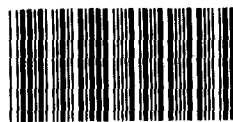


April 1991

# SMALL BUSINESS

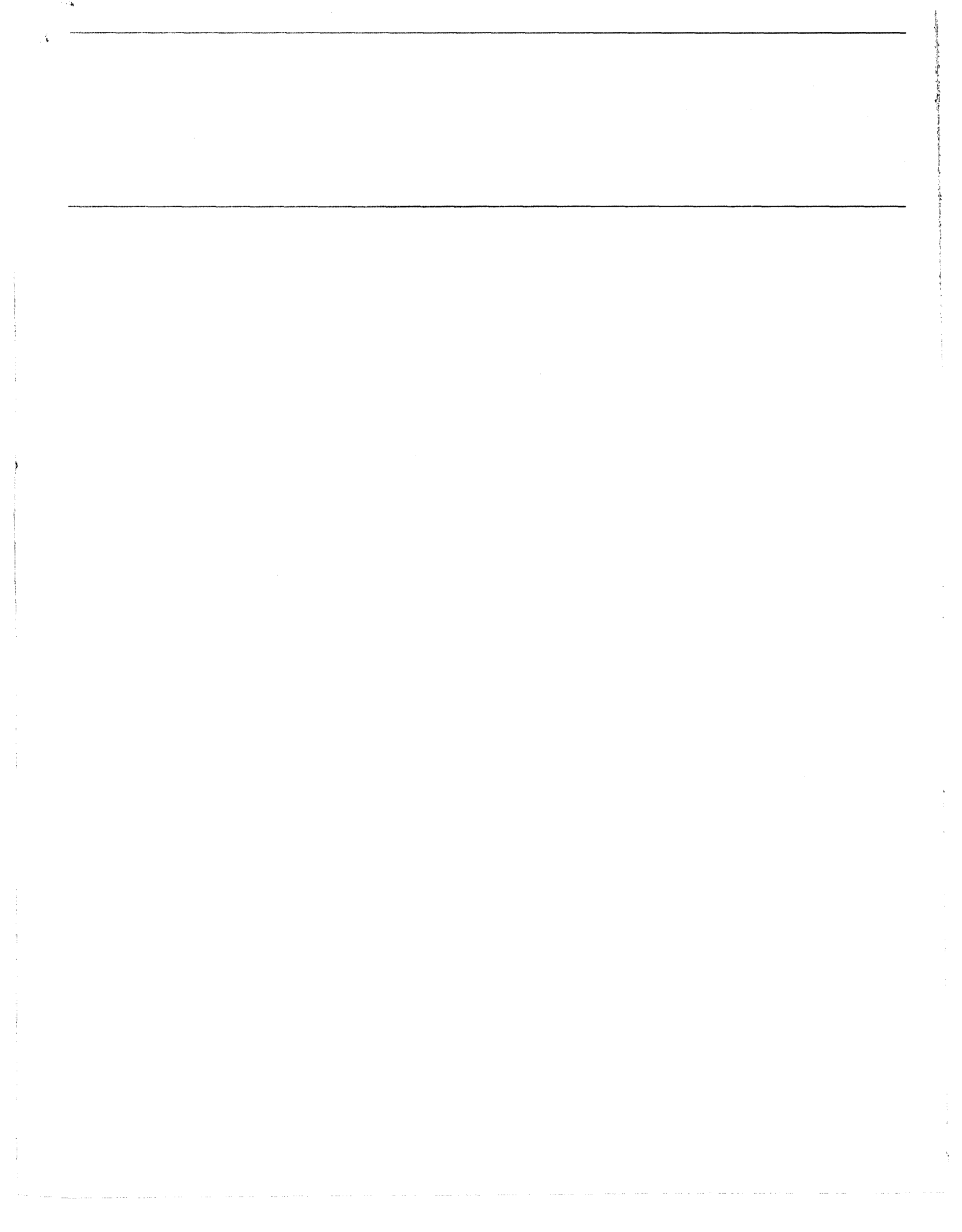
## Information on and Improvements Needed to Surety Bond Guarantee Programs



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**Resources, Community, and  
Economic Development Division**

B-242985

April 23, 1991

The Honorable Dale L. Bumpers  
Chairman, Committee on Small Business  
United States Senate

The Honorable John J. LaFalce  
Chairman, Committee on Small Business  
House of Representatives

This report responds to your request that we issue an interim report on the Small Business Administration's (SBA) surety bond guarantee programs. The report provides data on activity in the administration's existing Surety Bond Guarantee Program during fiscal years 1987-89 and discusses the status of the pilot Preferred Surety Bond Guarantee Program. In addition, this report also provides recommendations to the Administrator of the Small Business Administration for improving SBA's Surety Bond Guarantee Program data. We will issue a final report on our evaluation of the pilot program by March 1, 1994.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of the report to the Administrator, SBA, and other interested parties. We will also make copies available to others upon request.

This work was performed under the direction of John M. Ols, Jr., Director, Housing and Community Development Issues, who may be reached on (202) 275-5525. Other major contributors to this report are listed in appendix VI.



J. Dexter Peach  
Assistant Comptroller General

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# Executive Summary

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## Purpose

Since 1971 the Small Business Administration's (SBA) Surety Bond Guarantee (SBG) Program has helped qualified small businesses obtain bonds required for certain construction and service contracts from surety companies, bonds that would be unobtainable without an SBA guarantee. In the mid-1980s small businesses, especially those owned and operated by minorities, were having difficulty obtaining bonds. To address this problem, and to regain participation of larger surety companies that had left the program, the Congress in 1988 passed legislation establishing a pilot Preferred SBG Program. This program allows selected surety companies to underwrite and issue SBA-guaranteed bonds without SBA's prior review and approval. Subsequent legislation extended the pilot program by 2 years and established a reporting date of March 1, 1994, for GAO to report on its evaluation of the pilot program to the Senate and House Committees on Small Business.

As an interim measure, the Committee Chairmen asked GAO to provide information on (1) SBG Program activity during fiscal years 1987-89, to be used as a baseline for determining the impact of the pilot program, and (2) the status of the pilot Preferred SBG program. Because GAO obtained the information on program activity from the SBA's computer data base, GAO checked the reliability of the specific data that it reviewed.

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## Background

SBA can guarantee bonds for construction and service contracts of up to \$1,250,000 if (1) the bonds are required to obtain the contract, (2) the business requesting the bond had average annual gross receipts that did not exceed \$3.5 million during the preceding 3 years, and (3) the business was unable to obtain a bond without the SBA guarantee.

Initially, SBA-guaranteed bonds were underwritten by standard surety companies that also handled most of the bonds not guaranteed by SBA. Subsequently, the standard sureties began to withdraw from the SBA program, reportedly because of administrative burdens associated with the program. Specialty surety companies increased in number and increased their participation by underwriting SBA-guaranteed bonds and other high-risk bonds not normally handled by standard sureties.

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## Results in Brief

According to data obtained from SBA's SBG Program data base, in fiscal years 1987-89 SBA guaranteed a total of 33,408 bonds having a total contract value of \$3.9 billion. During that period, the number of bonds guaranteed remained stable at just over 11,000 each year, and the value of

contracts with SBA bond guarantees increased 15 percent (from \$1.22 billion in 1987 to \$1.40 billion in 1989). Minority contractors obtained about 15 percent of the bond guarantees during the period. The number of bond guarantees obtained by minority contractors declined from 1,749 in 1987 to 1,666 in 1989. Ninety-nine percent of all bonds guaranteed were underwritten by specialty sureties.

GAO's assessment of the reliability of selected data from the SBG data base showed that the overall reliability of those data could be improved. The weaknesses that GAO found included a lack of (1) guidance on what to do if the code used to identify minority contractors is left blank on the application form, (2) procedures for documenting the bond file when alternative sources of information are used, (3) definitions for types of entities requesting/requiring bonds, and (4) data entry verification. These weaknesses caused an error rate in the existing baseline data that may preclude GAO from drawing a conclusion on whether the new preferred program has increased minority participation in SBA's bond guarantee programs when GAO issues its final report.

SBA has been slow to implement the pilot Preferred SBG Program. The first bond guarantee was issued nearly 2 years after the program's authorization. According to SBA officials, the reasons for the delay in implementing the program included the lengthy processes of (1) drafting the program regulations and (2) consulting with the surety industry on establishing procedures for administering the program.

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## Principal Findings

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### Bond Guarantee Activity

During fiscal years 1987-89, federal agencies awarded about 15 percent of the contracts covered by the SBA-guaranteed bonds. However, more of the bond guarantees were for contracts awarded by local governments (35 percent), private entities (21 percent), and state governments (16 percent).

Seventy-five percent of the SBA-guaranteed bonds were obtained by nonminority contractors. Minority contractors obtained 15 percent of the guaranteed bonds, and those contractors whose background was reported as either undetermined or unknown obtained 10 percent. Of the seven categories of minority contractors, Black contractors obtained the largest share—6.2 percent.

During the 3-year period, eight specialty sureties underwrote 97 percent of all SBA-guaranteed bonds. The 20 standard sureties that participated in the SBG Program accounted for only 1 percent of the bonds guaranteed. A similar pattern existed for the bond guarantees obtained by minority contractors—99 percent of the minority contractor bonds were underwritten by the specialty sureties.

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### Data Could Be Improved

While assessing the reliability of selected information from the SBG data base, GAO found management control weaknesses that, if corrected, could improve the quality of these data in the future. For example, a lack of SBA guidance resulted in the inconsistent assignment of minority code classifications (designations identifying racial or ethnic background) to contractors receiving bond guarantees. GAO estimated that in 13.5 percent of the cases reviewed, a contractor minority code was entered into the SBG program data base although no code was checked on the application; in another 6.4 percent of the cases, applications containing no minority code designations were entered as “undetermined.” These errors occurred because SBA regional personnel responsible for entering the data did not have guidance on what to do if the minority code was missing from the application. In addition, if sources of information other than the applications were used to determine minority classifications, SBA lacked guidance on documenting these other sources in the bond file. GAO estimated that the data entries for contract amounts and bond amounts differed from those on the Surety Bond Guarantee Agreement forms approximately 3 and 4 percent of the time, respectively. These errors occurred because computer edits and/or data entry verification was nonexistent or inadequate. Further, GAO was unable to assess the reliability of obligee (the type of entity requiring the bond, such as the federal government) data because SBA had not defined various obligee types or developed procedures to instruct regional office staffs on how to code obligees.

The Assistant Administrator, Office of Surety Guarantees, acknowledged weaknesses with data entered into the SBG Program data base and the lack of adequate guidance in related operating procedures. She said that the Office plans to remove existing SBG Program information from the data base, rewrite the program’s standard operating procedures, and provide training to staff responsible for entering data into the revised computer system.

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## Delays in Implementing the Preferred SBG Program

Public Law 100-590, approved November 3, 1988, which established the Preferred SBG Program, stated that regulations implementing the pilot program were to be promulgated within 180 days (i.e., by May 12, 1989). Interim final regulations were first issued on May 8, 1989. However, because of the time that elapsed while SBA addressed the comments received on these interim regulations, it was March 6, 1990, before SBA announced in the Federal Register that qualified surety companies desiring to participate in the Preferred SBG Program should so advise SBA. The final rule for the program became effective on March 20, 1990. All together, 503 days elapsed between the enactment of P.L. 100-590 and the final rule. The first bond was issued on October 25, 1990.

To obtain the surety industry's support for the pilot program, SBA worked with industry representatives on such major components of the program as (1) the types of program data that are to be captured and reported by the participating surety companies, (2) the contents of the agreements that SBA will be entering into with each participating surety, and (3) the procedures for communicating program information between the sureties and SBA. According to SBA officials, obtaining the industry's input and reaching mutually satisfactory resolutions to the industry's concerns contributed to the delay in implementing the program. SBA also needed to modify the current SBG computer system for gathering, maintaining, and reporting Preferred SBG Program data.

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## Recommendations

GAO recommends that the SBA Administrator ensure that planned updates to the standard operating procedure for the surety bond guarantee programs provide for effective management controls and at a minimum include (1) guidance to field staff on what to do if the bond application forms contain no minority code classification, (2) instructions for documenting all entries made into the data base (i.e., annotating the source document), (3) procedures for verifying data being entered into the computer system, and (4) instructions for categorizing obligee types.

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## Agency Comments

As requested, GAO did not obtain official comments on this report. However, GAO did obtain the views of SBA officials directly responsible for the program and incorporated their comments in the report where appropriate. SBA Surety Bond Guarantee Program officials generally agreed with the information presented.

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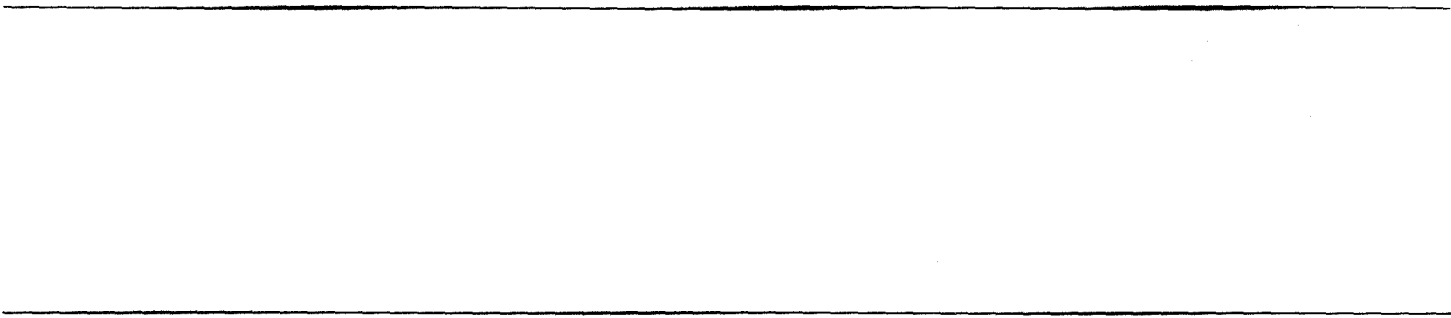
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**Abbreviations**

FAR	Federal Acquisition Regulation
GAO	General Accounting Office
OIRM	Office of Information Resource Management
OSG	Office of Surety Guarantees
SAA	Surety Association of America
SBA	Small Business Administration
SBG	Surety Bond Guarantee
SOP	standard operating procedure



# Introduction

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Bonding is a guarantee of the performance of a contract or other obligation. Bonds are usually required of contractors on public projects let by federal, state, or local government agencies; an increasing number of private project owners are requiring bonds as well. However, small businesses traditionally have had difficulty obtaining bonding in the commercial marketplace. The Small Business Administration's (SBA) Surety Bond Guarantee (SBG) Program was implemented in 1971 to help small firms obtain necessary bonding. Since its inception more than 200,000 contracts valued at more than \$17 billion have been awarded to small firms with SBA-guaranteed bonds.

In 1988 the Congress authorized SBA to develop and implement a pilot Preferred SBG Program. The Preferred SBG Program differs from the existing SBG Program in that it provides the surety companies additional authority and responsibility. As of February 5, 1991, 22 payment and performance bonds had been issued. This program will terminate on September 30, 1994.

The surety bonding process begins when a contractor applies for a bond. Surety companies are generally corporations that are licensed under various insurance laws and, under their charters, have legal power to act as a surety (making themselves responsible for another's obligations) for others. Most surety companies will accept business only through independent agents and brokers. In screening a bond applicant, a surety attempts to measure the contractor's ability to undertake and complete the job. When the surety's evaluation of the contractor's acceptability to perform the contract is favorable, the surety underwrites the bond. If the surety does not provide a bond to the bond applicant, the appropriate forms are forwarded to SBA for consideration of a surety bond guarantee.

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## Bond Requirements

The Miller Act of 1935 (40 U.S.C. 270a-270f) requires two types of bonds, performance and payment bonds, on federal construction contracts exceeding \$25,000. The principal purpose of the performance bond is to protect the government's financial interest. The performance bond ensures that if the contractor does not complete the work, the surety may either meet the costs of fulfilling the terms of a contract or pay up to 100 percent of the penal amount of the contract price to the government. The purpose of the payment bond is to protect subcontractors, material suppliers, and employees. The payment bond is intended as a guarantee that subcontractors, suppliers, and employees will be paid for work performed and/or material provided on the contract.

Federal Acquisition Regulation (FAR), 48 C.F.R. Subpart 28.1, which implements the Miller Act, also requires Miller Act contractors to post bid bonds. The bid bond is in addition to the performance bond and payment bond required by the act. The bid bond ensures that the bidder will not withdraw a bid within the time period specified for acceptance, and if the bid is accepted, the bidder will execute a written contract and furnish required bonds within the time period specified in the bid.

Most states and many local governments require the bonding of construction contracts. In addition, commercial purchasers of construction may require bonds of their contractors. Prime contractors may require bonds of their subcontractors on both public and private projects.

## SBA's Surety Bond Guarantee Program

A 1970 amendment to the Small Business Act of 1958 (15 U.S.C. 694a-c) established SBA's SBG Program to provide assistance for small businesses participating in the federal procurement market for construction as well as in other nonfederal markets that require bonding. The legislation, as amended, authorizes SBA to guarantee up to 90 percent of a surety company's losses on bonds issued to small businesses that cannot obtain bonding without the SBA guarantee. Current SBA regulations allow a 90-percent bond guarantee for all contracts (1) of \$100,000 or less or (2) awarded to small, socially and economically disadvantaged (minority) firms. Contracts between \$100,000 and \$1.25 million awarded to nonminority contractors are guaranteed at not more than 80 percent.

Initially SBA-guaranteed bonds were underwritten and issued by "standard" surety companies. According to an Office of Surety Guarantees (OSG) official, standard sureties provide bonds as well as other services such as property and casualty insurance. However, the Senate Committee on Small Business reported in 1988 that the standard companies' participation in SBA's SBG Program had declined because of the administrative burdens associated with this program. Administrative burdens included SBA's requirement that sureties submit all bond applications to SBA for its review and approval. In addition, the standard surety companies were dissatisfied having their underwriting decisions "second guessed" by SBA staff.

The void created by the departure of the "standard" sureties resulted in the expansion of "specialty" surety companies and their increased participation in the SBG Program. Initially, specialty surety companies devoted almost all their business exclusively to SBA-guaranteed bonds.

Specialty sureties have now expanded their business to include underwriting high-risk business ventures. According to OSG officials, specialty sureties require that collateral be provided for the projects they bond; in most cases, they charge higher premiums than standard sureties.

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## SBA's Preferred Surety Bond Guarantee Program

Title II of the Small Business Administration Reauthorization and Amendment Act of 1988 (P.L. 100-590, approved Nov. 3, 1988) amended Section 411(a) of the Small Business Investment Act of 1958 (15 U.S.C. 694b(a)) to authorize SBA to establish a Preferred SBG Program on a 3-year pilot basis. The intent of this legislation was to (1) encourage standard surety companies, which were participating minimally in the SBG Program, to expand their participation and (2) improve the access of bonding to small, disadvantaged business concerns that have historically had difficulty in obtaining surety bonding. Public Law 101-574, dated November 15, 1990, extended the pilot program for 2 additional years.

The inducement for "standard" sureties to participate in the Preferred SBG Program is that designated sureties do not have to seek prior SBA approval of their decisions on issuing and administering bonds guaranteed by SBA. The surety companies that participate in the Preferred SBG Program receive a 70-percent guarantee against losses versus 80- or 90-percent guarantees under the SBG Program. According to Senate report 100-416, the standard surety firms expressed a willingness to accept a reduced level of government guarantee under this program because of their confidence in their own underwriting standards and claims decisions. Thus, the sureties were willing to expose themselves to a larger risk of loss in exchange for the removal of the requirement that they obtain SBA's prior approval on bond applications.

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## Similarities Between and Differences in the Surety Bond Guarantee Programs

There are several similarities and differences between the SBG and Preferred SBG Programs. Similarly, under both programs (1) the purpose is to help qualified small businesses obtain bonds; (2) bonds cannot be guaranteed for contracts with a face value exceeding \$1.25 million; and (3) contractors and their affiliates in order to receive assistance must have average annual receipts not exceeding \$3.5 million for the last 3 fiscal years. To be eligible to issue SBA-guaranteed bonds, a surety company must be listed on the U.S. Treasury Department's list of companies eligible to issue bonds for federal procurement contracts. Differences between the programs include the procedures for determining surety eligibility, the procedures for approving bonds, the methods SBA uses to

collect bond data, and the requirement for audits of the participating surety companies. The following is a discussion of these differences.

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### Surety Eligibility Determinations

SBA's Preferred SBG regulations state that SBA-guaranteed bonds may not exceed one-quarter of the surety's total contract bond business income, whereas the SBG Program regulations contain no such restriction. According to SBA, the purpose of this restriction is to obtain experienced underwriting that is not influenced by the awareness of the government guarantee. In addition, Preferred SBG sureties cannot participate in the regular SBG Program. According to SBA, this will prevent sureties from placing their higher risk business (for example, asbestos abatement projects) into the SBG Program (where SBA guarantees 80 percent or 90 percent of the bond amount).

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### Bond Approvals

The administration of the SBG and Preferred SBG Programs is shared by SBA, the participating sureties, and the sureties' agents. The SBG Program is conducted by SBA's 10 regional offices. (App. I is a map of the SBA regional offices.) SBA's administration of the Preferred SBG Program is conducted through the Office of Surety Guarantees located at SBA headquarters. The procedures for guaranteeing bonds in the SBG Program require SBA approval of each bond application; in the Preferred SBG Program, sureties are delegated approval authority.

In the SBG Program contractors must (1) apply for a specific bond with an agent/surety company and (2) provide background, credit, and financial information required by the agent/surety company and SBA. (Most surety companies will accept business only through independent agents. Agents work with bond applicants on behalf of the surety company to process necessary application forms for the bond approval process.) Once the agent/surety has received the information, it processes the application. If the agent/surety decides it can execute the bond only with an SBA guarantee, the appropriate forms are forwarded to the SBA. SBA determines the contractor's performance capacity by reviewing the information and underwriting rationale provided by the surety. If performance capacity is established and all other aspects of the application are approved, the guarantee agreement will be signed by the authorizing SBA official and returned to the surety. In some cases, SBA's approval of a bond guarantee can be done with a "bonding line," which allows a surety a limited number of bond guarantees within strict limitations for approved contractors. If performance capacity is not self-evident in the surety's presentation, SBA will seek clarification from the surety's

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underwriter or agent. If performance capacity cannot be reasonably assured, SBA will decline the guarantee application.

In the Preferred SBG Program, the surety issues and administers SBA-guaranteed bonds without specific SBA approval. To be considered for participation in the Preferred SBG Program, a surety must apply to SBA's OSG for admission to the program. OSG determines the eligibility of the surety to participate. This includes a review of the surety's standards and procedures for underwriting, administration, and claims. To participate in the program, an approved surety must sign a Preferred Surety Bond Guarantee Agreement, observe all applicable SBA regulations, and obtain from its applicants all the information and certifications required by SBA. OSG allots each surety having an agreement a maximum guarantee authority. The amount of the authority varies by surety company.

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## Handling of Fees

The two SBA bond guarantee programs differ in the handling of the fees sureties charge to contractors and the fees SBA charges the sureties. In each program the fees the contractors are assessed by SBA are computed using different formulas.

For each bond guaranteed, SBA charges a fee of 20 percent of the bond premium to sureties participating in either the SBG or the Preferred SBG Programs. SBG sureties must remit these fees when they are billed by SBA. According to an OSG official, the surety companies are billed twice a month. The Preferred SBG Program sureties remit their guarantee fees to SBA on or before the 10th day of the month following the next succeeding month in which the bond became effective.

Under the SBG Program, contractors that receive SBA-guaranteed payment and/or performance bonds are assessed a fee to be remitted by the surety at \$6 per \$1,000 dollars of the contract amount (rounded off to the nearest \$1,000). The Preferred SBG Program's guarantee fee is remitted by the surety company and is computed at \$6 per \$1,000 for the contract or bond amount, depending upon the Preferred SBG surety's own premium base (rounded off to the nearest \$1,000). According to an OSG official, the fees for most construction contracts that require Preferred SBG bonds are based upon the contract value, as in the SBG Program. Service contracts that require Preferred SBG bonds have fees based upon the bond value.



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## Data Collection

The methods used by SBA to collect SBG and Preferred SBG Program data also differ. The surety companies submit the required forms to apply for a bond guarantee to SBA's regions. The SBA regional office staff then enter the data into SBA's SBG computer data base. This data base serves as the source of SBA's SBG Program management reports. SBA's regions are also responsible for storing the hard-copy bond application forms that were submitted to them by the sureties. Surety companies participating in the Preferred SBG Program transmit certain preferred program bond data to SBA electronically and the remainder on a bordereau (a memorandum of account containing an enumeration of documents). The bordereau is entered into the Preferred SBG data base by SBA's staff. The surety companies are responsible for storing the hard-copy bond forms.

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## Program Audits and Investigations

Finally, the Preferred SBG Program differs from the SBG Program in that the preferred program regulations require annual audits of the participating sureties by examiners selected and approved by SBA, whereas the SBG Program regulations state that participating sureties are to be audited at all reasonable times. In addition to the audits, investigations may be conducted as needed for both the SBG and the Preferred SBG Programs.

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## Objectives, Scope, and Methodology

Section 206 of the Small Business Administration Reauthorization and Amendment Act of 1988 mandated us to evaluate the Preferred SBG Program. In our meetings with the offices of the Senate and House Committees on Small Business, it was agreed that an interim report would be provided on (1) SBG Program activity and (2) the status of the Preferred SBG Program. Specifically, to answer the first objective, we agreed to provide the following information on the SBG Program for fiscal years 1987 through 1989: (1) the number and dollar amount of contracts with SBA guarantees, (2) the number and dollar amount of losses resulting from contractor defaults, (3) the number and dollar value of contracts with SBA bond guarantees by type of obligee (the type of entity requiring the bond), (4) the number and dollar amount of minority contractor contracts with SBA bond guarantees, and (5) the number and dollar value of contracts bonded by standard and specialty surety companies.

To respond to the first objective, we analyzed information from the SBG Program management reports that came from SBA's data base. We also reviewed the programs' authorizing legislation, regulations, and management reports. In addition, we contacted all 10 SBA regions to discuss how

they were reporting certain SBG Program data. We assessed the reliability of selected information from the SBG data base for the specific items under the first objective. On March 9, 1990, we obtained a copy of the SBG Program data base. From this version of the data base, containing 34,177 entries for bonds guaranteed by SBA during fiscal years 1987-89, we selected a simple random sample of 475 bonds. Because we took a simple random sample of bond entries, each estimate developed from the sample has a measurable precision. The precision indicates how closely we can reproduce from a sample the results that we would obtain if we were to review the specific data for all 34,177 entries in the universe using the same measurement methods. To indicate the precision of each of our estimates we provide a range called a confidence interval that was developed at the 95-percent confidence level. (See footnotes throughout text and app. III). The confidence interval, at the 95-percent confidence level, means that in 95 out of 100 instances the sampling procedure we used would produce a confidence interval containing the universe value we are estimating.

We asked SBA for copies of the source documentation for each sampled entry but received documentation for only 451 (95 percent) of the 475 bond entries. On the basis of the results obtained from our sample, we estimate that about 32,450 of the 34,177 entries in the data base version we reviewed had locatable documentation.<sup>1</sup> Data reliability estimates provided in chapter 3 and appendix III apply only to the estimated 32,450 documentable bond entries. We can provide no information on the accuracy of the data contained in the remaining bond entries. Much of the information presented in chapter 2 is based on a later version of the data base (dated August 29, 1990), which contained information on 33,408 bonds.

To respond to the second objective, we interviewed officials from SBA's Office of Surety Guarantees. We also reviewed their regulations and records implementing the Preferred SBG Program.

In addition to our work in response to the two specific objectives, we also reviewed the SBA Administrator's 1989 annual statement and report required by the Federal Managers Financial Integrity Act of 1982 to identify internal control weaknesses related to the SBG Program. In 1989 none were reported. According to SBA officials, there had been no

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<sup>1</sup>The lower and upper bounds of the 95-percent confidence interval for the estimated 32,450 entries are 31,645 and 33,058 entries, respectively.

internal control evaluations of the SBG Program because it was administered at the regional office level and all internal control evaluations had been conducted at the district office level. Therefore, our review of SBG Program internal controls was limited to those associated with the data problems we noted during our data reliability assessment (i.e., computer edits and manual data verification). About the same time our review was being completed, OSG conducted an internal review of the SBG Program as part of SBA's 1990 Federal Managers Financial Integrity Act review. According to the Assistant Administrator, the OSG review identified problems similar to those we found and determined that the SBG Program was a high-risk program susceptible to fraud and abuse.

We did our audit work between October 1989 and November 1990 in accordance with generally accepted government auditing standards. As requested, we did not obtain official agency comments on this report. We did, however, discuss the results of our work with appropriate agency officials and their comments are included as appropriate.

# Information on Bonds Guaranteed by SBA's Surety Bond Guarantee Program

During fiscal years 1987-89, the number of bonds that SBA guaranteed under the SBG Program remained stable at approximately 11,000 bonds per year. However, the total value of contracts with SBA-guaranteed bonds increased 15 percent, from \$1.22 billion in 1987 to \$1.40 billion in 1989. A slightly larger increase occurred in SBA's share of the bond guarantees. In addition, during this time period the number of defaulted bonds reported by sureties increased each year while SBA's net losses paid resulting from defaulted bonds decreased. SBA officials attributed this decrease to changes in SBA regulations that make it easier for the agency to decline liability for bond claims and stricter enforcement of the agency's regulations.

SBA's surety bond data for fiscal years 1987-89 indicated that most of the bonds guaranteed by SBA were for contracts awarded by local governments (35 percent) and private entities (21 percent). Seventy-five percent of the bonds guaranteed by SBA were for nonminority contractors. Of the different categories of minority contractors, Black contractors received the largest share of SBA-guaranteed bonds (6.2 percent). The number of minority contractor bonds guaranteed by SBA varied widely between SBA's regions, e.g., 920 were guaranteed in SBA's Atlanta region versus 22 in its New York region. Our analysis of bonds underwritten by standard and specialty sureties showed that between fiscal years 1987 and 1989, specialty sureties wrote 99 percent of all program bonds. We tested the accuracy of the data reported in chapter 3 and the results are reported in appendix III.

## Number and Value of Bonds Guaranteed

SBA guaranteed 33,408 bonds during fiscal years 1987-89 under the SBG Program. For this time period over half the bonds guaranteed by SBA were in its Atlanta, Chicago, and Kansas City regions. Less than 6 percent of the bonds guaranteed were in SBA's Boston, Philadelphia, and New York regions. Table 2.1 shows the number of bonds guaranteed by region.

According to the Assistant Administrator, Office of Surety Guarantees, there were differing explanations why the Boston, Philadelphia, and New York regions had guaranteed low numbers of SBG Program bonds. For instance, the Boston region had a slow economy, minimal construction activity during the winter, and was sparsely populated in Northern New England. The Philadelphia region has had difficulty keeping trained staff, and adequate resources for program outreach and promotion were not available. Surety companies in the New York region were

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reluctant to write bonds after a New York State Insurance Commissioner's ruling that resulted in the cancellation of many surety bonds in the mid-1970s. The Assistant Administrator said that she had not heard any complaints from firms that were not able to receive bonding in the New York and Philadelphia regions.

**Table 2.1: Number of Bonds Guaranteed, by SBA Region**

Region	Fiscal year			3-year total	Percent of total
	1987	1988	1989		
Atlanta	2,014	2,208	2,513	6,735	20.2
Chicago	2,121	1,913	1,906	5,940	17.8
Kansas City	1,511	1,541	1,566	4,618	13.8
Dallas	1,328	1,349	1,394	4,071	12.2
Denver	1,229	1,274	1,191	3,694	11.0
Seattle	1,343	1,063	870	3,276	9.8
San Francisco	978	1,163	968	3,109	9.3
Boston	329	324	441	1,094	3.3
Philadelphia	251	243	318	812	2.4
New York	24	9	16	59	.2
<b>Total</b>	<b>11,128</b>	<b>11,097</b>	<b>11,183</b>	<b>33,408</b>	<b>100.0</b>

Source: GAO analysis of SBA Consolidated Surety Bond Report (Report code SBG-321).

The total value of contracts with SBA-guaranteed bonds increased 15 percent, from \$1.22 billion in 1987 to \$1.40 billion in 1989. Somewhat consistent with the number of bonds issued, the SBA regions with the highest total contract values were Atlanta, Denver, and Chicago; the regional offices with the lowest total contract values were Boston, Philadelphia, and New York. For the 3 years from 1987 to 1989, the average total value of contracts with SBA bond guarantees varied greatly by region from \$1.8 million (New York) to \$323 million (Atlanta). (See table 2.2.) The Assistant Administrator said that the value of contracts with SBA-guaranteed bonds in the Boston, Philadelphia, and New York regions was low for the same reasons that the number of bonds guaranteed was low.

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**Table 2.2: Value of Contracts With SBA-Guaranteed Bonds**

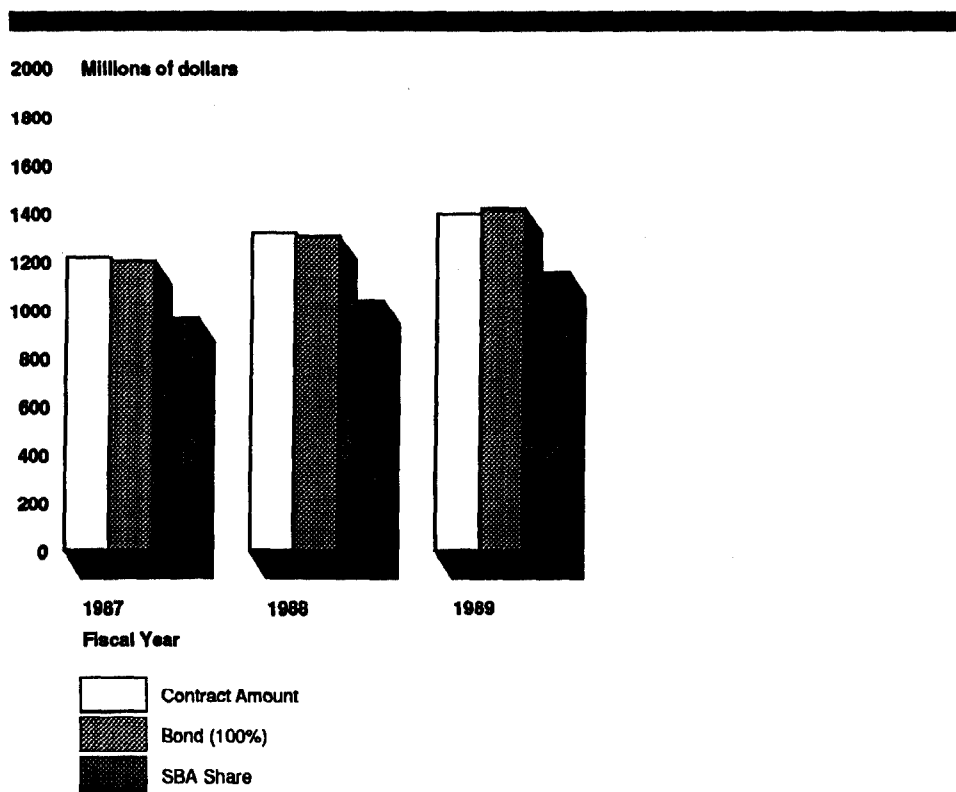
Thousands of dollars

Region	Fiscal year			Total	Percent of SBA total	3-year average
	1987	1988	1989			
Atlanta	\$280,748	\$313,202	\$375,781	<b>\$969,731</b>	24.7	\$323,244
Denver	169,125	188,435	188,691	<b>546,251</b>	13.9	182,084
Chicago	184,399	180,359	180,871	<b>545,629</b>	13.9	181,876
Dallas	127,423	158,739	180,678	<b>466,840</b>	11.9	155,613
K.C.	149,687	156,423	157,663	<b>463,773</b>	11.8	154,591
Seattle	130,425	119,851	93,971	<b>344,247</b>	8.8	114,749
S.F.	98,676	123,836	113,579	<b>336,091</b>	8.5	112,030
Boston	38,257	40,224	48,593	<b>127,074</b>	3.2	42,358
Phila.	34,610	35,028	56,003	<b>125,641</b>	3.2	41,880
New York	2,327	1,900	1,116	<b>5,343</b>	.1	1,781
<b>Total</b>	<b>\$1,215,677</b>	<b>\$1,317,997</b>	<b>\$1,396,946</b>	<b>\$3,930,620</b>	<b>100.0</b>	<b>\$1,310,206</b>

Source: GAO analysis of SBA Consolidated Surety Bond Report (SBG-321).

Normally the contract amount for a guaranteed bond is higher than, or equal to, the bond amount. However, in fiscal year 1989 the total value of bonds guaranteed exceeded the total value of contracts. The Assistant Administrator, Office of Surety Guarantees, said this probably occurred because the surety companies did not report changes in the contract price to SBA. For example, a bond guaranteed in fiscal year 1987 would have the full bond amount reported for fiscal year 1987 but might have the contract price reported as a percentage of the contract price (corresponding with the percentage of the work completed) for fiscal years 1987, 1988, and 1989. Further, change orders that would increase the contract price may not have been reported by the surety company to SBA and thus were not entered into the computer for fiscal years 1988 and/or 1989, resulting in the bond amount exceeding the contract amount. (See figure 2.1.)

Figure 2.1: SBA Bond Guarantee  
 Amounts for Fiscal Years 1987-89



Source: GAO Analysis of SBA Consolidated Surety Bond Report (SBG-321).

## Bond Guarantee Claims and Losses

When a contractor defaults on a bond guaranteed by the SBG Program, SBA could realize a loss. The number of claims resulting from defaults on SBG Program bonds increased in fiscal years 1988 and 1989, but the total net losses paid by SBA decreased in fiscal year 1989. Our analysis shows that the increase in the number of claims reported (from 595 in fiscal year 1987, to 711 in 1988, to 719 in 1989) may have been due, at least in part, to the receipt of claims on bonds issued in prior fiscal years. SBG officials attribute the decrease in net losses paid, from \$25.6 million in fiscal year 1988 to \$16.9 million in 1989, to changes in SBA regulations and stricter enforcement of these regulations by OSG.

In our analysis of bond guarantee claims and losses resulting from defaulted bonds, we used two SBG Program management reports. The SBG-321 report shows claims and losses information according to the fiscal year in which the default occurred. The SBG-499 report shows claims and losses information according to the year in which the bond

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was issued. According to the SBG-321 report, the total net losses paid and the average SBA loss amount all decreased in fiscal year 1989. (See table 2.3.)

**Table 2.3: Data on Defaulted Bonds, by Fiscal Year in Which Claim Was Received**

Fiscal year	Number of defaults	Net losses paid by SBA	
		Total	Average
1987	595	\$23,706,000	\$39,842
1988	711	25,597,000	36,001
1989	719	16,907,000	23,514

Note: SBG-321 reports defaults for the fiscal year in which the default occurred.

Source: SBA Consolidated Surety Bond Guarantee Report (SBG-321).

According to OSG's Claims Manager, losses paid decreased primarily because SBA made its claims regulation stricter, making it easier for OSG's Claims Department to deny liability on defaulted contracts (i.e., a claim would be denied when SBA determined that the contract amount exceeded the program contract limitation of \$1.25 million). She also said that the Claims Department has been more strictly enforcing the regulation.

The SBG-499 report shows that as of December 1990 the number of bond claims received by OSG had declined for bonds issued during fiscal years 1988 and 1989, from 652 in 1987, to 582 in 1988, to 448 in 1989. The report also shows a decrease in the losses paid. (See table 2.4.) However, according to the Assistant Administrator, bond claims are not always received in the same fiscal year the bond is issued. Therefore, it is likely that the number of claims received and amount of losses paid as shown in the December 1990 SBG-499 report will increase, especially for fiscal year 1989.

**Table 2.4: Data on Defaulted Bonds, by Fiscal Year in Which Bond Was Issued**

Fiscal year	Number of defaults	Net losses paid by SBA	
		Total	Average
1987	652	\$15,011,370	\$23,024
1988	582	11,726,635	20,149
1989	448	7,872,728	17,573

Note: SBG-499 reports bond defaults for the year in which the defaulted bond was guaranteed.

Source: SBA Surety Bond Guarantees Bond Year Report (SBG-499).



## Bond Obligees

SBA requires surety companies to report the type of bond obligee (i.e., the type of entity requiring the bond—federal, state, local, special district, private, or other). In the case of a bid bond, the obligee is the entity requesting bids for a proposed contract. In the case of a payment bond or performance bond, the obligee is the entity awarding a contract that requires a bond and to which the surety is primarily obligated in case of a breach of contract by the contractor.

Of the bonds guaranteed under the SBG Program, most were for contracts awarded by local governments (i.e., cities, towns, counties, etc.). For fiscal years 1987-89, bonds with local governments as obligees constituted 35 percent of all the bonds guaranteed by SBA (11,707 of 33,408) and accounted for 31 percent of the bonds' total value (\$984 million of \$3,159 million). However, the number of guaranteed bonds with local government obligees has been decreasing each year; 864 fewer bonds were guaranteed in 1989 than in 1987 (a 20-percent decrease). Private entities were the second largest obligee group, obtaining 7,009 (21 percent) of the SBA-guaranteed bonds issued during the 3-year period. The largest increase in the number of bonds guaranteed for an obligee type involved special districts (e.g., school districts), which increased 60 percent between fiscal years 1987 and 1989. (See table 2.5.) SBA's share of bonds guaranteed by obligee type during fiscal years 1987-89 had percentages of the total which were similar to the percentages reported in table 2.5. (See table 2.6.)

**Table 2.5: Number of Bonds Guaranteed in Fiscal Years 1987-89, by Obligee Type**

Obligee	Fiscal year			Total	Percent of total
	1987	1988	1989		
Local	4,246	4,079	3,382	11,707	35.0
Private	2,196	2,172	2,641	7,009	21.0
State	1,692	1,870	1,654	5,216	15.6
Federal	1,687	1,625	1,583	4,895	14.7
Special district	843	697	1,350	2,890	8.6
Other	464	654	573	1,691	5.1
<b>Total</b>	<b>11,128</b>	<b>11,097</b>	<b>11,183</b>	<b>33,408</b>	<b>100.0</b>

Source: GAO analysis of SBA report entitled Production and Losses by Obligee Type (SBG-615).

**Table 2.6: SBA's Share of Bonds Guaranteed in Fiscal Years 1987- 89, by Obligee Type**

Thousands of dollars

Obligee	Fiscal year			Total	Percent of total
	1987	1988	1989		
Local	\$331,874	\$345,965	\$306,632	\$984,471	31.2
Private	223,349	243,990	296,535	763,874	24.2
Federal	186,308	195,034	212,199	593,541	18.8
State	124,097	139,978	144,478	408,553	12.9
Special district	63,941	54,261	136,214	254,416	8.0
Other	36,394	58,954	58,889	154,237	4.9
<b>Total</b>	<b>\$965,963</b>	<b>\$1,038,182</b>	<b>\$1,154,947</b>	<b>\$3,159,092</b>	<b>100.0</b>

Source: GAO analysis of SBA report entitled Production and Losses by Obligee Type (SBG-615).

## Minority Classification of Contractors Obtaining SBA- Guaranteed Bonds

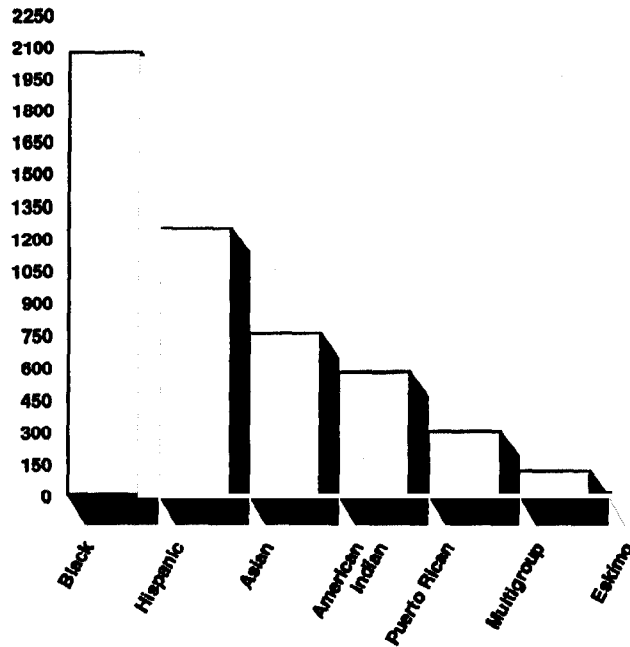
SBA data show that in fiscal years 1987-89, nonminority contractors received 75 percent of all SBA-guaranteed bonds issued, and minority contractors received about 15 percent. For about 10 percent of the bonds SBA guaranteed, the contractor's ethnic grouping was shown as undetermined.

SBA is authorized under Executive Order 11625 to request information on the minority classification of the contractors being bonded. The minority classification of the contractors participating in the SBG Program can be numerically coded into the data base as minority, nonminority, or undetermined. The contractor's bond guarantee application has a checklist with nine minority selections. One is "white," which is considered a nonminority designation. The selection "undetermined" is used when the contractor applicant does not check any designation. Seven categories are used to designate minorities on the application form: Black, Puerto Rican, American Indian, Hispanic (Mexican-American, Cuban, Central or South American, or others of Spanish descent), Asian (original peoples of the Far East, Southeast Asia, the Indian Subcontinent or Pacific Islands), Eskimos and Aleuts, and multigroups (mix of minority types). In addition, the data base contains an "unknown category" that results when an invalid minority code has been entered into the computer. However, fewer than 1 percent of the bonds guaranteed are in the unknown category.

## Guaranteed Bonds Issued to Minority Contractors

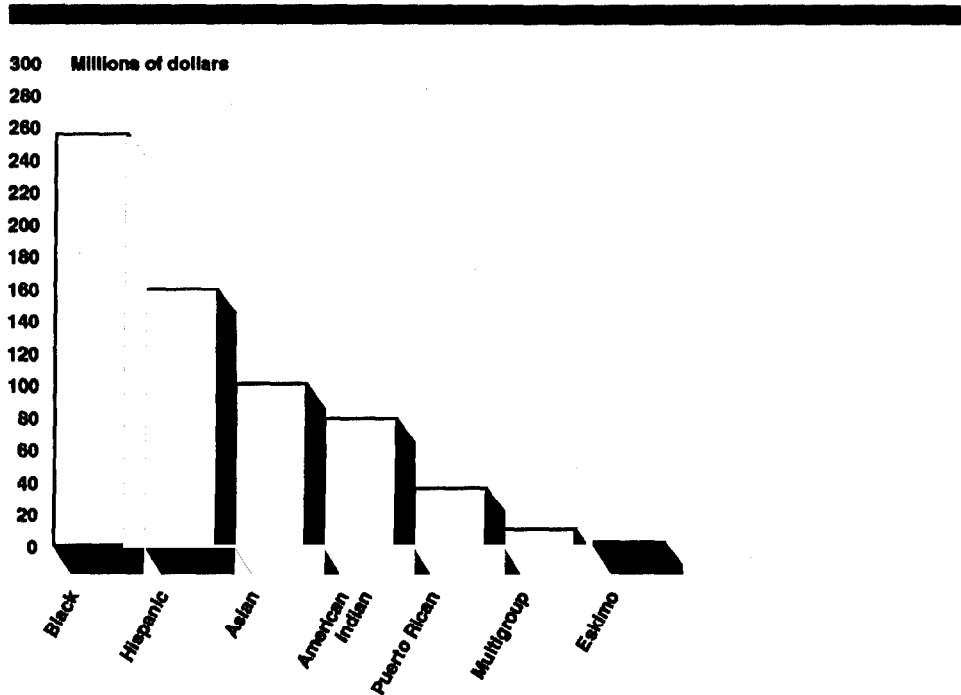
Minority contractors participating in SBA's SBG Program had 5,063 SBA-guaranteed bonds, or about 15 percent of the total number. The number of such bonds declined during the 3-year period, from 1,749 in fiscal year 1987 to 1,666 in fiscal year 1989. The minority group receiving the most guaranteed bonds was Black contractors. The group received 2,068 bond guarantees—66 percent more than the Hispanic contractors, the next largest minority group. (See figures 2.2 and 2.3.) (App. II provides additional data on bond guarantees by ethnic group.)

Figure 2.2: Number of SBA-Guaranteed Bonds by Minority Group, Fiscal Years 1987-89



Source: GAO analysis of SBA Minority Surety Bond Contractors Report (SBG-411).

**Figure 2.3: Value of Minority Contracts With SBA Bond Guarantees, Fiscal Years 1987-89**



Source: GAO analysis of SBA Minority Surety Bond Contracts Report (SBG-411).

### Minority Contractor Bonding Varied Greatly by SBA Region

The Atlanta region, which guaranteed more bonds than any other SBA region, also guaranteed the most minority contractor bonds in fiscal years 1987-89: a total of 920 bonds covering contracts valued at approximately \$137 million. The fewest minority contractor bonds were written by the New York region, which also had the fewest number of total bonds. The New York region guaranteed only 22 minority contractor bonds. (See table 2.7.) However, the SBA regions reporting the highest percentage of minority contractor participation relative to their bond guarantee activities were Philadelphia, New York, and San Francisco. Over 50 percent of the contract value of the Philadelphia region's guaranteed bonds were for minority firms, whereas only 9 percent of the Boston region's guaranteed bonds went to minority contractors. (See table 2.8.) The Assistant Administrator said that relatively few bonds were guaranteed for the Boston and Kansas City regions because both regions have few minority contractors.

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**Table 2.7: Minority Contractor Participation by Number of Contracts With SBA Bond Guarantees, Fiscal Years 1987-89**

<b>Regions</b>	<b>Number of contracts</b>	<b>Number of contracts to minorities</b>	<b>Percent of contracts to minorities</b>
Philadelphia	781	330	42.25
New York	59	22	37.29
San Francisco	2,451	744	30.35
Dallas	3,943	781	19.81
Seattle	2,622	446	17.01
Denver	3,574	532	14.89
Chicago	4,587	643	14.02
Atlanta	6,665	920	13.80
Kansas City	4,359	559	12.82
Boston	1,081	86	7.96
<b>Total</b>	<b>30,122</b>	<b>5,063</b>	<b>16.81</b>

Note: Calculations do not include the "undetermined" category.

Source: GAO analysis of SBA report entitled Minority Surety Bond Contracts (SBG-411S).

**Table 2.8: Minority Contractor Participation by Value of Contracts With SBA Bond Guarantees, Fiscal Years 1987-89**

Thousands of dollars			
<b>Regions</b>	<b>Total contract value</b>	<b>Minority contract value</b>	<b>Percent of total contract value</b>
Philadelphia	\$120,541	\$62,427	51.79
New York	5,343	2,165	40.52
San Francisco	272,923	78,819	28.88
Seattle	269,881	57,735	21.39
Dallas	445,976	79,660	17.86
Chicago	434,319	70,827	16.31
Denver	533,074	86,747	16.27
Atlanta	957,485	137,192	14.33
Kansas City	445,589	58,503	13.13
Boston	124,154	11,621	9.36
<b>Total</b>	<b>\$3,609,288</b>	<b>\$645,696</b>	<b>17.89</b>

Note: Calculations do not include the "undetermined" category.

Source: GAO analysis of SBA report entitled Minority Surety Bond Contracts (SBG-411S).

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## Participation by Standard and Specialty Surety Companies

In fiscal years 1987-89, specialty surety companies wrote 99 percent of all bonds guaranteed under the SBG Program. Of the 40 sureties participating in the program during this time period, 20 were standard sureties and 19 were specialty sureties (one surety could not be identified by SBA). SBA data on the surety companies' participation in the SBG Program showed that during this period a total of 32,628 bonds were issued for contracts with a total value of \$3.8 billion.<sup>1</sup>

Our analysis of the SBA data indicated that 8 of the 19 specialty surety companies issued 97 percent (31,717) of the SBA-guaranteed bonds. The contracts covered by these bonds had a value of \$3.7 billion—98 percent of the total value of all contracts with SBA bond guarantees. Two of these specialty surety companies issued 58 percent of the program bonds, accounting for 59 percent of the total contract value. The most SBG Program bonds written by a standard surety company during this 3-year period was 61 bonds with a total contract value of \$11.9 million.

Specialty sureties issued almost all bonds for minority contractors obtaining SBG Program bond guarantees—99 percent (4,973 of 5,015). These bonds covered 99 percent of the total value of minority contracts with SBA bond guarantees (\$619.7 million of \$625.8 million). Two specialty surety companies that issued 20 percent or more of their SBG Program bonds for minority contractors had a total of 31 minority contractor bonds. Three specialty sureties that issued a total of 10 SBG Program bonds did not issue any minority contractor bonds.

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<sup>1</sup>According to an OSG official, a possible explanation of why the number of bonds guaranteed differed from the number presented earlier in this chapter was that the data base extract that SBA provided us was probably missing a surety company.

# Surety Bond Guarantee Program Data Could Be Improved

While assessing the reliability of selected information from the SBG data base, we found some management control weaknesses that affected the quality of the information. The most significant of these problems involved the minority codes assigned to contractors receiving bond guarantees. SBA has provided no guidance to its field staff on what is to be entered into the SBG data base when the minority code on the bond application form is blank. As a result, sometimes this data field is coded as "undetermined," but in many instances a minority code apparently is obtained from another source and entered into the data base. However, SBA does not have procedures for documenting the use of supplemental sources of information to determine minority codes. In addition to these discrepancies, we found that some minority codes were entered into the data base incorrectly or had documentation that did not support the codes entered. We believe that minority code data that are in error and/or are characterized as undetermined could affect our ability to determine the effect of the Preferred SBG Program on minority contractors' participation in SBA's bond guarantee programs.

We estimated that the contract amounts and bond amounts in the data base differed from those recorded on the Surety Bond Guarantee Agreement forms approximately 3 and 4 percent of the time, respectively. We were unable to assess the reliability of obligee data because SBA had not defined various obligee types or developed procedures to instruct regional office staffs on how to code obligees.

The Assistant Administrator, Office of Surety Guarantees, acknowledged weaknesses in data entered in the SBG Program data base and the lack of adequate guidance in related operating procedures. She said that OSG plans to retire existing SBG Program information, rewrite the program's standard operating procedures (SOP), and train staff responsible for entering data into the revised computer system. (App. III provides more information on our assessment of data reliability.)

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## Minority Code Data Problems

The reliability of data representing the minority code assigned to contractors receiving bond guarantees could be improved. Problems have occurred in part because SBA has not provided guidance to its regional staffs on (1) what to do if the minority code had not been designated on the application or (2) how to document the use of alternative sources of information used to make this determination. Although these problems can be corrected in the future, the quality of existing data may limit our ability to determine the effect of the Preferred SBG Program on minority contractor participation in the SBA bond guarantee programs.

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## Minority Code Discrepancies Resulted From Lack of Guidance

In about 20 percent of the bond files, the minority status of the contractor was not recorded. However, a minority code had been entered into the data base about 13.5 percent<sup>1</sup> of the time. In the remainder of the cases, 6.4 percent,<sup>2</sup> no minority code was entered. The entries were handled differently because SBA has no uniform procedures for entering minority codes into the data base when they are missing from the application.

SBA officials attributed the data base's minority code discrepancies to several factors: (1) the contractor is not required to provide information on its minority classification, (2) SBA may obtain the information from the surety but not record it on the bond documents, and (3) SBA can retrieve this information from its records of prior bonds for the same contractor but may not record it on the current bond documents.

SBA requests that the contractor provide information on its minority classification on the SBA Form 994 Application for Surety Bond Guarantee Assistance. However, the form states that (1) the minority classification information provided will be used for statistical purposes only and does not have to be provided and (2) failure to provide this information will not affect the application.

According to the Assistant Administrator, the contractor's minority code is entered into the SBG data base when SBA enters the contractor's first bond guarantee and these data are carried forward for the contractor's subsequent bonds. SBA regional office personnel also told us that they sometimes obtain minority classification information from the surety or from other existing SBA records and then enter this information directly into the computer. These practices could possibly account for instances in which we found no minority codes designated on the bond application form but did find them in the data base. However, SBA has provided no guidance to its field staff on how to document the use of supplemental sources of information to determine the minority code when the information is missing from the bond application form.

OSG officials acknowledged that the current SOP for the SBG Program does not instruct regional office staffs on how they should document the bond file when entering into the data base information that is not on, or differs from information provided on, the bond application form. In

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<sup>1</sup>The lower and upper bounds of the 95-percent confidence interval are 10.5 and 17.0, respectively.

<sup>2</sup>The lower and upper bounds of the 95-percent confidence interval are 4.4 and 9.1, respectively.



addition, there are no procedures describing what employees who are entering data should do (e.g., enter the "undetermined" code into the data base, contact the surety to obtain the information and document the file, etc.) when a contractor does not provide a minority classification. The Assistant Administrator plans to require that contractors obtaining SBA bond guarantees self-certify their minority type for both the SBG and Preferred SBG Programs.

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**Undetermined and**  
**Erroneous Minority Code**  
**Data Could Affect Future**  
**Analysis of SBG Programs**

Undetermined and erroneous minority code data could affect our ability to determine the effect of the Preferred SBG Program on minority contractor participation in the SBA bond guarantee programs. For fiscal years 1987-89, the SBG Program data base records showed that 3,286, or almost 10 percent, of the bonds guaranteed by SBA were issued to contractors with an "undetermined" minority code. (See app. II.) Also, minority codes found in the automated data base were not always correct or were not documented in SBA's bond file. We asked SBA officials to provide us additional documentation for the minority codes in our sample in which the designation on the bond application form (including minority codes left blank) differed from the data base entry. On the basis of the additional data that they provided, we estimated that 2.9 percent of the minority codes entered in the data base were incorrect.

On March 1, 1994, we are required to transmit a report to the Senate and House Small Business Committees that evaluates the Preferred SBG Program. One of the report's objectives will be to evaluate whether access to bonds by small business concerns, especially small business concerns owned and controlled by socially and economically disadvantaged individuals, has been improved. However, we may be unable to conclude whether or not the preferred program increased minority contractor participation in the SBA guarantee program because the classifications in the data base (1) were coded as "undetermined" 10 percent of the time and (2) even when a minority code was specified in SBA's data base, it was incorrect an estimated 2.9 percent of the time. Our ability to draw a conclusion will be contingent upon whether the SBA bond guarantee programs' minority contractor participation data, following implementation of the preferred program, vary greatly from the baseline data shown in this report. If participation levels differ greatly, we may be able to draw a conclusion, but if the difference is relatively small, we probably will not.

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## Obligee Definitions Not Available

The lack of obligee definitions prevented us from testing the reliability of the obligee data. However, in reviewing our bond sample, we found that SBA's regions were inconsistently applying their own obligee classifications. The Assistant Administrator said that when OSG begins work on revising the SOP, it will include obligee definitions.

We were unable to assess the reliability of the bond obligee data because we could not determine whether certain obligee information was correct. The obligee types listed on the SBA Form 990 Surety Bond Agreement are federal, state, local, special district, private, and other. When we asked OSG officials for criteria to use in determining the correct obligee types, we were told that OSG did not have definitions for the various obligee types and that no procedures had been developed to instruct regional office staffs on how to code obligees.

OSG's SOP does not explain or define obligee types, and we found numerous inconsistencies in the way the SBA regions categorized certain types of obligees. OSG officials were unable to tell us which categorizations were correct. Particularly, we found inconsistencies involving (1) subcontractors working on federal, state, or local government projects and (2) contractors working on school board or school district projects. Sometimes the obligee on a subcontractor's bond was coded in the data base as a private obligee because the prime contractor was a private company. In other instances, the obligee was coded as a federal, state, or local government because the project was funded with federal, state, or local government funds even though the prime contractor was a private company. Projects involving school boards and school districts were sometimes coded as having local obligees and sometimes as special district obligees.

The Assistant Administrator said that obligee definitions and instructions would be developed and included in OSG's SOP 50-45, which was being revised and would not be available sooner than the beginning of fiscal year 1992.

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## Contract and Bond Amounts Lack Data Entry Verification

Two data reliability assessment techniques we used to check the contract and bond amounts disclosed apparent errors in entering these amounts into the SBG Program data base. These data entry errors occurred because computer edits and/or manual verification of the data were either nonexistent or inadequate.

First we compared the contract and bond amounts in the SBG Program data base to the source documents. On the basis of our sample, we estimated that 1.33 percent of the contract amounts in the data base differed from the source documents with no discernable explanation for the difference. However, we estimated that in 0.89 percent of the cases, the contract amounts in the data base were similar to the source document except for one digit, which indicates a probable error in data entry. No contract amount appeared on the bond application form for 0.22 percent of the cases, and the bond had been cancelled and the bond application form had been removed from the regional office's official bond file in 0.22 percent of the cases.

We estimated that 2.0 percent of the bond amounts in the data base differed from the source documents with no discernable explanation for the difference. However, we estimated that 1.11 percent of the bond amounts in the data base were similar to the source document except for one digit, again indicating a possible data entry error. In addition, in 0.44 percent of the instances, the bond amount did not appear on the bond application form, and in 0.44 percent of the instances the bonds had been cancelled but there was no supporting documentation for the bond amount in SBA's official bond file. Finally, we estimated that in 0.22 percent of the cases, two different bond amounts appeared on the bond application form. (Table III.2 provides the confidence intervals for this reliability test.)

The Assistant Administrator provided a possible explanation that could account for some of the differences between the contract amounts in the data base and the source documents. She said that a new SBA Form 990 Surety Bond Agreement would not be submitted for a contract change order unless the change order amount exceeded 20 percent of the original contract price. Therefore, some contract change orders would not be entered into the data base.

Our second test to check the reliability of specific SBG data identified bond records in which the bond amount exceeded the contract amount. According to SOP 50-45 "any situation in which the surety and SBA have a greater liability than does the obligee does not comply with SBA statutory language; therefore, performance bonds which are in a greater amount than the contract's face value are ineligible for SBG assistance." (An exception, according to the SOP, are demolition bonds, which may exceed the contract's face value.) When we compared contract amount and bond amount data for 32,628 bonds, we found further evidence of

data entry errors. In 219 instances the bond amount exceeded the contract amount; 165 of these instances appear to have resulted from data entry errors.

- In 103 instances the bond amounts and contract amounts were similar except for one digit (e.g., \$79,485 versus 74,485).
- In 40 instances the bond amounts and contract amounts were similar except that the bond amount had one additional digit (e.g., \$845,125 versus \$84,512).
- In 22 instances the bond amounts and contract amounts were similar except for the transposition of two digits in one of the amounts (e.g., \$402,604 versus \$402,064).

In the remaining 54 instances in which the bond amount exceeded the contract amount, we could not attribute discernable patterns to data entry errors.

For fiscal years 1987-89, the bond amounts for the 219 bonds exceeded the contract amounts by a total of \$13.5 million. The differences for individual bonds ranged from \$.01 to \$943,000.

**Table 3.1: Bond Amounts Exceeding Contract Amounts**

Fiscal year	Number	Difference	Range of error	
			Low	High
1987	83	\$5,153,000	\$.02	761,000
1988	80	4,992,000	.01	634,000
1989	56	3,400,000	.11	943,000
<b>Total</b>	<b>219</b>	<b>\$13,545,000</b>		

An Office of Information Resources Management official said that the SBG computer system did not have any edit functions that would “flag” instances when the bond amount exceeds the contract amount.

## Comments by Program Management

According to the Assistant Administrator, Office of Surety Guarantees, SBG computer system data integrity problems currently result in inaccurate SBG management reports. She also said that the data problems we identified in this review can be attributed to the following:

- Limited staffing levels. In the past OSG did not have the full support of SBA management. OSG was understaffed, yet staff assigned to the OSG program were often pulled to assist SBA’s other finance and investment

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program units because, until recently (June 3, 1990), OSG had been under the Office of Finance and Investment. OSG has also experienced a high turnover of staff. As a result, OSG program staff frequently have little SBG Program experience.

- Timing of bond applications. Often applications are not received from the sureties until just before the contract bid submission deadline. This puts pressure on the SBA staff to process the bond hastily, resulting in errors.

The Assistant Administrator said that a number of actions have been taken, or will be undertaken, during fiscal year 1991 that should improve guidance and procedures for entering surety bond guarantee data. OSG recently hired a computer systems analyst who will be visiting all SBA regional offices to assist the OSG staff with computer applications. She said that this action may preclude the repetition of some of the data entry problems that we found. However, because of the problems with the integrity of the data in the current data base, she plans to retire it (remove the existing data from the data base) by the end of fiscal year 1991.

The Assistant Administrator also acknowledged that SOP 50-45 is outdated. An OSG official said that OSG began to rewrite it in December 1990. When the revision of the SOP is complete, the regional office staffs will be trained in the revised procedures for entering bond guarantee data into the computer systems.

The Mainframe Systems Branch Chief, Office of Information Resources Management (OIRM), said that the SBG computer system was designed for the SBG accounting system and has built-in checks, supported by the reconciliation of the accounting books, so that errors in the accounting data are found whenever the accounts do not balance. However, when the computer system was expanded to produce SBG management reports, similar built-in verification checks were not included. As a result, the SBG Program management data entered into the computer system by SBA's regional office staffs must be manually verified.

According to an OIRM official, the Preferred SBG Program uses computer software with built-in checks that will identify and produce an erroneous data list when certain data errors occur. This enhanced capability will also be added to the SBG Program computer system. However, the computer system will not disclose instances in which bond amounts exceed contract amounts.

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About the time our review was being completed, OSG conducted an internal review of the SBG Program as part of SBA's 1990 Federal Managers Financial Integrity Act review. According to the Assistant Administrator, the OSG review identified problems similar to those we found and determined that the SBG Program was a high-risk program susceptible to fraud and abuse. Appendix IV describes the material weaknesses identified by OSG, their impact on agency operations, and OSG's planned corrective actions.

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## Conclusions

The SBG Program data base contains incomplete and incorrect information because of weaknesses in the guidance SBA has provided its field staff and in its procedures for entering and verifying data base entries. Our review of the specific data elements showed that the overall reliability of the SBG data base could be improved. To ensure that future efforts to collect program information are as accurate as possible, these weaknesses need to be corrected. Specifically, problems with the accuracy of the information on the SBG Program data base have been caused by a lack of (1) guidance to regional office staffs and (2) built-in computer checks and/or inadequate manual verifications of the program management data entered into the SBG computer system. OSG's current standard operating procedure (SOP 50-45) has no procedures (1) verifying the data entered into the computer system against the data on source documents or (2) covering what to do when the source documents do not contain requested information. The Assistant Administrator said that OSG plans to revise its standard operating procedure in fiscal year 1991 and that the revision will address these problems.

Problems with the reliability of existing SBG Program data could affect our ability to determine the impact of the pilot Preferred SBG Program, particularly with regard to whether this program has improved small, disadvantaged business concerns' access to bonds. The percentage of "undetermined" minority codes and the error rates in the minority codes, as well other data fields, could affect our ability to draw conclusions on the impact of the program if minority contractor participation levels change relatively little following full implementation of the Preferred SBG Program.

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**Recommendations**  
**to the SBA**  
**Administrator**

To ensure consistency among the 10 SBA regions and accurate reporting of SBG Program management data, we recommend that the Administrator, SBA, ensure that OSG's planned updates to the standard operating procedure include (1) guidance to field staff on what to do if the bond applications contain no minority code classification, (2) instructions for documenting all entries made into the data base (e.g., annotating the source document), (3) procedures for verifying data being entered into the surety bond guarantee computer system, and (4) instructions for categorizing obligee types.

# Delays in Implementing the Pilot Preferred Surety Bond Guarantee Program

As of early February 1991, over 2 years after the legislation authorizing the pilot Preferred SBG Program was enacted, only two surety companies had agreed to participate in the program and only one of them had issued any SBA-guaranteed bonds (22 final performance/payment bonds and 56 bid bonds). The first surety company enrolled in the program on May 11, 1990, and the first bond (a bid bond) was guaranteed by SBA on October 25, 1990.

According to OSG officials, 2 years elapsed before the Preferred SBG Program was implemented because of the time it took SBA (1) to promulgate the necessary regulations and (2) to reach agreement with the surety industry on how the program would be administered. SBA also had to develop a new system for gathering, maintaining, and reporting Preferred SBG Program data. Initially, the pilot Preferred SBG Program was to expire on September 30, 1992. However, because of the delays in implementing the program, the Congress included a provision in the SBA Reauthorization and Amendments Act of 1990 that extended the pilot program for an additional 2 years until September 30, 1994.

## Program Regulations

The SBA Reauthorization and Amendment Act of 1988, dated November 3, 1988, authorized the pilot Preferred SBG Program. It stated that promulgation of final regulations implementing the Preferred SBG Program were to be issued within 180 days (i.e., by May 2, 1989). Interim final regulations were issued on May 8, 1989, but it was March 6, 1990, before SBA announced in the Federal Register that qualified surety companies desiring to participate in the Preferred SBG Program should so advise SBA, and it was March 20, 1990, before the final rule for the program became effective.

According to the Assistant Administrator's Special Assistant, one of the reasons the Preferred SBG Program was delayed was the time it took to issue the program's regulations. In developing the May 1989 interim final regulations, OSG had tried to incorporate the Preferred SBG Program into the SBG Program's regulations, which confused many people and resulted in many comments from outside parties. After OSG officials analyzed those comments, they decided that it was necessary to write separate regulations for the two programs.

## Surety Industry Support/Agreements

To obtain the surety industry's support for the program, SBA worked with representatives of the Surety Association of America (SAA), which represents about 600 surety companies. According to OSG officials the



time required to obtain SAA's input, and to satisfactorily resolve the surety industry's concerns, delayed the implementation of the program.

OSG obtained input from SAA on such major program components as (1) the contents of the agreements that SBA will be entering into with each participating surety, (2) the types of program data that are to be captured and reported by the participating sureties, and (3) the procedures for communicating program information among the sureties and SBA.

According to the Assistant Administrator's Special Assistant, a second reason for the delay in implementing the Preferred SBG Program was the time it took to resolve the issue of the content of the program's pro forma agreement with the SAA's Preferred SBG Subcommittee. This subcommittee was comprised of four surety company representatives. OSG needed to ensure that the agreement would be accepted by SAA; otherwise, the standard sureties would not participate, which is a major objective of the program. As a result, OSG had to develop several different drafts of the pro forma Preferred SBG Program agreement before it had one acceptable to the SAA. Each change to the draft agreement was followed up with correspondence between OSG and SAA. The Special Assistant said that the time the participating sureties' legal departments took to review the program's agreement contributed to the delay.

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## **Preferred SBG Program Computer System**

SBA is modifying the current SBG computer system in order to develop the preferred SBG computer system. Additional records are being added to the data base and existing SBG records are being modified to hold the preferred SBG bond information. Participating surety companies have agreed to register contractors and enter the bid and final bond data, no later than 5 business days following the bond approval, via electronic reporting. Requests for claim payments and the payment of fees are to be submitted to SBA via bordereau, on or before the 10th day of the month following the succeeding month in which the bond became effective.

The modification of the SBG computer system to include Preferred SBG Program data is being carried out in two phases. Phase I, completed October 13, 1990, consisted of

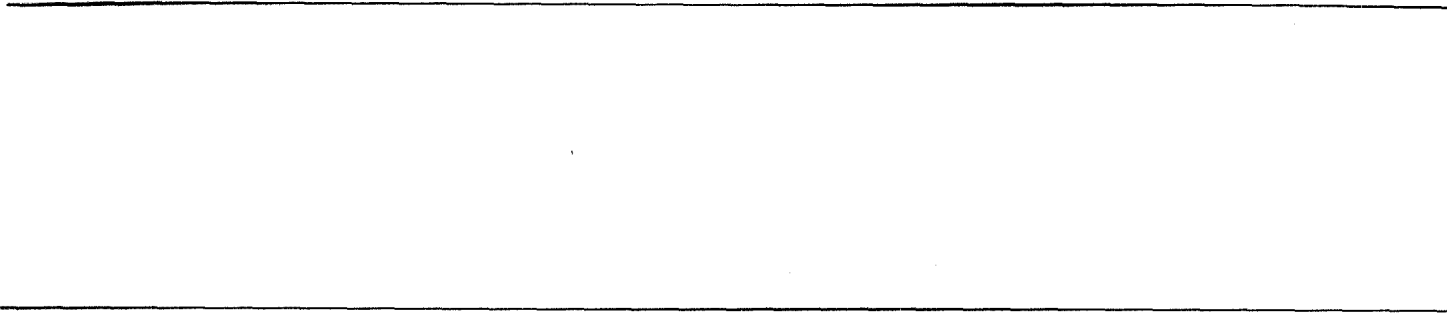
- establishing new data elements (required for our assessment of the pilot Preferred SBG Program),
- developing new computer screens for entering data on Preferred SBG Program bonds and for allotment and bond balance inquiry, and

- establishing a communications link with each preferred surety's place of business (so that the surety can enter bond data directly into SBA's computer system).

Phase II involves

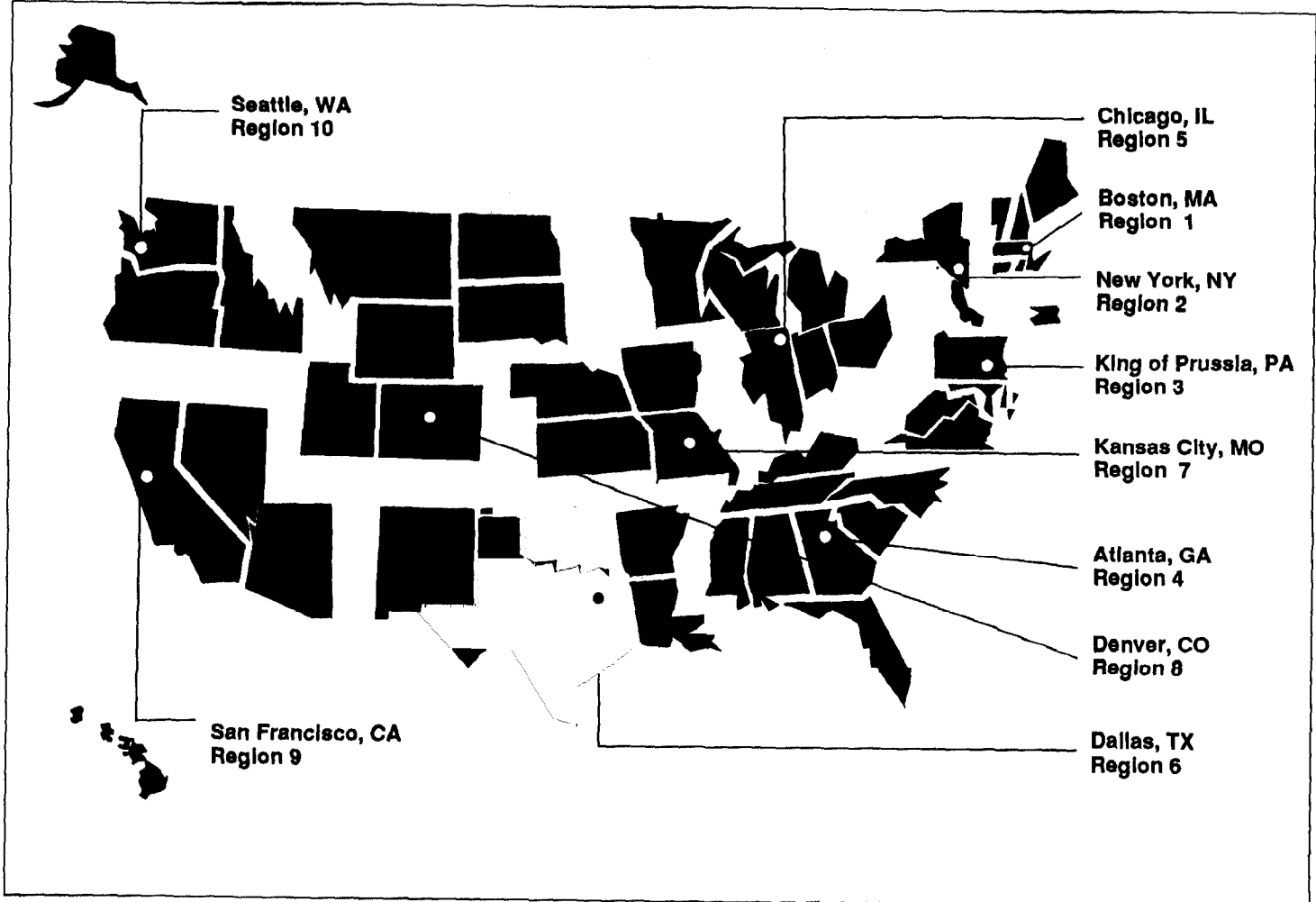
- modifying certain SBG Program data entry screens to include Preferred SBG Program data,
- developing new computer screens for entering data on Preferred SBG Program bond claims and system programs,
- modifying current SBG Program reports to include Preferred SBG Program information and developing new Preferred SBG Program reports,
- developing test data and testing the aforementioned system enhancements,
- preparing training materials,
- documenting the computer system (so that standard operating procedures can be prepared), and
- loading Preferred SBG Program data from the personal computer-based system currently being used to the preferred program's new on-line computer system.

As of April 1991, an OIRM official estimated that the Preferred SBG Program portion of the computer system would be fully operational sometime during the month. The official said that SBA still needs to develop the computer system for bond claims and report generation.



# Small Business Administration Regional Offices

## Surety Bond Guarantee Program Regional Office



Source: Small Business Administration.

# Categories of Contractors Receiving SBG Program Bonds

Dollars in thousands

Fiscal year	Number of contracts	Contract amounts	Percent of total number of contracts	Percent of total contract amount
<b>Black contractors</b>				
1987	768	\$82,278	6.90	6.77
1988	636	78,444	5.73	5.95
1989	664	95,010	5.94	6.80
<b>Total</b>	<b>2,068</b>	<b>\$255,732</b>		
<b>Puerto Rican contractors</b>				
1987	95	\$11,903	.85	.98
1988	101	14,871	.91	1.13
1989	101	9,310	.90	.67
<b>Total</b>	<b>297</b>	<b>\$36,084</b>		
<b>American Indian contractors</b>				
1987	198	\$24,789	1.77	2.04
1988	193	28,023	1.73	2.13
1989	183	27,023	1.63	1.93
<b>Total</b>	<b>574</b>	<b>\$79,835</b>		
<b>Hispanic contractors</b>				
1987	396	\$48,815	3.55	4.02
1988	396	45,185	3.56	3.43
1989	452	65,977	4.04	4.72
<b>Total</b>	<b>1,244</b>	<b>\$159,977</b>		
<b>Asian contractors</b>				
1987	254	\$33,323	2.28	2.74
1988	277	36,464	2.50	2.77
1989	224	31,123	2.00	2.23
<b>Total</b>	<b>755</b>	<b>\$100,910</b>		
<b>Eskimo contractors</b>				
1987	3	\$797	.02	.07
1988	3	781	.02	.06
1989	4	867	.03	.06
<b>Total</b>	<b>10</b>	<b>\$2,445</b>		

(continued)

**Appendix II  
Categories of Contractors Receiving SBG  
Program Bonds**

<b>Fiscal year</b>	<b>Number of contracts</b>	<b>Contract amounts</b>	<b>Percent of total number of contracts</b>	<b>Percent of total contract amount</b>
<b>Multi-group (minority) contractors</b>				
1987	35	\$2,818	.31	.23
1988	42	3,799	.37	.29
1989	38	4,102	.33	.29
<b>Total</b>	<b>115</b>	<b>\$10,719</b>		
<b>Nonminority contractors</b>				
1987	8,245	\$902,197	74.09	74.21
1988	8,304	998,940	74.83	75.79
1989	8,505	1,062,202	76.05	76.04
<b>Total</b>	<b>25,054</b>	<b>\$2,963,339</b>		
<b>Undetermined contractors</b>				
1987	1,130	\$108,550	10.15	8.93
1988	1,144	111,450	10.30	8.46
1989	1,012	101,333	9.04	7.25
<b>Total</b>	<b>3,286</b>	<b>\$321,333</b>		
<b>Unknown contractors</b>				
1987	4	\$208	.03	.02
1988	1	40	.01	.00
1989	0	0		
<b>Total</b>	<b>5</b>	<b>\$248</b>		

# Reliability of SBG Data

The Office of Information Resource Management located in SBA's Washington, D.C., headquarters maintains the SBG Program computer data base. However, bond data from documents submitted by participating surety companies are entered into the computer system by SBA's 10 regional offices. The data base is used to prepare reports on contingent liabilities, fee receivables, claim payables, and various program income and expenses. The information from the data base is also used to prepare management reports on program activities. We used two tests to check the reliability of selected SBG Program data.

We first tested the accuracy of the information in the data base by comparing information in the data base to source documents for a sample of bond entries. The comparisons were made for the following data fields:

- SBG bond number.
- Approval date (i.e., date approved by SBA).
- Contract amount.
- Bond amount.
- SBA share of the bond amount (in dollars).
- Minority code.
- Obligee type.
- Surety name.

The objectives, scope, and methodology section of this report contains information on the version of the data base we tested, our sample size and sampling method, and the data limitations that resulted from not being able to obtain documentation from SBA for each of the 475 data base entries we randomly sampled. The results of our accuracy tests are presented in table III.1.<sup>1</sup> In addition, analysis of our accuracy tests for the contract and bond amounts are presented in table III.2. We did no tests to determine whether the automated file contained an entry for each of the bonds guaranteed in fiscal years 1987-89 (the completeness of the data base) because of the high cost of sampling the documents used to originate guarantees, which are located at SBA's 10 regional offices.

<sup>1</sup>Chapter 3 discusses problems we identified in the contract amount, bond amount, minority category, and obligee type data.

**Appendix III  
Reliability of SBG Data**

**Table III.1: Results of Accuracy Test**

Datafield	Number of errors	Estimate of records in error (percent)	95-percent confidence level	
			Lower bound (percent)	Upper bound (percent)
SBG bond number	4	.9	.2	2.2
Approval date	33	7.3	5.1	10.1
Contract amount	12	2.7	1.4	4.6
Bond amount	19	4.2	2.6	6.5
SBA share of bond amount	21	4.7	2.9	7.0
Minority code	29	6.4	4.4	9.1
Database had an incorrect entry for a valid code	13	2.9	1.5	4.9
Data base entry was "undetermined but form provided a code other than "undetermined"	16	3.5	2.0	5.7
Surety name	9	2.0	.9	3.7

**Table III.2: Analysis of Contract and Bond Amounts Differing From Source Document**

Observation	Number of errors	Estimate of records in error (percent)	95- percent confidence level	
			Lower bound (percent)	Upper bound (percent)
<b>Contract amounts</b>				
No explanation for contract difference	6	1.3	.5	2.9
One digit difference	4	.9	.2	2.2
No contract amount on bond form	1	.2	.0	1.2
No bond form in bond file	1	.2	.0	1.2
<b>Bond amounts</b>				
No explanation for bond difference	9	2.0	.9	3.7
One digit difference	5	1.1	.4	2.6
No bond amount on bond form	2	.4	.1	1.6
No bond amount in cancelled bond file	2	.4	.1	1.6
Two different bond amounts provided on bond form	1	.2	.0	1.2

## Problems Found Through Statistical Analysis

Our second test of SBG Program data involved the use of statistical analysis computer software. To identify erroneous data, we analyzed 10 individual and 2 multiple data fields looking for unusual or out-of-range values and illogical patterns. These tests of data from the bonds guaranteed by SBA in fiscal years 1987-89 indicated that most of the data were within normal ranges or patterns.<sup>2</sup> However, one of the analyses

<sup>2</sup>These tests were performed on a version of the data base we received in April 1990.



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involved identifying bond records in which the bond amount exceeded the contract amount. In 219 instances the bond amount exceeded the contract amount. (This is allowed in SBA's SOP only on demolition contracts.) However, most of the 219 instances appear to have resulted from data entry errors.<sup>3</sup> (See ch. 3 for the discussion of bond amounts exceeding contract amounts.)

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<sup>3</sup>These tests were performed on a version of the data base we received in August 1990.

# Material Weaknesses Identified During OSG's Federal Managers Financial Integrity Act Review

The Office of Surety Guarantees, which conducted as part of SBA's Federal Managers Financial Integrity Act of 1990 an internal review of the SBG Program, determined that this was a high-risk program, i.e., at high risk for fraud and abuse. The review was finalized about the same time our review of the program was completed. The weaknesses identified by the Assistant Administrator, Office of Surety Guarantees, during the internal review are similar to those that our review identified. The following material weaknesses, their impact on agency operations, and planned corrective actions were identified:

- Both SBA standard operating procedures (SOPs) and the Code of Federal Regulations, which affect SBA's central office and regional office operations, are outdated and do not reflect changes in laws and procedures. Corrective actions taken include a meeting of field and central office personnel to establish an SOP Task Force. Planned corrective actions include completing a draft SOP (by the third quarter of fiscal year 1991) and publishing a final SOP (by the second quarter of fiscal year 1992).
- OSG field office personnel have been utilized in other program area activities, which has adversely affected the SBG Program. Staffing shortages have plagued SBA's regions and central office: staff levels have decreased while activities have intensified. Regional surety bond officers were reclassified in some areas and were performing dual duties between Finance and Investment Program activities and Surety Bond Guarantee Program activities. Lack of attention to OSG activities has resulted in underutilization of the program and poor underwriting and claims. Corrective actions taken include establishing the Office of Surety Guarantees as a primary office as of June 3, 1990, with greater autonomy over the management of its resources, people, and program and the establishment of management by objectives for OSG in the first quarter of fiscal year 1991. However, according to the Assistant Administrator, as of March 1991, SBA regional surety bond officers were still performing Finance and Investment Program duties. She plans on having the surety bond officers reclassified so that they will be responsible for working only under OSG.
- The current documents collection system has flaws caused by breaks in data collection, equipment failures, and insufficient trained personnel in OSG. Management Information Summary reports, etc., contained erroneous information, which was compounded by daily input of data to the current system. Planned corrective actions include retiring the system (by the second quarter of fiscal year 1991) and ongoing efforts to develop a new system that will have built-in audit trails that allow weekly audits of activity to determine data integrity.

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**Appendix IV  
Material Weaknesses Identified During OSG's  
Federal Managers Financial Integrity  
Act Review**

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- Training for SBG specialists, assistants, and other program staffers to improve both the effectiveness of their job performance and overall program delivery has been limited. Training is needed to establish uniform requirements and procedures for each OSG office to follow. Corrective actions taken include providing guidance to the field by verbal, written, and policy notices. Planned corrective actions include scheduling a central office/regional office training session for the first quarter of fiscal year 1991 and periodically thereafter reviewing/providing training needs as budget permits.
- Control procedures and operating methods necessary to fully observe all statutory and regulatory requirements in the delivery of Surety Guarantees Program services must be improved. Program audit responsibilities to eliminate the potential for waste, fraud, and abuse must be broadened to increase audits of SBA regions, sureties, and agents. Corrective actions taken have included planning/scheduling on-site reviews. Planned corrective actions involve performing on-site reviews.

# Funding Requirements for the Surety Bond Guarantee Programs

In the last decade SBG Program operations were constrained by funding limitations in fiscal year 1986. (See table V.1.) For fiscal year 1991 SBA requested and received \$250 million in additional funds over each of the 3 previous fiscal years to operate both the SBG and Preferred SBG Programs. However, an OSG official was uncertain about how much the implementation of the Preferred SBG Program will actually increase the overall demand for SBA bond guarantee funds.

**Table V.1: SBG Appropriations and Program Outlays**

Thousands of dollars			
Fiscal year	Amount appropriated	Actual outlay	Difference
1980	\$1,700,000	\$1,534,439	\$165,561
1981	1,600,000	1,382,489	217,511
1982	1,200,000	763,788	436,212
1983	1,200,000	567,380	632,620
1984	1,200,000	570,981	629,019
1985	1,115,000	959,097	155,903
1986	1,067,100	1,043,916	23,184
1987	1,096,000	957,432	138,568
1988	1,250,000	1,050,997	199,003
1989	1,250,000	1,151,562	98,438
1990	1,250,000	1,075,742	174,258
1991	1,500,000		

Source: SBA.

According to the Assistant Administrator's Special Assistant, in 1986 SBA had to stop guaranteeing surety bonds each quarter because it had approached its funding ceiling. To limit contractor participation and minimize the effect this constraint had on contractors that had been relying on SBA-guaranteed bonds, SBA tightened its underwriting requirements, e.g., made fewer bond guarantees available to new program participants and limited the amount of increase in the contract size of bonds SBA guaranteed for new participants. In addition, SBA reduced the guarantee percentage for sureties (80 percent) through regulations, rather than using the higher statutory guarantee percentage (90 percent). An OSG official said that in the first quarter of fiscal year 1989 SBA once again approached the program's funds ceiling but, in that instance, it was not necessary to restrict the issuance of bond guarantees.

SBA requested and received \$1.5 billion for operating both bond guarantee programs in fiscal year 1991, an increase of \$250 million over the amounts appropriated for the SBG Program in each of fiscal years 1988,

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**Appendix V**  
**Funding Requirements for the Surety Bond**  
**Guarantee Programs**

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1989, and 1990. OSG officials are uncertain how much additional money will actually be required to implement the Preferred SBG Program. However, as of November 9, 1990, SBA agreed to allot \$20 million to the one surety company and \$5 million to the other surety company that had agreed to participate in the Preferred SBG Program. As of February 5, 1991, only one surety company had issued guaranteed bonds. OSG officials expect to enter into an agreement with at least one additional surety company during fiscal year 1991.

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