Testimony of

Thomas A. Dumaresq

Chief Financial Officer

U.S. Small Business Administration

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Good afternoon Chairman Platts, Ranking Member Towns, and the rest of the subcommittee. On behalf of the U.S. Small Business Administration (SBA) and Administrator Barreto, I want to thank you for the opportunity to speak today about SBA's financial statements. I am Tom Dumaresq, SBA's Chief Financial Officer (CFO).

NEW CFO TEAM

Soon after Hector Barreto was sworn in as Administrator in July 2001, he became concerned about a number of issues regarding SBA's financial management even though the Agency had been receiving clean audit opinions. These issues included the timeliness and accuracy of financial data, the slow progress of the implementation of a loan monitoring system and the appropriateness of the expenditures, as well as issues surrounding loan asset sales. The asset sales issue is the subject of the Government Accounting Office's (GAO) report that they will be discussing here today.

Administrator Barreto is committed to improving the Agency's financial performance and he determined that in order to address these concerns effectively, a change in leadership was needed in the Office of the Chief Financial Officer (OCFO). In March 2002, I was named CFO. Jennifer Main, a senior financial management consultant and former employee of the Office of Management and Budget (OMB) with extensive credit reform act experience, was hired as the new Deputy CFO in September 2002.

I have been with SBA since 1977 in a variety of positions including direct program delivery, policy development and implementation, and most recently, extensive experience with the management and administration of the Agency's internal activities. Before becoming CFO, I had worked on various aspects of major Agency initiatives related to financial management including asset sales, loan monitoring, and implementation of a new administrative accounting system.

My management team's objective is to systematically identify and resolve problems associated with a number of longstanding issues related to the Agency's financial operations. We believe these are the critical steps to ensuring the OCFO's capacity to successfully deliver on its responsibility for sound financial management.
We are here today because SBA received a disclaimed opinion on its FY 2002 financial statements. From 1996 through 2001, the auditor issued unqualified opinions on SBA's financial statements. It is important to understand that the key issues that were raised in the FY 2002 audit have been elements of SBA's financial statements since 1999 and only this year did the auditor determine that these issues merited a "disclaimed" opinion. **It is not SBA's treatment of these issues that has changed, but rather the auditor's perspective regarding their significance. We generally agree with the auditor's recommendations.** However, we think it is important to note that **the changed audit opinion does not reflect a decline in the quality of our financial statements but rather a more in-depth assessment by the auditor of what has been in our financial statements for a number of years.**

Upon assuming the duties of CFO, I became aware of a number of challenges that needed to be addressed immediately. Several of these issues were related to the implementation of a new administrative accounting system based on software from Oracle Corporation. This system is called the Joint Accounting and Administrative Management System (JAAMS). In the second half of FY 2002 and the first quarter of FY 2003, significant resources were allocated to resolving implementation problems with this system. As a result, the Agency was able to complete installation of this new system and produce financial statements in a timely manner. This is a significant achievement that would not have happened without extraordinary efforts by the staff in the office of the CFO as well as the participation and cooperation of the Office of the Inspector General (IG) and our auditor.

During the same period that we were addressing the JAAMS challenges, I became aware of the extent of the issue of SBA's budgeting and accounting for asset sales. As you know, this issue was the principal cause for the auditor's withdrawal of its unqualified opinion for SBA's FY 2000 and FY 2001 financial statements. Subsequently, the FY 2002 financial statements (as well as the FY 2001 statements) received a disclaimed opinion again primarily because of the same asset sale issue, as well as two other items. I want to assure you that SBA was aware of the situation and had been taking steps to address it prior to the auditor's disclaimed opinions and the GAO report.

LOAN ASSET SALE ISSUE

SBA held its first asset sale in August 1999. Since then, SBA has conducted a total of seven asset sales and plans to continue the program if it is in the government's best interests. As early as the fall of FY 2000, SBA was aware that the accounting for the asset sales was resulting in losses on the financial statements rather than the gains calculated under the asset sales model. The former OCFO management was not able to resolve this apparent inconsistency.

In 2001, GAO was asked to review the loan asset sale program, and a report was published in January, 2003. Overall, SBA agreed with GAO's findings regarding the budgeting and accounting for asset sales, and we have made substantial progress in identifying and sorting out the underlying problem in the past few months. Before I discuss the actions we are taking, however, I want to make a few general points about this issue.

It is important to note that this area is not an area where extensive guidance has been developed. The guidance that exists from the OMB, the Federal Accounting Standards Advisory Board (FASAB), and others is relatively general in nature and requires interpretation for specific application. Throughout its loan asset sales program, SBA repeatedly sought outside experts recognized in this field to help interpret and apply the available guidance. The emergence of these difficult issues despite the professional advice SBA received underscores the complexity of the problem.

RESOLUTION OF THE ASSET SALE ISSUE

There are two distinct issues that SBA is working to resolve. The first issue is the discrepancy between the accounting system, which tracks program costs, and the budget models, which are used to forecast the lifetime loan program costs. Under the Federal Credit Reform Act, the "cost" estimated by the budget models should exactly cover the cost of the program as tracked through the accounting system. This has not been the case, however, for the Disaster loan program, which has made up the majority of the loans sold in the asset sales program. Resolving this "anomaly" – and understanding the extent to which asset sales contributed to it – has been our first priority.

The second issue is the discrepancy between the assets sales "hold model" which estimates the "value to government" of loans for sale and the budget model, which is used to measure the net budget impact of all loan payment events, including loan sales. Results from our asset sales program have indicated that, while the sales were profitable when measured against the hold model value estimates, the proceeds from the sales caused an increase in program costs as measured by the budget model.

Although readily apparent for several years, the inconsistencies between the hold value model, the subsidy model, and the financial statements were never sufficiently addressed. This is a complex problem and a somewhat new concept, and despite SBA's efforts to follow all applicable guidance in budgeting and accounting for asset sales, we recognize that the results of the process were inadequate.

Ultimately, responsibility for pursuing the resolution of these inconsistencies clearly rests with SBA. The new CFO management team is committed to resolving this issue. SBA believes we have found the root cause of the problem, and the issue will remain a top priority of the Agency until it is fully remedied.

SBA has worked aggressively to get to the bottom of these issues since last fall. During the audit process, we worked with our auditor to analyze the potential causes of the inconsistencies and identify options for resolving the situation. In January, we added a team of experienced credit reform accountants and budget analysts from IBM to work with OCFO staff.

Our analysis resulted in a number of key findings regarding SBA's accounting and subsidy methodology. The findings are preliminary and therefore it would be premature to discuss them today. However, I can say SBA has determined that going forward there must be only one model for budgeting and loan sale purposes. The single model must have the functionality to provide both the traditional budget results as well as the loan level value-to-government estimates that the hold model had provided previously. We believe this is the only way that SBA can ensure that the value-to- government calculation is entirely consistent with the budget cost estimate.

We have begun building a new budget subsidy model prototype. However, we will not be able to determine the impact of asset sales on the cost of the Disaster loan program until the new model is developed, tested and verified. We anticipate completion of the model, including review and validation, by the end of this fiscal year. SBA believes it will have valuable lessons learned to share with other Federal agencies.

OTHER AUDIT ISSUES

Next, I want to briefly mention SBA's efforts to address the other issues identified by our auditor. The SBA's assessment and treatment of the Master Reserve Fund (MRF) residual liability was identified in our FY 2002 audit process as contributing to the disclaimed opinion. For the secondary market component of the 7(a) program, SBA's Fiscal and Transfer Agent (FTA), Colson Services Corporation, maintains the MRF to ensure that investors receive their monthly payments of principal and interest in a timely manner. Should the fund ever have a shortfall, the SBA would have to step in to cover the gap. SBA's auditor has criticized SBA's ability to measure whether the MRF is adequately capitalized. From OCFO's perspective, the primary challenge to SBA's ability to measure the capitalization is hampered by the lack of data. We will be working with the FTA in the coming months to determine what cost effective alternatives are available to address this problem. At a minimum, we plan to develop a more sophisticated methodology for measuring the residual liability in the MRF for FY 2003.

Also included was SBA's treatment of pre-1992 loan guarantees, the financial reporting process, and funds control weaknesses. We are taking action to address each of these issues and believe these items are things that SBA can successfully resolve prior to completion of the FY 2003 financial statement process.

CFO RESPONSIBILITY'S

I'd like to discuss SBA's broader financial management issues next. With the Chief Financial Officer's (CFO) Act of 1990, the Congress mandated financial management reform and entrusted the responsibilities of sound financial management and accountability with the CFO at each designated Agency. More recently, President Bush, under his Management Agenda (PMA), also highlighted financial management as a key area in improving the management of government resources. The PMA standards of success include requiring the agency good quality financial data in day to day operations and a clean audit.

Reflecting the objectives of the CFO Act and President Bush's agenda, the mission of the SBA Office of the CFO (OCFO) is to use our personnel, processes, and systems to achieve sound financial management and to produce accurate, timely, and useful information that can – and should -- be used to support operating, budget, and policy decisions.

It is in this context that we have identified and are focused on three key objectives:

1 – Build trust, both internally and externally;

2 – Focus on and succeed at activities that are core to our mission; and

3 – Improve data quality.

The OCFO's approach to accomplishing its objectives involves addressing and solving the current challenges while building the capacity to make meaningful improvements in the underlying systemic problems facing the office. SBA is not only addressing the three issues identified specifically as contributing to the "disclaimer" in the FY 2002 audit but is also hard at work on a variety of other items that were raised in the auditor's internal controls report as well as other matters that we believe may affect our capacity to fulfill our core functions.

Through the SBA-wide Execution Scorecard system developed by the Deputy Administrator, the OCFO has established meaningful but manageable size projects that will lead us to success in each of the current issues listed above. The OCFO and SBA leadership are tracking these key projects through the use of specific milestones, deadlines, and budgets. The OCFO meets monthly with the Deputy Administrator to discuss progress and ensure we are on target. These include challenges that virtually all Federal government CFOs are facing: technology, human capital, information management, performance measures, and performance-based costing.

While SBA acknowledges that it still needs to make progress in all of these areas, SBA's view is that bringing these important financial management and reporting issues to light so we can resolve them is a positive step forward for the Agency. We believe we are on track to substantially improve the overall financial performance results at SBA this year. SBA is strongly committed to addressing all of the issues raised by our auditor and GAO and resolving them in this audit year.

Thank you and I am happy to answer any questions you may have.