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GAO

United States General Accounting Office

Briefing Report to Congressional Requesters

September 1986

SURETY BOND GUARANTEE PROGRAM

Small Business Administration's Actions on Prior Program Recommendations

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GAO United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

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September 18, 1986

The Honorable Lowell P. Weicker
Chairman, Committee on Small Business
United States Senate

The Honorable Dale Bumpers
Ranking Minority Member
Committee on Small Business
United States Senate

The Honorable John C. Danforth
United States Senate

Your letter of October 17, 1985, requested that we review the Small Business Administration's (SBA) management of its Surety Bond Guarantee Program. You asked us 10 questions primarily to determine whether SBA implemented the recommendations for improved program management made in our 1979 report[1] or by the SBA Inspector General in his March 11, 1982, testimony before the Senate Committee on Small Business. The recommendations focused primarily on SBA's underwriting and claims processes and its automated program information system. On July 18, 1986, we briefed your offices on the results of our review and, as requested, are providing you with this briefing report.

In performing the work, we interviewed SBA officials at headquarters in Arlington, Virginia, and the Atlanta, Dallas, and Philadelphia regional offices; and claims and/or underwriting staff of five surety companies. We also reviewed SBA's internal controls such as underwriting and claims procedures and guidelines and current and proposed program rules. Additionally, we reviewed underwriting and claims records, congressional hearings, SBA Inspector General reports, and other pertinent program documents. We did not determine if the conditions that led to GAO's and the Inspector General's recommendations in 1979 and 1982, respectively, currently exist. To do so would have required us to perform an extensive program evaluation, which was not practical given the time frames established for completing this assignment. Our review was conducted between October 1985 and May 1986.

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[1] The Surety Bond Guarantee Program: Significant Changes Are Needed in Its Management (CED-80-34, Dec. 27, 1979).

The Surety Bond Guarantee Program was established in 1971 to guarantee up to 90 percent of a surety company's losses on bonds issued to small businesses that cannot obtain bonding without the guarantee. From 1977 through fiscal year 1985, the program has operated with an average staff of 60 while guaranteeing bonds on over 106,000 contracts totaling more than $8.7 billion. Since program inception, SBA reported that the program resulted in net savings to the government (federal, state, and local) of about $557 million.

In summary, we found that SBA has implemented some of the recommendations made by us and the SBA Inspector General, such as issuing new underwriting guidelines and developing a procedure to calculate a program loss ratio comparable to the one used by the private sector. SBA is also incorporating the concept of one of the recommendations, relating to a guarantee fee schedule, in its proposed program rules. In addition, SBA is in the process of making operational the recommendation related to development of an accurate automated management information system. SBA has not, however, implemented most of the recommendations because SBA officials said that actions similar to the recommendations are already occurring, the recommendation is not practical, or budget constraints prevent implementation. In addition, SBA did not implement two recommendations related to the establishment of rates and fees because SBA's concern in cost control matters is the surety's "bottom line" loss experience.

Officials in SBA's Office of Surety Guarantees and the Office of the Inspector General reviewed a draft of this report and provided their comments, which we included where appropriate. We are sending copies of this report to the House Committee on Small Business and the Acting Administrator of the Small Business Administration. Copies will also be made available to other interested parties upon request. If I can be of further assistance, please call me at (202) 275-6111.

John H Luke

John H. Luke
Associate Director

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ABBREVIATIONS

GAO	General Accounting Office
IG	Inspector General
RCED	Resources, Community, and Economic Development Division
SBA	Small Business Administration

OVERVIEW OF ACTIONS TAKEN ON GENERAL ACCOUNTING OFFICE (GAO) AND SBA INSPECTOR GENERAL (IG) RECOMMENDATIONS ON THE SURETY BOND GUARANTEE PROGRAM

- SBA prepared underwriting guidelines, revised its default/claim form, developed a procedure to calculate a loss ratio comparable to the private sector, and provided training to its permanent employees.

- SBA is in the process of making its automated reporting system fully operational, developing a surety handbook, and incorporating the concept of a guarantee fee schedule in its proposed program rules.

- SBA did not implement recommendations related to the establishment of rates and fees because SBA's overall concern in cost control matters is the surety's "bottom-line" loss experience.

- SBA has not implemented several other recommendations because SBA officials said that actions similar to the recommendations are already occurring.

SECTION 1

OVERVIEW OF ACTIONS TAKEN ON GENERAL ACCOUNTING OFFICE AND SBA INSPECTOR GENERAL RECOMMENDATIONS ON THE SURETY BOND GUARANTEE PROGRAM

Recommendations to SBA	Source	SBA actions and views
Develop accurate automated management information system	SBA IG	System to be fully operational Dec. 1986 (p. 13).
Underwriting procedures		
--develop guidelines	GAO SBA IG	Guidelines developed (p. 15).
--require verification of data in selected applications	GAO	Agreed in 1979, but did not implement. Says unnecessary since all applications are screened in some detail (p. 17).
--require declination of applications with outdated, inaccurate, or incomplete data	GAO	Disagrees; did not implement. Says staff decline such applications as part of general underwriting practices (p. 18).
--require exclusion of surety agents who repeatedly submit unreliable data	GAO	Disagrees; did not implement. Says it takes informal action (p. 19).
Claims review procedures		
--require documentation to accompany a claim	SBA IG	Disagrees; did not implement. Considers more documentation impractical (p. 24).
--establish claims-handling reimbursement rates	GAO	Disagrees; did not implement. Concern is surety' bottom-line loss experience (p. 25).
--establish guidelines for reasonableness of attorney and other fees	SBA IG	Disagrees; did not implement. Concern is surety's bottom-line loss experience (p. 26).

Recommendations to SBA	Source	SBA actions and views
Proposed program for improved claims handling[a]		
--develop surety handbook	SBA Assoc. Admin.	Expected end of FY86 (p. 27).
--revise default/claim form	"	Form revised (p. 27).
--review sample of claims	"	Pilot-tested an abbreviated review of claim reimbursement requests (p. 27).
--use technical consultants	"	Consultant position not approved (p. 28).
--provide more training	"	Training for permanent staff provided (p. 28).
--convert to on-line computer	"	Converted Dec. 1985. System to be fully operational Dec. 1986 (p. 29).
Calculate loss ratio comparable to private sector approach	SBA IG	Procedure developed, but not used (p. 30).
Establish guidelines for sureties to monitor contractors' progress	GAO	Disagrees; did not implement. Says contractor monitoring is occurring without SBA guidelines (p. 33).
Have regular random audit of claims by SBA IG	SBA IG	Agrees, but did not implement due to budget constraints (p. 35).
Establish procedure for selective review of claims	GAO	SBA conducts on-site reviews of sureties (p. 36).
Establish a guarantee fee schedule	SBA IG	Concept being incorporated in proposed program rules (p. 39).

[a]The proposed program for improved claims handling was introduced by the SBA Associate Administrator for Finance and Investment during May 1983 testimony before the House Committee on Small Business. Although the proposed program was not included in GAO's or the IG's recommendations of 1979 and 1982, respectively, the requesters asked us to determine the status of the proposed program.

PROGRAM STATISTICS AND SBA'S

NEW MANAGEMENT INFORMATION SYSTEM

- Since 1984, the number and value of contracts guaranteed has increased.
- Number and value of claims paid are decreasing.
- Program savings to the government are increasing.
- Program staff is decreasing.
- SBA expects its new computerized information system to be fully operational in December 1986.

SECTION 2

PROGRAM STATISTICS AND SBA'S

NEW MANAGEMENT INFORMATION SYSTEM

REQUEST: Present an overview of Surety Bond Guarantee Program statistics (for each fiscal year 1976-85, if possible), including

(a) number and dollar value of contracts covered by guarantees;
(b) number of claims submitted;
(c) dollar value of claims submitted;
(d) number of claims paid;
(e) dollar value of claims paid;
(f) dollar savings to the government from contract being awarded to the small business low bidder rather than next lowest bidder;
(g) the net program cost considering losses, recoveries, and fee-generated program income; and
(h) number and type of personnel assigned to the review of bond applications, claims processing, and overall program management.

RESPONSE: SBA could not provide statistics for fiscal year 1976 because SBA's computer system aggregated figures from program inception through fiscal year 1976. Also, SBA was not able to provide statistics on the number and dollar value of claims submitted (b and c above). Such information was not maintained in SBA's computer system but is expected to be available when SBA's new system becomes operational. (See p. 13.) Further, for some requested statistics, such as the number of claims paid, SBA was not able to provide data for each of the requested fiscal years because the data were not easily retrievable. The following tables contain statistics for the fiscal years that were available from SBA's Office of Surety Guarantees. Some of the statistics were from manual records and some were computer-generated. We did not verify the information provided.

Table 2.1: Number and Value of Contracts Covered by SBA Guarantees, Fiscal Years 1977-85

Fiscal year	Number of contracts guaranteed	Value of contracts (millions)
1977	15,485	1,030.8
1978	19,044	1,363.7
1979	20,095	1,614.3
1980	not available	not available
1981[a]	15,960	1,454.8
1982	10,306	885.5
1983	7,703	646.2
1984	7,262	601.7
1985	10,778	1,123.1
Total	106,633[b]	$8,720.1[b]

[a]Through 8/31/81.

[b]Does not include statistics for fiscal year 1980.

Source: SBA Office of Surety Guarantees.

Table 2.2: Number and Value of Claims Paid, Fiscal Years 1977-85

Fiscal year	Number of claims paid	Value of claims paid (millions)
1977	not available	$15.7
1978	not available	34.5
1979	not available	31.4
1980	not available	27.7
1981	3,737	29.2
1982	4,028	28.1
1983	4,584	34.7
1984	4,794	27.1
1985	3,869	19.1
Total	21,012[a]	$247.5

Note: More than one claim may be paid on a defaulted contract.

[a]Does not include number of claims paid for 1977-80.

Source: SBA Office of Surety Guarantees.

Table 2.3: Cumulative Savings to the Government Based on Difference in Contract Prices Between Lowest and Next Lowest Bidders From Program Inception in 1971

Through fiscal year[a]	Savings to government[b] Gross	Net
	---(millions)---	
1977	$145.1	$ 72.2
1985	784.6	557.4

[a]SBA did not have statistics for other fiscal years.

[b]Includes savings to the federal, state, and local governments.

Source: SBA Office of Surety Guarantees and Study of the Small Business Administration Surety Bond Guarantee Program, Office of Planning, Research and Data Management, U.S. Small Business Administration, Nov. 1977.

Table 2.4: Net Program Costs From Program Inception in 1971

Through fiscal year[a]	+ Income[b]	+ Recoveries	- Admin. expenses[c]	- Interest to Treasury[d]	- Gross claims incurred	= Net cost (loss)
			(millions)			
1977	$15.2	$ 5.1	$ 3.8	$5.8	$ 83.6	($ 72.9)
1985	73.6	40.2	13.0	5.8	322.2	(227.2)

[a]SBA did not have statistics for other fiscal years.

[b]Income is generated from application fees, contractor fees, and surety premiums/fees.

[c]Administrative expenses consist of salaries and miscellaneous costs.

[d]According to SBA, no interest was paid to the Treasury for the program after 1976.

Source: SBA Office of Surety Guarantees, SBA Office of the Comptroller, and Study of the Small Business Administration Surety Bond Guarantee Program, Office of Planning, Research and Data Management, U.S. Small Business Administration, Nov. 1977.

Table 2.5: SBA Surety Bond Guarantee Program Staff, Fiscal Years 1977-85

Fiscal year (as of 9/30)	Field offices[a]		Headquarters[b]				
	Professional	Clerical	Manager	Professional	Clerical	Student	Total
1977	30	21	3	8	1	-	63
1978	30	22	2	7	1	-	62
1979	32	25	2	9	2	-	70
1980	19	15	2	7	1	12	56
1981	21	11	1	9	2	5	49
1982	22	6	1	9	3	17	58
1983	28	7	1	9	6	15	66
1984	24	8	2	11	6	8	59
1985	24	9	3	11	4	5	56

[a]Field office staff are responsible for reviewing surety bond guarantee applications. Figures for field offices prior to 1980 include district office personnel assigned to the Surety Bond Guarantee Program. In 1980-81, program operations were centralized in regional offices, resulting in personnel reductions.

[b]Headquarters staff (professional, clerical, and student) are responsible for processing claims. Headquarters managers have overall program management responsibility. All students were part-time trainees.

Source: SBA Office of Surety Guarantees.

REQUEST: Address whether the program has a reporting system providing program officials useful and timely management information in an automated format.

RESPONSE: During the March 1982 hearings before the Senate Committee on Small Business, the SBA Inspector General cited the lack of accurate, timely, and easily retrievable management information as a problem hampering the ability of program officials to effectively manage the Surety Bond Guarantee Program. According to the Inspector General's testimony, program officials informed him that 26 separate computer reports were prepared monthly, quarterly, or annually, which were "of little, if any, value, to them." The Inspector General's office, based on their own experience with the reports, concurred with the program officials' assessment.

Aware of the problems in its automated system, SBA has worked for several years to convert to a new management information system. The new system went on-line in December 1985 and program officials expect it to be fully operational in December 1986. Program officials expect the system, when fully operational, to produce reports that will assist program managers and provide often-requested information to the Congress and public sector.

UNDERWRITING GUIDELINES

- SBA has two documents that serve as underwriting guidelines.

- According to SBA

  --its staff does not perform in-depth verification of data in selected applications due to limited staffing and plans for less day-to-day involvement with sureties;

  --its staff declines applications with outdated, inaccurate, or incomplete data as part of general underwriting practices; and

  --sureties, not SBA, should take the necessary action to exclude surety agents who repeatedly submit unreliable data.

SECTION 3

UNDERWRITING GUIDELINES

REQUEST: Address whether underwriting guidelines are now available to assist program personnel and surety companies in evaluating contractors' surety bond guarantee applications, and, if available, whether they (a) require program staff to verify the data contained in selected contractor applications; (b) require staff to decline applications with outdated, inaccurate, or incomplete underwriting data; and (c) authorize the exclusion from the Surety Bond Guarantee Program of participating surety agents who repeatedly submit unreliable data.

RESPONSE: Our 1979 report, The Surety Bond Guarantee Program: Significant Changes Are Needed in Its Management (CED-80-34, Dec. 27, 1979), and the SBA Inspector General's testimony of March 1982 before the Senate Committee on Small Business[1] raised concern over the lack of useful standards for underwriting bond guarantee applications. According to our report, SBA provided general guidelines in its standard operating procedures, but the guidelines did not address the financial analysis that should be performed in underwriting. In his testimony, the Inspector General stated that guidelines are needed to assess bond guarantee applications and to hold the surety industry to consistent standards. Both the report and the testimony recommended that SBA develop specific underwriting guidelines. Since the 1982 testimony, SBA issued a guide to assist program personnel in evaluating surety bond guarantee applications. SBA also revised its standard operating procedures. Neither document contains requirements for verifying data, declining applications, or excluding surety agents who submit unreliable data.

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[1]Hearing before the Committee on Small Business, United States Senate, 97th Congress, Second Session, on Small Business Administration's Surety Bond Guarantee Program, March 11, 1982, p. 279 et seq.

Underwriting guidelines

In May 1982 SBA's Office of Special Guarantees[2], which administers the Surety Bond Guarantee Program, issued the Underwriting Training and Reference Guide, and in May 1983 the office revised the program's standard operating procedures.

The Underwriting Training and Reference Guide is a training document that is designed to alert new program underwriters and refresh more experienced personnel to some basic underwriting considerations. The guide is used primarily by regional program personnel, who are responsible for reviewing applications from surety agents.[3]

Two chapters of the guide are designed to help program personnel review guarantee applications. These chapters contain suggestions and thoughts for consideration on underwriting. They also contain a list of items that program underwriters may check when reviewing an applicant's financial statements. They do not, however, discuss the financial analysis that is usually performed in underwriting. Although one chapter lists a procedure that program underwriters could use when reviewing applications, the chapters do not list specific steps that program staff are required to follow when reviewing applications.

The standard operating procedures contains policy, procedures, and guidelines for implementing the program. Sections of the standard operating procedures discussing application procedures and underwriting considerations state what surety agents and program underwriters should determine from their reviews of surety bond guarantee applications. The standard operating procedures contains few specific instructions to program underwriters or surety agents concerning the financial analysis that should be done to determine whether an application should be approved.

The SBA underwriting manager at headquarters said that it is not the purpose of the Underwriting Training and Reference Guide or the standard operating procedures to require program staff to analyze bond guarantee applications by using rigid rules.

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[2]Name changed to Office of Surety Guarantees on Sept. 26, 1985.

[3]A surety agent, who represents a surety company, receives an application for an SBA-guaranteed bond from a contractor. The agent then submits the application, along with its underwriting review forms and the necessary fees, to SBA. Program underwriters then review the application package to decide whether to guarantee the surety bond.

Instead, the guide and standard operating procedures stress flexibility in underwriting. Further, he said that program staff, as well as surety agents, must consider many factors when underwriting a bond guarantee application. The number of factors to consider, as well as their relative importance, will vary depending on such information as the nature and length of the job and experience of the contractor. Program staff should consider these factors and use their individual judgment to decide whether to approve or decline an application.

Staff in two SBA regional offices we visited also believe that the application review process is subjective and involves individual judgment. Staff in these offices said that they appreciated that the standard operating procedures, as well as the underwriting guide, provided them considerable discretion in deciding whether to approve or decline an application.

No requirement for in-depth verification of data

In our 1979 report, we reviewed a sample of contractor files and concluded that SBA did not adequately evaluate applications from sureties. Surety agents submitted applications that contained incomplete or erroneous underwriting data, which SBA did not question. For example, SBA approved a bond guarantee application for a contractor whose application incorrectly reported two financial indicators--the contractor's working capital and net quick assets. The contractor later defaulted on the contract. The report concluded that program officials generally performed a cursory review of applications, relying heavily on the surety agent's recommendation regarding guarantee approval. The report recommended that program staff could significantly improve underwriting reviews by selecting certain contractor applications for in-depth verification and evaluation rather than performing cursory reviews of all applications. SBA agreed to implement this recommendation, stating that the need for in-depth reviews in certain instances is appropriate.

SBA has not established requirements for its staff to select contractor applications for in-depth verification. SBA officials pointed out that regional offices screen all applications in some detail and some regional offices verify selected information in applications, such as bank lines of credit. SBA officials also explained that limited staffing resources as well as its anticipated increased role as a reinsurer[4] (thus becoming less involved in reviewing each application) make implementation of our recommendation unnecessary. Staff in two regional offices we visited think that

[4]Reinsurance is a procedure by which one company, having assumed a risk by the issuance of a policy, shares the risk and the premium with other companies.

in-depth verification and evaluation of randomly selected applications are not necessary because surety agents are now submitting more reliable and complete applications.

The Underwriting Training and Reference Guide does not require verification of selected contractor applications or verification of any specific item in the application forms. The guide, however, suggests that certain current assets in a contractor's financial statements be verified, such as cash in the bank, large accounts receivable, and the cash value of life insurance. We found that these assets are not consistently verified by the regional offices we visited.

The standard operating procedures, like the guide, does not require program staff to verify data contained in selected applications or to verify specific items in application forms. According to program staff and the standard operating procedures, the primary underwriting responsibility lies with the surety agents, who certify that they have determined the accuracy and completeness of the information contained in their underwriting review. The agent is also expected to adhere to the surety industry's general principles and practices used in evaluating a contractor's application.

No requirement to decline applications with outdated, inaccurate, or incomplete data

According to our 1979 report, surety agents frequently provided incomplete or erroneous underwriting information to SBA. During the review of the program in 1979, we sampled over 600 applications and found that 87 percent of the applications contained underwriting deficiencies, such as an inaccurate calculation of working capital or an outdated income statement. The report stated that program losses could be reduced if SBA received reliable underwriting data and, therefore, recommended that SBA direct its program officers to decline applications with incomplete or erroneous data. SBA, in responding to our report in 1979, said that sureties themselves screen out many applicants, probably two to three times the number of applications actually forwarded to SBA. Further, SBA stated that it declines about 3 percent of the applications received.

SBA has not established written requirements specifying that program staff decline applications with incomplete or erroneous underwriting data. The underwriting manager said, however, that such applications are declined or returned to the surety. He stated that although there are no written requirements, general underwriting practice would lead program staff to decline applications with outdated and inaccurate data. Although the standard operating procedures does not require staff to decline incomplete forms and application packages, it does require staff to return them to the surety agents. (A "declined" application is one that has been reviewed but not approved for a surety bond guarantee. A "returned" application is not reviewed but is sent back to the surety agent for various reasons, such as missing information. After making any necessary changes to the returned application, the surety agent may resubmit the application.)

Staff in the three regional offices that we visited said that they did not receive many applications with outdated or inaccurate information but they occasionally received incomplete applications from sureties. We did not review applications to verify their statement. The staff did not automatically decline incomplete applications but returned the application to the surety or informed the surety by phone of any missing information. The surety would then submit the needed information.

No specific requirement to exclude surety agents who repeatedly submit unreliable data

Our 1979 report stated that SBA often did not take sufficient action to prevent surety agents from repeatedly submitting unreliable data. When a surety agent submitted unreliable data, SBA merely pointed out the underwriting shortcoming to the surety agent and suggested that the shortcoming not be repeated. We recommended that SBA direct regional offices to refuse to do business with those agents. SBA disagreed with the recommendation, commenting that it would not attempt to suspend agents who were under contract with surety companies. SBA stated that it would continue, however, to inform surety companies of poor performance and let the sureties take appropriate action. Further, SBA commented that failure by the surety to take corrective action could trigger action by SBA to punish the surety.

Because SBA disagreed with the recommendation, SBA did not establish specific instructions for excluding surety agents who repeatedly submit unreliable data. According to program officials, SBA still prefers to inform the surety company if an agent repeatedly submits unreliable data and to let the surety company take the necessary action. SBA further stated that "any unilateral attempt on SBA's part to eliminate such agents would be of questionable legal efficacy. In addition, it would erode the normal, legally-constituted relationship between a surety company and its guarantor/reinsurer." Staff in two regional offices that we visited said that they did not experience problems with surety agents frequently submitting unreliable data and had never recommended that a surety agent be eliminated from the program for this reason.

The Code of Federal Regulations contains a section giving SBA authority to refuse to issue further guarantees to a participating surety when a surety (1) fails to adhere to prudent underwriting standards or other practices relative to those of other sureties in the the Surety Bond Guarantee Program or (2) has committed an act of wrongdoing such as fraud or material misrepresentation. The code, however, does not specify the frequent submission of unreliable data as a reason to suspend or eliminate a surety.

CLAIMS REVIEW PROCEDURES AND LOSS RATES

- SBA requires that an itemization of payments accompany a surety's request for reimbursement.
- SBA does not think it is practical to develop claims-handling reimbursement rates; SBA's overall concern is a surety's bottom-line loss rate.
- SBA's draft proposed program rules allow for reimbursement of reasonable attorney fees, but SBA's overall concern is a surety's bottom-line loss rate.
- SBA has implemented, or is in the process of implementing, the majority of claims-handling procedures that it identified in 1983.
- SBA developed a procedure to compute a loss ratio comparable to that of industry.

SECTION 4

CLAIMS REVIEW PROCEDURES AND LOSS RATES

REQUEST: Address whether claims review procedures have been established that cover the following

(a) required documentation to accompany a surety's claim,
(b) claims-handling reimbursement rates based upon the surety's use of in-house personnel versus contract claims-handling personnel,
(c) guidelines for the "reasonableness" of fees for attorneys and other claims-handling personnel used by the surety (and their relation to prevailing industry standards), and
(d) SBA's proposed program for improved claims handling announced in 1983 testimony.

RESPONSE: The SBA Inspector General, in his 1982 testimony before the Senate Committee on Small Business, and we, in our 1979 report, voiced concern about SBA's procedures for reviewing claims on defaulted surety bonds. The Inspector General stated that documentation required to support claims and a definition of those charges that are reimbursable under the contract are essential. The Inspector General was particularly concerned about the nature and scope of legal and other fees chargeable to SBA as reasonable and proper expenses associated with the claims process. We were also concerned about claims-handling costs. In 1983 testimony before the House Committee on Small Business, SBA's Associate Administrator for Finance and Investment identified six ways SBA planned to improve its Surety Bond Guarantee Program claims-handling procedures.

In summary, we found that SBA requires sureties to submit an itemization of reimbursable expenses and has authority to request additional information from sureties before paying a claim. SBA disagreed with our recommendation in 1979 to develop claims-handling reimbursement rates and still disagrees with the recommendation. Instead, SBA's overall concern in controlling cost is the surety's bottom-line loss rate. SBA's draft program rules identify allocable expenses (including reasonable attorney fees) as those for which sureties may seek reimbursement. SBA implemented, or is in the process of implementing, the majority of claims-handling procedures that it identified in 1983.

SBA requires itemization of payments to accompany a surety's claim

The SBA Inspector General, in his 1982 testimony before the Senate Committee on Small Business, stated that "documentation required to support claims ... is essential." In response to a question raised during the hearing, the Inspector General said there was "no backup verification, no invoices ..." when claims were paid. The testimony, however, did not clearly explain the extent of claims documentation that the Inspector General thought was necessary. Staff currently in the Inspector General's office could not identify any reports or correspondence prepared around the time of the testimony that clarified the intent of the Inspector General's statement. (The Inspector General that testified in 1982 is deceased.) The Inspector General's staff, as well as the program staff, stated, however, that to require a surety to submit documentation, such as invoices and canceled checks, for a reimbursement request would be burdensome and costly and would not necessarily prevent reimbursement of inappropriate expenses. Further, staff from both offices said the program office does not have a sufficient number of staff to review such paperwork or file space to maintain such records. The Inspector General's staff generally favor the current approach, described below, for reimbursement requests.

Our 1979 report described the following as the way sureties sought reimbursement from SBA. Participating sureties submitted either a computerized claim reimbursement document or a standard SBA form that itemized the claim. The sureties were also responsible for submitting an affidavit stating that supporting documentation existed. Generally, surety forms were not accompanied by invoices, drafts, payroll sheets, or other documents supporting the claim.

This is basically the same procedure that SBA currently uses. A surety usually seeks reimbursement for a claim on either the SBA "claim for reimbursement" form or on the surety's computerized submission, called a "bordereau." Each lists the number and date of the surety's checks, the payee, and the amount. SBA does not require the surety to submit the original or copies of canceled checks. The SBA form, or an affidavit attached to the bordereau, is to be signed by the surety certifying that (1) the itemization and summary of payments are true and correct and (2) all payments made are substantiated by documentation, such as payroll sheets, copies of surety's drafts, and claimants' invoices, retained in the surety's office or in the office of the surety's claim account trustee with copies maintained in the surety's office. Further, the SBA form states "any intentionally false statement or willful misrepresentation in connection with a claim for payment pursuant to a Guarantee Agreement is a violation of Federal law, subject to criminal and civil prosecution ... carrying fines up to $10,000 and imprisonment of up to five years."

The SBA claims manager said she had no recollection of the Inspector General's office instructing or requesting her, either verbally or in writing, to require sureties to submit documentation in addition to the above.

SBA's Claims Reference Guide, the basic reference used by headquarters' staff in performing claims functions, states that SBA does not perfunctorily pay claims and ask questions later. Rather, SBA employees are required to resolve questionable claims before payment. According to the Code of Federal Regulations, SBA may request additional information from a surety before paying any claim. SBA correspondence files that we reviewed contained letters from SBA to sureties questioning some requests for reimbursement and asking for documentation.

SBA did not develop claims-handling reimbursement rates

Our 1979 report recommended that SBA establish claims-handling reimbursement rates that would result in reasonable and equivalent net claims-handling costs for the two types of sureties in the program--standard and specialty. According to the report, the standard sureties have in-house lawyers who handle claims, generally at no charge to SBA. The specialty sureties do not have that capability and charge SBA for claims handled by outside attorneys. The recommendation was directed at establishing various claims-handling reimbursement rates that were equitable to SBA, standard sureties, and specialty sureties. SBA, in commenting on a draft of the 1979 report, disagreed with the recommendation and considered it "unrealistic and impractical because its consequences to small and minority contractors would be extremely adverse." SBA still disagrees with the recommendation and thinks it would not be practical for SBA to set various rates. The Director, Office of Surety Guarantees, believes that the most appropriate way for SBA to control costs is to look at a surety's bottom-line loss rate and adjust the percentage of the loss that it guarantees accordingly. The varying of a surety's percentage of the loss that is guaranteed is included in SBA's proposed program rules.

SBA's proposed program rules allow for reimbursement of reasonable attorney fees

The SBA Inspector General, in his March 1982 testimony, expressed concern over the nature and scope of legal and other fees that can be charged to SBA as reasonable and proper expenses associated with the claims process. The concern seems to be generated from an Inspector General audit of a surety that did not handle claims internally but sought reimbursement for legal expenses that appeared to be administrative expenses. During the testimony, the Inspector General said problems stemmed from the fact that "there's really nothing in our regulations or the guarantee agreement regarding legal fees, per se, and you really have to relate legal fees to the definition of reimbursable losses." In follow-up to questions asked at the testimony, SBA said that it planned to deal with excessive legal costs and other expenses in connection with losses by redefining "loss."

SBA's current definition of loss, and the definition in effect at the time of the testimony, includes all expenses in connection with a claim. SBA's definition of loss in its most current (April 1986) version of the proposed program rules distinguishes between reimbursable and nonreimbursable expenses. Expenses specifically allocable to the settlement of a given claim, including "reasonable attorney's fees," would be reimbursable, whereas unallocated and overhead expenses of a surety would not be reimbursable. The proposed program rules do not define "reasonable attorney's fees" because SBA is not trying to monitor the cost of each expense. Instead, SBA's principal reliance in cost control matters will be a surety's bottom-line loss experience.

SBA has no guidelines on what attorney rates should be, but according to an SBA claims official in November 1985, the hourly rate charged SBA is usually in the $75-$100 range. An SBA official said that SBA has no indication of any difference in legal fees between those charged for SBA guaranteed bonds and those charged in the standard surety industry.

SBA implemented some items in proposed program for improved claims handling

The SBA Associate Administrator for Finance and Investment said, during testimony before the House Committee on Small Business in May 1983, that SBA planned six items to improve its claims-handling procedures. These items were

--preparation of a surety handbook,
--revision of an SBA form on default/claim activity,
--random sample review of claim payments processed,
--use of technical consultants on complex or suspect claims cases,
--additional training, and
--conversion to on-line computer processing.

During the testimony, the Associate Administrator did not specify when these items would be started or completed. SBA implemented, or is in the process of implementing, the majority of these items.

Surety handbook

SBA planned to prepare a handbook for sureties on surety bond guarantee default and claims processing that would eliminate much of SBA's case-by-case explanation of what was needed from sureties for adequate documentation. According to the SBA claims manager, other priorities and an insufficient number of permanent staff prevented SBA from preparing a handbook for sureties. SBA, however, is planning to develop a handbook by the end of fiscal year 1986. SBA anticipates the handbook will explain such things as why SBA can deny liability for a claim, how sureties should complete SBA claims forms, and the kind of documentation that should be submitted to SBA.

Revised SBA form on default/claim activity

SBA planned to expand and revise its default/claim activity form to provide SBA with information about a surety's contract completion arrangements that SBA was requesting on a case-by-case basis when not provided initially by the surety. The form was being revised for use with the new management information system. The new form requests the surety to provide detailed contract completion information (percentage of completion, remaining contract funds, method of selecting completion contractor, description of how claim situation arose, present condition, surety's plans for resolution and salvage, and anticipated loss) on the initial submission on a defaulted contract. SBA anticipates the form, just recently approved by the Office of Management and Budget, being used by sureties in 1986.

Random review of claims

SBA's Associate Administrator for Finance and Investment testified that SBA planned to perform a random, rather than its case-by-case, review of claim payments processed to save time. He pointed out during the 1983 testimony that the "consequence of public and internal criticism must be recognized and accepted if this procedure is to be adopted."

The SBA claims manager explained that the intent of this proposal was for SBA to perform an abbreviated review of claim reimbursement requests from selected sureties (while still giving full reviews to their initial and final requests), rather than to perform an actual random review of claims. According to the claims manager, SBA implemented this approach on a pilot basis in April 1984 for selected sureties that had good performance records. Because of some staffing and filing problems and a decrease in the number of submissions of claims for reimbursement, SBA switched back to reviewing each reimbursement request. On May 1, 1986, the claims manager indicated a possible return to the random sample approach because of an increasing number of submissions of claims for reimbursement.

Use of technical consultants

SBA planned to use technical consultants to assist program staff in verifying facts pertaining to particularly complex or suspect claims. Prior to and after the testimony, SBA had a consultant on board who reviewed selected SBA claims files. The consultant left SBA around January 1984 because of health reasons. According to the SBA claims manager, program staff were told in the early 1984 time period that technical consultant positions would not be approved, because of "shifting agency priorities."

Surety Bond Guarantee Program officials would also like to have a claims attorney and a bookkeeper/statistician assigned to the Office of Surety Guarantees to assist in the claims area, but program officials have been unable to accomplish this, largely because of budget constraints and competition for staff among SBA offices.

Additional training

SBA planned more intense training of part-time temporary employees and upgrading the training of permanent employees in order to have better quality case analyses. Subsequent to the testimony, program staff determined that intense training for part-time temporary employees--co-op students--was not cost-effective since the students usually did not return to SBA. Program officials said they have always supported training for the permanent employees. Staff have received training on such topics as surety law, construction contract litigation, and computer processing, but budget constraints and shifting agency priorities have precluded more training. For example, SBA planned both accounting and contract law courses for its claims staff in fiscal year 1986, but in December 1985, these courses were postponed "until further notice" because of budget constraints.

Conversion to on-line computer processing

SBA planned to convert to on-line computer processing, which was expected to save file retrieval and paper processing time. SBA's system went on-line in December 1985 and is expected to be fully operational in December 1986. (See sec. 2 for more details.)

REQUEST: Address the appropriateness of SBA's calculating the program's loss rate as a ratio of claims paid against premium dollars received rather than losses incurred against total value of contracts completed.

RESPONSE: The SBA Inspector General, in March 11, 1982, testimony before the Senate Committee on Small Business and an SBA 1981 Office of Inspector General report recommended that SBA use a system comparable to the private sector in computing loss rates to assist program staff in evaluating the performance of participating sureties. The 1981 report said that while the Surety Bond Guarantee Program was expected to incur losses at a higher rate than the surety industry in general, both the Congress and the public had a right to know how much higher the losses were. Program officials in 1981 disagreed with the Inspector General's recommendation, citing that the industry's ratio was maintained with a profit motive in mind, whereas the Surety Bond Guarantee Program did not expect to operate at a profit. The Inspector General's office, however, maintained its recommendation.

In March 1982 the SBA program staff accepted the Inspector General's recommendation, and in June 1982 the program staff submitted a loss computation approach that conformed to the Inspector General's recommendation. It was officially adopted in April 1983 as an alternate loss computation known as the "Surety Bond Private Sector Comparative Loss Ratio." At the time of our review, staff in both the Inspector General's office and the program office were unaware of this loss ratio computation ever having been employed. We are not taking a position on the appropriateness of a loss ratio for SBA since the recommendation, according to the office that made the recommendation, has been satisfied.

The program office continues to calculate a loss rate that it believes is more useful and appropriate than the private sector loss ratio. SBA computes its loss rate (technically called an incurred loss rate) as value of losses incurred (actual and reserve) divided by value of guaranteed contracts completed. SBA computes an incurred loss rate for the program as a whole and for each regional office. SBA's loss rate figures do not relate loss to the year in which a bond was written but rather base the loss rate on statistics from program inception through a given date. SBA's incurred loss rate for the program as a whole as of the end of fiscal year 1985 was 2.03 percent.

SURETY COMPANY MONITORING AND THE SBA

INSPECTOR GENERAL'S AUDITS

- SBA has not established written requirements instructing sureties to monitor contractor progress.

- The SBA Inspector General has not performed a claims audit since 1981 mainly because of a lack of (1) staff and (2) cost principles to apply during a claims audit.

SECTION 5

SURETY COMPANY MONITORING AND THE SBA

INSPECTOR GENERAL'S AUDITS

REQUEST: Address whether guidelines regarding a surety's responsibility for monitoring contractor progress have been established and, if so, whether they are being enforced.

RESPONSE: Our 1979 report stated that neither SBA nor many surety companies monitor contractor progress sufficiently to prevent defaults. We recommended that SBA establish and enforce guidelines regarding a surety's responsibilities in monitoring contractor progress and preventing defaults. SBA, in commenting on a draft of the report, disagreed with our recommendation, stating that requiring sureties to monitor contractor progress was not practical or cost-effective. One standard surety company that commented on the draft report stated that it was not economically feasible for sureties to monitor thousands of on-going contracts.

The report, however, mentioned that some standard sureties monitored job progress either by visiting job sites or by requiring monthly or quarterly work-in-progress reports from the project owner. The report also mentioned that one specialty surety made follow-up phone calls to a project's owner if the progress report that the surety sent to the owner was not completed and returned within 7 weeks. In response to SBA's comments on the draft report, we did not change our recommendation and maintained that "contractor monitoring ... is essential if SBA expects to prevent defaults and minimize losses."

In the May 1983 hearing of the House Committee on Small Business, the SBA Administrator spoke briefly on the difficulty for SBA or the sureties to monitor each contractor. The Administrator said it was beyond SBA's capabilities to track each contractor's performance and be responsible to see that the contractor does not default. The Administrator added that "not even a surety company will perform that kind of nursemaid treatment."

SBA has not established written requirements instructing sureties to monitor contractor progress. Instead, according to SBA's underwriting manager, normal surety industry practice dictates that sureties conduct some type of monitoring. The Director, Office of Surety Guarantees, said that SBA will not implement monitoring guidelines and deems them unnecessary because "contract monitoring is already going on ... by the industry, in whose interest it is to monitor such contracts."

The Director, as well as the underwriting manager, stated that sureties usually monitor contractor progress by sending a job status inquiry form to the owner. SBA believes that this type of monitoring is sufficient. An official from the specialty surety company responsible for underwriting the second largest number of SBA guaranteed bonds in fiscal year 1985 said that the surety monitors contractor progress by sending job status inquiries to owners every 90 days.

REQUEST: Address whether (1) procedures have been established regarding the selective review of claims for complete, current, and accurate documentation; (2) the program's claims are subject to a regular random audit by the SBA Inspector General; and (3) the sureties have been informed of the Inspector General's audit authority.

RESPONSE: We recommended in our 1979 report that SBA establish a systematic procedure for in-depth verification of selected surety company claims. We noted that SBA had not implemented sufficient controls to ensure that all claims submitted by surety companies were legitimate and supported by source documents. Although program staff recognized the need to verify surety claims, program officials said staff shortages and a backlog of work limited the work to a review of one surety company. In commenting on a draft version of the report in 1979, SBA said that our recommendation was reasonable but added

> "Depending upon the definition of "in-depth verification" and upon the availability of either internal or external audit resources, this effort will be carried out. Previous support from the Office of the Inspector General has been valuable and timely, and continued support as required will be forthcoming."

In its April 1981 report, the Inspector General's Office of Internal Audit recommended that additional auditor positions be requested to audit claims of participating sureties. The Inspector General agreed to assign auditors to audit sureties as soon as budget restraints were relaxed to allow for more auditor positions. However, the Inspector General's office said it was notified in March 1984 that no additional auditor positions would be made available.

The Inspector General, in testimony before the Senate Committee on Small Business in March 1982, raised concern over the lack of regular random audits of sureties' claims by program officials. The Inspector General stated that a surety's risk of a claims audit is very low and that most surety companies are aware of this. Therefore, the Inspector General recommended that program officials conduct regular claims reviews and that his office conduct systematic audits of certain claims.

The Code of Federal Regulations and the standard operating procedures state that SBA has the authority to audit the program's claims. According to the Inspector General, surety companies are aware of this authority. In the past, program staff from the Office of Surety Guarantees as well as auditors from the Inspector General's office have reviewed selected claims. However, SBA has not required the reviews to be regularly performed or claims to be randomly reviewed.

Claims reviews by program staff

SBA program staff periodically visit surety companies as a method of selectively reviewing claims files. The on-site reviews are conducted, among other reasons, to review selected surety underwriting and claims case files for conformance to SBA regulations, to identify items that may have been omitted from these case files, to establish personal communication and rapport between SBA and surety companies, and to discuss both SBA and surety company underwriting and claims-handling procedures and recovery techniques.

According to the Claims and Recovery Reference Guides, SBA reviews files during on-site visits for documentation on bond coverage, indemnity, contract specifications, underwriting, default information, claims, reserves, and recovery. SBA attempts to satisfy itself that the surety's requests for reimbursement are properly supported by adequate data.

From 1981 through July 1986, SBA staff conducted 36 on-site reviews of 24 sureties. Each visit lasted up to 5 days. For the remainder of fiscal year 1986 SBA plans two more on-site reviews. SBA tries to visit surety companies that are more active in the program.

Claims reviews by the Inspector General's office

Staff in the Inspector General's office said they perform a more in-depth review of claims than the program staff. The Inspector General's office performed 14 claims audits between 1980 and 1981, by examining books and records of the surety, contractors, subcontractors, and often suppliers. The Inspector General's office has performed no claims audits since then mainly because of a lack of staff due to budget constraints and a lack of cost principles to apply during the claims audits. The most current version (April 1986) of SBA's proposed program rules allow the Inspector General's office to apply whatever cost principles it feels are appropriate.

PROPOSED PROGRAM RULES

- SBA is proposing to vary from surety to surety the guarantee fee and the percent of loss guaranteed.
- Implementation of a plan to attract more standard sureties to the program is not imminent.
- SBA's proposed rules address some of the program weaknesses identified by GAO and the SBA Inspector General.

SECTION 6

PROPOSED PROGRAM RULES

REQUEST: Address whether SBA has established a guarantee fee schedule that considers a surety's loss rate and mitigation of losses.

RESPONSE: The SBA Inspector General, in testimony before the Senate Committee on Small Business in March 1982, voiced concern that some sureties have practically no risk of loss when they participate in the program. Currently, SBA usually guarantees 90 percent[1] of a surety's loss on a contract up to $250,000 and 80 percent of a loss on a contract between $250,000 and $1,000,000.[2] Therefore, when a bonded contractor defaults, the surety pays only 10 or 20 percent of the loss on the bond. The Inspector General recommended that SBA consider "some form of a sliding scale of guarantee fees based on loss rates incurred by the surety or any other creative structuring of relationships designed to better protect the interest of the SBA and sureties."

Currently, SBA does not have a guarantee fee schedule based on surety company loss rates. Instead, SBA charges all sureties a guarantee fee that is 20 percent of a surety's premium.[3] However, SBA's August 1985 proposed program rules, as well as the most current version (April 1986) of the proposed rules, include the concept of varying the guarantee fee from surety to surety, on the basis of the surety's past performance in the program. Under the proposed rules, SBA could vary the percent of a surety's premium that is due SBA.

The proposed rules also present the concept of varying from surety to surety the percent of the surety's loss that SBA would guarantee, on the basis of the surety's past performance in the program. The variation of the percent of loss guaranteed would directly affect the surety's risk of loss. For example, under the proposed rules, SBA could guarantee 75 percent of a surety's

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[1]As indicated in a June 9, 1986, Federal Register notice, SBA reduced the maximum guarantee for a surety's loss to 80 percent for all applications received after June 23, 1986.

[2]On April 7, 1986, the 1986 Budget Reconciliation Act was passed which raises the statutory contract limit from $1,000,000 to $1,250,000.

[3]Premium is the amount of money the surety charges the contractor to underwrite the bond. Premiums can vary by state.

loss on a contract on which SBA would currently guarantee 90 percent of the loss. The surety's risk of loss would therefore increase from 10 percent to 25 percent.

By varying the percent of the loss guaranteed and the guarantee fee on the basis of a surety company's performance, SBA hopes to encourage sureties to improve their performance in the program. The August 1985 proposed rules identified several performance factors that SBA would consider in determining the guarantee fee and the percentage of loss guaranteed. These factors were modified in the April 1986 version of the proposed rules and now include (1) the surety's loss rate in the program in comparison to other participating sureties, (2) the rating or ranking designation assigned to the surety by a recognized authority, (3) the average dollar amount of bond penalty per bond written in the program, and (4) the ratio of bid bonds to final bonds written in the program.

REQUEST: Address what efforts SBA has made to encourage standard surety companies to participate more fully in the program.

RESPONSE: A plan that is still in the discussion stage reflects SBA's efforts to encourage greater standard surety company participation in the Surety Bond Guarantee Program. The Director, Office of Surety Guarantees, does not know when the plan would become effective, since it will require a change in existing legislation. As of May 1986 no legislation had been introduced nor does SBA know when such legislation would be proposed.

The Surety Bond Guarantee Program was established with the idea that standard surety companies would participate. As the program developed, however, many of the standard companies did not participate, thus giving rise to a new type of surety--the specialty surety. In comparison to specialty sureties, standard sureties usually are larger, are more financially secure, provide bonds to firms that are financially sound and have completed many projects, and perform their own underwriting and claims functions. Specialty surety companies, on the other hand, usually are smaller, are more restrictive in their coverage, are not as financially strong, and contract out much of their underwriting and/or claims functions. Specialty surety companies came into existence because they were willing to bond contractors that the standard sureties would not consider and because SBA would guarantee the bond.

According to the SBA Administrator's testimony before the House Committee on Small Business in May 1983, specialty sureties underwrote 97 percent of the surety bonds guaranteed by SBA with about 10-15 standard sureties accounting for the remaining 3 percent of the bonding. SBA's underwriting manager estimated that as of June 1986, standard surety companies accounted for 3 percent or less of the current program volume. He did not anticipate this changing much in the next few years.

During May 1983 hearings of the House Committee on Small Business, the Surety Association of America (which represents standard surety companies) discussed a plan it developed to encourage greater program participation by standard surety companies. The plan, which was accepted in principle by SBA, is expected to reduce paperwork and give greater responsibility to the surety company. As of May 1986, both the SBA and the Surety Association of America were still interested in the plan.

Under the plan SBA anticipates that the surety company would make the actual day-to-day decisions on bonding. SBA's role would be essentially one of administration, and the surety company's role would include essentially the underwriting and claims-handling functions. SBA would not individually review and approve each bond guarantee application as it does now. Instead, SBA would deal on an annual basis with the surety company. Further, under the plan, the surety company would assume a greater portion of the loss (in the 25-30 percent range) on a defaulted bond and SBA would guarantee less of the loss (in the 70-75 percent range).

REQUEST: Evaluate whether the proposed Surety Bond Guarantee Program regulations published for public comment on August 21, 1985, and any final regulations issued, address the program weaknesses identified in GAO's 1979 report or by the SBA Inspector General in his 1982 testimony before the Senate Committee on Small Business.

RESPONSE: Our 1979 report, and the SBA Inspector General's 1982 testimony before the Senate Committee on Small Business, identified several weaknesses in the Surety Bond Guarantee Program. The weaknesses included (1) virtually no risk of loss for some sureties participating in the program, (2) no claims-handling reimbursement rates for specialty and standard sureties, (3) no guidelines regarding reasonableness of attorney fees, (4) a management information system that did not provide accurate and timely reports, (5) no requirement for a surety to monitor a contractor's progress, (6) the lack of an SBA loss ratio computation that was comparable to that used by the private sector, (7) a lack of useful underwriting guidelines, and (8) no requirement for the SBA Inspector General to conduct regular and random audits of sureties' claims.

SBA published advance proposed program rules on August 19, 1983. After considering voluminous comments, SBA published proposed rules on August 21, 1985. These rules also generated extensive comments, and SBA has revised them as of April 1986. SBA is in the process of getting internal agency approval before submitting the rules to the Office of Management and Budget. The SBA underwriting manager anticipates the program rules becoming final by the end of 1986. The proposed rules address some of the program weaknesses identified by the Inspector General and us.

In his 1982 testimony the Inspector General referred to the low risk of loss for surety companies participating in the program. To increase the risk of loss for these sureties, the proposed rules present the concept of varying the percent of the loss guaranteed by SBA, as well as the guarantee fee, from surety to surety. The percent of loss guaranteed by SBA and the guarantee fee for each surety would depend on the surety's past performance in the program. By varying the percent of loss guaranteed and the guarantee fee, SBA hopes to encourage sureties to improve their performance in the program.

The concept of increasing a surety's risk is also included in an SBA emergency final regulation issued in the Federal Register on June 9, 1986. The regulation, effective for all surety bond guarantee applications received by SBA after June 23, 1986, reduces SBA's guarantee of loss on all surety bonds to a maximum of 80 percent, thus making the surety share a greater portion (at least 20 percent) of the risk. SBA found it necessary to reduce the maximum guarantee to 80 percent to allow existing SBA resources to accommodate an increased demand for guarantees. According to SBA, this policy is not expected to affect its authority to vary the percent of loss guaranteed from surety to surety if the proposed rules become final.

Although the proposed rules do not discuss the claims-handling reimbursement rates that we recommended, they do contain a more detailed definition of loss, including expenses that will and will not be reimbursed by SBA. The April 1986 version of the draft rules allows the reimbursement of reasonable attorney fees, although reasonable is not specifically defined.

The proposed rules do not contain information on a program management information system, a surety's responsibility for monitoring a contractor's progress, or an SBA loss ratio computation comparable to that used by the private sector. Although the proposed rules (in August 1985 and in April 1986) contain new instructions to sureties to adhere to the general principles and practices of underwriting in SBA's standard operating procedures, the proposed rules do not contain instructions for agency staff to verify data in selected contractor applications; decline applications with inaccurate, incomplete, or outdated data; or exclude surety agents who repeatedly submit unreliable data.

Regarding the Inspector General's audits of claims, the August 1985 proposed rules specify that the Federal Acquisition Regulations should be employed when the Inspector General's staff perform audits. Based on comments received, the April 1986 version of the proposed program rules omit reference to the Federal Acquisition Regulations leaving SBA auditors free to apply whatever cost principles are appropriate. Nevertheless, neither version of the proposed rules requires that the Inspector General perform regular or random audits of claims.

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