GAO

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

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

B-261950

July 14, 1995

The Honorable Kweisi Mfume
House of Representatives

Dear Mr. Mfume:

We recently reported on the results of our survey of construction firms' experiences in getting surety bonds.[1] We compared the experiences of minority-owned[2] and women-owned firms with those of firms not owned by minorities and women; and we provided detailed statistics about the bonding experiences of these firms. We reported that there were differences based on the firm's size, and the gender and ethnicity of a firm's owners for certain experiences related to obtaining bonds. Because of the vast amount of information available in those reports and your interest in small construction companies owned by minorities, you asked us to summarize the detailed information from the survey about the experiences of minority-owned firms. Specifically, you asked that we summarize all of the survey information on (1) such firms' access to surety bonds and (2) barriers the firms experienced in applying for and obtaining bonds. You also asked us to describe the strategies used by some minority-owned firms that might improve other firms' access to bonds.

Surety bonds guarantee that if a bonded contractor defaults, the construction project will be completed and that certain suppliers and subcontractors will be paid. Construction companies that wish to bid on federal construction contracts for projects

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[1]Small Business: Construction Firms' Access to Surety Bonds (GAO/RCED-95-173FS, June 26, 1995) and its supplement, Small Business: Responses to Survey on Construction Firms' Access to Surety Bonds (GAO/RCED-95-173S, June 26, 1995).

[2]A minority-owned firm is one that reported in our survey that 51 percent or more of the firm was owned by members of one or more of the following minority groups: Blacks or African Americans, Hispanics, Asians, American Indians or Native Americans, or Pacific Islanders.



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worth more than $25,000[3] must obtain a surety bond. Most state and many local governments also require firms that are bidding on their projects to provide bonds. In the private sector, a lender that is financing a project may require that bonds be provided to ensure that the project will be completed and that the bills for labor and materials will be paid. Similarly, general contractors may require that a subcontractor provide bonds to cover the portion of work being done by the subcontractor.

This report summarizes descriptive information about small[4] minority-owned firms but does not make comparisons to firms not owned by minorities. It is important to note that we are only presenting the information reported to us by the firms. We did not verify this information. On the basis of a range of experiences reported to us, we identified those that may act as barriers or impediments to firms that want to obtain a bond. Many of the barriers may also be faced by firms not owned by minorities. We have no evidence to suggest that removing any particular barrier or adopting any particular strategy would lead to successfully obtaining a bond.

## SUMMARY

In summary, we found the following.

### Access to Surety Bonds

About one-half of the small minority-owned construction firms represented by the respondents to our survey have never obtained a surety bond. The majority of these firms have either not been asked to provide a bond or do not bid on construction projects that require bonds. However, on the basis of projections from our national survey, we estimate that from 18 to 31 percent of these firms have tried to get bonds.[5]

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[3]The Federal Acquisition Streamlining Act increased this amount to $100,000, effective Oct. 1, 1995.

[4]Small means eligible to participate in the programs of the Small Business Administration (SBA). SBA's size standards set a maximum for annual revenues over a 3-year period of $17 million for firms in building construction and heavy construction and $7 million for special trade contractors.

[5]We present our survey results as national estimates for minority-owned firms using ranges to allow for sampling error--the error that occurs from not mailing the survey to all construction firms. These ranges apply to the minority-owned firms that would have responded to our survey had we mailed it to them.

Among the firms that had obtained bonds from 1990 to 1993, more than 1 out of 4 firms had also been denied a bond at least once during that time.

While the average bond obtained by the firms in 1993 was between $250,000 and $500,000, from 21 to 42 percent of the firms that were bonded that year obtained bonds of $1 million or more. In contrast, 10 to 28 percent of the firms bonded in 1993 obtained no bonds that were larger than $100,000.

Among the minority-owned firms that had obtained bonds since 1990, from 4 to 15 percent derived all of their 1993 construction revenues from contracts for which they had obtained bonds, and from 13 to 28 percent had no construction revenues in 1993 from such jobs. Across all of these bonded firms,[6] the average percentage of 1993 construction revenues from jobs for which they had obtained bonds was 34 to 49 percent.

Enclosure I provides more detail about the experiences of minority-owned firms in getting surety bonds.

Barriers in Applying for and Obtaining Bonds

Obtaining a bond, especially the first time one is requested, can take longer than the time available to bid on a contract. About one-third to one-half of the bonded minority-owned firms said they lost at least one opportunity to bid on a project in 1993 because of the amount of time it took to get a bond.

The firms seeking bonds did not have the same satisfaction with their access to information about what is required to get a bond. Furthermore, the information provided by surety agents about denials or changes in requirements was not always clear or understandable to the firms.

Some minority-owned firms that had never obtained a bond said it was because the financial commitment required of them was more than they wanted to accept. The financial commitment required by surety companies can include a request that the firms' owners sign personal indemnity agreements--contracts that commit personal funds, if necessary, to cover a surety company's losses associated with a bond.

The firms also cited the amount of paperwork required and/or the cost of preparing it as reasons for not obtaining a bond. For example, most of the firms were required to

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[6]A bonded firm is one that obtained a bond or was approved by a surety company to obtain a bond after 1989 through our data collection period, which ended in July 1994.

have a certified public account (CPA) review their financial statements; about one-half to two-thirds were asked for CPA audits of their financial statements in order to obtain a bond.

Some firms said that the fees for bonds made it unprofitable for them to do work that required a bond. On average, the firms paid 1.9 to 3.5 percent of the contract amount for the first $100,000 of the contract. A small percentage of the firms paid less than 1.0 or more than 3.5 percent of the contract amount.

When bonded firms were denied new or additional bonds, they were most often told it was because theiy lacked sufficient financial strength or had not done a job as large as the one sought, had never worked in the location of that job before, or had never done the specific kind of work called for in the contract.

Enclosure II discusses in more detail the potential barriers faced by minority-owned firms trying to obtain surety bonds.

## Improving a Firm's Access to Bonds

The experiences reported by some firms suggested strategies that might improve other firms' access to bonds in the future, including firms not owned by minorities. All of these strategies require the cooperation of the surety industry and/or owners of construction projects. Other strategies not covered by our survey may also be effective in reducing the barriers to obtaining bonds. The experiences include

-- requesting a bonding line before needing one,

-- getting better information about requirements and fees, and

-- using government bonding assistance programs or alternatives to bonds.

Enclosure III provides more detail about the experiences of some minority-owned firms that might be used by other firms to make bonding more accessible.

## SCOPE AND METHODOLOGY

We surveyed 12,000 firms randomly selected from a list maintained by Dun & Bradstreet of (1) special trade contractors, such as plumbers, painters, electrical contractors, and concrete masons; (2) general building contractors doing commercial and industrial construction; and (3) heavy construction contractors, such as those building highways, bridges, and tunnels.[7] We do not know how many of the firms in our sample were owned by minorities. Of the firms in our sample, 16.9 percent did not respond to the questionnaire because they were out of business or not doing construction work or because we were unable to obtain a current address for them. Of the remainder, 50.2 percent responded to the questionnaire.

Usable questionnaires were returned by 310 small minority-owned firms: 148 companies that had obtained a bond or had a bonding line,[8] and 162 firms that had no bonding experience. Our results generalize to the 17,649 small minority-owned construction companies that we estimate would have answered our questionnaire if we had mailed it to all small construction companies. For this reason, we present our survey results as estimates of the statistics for those 17,649 firms. These estimates are presented as ranges that reflect sampling error--the error that arises from not mailing the survey to all firms.

We supplemented our survey data by interviewing representatives from the construction and surety industries and reviewing documents they provided us. We conducted our work between June 1993 and July 1995 in accordance with generally accepted government auditing standards.

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We are sending copies of this report to the Administrator, SBA. We will also make copies available to others on request.

Please call me at (202) 512-7631 if you or your staff have any questions.

Sincerely yours,

for Michael Gryszkowiec

Judy A. England-Joseph
Director, Housing and Community
Development Issues

Enclosures - 3

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[7]General contractors involved in single-family residential construction and builders/developers of residential buildings were not included in our survey.

[8]A bonding line is the total amount of bonds that a surety company is willing to provide to a construction firm.

## ACCESS TO SURETY BONDS

There are several statistics that indicate, or point to, the degree of a firm's access to surety bonds. These indicators include the ability to obtain bonds, the size of the bonds obtained, and changes over time in the dollar amount of the bonds that a surety company is willing to provide to a firm. Our survey included questions concerning each of these indicators.

### Minority-Owned Firms' Overall Rate of Obtaining Surety Bonds

Among the survey respondents whose firms were minority-owned, about half (42.1 to 53.3 percent) had obtained bonds. We believe that the actual percentage of minority-owned firms obtaining bonds among all construction companies may be considerably lower than half. This is because in the total sample--the ethnicity of the firms' owners aside--the firms that had obtained bonds were more likely than the firms with no bonding experience to have responded to the survey. As a result, the survey data may overstate the proportion of firms that had obtained bonds.

Of the minority-owned firms that had never obtained a bond, the majority (66.3 to 80.1 percent) reported that they were not asked to provide bonds or did not bid on jobs requiring bonds. However, others (from 18.1 to 31.3 percent of the firms that had never obtained a bond) reported that they had asked for a bond. Of the firms that had sought bonds but never obtained one, an estimated 410 to 1,071 firms were denied a bond at least once, and from 460 to 1,134 firms said that they were never denied a bond. The remainder, representing 410 to 1,071 firms, did not answer our question about being denied a bond. Among the firms that had obtained bonds from 1990 to 1993, more than 1 out of 4 firms (26.4 to 44.6 percent) had also been denied a bond at least once during that time. The firms reported a variety of reasons why they were denied bonds. These are discussed in enclosure II.

### Amount of Bonds

In 1993, the typical bonds obtained by minority-owned firms were, on average, between $242,892 and $511,884. The largest bonds obtained were, on average, between $643,890 and $1,151,230. More than half of the minority-owned firms that were bonded that year (56.3 to 80.5 percent) typically obtained bonds in 1993 valued at $100,000 or more; 21.3 to 41.9 percent of the firms obtained bonds of $1 million or more. On the other hand, from 10.3 to 27.7 percent of the firms obtained no bonds greater than $100,000 in 1993.

The bonded minority-owned construction firms derived a large portion of their construction revenues in 1993 from jobs for which they had obtained bonds. Among the firms that had obtained bonds since 1990, the average percentage of 1993 construction revenues from such jobs was 34.1 to 48.9 percent. This figure includes firms with no 1993 construction revenues from such jobs--12.5 to 27.7 percent of the total number of firms. Some firms (3.9 to 15.3 percent) derived all of their 1993 construction revenues from construction jobs for which they had obtained bonds.

Changes in Bond Capacity

Bond capacity is defined as both the largest bond a surety company would be willing to provide a firm and as the total or sum of the bonds that a surety company would be willing to provide a firm concurrently. Bond capacity fluctuates with a firm's financial status, the general economic conditions, and other factors. Because successfully competing for larger contracts may require increases or growth in bond capacity, we defined changes in this capacity as another indicator of access to bonds.

Among the bonded firms that reported experiences for both 1990 and 1993, about half reported an increase in their largest bond capacity (42.3 to 70.3 percent); others reported no change (12.8 to 37.3 percent) or a decrease in capacity (7.8 to 29.8 percent) over that period. Changes in the total bond capacity were similar. From 44.8 to 64.2 percent of the bonded firms said that surety companies had tightened up the requirements for them to get bonds over the past 5 years. Only 9.5 to 24.1 percent of the bonded firms said that the requirements for them had been relaxed over the past 5 years. The remainder (19.9 to 37.5 percent of firms) said the requirements had stayed about the same.

## BARRIERS IN APPLYING FOR AND OBTAINING BONDS

In deciding whether or not to provide a bond to a particular firm, a surety company performs a thorough evaluation of that firm's ability to complete the project under consideration. Construction firms seeking surety bonds must present detailed financial and other information to the surety company, meet the criteria established by the surety company to obtain the specific bond requested, and pay a fee for that service. While a surety company may "prequalify" a firm for bonds by giving the firm a bonding line, each individual bond request may be evaluated independently on the basis of the firm's current status and the nature of the contract for which the bond is required.

On the basis of a range of experiences reported by our survey respondents, we identified several experiences that act as potential barriers or impediments to a firm's success in obtaining a bond. The experiences described below occurred in a range of instances; they varied from being a rare event to being more frequent occurrences. We have no evidence to suggest that removing any particular barrier, which may affect minority-owned firms as well as firms not owned by minorities, would lead to successfully obtaining a bond. These barriers include

-- the time needed to obtain a bond,

-- the quality of the information about what is required to get a bond,

-- the need for a financial commitment from the firm's owners,

-- the amount of financial information needed and the cost of preparing it and meeting other requirements,

-- the fees charged by the surety companies for a bond, and

-- difficulty meeting the surety companies' criteria for obtaining bonds, such as those for financial strength and specific job experience.

Some of these barriers, such as the time taken to process a bond application and difficulty meeting the surety companies' criteria, were identified by firms that had been denied a bond as reasons for the denial. Others, such as the need for a financial commitment by owners and the costs involved in getting a bond, were identified by some firms as reasons for never obtaining a bond. While some firms identified these potential barriers as reasons for not obtaining a bond, the majority of the firms that had never obtained a bond reported that they had not been asked to provide one.

## Time Needed to Get Bonds

Surety companies suggest that contractors allow sufficient time to process their bond requests, especially their initial request for a bond or bonding line. It can take time--up to a month or more--for a contractor to prepare and submit all of the paperwork required by a surety company. It also takes time for the surety to evaluate the paperwork. The evaluation is an involved process, focusing primarily on the financial statements provided but including all of the information gathered by the surety company. Sometimes the amount of time taken for the process exceeded the time available to bid on a contract. While our survey did not address how long different steps took in the application process, we asked bonded firms how long it took overall for two decisions about bond requests: first-time approvals and recent denials, if any.

As expected, first-time approvals tended to take longer than recent denials for firms that had been bonded in the past. On average, the minority-owned firms requesting their first bond in 1990-93 waited an estimated 21.7 to 53.0 days for approval. Among the firms providing information about the time needed to obtain their first bond, an estimated 733 to 1,430 firms received approval within 10 days, 313 to 940 received approval within 11-30 days, and from 265 to 874 firms reported that it took longer than 30 days to receive their first bond approval. The most recent denial in the 1990-93 period for bonded minority-owned firms occurred, on average, within 12.0 to 29.7 days of the bond request. Of the firms providing information, we estimate that 248 to 777 firms were denied a bond within 10 days of requesting it, from 354 to 899 were denied a bond within 11-30 days, and from 24 to 431 firms reported that it took longer than 30 days to be denied a bond.

About one-third to one-half of the bonded firms (34.1 to 53.7 percent) said they lost at least one opportunity to bid on a contract in 1993 because of the time it took to process their bond requests. Also, from 4.6 to 29.6 percent of bonded firms said their most recent bond denial in 1990 to 1993 occurred because there was not enough time to process the bond request.

## Quality of Information Provided by Agents

Another potential barrier to obtaining surety bonds for some firms is getting information about what is required to get a bond. The firms were not equally satisfied with the information the agents provided about requirements for bonds the first time they sought such information. Of the bonded firms that recalled their first request for a bond, an estimated 497 to 1,211 firms said the agent explained requirements to "some" or "little or no" extent, from 600 to 1,335 firms said the agent explained requirements to a "moderate" extent, and 497 to 1,211 firms rated the extent of information provided as "great" or "very great."

Results were similar among the firms that had not obtained bonds: An estimated 633 to 1,301 firms said the extent of information provided was "some" or "little or none"; from 92 to 592 firms said it was "moderate"; and 418 to 1,062 firms said it was "great" or "very great."

Some bonded firms expressed uncertainty about the reasons why surety companies had tightened up bonding requirements for them and/or denied them bonds. Among the minority-owned firms reporting that surety companies had tightened up the requirements for them to get bonds over the last 5 years, 6.6 to 26.2 percent said that the reasons for this tightening provided by their agents were not clear or understandable. Similarly, when asked for the reasons given by their agents or brokers for their most recent bond denial since 1990, 6.7 to 33.3 percent of the bonded minority-owned firms that had previously obtained a bond said that the reasons were not clear or understandable. Most minority-owned firms (53.2 to 84.0 percent) were given the reasons for their most recent denial orally.

## Financial Commitment

Among the firms that had never obtained a bond, 11.8 to 23.8 percent said that the overall financial commitment required of them in order to get bonds was more than they wanted to provide. The financial commitment that surety companies require any firm to make can be substantial. Although surety is sometimes likened to insurance, unlike insurance companies, surety companies do not expect to sustain losses on the bonds they write. In the event that a surety does sustain a loss or incurs an expense in completing a contract, it expects reimbursement from the contractor or subcontractor. One way that surety companies minimize their risk of loss is to require contractors to sign personal indemnity agreements. These are contractual obligations for the firm's owners, spouses, or other principals to reimburse the surety companies for any losses under a bond. Personal indemnities require substantial financial commitments from the firm's owners to stand behind their firm with personal funds, if necessary. Other financial commitments can be required by sureties, such as having to set aside personal or the firm's assets as collateral for a bond.

## Preparing Financial Information and Meeting Other Requirements

Among the firms that had not used bonds, 10.8 to 22.4 percent said that the cost of preparing financial information was a reason for not obtaining bonds, while 11.8 to 23.8 percent cited the burden of preparing the information. Among the types of financial information that a surety company can require for any firm are financial statements, assurances from a certified public accountant (CPA), reports of work in progress, and tax returns. At times, the required assurance by a CPA is a review of financial statements, and at other times, the requirement is for a CPA audit. CPA audits are more comprehensive and provide more assurance about the credibility of financial statements than CPA reviews. They also are more expensive than CPA reviews.

Financial statements--personal and business--were routinely required of firms seeking bonds. Of the bonded minority-owned firms, more than 80 percent (81.1 to 93.9 percent) provided personal financial statements, and 74.3 to 89.1 percent provided "compilation" financial statements to sureties. One use of personal financial statements by surety companies is to assess the worth of personal indemnity agreements. Compilation statements are ones prepared by the construction company or its accountants with little or no assurance from a CPA that they meet professional accounting standards.

Surety companies view assurances from a CPA that the figures presented in the financial statements are credible as essential for a firm to obtain the optimum level of surety bonding. This was evidenced in our survey--most minority-owned firms (77.7 to 91.5 percent) reported having to provide this assurance through CPA reviews of their financial statements. About one-half to two-thirds of the minority-owned firms (44.2 to 63.4 percent) reported that surety companies required CPA audits of their statements.

Surety companies sometimes require interim financial statements that show how the current year is progressing. These statements can be compiled internally and reviewed or audited by a CPA. About one-half to three-fourths of the minority-owned firms (53.7 to 76.7 percent) that submitted periodic compilation financial statements reported providing them more than once a year. Less than half of the firms that were required to have their statements reviewed or audited periodically by a CPA said that they had to provide these reviews and/or audits more often than once a year; 23.6 to 46.0 percent of the firms were required to provide interim CPA reviews, and 15.4 to 43.2 percent of the firms were required to provide interim CPA audits.

Reports of work in progress, which include the firm's financial performance and expected earnings from ongoing contracts, are also routinely required. The firms in our study said that these reports were typically required by surety companies more often than once a year; 77.7 to 91.5 percent of the firms were required to provide them, and of those providing them periodically, 64.9 to 88.1 percent provided them more than once a year. Preparing these schedules accurately and according to the accounting method preferred by surety companies--the "percentage of completion" method--can involve additional cost to the contractor.

One way that surety companies use a firm's reports of work in progress is to evaluate requests for additional bonds. According to the 16.0 to 46.8 percent of the bonded firms that had been denied bonds, the last time they had been denied a bond (since 1990) they were told they could not obtain any more bonds until they completed their work on hand.

In addition, over half of the firms reported having to provide corporate (62.5 to 79.9 percent) and/or personal tax returns (67.8 to 84.2 percent) as part of the financial information required by the surety companies.

Fees Charged by Surety Companies for Bonds

The fee or premium a surety company charges for a bond is meant to cover the surety's expense of writing the bond; it does not reflect a probability of loss. Some firms that did not use bonds said it was because the fees for bonds charged by the surety companies make it unprofitable for them to do work that required a bond (7.0 to 17.2 percent of the firms). Our survey examined the range of fees paid by firms for the three types of bonds: bid, performance, and payment bonds.

When firms bid on public construction projects, they often are required to provide a bid bond. The bid bond provides assurance that the firm can be bonded if it is awarded the contract. About one-fourth to one-half of the minority-owned firms (28.2 to 53.2 percent) paid nothing in 1993 for their bid bonds, while the rest (46.8 to 71.8 percent of the firms) paid some kind of fee. The fees paid included an annual service fee, averaging $161 to $281 per year, to cover all of the bid bonds provided by the surety company during the year; a flat fee, most often $200 or less, for each bid bond provided; and/or a percentage of the contract amount, averaging from 1.9 to 4.0 percent.

Performance and payment bonds are the more costly bonds to obtain. These bonds guarantee that the project being bonded will be completed and that the suppliers and subcontractors will be paid. Performance and payment bonds are required once a contractor has been awarded the contract. Surety companies typically charge fees for these bonds on the basis of the amount of the construction contract.

For performance and payment bonds, the firms reported paying an average fee of 1.9 to 3.5 percent of the contract amount for the first $100,000 of the contract in 1993. Few firms (0.3 to 10.1 percent) paid less than 1.0 percent of the contract amount, and a small percentage (2.7 to 15.5 percent) paid more than 3.5 percent. Thus, for a hypothetical contract of $100,000, most firms would have paid in the range of $1,000 to $3,500 for performance and payment bonds, in addition to whatever fees they may have been charged for the bid bond.

Other Costs of Obtaining Bonds

Other requirements reported by some minority-owned firms that might involve additional costs include

-- setting aside assets as collateral for a project,

-- purchasing insurance from the bonding agent, and

-- establishing an escrow account to manage the flow of funds for a project.

About one-fourth to less than one-half of the minority-owned firms (27.6 to 46.0 percent) reported they had to set aside assets as collateral in order to get a bond. Collateral may consist of cash, marketable securities, a bank letter of credit, or equity in a home or other personal assets. Collateral is more likely required by those surety companies that specialize in bonding small contractors. The amount of collateral can be as low as 15 percent or 100 percent or more of the contract amount.

Some firms also reported other requirements that might add to the cost of doing work that requires a bond. Less than one-third of the minority-owned firms (14.0 to 29.8 percent) said they had to purchase insurance from the bonding agent. And less than 1 in 5 (6.1 to 18.7 percent) reported that they had to establish an escrow account controlled by the surety company.

Meeting the Criteria of the Surety Companies

Minority-owned firms and small firms, in general, may have difficulty meeting the criteria of the surety companies for obtaining bonds. While surety companies may prequalify a firm for bonding, they may evaluate each request for a bond independently. Thus, firms that are bonded for other projects may be denied a bond in a subsequent request. According to the surety industry, two important factors surety companies consider in evaluating a bond request are a firm's current financial status and experience relative to the specific contract being considered. Our survey data from minority-owned firms bear this out. That is, according to the bonded construction firms that had been denied a bond, the most common reason given by an agent for the denial was that their financial status was not good enough. More than half (53.2 to 84.0 percent) of the firms said this was the reason given to them for their most recent denial since 1990. The second most frequently cited reason (21.1 to 53.1 percent of the firms) for the most recent bond denial was a lack of specific contract-related experience, such as never having done a job of that size before, never having worked in that location, or never having done that specific kind of work.

More than 10 percent (11.8 to 23.8 percent) of the minority-owned firms that had never obtained a bond reported that they believed they would not be able to get a bond, so they did not request one. Our survey did not address the basis for this perception.

## IMPROVING A FIRM'S ACCESS TO BONDS

The experiences reported by some small firms suggested strategies that might improve the accessibility of bonds in the future for other small firms, including firms not owned by minorities. For firms that used them, these strategies may have moderated the effects of taking a long time to process a bond request, not having sufficient information about the requirements to get a bond, or not being able to meet the surety companies' criteria for obtaining a bond. The strategies include

-- requesting a bonding line before needing one,

-- getting better information about requirements and fees, and

-- using government bonding assistance programs or alternative to bonds.

All of these strategies require the cooperation of the surety industry and/or owners of construction projects. Other strategies not covered by our survey may also be effective in reducing the barriers to obtaining a bond.

### Requesting a Bonding Line Before Needing One

As discussed in enclosure II, an initial bond request can take as long as a month or more because the firm may need to develop and present data, address questions the surety company may have, or verify data. The surety company also needs to carefully review all of the documentation provided. The surety industry suggests that firms establish a relationship with a surety company by prequalifying for bonds before needing one. For firms that have never sought a bond, this may mean establishing a relationship with a surety company when the firm first considers entry into the area of public construction. Such a strategy would require the cooperation of the insurance agents and brokers who sell bonds for the surety companies. In our survey, about half of the firms (46.2 to 65.0 percent) reported having a preapproved bonding line. Of these, less than half (16.8 to 40.4 percent) reported getting their first preapproved bonding line before needing one.

### Getting Better Information About Requirements and Fees

According to industry officials, requirements and fees vary across surety companies. Bonds are obtained from standard or specialty surety companies. Standard surety companies handle mostly larger bonds and mostly bonds not guaranteed by the Small Business Administration (SBA). For example, in fiscal year 1993, standard surety companies in SBA's Preferred Surety Bond Program handled only 15 percent of the bonds and 20 percent of the contract dollars guaranteed by SBA. According to the National Association of Surety Bond Producers, the fees for performance and payment bonds charged by standard surety companies range from 0.5 to 3.5 percent of the contract amount, and these companies rarely charge for bid bonds. Specialty surety companies are more likely to issue bonds that have been guaranteed by SBA or involve high-risk business ventures. We previously reported[9] that specialty surety companies are more likely to require that collateral be provided for the projects they bond and charge higher premiums than standard surety companies. The bonds are typically sold through insurance agents and brokers who tend to work with either standard or specialty surety companies but usually not both types of companies.

While our survey did not assess whether firms used specialty or standard surety companies, it did reveal that firms paid a wide range of fees for performance and payment bonds, that firms were just as likely to pay for bid bonds as not, and that surety companies' requirements for collateral, CPA audits, etc. varied widely. As we discussed in enclosure II, some firms received extensive information about what was required to get a bond from their agents or brokers. Other firms may be able to improve their access to information, and possibly decrease the costs associated with bonds, by getting comparative information about surety companies' requirements and fees before requesting a bond.

For example, the names of surety companies authorized by the U.S. Department of the Treasury to write surety bonds on federal contracts is published annually in Treasury's Circular 570. The names of other companies may be available from state insurance commissioners, professional associations such as the National Association of Minority Contractors, the National Association of Surety Bond Producers, the American Subcontractors Association, or other construction industry associations. These groups may also provide additional guidance about what is required to obtain a bond.

One way that some firms have been able to obtain information about firm-specific barriers to obtaining a bond, such as insufficient financial status, is through a written explanation of the reasons why they were denied a bond. Our survey did not examine how easy or difficult it was to get information in writing or the quality of the written information provided. Of the bonded minority-owned firms that had been denied a bond since 1990, 16.0 to 46.8 percent, representing an estimated 320 to 933 firms, received a written explanation for their most recent bond denial. Obtaining information in writing can help to clarify the decision-making process.

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<u>Small Business: Information on and Improvements Needed to Surety Bond Guarantee Programs</u> (GAO/RCED-91-99, Apr. 23, 1991).

Government Bonding Assistance Programs and Alternatives to Bonds

As discussed in enclosure II, small minority-owned firms, as well as other small firms, can have difficulty meeting the criteria of the surety companies for obtaining bonds. Government bonding assistance programs were designed to help these firms. Some bonded minority-owned firms (8.1 to 21.5 percent) used these programs to get bonds from 1990 to 1993. Federal, state, and local government bonding assistance programs are available to help small and minority-owned contractors get bonds by providing the contractors with financial, technical, or other assistance, or by agreeing to assume part of the risk from the surety companies. SBA's two major programs are the Surety Bond Guarantee Program and the Preferred Surety Bond Program. The major difference between these programs is that under the former program, SBA must give prior approval on bonds it guarantees, while under the latter program, surety companies can issue bonds without SBA's prior approval. Under both programs, SBA guarantees bonds for contracts of up to $1.25 million. SBA guarantees bonds for federal, state, and local government contracts as well as private sector contracts. To be eligible for these programs, contractors must have average annual revenues over the last 3 years of $5 million or less. Some state and local governments have similar bond assistance programs.

Candidates for the government assistance programs include those firms in our survey that believed they could not get a bond and therefore did not apply for it (11.8 to 23.8 percent of the firms that had not obtained a bond) and firms that had been denied a bond from a surety company that did not pursue programs like those sponsored by SBA. Not all surety companies are authorized to issue bonds with SBA's guarantee. The names of the companies that have this authorization are available from SBA.

Some minority-owned firms reported using alternatives to bonds. For example, 5.0 to 14.2 percent of the minority-owned firms that had never obtained a bond said they had used alternatives such as cash. From 7 to 448 firms said that instead of a bond, they had used a letter from a surety company saying that they could be bonded. Also, a few firms reported that they had performed work in a partnership or joint venture with firms that were bonded (4.4 to 13.4 percent of the firms that had never obtained a bond). The use of these or other alternatives to bonds is only possible through the cooperation of the owners of the construction projects.

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