



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

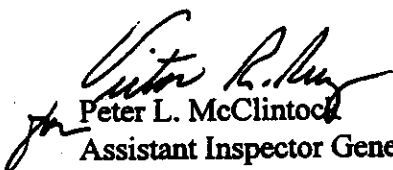
REVISED

AUDIT RELATED MEMORANDUM

Issue Date: September 30, 1997

Number: 7-7-H-006-025

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

FROM: 
Peter L. McClintock
Assistant Inspector General for Auditing

SUBJECT: Fidelity and Deposit Company of Maryland - Claims for

We are conducting an audit of Fidelity and Deposit Company of Maryland (F&D), a participant in SBA's Preferred Surety Bond guarantee program. While we are still conducting the audit, we are bringing a matter to your attention, which we raised with [redacted] and on which [redacted] has agreed to take appropriate corrective action. This memorandum addresses bonds issued by F&D to [redacted].

Finding - [redacted]

[redacted] were Improper

F&D did not follow SBA requirements in the underwriting of the bonds to [redacted]. [redacted] reported the bond issued to [redacted] on an untimely basis. The bond issued to [redacted] did not follow F&D's underwriting standards. On September 4, 1997, F&D stated that they were withdrawing the claims under bond numbers [redacted] for [redacted] and [redacted] for [redacted]. F&D stated they were in the process of verifying the payments made by SBA so the amounts could be refunded. A discussion of each case follows.

FOIA EX 4

On January 11, 1997, F&D executed bond for \$675,000. F&D did not report this bond to the SBA until March 1997. The Preferred Surety Bond Agreement (PSBA) requires the surety to submit bond information to SBA no later than ten business days following bond execution. The PSBA stipulates that SBA will not honor its guarantee on bonds which for the required information is received more than ten business days following bond execution unless specifically agreed upon by SBA. Such agreement will not unreasonably be withheld. F&D did not comply with the reporting requirement of the PSBA, and, under the circumstances, it was not unreasonable for SBA to withhold agreement. As a result, SBA guarantee was inapplicable to this bond on which, as of July 10, 1997, it had reimbursed F&D \$293,950 (see below).

| <u>PSB Number</u> | <u>Claim Number</u> | <u>Amount of Claim</u> |
|-------------------|---------------------|------------------------|
| | Loss Payments | \$392,260 |
| | Loss Expense | <u>28,548</u> |
| | Total | <u>\$420,808</u> |
| | SBA Share (70%) | <u>\$294,566**</u> |

**SBA has reimbursed F&D \$293,950.

F&D approved bond for \$629,582 without following their underwriting standards. F&D underwriting standards required, among other things, an evaluation of the (1) reasonableness of the cost and feasibility of successful completion of the project, and (2) contractor's experience and record of past performance for projects of similar scope, size and complexity to the bonded project.

F&D's underwriting files showed that the contractor had completed a larger project. Further analysis of this data would have showed, however, that substantially all of the work was performed by a bonded subcontractor. Also, there was no evaluation on the feasibility of successful completion of the project and the reasonableness of the cost, which appeared necessary because the award bid was significantly lower than the other bidders. (bid \$629,200. The closest bid was 17.4 percent higher and 6 of the 12 bids exceeded \$1.1 million.) After the default, F&D's independent surety claims consultant stated that it appeared the contractor was unable to complete the project at the bid price. The consultant estimated the cost to complete the project approximated \$1.1 million. As a result, SBA guaranteed an ineligible bond for and reimbursements to F&D would approximate \$639,926 (see following calculation).

FOIA Ex 4

| <u>PSB Number</u> | <u>Claim Number</u> | <u>Amount of Claim (as of 5/31/97)</u> | |
|-------------------|---------------------|--|--------------------|
| | | Loss Payments | \$654,170 |
| | | Loss Reserve | 10 |
| | 001785 | Loss Payments | 153,354 |
| | | Paid Expense | 4,833 |
| | | Loss Reserve | 96,646 |
| | | Expense Reserve | <u>5,167</u> |
| | | Total | <u>\$914,180</u> |
| | | SBA Share (70%) | <u>\$639,926**</u> |

**Of this amount, SBA has paid F&D \$572,992.

Recommendation

We recommend that the Associate Administrator, Office of Surety Guarantees, (1) ensure that the payments made to F&D are promptly and accurately refunded and (2) cease all future claim payments on these bonds.

Management Comment

The Associate Administrator, Office of Surety Guarantees, verbally agreed with our recommendation.

Supplementary Data

On December 10, 1997, F&D fully refunded the payments to SBA and no further actions are required.

* * * * *

The findings included in this report are the conclusion of the Office of Inspector General's Auditing Division based on testing of the auditee's operation. **The findings and recommendation 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 Form 1824, Recommendation Action Sheet. Should you or your staff have any questions, please contact Victor R. Ruiz, Director, Headquarters Operations, at (202) 205-7204.

Attachment

AUDIT REPORT DISTRIBUTION

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