

U.S. Small Business Administration

Agency Financial Report

Fiscal Year 2012

Enabling the Establishment & Growth of Small Businesses



ABOUT THIS REPORT

The U.S. Small Business Administration's (SBA) Agency Financial Report (AFR) for FY 2012 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 2012 APR, included as part of the FY 2014 Congressional Budget Justification (CBJ), which is the Agency's budget request to Congress, will be issued February 4, 2013; and the FY 2012 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, 2013.

FY 2012 HIGHLIGHTS

<i>(Dollars in Thousands)</i>	FY 2009	FY 2010	FY 2011	FY 2012
Loan Portfolio⁽¹⁾	\$ 90,451,263	\$ 93,339,844	\$ 99,203,933	\$ 102,630,652
Regular FTE Employees	2,098	2,135	2,175	2,089
Disaster Employees	1,743	1,120	1,141	1,145
Total Employees	3,841	3,255	3,316	3,234
Total Assets	\$ 12,626,459	\$ 15,230,476	\$ 16,882,801	\$ 14,014,855
Total Liabilities	\$ 15,315,059	\$ 16,765,021	\$ 17,191,824	\$ 13,640,581
Total Net Position	\$ (2,688,600)	\$ (1,534,545)	\$ (309,023)	\$ 374,274
Total Net Cost of Operations	\$ 5,995,716	\$ 5,277,197	\$ 3,460,562	\$ 1,274,805
Total Budgetary Resources	\$ 12,337,055	\$ 18,340,769	\$ 19,277,292	\$ 14,400,162

⁽¹⁾ The total portfolio consists of guaranteed business loans outstanding, direct business loans, and direct disaster loans. The data includes all performing loans and defaulted loans that have not been charged off.

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

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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.

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, 2010, and 2011



2006



2007



2008



2009



2010



2011

Message from the Administrator

November 15, 2012

We are pleased to present the U.S. Small Business Administration's Fiscal Year 2012 Agency Financial Report as an alternative to the consolidated Performance and Accountability Report.

This report details SBA's efforts to strengthen the nation's economy by enabling the establishment and growth of small businesses, as well as the Agency's efforts to support communities following disasters.



Over the last two decades, small and new businesses have been responsible for creating two out of every three net new jobs in the U.S., and today over half of all working Americans own or work for a small business.

The SBA is committed to ensuring that America's small businesses have the access and opportunities they need to start and grow their operations and create new jobs. In FY 2012, we continued to build on the Agency's strong track record of providing entrepreneurs and small businesses access to capital, opportunities in government contracting, entrepreneurial development and disaster assistance.

As part of these efforts, the SBA has streamlined and simplified its core programs and expanded the reach of our services to more communities and constituencies. As the economy has grown stronger, the SBA is filling the remaining gaps in the lending market. To accomplish this, we've developed new products, improved existing programs and worked to bring more financial institutions into small business lending.

Key SBA accomplishments in FY 2012:

Second Highest Year in SBA Lending: The SBA built on its record breaking year in FY 2011 with its second consecutive year supporting more than \$30 billion in lending. In addition, our 504 loan program set an all-time record in dollar terms in FY 2012. Overall for FY 2012, the SBA supported more than \$30.25 billion in lending to more than 47,000 companies.

Third Consecutive Record Year in Growth Capital: The Small Business Investment Company (SBIC) Debenture program had its third consecutive record breaking year. Investment funds licensed as SBICs provided nearly \$3 billion in growth capital to over 1,000 businesses, a 17 percent increase from FY 2011 and an 83 percent increase from FY 2010. In FY 2012, the SBA licensed a record 27 SBIC debenture funds and licensing times dropped over 60 percent from 14.6 months in FY 2009 to 5.4 months in FY 2012. This helped the SBIC program get out a record of more than \$1.9 billion in commitments to its funds in FY 2012.

Expanding Contracting Opportunities for Small Business: The SBA continues to work with agencies across the government to expand small business contracting opportunities. Since January 2009, small businesses have been awarded more than \$286.3 billion in federal contracts. That is \$32 billion more than the previous three years, even as overall contract spending decreased during those years. (FY 2012 contracting numbers continue to be collected and certified.)

Inclusive Entrepreneurship: SBA's resource partner network served over one million clients in FY 2012. In addition, we expanded the entrepreneurial playing field with new initiatives, including a partnership with

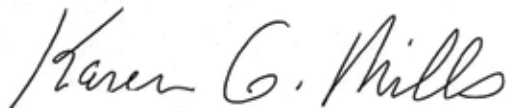
AARP to counsel more than 100,000 entrepreneurs over the age of 50 during the next year. The SBA also launched an important veterans initiative, *Boots to Business: From Service to Start-up*, a program designed to help returning service members transition into successful small business ownership.

In addition, the SBA continues to build on its successful place-based regional growth strategy, which includes the federal government's first official cluster strategy. During the first year of investment, research shows small business participation in SBA's 10 pilot clusters grew by 275 percent. Employment grew by 11.2 percent, and over two-thirds of small businesses that sought cluster services reported that they developed new products or services. Today, the SBA, in conjunction with other agencies, has invested in more than 40 regional clusters.

Streamlined Disaster Assistance: The SBA quickly responded to over 345 disasters and approved over \$689 million in loans to businesses, homeowners and renters in FY 2012. In addition, we further streamlined our disaster application process and today turnaround time for a disaster loan is under 10 days.

I'm pleased to provide an assurance that SBA's financial and performance data in this report are reliable and complete. SBA's auditors issued an unqualified opinion on our FY 2012 financial statements. The auditor did not note any material internal weaknesses.

Sincerely,

A handwritten signature in black ink that reads "Karen G. Mills". The signature is fluid and cursive, with the first name "Karen" being more prominent than the last name "Mills".

Karen G. Mills
Administrator

Management's Discussion & Analysis

Primer of SBA's Principal Programs

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

The SBA has a total loan portfolio of \$102.6 billion; \$87.1 billion of that total is 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 program are four sub-programs:

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 network of 14,000 business counselors, mentors and trainers 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 106 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 — Regional Innovation Clusters support small businesses by fostering a synergistic network of businesses, university researchers, economic development experts, stakeholders, and investors that work to develop and grow a particular industry or related set of industries, while providing targeted matchmaking business training, counseling, mentoring and other services.

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

The SBA supports high-growth small businesses that drive net new job growth through the following programs:

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 \$7.2 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: Creamier Yogurt Rises to the Top!

Chobani, Inc., Norwich, New York

It all started in 2005 with the purchase of a 100-year-old plant in upstate New York, a staff of three, an SBA 504 loan and an ambitious Turkish immigrant who switched his product line from feta cheese to Greek yogurt. Two years later, **Hamdi Ulukaya** and his team at Chobani, Inc. began producing Chobani Greek Yogurt.



Penetrating a market saturated with familiar names like Yoplait and Dannon was possible because Hamdi decided to create a creamier Greek yogurt with twice the protein without artificial flavors or preservatives. In October 2007 Chobani, Inc. sold its first shipment to a grocery store on Long Island. By 2008 the company had grown to 83 employees with sales of \$22.9 million. Within four years Chobani grew to become a major player in the U.S. Greek yogurt market with 1.7 million cases shipped weekly.

Chobani, Inc. is a job-creator, having expanded to 1,200 employees. The company expects to hire 400 Idaho residents when its Twin Falls plant opens in 2012. Hamdi's philosophy - "keep the product simple, know what you do and do it better than anybody" - is reflected in Chobani's tremendous success. Sales during the first nine months of 2011 were \$434 million, with the company's net worth at \$117 million. Chobani is the 2012 national winner of SBA's *Entrepreneurial Success of the Year Award*.

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 history, small businesses have played a critical role in job creation. Over the last two decades, small and new businesses have been responsible for creating two out of every three net new jobs in the U.S., and today over half of all working Americans own or work for a small business.

The SBA is committed to ensuring that America's small businesses have the access and opportunities they need to start, grow their operations and create new 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.

Throughout FY 2012, the SBA relied on three Strategic Goals to guide the Agency's actions:

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*

In FY 2012, the SBA built on its record breaking year in FY 2011 with its second consecutive year supporting more than \$30 billion¹ in lending. In addition, the 504 loan program set an all-time record in dollar terms in FY 2012. Overall, for FY 2012, the SBA supported more than \$30.25 billion in lending to more than 47,000 companies.

Notably, FY 2012 also reflected a third consecutive record breaking year for Small Business Investment Companies, a zero subsidy guaranty debenture program targeted at high-growth firms. Nearly \$3 billion in growth capital was provided to over 1,000 businesses, a 17 percent increase from FY 2011 and an 83 percent increase from FY 2010.

In FY 2012, the SBA launched a streamlined disaster loan application process, which resulted in a turnaround time for disaster loans of less than 10 days and more than \$689 million in loan approvals.

The SBA continues to work with agencies across the government to expand small business contracting opportunities. Since January 2009, small businesses have accessed more than \$286.3 billion dollars in federal contracts. That is \$32 billion more than the previous three years, even as overall contract spending has decreased during those years. (FY 2012 contracting numbers continue to be collected and certified.)

SBA's resource partner network served over one million clients in FY 2012 and the SBA expanded the entrepreneurial playing field with new initiatives, including a partnership with AARP and a veterans program designed to help returning service members transition into successful small business ownership.

Financial Results

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

For FY 2012, SBA's total budgetary resources for staffing and operations and subsidy costs were \$5.0 billion, and \$9.4 billion were in nonbudgetary resources for loan financing used to purchase guaranteed loans in default and to make direct loans. SBA's guaranteed portion of the outstanding loan principal balance rose 6.3 percent in FY 2012 to \$74.4 billion. New guaranties disbursed by SBA participating banks during FY 2012 were \$16.0 billion, a 3.6 percent decrease compared to FY 2011. Guaranteed loan purchases dropped again in FY 2012, falling from \$3.4 billion to \$2.6 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 continued to decline from \$8.4 billion to \$7.7 billion in FY 2012. A net reduction of defaulted guaranteed business loans accounted for \$508 million of this decrease while an additional \$203 million came from direct disaster loans. Disaster loans decreased as collections and charge-offs exceeded new loan disbursements. The decrease in guaranteed business loan receivables was due mostly to an increase in the subsidy allowance from FY 2012 subsidy reestimates along with a decrease in new purchases of defaulted guaranteed loans.

¹ "Lending Supported" includes gross approvals in the 17(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.

Program Results

(in-depth analysis found in SBA's Annual Performance Plan, to be released in February 2013)

The SBA by the Numbers table (see following page) reflects strong performance across all Agency programs in FY 2012. This includes:

- nearly \$22 billion in loans approved to small businesses through the 7(a), 504 and Microloan programs;
- increases across other capital access programs, such as Small Loan Advantage and CAPLines, due to streamlining and simplification efforts that cut turnaround times and opened them up to more lending institutions;
- third consecutive record year in growth capital by SBA's Small Business Investment Company Debenture program that targets high-growth small businesses;
- over \$90 billion in federal contracts to small businesses (projected);
- counseled and trained over one million small businesses through SBA resource partners; and
- provided over \$689 million in direct disaster loans to small businesses, homeowners and renters.

Management Results

In addition, the SBA achieved significant successes across its four Agency Priority Goals which are effective for FY 2012 and FY 2013:

1. Process business loans as efficiently as possible:

By September 30, 2013, increase the use of paperless processing in the 7(a) program from 72 percent to 90 percent and in the 504 program from 55 percent to 75 percent to improve the efficiency, effectiveness,

and level of service in its business loan programs.

The SBA exceeded its FY 2012 targets for this goal. The FY 2012 target for 7(a) was 85 percent and the SBA achieved 87.4 percent and the target for 504 was 62 percent and the SBA achieved 64.5 percent.

2. Maximize small business participation in government contracting:

Maximize small business participation in federal government contracting to meet the statutory goals and ensure program benefits flow to the intended recipients. Final federal-wide results for FY 2012 will not be available until 3rd or 4th quarter FY 2013. While the federal goal is 23 percent, based on preliminary data, the SBA expects to exceed its Agency's 67 percent target for small business contracting, by awarding over 70 percent of its FY 2012 contracts to small businesses and achieving all four disadvantaged business goals.

3. Process Disaster Assistance applications efficiently:

By September 30, 2013, increase the use of the Disaster Assistance electronic loan application (ELA) by 50 percent. The FY 2011 baseline number was 26 percent so the goal is to achieve 39 percent. In FY 2012, the SBA achieved 36.3 percent, exceeding the FY 2012 target of 27 percent by 133 percent.

4. Expand access to long-term capital:

From FY 2012 through September 30, 2013, commit at least \$4.3 billion of capital via the Small Business Investment Company program in order to facilitate access to capital for high growth companies and enhance job creation and retention by these companies. In FY 2012, the SBA licensed a record 27 SBIC debenture funds and licensing times have dropped over 60 percent from 14.6 months in FY 2009 to 5.4 months in FY 2012. This helped the SBIC program meet its FY 2012 target by getting out a record of more than \$1.9 billion in commitments to its funds in 2012.

Did
you
know

BusinessUSA implements a "no wrong door" approach for small businesses and exporters by using technology to quickly connect businesses to the services and information relevant to them. BusinessUSA combines information and services from 10 different government agencies through one consolidated website and coordinates telephone support through a single 800#.

For more information, go to www.Business.USA.gov.

SBA by the Numbers

(Dollars in Millions)

		FY 2009	FY 2010	FY 2011	FY 2012
Total Portfolio ⁽¹⁾	Outstanding Principal Balance	\$ 90,451	\$ 93,340	\$ 99,204	\$ 102,631
Capital ⁽²⁾					
7(a) Loans	Dollars of Gross Loans Approved	\$ 9,191	\$ 12,407	\$ 19,638	\$ 15,153
504 Loans	Dollars of Gross Loans Approved	\$ 3,834	\$ 4,433	\$ 4,845	\$ 6,712
Microloans ⁽³⁾	Dollars of Gross Loans Approved to Microborrowers	\$ 36	\$ 47	\$ 47	\$ 45
Surety Bond	Number of Bid and Final Bonds Guaranteed	6,135	8,348	8,638	9,503
Contracting ^{(3) (4)}					
Prime Contracting	Dollars of Annual Federal Contracts to SBs	\$ 96,834	\$ 97,947	\$ 91,468	\$ — ⁽⁵⁾
Prime Contracting	Percentage of Federal Contracts to SBs	21.89%	22.66%	21.65%	— ⁽⁵⁾
HUBZone	Dollars of HUBZone Contracts	\$ 12,413	\$ 11,969	\$ 9,915	\$ — ⁽⁵⁾
8(a) Program	Dollars of 8(a) Contracts	\$ 18,670	\$ 18,466	\$ 16,678	\$ — ⁽⁵⁾
Counseling and Training ⁽⁶⁾					
SCORE	Number of Clients Trained	176,621	236,853	221,019	292,264
SBDC	Number of Clients Trained	375,669	379,794	352,290	332,421
WBC	Number of Clients Trained	131,065	135,941	115,805	114,931
Microloans	Number of Clients Trained	10,908	15,180	15,964	15,892
Disaster ^{(1) (2)}					
Disaster Assistance	Dollars of Gross Loans Approved	\$ 1,130	\$ 574	\$ 739	\$ 690
High-growth Small Businesses					
SBIC	Dollars of SBA Debenture Leverage Committed to SBICs	\$ \$788	\$ 1,165	\$ 1,827	\$ 1,924
SBIC	Dollars of SBIC Debenture Capital to Small Businesses	\$ 1,227	\$ 1,587	\$ 2,589	\$ 2,950

(1) The total portfolio consists of guarantied business loans outstanding, direct business loans, and direct disaster loans. The data includes all performing loans and defaulted loans that have not been charged off.

(2) There are three basic ways to present loan data: (1) Gross Loans Approved (the total loans approved); (2) Net Loans Approved (gross loans approved plus any loan increases minus any cancellations); and, (3) Disbursed Loans (the amount that is actually given to the borrower). Gross Loans Approved is presented in the "Capital" and "Disaster Assistance" sections because it is the only loan data that remains constant over time.

(3) A more precise methodology was developed in FY 2012 to calculate "Loans Approved to Microborrowers." Prior year results have been restated to reflect this change.

(4) The federal goal is to give small businesses at least 23 percent of all government-wide contract dollars. The SBA negotiates goals annually with each federal agency on an individual basis, however, the SBA has no authority to enforce other federal agencies' contracting goals.

(5) Federal agencies have not yet certified their FY 2012 data. The SBA expects to receive the FY 2012 certified data in the 3rd or 4th quarter of FY 2013.

(6) The FY 2012 numbers for Counseling and Training are preliminary. Final numbers will appear in the FY 2014 CBJ/ FY 2012 APR which will be published February 4, 2013.

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:

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 (GC/BD) 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. GC/BD 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 an emphasis 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 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.

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 Resources Solutions, 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 or 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.

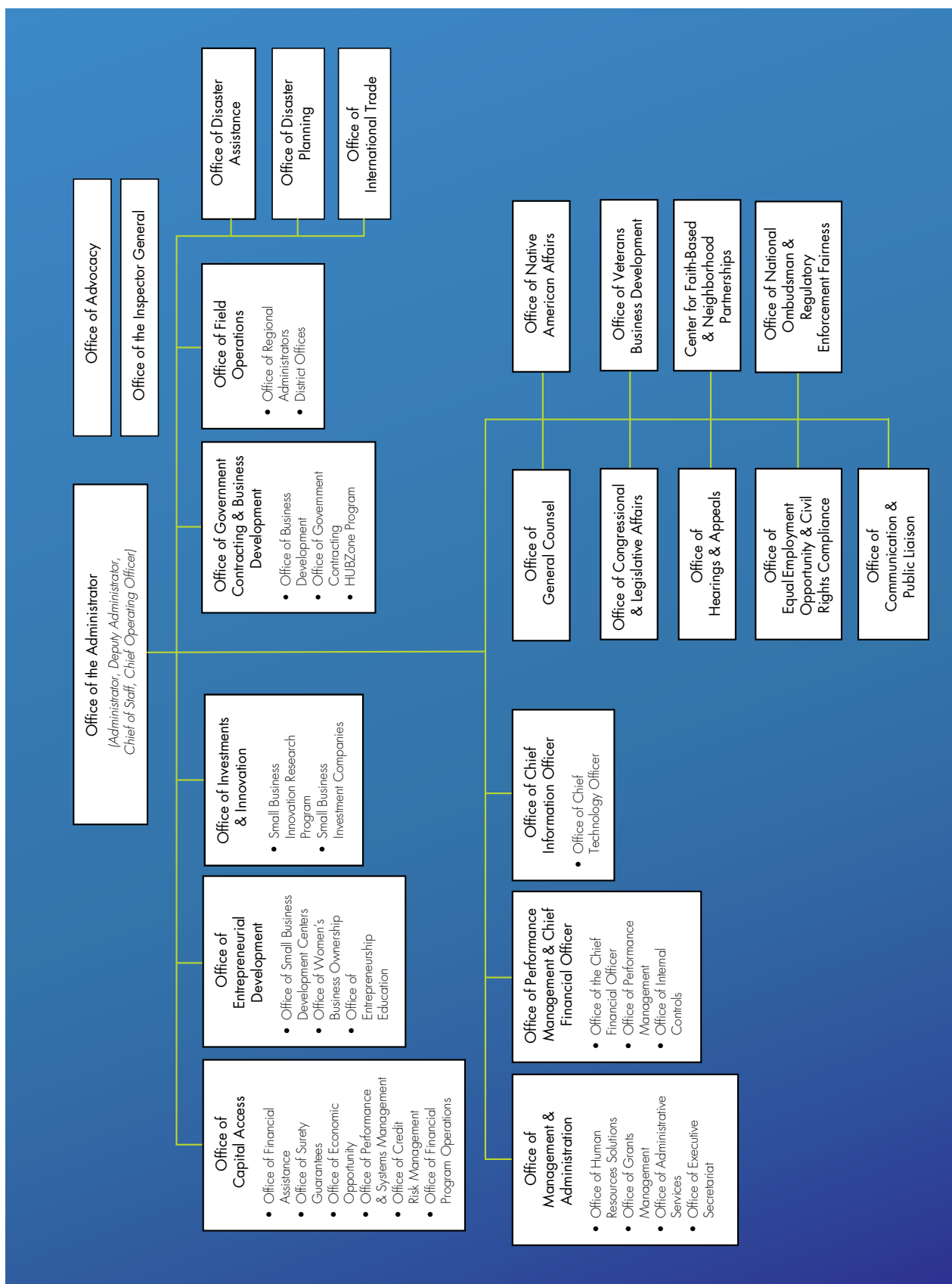
Statistics on Small Business — SBA's policy analysts are responsible for collecting data and statistics to help evaluate existing policies and programs of the SBA. They translate economic, social and demographic trends that have an impact on small business job creation into policy prescriptions that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

Did
you
know

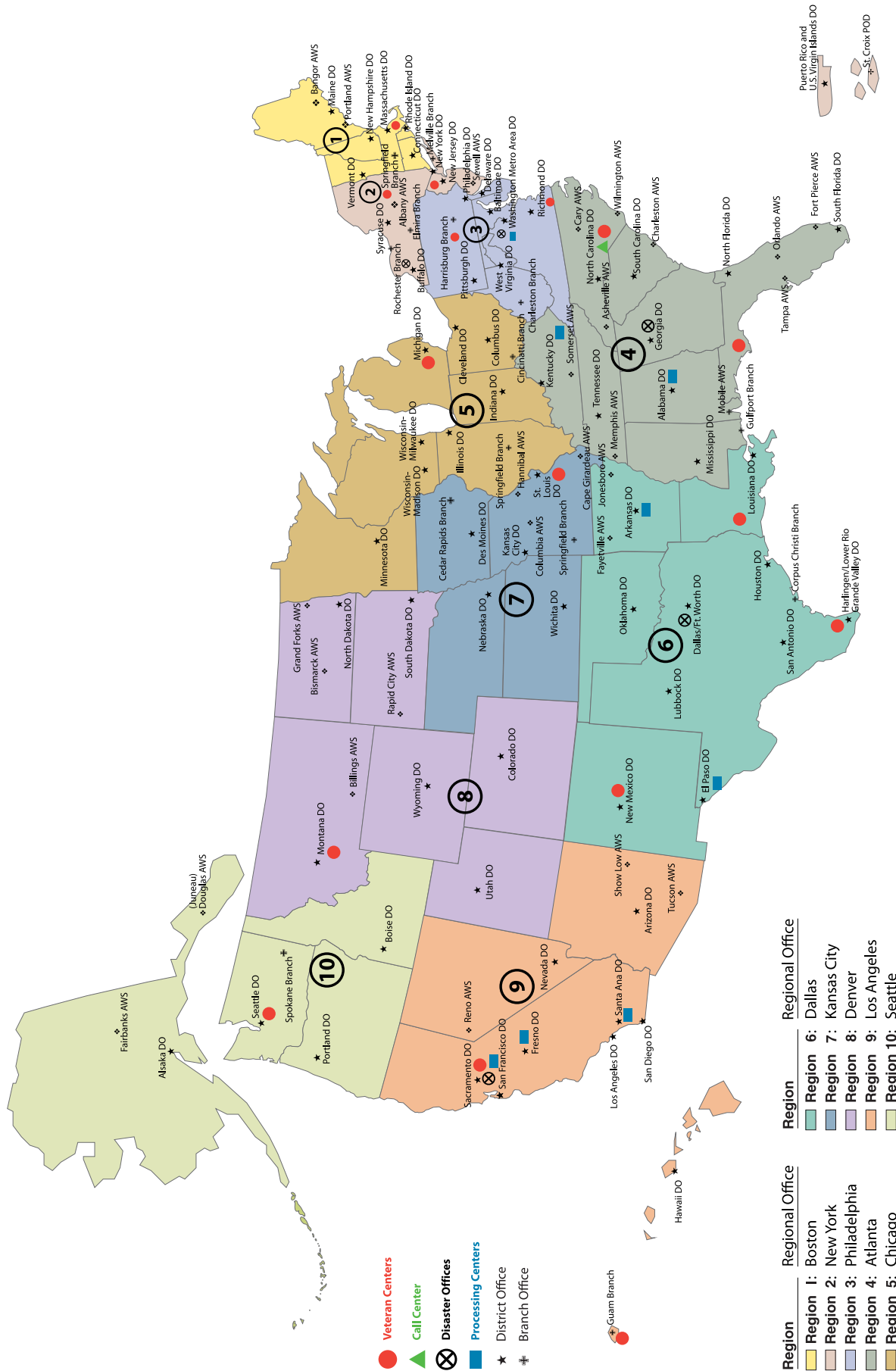
Don't think the SBA can help you? Think again! Small business owners from around the country share how they used an SBA service – everything from startup loans to disaster recovery - to help their business start, grow, and succeed. **Small Business Owners Speak** is a new online feature highlighting the voices of successful small business owners.

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

SBA Organization Chart



SBA Regions and Field Offices

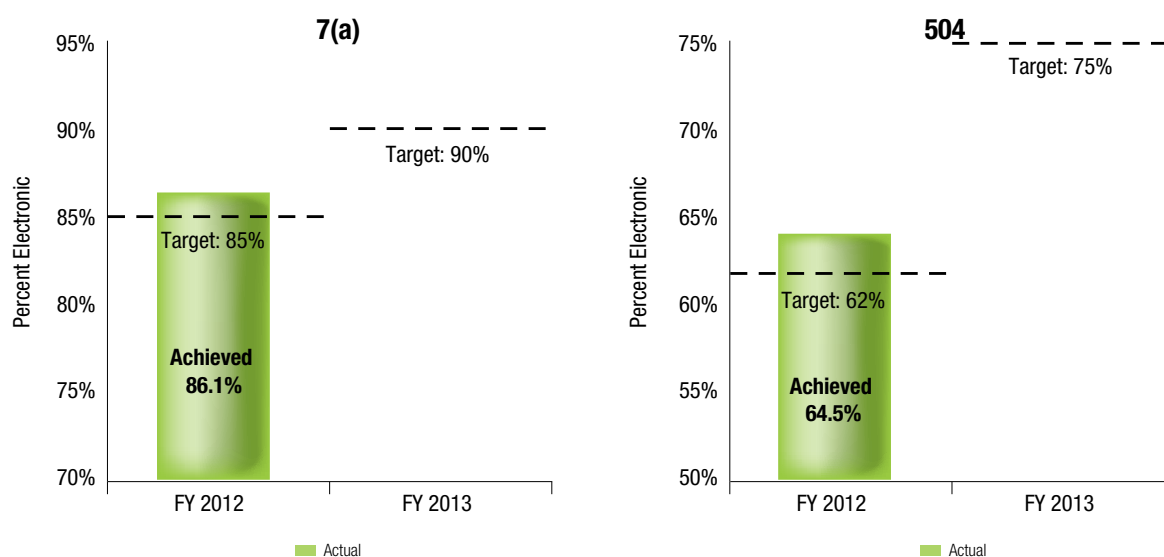


Analysis of SBA's Performance

Agency Priority Goals

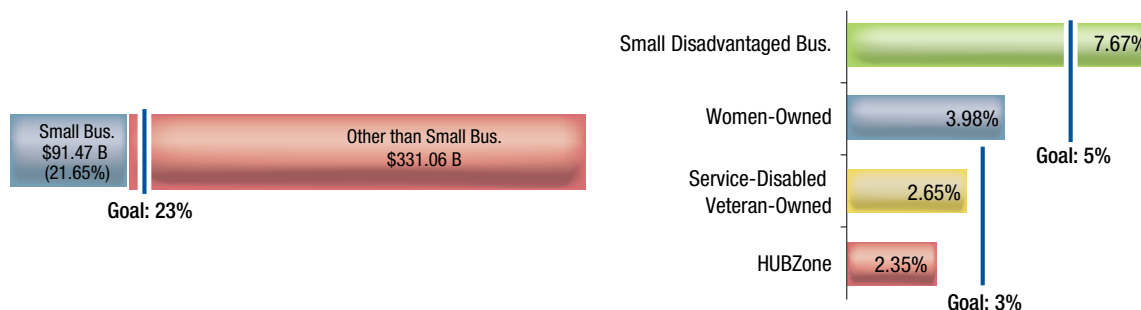
The SBA identified four Agency Priority Goals that reflect priorities of SBA leadership and the Administration, and are critical to success in SBA's strategic plan. These goals reflect the breadth and depth of SBA's commitment both to taxpayers and to the small business community. By actively pursuing these goals, the SBA can strengthen its national contributions to entrepreneurship, innovation, and competitiveness. These are two-year goals measuring program efficacy for FY 2012 and FY 2013.

Priority Goal #1: Process business loans as efficiently as possible. By September 30, 2013, increase the use of paperless processing in the 7(a) program from 72 percent to 90 percent and in the 504 program from 55 percent to 75 percent to improve the efficiency, effectiveness, and level of service in its business loan programs. The SBA exceeded its FY 2012 targets.



✓ **ACHIEVED FY 2012 TARGET**

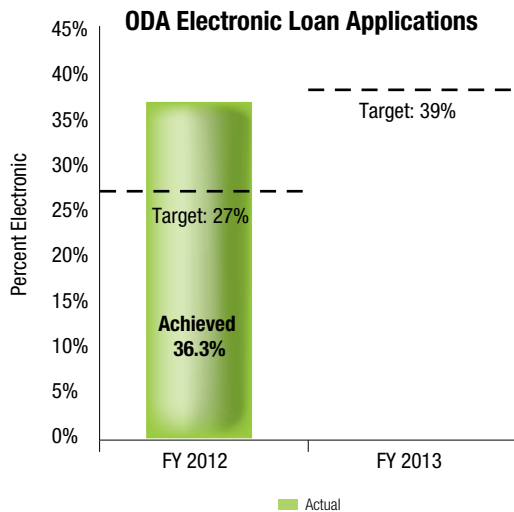
Priority Goal #2: Maximize small business participation in government contracting. Maximize small business participation in federal government contracting to meet the statutory goals and ensure program benefits flow to the intended recipients. The following chart for FY 2011 shows that out of \$422 billion of government contracts, small businesses received \$91.5 billion or 21.65 percent. The federal government substantially met its goal. (The data supporting the FY 2012 indicators are not finalized until the 3rd or 4th quarter of FY 2013. Therefore, FY 2011 data is reported on as required by OMB Circular A-11.) This Goal for FY 2012/13 was also a Priority Goal for FY 2010/11.



✓ **SUBSTANTIALLY ACHIEVED FY 2011 GOAL**

Priority Goal #3: Process Disaster Assistance

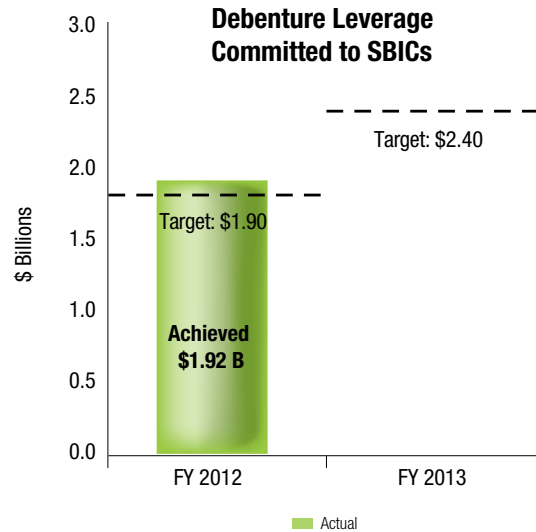
applications efficiently. By September 30, 2013, increase the use of the Disaster Assistance electronic loan application (ELA) by 50 percent. In FY 2011, 26 percent of applications were received through the use of the ELA, so the goal is to increase that to 39 percent by September 30, 2013. Increasing the number of paperless disaster loan applications will improve the delivery of the Disaster loan program. Response time to the disaster victim will be reduced by the time saved in not sending the application through the mail, and the integrity of the data used in the underwriting process will be improved as a result of not having to have staff input the data into the system. The SBA exceeded its FY 2012 target.



✓ **ACHIEVED FY 2012 TARGET**

Priority Goal #4: Expand access to long-term capital.

From FY 2012 through September 30, 2013, commit at least \$4.3 billion of capital via the Small Business Investment Company program in order to facilitate access to capital for high growth companies and enhance job creation and retention by these companies. In FY 2012, the SBA licensed a record 27 SBIC debenture funds and licensing times have dropped over 60 percent from 14.6 months in FY 2009 to 5.4 months in FY 2012. This helped the SBIC program get out a record of more than \$1.9 billion in commitments to its funds in FY 2012. The SBA achieved its FY 2012 target.



✓ **ACHIEVED FY 2012 TARGET**

Summary of Key SBA Programs

The following table presents key SBA FY 2012 performance data from **Strategic Goal 1 - Growing businesses and creating jobs**. Although the SBA has three Strategic Goals, 93 percent of all SBA program costs are in 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 2014 Congressional Budget Justification and FY 2012 Annual Performance Report which will be submitted February 4, 2013.

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

Capital

Program	Performance Indicator	Type of Indicator	FY 2008 Actual	FY 2009 Actual	FY 2010 Actual	FY 2011 Actual	FY 2012 Actual	FY 2012 Target	FY 2012 Variance
7(a) and 504	Lending Supported (\$ Billions) ⁽¹⁾	Output	\$24.6	\$17.8	\$22.4	\$30.5	\$30.3	\$22.4	35% G
7(a), 504, Microloan, and SBG	Jobs Supported ⁽²⁾	Outcome	713,574	514,035	583,737	700,736	609,437	574,800	6% 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	FY 2008 Actual	FY 2009 Actual	FY 2010 Actual	FY 2011 Actual	FY 2011 Target	FY 2011 Variance
Prime Contracting	Percent of Federal Contract Dollars Awarded to Small Businesses	Outcome	21.50%	21.89%	22.66%	21.65%	23%	-6% Y

(3) The data supporting the FY 2012 indicators are not finalized until the 3rd or 4th quarter of FY 2013. Therefore, FY 2011 numbers are reported as required by OMB Circular A-11.

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	FY 2008 Actual	FY 2009 Actual	FY 2010 Actual	FY 2011 Actual	FY 2012 Actual	FY 2012 Target	FY 2012 Variance
SBDC, WBC, SCORE and Online	Training Clients (#)	Output	1,220,051	1,295,355	1,232,588	923,114	739,616	N/A*	N/A
SBDC, WBC, and SCORE	Small Businesses Created (#)	Outcome	14,400	14,201	15,831	15,181	15,879	17,270	-8% Y

*New indicator. Did not Target for FY 2012.



The Actual result meets or exceeds target.



The Actual result is within 10% or less of the target.



The Actual result is less than 90% of the target.

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	FY 2008 Actual	FY 2009 Actual	FY 2010 Actual	FY 2011 Actual	FY 2012 Actual	FY 2012 Target	FY 2012 Variance
Disaster	Disasters Having a Field Presence Within 3 Days (%)	Output	100%	100%	100%	100%	100%	95%	5% G
Disaster	Customer Satisfaction Rate for Approvals (%)	Outcome	65%	72%	74%	80%	80%	71%	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.

Investment and Innovation

Program	Performance Indicator	Type	FY 2008 Actual	FY 2009 Actual	FY 2010 Actual	FY 2011 Actual	FY 2012 Actual	FY 2012 Target	FY 2012 Variance
SBIC	SBA Debenture Leverage Committed to SBICs (\$ Millions)	Output	1,029	788	1,165	1,827	1,924	1,900	1% G
SBIC	Small Businesses Assisted (#)	Output	1,905	1,481	1,331	1,339	1,094	1,500	-27% R

SUCCESS STORY: Success and Dedication to Others Go Hand in Hand

Clinical Research Management, Inc., Hinckley, Ohio

When **Victoria Tift** was a Peace Corps volunteer working on infectious disease control in Togo more than 20 years ago, she came down with malaria. But it was the suffering of the local people living under devastating third world conditions that led her to dedicate her life to fighting infectious diseases – and that's what she's done.

This year, Tift, president and CEO of Clinical Research Management, was named 2012 *National Small Business Person of the Year* by the SBA. "The innovation, inspiration and determination shown by Victoria Tift have elevated her company above and beyond the norm," said SBA Administrator Karen Mills. "These qualities are what make small businesses such a powerful force for job creation in the American economy and in their local communities."



Tift built her dream-fulfilling company from scratch after she took a job at the Walter Reed Army Institute of Research following her return from West Africa. While there, she identified an opportunity to help the Army with pre-clinical early and late-stage clinical vaccine trials. Seizing her chance, Victoria created Clinical Research Management, also known as ClinicalRM. The company supports development of FDA-regulated vaccines, pharmaceuticals, and medical devices for government and commercial customers. ClinicalRM helped create, and today manages, the Walter Reed Army Institute of Research's Clinical Trials Center. The Center develops vaccines for infectious diseases such as malaria and E. coli.

ClinicalRM has achieved amazing growth. Employing three people in 1994, the company maintains domestic and international operations today with a staff of 331. Annual revenues have increased from \$17 million in 2007 to \$40 million in 2010.

Operational Portfolio Analysis

The Small Business Administration is the taxpayers' custodian of a small business loan portfolio of over \$102.6 billion. SBA's two flagship loan programs – 7(a) working capital loans and 504 fixed asset loans – made up almost 85 percent of the outstanding loan portfolio at the end of FY 2012 (see **Chart I**). Their relative growth in the portfolio can be explained both by their absolute growth and by the relative declines in disaster loans due to tame hurricane seasons over the past few years and the winding down of the SBIC Participating Securities program. The absolute growth of 7(a) and 504 loans, driven by incentives such as higher guaranties and lower fees in the Recovery Act of 2009 and the Jobs Act of 2010, continued in FY 2012, buoyed by higher loan limits, a recovering economy, and streamlined program operations.

As seen in **Chart II**, the Recovery Act, passed in the second quarter of FY 2009, temporarily lowered fees

and raised guaranties for SBA's 7(a) and 504 loan programs, among its many other provisions. This stimulus helped double lending from a quarterly low of \$2.2 billion in Q2 FY 2009 to \$4.6 billion in Q4 FY 2009. When the Recovery Act and its extensions ended in Q4 FY 2010, the Jobs Act released a second round of

CHART I MAKEUP OF SBA'S OUTSTANDING LOAN PORTFOLIO

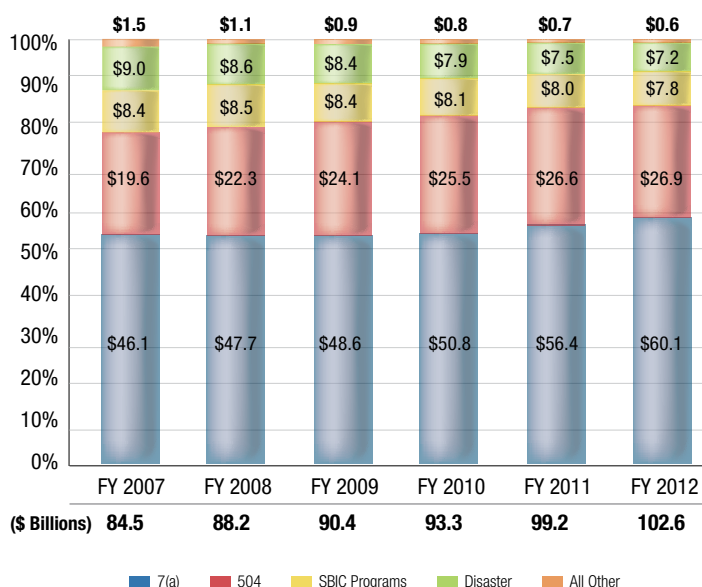
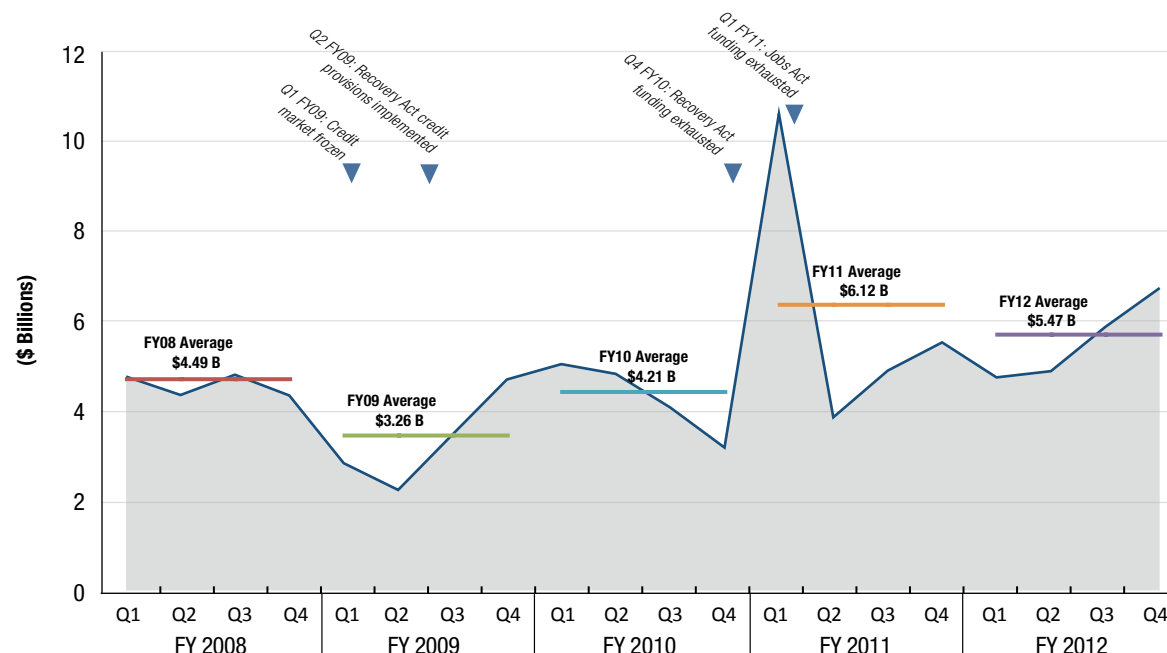


CHART II QUARTERLY GROSS 7(A) AND 504 LOAN APPROVALS



stimulus, leading to a record \$10.4 billion in Q1 FY 2011. While funding specific to the Jobs Act ran out in that quarter, its provisions for higher loan limits and revised size standards that determine who qualifies as a small business in a variety of industries were made permanent. It also led to a higher number of loan approvals in FY 2012 than in even the pre-crisis years. In FY 2012, the SBA approved \$15.2 billion in 7(a) loans and \$6.7 billion in 504 loans.

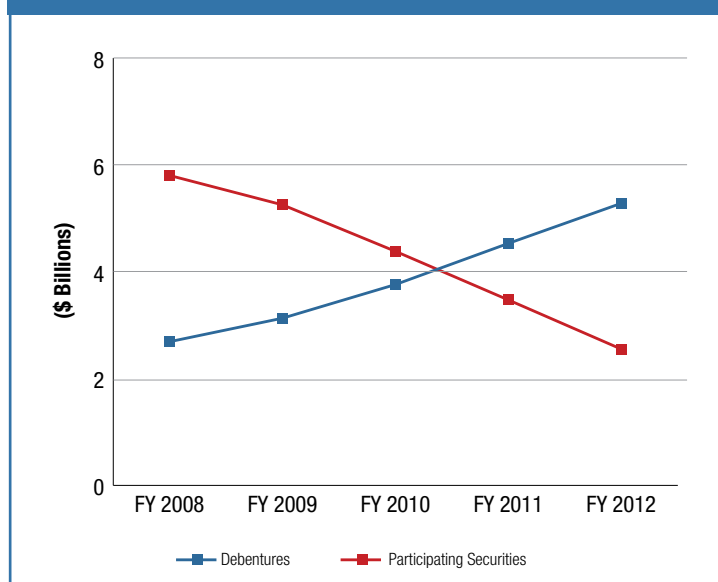
Concerted efforts to streamline program operations – a priority goal for the Agency is to process business loans as efficiently as possible – likely contributed to the rise in loan approval volume in FY 2012 as well. The use of electronic loan applications in the 7(a) program jumped nearly 20 percent and nearly 30 percent in the 504 program in FY 2012 compared to the previous year. The increased use of electronic loan applications improves quality through automatic checks for errors and reduces the complexity of the process, making the SBA loan program simpler and easier to use for small businesses and lending partners. The SBA also streamlined several loan products, prompting large increases in volume in 7(a) programs such as CAPLines which provide lines of credit to small businesses. The revamp of CAPLines resulted in a 393 percent increase in loan approvals in FY 2012. In addition, Small Loan Advantage 2.0, which speeds the process of receiving a loan guaranty for small loans, experienced a 251 percent increase in loans approved in the three months after it was streamlined in June 2012 than in the previous 16 months of its existence.

The rise in loan volumes over the past several years means the composition of SBA's outstanding loan portfolio is changing. More than half of the \$87 billion in outstanding 7(a) and 504 loans in the portfolio is from loans approved since FY 2009, and the risk profile of the portfolio has declined as a result. Delinquency rates (borrowers who are late on their payments) are good pre-indicators of eventual defaults of loans, in which case the SBA has to purchase the loan guaranty, and the taxpayer loses money. The loans made in the three years during the height of the housing bubble and just before the financial crisis had delinquency and purchase rates three or four times higher than the historical trend. Loans originated over the past four years, on the other hand, have

been tracking or out performing historical delinquency rates. Therefore, as the makeup of the portfolio shifts more fully into loans made post-crisis, the risk of loss to taxpayers in the form of purchased loan guaranties appears to be diminishing. This trend is confirmed by delinquency rates for 7(a) and 504 loans declining 16 percent and 25 percent year-over-year in FY 2012 and purchase amounts for the same dropping 23 percent and 29 percent respectively.

As seen in **Chart III**, the growth of the SBIC program over the past several fiscal years masks the divergent paths of two of its constituent parts. The core "Debenture" program, which now finances the bulk of SBICs, has been on a growth trajectory since FY 2008. By contrast, the "Participating Securities" (PS) program has been gradually winding down since Congress ended it in 2004. The two programs were roughly equal in size as recently as FY 2010. Today, however, debentures are more than 67 percent of the outstanding portfolio, and SBICs financed through the Debenture program now manage more than four times the capital of PS funds. Importantly, the SBIC program is run at zero subsidy. This means no taxpayer funds are appropriated to underwrite the credit costs of the program. While a small number of funds default on their obligations to the SBA, fees that the program charges more than offset those costs. In FY 2012, the SBA licensed a record 27 SBIC debenture funds and licensing times dropped over 60 percent from 14.6 months in FY 2009 to 5.4

CHART III COMPOSITION OF SBIC OUTSTANDING PORTFOLIO



months in FY 2012. This helped the SBIC program get out a record of more than \$1.9 billion in commitments to its funds in FY 2012.

Finally, the disaster loan section of SBA's outstanding loan portfolio declined in both relative and absolute terms as payments and the occasional charge-off on disaster loans made in previous years outpaced new disaster loans in FY 2012. The high volume of loans made in FY 2006 - \$11.7 billion - which included Hurricanes Katrina, Rita and Wilma, represents more than double the number of disaster loans approved in all the following years combined. Not surprisingly, this cohort continues to dominate the disaster loan portfolio,

accounting for almost 50 percent of the outstanding loans despite five years of repayments. Going forward, the relatively low charge-off rate for disaster loans - 2.36 percent in FY 2012 - will continue to make disaster loans an important tool for homeowners, businesses, and renters who may fall victim to a disaster.

Quarterly information on the status of SBA's loan portfolio, including outstanding balances and approvals by loan program and purchase rates, is available on SBA's website at www.sba.gov/content/small-business-administration-sba-loan-program-performance.

*Did
you
know*



Nine percent of small businesses are veteran-owned. These 2.45 million veteran-owned businesses employ more than 5 million people; and veterans are more likely than those with no active-duty military experience to be self-employed. SBA's **Operation Boots to Business: From Service to Startup** helps support veterans as they grow businesses and create jobs. In FY 2012, the SBA launched the first four pilot sites for this initiative.

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

Analysis and Highlights of Financial Statements and Results

Highlights of Financial Results (September 2012)

(Dollars in Thousands)

At End of Fiscal Year	2012	2011	% Change
CONDENSED BALANCE SHEET DATA			
Fund Balance with Treasury	\$ 6,273,663	\$ 8,469,322	-25.92%
Credit Program Receivables	7,654,295	8,354,739	-8.38%
All Other Assets	86,897	58,740	47.93%
Total Assets	\$ 14,014,855	\$ 16,882,801	-16.99%
Debt	7,919,801	11,190,279	-29.23%
Downward Reestimate Payable to Treasury	1,689,133	911,765	85.26%
Liability for Loan Guaranties	3,725,951	4,741,442	-21.42%
All Other Liabilities	305,696	348,338	-12.24%
Total Liabilities	13,640,581	17,191,824	-20.66%
Unexpended Appropriations	1,281,279	1,537,185	-16.65%
Cumulative Results of Operations	(907,005)	(1,846,208)	-50.87%
Total Net Position	374,274	(309,023)	-221.12%
Total Liabilities and Net Position	\$ 14,014,855	\$ 16,882,801	-16.99%

For the Fiscal Year

STATEMENT OF NET COST BY STRATEGIC GOAL

Goal 1: Growing Businesses and Creating Jobs			
Loan Subsidy Cost Including Reestimates	\$ 350,577	\$ 2,559,524	-86.30%
All Other Costs Net of Revenue	828,869	744,627	11.31%
Goal 2: Building an SBA that Meets the Needs of Today's and Tomorrow's Small Businesses	1,959	6,132	68.05%
Goal 3: Serving as the Voice for Small Business	14,369	13,454	6.80%
Costs Not Assigned	79,031	136,825	-42.24%
Net Cost of Operations	\$ 1,274,805	\$ 3,460,562	-63.16%

CONDENSED STATEMENT OF NET POSITION

Beginning Cumulative Results of Operations	\$ (1,846,208)	\$ (3,829,615)	-51.79%
Total Financing Sources	2,214,008	5,443,969	-59.33%
Less: Net Cost of Operations	1,274,805	3,460,562	-63.16%
Ending Cumulative Results	(907,005)	(1,846,208)	-50.87%
Beginning Unexpended Appropriations	1,537,185	2,295,070	-33.02%
Total Budgetary Financing Sources	(255,906)	(757,885)	-66.23%
Ending Unexpended Appropriations	1,281,279	1,537,185	-16.65%
Ending Net Position	\$ 374,274	\$ (309,023)	-221.12%

CONDENSED STATEMENT OF BUDGETARY RESOURCES

Unobligated Balance Brought Forward	\$ 7,384,285	\$ 5,226,984	41.27%
Other Budgetary Resources, Net	(1,938,161)	(769,832)	151.76%
Appropriations	3,592,151	5,608,629	-35.95%
Borrowing Authority	1,129,367	347,617	224.89%
Spending Authority from Offsetting Collections	4,232,520	8,863,894	-52.25%
Total Budgetary Resources	\$ 14,400,162	\$ 19,277,292	-25.30%
Obligations Incurred, Budgetary	4,130,864	6,919,443	-40.30%
Obligations Incurred, Nonbudgetary	4,636,930	4,973,564	-6.77%
Unobligated Balances, Available and Unavailable	5,632,368	7,384,285	-23.72%
Total Status of Budgetary Resources	\$ 14,400,162	\$ 19,277,292	-25.30%

Analysis of Financial Results

The SBA prepares its financial statements as a critical aspect of ensuring the accountability and stewardship for the public resources entrusted to it. The financial statements are prepared in accordance with guidance issued by the Office of Management and Budget (OMB) 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 of Financial Results references numbers in the Highlights to the financial statements on the previous page as well as those in the Financial Statements and Notes in this report. The Operational Portfolio Analysis does not reference the financial statements, but rather it provides an operational analysis of SBA's credit programs. 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 guaranteed loans is used in the Portfolio Analysis, where only SBA's guaranteed portion is used in the Analysis of Financial Results, as it ties to balances in the financial statements.

BACKGROUND

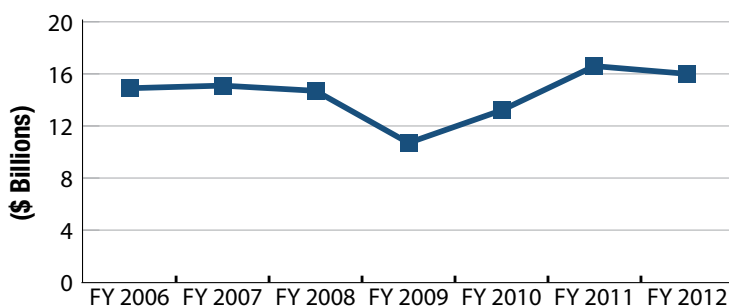
The SBA is a major federal credit agency of the U.S. government. The Agency has roughly 2,200 employees not counting its Disaster temporary employees. As a result less than \$1.0 billion of SBA's \$14.4 billion budgetary resources in FY 2012 were for salaries and expenses, with the rest being to support SBA's credit programs. Budgetary resources when apportioned by the Office of Management and Budget are 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, 2012 was \$74.4 billion an increase of 6.3 percent from the \$70.0 billion guaranteed at September 30, 2011 (see Note 6C in the financial statements). As shown in **Chart I**, new guaranties disbursed by SBA participating banks during FY 2012 were \$16.0 billion, a 3.6 percent decrease compared to FY 2011. This was still great enough to cause an overall increase in the outstanding principal amount. The 3.6 percent decrease in new guaranties disbursed by banks is consistent with the state of the economy and the expiration of the Small Business Jobs Act in FY 2011. The Small Business Jobs Act had extended the provisions in the American Recovery and Reinvestment Act that had enabled the SBA to provide guaranteed loans with reduced fees and increased guaranty percentages. This resulted in the large increase in loans disbursed in FY 2011. The Jobs Act also increased the maximum size of guaranteed loans. These larger loans helped support FY 2012 volume.

Credit program receivables for the SBA are comprised of business and disaster direct loans and defaulted business loans purchased per the terms of SBA's loan guaranty programs which are offset by an allowance for subsidy. An allowance for the subsidy cost of the gross loans receivable is recorded as a contra asset and the net

CHART I GUARANTIED LOANS DISBURSED



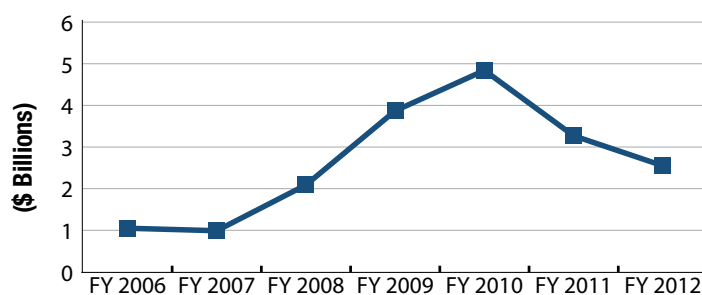
asset is reported on the Balance Sheet. The subsidy allowance is determined by modeling the projected future cash inflows and outflows of SBA credit programs using discounted cash flow methodology. Loan losses, the costs of loan servicing and loan interest rates are factors that affect the subsidy allowance.

SBA credit program receivables were valued at \$7.7 billion in FY 2012 which was a decrease of \$0.7 billion from FY 2011. The biggest changes in the credit program receivables were decreases in disaster loans of \$0.2 billion and guaranteed business loans of \$0.5 billion. Disaster loans decreased as collections and charge-offs exceeded new loan disbursements because there were no new major disasters in FY 2012. The decrease in guaranteed business loan receivables was due mostly to an increase in the subsidy allowance from FY 2012 subsidy reestimates along with a decrease in new purchases of defaulted guaranteed loans. The increase to the subsidy allowance at FY 2012 year-end was caused by a decrease in projected future recoveries on guaranteed receivables in the subsidy model in the FY 2012 subsidy reestimates.

As reflected in **Chart II**, guaranteed loan purchases decreased \$0.8 billion in FY 2012. This is still a high level historically, but it did contribute to a slight decrease in the outstanding guaranteed business loans receivable after including recoveries, expenses and charge-offs in the loans purchased portfolio.

SBA's assets and liabilities consist primarily of Fund Balances 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 the Treasury. Congress provides appropriations to cover the estimated long-term costs of SBA's disaster loans. While SBA's guaranteed business loan program costs are largely financed through fees, Recovery and Jobs Act loans were augmented by appropriations. Borrowings are repaid to the Treasury as loans are repaid to the SBA.

CHART II PURCHASES OF GUARANTIED LOANS



FINANCIAL POSITION

Assets

The SBA had total assets of \$14.0 billion at the end of FY 2012, down 17.0 percent from FY 2011. Total assets decreased primarily due to a \$2.2 billion decrease in the Fund Balance with Treasury. This decrease was due primarily to the repayment of Treasury borrowings in FY 2012 that were not needed to finance the cost of SBA's ongoing credit programs. Also, the \$0.7 billion decrease in credit program receivables, discussed previously, contributed to the decrease in SBA's assets.

Liabilities

The SBA had total liabilities of \$13.6 billion at the end of FY 2012, down 20.7 percent from FY 2011. 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 guaranteed loans under its guaranteed loan programs. The Liability for Loan Guaranties decreased \$1.0 billion primarily due to the year-end reestimate as well as subsidy and fees collected (offset by claim payments).

The Downward Reestimate Payable to Treasury increased \$0.8 billion due to the larger year-end accrual of the downward reestimates for the 7(a) Recovery Act and 7(a) Jobs Act loan cohorts. Lower than average purchases during FY 2012 decreased the overall purchase curve, in turn decreasing purchase projections in future years and contributing to a downward reestimate for FY 2012.

Debt with Treasury decreased \$3.3 billion as SBA's repayments of borrowings were greater than new borrowings made in FY 2012. In FY 2012 new borrowing was made to fund disaster loans and to cover cash shortfalls related to SBIC defaulted guaranties. Note 9 to the financial statements provides additional detail on SBA debt with Treasury.

Net Position

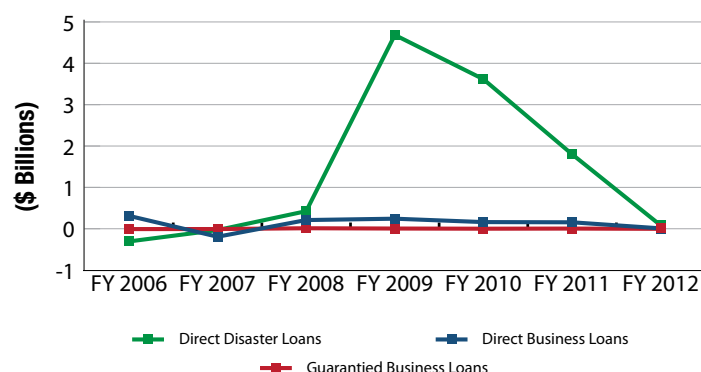
Cumulative Results of Operations is the accumulative difference between expenditures and financing sources since the inception of the Agency. This negative balance decreased \$0.9 billion due to unfunded subsidy reestimates at year-end for the 7(a) guaranty, 504 and SBIC programs which were less this year than last year. Upward subsidy reestimates determined at year-end are funded in the following year when they are received. Unexpended Appropriations decreased \$0.3 billion this year primarily because the appropriations used were greater than the appropriations received in FY 2012 for disaster and administrative activity. This affected Budgetary Financing Sources and the Ending Net Position.

Results of Operations

The Results of Operations primarily reflects the costs of SBA credit programs 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 guaranteed loan, or the 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 budget authority, while decreased costs are returned by the SBA to a Treasury general fund.

The net upward reestimated costs for the 7(a) and 504 guaranteed business programs decreased in FY

CHART III CREDIT PROGRAM SUBSIDY REESTIMATES



2012 from last year, and there was a change from a net downward to a net upward reestimate in the SBIC Participating Securities program. The subsidy reestimates for FY 2012 still netted an \$81 million increase, but that increase was much smaller than in FY 2011. Those subsidy reestimates were the largest components of the change (net decrease) in the Agency's net cost. **Chart III** reflects the decreases in the subsidy reestimates for the Guaranteed Business and Direct Disaster loan programs in FY 2012.

There are significant downward reestimates in the 7(a) Recovery Act and 7(a) Jobs Act programs. These downward reestimates of \$0.4 billion and \$0.2 billion were due mostly to lower than average purchases during FY 2012 that decreased the overall purchase curve, in turn decreasing purchase projections in future years and contributing to the downward reestimate for FY 2012.

The SBIC Participating Securities program had an upward reestimate of \$0.4 billion in FY 2012 that was due mostly to updated methodologies for assumption curves which allow for more accurate projections of future cash flows. These methodology changes resulted in decreased projections of recoveries, reimbursement of prioritized payments and annual fees for the remaining years within most of the cohorts.

The 504 program also had an upward reestimate of \$0.4 billion that was due mostly to poorer than expected performance for the FY 2005 through FY 2007 loan cohorts and updated model assumptions that increased the model projections of future purchases. Further detail on subsidy reestimates can be found in Note 61 to the financial statements in the Financial Reporting section of this report.

Budgetary Resources

Total Budgetary Resources decreased \$4.9 billion in FY 2012 from FY 2011. This decrease includes Appropriations, Spending Authority from Offsetting Collections, and Other Budgetary Resources, Net that were partially offset by increases in Borrowing Authority and Unobligated Balance Brought Forward October 1. Other Budgetary Resources, Net decreased by \$1.2 billion in FY 2012. This decrease is attributable to the large repayment of borrowings in FY 2012.

Spending Authority decreased \$4.6 billion in FY 2012. The decrease in Spending Authority is primarily in the loan guaranty financing fund and is due to the decrease in the loan subsidy reestimate and the increase in the repayment of borrowings from current year authority.

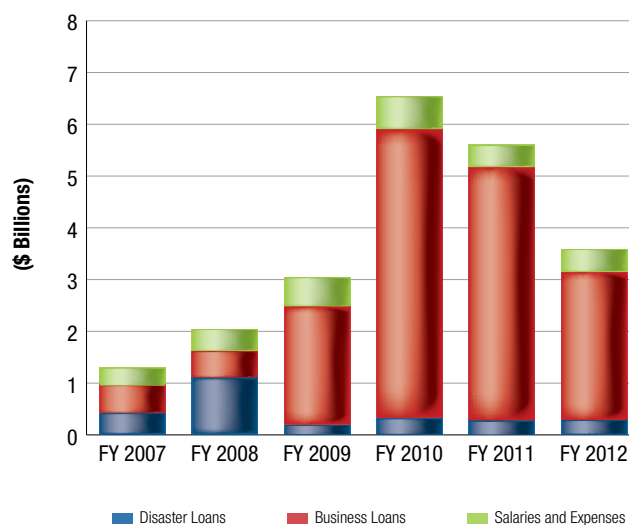
Borrowing Authority increased \$0.8 billion in FY 2012. Although borrowing authority granted to the SBA was practically the same in both years, the SBA decreased the authority by \$0.7 billion at year-end FY 2011 as it was unneeded to fund future credit program operations.

Appropriations decreased \$2.0 billion in FY 2012. The decrease was due to the decrease in the amount of appropriations needed to fund SBA's upward credit subsidy reestimates. **Chart IV** depicts that the substantial decrease in Appropriations is for business loans.

Status of Budgetary Resources

Total Status of Budgetary Resources decreased \$4.9 billion in FY 2012. This decrease included a decrease in unobligated balance of \$1.8 billion and a decrease in obligations incurred of \$3.1 billion. Obligations decreased by \$2.8 billion in the budgetary funds due to the large decrease in upward subsidy reestimates in FY

CHART IV APPROPRIATIONS



2012 for the guaranteed business programs. Obligations also decreased \$0.3 billion in the nonbudgetary financing funds. This decrease is primarily due to a decrease in default claims paid (purchased loans) in the loan guaranty financing fund plus a decrease in obligations in the disaster financing fund due primarily to the lack of major disasters in FY 2012.

Unobligated balances at September 30, 2012 and 2011 were \$5.6 billion and \$7.4 billion which include \$2.9 billion and \$5.3 billion of unavailable unobligated balances. These balances were unavailable because they were unapportioned by OMB. The SBA accumulates the majority of unobligated balances in its nonbudgetary financing accounts (\$4.8 billion in FY 2012 and \$6.4 billion in FY 2011) from reestimates that are used primarily to pay default claims in future years.

Analysis of SBA's Systems, Controls and Legal Compliance

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 and the Congress in a statement of assurance. 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. During FY 2012 the OIC conducted SBA's eighth annual assessment of internal control over financial reporting to comply with this circular. 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 10 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 none reached the level of material weakness.

This is the second year since the SBA transferred the procurement functions to the Office of the Chief Financial Officer. The FY 2012 review of internal controls over financial reporting revealed that, while there was considerable improvement in the contracting area, more time and resources will be required to resolve all outstanding issues. These include formalizing the acquisition process and related requirements through agency-wide Standard Operating Procedures, ensuring all contracting documents are signed by appropriate authorized individuals, and ensuring that invoices are reviewed by appropriate parties before payment is disbursed. The Agency takes this matter very seriously and the following steps have already been taken to make further improvements:

- contracted with acquisition experts to help update Standard Operating Procedures;
- trained and re-trained contracting officers, contracting officer representatives, and accounting personnel on the invoice certification process;
- explored the possibility of creating an interface between the System for Award Management and SBA's financial system to ensure the most current contractor information is available at the time of payment; and
- implemented electronic invoice routing and approvals in the financial system.

This year the SBA continued to have a significant deficiency in information technology security controls, including security management, vulnerability remediation, asset and configuration management, background clearance, security training, contingency planning, system interface security, access security, contract limitations, system auditing, and incident management. The Agency is sensitive to the need to protect SBA data, and continues 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:

- **Secure Network:** The SBA is promulgating technology that blocks connection of non-SBA government equipment to the SBA infrastructure.
- **Vulnerability Management:** The SBA has invested in leading vulnerability scanning tools and partnered with other federal agencies to prevent and detect inappropriate activities. Problem areas are immediately reported upon and remediated as required.
- **Asset Management:** A project is underway to obtain a tool to centrally track the lifecycle of all SBA hardware and software assets.
- **Configuration and Patch Management:** A project is underway to obtain a configuration management tool to centrally maintain a baseline of all SBA assets. A policy will be developed to ensure a revision to each asset's configuration undergoes formal change control. Leading enterprise patch management tools are in review to solidify the patching function.
- **Tracking of Plans of Action and Milestones (POAMs):** SBA's Office of the CIO (OCIO) now tracks each SBA IT system-related finding in the Agency's tool of record, CSAM. Remediation progress of each POAM is reviewed between IT Security and system owners on a weekly basis.
- **Contractor Clearance:** A policy and process is now in place that requires OCIO contractors to be cleared before gaining access to SBA systems. A periodic independent review will be instituted to identify and remove any inappropriate contractor access.
- **Security Training:** General IT security training now occurs on an annual basis for all SBA personnel. A vendor will be procured to provide IT role-based security training specific to OCIO staff.
- **Contingency Planning:** The OCIO is identifying disaster recovery solutions that can enable a reliable recovery in the event of an emergency. Periodic contingency tests will be performed to assess SBA's resiliency and capabilities against disasters.
- **System Interfaces:** A plan is underway to identify all system interconnections and establish formal agreements among system owners to ensure data transmission is confidential, accurate and retains integrity.
- **Access Management:** A policy will be developed to guide the provisioning and de-provisioning of access to SBA systems and physical locations. A periodic review of access occurs bi-annually to identify and take action on inappropriate access.
- **Third-Party Contracts:** OCIO contracts with third-party vendors will be evaluated and, where lacking, will be revised to include security clauses.
- **System Audit Log:** A project is underway to procure an audit log management tool to monitor systems for unauthorized activities or inappropriate occurrences.
- **Backup Tape Management:** A process will be implemented to account for all tapes with SBA data stored both onsite and offsite.
- **Incident Response:** A project is underway to establish an incident response program that is consistent with federal requirements.

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, enhancing 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.

Did
you
know



Small business owners can now take advantage of a new business tool to help them compete and grow. The free tool, called **SizeUp**, provides data analysis to help small businesses compare their performance to competitors and find areas to attract new customers.

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

Management Assurances: FMFIA and FFMIA Assurance Statement for FY 2012

The Small Business Administration continued to strengthen internal controls over its programs and operations during FY 2012. Creating and sustaining 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 me as to the status of their FY 2012 internal controls in their areas of responsibility. These assertions are supported by internal testing, checklists and other management reviews. Although a few 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, 2012, were operating effectively and no material weaknesses were identified in the design or operation of those internal controls. In addition, the Agency's financial management systems conform to the principles, standards, and related requirements prescribed by Section 4 of FMFIA.

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.

SBA's independent auditors issued an unqualified opinion on the Agency's FY 2012 financial statements for the eighth year in a row. However, our auditor identified one instance of non-compliance with applicable laws and regulations as of September 30, 2012. Specifically, due to ongoing system issues with the Agency's legacy mainframe information system, not all co-borrowers and guarantors 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). Over the past three years, Treasury has collected on average 1.33 percent of outstanding loan balances referred at 180 days delinquent. Treasury has collected on average 0.63 percent of outstanding loans balances referred after charge-off and all servicing actions have been completed by the SBA and third party lenders.

The SBA has 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 work together to identify and resolve each of the system problems. As a result of their efforts, the SBA has implemented improvements to support the ongoing referral of defaulted loans, including referrals of co-borrowers and guarantors, to Treasury. The Compliance Team continues to monitor and review issues affecting referrals and make system adjustments as necessary to confirm the completeness and accuracy of referrals to Treasury. However, the underlying system issues will likely continue to be a challenge for the Agency until the transition from the mainframe to a web-based system is complete.

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 2012.

A handwritten signature in black ink that reads "Karen G. Mills". The signature is written in a cursive, flowing style.

Karen G. Mills
Administrator
November 15, 2012

Improper Payments Summary

Three of SBA's four major credit programs, which were identified in the former section 57 of OMB Circular A-11, are subject to improper payment reporting: the 7(a) loan program, the Certified Development Company (504) loan program, and the Disaster loan program. OMB provided relief from reporting for the fourth program, the Small Business Investment Company program, due to the low occurrence of improper payments as determined by several years of review and the low probability for improper payments as determined by a risk assessment conducted in FY 2011.

The SBA includes loan guaranty approvals in its Improper Payment program reporting for the 7(a) and 504 loan programs. Most frequently the reason for an improper payment in this category was the lack of eligibility or a non-compliance with lending procedures. The result of SBA's testing for 7(a) loan guaranties and 504 CDC loan guaranties issued in FY 2012 indicated an improper payment rate of 1.8 percent totaling \$233.2 million and 2.0 percent totaling \$104.5 million, respectively. The increase in the improper payment rates of FY 2011 zero percent for both programs is due to an enhanced improper payment review procedure which identified more errors.

The FY 2012 improper payment rate for the 7(a) loan guaranty purchases was determined to be 3.15 percent or \$44.0 million, compared with last year's improper payment rate of 1.73 percent. The reasons for improper payments in this category tend to be the same as those cited for approvals. The increase in the improper payment rate is due primarily to an increase in the maximum loan amount in the 7(a) loan program (up to \$5 million) and the focus on selecting high dollar and early defaulted loans in the sampling methodology. In FY 2012 the SBA recovered \$103,000 of the \$1.6 million in overpayments identified in FY 2011 and will continue collection efforts to recapture the entire amount in FY 2012. Recovery efforts are underway to recapture all overpayments identified in FY 2012 from the lenders from which loans were improperly purchased.

To eliminate improper payments in the future for 7(a) guaranty approvals, purchases and 504 loan guaranty approvals, the Office of Capital Access will incorporate management's corrective action plan in the Quality Assurance process at each of the loan centers. The Quality Assurance teams will continuously monitor loan approvals and purchases to provide timely information to

management for follow-up which may include training or re-training of staff members.

The FY 2012 improper payment rate for the disaster loan program was determined to be 17.9 percent or \$91.0 million compared to 28.4 percent reported last year. Disaster improper payments are generally the result of loan documentation errors and do not result in an ineligible disaster victim receiving funds. The reduced improper payment rate in FY 2012 indicates an improvement in adherence to the requirements from the previous year. The Processing and Disbursement center continues to provide additional training to ensure that staff is aware of all requirements. A dedicated team continues to perform Quality Assurance reviews in addition to the Improper Payment reviews, which facilitate the identification and correction of areas of concern in a timely manner.

During FY 2011 the SBA conducted a pilot review for improper payments in the Agency's disbursements related to contracting, which led to the determination that those disbursements were susceptible to improper payments under the IPERA guidelines for FY 2011. The SBA recovered \$32,200 of the \$32,500 overpayments identified during the pilot review in FY 2011 but did not collect the remaining \$300 as it represented a large number of small interest overpayments and recovery was not determined to be cost-effective. The estimated improper payments for the baseline year (FY 2012) were 9.6 percent or \$12.1 million. The Agency will undertake the recovery of the \$5,239 identified as overpayments in the FY 2012 review and institute a corrective action plan to eliminate improper payments in the future. The plan includes electronic enhancements to systems to prevent improper payments and training and re-training of staff to ensure payment processing requirements are followed.

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

SUCCESS STORY: Husband and Wife Construction Team Are Successful Contractors

BrooAlexa LLC, Charleston, West Virginia

BrooAlexa, LLC, started out as a small trophy-making business in 2005 with just two employees. But when an SBA contract specialist advised the owners to change direction radically to gain access to federal contracting opportunities, the owners, **Frances Foster Brooks** and **Gene T. Brooks Jr.**, took the leap. Reborn as a construction company, BrooAlexa participated in SBA's Mentor- Protégé program and is certified in SBA's 8(a) Business Development and HUBZone programs.



BrooAlexa has developed into a multi-faceted construction company with offices in West Virginia, Ohio, Kansas, Missouri, Maryland, Florida and Oklahoma. The company's services include general construction, and it has secured successful design/build and construction management contracts. It has expanded from two employees in 2005 to eight full-time and 33 part-time employees today. Sales increased from \$86,000 in 2008 to \$1.7 million in 2010, and \$1.4 million through the first six months of 2012.

The company and its founders credit hard work and the SBA for the company's growing success. "We credit the success of our company to programs of the SBA. We were in the mentor program. And as a young company, our close relationship with the SBA and . . . the West Virginia Small Business Development Center . . . made all the difference," CEO Frances Brooks said.

Financial Reporting

SUCCESS STORY: Small Business Exporter of the Year

Rekluse Motor Sports, Inc., Boise, Idaho

By deploying creative, strategic marketing techniques, Rekluse Motor Sports, Inc., the SBA 2012 *Small Business Exporter of the Year*, has carved itself a niche in international markets despite the challenging economic situation both in the U.S. and abroad. Rekluse is the sole producer of Auto Clutch technology products for motorcycles and has targeted export markets through its racing series and team tie-ins.

A computer engineer by training, **Albert Youngwerth** was a motocross racing enthusiast from his childhood days. After developing a new auto-clutch for motorcycles in 2002, he launched Rekluse in 2003. He was later joined by **Joe DeGano** who in 2001 had founded his own company to train and develop aspiring motocross racers. **Alison Kelsey**, also a motorcyclist, joined Rekluse's team in 2010 and brings a unique retail sales perspective that helped her develop the company's successful international marketing and distribution strategy.

The company's export sales have grown year after year since its creation in 2003, thanks in part to an SBA guaranteed loan, and a grant from the state of Idaho funded by SBA's State Trade and Export Promotion program. During the height of the economic downturn in the U.S., Rekluse's international sales jumped 45 percent in 2010.



Message from the Chief Financial Officer

November 15, 2012

I am pleased to submit the U.S. Small Business Administration's (SBA) Agency Financial Report for FY 2012. For the sixth straight year the SBA has won the CEAR (Certificate of Excellence in Accountability Reporting) award.

An independent audit has earned the SBA an unqualified and clean opinion with no material weaknesses. However, our auditor identified one instance of non-compliance with applicable laws and regulations as of September 30, 2012. Due to ongoing system issues with the Agency's legacy mainframe information system, not all co-borrowers and guarantors for charged-off loans were referred to the Treasury for cross-servicing collection of debt as required by the Debt Collection Improvement Act (DCIA). 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.

In FY 2012, the SBA came within one percent of last year's all-time record in small business lending, supporting over \$30 billion in lending to over 47,000 small businesses. FY 2012's level of lending supported was achieved without the additional incentives provided by the Small Business Jobs Act of 2010.

In addition to its normal operations, the CFO's office began implementing two important process changes this fiscal year to improve Agency operations: the President's Do-Not-Pay initiative and Prime Contractor Quick-Pay. In FY 2012, the SBA embraced the Do-Not-Pay initiative and implemented a solution to reduce improper payments.

SBA's implementation of the Prime Contractor Quick-Pay initiative to ensure the timely payment of invoices to prime contractors has resulted in significant process improvements. To decrease the waiting time for internal invoice approvals, the accounting division developed a system of automatic email reminders sent to Agency staff when their invoices become idle. These process improvements led to a record 99.25 percent of invoices paid on time in FY 2012 by our Denver Finance Center. The SBA spent 75.7 percent less in annual invoice interest penalties in FY 2012 as compared to the prior fiscal year, primarily as a result of Quick-Pay's success.

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.

After integrating the budget and acquisition process under the OCFO last fiscal year, the SBA continues to leverage the financial management expertise of the Denver Finance Center's staff to drive efficiency. Throughout 2012, 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 2012 small business contracting goal — at 67 percent, the highest percentage goal in the government for small business contracts — as well as all socio-economic sub-goals.

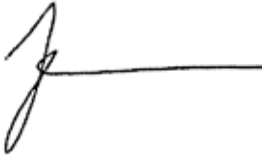
In the beginning of FY 2012, the Acquisition Division also conducted the Agency's Advanced Acquisition Strategy sessions to outline upcoming awards. These sessions enhanced the collaborative planning process and communication with requesting program offices. The Advanced Acquisition Strategies allowed the SBA to reduce a year-end workload crunch and smooth out the Agency's buying curve. Effective planning in FY 2012 also created an opportunity for SBA to take advantage of available federal resources to perform assisted acquisitions. The SBA entered into a Memorandum of Understanding with the Department of Interior's National Business Center (NBC) in May, 2012 and sent 20 contracts worth approximately \$11 million in FY 2012. Sending a limited number of complex

contract actions to NBC created additional flexibility for SBA's internal Acquisition Division to concentrate on compliance and training.

In addition to utilizing shared federal services in FY 2012, SBA's Office of Financial Analysis and Modeling (OFAM) has also become a provider. OFAM is now available to perform credit modeling services for other federal agencies to leverage SBA's best practices of financial management across the government. SBA's OCFO is committed not only to leading the Agency's financial management but also to teaching others the processes and practices that have made our operation so successful.

Finally, I want to recognize 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 financial management activities, and made recommendations pertaining to our financial statement footnotes and the AFR prior to publication. I thank them for their support and dedication to continued improvement.

Sincerely,

A handwritten signature in dark ink, consisting of a stylized 'J' followed by a horizontal line.

Jonathan I. Carver,
Associate Administrator for Performance Management
and 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 three times during the year with respect to these responsibilities on FY 2012 financial management and reporting. Two of the meetings were conducted 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 2012 AFR.



Edward J. Mazur
Chairman
Audit and Financial Management Advisory Committee

Inspector General's Audit Report

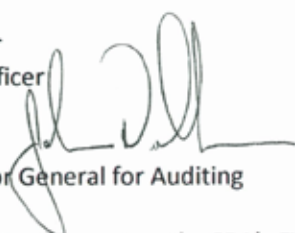


U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416

TRANSMITTAL MEMORANDUM
Report No. 13-04

DATE: November 14, 2012

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 2012 Financial Statements*

We contracted with the independent public accounting firm, KPMG LLP (KPMG), to audit the U.S. Small Business Administration's consolidated financial statements as of September 30, 2012, 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'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. The independent auditor issued an unqualified opinion on SBA's fiscal year 2012 consolidated financial statements. In summary, KPMG reported 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 KPMG'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's report and related documentation, and made necessary inquiries of their respective representatives. Our review was not intended to enable us to express, and we do not express, an opinion on the SBA's financial statements, KPMG's conclusions about the effectiveness of internal control, or its conclusions about SBA's compliance with laws and regulations. However, our review disclosed no instances where KPMG did not comply, in all material respects, with *Generally Accepted Government Auditing Standards*.

We provided a draft of KPMG'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. 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 2012 Financial Statements



KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

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, 2012 and 2011, 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 2012 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, 2012 and 2011, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in our opinion on the consolidated financial statements, the SBA changed its presentation for reporting the statement of budgetary resources in fiscal year 2012.

Our consideration of internal control over financial reporting resulted in identifying certain deficiencies, relating to information technology security controls, that we consider to be a significant deficiency, as defined in the Internal Control Over Financial Reporting section of this report.

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, relating to the *Debt Collection Improvement Act of 1996*, 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.

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.



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Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of the SBA as of September 30, 2012 and 2011, 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.

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, 2012 and 2011, and its net costs, changes in net position, and budgetary resources for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 15 to the consolidated financial statements, the SBA changed its presentation for reporting the combined statement of budgetary resources in fiscal year 2012, based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*. As a result, the SBA's combined statement of budgetary resources for fiscal year 2011 has been adjusted to conform to the current year presentation.

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The information in the Other Information section is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance 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



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fiscal year 2012 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 certain deficiencies in internal control over financial reporting described in Exhibit I, related to information technology security controls, that we consider to be a 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, which was also related to information technology security controls.

We noted certain additional matters that we have reported to management of the SBA in a separate letter dated November 14, 2012.

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). The DCIA assigns the U.S. Department of Treasury (Treasury) the responsibility for collecting delinquent debts (cross servicing) Government-wide. The DCIA requires federal agencies to transfer their nontax debt over 180 days delinquent to Treasury. During our testwork over loan charge-offs, we noted the SBA did not refer obligors (eligible principal borrowers, co-borrowers, and/or guarantors) to Treasury for offset or cross-servicing at the time of charge-off, as required by 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.

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.

Other Matter: 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.

* * * * *

Responsibilities

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



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Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2012 and 2011 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.

In planning and performing our fiscal year 2012 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 fiscal year 2012 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.

The SBA's written response to the findings identified in our audit and presented in Exhibit IV was not subjected to the auditing procedures applied in the audit of the SBA's consolidated financial statements and, accordingly, we express no opinion on it.



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This report is intended solely for the information and use of the SBA's management, the 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, 2012

Exhibit I

U.S. Small Business Administration
Significant Deficiency

The significant deficiency identified in our Fiscal Year (FY) 2012 audit, is summarized below:

Improvement Needed in Information Technology Security Controls

During our prior year, FY 2011, financial statement audit, we identified 18 information technology (IT) control findings, and recommended many corresponding corrective actions. During the FY 2012 financial statement audit, we found that the U.S. Small Business Administration (SBA) implemented corrective actions to remediate 3 of the 18 findings; however, we also identified 9 new IT control findings. Therefore, SBA's IT control environment continues to require improvement.

The IT control deficiencies that we noted during the FY 2012 audit are summarized below and fall under the following general IT control objectives: security access controls, segregation of duties, security management, software configuration management, and contingency planning. We did not provide details on the specific IT control deficiencies in this report due to sensitivity considerations surrounding the information systems. 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 the effectiveness of 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. Our audit found the following control deficiencies:

- Several high- and medium-risk security vulnerabilities affecting various financial systems.
- A weakness in network access controls.
- The SBA was unable to provide evidence that security incidents are analyzed, validated, and resolved.
- Physical access control procedures can be improved for all financial systems managed at SBA Headquarters (HQ) and one financial system hosted by an SBA service provider. In addition, access to the data centers can be improved.
- Several users had unnecessary access to an SBA financial subsystem.
- User accounts were not reviewed in accordance with SBA policy for five of the seven systems we reviewed.
- Complex and unique password configurations were not implemented and/or enforced.
- User accounts were not disabled or removed promptly upon personnel termination.
- Financial system user accounts and remote access authorizations were not properly authorized.
- Weak controls over the monitoring and review of audit logs for four of the seven systems we reviewed.

U.S. Small Business Administration

Significant Deficiency

Recommendations – Security Access Controls:

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

1. Enhance security vulnerability management processes. Specifically, (a) ensure that servers, operating systems, and databases are properly configured and updated on a routine basis; (b) monitor SBA vulnerability reports for required patches; (c) update systems based on risk determination and threats.
2. Develop and implement procedures to ensure mandatory domain authentication for Internet Protocol (IP) address issuance.
3. Fully implement the SBA entity-wide incident management and response program and ensure that procedures are enforced.
4. Ensure that information systems hosted by the SBA and third parties comply with SBA policy and National Institute of Standards and Technology guidance.
5. Develop and implement procedures for user access reviews to ensure that proper access rights are set for financial subsystems.
6. Ensure that all new system users are assigned random passwords and are subsequently required to change their password upon first log-in.
7. Develop and implement procedures for user access termination to ensure that access for terminated or transferred personnel is removed from systems in a timely manner.
8. Develop and enforce procedures for user access approvals, including remote access, and retain the evidence of the approvals.
9. Oversee the review and validation of financial system accounts on a quarterly basis.
10. 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. Our audit found the following control deficiencies:

- An authorized user had conflicting access rights in a key financial system.
- Twenty-eight service accounts were not properly restricted with unique log-ins and passwords.
- Users were authorized with conflicting rights as a database administrator (DBA) and system administrator to a financial application hosted by an SBA service provider.

Exhibit I**U.S. Small Business Administration****Significant Deficiency**Recommendations – Segregation of Duties:

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

11. Restrict access to software programs based on the principle of least privilege, and implement compensating controls over actions where limited resources cause individuals to perform conflicting job functions.
12. 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. Our audit found the following control deficiency:

- The CIO had not fully implemented a mandatory training program for IT security personnel.

Recommendations – Security Management:

We recommend the CIO:

13. Updates the position descriptions for IT security personnel to include minimum annual training requirements.
14. Develops and fully implement a comprehensive security education and training program for all IT security personnel, to include 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. Our audit noted the following control deficiencies:

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

U.S. Small Business Administration

Significant Deficiency

Recommendations – Software Configuration Management:

We recommend the CIO:

15. Enforces 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 coordinates with the CFO to:

16. 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. Our audit noted the following control deficiencies:

- Backup tapes necessary to restore system operations were not consistently rotated off-site for four of the seven systems we reviewed.
- Comprehensive contingency plans had not been developed and authorized for one key financial system. In addition, another system's plan was not updated to reflect the current environment.
- Five of the seven contingency plans, which includes the HQ Continuity of Operations Plan (COOP), were documented and approved but were not tested semiannually as prescribed by SBA policy. Two of the plans, which were first authorized in May 2011, had never been tested.
- One key financial system lacked adequate recovery capabilities commensurate with the system's Federal Information Processing Standards Publication 199 categorization.

Recommendations – Contingency Planning:

We recommend the CIO:

17. Enforces existing SBA policies to rotate backups off-site.
18. Conducts a Business Impact Analysis, develop and implement the contingency plans, and establish an alternate processing site.

We recommend the CIO coordinate with the CFO to:

19. Test system-specific plans and the HQ COOP on a frequency consistent with SBA policy.

Exhibit II

U.S. Small Business Administration
Status of Prior Year Significant Deficiency

Fiscal Year 2011 Finding	Fiscal Year 2012 Status of Finding
Improvement Needed in Information Technology (IT) Security Controls	<p>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.</p> <p>Therefore, in fiscal year 2012, 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.</p>

U.S. Small Business Administration

Status of Prior Year Noncompliance

Fiscal Year 2011 Finding	Fiscal Year 2012 Status of Finding
<p><i>Debt Collection Improvement Act of 1996 (DCIA)</i></p> <p>During our Fiscal Year (FY) 2011 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 loans to the Treasury for cross-servicing.</p>	<p>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 2012, we noted instances of noncompliance related to timely referrals of loan charge-offs to Treasury for offset and cross-servicing. We also noted that the approximately 5,000 eligible obligors identified in FY 2011 have not been properly referred to the Treasury as of FY 2012. Therefore, in FY2012, the issue is again presented in the Compliance and Other Matters section of our Independent Auditors' Report.</p> <p>We recommend the Associate Administrator for Capital Access¹:</p> <ul style="list-style-type: none"> 20. Conducts training to educate loan center staff on the proper steps to refer obligors to the Treasury through the system and how to correct errors after loans have been referred to Treasury. 21. Considers implementing a process to monitor loans that reach 150 days delinquent to ensure, that at 180 days, the loans are properly referred to the Treasury. 22. Continues to work with the Treasury to refer the more than 5,000 co-borrowers and guarantors that were not referred in FY 2011. 23. Continues to review system protocol to identify any other coding problems which may cause untimely referral of loans. 24. Implements quarterly monitoring reviews to identify all charged-off loans where the automatic referral did not occur.

¹ The recommendations listed in this exhibit were sequenced after the recommendations presented on Exhibit I, *IT Significant Deficiency*, to assist users of this report tracking the number of recommendations presented.



CFO Response to Draft Audit Report on FY 2012 Financial Statements

DATE: November 14, 2012

TO: John Needham, Assistant IG for Auditing

FROM: Jonathan Carver, Chief Financial Officer

SUBJECT: Draft Audit Report on FY 2012 Financial Statements

The Small Business Administration has received 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 pleased that the SBA has again received an unqualified audit opinion from the independent auditor with no 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 auditor. Our core financial reporting data and processes have further improved, 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 the report on the FY 2012 financial statements, the SBA implemented corrective action this year to remediate 3 of the 18 prior year IT control findings. The auditor, however, identified 9 new IT findings this year and re-issued one NFR related to it. The SBA will continue to work on improvements in IT security. The SBA will track, monitor, and aggressively mitigate vulnerabilities in all Agency systems. Furthermore, the SBA will 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 related to timely referral of 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 loans where co-borrowers and guarantors were not referred to Treasury. The SBA is working on procedures to correct this issue.

The audit report includes one other matter that may be a violation of the Federal Acquisition Regulation documentation retention requirements. This is the second year since the SBA transferred the procurement functions to the Office of the Chief Financial Officer. The FY 2012 review of internal controls over financial reporting revealed that, while there was considerable improvement in the contracting area, more time and resources will be required to resolve all outstanding issues. These include formalizing the acquisition process and related requirements through Agency-wide Standard Operating Procedures, ensuring all contracting documents are signed by appropriate authorized individuals, and ensuring that invoices are reviewed by appropriate parties before payment is disbursed. The Agency takes this matter very seriously and we have already taken steps to make further improvements.

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, 2012 and 2011

(Dollars in Thousands)

	2012	2011
ASSETS		
Intragovernmental Assets		
Fund Balance with Treasury (Note 2)	\$ 6,273,663	\$ 8,469,322
Accounts Receivable (Note 5)	—	406
Advances	6,871	—
Total Intragovernmental Assets	6,280,534	8,469,728
Assets - Public and Other		
Cash (Note 3)	5,485	2,935
Accounts Receivable, Net (Note 5)	72,423	52,813
Credit Program Receivables and Related Foreclosed Property, Net (Note 6)	7,654,295	8,354,739
General Property and Equipment, Net (Note 7)	2,118	1,804
Advances	—	782
Total Assets - Public and Other	7,734,321	8,413,073
Total Assets	\$ 14,014,855	\$ 16,882,801
LIABILITIES		
Intragovernmental Liabilities		
Interest Payable	\$ 4,928	\$ 1,347
Debt (Note 9)	7,919,801	11,190,279
Net Assets of Liquidating Funds Due to Treasury (Note 10)	52,200	63,970
Downward Reestimate Payable to Treasury (Note 1, Note 13)	1,689,133	911,765
Other (Note 8, Note 11)	12,678	13,657
Total Intragovernmental Liabilities	9,678,740	12,181,018
Other Liabilities - Public		
Accounts Payable (Note 1)	42,614	94,628
Accrued Grant Liability (Note 1)	94,000	76,000
Liability for Loan Guaranties (Note 6)	3,725,951	4,741,442
Federal Employee Compensation Act Actuarial Liability (Note 1, Note 8)	31,591	30,630
Surety Bond Guarantee Program Future Claims (Note 8)	22,606	20,385
Other (Note 8, Note 11)	45,079	47,721
Total Other Liabilities - Public	3,961,841	5,010,806
Total Liabilities	13,640,581	17,191,824
NET POSITION		
Unexpended Appropriations (Note 1)	1,281,279	1,537,185
Cumulative Results of Operations (Note 1)	(907,005)	(1,846,208)
Total Net Position	374,274	(309,023)
Total Liabilities and Net Position	\$ 14,014,855	\$ 16,882,801

The accompanying notes are an integral part of these statements.

U. S. Small Business Administration
Consolidated Statement of Net Cost
as of September 30, 2012 and 2011

(Dollars in Thousands)

	2012	2011
STRATEGIC GOAL 1:		
Growing Businesses and Creating Jobs		
Gross Cost	\$ 1,876,569	\$ 4,000,361
Less: Earned Revenue	697,123	696,210
Net Cost of Strategic Goal 1	1,179,446	3,304,151
STRATEGIC GOAL 2:		
Building an SBA that Meets the Needs of Today's and Tomorrow's Small Businesses		
Gross Cost	1,959	6,132
Total Program Cost of Strategic Goal 2	1,959	6,132
STRATEGIC GOAL 3:		
Serving as the Voice for Small Business		
Gross Cost	14,369	13,454
Total Program Cost of Strategic Goal 3	14,369	13,454
COST NOT ASSIGNED TO STRATEGIC GOALS		
Gross Cost	79,031	136,825
Total Program Cost Not Assigned to Strategic Goals	79,031	136,825
Net Cost of Operations	\$ 1,274,805	\$ 3,460,562

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, 2012 and 2011

(Dollars in Thousands)

	2012	2011
Beginning Cumulative Results of Operations	\$ (1,846,208)	\$ (3,829,615)
Budgetary Financing Sources		
Appropriations Used	3,840,682	6,353,577
Donations of Cash and Cash Equivalents	17	33
Other Financing Sources		
Imputed Financing from Costs Absorbed by Others	20,453	26,749
Other - Cancelled Authority	(252)	—
Other - Current Year Liquidating Equity Activity	(1,207)	(2,409)
Other - Non-entity Activity	(1,645,685)	(933,981)
Total Financing Sources	2,214,008	5,443,969
Less: Net Cost of Operations	1,274,805	3,460,562
Ending Cumulative Results of Operations	\$ (907,005)	\$ (1,846,208)
Beginning Unexpended Appropriations	\$ 1,537,185	\$ 2,295,070
Budgetary Financing Sources		
Appropriations Received	3,592,151	5,611,644
Rescissions	—	(1,462)
Adjustment - Cancelled Authority	(7,028)	(10,120)
Other Adjustments	(347)	(4,370)
Appropriations Used	(3,840,682)	(6,353,577)
Total Budgetary Financing Sources	(255,906)	(757,885)
Ending Unexpended Appropriations	\$ 1,281,279	\$ 1,537,185
Ending Net Position	\$ 374,274	\$ (309,023)

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, 2012 and 2011

(Dollars in Thousands)

	September 30, 2012		
	Budgetary	Nonbudgetary Financing	Total
BUDGETARY RESOURCES			
Unobligated Balance Brought Forward, October 1	\$ 969,277	\$ 6,415,008	\$ 7,384,285
Recoveries of Prior Year Obligations	89,736	234,613	324,349
Other Changes in Unobligated Balance	(20,608)	(2,241,902)	(2,262,510)
Unobligated Balance from Prior Year Budget Authority, net	1,038,405	4,407,719	5,446,124
Appropriations (discretionary and mandatory)	3,592,151	—	3,592,151
Borrowing Authority (discretionary and mandatory)	—	1,129,367	1,129,367
Spending Authority from Offsetting Collections	363,209	3,869,311	4,232,520
Total Budgetary Resources	\$ 4,993,765	\$ 9,406,397	\$ 14,400,162
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred	\$ 4,130,864	\$ 4,636,930	\$ 8,767,794
Apportioned	221,119	2,491,404	2,712,523
Unapportioned	641,782	2,278,063	2,919,845
Total Unobligated Balance, end of year	862,901	4,769,467	5,632,368
Total Status of Budgetary Resources	\$ 4,993,765	\$ 9,406,397	\$ 14,400,162
CHANGE IN OBLIGATED BALANCE			
Unpaid Obligations, Brought Forward, October 1 (gross)	\$ 747,111	\$ 584,678	\$ 1,331,789
Uncollected Customer Payments from Federal Sources Brought Forward, October 1	—	(246,756)	(246,756)
Obligated Balance Start of Year (net), before adjustments	747,111	337,922	1,085,033
Obligated Balance Start of Year (net), as adjusted	747,111	337,922	1,085,033
Obligations Incurred	4,130,864	4,636,930	8,767,794
Gross Outlays	(4,168,243)	(4,708,822)	(8,877,065)
Change in Uncollected Customer Payments from Federal Sources	—	70,075	70,075
Recoveries of Prior Year Unpaid Obligations	(89,736)	(234,613)	(324,349)
Unpaid Obligations, end of year (gross)	619,996	278,173	898,169
Uncollected Customer Payments from Federal Sources, end of year	—	(176,681)	(176,681)
Obligated Balance, End of Year	\$ 619,996	\$ 101,492	\$ 721,488
BUDGET AUTHORITY AND OUTLAYS, NET			
Budget Authority, gross (discretionary and mandatory)	\$ 3,955,361	\$ 4,998,678	\$ 8,954,039
Actual Offsetting Collections (discretionary and mandatory)	(363,722)	(6,016,599)	(6,380,321)
Change in Uncollected Customer Payments from Federal Sources (discretionary and mandatory)	—	70,075	70,075
Budget Authority, net (discretionary and mandatory)	\$ 3,591,639	\$ (947,846)	\$ 2,643,793
Gross Outlays (discretionary and mandatory)	\$ 4,168,243	\$ 4,708,822	\$ 8,877,065
Actual Offsetting Collections (discretionary and mandatory)	(363,722)	(6,016,599)	(6,380,321)
Net Outlays (discretionary and mandatory)	3,804,521	(1,307,777)	2,496,744
Less: Distributed Offsetting Receipts	(51)	(868,316)	(868,367)
Agency Outlays, net (discretionary and mandatory)	\$ 3,804,470	\$ (2,176,093)	\$ 1,628,377

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, 2012 and 2011

(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
Other Changes in Unobligated Balance	(21,289)	(909,519)	(930,808)
Unobligated Balance from Prior Year Budget Authority, net	1,816,838	2,640,314	4,457,152
Appropriations (discretionary and mandatory)	5,608,629	—	5,608,629
Borrowing Authority (discretionary and mandatory)	—	347,617	347,617
Spending Authority from Offsetting Collections	463,253	8,400,641	8,863,894
Total Budgetary Resources	\$ 7,888,720	\$ 11,388,572	\$ 19,277,292
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred	\$ 6,919,443	\$ 4,973,564	\$ 11,893,007
Apportioned	271,885	1,845,980	2,117,865
Unapportioned	697,392	4,569,028	5,266,420
Total Unobligated Balance, end of year	969,277	6,415,008	7,384,285
Total Status of Budgetary Resources	\$ 7,888,720	\$ 11,388,572	\$ 19,277,292
CHANGE IN OBLIGATED BALANCE			
Unpaid Obligations, Brought Forward, October 1 (gross)	\$ 676,054	\$ 443,586	\$ 1,119,640
Uncollected Customer Payments from Federal Sources Brought Forward, October 1	—	(230,303)	(230,303)
Obligated Balance Start of Year (net), before adjustments	676,054	213,283	889,337
Obligated Balance Start of Year (net), as adjusted	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)
Change in Uncollected Customer Payments from Federal Sources	—	(16,453)	(16,453)
Recoveries of Prior Year Unpaid Obligations	(69,518)	(91,458)	(160,976)
Unpaid Obligations, end of year (gross)	747,111	584,678	1,331,789
Uncollected Customer Payments from Federal Sources, end of year	—	(246,756)	(246,756)
Obligated Balance, End of Year	\$ 747,111	\$ 337,922	\$ 1,085,033
BUDGET AUTHORITY AND OUTLAYS, NET			
Budget Authority, gross (discretionary and mandatory)	\$ 6,071,882	\$ 8,748,258	\$ 14,820,140
Actual Offsetting Collections (discretionary and mandatory)	(463,253)	(8,384,188)	(8,847,441)
Change in Uncollected Customer Payments from Federal Sources (discretionary and mandatory)	—	(16,453)	(16,453)
Budget Authority, net (discretionary and mandatory)	\$ 5,608,629	\$ 347,617	\$ 5,956,246
Gross Outlays (discretionary and mandatory)	\$ 6,778,868	\$ 4,741,014	\$ 11,519,882
Actual Offsetting Collections (discretionary and mandatory)	(463,253)	(8,384,188)	(8,847,441)
Net Outlays (discretionary and mandatory)	6,315,615	(3,643,174)	2,672,441
Less: Distributed Offsetting Receipts	(97)	(153,211)	(153,308)
Agency Outlays, net (discretionary and mandatory)	\$ 6,315,518	\$ (3,796,385)	\$ 2,519,133

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 the OMB, the Federal Accounting Standards Advisory Board, and the Department of the Treasury. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting recognizes the legal 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.

The Federal Credit Reform Act of 1990 governs SBA's accounting for direct loans and loan guaranties made in FY 1992 and thereafter. Under the FCRA, the liability for loan guaranties is determined as the summarized discounted present value of the estimated future net cash inflows and outflows for each fiscal year's cohort of guaranties. For direct loans, the allowance is the current outstanding FCRA loans receivable balance less the discounted present value of the estimated future net cash flows for all the loan cohorts. A cohort of loans receivable or guaranteed loans is all of the loans made in a given fiscal year. Increases to individual loans in a cohort that are made in a subsequent fiscal year are accounted for in the subsequent year's loan cohort. Cohort cash flows include loan repayments, recoveries on defaulted guaranties and loan fees received by the SBA that are due from the lenders and borrowers when the loan is made and during the life of the loan cohort, as well as expenditures by the SBA for defaulted guaranties, loan servicing expenses and other required SBA expenditures. An initial allowance or liability for loan guaranties is established in the original year of the loan cohort. The initial amount of the allowance and liability for each cohort is reestimated annually at fiscal year-end, and the adjusted amount is included in SBA's annual financial statements. Note 6 further describes FCRA accounting.

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 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 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,	2012	2011
Appropriated Funds	\$ 1,398,400	\$ 1,641,312
Financing Funds	4,790,763	6,752,927
Liquidating Funds	22,896	16,013
Revolving Fund	61,457	58,933
Trust Fund	142	133
Total Entity Fund Balance with Treasury	6,273,658	8,469,318
Non-entity Fund Balance	5	4
Total Fund Balance with Treasury	\$ 6,273,663	\$ 8,469,322
Status of Fund Balance with Treasury		
Unobligated Balance Available	\$ 2,712,523	\$ 2,117,804
Unobligated Balance Unavailable	2,919,845	5,266,481
Obligated Balance Not Yet Disbursed	721,488	1,085,033
Borrowing Authority Not Converted to Funds	(80,198)	—
Nonbudgetary	5	4
Total Fund Balance with Treasury	\$ 6,273,663	\$ 8,469,322

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

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 \$5.5 million and \$2.9 million at September 30, 2012 and 2011.

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 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) guaranteed 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 \$19.2 billion and \$17.6 billion of outstanding SBA guaranteed loan principal in the secondary market at September 30, 2012 and 2011.

The MRA facilitates the operation of the 504 Development Company secondary market program. The MRA was authorized by Section 505 of the Small Business Investment Act of 1958 as a vehicle to receive, temporarily hold and distribute 504 program cash flows. The MRA receives monthly payments from the 504 borrowers, and retains the payments until a semi-annual debenture payment is due to the secondary market investors. The 504 secondary market program includes SBA's guaranty of timely payment, as well as a default guaranty, to 504 secondary market investors. There was \$26.2 billion and \$24.3 billion of SBA guaranteed 504 debentures outstanding in the secondary market at September 30, 2012 and 2011.

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

MASTER RESERVE FUND AND MASTER RESERVE ACCOUNT

(Dollars in Thousands)

FIDUCIARY ASSETS

AS OF SEPTEMBER 30,	2012	2011
Short Term Securities		
Money Market Funds	\$ 8,357	\$ 10,086
Treasury Bills	—	17,997
Repurchase Agreements	1,015,810	915,951
Total Short Term Securities	1,024,167	944,034
Long Term Securities		
Treasury Notes Including Interest	1,958,378	1,833,113
Total Long Term Securities	1,958,378	1,833,113
Net Assets	\$ 2,982,545	\$ 2,777,147

MASTER RESERVE FUND AND MASTER RESERVE ACCOUNT (CONTINUED)

(Dollars in Thousands)

RECONCILIATION OF FIDUCIARY ASSETS

FOR THE YEARS ENDING SEPTEMBER 30,

	2012	2011
Beginning Net Assets	\$ 2,777,147	\$ 2,626,436
Receipts		
Earned Income	44,062	56,057
Contributions	7,968,441	7,913,304
Net Realized Gain (Loss)	1,347	2,503
Total Receipts	8,013,850	7,971,864
Less Disbursements		
Payments to Investors	7,808,452	7,821,153
Total Disbursements	7,808,452	7,821,153
Ending Net Assets	\$ 2,982,545	\$ 2,777,147

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 guaranteed 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 amount for refunds and loan guaranty fees is not significant and no allowance is provided. Amounts over 180 days past due on guaranteed loans purchased by the SBA are written off for financial reporting purposes.

(Dollars in Thousands)

AS OF SEPTEMBER 30,	2012	2011
Intragovernmental		
Administrative Receivables	\$ —	\$ 406
Total Intragovernmental	\$ —	\$ 406
Public		
Guaranty Fees Receivable	\$ 66,184	\$ 37,108
Refunds	271	146
Other	5,971	15,561
Total Public	72,426	52,815
Allowance For Loss	(3)	(2)
Net Public	\$ 72,423	\$ 52,813

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	504 First Mortgage Loan Pooling
Business	Guarantied	504 CDC - Debt Refinancing
Business	Guarantied	Small Business Investment Company Debentures
Business	Guarantied	Small Business Investment Company Participating Securities
Business	Guarantied	America's Recovery Capital Loan
Business	Guarantied	Dealer Floor Plan
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 504 First Mortgage Loan Pooling program was authorized by the Recovery 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 504 CDC – Debt Refinancing program, a temporary program that was authorized by the Jobs Act, supported small businesses' ability to restructure their collateralized debt.

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 guarantied loan program authorized by the Recovery Act of 2009 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 guaranteed 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 Dealer Floor Plan is a temporary program that encourages SBA lenders to extend lines of credit to eligible dealers of new and used automobiles, motorcycles, boats, recreational vehicles and manufactured housing by providing guaranties of 75 percent for loans up to \$5,000,000.

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 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 LIABILITY 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 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. Guaranteed 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. Guaranteed 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 guaranteed 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 guaranteed 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 guaranteed 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 and 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, 2012 SBA's foreclosed property was \$45.6 million related to 78 loans. The properties had been held for an average of 725 days. At September 30, 2011 foreclosed property was \$39.9 million related to 72 loans. The properties had been held for an average of 789 days.

VALUATION METHODOLOGY FOR POST-1991 DIRECT LOANS AND LOAN GUARANTIES

The value of direct and guaranteed loans committed after FY 1991 is based on the net present value of their expected future cash flows. The SBA estimates future cash flows for guaranteed 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
- Loan fee rates

VALUATION METHODOLOGY FOR PRE-1992 DIRECT LOANS AND LOAN GUARANTIES

The SBA values pre-credit reform direct and defaulted guaranteed 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 guaranteed 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.

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B. Credit Program Receivables and Related Foreclosed Property, Net

(Dollars in Thousands)

AS OF SEPTEMBER 30, 2012	Pre-1992 Loans	Post-1991 Loans	Total
Direct Business Loans			
Business Loans Receivable	\$ 9,402	\$ 142,536	\$ 151,938
Interest Receivable	1,936	945	2,881
Foreclosed Property	3,107	—	3,107
Allowance	(1,188)	(34,197)	(35,385)
Total Direct Business Loans	13,257	109,284	122,541
Direct Disaster Loans			
Disaster Loans Receivable	6,634	7,174,910	7,181,544
Interest Receivable	45	34,733	34,778
Foreclosed Property	—	1,498	1,498
Allowance	(966)	(1,403,968)	(1,404,934)
Total Direct Disaster Loans	5,713	5,807,173	5,812,886
Defaulted Guaranteed Business Loans & Other Loans Receivable			
Defaulted Guaranteed Business Loans	26,529	8,079,439	8,105,968
Other Loans Receivable (see note below)	—	443,904	443,904
Interest Receivable	747	87,968	88,715
Foreclosed Property	3,244	37,737	40,981
Allowance	(20,227)	(6,940,473)	(6,960,700)
Total Defaulted Guaranteed Business Loans & Other Loans Receivable	10,293	1,708,575	1,718,868
Total Credit Program Receivables & Related Foreclosed Property, Net			\$ 7,654,295

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 Guaranteed Business Loans & Other Loans Receivable			
Defaulted Guaranteed 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 Guaranteed Business Loans & Other Loans Receivable	22,583	2,203,869	2,226,452
Total Credit Program Receivables & Related Foreclosed Property, Net			\$ 8,354,739

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,	2012	2011
Business Direct Loan Program	\$ 40,316	\$ 33,799
Disaster Loan Program	481,741	312,050
Total Direct Loans Disbursed	\$ 522,057	\$ 345,849
Outstanding Loan Obligations as of September 30,	2012	2011
Business Direct Loan Program	\$ 56,240	\$ 61,640
Disaster Loan Program	181,145	427,244
Total Direct Loan Obligations	\$ 237,385	\$ 488,884

GUARANTIED LOANS

New Loans Disbursed During the Year Ending September 30,	2012	2011
Total Principal Disbursed at Face Value	\$ 19,533,852	\$ 19,647,608
Total Principal Disbursed Guaranteed by the SBA	15,993,888	16,584,726
Outstanding Loan Obligations as of September 30,	2012	2011
Business Guaranteed Loan Programs	\$ 13,988,806	\$ 12,415,542
Loans Outstanding as of September 30,	2012	2011
Total Principal Outstanding at Face Value	\$ 87,433,714	\$ 82,233,722
Total Principal Outstanding Guaranteed by the SBA	74,371,378	70,011,195

SBA's guaranteed loan servicing agent provides data to the SBA on the unpaid principal balance of guaranteed loans within a precision of less than 1 percent due to timing.

D. Subsidy Cost Allowance Balances

(Dollars in Thousands)

For the Years Ending September 30,	2012	2011
Post-1991 Business Direct and Purchased Guaranteed Loans		
Beginning Balance of Allowance Account	\$ 6,719,794	\$ 6,003,982
Current Year's Subsidy (see 6G for breakdown by component)	6,700	5,128
Loans Written Off	(2,173,585)	(2,224,182)
Subsidy Amortization	(2,223)	(1,980)
Allowance Related to Guaranteed Loans Purchased This Year	2,337,586	2,860,687
Miscellaneous Recoveries and Costs	88,300	72,139
Balance of Subsidy Allowance Account before Reestimates	6,976,572	6,715,774
Technical Assumptions/Default Reestimates	(1,902)	4,020
Ending Balance of Allowance Account	\$ 6,974,670	\$ 6,719,794
Post-1991 Disaster Direct Loans		
Beginning Balance of Allowance Account	\$ 1,486,011	\$ 1,475,666
Current Year's Subsidy (see 6G for breakdown by component)	58,307	39,736
Loans Written Off	(169,471)	(212,044)
Subsidy Amortization	(26,784)	(14,522)
Miscellaneous Recoveries and Costs	47,303	41,529
Balance of Subsidy Allowance Account before Reestimates	1,395,366	1,330,365
Technical Assumptions/Default Reestimates	8,602	155,646
Ending Balance of Allowance Account	\$ 1,403,968	\$ 1,486,011

E. Liability for Loan Guaranties

(Dollars in Thousands)

For the Years Ending September 30,	2012	2011
Pre-1992 Business Loan Guaranties		
Beginning Balance of Liability for Loan Guaranties	\$ 306	\$ 574
Adjustment to Expected Losses, Guaranties Outstanding	(197)	(268)
Ending Balance of Liability for Loan Guaranties	109	306
Post-1991 Business Loan Guaranties		
Beginning Balance of Liability for Loan Guaranties	4,741,136	4,466,432
Current Year's Subsidy (see 6G for breakdown by component)	197,559	553,814
Fees	822,503	632,922
Interest Accumulation Factor	189,787	111,290
Claim Payments to Lenders	(2,567,534)	(3,418,876)
Adjustment Due to Reestimate & Guaranteed Loan Purchases	229,948	558,189
Miscellaneous Recoveries and Costs	31,132	36,185
Balance of Liability for Loan Guaranties before Reestimates	3,644,531	2,939,956
Technical Assumptions/Default Reestimates	81,311	1,801,180
Ending Balance of Liability for Loan Guaranties	3,725,842	4,741,136
Total Ending Balance of Liability for Loan Guaranties	\$ 3,725,951	\$ 4,741,442

F. 2012 Subsidy Rates by Program and Component

LOAN PROGRAM	Total Subsidy	Financing	Default	Other	Fee
Guaranty					
7(a)	1.05%	0.00%	5.25%	0.00%	-4.20%
504 CDC	1.09%	0.00%	9.07%	0.73%	-8.71%
SBIC Debentures	0.00%	0.00%	7.72%	0.16%	-7.88%
Direct					
Disaster (10-1-11 to 2-29-12)	11.28%	4.82%	12.34%	-5.88%	0.00%
Disaster (3-1-12 to 9-30-12)	10.93%	4.43%	12.35%	-5.85%	0.00%
Microloan	14.71%	4.47%	2.17%	8.07%	0.00%
Intermediary Lending Program	25.73%	22.94%	2.79%	0.00%	0.00%
Recovery Act Guaranty					
504 First Mortgage Loan Pooling	0.00%	0.00%	3.07%	0.51%	-3.58%
Jobs Act Guaranty					
504 CDC - Debt Refinancing	0.00%	0.00%	9.06%	0.74%	-9.80%
Dealer Floor Plan	0.49%	0.00%	3.99%	0.00%	-3.50%

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,	2012	2011
Business Loan Guaranties		
Interest	\$ 16	\$ 7,395
Defaults	835,394	993,474
Fees	(649,395)	(454,961)
Other	11,544	7,906
Subsidy Expense Before Reestimates and Loan Modifications	197,559	553,814
Reestimates	81,311	1,801,180
Total Guaranteed Business Loan Subsidy Expense	\$ 278,870	\$ 2,354,994
Business Direct Loans		
Interest	\$ 3,440	\$ 2,663
Defaults	896	692
Other	2,364	1,773
Subsidy Expense Before Reestimates	6,700	5,128
Reestimates	(1,902)	4,020
Total Business Direct Loan Subsidy Expense	\$ 4,798	\$ 9,148
Disaster Direct Loans		
Interest	\$ 29,503	\$ 21,926
Defaults	57,430	34,396
Other	(28,626)	(16,586)
Subsidy Expense Before Reestimates	58,307	39,736
Reestimates	8,602	155,646
Total Disaster Direct Loan Subsidy Expense	\$ 66,909	\$ 195,382

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,	2012	2011
Disaster Direct Loan Programs	\$ 189,704	\$ 190,228
Business Loan Programs	148,078	157,767
Total Administrative Expense	\$ 337,782	\$ 347,995

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 2012 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 GUARANTIED LOAN PROGRAMS

Net subsidy reestimates of business guaranteed loan programs follows:

(Dollars in Thousands)

Guaranteed Loan Program Subsidy Reestimates	2012	2011
7(a)	\$ (8,131)	\$ 1,235,733
7(a) - Recovery Act	(402,448)	115,495
7(a) - Jobs Act	(241,334)	(42,042)
Dealer Floor Plan	(871)	(214)
504 CDC	357,707	1,063,772
504 CDC - Recovery Act	(24,712)	209,379
504 CDC - Jobs Act	22,684	20,478
504 CDC - Debt Refinancing	32,352	2,221
504 First Mortgage Loan Pooling - Recovery Act	2,309	5,054
SBIC Debentures	(70,163)	28,010
SBIC Participating Securities	444,090	(757,505)
Secondary Market Guaranty Program	(12,376)	(9,916)
ARC - Recovery Act	(28,625)	(66,210)
All Other Guaranty Loan Programs	10,829	(3,075)
Total Guaranteed Loan Program Subsidy Reestimates	\$ 81,311	\$ 1,801,180

The 7(a) Loan Guaranty program, SBA's flagship and largest program had a net downward reestimate in FY 2012 of \$8.1 million. While loans in cohorts 2009 through 2011 performed better than projected in FY 2012, loans in cohort 2000 through 2008 performed worse than projected. This offsetting performance resulted in a nearly flat reestimate. Additionally, FY 2012 loan performance contributed to updated model assumptions, which resulted in increased purchase projections for the remaining years within cohorts 2005 through 2008 and resulted in decreased purchase projections for the remaining years within the cohorts 2009 through 2011.

The 7(a) Recovery Act program had a net downward reestimate in FY 2012 of \$402.4 million. A significant portion of the reestimate is due to better than projected FY 2012 loan performance. Purchases in the 7(a) Recovery Act program during FY 2012 represented only 36 percent of the purchases projected for FY 2012 by last year's reestimate model. Additionally, FY 2012 loan performance contributed to updated model assumptions, which resulted in decreased purchase projections for the remaining years of all 7(a) Recovery Act program cohorts.

The 7(a) Jobs Act cohort had a net downward reestimate in FY 2012 of \$241.3 million. A significant portion of the reestimate is due to better than projected FY 2012 loan performance. Purchases in the 7(a) Jobs Act cohort during FY 2012 represented only 14 percent of the purchases projected for FY 2012 by last year's reestimate model. Additionally, FY 2012 loan performance contributed to updated model assumptions, which resulted in decreased purchase projections for the remaining years in the 7(a) Jobs Act program cohort.

The Dealer Floor Plan program had a net downward reestimate of \$0.9 million, due to better than projected performance during FY 2012.

The 504 Certified Development Company program had a net upward reestimate of \$357.7 million. While the 2008 through 2011 cohorts performed better than expected in FY 2012, many other cohorts, especially 2005 through 2007, performed worse. Additionally, updated model assumptions resulted in increased purchase projections and decreased recovery projections for the remaining years of almost all cohorts. The remainder of the reestimate was due to increased loss projections for the remaining years in the 2011 and 2012 cohorts as compared to their original budget formulation loss projections.

The 504 Recovery Act program had a net downward reestimate of \$24.7 million. The reestimate is due to better than projected FY 2012 loan performance. Purchases in the 504 Recovery Act program represented only 34 percent of the purchases projected for FY 2012 by last year's reestimate model.

The 504 Jobs Act program had a net upward reestimate of \$22.7 million despite having better than projected loan performance in FY 2012. The reestimate is due to increased loss projections for the remaining years in the 504 Jobs Act cohorts as compared to the original budget formulation loss projections.

The 504 Debt Refinancing program had a net upward reestimate of \$32.4 million despite having better than projected loan performance in FY 2012. The reestimate is due to increased loss projections for the remaining years in the 504 Debt Refinancing cohorts as compared to the original budget formulation loss projections.

The 504 First Mortgage Loan Pooling program had a net upward reestimate of \$2.3 million. While pools in the 504 First Mortgage Loan Pooling program performed better in FY 2012 than projected by last year's reestimate model, additional loan performance data increased loss projections for the remaining years within the cohorts.

The SBIC Debentures program had a net downward reestimate of \$70.2 million. The reestimate was largely due to a decrease in projected purchases for the remaining years within cohorts 2000 through 2011.

The SBIC Participating Securities program had a net upward reestimate of \$444.1 million. The reestimate was largely due to updated methodologies for assumption curves which allow for more accurate projections of future cash flows. These methodology changes resulted in decreased projections of recoveries, reimbursement of prioritized payments and annual fees for the remaining years within most of the cohorts.

The Secondary Market Guaranty program had a net downward reestimate of \$12.4 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 \$28.6 million. Over half of the ARC downward reestimate is due to better than projected loan performance in FY 2012. The remainder of the reestimate is mostly due to lower purchase projections, as a result of recent actual loan performance, for future fiscal years.

All Other Guaranty Loan programs, which include the SBIC New Market Venture Capital program, had a net upward reestimate of \$10.8 million. The majority of the reestimate was due to higher than projected purchases in FY 2012, in particular the 2002 cohort.

BUSINESS DIRECT LOAN PROGRAMS

Net subsidy reestimates for business direct loan programs follows:

(Dollars in Thousands)

Business Direct Loan Program Subsidy Reestimates	2012	2011
7(m) Microloan	\$ (2,350)	\$ (2,115)
7(m) Microloan - Recovery Act	806	2,004
SBIC Preferred Stock	(101)	4,189
All Other Direct Loan Programs	(257)	(58)
Total Direct Loan Program Subsidy Reestimates	\$ (1,902)	\$ 4,020

The 7(m) Direct Microloan program had a net downward reestimate of \$2.4 million. The reestimate is largely due to better than projected performance during FY 2012.

The 7(m) Direct Microloan Recovery Act program had a net upward reestimate of \$0.8 million. While both the Recovery Act cohorts performed slightly better than expected during FY 2012, the upward reestimate is primarily due to updated assumption curves for the Recovery Act cohorts.

DISASTER DIRECT LOAN PROGRAM

Net subsidy reestimates for the disaster direct loan programs follows:

(Dollars in Thousands)

Disaster Direct Loan Program Subsidy Reestimates	2012	2011
Disaster	\$ 8,602	\$ 155,646
Total Disaster Direct Loan Program Subsidy Reestimates	\$ 8,602	\$ 155,646

The Disaster Assistance program had a net upward reestimate of \$8.6 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 half 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 2012 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 depreciates 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 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 at September 30, 2012 and 2011 are detailed below.

(Dollars in Thousands)

	2012	2011
Equipment	\$ 2,602	\$ 1,787
Accumulated Depreciation	(1,875)	(1,394)
Net	727	393
Leasehold Improvements	1,811	1,811
Amortization of Leasehold Improvements	(551)	(400)
Net	1,260	1,411
Software in Development	131	—
Software in Use	30,546	30,546
Amortization of Software in Use	(30,546)	(30,546)
Net	131	—
Total General Property and Equipment, Net	\$ 2,118	\$ 1,804

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, 2012 and 2011 consisted of:

(Dollars in Thousands)

	2012	2011
Intragovernmental Liabilities - Other		
Employment Taxes Payable	\$ 1,815	\$ 1,946
Federal Employees' Compensation Act Payable	5,808	5,850
Total Intragovernmental Liabilities - Other	7,623	7,796
Federal Employees' Compensation Act Actuarial Liability	31,591	30,630
Surety Bond Guarantee Program Future Claims	22,606	20,385
Other Liabilities		
Prior Liens on Real Estate Payable	59	440
Accrued Unfunded Annual Leave	25,758	26,897
Total Other Liabilities	25,817	27,337
Total Liabilities Not Covered by Budgetary Resources	\$ 87,637	\$ 86,148

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, 2012 and 2011 and resulting balances are:

INTRAGOVERNMENTAL DEBT

(Dollars in Thousands)

Department of Treasury	2012	2011
Beginning Balance	\$ 11,189,686	\$ 11,751,594
New Borrowing	1,049,171	347,617
Repayments	(4,319,116)	(909,525)
Ending Balance	\$ 7,919,741	\$ 11,189,686
Federal Financing Bank	2012	2011
Beginning Balance	\$ 593	\$ 2,187
Repayments	(518)	(1,552)
Change in Interest Payable	(15)	(42)
Ending Balance	\$ 60	\$ 593
Total Debt	\$ 7,919,801	\$ 11,190,279

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,	2012	2011
Pollution Control Equipment Guaranty Fund	\$ 2,125	\$ 2,646
Disaster Loan Fund	9,748	12,263
Business Loan and Investment Fund	40,327	49,061
Total Due Treasury	\$ 52,200	\$ 63,970

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Persons impacted by a disaster may now apply for disaster loan assistance through the **Electronic Loan Application**. The ELA simplifies the application process and speeds delivery of assistance. It allows anyone whose home or business was damaged by a declared disaster to apply for disaster loan assistance. Homeowners and renters can apply for damages to their home, personal property, and vehicles. Businesses can apply for damages to their real estate or business contents and for economic losses. For more information, go to www.sba.gov/disaster.

Note 11 Other Liabilities

Other liabilities at September 30th were:

(Dollars in Thousands)

	2012	2011
OTHER LIABILITIES - INTRAGOVERNMENTAL		
Entity		
Current		
Employment Taxes Payable	\$ 4,380	\$ 4,496
Advances from Other Agencies	721	1,282
Total Current	5,101	5,778
Non-current		
Employment Taxes Payable	1,815	1,946
Federal Employees' Compensation Act Payable	5,808	5,850
Payable to Federal Financing Bank	(53)	76
Total Non-current	7,570	7,872
Total Entity	12,671	13,650
Non-entity		
Current		
Payable to Treasury	7	7
Total Other Liabilities - Intragovernmental	\$ 12,678	\$ 13,657
OTHER LIABILITIES - PUBLIC		
Entity		
Current		
Accrued Funded Payroll and Benefits	\$ 19,017	\$ 20,133
Accrued Unfunded Annual Leave	25,758	26,897
Suspense Accounts	241	247
Total Current	45,016	47,277
Non-current		
Prior Liens on Real Estate Payable	59	440
Total Non-current	59	440
Total Entity	45,075	47,717
Non-entity		
Current		
Non-entity Current Payable	4	4
Total Other Liabilities - Public	\$ 45,079	\$ 47,721

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 2012 and 2011 facilities lease costs were \$47.2 million and \$41.9 million. FY 2012 lease costs included \$2.0 million associated with FY 2011 occupancy in the new lease for the SBA Headquarters building that was signed on November 24, 2010. Future lease payments shown below assume a 3 percent inflation factor from the following years' projected totals as estimated by GSA, as well as

continued costs during the next five years as leases expire and new leases are added. Payments after five years reflect only current leases that will still be in effect then, projected to the end of each lease term.

(Dollars in Thousands)

FUTURE FACILITIES OPERATING LEASE PAYMENTS

FY	Lease Payments
2013	\$ 44,939
2014	46,028
2015	47,149
2016	48,305
2017	49,495
After 2017	65,824
Total	\$ 301,740

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)

	2012	2011
Entity		
Financing Fund Payable	\$ (1,689,133)	\$ (911,765)
Non-entity		
Miscellaneous Receipts Fund Receivable	1,689,133	911,765
Downward Reestimate Payable to Treasury	(1,689,133)	(911,765)
Balance Sheet Reported Payable	\$ (1,689,133)	\$ (911,765)

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 revenue arises from exchange transactions, and is deducted from the full cost of SBA's major strategic goals to arrive at net strategic goals costs. The SBA recognizes earned revenue 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

The SBA reports costs consistent with its three strategic goals. Costs Not Assigned to strategic goals on the Statement of Net Cost includes costs of congressionally mandated grant programs and the Office of the Inspector General. Congressionally mandated programs are community enhancement projects that do not necessarily involve small business. The Office of the Inspector General mission and funding is independent of the SBA's.

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.

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For the fifth year, SBA's **Emerging 200** initiative (e200) trained small business owners in 27 cities across the country and helped nearly 1,000 urban and Native American small business owners to sustain and grow their business. Each participant receives eight months of intensive training.

For more information, visit

<http://www.sba.gov/content/sba-emerging-200-initiative-0>.

(Dollars in Thousands)

INTRAGOVERNMENTAL COSTS AND EXCHANGE REVENUE**For the Years ending September 30,**

	2012	2011
STRATEGIC GOAL 1:		
Growing Businesses and Creating Jobs		
Intragovernmental Gross Cost	\$ 596,821	\$ 656,169
Gross Cost with the Public	1,279,748	3,344,192
Total Strategic Goal 1 Gross Cost	1,876,569	4,000,361
Intragovernmental Earned Revenue	257,952	308,917
Earned Revenue from the Public	439,171	387,293
Total Strategic Goal 1 Earned Revenue	697,123	696,210
STRATEGIC GOAL 2:		
Building an SBA that Meets the Needs of Today's and Tomorrow's Small Businesses		
Intragovernmental Gross Cost	\$ 366	\$ 1,159
Gross Cost with the Public	1,593	4,973
Total Strategic Goal 2 Gross Cost	1,959	6,132
STRATEGIC GOAL 3:		
Serving as the Voice for Small Business		
Intragovernmental Gross Cost	\$ 2,687	\$ 2,543
Gross Cost with the Public	11,682	10,911
Total Strategic Goal 3 Gross Cost	14,369	13,454
COST NOT ASSIGNED TO STRATEGIC GOALS		
Intragovernmental Gross Cost	\$ 14,778	\$ 25,861
Gross Cost with the Public	64,253	110,964
Total Gross Cost Not Assigned to Strategic Goals	79,031	136,825
Net Cost of Operations	\$ 1,274,805	\$ 3,460,562

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, 2012 and 2011. SBA's total budgetary resources were \$5.0 billion and \$7.9 billion for the years ended September 30, 2012 and 2011. Additionally, \$9.4 billion and \$11.4 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, 2012 and 2011.

OMB Circular A-136 required a change in format for the Combined Statement of Budgetary Resources to better align with the SF133 Report on Budget Execution and Budgetary Resources. The FY 2011 balances have been reclassified for comparability as required by Circular A-136.

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 2012 and FY 2011, the SBA received \$1.1 billion and \$0.3 billion of borrowing authority from the OMB. At the end of FY 2012, the SBA had \$0.1 billion in borrowing authority available that will be used to fund guarantied loans disbursed in the future. 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 uninvested 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 2012 and FY 2011, the SBA incurred \$8.8 billion and \$11.9 billion of direct and reimbursable obligations of which \$0.7 billion and \$0.8 billion was apportioned in category A; \$8.1 billion and \$11.1 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, 2012 and 2011 are \$5.6 billion and \$7.4 billion which include \$2.9 billion and \$5.3 billion of unavailable unobligated balances. These balances are unavailable primarily because they are unapportioned by the OMB. The SBA accumulates the majority of these unobligated balances in its nonbudgetary financing accounts during the fiscal year (\$4.8 billion in FY 2012 and \$6.4 billion in FY 2011) 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 (\$0.9 billion in FY 2012 and \$1.0 billion in FY 2011) that are used to finance SBA's ongoing program operations.

Undelivered Orders

Undelivered orders for the periods ended September 30, 2012 and 2011 were \$0.7 billion and \$1.1 billion.

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

There was no material difference between the FY 2011 Statement of Budgetary Resources and the President's FY 2013 budget submission. The President's Budget with actual numbers for FY 2014 has not yet been published. The SBA expects no material differences between the President's Budget "actual" column and the FY 2012 reported results when the budget becomes available in February 2013.

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*

Am I a small business? The SBA uses the North American Industry Classification System (NAICS) as the basis for its size standards. This tool can help you determine if you qualify as a small business under SBA size standards. Qualifying as “small” may allow your business to take advantage of valuable government contracting opportunities reserved for small businesses. NAICS assigns numerical codes to classify business activities to various economic sectors and industries. For more information, visit <http://www.sba.gov/size-standards-tool>.

CONSOLIDATED RECONCILIATION OF BUDGETARY OBLIGATIONS TO NET COST

For the years ended September 30, 2012 and 2011

(Dollars in Thousands)

	2012	2011
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated		
Obligations Incurred	\$ 8,767,794	\$ 11,893,007
Less: Spending Authority from Offsetting Collections and Recoveries	6,634,592	9,024,868
Obligations Net of Offsetting Collections and Recoveries	2,133,202	2,868,139
Less: Offsetting Receipts	868,367	153,308
Net Obligations	1,264,835	2,714,831
Other Resources		
Imputed Financing	20,453	26,749
Other Financing Sources	(1,647,144)	(936,390)
Net Other Resources Used to Finance Activities	(1,626,691)	(909,641)
Total Resources Used to Finance Activities	(361,856)	1,805,190
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	325,086	(257,869)
Resources that Fund Expenses Recognized in Prior Periods	(1,817,256)	(3,796,986)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations		
Credit Program Collections	6,016,599	8,384,188
Offsetting Receipts	868,367	153,308
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(4,651,674)	(4,648,463)
Other - Current Year Liquidating Equity Activity	1,207	2,409
Other Resources that Do Not Affect Net Cost of Operations	257	3
Total Resources that Do Not Finance Net Cost of Operations	742,586	(163,410)
Total Resources Used to Finance the Net Cost of Operations	380,730	1,641,780
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	(1,139)	139
Upward Reestimates of Credit Subsidy Expense	882,560	1,816,761
Change in Revenue Receivable from Public	(306)	309
Provision for Losses on Estimated Guaranties	2,221	846
Change in Unfunded Employee Benefits	961	670
Total Components Requiring or Generating Resources in Future Periods	884,297	1,818,725
Components Not Requiring or Generating Resources		
Depreciation or Amortization	632	1,014
Change in Bad Debt Expense - Pre-1992 Loans	8,517	(452)
Other (Income) Expenses Not Requiring Budgetary Resources	629	(505)
Total Components Not Requiring or Generating Resources	9,778	57
Total Components of the Net Cost of Operations that Will Not Require or Generate Resources in the Current Period	894,075	1,818,782
Net Cost of Operations	\$ 1,274,805	\$ 3,460,562

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,	2012	2011
Current Year Liabilities Not Covered By Budgetary Resources	\$ 87,637	\$ 86,148
Less: Prior Year	86,148	84,622
Change in Liabilities Not Covered By Budgetary Resources	1,489	1,526
Upward Reestimates of Credit Subsidy Expense	882,560	1,816,761
Change in Revenue Receivable from Public	(306)	309
All Other	554	129
Components (of Net Cost) Generating Resources in Future Periods (Per Reconciliation Above)	\$ 884,297	\$ 1,818,725

*Did
you
know*

SBA training and counseling resource partners — Small Business Development Centers, Women's Business Centers, and SCORE — serve more than a million small business owners and aspiring small business owners annually. They serve as counselors advisors and mentors to aspiring entrepreneurs and business owners.

For more information, go to <http://www.sba.gov/training>.

Required Supplementary Information

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the year ended September 30, 2012

(Dollars in Thousands)

	BLIF		DLF		SBGRF	PCEC&F
	Budgetary	Nonbudgetary Financing	Budgetary	Nonbudgetary Financing	Budgetary	Budgetary
BUDGETARY RESOURCES						
Unobligated Balance Brought Forward, October 1	\$ 179,425	\$ 5,665,347	\$ 519,659	\$ 749,661	\$ 58,705	\$ 2,491
Recoveries of Prior Year Obligations	33,151	6,950	30,670	227,663	—	—
Other Changes in Unobligated Balance	(6,420)	(1,265,836)	(4,677)	(976,066)	—	(2,491)
Unobligated Balance from Prior Year Budget Authority, net	206,156	4,406,461	545,652	1,258	58,705	—
Appropriations (discretionary and mandatory)	2,869,413	—	278,003	—	—	2,000
Borrowing Authority (discretionary and mandatory)	—	383,619	—	745,748	—	—
Spending Authority from Offsetting Collections	19,037	3,782,397	2,419	86,914	10,266	63
Total Budgetary Resources	\$ 3,094,606	\$ 8,572,477	\$ 826,074	\$ 833,920	\$ 68,971	\$ 2,063
STATUS OF BUDGETARY RESOURCES						
Obligations Incurred	\$ 2,867,382	\$ 3,853,024	\$ 378,321	\$ 783,906	\$ 7,544	\$ —
Apportioned	68,564	2,441,390	43,373	50,014	8,736	2,063
Unapportioned	158,660	2,278,063	404,380	—	52,691	—
Total Unobligated Balance, end of year	227,224	4,719,453	447,753	50,014	61,427	2,063
Total Status of Budgetary Resources	\$ 3,094,606	\$ 8,572,477	\$ 826,074	\$ 833,920	\$ 68,971	\$ 2,063
CHANGE IN OBLIGATED BALANCES						
Unpaid Obligations, Brought Forward, October 1 (gross)	\$ 191,203	\$ 155,285	\$ 57,968	\$ 429,393	\$ 227	\$ —
Uncollected Customer Payments from Federal Sources Brought Forward, October 1	—	(189,160)	—	(57,596)	—	—
Obligated Balance Start of Year (net), before adjustments	191,203	(33,875)	57,968	371,797	227	—
Obligated Balance Start of Year (net), as adjusted	191,203	(33,875)	57,968	371,797	227	—
Obligations Incurred	2,867,382	3,853,024	378,321	783,906	7,544	—
Gross Outlays	(2,864,513)	(3,905,507)	(384,740)	(803,315)	(7,741)	—
Change in Uncollected Customer Payments from Federal Sources	—	33,338	—	36,737	—	—
Recoveries of Prior Year Unpaid Obligations	(33,151)	(6,950)	(30,670)	(227,663)	—	—
Unpaid Obligations, end of year (gross)	160,921	95,852	20,879	182,321	30	—
Uncollected Customer Payments from Federal Sources, end of year	—	(155,822)	—	(20,859)	—	—
Obligated Balance, End of Year	\$ 160,921	\$ (59,970)	\$ 20,879	\$ 161,462	\$ 30	\$ —
BUDGET AUTHORITY AND OUTLAYS, NET						
Budget Authority, gross (discretionary and mandatory)	\$ 2,888,450	\$ 4,166,016	\$ 280,423	\$ 832,662	\$ 10,266	\$ 2,063
Actual Offsetting Collections (discretionary and mandatory)	(19,548)	(4,865,525)	(2,417)	(1,151,074)	(10,265)	(63)
Change in Uncollected Customer Payments from Federal Sources (discretionary and mandatory)	—	33,338	—	36,737	—	—
Budget Authority, net (discretionary and mandatory)	\$ 2,868,902	\$ (666,171)	\$ 278,006	\$ (281,675)	\$ 1	\$ 2,000
Gross Outlays (discretionary and mandatory)	\$ 2,864,513	\$ 3,905,507	\$ 384,740	\$ 803,315	\$ 7,741	\$ —
Actual Offsetting Collections (discretionary and mandatory)	(19,548)	(4,865,525)	(2,417)	(1,151,074)	(10,265)	(63)
Net Outlays (discretionary and mandatory)	2,844,965	(960,018)	382,323	(347,759)	(2,524)	(63)
Less: Distributed Offsetting Receipts	—	(865,830)	—	(2,486)	—	—
Agency Outlays, net (discretionary and mandatory)	\$ 2,844,965	\$ (1,825,848)	\$ 382,323	\$ (350,245)	\$ (2,524)	\$ (63)

Required Supplementary Information

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the year ended September 30, 2012

(Dollars in Thousands)

(Dollars in Thousands)	SE		OIG		ADVOCACY		BATF		TOTAL		TOTAL			
	Budgetary		Budgetary		Budgetary		Budgetary		Budgetary		Nonbudgetary Financing		TOTAL	
BUDGETARY RESOURCES														
Unobligated Balance Brought Forward, October 1	\$	198,910	\$	9,955	\$	—	\$	132	\$	969,277	\$	6,415,008	\$	7,384,285
Recoveries of Prior Year Obligations		25,295		620		—		—		89,736		234,613		324,349
Other Changes in Unobligated Balance		(6,972)		(46)		—		(2)		(20,608)		(2,241,902)		(2,262,510)
Unobligated Balance from Prior Year Budget Authority, net		217,233		10,529		—		130		1,038,405		4,407,719		5,446,124
Appropriations (discretionary and mandatory)		417,348		16,267		9,120		—		3,592,151		—		3,592,151
Borrowing Authority (discretionary and mandatory)		—		—		—		—		—		1,129,367		1,129,367
Spending Authority from Offsetting Collections		330,401		1,006		—		17		363,209		3,869,311		4,232,520
Total Budgetary Resources	\$	964,982	\$	27,802	\$	9,120	\$	147	\$	4,993,765	\$	9,406,397	\$	14,400,162
STATUS OF BUDGETARY RESOURCES														
Obligations Incurred	\$	849,104	\$	20,067	\$	8,440	\$	6	\$	4,130,864	\$	4,636,930	\$	8,767,794
Apportioned		93,049		4,530		680		124		221,119		2,491,404		2,712,523
Unapportioned		22,829		3,205		—		17		641,782		2,278,063		2,919,845
Total Unobligated Balance, end of year		115,878		7,735		680		141		862,901		4,769,467		5,632,368
Total Status of Budgetary Resources	\$	964,982	\$	27,802	\$	9,120	\$	147	\$	4,993,765	\$	9,406,397	\$	14,400,162
CHANGE IN OBLIGATED BALANCES														
Unpaid Obligations, Brought Forward, October 1 (gross)	\$	494,945	\$	2,766	\$	—	\$	2	\$	747,111	\$	584,678	\$	1,331,789
Uncollected Customer Payments from Federal Sources Brought Forward, October 1		—		—		—		—		—		(246,756)		(246,756)
Obligated Balance Start of Year (net), before adjustments		494,945		2,766		—		2		747,111		337,922		1,085,033
Obligated Balance Start of Year (net), as adjusted		494,945		2,766		—		2		747,111		337,922		1,085,033
Obligations Incurred		849,104		20,067		8,440		6		4,130,864		4,636,930		8,767,794
Gross Outlays		(884,275)		(19,850)		(7,117)		(7)		(4,168,243)		(4,708,822)		(8,877,065)
Change in Uncollected Customer Payments from Federal Sources		—		—		—		—		—		70,075		70,075
Recoveries of Prior Year Unpaid Obligations		(25,295)		(620)		—		—		(89,736)		(234,613)		(324,349)
Unpaid Obligations, end of year (gross)		434,479		2,363		1,323		1		619,996		278,173		898,169
Uncollected Customer Payments from Federal Sources, end of year		—		—		—		—		—		(176,681)		(176,681)
Obligated Balance, End of Year	\$	434,479	\$	2,363	\$	1,323	\$	1	\$	619,996	\$	101,492	\$	721,488
BUDGET AUTHORITY AND OUTLAYS, NET														
Budget Authority, gross (discretionary and mandatory)	\$	747,749	\$	17,273	\$	9,120	\$	17	\$	3,955,361	\$	4,998,678	\$	8,954,039
Actual Offsetting Collections (discretionary and mandatory)		(330,404)		(1,008)		—		(17)		(363,722)		(6,016,599)		(6,380,321)
Change in Uncollected Customer Payments from Federal Sources (discretionary and mandatory)		—		—		—		—		—		70,075		70,075
Budget Authority, net (discretionary and mandatory)	\$	417,345	\$	16,265	\$	9,120	\$	—	\$	3,591,639	\$	(947,846)	\$	2,643,793
Gross Outlays (discretionary and mandatory)	\$	884,275	\$	19,850	\$	7,117	\$	7	\$	4,168,243	\$	4,708,822	\$	8,877,065
Actual Offsetting Collections (discretionary and mandatory)		(330,404)		(1,008)		—		(17)		(363,722)		(6,016,599)		(6,380,321)
Net Outlays (discretionary and mandatory)		553,871		18,842		7,117		(10)		3,804,521		(1,307,777)		2,496,744
Less: Distributed Offsetting Receipts		(51)		—		—		—		(51)		(868,316)		(868,367)
Agency Outlays, net (discretionary and mandatory)	\$	553,820	\$	18,842	\$	7,117	\$	(10)	\$	3,804,470	\$	(2,176,093)	\$	1,628,377

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 an array of services to small businesses and prospective business owners using an extensive network of lead centers and service delivery points. SBDCs deliver professional counseling and training in key management areas to small business clients throughout the U.S.

SCORE is a nonprofit association comprised of over 12,000 volunteer business counselors that serve entrepreneurs with in-person mentoring and local training workshops. SCORE adapts its structure and services to meet the needs of specific small businesses.

Women's Business Centers provide counseling and training through educational centers across the nation. They provide services on a variety of topics including how to write a business plan and specialized programs to meet specific customer needs.

Microloan Program helps the smallest of small businesses become established and achieve success. Community-based intermediary lenders provide business-based training and technical assistance to microbusinesses.

All Other Training and Assistance Programs includes 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 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 PRIME Technical Assistance and the 7(j) program resources.

Performance results are provided in the Management Discussion and Analysis section of SBA's annual Agency Financial Report in "SBA by the Numbers" and "Performance Information on Key SBA Programs."

Significant Human Capital investments occur within the following programs:

For the Five Years Ended September 30, 2012

(Dollars in Thousands)

	2012	2011	2010	2009	2008
Small Business Development Centers	\$ 152,835	\$ 123,097	\$ 130,046	\$ 116,909	\$ 98,484
SCORE	9,331	14,094	11,134	9,899	10,960
Women's Business Centers	25,006	13,080	16,924	21,504	23,655
Microloan Technical Assistance	22,487	30,485	23,426	11,606	315
All Other Training and Assistance Programs	41,054	36,609	57,631	49,750	41,003
Total	\$ 250,713	\$ 217,365	\$ 239,161	\$ 209,668	\$ 174,417

Other Accompanying Information

SUCCESS STORY: Outstanding Small Business Disaster Recovery

O'Donovan's Pub, Cranford, New Jersey

Barry O'Donovan was planning a celebration – the third anniversary of his Kilkenny House restaurant, named after the town in Ireland where he grew up. But then, in August 2011, Hurricane Irene devastated his town and his business. The storm left 12 feet of water in the basement, where the restaurant's office, electrical system, food prep and refrigeration areas were housed. The flooring in the restaurant was destroyed, and, all told, the losses totaled about \$300,000.



An astute business owner, Barry had already worked to establish a reputation as one of Cranford, New Jersey's most eager boosters, always ready to support local fundraisers. To support the recovery of local produce vendors and the small brewery in town, he set a goal to be open for business by October 15. Barry also helped find temporary jobs for his staff. Meanwhile, he received an SBA disaster loan for \$262,000, which he used to cover the rebuilding costs. Only six weeks after the flood – a week before his October 15 deadline – Barry and his staff of 22 reopened Kilkenny House. O'Donovan is the recipient of the SBA 2012 *Phoenix Award for Outstanding Small Business Disaster Recovery*.

U. S. Small Business Administration

Schedule of Spending

For the year ended September 30, 2012

(Dollars in Thousands)

	Budgetary	Nonbudgetary Financing	Total
What Money is Available to Spend?			
Total Resources	\$ 4,993,765	\$ 9,406,397	\$ 14,400,162
Less Amount Available but Not Agreed to be Spent	221,119	2,491,404	2,712,523
Less Amount Not Available to be Spent	641,782	2,278,063	2,919,845
Total Amounts Agreed to be Spent	\$ 4,130,864	\$ 4,636,930	\$ 8,767,794
	Budgetary	Nonbudgetary Financing	Total
How was the Money Spent?			
Administrative			
Salary & Benefits	\$ 413,408	\$ —	\$ 413,408
Grants	253,733	—	253,733
Contracts	122,310	—	122,310
Travel	20,082	—	20,082
Other	101,721	—	101,721
Surety Bonds Defaults	7,740	—	7,740
Business Direct			
Interest Paid to Treasury	133	6,442	6,575
Loans Direct	6,700	40,315	47,015
Other	239	796	1,035
Treasury Reestimate	—	2,977	2,977
Admin Program Fund	41,248	—	41,248
Subsidy Reestimate Program	5,329	—	5,329
Business Guaranty			
Interest Paid to Treasury	803	119,760	120,563
Loans Guaranteed	197,575	—	197,575
Other	610	121,900	122,510
Treasury Reestimate	—	862,836	862,836
Default Claims	1,057	2,750,484	2,751,541
Admin Program Fund	106,967	—	106,967
Subsidy Reestimate Program	2,503,848	—	2,503,848
Disaster			
Interest Paid to Treasury	410	309,320	309,730
Loans Direct	58,307	481,741	540,048
Other	19	9,765	9,784
Treasury Reestimate	—	2,486	2,486
Default Claims	—	—	—
Admin Program Fund	167,301	—	167,301
Subsidy Reestimate Program	158,703	—	158,703
Total Spending	4,168,243	4,708,822	8,877,065
Amounts Remaining to be Spent	(37,379)	(71,892)	(109,271)
Total Amounts Agreed to be Spent	\$ 4,130,864	\$ 4,636,930	\$ 8,767,794

OIG Report on the Most Serious Management and Performance Challenges

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

Report No. 13-02

*Report on the Most Serious Management and
Performance Challenges
Facing the Small Business Administration
In Fiscal Year 2013*

October 15, 2012



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

October 15, 2012

MEMORANDUM

TO: Karen G. Mills
Administrator

FROM: Peggy E. Gustafson
Inspector General

A handwritten signature in black ink, appearing to read "Peggy E. Gustafson".

SUBJECT: Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2013

In accordance with the Reports Consolidation Act of 2000, we are providing you with the Office of Inspector General's (OIG) Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration (SBA) in Fiscal Year (FY) 2013.

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 the SBA reported as of September 30, 2012.

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 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, 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 fiscal years (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 Most Serious Management and Performance Challenges Facing the SBA in FY 2013.

Table 1: Summary of the Most Serious Management and Performance Challenges Facing the SBA in FY 2013

		Color Scores					
		Status at End of FY 2012				Change from Prior Year	
	Challenge	Green	Yellow	Orange	Red	Up ↑	Down ↓
1	Small Business Contracting	1		2		1	
2	IT Security		3	2			
3	Human Capital		1	3		1	
4	Loan Guaranty Purchase		1				
5	Lender Oversight	1	1	1		1	
6	8(a) Business Development Program		1	1	1		
7	Loan Agent Fraud	1	1			1	
8	Loan Management and Accounting System		1		3	1	3
9	Improper Payments – 7(a) program		2	2		1	
10	Improper Payments – Disaster Loan program		1				
11	Acquisition Management (NEW)						
	TOTAL	3	12	11	4	6	3

We would like to thank the 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 the SBA's leadership team in addressing the Agency's Management Challenges.

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

Previous OIG audits and other governmental studies have shown widespread misreporting by procuring agencies since many contract awards that were reported as having gone 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. The SBA needs to ensure that contracting personnel are adequately trained on small business procurement and are reviewing this database prior to awarding contracts.

The SBA also needs to address a loophole within General Services Administration (GSA) Multiple Awards Schedule (MAS) contracts, which 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.

The SBA made limited progress on this challenge. In FY 2012, the SBA progressed to a “Green” rating to provide reasonable assurance that agencies are providing small business contracting training to acquisition personnel. As part of the training requirements for Level I, II, and III contracting officer certifications, course curricula includes training on aspects of small business programs. The SBA also introduced a revised checklist for conducting surveillance reviews, and submitted for clearance a revised Standard Operating Procedure (SOP) to ensure consistency in conducting its surveillance reviews. The SBA also obtained comments on a proposed rule that would provide a contracting officer multiple options for assigning codes on a multiple award contract and is currently drafting a final rule for assigning industrial codes on multiple award contracts.

Challenge History Fiscal Year (FY) Issued: 2005	Actions Accomplished (Green Status) during Past 4 FYs			
	08-1	09-0	10-0	11-1
Recommended Actions for FY 2013				Status at end of FY 2012
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.				Green ↑
2. Revise the surveillance review process to ensure that they are conducted in a thorough and consistent manner				Orange
3. 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. <i>(Previously action 3)</i>				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. The SBA's computer security program operates in a dynamic and highly decentralized environment, and requires management's attention and resources as weaknesses are identified.

The SBA improved in information system security in some critical areas during FY 2012. For example, the Chief Information Security Officer instituted a review of all Plan of Action and Milestones (POA&M) for SBA IT systems and began the acquisition of an application to manage SBA's IT systems. Vulnerability Assessment Team procedures were implemented to timely identify, prioritize and remediate critical issues.

To show further progress, the SBA needs to address both known and newly reported information security issues. For example, the 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. The SBA has improved in some areas; however, fieldwork for the FY 2012 Financial Statement Audit has identified new weaknesses and findings and is anticipated for the FY 2012 Federal Information Security Management Act (FISMA) review.

Challenge History Fiscal Year (FY) Issued: 1999	Actions Accomplished (Green Status) during Past 4 FYs			
	08-2	09-0	10-0	11-0
Recommended Actions for FY 2013				Status at end of FY 2012
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.				Yellow

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

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

The SBA has experienced downsizing, high turnover, reorganizations, and realignments over the last several years. In FY 2010, the SBA experienced significant turnover in the Office of Human Capital Management (OHCM) which seriously impacted the level and scope of services provided to the Agency. In October 2011, the U.S. Office of Personnel Management (OPM) completed a review that identified weaknesses in the SBA's human capital policies and practices that highlight the serious human capital challenges facing the Agency.

In late FY 2011, OHCM restructured and the Office of Human Resources Solutions (OHRS) was established. During FY 2012, as part of its effort to restructure and address these issues, the SBA issued its Strategic Human Capital Plan (SHCP) for FYs 2013 – 2016 that reflects a partnership between Program Offices and Human Resources. The SHCP is designed to support the goals identified in the SBA's Strategic Plan, which is aimed at aligning human capital programs with the Agency's mission, goals, and objectives. Further, the SHCP incorporates the OIG's recommended actions from the Management Challenges report with timeframes for implementation.

The SBA demonstrated progress in FY 2012, by aligning current staff according to their competencies, verifying current full-time equivalent (FTE) allocations for programs and offices, and establishing new FTE ceilings based on workload analysis protocol between OHRS and Program Offices. The SBA also completed an impact study of retirement projections, and continued efforts toward recruiting, hiring, and retaining people with critical skills. OHRS has been proactive in making needed improvements; however, continued progress is needed to complete the OIG's recommended actions.

The results of Federal Human Capital Surveys—now called the Employee Viewpoint Survey (EVS)—also have highlighted SBA's serious human capital challenges. The 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 these indices. In addition, the SBA was ranked 28th out of 33 large agencies in the Partnership for Public Service's 2011 "Best Places to Work" rankings. The 2012 EVS scores and ranking were not available in time for this report.

Challenge History Fiscal Year (FY) Issued: 2001 (Revised 2007)	Actions Accomplished (Green Status) during Past 4 FYs			
	08-0	09-0	10-0	11-0
Recommended Actions for FY 2013				Status at end Of FY 2012
1. Ensure the Agency has an effective, comprehensive workforce and succession plan that align talent needs and capabilities with SBA's FY 2011-2016 Strategic Plan. The 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.				Orange ↑
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.				Orange
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.				Orange
4. Take steps to correct problems identified in the 2010 EVS. Demonstrate improvement by increasing overall scores/Agency rankings in the 2011 EVS.				Yellow

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

Challenge 4. The SBA needs to implement a quality control program in its loan centers.

The initial focus of this challenge was on improving deficiencies identified in the SBA's 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 control.

The Office of Financial Program Operations (OFPO) has made significant progress in developing a Quality Control (QC) program for all of its loan centers to verify and document compliance with the loan process.

The QC program will assess the loan process from origination to close-out to identify where material deficiencies may exist so that remedial action can be taken. A project guide for the QC program has been developed and agreed upon by relevant parties within the Office of Capital Access. The QC program will assess the overall quality of the centers' deliverables to provide confidence to its stakeholders. The SBA hired a QC manager to oversee the development of the program and established QC specialist positions for each center. Furthermore, the SBA (1) developed and documented Quality Program Manuals for each center, (2) updated checklists for each critical center function and, (3) refined feedback, training, and reporting processes.

While the SBA has made substantial progress in its development of a quality control program, additional work remains before the SBA can demonstrate that all elements of the QC program are being completed and that the program is effective at identifying and correcting material deficiencies. For example, an ongoing audit of the SBA's FY 2011 improper payment rate in the 7(a) loan guaranty purchase program found that improper payment reviews led by the QC teams did not detect a high number of material improper payments. Additionally, the audit determined that some QC specialists responsible for reviewing the loans were either unfamiliar with or misinterpreted Agency policies, and applied internal guidance that conflicted with Agency policies and procedures. In order to demonstrate that the QC program has been fully implemented, the SBA will need to provide the results of QC reviews and other evidence to demonstrate that the reviews are effective at identifying and correcting material deficiencies.

Challenge History Fiscal Year (FY) Issued: 2007	Actions Accomplished (Green Status) during Past 4 FYs			
	08-2	09-0	10-1	11-0
Remaining Recommended Actions for FY 2013				Status at end of FY 2012
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. The SBA needs to further strengthen its oversight of lending participants

Since its inception in 1953, the SBA has loaned or guaranteed billions of dollars to finance and spur investment in small businesses. In FY 2011, approximately 51 percent of loan dollars guaranteed by the SBA were made using delegated authorities with limited oversight. Prior Office of Inspector General (OIG) and Government Accountability Office reports disclosed weaknesses in the SBA's oversight of its lending participants. In a September 2012 audit report, the OIG found that during its onsite reviews, the SBA did not always recognize the significance of lender weaknesses and determine the risks they posed to the Agency. Additionally, the SBA did not link the risks associated with the weaknesses to the lenders' corresponding risk ratings and assessments of operations. Further, the SBA did not require lenders to correct performance problems that could have exposed the Agency to unacceptable levels of financial risk. The risks inherent in delegated lending require an effective oversight program to (1) monitor compliance with SBA policies and procedures, and (2) take corrective actions when a material non-compliance is detected.

Since this management challenge was created in 2001, the SBA has made significant progress in its oversight of lending participants. In FY 2012, the SBA expanded its review selection criteria to include portfolio size, risk ratings, high growth, credit quality of new loans, and projected purchased rate of existing portfolio. Furthermore, the SBA drafted a new composite risk measurement protocol to assess lender performance, asset and liability management, compliance with program requirements, risk mitigation, and other factors.

In FY 2012, the SBA also fully implemented guidance for effective supervision and enforcement by taking one enforcement action and several supervisory actions, while also preparing for others.

Although the Agency has made progress, it needs to demonstrate that onsite reviews are conducted on the highest risk lending participants, which are selected for review based on its expanded selection criteria.

The SBA also needs to demonstrate that it tailors onsite reviews to determine the root cause of the risks in a participant's portfolio. Furthermore, the Agency needs to ensure that corrective actions are required for material non-compliances and monitored for implementation and effective resolution.

Challenge History Fiscal Year (FY) Issued: 2001	Actions Accomplished (Green Status) during Past 4 FYs			
	08-7(a)-2 08-504-2	09-7(a)-0 09-504-0	10-7(a)-0 10-504-0	11-7(a)-0 11-504-0
Recommended Actions for FY 2013				Status at end of FY 2012
				7(a) 504
1. Expand the scope of lender oversight and improve the process for reviewing lenders and Certified Development Companies.				Yellow Yellow
2. Implement guidance providing for effective supervision and enforcement.				Green ↑ Green ↑
3. Monitor and verify implementation of corrective actions to ensure effective resolution prior to close-out.				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 the SBA ensures that firms follow 8(a) regulations when completing contracts.

The SBA's 8(a) Business Development (BD) program was created to assist eligible small disadvantaged business concerns 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.

The SBA had made progress towards addressing issues that hinder the Agency's ability to deliver an effective 8(a) program. For example, the 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. These revised 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. In December 2011, the SBA awarded a contract to develop and deploy a new system by December 2012 to assist SBA employees in monitoring 8(a) program participants. However, the SBA has delayed deployment of the new system until January 2013.

Challenge History Fiscal Year (FY) Issued: 2003	Actions Accomplished (Green Status) during Past 4 FYs			
	08-1	09-1	10-0	11-0
Recommended Actions for FY 2013				Status at end of FY 2012
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.				Orange
2. Develop and implement Regulations and SOP provisions to ensure that participants are graduated once they reach the levels defined as business success.				Yellow
3. Establish objective and reasonable criteria that effectively measures "economic disadvantage" and implement the new criteria.				Red

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 years, OIG investigations have revealed a pattern of fraud by loan packagers and other for-fee agents in the 7(a) loan guaranty program. These schemes have involved hundreds of millions of dollars, yet SBA's 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, the SBA has proposed various methods of tracking loan agent activity. After attempting and then rejecting various initiatives during Fiscal Years (FYs) 2007 through 2009, during FY 2010, the SBA advised that it would capture the data by having lenders fax the Form 159 (Fee Disclosure Form and Compensation Agreement for Agency Services) to the SBA's Fiscal and Transfer Agent (FTA). At the end of FY 2010, the SBA issued a Notice with instructions on how lenders were to submit this data. During FY 2011, the Agency provided additional guidance to lenders on how to submit Form 159 data (including loan identification numbers) to the FTA, and updated loan review guidance so that the Office of Credit Risk Management (OCRM) could identify loan agent-related problems. The SBA also issued the loan agent data collection requirement as permanent guidance in SOP 50 10 effective October 1, 2011. During FY 2012, the Agency made additional progress by beginning to link Form 159 information with its loan data. Although the SBA continues to experience problems with data completeness and categorization, data quality is steadily improving. Moreover, the SBA is considering implementing a registration system that would assign identifying numbers to registered loan agents, thus enhancing its tracking capability.

Loan Agent Enforcement Procedures. In FY 2007, the Agency made progress by issuing SOP 51 00 that contained procedures for reviewing loan agent information during onsite reviews and examinations and by revising the guaranty purchase checklist (which lists the records that lenders need to provide when requesting the 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, the SBA issued the Lender Supervision and Enforcement SOP 50 53 with provisions for enforcement actions against loan agents and a delegation of authority to undertake these actions to the Director of OCRM. A revised version of that SOP with improved procedures went into effect on June 1, 2012. At the end of FY 2012, the Agency updated its website to notify lenders of those loan agents that had been the subject of enforcement actions.

Challenge History Fiscal Year (FY) Issued: 2000	Actions Accomplished (Green Status) during Past 4 FYs			
	08-1	09-00	10-0-	11-0
Recommended Actions for FY 2013				Status at end of FY 2012
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.				Green ↑

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, the 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. An [OIG report](#) in 2005 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.

In 2010, the Office of Management and Budget (OMB) issued [Memorandum 10-26](#), recommending that Federal agencies split large-scale modernization efforts into smaller, simpler segments with clear deliverables. In response, the 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. This strategy separated LMAS into seven Incremental Improvement Projects (IIP). In addition, the SBA created a new Standard Operating Procedure (SOP) to provide guidance for its IT Quality Assurance (QA) program. However, to show further progress, the SBA needs to implement its QA/Independent Verification and Validation (IV&V) process that encompasses all of the requirements of its enterprise SDM, and provides sufficient evidence that all LMAS work products undergo IV&V activities in accordance with the Agency's Enterprise Quality Assurance Plan.

Previous OIG and GAO reports on the LMAS identified concerns about SBA's management of the project and the project's noncompliance with the Agency's System Development Methodology (SDM) in key areas, which impacted SBA's ability to control project costs and quality; and the lack of an enterprise-wide or project-level Quality Assurance (QA) functions to ensure that LMAS deliverables met SBA's requirements and quality standards.

In 2012, the SBA upgraded its Oracle accounting software, and implemented a number of web-based user interface screens to initiate migration from the mainframe and is currently migrating its mainframe COBOL computer code to a more modern platform. Also, in 2012, the SBA did not deploy an independent QA and IV&V entity to ensure that LMAS deliverables meet SBA requirements and quality standards. These needs were identified in previous OIG and GAO LMAS audit reports.

Challenge History Fiscal Year (FY) Issued: 2010	Actions Accomplished (Green Status) during Past 4 FYs			
	N/A	N/A	10-0	11
Recommended Actions for FY 2013				Status at end of
1. Migrate LAS to a new operating platform before the current mainframe contract expires in 2013.				Yellow ↑
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.				Red ↓
3. Establish a process for reviewing and accepting LMAS deliverables that complies with Quality Assurance and Systems Development Methodology requirements. This includes hiring or fully staffing an IV&V entity to validate deliverable acceptance.				Red ↓
4. Implement a Quality Assurance process in LMAS in accordance with SBA's Enterprise Quality Assurance Plan.				Red ↓

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

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

Previous OIG audits have determined that the SBA's reported improper payment rates for 7(a) loan approvals and purchases were significantly understated. In FY 2011, the SBA reported no improper payments for 7(a) loan approvals. However, 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. This resulted in at least \$869.5 million in inappropriate or unsupported loan approvals. Furthermore, in FY 2011, the SBA reported that the improper payment rate for 7(a) purchases was 1.73-percent, or \$40.7 million, when the rate could have been as high as 20-percent, or about \$472 million. The 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. The SBA also has not aggressively pursued recovery of 7(a) improper payments.

Earlier OIG audits identified 7(a) loans that were not properly closed, or were made to borrowers who were ineligible or who lacked repayment ability. In 2012, we reported that the limited reviews of lender underwriting performed at guaranty purchase on early defaulted loans were not consistent with statutory and regulatory authority and were contrary to SBA procedures, resulting in improper payments. We also reported that high-dollar early-defaulted loans were not reviewed with the scrutiny required to identify improper payments at guaranty purchase.

The Office of Capital Access (OCA) has taken actions to correct many of the deficiencies identified by the OIG. The OCA has (1) acquired a statistician and revised its improper payment sampling methodology; (2) improved and formalized its improper payment review process for 7(a) loan approvals and 7(a) loan purchases; and (3) revised and formalized its process to review disputed denial, repair, and improper payment decisions. The OCA has also improved the scrutiny applied to high-dollar early-defaulted loans by requiring every loan to receive a quality control review prior to purchase. However, additional actions are needed to accurately report, significantly reduce, and recover improper payments. The OCA needs to incorporate the improper payment recovery process into formal policy. Additionally, the OCA needs to establish repayment ability review requirements to be applied at guaranty purchase, develop a corrective action plan for 7(a) loan approvals, and demonstrate that its corrective action plan for 7(a) loan purchases is effective in reducing improper payments.

Challenge History Fiscal Year (FY) Issued: 2010	Actions Accomplished (Green Status) during Past 4 FYs			
	N/A	N/A	N/A	11-0
Recommended Actions for FY 2013			Status at end of FY 2012	
			7(a) Approvals	7(a) Purchases
1. Ensure that processes used to calculate the improper payment rates for 7(a) loan approvals and purchases are designed and implemented to effectively identify improper payments as defined by Office of Management and Budget (OMB) Circular A-123.			Yellow ↑	Yellow ↑
2. Reassign responsibility for final approval of disputed denial, repair, and improper payment decisions from the Office of Financial Assistance (OFA) to the Office of Credit Risk Management (OCRM) to ensure an adequate and timely resolution of disputes.			N/A	Yellow
3. Establish a process and time standards to expeditiously recover improper payments identified during Agency reviews and OIG audits.			N/A	Orange
4. Demonstrate that corrective action plans are effective in reducing improper payments in the 7(a) loan program.			Orange	Orange
Green - Implemented Yellow - Substantial Progress Orange - Limited Progress Red - No Progress				

Challenge 10. The SBA Needs to Significantly Reduce Improper Payments in the Disaster Loan Program.

Previous OIG audits of the SBA's Disaster Loan program determined that the improper payment rates reported for this program were significantly understated. The 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. The 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 the program.

Previously, management challenge 9, "SBA needs to accurately report, significantly reduce, and strengthen efforts to recover improper payments in the Disaster and 7(a) loan programs," included both the Disaster Loan program and 7(a) program. There were three recommended actions applicable to the Disaster Assistance Program. Of the three recommended actions, one was implemented during FY 2010 and the two remaining actions were implemented during FY 2011. One recommended action was to develop and implement a corrective action plan to reduce improper payments. Although the Office of Disaster Assistance (ODA) implemented the recommended action, the Agency has not achieved its reduction targets since implementation. Specifically, the Agency missed its target goals of 16.7 percent for FY 2010 and 20.0 percent for FY 2011, instead reporting rates of 34.2 and 28.4 percent, respectively. The target goals in the FY 2011 Agency Financial Report are 20 percent for FY 2012, 17 percent for FY 2013, and 15 percent for FY 2014.

At the end of FY 2011, a new recommended action was added requiring the SBA to demonstrate that the corrective action plan is effective in reducing improper payments in the Disaster Assistance Program.

The Agency has implemented an improved corrective action plan that specifically addresses root causes and provides specific remedies, such as targeted training and inclusion of improper payments in personal business commitment plans for employees. If properly implemented, we believe this course of action should effectively reduce the rate in future years. The Agency's internal improper payment assessment for FY 2012 indicated a rate of 17.9 percent. This rate is lower than the 20 percent target necessary to achieve a rating of Yellow. Therefore, the color status for FY 2012 is Yellow.

Challenge History Fiscal Year (FY) Issued: 2012	Actions Accomplished (Green Status) during Past 4 FYs			
	N/A	N/A	N/A	NEW
Remaining Recommended Actions for FY 2013				Status at end of FY 2012
1. Demonstrate that corrective action plans are effective in reducing improper payments in the Disaster Loan program.				Yellow

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

Challenge 11: The SBA Needs to Effectively Manage the Acquisition Program

In October 2010, the SBA realigned its acquisition program to address several significant deficiencies that included high staff turnover; compliance with laws and regulations; application of funding principles; training and certification of key contracting personnel; contractor oversight, and measuring performance through validated metrics. Since realignment, the SBA has provided training to, and increased the number of, acquisition staff. Our recent audit work and familiarity with SBA's current acquisition activities indicate that while improvements are in process, continuing challenges exist, including (1) poorly defined requirements, (2) internal control deficiencies, (3) improper funding of contracts, (4) inadequate oversight, and (5) outdated and incomplete SOPs related to acquisition.

For example, the SBA inadequately defined its requirements in its acquisition plan for the procurement of information systems and IT hardware and software. In addition, the SBA's contract management system PRISM does not fully interface with the Agency's current financial system JAAMS, exposing an internal control deficiency. The SBA improperly funded contracts by violating the bona fide needs rule for procuring IT hardware and software as well as reported an improper payments rate. Likewise, the SBA inadequately monitored contracts to ensure products and services were delivered in accordance with contract requirements. Furthermore, the SBA's acquisition SOP is outdated; however, the SBA's management plans to hire a contractor to update its SOP. Finally, the SBA has not conducted an internal control review of its acquisition functions consistent with the OMB requirements prior to this year, but is currently in the process of completing its assessment. Whether this assessment will fully address the four key acquisition management areas identified in OMB's *Assessment Guidelines for Assessing the Acquisition Function* will have to be determined.

Agency managers are required by OMB Circular A-123, *Managements Responsibility for Internal Control* to continuously monitor and improve the effectiveness of agency internal controls. However, the problems discussed above indicate continuing systemic acquisition management issues for the SBA. Therefore, the SBA still needs to better prepare its acquisition workforce for proper procurement planning, monitoring of contractor performance, and conducting effective contract administration.

Challenge History Fiscal Year (FY) Issued: 2013	Actions Accomplished (Green Status) during Past 4 FYs			
	N/A	N/A	N/A	NEW
Recommended Actions for FY 2013				Status at end of FY 2012
1. Complete an assessment of the Agency's acquisition activities using the OMB's <i>Guidelines for Assessing the Acquisition Function</i> .				New
2. Create and implement a comprehensive improvement plan — based on the results of the acquisition function assessment — that has measurable goals, objectives, prioritized actions and timeframes to address deficiencies identified in the organizational alignment and leadership assessment area.				New
3. Create and implement a comprehensive improvement plan — based on the results of the acquisition function assessment — that has measurable goals, objectives, prioritized actions and timeframes to address deficiencies identified in the acquisition policies and processes assessment area (i.e. acquisition management SOP).				New

4. Create and implement a comprehensive improvement plan — based on the results of the acquisition function assessment — that has measurable goals, objectives, prioritized actions and timeframes to address deficiencies identified in the acquisition workforce assessment area.	New
5. Create and implement a comprehensive improvement plan — based on the results of the acquisition function assessment — that has measurable goals, objectives, prioritized actions and timeframes to address deficiencies identified in the knowledge management and information systems assessment area.	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. Armendáriz, 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 FY 2008 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 2011*
- 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, *A Detailed Repayment Ability Analysis is Needed on High-Dollar Early-Defaulted Loans to Prevent Future Improper Payments*, Report 12-18, August 16, 2012
- SBA OIG, *High-Dollar Early-Defaulted Loans Require an Increased Degree of Scrutiny and Improved Quality Control at the National Guaranty Purchase Center*, Report 12-11R, March 23, 2012
- SBA OIG, *SBA Generally Meets IPERA Reporting Guidance but Immediate Attention Is Needed to Prevent and Reduce Improper Payments*, Report 12-10, March 15, 2012.
- SBA OIG, *Origination and Closing Deficiencies Identified In 7(a) Recovery Act Loan Approvals*, ROM 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*, ROM 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*, ROM 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*, ROM 11-03, March 2, 2011
- SBA OIG, *Material Deficiencies Identified in Early-Defaulted and Early-Problem Recovery Act Loans*, ROM 10-19, September 24, 2010
- SBA OIG, *SBA's Management of the Backlog of Post-purchase Reviews at the National Guaranty Purchase Center*, Report 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*, Report 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*, Report 9-08, January 30, 2009
- SBA OIG, *Audit of Six SBA Guaranteed Loans*, Report 8-18, September 8, 2008

- SBA OIG, *Audit of Loan Classifications and Overpayments on Secondary Market Loans*, [Report 8-09](#), March 26, 2008
- SBA OIG, *Audit of UPS Capital Business Credit's Compliance with Selected 7(a) Lending Requirements*, [Report 8-08](#), March 21, 2008
- SBA OIG, *Audit of the Guaranty Purchase Process for Section 7(a) Loans at the National Guaranty Purchase Center*, [Report 7-23](#), May 8, 2007
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 7-17](#), March 12, 2007
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 7-15](#), February 12, 2007
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 7-10](#), January 16, 2007
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 7-09](#), January 9, 2007
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 7-07](#), December 29, 2006
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 7-06](#), December 28, 2006
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 7-05](#), December 20, 2006
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 7-02](#), October 23, 2006
- 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, *Audit of an SBA Guaranteed Loan*, [Report 6-22](#), May 17, 2006
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 6-17](#), March 20, 2006
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 6-16](#), March 20, 2006
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 6-14](#), March 2, 2006
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 5-26](#), September 28, 2005
- SBA OIG, *Audit of an SBA Guaranteed Loan*, [Report 5-21](#), July 15, 2005
- 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 an Early Defaulted Loan*, [Report 4-38](#), August 24, 2004
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 4-33](#), July 30, 2004
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 4-28](#), July 9, 2004
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 4-25](#), June 22, 2004
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 4-06](#), January 8, 2004
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 3-38](#), September 22, 2003
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 3-30](#), June 19, 2003
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 3-27](#), May 22, 2003
- SBA OIG, *Audit of the Guaranty Purchase Process*, [Report 3-15](#), March 17, 2003
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 3-07](#), January 23, 2003
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 2-32](#), September 30, 2002
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 2-30](#), September 24, 2002
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 2-23](#), August 7, 2002
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 2-15](#), March 29, 2002
- SBA OIG, *Improvements are Needed in Small Business Lending Company Oversight Process*, [Report 2-12](#), March 21, 2002
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 2-03](#), February 27, 2002
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 2-05](#), February 27, 2002
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 1-10](#), March 9, 2001
- GAO, *Major Management Challenges and Program Risks*, GAO-01-260, January 2001
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 0-10](#), April 23, 2000
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 0-12](#), March 28, 2000
- SBA OIG, *Audit of an Early Defaulted Loan*, [Report 0-05](#), February 14, 2000

Challenge 5:

- SBA OIG, *Addressing Performance Problems of High-Risk Lenders Remains a Challenge for the Small Business Administration*, [Report 12-20R](#), September 28, 2012
- 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
- SBA OIG, *Operation Clean sweep*, Memorandum, August 21, 1996

Challenge 8:

- SBA OIG, *Adequacy of Quality Assurance Oversight of the Loan Management and Accounting System Project*, [Report 10-14](#), September 13, 2010
- SBA OIG, *Review of Allegations Concerning How the Loan Management and Accounting System Modernization Project is Being Managed*, [Report 9-17](#), July 30, 2009
- SBA OIG, *Planning for the Loan Management and Accounting System Modernization and Development Effort*, Report 8-13, May 14, 2008

- SBA OIG, *SBA Needs to Implement a Viable Solution to its Loan Accounting System Migration Problem*, [Report 5-29](#), September 20, 2005
- GAO, *Information Technology: Agencies Need to Improve the Accuracy and Reliability of Investment Information*, GAO-06-250, January 12, 2006
- GAO, *Major Management Challenges and Program Risks: Small Business Administration*, GAO-03-116, January 1, 2003
- GAO, *SBA Loan Monitoring System: Substantial Progress Yet Key Risks and Challenges Remain*, Testimony of Joel C. Willemssen, Director, Civil Agencies Information Systems Accounting and Information Management Division, Before the Subcommittee on Government Programs Statement Committee on Small Business, House of Representatives, GAO/T-AIMD-00-113, February 29, 2000
- GAO, *SBA Needs to Establish Policies and Procedures for Key IT Processes, Accounting and Information Management Division*, GAO/AIMD-00-170, May 31, 2000

Challenge 9:

- SBA OIG, *A Detailed Repayment Ability Analysis is Needed on High-Dollar Early-Defaulted Loans to Prevent Future Improper Payments*, [Report 12-18](#), August 16, 2012
- SBA OIG, *High-Dollar Early-Defaulted Loans Require an Increased Degree of Scrutiny and Improved Quality Control at the National Guaranty Purchase Center*, [Report 12-11R](#), March 23, 2012
- SBA OIG, *SBA Generally Meets IPERA Reporting Guidance but Immediate Attention Is Needed to Prevent and Reduce Improper Payments*, [Report 12-10](#), March 15, 2012.
- SBA OIG, *Origination and Closing Deficiencies Identified In 7(a) Recovery Act Loan Approvals*, [ROM 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*, [ROM 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*, [ROM 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*, [ROM 11-03](#), March 2, 2011
- SBA OIG, *Material Deficiencies Identified in Early-Defaulted and Early-Problem Recovery Act Loans*, [ROM 10-19](#), September 24, 2010
- SBA OIG, *SBA's Management of the Backlog of Post-Purchase Reviews at the National Guaranty Purchase Center*, [Report 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*, [Report 9-16](#), July 10, 2009
- SBA OIG, *Audit of Borrower Eligibility for Gulf Coast Disaster Loans*, [Report 9-09](#), March 31, 2009
- SBA OIG, *The Small Business Administration's Fiscal Year 2007 Improper Payment Rate for the Disaster Loan Program*, [Report 9-10](#), March 26, 2009
- SBA OIG, *Audit of the Liquidation Process at the National Guaranty Purchase Center*, [Report 9-08](#), January 30, 2009
- SBA OIG, *The Use of Proceeds From Gulf Coast Disaster Loans*, [Report 9-06](#), January 15, 2009
- SBA OIG, *Disaster Loss Verification Process*, [Report 8-15](#), June 17, 2008
- SBA OIG, *Review of the Adequacy of Supporting Documentation for Disbursements*, [Report 8-07](#), January 29, 2008
- SBA OIG, *The Quality of Loans Processed Under the Expedited Disaster Loan Program*, [Report 7-34](#), September 28, 2007
- SBA OIG, *SBA's Quality Assurance Reviews of Loss Verifications*, [Report 7-29](#), July 23, 2007

- SBA OIG, *Securing Collateral for Disaster Loan Disbursements*, Report 7-22, May 9, 2007

Challenge 10:

- SBA OIG, *Origination and Closing Deficiencies Identified In 7(a) Recovery Act Loan Approvals*, ROM 11-07, September 30, 2011

Challenge 11:

- SBA, OIG, *The Small Business Administration's Process Could Lead to Possible Anti-Deficiency Act Violations*, Report 12-22, September 28, 2012
- SBA, OIG, *The Small Business Administration's Inappropriate Use of the Government Purchase Card for Construction Purchases*, Report 12-16, August 6, 2012
- SBA OIG, *The SBA's Improper Payment Review and Reporting for its Contracting Activities did not Comply with IPERA and IPIA Requirements During FY 2011*, Report 12-07, March 8, 2012
- SBA OIG, *Small Business Administration's Funding of Information Technology Contracts Awarded to Isika Technologies, Inc.*, Report 11-14, June 2, 2011
- SBA OIG, *SBA's Procurement of Information Technology Hardware and Software through Isika Technologies, Inc.*, Report 11-08, February 25, 2011
- SBA OIG, *SBA's Planning and Award of the Customer Relationship Management Contracts*, ROM 10-16, June 29, 2010
- SBA OIG, *SBA's Efforts to Improve the Quality of Acquisition Data in the Federal Procurement Data System*, Report 10-08, February 26, 2010
- SBA OIG, *Adequacy of Procurement Staffing and Oversight of Contractors Supporting the Procurement Function*, ROM 10-13, April 9, 2010
- SBA OIG, *Office of Business Operations Contracting Personnel Qualifications and Warrant Authority*, Report 9-14, July 6, 2009

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As part of the **Start-Up America** initiative, over the next five years, the SBA will commit \$2 billion as a match to private sector investment in promising high-growth companies. Using existing authority, with no new cost to taxpayers, and the operating infrastructure of the Small Business Investment Company program SBA guaranteed bonds will match private capital raised by these privately-owned and managed investment funds and serve as a catalyst for accelerating capital support for startups and high-growth firms.

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

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					

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 2012, there were 116 Final Actions, resulting from 15 monetary and 101 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 the SBA's final action activity for FY 2012. 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, 2011 – SEPTEMBER 30, 2012**

	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.	12	\$11,231
B. Recommendations on which management decisions were made during the period.	7	5,879
C. Total recommendations pending final action during period.	19	\$17,110
D. Recommendations on which final action was taken during the period.		
1. Recoveries:		
(a) Collections and Offsets	10	\$4,718
(b) Property		
(c) Other	4	5,251
2. Write-Offs	1	3,631
3. Total	15	\$13,600
E. Recommendations needing final action at the end of the period.	4	\$3,510

**TABLE 2 FINAL ACTION ON AUDIT RECOMMENDATIONS WITH FUNDS PUT TO BETTER USE
OCTOBER 1, 2011 – SEPTEMBER 30, 2012**

	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.	4	\$54,242
B. Recommendations on which management decisions were made during the period.	2	7,700
C. Total recommendations pending final action during period.	6	\$61,942
D. Recommendations on which final action was taken during the period.		
1. Value of recommendations implemented (completed).		
2. Value of recommendations that management concluded should not or could not be implemented or completed.		
3. Total	0	\$0
E. Recommendations needing final action at the end of the period.	6	\$61,942

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know*



The SBA's **Regional Cluster** initiative helps develop and grow regional economies and promote small business growth across the country. During year one (September 2010 – September 2011), the Cluster initiative increased small business participation in 10 regional economies, known as “clusters,” by over 275 percent. Small business participants in the clusters grew from 179 to 672 during the first year.

Improper Payments

Improper Payments

As required by the Improper Payment Information Act of 2002 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 for FY 2012. A significant improper payment is defined as a payment in any one program that exceeds either 2.5 percent of program payments and \$10 million annually or that exceeds \$100 million (regardless of the improper payment percentage of total program payments).

Risk Assessment

OMB Circular A-123 requires risk assessments at least once every three years for programs not deemed risk susceptible. The circular also requires risk assessments when a significant change in legislation and/or a significant increase in funding levels occur. With the passage of IPERA, the SBA was required to assess all programs and activities in FY 2011 for susceptibility to significant improper payments. During FY 2012, no significant changes occurred to any SBA program or activity to warrant conducting any new risk assessments.

Three of 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 program
2. 504 Certified Development Company loan guaranty program
3. Disaster loan program

For the fourth major credit program, Small Business Investment Company program, the SBA obtained approval from OMB for relief from reporting due to the low occurrence of improper payments determined by several years' review and low probability for improper payments as determined by the FY 2011 risk assessment.

The SBA also identified disbursements for goods and services in its FY 2011 assessment of activities suscep-

tible to significant improper payments and included it in the Improper Payments program in FY 2012.

Statistical Sampling

The statistical sampling processes used in FY 2012 were unchanged from those used in FY 2011; however, test programs were changed for the 7(a) and 504/CDC loan guaranty programs to promote a more in-depth review. Changes were also made to the disbursements related to contracting activities to promote a more effective review.

The 7(a) and 504/CDC populations contain loan types that are not homogeneous and exhibit skewed distributions in loan size. That is, large loans constitute a relatively smaller percentage of the populations by count but a relatively larger percentage by dollar amount. Therefore, the SBA stratified the data on several key variables and used a sampling method known as Probability Proportional to Size (PPS) sampling with replacement. This is a sampling technique in which the probability that a particular loan will be selected for the sample is proportional to the population size of the corresponding strata. By using PPS, the SBA attempts to create a comprehensive sample that addresses the fact that different types of loans may have unequal improper payment probabilities.

7(a) loan guaranty purchase review sample cases were chosen using PPS sampling with replacement from all purchases approved during the 12 month period ended March 31, 2012. The purchase population was divided into four strata based on the following factors: (1) which servicing office processed the purchase, and (2) whether the loan was considered an early default, regardless of servicing office. Using the PPS approach, the SBA determined the appropriate total sample size to be 377 loans from the population. Using the Hansen-Hurwitz estimation method, the estimated improper payment rate for the 7(a) loan guaranty purchase population is 3.15 percent for the annual period ending March 31, 2012.

7(a) loan guaranty approval review sample cases were chosen using PPS sampling with replacement from all loan guaranties approved during the 12 month period ended March 31, 2012. The approval population was divided into two strata based on whether the loan was SBAExpress or not. The SBA determined the appropriate total sample size to be 111 loans from the

population. Using the Hansen-Hurwitz estimation method, the estimated improper payments rate for the annual period ending March 31, 2012 was calculated as 1.8 percent. The rate also was calculated using total approval amount (guaranteed and unguaranteed). This sample included improper payments of \$4,475,500 and the SBA estimated an improper payments rate of 2.71 percent for the annual period ending March 31, 2012.

The 7(a) loan guaranty purchase and approval reviews were conducted to examine whether the lender or the SBA complied materially with the 7(a) loan program origination requirements including statutory provisions, SBA regulations, any agreement the lender executed with the SBA, standard operating procedures, loan authorizations, and official SBA notices and forms applicable to the 7(a) loan program. The reviews were to determine if the lender or the SBA (1) originated, serviced, and liquidated the loan in a prudent and commercially reasonable manner, (2) misrepresented or failed to disclose a material fact to the SBA, and/or (3) put SBA's financial interest at risk.

504 CDC guaranty approval review sample cases were chosen using PPS sampling with replacement from all loan guaranties approved during the 12 month period ended March 31, 2012. Unlike FY 2011, the approval population was not stratified because there was no empirical evidence that multiple smaller strata increased the efficiency of the estimate. The SBA determined the appropriate total sample size to be 49 loans from the population. Using the Hansen-Hurwitz estimation method, the estimated improper payments rate for the annual period ending March 31, 2012 was calculated as 2.04 percent.

Disaster direct loans approved undergo a semi-annual Quality Assurance Review (QAR). As part of the QAR, disaster loans are sampled and examined for any deficiency that would result in an improper payment. The sample size is determined using statistical software and methods that follow widely accepted practices, and based on assumptions about the likely prevalence and severity of improper payments. A total of 500 randomly selected loans were reviewed with disbursements made during the 12 month period ended June 30, 2012. The total number of loans from the reference period is 19,478 and the total value of disbursements is \$509,181,000. The improper payment rate of 17.9 percent would reflect \$91,028,000 in improper payments for the reference period. The stated improper

payment rate does not truly reflect the potential that disaster loans are disbursed to disaster victims that are not eligible under the disaster direct loan program. The improper payments consisted of 99 disbursements out of the 500 disbursements reviewed. Of the 99 considered to be improper payments, 50 were for "paperwork" issues. The paperwork issues do not result in a disaster loan borrower's receiving any loan funds that they were not eligible to receive or have any impact on SBA's ability to collect on the disaster loans.

Disbursements for goods and services review samples were chosen using PPS with replacement for payments disbursed during the 12 months ended March 31, 2012. The total number of disbursements for the reference period is 7,622 and the total dollar amount is \$129,977,541. The SBA determined the appropriate total sample size to be 216 invoices with total outlays of \$46,858,387. The scope of the review covered three areas: invoice accuracy, compliance with contract terms and accuracy of invoice processing. Based upon the sample results, the estimated FY 2012 contracting improper payment rate is 9.6 percent for a total of \$12.1 million.

Corrective Action

The 7(a) loan and 504/CDC guaranty approval and 7(a) loan guaranty purchase improper payments programs identify and track the reasons for any improper payments discovered during the reviews and then appropriately adjust the loan making or purchase processes to reduce future errors in addition to making recoveries as appropriate.

The root cause for all identified improper payments for the 7(a) loan guaranty purchase, the 7(a) loan guaranty approval and 504 CDC guaranty approval programs were Administrative and Documentation Errors. The error rates were 3.15 percent for a total of \$44,084,477, 1.8 percent for a total of \$233,234,994 and 2.04 percent for a total of \$104,523,284, respectively. Neither Authentication nor Verification errors were found. Given the nature of SBA's programs and activities, Medical Necessity errors are not a possibility.

Improper payments generally arise from the failure of an approval or purchase processor to identify material lender deficiencies in the handling of an SBA guaranteed loan. Primary reasons for errors in approvals and 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;
- ineligible loan structures;
- 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) loan 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 Quality Improvement Program (QIP) process. A fully documented guaranty purchase procedure handbook is updated periodically. Remedial actions taken by the QIP 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 direct feedbacks; and
- supplement center resources where possible to ensure ongoing QIP 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.

Disaster direct loans substantially reduced the improper payment rate over the last fiscal year. The root cause of the actions that have resulted in the improper payments was that the processing and disbursement staff was not following the guidance provided in the SOP and policy memos. As a result,

the SBA expanded training efforts to include individual one-on-one training with the individuals identified in audits as either taking the action or approving the action that resulted in an improper payment. Additionally, the SBA added reduction of the improper payment rate to the personal business commitment plans of all the processing and disbursement staff at the processing and disbursement center (PDC) in Fort Worth, Texas. To ensure that reduction of improper payments remains a high priority, the PDC is establishing a team that will report directly to the center manager for the express purpose of identifying and correcting potential improper payments.

Disbursements related to contracting sample results demonstrate the SBA has made improvements in issues surrounding improper payments in both testing and processes. The estimated improper payment rate for contracting is 9.6 percent totaling \$12.5 million. The nature of errors found in the FY 2012 contracting improper payment review are administrative and documentation errors with the root causes being:

- inadequate comparison of the invoice to the contract to verify period of performance, labor rates and categories to ensure they agree;
- payment accuracy issues where the financial system was not updated with current (at the time of payment) information from the Central Contractor Registry (CCR) (now System for Award Management [SAM]);
- amounts paid were different than what was recommended for payment; and
- interest over-payments due to improper prompt payment data selection criteria.

Although recoveries will be made where appropriate, it is important to note that findings revealed no apparent significant overpayments or opportunities for recapture and that all payments correspond to valid goods and services received. To prevent the administrative and documentation errors noted in the improper payment review, the SBA has completed or plans to complete the following corrective actions in the coming year:

- training and re-training of Contracting Officers, Contracting Officer Representatives, and accounting personnel on required invoice information, and comparison of invoice to the contract;

- exploring the possibility of an interface between the CCR and the financial system to ensure the most current contractor information is available at the time of payment;
- implementing electronic invoice routing and approvals in the financial system; and
- adding data fields in the financial system to prevent payment of invoices outside the contract period of performance for contracts with actions occurring in 2nd quarter of FY 2012 forward.

Improper Payment Reporting

The table on this page presents SBA's Improper Payment program results for FY 2012.

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. Since the SBA does not conduct recapture audits, tables 2-5 from A-136 are not included in this report.

7(a) loan 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 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 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 tracks 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. This is a case-by-case determination that varies substantially

IMPROPER PAYMENT REDUCTION OUTLOOK (\$ IN MILLIONS)																	
Program	FY 2011 ¹ \$ Outlays	FY 2011 IP %	FY 2011 IP \$	FY 2012 ¹ \$ Outlays	FY 2012 IP %	FY 2012 IP \$	FY 2012 \$ Over- paid	FY 2011 Under- paid	FY 2013 ¹ \$ Outlays	FY 2013 IP %	FY 2013 IP \$	FY 2014 ¹ \$ Outlays	FY 2014 ¹ IP %	FY 2014 IP \$	FY 2015 \$ Outlays	FY 2015 ¹ IP %	FY 2015 IP \$
7(a) Guaranty Purchases ¹	2,355.6	1.73	40.7	1,398.4	3.2	44.0	44.0	0.0	2,000.0	2.0	40.0	1,800.0	1.5	27.0	1,600.0	1.0	16.0
7(a) Guaranty Approvals ^{1,2}	15,327.8	0	0	12,933.7	1.8	233.2	233.2	0.0	15,500.0	1.5	232.5	15,500.0	1.0	155.0	15,500.0	0.0	0.0
CDC Loans Guaranteed ¹	4,375.3	0	0	5,121.6	2.0	104.5	104.5	0.0	6,000.0	1.5	90.0	6,500.0	1.0	65.0	7,000.0	0.0	0.0
Disaster Loan Disbursements ¹	339.6	28.4	96.3	509.1	17.9	91.0	91.0	0.0	800.0	14.0	112.0	800.0	10.0	80.0	800.0	10.0	80.0
Contract Disbursements ³	133.4	N/A	N/A	130.0	9.6	12.5	12.5	0.0	130.0	4.6	6.0	130.0	2.3	3.0	130.0	1.0	1.3

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 re-estimates 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 guaranteed loans. Outlays for 7(a) Guaranty Approvals are the amount of new guaranty approvals by banks and other SBA lending partners. Outlays for CDC Loans Guaranteed 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. For 7(a) Guaranty Approvals, amounts reported are based on the Guaranteed Amount Only. When considering the Full Approval Amount the IP % is 2.7 and the IP \$ are 350.2.
3. The SBA identified contract disbursements as susceptible to significant improper payments in FY 2011. The SBA conducted a test of these payments that examined invoice processing, contracting and invoice payment.

depending on the circumstances of the loan making, servicing, purchases and liquidation.

Disaster direct loans would not benefit from a separate recapture audit. Based upon the results of the second portion of the program's semi-annual Quality Assurance Review, a separate recapture audit would not be cost-effective. The QAR team located in the PDC completed the review under the supervision of the Director of Program Policy and Evaluation in Washington, DC. The review identified 54 disbursements as improper payments totaling \$13,493,413. Of the improper payments, 20 disbursements totaling \$4,278,500 were for paperwork issues and not subject to recovery. The remaining 34 disbursements totaling \$9,214,913 had an eligibility issue that was missed in the processing and disbursing of the loans. Further analysis concluded the eligibility issue could be resolved resulting in an additional 23 of the exceptions totaling \$6,915,100 being classified as not subject to recovery. The remaining improper payments subject to recovery were 11 disbursements totaling \$2,299,813. Of the \$2,299,813 in disbursements, the potential recovery amount was \$214,835. Before the SBA attempts to recover any overpayments on a disaster loan, the borrower is given an opportunity to resolve any eligibility issues. For two of the potential recovery items, it is expected they would be found eligible during this phase of the process. Therefore, the resulting amount subject to recovery would be \$17,835 or 0.04% of the sample amount. Based on the sample results, the amount of disaster direct loan disbursements subject to recovery for the entire population in the second half of the QAR is \$86,535. The second half of the semi-annual QAR required 2,200 hours of staff time to complete and the cost of the audit in terms of just staff hours to produce the report was \$92,925. In evaluating the time and cost to identify the total improper payments it is clear that further expenditures for a separate recapture audit would not be cost-effective: the recoverable amount is less than the cost of the audit. Furthermore, the over-disbursed amount is in the form of a loan which will be repaid according to the terms and conditions in the Loan Authorization and Agreement.

Disbursements for goods and services also would not benefit from a separate recapture audit. The improper payment testing required 867 labor hours at a cost of \$56,837. Payments identified during the improper payment review as eligible for recapture totaled \$5,239; thus the cost of the review far exceeds the return. The SBA determined it is not cost-effective to do separate payment recapture audits.

Overpayments Recaptured Outside of Payment Recapture Audits are applicable only to 7(a) Loan Guaranty Purchases or disbursements for goods and services as payments made within these program areas are recoverable from vendors and lenders as appropriate. Overpayments for disaster loans are collected through the normal loan repayment process if the overpayment was due to a SBA error. Overpayments as a result of fraudulent actions of a borrower are immediately recaptured. The amount identified for recapture during the 7(a) Loan Guaranty Purchase improper payment review was \$6,462,350. The disbursement overpayments that relate to cash payments made for an inaccurate amount or not according to contract terms, total \$5,239; all other over payments were due to missing or incomplete documentation. The amount not recaptured in FY 2011 for disbursements of goods and services is approximately \$300 which represents a large number of small interest overpayments whose recovery was not determined to be cost-effective.

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

OVERPAYMENTS RECAPTURED OUTSIDE OF PAYMENT RECAPTURE AUDITS (\$ IN THOUSANDS)							
Source of Recovery	Amount Identified FY 2012	Amount Recovered FY 2012	Amount Identified FY 2011	Amount Recovered FY 2011	Cumulative Amount Identified	Cumulative Amount Recovered	Cumulative Amount Collectable
7(a) Loan Guaranty Purchase IP Review	\$6,462	0	\$1,600	\$103	\$8,064	\$103	0
Contract IP Review	5.2	0	32.5	32.2	37.7	32.2	0.3

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 helps assure accountability of improper payment administration.

Information Systems and Other Infrastructure

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

7(a) loan guaranty approvals and 504 CDC guaranty approvals are supported by E-Tran, SBA's electronic loan processing/servicing system. Both the SBA and delegated lenders process applications through the system and lenders may also handle unilateral servicing actions electronically. The system provides increased efficiency and decreased costs in the loan guaranty origination and servicing processes.

Disaster direct loan program has the information systems and other infrastructure it needs to reduce

improper payments to targeted levels. For example, the ODA has an integrated, electronic loan processing system, the Disaster Credit Management System (DCMS) to streamline, enhance and improve the loan-making process. This system supports workflow management, electronic file management and document generation functions. In fact, the ODA Quality Assurance team is continually working with the 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.

Disbursements for goods and services are supported by the Oracle Federal Financial System and the contracting process is supported by 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 expanded the two-way interface between the PRISM and the financial systems and plans to continue development in connecting the acquisition and financial systems.

Statutory or Regulatory Barriers

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

Appendices

SUCCESS STORY: Women-owned Business Provides Vehicles With Alternative Power Sources

SVI dba Specialty Vehicles, Henderson, Nevada

For **Nancy and Leah Munoz** and **Rachel Munoz Drenk**, Specialty Vehicles is a family business that's been woman-owned for two generations. Nancy started off working for her father, a manufacturer of trolleys and trams. After his passing, she reincorporated the company as Specialty Vehicles. Her daughters Leah and Rachel began working for the company as teenagers. From one trolley model at the start, the product line has grown to 27 vehicles. Today, Specialty Vehicles is a major provider of a diversified line of transportation vehicles, including specialty trolleys, trams, mini-trams and buses. The vehicles have options for alternative fuel sources and zero-emission battery power with solar panels.

During tight economic times, even though upfront costs were daunting, Specialty Vehicles grew with the help of an SBA-guaranteed loan for working capital to develop new lines. Net worth and employment rolls have steadily increased, and Specialty Vehicles secured an SBA 504 loan to purchase an industrial building to expand manufacturing and distribution operations.



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 here:

SBA INFORMATION	
About SBA	www.sba.gov/about-sba
SBA Direct	www.sba.gov/sba-direct
SBA Strategic Plan	www.sba.gov/AgencyStrategicPlan
SBA Performance, Budget & Planning	www.sba.gov/performance
STARTING AND MANAGING A BUSINESS	
What is a Small Business?	www.sba.gov/content/am-i-small-business-concern
Thinking about starting a business?	http://www.sba.gov/thinking-about-starting/
Resources	
Local Assistance	www.sba.gov/local-assistance
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.sam.gov
Explore Exporting	www.sba.gov/size
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
ADDITIONAL RESOURCES	
Office of Advocacy	www.sba.gov/advocacy
Office of the National Ombudsman	www.sba.gov/ombudsman
Office of the Inspector General	www.sba.gov/oig

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

SUCCESS STORY: Bringing Safety to Manufacturing and Construction

Banda Group International, LLC, Chandler, Arizona

Zeferino Banda was a certified safety professional with two decades of experience and a master's degree in safety working for a construction company on a large semiconductor project in Ireland. He realized that large manufacturing and construction firms need environmental health and safety personnel for their projects, so he decided to start a business to provide those services.

Banda Group International is a growing environmental health, safety and technical consulting company headquartered in Chandler, Arizona. Since its creation in 2003, the firm has grown to 32 employees and opened additional offices in New Mexico and Texas. In 2007, the company received certification in SBA's 8(a) Business Development program. Since then BGI has won a five-year NASA contract at the Goddard Space Flight Center and a contract for occupational safety support services for the Transportation Safety Administration. BGI has also worked on projects in Algeria, China, Ireland, Israel, Kuwait, Laos, Mexico and Venezuela.

Banda, a veteran of the U.S. Air Force, actively supports the military and his fellow veterans. For the past three years he has served as chairman of Safety Professionals and the Latino Workforce, a forum for safety professionals to better engage with Latino workers on the topic of safety. Zeferino Banda is the *2012 Arizona Small Business Person of the Year*.



Appendix 2 - Glossary

(Available at: “FY 2012 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.	APR	Annual Performance Report Required by the Government Performance and Results Act, it presents a federal agency’s progress in achieving the goals in its strategic plan and performance budget.
7(a)	7(a) Loan Guaranty Program SBA’s primary loan program. It provides general loan financing for a wide variety of purposes.	ARC	America’s Recovery Capital Loan Program A temporary guaranty loan program authorized by the American Recovery and Reinvestment Act of 2009.
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.	ARRA	American Recovery and Reinvestment Act of 2009 Most often referred to as the Recovery Act in SBA documents.
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.	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.
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.	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.
AARP	Association for the Advancement of Retired Persons	BLIF	Business Loan and Investment Fund Operated by the Treasury Department to maintain the accounting records of loans approved prior to 1992.
AFMAC	Audit and Financial Management Advisory Committee Assists the Administrator in overseeing SBA’s financial operations.	CAPLine	An SBA program to help small businesses meet their short-term and cyclical working capital needs.
AFR	Agency Financial Report One of the annual PAR reports.	CBJ	Congressional Budget Justification A federal agency’s annual budget request to Congress.
ANC	Alaska Native Corporation	CDC	Certified Development Company Refers to the Section 504 Certified Development Company debenture program.

CEAR	Certificate of Excellence in Accountability Reporting, An award given by the Associate of Government Accountants.	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.
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.	FECA	Federal Employees Compensation Act Provides compensation benefits to federal civilian employees for work-related injuries or illnesses and to their surviving dependents.
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.	FEMA	Federal Emergency Management Agency The agency that is tasked with responding to, planning for, recovering from and mitigating against disasters.
COBOL	A computer programming language designed for business applications.	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.
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.	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 USSGL.
COTS	Commercial Off-The-Shelf Software or hardware products that are ready-made and available for sale to the general public.	FICA	Federal Insurance Contributions Act A law requiring a deduction from paychecks and income that goes toward the Social Security program and Medicare.
CRM	Office of Credit Risk Management. See OCRM.	FISMA	Federal Information Security Management Act
CSAM	Cyber Security Assessment and Management	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.
DCMS	Disaster Credit Management System The electronic system used by the SBA to process loan applications for all new disaster declarations.	FPDS-NG	A system used for reporting, recording and tracking agencies' procurement actions
DLF	Disaster Loan Fund Assists eligible small businesses impacted by disasters.		
FAR	Federal Acquisition Regulations		

FTA	Fiscal and Transfer Agent	IPIA	Improper Payment Information Act A federal law enacted in 2002 to identify and reduce erroneous payments in the government's programs and activities.
FTE	Full Time Equivalent Indicates the workload of an employed person; an FTE of 1.0 means that the person is equivalent to a full-time worker, while an FTE of 0.5 signals that the worker is only half-time.	IT	Information Technology Refers to matters concerned with the design, development, installation and implementation of information systems and applications.
FY	Fiscal Year The federal government fiscal year begins October 1 and ends the following September 30.	ITQA	Information Technology Quality Assurance program
GAO	U.S. Government Accountability Office The audit, evaluation and investigative arm of Congress.	IV&V	Independent Validation and Verification A review of SBA Office of Financial Analysis and Modeling (OFAM) Financial Models for accuracy and proper functioning by an outside expert.
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.	JAAMS	Joint Administrative Accounting Management System
GPRA	Government Performance and Results Act , modified in 2010.	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.
GSA	General Services Administration	LAS	Loan Accounting System SBA's loan origination servicing and disbursement system.
GWAC	Government-wide Acquisition Contract	LMAS	Loan Management and Accounting System Financial management system that supports loan accounting.
High-growth Small Business	Rapidly expanding small businesses that drive net new job growth. The SBA supports high-growth small businesses through its SBIR, SBIC and export programs, among others.	MAS	The GSA Multiple Awards Schedule
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.	MD&A	Management's Discussion and Analysis The MD&A is considered required supplementary information for federal financial statements and is designed to provide a high level overview of the Agency.
IDIQ	Indefinite-delivery indefinite-quantity	MED	Minority Enterprise Development
IIP	Incremental Improvement Project		
IP	Internet Protocol		

MRA	Master Reserve Account SBA's fiscal agent maintains this escrow fund to facilitate the operation of the Certified Development Company program.		federal assistance for non-farm, private sector disaster losses for individuals and businesses.
MRF	Master Reserve Fund SBA's fiscal and transfer agent maintains this reserve fund to facilitate the operation of the 7(a) secondary market program.	OFA	Office of Financial Assistance SBA office that administers various loan programs to assist small businesses.
NAICS	North American Industry Classification System 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.	OFAM	Office of Financial Analysis and Modeling An office in the SBA Office of Performance Management and Chief Financial Officer.
NBC	National Business Center In the Department of the Interior	OFPO	Office of Financial Program Operations
NIST	National Institute of Standards and Technology An agency of the U.S. Department of Commerce.	OHCM	SBA Office of Human Capital Management Now referred to as Office of Human Resources Solutions.
NWBC	National Women's Business Council 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.	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.
OCA	Office of Capital Access The office responsible for small business program loans, lender oversight, and the surety bond program.	OIG	Office of Inspector General Conducts and supervises audits, inspections and investigations relating to SBA programs and operations.
OCFO	Office of the Chief Financial Officer	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.
OCRM	Office of Credit Risk Management SBA office that manages program credit risk, monitors lender performance, and enforces lending program requirements.	OPM	U.S. Office of Personnel Management The federal government's human resources agency.
ODA	Office of Disaster Assistance SBA office that promotes economic recovery in disaster ravaged areas. SBA disaster loans are the primary form of	ORACLE	The accounting program used by SBA's Administrative Accounting Division.
		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.			agreements with universities and colleges and government organizations.
POA&M	Plan of Action and Milestones			
PPS	Probability Proportional to Size			
QA	Quality Assurance Functions to assure that project deliverables meet SBA's requirements and quality standards.	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.	
QAR	Quality Assurance Review	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.	
R&D	Research and Development	SBIC	Small Business Investment Company Provides long-term loans, debt-equity investments and management assistance to small businesses, particularly during their growth stages.	
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.	SBIR	Small Business Innovation Research SBA office that supports scientific excellence and technological innovation through the investment of federal research funds.	
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.	SBJA	Small Business Jobs Act of 2010, most often referred to as the Jobs Act in SBA documents.	
SAT	Senior Assessment Team	SBLC	Small Business Lending Company Non-depository small business lending companies listed by the SBA Office of Capital Access.	
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.	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.	
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.	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.	
SBDC	Small Business Development Center Program Delivers management and technical assistance, economic development and management training to existing and prospective small businesses through cooperative	SHCP	Strategic Human Capital Plan	

SOP	Standard Operating Procedure. SOPs are the primary source of the Agency's internal control.
SPFI	Summary of Performance and Financial Information One of three annual financial and performance reports required of federal agencies.
STEP	Refers to State Trade and Export Promotion program or grant.
USSGL	United States Standard General Ledger
VAT	Vulnerability Assessment Team Performs monthly scans of network-attached devices to identify and remedy network vulnerabilities.
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.

*Did
you
know*



In May 2012, the SBA and AARP formed a strategic alliance to provide counseling and training to entrepreneurs over the age of 50, known as “**encore entrepreneurs**,” who want to start or grow a small business. Jointly, the SBA and AARP expect to train over 100,000 entrepreneurs.

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

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Enabling the Establishment & Growth of Small Businesses

