

**SMALL BUSINESS GUARANTEE
AND FINANCE CORPORATION
STATE OF POHNPEI**

AUDIT REPORT NO. 001-03
For Fiscal Year Ended September 30, 2002



OFFICE OF THE POHNPEI STATE AUDITOR

ANNES LEBEN
Pohnpei State Auditor
P.O. Box 370
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SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITOR'S REPORT**

YEAR ENDED SEPTEMBER 30, 2002

**SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
STATE OF POHNPEI**

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August 20, 2003

The Honorable Johnny P. David, Governor, State of Pohnpei
The Honorable Feliciano M. Perman, Speaker, Pohnpei State Legislature
The Honorable Members of the Pohnpei State Legislature
Mr. Eddie J. Linus, Executive Director, Small Business Guarantee and Finance Corp.
Board of Directors, Small Business Guarantee and Finance Corporation

EXECUTIVE SUMMARY

We are pleased to submit the audit report of Small Business Guarantee and Finance Corporation (the Corporation) as of and for the year ended September 30, 2002.

We conducted our audit 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. The audit was also conducted pursuant to Article 11, Section 8 (2) of the Pohnpei State Constitution and Pohnpei State Law no. 1L-10-79, and such other laws promulgated thereafter.

The objectives of our audit were to determine whether:

1. The financial statements of the Corporation present fairly, in all material respects, the financial position and the results of its operations in conformity with generally accepted accounting principles;
2. The Corporation's compliance with applicable laws and regulations and internal controls over financial reporting are effectively and efficiently in place.

Also, as part of our audit, we conducted a review of management controls to determine whether there is reasonable assurance that management's objectives will be achieved efficiently and effectively.

The audit report consists of the financial, compliance and internal control sections. The financial section includes the Corporation's financial statements, and notes to the financial statements. In the compliance and internal control sections, we have offered our recommendations to each of the findings, we believe once implemented could improve the operations of the Corporation.

This is the second financial audit of Small Business Guarantee and Finance Corporation.

The highlights of the report are as follows:

- An unqualified opinion was rendered on the financial statements of the Corporation for the period.
- The Corporation had total assets of \$1,756,318, total liabilities of \$3,154 and total fund equity of \$1,753,164 as of September 30, 2002.
- The Corporation incurred a net loss of \$40,460 in fiscal year 2002. This is the second consecutive year that the Corporation posted a net deficit.
- The audit cited eleven (11) instances of noncompliance with laws and regulations. Five (5) of the findings were considered material, viz:
 1. The Corporation guaranteed the loan of a company, which is not considered small or medium enterprise. The amount guaranteed by the Corporation was \$247,950.
 2. The Corporation guaranteed loans, portion of which were used to liquidate or refinance existing loans with private banks. The total amount of loan used for this purpose was \$377,300.
 3. The Corporation's Board of Directors incurred 49% of total travel expenses for the year, which is not in compliance with the intention of its travel and training budget. In subsequent period, the Corporation's travel expense exceeded its budget for the 2nd Study Tour.
 4. Fixed asset purchases were not budgeted and were not documented by Board approval. In addition, the sale of the Corporation's jeep was not evident of Board's authorization.
 5. The Corporation had used \$160,438 of the interest income earned on the \$1.5M capitalization and business development project funding for its operational and administrative expenses.
- On the assessment of the Corporation's internal control structure, the audit disclosed five (5) reportable conditions, however, none of them were considered material weaknesses.

As is customary, a draft of this report has been provided to and reviewed by the management of the Corporation, whose responses and corrective action plans to the findings are included in this report as Exhibit 1 (page 48). As required by the provisions of Pohnpei State Law no. 5L-08-00, an amendment to the law that created the Office of

the Pohnpei State Auditor (OPSA), the Corporation is required to submit a monthly report to the OPSA indicating its progress in clearing deficiencies cited in the audit report, which period shall not exceed six months.

Lastly, we wish to express our sincerest appreciation to the management and staffs of Small Business Guarantee and Finance Corporation, for the cooperation and assistance extended to us during the course of our audit.

Respectfully submitted,

Annes Leben
Pohnpei State Auditor

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

FINANCIAL STATEMENTS

AND

INDEPENDENT AUDITOR'S REPORT

YEAR ENDED SEPTEMBER 30, 2002

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Small Business Guarantee and Finance Corporation

We have audited the accompanying balance sheet of the Small Business Guarantee and Finance Corporation (the Corporation), a component unit of the State of Pohnpei, as of September 30, 2002, and the related statement of revenues, expenses and changes in fund equity and cash flow for the year 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 audit.

We conducted our audit 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 audit 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, 2002, and the result of its operations and its cash flow for the year 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 April 10, 2003, 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
April 10, 2003

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Balance Sheet As of September 30, 2002

<u>Assets</u>	
Current assets:	
Cash and equivalents (note 2)	1,718,109
Accounts receivable, net (note 3)	6,911
Travel advances	2,372
Employee loans receivable (note 4)	4,751
Interest receivable	2,339
Total current assets	<u>1,734,482</u>
Property, plant and equipment, net (note 5)	<u>10,142</u>
Other non-current assets:	
Notes receivable (note 6)	<u>11,694</u>
Total other non-current assets	<u>11,694</u>
Total assets	<u><u>1,756,318</u></u>

Liabilities and Fund Equity

Current liabilities:	
Accrued expenses	1,177
Taxes & Employee benefits payable	<u>1,977</u>
Total current liabilities:	<u>3,154</u>
Fund Equity:	
Contributed capital (note 7)	1,672,877
Retained earnings	<u>80,287</u>
Total fund equity	<u>1,753,164</u>
Contingencies and commitments (note 11)	
Total liabilities and fund equity	<u><u>1,756,318</u></u>

See accompanying notes to financial statements

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Statement of Revenues, Expenses, and Changes in Fund Equity For the Year Ended September 30, 2002

Operating revenues:	
Loan guarantee fee (note 8)	7,607
Loan packaging fee	350
Total operating revenues	<u>7,957</u>
Operating expenses:	
Salaries	62,539
Travel	23,702
Bad debts	19,407
Depreciation	7,573
Office supplies	7,156
Rent	5,936
Litigation	5,673
Legal and professional	5,000
Utilities	2,457
Postage and telephone	2,409
Repairs and maintenance	2,291
Employee benefits	1,995
Payroll tax	1,944
Representation and entertainment	1,532
Janitorial & Cleaning	1,483
Gasoline	993
Meeting allowance	680
Advertising	387
Miscellaneous	128
Bank charges	1
Total operating expenses	<u>153,286</u>
Operating income (loss)	<u>(145,329)</u>
Non-operating revenues (expenses):	
Operating transfers-in (note 9)	70,530
Interest income (note 10)	34,894
Other income	180
Loss on sale of assets	(735)
Total non-operating revenues (expenses)	<u>104,869</u>
Net income (loss)	(40,460)

Add depreciation on fixed assets acquired by capital contributions that reduce contributed capital	<u>0</u>
Increase (decrease) in retained earnings	(40,460)
Retained earnings at beginning of year	<u>120,747</u>
Retained earnings at end of year	<u>80,287</u>
Contributed capital at beginning of year	1,672,877
Contributions	0
Less: depreciation on assets acquired by capital contribution	<u>0</u>
Contributed capital at end of year	<u>1,672,877</u>
Fund equity at end of year	<u><u>1,753,164</u></u>

See accompanying notes to financial statements.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Statement of Cash Flows Year Ended September 30, 2002

Cash flows from operating activities:	
Operating income (loss)	(145,329)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Depreciation	7,573
Bad debts	19,407
Prior year adjustments	619
(Increase) decrease in assets:	
Accounts receivable	(17,126)
Advances	11,130
Employee loans receivable	4,352
Receivable from PSG	4,313
Interest receivable	133,809
Prepaid rent	3,569
Notes receivable	(4,985)
Increase (decrease) in liabilities:	
Accounts payable	(301)
Accrued expenses	(413)
Taxes and employee benefits payable	(1,009)
Due to FSMDB	(1,015)
	<hr/>
Net cash provided by operations	14,594
Cash flows from noncapital financing activities:	
Operating transfers- in (note 9)	70,530
Other income	179
	<hr/>
Net cash provided by noncapital financing activities:	70,709
Cash flows from capital and related financing activities:	
Purchase of fixed assets	(7,025)
Proceeds from sale of fixed assets	2,100
	<hr/>
Net cash provided by (used for) capital and related financing activities	(4,925)

Cash flows from investing activities:	
Interest income	<u>34,894</u>
Net cash provided by investing activities	<u>34,894</u>
Net increase (decrease) in cash and equivalents	115,272
Cash and equivalents at beginning of year	<u>1,602,837</u>
Cash and equivalents at end of year	<u><u>1,718,109</u></u>
See accompanying notes to financial statements	

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2002

(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 Accounting 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 and Administration 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.

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

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

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

with the policies set out by the Board of Directors and implementation of the guarantee program.

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. The powers of the Corporation shall be 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 shall come from the private sector and the other three members are from the public sector.

At present, however, the Department of Commerce and Industry has been dissolved while the SED Council is unoperational. Also, the Board of Directors consists of only six 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 established 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, 2002

(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

The Corporation operates on an annual budget appropriated by the Pohnpei State Legislature (PSL). The enabling legislation allows funds not expended in any given fiscal year to be carried over in subsequent fiscal years. In fiscal year 2002, PSL appropriated \$70,530 for the Corporation’s current year operation.

D. Cash and Equivalents

For the purpose of the balance sheet and statement of cash flows, cash and equivalents are defined as cash on hand and cash in banks, including time certificates of deposit that mature within one year. Of these amounts, \$200,000 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, 2002

(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 accounting principle generally accepted in the United States of America of reducing contributed capital for depreciation on related assets acquired through capital grants. The account is comprised of CIP capitalization funding of \$1,000,000, business development projects funding of \$500,000, and fixed assets donated by State Government.

H. Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, 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, 2002, the Corporation had deposits and cash on hand as follows:

tty cash	\$	300
sh in bank-savings ITA		87,662
sh in bank-savings		41,397
CD-Short term		<u>1,588,750</u>
	\$	<u>1,718,109</u>

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2002

(3) Accounts Receivable

The receivable from the former employee consists of travel and payroll advances, and employee loans and advances. The rest of the receivables arose from advances for travel. A summary of the receivable follows:

<u>Description</u>	<u>Gross Amount</u>	<u>allowance for Bad Debts</u>	<u>Net Amount</u>
former employee	\$ 24,259	\$ 19,407	\$ 4,852
employee	182		182
ward	1,074		1,074
airline company	803		803
	<u>26,318</u>	<u>19,407</u>	<u>6,911</u>
Total	\$ <u>26,318</u>	\$ <u>19,407</u>	\$ <u>6,911</u>

(4) Employee Loans Receivable

The Corporation has adopted 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, 2002 is presented below:

<u>Employee</u>	<u>Loan amount</u>
Executive Director	\$ 1,322
Loan Officer	<u>3,429</u>
Total	\$ <u>4,751</u>

(5) Property, Plant and Equipment

The Corporation's fixed assets are recorded at cost except for donated assets, which are recorded by the Corporation using fair market value since no documents were available to show their acquisition costs. The assets and its corresponding accumulated depreciation, at September 30, 2002, are as follows:

<u>Description</u>	<u>Useful life</u>	<u>Cost</u>	<u>Acc. Depr.</u>	<u>Net Book Value</u>
Vehicles	5 yrs	\$ 3,844	\$ 2,114	\$ 1,730
Furniture and fixtures	2-3 yrs	23,830	15,418	8,412
		<u>27,674</u>	<u>17,532</u>	<u>10,142</u>

Total	\$ 27,674	\$ 17,532	\$ 10,142
SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION			

Notes to Financial Statements
September 30, 2002

(6) Notes Receivable

The amount represents three (3) promissory notes arising from called off guarantees. The details of the notes are as follows:

	<u>Note made</u>	<u>Note due</u>	<u>Note Amount</u>	<u>Interest</u>
ote 1	9-25-2001	9-25-2004	\$ 5,754	9%
ote 2	2-21-2002	4-30-2004	2,185	9%
ote 3	2-22-2002	3-22-2005	5,016	9%

(7) Contributed Capital

The account is comprised of CIP capital funding of \$1,000,000, business development projects funding of \$500,000, and fixed assets donated by the State Government.

(8) Loan Guarantee Fee

The amount represents one percent (1%) fee collected on newly approved guarantee applications, and existing guarantees issued in previous years. As of September 30, 2002, the Corporation has issued 55 guarantees, with a total exposure of \$792,579.

(9) Operating Transfers-In

The Pohnpei State Legislature appropriated \$70,530 in fiscal year 2002 for the Corporation's current operations.

(10) Interest Income

This represents interest earned on all bank accounts maintained by the Corporation and includes interest earned on employee loans.

(11) 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.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements
September 30, 2002

(11) Contingencies, continued:

Claims

The Corporation has been charged for breach of contract arising from labor-related issues. The case is still pending in the Pohnpei Supreme Court. 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 three (3) guarantees called off as of September 30, 2002, 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 year ended September 30, 2002, and have issued our report thereon dated April 10, 2003. We conducted our audit 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 47) in finding numbers 1 to 4, and 16.

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 47) in finding numbers 5 to 10.

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 (page 18 through 47) as finding numbers 11 through 15.

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. However, none of the reportable conditions described above is believed to be a material weakness.

This report is intended solely for the information and use of the Board of Directors and management of Small Business Guarantee and Finance Corporation, federal awarding

agencies, pass-through entities, and the 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

April 10, 2003

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Borrower eligibility for loan guarantee

1. Criteria:

Pursuant to PSL no. 3L-86-95 (or the Corporation's establishing law) and the Corporation's lender guide, loans guaranteed by the Corporation shall benefit small and medium scale enterprises. Section 3 of the law defines "small and medium enterprises" as *any business activity or enterprise engaged in industry, agribusiness, tourism, trade and/or industrial and business services, whether single proprietorship, cooperative, partnership or corporation, whose total assets, inclusive of those arising from loans but exclusive of the land on which the particular business entity's office, plant and equipment are situated, must have value falling under the following categories:*

<i>Cottage:</i>	<i>less than \$5,000</i>
<i>Small:</i>	<i>\$5,001 to \$25,000</i>
<i>Medium:</i>	<i>\$25,001 to \$250,000"</i>

Condition:

The Corporation guaranteed the loan of a company, which is not considered small or medium enterprise considering that its total asset is \$341,681. The Corporation guaranteed \$247,950 of the loan. The maximum amount that the Corporation may guarantee is \$250,000.

Cause:

The Board of Directors approved the guarantee request of a local bank without taking into consideration the eligibility requirement of the law and policy.

Effect:

The above condition is a noncompliance to the abovementioned law and policy. It also defeats the mission and purpose of the Corporation, which is to assist small and medium size businesses. Also, more small-medium enterprises could have availed of the guarantee had the request was decided otherwise.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Borrower eligibility for loan guarantee, continued:

Recommendation:

We recommend that the Corporation's Board of Directors, who approves the guarantee requests, should ensure that the eligibility requirements of the borrowers are met before they approve the guarantee.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Loan guarantees

2. Criteria:

Pursuant to PSL no. 3L-86-95 (or the Corporation's establishing law) and the Corporation's lender 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.
- Credit line accommodation for temporary or seasonal working capital.

Condition:

The Corporation guaranteed six (6) loans totaling \$433,930, portion of which were used to liquidate/refinance existing loans with private banks. The total loan amount used for this purpose was \$377,300.

Cause:

The Board of Directors approved the loan guarantee requests without taking into consideration the loan purpose requirement of the loan guarantee.

Effect:

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

Prior Year Status:

The above condition was reported as a finding in the financial audit of the Corporation for fiscal years 2001-2000.

Recommendation:

We recommend that the Board of Directors should approve the loan guarantee requests in accordance with policy

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Loan guarantees, continued:

Auditee Response:

Please see Exhibit 1.

Auditor's Reply to Auditee Response dated July 25, 2003:

The purposes of the loan that the Corporation could guarantee are very clear in the enabling law of the Corporation and refinancing is not one of them. Also, the financial glossary defines "refinancing" as an extension and/or increase in amount of existing debt; while "rediscounting" means to discount short-term negotiable debt instruments for a second time after they have been discounted with a bank.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Travel expenses

3. Criteria:

The Corporation approved a travel & training budget of \$34,400 in fiscal year 2002. The justification for the budget was to cover costs of travel for staff training.

Condition:

The Corporation incurred travel & training expenses of \$23,702.40 in fiscal year 2002, detailed as follows:

<u>Travel purpose</u>	<u>of Travelers</u>	<u>total Cost of Airfare</u>	<u>total Per Diem & Car Rental</u>	<u>Other Cost</u>	<u>total Travel Cost</u>	<u>marks</u>
Training-Study Tour	1 staff & 3 board)	\$4,523.48	\$7,940.95	\$3,460.00	\$15,924.43	
Training-Association of Pacific Islands Public Auditors (APIPA)	of staff)	564.86	1,762.65	0.00	2,327.51	
Training-Finance Resource Conference	board)	564.86	1,919.60	0.00	2,484.46	
Training-Credit/Project Appraisal and Supervision Course	staff)	966.00	0.00	2,000.00	2,966.00	
Total					<u>\$23,702.40</u>	

/a The training was self-initiated. The schedule submitted by the training consultant consists of various short visits/tours to: institutions extending assistance to small enterprises (e.g. banks), some small business enterprises, and cultural visits to various landmarks (e.g. parks). The Corporation paid \$3,400 to the training consultant.

One of the Board members was late for the training. The travel authorization (TA) amendment reflecting the change in travel dates was not fund certified and was dated before the original TA. One of the documents supporting the travel voucher was a letter of the traveler addressed to the Executive Director explaining why he was late for the training and why he overstayed for 3 days in Guam after completion of the training.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Travel expenses, continued:

Condition, continued:

- /b The Board Chairman was initially scheduled to attend the APIPA training. His TA amendment reflecting the change of conference from APIPA to Finance Resource Conference was not properly signed and was dated on the same date as the original TA. We noted from his trip report that the Finance Resource conference was only recommended by the president of a development bank whom he met during his trip. In addition, the Board Chairman's original itinerary showed that he would leave Pohnpei on May 23, 2002 and return on May 27, 2002. The Finance Resource Conference, which he attended, was held from May 29-30, 2002.

We calculated that 49% of total travel expenses or \$11,559.02 was incurred by the Corporation's Board of Directors.

In the subsequent period, the Board Chairman, one of the Board Members, and the Executive Director again traveled to attend the 2nd Study Tour in the Philippines. The total travel expense incurred for this trip was \$12,115, however, the budget for this trip was only \$9,116.

Cause:

The Executive Director and the Board of Directors approved the above travels.

Effect:

The above condition is an apparent disregard of the Corporation's travel and training budget intention. Also, the attendance of some persons in the trainings appeared unwarranted. The travel in the subsequent period has resulted to an overrun in the budget of \$2,999.

Recommendation:

We recommend that the management of the Corporation should ensure to the maximum that budget requests are used as intended. Also, management should select the trainings that are essential to the Corporation's business. Most importantly, the Corporation should send staffs to training that are appropriate to the nature of their works to benefit the Corporation.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Travel expenses, continued:

Auditee Response:

Please see Exhibit 1.

Auditor's Reply to Auditee Response dated July 25, 2003:

The Board's decision to amend the travel budget was not evident by minutes of Board meetings.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Fixed assets

4. Criteria:

The Corporation's policy on fixed assets requires that the disposal of assets should be authorized by the Board and must be done by public bidding. Purchase of fixed assets on the other hand should be budgeted.

Condition:

During the year, the Corporation purchased three (3) computer units for \$7,025. The purchase was not budgeted and there was no document evidencing Board approval of the purchase.

In addition, the Corporation sold their jeep but such sales and public bidding was not evident of Board's authorization.

We also noted in our review of subsequent events that the Corporation purchased a jeep for \$4,300 even though the purchase was not budgeted. The available minutes of meeting did not indicate the Board's approval of the purchase.

Cause:

The management claimed that the purchase and disposal was approved by the Board but unable to furnish us with documents showing the approval.

Effect:

The above condition is a possible noncompliance to the Corporation's policy. Also, unauthorized transactions may have resulted from the above condition.

Recommendation:

We recommend that management should ensure that the Board authorizes the purchase and disposal of fixed assets and the approval of such should be documented in the minutes of meetings. In addition, the Corporation should also ensure that fixed asset purchases are budgeted so as not to deplete its fund intended for other operations/business.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Fixed assets, continued:

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Purchase of cellular phones

5. Criteria:

The Pohnpei State Government, through a directive by the Governor, prohibits the purchase of cellular phones for government employees, out of government funds.

Condition:

The Corporation purchased five (5) units of cellular phones during the year. Four (4) units were given to the Board of Directors, and one (1) unit was given to the Executive Director, for their use.

At present, one (1) unit was lost and another unit was broken. The Board Chairman, Board Secretary, and one (1) of the Board members are currently using the three (3) other units.

Cause:

The Corporation claimed they have no knowledge of the Governor's directive.

Effect:

The above condition is a noncompliance with the Governor's directive. Also, there is no assurance that the cellular phones are not being used privately.

Recommendation:

We recommend that the Corporation should comply and not conflict with the Governor's directive. The cellular phone in its very nature is susceptible to private use, and control measures for its use would be very difficult for the Corporation to implement, hence, we also recommend that the users reimburse the Corporation for the cost of the cellular phones.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Petty cash borrowings

6. Criteria:

The Corporation's policy authorized a petty cash fund in the amount of \$300 to accommodate minor expenses for daily operations of the office.

Condition:

During our count of petty cash on September 30, 2002, we noted petty cash borrowings of some employees. The borrowings were documented by a signed small piece of paper.

Cause:

The petty cash custodian, who was new on the job, allowed the borrowings.

Effect:

The above condition is a noncompliance to the Corporation's policy.

Recommendation:

We recommend that the petty cash custodian should cease the use of petty cash as advances to the employees of the Corporation and ensure that the petty cash fund is used only as intended.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Minutes of Board meetings

7. Criteria:

The Corporation's by-laws require the Secretary of the Board to keep a book of minutes of all meetings of the Board of Directors, whether regular or special, if special, how authorized, the notice whereof given, the names of those present or represented at the meetings, and the proceedings thereof. In the absence of the Secretary at any meeting, the presiding officer may appoint any one of the Board members to act as Secretary of the meeting.

Condition:

Six (6) of the sixteen (16) Board meetings did not have minutes of meetings. The Executive Director prepared the minutes of the other ten (10) Board meetings. Only three (3) of the meeting minutes were certified as being true and accurate recordings, as evidenced by the signature of the Secretary of the Board, as approving officer.

Cause:

The Secretary of the Board did not ensure that meeting minutes are properly prepared and completed.

Effect:

The above condition is a noncompliance to the Corporation's by-laws. Also, complete proceedings of the six (6) meetings were not known.

Prior Year Status:

The above condition was reported as a finding in the financial audit of the Corporation for fiscal years 2001-2000.

Recommendation:

We recommend that the Board of Directors should comply with its own by-laws and ensure that the Secretary of the Board or his designee should keep a record of all meeting proceedings. Also, the minutes of Board meetings should be properly signed.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002

Minutes of Board meetings, continued:

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Travel voucher submission

8. Criteria:

The Corporation's travel policy requires the traveler to submit a travel voucher to the Comptroller within a week from the date travel is completed, which must be supported by all receipts for non-per diem expenses and car rental. If the travel cost is less than the advanced amount, the traveler must pay the difference within 30 days from end of travel.

Condition:

Our review of travel vouchers and supporting documents submitted by the travelers disclosed the following:

1. There were five (5) instances when travelers submitted their travel voucher liquidations more than thirty (30) days after the travels were completed.
2. In most cases, the travelers did not submit the complete airline boarding passes; hence, we could not determine the exact period of travels.
3. Two (2) travelers charged the penalty charges for changing flight schedule to the Corporation. The purpose of the change/s in flight schedule was not documented.
4. There were five (5) instances when travelers did not reimburse the Corporation for the excess travel advance. At September 30, 2002, the amount of \$1,216.40 was still recorded as "Accounts Receivable" from the travelers.
5. All of the travelers who attended the Study Tour training in the Philippines did not attach trip reports to their travel voucher submission.

Cause:

According to the Comptroller, verbal follow-ups were made to the Board of Directors for the submission of the travel vouchers. For the overdrawn travel advances, the Comptroller sent letters to the travelers requesting them to pay the excess travel advances; but such letters were apparently ignored. The submission of the trip report after completion of the trip was not required in the Corporation's travel policy.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Travel voucher submission, continued:

Effect:

The above condition is a noncompliance to the Corporation's travel policy.

Prior Year Status:

The above condition was reported as a finding in the financial audit of the Corporation for fiscal years 2001-2000.

Recommendation:

We recommend that the Comptroller should actively follow-up the submission of the travel liquidation from the travelers in writing, and ensure that the travel vouchers when submitted, are properly supported. We also recommend that the Corporation consider releasing 80% of estimated travel cost to traveler instead of the 100% that it usually provides. This way, the travelers would have the initiative to submit travel vouchers timely. Furthermore, we suggest that the Corporation should require all travelers to submit trip reports, which will outline the exact purpose and nature of the trips and how the trips provide benefit to the Corporation.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Double compensation

9. Criteria:

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

Condition:

A Board member of the Corporation is concurrently a Pohnpei State Government employee. The Corporation paid him \$200 as meeting allowance during the year.

A review of the minutes of Board meetings disclosed that most of the meetings were held during regular working hours.

Cause:

The Accounting Division of the Corporation paid the Board member's allowance without taking into consideration the issue of double compensation.

Effect:

The above condition has possibly resulted to double compensation.

Prior Year Status :

The above condition was reported as a finding in the financial audit of the Corporation for fiscal years 2001-2000.

Recommendation:

We recommend that the management of the Corporation should ensure that the Board member has clearly established that he is not performing dual responsibilities before paying him the meeting allowance. The Pohnpei State Attorney General opined that payment should be made only when the meeting is held after working hours or when the Board member takes a leave of absence from his regular work while attending the Corporation's Board meetings.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Double compensation

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Direct lending

10. Criteria:

The Corporation's policy states that loans approved under the Direct Lending Program should be utilized for the following purposes:

- a. Acquisition of fixed assets, provided that not more than 25% of approved loan is used for that purpose.
- b. Building improvements/expansion or construction of a new facility.
- c. Permanent working capital.
- d. Credit line accommodation for temporary working capital.
- e. Projects that contribute to the economic development of the state.

The policy also requires that the business (borrower) must be duly registered with the appropriate agency as presently provided by law or as provided by rules and regulations established by the State.

Condition:

The Corporation started its Direct Lending Program in March 2003. We noted that three (3) out of the five (5) approved loans were used to acquire fixed assets. However, more than 25% of the loan amounts were used for the purpose.

In addition, we did not see the business licenses of three (3) approved borrowers in their respective loan files.

Cause:

The Executive Director and the Board of Directors approved the loans.

Effect:

The above condition is a noncompliance to the Corporation's policy.

Recommendation:

We recommend that the management and Board of Directors should ensure that direct loans are approved in accordance with policy.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Direct lending, continued:

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Budget overrun

11. Criteria:

Expenditures should be kept within the appropriated or approved budget.

Condition:

The following expenses exceeded authorized budgets:

Account	<u>Budget</u>	<u>Actual</u>	<u>Overrun</u>	%	
Office supplies	\$ 2,500	\$ 7,156	\$ 4,656	186	/a
Rent	0	5,936	5,936	100	/b
Litigation	0	5,673	5,673	100	/c
Legal & Professional	0	5,000	5,000	100	/d
Representation & Entertainment	0	1,532	1,532	100	/e
Janitorial & Cleaning	0	1,482	1,482	100	/b
Advertising	0	387	387	100	/b
Gasoline	500	993	493	99	/f

We noted the following during our review of the variances:

/a The Corporation did not budget for the purchase of items below the capitalization threshold like filing cabinet, calculator, and desk. The Corporation also bought 5 units of cellular phones.

/b Recurring expenses were not budgeted.

/c The Corporation settled its former lessor's claim for breach of contract. Management claimed that the Corporation's lawyer advised the settlement of the claim, however, there is no document submitted to show the lawyer's advice. The Board only approved the settlement of one-half of the claim.

/d The Corporation retained the services of a lawyer for two months. This matter was not mentioned in the minutes of Board meetings.

- /e The expenses for the Christmas party and various lunches for the Board meetings were charged to this account. The purpose/s or the names of the persons entertained were not indicated in some of the invoices/official receipts.
- /f In most cases, the Corporation exceeded its allowable purchase limit of 25 gallons a month.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Budget overrun, continued:

Condition, continued:

For telephone expenses, although the account did not exceed its budget; we came across a payment made by the Corporation on September 17, 2002 for \$204.36 for internet usage that exceed the allowable limit by 6,288 minutes. Per inquiry, we were informed that an employee forgot to log out and the internet was online over the weekend.

Cause:

The causes of the above condition are: some recurring expenses were not budgeted, the original budget was not amended, some expenses lacked proper authorization, and lack of controls in internet usage.

Effect:

The above condition resulted to an overall budget overrun of \$6,206.

Prior Year Status:

The above condition was reported as a finding in the financial audit of the Corporation for fiscal years 2001-2000.

Recommendation:

We recommend that the Corporation should operate within its approved budget. The management should ensure that revenue sources and all anticipated expenses are fully considered in the budget before submitting them to the Board for approval. Any amendment to the budget should be documented and approved by the Board. The management should also establish controls in the use of internet by its employees.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Employee loans

12. Criteria:

The Corporation's policy provides a staff loan program that allows its employees to obtain a maximum loan of \$5,000. The following are the eligibility requirements of the loan program:

1. The purpose of the loan shall fall within the ten (10) specified purposes mentioned in the policy.
2. Employee must have been with the Corporation for at least one (1) year.
3. Employee performance rating must be good or excellent.
4. Employee must have good credit records with other lending institutions.
5. The loan must have adequate security;
 - a. It must be 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%.

In addition, a majority of the Corporation's Credit Committee composed of the Executive Director, Chairman and Vice Chairman of the Board, shall approve the loan application. In the event that the Executive Director has an application, the Administrative Officer will take his place at the credit committee meeting.

Condition:

Two (2) of the three (3) employee loans did not show documentation of credit committee approval. Said loans belong to the Executive Director. His loans were approved without the attendance of the Administrative Officer in the credit committee meeting.

In addition, all three (3) loans were granted even though some of the eligibility requirements were not complied with or completed.

Cause:

The employee loans were processed and paid without complete documentation and approval.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Employee loans, continued:

Effect:

The above condition is a noncompliance to the Corporation's policy.

Prior Year Status:

The above condition was reported as a finding in the financial audit of the Corporation for fiscal years 2001-2000.

Recommendation:

We recommend that the management and Board of Directors should follow its loan policy requirements.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Employees' leave record

13. Criteria:

As a control procedure, the Corporation should maintain a complete record of employees' leave.

Condition:

During our review of payroll, we noted that the Corporation's record of leave usage and balances was not accurate for two (2) employees. By comparing the timesheet with the leave record, we found instances of leave use per timesheet that were not recorded and leave use recorded but not reflected in the timesheet.

Cause:

There is no check and balance in the maintenance of leave records.

Effect:

The effect of the above condition is inaccurate record of leave balances, e.g. one employee used 16 hours of sick leave in excess of allowed leave, another employee used 36 hours of vacation leave in excess of allowed leave.

Prior Year Status :

The above condition was reported as a finding in the financial audit of the Corporation for fiscal years 2001-2000.

Recommendation:

We recommend that a responsible officer should periodically review the Corporation's record of leave maintained by the Administrative Officer. The corresponding employees should reimburse any excess leave that were paid.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Execution of contracts, etc.

14. Criteria:

The Corporation's by-laws should be prepared in such a way that no one person is in complete control of the affairs of the Corporation.

Condition:

Section 5 Article IV of the Corporation's by-laws states that: "Unless so authorized by the Board of Directors, only the Chairman shall have the power or authority to bind the Corporation by any contract or engagement, or to pledge its credit or to render it liable for any purposes or to any amount". By this power, the Board Chairman signed a promissory note on behalf of the Corporation on November 13, 2002, in the amount of \$3,638.06. The note was intended to pay for past services provided by the telecommunication company to the dissolved Division of Commerce and Industry of Pohnpei State Government. There was no evidence to show the approval of the Board of Directors on the Board Chairman's action.

The above action however is in conflict with the provision of Section 6 Article III, which states that: "The Chairman of the Board, shall, if present, preside at all meetings of the Board of Directors, and exercise and perform such other powers and duties as may be from time to time assigned to him by the Board of Directors".

Cause:

The Executive Director asked the Board Chairman to sign the promissory note. The Chairman, acting by the power vested in him by the Corporation's by-laws signed the note.

Effect:

The above condition has resulted to the recording of the payable account that decreased the Corporation's retained earnings.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Execution of contracts, etc., continued:

Recommendation:

We recommend that the Corporation should amend its by-laws to remove the conflict of powers vested to the Chairman of the Board.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Indirect expenses

15. Criteria:

The Corporation should only pay for expenses directly related to the Corporation.

Condition:

The Corporation paid for expenses relating to Pacific Island Development Bank (PIDB) and Pacific Island Small Business Development Center Network (PISBDCN), as follows:

- Petty cash was used to fax a letter to PIDB. The faxed letter was from the Pohnpei State Assistant Attorney General to the Administrator of the Economic Affairs re: Proposed Memorandum of Understanding (MOU) between PISBDCN and Pohnpei State. The Administrator of Economic Affairs is also the Chairman of Small Business Guarantee and Finance Corporation.
- The Corporation paid a local radio station for advertisement that says “application for PIDB is now available at SBGFC office”.
- The Corporation purchased prepaid phone cards that were used to call the PIDB President in Guam. The purposes of the calls were not documented.
- The Board Chairman went to Guam on the Corporation’s expense to meet with the PIDB President.

Cause:

According to the Executive Director, the Corporation has agreed to assist PISBDCN and PIDB on administrative matters.

Effect:

The above condition may have resulted to unnecessary expenses for the Corporation.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Indirect expenses, continued:

Recommendation:

We recommend that the Corporation should refrain from paying for expenses not directly involved with its operations. If the Corporation agreed to pay for expenses for administrative services in favor of other government agencies, such should be approved by its Board of Directors. In addition, the Corporation should ensure that the benefit derived by the Corporation should outweigh its costs.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Schedule of Findings and Recommendations Fiscal Year Ended September 30, 2002

Interests Income

16. Criteria:

The Corporation had an initial capitalization of \$1,000,000, funding of which comes from Pohnpei State Legislature. In addition, the Comprehensive Budget Act for fiscal year 1994 appropriated \$500,000 to the Corporation for Business Development Project. Therefore, the \$1.5M capitalization and projects funding and any interests earned thereto, should only be used to perform its prescribed purposes and functions, which are: 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.

Condition:

As of September 30, 2002, the Corporation had transferred the total amount of \$200,253.67 to its ITA-Savings account, representing interest income earned from the \$1.5M funding for capitalization and business development project. The ITA-Savings account is the account used by the Corporation for its operations, which, at September 30, 2002, had a balance of only \$39,815.73. Hence, the amount of \$160,437.94 was used for operations and advances as of September 30, 2002.

We sought legal opinion on the Corporation's use of the interests earned and the Attorney General opined that Small Business Guarantee and Finance Corporation is precluded from using or applying certain amount out of its interest income earned on its capital stock and business development project funds to defray its operational/administrative expenses.

Cause:

The management approved the fund transfers because the Pohnpei State Legislature did not appropriate funding for fiscal year 2001 operations.

Effect:

The above condition is a possible noncompliance to the intent and purpose of the \$1.5M capitalization and project funds.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2002**

Interests Income, continued:

Recommendation:

We recommend that management should cease from using interests income earned from the \$1.5M currently invested in time certificate of deposits, for its operational and administrative expenses. Otherwise, we recommend that in order for the Corporation to comply with the intent and purpose of the \$1.5M capitalization and project funds, management should request Pohnpei State Legislature to authorize the use of a portion of the interest earned on the \$1.5M, in the event that the Legislature does not appropriate any funds for its operations.

Auditee Response:

Please see Exhibit 1.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

AUDITEE RESPONSE (EXHIBIT 1)

YEAR ENDED SEPTEMBER 30, 2002