



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

AUDIT REPORT
Issue Date: February 28, 2002
Number: 2-07

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

From: Robert G. Seabrooks
Assistant Inspector General for Auditing

Subject: Audit of Safeco/First National Insurance Company

Attached is the audit report on Safeco/First National Insurance Company issued by Cotton & Company LLP. The report discusses the following issues: (1) copies of SBA underwriting form numbers 1624 and 912 were not maintained for one bond, and (2) SBA was not notified of default in a timely manner for one bond.

You may release this report to the duly authorized representative of Safeco/First National Insurance Company. The findings included in this report are based on the auditors' conclusions. The findings 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 provide us your proposed management decision for each recommendation on the attached forms 1824, Recommended Action Sheet, within 80 days.

This report may contain proprietary information subject to the provisions of 18 USC 1905. Therefore, you should not release this report to the public or another agency without permission of the Office of Inspector General. Should you or your staff have any questions, please contact Robert Hultberg, Business Development Programs Group at (202) 205-7577.

Attachments

INDEPENDENT ACCOUNTANTS'
REPORT ON THE PERFORMANCE AUDIT OF
SAFECO/FIRST NATIONAL INSURANCE COMPANY

Performed by:

Cotton & Company LLP
Certified Public Accountants
333 North Fairfax Street, Suite 401
Alexandria, Virginia 22314

COTTON & COMPANY LLP

auditors • advisors

DAVID L. COTTON, CPA, CFE, CGFM • CHARLES HAYWARD, CPA, CFE, CISA • MICHAEL W. GILLESPIE, CPA, CFE • CATHERINE L. NOCERA, CPA
MATTHEW H. JOHNSON, CPA, CGFM • SAM HADLEY, CPA, CGFM • COLLETTE Y. WILSON, CPA

November 2, 2001

U.S. Small Business Administration
Office of Inspector General

BACKGROUND

The Small Business Investment Act of 1958, as amended, authorized the U.S. Small Business Administration's (SBA) Surety Bond Guarantee Program (SBG) to assist small, emerging, and minority construction contractors. SBA indemnifies surety companies from potential losses by providing a Government guarantee on bonds issued to such contractors. SBA guarantees up to 90 percent of losses incurred by sureties for contracts not exceeding \$1.25 million (increased to \$2 million effective January 25, 2001). SBA's Office of Surety Guarantees (OSG) administers the SBG program.

OBJECTIVE, SCOPE AND METHODOLOGY

SBA's Office of Inspector General (OIG) requested Cotton & Company to conduct a performance audit of Safeco/First National Insurance Company. The primary objectives were to determine if Safeco/First National:

1. Complied with applicable policies and procedures, including SBA's policies and standards generally accepted by the surety industry in issuing SBA-guaranteed bonds.
2. Submitted claims and expenses to SBA that were allowable, allocable, and reasonable.
3. Accurately calculated fees due to SBA and remitted them in a timely manner.

We obtained the universe of Safeco/First National bonds for which SBA had paid claims from October 1, 1999, through September 30, 2001. This universe contained eight bonds, and we randomly selected two as sample bonds for review. We also randomly selected two additional bonds originally approved in Fiscal Years (FYs) 2000 and 2001 for underwriting review only. Thus, our total sample size was 4 bonds with claims (net of recoveries) totaling \$372,376.94. [FOIA Ex. 4].

We tested sample bonds for compliance with SBA regulations for underwriting and fees by reviewing underwriting files and Safeco/First National's accounting records. We tested claims incurred under sample bonds from October 1, 1999, through September 30, 2001, by reviewing Safeco/First National's supporting documentation in the claim files and accounting records. We obtained a list of all



established 1981

SBA-guaranteed final bonds from October 1, 1999, through September 30, 2001, and identified contractors with total bonds exceeding \$1.25 million (\$2 million for bonds issued after January 25, 2001) for contracts with the same obligee and bond issue dates within several months. We then reviewed project descriptions to determine if the bonds were for a single project divided into more than one contract.

We conducted fieldwork during October and November 2001 at Safeco/First National’s offices in Redmond, Washington. The audit was conducted in accordance with *Government Auditing Standards*, 1994 Revision.

AUDIT RESULTS AND RECOMMENDATIONS

Safeco/First National correctly calculated and remitted all sample bond fees to SBA in a timely manner. Safeco/First National did not always comply with SBA regulations for underwriting and servicing bonds and processing claims. Specifically, Safeco/First National did not maintain copies of SBA underwriting form numbers 1624 and 912 for one of four bonds tested. In addition, it did not notify SBA of default for one bond in a timely manner, as required by SBA regulations.

We concluded that management and financial controls were adequate to protect assets and prevent errors and fraud, except as noted below. We concluded that Safeco/First National did not comply in all material aspects with SBA regulations for obtaining and maintaining documents to support proper underwriting of SBA bond guarantees. Also, Safeco/First National did not have procedures in place to ensure timely notification of default to SBA.

We conducted an exit conference with Safeco/First National personnel on November 2, 2001. They generally agreed with factual aspects of the findings.

Our findings and recommendations are discussed in detail below.

Record Retention

Safeco/First National did not maintain copies of SBA underwriting forms 1624 and 912 for one sample bond, as required by SBA regulations. Additionally, the surety was unable to obtain copies of these documents from their agent. Safeco/First National is required to provide critical underwriting documents that may be necessary to settle existing claims or defend or enhance any litigation actions against indemnitors, obligees, or other claimants.

Contractor	SBG No.	Bond Date	Missing Documents
[FOIA Ex. 4]			SBA Form 1624, 912

Title 13, CFR, Section 115.21(b), Audits and Investigations, requires a surety to maintain all documentation submitted by the principal in applying for the bond, for the term of each bond, plus additional time required to settle any claims for reimbursement from SBA and to attempt salvage or other recovery, plus an additional 3 years.

Recommendation: We recommend that the OSG Associate Administrator advise Safeco/First National to implement and enforce policies and procedures that would ensure that all required SBA documentation for underwriting and servicing SBA-guaranteed bonds be maintained in accordance with SBA regulations.

Timely Notification of Default

Safeco/First National did not notify SBA in a timely manner when the principal for one of the two bonds reviewed with claims activity defaulted. In the default notification letter that Safeco/First National sent to SBA, it acknowledged late notification of default. Safeco indicated that the late notification was the result of a change in personnel handling the file and the new individual was unfamiliar with the SBA reporting requirement. Safeco/First National emphasized, however, that its personnel are aware of the SBA reporting requirement.

Contractor	SBG No.	Bond Default Date	Date SBA Notified
[FOIA Ex. 4 and 6]		September 19, 1998	November 17, 1998

Title 13 CFR 115.65 (c)(2) defines other events requiring notification as follows:

The PSB Surety must notify SBA within 30 calendar days of the name and address of any principal against whom legal action on the bond has been instituted; whenever an obligee has been declared in default; whenever the Surety has established or added to a claim reserve; of the recovery of any amounts on the guaranteed bond; and of any decision by the Surety to bond any such Principal again.

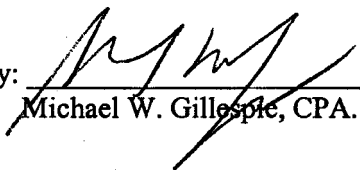
Recommendation: We recommend that the OSG Associate Administrator advise Safeco/First National to continue to enforce its policies and procedures to ensure that SBA receives timely notification of default in accordance with SBA regulations.

Safeco/First National’s Response: Safeco/First National stated that they have reviewed the draft audit report and accept the findings as presented (see appendix).

SBA MANAGEMENT’S RESPONSE

The Associate Administrator, Office of Surety Guarantees, agreed with the recommendations in our draft audit report. He stated that his office will implement the recommendations upon completion of the audit, as appropriate.

COTTON & COMPANY LLP

By: 
Michael W. Gillespie, CPA. CFE

SAMPLE BONDS

Sample No.	Surety Bond Guarantee No.	Safeco/First National Bond No.	Contractor Name	Bond Approval Date	Bond Default Date
1	[FOIA Ex. 4 and 6]				
2					
3					
4					

N/A = Sample bond selected for underwriting review only.

APPENDIX

**SAFECO/FIRST NATIONAL INSURANCE COMPANY
RESPONSE TO THE DRAFT REPORT**



SAFECO SURETY

Adams Building
4634 154th PL NE
Redmond, WA 98052

Phone: (425) 376-6535
Fax: (425) 376-6533
www.safeco.com

Mailing Address:
SAFECO Surety

Shipping Address
Adams Building

February 12, 2002

Mr. Robert Seabrooks
Small Business Administration
Office of Inspector General
Auditing Division, Mail Code 4112
409 3rd Street, S.W.
Washington, DC 20416

Dear Mr. Seabrooks:

I have received the draft audit report on the performance audit of SAFECO/First National as it pertains to their involvement in the SBA Plan B program. The on-site audit was conducted in our offices by representatives of Cotton & Company LLP during the month of November 2001.

I have reviewed this draft audit report and I'd like to advise you that SAFECO and First National accepts the findings as presented, therein.

Regards,

EX. 6

REPORT DISTRIBUTION

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