



**U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416**

AUDIT REPORT
Issue Date: September 30, 1998
Number: 8-8-H-004-027

To: Robert J. Moffitt
Associate Administrator
Office of Surety Guarantees

From: *Peter L. McClintock*
Peter L. McClintock
Assistant Inspector General for Auditing

Subject: Audit of SBG Fee Refunds

Background

SBA's Surety Bond Guarantee (SBG) program assists small business contractors in obtaining bonds for construction, service and supply contracts. In the prior approval program, SBA's review and approval is required for each bond guarantee. In the preferred surety program, SBA certifies "preferred" surety companies to issue, monitor, and service SBA guaranteed bonds without SBA's prior review and approval. Both programs are funded through fees paid by the participating surety companies and by the small business contractors. The surety company pays a percentage of the premium that it collects from the contractor. The contractor pays a percentage of the bonded contract amount. If fees collected exceed fees due, a refund of the excess amount is necessary. This occurs, for example, when the contractor or surety company makes an overpayment or when a bond is canceled or reduced after the fees have been paid.

The SBG information system, implemented at the beginning of fiscal year 1997, is used to calculate and record fee amounts due and collected. This system was programmed to generate fee refunds automatically when the recorded amount of fees collected exceeded the recorded amount of fees due. In fiscal year 1997, SBA made fee refund disbursements totaling \$691,682 for 518 bonds.

Objective and Scope

The audit objective was to determine if SBG fee refunds paid in fiscal year 1997 were appropriate. Refunds were deemed appropriate if the surety or contractor fees collected exceeded the amounts due. We reviewed 48 bonds with net refunds totaling \$234,162, selected as follows:

- 2 bonds with refund amounts disbursed greater than fee amounts collected,
- 5 bonds with the longest periods of time between dates of bond approval and cancellation (an indicator that the cancellation might be incorrect),
- 14 bonds selected randomly, and
- 27 bonds with the highest refund amounts disbursed, net of cancellations and reversals.

We reviewed records from the surety companies, the Office of Surety Guarantees, SBA's Finance Center, the SBG Area Offices, and the Office of the Chief Information Officer. We verified fee amounts due and collected and, when appropriate, determined whether contract cancellations or reductions were supported. We also interviewed representatives from the various offices and organizations involved. Fieldwork was performed in Washington, D.C. between December 1997 and August 1998. The audit was conducted in accordance with government auditing standards.

Results

Of the 48 bonds reviewed, 19 had inappropriate fee refunds totaling \$99,330. The inappropriate refunds occurred and were not detected because of data entry errors, SBG system conversion problems, and lack of controls for preventing and detecting data entry errors and inappropriate refunds. A summary of the review results is shown in the following table (Attachment 1 provides details). Although \$99,330 of refunds were inappropriately disbursed, as of August 1998, only \$87,325 was due SBA.¹ This is because for eight bonds, \$17,257 was either returned by the payees or canceled as stale by the Treasury, and for four bonds, we identified fee underpayments totaling \$5,252.

Selection Method	Bonds Reviewed (#)	Refund Total Net (\$)	Bonds with Inappropriate Refunds (#)	Inappropriate Refund Amount (\$)	Due SBA (\$)
Disbursed Amount greater than Collected Amount	2	\$19,577.90	2	\$11,722.42	\$11,092.45
Lengthy Delay between Approval & Cancellation	5	\$25,675.52	2	\$8,353.17	\$5,657.02
Random	14	\$4,164.91	3	\$2,980.94	\$2,472.30
Highest Dollar Value	27	\$184,743.93	12	\$76,273.93	\$68,103.09
Total	48	\$234,162.26	19	\$99,330.46	\$87,324.86

¹ At the exit conference we were advised that some of the amounts due SBA may have already been collected, but not yet applied to the accounting records.

The data entry errors that caused inappropriate refunds included duplicate recording of fee collections, creation of duplicate bond records, entry of incorrect premium amounts, cancellation of the wrong bonds, and a duplicate cancellation. System conversion problems included the transfer of incorrect bond numbers and fee receivables. (The system conversion was a one-time event; therefore, recommendations specifically aimed at preventing system conversion problems were beyond the scope of this audit.)

The SBG system did not have edit checks to help prevent data entry errors. For example, there was no reasonableness check, based on contract amount, to help ensure that correct surety premium amounts were entered. Also, there were no warning flags to identify cancellation dates that were an unreasonable period of time after bond approval dates. Personnel from the Office of the Chief Information Officer stated these types of edit checks would involve only minor modifications to the system.

The SBG system did not have controls to help detect refund errors. For example, there were no reports to identify abnormal conditions such as bonds with negative liability account balances or unreasonable revenue amounts in comparison to the bonded contract amounts.

Recommendations

We recommend the Associate Administrator for Surety Guarantees –

1. Develop data entry edit checks for the SBG system to prevent or flag (a) duplicate recording of fee collections, (b) duplicate bond records, (c) unreasonable surety premium amounts, (d) cancellation of bonds an unreasonable period of time after bond approval, and e) duplicate cancellations.
2. Develop a report that shows bonds with negative liability account balances or unreasonable fee revenues. Analyze the report and collect any inappropriate fee refunds due SBA.
3. Determine if any of the \$87,325 shown due on Attachment 1 has been collected. Collect any amounts still due SBA.

SBA Management Response

The Associate Administrator, Office of Surety Guarantees (OSG) agreed with the finding and recommendations, and stated that OSG has already implemented several procedures to prevent and detect inappropriate refunds (see Attachment 2).

* * * * *

The finding included in this report is the conclusion of the Office of Inspector General's Auditing Division based on testing of the auditee's operation. **The finding and recommendations are subject to review, management decision, and corrective action by**

your office in accordance with existing Agency procedures for audit follow-up and resolution.

Please sign the attached SBA forms 1824, Recommendation Action Sheet. Should you or your staff have any questions, please contact Victor R. Ruiz, Director, Headquarters Operations, at (202) 205-7204.

Attachments

SBG Bonds With Inappropriate Fee Refunds

<i>Bond #</i>	<i>Refund Error</i>	<i>Due SBA</i>	<i>Comment</i>
1 [	EX. 4		] System conversion error (contractor's address was incorrectly migrated) resulted in duplicate contractor fee refund.
2 [	EX. 4		] Duplicate recording of fee collections and system conversion error (fee receivables were not migrated properly) resulted in inappropriate refunds and underpayment of surety fee.
3 [	EX. 4		] Duplicate recording of fee collections.
4 [	EX. 4		] System conversion error (fees receivable were incorrectly established at old rate) resulting in inappropriate contractor fee refund and underpayment of surety fee.
5 [	EX. 4		] Duplicate bond record.
6 [	EX. 4		] System conversion error ("bid" bond was migrated as "final"). System incorrectly assumed contractor fee had been paid. In addition, surety fee was not collected.
7 [	EX. 4		] Bond was cancelled in error.
8 [	EX. 4		] Duplicate bond record.
9 [	EX. 4		] Bond was canceled in error.
10 [	EX. 4		] Surety company incorrectly entered total surety premium, but returned the inappropriate refund to SBA.
11 [	EX. 4		] System conversion error, (bond number and fee receivables were improperly migrated) and duplicate bond records, incorrect calculation of contractor fee, and an incorrect cancellation.
12 [	EX. 4		] Surety cancelled bond twice.

SBG Bonds With Inappropriate Fee Refunds

<i>Bond #</i>	<i>Refund Error</i>	<i>Due SBA</i>	<i>Comment</i>
13 [	EX. 4		] System conversion error (bond number and fee receivables were improperly migrated). System incorrectly assumed fees had been paid
14 [	EX. 4		] Bond was canceled in error. Surety fee was not collected.
15 [	EX. 4		] Collection was applied to the wrong bond.
16 [	EX. 4		] System conversion error (bond number and fee receivables were not migrated properly).
17 [	EX. 4		] Duplicate recording of contractor fee collection.
18 [	EX. 4		] Surety premium amount was entered incorrectly when contract was reduced.
19 [	EX. 4		] System conversion error (bond number not migrated properly). System incorrectly assumed fees had been collected.
Totals		<u>\$99,330.46</u>	<u>\$87,324.86</u>



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Date: September 29, 1998

To: Victor R. Ruiz
Director, Headquarters Operations
Office of Inspector General

From: Robert J. Moffitt
Associate Administrator
Office of Surety Guarantees

A handwritten signature in black ink, appearing to read "Robert J. Moffitt", written over the typed name and title.

Subject: Audit of SBG Fee Refunds

I received the revised draft audit report of SBG Fee Refunds on September 29, 1998 and I appreciate your efforts and willingness to address our concerns. As we discussed previously, I believe that many of the inappropriate fee refunds cited in the report occurred shortly after the new OSG computer system was brought on line on October 1, 1996. In 1997 we implemented new procedures and controls to address inappropriate fee refunds which I will go into later. I believe that these new procedures and additional changes already planned will catch and eliminate almost all inappropriate fee refunds and identify any not corrected before they are made.

The report states that in FY 1997, SBA made fee refund disbursements totaling \$691,682 for 518 bonds. I was told that this is a gross figure and does not reflect the amount of fee refunds that were reversed and therefore never made. The actual fee refund disbursement for FY 1997 is less than the above number. To further put the above figures in perspective, in FY 1997, SBA guaranteed 4021 final bonds, which resulted in fee income of \$10,231,088. The total fee refunds for FY 1997 represent approximately 6% of the fees collected. Most of the fees refunded were appropriate.

When this Office realized that inappropriate fee refunds were being made because of computer system problems and human input errors we took several actions to correct the situation. As we identified specific system problems we notified OCIO and they took actions to modify the system. One such correction is the validation edit on old system SBG and PSB numbers that prevents a person from migrating an invalid number into the new system which can cause an inappropriate fee refund. Another change made to the system now prevents the cancellation of the same bond twice.

This Office also has been reviewing daily payment schedules generated by the Denver Financial Center to ensure that fee refunds are valid. We implemented this procedure in early 1997 when we recognized that there was a problem with incorrect refunds. When a questionable refund is identified, staff from this Office investigates the case to determine the problem and resolve the discrepancy. The staff is in constant contact with sureties, area field offices, OCIO and the CFO's office to make necessary corrections. This is a very time consuming process that requires research on each bond in question. One tool we had OCIO develop is the SBG/PSB Cancellations Report. It provides information of each bond cancellation and helps identify improper cancellations, which leads to inappropriate fee refunds. A sample of this report is attached.

I have reviewed the report recommendations and present the following comments:

Recommendation 1. Request OCIO to develop data entry edit checks for the SBG system to prevent or flag (a) duplicate of fee collections, (b) duplicate bond records, (c) unreasonable surety premium amounts, (d) cancellation of bonds an unreasonable period of time after bond approval, and (e) duplicate cancellations.

Comments: 1 (a) is currently being requested from OCIO. 1(b) is already on the to-do list and 1(c) is already available. I have asked my staff and OCIO to determine the feasibility of implementing 1(c) and 1(d).

Recommendation 2: Request OCIO to develop a report that shows bonds with negative payable balances or unreasonable fee revenue. Analyze the report and collect any inappropriate fee refunds due SBA.

Comment: I will ask OCIO to determine the feasibility of developing such a report.

Recommendation 3: Request the Denver Finance Center to determine if any of the \$87,325 shown due on Attachment 1 has been collected. Collect any amounts still due SBA.

Comment: We are working with OCIO, the CFO's office, our area offices and sureties to collect the amounts due SBA as identified on Attachment 1.

Comments on Attachment 1 #6: The system did not set up receivables for contractors and surety fees. This happened early in the conversion to the new computer system. Field staff have received additional instructions on how to input bonds. We are working with OCIO to correct this in the computer system so that the correct receivables are set up and the surety is billed. We will also have the field office contact the contractor for the contractor's fee.

Comment on Attachment 1 #7: The contractor already returned the refund check for [ex. 4] The surety has been billed for [EX.4] but has questioned the amount billed because we previously refunded the same amount. We are working with the surety to resolve the discrepancy.

Comment of Attachment 1 #14: We are working with OCIO and the area office to reinstate the bond in the system and collect the fees.

Comment on Attachment 1 #18: We are working with OCIO and the area office to correct the premium in the system and collect the correct fee.



Small Business Administration
 SBC Cancellations
 From 09/01/1998 To 09/21/1998

Date: 09/21/1998

Business Name	Bond#	Bond Type	Fund Dt	Current Status	Status Dt	Contr. Amt	Contr. Fee Refund	Surety Fee Refund
FOIA EX. 4								

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