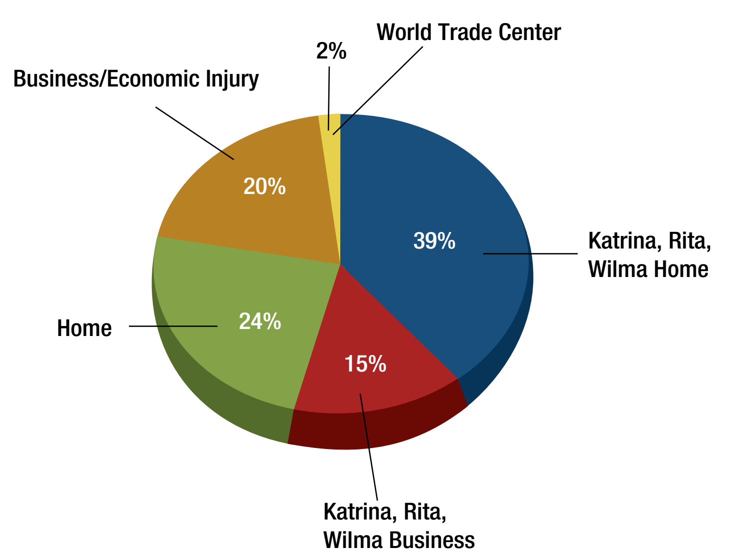
**CHART XI SBIC DEBENTURE FINANCINGS TO SMALL BUSINESSES**




## Absence of Major Disasters Shrinks Portfolio

The direct disaster portfolio decreased six percent in FY 2011, from $7.9 billion to $7.5 billion. This decline continues the trend seen last year as repayments from hurricanes Katrina, Rita, and Wilma disaster loans significantly outpaced any new loan disbursements for disasters in FY 2011. Unpaid principal from these hurricanes fell 8.2 percent in FY 2011. However, after five years these three storms still account for $4 billion or, 54 percent, of the $7.5 billion disaster portfolio as seen in **Chart XII**. Disaster loans associated with the top three FY 2011 disasters – spring floods in North Dakota and the tornadoes in Alabama and Missouri – led to approximately 4,600 approved loans totaling over $373 million. While Hurricane Irene caused extensive damage along the Eastern Seaboard in late August, the costs will likely not show up in SBA's disaster portfolio until FY 2012.

**CHART XII FY 2011 DISASTER OUTSTANDING PORTFOLIO BY LOAN TYPE**




8 www.brookings.edu/~/media/Files/Programs/ES/BPEA/2011_fall_bpea_papers/2011_fall_bpea_conference_hurst.pdf

# Analysis of SBA's Systems, Controls and Legal Compliance

## Financial Management Systems Strategy

Financial management systems at the SBA are designed to support effective internal control, produce reliable, timely financial information, and ensure cost effective loan guaranty processing. Management remains focused on robust financial management systems that improve SBA's ability to comply with laws and regulations, provide timely and accurate data to support management analysis and decision-making, enable the Agency to keep pace with its lending partners, and effectively use automation to achieve operational efficiency.

As demonstrated throughout this Agency Financial Report, the SBA seeks to comply with all federal financial management system requirements and there have been no deficiencies identified under FFMIA.

The SBA is in the process of conducting a series of incremental improvement projects designed to modernize the financial management systems to improve financial system controls, reduce sustainment costs, provide additional functionality for external lending partners, and prolong system useful lives. These projects include the migration of the systems to more current technology platforms and relocation to more modern data centers that provide expanded capability for continuity of operations.

In addition to modernization of the financial system platforms, the incremental improvement projects will also add missing functionality to the financial systems, building improved integration between the systems, improving consistency of data, enhanced reporting capability, and improving SBA's automation of funds control for loan programs and loan subsidy.

When completed, the incremental improvement projects enhance SBA's financial system controls over lending programs and provide for improvement in accessibility to common information, financial and budget management, and financial reporting.

Core financial systems at the SBA are comprised of three systems operated and managed by the Offices of the Chief Financial Officer, Capital Access, and Chief Information Officer. The systems include:

- *Oracle Federal Financials* – Recently upgraded to the most current release, this COTS package is used for budget execution and management for administrative activity.
- *Loan Systems* – A series of SBA-built systems used to support the lifecycle of loan guaranty processing, loan program funds control, management and accounting for loan activity, and a COTS package used for disaster loan application processing.
- *Financial Management System (FMS)* – An SBA-built system used to consolidate administrative and loan activity, manage cash and control funds, and provide financial reporting.

Problems associated with the aging of the SBA-developed financial systems are being addressed as part of the modernization projects included in SBA's financial systems strategy.

## Internal Control Environment

The SBA believes that maintaining integrity and accountability in all programs and operations is critical for good government, demonstrates responsible stewardship over assets and resources, ensures high quality, is a sign of responsible leadership, ensures the effective delivery of services to customers, and maximizes desired program outcomes. The SBA has developed and implemented management, administrative and financial system controls to reasonably ensure that:

- programs and operations achieve intended results efficiently and effectively;
- resources are used in accordance with the mission of the Agency;
- programs and resources are protected from waste, fraud and mismanagement;

- program and operations activities are in compliance with laws and regulations; and
- reliable, complete and timely data are maintained and used for decision-making at all levels.

The Federal Managers' Financial Integrity Act of 1982 requires federal agencies to conduct an annual assessment of internal control and report the results to the President. The conclusion of the Administrator's Annual FMFIA assurance statement is based on the self-assessment of program managers, internal control reviews, and audits and reviews done by the Government Accountability Office and SBA's Office of the Inspector General.

The SBA continues to strengthen and improve the execution of its mission through the application of sound internal controls. The Office of Internal Controls (OIC) is responsible for overseeing the Requirements of the Office of Management and Budget's revised Circular No. A-123, Appendix A, Internal Control Over Financial Reporting. The OIC conducted SBA's seventh annual assessment of internal control over financial reporting to comply with this circular. The revised A-123 requires the managers of federal agencies to take responsibility for assessing internal controls over financial reporting.

The Senior Assessment Team (SAT), chaired by the Chief Financial Officer and comprised of SBA managers from the major programs and support offices, directed this effort. The OIC reviewed the key business processes impacting financial operations and the financial statements. In addition, the SAT members reviewed some of the business processes with no material impact on the financial statements, but which have some potential for risk or exposure for the Agency.

Based on the evaluation of 15 business processes, the OIC identified a number of deficiencies in the internal control over financial reporting, including several in SBA's key business areas. However, the OIC determined that most of the items were relatively minor and none reached the level of material weakness.

Given the size of its $99.2 billion loan portfolio, the SBA's lender and loan monitoring and review activities represent a critical component of the Agency's internal control framework. The Agency's Office of Credit Risk Management rates lenders that disburse SBA-guarantied loans according to risk. This analysis allows the SBA to focus resources on those lenders that represent the most risk in terms of exposure and credit quality. Larger lenders are subject to periodic on-site reviews; other lenders are on a case-by-case basis. The SBA also conducts reviews of certified development companies, examinations of small business investment companies, guarantied loan purchase reviews and reviews of improper payments for business and disaster loans and contracts.

### LEGAL COMPLIANCE

The SBA's independent auditor has identified one instance of non-compliance with applicable laws and regulations as of September 30, 2011. Due to ongoing system issues with the Agency's legacy mainframe information system, not all obligors on 7(a), 504 and disaster charged-off loans were referred to the Treasury Department for collection of debt as required by the Debt Collection Improvement Act (DCIA). In FY 2010, a separate system error related to disaster loan referrals was identified as the cause of non-compliance with DCIA. A mitigation plan was implemented that successfully resolved that issue; however, other system issues were identified in FY 2011. As a result, the SBA organized a DCIA Compliance Team made up of representatives from the Office of Capital Access, the Office of the Chief Financial Officer, and the Office of the Chief Information Officer who worked together to identify and resolve each of the system problems. The SBA implemented improvements to support the ongoing referral of all disaster loans as well as co-borrowers and guarantors on all loans. The DCIA Compliance Team will continue to review any issues affecting referrals and will make system adjustments as necessary during the imminent transition from the mainframe to a web-based system to confirm the completeness and accuracy of referrals to Treasury.

### AUDIT FOLLOW-UP

SBA's OIG conducts audits and reviews of the Agency's operations, and the Office of the Chief Financial Officer works closely with SBA management and the OIG to complete actions necessary to respond to OIG audits. The OCFO tracks the completion of these audit recommendations and posts the status of all open OIG recommendations on SBA's Intranet for managers' information. In addition, the Agency's financial and program-related internal control has improved substantially over the years through the remediation of audit recommendations made by the Agency's independent auditor in the annual financial statements audit. Finally, the SBA also considers and responds to recommendations from audits and reviews conducted by the GAO.

During FY 2011, the OCFO continued to strengthen its financial management team through communication on emerging issues and training activities.

The SBA recognized that its acquisition function was not meeting the Agency's procurement needs and was suffering from significant control issues. Responding to this need and in partnership with various stakeholders, SBA leadership initiated a re-organization of the procurement office. This process culminated with the transfer of the procurement function from the Office of Management and Administration to the Office of Chief Financial Officer in FY 2011. The newly formed procurement team began identifying significant contracting issues, such as missing documentation in the contract files and the receipt of valid invoices for expired contracts. The Improper Payment review result also revealed that many contracts issued prior to FY 2011 were missing required documentation. The procurement division has taken the following steps to improve the procurement process and strengthen the internal controls:

- Implement training, including COTR and program manager training and contracting staff invoice training.
- Expand the Contract Management System and financial system two-way interfaces and evaluate possible use of Treasury's Integrated Payments Platform (IPP) system.
- Develop a review checklist and review all active contract files to identify missing documents and correct documentation errors.
- Re-institute legal reviews and expanded legal staff for contracting support in February 2011.
- Enhance training and the intake checklist for invoices to better assess the acceptability of invoices.
- Revise standard operating policy and procedures for Acquisition function.

### INFORMATION SYSTEMS

This year the SBA continued to have a significant deficiency in the information technology security controls, including contingency planning, security management, security access, segregation of duties, and software configuration. The Agency is sensitive to the need to protect SBA data and plans to work diligently to improve both process and performance in this critical area. The following steps to remediate findings pointed out in the Auditors' Report are currently underway:

- The Office of the CIO (OCIO) is identifying disaster recovery solutions that can enable a reliable recovery in the event of an emergency. Periodic tests will be performed to assess SBAs resiliency and capabilities against disasters.
- The SBA has invested in a leading vulnerability scanning tool and is configuring it to prevent and detect inappropriate activities. Problem areas are reported daily with immediate remedial action taken when required.
- The OCIO will communicate guidance Agency-wide to adequately separate key functions to avoid conflicts in duties as well as

the adoption of security measures necessary to safeguard SBA assets and personnel.

- The OCIO will assist with establishing completeness, integrity and availability of data in systems and security during transmission.
- The SBA is promulgating a new policy that blocks connection of non-SBA government equipment to the SBA infrastructure.
- The OCIO selected a leading vendor to provide periodic security training with the latest in security principles.
- The OCIO is updating policies related to configuration and patch management as well as authorizing baseline configurations for all technologies. Leading enterprise patch management tools are in review to solidify the patching function.
- The OCIO is establishing processes to ensure all contractors undergo a consistent background investigation before gaining access to sensitive SBA facilities and data.
- The SBA is determining policies, personnel and technologies to effectively account for, manage and decommission assets throughout the Agency.
- The OCIO is updating policies and procedures aimed at providing incident response guidance. These documents will be communicated to appropriate personnel and training will be conducted to reinforce the incident handling process.

**Did you know**

Green Government Opportunities is an SBA website that serves as a one-stop destination for all things green in small business. Its purpose is to provide a resource through which small businesses can gain access to green contracts, grants and partnerships with the Navy.

For more information, go to http://green.sba.gov/.

## Summary of Financial Statement Audit and Management Assurances

As required by OMB Circular A-136, Section II.5.6, the following summarizes SBA's financial statement audit and SBA's Management Assurances:

### SUMMARY OF FINANCIAL STATEMENT AUDIT

| | | | | | | |
|---|---|---|---|---|---|---|
| Audit Opinion | Unqualified | | | | | |
| Restatement | No | | | | | |
| | | | | | | |
| Material Weaknesses | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
| Financial Reporting | 0 | 0 | N/A | N/A | N/A | 0 |

### SUMMARY OF MANAGEMENT ASSURANCES

| | | | | | | |
|---|---|---|---|---|---|---|
| Effectiveness of Internal Control over Financial Reporting (FMFIA § 2) | | | | | | |
| Statement of Assurance | Unqualified | | | | | |
| | | | | | | |
| Material Weaknesses | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
| Financial Reporting | 0 | 0 | N/A | N/A | N/A | 0 |
| | | | | | | |
| Effectiveness of Internal Control over Operations (FMFIA § 2) | | | | | | |
| Statement of Assurance | Unqualified | | | | | |
| | | | | | | |
| Material Weaknesses | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
| None | 0 | 0 | N/A | N/A | N/A | 0 |
| | | | | | | |
| Conformance with financial management system requirements (FMFIA § 4) | | | | | | |
| Statement of Assurance | Systems conform to financial management system requirements. | | | | | |
| | | | | | | |
| Non-Conformances | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
| None | 0 | 0 | N/A | N/A | N/A | 0 |
| | | | | | | |

| Conformance with Federal Financial Management Improvement Act (FFMIA) | | |
|---|---|---|
| | Agency | Auditor |
| Overall Substantial Compliance | Yes | Yes |
| 1. System Requirements | Yes | |
| 2. Accounting Standards | Yes | |
| 3. USSGL at Transaction Level | Yes | |

## FMFIA and FFMIA Assurance Statement for FY 2011

The Small Business Administration continued to strengthen its internal controls over its programs and operations during FY 2011. Creating a culture of responsibility and accountability while eliminating and preventing waste, fraud and abuse is critical to meeting our mission at the SBA. I am pleased to report that the SBA is on course to achieve its internal control objectives.

SBA management is responsible for establishing and maintaining effective internal controls and financial management systems that meet the objective of the Federal Managers Financial Integrity Act (FMFIA). The SBA conducted its assessment of internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, Management's Responsibility for Internal Controls. Agency managers have issued assertions to the Administrator as to the status of their FY 2011 internal controls, and these assertions are supported by internal testing, checklists and other management reviews. Although Agency managers reported some operating deficiencies, these were not of a material nature. Based on the results of this evaluation, I can provide reasonable assurance that internal controls over operations and compliance with applicable laws and regulations, as of September 30, 2011, were operating effectively and no material weaknesses were identified in the design or operation of those internal controls.

In addition, the SBA conducted its assessment of the effectiveness of internal controls over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, I can provide reasonable assurance that internal controls over financial reporting were operating effectively and no material weaknesses were identified in the design or operation of internal controls over financial reporting.

Results from SBA's improper payment testing revealed that several contracts issued prior to FY 2011 are missing certain required documentation. The SBA has taken steps to improve its internal control processes in this area. In FY 2010, the Agency recognized that its acquisition function was not meeting the Agency's procurement needs. In response to this need, and in partnership with various stakeholders, we initiated a re-organization of the procurement office. This process culminated with the transfer of the procurement function from the Office of Management and Administration to the Office of Performance Management and Chief Financial Officer in FY 2011. As a result of this re-alignment we have made significant improvements in this area; however, resolving all the outstanding problems will require additional time and resources. Nevertheless, we continue to move forward and strengthen internal controls and processes.

SBA's independent auditors issued an unqualified opinion on the Agency's FY 2011 financial statements for the seventh year in a row. However, our auditor identified one instance of non-compliance with applicable laws and regulations as of September 30, 2011. Specifically, due to ongoing system issues with the Agency's legacy mainframe information system, not all obligors on 7(a), 504 and disaster charged-off loans were referred to the Department of Treasury for collection of debt as required by the Debt Collection Improvement Act (DCIA). In FY 2010, a separate system error related to disaster loan referrals was identified as the cause of non-compliance with DCIA. A mitigation plan was implemented that successfully resolved that issue; however, other system issues were identified in FY 2011. As a result, the SBA organized a DCIA Compliance Team, made up of representatives from the Office of Capital Access, the Office of the Chief Financial Officer, and the Office of the Chief Information Officer, who worked together to identify and resolve each of the system problems. The SBA has implemented improvements to support the ongoing referral of defaulted disaster loans to Treasury as well as co-borrowers and guarantors on all other loans. The DCIA Compliance Team will continue to review any issues affecting referrals and will make system adjustments as necessary during the imminent transition from the mainframe to a web-based system to confirm the completeness and accuracy of referrals to Treasury.

The Federal Financial Management Improvement Act (FFMIA) requires federal agencies to implement and maintain financial management systems that are in substantial compliance with federal financial management systems requirements, federal accounting standards, and the United States Government Standard General Ledger. Based on the FFMIA criteria, the SBA provides reasonable assurance that its financial management systems substantially comply with FFMIA for FY 2011.

Karen G. Mills
Administrator
November 15, 2011

## Improper Payments Summary

The Improper Payment Information Act of 2002 (IPIA) requires that agencies: (1) review programs and identify those susceptible to significant improper payments; (2) report to Congress on the amount and cause of improper payments; and (3) develop approaches for reducing such payments. Appendix C to OMB Circular A-123, Management's Responsibility for Internal Controls, provides additional guidance on agency compliance with IPIA requirements. On July 22, 2010, the President signed into law the Improper Payments Elimination and Recovery Act (IPERA), which amends the IPIA by providing alternative improper payments measurements, increasing the requirements for corrective action plans, and expanding the scope of recapture auditing to include all types of payments and program activities with more than $1 million in annual outlays, if cost-effective. Parts I and II of Appendix C of the OMB circular were updated on April 14, 2011 to address the new requirements. In addition, OMB Circular A-136 provides guidance on the form and content of IPIA reporting to be included in the Agency Financial Report. The SBA's improper payment program and reporting is subject to this guidance.

SBA's four major credit programs are subject to improper payment reporting as required by the former Section 57 of Circular A-11. The four programs are the 7(a) Business Loan program, the Section 504 Certified Development Company (504) loan program, the Small Business Investment Company (SBIC) program and the Disaster Assistance loan program. SBA's risk assessment of the 7(a), 504, and SBIC guaranty approval programs for improper payment indicate a low level of risk due to the internal controls applied over these programs. Improper payments in these guaranty approval programs are extremely low or non-existent. The SBA considers the 7(a) guaranty purchase program to have a medium risk of improper payments. The Disaster Assistance program has a low risk of loss, but improper payment reviews have found that compliance with the paperwork required in Disaster Assistance program lending procedures needs improvement.

In FY 2010, the SBA recognized that its acquisition function was not meeting the Agency's procurement needs and was suffering from significant control issues. Responding to this need the SBA initiated a re-organization of the procurement office. This process culminated with the transfer of the procurement function from the Office of Management and Administration to the Office of Performance Management and Chief Financial Officer in FY 2011. The newly formed procurement office began identifying significant contracting issues, and it was determined to conduct a pilot review for improper payments. As a result, contracting was determined to be risk-susceptible under IPERA for FY 2011, and the SBA developed a statistical sampling methodology to test the effectiveness of this measurement. Since this was the first year that the SBA tested contracting payments, the Agency is continuing to identify the most appropriate measurement process. The SBA will take lessons learned from the test in FY 2011 to refine the measurement process and report improper payment estimates in the FY 2012 Agency Financial Report. Moving forward, the SBA will not only improve its improper payments measurement for contracting over the coming year, but it will improve the business processes and controls currently in place.

The 7(a) guaranty purchase operation includes centers in Herndon, Virginia, Fresno, California, and Little Rock, Arkansas that are aligned within the Office of Capital Access. The FY 2011 7(a) guaranty purchase improper payment rate was determined to be 1.73 percent or $40.7 million compared with last year's improper payment rate of 1.87 percent. The 7(a) guaranty purchase review contains a number of judgmental considerations concerning whether the originating lender exercised reasonable commercial care and prudence in the execution, servicing and liquidation of the loan in accordance with SBA loan program requirements; and whether or not the lender's actions or inactions have placed the SBA at financial risk or contributed materially to the loan default. The evaluation of the lender's exercise of reasonable commercial lending practices is critical and needs to be consistent with the lending practices exercised related to loans that did not default. The exercise of SBA's judgment in this area is significant to the improper rate calculation since over 85 percent of SBA 7(a) loans are approved by lenders using delegated authority where they make the credit underwriting decisions.

In accordance with OMB guidance, the SBA includes loan guaranty approvals issued during FY 2011 in its Improper Payment program reporting for its 7(a), 504 and SBIC programs. Although these guaranties have not yet resulted in federal outlays, they could possibly in the future and they are therefore included. Most frequently, the reason for an improper payment in this category would be the lack of appropriate eligibility or a non-compliance with lending procedures. The result of SBA's testing for 7(a) and 504 guaranties issued in FY 2011 indicated a zero percent improper payment rate for both guaranty approval programs. The SBIC program testing found few administrative and documentation errors and the SBA is continuing to train fund managers and perform compliance checks on licensees to reduce the error rate. The improper payment rate for SBIC is 1.2 percent or $17.0 million when extrapolated.

The Disaster Assistance program operation includes a processing center in Fort Worth and operation centers in Atlanta and Sacramento, as well as a Buffalo customer service center. The FY 2011 disaster improper payment rate was determined to be 28.4 percent or $96.3 million compared to 34.2 percent reported last year. Disaster improper payments are generally the result of loan documentation errors and do not result in a disaster victim receiving funds that they are not eligible to receive. If the improper payment measurement only reflected payments made to potentially ineligible borrowers or in an incorrect payment amount, the improper payment rate would be 12.1 percent. Furthermore, the majority of loans made are collateralized and all such loans have to be repaid, and SBA's loan servicing and liquidation operation attains maximum recovery. The reduced improper payment rate in FY 2011 indicates an improvement in adherence to the documentation requirements from the previous year; however, the rate did not decrease as rapidly as anticipated as older loans have not all been fully disbursed and are therefore still subject to Improper Payment selection criteria. The disaster centers continue to provide additional training to ensure that staff is aware of all paperwork requirements. A dedicated team continues to perform Quality Assurance reviews in addition to the Improper Payment reviews which facilitates the identification of areas of concern and correction in a timely manner.

The Agency tested disbursement transactions and corresponding documentation related to contracts for the period of April 1, 2010 to March 31, 2011. Given the selected timeframe, 99 percent of the contracts included for testing were awarded prior to FY 2011. In a validation of prior observations by the new contracting office, the results from the Improper Payment testing revealed that many contracts issued prior to FY 2011 were missing required documentation. Every payment related to a contract with some form of missing documentation could be considered an improper payment, and therefore SBA's improper payment rate could reach 89 percent or $118.4 million. However, the majority of these documentation errors did not result in actual payment errors and the SBA received goods and services in exchange for contract payments. An improper payment rate that considered only payments made for incorrect amounts or not in strict compliance with contract terms (payment errors) would result in an improper payment rate of 3 percent or $4.5 million.

This is the first year that improper payment testing was performed in the contracting area; therefore, there is no historical data with which to compare the outcome of the FY 2011 review. SBA's procurement office has made immediate corrective actions. Specifically, it has provided extensive training to staff throughout the Agency, established a Quality Assurance Branch and has worked to correct problems in a timely manner as they are identified. Many of the payments in the improper payment sample were associated with aged contracts and therefore evidence of the improvements made will not be seen immediately.

In summary, the SBA places a top priority on the detection and remediation of improper payment occurrence. The contracting activities, 7(a) guaranty approval and purchase, 504 guaranty approval, SBIC and Disaster Assistance loan programs now have staff that monitor and review their operations for improper payments and are charged with implementing improvements that will reduce the Agency's improper payment rate.

*Did you know*

**SBA Lenders play a vital role in helping the SBA achieve its mission in helping small businesses start and grow across the United States. In FY 2011, the SBA supported over $30 billion in lending to over 54,000 small businesses.**

**For more information, go to www.sba.gov/for-lenders.**

# Financial Reporting

## *Success Story*

## An Engineering Focus on the Unique Needs of Urban Areas

Integrated Management Services, Jackson, Mississippi

Integrated Management Services was formed in 1996 by two visionaries who saw the need for an engineering firm focused on the unique needs of urban areas. John D. Calhoun and Rod L. Hill, both former employees of the city of Jackson, now operate a thriving business that offers full-service consulting, engineering, technical, emergency response, construction management and operations assistance to help public and private clients improve their environment and infrastructure.

Today, IMS successfully manages construction projects with values exceeding $1 billion annually. IMS worked on multiple Gulf Coast rebuilding projects after Hurricane Katrina and secured a $69,560 federal contract in 2010 from the U.S. Department of the Army for general engineering services performed under the American Recovery and Reinvestment Act. IMS received a $102,000 SBA-guarantied CAPLine line of credit in 1998 to sustain its early growth, and participated in SBA's 8(a) Business Development program to boost procurement opportunities.

The company has grown from a two-person firm in Jackson to a staff of 178 today with additional offices in Greenville, Mississippi, Memphis, Tennessee., New Orleans, and Detroit. The firm recorded a phenomenal sales growth of 908 percent during its first five years in operation.

**Did you know**

**The SBA Community site provides open, publicly accessible forums and communication tools for small business owners to learn, share, and discuss practical solutions to everyday business problems with each other, industry experts, and experts at government agencies.**

**For more information, go to http://community.sba.gov/register.**

# Message from the Chief Financial Officer

November 15, 2011

I am pleased to submit the U.S. Small Business Administration's Agency Financial Report for FY 2011. For the fifth straight year the SBA has won the prestigious Certificate of Excellence in Accountability Reporting award. This success is attributed to my staff, and I would like to thank them for their hard work and commitment to reporting transparency and accountability.

An independent audit has earned the SBA an unqualified opinion with no material weaknesses. However, our auditor identified one instance of non-compliance with applicable laws and regulations as of September 30, 2011. Due to ongoing system issues with the Agency's legacy mainframe information system, not all co-borrowers and guarantors and disaster charged-off loans were referred to the Treasury for cross-servicing collection of debt as required by the Debt Collection Improvement Act. Improvements have been implemented to support the referral of loans and the SBA will make system adjustments as necessary to confirm the completeness and accuracy of referrals to Treasury.

This year, the SBA reached an all-time record in small business lending, supporting over $30 billion in lending to over 60,000 small businesses. The supported amount for 504 loans includes the SBA share and third party loans that are made by commercial lenders as part of the funding package. The first quarter of the year, at over $12 billion supported, was the most active single quarter ever for SBA-backed loans. The unprecedented loan volume was prompted by critical provisions of the Small Business Jobs Act, which allowed the SBA to raise loan guaranties in its 7(a) loan program and reduce fees in its 7(a) and 504 loan programs. I am pleased to report that our financial management team once again expertly handled the challenges associated with accounting for this historic loan volume.

SBA's efforts to assist entrepreneurs and small business owners are especially critical as the U.S. economy continues to recover and grow. Throughout America's history, small businesses have played the leading role in job creation. In fact, more than half of working Americans own or work for a small business, and small businesses are responsible for two out of every three net new private sector jobs created over the past decade. The SBA plays a critical role in strengthening America's economy by providing tools to help grow businesses and create jobs. At the same time, the federal government is entering a period of renewed focus on how to spend the taxpayers' money most effectively and efficiently.

In June 2011, the President signed the Executive Order, *Delivering an Efficient, Effective, and Accountable Government,* and OMB announced the White House's Campaign to Cut Waste. As part of SBA's efforts to support this initiative, we revamped how the Agency processes outstanding receivables to speed the collection of $25 million in outstanding debt. The changes we made in response to this challenge allowed us to deploy our resources more effectively and to provide more thorough oversight of the collections process. To date, we have collected $15 million, and we are on target to retire this delinquent debt by the close of FY 2012.

Recognizing the need to integrate budget and acquisition processes, the SBA transitioned the acquisition function to the Office of Performance Management and Chief Financial Officer, with primary operations being conducted in SBA's Denver Finance Center. This transition has been possible only because of the hard work and determination of Agency staff to improve operations. Throughout FY 2011, a realigned Acquisition Division has made considerable progress toward standardizing and improving SBA's procurement process. As of October 1, the SBA met its overall FY 2011 small business contracting goal — at 67.5 percent, the highest percentage goal in the government for small business contracts — as well as all socio-economic sub-goals.

In FY 2011, our Performance Management Office led an enhanced weekly, monthly and quarterly Agency-wide performance reporting process to track progress against Agency goals, including the High Priority Performance Goals. We also worked with our Office of Communication and Public Liaison to create a performance portal on SBA's redesigned website, www.sba.gov/performance, to provide the public with easy access to the Agency's performance and financial information.

To ensure that the SBA continues to have the resources necessary to help small businesses grow and create jobs, we have begun to reassess our succession planning model. A substantial number of SBA career Senior Executive Service and permanent General Schedule employees are fully eligible or will become eligible to retire between FY 2011 and FY 2016. The Small Business Administration's leadership team has identified this as a High Risk Challenge that must be addressed. As of February 24, 2011, 48.4 percent of the full time SBA GS employees are eligible to retire within five years. As a result, the Agency has taken steps to address this challenge through Voluntary Early Retirement Authority and Voluntary Separation Incentive Payment programs and succession planning to offset risk.

Finally, I want to thank the independent Audit and Financial Management Advisory Committee who, since late FY 2004, has advised us in the financial reporting process and audit cycle, provided oversight of activities, and made recommendations for our financial statement footnotes and the AFR prior to publication. We are proud to work with one of the few independent audit committees within the federal government and appreciate the opportunity to have such an esteemed group of professionals advising us. I thank them for their support and dedication to continued improvement.

Sincerely,

Jonathan I. Carver,
Associate Administrator for Performance Management
& Chief Financial Officer

# Audit and Financial Management Advisory Committee's Report

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 four times during the year with respect to these responsibilities on FY 2011 financial management and reporting. Two of the meetings were conducted by the Committee via teleconference. 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 2011 AFR.

Edward J. Mazur
Chairman
Audit and Financial Management Advisory Committee

# Inspector General's Audit Report

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

**TRANSMITTAL MEMORANDUM**
Report No. 12-02

**DATE:** NOVEMBER 14, 2011

**TO:** JONATHAN I. CARVER
Chief Financial Officer

**FROM:** JOHN K. NEEDHAM
Assistant Inspector General for Auditing

**SUBJECT:** *Independent Auditors' Report* on the SBA's FY 2011 Financial Statements

We contracted with the independent public accounting firm, KPMG LLP, to audit the U.S. Small Business Administration's consolidated financial statements as of September 30, 2011, and for the years then ended. The contract required that the audits be conducted in accordance with *Generally Accepted Government Auditing Standards;* the Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended; and the U.S. Government Accountability Office's *Financial Audit Manual and Federal Information System Controls Audit Manual.* This audit is an annual requirement of the Chief Financial Officers Act of 1990.

The results of KPMG LLP's audits are presented in the attached report. The report includes an opinion on SBA's financial statements, internal control over financial reporting, and compliance and other matters that have a direct and material effect on the financial statements. KPMG LLP issued an unqualified opinion on SBA's fiscal year 2011 consolidated financial statements. In summary, KPMG LLP found that:

- The financial statements were fairly presented, in all material aspects, in conformity with U.S. generally accepted accounting principles.
- There were no material weaknesses in internal control.
- There is a significant deficiency related to SBA's information technology security controls, which is a repeat condition.
- There is one instance of noncompliance with laws and regulations related to the Debt Collection Improvement Act of 1996, which is also a repeat condition.

The report also includes one other matter related to possible violations of the Federal Acquisition Regulation's documentation retention requirements. Details regarding the auditor's conclusions are included in the Compliance and Other Matters Section of the *Independent Auditors' Report*. Within 30 days of this report, KPMG expects to issue a separate letter to management regarding other less significant matters that came to its attention during the audit.

We reviewed a copy of KPMG LLP'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 LLP'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 LLP did not comply, in all material respects, with *Generally Accepted Government Auditing Standards.*

We provided a draft of KPMG LLP's report to SBA's Chief Financial Officer who concurred with its findings and recommendations and agreed to implement the recommendations. The Chief Financial Officer's comments are attached as Exhibit IV to this report.

We appreciate the cooperation and assistance of the SBA and KPMG LLP. 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 Auditor's Report on FY 2011 Financial Statements

KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

## 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, 2011 and 2010, 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 (FY) 2011 audit, we also considered the SBA's internal control over financial reporting and tested the 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 the SBA's consolidated financial statements as of and for the years ended September 30, 2011 and 2010, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

Our consideration of internal control over financial reporting resulted in identifying certain deficiencies that we consider to be significant deficiencies, as defined in the Internal Control Over Financial Reporting Section of this report, as follows:

*Improvement Needed in Information Technology Security Controls*

We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined in the Internal Control Over Financial Reporting Section of this report.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed one instance of noncompliance and one other matter 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.

*Noncompliance with the Debt Collection Improvement Act of 1996*

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 the 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 the SBA as of September 30, 2011 and 2010, 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.

U.S. Small Business Administration
November 14, 2011
Page 2 of 4

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the SBA as of September 30, 2011 and 2010, 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.

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.

The information in the Other Accompanying Information section is presented for purposes of additional analysis and is not required as part of the consolidated financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

**Internal Control Over Financial Reporting**

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 material weakness is a deficiency, or a 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.

Our consideration of 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 internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our FY 2011 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting described in Exhibit I that we consider to be significant deficiency in internal control over financial reporting. 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.

Exhibit II presents the status of the prior year significant deficiency.

We noted certain additional matters that we have reported to management of the SBA in a separate letter dated November 14, 2011.

**Compliance and Other Matters**

The results of certain of our tests of compliance as 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 and one other matter that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and are described below.

**Debt Collection Improvement Act of 1996 (DCIA).** During our testwork over loan charge-offs, we noted the SBA did not refer obligors to the U.S. Department of Treasury (Treasury) for offset or cross-servicing, in accordance with DCIA. Specifically, we noted the SBA did not refer obligors (eligible principal borrowers, co-borrowers, and/or guarantors) associated with 504 delinquent Disaster Assistance loans to the Treasury for offset or cross-servicing at time of charge-off. We also noted in the 7(a), 504, and Disaster programs more than 5,000 eligible co-borrowers and guarantors were not referred for offset or cross-

U.S. Small Business Administration
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servicing, in conjunction with the principal borrower at time of loan charge-off. In both conditions, the obligors were not referred to the Treasury for collection during the period under review due to systemic problems with the legacy mainframe system utilized by the SBA to facilitate the referral process. Specifically, certain outdated system edits in the SBA's referral protocol prevented certain loans in charged-off status from being transferred to the Treasury for collection. Also, programmers in the Office of the Chief Information Officer modified the system code (referral protocol) but did not test the program changes during the development phase prior to implementing the changes in production. We noted during the fourth quarter of FY 2011 that the Office of the Chief Information Officer was in the process of implementing actions to address these deficiencies which led to the noncompliance with the DCIA. Exhibit III presents the status of the prior year noncompliance finding, which was also related to DCIA.

The results of our other tests of compliance as described in the Responsibilities Section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance and one other matter that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

A matter has been identified that may be a violation of the Federal Acquisition Regulation documentation retention requirements. This matter is currently under review by SBA management and the Office of Inspector General. The outcome of this matter is not presently known.

The results of our tests of FFMIA disclosed no instances in which the 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 United States Government 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 the SBA.

**Auditors' Responsibilities.** Our responsibility is to express an opinion on the FY 2011 and 2010 consolidated financial statements of the 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 the 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.

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Page 4 of 4

In planning and performing our FY 2011 audit, we considered the 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, but not for the purpose of expressing an opinion on the effectiveness of the 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. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

As part of obtaining reasonable assurance about whether the SBA's FY 2011 consolidated financial statements are free of material misstatement, we performed tests of the 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 the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the 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 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, 2011

**Exhibit I**

**U.S. Small Business Administration**

Significant Deficiency

The significant deficiency identified for the year ended September 30, 2011, is summarized below:

***Improvement Needed in Information Technology Security Controls***

During the Fiscal Year (FY) 2010 financial statement audit, we identified 20 information technology (IT) control findings and recommended many corresponding corrective actions. During the FY 2011 financial statement audit, we found that the U.S. Small Business Administration (SBA) implemented corrective actions to substantially remediate 10 of the 20 findings; however, we also identified 8 new IT control findings. Therefore, SBA's IT control environment continues to require improvement. The FY 2011 IT control deficiencies fall within the control areas of security access, including configuration and patch management, segregation of duties, and contingency planning. We are not providing details in this report on the specific deficiencies due to sensitivity considerations, but we have provided the details in a separate report to SBA management. Exhibit II of our report discloses the status of prior year IT findings.

*Security Access Controls*

Integral to an organization's security program management efforts, system security access controls 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 FY 2011 SBA financial statement audit follows:

- We identified several high- and medium-risk security vulnerabilities affecting various financial systems. We provided the detailed vulnerabilities to SBA management.
- We identified weaknesses in network access controls and one financial system.
- SBA was unable to provide evidence that security incidents are analyzed, validated, and resolved.
- Physical access control procedures can be improved for a financial system hosted by an SBA service provider. In addition, access to the service provider data center can be improved.
- Several users have unnecessary access to one SBA financial subsystem.
- User accounts are not reviewed in accordance with SBA policy for five of the seven systems we reviewed.
- There are weak controls over the monitoring and review of audit logs for two of the seven systems we reviewed.

Recommendation – Security Access Controls:

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

1. Enhance security vulnerability management processes. Specifically, SBA should: (a) redistribute procedures and train employees on the process for reviewing and mitigating security vulnerabilities, (b) periodically monitor the existence of unnecessary services and protocols running on their servers and network devices, (c) perform vulnerability assessments with administrative credentials and penetration tests on all SBA offices from a centrally managed location with a standardized reporting

**Exhibit I**

**U.S. Small Business Administration**

Significant Deficiency

mechanism that allows for trending, on a regularly scheduled basis in accordance with National Institute of Standards and Technology (NIST) guidance, (d) develop a more thorough approach to track and mitigate configuration management vulnerabilities identified during monthly scans, and (e) monitor security vulnerability reports for necessary or required configuration changes to their environment.

2. Update the vulnerability assessment team (VAT) procedures, to include: (a) updating the VAT policies and procedures in accordance with NIST, (b) performing technical reviews of the results for critical issues that need immediate action and take timely corrective action, (c) executing procedures to monitor the completion of the patch management deployment across the SBA enterprise, and (d) prioritizing vulnerabilities as part of the ongoing continuous monitoring process.
3. Prevent users from anonymously connecting unauthorized devices by developing and implementing procedures to ensure mandatory domain authentication for Internet Protocol (IP) address issuance.
4. Ensure users' access rights are authorized prior to gaining access to financial systems.
5. Fully implement the SBA entity wide incident management and response program and ensure that procedures are enforced.
6. Ensure that information systems hosted by third parties comply with SBA policy and NIST guidance.
7. Develop and implement procedures for user access reviews to ensure that proper access rights are set for financial subsystems.
8. Oversee the review and validation of financial system accounts on a quarterly basis.
9. Implement a process to monitor the audit logs of all financial applications on a regular basis.

*Segregation of Duties*

The primary focus of an organization's segregation of duties controls is to provide reasonable assurance that incompatible duties are effectively segregated. Without such controls, there is a risk that unauthorized changes could be implemented into the IT environment, and users may have access that is inappropriate for their duties. As a result, the confidentiality, integrity, and availability of financial data are at risk of possible loss, modification, or disclosure.

A summary of the segregation of duties control deficiencies we identified during the FY 2011 SBA financial statement audit follows:

- An authorized user had conflicting access rights in a key financial system.
- Six users were authorized with rights as a database administrator (DBA) and system administrator to a financial application hosted by a SBA service provider.

<u>Recommendations – Segregation of Duties:</u>

We recommend the CIO coordinate with the Chief Financial Officer (CFO) to:

10. Restrict access to software program libraries based on the principle of least privilege, and implement compensating controls over actions where limited resources cause individuals to perform conflicting job functions.

**Exhibit I**

**U.S. Small Business Administration**

Significant Deficiency

11. Ensure that DBA and system administrator access is restricted through role-based segregation of duties and managed through an effective audit log review process.

*Security Management*

An entity-wide information security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. This security management program should establish a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. During the FY 2011 SBA financial statement audit, we found that a mandatory training program for IT security personnel has not been implemented.

<u>Recommendations – Security Management:</u>

We recommend the CIO:

12. Develop a comprehensive security education and training program for all IT security personnel and a method for monitoring the training program.

*Software Configuration Management*

The primary focus of an organization's software configuration management process is to control the software changes made to networks and systems. 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.

A summary of the configuration management deficiencies we identified during the FY 2011 SBA financial statement audit follows:

- The configuration management process is not centralized, and the Enterprise Change Control Board governance processes are not fully implemented across SBA.
- SBA personnel could not provide sufficient evidence to support software change authorizations for one financial system.
- For one financial subsystem, loan charge-off software changes were not tested before being moved to production, which impacted the SBA's compliance with the Debt Collection Improvement Act of 1996 (DCIA). Note that these issues were reported as a noncompliance with the DCIA in the Compliance and Other Matters section of our audit report.

<u>Recommendations – Software Configuration Management:</u>

We recommend the CIO:

13. Enforce an organization-wide configuration management process, to include policies and procedures for maintaining documentation that supports testing and approvals of software changes.

We recommend the CIO coordinate with the CFO to:

I-3

**Exhibit I**

**U.S. Small Business Administration**

Significant Deficiency

14. Implement configuration management policies and procedures for document retention to include supporting evidence to validate the authorization of operating system changes.

*Contingency Planning*

The focus of an organization's contingency planning program should provide reasonable assurance that information resources are protected and the risk of unplanned interruptions is minimized. Without such controls, there is a risk that data may be lost or that critical operations may not resume in a timely manner.

A summary of the contingency planning weaknesses we identified during the FY 2011 SBA financial statement audit follows:

- Backup tapes necessary to restore system operations are not consistently rotated off-site for four of the seven systems we reviewed.
- Comprehensive contingency and disaster recovery plans have not been developed, authorized, nor tested for three of the seven systems reviewed. Additionally, we noted that two financial systems and the Headquarters (HQ) Continuity of Operations Plan (COOP) were in place; however, the plans were not tested on a semiannual basis as prescribed by SBA policy.

Recommendations – Contingency Planning:

We recommend the CIO:

15. Enforce existing SBA policies to rotate backups off-site.

We recommend the CIO coordinate with the CFO to:

16. Create, implement, and test system specific and the HQ COOP.

**Exhibit II**

**U.S. Small Business Administration**

Status of Prior Year Significant Deficiency

| **Fiscal Year 2010 Finding** | **Fiscal Year 2011 Status of Finding** |
|---|---|
| Improvement Needed in Information Technology (IT) Security Controls | During our review of SBA's IT general and application controls, we noted some improvements made to address prior year findings. However, control deficiencies continue to exist.<br><br>Therefore, in Fiscal Year (FY) 2011, the issue is again presented in Exhibit I. 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 the associated impact on the consolidated financial statements. |

**Exhibit III**

**U.S. Small Business Administration**

Status of Prior Year Noncompliance

| **Fiscal Year 2010 Finding** | **Fiscal Year 2011 Status of Finding** |
|---|---|
| *Debt Collection Improvement Act of 1996 (DCIA)*<br><br>During our Fiscal Year (FY) 2010 audit, we noted the agency was noncompliant with the DCIA. The noncompliance was due to instances where SBA did not refer a substantial number of charged-off disaster loans to Treasury for cross-servicing. | During our review over SBA's compliance with the DCIA, we noted improvements made in SBA's Treasury cross-servicing referral process. However, during FY 2011, we noted instances of noncompliance related to timely referrals of loan charge-offs to Treasury for offset and cross-servicing.<br><br>Therefore, in FY 2011, the issue is again presented in the Compliance and Other Matters section of our Independent Auditors' Report. |

III-1

Exhibit IV

# CFO Response to Draft Audit Report on FY 2011 Financial Statements

**DATE:** November 14, 2011

**TO:** John Needham, Assistant IG for Auditing

**FROM:** Jonathan Carver, Chief Financial Officer

**SUBJECT:** Draft Audit Report on FY 2011 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 its 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 with no reported material weaknesses. 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 in past 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 audit report includes a continuing significant deficiency in SBA's information technology controls. As the auditor noted in its report on the 2011 financial statements, the SBA implemented corrective action this year to substantially remediate 10 of the 20 prior year IT control findings. The auditor, however, identified 8 new IT findings this year. The SBA will continue to improve the Agency's IT security during the upcoming fiscal year. The SBA will continue to track, monitor, and aggressively mitigate vulnerabilities in all Agency systems. Furthermore, the SBA will continue its work to clarify and strengthen detailed procedures required to ensure security access controls are in place to protect SBA data from unauthorized modification, disclosure, and loss.

The auditor reported again this year that the SBA is not compliant with the Debt Collection Improvement Act of 1996 in the non referral of delinquent and charged-off loans to the Department of the Treasury for its tax refund offset and collection programs. Although the SBA made improvements to correct systemic errors identified last year, the auditor again found instances of charged off disaster loans and eligible business loan co-borrowers and guarantors that were not referred to Treasury. Research by the SBA identified the systemic issues that caused this finding and they were rectified this year. The SBA is working aggressively on this non compliance issue to eliminate it in FY 2012.

During the audit, the auditor identified a potential non compliance with Federal Acquisition Regulation requirements for document retention. The SBA had previously recognized the need for improvement to its acquisition process and has taken action to reorganize and improve its processes concerning the acquisition of goods and services. Furthermore, procurement actions during the current year have been conducted in accordance with FAR requirements, including file documentation, and the SBA is now working to review and fully document prior year procurement files.

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 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 used, along with other financial reports, to monitor and control budgetary resources. The SBA prepares these financial statements from its books and records in accordance with generally accepted accounting principles in the United States as well as 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 includes offsetting receipts in this statement for the purpose of reconciling outlay information presented in 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, 2011 and 2010

*(Dollars in Thousands)*

| | 2011 | 2010 |
|---|---|---|
| **ASSETS** | | |
| Intragovernmental Assets | | |
| Fund Balance with Treasury (Note 2) | $ 8,469,322 | $ 6,116,325 |
| Accounts Receivable (Note 5) | 406 | – |
| Total Intragovernmental Assets | 8,469,728 | 6,116,325 |
| Assets - Public and Other | | |
| Cash (Note 3) | 2,935 | 3,031 |
| Accounts Receivable, Net (Note 5) | 52,813 | 30,961 |
| Credit Program Receivables and Related Foreclosed Property, Net (Note 6) | 8,354,739 | 9,076,679 |
| General Property and Equipment, Net (Note 7) | 1,804 | 2,817 |
| Advances | 782 | 663 |
| Total Assets - Public and Other | 8,413,073 | 9,114,151 |
| **Total Assets** | **$ 16,882,801** | **$ 15,230,476** |
| **LIABILITIES** | | |
| Intragovernmental Liabilities | | |
| Interest Payable | $ 1,347 | $ 1,435 |
| Debt (Note 9) | 11,190,279 | 11,753,781 |
| Net Assets of Liquidating Funds Due to Treasury (Note 10) | 63,970 | 68,359 |
| Downward Reestimate Payable to Treasury (Note 1, Note 13) | 911,765 | 130,993 |
| Other (Note 8, Note 11) | 13,657 | 14,234 |
| Total Intragovernmental Liabilities | 12,181,018 | 11,968,802 |
| Other Liabilities - Public | | |
| Accounts Payable (Note 1) | 94,628 | 169,723 |
| Accrued Grant Liability (Note 1) | 76,000 | 62,576 |
| Liability for Loan Guaranties (Note 6) | 4,741,442 | 4,467,006 |
| Federal Employees' Compensation Act Actuarial Liability (Note 1, Note 8) | 30,630 | 29,960 |
| Surety Bond Guarantee Program Future Claims (Note 8) | 20,385 | 19,539 |
| Other (Note 8, Note 11) | 47,721 | 47,415 |
| Total Other Liabilities - Public | 5,010,806 | 4,796,219 |
| **Total Liabilities** | **17,191,824** | **16,765,021** |
| **NET POSITION** | | |
| Unexpended Appropriations (Note 1) | 1,537,185 | 2,295,070 |
| Cumulative Results of Operations (Note 1) | (1,846,208) | (3,829,615) |
| **Total Net Position** | **(309,023)** | **(1,534,545)** |
| **Total Liabilities and Net Position** | **$ 16,882,801** | **$ 15,230,476** |

*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, 2011 and 2010

*(Dollars in Thousands)*

| | 2011 | 2010 |
|---|---|---|
| **STRATEGIC GOAL 1:** | | |
| **Growing Businesses and Creating Jobs** | | |
| Gross Cost | $ 4,000,361 | $ 5,799,783 |
| Less: Earned Revenue | 696,210 | 626,087 |
| **Net Cost of Strategic Goal 1** | **3,304,151** | **5,173,696** |
| **STRATEGIC GOAL 2:** | | |
| **Building an SBA that Meets the Needs of Today's and Tomorrow's Small Businesses** | | |
| Gross Cost | 6,132 | 5,343 |
| **Total Program Cost of Strategic Goal 2** | **6,132** | **5,343** |
| **STRATEGIC GOAL 3:** | | |
| **Serving as the Voice for Small Business** | | |
| Gross Cost | 13,454 | 12,738 |
| **Total Program Cost of Strategic Goal 3** | **13,454** | **12,738** |
| **COST NOT ASSIGNED TO STRATEGIC GOALS** | | |
| Gross Cost | 136,825 | 85,420 |
| **Total Program Cost Not Assigned to Strategic Goals** | **136,825** | **85,420** |
| **Net Cost of Operations** | **$ 3,460,562** | **$ 5,277,197** |

**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, 2011 and 2010

*(Dollars in Thousands)*

| | 2011 | 2010 |
|---|---|---|
| **Beginning Cumulative Results of Operations** | **$ (3,829,615)** | **$ (4,672,104)** |
| **Budgetary Financing Sources** | | |
| Appropriations Used | 6,353,577 | 6,231,677 |
| Donations of Cash and Cash Equivalents | 33 | 24 |
| **Other Financing Sources** | | |
| Imputed Financing from Costs Absorbed by Others | 26,749 | 32,765 |
| Other - Cancelled Authority | – | (3) |
| Other - Current Year Liquidating Equity Activity | (2,409) | (760) |
| Other - Non-entity Activity | (933,981) | (144,017) |
| **Total Financing Sources** | **5,443,969** | **6,119,686** |
| **Less: Net Cost of Operations** | **3,460,562** | **5,277,197** |
| **Ending Cumulative Results of Operations** | **$ (1,846,208)** | **$ (3,829,615)** |
| **Beginning Unexpended Appropriations** | **$ 2,295,070** | **$ 1,983,504** |
| **Budgetary Financing Sources** | | |
| Appropriations Received | 5,611,644 | 6,554,119 |
| Rescissions | (1,462) | – |
| Adjustment - Cancelled Authority | (10,120) | (7,598) |
| Other Adjustments | (4,370) | (3,278) |
| Appropriations Used | (6,353,577) | (6,231,677) |
| **Total Budgetary Financing Sources** | **(757,885)** | **311,566** |
| **Ending Unexpended Appropriations** | **$ 1,537,185** | **$ 2,295,070** |
| **Ending Net Position** | **$ (309,023)** | **$ (1,534,545)** |

*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, 2011 and 2010

*(Dollars in Thousands)*

| | September 30, 2011 | | |
|---|---|---|---|
| | **Budgetary** | **Nonbudgetary Financing** | **Total** |
| **BUDGETARY RESOURCES** | | | |
| Unobligated Balance | | | |
| Brought Forward October 1 | $ 1,768,609 | $ 3,458,375 | $ 5,226,984 |
| Recoveries of Prior Year Obligations | 69,518 | 91,458 | 160,976 |
| Budget Authority | | | |
| Appropriations Received | 5,611,644 | – | 5,611,644 |
| Borrowing Authority | – | 1,078,132 | 1,078,132 |
| Spending Authority from Offsetting Collections | | | |
| Earned | 384,449 | 8,384,188 | 8,768,637 |
| Change in Unfilled Customer Orders | 78,802 | 16,453 | 95,255 |
| Total Budget Authority | 6,074,895 | 9,478,773 | 15,553,668 |
| Permanently Not Available | (24,302) | (1,640,034) | (1,664,336) |
| **Total Budgetary Resources** | **$ 7,888,720** | **$ 11,388,572** | **$ 19,277,292** |
| **STATUS OF BUDGETARY RESOURCES** | | | |
| Obligations Incurred, Net | | | |
| Direct | $ 6,103,428 | $ 4,973,564 | $ 11,076,992 |
| Reimbursable | 816,015 | – | 816,015 |
| Total Obligations Incurred, Net | 6,919,443 | 4,973,564 | 11,893,007 |
| Unobligated Balances, Available | 271,885 | 1,845,919 | 2,117,804 |
| Unobligated Balances, Not Available | 697,392 | 4,569,089 | 5,266,481 |
| **Total Status of Budgetary Resources** | **$ 7,888,720** | **$ 11,388,572** | **$ 19,277,292** |
| **CHANGE IN OBLIGATED BALANCES** | | | |
| Obligated Balance Brought Forward, Net October 1 | | | |
| Unpaid Obligations Brought Forward | $ 676,054 | $ 443,586 | $ 1,119,640 |
| Uncollected Customer Payments from Federal Sources Brought Forward | – | (230,303) | (230,303) |
| Total Obligated Balance Brought Forward, Net | 676,054 | 213,283 | 889,337 |
| Obligations Incurred | 6,919,443 | 4,973,564 | 11,893,007 |
| Gross Outlays | (6,778,868) | (4,741,014) | (11,519,882) |
| Recoveries of Prior Year Unpaid Obligations | (69,518) | (91,458) | (160,976) |
| Change in Uncollected Customer Payments from Federal Sources | – | (16,453) | (16,453) |
| Obligated Balance, Net, End of Period | | | |
| Unpaid Obligations | 747,111 | 584,678 | 1,331,789 |
| Uncollected Customer Payments from Federal Sources | – | (246,756) | (246,756) |
| **Total Obligated Balance, Net, End of Period** | **$ 747,111** | **$ 337,922** | **$ 1,085,033** |
| **NET OUTLAYS** | | | |
| Gross Outlays | $ 6,778,868 | $ 4,741,014 | $ 11,519,882 |
| Offsetting Collections | (463,253) | (8,384,188) | (8,847,441) |
| Net Outlays Before Offsetting Receipts | 6,315,615 | (3,643,174) | 2,672,441 |
| Offsetting Receipts | (97) | (153,211) | (153,308) |
| **Net Outlays** | **$ 6,315,518** | **$ (3,796,385)** | **$ 2,519,133** |

**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, 2011 and 2010

*(Dollars in Thousands)*

| | September 30, 2010 | | |
|---|---|---|---|
| | Budgetary | Nonbudgetary Financing | Total |
| **BUDGETARY RESOURCES** | | | |
| Unobligated Balance | | | |
| Brought Forward October 1 | $ 1,506,612 | $ 1,195,311 | $ 2,701,923 |
| Recoveries of Prior Year Obligations | 53,179 | 81,604 | 134,783 |
| Budget Authority | | | |
| Appropriations Received | 6,554,119 | – | 6,554,119 |
| Borrowing Authority | – | 2,737,959 | 2,737,959 |
| Spending Authority from Offsetting Collections | | | |
| Earned | 395,025 | 7,823,359 | 8,218,384 |
| Change in Unfilled Customer Orders | (116,593) | (5,571) | (122,164) |
| Total Budget Authority | 6,832,551 | 10,555,747 | 17,388,298 |
| Permanently Not Available | (25,123) | (1,859,112) | (1,884,235) |
| **Total Budgetary Resources** | **$ 8,367,219** | **$ 9,973,550** | **$ 18,340,769** |
| **STATUS OF BUDGETARY RESOURCES** | | | |
| Obligations Incurred, Net | | | |
| Direct | $ 5,981,675 | $ 6,515,175 | $ 12,496,850 |
| Reimbursable | 616,935 | – | 616,935 |
| Total Obligations Incurred, Net | 6,598,610 | 6,515,175 | 13,113,785 |
| Unobligated Balances, Available | 215,473 | 2,060,909 | 2,276,382 |
| Unobligated Balances, Not Available | 1,553,136 | 1,397,466 | 2,950,602 |
| **Total Status of Budgetary Resources** | **$ 8,367,219** | **$ 9,973,550** | **$ 18,340,769** |
| **CHANGE IN OBLIGATED BALANCES** | | | |
| Obligated Balance Brought Forward, Net October 1 | | | |
| Unpaid Obligations Brought Forward | $ 613,478 | $ 389,934 | $ 1,003,412 |
| Uncollected Customer Payments from Federal Sources Brought Forward | – | (235,874) | (235,874) |
| Total Obligated Balance Brought Forward, Net | 613,478 | 154,060 | 767,538 |
| Obligations Incurred | 6,598,610 | 6,515,175 | 13,113,785 |
| Gross Outlays | (6,482,855) | (6,379,919) | (12,862,774) |
| Recoveries of Prior Year Unpaid Obligations | (53,179) | (81,604) | (134,783) |
| Change in Uncollected Customer Payments from Federal Sources | – | 5,571 | 5,571 |
| Obligated Balance, Net, End of Period | | | |
| Unpaid Obligations | 676,054 | 443,586 | 1,119,640 |
| Uncollected Customer Payments from Federal Sources | – | (230,303) | (230,303) |
| **Total Obligated Balance, Net, End of Period** | **$ 676,054** | **$ 213,283** | **$ 889,337** |
| **NET OUTLAYS** | | | |
| Gross Outlays | $ 6,482,855 | $ 6,379,919 | $ 12,862,774 |
| Offsetting Collections | (278,430) | (7,823,359) | (8,101,789) |
| Net Outlays Before Offsetting Receipts | 6,204,425 | (1,443,440) | 4,760,985 |
| Offsetting Receipts | (110) | (77,891) | (78,001) |
| **Net Outlays** | **$ 6,204,315** | **$ (1,521,331)** | **$ 4,682,984** |

**Note 15**

*The accompanying notes are an integral part of these statements.*

# NOTE 1 Significant Accounting Policies

## 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 natural 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 to report 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 using 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 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 commitment or obligation of funds in advance of the proprietary accruals and facilitates compliance with legal constraints and controls over the use of federal funds.

## Use of Estimates

SBA's management makes assumptions and uses 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 guidelines in the Federal Credit Reform Act of 1990. The SBA recognizes the sensitivity of credit reform modeling to slight changes in some model assumptions and therefore continually reviews its model factors and statistical modeling techniques to reflect the most accurate credit program costs possible in its annual financial statements.

## 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 Department of 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. Similarly, appropriations received for the long-term cost of loan guaranties are reserved when the guarantied loans are disbursed.

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 Treasury borrowings, the collection of loan fees, repayments and default recoveries, and the disbursement of loans and loan expenses.

## 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 SBA lenders for their 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 subject 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.

## 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 subsidy 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. Such 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 benefits 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 of these benefits is funded through Agency contributions, employee compensation to the extent withheld from employee and retiree pay, from matching of employee withholding for the 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 these imputed costs 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. Cash receipts are deposited into SBA's Treasury General accounts. 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, | 2011 | 2010 |
|---|---|---|
| Appropriated Funds | $ 1,641,312 | $ 2,373,450 |
| Financing Funds | 6,752,927 | 3,671,657 |
| Liquidating Funds | 16,013 | 14,588 |
| Revolving Fund | 58,933 | 56,363 |
| Trust Fund | 133 | 263 |
| **Total Entity Fund Balance with Treasury** | **8,469,318** | **6,116,321** |
| **Non-entity Fund Balance** | **4** | **4** |
| **Total Fund Balance with Treasury** | **$ 8,469,322** | **$ 6,116,325** |
| | | |
| **Status of Fund Balance with Treasury** | | |
| Unobligated Balance Available | $ 2,117,804 | $ 2,276,382 |
| Unobligated Balance Unavailable | 5,266,481 | 2,950,602 |
| Obligated Balance Not Yet Disbursed | 1,085,033 | 889,337 |
| Nonbudgetary | 4 | 4 |
| **Total Fund Balance with Treasury** | **$ 8,469,322** | **$ 6,116,325** |

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 $2.9 million and $3.0 million at September 30, 2011 and 2010.

## 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.

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 SBA policy entirely in Treasury securities and repurchase agreements that are backed by Treasury securities. The MRF is an integral part of the 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 SBA's guaranty of timely payment, as well as a default guaranty, to 7(a) secondary market investors. There was $17.6 billion and $15.5 billion of outstanding SBA guarantied loan principal in the secondary market at September 30, 2011 and 2010.

The MRA facilitates the operation of the 504 Certified 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. There was $24.3 billion and $23.4 billion of SBA guarantied 504 debentures outstanding in the secondary market at September 30, 2011 and 2010.

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, | 2011 | 2010 |
|---|---|---|
| **Short Term Securities** | | |
| Money Market Funds | $ 10,086 | $ 27,767 |
| Treasury Bills | 17,997 | 47,957 |
| Repurchase Agreements | 915,951 | 826,147 |
| **Total Short Term Securities** | **944,034** | **901,871** |
| **Long Term Securities** | | |
| Treasury Notes Including Interest | 1,833,113 | 1,724,565 |
| **Total Long Term Securities** | **1,833,113** | **1,724,565** |
| **Net Assets** | **$ 2,777,147** | **$ 2,626,436** |

**RECONCILIATION OF FIDUCIARY ASSETS**

| FOR THE YEARS ENDING SEPTEMBER 30, | 2011 | 2010 |
|---|---|---|
| **Beginning Net Assets** | **$ 2,626,436** | **$ 2,386,495** |
| **Receipts** | | |
| Earned Income | 56,057 | 63,178 |
| Contributions | 7,913,304 | 7,808,155 |
| Net Realized Gain (Loss) | 2,503 | 3,097 |
| **Total Receipts** | **7,971,864** | **7,874,430** |
| **Less Disbursements** | | |
| Payments to Investors | 7,821,153 | 7,634,350 |
| Expenses | – | 139 |
| **Total Disbursements** | **7,821,153** | **7,634,489** |
| **Ending Net Assets** | **$ 2,777,147** | **$ 2,626,436** |

# 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 aging of delinquent balances. The uncollectible or unrecoverable amounts for Guaranty Fees Receivable, Refunds and Other accounts receivable are not significant and no allowance is provided.

*(Dollars in Thousands)*

| AS OF SEPTEMBER 30, | | 2011 | | 2010 |
|---|---|---|---|---|
| **Intragovernmental** | | | | |
| Administrative Receivables | $ | 406 | $ | – |
| **Total Intragovernmental** | **$** | **406** | **$** | **–** |
| | | | | |
| **Public** | | | | |
| Guaranty Fees Receivable | $ | 37,108 | $ | 13,559 |
| Refunds | | 146 | | 18 |
| Other | | 15,561 | | 17,403 |
| **Total Public** | | **52,815** | | **30,980** |
| Allowance For Loss | | (2) | | (19) |
| **Net Public** | **$** | **52,813** | **$** | **30,961** |

# 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 | 504 Certified Development Company |
| Business | Guarantied | Small Business Investment Company Debentures |
| Business | Guarantied | Small Business Investment Company Participating Securities |
| Business | Guarantied | America's Recovery Capital Loan |
| Business | Guarantied | 504 First Mortgage Loan Pooling |
| Business | Direct | 7(m) Microloan |
| Business | Direct | Intermediary Lending Pilot Program |

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 4 percent for loan applicants without credit available elsewhere and 8 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 businesses. America's Recovery Capital Loan program was a temporary guaranty loan program authorized by the American Recovery and Reinvestment Act of 2009 (ARRA) until September 30, 2010. 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 guarantied by the SBA to the lender, and have no fees associated with them. The SBA will continue to service the ARC loan portfolio until its maturity. The 504 First Mortgage Loan Pooling program was authorized by the American Recovery and Reinvestment Act to provide liquidity to banks through the sale in the secondary market of SBA Guarantied pools of bank loans related to the 504 CDC program so that the banks can make additional loans to small businesses. The 7(m) Microloan program provides direct loans to nonprofit intermediaries, which use these funds to make loans up to $50,000 to eligible small businesses. The Intermediary Lending Pilot program was authorized in the Small Business Jobs Act to provide $20 million of loans to Intermediaries for relending to small businesses in economically distressed areas with a lack of credit availability to small business.

## 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 receivable 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 loans receivable 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 loans receivable 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 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. The advances are liquidated by receipt of the payments due from borrowers in these programs. To the extent that borrower payments may not repay advances, balances that remain collectible are reported as credit program receivables. Advances are also made to the Federal Financing Bank for loans guarantied under Section 503 of the Small Business Act. 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 disbursed 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. The SBA records subsidy expenses when loans are disbursed. In accordance with FCRA, subsidy costs are reestimated annually.

### 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.

### FORECLOSED PROPERTY

Foreclosed property is comprised of real and business-related personal property acquired through foreclosure on direct 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. At September 30, 2011 SBA's foreclosed property was $39.9 million related to 72 loans. The properties had been held for an average of 789 days. At September 30, 2010 foreclosed property was $44.9 million related to 79 loans. The properties had been held for an average of 616 days.

### VALUATION METHODOLOGY FOR POST-1991 DIRECT LOANS AND LOAN GUARANTIES

The value of direct and guarantied loans committed after FY 1991 is 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.

SBA's models vary in the specific methodologies employed to forecast future program cash flows. In general, however, models for all major credit programs use historical data as the basis for assumptions about future program performance and then translate these assumptions into nominal cash flow estimates by applying rules about program structure. Nominal cash flow forecasts are discounted using the Office of Management and Budget's Credit Subsidy Calculator that has both forecasted and actual Treasury interest rates.

Historical data is used as the basis for program performance assumptions. The historical data undergoes quality review and analysis prior to its use in developing model assumptions.

Key input to the subsidy models varies by program. Input includes items such as:

- contractual terms of the loan or guaranty such as loan amount, interest rate, maturity and grace period;
- borrower characteristics;
- loan origination methods;
- economic indicators such as gross domestic product growth and unemployment rate;
- loan performance assumptions, for example: conditional purchase and prepayment rates and recovery rates; and
- loan fee rates

### VALUATION METHODOLOGY FOR PRE-1992 DIRECT LOANS AND LOAN GUARANTIES

The SBA values pre-credit reform direct and defaulted guarantied loans by estimating an allowance for loan losses. This allowance is offset against gross loan receivables to obtain SBA's expected net collections from these assets. The SBA establishes a 100 percent allowance for pre-credit reform direct and guarantied loans that are past due more than 180 days. A liability is also established for active pre-credit reform loan guaranties. The liability is estimated based on historical experience.

## B. Credit Program Receivables and Related Foreclosure Property, Net

*(Dollars in Thousands)*

| AS OF SEPTEMBER 30, 2011 | Pre-1992 Loans | Post-1991 Loans | Total |
|---|---|---|---|
| **Direct Business Loans** | | | |
| Business Loans Receivable | $ 14,810 | $ 125,065 | $ 139,875 |
| Interest Receivable | 1,907 | 997 | 2,904 |
| Foreclosed Property | 3,106 | – | 3,106 |
| Allowance | (1,824) | (31,635) | (33,459) |
| **Total Direct Business Loans** | **17,999** | **94,427** | **112,426** |
| **Direct Disaster Loans** | | | |
| Disaster Loans Receivable | 8,563 | 7,459,690 | 7,468,253 |
| Interest Receivable | 65 | 33,797 | 33,862 |
| Foreclosed Property | – | 799 | 799 |
| Allowance | (1,042) | (1,486,011) | (1,487,053) |
| **Total Direct Disaster Loans** | **7,586** | **6,008,275** | **6,015,861** |
| **Defaulted Guarantied Business Loans & Other Loans Receivable** | | | |
| Defaulted Guarantied Business Loans | 39,829 | 8,285,473 | 8,325,302 |
| Other Loans Receivable (see note below) | – | 502,332 | 502,332 |
| Interest Receivable | 794 | 71,489 | 72,283 |
| Foreclosed Property | 3,238 | 32,734 | 35,972 |
| Allowance | (21,278) | (6,688,159) | (6,709,437) |
| **Total Defaulted Guarantied Business Loans & Other Loans Receivable** | **22,583** | **2,203,869** | **2,226,452** |
| **Total Credit Program Receivables & Related Foreclosed Property, Net** | | | **$ 8,354,739** |

| AS OF SEPTEMBER 30, 2010 | Pre-1992 Loans | Post-1991 Loans | Total |
|---|---|---|---|
| **Direct Business Loans** | | | |
| Business Loans Receivable | $ 18,218 | $ 120,151 | $ 138,369 |
| Interest Receivable | 2,457 | 1,077 | 3,534 |
| Foreclosed Property | 3,104 | – | 3,104 |
| Allowance | (1,595) | (30,646) | (32,241) |
| **Total Direct Business Loans** | **22,184** | **90,582** | **112,766** |
| **Direct Disaster Loans** | | | |
| Disaster Loans Receivable | 10,643 | 7,931,998 | 7,942,641 |
| Interest Receivable | 73 | 12,191 | 12,264 |
| Foreclosed Property | – | 658 | 658 |
| Allowance | (740) | (1,475,666) | (1,476,406) |
| **Total Direct Disaster Loans** | **9,976** | **6,469,181** | **6,479,157** |
| **Defaulted Guarantied Business Loans & Other Loans Receivable** | | | |
| Defaulted Guarantied Business Loans | 51,002 | 7,763,190 | 7,814,192 |
| Other Loans Receivable (see note below) | – | 583,745 | 583,745 |
| Interest Receivable | 408 | 48,719 | 49,127 |
| Foreclosed Property | 3,281 | 37,910 | 41,191 |
| Allowance | (30,163) | (5,973,336) | (6,003,499) |
| **Total Defaulted Guarantied Business Loans & Other Loans Receivable** | **24,528** | **2,460,228** | **2,484,756** |
| **Total Credit Program Receivables & Related Foreclosed Property, Net** | | | **$ 9,076,679** |

*Note: Other Loans Receivable includes payments advanced by the SBA against future reimbursements in the SBIC and 504 guaranty programs.*

## C. Loans Disbursed and Outstanding Loan Obligations

*(Dollars in Thousands)*

### DIRECT LOANS

| New Loans Disbursed During the Year Ending September 30, | 2011 | 2010 |
|---|---|---|
| Business Direct Loan Program | $ 33,799 | $ 31,620 |
| Disaster Loan Program | 312,050 | 387,058 |
| **Total Direct Loans Disbursed** | **$ 345,849** | **$ 418,678** |

| Outstanding Loan Obligations as of September 30, | 2011 | 2010 |
|---|---|---|
| Business Direct Loan Program | $ 61,640 | $ 41,547 |
| Disaster Loan Program | 427,244 | 217,463 |
| **Total Direct Loan Obligations** | **$ 488,884** | **$ 259,010** |

### GUARANTIED LOANS

| New Loans Disbursed During the Year Ending September 30, | 2011 | 2010 |
|---|---|---|
| Total Principal Disbursed at Face Value | $ 19,647,608 | $ 15,060,123 |
| Total Principal Disbursed Guarantied by the SBA | 16,584,726 | 13,150,441 |

| Outstanding Loan Obligations as of September 30, | 2011 | 2010 |
|---|---|---|
| Business Guarantied Loan Programs | $ 12,415,542 | $ 10,081,005 |

| Loans Outstanding as of September 30, | 2011 | 2010 |
|---|---|---|
| Total Principal Outstanding at Face Value | $ 82,233,722 | $ 76,247,818 |
| Total Principal Outstanding Guarantied by the SBA | 70,011,195 | 64,433,140 |

## D. Subsidy Cost Allowance Balances

*(Dollars in Thousands)*

| FOR THE YEARS ENDING SEPTEMBER 30, | 2011 | 2010 |
|---|---|---|
| **Post-1991 Business Direct and Purchased Guarantied Loans** | | |
| **Beginning Balance of Allowance Account** | **$ 6,003,982** | **$ 4,370,380** |
| Current Year's Subsidy (see 6G for breakdown by component) | 5,128 | 3,671 |
| Loans Written Off | (2,224,182) | (2,425,174) |
| Subsidy Amortization | (1,980) | (2,583) |
| Allowance Related to Guarantied Loans Purchased This Year | 2,860,687 | 4,015,052 |
| Miscellaneous Recoveries and Costs | 72,139 | 41,835 |
| Balance of Subsidy Allowance Account before Reestimates | 6,715,774 | 6,003,181 |
| Technical Assumptions/Default Reestimates | 4,020 | 801 |
| **Ending Balance of Allowance Account** | **$ 6,719,794** | **$ 6,003,982** |
| | | |
| **Post-1991 Disaster Direct Loans** | | |
| **Beginning Balance of Allowance Account** | **$ 1,475,666** | **$ 1,597,336** |
| Current Year's Subsidy (see 6G for breakdown by component) | 39,736 | 47,079 |
| Loans Written Off | (212,044) | (303,284) |
| Subsidy Amortization | (14,522) | (64,274) |
| Miscellaneous Recoveries and Costs | 41,529 | 37,516 |
| Balance of Subsidy Allowance Account before Reestimates | 1,330,365 | 1,314,373 |
| Technical Assumptions/Default Reestimates | 155,646 | 161,293 |
| **Ending Balance of Allowance Account** | **$ 1,486,011** | **$ 1,475,666** |

## E. Loan Guaranty Liability Balances

*(Dollars in Thousands)*

| FOR THE YEARS ENDING SEPTEMBER 30, | 2011 | 2010 |
|---|---|---|
| **Pre-1992 Business Loan Guaranties** | | |
| **Beginning Balance of Liability for Loan Guaranties** | **$ 574** | **$ 809** |
| Adjustment to Expected Losses, Guaranties Outstanding | (268) | (235) |
| **Ending Balance of Liability for Loan Guaranties** | **306** | **574** |
| | | |
| **Post-1991 Business Loan Guaranties** | | |
| **Beginning Balance of Liability for Loan Guaranties** | **4,466,432** | **3,993,827** |
| Current Year's Subsidy (see 6G for breakdown by component) | 553,814 | 574,260 |
| Fees | 632,922 | 394,739 |
| Interest Accumulation Factor | 111,290 | (31,617) |
| Claim Payments to Lenders | (3,418,876) | (4,925,476) |
| Adjustment Due to Reestimate & Guarantied Loan Purchases | 558,189 | 910,425 |
| Miscellaneous Recoveries and Costs | 36,185 | (64,707) |
| Balance of Liability for Loan Guaranties before Reestimates | 2,939,956 | 851,451 |
| Technical Assumptions/Default Reestimates | 1,801,180 | 3,614,981 |
| **Ending Balance of Liability for Loan Guaranties** | **4,741,136** | **4,466,432** |
| | | |
| **Total Ending Balance of Liability for Loan Guaranties** | **$ 4,741,442** | **$ 4,467,006** |

## F. 2011 Subsidy Rates by Program and Component

| LOAN PROGRAM | Total Subsidy | Financing | Default | Other | Fee |
|---|---|---|---|---|---|
| **Guaranty** | | | | | |
| 7(a) | **1.01%** | 0.00% | 4.91% | 0.00% | -3.90% |
| 7(a) (after 1/1/11) | **0.97%** | 0.00% | 4.88% | 0.00% | -3.91% |
| 504 CDC | **0.00%** | 0.00% | 6.01% | 0.35% | -6.36% |
| Disaster Guaranty - Immediate | **1.89%** | 0.00% | 1.89% | 0.00% | 0.00% |
| SBIC Debentures | **0.00%** | 0.00% | 6.15% | 0.04% | -6.19% |
| | | | | | |
| **Direct** | | | | | |
| Disaster | **13.53%** | 8.76% | 10.77% | -6.00% | 0.00% |
| Microloan | **15.06%** | 6.17% | 2.15% | 6.74% | 0.00% |
| ILP | **30.58%** | 28.01% | 2.57% | 0.00% | 0.00% |
| | | | | | |
| **ARRA Guaranty** | | | | | |
| 504 First Mortgage Loan Pooling | **0.00%** | 0.00% | 1.28% | 0.00% | -1.28% |
| | | | | | |
| **Jobs Act Guaranty** | | | | | |
| 7(a) | **5.48%** | 0.00% | 7.37% | 0.00% | -1.89% |
| 504 CDC | **2.18%** | 0.00% | 6.01% | 0.35% | -4.18% |
| 504 CDC - Debt Refinancing | **0.00%** | 0.00% | 7.78% | 0.51% | -8.29% |
| Dealer Floor Plan | **0.02%** | 0.00% | 0.15% | 0.00% | -0.13% |

The subsidy rates in Table F pertain only to loans obligated in the current year. These rates cannot be applied to the loans disbursed during the current year to yield the subsidy expense because loans disbursed during the current year include loans obligated in prior years. Subsidy expenses reported in Table G result from the disbursement of loans obligated in the current year as well as in prior years, and include reestimates.

## G. Subsidy Expense by Component

*(Dollars in Thousands)*

| FOR THE YEARS ENDING SEPTEMBER 30, | 2011 | 2010 |
|---|---|---|
| **Business Loan Guaranties** | | |
| Interest | $ 7,395 | $ 40,675 |
| Defaults | 993,474 | 757,709 |
| Fees | (454,961) | (232,850) |
| Other | 7,906 | 8,726 |
| Subsidy Expense Before Reestimates and Loan Modifications | 553,814 | 574,260 |
| Reestimates | 1,801,180 | 3,614,981 |
| **Total Guarantied Business Loan Subsidy Expense** | **$ 2,354,994** | **$ 4,189,241** |
| | | |
| **Business Direct Loans** | | |
| Interest | $ 2,663 | $ 1,730 |
| Defaults | 692 | 410 |
| Other | 1,773 | 1,531 |
| Subsidy Expense Before Reestimates | 5,128 | 3,671 |
| Reestimates | 4,020 | 801 |
| **Total Business Direct Loan Subsidy Expense** | **$ 9,148** | **$ 4,472** |
| | | |
| **Disaster Direct Loans** | | |
| Interest | $ 21,926 | $ 22,663 |
| Defaults | 34,396 | 42,449 |
| Other | (16,586) | (18,033) |
| Subsidy Expense Before Reestimates | 39,736 | 47,079 |
| Reestimates | 155,646 | 161,293 |
| **Total Disaster Direct Loan Subsidy Expense** | **$ 195,382** | **$ 208,372** |

## H. Administrative Expense

The SBA received appropriations to administer its credit programs, including the making, servicing and liquidation of its loans and guaranties. Amounts expensed in the Statement of Net Cost are:

*(Dollars in Thousands)*

| FOR THE YEARS ENDING SEPTEMBER 30, | 2011 | 2010 |
|---|---|---|
| Disaster Direct Loan Programs | $ 190,228 | $ 203,716 |
| Business Loan Programs | 157,767 | 151,098 |
| **Total Administrative Expense** | **$ 347,995** | **$ 354,814** |

## I. Credit Program Subsidy Reestimates

Reestimates are performed annually, on a cohort-by-cohort basis. The purpose of reestimates is to update original program cost estimates to reflect actual cash flow experience as well as changes in forecasts of future cash flows. Forecasts of future cash flows are updated based on additional information about historical program performance, revised expectations for future economic conditions, and enhancements to cash flow projection methods. Financial statement reestimates were performed using a full year of performance data for FY 2011 for SBA's large loan programs and with nine months of actual and three months of projected performance data for the Secondary Market Guaranty and the small loan programs.

### BUSINESS GUARANTY LOAN PROGRAMS

Net subsidy reestimates of business guaranty loan programs follows:

*(Dollars in Thousands)*

| **Guarantied Loan Program Subsidy Reestimates** | **2011** | **2010** |
|---|---|---|
| 7(a) | $ 1,235,733 | $ 1,504,397 |
| 7(a) - ARRA | 115,495 | (9,543) |
| 7(a) - Jobs Act | (42,042) | – |
| Dealer Floor Plan | (214) | – |
| 504 CDC | 1,063,772 | 1,597,460 |
| 504 CDC - ARRA | 209,379 | 156,312 |
| 504 CDC - Jobs Act | 20,478 | – |
| 504 CDC - Debt Refinancing | 2,221 | – |
| 504 First Mortgage Loan Pooling | 5,054 | – |
| SBIC Debentures | 28,010 | 40,407 |
| SBIC Participating Securities | (757,505) | 336,858 |
| Secondary Market Guaranty Program | (9,916) | (8,208) |
| ARC - ARRA | (66,210) | – |
| All Other Guaranty Loan Programs | (3,075) | (2,702) |
| **Total Guarantied Loan Program Subsidy Reestimates** | **$ 1,801,180** | **$ 3,614,981** |

The 7(a) Loan Guaranty program, SBA's flagship and largest program had a net upward reestimate in FY 2011 of $1,235.7 million. A significant portion of the reestimate is due to updated model assumptions, which resulted in increased purchase projections for the remaining years within the cohorts. The remainder of the reestimate is due to the difference between the actual and forecasted performance during FY 2011.

The 7(a) ARRA program had a net upward reestimate of $115.5 million, despite better than projected performance in FY 2011. A significant portion of the reestimate is due to updated model assumptions that reflect historical experience and the current economic environment, which resulted in increased purchase projections for the remaining years within the cohort. This includes loans funded in FY 2009 and FY 2010 by the American Recovery and Reinvestment Act, as well as loans funded by several appropriations during FY 2010 that provided additional funds to continue the ARRA provisions.

The 7(a) Jobs Act cohort had a net downward reestimate of $42 million, due to slightly better performance projections than originally estimated.

The Dealer Floor Plan program had a net downward reestimate of $0.2 million, due to better than projected performance during FY 2011.

The 504 Certified Development Company program had a net upward reestimate of $1,063.8 million. While the 2009 and 2010 cohorts performed better than expected in FY 2011, many earlier cohorts performed worse. The majority of the reestimate was due to updated model assumptions, which will allow for more accurate projections of future cash flows. These updated assumptions resulted in increased purchase projections for the remaining years within the cohorts. The remainder of the reestimate was mostly due to higher than projected purchases in FY 2011, in particular for cohorts 2006 and 2007.

The 504 ARRA program had a net upward reestimate of $209.4 million despite better than projected performance in FY 2011. The reestimate was due in large part to updated model assumptions, which will allow for more accurate projections of future cash flows. These methodology changes resulted in increased purchase projections and decreased recovery projections for the remaining years within the cohorts.

The 504 Jobs Act cohort had a net upward reestimate of $20.5 million, in part due to worse than expected performance in FY 2011. The majority of the reestimate was due to updated model assumptions and methodologies, which will allow for more accurate projections of future cash flows. These updated assumptions resulted in increased purchase projections and decreased recovery projections for the remaining years within the cohorts.

The 504 Debt Refinancing program had a net upward reestimate of $2.2 million. The reestimate was due in large part to updated model assumptions, which will allow for more accurate projections of future cash flows. These updated assumptions resulted in increased purchase projections for the remaining years within the cohorts.

The 504 First Mortgage Loan Pooling program had a net upward reestimate of $5.1 million. The majority of the reestimate was due to updated model assumptions and methodologies, which will allow for more accurate projections of future cash flows. These methodology changes resulted in increased purchase projections and decreased recovery projections for the remaining years within the cohorts.

The SBIC Debentures program had a net upward reestimate of $28 million. The reestimate was mostly due to higher than projected purchases in the 2001 and 2002 cohorts during FY 2011 and a decrease in projected recoveries for the remaining years within most cohorts.

The SBIC Participating Securities program had a net downward reestimate of $757.5 million. The reestimate was mostly due to lower than projected purchases and higher than projected recoveries during FY 2011. The remaining reestimate amount was due to a decrease in projected purchases and an increase in projected recoveries for the remaining years within the cohorts. Poor economic conditions in recent years, as well as SBA's decision to liquidate poor performing SBICs in an expedited manner caused an increase in purchases in FY 2009 and FY 2010 that led to upward reestimates in those years. The increase in purchases in FY 2009 and FY 2010 also increased projections of purchases in future years. Furthermore, funds that were adversely impacted by the weak economy were liquidated during FY 2009 and FY 2010, and fewer poor performers were remaining during FY 2011. This caused purchases to be lower than projected, contributing to the downward reestimate for FY 2011.

The Secondary Market Guaranty program had a net downward reestimate of $9.9 million. This downward reestimate was due to a decrease in the projected interest rate paid to investors for the remaining years within the cohorts.

The America's Recovery Capital program had a net downward reestimate of $66.2 million. This downward reestimate was mostly due to lower than projected purchases during FY 2010 and FY 2011 than were originally projected at budget formulation.

## BUSINESS DIRECT LOAN PROGRAMS

Net subsidy reestimates for business direct loan programs follows:

*(Dollars in Thousands)*

| **Business Direct Loan Program Subsidy Reestimates** | | **2011** | | **2010** |
|---|---|---|---|---|
| 7(m) Microloan | $ | (2,115) | $ | 487 |
| 7(m) Microloan - ARRA | | 2,004 | | 973 |
| SBIC Preferred Stock | | 4,189 | | (708) |
| All Other Direct Loan Programs | | (58) | | 49 |
| **Total Direct Loan Program Subsidy Reestimates** | **$** | **4,020** | **$** | **801** |

The 7(m) Direct Microloan program had a net downward reestimate of $2.1 million. Financial statement reestimates for the Direct Microloan program are performed using 9 months of actual and 3 months of projected performance data. The FY 2011 reestimate is mostly due to better performance during the fourth quarter of FY 2010 than was projected.

The 7(m) Direct Microloan ARRA program had a net upward reestimate of $2 million. This reestimate is partly due to the 2010 cohort, which was reestimated for the first time this year. For both the 2009 and 2010 cohorts, a decrease in the average interest rate charged to intermediary lenders caused actual interest collected during FY 2011 as well as projected interest collections for the remaining years to decrease.

The SBIC Preferred Stock program had a net upward reestimate of $4.2 million. Financial statement reestimates for the SBIC Preferred Stock program are performed using 9 months of actual and 3 months of projected performance data. Approximately half of the FY 2011 reestimate is due to two loans in the 2005 cohort that were projected to mature as of June 30, 2010, but that actually defaulted during the fourth quarter of FY 2010. These defaults are reflected in the FY 2011 reestimate. The remaining reestimate amount is due to lower recoveries in FY 2011 than were projected for three 1994 cohort loans that defaulted during FY 2010.

### DISASTER DIRECT LOAN PROGRAM

*(Dollars in Thousands)*

| Disaster Direct Loan Program Subsidy Reestimates | 2011 | 2010 |
|---|---|---|
| Disaster | $ 155,646 | $ 161,293 |
| **Total Disaster Direct Loan Program Subsidy Reestimates** | **$ 155,646** | **$ 161,293** |

The Disaster Assistance Loan program had a net upward reestimate of $155.6 million, primarily in the 2006 cohort. The 2006 cohort mostly consists of loans made in response to the Gulf Coast hurricanes of 2005. These loans currently account for 54 percent of the outstanding portfolio of direct Disaster loans. The upward reestimate is largely the result of performance probabilities being updated with actual performance during FY 2010 which resulted in an increase in projected defaults.

## NOTE 7 General Property and Equipment, Net

The SBA capitalizes equipment with a cost of $50,000 or more per unit and a useful life of 2 years or more at full cost and depreciated using the straight-line method over the useful life. The SBA expenses other equipment items not meeting the capitalization criteria when purchased.

Leasehold improvements with modifications of $50,000 or more and a useful life of 2 years or more are capitalized and amortized using the straight-line method over the useful life of the improvement or the lease term, whichever is shorter. Other leasehold improvement expenditures not meeting the capitalization criteria are expensed.

Software intended for internal use, whether internally developed, contractor developed or purchased, is capitalized at cost if the initial unit acquisition cost is $250,000 or more and service life is at least 2 years. Capitalized software costs include all direct and indirect costs incurred, including overhead to develop the software. Software for internal use is amortized using the straight-line method over its useful life, not to exceed 5 years. Amortization begins when the software or equipment is put into production. The costs of enhancements are capitalized when it is more likely than not that the enhancements will result in significant additional capabilities. Costs that do not meet the capitalization criteria are expensed when incurred.

Assets meeting the capitalization thresholds established at September 30, 2011 and 2010 are detailed below.

*(Dollars in Thousands)*

| | 2011 | 2010 |
|---|---|---|
| Equipment | $ 1,787 | $ 1,787 |
| Accumulated Depreciation | (1,394) | (1,049) |
| Net | 393 | 738 |
| Leasehold Improvements - Construction in Progress | – | 315 |
| Leasehold Improvements | 1,811 | 1,496 |
| Amortization of Leasehold Improvements | (400) | (249) |
| Net | 1,411 | 1,562 |
| Software in Use | 30,546 | 30,545 |
| Amortization of Software in Use | (30,546) | (30,028) |
| Net | – | 517 |
| **Total General Property and Equipment, Net** | **$ 1,804** | **$ 2,817** |

## NOTE 8 Liabilities Not Covered by Budgetary Resources

Liabilities not covered by budgetary resources are liabilities for which congressional action is needed before budgetary resources can be provided. These unfunded liabilities at September 30, 2011 and 2010 consisted of:

*(Dollars in Thousands)*

| | 2011 | 2010 |
|---|---|---|
| **Intragovernmental Liabilities - Other** | | |
| Employment Taxes Payable | $ 1,946 | $ 2,091 |
| Federal Employees' Compensation Act Payable | 5,850 | 5,865 |
| **Total Intragovernmental Liabilities - Other** | **7,796** | **7,956** |
| **Federal Employees' Compensation Act Actuarial Liability** | **30,630** | **29,960** |
| **Surety Bond Guarantee Program Future Claims** | **20,385** | **19,539** |
| **Other Liabilities** | | |
| Prior Liens on Real Estate Payable | 440 | 409 |
| Accrued Unfunded Annual Leave | 26,897 | 26,758 |
| **Total Other Liabilities** | **27,337** | **27,167** |
| **Total Liabilities Not Covered by Budgetary Resources** | **$ 86,148** | **$ 84,622** |

The liability for Surety Bond Guarantees is an estimate of future claims in the SBG Program for guaranties outstanding at year-end.

## NOTE 9 Debt

Borrowings payable to the Treasury result from loans provided by the Treasury to fund the portion of direct loans not covered by subsidy appropriations and to fund the payment of downward subsidy reestimates and other credit program disbursements (see Note 15). The SBA makes periodic principal repayments to the Treasury based on the analysis of its cash balances and future disbursement needs.

Borrowings payable to the Federal Financing Bank are the result of its financing of SBA Section 503 Debentures issued prior to 1988.

All debt is intragovernmental and covered by budgetary resources. Debt transactions for the periods ending September 30, 2011 and 2010 and resulting balances are:

### INTRAGOVERNMENTAL DEBT

*(Dollars in Thousands)*

| **Department of Treasury** | | **2011** | | **2010** |
|---|---|---|---|---|
| **Beginning Balance** | **$** | **11,751,594** | **$** | **10,872,754** |
| New Borrowing | | 347,617 | | 1,578,644 |
| Repayments | | (909,525) | | (699,804) |
| **Ending Balance** | **$** | **11,189,686** | **$** | **11,751,594** |
| | | | | |
| **Federal Financing Bank** | | **2011** | | **2010** |
| **Beginning Balance** | **$** | **2,187** | **$** | **5,529** |
| Repayments | | (1,552) | | (3,249) |
| Change in Interest Payable | | (42) | | (93) |
| **Ending Balance** | **$** | **593** | **$** | **2,187** |
| **Total Debt** | **$** | **11,190,279** | **$** | **11,753,781** |

## NOTE 10 Net Assets of Liquidating Funds Due to Treasury

Net Assets of Liquidating Funds Due to Treasury is the residual of the book value of assets less liabilities in the Liquidating Funds for loans made prior to FY 1992. Subsequent to the issuance of its audited financial statements each year, the SBA returns to the Treasury the portion of this balance that is considered to be the unobligated balance for budgetary reporting at fiscal year-end.

*(Dollars in Thousands)*

| **AS OF SEPTEMBER 30,** | | **2011** | | **2010** |
|---|---|---|---|---|
| Pollution Control Equipment Guaranty Fund | $ | 2,646 | $ | 3,996 |
| Disaster Loan Fund | | 12,263 | | 14,428 |
| Business Loan and Investment Fund | | 49,061 | | 49,935 |
| **Total Due Treasury** | **$** | **63,970** | **$** | **68,359** |

# NOTE 11 Other Liabilities

Other liabilities at September 30th were:

*(Dollars in Thousands)*

| | 2011 | 2010 |
|---|---|---|
| **OTHER LIABILITIES - INTRAGOVERNMENTAL** | | |
| **Entity** | | |
| **Current** | | |
| Employment Taxes Payable | $ 4,496 | $ 3,977 |
| Advances from Other Agencies | 1,282 | 2,086 |
| **Total Current** | **5,778** | **6,063** |
| **Non-current** | | |
| Employment Taxes Payable | 1,946 | 2,091 |
| Federal Employees' Compensation Act Payable | 5,850 | 5,865 |
| Payable to Federal Financing Bank | 76 | 209 |
| **Total Non-current** | **7,872** | **8,165** |
| **Total Entity** | **13,650** | **14,228** |
| **Non-entity** | | |
| **Current** | | |
| Payable to Treasury | 7 | 6 |
| **Total Other Liabilities - Intragovernmental** | $ **13,657** | $ **14,234** |
| **OTHER LIABILITIES - PUBLIC** | | |
| **Entity** | | |
| **Current** | | |
| Accrued Funded Payroll and Benefits | $ 20,133 | $ 19,967 |
| Accrued Unfunded Annual Leave | 26,897 | 26,758 |
| Suspense Accounts | 247 | 275 |
| **Total Current** | **47,277** | **47,000** |
| **Non-current** | | |
| Prior Liens on Real Estate Payable | 440 | 409 |
| **Total Non-current** | **440** | **409** |
| **Total Entity** | **47,717** | **47,409** |
| **Non-entity** | | |
| **Current** | | |
| Non-entity Current Payable | 4 | 6 |
| **Total Other Liabilities - Public** | **$ 47,721** | **$ 47,415** |

# NOTE 12 Leases

The SBA leases all of its facilities from the General Services Administration. The SBA enters into an Occupancy Agreement with GSA for each facility. GSA, in turn, leases commercial facilities or provides space in federal buildings. Agreements for space in federal buildings can be vacated with 120 to 180 days notice. However, the SBA anticipates continuing the same or similar facilities leases in the future. These leases with GSA are operating leases and are expensed in the Statement of Net Cost when incurred. FY 2011 and 2010 facilities lease costs were $41.9 million and $42.4 million. Future lease payments shown below assume a 3 percent inflation factor from the following years' projected totals as estimated by GSA. The downward trend after 2016 is due to the expiration of a number of leases.

*(Dollars in Thousands)*

**FUTURE FACILITIES OPERATING LEASE PAYMENTS**

| FY | | Lease Pmts |
|---|---|---|
| 2012 | $ | 41,832 |
| 2013 | | 43,086 |
| 2014 | | 44,379 |
| 2015 | | 45,710 |
| 2016 | | 47,082 |
| After 2016 | | 41,202 |
| **Total** | **$** | **263,291** |

## NOTE 13 Non-entity Reporting

Non-entity assets are assets held by the SBA but not available to the SBA. The primary non-entity asset is for SBA's downward subsidy reestimates in its loan programs. Because the loan programs are discretionary, the downward reestimates are not available to the SBA and they are returned to the Treasury in the fiscal year following the accrual of the reestimates. During the year, these general fund accounts contain SBA's prior year reestimates. At year-end, the funds are swept by the Treasury with the exception of one deposit fund. Also at year-end, the SBA accrues the current year's reestimates, including downward reestimates as applicable. For the downward reestimates, in the loan financing funds, the SBA records an accrual adjustment that records a transfer out to the non-entity fund, a reduction of subsidy allowance or loan guaranty liability, and an account payable to the non-entity fund. In the loan program funds the SBA records a reduction of loan subsidy expense and the associated impact on the net cost. The non-entity Treasury general funds contain a corresponding account receivable in anticipation of the receipt of the downward reestimates in the following year and a Downward Reestimate Payable to the Treasury.

For consolidated financial statement presentation, the SBA eliminates the payable to the non-entity fund and the non-entity Treasury general fund receivable from the financing funds; since both are included in SBA's reporting entity. The Downward Reestimate Payable to the Treasury in the non-entity Treasury general fund is not eliminated and is reflected on the Balance Sheet as a liability line item.

*(Dollars in Thousands)*

| | | 2011 | | 2010 |
|---|---|---|---|---|
| **Entity** | | | | |
| Financing Fund Payable | $ | (911,765) | $ | (130,993) |
| **Non-entity** | | | | |
| Miscellaneous Receipts Fund Receivable | | 911,765 | | 130,993 |
| Downward Reestimate Payable to Treasury | | (911,765) | | (130,993) |
| **Balance Sheet Reported Payable** | **$** | (911,765) | **$** | (130,993) |

# NOTE 14 Consolidated Statement of Net Cost

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

## Operating Cost

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

## Earned Revenue

Earned revenues arise from exchange transactions, and are deducted from the full cost of SBA's major strategic goals to arrive at net strategic goals costs. The SBA recognizes earned revenues when reimbursements are payable from other federal agencies and the public, as a result of costs incurred or services performed. A major source of earned revenue includes interest earned on SBA's outstanding Business and Disaster loan portfolios and interest earned on uninvested funds in the credit reform financing accounts.

## Reporting by Strategic Goal

On September 20, 2010, the SBA updated its Strategic Plan for fiscal years 2011 to 2016. The new plan contains three strategic goals and the FY 2011 Statement of Net Cost is configured according to the three new strategic goals. As a result, the FY 2010 costs have been reconfigured to be comparable to the new plan. The major change between FY 2010 and FY 2011 is that SBA's disaster assistance costs, which used to be mapped to a separate goal, are now included under Strategic Goal 1 – *Growing Businesses and Creating Jobs* – along with other programs. In order to fully allocate program support and overhead costs per cost accounting requirements, most of the costs associated with Strategic Goal 2 – *Building an SBA that Meets the Needs of Today's and Tomorrow's Small Businesses* – are allocated to the other two strategic goals. The reallocated costs associated with Strategic Goal 2 in FY 2011 were $140.7 million and the comparable amount in FY 2010 was $146.3 million. Costs Not Assigned to Strategic Goals on the Statement of Net Cost includes costs of congressionally mandated grant programs, Automation under the Recovery Act, Drug Free Workplace, and the Office of the Inspector General.

Intragovernmental Gross Cost is cost incurred by the SBA in exchange transactions with other federal agencies. Gross Cost with the Public is cost incurred by the SBA in exchange transactions. Intragovernmental Earned Revenue is revenue earned by the SBA in exchange transactions with other federal agencies. Earned Revenue from the Public is revenue earned by the SBA in exchange transactions.

The classification as Intragovernmental Costs or Gross Cost with the Public relate to the source of goods and services received by the SBA and not to the classification of related revenue. The classification of revenue or cost being defined as "intragovernmental" or "public" is defined on a transaction by transaction basis. The purpose of this classification is to enable the federal government to provide consolidated financial statements, and not to match the public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

*(Dollars in Thousands)*

**INTRAGOVERNMENTAL COSTS AND EXCHANGE REVENUE**

| FOR THE YEARS ENDING SEPTEMBER 30, | 2011 | 2010 |
|---|---|---|
| **STRATEGIC GOAL 1:** | | |
| **Growing Businesses and Creating Jobs** | | |
| Intragovernmental Gross Cost | $ 656,169 | $ 721,083 |
| Gross Cost with the Public | 3,344,192 | 5,078,700 |
| **Total Strategic Goal 1 Gross Cost** | **4,000,361** | **5,799,783** |
| Intragovernmental Earned Revenue | 308,917 | 247,839 |
| Earned Revenue from the Public | 387,293 | 378,248 |
| **Total Strategic Goal 1 Earned Revenue** | **696,210** | **626,087** |
| **STRATEGIC GOAL 2:** | | |
| **Building an SBA that Meets the Needs of Today's and Tomorrow's Small Businesses** | | |
| Intragovernmental Gross Cost | $ 1,159 | $ 1,173 |
| Gross Cost with the Public | 4,973 | 4,170 |
| **Total Strategic Goal 2 Gross Cost** | **6,132** | **5,343** |
| **STRATEGIC GOAL 3:** | | |
| **Serving as the Voice for Small Business** | | |
| Intragovernmental Gross Cost | $ 2,543 | $ 2,797 |
| Gross Cost with the Public | 10,911 | 9,941 |
| **Total Strategic Goal 3 Gross Cost** | **13,454** | **12,738** |
| **Cost Not Assigned to Strategic Goals** | | |
| Intragovernmental Gross Cost | $ 25,861 | $ 18,755 |
| Gross Cost with the Public | 110,964 | 66,665 |
| **Total Gross Cost Not Assigned to Strategic Goals** | **136,825** | **85,420** |
| **Net Cost of Operations** | **$ 3,460,562** | **$ 5,277,197** |

# NOTE 15 Statement of Budgetary Resources

The Statement of Budgetary Resources presents information about total budgetary resources available to the SBA and the status of those resources as of September 30, 2011 and 2010. SBA's total budgetary resources were $7.9 billion and $8.4 billion for the years ended September 30, 2011 and 2010. Additionally, $11.4 billion and $10.0 billion of nonbudgetary resources including borrowing authority and collections of loan principal, interest and fees in financing funds were reported for the years ended September 30, 2011 and 2010.

## Permanent Indefinite Appropriations

The SBA receives permanent indefinite appropriations annually to fund increases in the projected subsidy costs of loan programs as determined by the reestimation process required by the Federal Credit Reform Act of 1990. The appropriations are received initially in the SBA Program Funds and then transferred to the Financing Funds where they are used to fund obligations. SBA's Liquidating Funds also receive permanent indefinite appropriations to fund obligations. The Financing Funds are used to account for credit program obligations made subsequent to FY 1991. Liquidating Funds are used to account for credit program obligations made prior to FY 1992.

Decreases in projected subsidy costs in the Financing Funds are returned to the Treasury through SBA's annual reestimation process. The prior year's ending unobligated balances in SBA's Liquidating Funds are also transferred to the Treasury annually.

## Borrowing Authority and Terms of Borrowing

The SBA is authorized to borrow from the Treasury's Bureau of Public Debt when funds needed to disburse direct loans and purchase guarantied loans exceed subsidy costs and collections in the nonbudgetary loan financing funds. In FY 2011 and FY 2010, the SBA received $1.1 billion and $2.7 billion of borrowing authority from the OMB. The SBA pays interest to the Treasury based on Treasury's cost of funds. The rate at which interest is paid to the Treasury on the amounts borrowed (or received from the Treasury on un-invested cash balances) in a loan financing fund for a particular cohort is a disbursement-weighted average discount rate for cohorts prior to FY 2001 and a single effective rate for cohorts beginning with FY 2001. The SBA calculates and repays borrowings not needed for working capital at midyear for prior year cohorts. The SBA uses the loan principal, interest and fees collected from the borrowers in its loan financing funds to repay its Treasury borrowings. The repayment maturity dates for the borrowing from the Treasury are based on the loan maturities used in the subsidy calculation. The maturities range from 16 years for Direct Business loans, 25 years for Guarantied Business loans and 30 years for Disaster loans.

## Apportionment Categories of Obligations Incurred

During FY 2011 and FY 2010, the SBA incurred $11.9 billion and $13.1 billion of direct and reimbursable obligations of which $0.8 billion and $0.9 billion was apportioned in category A; $11.1 billion and $12.2 billion was apportioned in category B. Category A apportionments are restricted by quarter and program, category B apportionments are restricted by purpose and program.

## Unobligated Balances

Unobligated balances at September 30, 2011 and 2010 are $7.4 billion and $5.2 billion which include $5.3 billion and $3.0 billion of unavailable unobligated balances. These balances are unavailable primarily because they are unapportioned by OMB. The SBA accumulates the majority of these unobligated balances in its nonbudgetary financing accounts during the fiscal year ($6.4 billion in FY 2011 and $3.5 billion in FY 2010) from reestimates that are used primarily to pay default claims in the following fiscal year. In addition, unobligated balances are accumulated in budgetary accounts from appropriations ($1.0 billion in FY 2011 and $1.8 billion in FY 2010) that are used to finance SBA's ongoing program operations.

## Undelivered Orders

Undelivered orders for the periods ended September 30, 2011 and 2010 were $1.1 billion and $0.9 billion.

## Differences between the Statement of Budgetary Resources and the Budget of the U. S. Government

There was no material difference between the FY 2010 Statement of Budgetary Resources and the President's FY 2012 budget submission. The President's Budget with actual numbers for FY 2013 has not yet been published. The SBA expects no material differences between the President's Budget "actual" column and the FY 2011 reported results when the budget becomes available in February 2012.

# NOTE 16 Reconciliation of Budgetary Obligations Incurred to Net Cost of Operations

The SBA presents the Statement of Net Cost using the accrual basis of accounting. This differs from the obligation-based measurement of total resources supplied, both budgetary and from other sources, on the Statement of Budgetary Resources.

The Federal Financial Accounting Standard No. 7 requires "a reconciliation of proprietary and budgetary information in a way that helps users relate the two." The focus of this presentation is to reconcile budgetary net obligations to the net cost of operations. The objective of this information is to categorize the differences between budgetary and financial (proprietary) accounting.

*Did you know*

**In FY 2011, there were over 334 disasters declared in the U.S. The SBA Office of Disaster Assistance approved over 13,600 loans totaling over $730 million to disaster victims across the U.S. and its territories.**

**For more information, go to www.sba.gov/disasterassistance.**

## CONSOLIDATED RECONCILIATION OF BUDGETARY OBLIGATIONS TO NET COST

For the years ended September 30, 2011 and 2010

*(Dollars in Thousands)*

| | 2011 | 2010 |
|---|---|---|
| **RESOURCES USED TO FINANCE ACTIVITIES** | | |
| **Budgetary Resources Obligated** | | |
| Obligations Incurred | $ 11,893,007 | $ 13,113,785 |
| Less: Spending Authority from Offsetting Collections and Recoveries | 9,024,868 | 8,231,003 |
| Obligations Net of Offsetting Collections and Recoveries | 2,868,139 | 4,882,782 |
| Less: Offsetting Receipts | 153,308 | 78,001 |
| **Net Obligations** | **2,714,831** | **4,804,781** |
| **Other Resources** | | |
| Imputed Financing | 26,749 | 32,765 |
| Other Financing Sources | (936,390) | (144,780) |
| **Net Other Resources Used to Finance Activities** | **(909,641)** | **(112,015)** |
| **Total Resources Used to Finance Activities** | **1,805,190** | **4,692,766** |
| **RESOURCES THAT DO NOT FINANCE NET COST OF OPERATIONS** | | |
| (Increase) Decrease in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered But Not Yet Provided | (257,869) | (74,812) |
| Resources that Fund Expenses Recognized in Prior Periods | (3,796,986) | (4,637,929) |
| Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations | | |
| Credit Program Collections | 8,384,188 | 7,823,359 |
| Offsetting Receipts | 153,308 | 78,001 |
| Resources that Finance the Acquisition of Assets or Liquidation of Liabilities | (4,648,463) | (6,406,831) |
| Other - Current Year Liquidating Equity Activity | 2,409 | 760 |
| Other Resources that Do Not Affect Net Cost of Operations | 3 | (15) |
| **Total Resources that Do Not Finance Net Cost of Operations** | **(163,410)** | **(3,217,467)** |
| **Total Resources Used to Finance the Net Cost of Operations** | **1,641,780** | **1,475,299** |
| **COMPONENTS OF THE NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD** | | |
| **Components Requiring or Generating Resources in Future Periods** | | |
| Change in Annual Leave Liability | 139 | 1,444 |
| Upward Reestimates of Credit Subsidy Expense | 1,816,761 | 3,796,430 |
| Change in Revenue Receivable from Public | 309 | (249) |
| Provision for Losses on Estimated Guaranties | 846 | (1,278) |
| Change in Unfunded Employee Benefits | 670 | 320 |
| **Total Components Requiring or Generating Resources in Future Periods** | **1,818,725** | **3,796,667** |
| **Components Not Requiring or Generating Resources** | | |
| Depreciation or Amortization | 1,014 | 987 |
| Change in Bad Debt Expense - Pre-1992 Loans | (452) | 3,721 |
| Other (Income) Expenses Not Requiring Budgetary Resources | (505) | 523 |
| **Total Components Not Requiring or Generating Resources** | **57** | **5,231** |
| **Total Components of the Net Cost of Operations that Will Not Require or Generate Resources in the Current Period** | **1,818,782** | **3,801,898** |
| **Net Cost of Operations** | **$ 3,460,562** | **$ 5,277,197** |

Liabilities Not Covered by Budgetary Resources on the Balance Sheet (Note 8) differs from Components Requiring or Generating Resources in Future Periods in this reconciliation primarily due to reestimated subsidy costs of loan programs. The subsidy costs are shown in the Statement of Net Cost and are to be covered by budgetary resources but these resources, while available under permanent and indefinite authority, were not provided by year-end. Additionally, there will always be a difference for existing liabilities because the Reconciliation of Budgetary Obligations Incurred to Net Cost of Operations reports only current year changes, not balances.

The following table details these differences:

*(Dollars in Thousands)*

| AS OF SEPTEMBER 30, | 2011 | 2010 |
|---|---|---|
| Current Year Liabilities Not Covered By Budgetary Resources | $ 86,148 | $ 84,622 |
| Less: Prior Year | 84,622 | 84,893 |
| Change in Liabilities Not Covered By Budgetary Resources | 1,526 | (271) |
| Upward Reestimates of Credit Subsidy Expense | 1,816,761 | 3,796,430 |
| Change in Revenue Receivable from Public | 309 | (249) |
| All Other | 129 | 757 |
| **Components (of Net Cost) Generating Resources in Future Periods (Per Reconciliation Above)** | **$ 1,818,725** | **$ 3,796,667** |

# NOTE 17 Significant Events

## Recovery Act and Jobs Act

The President signed the American Recovery and Reinvestment Act on February 17, 2009. The ARRA provided for SBA guarantied loans having reduced fees and increased guaranty percentages that continued into FY 2010. On September 27, 2010, the President signed the Small Business Jobs Act of 2010 that provided $505 million of additional appropriations to fund 7(a) and 504 guarantied loans with the ARRA fee relief and guaranty percentage provisions. This contributed to a substantial increase in first quarter FY 2011 guarantied loan volume that pushed yearly 7(a) volume close to the statutory limit of $17.5 billion. The Small Business Jobs Act of 2010 also raised the maximum loan amounts for the 7(a), 504 and Microloan programs, created a new Intermediary Lending Pilot program and a new 504 Commercial Debt Refinancing program, and enhanced the Dealer Floor Plan program initiated by the SBA during FY 2009. In total the Small Business Jobs Act, as well as the state of the U.S. economy, contributed to $30.5 billion of SBA assistance during FY 2011 for all of its loan programs. This amount, which includes all the non-guarantied amounts associated with SBA guarantied loans, is a record level.

## Economic Conditions

The slow economic growth in FY 2011 led to higher than projected losses in this fiscal year. Continued projections of higher than average unemployment, coupled with the addition of performance data from the past year is leading the subsidy models to project higher losses in future years than was projected last year. For the medium to longer term, the Mid-Session Review of Economic Assumptions continue to show higher unemployment forecasts as compared to last year's forecasts, which increase projections for further defaults. These factors contributed to the upward reestimate in the SBA loan programs (as discussed in Note 6I). Under the Federal Credit Reform Act, upward reestimates are automatically covered by permanent indefinite budget authority. Such authority provides the SBA resources to address losses incurred in its existing portfolio without further action by Congress.

# Required Supplementary Information

## COMBINING STATEMENT OF BUDGETARY RESOURCES

For the year ended September 30, 2011

(Dollars in Thousands)

| | BLIF | | DLF | | SBGRF | PCECGF |
|---|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | Budgetary | Nonbudgetary Financing | Budgetary | Nonbudgetary Financing | Budgetary | Budgetary |
| Unobligated Balance | | | | | | |
| Brought Forward October 1 | $ 649,087 | $ 2,696,847 | $ 809,405 | $ 761,528 | $ 56,256 | $ 2,225 |
| Recoveries of Prior Year Obligations | 30,676 | 1,890 | 10,075 | 89,568 | – | – |
| Budget Authority | | | | | | |
| Appropriations Received | 4,883,175 | – | 276,731 | – | – | 2,000 |
| Borrowing Authority | – | 89,832 | – | 988,300 | – | – |
| Spending Authority from Offsetting Collections | | | | | | |
| Earned | 8,098 | 7,190,235 | 3,272 | 1,193,953 | 8,987 | 491 |
| Change in Unfilled Customer Orders | – | (16,282) | – | 32,735 | – | – |
| Total Budget Authority | 4,891,273 | 7,263,785 | 280,003 | 2,214,988 | 8,987 | 2,491 |
| Permanently Not Available | (6,541) | (319,517) | (4,543) | (1,320,517) | – | (2,225) |
| **Total Budgetary Resources** | **$ 5,564,495** | **$ 9,643,005** | **$ 1,094,940** | **$ 1,745,567** | **$ 65,243** | **$ 2,491** |
| **STATUS OF BUDGETARY RESOURCES** | | | | | | |
| Obligations Incurred, Net | | | | | | |
| Direct | $ 5,220,666 | $ 3,977,658 | $ 312,409 | $ 995,906 | $ – | $ – |
| Reimbursable | 164,404 | – | 262,872 | – | 6,538 | – |
| Total Obligations Incurred, Net | 5,385,070 | 3,977,658 | 575,281 | 995,906 | 6,538 | – |
| Unobligated Balances, Available | 53,657 | 1,340,587 | 59,453 | 505,332 | 8,448 | 2,350 |
| Unobligated Balances, Not Available | 125,768 | 4,324,760 | 460,206 | 244,329 | 50,257 | 141 |
| **Total Status of Budgetary Resources** | **$ 5,564,495** | **$ 9,643,005** | **$ 1,094,940** | **$ 1,745,567** | **$ 65,243** | **$ 2,491** |
| **CHANGE IN OBLIGATED BALANCES** | | | | | | |
| Obligated Balance Brought Forward Net October 1 | | | | | | |
| Unpaid Obligations Brought Forward | $ 208,364 | $ 224,257 | $ 25,350 | $ 219,329 | $ 106 | $ – |
| Uncollected Customer Payments from Federal Sources Brought Forward | – | (205,442) | – | (24,861) | – | – |
| Total Obligated Balance Brought Forward, Net | 208,364 | 18,815 | 25,350 | 194,468 | 106 | – |
| Obligations Incurred | 5,385,070 | 3,977,658 | 575,281 | 995,906 | 6,538 | – |
| Gross Outlays | (5,371,555) | (4,044,740) | (532,588) | (696,274) | (6,417) | – |
| Recoveries of Prior Year Unpaid Obligations | (30,676) | (1,890) | (10,075) | (89,568) | – | – |
| Change in Uncollected Customer Payments from Federal Sources | – | 16,282 | – | (32,735) | – | – |
| Obligated Balance, Net, End of Period | | | | | | |
| Unpaid Obligations | 191,203 | 155,285 | 57,968 | 429,393 | 227 | – |
| Uncollected Customer Payments from Federal Sources | – | (189,160) | – | (57,596) | – | – |
| **Total Obligated Balance, Net, End of Period** | **$ 191,203** | **$ (33,875)** | **$ 57,968** | **$ 371,797** | **$ 227** | **$ 0** |
| **NET OUTLAYS** | | | | | | |
| Gross Outlays | $ 5,371,555 | $ 4,044,740 | $ 532,588 | $ 696,274 | $ 6,417 | $ – |
| Offsetting Collections | (8,098) | (7,190,235) | (3,272) | (1,193,953) | (8,987) | (491) |
| Net Outlays Before Offsetting Receipts | 5,363,457 | (3,145,495) | 529,316 | (497,679) | (2,570) | (491) |
| Offsetting Receipts | – | (116,081) | – | (37,130) | – | – |
| **Net Outlays** | **$ 5,363,457** | **$ (3,261,576)** | **$ 529,316** | **$ (534,809)** | **$ (2,570)** | **$ (491)** |

## COMBINING STATEMENT OF BUDGETARY RESOURCES

For the year ended September 30, 2011

| *(Dollars in Thousands)* | SE | OIG | BATF | TOTAL | TOTAL | TOTAL |
|---|---|---|---|---|---|---|
| | | | | | Nonbudgetary | |
| **BUDGETARY RESOURCES** | Budgetary | Budgetary | Budgetary | Budgetary | Financing | |
| Unobligated Balance | | | | | | |
| Brought Forward October 1 | $ 239,155 | $ 12,239 | $ 242 | $ 1,768,609 | $ 3,458,375 | $ 5,226,984 |
| Recoveries of Prior Year Obligations | 28,266 | 482 | 19 | 69,518 | 91,458 | 160,976 |
| Budget Authority | | | | | | |
| Appropriations Received | 433,438 | 16,300 | – | 5,611,644 | – | 5,611,644 |
| Borrowing Authority | – | – | – | – | 1,078,132 | 1,078,132 |
| Spending Authority from Offsetting Collections | | | | | | |
| Earned | 362,518 | 1,050 | 33 | 384,449 | 8,384,188 | 8,768,637 |
| Change in Unfilled Customer Orders | 78,851 | (49) | – | 78,802 | 16,453 | 95,255 |
| Total Budget Authority | 874,807 | 17,301 | 33 | 6,074,895 | 9,478,773 | 15,553,668 |
| Permanently Not Available | **(10,906)** | (87) | – | (24,302) | (1,640,034) | (1,664,336) |
| **Total Budgetary Resources** | **$ 1,131,322** | **$ 29,935** | **$ 294** | **$ 7,888,720** | **$ 11,388,572** | **$ 19,277,292** |
| **STATUS OF BUDGETARY RESOURCES** | | | | | | |
| Obligations Incurred, Net | | | | | | |
| Direct | $ 551,147 | $ 19,044 | $ 162 | $ 6,103,428 | $ 4,973,564 | $ 11,076,992 |
| Reimbursable | 381,265 | 936 | – | 816,015 | – | 816,015 |
| Total Obligations Incurred, Net | 932,412 | 19,980 | 162 | 6,919,443 | 4,973,564 | 11,893,007 |
| Unobligated Balances, Available | 143,330 | 4,538 | 109 | 271,885 | 1,845,919 | 2,117,804 |
| Unobligated Balances, Not Available | 55,580 | 5,417 | 23 | 697,392 | 4,569,089 | 5,266,481 |
| **Total Status of Budgetary Resources** | **$ 1,131,322** | **$ 29,935** | **$ 294** | **$ 7,888,720** | **$ 11,388,572** | **$ 19,277,292** |
| **CHANGE IN OBLIGATED BALANCES** | | | | | | |
| Obligated Balance Brought Forward Net October 1 | | | | | | |
| Unpaid Obligations Brought Forward | $ 439,273 | $ 2,939 | $ 22 | $ 676,054 | $ 443,586 | $ 1,119,640 |
| Uncollected Customer Payments from Federal Sources Brought Forward | – | – | – | – | (230,303) | (230,303) |
| Total Obligated Balance Brought Forward, Net | 439,273 | 2,939 | 22 | 676,054 | 213,283 | 889,337 |
| Obligations Incurred | 932,412 | 19,980 | 162 | 6,919,443 | 4,973,564 | 1,893,007 |
| Gross Outlays | (848,474) | (19,671) | (163) | (6,778,868) | (4,741,014) | (11,519,882) |
| Recoveries of Prior Year Unpaid Obligations | (28,266) | (482) | (19) | (69,518) | (91,458) | (160,976) |
| Change in Uncollected Customer Payments from Federal Sources | – | – | – | – | (16,453) | (16,453) |
| Obligated Balance, Net, End of Period | | | | | | |
| Unpaid Obligations | 494,945 | 2,766 | 2 | 747,111 | 584,678 | 1,331,789 |
| Uncollected Customer Payments from Federal Sources | – | – | – | – | (246,756) | (246,756) |
| **Total Obligated Balance, Net, End of Period** | **$ 494,945** | **$ 2,766** | **$ 2** | **$ 747,111** | **$ 337,922** | **$ 1,085,033** |
| **NET OUTLAYS** | | | | | | |
| Gross Outlays | $ 848,474 | $ 19,671 | $ 163 | $ 6,778,868 | $ 4,741,014 | $ 11,519,882 |
| Offsetting Collections | (441,370) | (1,002) | (33) | (463,253) | (8,384,188) | (8,847,441) |
| Net Outlays Before Offsetting Receipts | 407,104 | 18,669 | 130 | 6,315,615 | (3,643,174) | 2,672,441 |
| Offsetting Receipts | (97) | – | – | (97) | (153,211) | (153,308) |
| **Net Outlays** | **$ 407,007** | **$ 18,669** | **$ 130** | **$ 6,315,518** | **$ (3,796,385)** | **$ 2,519,133** |

# Required Supplementary Stewardship Information

## Stewardship Investments in Human Capital

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

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

**SCORE** is a nonprofit organization that provides small business counseling and training under a grant from the SBA. SCORE members are successful business men and women who volunteer their time to assist aspiring entrepreneurs and small business owners. There are SCORE chapters in every state.

**Women's Business Centers** provide quality counseling and training services primarily to women entrepreneurs in a number of locations around the U.S. and its territories.

**All Other Training and Assistance Programs** includes primarily small business training provided by a counselor from a resource partner, district office, or SBA sponsor who delivers a structured program of knowledge, information or experience on a business-related subject. The training lasts for one or more hours and includes an agenda, attendee list, and a trainer evaluation. The session may be for an individual or a class. Training is also available online on a number of subjects of interest to the small business person. Other programs not separately detailed include Native American Outreach and Drug Free Work Place. As additional years of data accumulate, the investments will be presented separately.

Performance results are discussed in the Management Discussion and Analysis section of SBA's annual Agency Financial Report in the Program Results section of the Executive Summary.

Significant Human Capital investments occur within the following programs:

For the Five Years Ending September 30, 2011

*(Dollars in Thousands)*

| | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| Small Business Development Centers | $ 123,097 | $ 130,046 | $ 116,909 | $ 98,484 | $ 99,748 |
| SCORE | 14,094 | 11,134 | 9,899 | 10,960 | 12,267 |
| Women's Business Centers | 13,080 | 16,924 | 21,504 | 23,655 | 16,382 |
| All Other Training and Assistance Programs | 67,094 | 81,057 | 61,356 | 41,318 | 62,787 |
| **Total** | **$ 217,365** | **$ 239,161** | **$ 209,668** | **$ 174,417** | **$ 191,184** |

# Other Accompanying Information

*Success Story*

## Home Grown Marketing of Dream Vacations

Media Marketing, Inc., St. Thomas, Virgin Islands

The U.S. territory of the Virgin Islands is a tourist's dream vacation spot, and the natural beauty of the islands is extolled in brochures and travel publications. In 2003, Rita Jones and Jennifer Sibilly decided it was time a tourist guide for the Virgin Islands was published by a local firm. So, after more than a decade working together at a publishing firm in St. Thomas, the duo decided to venture out and establish their own business, Media Marketing, Inc., specializing in publishing guidebooks about the Virgin Islands for visitors and locals alike.

With the assistance of the University of the Virgin Islands Small Business Development Center, Rita and Jennifer put together a business plan which, in turn, helped them obtain an SBA-guarantied 7(a) loan to finance their project.

Today, Media Marketing generates $600,000 in annual sales and has grown to become the "go-to" publishing company for Virgin Islands tourism guides. Media Marketing, Inc. produces various publications every year, including the Places to Explore, Places to Go, and Places to Eat maps, and Marine Guide, the only one of its kind in the Virgin Islands and the official publication of the Virgin Islands Hotel and Tourism Association.

**Did you know**

**The America's Best video series was produced under a co-sponsorship agreement between SBA and ADP®. Through such partnerships the SBA is able to provide the small business community with quality educational and motivational products, such as the America's Best video series.**

**To watch the videos, please visit www.sba.gov/americasbest.**

# OIG Report on the Most Serious Management and Performance Challenges

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

**Report No. 12-01**

*Fiscal Year 2012*
*Report on the Most Serious Management and*
*Performance Challenges*
*Facing the Small Business Administration*

October 21, 2011

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

October 21, 2011

MEMORANDUM

TO: Karen G. Mills
Administrator

FROM: Peggy E. Gustafson
Inspector General

SUBJECT: Fiscal Year 2012 Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration

In accordance with the Reports Consolidation Act of 2000, we are providing you with the Office of Inspector General's (OIG) Fiscal Year (FY) 2012 Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration (SBA). This report represents our current assessment of agency programs and/or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, mismanagement, or inefficiencies. The Challenges are not presented in order of priority, as we believe that all are critical management or performance issues.

Our report is based on specific OIG, Government Accountability Office (GAO), and other official reports, as well as our general knowledge of SBA's programs and operations. Our analysis generally considers those accomplishments that SBA reported as of September 30, 2011.

Within each Management Challenge, there are a series of "recommended actions" to resolve the Challenge. Each recommended action is assigned a color "status" score. The scores are as follows: Green for "Implemented"; Yellow for "Substantial Progress"; Orange for "Limited Progress", and Red for "No Progress". An arrow in the color box indicates that the color score either went up or down from the prior year. If a recommended action was added since last year's report, no color score has been assigned and the recommended action has been designated as "New".

As part of the OIG's continuing evaluation of the Management Challenges, certain Challenges have been updated or revised. In addition, actions that were scored Green last year, and which remained Green this year, have been moved up to the "history bar" above the recommended actions. The history bar highlights any progress that the agency has made on a Challenge over the past four FYs (or as long as the Challenge has existed, if shorter) by showing the number of actions that have moved to Green each year.

The following table provides a summary of the FY 2012 Most Serious Management and Performance Challenges Facing SBA.

**Table 1: Summary of the FY 2012 Most Serious Management and Performance Challenges Facing SBA.**

| | | Color Scores | | | | | |
|---|---|---|---|---|---|---|---|
| | | Status at End of FY 2011 | | | | Change from Prior Year | |
| | Challenge | Green | Yellow | Orange | Red | Up ⇧ | Down ⇩ |
| 1 | Small Business Contracting | 1 | | 2 | | 1 | 1 |
| 2 | IT Security | | 2 | 2 | | | 1 |
| 3 | Human Capital | | 1 | | 1 | | 1 |
| 4 | Loan Guaranty Purchase | | 1 | | | 1 | |
| 5 | Lender Oversight | | 4 | 2 | | | |
| 6 | 8(a) BD Program | | 1 | 2 | 1 | | 3 |
| 7 | Loan Agent Fraud | | 2 | | | | |
| 8 | Loan Management and Accounting System | | | 4 | | | |
| 9 | Improper Payments | 3 | | 3 | | 3 | |
| | **TOTAL** | **4** | **11** | **15** | **2** | **5** | **6** |

We would like to thank SBA's management and staff for their cooperation in providing us with information needed to prepare this report. We look forward to continuing to work with SBA's leadership team in addressing the agency's Management Challenges.

## Contents

## Challenge 1. Procurement flaws allow large firms to obtain small business awards and agencies to count contracts performed by large firms towards their small business goals.

The Small Business Act establishes a government-wide goal that 23 percent of the total value of all prime contract awards for each FY be awarded to small businesses. As the advocate for small business, SBA should strive to ensure that only small firms obtain and perform small business awards and that procuring agencies accurately report contracts awarded to small businesses when representing its progress in meeting small business contracting goals.

OIG audits and other governmental studies have shown widespread misreporting by procuring agencies since many contract awards that were reported as going to small firms have actually been performed by larger companies. While some contractors may misrepresent or erroneously calculate their size, most of the incorrect reporting results from errors made by government contracting personnel, including misapplication of small business contracting rules. In addition, contracting officers do not always review the on-line certifications that contractors enter into a governmental database prior to awarding contracts. SBA needs to ensure that contracting personnel are adequately trained on small business procurement and are reviewing this database prior to awarding contracts.

SBA also needs to address a loophole within General Services Administration (GSA) Multiple Awards Schedule (MAS) contracts that contain multiple industrial codes. Currently, a company awarded such a contract can identify itself as small on individual task orders awarded under that contract even though it does not meet the size criteria for the applicable task. Thus, agencies may obtain small business credit for using a firm classified as small, when the firm is not small for specific orders under the MAS contract.

SBA has made mixed progress on this challenge. In FY 2011, SBA progressed to a "Green" rating for its efforts to develop a program to ensure that contracting personnel are reviewing contractor size certifications. However, although they have been working on the development of training programs on small business procurement for contracting personnel, updated courses have not been implemented. SBA also has committed to improving the surveillance review process in response to an OIG audit to enhance its oversight of contract awards and performance on set-aside contracts, but has yet to implement tangible changes. SBA also made limited progress during FY 2011 in developing regulations to correct misapplication of industry codes on long-term and multiple award set-aside contracts.

| **Challenge History**<br>**Fiscal Year (FY) Issued: 2005** | **Actions Accomplished (Green Status) during Past 4 FYs** | | | |
|---|---|---|---|---|
| | 07-0 | **08-1** | 09-0 | 10-0 |

| **Recommended Actions for FY 2012** | **Status at end of FY 2011** |
|---|---|
| 1. Develop and take steps to provide reasonable assurance that agencies are providing adequate basic and continuing education training to contracting personnel on small business contracting procedures. | **Orange** ↓ |
| 2. Revise the surveillance review process to ensure that they are conducted in a thorough and consistent manner | New |
| 3. Develop and implement a program that promotes accurate contractor certifications and ensures that contracting personnel review contractor certifications. *(Previously action #2)* | **Green** ↑ |
| 4. Issue regulations that require firms to meet the size standard for each specific order they receive under a GSA schedule and Government-wide Acquisition Contract (GWAC) and show that the regulations are being followed. *(Previously action #3)* | **Orange** |

**Green**-Implemented Yellow-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

## Challenge 2. Weaknesses in information systems security controls pose significant risks to the agency.

The confidentiality, integrity, and availability of SBA's information systems are vital to the continued successful operation of the agency. While information technology (IT) can result in a number of benefits, such as information being processed more quickly and communicated almost instantaneously, it can also increase the risk of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services. SBA's computer security program operates in a dynamic and highly decentralized environment and requires management attention and resources as weaknesses are identified.

SBA improved in information system security in some critical areas during FY 2011. SBA updated procedures disallowing users to connect unauthorized devices to the network and implemented network access controls at SBA headquarters and has plans to extend network access controls to SBA field offices. The Chief Information Security Officer instituted a review of all Plan of Action and Milestones (POA&M) for SBA IT systems and began acquisition of an application to manage SBA's IT systems.

To show further progress, SBA needs to address both known and newly reported information security issues. For example, SBA needs to demonstrate a process that accomplishes timely mitigation of system risks that are identified as "medium" and "high;" enforce an enterprise-wide configuration management process; and ensure segregation of duties controls are in place and operating for all of its systems. SBA has improved in some areas, however, the FY 2011 Financial Statement Audit has identified new weaknesses and findings and are also anticipated for the FY 2011 Federal Information Security Management Act (FISMA) review.

| **Challenge History<br>Fiscal Year (FY) Issued: 1999** | **Actions Accomplished (Green Status) during Past 4 FYs** | | | |
|---|---|---|---|---|
| | **07-2** | **08-2** | 09-0 | 10-0 |
| **Recommended Actions for FY 2012** | | | | **Status at end of FY 2011** |
| 1. Access controls are in place and operating effectively, and contractors are not granted system access until they have obtained the required background investigations and/or security clearances. | | | | Yellow |
| 2. System software controls are in place and operating effectively. | | | | **Orange** ⇩ |
| 3. Segregation of duty controls are in place and operating effectively. | | | | **Orange** |
| 4. The POA&M accurately reports all computer security weaknesses and corrective actions. | | | | Yellow |
| 5. The IT security management program is effective to address information security in systems that support the operations and assets of the organization. | | | | New |

**Green**-Implemented Yellow-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

## Challenge 3. Effective human capital strategies are needed to enable SBA to carry out its mission successfully and become a high-performing organization.

During the past decade, facing budget constraints at the same time that virtually of all its programs were growing significantly, SBA restructured key agency operations, reengineered its largest loan programs, and downsized personnel levels. While these actions transformed the way SBA does business, the agency has not adequately analyzed priorities and allocated resources consistent with those priorities and its new business processes. As a result, there is no assurance that sufficient resources—in terms of both numbers of staff and the knowledge and skills possessed by the staff—are available and appropriately deployed to perform critical functions.

A recent review by the U.S. Office of Personnel Management (OPM) identified weaknesses in SBA's human capital policies and practices that highlight the serious human capital challenges facing the agency. The review found that SBA did not meet over 40 percent of expected outcomes across five Human Capital Assessment and Accountability Framework (HCAAF) areas—Strategic Alignment, Leadership and Knowledge Management, Results-Oriented Performance Culture, Talent Management, and Accountability. OPM traced many of the problems to the absence of an OPM-approved human capital accountability system and a lack of leadership and direction when it comes to the strategic management of human capital at SBA. For example, the OPM found that SBA's human capital policies and procedures were not aligned with the organizational objectives and strategic goals in its FY 2011-2016 Strategic Plan. Further, there was no evidence that SBA engaged in any recent agency-wide workforce planning or competency gap analyses to estimate the staffing and skill levels needed to achieve the agency's performance goals and mission.

The results of the Federal Human Capital Surveys—now called the Employee Viewpoint Survey (EVS)—also have highlighted SBA's serious human capital challenges. SBA has consistently ranked near the bottom on all four human capital indices—Leadership and Knowledge Management, Results-Oriented Performance Culture, Talent Management, and Job Satisfaction. While the agency showed some improvement in the 2011 EVS, it still fell below the government wide average on the four human capital indices. In addition, SBA was 29 out of 31 large agencies in the Partnership for Public Service's 2010 "Best Places to Work" rankings (the 2011 rankings will be available in November 2011).

| **Challenge History Fiscal Year (FY) Issued: 2001 (Revised 2007)** | **Actions Accomplished (Green Status) during Past 4 FYs** | | | |
|---|---|---|---|---|
| | 07-0 | 08-0 | 09-0 | 10-0 |

| **Recommended Actions for FY 2012** | **Status at end of FY 2011** |
|---|---|
| 1. Ensure the agency has an effective, comprehensive workforce and succession plan that aligns talent needs and capabilities with SBA's FY 2011-2016 Strategic Plan. SBA's workforce and succession planning goals should reflect the need to recruit and retain the appropriate talent, and should establish appropriate metrics to gauge SBA's success at having the right people, in the right jobs, at the right time. *(Previously action #3)* | **Red ⇩** |
| 2. Ensure the Office of Human Capital Management (OHCM) is structured and equipped so as to add value by delivering needed strategic support and services such as continuity planning, talent management, organizational development, and strategic consulting to implement the agency's human capital plan and its mission. | New |
| 3. Ensure that Human Capital Management Standard Operating Procedures (SOPs) are updated and appropriately structured to support the agency's long-term goals and objectives and government-wide Human Capital Management initiatives. | New |
| 4. Take steps to correct problems identified in the 2010 EVS. Demonstrate improvement by increasing overall scores/agency rankings in the 2011 EVS. *(Previously action #2)* | Yellow |

**Green**-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

## Challenge 4. SBA needs to implement a quality assurance program in its loan centers.

The initial focus of this challenge was on improving deficiencies identified in SBA loan liquidation and guaranty purchase processes. Over the last decade, the agency has made significant progress to improve these processes at its loan centers, but a significant deficiency continues to exist in the area of quality assurance.

The Office of Financial Program Operations has made progress in developing a Quality Assurance Review (QAR) program for all of its loan centers to verify and document compliance with the loan process, from origination to close-out, and to identify where material deficiencies may exist so that remedial action can be taken. A QAR project guide has been developed and agreed upon by relevant parties within the Office of Capital Access. The QAR program will assess the overall quality of the centers' deliverables to provide confidence to its stakeholders. SBA hired a quality control (QC) manager to oversee the development of the program and identified a QC specialist for each center. Furthermore, a QC team was established and has (1) identified existing processes and ranked the functions within the centers as high, moderate and low risk, (2) identified and ranked critical areas that the centers will focus on for quality control, and (3) developed and documented Quality Program Manuals for each center. The QC team has also developed and implemented checklists for each critical center function and developed quality and risk element databases to be utilized for quality metrics.

While SBA has made substantial progress in its development of a quality assurance program, additional work remains before SBA can demonstrate that all elements of the program are being completed and followed. For example, an ongoing audit found that the early default QAR checklist used at the National Guaranty Purchase Center does not require an adequate review of lender compliance with material loan origination and closing requirements including eligibility, creditworthiness, and use of loan proceeds. Prior OIG audits identified material noncompliance in these areas, which resulted in improper payments and significant loss to SBA. Therefore, a thorough review of eligibility, creditworthiness, and use of loan proceeds is critical to the quality of the center's deliverables and the integrity of the 7(a) loan program.

| **Challenge History Fiscal Year (FY) Issued: 2001** | **Actions Accomplished (Green Status) during Past 4 FYs** | | | |
|---|---|---|---|---|
| | 07-0 | **08-2** | 09-0 | **10-1** |
| **Recommended Action for FY 2012** | | | | **Status at end of FY 2011** |
| 1. Implement a Quality Assurance Program for all SBA loan centers. | | | | Yellow ↑ |

**Green**-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

## Challenge 5. SBA needs to further strengthen its oversight of lending participants.

Since its inception in 1953, SBA has loaned or guaranteed billions of dollars to finance and spur investment in small businesses. In fiscal year 2011, approximately 67 percent of the 7(a) loan dollars guaranteed by SBA were made by lenders using delegated authorities with limited oversight. Prior OIG and GAO reports, including an OIG report issued in May 2008 disclosed that (1) onsite lender examinations did not adequately assess lender risk and were limited in scope, (2) reviews were not conducted of high-risk, medium sized lenders, and (3) SBA did not take adequate risk mitigation measures to hold lenders accountable for their performance. High-risk lenders account for approximately 35 percent of SBA's 7(a) outstanding loan dollars made by active lenders. The risks inherent in delegated lending require an effective oversight program to (1) monitor lenders compliance with SBA policies and procedures, and (2) take corrective actions when a material noncompliance is detected.

The agency has made significant progress in its oversight of lenders in its 7(a) and 504 loan programs since this management challenge was created in 2001. For example, SBA expanded the scope of its oversight by more than doubling the number of on-site reviews of large high-risk lenders. In September 2006, the agency issued SOP 51 00, *On-site Lender Reviews and Examinations*, to guide the on-site review process. The agency also modified its Lender Risk Rating System to further strengthen lender risk assessments. In October 2010, SBA issued SOP 50 53, *Lender Supervision and Enforcement*, which established an oversight framework including enforcement actions to be taken against lenders with unacceptable performance. SBA also recently completed its risk management assessment and plans to (1) re-stratify its oversight activities to better target high-risk lenders and Certified Development Companies (CDCs), (2) expand its assessment of risk, and (3) use statistical samples so that onsite review results can be extrapolated to the lenders' total portfolios.

Although the agency has made progress, it needs to demonstrate consistent adherence to its procedures and ensure that corrective action plans effectively address material noncompliance and actually improves the performance of high-risk lenders.

| **Challenge History**<br>**Fiscal Year (FY) Issued: 2001** | **Actions Accomplished (Green Status) during Past 4 FYs** | | | |
|---|---|---|---|---|
| | **07-7(a)-0**<br>**07-504-1** | **08-7(a)-2**<br>**08-504-2** | 09-7(a)-0<br>09-504-0 | 10-7(a)-0<br>10-504-0 |

| **Recommended Actions for FY 2012** | **Status at end of FY 2011** | |
|---|---|---|
| | **7(a)** | **504** |
| 1. Expand the scope of lender oversight and improve the process for reviewing lenders and CDCs for compliance risks. | Yellow | Yellow |
| 2. Implement guidance providing for effective oversight of lending programs. | Yellow | Yellow |
| 3. Ensure that effective corrective actions are implemented, monitored, and result in improvement in the performance of participants with unacceptable performance. | **Orange** | **Orange** |

Green-Implemented Yellow-Substantial Progress Orange-Limited Progress Red-No Progress

**Challenge 6. The Section 8(a) Business Development program needs to be modified so more firms receive business development assistance, standards for determining economic disadvantage are justifiable, and SBA ensures that firms follow 8(a) regulations when completing contracts.**

SBA's 8(a) Business Development (BD) program was created to assist eligible small disadvantaged business concerns to compete in the American economy through business development.

Previously, the agency did not place adequate emphasis on business development to enhance the ability of 8(a) firms to compete, and did not adequately ensure that only 8(a) firms with economically disadvantaged owners in need of business development remained in the program. Companies that were "business successes" were allowed to remain in the program and continue to receive 8(a) contracts, causing fewer companies to receive most of the 8(a) contract dollars and many to receive none.

SBA made progress in the past towards addressing issues raised by this management challenge that hinder the agency's ability to deliver an effective 8(a) program. This progress included increased training of relevant SBA personnel, improvements in the agency's ability to provide business development skills to program participants, and taking steps to ensure that owners of 8(a) firms that were no longer economically disadvantaged were removed from the program. However, during the past year it regressed. The BD Office had developed a data base (the BD Assessment Tool) to track participant progress, but it has now concluded that the system does not provide the best way to measure business success. Accordingly, SBA is planning to award a contract shortly to develop and deploy a new system to provide SBA employees to monitor program participants, which it expects to deploy by December 2012. SBA took a positive step by revising its regulations in March 2011 to ensure that companies that are "business successes" are graduated out of the program, and by working to update its SOP for the BD program to reflect these regulatory changes. The new regulations also establish additional standards to address the definition of "economic disadvantage," however, the agency has not provided an economic analysis to justify these standards. A recent OIG audit also found that the agency was not effectively performing surveillance reviews to determine whether contracting activities complied with small business and 8(a) requirements. SBA needs to update the relevant SOP governing surveillance reviews for the BD program.

<table>
<tr><td rowspan="2">Challenge History<br>Fiscal Year (FY) Issued: 2003</td><td colspan="4">Actions Accomplished (Green Status) during Past 4 FYs</td></tr>
<tr><td>07-1</td><td>08-1</td><td>09-1</td><td>10-0</td></tr>
<tr><td colspan="4">Recommended Actions for FY 2012</td><td>Status at end of FY 2011</td></tr>
<tr><td colspan="4">1. Develop and implement a plan, including SOP provisions, which ensures that the 8(a) BD program identifies and addresses the business development needs of program participants on an individualized basis.</td><td>Orange ⇩</td></tr>
<tr><td colspan="4">2. Develop and implement Regulations and SOP provisions to ensure that participants are graduated once they reach the levels defined as business success.</td><td>Yellow</td></tr>
<tr><td colspan="4">3. Establish objective and reasonable criteria that effectively measures "economic disadvantage" and implement the new criteria.</td><td>Red ⇩</td></tr>
<tr><td colspan="4">4. On a regular basis, conduct surveillance reviews of procuring agencies to ensure they are effectively monitoring and enforcing compliance with specified 8(a) BD regulations on the contracts they administer.</td><td>Orange ⇩</td></tr>
</table>

**Green**-Implemented Yellow-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

## Challenge 7. Effective tracking and enforcement would reduce financial losses from loan agent fraud.

For more than a decade, OIG investigations have revealed a pattern of fraud in the 7(a) business loan guaranty program by loan packagers and other for-fee agents. Fraudulent schemes have involved hundreds of millions of dollars, yet SBA oversight of loan agents has been limited, putting taxpayer dollars at risk. The agency could reduce this risk by establishing effective loan agent disclosure requirements, a database or equivalent means to track loan agent involvement with its loans, and a more effective agent enforcement program.

Tracking Loan Agent Data. Over the years, in response to this Management Challenge, SBA has proposed various methods of tracking loan agent activity. At one point, SBA proposed to revise its E-Tran system (which collects loan data electronically from participating lenders) to collect loan agent information. The agency later concluded that this approach was not feasible. At the end of FY 2007, SBA proposed a new approach to integrate information from the Form 159 (which asks for information about loan agents) into the Form 1502 electronic data collection process by SBA's Fiscal and Transfer Agent (FTA). The OIG revised recommended action #1 below, but SBA made no progress on it during FY 2008, in part due to a protest of the award of the FTA contract. At the end of FY 2009, SBA presented a succinct plan for implementing the 1502 approach. However, during FY 2010, SBA again changed its position, and advised that it would capture the data by having the Form 159 faxed to the FTA. At the end of FY 2010, SBA issued a notice with directions on how this data was to be submitted. During FY 2011, the agency instructed lenders how to submit Form 159 data (including loan identification numbers) to the FTA, analyzed the data, and updated loan review guidance so that the Office of Credit Risk Management (OCRM) could identify loan agent-related problems. Although loan agent data does not appear in the Loan Accounting System (LAS), SBA officials stated that it could be linked to LAS through a virtual database. It is not yet clear whether such a process would be user-friendly for non-technical users. Finally, SBA issued the loan agent data collection requirement in an SOP effective October 1, 2011.

Loan Agent Enforcement Procedures. In FY 2007, the agency made progress by issuing its Lender Oversight SOP and by previously revising the guaranty purchase checklist (which lists the records that lenders need to provide when requesting SBA to pay a guaranty) to include the submission of the Form 159. However, the agency also needed to establish a more effective enforcement program to deter fraudulent loan agent activity. Effective October 1, 2010, SBA issued a Lender Supervision and Enforcement SOP with provisions for loan agent enforcement actions and a delegation of authority to the Director of OCRM. However, the agency recently advised that this SOP needed to be revised to implement more effective procedures.

| **Challenge History<br>Fiscal Year (FY) Issued: 2000** | **Actions Accomplished (Green Status) during Past 4 FYs** | | | |
|---|---|---|---|---|
| | **07-1** | **08-1** | 09-0 | 10-0 |
| **Recommended Actions for FY 2012** | | | | **Status at end of FY 2011** |
| 1. Develop an effective method of disclosing and tracking loan agent involvement in SBA business loan programs. | | | | Yellow |
| 2. Implement procedures for enforcement actions against loan agents for improper and fraudulent conduct. | | | | Yellow |

**Green**-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

## Challenge 8. SBA needs to modernize its Loan Accounting System and migrate it off the mainframe.

In November 2005, SBA initiated the Loan Management and Accounting System (LMAS) project to update the agency's Loan Accounting System and migrate it off of the mainframe. Previous OIG reports noted that the system was close to the end of its expected useful life, relied on obsolete technology, contained major security vulnerabilities that could not be addressed until the system was moved to a new operating platform, and was costly to operate. Additionally, the OIG reported concerns about SBA's management of the project; the project's noncompliance with the agency's System Development Methodology (SDM) in key areas, which impacts SBA's ability to control project costs and quality; and the lack of an enterprise-wide or project-level Quality Assurance (QA) function to ensure that LMAS deliverables met SBA's requirements and quality standards. Finally, the OIG reported that the LMAS QA contractor had not performed all of the activities stipulated in its contract and that none of the issued LMAS task orders had undergone Independent Validation and Verification (IV&V) testing.

In 2009, SBA contracted with McKinsey & Company to conduct a review of the LMAS project. This review identified multiple weaknesses in SBA's LMAS project management activities and recommended (1) focusing on core mainframe legacy platform replacement, (2) strengthening project governance, (3) increasing project team resources, (4) focusing on COTS capabilities while minimizing customization, and (5) improving vendor management.

In 2010, OMB issued Memorandum 10-26, recommending that Federal agencies split large-scale modernization efforts into smaller, simpler segments with clear deliverables. In response, SBA changed its strategy for LMAS going forward to accelerate the migration of user interfaces from the mainframe legacy platform to the agency's current architecture, and convert batch COBOL systems from the mainframe to a more current and platform-independent environment. SBA staffed its IT QA function and created a new SOP to provide guidance for its IT QA program. However, to show further progress, SBA needs to implement its QA/IV&V process that encompasses all of the requirements of its enterprise SDM, and provide sufficient evidence that all LMAS work products undergo IV&V activities in accordance with the agency's Enterprise Quality Assurance Plan.

<table>
<tr><td rowspan="2">Challenge History<br>Fiscal Year (FY) Issued: 2010</td><td colspan="4">Actions Accomplished (Green Status) during Past 4 FYs</td></tr>
<tr><td>N/A</td><td>N/A</td><td>N/A</td><td>10-0</td></tr>
<tr><td colspan="4">Recommended Actions for FY 2012</td><td>Status at end of FY 2011</td></tr>
<tr><td colspan="4">1. Migrate LAS to a new operating platform before the current mainframe contract expires in 2012.</td><td>Orange</td></tr>
<tr><td colspan="4">2. Modify the LMAS QA/IV&V contract and establish an effective Quality Assurance (QA) process which provides senior management independent assurance that LMAS development activities and related project deliverables meet SBA Quality standards.</td><td>Orange</td></tr>
<tr><td colspan="4">3. Establish a process for reviewing and accepting LMAS deliverables that complies with Systems Development Methodology requirements.</td><td>Orange</td></tr>
<tr><td colspan="4">4. Implement a Quality Assurance process in LMAS in accordance with SBA's Enterprise Quality Assurance Plan.</td><td>Orange</td></tr>
</table>

**Green**-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

## Challenge 9. SBA needs to accurately report, significantly reduce, and strengthen efforts to recover improper payments in the Disaster and 7(a) loan programs.

OIG audits of SBA's Disaster and 7(a) Loan programs determined that the improper payment rates reported for these programs were significantly understated. SBA estimated that improper payments in the Disaster Loan program were about $4.5 million, or 0.55 percent of loans approved in FY 2007, while the OIG reported that it was at least 46 percent, or approximately $1.5 billion. SBA also reported that the improper payment rate for 7(a) purchases was 0.53 percent of FY 2008 program outlays, although the OIG estimated the rate to be 27 percent, or approximately $234 million. SBA's improper payment rates were understated because the agency did not adequately review sampled loans, used flawed sampling methodologies, and did not accurately project review findings for both programs. Additionally, the Office of Financial Assistance (OFA) inappropriately overturned improper payments identified by reviewers.

OIG audits in prior years have also identified high percentages of disaster and business loans that were made to borrowers who were ineligible, lacked repayment ability, or did not provide the required support for loan disbursement. In 2009, we reported that over 30 percent of reviewed disaster loans were disbursed for properties that were not the applicant's primary residence and identified an estimated $30 million in improper loan guaranty purchases in the 7(a) program. Furthermore, a recent OIG audit estimated that at least 1,196 7(a) Recovery Act loans were not originated and closed in compliance with SBA requirements, resulting in at least $869.5 million in inappropriate or unsupported loan approvals. SBA also has not aggressively pursued recovery of 7(a) improper payments.

The Office of Capital Access (OCA) has taken actions to correct many of the deficiencies identified by the OIG. For example, the agency has (1) acquired a statistician to ensure its sample selection and projection of results are in compliance with Office of Management and Budget (OMB) requirements, (2) established a pilot program for disputed denial, repair and improper payment decisions on 7(a) loans, and (3) developed and implemented a corrective action plan. However, additional actions are needed to accurately report, significantly reduce, and recover improper payments. OCA needs to incorporate into formal policy (1) the improper payment review processes, (2) the denial, repair and improper payment dispute resolution process, and (3) the improper payment recovery process. Furthermore, while OCA and the Office of Disaster Assistance (ODA) have acceptable corrective action plans in place, they need to demonstrate that the corrective action plans are effective in reducing improper payments in the 7(a) and Disaster Loan programs.

| **Challenge History<br>Fiscal Year (FY) Issued: 2010** | **Actions Accomplished (Green Status) during Past 4 FYs** | | | |
|---|---|---|---|---|
| | N/A | N/A | N/A | N/A |

| **Recommended Actions for FY 2012** | **Status at end of FY 2011** | |
|---|---|---|
| | **Disaster** | **7(a)** |
| 1. Ensure that processes used to calculate the improper payment rate for disaster and 7(a) loans are designed to effectively identify improper payments as defined by OMB Circular A-123. | **Green ⇑** | **Orange** |
| 2. Reassign responsibility for final approval of disputed denial, repair, and improper payment decisions from OFA to OCRM to ensure an adequate and timely resolution of disputes. | N/A | **Orange** |
| 3. Develop and implement corrective action plans to reduce improper payments in the 7(a) and Disaster Loan programs. *(Previously action #4)* | **Green ⇑** | **Green ⇑** |
| 4. Establish a process and time standards to expeditiously recover improper payments identified during agency reviews and OIG audits. *(Previously action #5)* | N/A | **Orange** |
| 5. Demonstrate that corrective action plans are effective in reducing improper payments in the 7(a) and Disaster Loan programs. | New | New |

**Green**-Implemented **Yellow**-Substantial Progress **Orange**-Limited Progress **Red**-No Progress

## Appendix: Relevant Reports

*Most of the SBA OIG Reports listed can be found at http://www.sba.gov/office-of-inspector-general.*

### Challenge 1:

- SBA OIG, SBA's Planning and Award of the Customer Relationship Management Contracts, ROM 10-16, June 29, 2010.
- Interagency Task Force on Federal Contracting Opportunities for Small Businesses Report, September 2010.
- SBA Advocacy, Analysis of Type of Business Coding for the Top 1,000 Contractors Receiving Small Business Awards in FY 2002, December, 2004.
- The Center for Public Integrity, The Big Business of Small Business: Top defense contracting companies reap the benefits meant for small businesses, September 29, 2004.
- The Center for Public Integrity, The Pentagon's $200 Million Shingle: Defense data shows billions in mistakes and mislabeled contracts, September 29, 2004.
- SBA OIG, Audit of SBA's Administration of the Procurement Activities of Asset Sale Due Diligence Contracts and Task Orders, Report #4-16, March 17, 2004, pp. 8-9.
- GAO, Contract Management: Reporting of Small Business Contract Awards Does Not Reflect Current Business Size, GAO-03-704T. May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, Are Big Businesses Being Awarded Contracts Intended for Small Businesses? Testimony of Mr. Fred C. Armendariz, Associate Deputy Administrator, SBA, May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, Are Big Businesses Being Awarded Contracts Intended for Small Businesses? Testimony of Mr. Felipe Mendoza, Associate Administrator, Office of Small Business Utilization, U.S. General Services Administration, May 7, 2003.
- SBA OIG, Review of Selected Small Business Procurements, Report #5-16, March 8, 2005.
- SBA OIG, SBA Small Business Procurement Awards Are Not Always Going to Small Businesses, Report #5-14, February 24, 2005.

### Challenge 2:

- SBA OIG, Weaknesses Identified During the FY 2010 Federal Information Security Management Act Review, Report 11-06, January, 28, 2011
- SBA OIG, Audit of SBA's FY 2010 Financial Statements, Report 11-03, November 12, 2010
- SBA OIG, Audit of SBA's FY 2009 Financial Statements, Report #10-04, November 13, 2009
- SBA OIG, SBA's FY2008 Financial Statements, Report #9-03, November 14, 2008
- SBA OIG, Audit of SBA's Financial Statements for FY 2006, Report #7-03, November 15, 2006
- SBA OIG, Audit of SBA's Information System Controls for FY 2004, Report #5-12, February 24, 2005

### Challenge 3:

- OPM, 2011 Federal Employee Viewpoint Survey
- Partnership for Public Service, Best Places to Work in the Federal Government 2010
- OPM, 2010 Federal Employee Viewpoint Survey
- SBA OIG, The Colorado District Office's Servicing of 8(A) Business Development Program Participants, Report #10-15, September 30, 2010
- SBA OIG, Adequacy of Procurement Staffing and Oversight of Contractors Supporting the Procurement Function, ROM 10-13, April 9, 2010
- SBA OIG, SBA's Administration of the Microloan Program under the Recovery Act, ROM 10-10, December 28, 2009
- Partnership for Public Service, Best Places to Work in the Federal Government 2009
- OPM, 2008 Federal Human Capital Survey

- GAO, Agency Should Assess Resources Devoted to Contracting and Improve Several Processes in the 8(a) Program, GAO-09-16, November 2008
- GAO, Opportunities Exist to Build on Leadership's Efforts to Improve Agency Performance and Employee Morale, GAO-08-995, September 2008
- SBA OIG, Non-Native Managers Secured Millions of Dollars from 8(a) Firms Owned by Alaska Native Corporations through Unapproved Agreements that Jeopardize the Firms' Program Eligibility, Report #8-14, August 7, 2008
- GAO, Opportunities Exist to Improve Oversight of Women's Business Centers and Coordination Among SBA's Business Assistance Programs, GAO-08-49, November 2007
- SBA OIG, Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program, Report #7-19, March 30, 2007
- SBA OIG, Management Advisory Report on the Transfer of Operations to the National Guaranty Purchase Center, Report #4-39, August 31, 2004
- GAO, Small Business Administration: Progress Made, but Transformation Could Benefit from Practices Emphasizing Transparency and Communication, GAO-04-76, October 2003
- GAO, Results Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations, GAO-03-699, July 2003
- GAO, Small Business Administration: Workforce Transformation Plan is Evolving, GAO-02-931T, July 16, 2002
- SBA OIG, Modernizing Human Capital Management, Report #2-20, May 31, 2002
- GAO, Small Business Administration: Current Structure Presents Challenges for Service Delivery, GAO-02-17, October 2001
- GAO, Small Business Administration: Steps Taken to Better Manage its Human Capital, but More Needs to be Done, GAO/T-GGD/AIMD-00-256, July 20, 2000
- SBA OIG, A Framework for Considering the Centralization of SBA Functions, November 1996

## Challenge 4:

- SBA OIG, Origination and Closing Deficiencies Identified In 7(a) Recovery Act Loan Approvals, Report #11-07, September 30, 2011
- SBA OIG, Material Deficiencies Identified in Five 7(a) Recovery Act Loans Resulted in $2.7 Million of Questioned Costs, Report #11-06, August 25, 2011
- SBA OIG, Banco Popular Did Not Adequately Assess Borrower Repayment Ability When Originating Huntington Learning Center Franchise Loans, Report #11-16, July 13, 2011
- SBA OIG, Material Deficiencies Identified in Four 7(a) Recovery Act Loans Resulted in $3.2 Million of Questioned Costs, Report #11-05, June 29, 2011
- SBA, OIG America's Recovery Capital Loans Were Not Originated and Closed In Accordance With SBA's Policies and Procedures, Report #11-03, March 2, 2011
- SBA OIG, Material Deficiencies Identified in Early-Defaulted and Early-Problem Recovery Act Loans, #10-19, September 24, 2010
- SBA OIG, SBA's Management of the Backlog of Post-purchase Reviews at the National Guaranty Purchase Center, #9-18, August 25, 2009
- SBA OIG, , The Small Business Administration's Fiscal Year 2008 Improper Payment Rate for the 7(a) Guaranty Loan Program #9-16, July 10, 2009
- SBA OIG, Review of Key Unresolved OIG Audit Recommendations in Program Areas Funded by the American Recovery and Reinvestment Act and Related Activities Need to Safeguard Funds, #ROM 09-1, April 30, 2009
- SBA OIG, Audit of the Liquidation Process at the National Guaranty Purchase Center, #9-08, January 30, 2009
- SBA OIG, Audit of Six SBA Guaranteed Loans, #8-18, September 8, 2008
- SBA OIG, Audit of Loan Classifications and Overpayments on Secondary Market Loans, #8-09, March 26, 2008
- SBA OIG, Audit of UPS Capital Business Credit's Compliance with Selected 7(a) Lending Requirements, #8-08, March 21, 2008

- SBA OIG, Audit of the Guarantee Purchase Process for Section 7(a) Loans at the National Guaranty Purchase Center, Report #7-23, May 8, 2007
- SBA OIG, Audit of Deficiencies in OFA's Purchase Review Process for Backlogged Loans, Report #6-35, September 29, 2006
- SBA OIG, Survey of the Quality Assurance Review Process, Report #6-26, July 12, 2006
- SBA OIG, Audit of SBA's Implementation of the Improper Payments Information Act, Report #6-25, June 21, 2006
- SBA OIG, Management Advisory Report on the Transfer of Operations to the National Guaranty Purchase Center, Report #4-39, August 31, 2004
- SBA OIG, Audit of the Guaranty Purchase Process, Report #3-15, March 17, 2003
- SBA OIG, Improvements are Needed in Small Business Lending Company Oversight Process, Report #2-12, March 21, 2002
- GAO, Major Management Challenges and Program Risks, GAO-01-260, January 2001

## Challenge 5:

- SBA OIG, SBA's Oversight of SBA Supervised Lenders, Report #8-12, May 9, 2008
- SBA OIG, UPS Capital Compliance with Selected 7(a) Lending Requirements, Report #8-08, March 21, 2008
- GAO, Small Business Administration: Additional Measures Needed to Assess 7(a) Loan Program's Performance, GAO-07-769, July 13, 2007
- SBA OIG, SBA's Oversight of Business Loan Center, LLC, Report #7-28, July 11,2007.
- SBA OIG, SBA's Use of the Loan and Lender Monitoring System, Report #7-21, May 2, 2007.
- SBA OIG, Audit of the Office of Lender Oversight Corrective Action Process, Report #7-18, March 14, 2007.
- GAO, Small Business Administration: Improvements Made, But Loan Programs Face Ongoing Management Challenges, GAO-06-605T, April 6, 2006
- SBA OIG, SBA's Administration of the Supplemental Terrorist Activity Relief (STAR) Loan Program, Report #6-09, December 23, 2005
- GAO, Small Business Administration: New Service for Lender Oversight Reflects Some Best Practices, But Strategy for Use Lags Behind, GAO-04-610, June 8, 2004
- GAO, Continued Improvements Needed in Lender Oversight, Report #03-90, December 2002
- SBA OIG, Impact of Loan Splitting on Borrowers and SBA, Advisory Memorandum Report #2-31, September 30, 2002
- SBA OIG, Improvements needed in SBLC Oversight, Advisory Memorandum Report, #2-12, March 20, 2002
- SBA OIG, Preferred Lender Oversight Program, Report #1-19, September 27, 2001
- SBA OIG, SBA Follow-up on SBLC Examinations, Report #1-16, August 17, 2001

## Challenge 6:

- SBA OIG, Audit on the Effectiveness of the SBA's Surveillance Review Process, Report # 11-11, March 31, 2011
- SBA OIG, Audit of Two 8(a) Sole –Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program, Report #7-19, March 30, 2007
- SBA OIG, Audit of Monitoring Compliance with 8(a) Business Development Regulations During 8(a) Business Development Contract Performance, Report #6-15, March 16, 2006
- SBA OIG, Business Development Provided by SBA's 8(a) Business Development Program, Report #4-22, June 2, 2004.
- SBA OIG, SACS/MEDCOR: Ineffective and Inefficient, Report #4-15, March 9, 2004
- SBA OIG, Section 8(a) Program Continuing Eligibility Reviews, Report #4-3-H-006-021, September 30, 1994

## Challenge 7:

- SBA OIG, Applicant Character Verification in SBA's Business Loan Program, Report #3-43, April 5, 2001
- SBA OIG, Summary Audit of Section 7(a) Loan Processing, Report #0-03, January 11, 2000
- SBA OIG, Loan Agents and the Section 7(a) Program, Report #98-03-01, March 31, 1998
- SBA OIG, Fraud Detection in SBA Programs, Report #97-11-01, November 24, 1997
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# SBA Response to the OIG Report on Management and Performance Challenges

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

**Date:** **October 28, 2011**

**To:** **Peggy E. Gustafson**
**Inspector General**

**From:** **Marie C. Johns**
**Deputy Administrator**

**Subject: FY 2012 OIG-Identified Major Management Challenges**

On October 21, 2011, the OIG submitted to SBA its report entitled: "Fiscal Year 2012 Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration." The Management Challenge Report, which is published each November in the Agency's Annual Financial Report (AFR), provides an OIG assessment of major Agency management challenges during the previous fiscal year that pose significant risks, including those that are particularly vulnerable to waste, fraud, error, or mismanagement.

To summarize, SBA notes the following results in this year's Report:

1. Achieved four green ("fully successful") ratings on 32 OIG-recommended actions, 11 yellow ("substantial progress"), 15 orange ("limited progress"), and two reds ("no progress");
2. Improved ratings in five of the 32 actions and downward changes from last year in six of the 32 actions;
3. Two performance challenges were identified for priority management and performance focus in FY 2012; namely, execution of an effective Agency-wide workforce and succession plan and improvements in managing the Section 8(a) Business Development program.

One of the Agency's core management priorities is to ensure effective program oversight and execution of its fiduciary responsibility to safeguard taxpayer resources. SBA appreciates the cooperation and work done by the OIG in helping the Agency to continue to address its major management challenges. Instituting sound internal management processes leads to reduced government risk; lower cost to the taxpayer; and reduced potential for waste, fraud and abuse.

Thank you and your staff for your continued commitment in helping us to improve our management environment.

# Summary of OIG Audit Follow-up

Throughout the year, the OIG conducts audits of SBA's processes, procedures and programs, and makes recommendations for improvement. Many of these recommendations are not material, relative to their dollar impact on SBA's financial and administrative operation, but are beneficial to SBA's management. If SBA management disagrees with an OIG recommendation, the OIG may revise the recommendation or refer the issue to a higher level of SBA management. When both SBA management and the OIG agree on the recommendation, SBA management develops a corrective action plan, including a target date for completion. This recommendation is identified as having a "Management Decision." When the corrective action plan is implemented and the recommendation has been fully addressed, the recommendation is identified as having a "Final Action."

The OCFO maintains a database to track the recommendations through to the conclusion, or Final Action. During FY 2011, there were 114 Final Actions resulting from 4 monetary and 110 non-monetary recommendations. The status of the corrective actions is updated regularly and is available for review on the SBA Intranet. The status of all audit recommendations is reconciled with the OIG to ensure actions are posted promptly and accomplished in accordance with the agreed-upon target dates.

The following two tables depict SBA's final action activity for FY 2011. Detailed information by report number on final action with disallowed or questioned costs, funds put to better use, and status of corrective action plans not implemented within one year can be found in Supplementary Information #3 that accompanies this Agency Financial Report.

TABLE 1 FINAL ACTION ON AUDIT RECOMMENDATIONS WITH DISALLOWED OR QUESTIONED COSTS
OCTOBER 1, 2010 – SEPTEMBER 30, 2011

| | Number of Recommendations | Disallowed Costs (Rounded to Thousands) |
|---|---|---|
| A. Recommendations with management decisions on which final action had not been taken at the beginning of the period. | 2 | $2,780 |
| B. Recommendations on which management decisions were made during the period. | 11 | 6,423 |
| C.Total recommendations pending final action during period. | 13 | $9,203 |
| D. Recommendations on which final action was taken during the period. | | |
| 1. Recoveries: | | |
| (a) Collections and Offsets | 1 | 3 |
| (b) Property | | |
| (c) Other | | |
| 2. Write-Offs | 1 | 269 |
| 3. Total | **2** | **$272** |
| E. Recommendations needing final action at the end of the period. | 11 | $8,931 |

## TABLE 2 FINAL ACTION ON AUDIT RECOMMENDATIONS WITH FUNDS PUT TO BETTER USE OCTOBER 1, 2010 – SEPTEMBER 30, 2011

| | Number of Recommendations | Funds to be Put to Better Use (Rounded to Thousands) |
|---|---|---|
| A. Recommendations with management decisions on which final action had not been taken at the beginning of the period. | 3 | $54,242 |
| B. Recommendations on which management decisions were made during the period. | 3 | 53,000 |
| C. Total recommendations pending final action during period. | 6 | $107,242 |
| D. Recommendations on which final action was taken during the period. | | |
| 1. Value of recommendations implemented (completed). | 2 | 53,000 |
| 2. Value of recommendations that management concluded should not or could not be implemented or completed. | | |
| 3. Total | **2** | **$53,000** |
| E. Recommendations needing final action at the end of the period. | 4 | $54,242 |

## Improper Payments

As required by the Improper Payment Information Act of 2002 (IPIA) and as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) and OMB Circular A-123, Management's Responsibility for Internal Controls, Appendix C, the SBA has reviewed all programs and activities for susceptibility to significant improper payments as of FY 2011.

### Risk Assessment

In FY 2011, the SBA conducted a qualitative or quantitative risk assessment for each of the following programs or activities to determine the susceptibility to significant improper payments: contracting, 7(a) guaranty loans, disaster loans, small business development centers, small business investment companies, 504 certified development company loans, congressional grants, women's business ownership grants, surety bond guaranties, and microloans. Based on OMB's new IPERA implementation guidance in OMB Circular A-123, Appendix C released in April 2011, the SBA determined that contracting had high risk factors likely to contribute to improper payments, and the program was included in the improper payments review for the first time because it did not previously meet the dollar threshold for inclusion. In compliance with OMB guidance, the SBA has determined that its contracting program is risk-susceptible, and the Agency will continue to identify the most appropriate improper payments measurement in the coming year. The SBA anticipates it can report an error rate for contracting in FY 2012.

The SBA's four major credit programs were included in the Improper Payments program as they were previously identified in the former Section 57 of Circular A-11.

1. 7(a) business loan guaranty approvals and defaulted loan purchases
2. 504 certified development company guaranty approvals
3. small business investment company financings
4. disaster loans

The first three are loan guaranty programs and Disaster is a direct lending program.

### Statistical Sampling

The statistical sampling process used in FY 2011 is practically unchanged from that used in FY 2010.

**7(a) guaranty purchase** statistical sampling used Probability Proportional to Size (PPS) with replacement in FY 2011. This method was used because large loans in the sample can skew the result. The sampling period was the 12 months ended March 31, 2011. The sample was stratified based on SBA service center, purchase process and early default. Using PPS, the SBA determined the appropriate total sample size to be 303 loans with aggregate purchase outlays of $123.5 million, and improper payments of $1.6 million were identified within the sample. Using the Hansen-Hurwitz estimation method, the estimated improper payment rate for the 7(a) guaranty purchase population is 1.73 percent compared to a 1.87 percent rate last year.

**7(a) approval** reviews also used PPS Sampling with replacement for all loan guaranties approved during the 12 month period ended March 31, 2011. The approval population was divided into six strata based on the loan delivery method. The SBA determined the appropriate total sample size to be 112 loans from the population. The estimated improper payments rate for the annual period ending March 31, 2011 was calculated as 0 percent based on the aggregate net approval amount of $130,057,688 on the approved loans sampled with no improper payments found.

**504 CDC approval** used PPS sampling with replacement from all loan guaranties approved during the 12 month period ended March 31, 2011. The approval population was divided into three strata based on the loan delivery method. The SBA determined the appropriate total sample size to be 50 loans from the population. The estimated improper payments rate was calculated as 0 percent based on the aggregate net approval amount of $61,719,000 on the approved loans sampled with no improper payments found.

**SBIC** used a random sample of 95 SBIC financings by SBIC's having SBA guarantied leverage during the 12 month period ended March 31, 2011. Improper payments were identified when an SBIC examination (either regularly scheduled or a special examination) found a discrepancy with SBIC program regulations in the sampled financings. The examinations identified two potential improper payments. One was a possible inappropriate prepayment restriction and the other was a financing to a potential ineligible business. The two financings constituted $2,258,333 of the $185,758,518 in financings sampled, or 1.2 percent of the total.

**Disaster** used PPS sampling with replacement from all disbursed loans during the 12 months ended June 30, 2011 based on assumptions about the likely prevalence and severity of improper payments. The SBA's Quality Assurance Review (QAR) sample size was 494 disbursed disaster loans. The scope of the QAR covers three compliance areas: (1) basic eligibility; (2) adherence to relevant laws, rules, regulations and standard operating procedures; and, (3) creditworthiness. The review found a 28.4 percent improper payment rate or $96,336,000 of the $339,630,000 in total disbursements. The high rate of improper payments is generally the result of paperwork errors, not eligibility or creditworthiness errors. If the measurement reflected payments made to potentially ineligible borrowers or in an incorrect payment amount, the improper payment rate would be 12.1 percent.

**Contracting** activities suggest a higher than acceptable improper payments rate. In FY 2011, the first year that contracting was determined to be risk-susceptible under IPERA, the SBA developed a statistical sampling methodology to test the effectiveness of this measurement. Since this was the first year that the SBA tested contracting payments, the Agency is continuing to identify the most appropriate measurement process. The SBA will take lessons learned from the test in FY 2011 to refine the measurement process and report improper payment estimates in the FY 2012 Agency Financial Report. In the meantime, the test in FY 2011 utilized statistical sampling using PPS with replacement in FY 2011. The sampling period was the 12 months ended March 31, 2011. The SBA determined the appropriate total sample size to be 150 invoices with total outlays of $29,300,644.31. The scope of the review covers three areas: (1) invoice payment, (2) contracting, and (3) invoice processing. Under this first review, the estimated improper payment rate was determined to be 89 percent or $118,392,584. The high rate of improper payments is generally the result of documentation errors, not due to payment errors or non-receipt of goods or services. If the measurement reflected payments made in inaccurate amounts or non-compliance with contract terms, the improper payment rate would be 3 percent or $4.5 million. As indicated, the SBA is taking the lessons learned from this first test measurement and will be refining the measurement methodology, but it plans to report an error measurement for contracting in FY 2012.

## Corrective Action

**The 7(a) guaranty purchase** improper payments program identifies and tracks the reasons for any improper payments discovered in the reviews, and then appropriate adjustments to the guaranty purchase process are made to reduce future errors.

The root cause for all identified improper payments for the 7(a) purchase program was Administrative and Documentation Errors; the error rate was 1.73 percent for a total of $40.7 million. There was no Authentication and Medical Necessity Errors nor Verification Errors.

Improper payments arise from the failure of a purchase processor to identify material lender deficiencies in the handling of an SBA guarantied loan. Primary reasons for errors in purchases reviewed this year were:

- improper use of loan proceeds (not in accordance with loan authorization);

- failure to conduct timely site visit;
- failure of lender to assure adequate technical assistance on Community Express loan;
- failure of lender to perfect security interest in collateral;
- failure to verify borrower financial information using IRS tax transcripts;
- inadequate credit scoring model for Community Express loan approvals;
- underpayment of interest to lender because incorrect interest rate was used; and
- reimbursement of lender expenses that were not fully justified.

Ongoing corrective action procedures followed for the 7(a) guaranty purchase process involve advising the purchase processing team of improper payment determinations and clarification of the issues to avoid possible improper payments in the future through a newly revised quality control (QC) process. A fully documented guaranty purchase procedure handbook is updated periodically. Remedial actions taken by the QC team on an ongoing basis include:

- identify and analyze error patterns;
- communicate error patterns to the staff processing purchases;
- review current policies and procedures to ensure that any error patterns are appropriately addressed in current guidance;
- revise policies and procedures where necessary;
- issue guidance to the purchase staff on specific issues;
- provide training; and
- supplement center resources where possible to ensure ongoing quality control procedures that will identify any emerging patterns or potential problem areas that might result in future improper payments, as well as take action to mitigate these potential problem areas.

**7(a) loan guaranty approvals and 504 CDC loan** approvals had no improper payments. There appear to be sufficient safeguards in place to prevent improper payments in 7(a) loan processing and 504 loan originations because of multiple reviews that take place when a loan is being processed.

**SBIC financings** had only two potential erroneous payments. The minimal number of erroneous payments will continue due to rigorous program standards.

The root cause for all identified improper payments for the SBIC program was Administrative and Documentation Errors; the error rate was 1.2 percent for a total of $17.0 million. There were no Authentication and Medical Necessity Errors nor Verification Errors.

The following ongoing steps will further reduce future improper payment rates:

- Licensing standards require knowledgeable fund managers and this reduces the likelihood of program errors and fraud.
- All fund managers must undergo training on SBIC regulations as a condition for receiving leverage. Therefore, almost all SBICs are very knowledgeable service providers that have extensive experience in the program.
- Licensing includes extremely detailed background checks on fund managers by both the Office of the Inspector General and the Federal Bureau of Investigation.
- Credit checks are performed on all potential fund managers as part of SBIC licensing.
- Licensees are audited on a periodic basis to determine ongoing compliance with regulatory requirements.

**Disaster** improper payment rate was greater than projected. The increased rate does not reflect greater risk in the portfolio but does indicate a need to adhere to the documentation requirements of the Standard Operating Procedures. Over half the notations for improper payments reflect paperwork that was not received or completed timely to meet the procedural requirements. If the measurement reflected payments made to potentially ineligible borrowers or in an incorrect amount, the improper payment rate would be 12.1 percent. In addition, the sample selected for review contained numerous disbursements for loans established prior to the current reference period beginning July 2010, previous to the implementation of the corrective actions taken to mitigate past errors. As these older loans are fully disbursed, it is anticipated the improper payment rate will be reduced.

The root cause for all identified improper payments for the Disaster program was Administrative and Documentation Errors; the error rate was 28.4 percent for a total of $96.3 million. There was no Authentication and Medical Necessity Errors nor Verification Errors.

The following ongoing steps will further reduce future Improper Payment rates:

- Additional training has been instituted to ensure that staff is aware of all paperwork requirements and waiver procedures when appropriate.
- A dedicated team that reports directly to SBA headquarters will complete the annual Improper Payment review and continuously review the work of the Production and Disbursement Center.
- Areas of concern will be identified and corrected in a timely manner.

Disaster improper payments identified thru annual Quality Assurance Reviews indicate minimal findings of unauthorized and/or ineligible loans. Disaster program internal controls include the following:

- Disaster related damages are verified onsite by SBA staff. The cost to repair and/or replace the disaster damaged property is determined by SBA construction analysts.
- Disaster procedures include credit checks, verification of income, verification of ownership and checks with FEMA to ensure that federal assistance is not duplicated during loan processing and disbursement of all disaster loans.
- Every secured disaster loan is reviewed by disaster staff attorneys for legal sufficiency and the use of electronic funds transfer is utilized to prevent lost and stolen checks.

**Contracting** has been identified as risk-susceptible under IPERA. While the SBA is still developing an improper payment methodology, actions are being taken to address improper payments in this area.

SBA's contracting activities were transferred to the Acquisition Division in the Denver Finance Center, Office of Performance Management and Chief Financial Officer, in October 2010. Most of the individual sampled invoices correspond to contracts that were awarded prior to FY 2011, which predates a number of actions already taken by the SBA to improve the quality of its staff, file documentation, and data integrity.

The Acquisition Division has taken the following steps to reduce improper payments:

- Improving training by expanding COTR and program manager training in many areas such as appropriate invoicing (December 2010 and January 2011, respectively, and will be on-going).
- Enhancing the Contract Management System and financial system two-way interfaces and evaluated possible use of Treasury's Integrated Payments Platform (IPP) system with a target date of March 2012.
- Developing a "Review Checklist" and conducting a review of all active contract files to identify missing documents and correct documentation errors with a target date of January 2012.
- Re-instituting legal reviews and expanded legal staff for contracting support in February 2011.
- Enhancing training and the intake checklist for invoices to better assess the acceptability of invoices with a target date of December 2011.
- Revise standard operating policy and procedures for SBA Acquisition with a target date of June 2012.

## Improper Payment Reporting

The table on this page presents SBA's Improper Payment program results for FY 2011.

## Recapture of Improper Payments

The existing reviews performed by SBA personnel are considered to be sufficient to identify and recapture overpayments. Due to the historical low error rates and the complex nature of the programs, further recapture audits would not be cost-effective.

**7(a) guaranty purchase** improper payments are identified and recovered by three different sources:

1. A random sample of loan purchases for 12 months ending March 31, validated by a contractor-statistician, is reviewed for potential improper payments to lenders each year. The results of this targeted review for potential improper payments are reported annually in SBA's Agency Financial Report.
2. Improper payment approval reviews are conducted by four loan officers who were not associated with the approval process for the individual loan being reviewed. Improper payments have not been detected in these reviews in the recent past, due to the multiple reviews that take place when a loan is being processed.
3. Continuous Quality Control reviews assess the quality of the loan and loan documentation and include a review for potential improper payments for targeted loans, such as those from "problem" lenders, high dollar loans, or those that experience early default. The SBA's Quality Control staff in the Office of Capital Access conducts the reviews and track the reasons for any improper payments discovered in the reviews. As a result of the root cause identification, appropriate adjustments to the guaranty purchase process are made to reduce future errors.

Overpayments identified in any of the three reviews listed are recovered from the lender as appropriate. Portfolio management negotiates with the lender as to the lender's liability. This is a case-by-case determination that varies substantially depending on the circumstances of the loan making, servicing, purchases and liquidation.

**IMPROPER PAYMENT REDUCTION OUTLOOK ($ IN MILLIONS)**

| Program | FY10[1] $ Outlays | FY10 IP % | FY10 IP $ | FY11[1] $ Outlays | FY11 IP % | FY11 IP $ | FY11 $ Over-payments | FY11 Underpay-ments | FY12[1] $ Outlays | FY12 IP % | FY12 IP $ | FY13[1] $ Outlays | FY13[1] IP % | FY13 IP | FY14 $ Outlays | FY14[1] IP % | FY14 IP |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 7(a) Guaranty Purchases[1] | 2,392.20 | 1.87 | 44.8 | 2,355.60 | 1.73 | 40.7 | 40.7 | 0 | 2,300.00 | 1.4 | 32.2 | 2,200.00 | 1.3 | 28.6 | 2,100.00 | 1.3 | 27.3 |
| 7(a) Guaranty Approvals[1] | 11,638.70 | 0 | 0 | 5,327.80 | 0 | 0 | 0 | 0 | 16,000.00 | 0 | 0 | 16,500.00 | 0 | 0 | 17,000.00 | 0 | 0 |
| CDC Debentures[2] | 4,500.20 | 0 | 0 | 4,375.30 | 0 | 0 | 0 | 0 | 5,500.00 | 0 | 0 | 6,000.00 | 0 | 0 | 6,500 | 0 | 0 |
| CDC Loans Guarantied[1] | 4,500.20 | 0 | 0 | 4,375.30 | 0 | 0 | 0 | 0 | 5,500.00 | 0 | 0 | 6,000.00 | 0 | 0 | 6,500 | 0 | 0 |
| SBIC Guaranties[3] | 1,475.00 | 0.99 | 14.6 | 1,421 | 1.2 | 16.7 | 16.7 | 0 | 1,400.00 | 1.2 | 16.8 | 1,400.00 | 1.1 | 15.4 | 1,400.00 | 1 | 14 |
| Disaster Loan Disbursements[4] | 372.1 | 34.2 | 127.1 | 339.6 | 28.4 | 96.3 | 96.3 | 0 | 800 | 20 | 160 | 800 | 17 | 136 | 800 | 15 | 120 |
| Contract Disbursements[4] | N/A | N/A | N/A | 133.4 | N/A | N/A | N/A | 0 | 130 | N/A | N/A | 130 | N/A | N/A | 130 | N/A | N/A |

1. Outlays in this report represent the base amount of the program activity related to SBA improper payments; and this amount will differ from the amount reported as outlays in SBA's President's Budget submissions because they include reestimates of subsidy cost, reimbursements to SBA administrative funds and other costs. Outlays for 7(a) Guaranty Purchases are the amount of disbursements for the purchase of defaulted guarantied loans. Outlays for 7(a) Guaranty Approvals are the amount of new guaranty approvals by banks and other SBA lending partners. Outlays for CDC Debentures and CDC Loans Guarantied are approvals irrespective of disbursement, net of approval increases, decreases, reinstatements and cancellations for the current year. Outlay figures for Disaster are loan disbursements on current year approvals.
2. The SBA has zero improper payments assumed for CDC debentures.
3. SBIC Guaranties include SBA guaranties of leverage extended to SBICs.
4. The SBA identified contract disbursements as susceptible to significant improper payments in FY 2011. This year the SBA conducted a test of these payments that examined invoice processing, contracting, and invoice payment. Based on this year's test results, the SBA will refine its measurement and plans to report a measurement in FY 2012.

**SBIC** improper payments are identified through annual examinations performed by SBA personnel for leveraged SBICs. When an improper payment is identified, the SBA sends a letter to the SBIC with a recommendation for resolution and monitors the issue until it is resolved. Because SBICs obtain private financing from a number of sources, including banks, pension funds, corporations, and individuals and only supplement their private investment capital with funds guaranteed by SBA, it would be impossible to identify the amount invested in a particular business that was provided solely or specifically by the SBA guarantee. In the rare occasions an investment in an ineligible small business is identified, SBA requires the SBIC to divest itself from the small business recipient. In even rarer instances, the SBIC might be found to be in default of its covenants and will be referred to SBA's Office of SBIC Liquidations where recovery efforts will be implemented. This has not been necessary for the most part.

The current procedures are considered to be sufficient to identify potential improper payments. For the most part any identified improper payment is easily rectified by simply changing the terms of the financing. It would not be cost effective to use an outside entity to conduct additional reviews, as leveraged SBICs are already being reviewed every 12 months and the historically low improper payment rate would not support using additional resources for additional payment recovery audits.

**Disaster** improper payments are generally the result of loan documentation errors and do not result in a disaster victim receiving funds that they are not eligible to receive. Loan documentation legally obligates the recipient of a disaster loan to pay back the entire loan amount whether or not the loan contains any improper payments. Therefore, improper payments are not recovered upon discovery but realized as the borrower makes each payment on the loan. Further, the majority of loans are collateralized which promotes maximum recovery. Therefore, a PRA is not cost-effective for this direct loan program.

**Contracting** at SBA did not meet the requirements for reporting improper payments prior to the Improper Payment Elimination and Recovery Act of July 2010; therefore, a systematic review for improper payments was not established prior to FY 2011. Due to the limited amount of outlays ($133.4 million for the improper payment scope period) the SBA has determined that recapture audits are not cost-effective.

**Overpayments Recaptured Outside of Payment Recapture Audits** are applicable only to Contracts and 7(a) Purchases as they are recoverable from vendors and lenders as appropriate. The Contract overpayments that relate to cash payments made for an inaccurate amount or not according to contract terms which the SBA does not plan to ratify through a legal process total $32,477; all other over payments were due to missing or incomplete documentation or can be ratified through legal review. Contracts were reviewed for improper payments for the first time this year and therefore FY 2010 information is not applicable. As FY 2011 is the first year recovery of overpayments has been requested, the 7(a) Purchases overpayments, which represent recoverable payments made to lenders, is not readily available but will be in future years.

| Source of Recovery | Amount Identified FY 2011 | Amount Recovered FY 2011 | Amount Identified FY 2010 | Amount Recovered FY 2010 | Cumulative Amount Identified | Cumulative Amount Recovered |
|---|---|---|---|---|---|---|
| Contract IP Review | 32,477 | ** | N/A | N/A | 32,477 | ** |
| 7(a) IP Purchase Review | $1.6 M | ** | Not Available | Not Available | $1.6 M | ** |

**The improper payment reviews were completed in September 2011 and the SBA is in the process of recovering improper payments for the current year.

## Accountability

SBA's Strategic Goal 2 is to build an SBA that meets needs of today's and tomorrow's small businesses. Within that goal is Strategic Objective 2.1 which is to strengthen SBA's core programs and operations to ensure that they are high performing, effective, and relevant to the needs of the small business community. The SBA's strategic goals are included in annual performance plans for all of its programs as business objectives, and these business objectives are included in employee performance plans. SBA management monitors accomplishment of its business objectives in its performance plan using its performance management process, and action is taken when progress is not on target. Executive and management bonuses are based on the accomplishment of business objectives included in employee annual performance plans. This management process assures accountability of improper payment administration.

## Information Systems and other Infrastructure and Improper Payments

**7(a) loan purchase** is supported very well by the Guaranty Purchase Tracking System. It is continually updated to enhance the overall integrity of the purchase process.

**504 CDC** software used by the Central Servicing Agent is owned by the SBA. Therefore the Agency has a higher level of control over that software than would typically exist with contractor owned systems. In addition the contractor provides audited financial statements and a SAS 70 report to verify its system.

**SBIC financings** are supported very well by a data system that tracks exams, exam findings and resolution of exam findings. All individuals are empowered to refer any case of suspected fraud to the Inspector General.

**Disaster** does have the information systems and other infrastructure it needs to reduce improper payments to targeted levels. Disaster is engaged in an ongoing process of developing and has already implemented an integrated, electronic loan processing system to streamline, enhance and improve the loan-making process. This system will support workflow management, electronic file management and document generation functions. The newly formed Quality Assurance Team is working with the Disaster Credit Management System (DCMS) development team to improve the Quality Assurance process with a goal to minimize future Improper Payments events as much as possible. Many of the business rules that govern the programming of this system have been designed to help improve the Quality Assurance process.

**Contracting** is supported by the PRISM Contract Management System which tracks and records acquisitions. Management of the PRISM and financial systems falls within the CFO's Office of Financial Systems. The Acquisition Division plans to expand the two-way interface between the PRISM and the financial systems and explore the possible use of Treasury's Integrated Payments Platform (IPP) system.

## Statutory or Regulatory Barriers

The SBA does not have any statutory or regulatory barriers limiting improvement to its performance on improper payments initiative.

# Appendices

## Success Story

### Grit, Perseverance, and Excellent Cakes!

Haydel's Bakery, Jefferson, Louisiana

For three generations, Haydel's bakery has been a symbol of New Orleans' grit, perseverance, and excellent cakes! The company started in 1959 when Lloyd Haydel, took over the Sunny Flake Donut Shop. Six years later, Hurricane Betsy destroyed the building, but Lloyd secured an SBA disaster loan and rebuilt on-site, renaming it Haydel's Sunny Flake Bakery. He hired some of the best bakers in the city and started selling cakes and pastries. Soon, his sons David and Gary were learning the craft.

When Lloyd died suddenly in 1974, David and Gary expanded the business and by the mid 1980s they where shipping their pastries nationwide. Their King Cakes, a Mardi Gras favorite, were big hits, and Haydel's continued growing, building a reputation for quality service and fine pastries.

When Hurricane Katrina struck in 2005, the damage wasn't severe and the bakery reopened in 29 days. David's two sons, David Jr. and Ryan, also contributed to Haydel's continued expansion. Last September, they staged an event to raise money for breast cancer research and nabbed the Guinness World Record by creating the largest King Cake in the world, an 8,688-pound behemoth, which they wound around the Superdome and sold by the slice.

## Did you know

**The SBA has 10 regional offices, 68 district offices and 14 branch offices to provide quality services to the small businesses community.**

**For more information, go to www.sba.gov/about-offices-list/2.**

# Appendix 1 - Contact SBA: Useful Sites and Numbers

The SBA home page is **www.sba.gov**. Information on SBA programs may be accessed from this site. Several of the more frequently visited sites are listed below:

| SBA INFORMATION | |
|---|---|
| About SBA | www.sba.gov/about-sba |
| SBA Direct | www.sba.gov/sba-direct |
| SBA Strategic Plan | www.sba.gov/about-sba-info/11572 |
| SBA Performance, Budget & Planning | www.sba.gov/performance |
| SBA's Role in Small Business Advocacy | www.sba.gov/advocacy |
| Inspector General | www.sba.gov/oig |
| Small Business Jobs Act of 2010 | www.sba.gov/jobsact |

| STARTING AND MANAGING A BUSINESS | |
|---|---|
| What is a Small Business? | www.sba.gov/content/am-i-small-business-concern |
| Thinking about starting a business? | www.sba.gov/category/navigation-structure/starting-managing-business/starting-business/thinking-about-starting |
| Resources | |
| SBA District Offices | www.sba.gov/about-offices-list/2 |
| Lender Resources | www.sba.gov/lender_resources |
| Financing Growth | www.sba.gov/content/financing-growth |
| Explore Exporting | www.sba.gov/exporting |

| LOANS and GRANTS | |
|---|---|
| Small Business Loans | www.sba.gov/financialassistance |
| Bonds | www.sba.gov/content/surety-bonds-explained |
| | www.sba.gov/content/tax-exempt-bonds |
| Grants | www.sba.gov/content/facts-about-government-grants |

| CONTRACTING | |
|---|---|
| Government Contracting | www.sba.gov/contracting |
| Contracting Opportunities | www.sba.gov/contracting-opportunities |
| Register as a Contractor | www.bpn.gov/ccr/default.aspx |

| COUNSELING and TRAINING | |
|---|---|
| Online Training | www.sba.gov/training |
| SBDCs | www.sba.gov/sbdc |
| Women's Business Centers | www.sba.gov/content/womens-business-centers |
| SCORE Counselors | www.sba.gov/score |
| Veterans Outreach | www.sba.gov/content/veterans-business-outreach-centers |

| DISASTER ASSISTANCE | |
|---|---|
| Disaster Assistance | www.sba.gov/disaster |
| Disaster Area Office Locations | www.sba.gov/about-offices-list/4 |
| Response Office Locations for a Declared Disaster | Go to www.sba.gov/content/current-disaster-declarations and then select the disaster/affected area in question |
| FEMA Information | www.fema.gov |

**Facebook: www.facebook.com/sbagov**
**Twitter: www.twitter.com/sbagov**
**YouTube: www.youtube.com/sba**

**SBA National Answer Desk (Toll Free) (800) 827-5722**
**Disaster Customer Service Center (Toll Free) (800) 659–2955**

### Did you know

What do Apple Computer, Calloway Golf, and Staples have in common? They all received SBA assistance. Learn about the SBA Investment Division at www.sba.gov/inv.

# Appendix 2 - Glossary of Acronyms and Abbreviations

(Available at: "FY 2011 Agency Financial Report" www.sba.gov/performance)

**504** — **504 Certified Development Loan Program**
Provides small businesses with long-term, fixed-rate financing for the purchase of land, buildings and long-life capital equipment.

**7(a)** — **7(a) Loan Guaranty Program**
SBA's primary loan program. It provides general loan financing for a wide variety of purposes.

**8(a)** — **8(a) Business Development Program**
Assists firms owned and controlled by socially and economically disadvantaged individuals to enter and succeed in the economic mainstream.

**7(m)** — **The 7(m) Microloan Program**
Provides small, short-term loans to small business concerns and certain types of not-for-profit child-care centers.

**A-123** — Designation for OMB Circular on "Internal Control Systems." It prescribes policies and procedures to be followed by executive departments and agencies in establishing, maintaining, evaluating, improving, and reporting on internal controls in their program and administrative activities.

**AA** — **Associate Administrator**

**AFMAC** — **Audit and Financial Management Advisory Committee**
Assists the Administrator in overseeing SBA's financial operations.

**AFR** — **Agency Financial Report**
An annual report that presents a federal agency's audited financial statements.

**APR** — **Annual Performance Report**
An annual report that presents a federal agency's progress in achieving the goals in its strategic plan and performance budget.

**ARC** — **America's Recovery Capital Loan Program**
A temporary guaranty loan program authorized by the American Recovery and Reinvestment Act of 2009.

**ARRA** — **American Recovery and Reinvestment Act of 2009**
Most often referred to as the Recovery Act in SBA documents.

**BATF** — **Business Assistance Trust Fund**
A trust fund in the U.S. Treasury maintained to receive and account for donations made by private entities for activities to assist small business.

**BD** — **Business Development**
The Office of Business Development uses SBA's statutory authority to provide business development and federal contract support to small disadvantaged firms.

**BDMIS** — **Business Development Management Information System**
The system that automates the certification and annual review process for the 8(a) program.

**BLIF** — **Business Loan and Investment Fund**
Operated by the Treasury Department to maintain the accounting records of loans approved prior to 1992.

**CA** — **Capital Access (See OCA)**

**CDC** — **Certified Development Company**
Refers to the Section 504 Certified Development Company debenture program.

**CFO** — **Chief Financial Officer**
The CFO is responsible for the financial leadership of the Agency. This includes responsibility for all Agency disbursements, management and coordination of Agency planning, budgeting, analysis and accountability processes.

**CFR** — **Code of Federal Regulations**
The codification of the general and permanent rules published in the Federal Register by the executive departments and agencies of the federal government.

**CIO** — **Chief Information Officer**
The CIO is responsible for the management of information technology for the Agency, including the design, implementation and continuing successful operation(s) of information programs and initiatives.

**CLA** — **Office of Congressional and Legislative Affairs**
Assists in the development and enactment of SBA legislative proposals and serves as the liaison for SBA's communications on all legislative and congressional activities.

**COOP** — **Continuity of Operations Plan**
A predetermined set of instructions or procedures that describes how an organization's essential functions will be sustained for up to 30 days following a disaster and then return to normal operations.

**CRC** — **Civil Rights Center**
Administers and enforces various federal statutes, regulations and Executive Orders that relate to nondiscrimination and equal opportunity.

**CY** — **Current Year**

**DAP** — **Disaster Assistance Plan**
Executive Order 13411 mandates that federal agencies create a single application that fulfills the information requirements of all applicable federal disaster assistance programs.

**DCIA** — **Debt Collection Improvement Act**
A federal law to maximize collections of delinquent debts owed to the government.

**DCMS** — **Disaster Credit Management System**
The electronic system used by the SBA to process loan applications for all new disaster declarations.

**DFP** — **Dealer Floor Plan**
A small pilot program to make revolving loans to retail dealerships including automobile dealers that began in July 2009.

**DLF** — **Disaster Loan Fund**
Assists eligible small businesses impacted by disasters.

**ECCB** — **Enterprise Change Control Board**
The ECCB is in charge of the administration of the centralized network accounts for the SBA.

**EEO** — **Equal Employment Opportunity**

**ELA** — **Electronic Loan Application**
Simplifies the application process by providing electronic loan applications.

**EVB** — **Entrepreneurship Boot Camp for Veterans With Disabilities**

**FASAB** — **Federal Accounting Standards Advisory Board**
Promulgates accounting principles for federal government reporting entities.

**FCRA** — **Federal Credit Reform Act**
A law enacted to provide a more realistic picture of the cost of U.S. government direct loans and loan guaranties.

**FECA** — **Federal Employees Compensation Act**
Provides compensation benefits to federal civilian employees for work-related injuries or illnesses and to their surviving dependents.

**FEMA** — **Federal Emergency Management Agency**
The agency that is tasked with responding to, planning for, recovering from and mitigating against disasters.

**FERS** — **Federal Employees' Retirement System**
A three-tiered retirement plan for federal employees hired after 1984, composed of Social Security benefits, a basic benefit plan, and contributions to a Thrift Savings Plan.

**FEVS** — **Federal Employee Viewpoint Survey**

**FFMIA** — **Federal Financial Management Improvement Act**
A law that requires each agency to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger.

**FHCS** — **Federal Human Capital Survey**
A survey administered by the Office of Personel Management to measure federal employees' perceptions about how effectively agencies have managed their workforces.

**FICA** — **Federal Insurance Contributions Act**

**FMFIA** — **Federal Managers Financial Integrity Act**
A law that primarily requires ongoing evaluations and reports on the adequacy of the internal accounting and administrative control systems of executive agencies.

**FPDS** — **Federal Procurement Data System**

**FRIS** — **Financial Reporting Information System**
SBA's consolidated general ledger system.

**FTA** — **Fiscal and Transfer Agent**

**FY** — **Fiscal Year**
The federal government fiscal year begins October 1 and ends the following September 30.

**GAO** — **U.S. Government Accountability Office**
The audit, evaluation and investigative arm of Congress.

**GC/BD** — **Office of Government Contracting and Business Development**
GC/BD works to create an environment for maximum participation by small, disadvantaged and women-owned business in federal government contract awards and large prime subcontract awards.

**GDP** — **Gross Domestic Product**

**GPRA-Mod** — **GPRA (Government Performance and Results Act) Modernization Act of 2010**
Most often referred to as GRPA-Mod.

**GS** — **General Schedule**

**GSA** — **General Services Administration**

**GWAC** — **Government-wide Acquisition Contract**

**HUBZone** — **Historically Underutilized Business Zone**
Program that encourages economic development by the establishment of federal contract award preferences for small businesses located in historically underutilized business zones.

**IP** — **Improper Payments (See IPIA)**

**IPA** — **Independent Public Accountant**
A firm or person, other than the agency's Inspector General, who meets the independence standards specified in GSA, and is engaged to perform the audit of a federal agency or for other purposes.

**IPIA** — **Improper Payment Information Act**
A federal law enacted in 2002 to identify and reduce erroneous payments in the government's programs and activities.

**IT** — **Information Technology**
Refers to matters concerned with the design, development, installation and implementation of information systems and applications.

**IV&V** — **Independent Validation and Verification**
A review of SBA Office of Financial Analysis and Modeling Financial Models for accuracy and proper functioning by an outside expert.

**Jobs Act** — **Small Business Jobs Act of 2010**
Most often referred to as the Jobs Act in SBA documents, may also be referred to as SBJA.

| | | |
|---|---|---|
| LAS | **Loan Accounting System**<br>SBA's loan origination servicing and disbursement system. |
| LLG | **Liability for Loan Guaranties**<br>Net present value of expected future cash flows for outstanding guaranties. |
| LMAS | **Loan Management and Accounting System**<br>Financial management system that supports loan accounting. |
| LMS | **Loan Monitoring System**<br>Aids the SBA in managing its core loan guaranty programs and serves as one of the building blocks in the overall systems modernization project. |
| MAS | **Multiple Awards Schedule** |
| MAX | **Budget Information System**<br>OMB uses the MAX Budget Information System to collect, validate, analyze, model and publish budget information. |
| MD&A | **Management's Discussion and Analysis**<br>The MD&A is considered required supplementary information for an agency's Annual Financial Report and is designed to provide a high level overview of the Agency. |
| MED | **Minority Enterprise Development** |
| MRA | **Master Reserve Account**<br>SBA's fiscal agent maintains this escrow fund to facilitate the operation of the Certified Development Company program. |
| MRF | **Master Reserve Fund**<br>SBA's fiscal and transfer agent maintains this reserve fund to facilitate the operation of the 7(a) secondary market program. |
| NAICS | **North American Industry Classification System**<br>NAICS is the standard used by federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy. |
| NGPC | **National Guaranty Purchase Center**<br>SBA's centralized loan guaranty purchase processing center. |
| NIST | **National Institute of Standards and Technology**<br>An agency of the U.S. Department of Commerce. |
| NPV | **Net Present Value** |
| NWBC | **National Women's Business Council**<br>A bi-partisan federal advisory council created to serve as an independent source of advice and policy recommendations to the President, Congress, and the SBA on economic issues of importance to women business owners. |
| OCA | **Office of Capital Access**<br>The office responsible for small business program loans, lender oversight, and the surety bond program. |
| OCPL | **Office of Communications and Public Liaison**<br>SBA office that provides communication for the Agency's programs and priorities to small businesses, their partners, and the public at large. |
| OCRM | **Office of Credit Risk Management**<br>SBA office that manages program credit risk, monitors lender performance, and enforces lending program requirements. |
| ODA | **Office of Disaster Assistance**<br>SBA office that promotes economic recovery in disaster ravaged areas. SBA disaster loans are the primary form of federal assistance for non-farm, private sector disaster losses for individuals and businesses. |
| OED | **Office of Entrepreneurial Development**<br>SBA office that provides business counseling and training through its resource partner network composed of small business development centers, women's business centers and SCORE, as well |

as through online training and related resources through SBA's website.

**OFA** **Office of Financial Assistance**
SBA office that administers various loan programs to assist small businesses.

**OFO** **Office of Field Operations**
SBA office that represents field offices, including regional and district offices, at headquarters.

**OGC** **Office of General Counsel**
Provides legal advice for senior management and legal support for all Agency programs, initiatives and administrative responsibilities.

**OGM** **Office of Grants Management**
SBA office that awards and administers all grants under SBA's authorization and appropriations, with the exception of the small business development centers and women's business center grants which are awarded and administered by respective program offices.

**OHA** **Office of Hearings and Appeals**
SBA office that provides an independent, quasi-judicial appeal of certain SBA program decisions.

**OHCM** **Office of Human Capital Management**
Supports the strategic management of human capital in the accomplishment of the Agency's mission.

**OIC** **Office of Internal Control**
Part of the SBA Office of the Chief Financial Officer, has the lead in making sure managers can comply with internal control standards.

**OIG** **Office of Inspector General**
Conducts and supervises audits, inspections and investigations relating to SBA programs and operations.

**OII** **Office of Investments and Innovation**
Assists small businesses through the administration of the Small Business Investment Company program and the Small Business Innovation Research program.

**OIT** **Office of International Trade**
SBA office that encourages small business exports and assists small businesses seeking to export.

**OMB** **U. S. Office of Management and Budget**
White House office that oversees preparation of the federal budget and supervises its administration in Executive Branch agencies.

**ONAA** **Office of Native American Affairs**
SBA office that coordinates Native American initiatives and develops policies and procedures to ensure that SBA assistance is made available to American Indians, Native Alaskans, and Native Hawaiians.

**OPM** **U.S. Office of Personnel Management**
The federal government's human resources agency.

**ORACLE** The accounting program used by SBA's Administrative Accounting Division.

**ORCA** **Online Representation and Certification Application**
An e-government initiative that was designed to replace the paper-based representations and certifications process.

**OVBD** **Office of Veterans Business Development**
SBA office that works to enhance and increase successful small business ownership by veterans.

**PAR** **Performance and Accountability Report**
Annual report that presents financial, budgetary and performance information to OMB, Congress and the public.

**PCECGF** **Pollution Control Equipment Contract Guaranty Fund**
Supports costs associated with the credit portfolio of pre-October 1991 pollution control equipment loans and guaranties being liquidated by the SBA.

**PIA** **Privacy Impact Assessment**
Part of the Privacy Impact Statement from the Privacy Act.

**PII** — **Personally Identifiable Information**
Any information that can identify a person.

**PLP** — **Preferred Lender Program**
Covers certified or preferred lenders that receive full delegation of lending authority.

**POA&M** — **Plan of Action and Milestones**

**PPS** — **Probability Proportional to Size**

**PY** — **Prior Year**

**QA** — **Quality Assurance**
Functions to assure that project deliverables meet SBA's requirements and quality standards.

**QAR** — **Quality Assurance Review**

**Recovery Act** — **American Recovery and Reinvestment Act of 2009**
Most often referred to as the Recovery Act in SBA documents, may also be referred to as ARRA.

**SAS** — **Statement on Auditing Standards**
Establishes standards and provides guidance on the design and selection of an audit sample and the evaluation of the sample results.

**SAT** — **Senior Assessment Team**

**SBA** — **U.S. Small Business Administration**
A federal agency of the Executive Branch whose mission is to aid, counsel and protect the interests of small businesses and help families and businesses recover from disasters.

**SBA Express** — Provides selected lenders with a 50 percent guaranty on their loans in exchange for the ability to primarily use their own application and documentation forms, making it easier and faster for lenders to provide small business loans of $250,000 or less.

**SBDC** — **Small Business Development Center Program**
Delivers management and technical assistance, economic development and management training to existing and prospective small businesses through cooperative agreements with universities and colleges and government organizations.

**SBG** — **Surety Bond Guarantee Program**
Provides guaranties, bid, performance and payment bonds for contracts up to $2 million for eligible small businesses that cannot obtain surety bonds through regular commercial channels.

**SBGRF** — **Surety Bond Guaranty Revolving Fund**
All the contractor and surety fees collected by the SBA are deposited in the SBGRF at the Treasury Department, which is used to pay claims.

**SBIC** — **Small Business Investment Company**
Provides long-term loans, debt-equity investments and management assistance to small businesses, particularly during their growth stages.

**SBIR** — **Small Business Innovation Research**
SBA office that supports scientific excellence and technological innovation through the investment of federal research funds.

**SBLC** — **Small Business Lending Company**
Non-depository small business lending companies listed by the SBA Office of Capital Access.

**SBPRA** — **Small Business Paperwork Relief Act of 1992**

**SBREFA** — **Small Business Regulatory Enforcement Fairness Act**

**SCORE** — A volunteer organization sponsored by the SBA that offers counseling and training for small business owners who are starting, building or growing their businesses.

**SDB** — **Small Disadvantaged Business**
Small business owned and controlled by individual(s) who are socially and economically disadvantaged.

**SDM** — **System Development Methodology**
A software development methodology or system development methodology in software engineering is a framework that is used to structure, plan, and control the process of developing an information system.

**SES** — **Senior Executive Service**

**SFFAS** — **Statements of Federal Financial Accounting Standards**
Agreed upon specific standards and concepts published in the Federal Register.

**SOP** — **Standard Operating Procedure**
SOPs are the primary source of the Agency's internal control.

**SOX** — **Sarbanes-Oxley Act 2002**
The law introduced major changes to the regulations of financial practice and corporate governance.

**SSBIC** — **Specialized Small Business Investment Company**
Provides equity capital, long-term loans, debt-equity investments and management assistance to socially or economically disadvantaged small businesses.

**TOP** — **Treasury Offset Program**
A centralized debt collection program developed by the Treasury Department's FMS to assist agencies in the collection of delinquent debts owed to the federal government.

**VAT** — **Vulnerability Assessment Team**
Performs monthly scans of network-attached devices to identify and remedy network vulnerabilities.

**VBOC** — **Veteran Business Outreach Center**
Provides outreach, counseling, training and directed referral access to all SBA programs and services for veterans, Reserve Component members, Transition Assistance Program eligible service members and their spouses.

**V-WISE & Operation Endure and Grow** — Programs specifically targeting entrepreneurial development services to women veterans and to Reserve Component members of the U.S. Military and their families.

**WBC** — **Women's Business Center**
WBCs provide long-term training and counseling to women owning or managing a business, including financial, management, marketing and technical assistance, and procurement.

## Success Story

### Native American, Woman-owned, 8(a) Making Good!

Exhibit Arts, LLC, Wichita, Kansasa


In 2000, Elizabeth and Vernon Harshfield combined her expertise in management and marketing and his experience putting on events to form Exhibit Arts, LLC, a Native American, woman-owned and 8(a) certified small business specializing in tradeshows and promotional products. Although the company still offers those services, Exhibit Arts has expanded to include administrative and professional staffing services and now has 151 employees. The company also manages a diverse portfolio of contracts with private sector companies and federal agencies such as the U.S. Army, U.S. Air Force, the National Guard, the U.S. Navy and the General Services Administration.

With the help of an SBA-backed loan, Exhibit Arts was able to purchase its current facility to support more federal contracting work. Exhibit Arts has successfully won contracts with notable household names such as Amtrak, Cargill and Cessna. It is currently pursuing more contracts with other well-known companies, including Hallmark, Learjet and Walmart. The company subcontracts work to eight other small businesses and always tries to have a reasonable representation of women-owned, small disadvantaged and service-disabled veteran-owned small businesses on its projects, including The Bill Guy Technology Solutions Inc., recipient of SBA's 2011 Kansas Small Business Person of the Year award.

**Did you know**

**Small businesses can learn how to participate in the federal contracting arena. Take a look at the SBA Office of Government Contracting and Business Development online training course for women and veteran entrepreneurs at www.sba.gov/training/governmentcontracting.**

## ACKNOWLEDGMENTS

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We offer our special thanks to Innovative Consultants International and Corporate Visions for their outstanding contributions to producing this report.

# The SBA 100

**Go to www.sba.gov/100 to meet 100 businesses across the country that each created at least 100 jobs since receiving SBA assistance! SBA — providing capital, contracting, and counseling to America's small business community — to create more than 10,000 American jobs!**

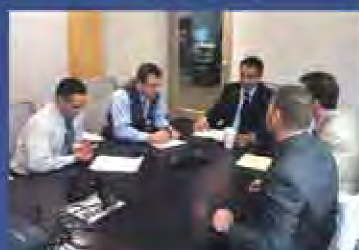

Great Clips


A123 Systems


Agro Farma


SoBran, Inc.


Leader Communications


Versatile Marketing Solutions


DQ Grill and Chill


Morrison & Maierle, Inc.


TSAY Construction


Martek Biosciences Corp.


HMS Technologies, Inc.


YS Catering, Inc.

# sba.gov/100

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SBA
*U.S. Small Business Administration*