

EXECUTIVE SUMMARY

INTRODUCTION

The Small Business Guarantee and Finance Corporation (SBGFC) is a government corporation created on January 24, 1991 by virtue of Section 11 of Republic Act No. 6977, amended on May 6, 1997 by Republic Act No. 8289, otherwise known as Magna Carta for Small and Medium Enterprises. On May 23, 2008, the President of the Philippines signed into law Republic Act No. 9501, titled "An Act to Promote Entrepreneurship by Strengthening Development and Assistance Programs to Micro, Small and Medium Scale Enterprises Amending for the Purpose Republic Act No. 6977, as amended, otherwise known as the "Magna Carta for Small and Medium Enterprises" and for other purposes". The law, among other items, increases the Corporation's authorized capital stock from 5 billion to 10 billion pesos. Under Section 11 of Republic Act No. 9501 the SBGFC, is hereinafter referred to as the Small Business Corporation (SB Corporation), which shall be charged with the primary responsibility of implementing comprehensive policies and programs to assist Micro, Small and Medium Enterprises (MSMEs) in all areas, including but not limited to finance and information services, training and marketing."

SBGFC is under the policy program and administrative supervision of the Small and Medium Enterprise Development (SMED) Council of the Department of Trade and Industry,

The Corporation's principal address is at the 17th and 18th floors, 139 Corporate Center, 139 Valero St., Salcedo Village, Makati City. It has four area offices and seven desk offices within the Philippines and has 142 regular employees for the calendar year 2011.

The policy making body of the Corporation is the Board of Directors composed of ten members headed by a Chairman, who likewise performs the functions of the Chief Executive Officer. The President of SBGFC acts as the Chief Operating Officer.

The Corporate Operating Budget (COB) for Calendar Year 2011 of SB Corporation as approved by the Board of Directors consists of the following:

| | |
|-----------------------------|----------------------------|
| Revenues | P410,000,000 |
| Expenses | <u>327,000,000</u> |
| Net Operating Income | <u>P 83,000,000</u> |
| | |
| Capital Outlay | P 10,000,000 |

FINANCIAL HIGHLIGHTS

1. Comparative Financial Position (In Philippine Peso)

| Particulars | 2011 | 2010 | Increase (Decrease) |
|-------------|---------------|---------------|------------------------|
| Assets | 6,274,411,871 | 6,290,847,374 | (16,435,503) |
| Liabilities | 3,793,851,994 | 3,772,621,023 | 21,230,971 |
| Equity | 2,480,559,877 | 2,518,226,351 | (37,666,474) |

2. Comparative Results of Operations (In Philippine Peso)

| Particulars | 2011 | 2010 | Increase (Decrease) |
|--|---------------------|--------------------|------------------------|
| Income from operations (net of finance cost and allowance for loan impairment) | 233,196,082 | 211,922,219 | 21,273,863 |
| Other income | 20,321,715 | 31,846,786 | (11,525,071) |
| Total income | 253,517,797 | 243,769,005 | 9,748,792 |
| Personal services | 110,628,555 | 106,248,764 | 4,379,791 |
| Maintenance and other operating expenses | 78,997,505 | 72,872,745 | 6,124,760 |
| Other expenses | 4,116,923 | 5,033,251 | (916,328) |
| Total expenses | 193,742,983 | 184,154,760 | 9,588,223 |
| Net income before tax | 59,774,814 | 59,614,245 | 160,569 |
| Income tax - Deferred | 13,356,523 | 42,048,020 | (28,691,497) |
| Net income | 73,131,337 | 101,662,265 | (28,530,928) |
| Other comprehensive income (loss) | (96,745,490) | (27,264,044) | (69,481,446) |
| Total comprehensive income (loss) | (23,614,153) | 74,398,221 | (98,012,374) |

SCOPE OF AUDIT

Our audit covered the accounts and operations of the Small Business Corporation for the calendar year 2011. It aimed to ascertain the fairness of the presentation of the financial statements in accordance with the Philippine Financial Reporting Standards. Our audit was also made to assess the propriety of financial transactions and compliance with laws, rules and regulations.

INDEPENDENT AUDITOR'S REPORT

We rendered an unqualified opinion since all material adjustments arising from audit recommendations on significant audit observations were taken up in the books.

However, attention was drawn to Note No. 9 to the financial statements and item no. 1 of the Observations and Recommendations on the accounting treatment of the Foreign Exchange Risk Cover as a derivative financial instrument and the adoption of the Black-Scholes Model in measuring the value of the call option, which resulted in the increase of the Corporation's assets by P693.337 million. We have reservations on the propriety and applicability of the derivative call option as a type of derivative and the valuation methodology on account of uncertainty in the assumptions used in the application of the model.

OTHER SIGNIFICANT AUDIT OBSERVATIONS AND RECOMMENDATIONS

In addition to the aforementioned audit observation, the following are the other significant observations and recommendations:

1. The approval of the term loan of P40 million granted to a rural bank under Board Resolution No. 1803, series of 2011 for building construction was contrary to the Corporation's Small and Medium Enterprises (SME) Wholesale Lending Program thus, depriving micro, small and medium entrepreneurs of needed funds.

1.1 We recommend that Management revisit the Corporation's SME program objectives to determine if any deviation from its implementation would have no negative impact on the pursuance of its mandate;

2. Utilization of the seed money of P50 million was only P15.437 million or 31 per cent during the period 2004-2011 due partly to lack of expertise in SME Venture Capital Financing, as well as absence of project implementation timetable and limited source of potential investee which hampered the accomplishment of project objectives under the mandate.

2.1. We recommend that Management:

1. Assess the project's implementation to determine whether it was efficiently and effectively carried out for the past nine years counting from year 2002 when the guidelines for program implementation were approved;

2. Address issues and concerns regarding training and personnel constraints to improve productivity;

3. Set up doable targets according to established timetable and conduct performance evaluation duly supported by accomplishment reports based on Key Result Areas (KRAs); and

4. Prepare and submit an evaluation/progress report on the implementation of the SME Venture Capital Financing Program.

3. Necessary actions were not implemented on loan accounts totaling P112.875 million that have been past due contrary to SB Corporation's Memorandum dated August 4, 2009 dealing on procedural guidelines on handling of past due accounts and approved implementation of restructured accounts.

3.1.1. We recommend that Management:

1. Strictly observe the procedural guidelines on handling past due accounts;

2. Address the causes for the delay in the submission of the Borrower-Level Past Due Report; and

3. Strengthen the Credit Risk Management Group (CRMG) to improve its performance. Also, in order for CMRG to function efficiently and effectively, it should be independent or free from the supervision of the head of Financing and Capacity Building Sector (FCBS).

4. Despite efforts, collection remained doubtful for Accounts Receivable amounting to P25.271 million which was outstanding for 10 years, thus depriving the agency of much needed funds to sustain its operations contrary to Section 5 of the Memorandum of Agreement (MOA) dated October 1993 between Department of Agriculture (DA)-Agricultural Credit Policy Council (ACPC) and Guarantee Fund for Small and Medium Enterprises (GFSME).

4.1 We recommend that Management:

1. Start negotiation with ACPC with the aim of collecting directly the administration fee from them;
2. Pursue another mode of collection from Quedan and Rural Credit Guarantee Corporation (QUEDANCOR) other than Dacion En Pago; and
3. Seek the intervention of the Department of Agriculture for a possible solution to the problem.

5. Acquired assets with aggregate book and appraised values of P8.833 million and P19.140 million, respectively, were not adequately managed contrary to the policies and guidelines in the Management and of Acquired Assets approved under Board Resolution No. 466 dated February 20, 1998, thus making them less attractive to would-be buyers.

5.1 We recommend that Management institute measures to improve the management of acquired assets, such as the following:

1. Collect lease rental on properties occupied by the former owner/s;
2. Maintain signs and fences to secure the property/ies from trespassing, squatting and other forms of illegal occupancy;
3. Initiate an investigation to determine the persons responsible for accepting properties without right/s of way or access road as loan collateral;
4. Require Department of Agrarian Reform (DAR) clearance before accepting agricultural land as collateral; and
5. Expedite the transfer of titles in the name of SB Corporation.

STATUS OF IMPLEMENTATION OF PRIOR YEARS' AUDIT RECOMMENDATIONS

Two of the four audit recommendations embodied in the 2010 Annual Audit Report were fully implemented. On the other hand, five of the prior years' audit recommendations were fully implemented.