

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Small Business Guarantee and Finance Corporation

We have audited the accompanying balance sheets of the Small Business Guarantee and Finance Corporation (the Corporation), a component unit of the State of Pohnpei, as of September 30, 2001 and 2000, and the related statements of revenues, expenses and changes in fund equity and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Government Auditing Standards require that the Office of the Pohnpei State Auditor (OPSA) should have an external quality control review at least once every three- (3) years. The last review was conducted in October 1998.

Except for the timeliness of an external quality control review, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Small Business Guarantee and Finance Corporation as of September 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 7, 2002, on our consideration of the Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Ursula S. Abalos
Acting Pohnpei State Auditor
March 7, 2002

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Balance Sheets
September 30, 2001 and 2000

<u>Assets</u>	<u>2001</u>	<u>2000</u>
Current assets:		
Cash and equivalents (note 2)	1,602,837	685,226
Accounts receivable-employees	9,192	9,476
Advances (note 3)	13,502	9,913
Employee loans receivable (note 4)	9,104	-
Receivable from PSG (noted 5)	4,313	4,313
Interest receivable (note 6)	136,147	80,070
Prepaid rent	3,569	5,593
Total current assets	1,778,664	794,591
Property, plant and equipment, net (note 8)	13,524	17,381
Other non-current assets:		
Long term certificate of deposit (note 9)	-	1,000,000
Notes receivable (note 7)	6,709	-
Total other non-current assets	6,709	1,000,000
Total assets	1,798,897	1,811,972
 <u>Liabilities and Fund Equity</u> 		
Current liabilities:		
Accounts payable	301	-
Accrued salaries	1,590	1,104
Accrued taxes and other liabilities	2,987	3,163
Due to FSMDB	1,015	-
Total current liabilities:	5,893	4,267
Fund Equity:		
Contributed capital	1,666,844	1,669,860
Retained earnings	126,160	137,845
Total fund equity	1,793,004	1,807,705
Contingencies and commitments (note 15)		
Total liabilities and fund equity	1,798,897	1,811,972

See accompanying notes to financial statements

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Statements of Revenues, Expenses, and Changes in Fund Equity
Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Operating revenues:		
Loan guarantee fee (note 11)	2,398	1,540
Loan packaging fee (note 12)	800	1,480
Transfers-in (note 10)	-	155,394
Total operating revenues	<u>3,198</u>	<u>158,414</u>
Operating expenses:		
Salaries	70,208	102,285
Rent	10,571	4,310
Depreciation	7,007	5,272
Travel	5,555	8,897
Payroll tax	2,859	2,892
Postage and telephone	2,397	1,881
Repairs and maintenance	2,354	3,695
Employee benefits program	1,745	1,023
Office supplies	1,661	5,147
Utilities	1,648	725
Representation and entertainment	1,555	1,341
Gasoline	650	425
Meeting allowance	420	1,100
Miscellaneous	395	413
Janitorial & Cleaning	40	-
Bank charges	2	1
Advertising	-	897
Dues and membership	-	20,000
Printing and reproduction	-	-
Total operating expenses	<u>109,067</u>	<u>160,304</u>
Non-operating revenues:		
Interest income	91,158	88,184
Other income	10	-
MEDC (note 13)	-	289
Gain on sale of assets	-	2,250
Total non-operating revenues	<u>91,168</u>	<u>90,723</u>
Net income (loss)	(14,701)	88,833

	<u>2001</u>	<u>2000</u>
Add depreciation on fixed assets acquired by capital contributions that reduce contributed capital	3,016	3,016
	<hr/>	<hr/>
Increase (decrease) in retained earnings	(11,685)	91,849
Retained earnings at beginning of year	137,845	45,996
	<hr/>	<hr/>
Retained earnings at end of year	126,160	137,845
Contributed capital at beginning of year	1,669,860	-
Contributions	-	1,672,876
Less: depreciation on assets acquired by capital contribution	(3,016)	(3,016)
	<hr/>	<hr/>
Contributed capital at end of year	1,666,844	1,669,860
Fund equity at end of year	<u>1,793,004</u>	<u>1,807,705</u>

See accompanying notes to financial statements.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Statements of Cash Flows
Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Cash flows from operating activities:		
Net income (loss)	(14,701)	88,833
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	7,007	5,272
(Increase) decrease in assets:		
Accounts receivable-employees	283	(9,476)
Advances	(3,588)	(9,913)
Employee loans receivable	(9,104)	-
Receivable from PSG	-	41,683
Interest receivable	(56,077)	(80,070)
Prepaid rent	2,024	(5,593)
Notes receivable	(6,709)	-
Increase (decrease) in liabilities:		
Accounts payable	301	-
Accrued salaries	486	1,104
Accrued taxes and other liabilities	(176)	3,163
Due to FSMDB	1,015	-
	<hr/>	<hr/>
Net cash provided by operations	(79,239)	35,003
Cash flows from investing activities:		
Certificate of deposit-long term	1,000,000	(1,000,000)
	<hr/>	<hr/>
Net cash used in investing activities	1,000,000	(1,000,000)
Cash flows from capital and financing activities:		
Proceeds from contributed capital	-	1,662,826
Purchase of property, plant & equipment	(3,150)	(12,603)
	<hr/>	<hr/>
Net cash provided by capital and financing activities	(3,150)	1,650,223
Net increase (decrease) in cash	917,611	685,226
Cash at beginning of year	685,226	-
	<hr/>	<hr/>
Cash at end of year	1,602,837	685,226
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SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(1) Summary of Significant Accounting Policies

The accounting policies of Small Business Guarantee and Finance Corporation conform with accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Auditing Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletin of the Committee on Accounting Procedures issued on or before November 30, 1989. The Corporation has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

A. Reporting Entity

The Corporation was established by Pohnpei State Law No. 3L-86-95 on February 14, 1995. The accounting system was actually transferred from the Department of Treasury to the Corporation on October 1, 1999. The Corporation's mission is to provide, promote, develop, and widen in both scope and service reach various alternative modes of financing for small enterprises, including, but not limited to, direct and indirect project lending, venture capital, financial leasing, secondary mortgage and/or rediscounting of loan papers to small businesses.

Under the law, the Corporation shall be attached to the Pohnpei State Government's Department of Commerce and Industry, and shall be under the policy, program, and administrative supervision of the Small Enterprise Development (SED) Council. It shall, however, exercise all the general powers conferred by law upon corporations as are incidental or conducive to the attainment of the act (Business Development Act of 1994), including the power to promulgate articles of incorporation, bylaws, rules and regulations, guiding programs and policies.

The Corporation's main function is to guarantee loans to qualified small enterprises, local and/or regional associations' small enterprises and industries, private voluntary organizations and/or cooperatives. It may guarantee loans up to 85% and may also provide second guarantees on

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(1) Summary of Significant Accounting Policies, Continued

the credit and/or investment guarantees made by credit guarantee associations and other institutions in support of small enterprises.

The powers of the Corporation are vested upon a seven-member Board of Directors. The Director of the Department of Commerce and Industry shall serve as Chairman, with the other six members appointed by the Governor upon recommendation of the SED Council with the advice and consent of the Legislature. Three members are from the private sector and the other three members are from the public sector.

The Corporation is administered by an Executive Director, appointed by the Board of Directors and who reports directly to the Board. He/she is charged with the responsibility of ensuring smooth operation of the Corporation in line with the policies set out by the Board of Directors and implementation of the guarantee program.

At present, the Department of Commerce and Industry has been dissolved while the SED Council is unoperational. Also, the Board of Directors consists of only five members. Since the abolishment of the Department of Commerce and Industry, the Chief of the Economic Affairs Office became the Chairman of the Board of Directors of the Corporation. No new law has been created to amend the enabling act that created the Corporation.

B. Fund Structure, Measurement Focus, and Basis of Accounting

The accounts of the Corporation are organized as a proprietary fund-component unit of Pohnpei State Government. Proprietary funds are used by governmental units to account for operations that are financed and operated in a manner similar to private business enterprises. The purpose of a proprietary fund is to provide periodic determination of revenues, expenses and net income, with maintenance of capital.

Proprietary funds are accounted for on a flow of economic resources measurement focus, whereby all assets and liabilities associated with the operations of the funds are included in the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets. This is in contrast to

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(1) Summary of Significant Accounting Policies, Continued

“governmental fund type accounting, which uses a current financial resources measurement focus whereby only current assets and current liabilities generally are included in the balance sheet.

Basis of accounting refers to when revenues and expenses are recorded in the accounts and reported in the financial statements. The Corporation utilizes the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when cash is received or payment is made.

C. Budget

During its initial years, the Corporation operates on an annual budget appropriated by the Pohnpei State Legislature (PSL), which is accounted for by the Pohnpei State Department of Treasury. Appropriation acts require that funds be administered in accordance with the provisions of the State’s Financial Management Act. The enabling legislation does provide the Corporation with the power to expend revenues generated by projects maintained by the Corporation. Such expenditures, must, however, be in accordance with the provisions of the Financial Management Act and other applicable laws and regulations. In fiscal year 2000, PSL appropriated \$155,394 for the Corporation’s operations. However, no appropriation was given to the Corporation in fiscal year 2001.

D. Cash and Equivalents

For the purpose of the balance sheet and statement of cash flows, cash and equivalents are defined as cash in bank and cash on hand. Of these amounts, \$300,000 is insured through the FDIC, with the remaining balance exceeding insurable limits. The Corporation does not require collateralization of its deposits by its banks. Therefore, the amounts, which exceed the FDIC insurable limits, are characterized as uncollateralized.

E. Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation. Depreciation is based on the straight-line method over the estimated useful lives of the respective assets.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(1) Summary of Significant Accounting Policies, Continued

F. Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefit accrues to employees. In accordance with the provisions of FASB Statement No. 43-Accounting for Compensated Absences, no liability is recorded for nonvesting accumulating rights to receive sick pay benefits. The related sick pay expense is recorded when the benefit is actually taken.

G. Contributed Capital

The Corporation has adopted the generally accepted accounting principle of reducing contributed capital for depreciation on related assets acquired through capital grants. The account is comprised of CIP capital funding of \$1.5 million and fixed assets donated by State Government.

H. Management Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual reports could differ from those estimates.

(2) Cash and Equivalents

At September 30, 2001 and 2000, the Corporation had deposits and cash on hand as follows:

	<u>2001</u>	<u>2000</u>
Petty cash	\$ 300	\$ 300
Cash in bank-Savings ITA	95,821	13,798
Cash in bank-savings	6,114	8,964
Cash in bank-checking	602	1,376
TCD-Short term	<u>1,500,000</u>	<u>660,788</u>
	<u>\$ 1,602,837</u>	<u>\$ 685,226</u>

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(3) Advances

Advances represent cash advances extended to the Corporation's employees, summarized as follows:

	<u>2001</u>	<u>2000</u>
Payroll advance	\$ 1,519	\$ 409
Travel advance	6,649	0
Employee advance	<u>5,334</u>	<u>9,504</u>
	<u>\$ 13,502</u>	<u>\$ 9,913</u>

(4) Employee Loans Receivable

The Corporation has a staff loan program as an incentive to its employees. The program allows maximum loan of \$ 5,000 per employee. A summary of employee loans receivable at September 30, 2001 is presented below:

<u>Employee</u>	<u>2001</u>
Former Executive Director	\$ 5,634
Administrative Assistant	<u>3,470</u>
	<u>\$ 9,104</u>

(5) Receivable from PSG

The receivable from Pohnpei State Government consists of unremitted fund balance from unexpended operating budget and CIP account as well as the interest income earned on TCD placement by Pohnpei State Finance. Details of the account is shown below:

Transfers-in

	<u>2000</u>	<u>1999</u>	<u>Total</u>
Appropriations including energy grant	\$ 155,394	\$ 106,458	\$ 261,852
Expenses per 135-P	<u>(20,529)</u>	<u>(60,462)</u>	<u>(80,991)</u>
Fund balance	<u>134,865</u>	<u>45,996</u>	180,861
Reimbursement to the Corporation in fiscal year 2000			<u>(178,586)</u>
Unremitted appropriations			<u>\$ 2,275</u>

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(5) Receivable from PSG, Continued

CIP Account

	<u>Amount</u>
Total interest from \$1M TCD previously invested by State Finance	\$ 109,862
Interest remitted to the Corporation	<u>108,031</u>
	1,831
Interest loss	<u>207</u>
Unremitted interest	<u>\$ 2,038</u>
 Total Receivable from PSG at September 30, 2001	 <u>\$ 4,313</u>

(6) Interest Receivable

This amount includes interest accruals on the \$1.5 M capitalization fund that was given to the Corporation at the start of its operations, presently invested in Time Certificate of Deposits (TCD).

(7) Notes Receivable

The amount represents a promissory note arising from a called off guarantee. The note bears interest at 9% per annum and is due on September 25, 2004.

(8) Property, Plant and Equipment

The Corporation's fixed assets are recorded at cost except for donated assets. These assets are recorded by the Corporation using fair market value since no documents were available to show its acquisition cost. The assets and its corresponding accumulated depreciation, at September 30, 2001 and 2000, are as follows:

<u>Description</u>	<u>Useful life</u>	<u>Cost</u>		<u>Accumulated Depr.</u>		<u>Net Book Value</u>	
		<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Vehicles	5	\$ 8,998	\$ 8,998	\$ 3,149	\$ 1,350	5,849	7,648
Furniture and fixtures	2-3	16,805	13,655	9,130	3,922	7,675	9,733
		<u>\$25,803</u>	<u>\$22,653</u>	<u>\$12,279</u>	<u>\$5,272</u>	<u>13,524</u>	<u>17,381</u>

Donated furniture and fixtures were approximately valued at \$10,050, although transfer of title to the corporation was not yet done.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(9) Certificate of Deposit – Long Term

In fiscal year 2000, the amount of \$1,000,000, received by the Corporation from the State Government, was invested in long-term time certificate of deposit (TCD).

(10) Transfers-in

The amount represents operating fund appropriated by Pohnpei State Legislature for the Corporation. In fiscal year 2000, the corporation was given an amount of \$155,394 and none for 2001.

(11) Loan Guarantee Fee

The amount represents one percent (1%) fee collected on bank loans approved for guarantee. Out of the approved loans, the Corporation has already issued forty-five (45) guarantees since it started its operations. At September 30, 2001, total guarantee exposure is \$350,939.

(12) Loan Packaging Fee

The Corporation, aside from guaranteeing loans, also assists in the development of business plan for individuals who seek financing for their new or existing business. For this service, the Corporation charges \$25.00 fee for each proposal written-up.

(13) MEDC Grant

The amount represents the balance of checking account maintained by the former Division of Commerce and Industry (C & I). The account was originally a grant from the Australian Embassy. Upon dissolution of the Division of C & I, the left over balance of the account was subsequently transferred to the Corporation. Fees received by the Corporation from business plan development assistance are deposited to this account.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(14) Related Party

The Corporation leases its office from a relative of the former Executive Director.

(15) Contingencies

Risk Management

The Corporation does not purchase commercial insurance covering its potential risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

Claims

The Corporation's former lessor, through a letter dated January 2, 2002, is claiming for damages sustained in a breach of contract against the Corporation. The Corporation has decided to settle the claim and referred the matter to its lawyer. However, no liability as a result of the ultimate resolution of this matter has been recorded in the accompanying financial statements.

Guarantees

Pursuant to the Corporation's enabling act [PSL no. 3L-86-95, Section 15 (3)], the Corporation shall become liable under its guarantees upon proof that the loan has become past due under such terms and guidelines adopted by its Board and printed on the contract of guarantee. Except for one (1) guarantee called off in fiscal year 2001, no provision for any liability that may result from this matter has been recorded in the accompanying financial statements.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE

AND

ON INTERNAL CONTROL OVER FINANCIAL REPORTING

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

The Board of Directors
Small Business Guarantee and Finance Corporation

We have audited the financial statements of the Small Business Guarantee and Finance Corporation (the Corporation), as of and for the two-years ended September 30, 2001, and have issued our report thereon dated March 7, 2002. *Government Auditing Standards* require that the Office of the Pohnpei State Auditor (OPSA) should have an external quality control review at least once every three- (3) years. The last review was conducted in October 1998. Except for the timeliness of an external quality control review, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion.

The results of our tests disclosed material instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Findings and Recommendations (pages 18 through 55) in finding numbers 1 to 7, and finding number 9.

We also noted certain immaterial instances of noncompliance that we are reporting to the management of Small Business Guarantee and Finance Corporation, which are described

in the accompanying Schedule of Findings and Recommendations (pages 18 through 55) in finding number 8 and finding numbers 10 to 12.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Corporation's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Recommendations as finding numbers 13 through 26.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We noted matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. These are described in the accompanying Schedule of Findings and Recommendations as finding numbers 13 to 17, and finding number 20.

This report is intended solely for the information of the Board of Directors and management of Small Business Guarantee and Finance Corporation, federal awarding agencies, pass-through entities, cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.

Ursula S. Abalos
Acting Pohnpei State Auditor
March 7, 2002

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Employee/Payroll advances

1. Criteria:

Payroll advance is the only allowed advance by the Corporation and may be extended to employees only when the following are met:

1. Due to extreme necessities;
2. Written approval from the Executive Director; and
3. Advances shall not exceed net pay of the corresponding pay period of which advance will be paid.

Condition:

The amounts aggregating to \$25,724.21 and \$20,417.88 in fiscal years 2001 and 2000 respectively were advances extended to the employees as Employee/Payroll advances. Further verification of the advances revealed the following:

1. On June 28, 2000, a check no. 1113 for \$1,700 was advanced to the former Executive Director allegedly for the purchase of video and digital cameras for the corporation. The purchase was not completed and the amount of \$1,700 was recorded as "Employee Advance" on September 30, 2000.
2. The former Executive Director advanced \$2,000 from the Corporation in July 24, 2000. The amount was recorded under the "Employee Advances" account. She has not settled the account to date.
3. Payroll advances were extended to employees without supporting documents, e.g. request for advance stating the reason/s for the advance, with the written approval of the Executive Director.
4. Payroll advances, some exceeding net pay of the corresponding payroll for which the advance will be paid, were consistently extended to employees as follows:

<u>FY</u>	<u>Employee</u>	<u>Dates when advances were extended (does not include all dates)</u>
2001	Former Executive Director	10/26/00, 11/10/00, 11/24/00, 11/29/00, 12/11/00, 12/13/00, 12/15/00, 12/26/00
2001	Former Executive Director	5/14/01, 5/23/01, 5/31/01, 6/14/01, 6/27/01, 7/20/01, 7/31/01
2001	Administrative Assistant	6/1/01, 6/13/01, 6/25/01, 7/6/01, 7/25/01, 8/8/01, 8/22/01

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Employee/Payroll advances, Continued

Condition, continued:

5. Advances were extended up to \$2,000 at a time.

A schedule of Payroll and Employee advances as of September 30, 2001 and 2000 is shown below:

	FY2001		FY2000	
	<u>PA</u>	<u>EA</u>	<u>PA</u>	<u>EA</u>
Former Executive Director	\$ 413.58	\$ 5,253.73	\$ 50.00	\$ 7,853.20
Admin Assistant	794.19		358.80	1,596.45
Bus. Dev. Specialist	310.89	79.92		55.01

Note: PA – payroll advance; EA – employee advance

Cause:

The management approved the advances and failed to make timely collection from employees.

Effect:

It appears that a breakdown of control in employee advances occurred.

Recommendation:

We recommend that the Corporation limit the granting of payroll advances to emergencies and it must be paid off from the next payroll.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Travel advances

2. Criteria:

The Corporation's policy on travel states that all travelers with duly approved Travel Authorizations shall be entitled to receive a travel advance for the estimated cost of travel, excluding airfare, which will be paid directly to the airline and/or travel agency.

Condition:

We noted three (3) instances where travel advances were requested and received in excess of the estimated cost of travel as specified in the Travel Authorization (TA). These are:

1. On January 12, 2000, the former Executive Director requested and received 100% of per diem as travel advance equivalent to \$3,976. The travel advance was split into two (2) checks because one of the signatories authorized to sign checks in excess of \$2,000 is off-island. On January 21, 2000, she requested and received ground transportation allowance (100%) of \$500.00. Then, on January 24, 2000, she requested and received again another travel advance equivalent to \$2,900 against the same TA and again two checks were issued to facilitate the signing of the checks.
2. On February 16, 2001, the former Executive Director requested and received 100% of per diem amounting to \$ 3,447 as travel advance for her trip to Cook Islands. On March 8, 2001, she again requested advance of \$1,950 allegedly to host a dinner for the participants of the Cook Island seminar. The trip was later cancelled.
3. In another trip, the Vice Chairman of the Board received \$1,428 per diem against TA no. 2001-02 on March 6, 2001. Again, on March 29, 2001, travel advance in the amount of \$408 was issued to the Vice Chairman for the same TA.

In addition, the former Executive Director received travel advances totaling \$7,153 for two (2) travel authorizations (TA) in fiscal year 2001. The travels however were cancelled and yet the traveler did not return the travel advances. The said amount still remains in the "Travel Advance" account.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Travel advances, Continued

Cause:

The management allowed the payment of the excess travel advances and did not request the traveler to return the travel advances for the cancelled trips.

Effect:

The above condition has resulted to unliquidated travel advances of \$6,649.53 as of September 30, 2001.

Recommendation:

We recommend that the Corporation should strictly comply with its own policy on travel, particularly on travel advance.

Auditee Response:

Please see Exhibit 1.

Auditor's Reply to Auditee's Response dated May 16, 2002:

Although the additional travel advance given to the Vice Chairman was legitimate, the Corporation did not support this transaction with document, such as TA amendment.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Travel voucher submission

3. Criteria:

The travel policy of the Corporation requires the traveler to submit a travel voucher to the Comptroller within a week from the date travel is completed and must be supported by all receipts for non-per diem expenses.

Condition:

The Vice Chairman of the Board submitted travel voucher liquidation on August 31, 2001, for a travel made from March 10 to March 19, 2001.

Further to our review of travel vouchers and its supporting documents; we noted the following:

- a. The former Executive Director went on a trip to Guam; the purpose however appears to be not related to the Corporation's business.
- b. Ambassadorial allowance of \$ 30 per day instead of \$ 20 was paid to the former Executive Director and Vice Chairman.
- c. In most cases, we noted that the travelers did not submit the airline boarding passes and/or copies of airline tickets; hence, we could not determine the exact period of travel.

Cause:

The Corporation is not actively following up the submission of the travel liquidation from its travelers.

Effect:

The travel advances of the former Executive Director amounting to \$ 6,649.53 remain outstanding as of September 30, 2001.

Recommendation:

We recommend that the Corporation enforce strict liquidation of its travel advance.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Travel voucher submission, continued

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Unbudgeted travel

4. Criteria:

The Executive Director must approve all travel expenditures that are budgeted as per Corporation policy. All other travels will require the approval of the Board.

Condition:

During fiscal years 2000 and 2001, the former Executive Director approved and signed four (4) of her own Travel Authorizations. Five (5) of her travels were not budgeted, although one trip was approved by the Board. Two (2) trips were cancelled.

Cause:

The Corporation did not comply with their policy on travel.

Effect:

The Corporation incurred travel expenses of \$6,884.40 that were not budgeted and outstanding travel advances of \$6,649.53.

Recommendation:

We recommend that as a control measure the Board should approve all travels of the Executive Director.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Employee loans

5. Criteria:

The Corporation's Manual of Administration contained an incentive scheme to promote efficiency and reward employees contributing to the advancement of the corporation. The policy sets the eligibility requirements of the staff loan program with the maximum amount of \$5,000 and is guided by the following:

1. Purpose of the loan shall fall within the specified purpose mentioned in the policy.
2. Employee must have been with the Corporation for at least one year.
3. Employee performance rating must be excellent.
4. Employee must have good credit records with other lending institutions.
5. Loan must have adequate security:
 - a. Secured with collateral
 - b. Borrower must be covered by credit life insurance for the tenure of the loan.
6. Employee must have debt to income (salary) ratio of not more than 50%.

Furthermore, the loan application shall be submitted to the credit committee for approval. The credit committee shall be composed of the Executive Director, the Chairman and Vice Chairman of the Board.

Condition:

A review of the employees loan account disclosed the following:

1. All loans except one do not have credit investigation/check on the employee's borrowing.
2. There were no performance ratings in the loan files.
3. All loans were not adequately secured.
4. The loan files did not contain computation of the debt to income ratio.
5. The loan documents did not show approval of the loan by the credit committee.
6. The loan balance of the former Executive Director as of September 30, 2001 is \$5,633.48, which is over the maximum allowable amount of \$5,000.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Employee loans, Continued

Condition, continued:

The auditors were informed that the Manual of Administration, which included the policy on staff loan program, although finalized in July 2000 was only approved by the Board in November 2001. However, no documents were available to substantiate the legitimacy of the approval.

Cause:

The above condition is an apparent disregard on the effective date of the Manual of Administration.

Effect:

Unauthorized employee loans were granted.

Recommendation:

We recommend that the Board of Directors review the employee's loan procedures and if needed, amend the loan program scheme to place more controls.

Auditee Response:

Please see Exhibit 1.

Auditor's Reply to Auditee's Response dated May 16, 2002:

The auditors have yet to receive documents containing the approval of the Manual of Administration.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Loan guarantees

6. Criteria:

Pursuant to Section 18 of the Pohnpei State Legislature Public Law no. 3L-86-95 and as per Corporation Lender's Guide, loans guaranteed by the Corporation shall be utilized for the following purposes:

- Acquisition of fixed assets;
- Building improvement/expansion or construction of plant facilities;
- Permanent working capital; and
- Credit line accommodation for temporary or seasonal working capital.

Condition:

Five (5) loans guaranteed by the Corporation were used to pay off existing loans with financial institutions, including four (4) from subsequent period. Total amount of loan guarantees is \$133,288. In addition, twenty-three (23) loan guarantees were approved for fisheries project; however two (2) of the applications for the same purpose were not approved because of market saturation.

Cause:

The former Executive Director approved the guarantee requests by the financial institution.

Effect:

The above condition is a noncompliance to the Pohnpei State law and the Corporation's loan guarantee policy.

Recommendation:

We recommend that the Corporation carefully review loan requests for guarantee and approve only requests that are covered by the loan guarantees.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 1999 to 2001

Loan guarantee approval

7. Criteria:

The Corporation's main focus is on the provision of guarantees to eligible lending institutions to support loans they may provide to small or medium sized business customers, particularly those embarking on new ventures or looking to expand existing operations. Having this focus, the Corporation should maintain a clear policy on guarantee provision.

Condition:

The Corporation's lender guide discussed some aspects of the guarantee scheme as follows: the participating lenders, borrower's eligibility, guarantee loan terms, fees, and applications to the Corporation. The guide however failed to specify the most important aspect of the guarantee scheme, which is the approval of the guarantee request.

During fiscal years 2000 and 2001, the former Executive Director approved almost all guarantee requests, with the exception of seven (7), which she disapproved. As of September 30, 2001, the Corporation's total exposure on loan guarantees is \$350,939.

In the review of subsequent period, the Corporation's Board of Directors adopted a resolution (BR no. 01-02) that require all loans that seek guarantee from the Corporation will be subject to the review and approval of the Credit Committee. The Credit Committee is composed of the Executive Director, Chairman and Vice-Chairman of the Board. However, the Vice-Chairman of the Board is a Senior Loan Officer at the lending institution, requesting for guarantee.

Cause:

The cause of the above condition is the absence of written policy on the approval of loan guarantees.

Effect:

In fiscal years 2001 and 2000, the former Executive Director single-handedly approved loan guarantees in the amount of \$ 350,939. In the subsequent period,

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Loan guarantee approval, Continued

Effect, continued:

there is an appearance of conflict of interest on the part of the Vice-Chairman of the Board.

Recommendation:

We recommend that the management and the Board of Directors should provide clear and specific written guidelines in the approval of loan guarantees. Also, the Board should remove any conflict of interest from the Credit Committee.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Personnel files

8. Criteria:

The Corporation's policy on personnel requires that the Executive Director maintain personnel files for each employee. The file should contain all payroll information.

Condition:

Personnel files for four (4) employees of the Corporation were missing. The only personnel files that remain are that of two (2) resigned/terminated employees.

Cause:

According to the Comptroller, the former Executive Director borrowed all the personnel files from her. At present, no one in the corporation knows the whereabouts of the files.

Effect:

The above condition resulted to the loss of important files of the corporation.

Recommendation:

We recommend that the Corporation shall ensure that personnel files are maintained for all employees.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Employees' leave absences

9. Criteria:

Employees' leave should only be paid when supported by approved leave application forms. Further, total employees' leave should not exceed the authorized leave for each employee.

Condition:

Our review of payroll disclosed the following:

Application for Leave

- We compared employees' absences from attendance records with duly approved leave application forms. Our comparison revealed that in fiscal year 2000, only 80 hours of leave absences were supported by approved leave forms and 32 sick leave hours were supported by medical slips. The same condition also happened in fiscal year 2001, with only 364 hours of leave absences were supported by approved leave forms and 280 sick leave hours were supported by medical slips. The rest of the leave absences, numbering 1,068 hours in fiscal year 2001 and 1,784 hours in fiscal year 2000, were not supported at all.

Leave records

- The Administrative Assistant does not maintain record of leave absences.
- In fiscal year 2000, leave absences of five (5) out of six (6) employees were calculated to have exceeded the authorized leave of 184 hours (Annual leave=80 and Sick leave=104 hours) and yet were paid.
- In fiscal year 2001, leave absences of all four employees were calculated to have exceeded the authorized leave hours.

Cause:

The Corporation did not maintain complete documentation of payroll files.

Effect:

Employees were paid excess leaves amounting to \$9,603.84 and \$8,800.52 in fiscal years 2001 and 2000. In addition, the amounts of \$ 10,781.72 and

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Employees' leave absences, Continued

Effect, continued:

\$17,510.84 were calculated to have been paid to employees with no approved leave applications in fiscal years 2001 and 2000.

Recommendation:

We recommend that the Corporation should ensure that leave forms are completed by employee and approved by the Executive Director before payment is made to employee. In addition, we recommend that the Administrative Assistant should monitor employees' leave by keeping record of leave balances. Furthermore, employees should be asked to reimburse the corporation for unauthorized and excess absences that were paid.

Auditee Response:

Please see Exhibit 1.

Auditor's Reply to Auditee's Response dated May 16, 2002:

The absence of policy on leave does not exempt the Corporation from establishing controls over employees' leave transactions.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Board minutes

10. Criteria:

The Corporation's By-laws require the Secretary of the Board of Directors to prepare complete and accurate recording of all Board meetings and shall certify the minutes of the meeting as being true and accurate recording.

Condition:

During the year, the Corporation's Board of Directors had twenty-eight (28) board meetings. The former Executive Director signed five (5) records of minutes of meetings, on behalf of the Secretary of the Board. The rest of the minutes were not signed. In addition, two meetings held on November 30, 2000 and December 22, 2000 were not supported by minutes of Board meeting.

Cause:

The cause of the above condition is unknown.

Effect:

The above condition is a noncompliance with the Corporation's by-laws.

Recommendation:

We recommend that the Corporation comply with its own By-laws and ensure that minutes of Board meetings are prepared and signed by responsible person.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Non-deduction of tax and social security on salary

11. Criteria:

Section 4.2 of the Pohnpei State Financial Management Act states that withholding tax and social security contributions shall be deducted from employee salaries.

Condition:

In fiscal year 2000, the required income tax and the social security contributions of the Corporation's Financial Investment Advisor were not deducted from his salary. The said employee was hired on November 1, 1999 until October 31, 2000.

Cause:

According to the Comptroller, the former employee refused to get an FSM social security number. The former employee allegedly requested the former Executive Director not to make deductions on his pay because he will only stay with the Corporation for one year.

Effect:

An overpayment of salary and underpayment of social security and withholding tax resulted from this condition.

Recommendation:

We recommend that the Corporation should ensure that corresponding tax deductions from employees' salaries are being made to comply with the National and State's Tax Code.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Fixed Assets

12. Criteria:

The Corporation's policy on fixed assets states that all purchases of fixed assets with a value in excess of \$1,000 and have an estimated useful life in excess of one year shall be capitalized and depreciated over the estimated useful life of the asset. In addition, disposal of assets should be authorized by the Board and must be done by public bidding. Furthermore, movement of fixed assets shall always be documented.

Condition:

Our review of the Corporation's fixed asset control procedures revealed the following:

- Items purchased for less than \$1,000 were capitalized.
- Assets were not identified by tag or property numbers.
- Donated fixed assets were not supported by transfer of title.

Cause:

The Corporation lacks proper accountability and monitoring of fixed assets.

Effect:

The effect of the above condition is a noncompliance with the Corporation's policy on fixed assets.

Recommendation:

We recommend that the Corporation comply with its own capitalization policy of fixed assets. As a control measure, we further recommend that movement of fixed assets should always be documented and disposals of fixed assets are authorized by the Board.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Discrepancy between financial statements and General Ledger balances

13. Criteria:

Accounting doctrines dictate that the amount reported in the financial statements could be tied in to the amount in the General Ledger (GL) and Subsidiary ledgers.

Condition:

We noted discrepancies in the amount shown in the financial statements and the general ledger for fiscal year 2000 as follows:

<u>Account</u>	<u>Amount per FS</u>	<u>Amount per GL</u>	<u>Discrepancy</u>
Accounts Receivable	\$12,388.96	\$19,388.97	\$7,000.00
Fixed Assets-Office Furniture & Fixtures	13,015.54	6,015.54	(7,000.00)

Cause:

According to the Comptroller, the discrepancy in amount as noted above is due to the changes made in the financial statements by the former Executive Director.

Effect:

The amounts of the two accounts were misstated in the unaudited financial statements.

Recommendation:

We recommend that the Corporation should ensure that amounts presented in the financial statements are fairly stated. In addition, to document propriety, all internal reports of the corporation should be signed by the preparer and reviewed by the responsible officer prior to submission to external parties.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Opening/closing of bank accounts

14. Criteria:

Bank accounts in the name of the Small Business Guarantee and Finance Corporation should only be opened and closed with the prior approval of the Corporation's Board of Directors.

Condition:

The Corporation maintains the following bank accounts:

1. An ITA-Savings account that was opened on January 25, 2000, in lieu of the general and payroll accounts previously maintained by the Corporation. Signatories of the account are the Executive Director, Comptroller and the Vice-Chairman of the Board.
2. Savings account is a depository of all interest income earned from Time Certificate of Deposits (TCD). Signatories of the account are the Executive Director and the Vice-Chairman of the Board.
3. A Checking account not in the name of the corporation is an account where collections from loan business proposal fee of \$25 were deposited. Signatories of the account are the Executive Director and the Business Development Specialist.
4. Savings account was established upon receipt of the initial collection from Pohnpei State Government from the leftover funds in fiscal year 1999. The signatories of the account are the Executive Director and the Comptroller.

Neither the minutes of the Board meetings nor copies of the Board resolutions specify the opening and closing of the Corporation's authorized bank account.

Cause:

The cause of the above condition is unknown.

Effect:

Bank accounts appear to have opened without the Board's approval.

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**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Opening/closing of bank accounts, Continued

Recommendation:

We recommend that any bank account opening should be approved by the Board. Likewise, as a control measure, the Comptroller should not be included as one of the signatories of the accounts.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Withdrawal and transfer of funds

15. Criteria:

Good internal control requires that withdrawal and transfer of cash from bank accounts to another should be properly supported by authorization or memoranda that contains important information such as bank account, amount, and purpose of the withdrawal or transfer.

Condition:

Withdrawals from savings account totaling \$28,500 were only supported by withdrawal slip. There were no authorizations or memoranda stating the purpose of the withdrawal. Further verification of the withdrawals disclosed that these amounts were employees' loans and advances.

Cause:

The Corporation did not require internal authorization form for the withdrawal of cash from its savings account.

Effect:

There is lack of control on savings account transactions.

Recommendation:

We recommend that an authorization letter or form detailing the bank account, amount, and purpose of the withdrawal or transfer should always support the withdrawals and transfers of cash from bank accounts.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Unrecorded withdrawal

16. Criteria:

Deposit to and withdrawal from the bank should be recorded in the books timely to ensure up - to date cash balances.

Condition:

A bank withdrawal of \$17,000 was made in March 2000 and was not recorded in the Corporation's books. In April 2000, a deposit of \$10,000 was made to return the portion of the withdrawal. The transaction was captioned as transfer of funds. The remaining \$7,000 was only recorded in the books on September 30, 2000 as "Accounts Receivable - Employee" account under the name of the former Executive Director.

Cause:

The auditor was informed that the former Executive Director allegedly borrowed the amount withdrawn, which is \$ 17,000.

Effect:

There is lack of control on cash withdrawal. Also, there is an over statement of cash balance by \$ 7,000 from April to September 29, 2000.

Recommendation:

We recommend that all transactions should be recorded timely in the Corporation's books of accounts.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Accounting manual

17. Criteria:

The Corporation's accounting manual and other procedural manuals shall serve as guide to its personnel in the performance of their functions. Hence, the Board of Directors must approve them. Any amendments to the manual should likewise be approved by the Board and must be documented in the minutes of Board meetings.

Condition:

The Office of the Pohnpei State Auditor (OPSA) reviewed and certified the Corporation's accounting manual in August 1999. At the start of the audit, the Corporation furnished the auditors with a copy of their accounting manual. Upon review, we noted discrepancies between the accounting manual submitted by the Corporation and the accounting manual certified by OPSA. Some of the discrepancies noted are as follows:

- a. The submitted accounting manual includes an Investment Policy, while the certified accounting manual has none.
- b. The submitted accounting manual does not have policy on Purchasing, while the certified accounting manual has one.
- c. The certified accounting manual includes in its policy under Guarantee Foreclosure that "All loans and collateral requirements shall be written in accordance with Section 18-29 of PSL no. 3L-86-95", in which the submitted accounting manual does not have.
- d. The submitted accounting manual has the policy and accounting procedures for an "Employee Emergency Loan". The certified accounting manual has none.
- e. The certified accounting manual has a statement that says, "The bank reconciliation statement will bear the preparer's signature and approval of the Comptroller". The submitted accounting manual has none.
- f. The submitted accounting manual explained "Accounts Receivable" as an "account category that shall account for short-term amounts due from clients and employees". On the other hand, the certified accounting manual explained it as an "account category that shall account for short-term amounts owing or open account from customers and clients".

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Accounting manual, Continued

Condition, continued:

Further verification disclosed that the Board did not approve above-mentioned changes, as evidence by the absence of documentation in minutes of Board meetings.

Cause:

It appears that changes are made to the accounting manual to cover the current practices of the corporation.

Effect:

Amendments are made to the accounting manual without documentation of the Corporation's Board approval.

Recommendation:

We recommend that the Corporation ensure that its Board of Directors approves all procedural manuals, including amendments before its implementation. The Board's approval should be documented in a duly signed minutes of Board meetings, and/or approved Board resolutions.

Auditee Response:

Please see Exhibit 1.

Auditor's Reply to Auditee's Response dated May 16, 2002:

A copy of the certified Accounting Manual has been provided to the Corporation on May 17, 2002.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations
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Cash receipts

18. Criteria:

Cash Receipts should be pre-numbered and must be issued in sequence. Furthermore, cash received daily should be deposited in a financial institution in a timely manner.

Condition:

The Corporation uses generic cash receipts booklet bought from stores. A review of the numerical sequence of the cash receipts issued disclosed seventeen (17) instances where cash receipts issued were out of sequence. We also reviewed the frequency of bank deposits by the Corporation and noted that the following cash receipts were deposited three (3) or more days from the date of receipt:

<u>Date of CR</u>	<u>CR no.</u>	<u>Amount</u>	<u>Date of Deposit</u>	<u>No. of days late</u>
3/22/00	0034	\$ 25.00	3/30/00	4
3/22/00	0035	30.00	3/30/00	4
7/05/00	0067	25.00	7/10/00	3
10/3/00	0515	60.68	10/9/00	4
10/3/00	0516	132.60	10/9/00	4
12/5/00	0542	25.00	12/10/00	3
2/16/01	0562	53.96	2/21/01	4
2/16/01	0563	59.37	2/21/01	4
5/21/01	0575	25.00	6/1/01	9
6/20/01	0583	96.92	9/13/01	78

Cause:

Delays in deposit may be due to the materiality of the collection. For cash receipt no. 583 amounting to \$96.92, the deposit was made after 78 days because allegedly, the former Executive Director borrowed the money. The amount was only paid after more than two months.

Effect:

There is a risk that loss from misuse; theft or fire could result from the above condition. In addition, cash is not available for investment or expenditures.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
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Cash receipts, Continued

Recommendation:

We recommend that the Corporation ensure that cash receipts are issued in sequence. It may consider placing an order of cash receipts from the printing shop that could maintain the series of the cash receipts number. We also recommend that the Corporation ensure that deposits are made daily in order to ensure the maximum utilization of cash and preclude potential losses.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
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Disbursement of funds

19. Criteria:

The Corporation's policy dictates that all disbursement of funds be supported by adequate and valid documents, which are but should not be limited to original invoices, purchase orders, and receipts. Furthermore, all disbursements shall be accompanied by a request approved by the Executive Director and submitted to the Comptroller for fund certification and verification of the need for the purchase.

Condition:

We have reviewed 281 disbursements during the two-year period. We noted that 36 lacked supporting documentation as follows:

<u>Documents needed</u>	<u>Instance</u>	<u>Remarks</u>
Purchase order	6	4 with PO but not approved
Travel authorization or amendment	4	
Account withdrawal authorization	3	
Request for payroll/cash advance	12	
Vendor's invoice	6	
Fund certification	1	
Board meeting attendance	4	
Total	<u>36</u>	

We also noted check no. 10 issued on November 17, 1999 for \$2,000 without check voucher and supporting documents. The check was purportedly issued to a close relative of the former Executive Director as payment for office renovation.

Cause:

The Corporation paid the vendors even with incomplete documentation.

Effect:

The above condition resulted to the payment of unsupported transactions.

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**Schedule of Findings and Recommendations
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Disbursement of funds, Continued

Recommendation:

We recommend that the Corporation should ensure that all supporting documents covering disbursements are verified, checked, and approved prior to payment.

Auditee Response:

Please see Exhibit 1.

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**Schedule of Findings and Recommendations
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Budget overrun

20. Criteria:

Expenditures should be kept within the appropriated or approved budget.

Condition:

Our review of expenditures revealed overruns for the following accounts:

<u>Account</u>	<u>Budget</u>	<u>Actual</u>	<u>Overrun</u>	<u>%</u>	
<i>FY 2001</i>					
Consumable Goods	14,000.00	21,272.93	7,272.93	50	/a
Fixed Assets	0.00	3,150.00	3,150.00	100	/b
<i>FY 2000</i>					
Personnel	\$ 93,749.38	\$106,199.76	\$ 12,450.38	13	/c
Travel	0.00	8,896.93	8,896.93	100	/d
Consumable Goods	8,840.00	18,835.88	9,995.88	86	/e
Fixed Assets	0.00	12,603.25	12,603.25	100	/f

Variances were due to the following:

/a. There was no budget for these expenses:

- a.1 Gasoline \$650.58
- a.2 Miscellaneous \$394.88
- a.3 Rent \$10,570.70
- a.4 Representation \$1,555.30

/b. Purchase of two (2) air conditioners was not budgeted.

/c. The salary of the Financial Investment Advisor was not budgeted.

/d. Includes reimbursement of airfare to Financial Investment Advisor (recruitment) and payment of relocation expenses (household effects), which are not specified in his contract. Also, the travel of the former Executive Director to Fiji & Solomon Islands was budgeted in fiscal year 2001 and not in fiscal year 2000.

/e. There was no budget for these expenses:

- e.1 Gasoline \$425.49 – for office vehicles
- e.2 Miscellaneous \$413.50
- e.3 Rent \$4,310 – office rental
- e.4 Representation \$1,340.81
- e.5 Advertising \$897.00

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
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Budget overrun, Continued

Condition, continued:

/f. Purchase of two (2) vehicles, computers and other furniture & fixtures, that were not budgeted.

In addition, a car rental in the amount of \$488 was paid on August 10, 2001 because the corporation jeep was under repair. The corporation's sedan however is running.

Cause:

Management did not monitor and control the expenditures.

Effect:

The above condition resulted to budget overruns of \$42,816.85 and \$20,903.47 in fiscal years 2000 and 2001.

Recommendation:

We recommend the Corporation to operate within its budget and monitor its expenses. In addition, we recommend that the Corporation ensure that all anticipated expenses are fully considered in their annual budget.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Years Ended September 30, 2001 and 2000

Representation expense

21. Criteria:

Representation funds should be spent to promote the interest of and to advance the cause of the Corporation. Hence, the funds should be incurred for expenses related to business dealings and meetings with clients of the Corporation.

Condition:

Our review of representation expenses revealed the following:

1. Six (6) checks issued totaling \$596.72 were paid to two stores owned by the former Executive Director. The purpose of the check payment was not explained in one of the check vouchers.
2. One check for \$83.51 was paid to a grocery store supposed to be for payment of food for the Corporation's 2000 Christmas party. Although the payment was supported by a receipt no. 44 and labeled as "groceries", the cash register tape for the payment showed the following items: twenty-four (24) rolls of Charmin tissue, Folgers instant coffee, Kellogg's Tri-fun cereals, three (3) pieces of Safeguard soap, bleach (96oz), fabric softener, and a pack of Thin Sup Maxi. Total purchase that appeared to be for personal use is \$52.18.
3. A check for \$200 was issued for catering services for fiscal year 2000 Christmas party. The endorsement at the back of the cancelled check showed that the check was deposited to the bank account of the former Executive Director.
4. Two (2) checks paid for purchase of pig and sakau for the funeral of a Board of Director were not supported by invoices.

Cause:

The Corporation allowed these purchases.

Effect:

The above condition resulted to questionable representation expenses.

Recommendation:

We recommend that the management should exercise prudent action in the use of representation expense.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Representation expense, Continued

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Double compensation

22. Criteria:

Government employees should be free from double compensation arising out of dual responsibilities.

Condition:

Two (2) Board Members are at the same time Pohnpei State Government employees. The meeting allowances paid to them is as follows:

	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>
Board member 1	\$ 80	\$ 220	
Board member 2			\$ 120

The time of the Board meetings were held between 10:00 in the morning to 3:00 in the afternoon.

Cause:

The Corporation allowed the payment of the above allowances without giving consideration to dual compensation.

Effect:

There is a possibility that double compensation from the above condition could occur.

Recommendation:

We recommend that the Corporation should ensure that allowances paid to Board Members who are also PSG employees do not constitute dual compensation. For example payment should be made only when the meeting is held after working hours or when the Board member takes a leave of absence from work while attending Board meetings.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Meeting allowance

23. Criteria:

Board meeting allowance should be paid based on roster of attendance.

Condition:

The Vice Chairman of the Board was paid meeting allowance of \$20 even though he was absent from a Board meeting in fiscal year 1999. In addition, three (3) Board members were also overpaid in meeting allowances for \$ 140 in fiscal year 2000.

Cause:

The Corporation's personnel might have overlooked the payment.

Effect:

The effect of the above condition is an overpayment of meeting allowance by \$160.00.

Recommendation:

We recommend that the Corporation ensure that meeting allowances are paid to Board of Directors who actually attended the Board meetings.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

No segregation of duties and responsibilities

24. Criteria:

Sound internal control requires that no employee should be in complete control of pecuniary functions.

Condition:

The Comptroller appears to be in complete control of the pecuniary functions. She prepares the disbursement checks, signs checks, prepares journal voucher entries, input the transactions in the computer system and reconciles the accounts including the bank reconciliation.

Cause:

The cause of the above condition may be because no employee was assigned under her direction.

Effect:

The above condition resulted in the absence of checks and balances. Also, there is no training being given to prepare the Micronesian employee in assuming the position in the future.

Recommendation:

We recommend that the Corporation should redirect the assignment of duties and responsibilities among its employees in such a way that no one has complete control of cash - related functions.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

Bank reconciliation

25. Criteria:

Bank reconciliation statements should be signed by the preparer, reviewed and approved by responsible officer who has no access to bank account.

Condition:

Though bank reconciliation was prepared for Small Business Guarantee and Finance Corporation's bank accounts, the bank reconciliation statements were not signed by the preparer and reviewed/approved by appropriate officials of the Corporation.

Cause:

The above condition may be due to the bank reconciliation being printed from the corporation's accounting system.

Effect:

The effect of the above condition is the absence of document to pinpoint responsibility.

Recommendation:

We recommend that the Corporation ensure that bank reconciliation statements are signed, reviewed and approved by responsible personnel.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Years Ended September 30, 2001 and 2000**

No subsidiary ledger

26. Criteria:

Good internal control requires that general ledger balances be supported by subsidiary ledger.

Condition:

The Corporation did not maintain subsidiary ledgers for Payroll advances, Travel advances and Accounts Receivable—employees.

Cause:

The cause of the above condition might be because the accounts have only few transactions.

Effect:

The Comptroller might not correctly monitor the accounts.

Recommendation:

We recommend that the Corporation should maintain subsidiary ledgers for all general ledger accounts.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

AUDITEE RESPONSE (EXHIBIT 1)

YEARS ENDED SEPTEMBER 30, 2001 AND 2000