



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

**AUDIT REPORT**

**Issue Date: September 10, 1999**

**Number: 9-20**

TO: Robert J. Moffitt, Associate Administrator, Office of Surety Guarantees  
[Ex. 6 ]  
FROM: John E. Dye, Acting Assistant Inspector General for Auditing  
SUBJECT: Audit of Bankers Insurance Company SBA Guaranteed Bonds with  
Georgia Coastal Construction Group

**BACKGROUND**

At the request of the Associate Administrator, Office of Surety Guarantees, we completed an audit of a SBA guaranteed payment and performance bond (SBG number [Ex 2 ] Bankers Insurance Company's (Bankers) independent agent, The Surety Group (the agent), issued the bonds to Georgia Coastal Construction Group (Georgia Coastal), a subcontractor under Beers Construction Company (Beers). Beers allowed Georgia Coastal to start work before bonding. Since work had started prior to bond execution, SBA required certification from Beers on SBA Form 991 that the work to date was satisfactory. Approximately four months after the SBA guaranteed bonds were issued, Georgia Coastal's subcontract was terminated because of performance problems. An investigation by Bankers found that the general contractor had improperly certified that Georgia Coastal was performing satisfactorily and an arbitrator discharged the surety's liability under the bonds based partly on the improper certification. Relief for the legal and consultation expenses incurred by the surety related to the arbitration, however, was not granted. Bankers then submitted a reimbursement claim to SBA for a portion of the expenses based on the guaranteed percentage of the bonds.

**AUDIT OBJECTIVE AND SCOPE**

The audit objective was to determine if Bankers complied with SBA's policies and procedures in originating the bonds and if SBA, therefore, was liable for the legal and consultation expenses incurred by the surety. The audit scope was limited to a

review of Bankers' origination procedures on the bonds because the Associate Administrator believed the expenses would otherwise be allowable. We reviewed Bankers' files and interviewed SBA and Bankers' representatives. Fieldwork was performed from April 1999 to July 1999. The audit was conducted in accordance with Government Auditing Standards.

## RESULTS OF AUDIT

Bankers complied with SBA's policies and procedures in applying for the bond guarantees, except for two omissions. Consequently, Banker's underwriting of the bonds would not have precluded SBA's approval of the bond guarantees or liability for its share of the legal and consultation expenses incurred by the surety.

- The agent's files showed no record of a credit evaluation when the bond was underwritten. Title 13 CFR 115.32(a) requires an evaluation of the principal's credit during underwriting to assure a reasonable expectation that the principal will perform the contract. Bankers stated they expect the agent to evaluate credit using prudent underwriting standards. Bankers also stated that they pull credit reports on bonds within the agent's underwriting authority after bond approval. The credit report pulled by Bankers showed the individual indemnitors had some charge-off and collected accounts. A Dun & Bradstreet report on the business showed slow payments. Bankers had informed the agent that Georgia Coastal must exhibit good credit for at least one year prior to consideration for a non-SBA bond. Although a credit evaluation should have been performed during underwriting, Bankers stated that the bonds would have been approved if the credit reports were available.
- The agent's files had no record of contact with job references to determine the level of performance on four completed jobs listed by Georgia Coastal on its bond application. The auditors found that Beers had terminated the contractor on a portion of one of the completed contracts. Title 13 CFR 115.32(a) requires a surety to evaluate the capacity of a contractor in accordance with generally accepted standards of the surety business. Introductory Principals of Suretyship: Underwriting Construction Accounts, published by the American Surety Association, states that a surety has an obligation to determine the prior performance of the principal. Bankers stated that it is standard practice to obtain reference checks on completed projects. The agent stated that Beers was contacted for the required SBA Form 991 certification on the current contract and as they were one of the obligees on the completed contracts listed by Georgia Coastal, they would have disclosed any performance problems. The certification completed by the obligee did not disclose any performance problems on the current contract or completed contract. The auditors, however, determined that the project manager that the agent contacted was not the same project manager for the completed contract.

## **Recommendations:**

We recommend that the Associate Administrator, Office of Surety Guarantees,

- 1A. Notify Bankers to revise its underwriting procedures to have its agents evaluate credit within the agent's authority in the same manner as SBA bonds that require Bankers' approval prior to submission to SBA.
- 1B. Notify Bankers to contact obligees on prior completed contracts to determine the contractor's prior performance.

## **SBA Management's Response and OIG Evaluation**

The Associate Administrator, Office of Surety Guarantees, agreed to implement our recommendations. The comments provided by the Associate Administrator are responsive to our recommendations.

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The findings included in this report are the conclusions of the Office of Inspector General's Auditing Division. **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 decisions for the recommendations within 80 days on the SBA Forms 1824, Recommendation Action Sheet. If you disagree with a recommendation, please provide your reasons in writing.

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Should you or your staff have any questions, please contact Victor R. Ruiz, Director, Business Development Programs Group at (202) 205-[Ex 2]

Attachment

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