SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

AUDIT REPORT NO. 005-17

FISCAL YEAR ENDED SEPTEMBER 30, 2016

OFFICE OF THE PUBLIC AUDITOR

P. O. Box 370
Kolonia, Pohnpei 96941
Federated States of Micronesia

SMALL BUSINESS GUANRANTEE AND FINANCE CORPORATION
AUDIT REPORT
FISCAL YEAR ENDED SEPTEMBER 30, 2016

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POHNPEI STATE GOVERNMENT
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June 26, 2017

The Honorable Marcelo Peterson, Governor, State of Pohnpei
The Honorable Fernando Scaliem, Speaker, Pohnpei State Legislature
The Honorable Members of the Pohnpei State Legislature
The Honorable Board of Directors, Small Business Guarantee & Finance Corporation
Mrs. Monalisa Roby, 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, 2016. 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, 2016, 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.

as compared to $35,249 in fiscal year 2015.

- At September 30, 2016, the Corporation's total operating expense was $190,685. The amount is $19,894 or 9% lower than last year's figure of $210,579.

- The Corporation's net asset was decreased by $82,043.

- The Corporation's loan accounts decreased from a net of $602,730 in fiscal year 2015 to a total net of $569,398 in the current year. One contributing factor is that several accounts were paid off but new loans approved were few.

Findings and Recommendations

- There are three (3) findings this fiscal year, two concerning non-compliance with laws, regulations, policies or procedures, and one regarding control deficiencies in the accounting system. 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 20 to 22.

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 24 and 25.

The Pohnpei State Law No. 5L-08-00, requires the auditee to submit monthly report to OPA 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 July 26, 2017.

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

Sincerely,

Iso Ihlen K. Joseph
State Public Auditor

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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, 2016 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, 2016, 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 May 26, 2017 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.

Iso Ihlen K. Joseph
State Public Auditor
May 26, 2017

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Management's Discussion and Analysis
Year Ended September 30, 2016

The Small Business Guarantee and Finance Corporation presents an overview of its financial performance as of and for the fiscal year ended September 30, 2016. This Management's Discussion and Analysis should be read in conjunction with the Corporation's financial statements, on pages 5 to 7 of this audit report.

Financial Highlights

- For the fiscal year ended September 30, 2016, the Corporation's total operating revenues increased by $21,862 or 62% over last year's figure.
- The net asset at September 30, 2016 is $1,613,880 which is lower than last year's amount of $1,695,923.
- The decrease in net assets for the year is $82,043.
- During the year, total operating expense decreased by $19,894 or 9%, as compared with prior year.
- The Corporation experienced an operating loss of $133,574 in FY 2016.

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.

Financial Analysis of the Corporation as a 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 result of the operation for the period as compared to last year is summarized below:

	2016	2015	% Increase/ (Decrease)
Operating revenues	$ 57,111	$ 35,249	62%
Operating expenses	190,685	210,579	(9%)
Operating income (loss)	(133,574)	(175,330)	(24%)
Non-operating revenues	51,531	96,464	(47%)
Net income (loss)	(82,043)	(78,866)	4%

Capital Assets and Debt Administration

Capital assets

As of September 30, 2016, the Corporation's investment in capital assets is $4,640 (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

Statements of Revenues, Expenses, and Changes in Net Assets
Year Ended September 30, 2016
(With Comparative totals for September 30, 2015)

	2016	2015
Operating revenues		
Interest income (note 9)	$ 52,680	$ 30,424
Loan processing fee	2,029	2,031
Loan restructuring fee	325	305
Income – CLI commission	2,078	2,489
Total operating revenues	$ 57,111	$ 35,249
Operating expenses		
Salaries	$ 76,732	$ 85,125
Employee benefit program	6,981	8,262
Social security tax	6,307	6,543
Cost of living allowance	3,750	4,110
Travel	30,192	43,853
Bad debt expense	18,273	-
Depreciation	13,246	23,185
Office supplies	6,222	8,862
Telephone and communication	3,268	6,278
Utilities	4,173	4,849
Annual dues	487	3,001
Gasoline	2,279	3,000
Representation and entertainment	2,096	2,986
Legal and professional fees	1,376	2,580
Repairs and maintenance	3,563	2,067
Janitorial and cleaning	2,080	1,895
Bank charges	2,607	1,792
Meeting allowance	680	780
Membership fee	716	750
Miscellaneous	467	313
Advertising	-	200
Penalties and fees	1,357	148
Security service	4,320	-
Total operating expenses	$ 190,685	$ 210,579
Operating loss	$ (133,574)	$ (175,330)
Non-operating revenues		
Transfers in (note 10)	44,000	94,000
Other income (note 11)	4,264	-
Interest income other (note 12)	1,493	2,464
interest income other- employee loan (note 12)	1,774	-
Total non-operating revenues	51,531	96,464
Increase (decrease) in net assets	(82,043)	(78,866)
Net assets (liabilities) – beginning of year	1,695,923	1,774,789
Net assets (liabilities) – end of year	$ 1,613,880	$ 1,695,923

(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.

The Corporation is managed by an Executive Director, appointed by the Board of Directors and who reports directly to the Board. He 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.

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

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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

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.

(5) ADVANCES

The summary of the Corporation's advances at September 30, 2016 is as follows:

Total amount of advances	$3,291
Allowance for doubtful accounts	(3,041)
Net	**250**

(6) INTEREST RECEIVABLE

The Corporation charges 9% on its direct loans and the loans from the defaulted guarantees. At September 30, 2016, 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, 2016 are as follows:

Description	Beginning Balance	Increases	(Decrease)	Ending Balance
Vehicles	$ 12,696			12,696
Office equipment	15,703	1,484		17,187
Software	101,064			101,064
Total cost	$129,463	1,484		130,947

(Less) accumulated depreciation for:	
Vehicles	$ (9,563)
Office equipment	(15,680)
Software	(101,064)
Total accumulated depreciation	$ (126,307)
Capital assets, net	**4,640**

(8) NOTES RECEIVABLE

The account represents two (2) promissory notes arising from defaulted loan guarantees and seventy five (75) promissory notes ensuing from the Micro Loan Program.

A summary of the notes receivable at September 30, 2016 is as follows:

(14) 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 2016.

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

Chairman
Board of Directors
Small Business Guarantee & Finance Corporation

We have audited the financial statements of the Small Business Guarantee & Finance Corporation (the Corporation), as of and for the year ended September 30, 2016, and have issued our report thereon dated May 26, 2017. 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 an instance of noncompliance, which is described in the accompanying Schedule of Findings and Recommendations (page 20) as finding number 2016-01 that is required to be reported under *Government Auditing Standards.* There was also an immaterial instance of noncompliance found which is described on page 22 of this report as finding number 2016-03.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Corporation's ability

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION
Schedule of Findings and Recommendations
Fiscal Year Ended September 30, 2016

Finding No. 2016-01Budget Cut Linked to Unauthorized Use of Loan Funds

Criteria:

The Pohnpei Legislature authorized funds through S. L. No. 3L-44-93, the Comprehensive Budget Act for Fiscal Year 1994, as amended, to Small Business Guarantee and Finance Corporation for the purpose of financing small enterprises. The funds are specifically for business loans and should not be used for other purposes without prior approval of the Legislature.

Condition:

Our review disclosed that the Corporation made several withdrawals accumulating $90,000 from one of its loan fund accounts to supplement its operation budget for the fiscal year 2016.The use of the loan funds for operation without the approval of Legislature is contrary to the intended purpose of the funds.

Cause:

The $44,000 appropriated by the Pohnpei Legislature was insufficient to defray the cost of the Corporation's operation for the fiscal year 2016. The authorized amount was $50,000 less than what the Corporation requested in its proposed budget submitted to the Executive Budget Review Committee (EBRC). EBRC reduced the Corporation's budget by $50,000. The Pohnpei Legislature therefore approved the Corporation's reduced budget without regards to the Corporation's costs of operation and its income earning ability.

Effect:

The Corporation's use of the loan funds for operation resulted in non-compliance with the law and reduced the amount of funds available for business loans.

Recommendation:

We recommend that the Board should ensure the following are implemented as soon as practical:

(a) Discontinue the use of business loan funds for operation;

(b) Work with management in resolving the Corporation's budget reduction; and,

(c) Direct management to prepare a plan on ways and how to increase and expand the Corporation's revenues. Revenues should be adequate to cover operation's costs.

Auditee Response: Please refer to Exhibit I on pages 24 and 25 of this report.

Finding No. 2016-03 Prior Year Finding Not Resolved Fully

Criteria:

Pohnpei State Law No. 5L-08-00 requires the office being audited to resolve the deficiencies cited in the audit report and communicate its progress monthly to the Office of the Public Auditor, which period shall not exceed six (6) months. Equally important, management must ensure that effective control activities are in place to prevent re-occurrence of the same findings.

Condition:

Our follow up review of the Corporation's prior year audit findings disclosed the following finding is still not fully resolved.

No.	Finding Description	Status of the Finding
2011-02	Advance not properly approved is still outstanding	Partly resolved.

Cause:

The condition involves another party and that resolution may take time.

Effect:

The condition will continue to hinder the effective maintenance of internal control similar to the prior years.

Recommendation:

We recommend that management should resolve all prior year audit findings and ensure they do not re-occur.

Auditee Response: Please refer to Exhibit I on pages 24 and 25 of this report.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

EXHIBIT
AUDITEE RESPONSE

FISCAL YEAR ENDED SEPTEMBER 30, 2016

Exhibit I

Auditee Response

Auditor's Finding and Recommendation are well noted. A priority goal for management. As discussed during the exit conference, a special arrangement between SBGFC and the State Financial Advisor to assist our Accountant while a qualified person is sought temporarily to train our Accountant with the necessary training in regards to the accounting and financial reporting function of the Corporation.

Finding No. 2016-03 Prior Year Findings

Auditor's Recommendation

Management should resolve all prior year audit findings and ensure they do not re-occur.

Auditee Response

Audit finding and recommendation are well noted. Board of Director and Management is still working with AG to resolve this. Current communication revealed the next step to solving this finding is in the process of forwarding to Supreme Court anytime soon.

Ni wahu,

Monalisa S. Roby
Executive Director

cc: Chairman, Board of Directors
File