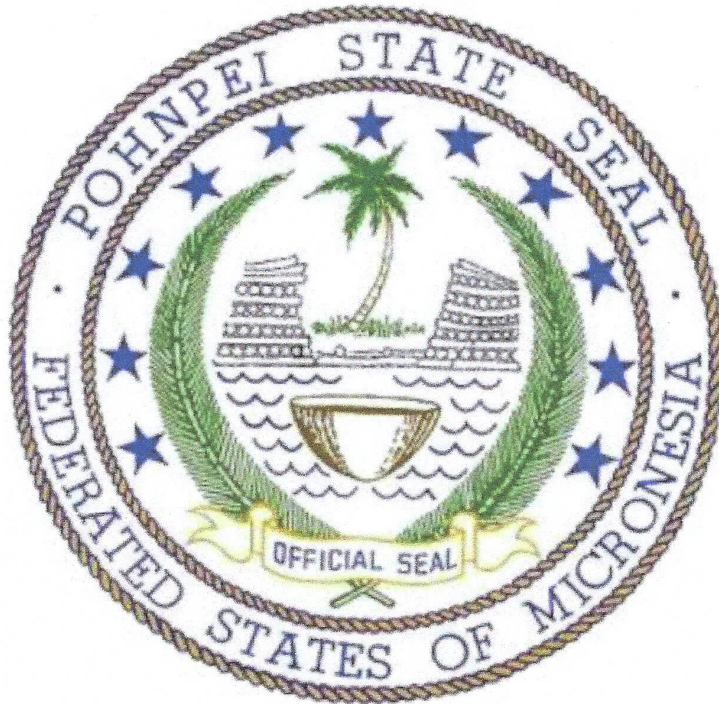


POHNPEI OFFICE OF THE PUBLIC AUDITOR

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

**FINANCIAL AUDIT
YEAR ENDED SEPTEMBER 30, 2025**

AUDIT REPORT NO. 04-26



State Public Auditor
P.O Box 1684
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Small Business Guarantee and Finance Corporation

Financial Audit

Fiscal Year Ended September 30, 2025

Audit Report No. 04-26

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July 6, 2026

The Honorable Steven Jospheh, State of Pohnpei
The Honorable Marvin Yamaguchi, Speaker, 11th Pohnpei Legislature
Honorable Members of 10th Pohnpei Legislature
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 financial audit report of the Small Business Guarantee and Finance Corporation (the Corporation), as of and for the fiscal year ended September 30, 2025. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the *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, as amended.

The objectives of our audit were:

- (i) 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;
- (ii) reporting on the internal control relevant to an audit of the financial statements; and
- (iii) reporting on the Corporation's compliance with laws and regulations, which could have a material effect on the financial statements. We also conducted a review of management controls to determine whether there is reasonable assurance that management's objectives were 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 and for the fiscal year ended September 30, 2025, 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

- (i) The Corporation incurred a total of \$74,169 loss during the fiscal year, as compared to the \$22,133 operating loss in fiscal year 2024.
- (ii) At September 30, 2025, the Corporation's operating expenses totaled \$387,359. The amount is \$101,762 or 36% higher than last year's figure of \$285,597.
- (iii) The Corporation's net asset was increased by \$125,278.
- (iv) The Corporation's loan accounts increased from a net of \$2,492,110 in fiscal year 2024 to a total net of \$2,568,955 in the current year.

Findings and Recommendations

We followed up on the prior year audit findings and found that SBGFC did not resolve a prior year outstanding audit finding regarding its failure to charge off loan accounts overdue by more than 120 days. In response to this ongoing issue however, the Corporation's Board of Directors passed a resolution in September 2025 amending its policy to extend the charge-off period from 120 days to 360 days. For the current fiscal year, we identified two significant instances of non-compliance shown below:

- i. The Corporation amended its account charge off policy in September 2025, extending the period from 120 days to 365 days. This was done inappropriately as there no adequate justification, and management and the Board did not consider the impact and/or the implication of the new policy, but approved the implementation nonetheless; and,
- ii. Not deducting and not paying income tax on employee cost of living allowance (COLA) is non-compliance with applicable FSM income tax laws.

The audit findings are fully discussed in the Schedule of Findings and Recommendations shown on pages 21 to 23.

As is customary, we have discussed the draft audit report with management of the Corporation and have requested for their response to our findings and recommendations. The Corporation's response is shown on pages 24-29 of this report, as Exhibit I. For the Corporation's response, we also have provided our reply on pages 30-32, as Exhibit II.

The Pohnpei State Law No. 5L-08-00, requires the auditee to prepare and submit monthly report to the Public Auditor indicating corrective measures already taken or will be shortly implemented to clear the audit deficiencies cited in the report until all findings are satisfactorily resolved, which period shall not exceed one year. Accordingly, the first progress report from the Corporation should be due around August 6, 2026.

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

Sincerely,



Erick Paul
State Public Auditor
Pohnpei State



OFFICE OF THE PUBLIC AUDITOR

STATE of POHNPEI

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Independent Auditor's Report

The Board of Directors
Small Business Guarantee and Finance Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of Small Business Guarantee and Finance Corporation (the Corporation), a component unit of the State of Pohnpei, which comprise the statements of the net position as of September 30, 2025 and 2024, and the related statements of revenues, expenses and changes in net position and cash flows for the years ended, and related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant

to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of the entity's internal controls. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for audit opinion.

Opinion

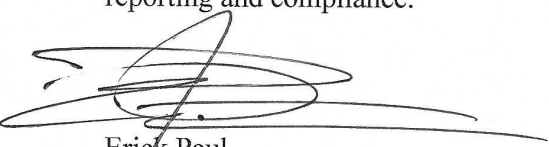
In our opinion, the aforementioned financial statements present fairly, in all material respects, the financial position of the Corporation, as of September 30, 2025, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Other Matters

The Management's Discussion and Analysis on pages 3 to 5 is not a required part of the financial statement but is supplementary information required by the Government 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 8, 2026 on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Corporation's internal control over financial reporting or on compliance. That report is an integral part of audit performed in accordance with *Government Accounting Standards* in considering the Corporation's internal control over financial reporting and compliance.



Erick Paul
State Public Auditor
8 May 2026

Audit Report - Small Business Guarantee and Finance Corporation

Management's Discussion and Analysis **Year Ended September 30, 2025**

The Small Business Guarantee and Finance Corporation present an overview of its financial performance as of and for the fiscal year ended September 30, 2025. This Management's Discussion and Analysis should be read in conjunction with the Corporation's financial statements, on pages 6 to 9 of this audit report.

Financial Highlights

- (i) For the fiscal year ended September 30, 2025, the Corporation's total operating revenues increased by \$49,726 or 19% over last year's figure.
- (ii) The net asset as of September 30, 2025 was \$3,384,455, which is an increase of \$125,278 or 6% higher than last year's amount of \$3,259,177.
- (iii) For the year, total operating expenses was \$387,359, which is an increase of \$101,762 or 36% as compared with prior year.
- (iv) The Corporation incurred an operating loss of \$74,169 compared to an operating loss of \$22,133 last year.
- (v) Current assets of the Corporation increased by \$35,355 or about 5% compared to fiscal year 2024.-
- (vi) Liabilities increased by \$2,195 of 7% as compared to fiscal year 2024.

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.

Audit Report - Small Business Guarantee and Finance Corporation

Management's Discussion and Analysis

Year Ended September 30, 2025

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 FY2025 and FY2024.

	<u>2025</u>	<u>2024</u>	<u>% Increase/ (Decrease)</u>
Current assets	\$ 819,642	\$ 784,285	5%
Capital assets, net	29,007	13,734	111%
Other non-current assets	<u>2,568,955</u>	<u>2,492,110</u>	<u>3%</u>
Total assets	<u>3,417,603</u>	<u>3,290,129</u>	<u>4%</u>
Current liabilities	<u>33,147</u>	<u>30,952</u>	<u>7%</u>
Net assets:			
Invested in capital assets	29,007	13,734	111%
Restricted	3,323,861	3,207,143	4%
Unrestricted	<u>31,589</u>	<u>38,299</u>	<u>(18%)</u>
Total liabilities and net assets	\$ <u>3,417,603</u>	\$ <u>3,290,129</u>	<u>4%</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 9% 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.

Audit Report - Small Business Guarantee and Finance Corporation

Management's Discussion and Analysis

Year Ended September 30, 2025

Personal/Consumer Loan Program was established in June 2020 for eligible Pohnpei citizens. The loan program charges 13% interest per annum and 2% penalty fee for delinquent loans based on the monthly amortization. The Corporation charges \$25 upon closing of the loan. The loan ceiling is \$7,500 and the maximum repayment term is 3 years.

Loan program disbursed under the Economic Development Administration (EDA) charges 9% interest per annum and 1% penalty fee for delinquent payments based on the monthly amortization. The corporation charges 1% processing fee based on the total amount of loan.

In fiscal year 2025, about 38% of the Corporation's operation was subsidized by the State Government, while the remaining 62% 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>2025</u>	<u>2024</u>	<u>% Increase/ (Decrease)</u>
Operating revenues	\$ 313,190	\$ 263,464	19%
Operating expenses	<u>387,359</u>	<u>285,597</u>	36%
Operating income (loss)	(74,169)	(22,133)	(235%)
Non-operating revenues	<u>199,449</u>	<u>597,072</u>	(67%)
Net income (loss)	\$ <u>125,279</u>	\$ <u>574,939</u>	(78%)

Capital Assets and Debt Administration

As of September 30, 2025, the Corporation's investment in capital assets is \$29,007 (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.

Audit Report - Small Business Guarantee and Finance Corporation

Statement of Net Assets

September 30, 2025

(With Comparative totals for September 30, 2024)

ASSETS	<u>2025</u>	<u>2024</u>
Current assets:		
Cash and equivalents – unrestricted (note 2)	\$ 500	\$ 500
Cash and equivalents – restricted (note 2)	754,906	715,035
Prepaid Insurance	1,012	506
Accounts receivable, net (note 3)	1,250	1,250
Employee loans receivable (4)	9,697	10,686
Advances, net (note 5)	5,255	9,288
Interest receivable (note 6)	47,023	47,023
Total current assets	<u>819,642</u>	<u>784,285</u>
Non-current assets:		
Property and equipment, net (note 7)	29,007	13,734
Notes receivable – restricted (note 8)	2,568,955	2,492,110
Total non-current assets	<u>2,597,962</u>	<u>2,505,844</u>
Total assets	<u>\$ 3,417,603</u>	<u>\$ 3,290,129</u>
LIABILITIES		
Current liabilities:		
Social security payable	\$ 6,925	\$ 5,185
Withholding tax payable	3,783	2,742
Credit life insurance payable	91	91
Accounts Payable (note 9)	22,104	22,104
Accrued expense	0	584
Cash Short/Over	245	245
Total liabilities	<u>\$ 33,147</u>	<u>\$ 30,952</u>
NET ASSETS		
Invested in capital assets, net of related debt	\$ 29,007	\$ 13,734
Restricted for capital stock and business development project	3,307,568	3,191,859
Restricted for employee loan program	16,294	15,284
Unrestricted net assets	31,589	38,299
Total Net Assets	<u>3,384,455</u>	<u>3,259,177</u>
Total liabilities and net assets	<u>\$ 3,417,603</u>	<u>\$ 3,290,129</u>

See accompanying notes to financial statements.

Audit Report - Small Business Guarantee and Finance Corporation

Statement of Revenues, Expenses, and Changes in Net Assets

September 30, 2025

(With Comparative totals for September 30, 2024)

	<u>2025</u>	<u>2024</u>
Operating revenues		
Interest income (note 10)	\$ 284,223	\$ 240,492
Loan processing fee	14,507	14,147
Loan restructuring fee	1,000	1,125
Income – CLI commission	0	0
Recovery of loans PDLF	13,460	7,699
Total operating revenues	\$ <u>313,190</u>	\$ <u>263,464</u>
Operating expenses		
Salaries	\$ 160,959	\$ 120,099
Employee benefit program	8,693	4,913
Retirement Plan Employer	3,868	2,488
Social security tax	11,856	9,008
Cost of living allowance	18,260	17,050
Travel	29,479	39,517
Depreciation	8,934	15,173
Office supplies	9,554	6,772
Telephone and communication	2,681	2,941
Utilities	1,819	3,435
Annual dues	0	0
Gasoline	4,363	5,134
Representation and entertainment	17,442	14,030
Repairs and maintenance	3,174	2,608
Janitorial and cleaning	2,940	3,100
Bank charges	4,068	1,915
Meeting allowance	20,340	13,800
Membership fee	848	857
Security service	0	4,320
Promotion and Advertising	60	705
Printing and Production	202	24
Legal and Professional fee	5,500	6,683
Insurance Expense	583	1,104
Miscellaneous	336	1
Bad Debt Expense	61,384	0
Annual System Maintenance	10,016	9,921
Total operating expenses	\$ <u>387,359</u>	\$ <u>285,597</u>
Operating loss	\$ <u>(74,169)</u>	\$ <u>(22,133)</u>

Audit Report - Small Business Guarantee and Finance Corporation

Non-operating revenues		
Transfers in (note 11)	193,090	593,090
Grant Contribution	0	0
Interest Income (note 10)	330	215
Other income (note 14)	6,007	3,615
Interest income - employee loan	22	151
Total non-operating revenues	<u>199,449</u>	<u>597,072</u>
 Increase (decrease) in Net Assets	 <u>125,279</u>	 <u>574,939</u>
 Net assets (liabilities) – beginning of year	 <u>3,259,177</u>	 <u>2,684,237</u>
 Net assets (liabilities) – end of year	 \$ <u>3,384,455</u>	 \$ <u>3,259,177</u>

See accompanying notes to financial statements.

Audit Report - Small Business Guarantee and Finance Corporation

Statement of Cash Flows For the year ended September 30, 2025

Cash flows from operating activities:	
Receipts from customers	\$ 2,035,680
Payments to suppliers and employees	2,171,052
Net cash used by operating activities	<u>(135,372)</u>
Cash flows from non-capital financing activities:	
Transfers in	193,090
Grant Contribution-EDA	0
Interest income	352
Other income	6,007
Net cash provided by non-capital financing activities	<u>199,449</u>
Cash flows from capital and related financing activities:	
Purchase of capital asset	<u>(24,207)</u>
Net cash used by capital and related financing activities	<u>(24,207)</u>
Net cash and equivalents decrease for the year	39,870
Cash and equivalents at beginning of year	<u>715,535</u>
Cash and equivalents at End of Year	<u>\$ 755,406</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:	
Operating loss	\$ (74,169)
Depreciation	8,934
Bad Debts Expense	61,384
(Increase) decrease in assets:	
Accounts receivable	0
Prepaid Insurance	(507)
Advances	4,032
Interest receivable	0
Employee loans receivable	988
Notes receivable	(138,230)
Increase (decrease) in liabilities:	
Accounts payable	0
Accrued expense	(584)
Credit life insurance payable	0
Social security tax payable	1,739
Cash Short/Over	0
Suspense Account	0
Withholding tax payable	<u>1,041</u>
Net cash used by operating activities	<u>\$ (135,372)</u>

See accompanying notes to financial statements.

Audit Report - Small Business Guarantee and Finance Corporation

Notes to Financial Statements

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

Audit Report - Small Business Guarantee and Finance Corporation

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 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.

Audit Report - Small Business Guarantee and Finance Corporation

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.

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)

Audit Report - Small Business Guarantee and Finance Corporation

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.

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.

Audit Report - Small Business Guarantee and Finance 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.

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.

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.

Audit Report - Small Business Guarantee and Finance Corporation

(2) CASH AND EQUIVALENTS

The Corporation's cash and equivalents at September 30, 2025 is summarized below:

	Restricted	Unrestricted	Total
Petty cash		\$ 500	\$ 500
Cash in bank – Savings ITA	\$ 6,746		6,746
Cash in bank – BOG	355,457		355,457
Cash in bank - PDLF Savings	100,038		100,038
Cash in bank - Employee Loan Program	16,294		16,294
Cash in bank – Direct Loan Program	255,900		255,900
Cash in bank – EDA	20,471		20,471
Total cash and equivalents	\$ <u>754,906</u>	\$ <u>500</u>	\$ <u>755,406</u>

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 10); and,
- Initial employee loan fund of \$10,000.
- During the year the Corporation received \$193,090 from the Pohnpei State Legislature designated for operation program (see also Note 11)

(3) ACCOUNTS RECEIVABLE

The Corporation's accounts receivable at September 30, 2025 is **\$1,250**.

(4) EMPLOYEE LOANS RECEIVABLE

The total balance of employees' loans with the Corporation at September 30, 2025 is **\$9,697**.

(5) ADVANCES

The summary of the Corporation's advances at September 30, 2025 is as follows:

Total amount of advances	\$ 8,296
Less: Allowance for doubtful accounts	<u>3,041</u>
Net	\$ <u>5,255</u>

Audit Report - Small Business Guarantee and Finance Corporation

(6) INTEREST RECEIVABLE

The Corporation charges 15% on its direct loans and the loans from the defaulted guarantees. At September 30, 2025, 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, 2025 are as follows:

Description	Beginning Balance	Increases	(Decrease)	Ending Balance
Vehicles	\$ 15,132	\$ 21,000	0	\$ 36,132
Office equipment	18,245	3,207	0	21,452
Software	160,064	0	0	160,064
Total cost	\$ 193,441	\$ 24,207	0	\$ 217,648
(Less) accumulated depreciation for:				
Vehicles				\$ (10,999)
Office equipment				(17,577)
Software				(160,064)
Total accumulated depreciation				(188,639)
Capital assets, net				\$ 29,007

(8) NOTES RECEIVABLE

The account represents two (2) promissory notes arising from defaulted loan guarantees, forty-five (45) promissory notes ensuing from the Micro Loan Program, five (5) promissory notes for PDLF, eight-hundred-fifty (850) promissory notes from the consumer loan program and thirty-four (34) promissory notes from the EDA Grant.

A summary of the notes receivable at September 30, 2025 is as follows:

Description	Gross Amount	Allowance for Bad Debts	Net Amount
Micro Loan Program (45 accounts)	\$ 300,174	\$ (143,756)	\$ 156,418
Defaulted Loan Guarantees (2 accounts)	166,429	(166,429)	0.00
PDLF (5 accounts)	239,316	(239,316)	0.00
Consumer Loan Program (850 accounts)	2,036,143	\$ (40,906)	1,995,237
EDA Grant (34 accounts)	417,300	0.00	417,300
Total	\$ 3,159,362	\$ (590,407)	\$ 2,568,955

(9) ACCOUNTS PAYABLE

The amount represents accumulated total overpayment of loan. At September 30, 2025 accounts payable is **\$22,104**

Audit Report - Small Business Guarantee and Finance Corporation

(10) INTEREST INCOME

The amounts represent 9% interests earned on the direct loans under Micro Loan Program (MLP), the loans from the defaulted loan guarantees (DLG) and 13% interest earned on the Consumer Loan program for the year ended September 30, 2025.

(11) TRANSFERS-IN

For the fiscal year 2025, the Pohnpei State Legislature appropriated a total of \$193,090 was designated to subsidize the Corporation's operations

(12) GRANT CONTRIBUTION

No grant received for the current year.

(13) 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 for 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.

(14) 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, 2025.

(15) CONTINGENCIES

Risk Management

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

Claims

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 2025.

Audit Report - Small Business Guarantee and Finance Corporation

SMALL BUSINESS GUARANTEE & FINANCE CORPORATION

Independent Auditor's Report on Compliance & Internal Control Over Financial Reporting

YEAR ENDED SEPTEMBER 30, 2025



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

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, 2025, and have issued our report thereon dated May 8, 2026. 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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such as opinion. The result of our tests disclosed an instance of non-compliance, which is described in the accompanying Schedule of Findings and Recommendations (pages 21 – 23) as finding number 2026-002 that is 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 (internal control) as a basis for designing auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements but not for the purposes of expressing an opinion on the effectiveness of the Corporation's internal control.

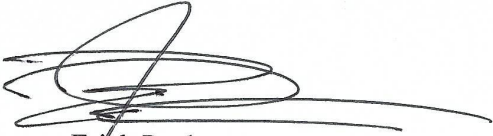
However, we noted certain matter involving the internal control over financial reporting and its operation that we consider to be reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control 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 condition is described in the accompanying Schedule of Findings and Recommendations (pages 21 – 23) as finding 2026-001.

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 number 2026-001, identified as reportable condition described above is a material weakness.

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.

Purpose of the Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Erick Paul
State Public Auditor
08 May 2026

Audit Report - Small Business Guarantee and Finance Corporation

SCHEDULE OF FINDINGS AND RECOMMENDATIONS FISCAL YEAR ENDED SEPTEMBER 30, 2025

Finding No. 2026-001 Inappropriate Extension of Charge-Off Period May Result to Overstatement of Notes Receivable and Deferred Loss Recognition

Criteria:

Per SBGFC Resolution No. 25-06, adopted on September 25, 2025, the Board of Directors amended Chapter 8, Section 13.1.5 of the consumer loan policy (Consumer Loan Program), expanding the required period for charging off delinquent accounts from 120 days to 360 days past due.

Condition:

Our review revealed that the SBGFC Board of Directors approved an extension of the delinquency period required for charging off of uncollectible accounts from 120 to 360 days. This was done without a documented historical recovery analysis, improved management plan on loan monitoring and collection, or other review/study/research that justifies the change of policy to support or improve the collectability of its delinquent accounts. The implementation of the new policy only defers the recognition of bad debts and does not improve the collectability of these accounts. Carrying them longer in the books could misstate the financial statements. For example:

- Sixty-two (62) delinquents accounts from FY2024, totaling \$185,639.20 (out of 107 total delinquent accounts) were still recorded in the FY2025 financial reports yet the collectability of these accounts is uncertain with several of the borrowers confirmed deceased, unemployed or left the island. Even when no payments were received or other assurance that the accounts could be recovered with longer charge-off period, the policy was changed nonetheless.
- We also noted that the Corporation did not charge off other delinquent accounts amounting to \$61,384 due to the extension of the charge off period.

Cause:

The condition is a weakness in policy review and oversight over loan collection. The Board of Directors approved the policy change without proper review and consideration of the impact these doubtful accounts would have on the overall financial reporting of the Corporation.

Effect:

The policy change could result to material overstatement of notes receivable and interest income while understating bad debt expense and delay the recognition of loan losses.

Audit Report - Small Business Guarantee and Finance Corporation

Recommendations:

We recommend SBGFC Management should:

- Perform historical recovery analysis for account over 120-360 days and quantify the effect on recoverability.
- Reassess where appropriate and provide provisions for loan loss and charge-off accounts identified with high probability of being not collected.
- Strengthen governance, institute better policy review and procedures change, and implement improved monitoring of loans collection and delinquent accounts and recovery performance.
- Prepare a better collection plan and implement it consistently to prevent higher risks of delinquency and ensure better recovery of delinquent accounts.

Auditee Response: Please refer to auditee response on Appendix I pages 25 - 29 of this report.

Auditor Reply: Please refer to auditor's reply on Appendix II pages 31 - 32 of this report.

Finding No. 2026-002: Non-Compliance with FSM Public Law

Criteria:

The FSM Public Law No. 18-114, which governs COLA implementation in the Federated States of Micronesia (FSM):

- Adjusted Base Salary: COLA is defined as a direct structural increase to an employee's base salary. Accordingly, an individual total taxable gross income includes both the base salary and the COLA.
- Taxability: COLA is explicitly subject to national tax withholding and is not classified as a tax-free benefit.

Condition:

During the audit of SBGFC, we observed that a total of \$18,260 was paid as Cost-of-Living Allowance (COLA) to employees tax-free contrary to the FSM Public Law No. 18-114. The Corporation did not pay approximately \$1,827.40 of income taxes to FSM finance on these allowance payments.

Cause:

The management of SBGFC were not aware of the FSM National tax law regarding the inclusion of COLA in taxable gross income.

Audit Report - Small Business Guarantee and Finance Corporation

Effect:

Non-withholding of mandated taxes is non-compliance with the law and may result to added payments due to penalties.

Recommendation:

We recommend that SBGFC Management work with FSM National Treasury on the accumulated outstanding liabilities on income tax for COLA. We also recommend that management should update themselves on all the laws and regulations relating to its operation to avoid such non-compliance.

Auditee Response: *Please refer to auditee response on Appendix I pages 25 - 29 of this report.*

Auditor Reply: *Please refer to auditor's reply on Appendix II pages 31 - 32 of this report.*

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Auditee Response (Exhibit I)

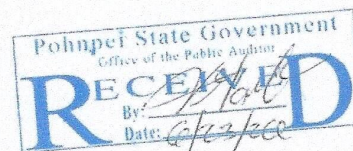
YEAR ENDED SEPTEMBER 30, 2025



SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

P.O. Box 1751 Kolonia, Pohnpei FM 96941 Telephone Number (691) 320-2968/3264

June 18, 2026



Mr. Erick Paul
State Public Auditor
P.O. Box 1684
Pohnpei, FM 96941

Subject: Management Response to Audit Findings No. 2026-001 and No. 2026-002

Dear State Public Auditor Paul,

The Small Business Guarantee and Finance Corporation (SBGFC) respectfully submit the following responses to the audit findings identified in the FY2025 Audit Report.

Audit Findings No. 2026-001

Management Response: Disagree

SBGFC respectfully disagrees with the finding and recommendations.

The Board of Directors is vested with the authority to manage the affairs of the Corporation and exercise its corporate powers pursuant to State Law No. 3L-86-95, the Corporation's Articles of Incorporation, By-Laws, and governing policies. Consistent with this authority, the Board adopted Resolution No. 25-06 amending Chapter 8, Section 13.1.5 of the Consumer Loan Policy to extend the charge-off period from 120 days to 360 days past due. The amendment was duly approved through formal Board action in accordance with the Corporation's established policy amendment procedures.

Management disagrees with the finding's conclusion that the amendment was implemented primarily to reduce the immediate impact of bad debt expense on the Corporation's net income. The audit report does not identify any evidence demonstrating that the Board's purpose in adopting the amendment was to manipulate earnings, defer loss recognition, or misstate the Corporation's financial condition. Rather, the amendment was adopted in response to actual operational challenges affecting the Corporation's ability to pursue collection and recovery actions within the previously established 120-day period.



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Historically, SBGFC retained private legal counsel to pursue collection actions against delinquent borrowers. Following a legal opinion issued by the Office of the Attorney General, responsibility for legal collection matters involving SBGFC accounts was transferred to the Attorney General's Office. As a result, numerous delinquent accounts were referred to the Attorney General's Office for review and legal action. Many of these accounts remain pending due to factors beyond the Corporation's direct control. The Board considered these circumstances, together with the time required for legal proceedings, collateral repossession efforts, and recovery actions, when evaluating the appropriateness of the existing charge-off period.

Management further notes that a substantial portion of the accounts identified in the audit finding remains subject to active recovery efforts and should not automatically be deemed uncollectible solely because they exceeded 120 days delinquency. Approximately 30 percent of the cited balance consists of commercial loans secured by pledged collateral that remain recoverable through repossession and liquidation proceedings. An additional significant portion of the cited accounts has been referred to the Attorney General's Office for legal review and collection action. The existence of ongoing recovery efforts, collateral security, and pending legal proceedings demonstrates that collectability cannot be determined solely based on the age of delinquency.

Management also disagrees with the finding that the Board acted without adequate consideration. While the Corporation did not prepare a formal historical recovery study prior to adoption of the amendment, the Board's decision was based upon management's operational experience, actual collection history, legal collection constraints, collateral recovery considerations, and the Corporation's overall collection environment. The Board determined that extending the charge-off period would provide a more realistic timeframe within which recovery efforts could be pursued before administrative charge-off occurs.

Additionally, although Resolution No. 25-06 was adopted during Fiscal Year 2025, implementation of the revised charge-off standard was delayed due to limitations within the Corporation's loan management system. The existing system lacked the functionality necessary to process charge-offs and loan rewrites under the revised standard. The required system modifications were not completed until May 2026 when the Corporation's loan system provider implemented the necessary upgrades. Consequently, Fiscal Year 2026 represents the first period during which the revised policy can be fully implemented and evaluated.

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

Management acknowledges the importance of maintaining effective collection practices and continues to strengthen collection and recovery efforts. In January 2026, the Corporation hired a dedicated in-house Collector whose primary responsibilities include borrower follow-up, repayment arrangements, delinquency monitoring, collection activities, and recovery efforts. Management has also strengthened internal collection procedures, increased direct engagement with delinquent borrowers, and continues to coordinate legal collection and collateral recovery efforts with the Attorney General's Office and other relevant agencies.

While SBGFC respectfully disagrees with the finding and recommendations, management recognizes the importance of periodically evaluating policy effectiveness. The Corporation will continue monitoring collection performance, documenting recovery efforts and outcomes, and assessing the effectiveness of the revised charge-off policy as sufficient operational data becomes available. Given that the necessary system enhancements were not completed until May 2026, management believes that Fiscal Year 2026 will provide the first meaningful opportunity to evaluate whether the revised 360-day charge-off standard appropriately reflects the Corporation's collection environment and recovery experience.

Corrective Action Planned:

Although SBGFC disagrees with the finding and recommendations, management will continue strengthening collection and recovery efforts through the dedicated in-house Collector position, ongoing coordination with the Office of the Attorney General, pursuit of collateral recovery actions, and periodic review of collection policies and procedures. Management will monitor the effectiveness of the revised charge-off policy during Fiscal Year 2026, maintain documentation supporting collection and recovery efforts, and evaluate policy performance as part of future operational and policy reviews.

Responsible Official: Executive Director

Target Completion Date: Ongoing



SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

P.O. Box 1751 Kolonia, Pohnpei FM 96941 Telephone Number (691) 320-2968/3264

Audit Findings No. 2026-002

Management Response: Partially Disagree

SBGFC respectfully submits the following response to the audit finding. After careful review of the Corporation's policies, practices, and relevant guidance, management disputes the assertion that the Corporation knowingly failed to withhold taxes on Cost-of-Living Allowance (COLA) payments and offers the following explanation.

COLA is provided to employees to assist in offsetting increased living expenses associated with the local economic environment and rising costs of essential goods and services. The intent of the allowance is not to compensate employees for services rendered beyond their regular duties, but rather to help maintain employees' purchasing power and mitigate the effects of inflation and increased living costs. Accordingly, management historically viewed the allowance as distinct from regular salary compensation.

Management's interpretation was influenced by guidance distinguishing compensation for services from certain allowances and reimbursement-type payments intended to offset specific costs incurred by employees. Based on this understanding, the Corporation treated COLA as a separate allowance rather than taxable salary. This treatment was adopted in good faith and was not intended to avoid any tax obligations.

SBGFC has consistently treated COLA as a non-taxable allowance since its implementation. This practice has been applied uniformly to all eligible employees and was based on management's understanding of the nature and purpose of the allowance. To management's knowledge, prior audits did not identify this matter as a reportable finding requiring corrective action.

The Cost-of-Living Allowance was established through Board action pursuant to the Corporation's authority to establish and amend personnel policies and compensation practices as necessary to address operational needs. When the Board approved the allowance, its intent was not to establish additional base salary or permanent compensation. Rather, the allowance was authorized as a discretionary measure to assist employees in addressing increases in the cost of living and to support employee retention and recruitment in a challenging economic environment.



SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

P.O. Box 1751 Kolonia, Pohnpei FM 96941 Telephone Number (691) 320-2968/3264

The allowance was established separately from base salary and was intended to remain subject to modification, reduction, suspension, or termination by future Board action should the economic conditions, operational requirements, or the Corporation's financial position warrant such changes. Accordingly, management understood the allowance to be a temporary and discretionary benefit rather than a permanent adjustment to employee compensation.

Management respectfully disagrees with the audit finding's conclusion that the Corporation intentionally failed to withhold taxes or disregarded applicable requirements. The treatment of COLA was based on management's good-faith interpretation of the nature of the allowance, the Board's intent when approving the benefit, and longstanding administrative practice. Nevertheless, should the auditors maintain that FSM law requires COLA to be treated as taxable income, management is willing to seek clarification from the Office of the Attorney General, or other appropriate authorities to ensure future compliance and consistent application of the law.

Corrective Action Planned:

If clarification from the appropriate authorities confirms that COLA is subject to withholding requirements, SBGFC will implement the necessary payroll adjustments and ensure compliance with all applicable tax withholding and reporting requirements going forward.

Responsible Official: Executive Director

Target Completion Date: Upon receipt of legal and tax guidance.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas S. Pablo", is written over a horizontal line.

Thomas S. Pablo

Executive Director

Small Business Guarantee and Finance Corporation

Cc: SBGFC Board of Directors

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Auditor Reply (Exhibit II)

YEAR ENDED SEPTEMBER 30, 2025



OFFICE OF THE PUBLIC AUDITOR

STATE of POHNPEI

P.O. BOX 1684

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WEBSITE: www.opapni.fm E-MAIL: erickpaul691@gmail.com

July 6, 2026

Mr. Thomas S. Pablo
Executive Director
Small Business Guarantee and Finance Corporation (SBGFC)
Kolonia, Pohnpei, FM 96941

Dear Executive Director Pablo,

Thank you for providing the Small Business Guarantee and Finance Corporation's (SBGFC) management response dated June 18, 2026, regarding the FY2025 Audit Report. We have reviewed your explanations and summarize our final position below.

Regarding Audit Finding No. 2026-001: Extension of Loan Charge-Off Period

We understand that the law, S. L. No. 3L-86-95, provides the Board legal authority to amend SBGFC's policies. POPA's concern is on the impact that this new policy will have on the financial statements of SBGFC. By extending the charge off period from 120 days to 360 days, can potentially increases credit risk and material misstatements on SBGFC's financial statements, which may affect audit opinion in the subsequent audits. Management did not consider the impact or the implication of this new policy yet approved its implementation.

Referring delinquent accounts to the Attorney General where loanees are already deceased, relocated or unemployed does not lower the risks of these accounts not being collected. On the contrary, the new policy only delays recognition of loss provisioning and inflate gross loan portfolio size. That is, the loans that would have been charged off at 120 days now have to be maintained and remained on the books for up to a year.

In addition, charging off of delinquent accounts does not mean collection and recovery efforts stop. Instead, the charge off should trigger rigorous collection efforts and measures where regular monitoring and collection were not successful. Therefore, extending the charge off period may delay the crucial time these accounts are scrutinized and rigorous collection efforts are initiated.

Regarding Audit Finding No. 2026-002: Tax Withholding on Cost-of-Living Allowance (COLA)

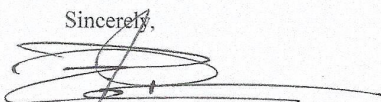
We note your partial disagreement and would like to clarify that COLA initially was treated as a non-taxable allowance by both the State and National Governments. Due to the FSM Public Law and the taxable income as defined in the FSM tax law, the National Government started taxing COLA. Recently,

the State Government has also implemented the income tax law relating to taxable income. The absence of audit findings does not negate SBGFC management's responsibility to comply with all applicable laws and regulations. The COLA is taxable income under the FSM tax law and the Board does not have the authority to establish SBGFC policy that is contrary to applicable public laws.

The Board of Directors and management's ultimate responsibility is to fulfill its fiduciary duty to ensure the Corporation adheres to statutory obligations in line with public laws. Hence, it is the responsibility of management to proactively ensure full compliance with all relevant tax regulations under FSM law. We insist that SBGFC Boards and Management work with FSM Finance to resolve the income tax issue.

Accordingly, we maintain our audit findings and urge management to establish and implement management corrective action plan to resolve the cited audit findings.

Sincerely,

A handwritten signature in black ink, appearing to read 'Erick Paul', with a long horizontal line extending to the right.

Erick Paul
State Public Auditor
Pohnpei State Government



IMPORTANT MESSAGE

We actively solicit and welcome allegations of any insufficient and wasteful practices, fraud and abuse of Pohnpei State Government public resources. Fraud, waste and abuse in government should be concern of everyone in Pohnpei. You can report allegations of fraud and abuse by contacting us at address below:

Office of the Public Auditor
P. O. Box 1684
Kolonia, Pohnpei State, FM 96941
Phone: (691) 320-2638
Hotline: (691) 320-8497 (24/7)
Email: erickpaul691@gmail.com
Website: www.opapni.fm

MEHN KAPESE KESEMPWAL

Pwukoa en tetehek, apwapwalih oh doadoahki mwohni oh dipwisou en kopworment en wein Pohnpei sapwelimatail koaros (tohn doadoahk en kopworment, Ohpis en Public Auditor oh aramas koaros en Pohnpei). Komw kak repwohtki omwi iren kapwunod kan meh pid sou itar en apwalih mwohni, dipwsou de awahn doadoahk en kopworment en Pohnpei ni ansou karos ohng ni:

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