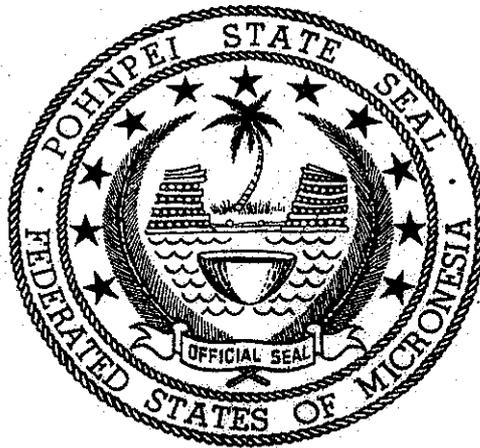


**SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION**

**AUDIT REPORT NO. 002-16**

**FISCAL YEAR ENDED SEPTEMBER 30, 2015**



**OFFICE OF THE PUBLIC AUDITOR**

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

**SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION  
AUDIT REPORT  
FISCAL YEAR ENDED SEPTEMBER 30, 2015**

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# POHNPEI STATE GOVERNMENT

## OFFICE OF THE PUBLIC AUDITOR

P.O. Box 370

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June 3, 2016

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  
Mr. Richard Jano, 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, 2015. 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, 2015, and the results of its operations, and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

## Financial Analysis

- The Corporation earned revenues of \$35,249 this fiscal year, a \$31,525 or 47% decrease as compared to \$66,774 in fiscal year 2014.
- At September 30, 2015, the Corporation's total operating expense was \$210,579. The amount is \$21,288 or 11% higher than last year's figure of \$189,291.
- The Corporation's net asset was decreased by \$78,866.
- The Corporation's loan accounts were decreased from seventy four (74) accounts or a net of \$627,058 in fiscal year 2014 to seventy-three (73) loan accounts with a total net of \$602,730 in the current year. One contributing factor is that several accounts were paid off but the new approved loans were few.

## Findings and Recommendations

- There are three (3) internal control findings this fiscal year, two of which are material weaknesses regarding control deficiencies in the accounting control system and the recurring operating losses. 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 23.

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 25 and 26.

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 June 25, 2016.

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

Sincerely,

  
Iso Ihlen K. Joseph  
State Public Auditor



# OFFICE OF THE 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, 2015 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, 2015, 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 17, 2016 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 17, 2016

# SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

## Management's Discussion and Analysis Year Ended September 30, 2015

The Small Business Guarantee and Finance Corporation presents an overview of its financial performance as of and for the fiscal year ended September 30, 2015. 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, 2015, the Corporation's total operating revenues decreased by \$31,525 or 47% over last year's figure.
- The net asset at September 30, 2015 is \$1,695,923 which is lower than last year's amount of \$1,774,789.
- The decrease in net assets for the year is \$78,866.
- During the year, total operating expense increased by \$21,288 or 11%, as compared with prior year.
- The Corporation experienced an operating loss of \$175,330 in FY 2015.

### **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.

## SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

### Management's Discussion and Analysis Year Ended September 30, 2015

The following table summarizes the changes in net assets of the Corporation for FY 2015 and FY 2014.

	<u>2015</u>	<u>2014</u>	<u>% Increase/ (Decrease)</u>
Current assets	\$1,080,486	\$1,113,960	(3%)
Capital assets, net	16,402	39,588	(59%)
Other non-current assets	<u>602,730</u>	<u>627,058</u>	<u>(3.9%)</u>
Total assets	<u>1,699,618</u>	<u>1,780,606</u>	<u>(4.6%)</u>
Current liabilities	<u>3,695</u>	<u>5,817</u>	<u>(36%)</u>
Net assets:			
Invested in capital assets	16,402	39,588	(59%)
Restricted	1,619,269	1,669,367	(3%)
Unrestricted	<u>60,251</u>	<u>65,834</u>	<u>(8.5%)</u>
Total net assets	<u>1,695,923</u>	<u>1,774,789</u>	<u>(4.4%)</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 1% penalty fee for delinquent loans, based on the monthly amortization in the event an installment is made after the fifteenth (15<sup>th</sup>) day of the due date. Upon closing of the loan, the Corporation charges 0.5% processing fee and a 35% agent's commission on every credit life insurance premium the Corporation issues on each loan. The loan ceiling is \$25,000.

In fiscal year 2015, about 45% of the Corporation's operation is subsidized by the State Government, while the remaining 55% was provided through the Corporation's project income and other revenues, as approved and authorized by the Legislature. Interest income from the \$1.5 million capitalization accrues to the benefit of the Corporation.

# SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

## Management's Discussion and Analysis Year Ended September 30, 2015

The result of the operation for the period is summarized below:

	<u>2015</u>	<u>2014</u>	<u>% Increase/ (Decrease)</u>
Operating revenues	\$ 35,249	\$ 66,774	(47%)
Operating expenses	<u>210,579</u>	<u>189,291</u>	11%
Operating income (loss)	( 175,330)	( 122,517)	43%
Non-operating revenues	<u>96,464</u>	<u>199,060</u>	(52%)
Net income (loss)	<u>(78,866)</u>	<u>(76,543)</u>	3%

### **Capital Assets and Debt Administration**

#### **Capital assets**

As of September 30, 2015, the Corporation's investment in capital assets is \$16,402 (net of accumulated depreciation). The Corporation's capital assets include office furniture and equipment, software and vehicles.

### **Contacting the Corporation's Financial Management**

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

# SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

## Statement of Net Assets September 30, 2015 (With Comparative totals for September 30, 2014)

<b>ASSETS</b>	<b>2015</b>	<b>2014</b>
<b>Current assets:</b>		
Cash and equivalents – unrestricted (note 2)	\$ 300	\$ 300
Cash and equivalents – restricted (note 2)	1,016,540	1,042,310
Accounts receivable, net	-	-
Employee loans receivable (3)	12,642	15,443
Advances, net (note 4)	3,981	6,979
Interest receivable (note 5)	47,023	47,023
Deferred charges	-	1,905
Total current assets	1,080,486	1,113,960
<b>Non-current assets:</b>		
Property and equipment, net (note 6)	16,402	39,588
Notes receivable – restricted (note 7)	602,730	627,058
Total non-current assets	619,132	666,646
Total assets	\$ 1,699,618	\$ 1,780,606
 <b>LIABILITIES</b>		
<b>Current liabilities:</b>		
Social security payable	\$ 1,669	\$ 2,629
Employee benefits payable	-	1,302
Withholding tax payable	1,671	1,290
Credit life insurance payable	355	473
Retirement plan payable	-	123
Deductions payable	-	-
Total liabilities	\$ 3,695	\$ 5,817
 <b>NET ASSETS</b>		
Invested in capital assets, net of related debt	\$ 16,402	\$ 39,588
Restricted for capital stock and business development project	1,613,783	1,667,402
Restricted for employee loan program	5,487	1,965
Unrestricted net assets	60,251	65,834
	1,695,923	1,774,789
Total liabilities and net assets	\$ 1,699,618	\$ 1,780,606

See accompanying notes to financial statements.

**SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION**

Statements of Revenues, Expenses, and Changes in Net Assets  
Year Ended September 30, 2015  
(With Comparative totals for September 30, 2014)

	<u>2015</u>	<u>2014</u>
<b>Operating revenues</b>		
Interest income (note 8)	\$ 30,424	\$ 64,231
Loan processing fee	2,031	1,319
Loan restructuring fee	305	983
Income - CLI commission	2,489	241
Total operating revenues	\$ <u>35,249</u>	\$ <u>66,774</u>
<b>Operating expenses</b>		
Salaries	\$ 85,125	\$ 79,911
Employee benefit program	8,262	4,886
Social security tax	6,543	5,635
Cost of living allowance	4,110	3,690
Travel	43,853	27,550
Depreciation	23,185	23,790
Office supplies	8,862	6,959
Telephone and communication	6,278	7,146
Utilities	4,849	6,025
Annual dues	3,001	5,960
Gasoline	3,000	2,848
Representation and entertainment	2,986	5,260
Legal and professional fees	2,580	-
Repairs and maintenance	2,067	1,156
Janitorial and cleaning	1,895	1,915
Bank charges	1,792	826
Meeting allowance	780	900
Membership fee	750	1,590
Miscellaneous	313	-
Advertising	200	165
Penalties and fees	148	-
Bad debt	-	3,041
Postage	-	38
Total operating expenses	\$ <u>210,579</u>	\$ <u>189,291</u>
Operating loss	\$ <u>(175,330)</u>	\$ <u>(122,517)</u>
<b>Non-operating revenues</b>		
Transfers in (note 9)	94,000	94,000
Contribution - PDLF (note 10)	-	102,700
Interest income (note 11)	2,464	2,235
Other income	-	125
Total non-operating revenues	<u>96,464</u>	<u>199,060</u>
Increase (decrease) in net assets	(78,866)	76,543
<b>Net assets (liabilities) - beginning of year</b>	<u>1,774,789</u>	<u>1,698,246</u>
<b>Net assets (liabilities) - end of year</b>	\$ <u>1,695,923</u>	\$ <u>1,774,789</u>

# SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

## Statement of Cash Flows Fiscal Year Ended September 30, 2015

<b>Cash flows from operating activities:</b>	
Receipts from customers	\$ 319,429
Payments to suppliers and employees	(441,663)
Net cash provided by operating activities	(122,234)
 <b>Cash flows from non-capital financing activities:</b>	
Transfers in	94,000
Interest income	2,464
Net cash provided by non-capital financing activities	96,464
 <b>Cash flows from capital and related financing activities:</b>	
Purchase of capital asset	-
Net cash provided by capital and related financing activities	-
Net cash and equivalents increase for the year	( 25,770)
Cash and equivalents at beginning of year	1,042,610
Cash and equivalents at end of year	\$ 1,016,840
 <b>Reconciliation of operating income (loss) to net cash provided (used) by operating activities:</b>	
Operating loss	\$ (175,330)
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:	
Depreciation	23,185
Bad debts	-
(Increase) decrease in assets:	
Accounts receivable	-
Advances	2,998
Interest receivable	-
Employee loans receivable	2,801
Notes receivable	24,328
Deferred charges	1,905
Increase (decrease) in liabilities:	
Employee benefit payables	(1,302)
Deduction payable	
Retirement plan payable	(123)
Credit life insurance payable	(117)
Social security tax payable	(960)
Withholding tax payable	381
	381
Net cash provided by operating activities	\$ 122,234

See accompanying notes to financial statements.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

Notes to Financial Statements

September 30, 2015

(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

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION  
Notes to Financial Statements  
September 30, 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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 nonoperating 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.

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 uses certain revenues generated by its activities to supplement its annual budget.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION  
Notes to Financial Statements  
September 30, 2015

(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.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION  
Notes to Financial Statements  
September 30, 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

J. Net Assets

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

K. New Accounting Standards

During the year, the Corporation implemented the following pronouncements:

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

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

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION  
Notes to Financial Statements  
September 30, 2015

(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.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION  
Notes to Financial Statements  
September 30, 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

K. New Accounting Standards, Continued

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

(2) CASH AND EQUIVALENTS

At September 30, 2015, the Corporation has deposits and cash on hand as follows:

	<u>Restricted</u>	<u>Unrestricted</u>	<u>Total</u>
Petty cash	\$	300	300
Cash in bank – Investment Transaction Account	9,255		9,255
Cash in bank – Savings	663,748		663,748
Cash in bank - PDLF Savings	132,409		132,409
Cash in bank - Employee Loan Program	5,487		5,487
Cash in bank – Direct Loan Program	205,641		205,641
Total cash and equivalents	<u>\$ 1,016,540</u>	<u>300</u>	<u>1,016,840</u>

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

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

(3) EMPLOYEE LOANS RECEIVABLE

The total balance of employees' loans with the Corporation at September 30, 2015 is **\$12,642**.

(4) TRAVEL ADVANCE

The summary of the Corporation's travel advance at September 30, 2015 is as follows:

Total amount of advances	\$ 7,022
Allowance for doubtful accounts	<u>(3,041)</u>
Net	<u><b>3,981</b></u>

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION  
Notes to Financial Statements  
September 30, 2015

(5) INTEREST RECEIVABLE

The Corporation charges 9% on its direct loans and the loans from the defaulted guarantees. At September 30, 2015, the loans have accrued interests of \$47,023.

(6) CAPITAL ASSETS

The capital assets' activities as of and for the fiscal year ended September 30, 2015 are as follows:

Description	<u>Beginning Balance</u>	<u>Increases</u>	<u>(Decrease)</u>	<u>Ending Balance</u>
Vehicles	\$ 12,696			\$ 12,696
Office equipment	15,703			15,703
Software	101,064			101,064
Total cost	\$129, 463			129,463
 (Less) accumulated depreciation for:				
Vehicles				\$ ( 4,018)
Office equipment				( 13,841)
Software				( 95,202)
Total accumulated depreciation				\$ (113,061)
Capital assets, net				16,402

672

(7) NOTES RECEIVABLE

The account represents two (2) promissory notes arising from defaulted loan guarantees and seventy one (71) promissory notes ensuing from the Micro Loan Program. A summary of the notes receivable at September 30, 2015 is as follows:

Description	Gross Amount	Allowance for Bad Debts	Net Amount
Micro Loan Program (71 accounts)	\$ 547,875	\$ -	\$ 547,875
Defaulted Loan Guarantees (2 accounts)	167,754	( 112,899)	54,855
Total	\$ 715,629	\$ ( 112,899)	\$ 602,730

632

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION  
Notes to Financial Statements  
September 30, 2015

(8) INTEREST INCOME

The amounts represent 9% interests earned on the direct loans under Micro Loan Program (MLP) and the loans from the defaulted guarantees (DLG) for the year ended September 30, 2015. PF

(9) TRANSFERS-IN

The Pohnpei State Legislature appropriated \$94,000 to subsidize the Corporation's operation for the fiscal year 2015. The amount is recorded as non-operating revenue. 505

(10) 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.

(11) INTEREST INCOME - OTHER

This amount represents interest earned on all bank accounts maintained by the Corporation and interest earned on employees' loans for the year ended September 30, 2015 as summarized below:

Interest income – bank accounts	\$ 1,542
Interest income – employee loans	<u>922</u>
Total	<u>\$ 2,464</u>

(12) 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. 672

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION  
Notes to Financial Statements  
September 30, 2015

CONTINGENCIES, CONTINUED

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 2015.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

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

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YEAR ENDED SEPTEMBER 30, 2015



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

P.O. Box 370  
Kolonia, Pohnpei FM 96941  
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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**

Mr. Adelino Lorens  
Chairman  
Board of Directors  
Small Business Guarantee & Finance Corporation

Dear Chairman Lorens:

We have audited the financial statements of the Small Business Guarantee & Finance Corporation (the Corporation), as of and for the year ended September 30, 2015, and have issued our report thereon dated May 17, 2016. 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 did not disclosed any instances of noncompliance that are required to be reported under *Government Auditing Standards*. Also, there was no immaterial instance of noncompliance found.

**Internal Control Over Financial Reporting**

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

management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Recommendations (pages 20 to 23) as finding numbers 2015-01 to 2015-03.

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 items 2015-01 and 2015-02 identified as reportable conditions described above are material weaknesses.

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



Iso Ihlen K. Joseph  
State Public Auditor  
May 17, 2016

# SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

## Schedule of Findings and Recommendations

Fiscal Year Ended September 30, 2015

### Finding No. 2015-01 Weakness in Accounting Control System

#### Criteria:

The Corporation's Manual of Accounting requires the "Comptroller" to, among others, develop, implement, and maintain an accounting system consistent with generally accepted accounting principles (GAAP). The system should have the capability to accurately interpret, records and reports the financial activities and affairs of the Corporation accurately, timely and in accordance with GAAP. The Board of Directors and management have the responsibility to ensure that the system function effectively.

#### Condition:

The Board of Directors and management did not ensure that the accounting control system of the Corporation was functioning effectively. The Corporation's financial statements and supporting records were not reviewed prior to submittal to the Office of the Public Auditor. The auditors noted the following weaknesses:

- The financial statements reflected large debit balances for accounts payable and various payroll related liabilities.
- Account schedules were either not prepared, updated or reconciled with the general ledger.

The auditors' detailed review and reconciliation revealed the following:

- Except for cash account, all the other asset accounts contained errors including Notes Receivable, Property, Plant and Equipment, Travel advance, Payroll advance, Employee Loans Receivable, etc. Hence, applicable expenses were erroneously recorded.
- Several transactions were not classified and recorded correctly such as payroll related liabilities and expenses, travel advances and claim, for example.
- All the payables reported with debit balances were the results of recording errors.

The condition has been a recurring finding in the financial statement audits of the Corporation since fiscal year ended September 30, 2012.

#### Cause:

The condition keeps recurring because Management did not fully implement the auditors' recommendation from prior audits of the Corporation. The Board and Management were not doing its oversight responsibilities in monitoring and reviewing the Corporation's financial reports to detect and/or prevent material misstatement in the financial statements. Considering the difficulty and the load of work the Accountant has to perform, the Corporation has not provided adequate and comprehensive training to prepare him to assume all the accounting functions and financial reporting responsibilities of the Corporation.

**SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION**

**Schedule of Findings and Recommendations**

**Fiscal Year Ended September 30, 2015**

**Finding No. 2015-01 Weakness in Accounting Control System, Continued**

Effect:

As a result, the Corporation's financial statements were erroneously recorded by more than \$116,990 before adjustments. Also, the problem will re-occur if the auditors' recommendation is not implemented. The condition of the Corporation's financial records contributed to the late completion of the audit work.

Recommendation:

We recommend that management should ensure that a qualified accounting person is retained temporarily to carry on the accounting and financial reporting functions of the Corporation while training the Accountant appropriately to assume the tasks.

We also recommend that the Board and Management should duly monitor and review the financial statements and supporting records to ensure accuracy.

**SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION**

**Schedule of Findings and Recommendations**

**Fiscal Year Ended September 30, 2015**

**Finding No. 2015-02 Recurring Operating Losses**

**Criteria:**

One of the fundamental responsibilities of the Board is to provide sound financial advice and oversight of the Corporation's financial affairs. The Board should ensure that the Corporation not only operates effectively and efficiently, but it should also be financially stable.

**Condition:**

The Corporation's budget for the year was prepared with unrealistic projections. The Board approved the Corporation's budget for fiscal year 2015 with over projected revenues of about \$60,000. Additionally, the expenses were not maintained within earned or known revenues.

The Corporation's operating results for the past five years shows the following:

	2015	2014	2013	2012	2011
Operating revenues	35,249	66,774	62,842	104,292	92,612
Trend in %	(47%)	6.3%	(40%)	13%	
Operating expenses	210,579	189,291	226,995	177,291	160,652
Trend in %	11%	(17%)	28%	10%	
Operating income (loss)	(175,330)	(122,517)	(164,153)	(72,999)	(68,040)
Trend in %	43%	(25%)	56%	7.3%	

**Cause:**

The Board and management are not reviewing the Corporation's financial results and monitoring the revenues and expenses. They were not minimizing the operating expenses to be within realistic revenue earned.

**Effect:**

The Corporation has been experiencing operating losses since fiscal year 2011 which has a negative effect on the Corporation's net assets.

**Recommendation:**

We recommend that the Board and Management should be prudent in its oversight and leadership capacity. Appropriate actions to curtail unnecessary expenses should be observed to ensure that the Corporation operating loss is minimized.

We also recommend that the budget should be prepared and approved based on realistic and achievable projections to maintain financial stability of the Corporation.

# SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

## Schedule of Findings and Recommendations

Fiscal Year Ended September 30, 2015

### Finding No. 2015-03 Control Policies and Procedures Not Consistently Applied

#### Criteria:

Control policies and procedures must be applied consistently to support and ensure the overall effective functioning of the internal control structure and compliance with applicable laws, regulations, policies and procedures.

#### Condition:

Our review of the Corporation's cash account revealed notable improvements including updated bank reconciliation and that all deposits were made intact. During the review however, we also observed inconsistencies in the application of control activities over cash receipts and cash disbursements.

We tested 188 cash receipts and noted that the collections were deposited timely, except for three times that deposits were made after two days. We also noted that on 7 occasions, cash receipts were dated after deposit dates.

Of the 171 disbursement transactions tested, we found the following:

- 6 instances that petty cash vouchers were not approved;
- 32 times that the receiving of goods or services were not evidenced in the supporting documents;
- 2 disbursement transactions were not supported with invoices;
- 2 instances where purchase orders are prepared after services were rendered and a case where a disbursement was not supported with a purchase order;
- An instance where the purpose of the purchase is not documented;
- An instance where a purchase made on line is not supported with a purchase order;
- A co-payment for a trip was not properly supported;
- 8 instances that payment for janitorial services was only supported by a petty cash voucher.

#### Cause:

The condition happened because management and staff became lax in applying the control activities or procedures due to lack of review or audit coverage and citations. This also happens due to over load of personnel's work and responsibilities.

#### Effect:

The condition increases the risk of material non-compliance and can exposes the Corporation to more serious problems or errors.

#### Recommendation:

We recommend management to duly ensure that required control policies and procedures are performed to ensure that any potential risk for intentional or unintentional errors are prevented or kept at the minimum.

SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

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EXHIBIT  
AUDITEE RESPONSE

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FISCAL YEAR ENDED SEPTEMBER 30, 2015



## Exhibit I

### SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

P.O. Box 1751 Kolonia, Pohnpei FM 96941

June 2, 2016

Honorable Iso Ihlen K. Joseph  
State Public Auditor  
Office of the Public Auditor  
Pohnpei State Government  
Pohnpei FM 96941

*agnc  
6/2/16*

**RE: Response to FY-2015 Audit Findings.**

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Dear Honorable Iso,

I am honored to transmit to you the above communication highlighting the corrective actions that are critical and necessary to improve the operation of Small Business Guarantee and Finance Corporation most especially in the financial aspect of the Corporation.

**Finding No. 2015-01 Weakness in Accounting Control System**

Auditor's recommendation:

Management should ensure that a qualified accounting person is retained temporarily to carry on the accounting and financial reporting functions of the Corporation while training the Accountant appropriately to assume the task.

Auditee Response:

Auditor's findings and recommendation are well noted. Management should ensure that a qualified personnel is identified as soon as possible to assume the accounting task and offer proper training to the Accountant.

**Finding No. 2015-02 Recurring Operating Losses**

Auditor's Recommendation:

## Exhibit I

### SMALL BUSINESS GUARANTEE AND FINANCE CORPORATION

P.O. Box 1751 Colonia, Pohnpei FM 96941

That the board and management should be prudent in its oversight and leadership capacity. Appropriate actions to curtail unnecessary expenses should be observed to ensure that the Corporation is not incurring losses.

That a budget should be prepared and approved based on realistic and achievable projections to maintain financial stability of the Corporation.

Auditee's Response:

Auditor's findings and recommendations are well noted. Management will ensure that for the monthly boards meetings, a table showing the budget and actual spending will be provided for board's awareness and appropriate recommendation.

Also, management to introduce and recommend to the board other profitable products or services for SBGFC.

#### **Finding No. 2015-03 Control Policies and Procedures Not Consistently Applied**

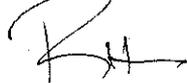
Auditor's Response:

Management to duly ensure that a required control policies and procedure are performed to ensure that any potential risk for intentional or unintentional errors are prevented or kept at the minimal.

Auditee's Response:

Auditor's finding and recommendation are well noted. Management will ensure that corporation's regulation, policies and procedures regarding cash disbursements are properly followed at all times.

Ni wahu,



Ricky Jano  
Executive Director

xc: File