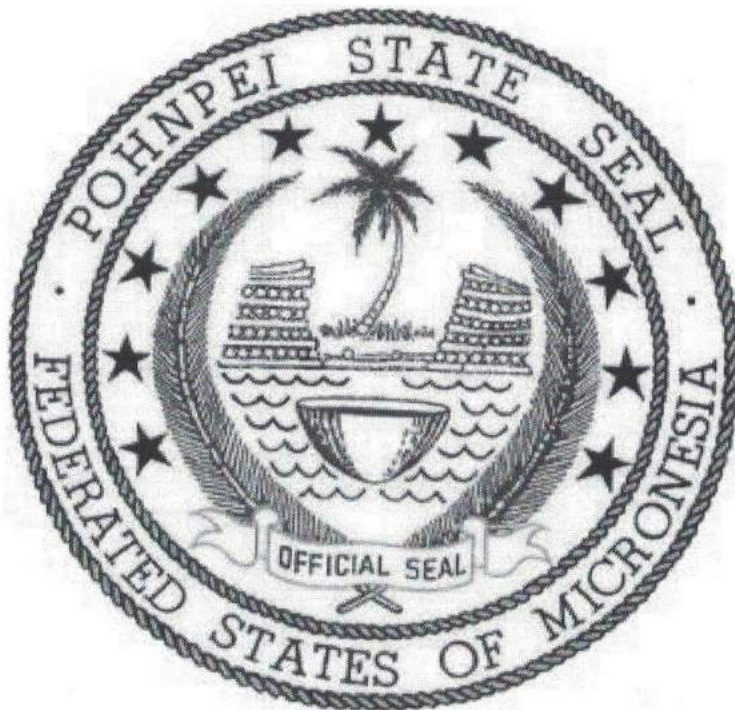


**SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
FINANCIAL AUDIT
FISCAL YEAR ENDED SEPTEMBER 30, 2019**

AUDIT REPORT NO. 002-20

**Office of the Public Auditor
State of Pohnpei**



State Public Auditor
P.O. Box 370
Kolonias, Pohnpei, FM 96941

Phone: 320-2638
Hotline: (691) 320-8497 (24/7)
Email: opsa_psa@mail.fm
website: www.opapni.fm

**SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
AUDIT REPORT
FISCAL YEAR ENDED SEPTEMBER 30, 2019**

Table of Contents

	<u>Page No.</u>
Executive Summary	i-ii
Independent Auditor's Report	1
Management Discussion and Analysis	2-4
Statement of Net Assets	5
Statement of Revenues, Expenses and Changes in Net Assets	6-7
Statement of Cash Flow	8
Notes to the Financial Statements	9-17
Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting	19-20
Schedule of Findings and Recommendations	21-32
Exhibit I	33
Exhibit I - Auditee Response	34-43



**POHNPEI STATE GOVERNMENT
OFFICE OF THE PUBLIC AUDITOR**

P.O. BOX 370

KOLONIA POHNPEI FM 96941

TEL: (691) 320-2638/8497

WEBSITE: WWW.OPSA.FM E-MAIL: opsa_psa@mail.fm

October 13, 2020

The Honorable Oliver Reed, Governor, State of Pohnpei
The Honorable Ausen T. Lambert, Speaker, Pohnpei State Legislature
Honorable Members 10th Pohnpei Legislature
Honorable Board of Directors, Small Business Guarantee & Finance Corporation
Mr. Thomas Pablo Executive Director, Small Business Guarantee & Finance Corp.

EXECUTIVE SUMMARY

We are pleased to submit the audit report of Small Business Guarantee and Finance Corporation (the Corporation), as of and for the fiscal year ended September 30, 2019. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. The audit was also performed pursuant to Article 11, Section 8 (2) of the Pohnpei State Constitution and Pohnpei State Law No. 1L-10-79, and such other related laws enacted thereafter.

The objectives of our audit were: (1) the expression of an opinion concerning whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of Small Business Guarantee and Finance Corporation, in conformity with accounting principles generally accepted in the United States of America, (2) reporting on the internal control relevant to an audit of the financial statements, and (3) reporting on the Corporation's compliance with laws and regulations, which could have a material effect on the financial statements. 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 highlights of the report are as follows:

Auditor's Opinion

- The Corporation's financial statements present fairly, in all material respects, the financial position of the Corporation, as of September 30, 2019, and the results of its operations, and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Financial Analysis

- The Corporation earned revenues of \$55,214 this fiscal year, a \$8,539 or 13% decrease as compared to \$63,753 in fiscal year 2018.
- At September 30, 2019, the Corporation's total operating expense was \$156,396. The amount is \$26,097 or 20% higher than last year's figure of \$130,299.
- The Corporation's net asset was decreased by \$2,774.
- The Corporation's loan accounts increased from a net of \$534,389 in fiscal year 2018 to a total net of \$572,086 in the current year. One contributing factor is that several accounts were paid off but new loans were approved.

Findings and Recommendations

- There are eight (8) findings this fiscal year, regarding control deficiencies in the accounting system and SBG&FC's own policies and procedures. For the findings, we have provided our recommendations if implemented, could improve the Corporation's operation.

The findings are fully discussed in the Schedule of Findings and Recommendations on pages 21 to 32.

As is customary, we have discussed the draft report with management of the Corporation and have requested for their response to our findings and recommendations. The Corporation's response is included in this report on pages 34-43.

The Pohnpei State Law No. 5L-08-00, requires the auditee to submit monthly report to POPA indicating corrective measures already taken or will be shortly implemented to clear the deficiencies cited in the audit report until all findings are satisfactorily resolved, which period shall not exceed six months. Accordingly, the first progress report from the Corporation should be due around November 20, 2020.

In closing, we would like to extend our sincere appreciation to the Corporation's Executive Director and members of the workforce for their support and assistance extended to us during the course of our audit.

With warm regards, I am.

Sincerely,


Iso Ihlen K. Joseph
State Auditor
Pohnpei



**POHNPEI STATE GOVERNMENT
OFFICE OF THE PUBLIC AUDITOR**

P.O. BOX 370

KOLONIA POHNPEI FM 96941

TEL: (691) 320-2638/8497

WEBSITE: WWW.OPSA.FM E-MAIL: opsa_psa@mail.fm

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Small Business Guarantee and Finance Corporation:

We have audited the accompanying financial statements of Small Business Guarantee and Finance Corporation (the Corporation), a component unit of the State of Pohnpei, as of September 30, 2019 and for the fiscal 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 provides a reasonable basis for our opinion.

In our opinion, the aforementioned financial statements present fairly, in all material respects, the financial position of the Small Business Guarantee and Finance Corporation, as of September 30, 2019, and the results of its operations and its cash flows 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 17, 2020 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.

The Management's Discussion and Analysis on pages 2 to 4 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.


Ihlen K. Joseph
State Auditor
Pohnpei
17 April 2020

Small Business Guarantee and Finance Corporation
Management's Discussion and Analysis
Year Ended September 30, 2019

The Small Business Guarantee and Finance Corporation presents an overview of its financial performance as of and for the fiscal year ended September 30, 2019. This Management's Discussion and Analysis should be read in conjunction with the Corporation's financial statements, on pages 5 to 8 of this audit report.

Financial Highlights

- For the fiscal year ended September 30, 2019, the Corporation's total operating revenues decreased by \$8,539 or 13% from last year's figure.
- The net asset as of September 30, 2019 was \$1,829,944 which is lower than last year's amount of \$1,832,718.
- Net assets was decreased by \$2,774.
- During the year, total operating expense increased by \$26,097 or 20%, as compared with prior year.
- The Corporation experienced an operating loss of \$101,182 in FY 2019 which is 52% higher than last year's operating loss of \$66,546 due to decrease in operating revenues and increase of expenses.

Overview of the Financial Statements

The financial statements presented herein include all activities of the Small Business Guarantee and Finance Corporation. Included in this report are the statement of net assets, the statement of revenues, expenses, and changes in net assets, and statement of cash flows. These financial statements present the complete financial picture of the Corporation from the economic measurement focus using the accrual basis of accounting. It can be read from these statements whether the cash inflow of the Corporation is sufficient to take care of its financial obligations and commitments. These financial statements help management to measure company performance and determine flaws in its financial policies and consequently to assist management in determining the appropriate remedial measures.

The Corporation's budget that is subsidized partly by Pohnpei State is prepared annually by the management and transmitted through the Board of Directors for approval of the Pohnpei State Legislature. The budget contains the projected revenues, expenses and capital expenditures.

Small Business Guarantee and Finance Corporation

Management's Discussion and Analysis
Year Ended September 30, 2019

Financial Analysis of the Corporation as Whole

Changes in Net Assets

The statement of net assets presents the financial position or condition of the Corporation and it shows the information on all of the Corporation's assets and liabilities, with the difference between the two reported as net assets or net liabilities. The passage of time and/or increases or decreases in net assets may serve as an indicator whether the financial position of the Corporation is improving or deteriorating.

The following table summarizes the changes in net assets of the Corporation for FY2019 and FY2018.

	<u>2019</u>	<u>2018</u>	<u>% Increase/ (Decrease)</u>
Current assets	1,271,044	\$1,292,778	(1.7%)
Capital assets, net	9,052	12,648	(28%)
Other non-current assets	<u>572,086</u>	<u>534,389</u>	<u>7%</u>
Total assets	<u>1,852,182</u>	<u>1,839,815</u>	<u>.67%</u>
Current liabilities	<u>22,238</u>	<u>7,097</u>	<u>213%</u>
Net assets:			
Invested in capital assets	9,052	12,648	(28%)
Restricted	1,774,213	1,762,472	.67%
Unrestricted	<u>46,679</u>	<u>57,598</u>	<u>(19%)</u>
Total liabilities and net assets	<u>1,852,182</u>	<u>1,839,815</u>	<u>.67%</u>

Operating Activities

The Corporation charges 1% guarantee fee per annum on the guaranteed outstanding loan based on the diminishing balance thereof and payable one (1) prepayment period in advance.

On the Micro Loan Program, the Corporation charges 15% interest per annum and 2% penalty fee for delinquent loans, based on the monthly amortization in the event an installment is made after the fifteenth (15th) day of the due date. Upon closing of the loan, the Corporation charges 0.5%

processing fee and a 35% agent's commission on every credit life insurance premium the Corporation issues on each loan. The loan ceiling is \$25,000.

In fiscal year 2019, about 60% of the Corporation's operation was subsidized by the State Government, while the remaining 40% was provided through the Corporation's project income and other revenues. Interest income from the \$1.5 million capitalization accrues to the benefit of the Corporation.

The result of the operation for the period as compared to last year is summarized below:

	<u>2019</u>	<u>2018</u>	<u>% Increase/ (Decrease)</u>
Operating revenues	\$ 55,214	\$ 63,753	(13%)
Operating expenses	<u>156,396</u>	<u>130,299</u>	20%
Operating income (loss)	(101,182)	(66,546)	(52%)
Non-operating revenues	98,408	49,329	99%
Capital Contribution from PSG	-	-	-
Net income (loss)	<u>\$ (2,774)</u>	<u>(17,217)</u>	(84%)

Capital Assets and Debt Administration

Capital assets

As of September 30, 2019, the Corporation's investment in capital assets was \$9,052 (net of accumulated depreciation). The Corporation's capital assets include office furniture and equipment, software and vehicles.

Contacting the Corporation's Financial Management

This Management's Discussion and Analysis is designed to provide the customers, creditors, investors, board of directors and other interested parties, with a general overview of the Corporation's financial activities. Questions concerning any of the information provided in this discussion and analysis or requests for additional information should be addressed to the Executive Director, Small Business Guarantee and Finance Corporation at P.O. Box 1751 Kolonia, Pohnpei, FM 96941, or call (691) 320-2968 or (691) 320-3264.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Statement of Net Assets

September 30, 2019

(With Comparative totals for September 30, 2018)

ASSETS

Current assets:

	2019	2018
Cash and equivalents – unrestricted (note 2)	\$ 800	\$ 800
Cash and equivalents – restricted (note 2)	1,202,127	1,228,083
Prepaid Insurance	379	345
Accounts receivable, net (note 3)	631	631
Employee loans receivable (4)	19,284	15,496
Advances, net (note 5)	800	400
Interest receivable (note 6)	47,023	47,023
Total current assets	<u>1,271,044</u>	<u>1,292,778</u>

Non-current assets:

Property and equipment, net (note 7)	9,052	12,648
Notes receivable – restricted (note 8)	572,086	534,389
Total non-current assets	<u>581,138</u>	<u>547,037</u>

Total assets	\$ <u>1,852,182</u>	\$ <u>1,839,815</u>
--------------	---------------------	---------------------

LIABILITIES

Current liabilities:

Social security payable	\$ 3,138	\$ 1,882
Withholding tax payable	1,075	1,106
Credit life insurance payable	765	649
Accrued expense	3,585	3,445
Accounts payable	13,020	14
Suspense Account	655	-
Total liabilities	\$ <u>22,238</u>	\$ <u>7,097</u>

NET ASSETS

Invested in capital assets, net of related debt	\$ 9,052	\$ 12,648
Restricted for capital stock and business development project	1,772,063	1,757,898
Restricted for employee loan program	2,150	4,574
Unrestricted net assets	46,679	57,598
	<u>1,829,944</u>	<u>1,832,718</u>
Total liabilities and net assets	\$ <u>1,852,182</u>	\$ <u>1,839,815</u>

See accompanying notes to financial statements.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Statement of Revenues, Expenses, and Changes in Net Assets
September 30, 2019
(With Comparative totals for September 30, 2018)

	<u>2019</u>	<u>2018</u>
Operating revenues		
Interest income (note 9)	\$ 43,080	\$ 50,544
Loan processing fee	3,759	2,893
Loan restructuring fee	475	250
Income – CLI commission	0.00	1,035
Recovery of loans PDLF	7,900	9,031
Total operating revenues	<u>\$ 55,214</u>	<u>\$ 63,753</u>
Operating expenses		
Salaries	75,333	74,032
Employee benefit program	1,528	\$ 1,308
Retirement Plan Employer	2,772	2,450
Social security tax	5,541	5,476
Cost of living allowance	3,780	3,660
Travel	6,953	5,113
Depreciation	3,596	3,831
Office supplies	7,941	5,784
Telephone and communication	2,954	3,014
Utilities	3,774	3,943
Annual dues	2,990	3,400
Gasoline	2,577	1,579
Representation and entertainment	7,574	4,285
Repairs and maintenance	1,012	781
Janitorial and cleaning	1,860	2,050
Bank charges	1,917	2,027
Meeting allowance	2,500	1,400
Membership fee	967	792
Security service	17,280	4,320
Other Expense	195	205
Printing and Production	128	0.00
Legal and Professional fee	2,539	0.00
Insurance Expense	412	382
Miscellaneous	273	467
Total operating expenses	<u>\$ 156,396</u>	<u>\$ 130,299</u>
Operating loss	<u>\$ (101,182)</u>	<u>\$ (66,546)</u>

Non-operating revenues		
Transfers in (note 10)	94,000	44,000
Interest Income (note 9)	2,273	1,695
Other income (note 12)	696	2,387
Interest income - employee loan	1,439	1,247
Total non-operating revenues	<u>98,408</u>	<u>49,329</u>
Contributed Capital	-	-
Increase (decrease) in net assets	(2,774)	(17,217)
Net assets (liabilities) – beginning of year	<u>1,832,718</u>	<u>1,849,935</u>
Net assets (liabilities) – end of year	<u>\$ 1,829,944</u>	<u>\$ 1,832,718</u>

See accompanying notes to financial statements.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Statement of Cash Flows

September 30, 2019

Cash flows from operating activities:	
Receipts from customers	\$ 694,673
Payments to suppliers and employees	(819,037)
Net cash provided (used for) by operating activities	<u>(124,364)</u>
Cash flows from non-capital financing activities:	
Transfers in	94,000
Interest income	3,712
Other income	696
Net cash provided (used for) by non-capital financing activities	<u>98,408</u>
Cash flows from capital and related financing activities:	
Purchase of capital asset	-
Net cash provided (used for) by capital and related financing activities	<u>-</u>
Net cash and equivalents increase for the year	(25,956)
Cash and equivalents at beginning of year	<u>1,228,883</u>
Cash and equivalents at end of year	<u>\$ 1,202,927</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:	
Operating loss	\$ (101,182)
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:	114
Depreciation	3,596
(Increase) decrease in assets:	
Accounts receivable	-
Prepaid Insurance	(34)
Advances	(400)
Interest receivable	-
Employee loans receivable	(3,788)
Due from PSG	
Notes receivable	(37,697)
Increase (decrease) in liabilities:	
Accounts payable	13,006
Accrued expense	140
Credit life insurance payable	115
Social security tax payable	1,257
Suspense Account	655
Withholding tax payable	(32)
Net cash used for operating activities	<u>\$ (124,364)</u>

See accompanying notes to financial statements.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Notes to Financial Statements
September 30, 2019

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Corporation was established by Pohnpei State Law No. 3L-86-95 on February 14, 1995. However, it officially started its operation on October 1, 1999 when the accounting system was transferred from the Department of Treasury and Administration to the Corporation. 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, and secondary mortgage and/or rediscounting of loan papers to small businesses.

Pursuant to Pohnpei State Law No. 5L-14-00 (Executive Reorganization Act of 2000), the Corporation shall be attached to the Pohnpei State Government's Office of Economic Affairs, and shall be under the policy, program, and administrative supervision of the Small Enterprise Development (SED) Council. It shall exercise all the general powers conferred by law upon corporations as are incidental or conducive to the attainment of the 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 powers of the Corporation shall be vested upon a seven-member Board of Directors. The Administrator of the Office of Economic Affairs 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. The Board consists of seven (7) members, including its Chairman. Effective March 17, 2019 a new State Law No. 9L-103-19, provides that "The members of the Board shall elect a chairman of the Board during the first meeting of the Board, following the most recent amendment to this section of the Code, who shall serve a term of chairman as set forth in the bylaws of the Corporation."

The Corporation is managed by an Executive Director, appointed by the Board of Directors and who reports directly to the Board. The Director is charged with the responsibility of ensuring smooth operation of the Corporation in line with the policies

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

established by the Board of Directors. He is also in charge of the implementation of the guarantee program.

B. Financial Statements

The financial statements of Small Business Guarantee and Finance Corporation have been prepared in conformity 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 Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989.

The Corporation has implemented the general provisions of GASB Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments", pursuant to paragraph 142 of the Statement. The financial statements in this report include the Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; and Statement of Cash Flows.

C. 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 as well as the 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 statement of net assets. Net asset is segregated into three (3) components: invested in capital assets, restricted, and unrestricted. The operating statement for proprietary funds is the statement of revenues, expenses, and changes in fund net assets. Revenues are reported by major sources and distinguished between operating and non-operating revenues.

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

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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.

D. Budget

The Corporation operates on an annual budget determined and appropriated by the Pohnpei State Legislature (PSL). The Corporation, upon approval by the Board of Directors, may also use certain revenues generated by its activities to supplement its annual budget.

E. Cash and Equivalents

For the purpose of the statement of net assets and statement of cash flow, 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, \$250,000 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.

F. Capital Assets

Assets with value of \$1,000 or more are capitalized and recorded at cost less accumulated depreciation. Depreciation is based on the straight-line method over the estimated useful lives of the respective assets.

G. Revenues

Annual operating subsidies to the Corporation, which finance either capital or current operations, are reported as non-operating revenues based on GASB Statement No. 33.

H. 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 non-vesting accumulating rights to receive sick pay benefits. The related sick pay expense is recorded when the benefit is actually taken.

I. 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.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

J. Net Assets

The Corporation complied with the requirements of GASB Statement No. 34, regarding the presentation of net assets in the financial statements. The difference between the assets and liabilities is displayed as “net assets”, which is further segregated into three (3) components: “invested in capital assets”, “restricted”, and “unrestricted”. The restricted component of net assets includes cash, notes receivable and investment where the fund source has been restricted for capital stock and business development projects. The unrestricted component of net assets includes unrestricted cash, other current assets and liabilities that are not restricted for use by the Corporation.

K. New Accounting Standards

During the year, the Corporation implemented the following pronouncements:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple- Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment to GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty’s credit support provider, is replaced. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of Small Business Guarantee and Finance Corporation.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

K. New Accounting Standards, Continued

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of Small Business Guarantee and Finance Corporation.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management has not yet determined the effect of implementation of this statement on the financial statements of the Corporation.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of Small Business Guarantee and Finance Corporation.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Corporation.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

K. New Accounting Standards, Continued

In June 2012, GASB issued Statement No. 67, Financial Reporting for Pension Plans, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, Accounting and Financial Reporting for Pensions, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the Corporation's financial statements.

(2) CASH AND EQUIVALENTS

The Corporation's cash and equivalents at September 30, 2019 is summarized below:

	<u>Restricted</u>	<u>Unrestricted</u>	<u>Total</u>
Petty cash	\$	800	800
Cash in bank – Savings ITA	18,304		18,304
Cash in bank – BOG	454,603		415,238
Cash in bank - PDLF Savings	415,238		454,238
Cash in bank - Employee Loan Program	2,150		2,150
Cash in bank – Direct Loan Program	110,600		110,600
Cash in bank- TCD	201,232		201,232
Total cash and equivalents	\$ 1,202,127	800	1,202,927

The restricted cash represents balances of cash in banks arising from the following:

- The Original capitalization of \$1,000,000;
- Business development projects fund of \$500,000 received by the Corporation in fiscal year 2000;
- A transfer of \$102,700 from the defunct Development Loan Fund. (See also Note 11); and,
- Initial employee loan fund of \$10,000.

(3) ACCOUNTS RECEIVABLE

The Corporation's accounts receivable at September 30, 2019 is **\$631**.

(4) EMPLOYEE LOANS RECEIVABLE

The total balance of employees' loans with the Corporation at September 30, 2019 is **\$19,284**.

(5) ADVANCES

The summary of the Corporation's advances at September 30, 2019 is as follows:

Total amount of advances	\$3,841
Allowance for doubtful accounts	<u>(3,041)</u>
Net	<u>800</u>

(6) INTEREST RECEIVABLE

The Corporation charges 15% on its direct loans and the loans from the defaulted guarantees. At September 30, 2019, the loans have accrued interests of **\$47,023**.

(7) CAPITAL ASSETS

The capital assets' activities as of and for the fiscal year ended September 30, 2019 are as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>(Decrease)</u>	<u>Ending Balance</u>
Vehicles	\$ 14,532	0	0	\$ 14,532
Office equipment	18,644	0	0	18,644
Software	101,064	0	0	101,064
Total cost	<u>\$134,240</u>	<u>0</u>	<u>0</u>	<u>134,240</u>
(Less) accumulated depreciation for:				
Vehicles				\$ (6,208)
Office equipment				(17,916)
Software				<u>(101,064)</u>
Total accumulated depreciation				<u>\$ (125,188)</u>
Capital assets, net				<u>9,052</u>

(8) NOTES RECEIVABLE

The account represents two (2) promissory notes arising from defaulted loan guarantees and eighty-four (84) promissory notes ensuing from the Micro Loan Program.

(8) NOTES RECEIVABLE, CONTINUED

A summary of the notes receivable at September 30, 2019 is as follows:

Description	Gross Amount	Allowance for Bad Debts	Net Amount
Micro Loan Program (84 accounts)	\$ 701,179	\$ (129,093)	\$ 572,086
Defaulted Loan Guarantees (2 accounts)	166,429	(166,429)	0.00
PDLF	266,836	(266,836)	0.00
Total	\$ 1,134,444	\$ (562,358)	\$ 572,086

Of the above amount, one (1) loan is for an individual who is related to the former official of the Corporation. (see also note 14 for detail)

(9) INTEREST INCOME

The amounts represent 15% interests earned on the direct loans under Micro Loan Program (MLP) and the loans from the defaulted loan guarantees (DLG) for the year ended September 30, 2019.

(10) TRANSFERS-IN

The Pohnpei State Legislature appropriated \$94,000 to subsidize the Corporation's operation for the fiscal year 2019. The amount is recorded as non-operating revenue.

(11) POHNPEI DEVELOPMENT LOAN FUND (PDLF)

In December 2013 the Governor signed into law S. L. No. 8L-36-13 authorizing the transfer of \$100,000 of the liquid capital of the defunct Development Loan Fund (the Fund) and all the outstanding loan portfolio of the Fund to the Corporation. The fund is contributed as capital to the Corporation for the purpose of providing government assistance to qualifying businesses. The capital including payments/interests in the total amount of \$102,700 was recorded in the Corporation's books in June 2014 and named as Pohnpei Development Loan Fund.

(12) OTHER INCOME

The amounts represent interest earned on operation bank accounts maintained by the Corporation and interest earned on employees' loans for the year ended September 30, 2019.

(13) 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

There is currently no outstanding lawsuit or claim filed or threatened to be filed against the Corporation.

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. The Corporation did not enter into new loan guarantees during the fiscal year 2019.

(14) Related Party Transaction

The Corporation has one (1) related party loan at September 30, 2019 with a balance of \$24,995.

SMALL BUSINESS GUARANTEE & FINANCE CORPORATION

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
AND
ON INTERNAL CONTROL OVER FINANCIAL REPORTING

YEAR ENDED SEPTEMBER 30, 2019



**POHNPEI STATE GOVERNMENT
OFFICE OF THE PUBLIC AUDITOR**

P.O. BOX 370
KOLONIA POHNPEI FM 96941
TEL: (691) 320-2638/8497
WEBSITE: WWW.OPSA.FM E-MAIL: opsa_psa@mail.fm

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

Chairman
Board of Directors
Small Business Guarantee and Finance Corporation:

We have audited the accompanying financial statements of Small Business Guarantee and Finance Corporation (the Corporation), as of and for the year ended September 30, 2019, and have issued our report thereon dated April 17, 2020. 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 result of our tests disclosed instances of non-compliances, which are described in the accompanying Schedule of Findings and Recommendations (pages 21-26) as finding numbers 2019-001 to 2019-003 that are required to be reported under Government Auditing Standards.

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 do not 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 judgement, 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 (pages 26-32) as finding numbers 2019-004 to 2019-008.

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, we believe that item numbers 2019-004, 2019-06 and 2019-008, identified as reportable conditions described above are material weaknesses.

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



Ihlen K. Joseph
State Auditor
17 April 2020

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-01 Improper Transfer of \$10,000 from Restricted Guarantee Loan

Criteria: State Law No. 3L-86-95 created the Small Business Guarantee and Finance Corporation to “provide, promote, develop, and widen in both scope and service-reach, various alternative modes of financing for small enterprises.....” In addition, “the Corporation shall guarantee loans obtained by qualified small enterprises, local, and/or regional associations’ small enterprises and industries, private voluntary organizations and/or cooperatives,”...and was provided with the initial capital stock of \$1,000,000 to implement the law concerning guarantee loans to small business enterprises.

The law does not allow SBGFC to use the guarantee loan funds for other purposes, and to do so, SBGFC must first obtain Legislature’s authorization.

Condition: The Corporation made a questionable transfer of \$10,000 from the restricted guarantee loan fund into its operation account for legal consultation fee. The fee was paid in March 2019 to the legal counsel that the Corporation retained. Subsequent to the payment, the Attorney General learned about the arrangement and advised the Corporation to terminate the contract, which it did. In August 2019, the Corporation received back \$9,461.24 of the original amount from the legal counsel and deposited the money into its operation account.

Cause: The condition happened because the Board endorsed management plan/decision without taking into consideration possible consequence and implications of its action.

Effect: The condition incurred more than \$500 cost to the Corporation and decreased the balance of the guarantee loan funds by \$10,000. Also significant, the condition has been recurring yearly for the past several years and the implication that it could happen again is high.

Recommendation: We recommend that the Board should diligently deliberate on all matters and issues brought to its attention by management or others to ensure that provisions and requirements of laws are observed. The guarantee loan funds should only be used for allowable programs and activities authorized by laws. We also recommend that the Board direct the Executive Director to return the \$9,461.24 from operation account to the loan guarantee fund. For additional expenses or activities not approved in the budget, the Corporation should find alternative ways and/or seek out other sources of funding, even so, all mandatory approvals should be satisfied and provisions of laws complied with.

Auditee Response: Please refer to the entire response from SBG&FC on page 34 as Exhibit I.

Specific to this finding, the Corporation concurred but stated that “equally important to note is the collections of outstanding (defaulted) loans” for which it transferred the loan fund “to retain a special counsel to legally pursue collection from these delinquent borrowers.”

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-01 Improper Transfer of \$10,000 from Restricted Guarantee Loan continued

Auditor Reply: POPA does not disagree with the Corporation pursuing collection from delinquent borrowers with the assistance of a legal counsel. However, the Corporation used the restricted loan funds to retain the legal counsel without obtaining authorization from the Legislature. The use of the restricted loan funds for other purpose than financing loans for small business is contrary to the law.

Finding No. 2019-002 Unauthorized and Questionable Consolidation of Employee Loan

Criteria: The Corporation's Administrative Manual specifies the policies and procedures for the employee loan program's application process, accounting, reporting and collection. The Manual specifies and requires that payment of the loan is through bi-weekly payroll deductions. In case of resignation from the SBGFC, employee with any outstanding loan balance must pay off his/her account, otherwise resignation is not accepted and any money due the employee will be applied to the loan. If an employee was terminated, an arrangement to liquidate the assets pledged for collateral will be worked out first, for foreclosure if necessary. For contract employees, the Corporation's Accounting Manual limits the term of employee loan payment not to exceed the term of employee contract.

The Corporation's policy does not cover every situation, but it is expected that matters not covered are brought to the Board's attention.

Condition: We found during the audit that a former SBGFC Official's loan (personal loan) obtained through the Corporation's Employee Loan Program was consolidated with her husband's loan received under the SBGFC small business loans or Micro Loan Program (MLP). Consolidation of loans is not addressed in the Corporation's policy yet the matter was not referred to the Board and/or the Credit Committee for proper review and deliberation. Instead, the Accountant approved the consolidation without consulting with the Board. Further review disclosed the following:

- An erroneous payout of \$3,909.09 was made from the MLP bank account to the Corporation's Employee Loan Account;
- The term of the official's loan payment surpassed the term of her contract.
- The loanee's (spouse of the SBGFC officer) account was delinquent in payments, yet it was not considered as a factor since consolidation would further increase the outstanding principal; and,

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-002 Unauthorized and Questionable Consolidation of Employee Loan continued

- There was no documented concurrence of the loanee with the arrangement.

In addition, another employee that left the Corporation still has an outstanding employee loan balance. The Corporation did not make arrangement for the liquidation of asset(s) pledged as security of the loan and the balance was still unpaid as of September 30, 2019.

Cause: Overall, the condition happened because management did not duly implement the Corporation's policies and ensure that its actions and dealings are in line with good business practice. Specific to the former SBGFC official, the Corporation lacks adequate process in place to identify and manage on-going interests (of employees and officers) to ensure that the Corporation's interest is considered and protected. Also, the former official failed to exercise prudent judgment on the matter. Instead of submitting her request to the Board for review she gave it to the Accountant to approve. Due to lack of understanding the Corporation's policies and acceptable business practice, the employees did not question this nonstandard loan consolidation.

Effect: As a result, the Corporation faces a possibility of financial loss if either of the loans is not settled satisfactorily. In addition, the MLP bank account is short by \$3,909.09, paid out improperly to the Employee Loan Account. Further, there is an appearance that bias or undue influence may have played a role in the resulting decision surrounding the former SBGFC official's loan consolidation. Furthermore, the matter entails possible conflicts of interests and undermined the Corporation's commitment to transparency and impartiality regarding its programs and activities, particularly those considered to benefit its employees.

Recommendation: We recommend that the Executive Director should:

- Strictly implement the Corporation's policies and procedures on employee loan program and direct all employees to follow closely. (The policies and procedures should be communicated and that the principles, rules, and conditions stipulated therein are understood by all employees);
- Initiate actions to collect the outstanding loan balance of former employee, and return \$3,909.09 back to the MLP bank account used to pay off the official's loan;
- Ensure that services to the public and activities of the Corporation are performed in accountable and transparent manner. Matters not covered in the policy should be referred to the Board of Directors for their review; and,

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-002 Unauthorized and Questionable Consolidation of Employee Loan continued

- Establishes a suitable to identify and manage situations that could give rise to conflict of interests, bias, unexpected or other difficult situations not specifically covered in the Administrative Manual.

Auditee Response: Please refer to Exhibit I on pages 34-43 of this report.

Finding No. 2019-003 Payroll related matters Not in Accord with Policies and Procedures

Criteria: Payroll advance is strictly prohibited by Pohnpei State Financial Management Regulations (FMR) 4.3. To be in line with FMR and still can accommodate special needs of its employees, the Corporation's Manual of Administration allows the Executive Director to authorize salary advances for "designated employees" only "when special needs are established and the employee has accrued wages". Special needs are defined in 5.8 of the Manual as follows:

- a death has occurred in the employee's immediate family;
- employee has not received his wages or part thereof in the normal way;
- the Employee is to commence duty travel prior to pay day; and,
- any other special circumstances deemed by the Executive Director to be sufficient to warrant such action.

In addition, 7.2.1 of the Corporation's Manual of Administration provides that request for annual leave for only one or two days should not be approved. On 7.2.3 of the Manual, it requires that annual leave shall be made in advance for submission to the Executive Director for approval; and 7.4.3 specifies that sick leave of three (3) days or more shall require certificate from a qualified practitioner attesting to the cause of illness and indicating when the employee will be fit to resume duty.

Condition: The Corporation was not constantly following its own policies on salary advances. For example, we found numerous instances where employees have not accrued wages but were allowed advances. Advances were frequent and most did not appear to be based on "special needs". On detail testing of eleven (11) samples, we noticed the following:

- a) Seven (7) instances where purposes of payroll advances were not indicated on the request forms and one of the forms was requested and approved by the same person. We further observed that payments for five of these advances were not enforced by management; and
- b) One (1) instance where advance was released but the request form was not signed to show approval.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-003 Payroll related matters Not in Accord with Policies and Procedures continued

In addition, on our tests of sixty-three (63) payroll transactions, we noted that all 63 payrolls were released in advance of the scheduled payroll dates. We also found an instance where an employee received his regular paycheck including twenty-four (24) hours administration leaves (Ad/L) which were approved and paid to all Corporation's employees. Yet, we found a separate check paid to the employee for the same Ad/L hours that he already received through the normal payrolls.

Further review disclosed the following:

- 1) Eleven (11) instances of paid leaves where eight (8) were not justified with relevant supporting documents/information, and three (3) with approved leave forms did not reflect plausible reasons for the leaves;
- 2) One (1) instance where sick leave of more than 2 days was not supported by a medical certificate.
- 3) Three (3) instances where leave forms were not approved by the authorized person.
- 4) Approval of designated administration leave for the Corporation's employees was not documented and payment not supported.

Cause: The condition happened because management was lenient in granting payroll advances and other payroll related administrative matters and not closely enforcing the Corporation's policies and procedures. There was obvious lapse in proper supervisory review on payroll related administrative matters to ensure that only legitimate and justified requests are approved and paid. Management also disregarded the prior years' audit recommendation regarding payroll related matters as this is a repeated finding from prior years.

Effect: The condition undermined the Corporation's policies and has improperly contributed to unacceptable habit. The Corporation's practice of advancing employees' salaries is also direct violation of the FMR. The condition has resulted to advances of unearned hours totaling 1,608 or wages equivalent to \$12,054 and a (double) payment of administrative leaves in the amount of \$224. If the practice continues, it could lead to loss and/or negative impact on the image and reputation of the Corporation if not controlled.

Recommendation: We recommend that the Executive Director should strictly implement the Corporation's policies and procedures regarding payroll related administrative matters including advances of salaries. The Corporation should not pay for hours that have not been earned. He should require proper review and verification of all payroll related matters to ensure validity of

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-003 Payroll Related Matters Not in Accord with Policies and Procedures, Continued

requests and payments. Moreover, approved payroll plans and schedules should be followed closely and changes if necessary should be appropriately and reasonably justified.

Auditee Response: Please refer to Exhibit I on pages 34-43 of this report.

Finding No. 2019-004 Lapse in Reconciliation Resulted in Numerous Adjusting Entries Proposal

Criteria: The Corporation's Manual of Accounting requires monthly reconciliation of all its accounts and books and provides that any error or differences found shall be investigated and corrected, by journal entry, if necessary. Reconciliation is an excellent tool and if done properly and timely, it would ensure and provide management with accurate and updated financial records and reports.

Condition: Based on our audit, we found several errors and discrepancies in the Corporation's books and accounting records, including unsupported adjusting entries that were not detected by the system in place. The Accountant is the only personnel assigned with all the accounting responsibility and related duties of the Corporation.

This condition is a repeated prior year audit finding.

Cause: The condition happened because the Corporation has not implemented prior year's audit recommendation. The current Accountant has not been trained adequately and still short on the skill set and the knowledge to successfully fulfill the responsibilities and duties required of the position.

Effect: As a result, twenty-eight (28) adjusting entries, aggregating \$31,182 were proposed by the auditors. The adjusting entries if not taken up would materially misstate specific accounts of the Corporation and may affect its financial statements.

Recommendation: We recommend the Executive Director and the Board to explore and find the best way to resolve the Corporation's accounting and reporting deficiencies. Management could consider appointing a temporary Comptroller or Consultant for the main purpose of training the Accountant the required skills to carry out the financial and accounting duties and responsibilities successfully.

Auditee Response: Please refer to Exhibit I on pages 34-43 of this report.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-05 Control Deficiencies in Disbursement Process

Criteria: The Corporation's Accounting Manual provides that all "disbursement requests shall be approved by the Executive Director and submitted to the Comptroller for certification and verification of the need for the purchase." In addition, disbursement must be properly supported with Purchase Order and original invoice and the invoice is "verified for accuracy mathematically and for goods and services received." Supporting documents should indicate or explain the purpose of purchases and/or disbursements.

Condition: Our review of sixty-three (63) samples of disbursements revealed deviations from the Corporation's policies, as follows:

- a. Seventeen (17) instances where invoices or supporting documents were not attached with disbursement vouchers for proper review including verification of arithmetical accuracy of the amounts.
- b. Seven (7) instances where supporting documents did not provide indication or proof of payments.
- c. Four (4) instances where explanation was not provided on documents to justify disbursements.
- d. Three (3) instances where disbursements did not show evidence of approval.

Cause: The above condition happened due to lax in supervisory review, monitoring and enforcing proper maintenance of supporting documents.

Effect: The condition resulted in instances of double payments, unrecorded liability and payments not made in timely manner. Material loss of funds or misstatement to the financial statements could result from the above condition if not resolved.

Recommendation: We recommend that the Executive Director should implement effective supervisory review and monitoring of the disbursements process and related activities including proper maintenance of pertinent supporting documents. The Executive Director should also direct all responsible employees to observe and duly follow the policies and procedures governing disbursements and proper maintenance of related records to ensure costly mistakes and oversights are prevented.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-05 Control Deficiencies in Disbursement Process, continued

Auditee Response: Please refer to the entire response from SBG&FC on page 35 of this report as Exhibit I.

Auditors Reply: The Corporation generally concurred with this finding but added that Condition letters b and c should be removed. For Condition letter b, the Corporation claimed that “proof of payments does not apply to the State and for this reason should be the same for SBG&FC”; and, Condition letter c, the Corporation states that “the citation was not reasonable due to the fact that there was a line item budget for representation.”

POPA tested sixty-three (63) disbursements, and out of those samples, found seven (7) instances (Condition letter b) where supporting documents did not indicate proof of payment, but fifty-six (56) of them did. POPA would like to emphasize consistency and proper maintenance of supporting documents for disbursements to prevent, for example, double payments. Similarly, for Condition letter c, POPA insists that the purpose for disbursement should be apparent, otherwise supplemental information or appropriate justification is needed.

Finding No. 2019-006 Lack of Proper Review and Documentation

Criteria: The Corporation must have suitable and effective internal control structure in place to ensure that policies and procedures are adhered to, diligent reviews are performed to prevent and/or detect irregularities, proper approvals and documentation of transactions are recorded and maintained, and that operation is run within the boundaries of law.

Condition: During the audit we found instances of inadequate supervisory review and documentation of records:

Board Related Matters

- a) Board meeting held but minutes was not prepared;
- b) Two (2) instances where minutes of meetings could not be found in the files.

Other Matters

- a) Seventeen (17) instances of incomplete loan documentation, for example, business licenses not in loanees’ files, loan used for items not related to the purpose of the business loan, and etc.
- b) General journal provided by the Corporation did not provide sufficient data and information (audit trail) for an efficient review.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-006 Lack of Proper Review and Documentation, continued

Other Matters

- c) A traveler did not submit required supporting for non-perdiem items but received the remaining 20% of the per diem.
- d) Two (2) instances where requests for cease of allotment were not attached to the payroll check vouchers.
- e) An instance where the daily cash collection report was not verified, and also an instance of double issuance of receipts.

Cause: The condition happened due to lapse of management and oversight communicating proper review and documentation of records, information and transactions.

Effect: The condition could result to matters, issues and transactions being questioned for legitimacy or appropriateness without proper review, documented approval or supporting documents/information.

Recommendation: We recommend the Executive Director and the Board to implement suitable internal control structure that enable improved review and documentation of all pertinent matters and transactions of the Corporation.

Auditee Response: Please refer to Exhibit I on pages 34-43 of this report for the auditee response.

Finding No. 2019-007 Non-capital Assets Not Properly Maintained

Criteria: The Corporation's Accounting manual provides that "Fixed assets with a value less than \$1,000 shall be expensed, however these assets should be accounted with the fixed assets tags and a listing should be maintained with the assets description, in order to prevent loss." The Accounting Manual also specifies that "upon disposal, fixed assets shall be removed from the register."

Condition: Our audit revealed that the Corporation's asset register is not kept updated. We found the following:

- a) Eight (8) assets were not properly tagged;
- b) Three (3) assets were already disposed but still included in the asset register and one (1) asset is missing;
- c) One (1) asset included in the register is not in a working condition;
- d) One (1) instance where an asset described in the register is different from the actual asset; and,

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-007 Non-capital Assets Not Properly Maintained, Continued

e) Two (2) assets were not included in the asset register.

Cause: The condition happened due to inadequate asset management, such as periodic review, inventory count and inspection of actual assets compared to the asset register or listing.

Effect: As a result, the asset register did not reflect accurate records and information matching actual assets and can lead to abuse or other misdeed involving the Corporation's properties and related financial records and information.

Recommendation: We recommend that the Executive Director should ensure that the responsible employee(s) regularly perform inventory count and inspection of the Corporation's assets. Any discrepancies found should be reconciled and/or resolved to maintain accuracy of assets and related records.

Auditee Response: Please refer to Exhibit I on pages 34-43 of this report for the auditee response.

Finding No. 2019-008 Unresolved Prior Year's Finding

Criteria: Pursuant to Pohnpei State Law No. 5L-08-00, the Authority is required to submit to the Public Auditor a report on its progress in clearing the deficiencies cited in the audit report until such time that all the deficiencies have been cleared, which period shall not exceed six (6) months.

Condition:

The table that follows shows the status of the implementation of prior year's recommendations:

Audit Findings	Status of Implementation of Recommendation	Auditor's Remarks
<p>Finding No. 2017-001 Unauthorized use of Loan Funds</p> <p>The Corporation used the restricted loan funds for operation expenses but did not obtain proper authorization from the Legislature.</p>	<p>The finding has not been resolved</p>	<p>Auditor recommends SBGFC Board should ensure this finding is resolved appropriately.</p>

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-008 Unresolved Prior Year's Finding, continued

Audit Findings	Status of Implementation of Recommendation	Auditor's Remarks
<p>Finding No. 2018-001 Non-Compliance with payroll policy.</p> <p>SBGFC policy allows payroll advances only for hours already earned. The Executive Director however allowed advance of payrolls including hours that have not been earned.</p>	Not Implementation—still outstanding.	Current audit
<p>Finding No. 2018-002 Deficiencies in the Documentation of Loans</p> <p>Make sure that all the required documents are complete.</p>	Still outstanding	There was slight improvement compared from last year
<p>Finding No. 2018-004 Control Weaknesses in the Financial Reporting and Supporting Accounting Records</p> <p>Management should recruit a qualified person to account and report on the financial activities of the Corporation and train the current Accountant to eventually assume the duties and responsibilities.</p>	Still Outstanding	Accountant still needs more training

Cause:

Management did not develop and implement corrective measures to resolve all prior year audit findings. The condition reflects unconcerned attitude of management not taking action that would improve the operation as well as protect the Corporation's interest.

Effect:

The non-resolution of the prior years' audit findings will continue to hinder the effective maintenance of a suitable internal control system as well as Corporation's compliance with applicable laws and regulations.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2019

Finding No. 2019-008 Unresolved Prior Year's Finding continued

Recommendation:

We recommend the Corporation to resolve all prior years' audit findings. The Board should ensure that the Executive Director develops and implements suitable corrective measures that would satisfactorily resolve the audit findings to improve the internal control system and compliance issues of the Corporation.

Auditee Response: Please refer to Exhibit I on pages 34-43 of this report for the auditee response.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

AUDITEE RESPONSE (EXHIBIT I)

YEAR ENDED SEPTEMBER 30, 2019



SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

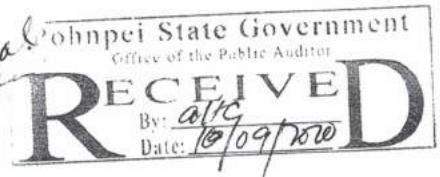
P.O. Box 1751 Kolonia, Pohnpei FM 96941

Telephone Numbers: (691) 320-2968/3264 Fax: (691) 320-5082

SALVASON
SALVADOR
CHAIRMAN

October 08, 2020

*AM copy 10/12/20
Take note and
proceed with final
report for publication
Share
(JK)*



ALBERT JOHNNY
VICE CHAIRMAN

Honorable ~~Mr.~~ Ihlen K. Joseph
State Public Auditor
Office of the Public Auditor
Pohnpei State Government
Kolonia, Pohnpei
FSM 96941

JOSEPH FELIX, JR.
SECRETARY

RULLENS PHILLIP
DIRECTOR

Ref: Auditee Response to Audit finding of SBGFC financial statements for the Fiscal Year 2019

Maing Mr. Joseph

JOHNNY
MUSRASRIK
DIRECTOR

I am pleased and honored on behalf of the Board of Directors and the Management of the SBGFC to submit our Audit Response to address the Audit Findings for the said fiscal year.

HUBERT YAMADA
DIRECTOR

Finding No. 2019-001 Improper Transfer of \$10,000 from Restricted Guarantee Loan

Auditee Response: While we respect and concur with the finding, equally important to note is the collections of outstanding (defaulted) loans which was the cause of the transferred, to retain a special counsel to legally pursue collection from these delinquent borrowers. **The Corrective Action**, management has prepared a journal voucher to reflect the cash transfer for FY 2020. Furthermore, SBGFC wishes to note that a request has been forwarded to the Office of Governor and Speaker requesting to lift restrictions on the said funds. (see Exhibit 1 & 4).

Finding No. 2019-002 Unauthorized and Questionable Consolidation of Employee Loan

Auditee Response: We concur with the finding. Please note that the Board of Directors recently repealed the Section 14 of the Manual of Administration which provided the employees an incentive scheme under the Manual of Administration that provided for employee loans. Hence forward, such findings will no longer be an issued. **Corrective Action Plan.** With respect to employees' outstanding balances, please refer to the enclosed Corporate Resolution No. 20-09 & Exhibit 2.

Finding No. 003. Salary Advances Not in Accord with Policies and Procedures

Auditee Response: *We concur with the finding.* **Corrective Action Plan:** Pay date has been moved from Wednesday to Friday of the payday week to ensure that all hours paid in a given pay period are all earned. Plus, management will ensure that Corporation's policies and procedures regarding advances of salaries are adhere to at all time (see Exhibit 3).

Finding No. 004 Lapse in Reconciliation resulted in Numerous adjusting Entries

Auditee Response: We concur with the finding. **Corrective Action Plan:** Management intends to improve the Accountant "know how" through an intense training program when funding and travel permits (or when on-island opportunities arise). In the meantime, we are in consultation with the MCU for "one-on-one" cross training with their Accountant.

Finding No. 005 Control Deficiencies in Disbursement Process

Auditee Response: In general, we concur with the finding but believe that letter b and c under the Condition should be removed for the following reasons; 1) proof of payments does not apply to the state and for this reason should be the same for SBGFC. 2) the citation was not reasonable due to the fact that there was a line item budget for Representation.

Corrective Action Plant: As for the rest of the citation, please refer to the enclosed directive label as exhibit 3.

Finding No. 006 Lack of proper Review and Documentation

Auditee Response: Again, in general we concur with the finding.

Corrective action Plan. All future documents must be reviewed by either the accountant or the loan manager before the final approval by the executive directors. A person who prepares the transaction shall not be the same person who does the review (refer to Exhibit 3).

Finding No. 2019-007 Non-capital Assets Not properly Maintained

Auditee Response: We concur with the finding. **Corrective action Plan:** An update of the SBGFC Capital Assets and Non-Capital Assets will be done asap to ensure this is addressed in FY2020 audit, (refer to enclosed directive label as Exhibit 3).

Finding No. 2018-008 Unresolved Prior Year's Finding

Auditee Response: All of the prior year audit findings were also FY2019 citation. Therefore, our **corrective plan** was already enumerated above.

Again, we wish to express our sincere appreciation and gratitude for the opportunity to provide our response to each of the citations mentioned above. However, we wish to register a concern which we hope can be easily addressed in future audits. This relates to the issuance date for the draft audit report and the response time given to the auditee. As you will recall, the draft report was received on September 29, 2020 at 10:20 a.m. and we were asked to provide our response by October 9, 2020. Nine days is simply too short for thorough review of these citations. Nevertheless, we will strive for fewer citations in the future and, if possible, no citations in our next audit.

Kalahngan oh Ni Wahu


Salvador Salvador
Chairman



SMALL BUSINESS GUARANTEE & FINANCE CORPORATION


P.O. Box 1751 Kolonia, Pohnpei FM 96941

Telephone Number (691) 320-2968/3264

JOURNAL VOUCHER

JV #: 2020-21

Date	Acct. No	Account Description	Debit	Credit
9/30/2020	10600	Cash in Bank-Savings Restricted	9,461.24	
9/30/2020	10450	Cash in Bank-Savings ITA		9,461.24
		To record the returning of remaining fund used for retainage of Legal Counsel.		
TOTAL			9,461.24	9,461.24

Prepared By: 
Alpino Kerman, Jr.

Approved By: 
Thomas Pablo



SMALL BUSINESS GUARANTEE & FINANCE CORPORATION

P.O. Box 1751 Kolonia, Pohnpei FM 96941


Telephone Number (691) 320-2968/3264

JOURNAL VOUCHER

JV #: 2020-22

Date	Acct. No	Account Description	Debit	Credit
9/30/2020	10600	Cash in Bank-Employee Loan Program	2,973.82	
9/30/2020	10450	Cash in Bank-Direct Loan Program		2,973.82
<p>To record the closing and transferring of the employee loan account. (Resolution # SBGFC 20-09)</p>				
TOTAL			2,973.82	2,973.82

Prepared By: 
Alpino Kerman, Jr.

Approved By: 
Thomas Pablo



SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
P.O. Box 1751 Kolonia, Pohnpei FM 96941 Telephone Number (691) 320-2968/3264

October 6, 2020, 2019

All Employees
Small Business Guarantee & Finance Corporation
Kolonia, Pohnpei FSM 96941

Ref. Audit Finding Resolution

Dear Employees,

This directive has been issued to address some of the Audit Findings reflected on the Fiscal Year Ending September 30, 2019 audit of the Corporation's Financial Statements. Although a Corrective Action Plan was already put in place by the Management to address these findings, the purpose of this Directive is to officially document these added processes through this communication. Hence, effective immediately the following shall take effect:

Issuance of the bi-weekly payroll for the employees of the corporation shall no longer be issued on Wednesdays but Fridays of the pay day week. This will ensure that hours that have been compensated were all earned prior to the disbursement. This directive supersedes any previous communication issued relative to this issue.

Payroll Advances on unearned hours are strictly prohibited and shall not be entertained.

Disbursement of new loans shall comply with the corporation's disbursement policies and procedures. All new loans will be accompanied by a check list sheet that would indicate the completeness of each loan before it is handed to the Executive Director for his final signature. Plus, disbursement of loans shall be in line with the intent and purpose of the approved loan. Deviations from the loan intent and purpose is strictly prohibited unless otherwise approved by the Board of Directors.

Documentation is vital and essential to an institution such as SBGFC. Therefore, effective immediately the person/employee who prepares a document shall not be the same person who reviews and certifies the document. The reviewing and certifying officer will ensure for the completeness and the allowability of a given transaction.

An update of SBGFC Fixed Assets must commence ASAP by the Secretary and the Accountant to ensure that SBGFC has addressed this audit finding before the commencement of the Fiscal Year 2020 audit.

Lastly, I wish to remind all that working hours are from 8:00 a.m. to 5:00 p.m. with a one-hour lunch break. Tardiness is not an acceptable behavior and should be avoided. The public (customers) expect and deserve better from us.

These changes are put in place not only to address the audit findings but to safeguard the assets of the corporation (SBGFC) and for us to be a transparent organization.

Should you have any questions relative to this directive, please feel to ask.

Sincerely,



Thomas Pablo
Executive Director



SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

P.O. Box 1751 Kolonia, Pohnpei FM 96941

Telephone Numbers: (691) 320-2968/3264 Fax: (691) 320-5082

BOARD OF DIRECTORS

SALVASON
SALVADOR
CHAIRMAN

September 21, 2020

9/22/20

Tracy Wilson

ALBERT
JOHNNY
VICE
CHAIRMAN

Hon. Reed B. Oliver
Governor
Pohnpei State Government

JOSEPH FELIX,
JR.
SECRETARY

RE: Request for Pohnpei State Legislature to provide lift restrictions on use of funds within the SBGFC Consumer Loan Program

Dear Governor Oliver,

RULLENS
PHILLIP
DIRECTOR

I am writing this letter to inform you that the newly launched consumer lending program from the SBGFC has been very successful in providing small consumer loans to the people of Pohnpei. Since the Administration signed into a law the amendments to the legislation that allowed the SBGFC to be able to provide small consumer loans to the people of Pohnpei a few months ago, we have nearly exhausted our total lending capacity of \$500,000.00. This is a sure sign that the people of Pohnpei are impacted by the COVID-19 pandemic restrictions and that the SBGFC program is one important way to help meet the current need for small financing. Because of these extreme circumstances, we are seeking to free up additional funds to recapitalize our Consumer Lending Program. We are asking the Legislature to lift the restrictions on the use of our remaining current internal restricted funds so that we can recapitalize this program. We would like to pull the remaining funds of \$580,000 from the PDLF or Restricted fund accounts that SBGFC has. To do this, we need the assistance of your office and the Legislature to authorize the withdrawal of these funds by law.

JOHNNY
MUSRASRIK
DIRECTOR

HUBERT
YAMADA
DIRECTOR

We believe that with an additional fund, we will be able to meet the needs of the people of Pohnpei for small consumer loans up to \$7,500. With the level of lending we are doing, we are well on our way for creating a more sustainable lending program through the SBGFC. The revenues generated will help SGBFC become less dependent on future annual appropriations for our operating budget, so there is a bright future for this program.

We seek your assistance and support for appropriate office(s) to begin working on this request to amend appropriate laws or Acts that would authorize us to get the additional funds surely needed. Please advise if additional information is required.

Sincerely,



Salvador Salvador



SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

P.O. Box 1751 Kolonia, Pohnpei FM 96941

Corporate Resolution: SBGFC 20-09

Adopted

A RESOLUTION

Pursuant to the powers vested with the Board of Directors of Small Business Guarantee & Finance Corporation ("SBGFC") as provided by Business Development Act of 1994, S.L. 3L-86-95, as amended, and its Article of Incorporation and By-laws, the following resolution is hereby adopted.


WHEREAS, on August 27, 2020 and its subsequent Board of Directors Meetings, the Board of Directors discussed and agreed to repeal sections 14 of the Manual of Administration which provide for the Incentive Scheme Program to the employees of the SBGFC.

BE IT RESOLVED, that Section 14 of the SBGFC Manual of Administration is now repealed in its entirety, and

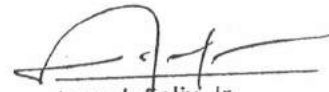
BE IT FURTHER RESOLVED, that Management take appropriate actions necessary to addresses the following; collections of outstanding loans by employees, closer any bank account (if there is any) and preforms all accounting entries/transactions required into the general accounts.


Certified copy(s) of this resolution shall be maintained by the Management for future references.

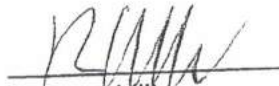
Adopted this date September 24 2020


Salvason Salvador
Chairman

Albert Johnny
Vice-Chairman


Joseph Felix, Jr.
Secretary


Johnny Musrastik
Director


Rullens Phillip
Director

Hubert Yamada
Director

