

**INDEPENDENT ACCOUNTANTS'  
REPORT ON THE PERFORMANCE AUDIT OF  
FARMINGTON CASUALTY COMPANY**

Performed by:

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



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

|                                      |
|--------------------------------------|
| <b>AUDIT REPORT</b>                  |
| <b>Issue Date: February 11, 2004</b> |
| <b>Number: 4-12</b>                  |

**To:** Johnnie Albertson  
Associate Administrator for Surety Guarantees

/S/ original signed

**From:** Robert G. Seabrooks  
Assistant Inspector General for Auditing

**Subject:** Audit of Farmington Casualty Company

Attached is the audit report on Farmington Casualty Company. The audit found that Farmington complied with SBA regulations for underwriting and servicing bonds and for processing claim payments. The audit also found that Farmington correctly calculated and remitted all sample bond fees to SBA in a timely manner.

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. You may, however, release this report to the duly authorized representative of Farmington.

Should you or your staff have any questions, please contact Robert Hultberg, Business Development Programs Group at (202) 205-7577.

Attachment

# COTTON & COMPANY LLP

auditors • advisors

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November 20, 2003

U.S. Small Business Administration  
Office of Inspector General

## BACKGROUND

The Small Business Investment Act of 1958, as amended, authorized the Small Business Administration's (SBA) Surety Bond Guarantee Program 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 for contracts not exceeding \$1.25 million (\$2 million effective January 25, 2001). SBA's Office of Surety Guarantees administers the Surety Bond Guarantee Program.

## OBJECTIVE, SCOPE, AND METHODOLOGY

SBA's Office of Inspector General requested Cotton & Company to conduct a performance audit of Farmington Casualty Company (Farmington). The primary objectives were to determine if:

1. Farmington complied with policies and procedures, including SBA's policies and standards generally accepted by the surety industry in issuing SBA-guaranteed bonds.
2. Claims and expenses submitted to SBA were allowable, allocable, and reasonable.
3. Farmington accurately calculated fees due to SBA and remitted them in a timely manner.

We obtained the universe of bonds for which SBA had paid claims from October 1, 2000, through September 30, 2003. This universe contained 22 bonds, and we selected 3 as sample bonds for review. We also randomly selected 3 additional bonds originally approved in Fiscal Year 2003 for underwriting review only. Thus, our total sample size was 6 bonds (see Attachment) with claims (net of recoveries) totaling \$168,062.77. This represents 10 percent of the \$1,704,639.27 total claim payments (net of recoveries) per SBA's Claim Payment History Reports.

We tested sample bonds for compliance with SBA regulations for underwriting and fees by reviewing underwriting files and Farmington's accounting records. We tested claims incurred under sample bonds from October 1, 2000, through September 30, 2003, by reviewing Farmington's supporting documentation in the claim files and accounting records. We obtained a list of all SBA-guaranteed final bonds from October 1, 2000, through September 30, 2003, and identified contractors with total bonds exceeding \$2.0 million 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 November 2003 at Farmington's offices in Philadelphia, Pennsylvania. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States in 2003.

**FOLLOW-UP ON PRIOR AUDITS**

The scope of our audit did not include following-up on findings and recommendations from previous audit reports.

**AUDIT RESULTS AND RECOMMENDATIONS**

Farmington correctly calculated and remitted all sample bond fees to SBA in a timely manner. Farmington did comply with SBA regulations for underwriting and servicing bonds. Farmington complied with SBA regulations for processing claim payments.

We concluded that management and financial controls were adequate to protect assets and prevent errors and fraud. We concluded that Farmington complied in all material aspects with SBA regulations for obtaining and maintaining documents to support claim payments.

We conducted an exit conference with Farmington personnel on November 20, 2003. They agreed with the audit results. In its response to the draft audit report (see Appendix), Farmington provided invoices and other proofs-of-claim to support all questioned costs.

Very truly yours,

COTTON & COMPANY LLP

[ FOIA Ex. 6 ]

Michael W. Gillespie, CPA, CFE

## Attachment

## SAMPLE BONDS

| Sample No. | Surety Bond Guarantee No. | Farmington Bond No. | Contractor Name | Bond Approval Date | Bond Default Date |
|------------|---------------------------|---------------------|-----------------|--------------------|-------------------|
| 1          | [                         |                     |                 | 2002               | ]2003             |
| 2          |                           |                     |                 | 1998               | 1999              |
| 3          |                           |                     |                 | 1999               | ]2000             |
| 4          |                           |                     |                 | 2003               | N/A               |
| 5          |                           |                     |                 | 2003               | N/A               |
| 6          | [                         |                     |                 | ]2003              | N/A               |

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

**FARMINGTON CASUALTY COMPANY'S  
RESPONSE TO DRAFT AUDIT REPORT**



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January 16, 2004

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

RE: Draft audit report

Dear Mr. Seabrooks:

In response to your letter of January 14, 2003 I enclose a copy of the invoice for the \$363.00 payment to FOIA Ex A That should resolve the missing invoice issue pertaining to that payment.

Please note that the payment of \$255.48 to FOIA Ex. 4 includes not only a percentage of the labor cost (\$216.00) but also a portion of the costs on that invoice (\$39.48). Second, as I explained in my letter of December 5, 2003 to Cotton & Cotton the Legal Guard payment (\$28.83) is a percentage of the larger bill (which we cannot locate) that was allocated to the file. We did however give Cotton & Cotton a copy of the check relating to that allocation.

Finally, I would like to clarify that the findings in the draft audit relate to FOIA Ex. 4 Ex. 4 claims/bonds, not a Farmington Casualty (Travelers) claim/bond as stated in the draft audit. This is an important distinction because Travelers did not acquire the Ex. 4 surety book of business, and therefore claims handling responsibilities, until May 31, 2000.

Thank you for your attention to this matter.

Sincerely,

[ FOIA Ex. 6 ]

Marchelle M. Houston, Esq.

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