

## SURETY SECRETS: WHAT TO PRESENT TO YOUR SURETY

In general, a surety company would favorably review a submission that contained material allowing it to make a complete review of the finances and business operations of the applying contracting company. Smaller contractors, who have needs for smaller bonds, do not need to be as thorough as larger, more complex contractors with more complex entity interrelationships.

### *Information needed for bond submission*

**Financial statements:** The bond companies require at least review-quality CPA-prepared financial statements prepared in accordance with generally accepted accounting principles, using percentage of completion revenue recognition, prepared as of fiscal year-end, for the last four or five years. Audited financial statements are preferred.

The statements must have schedules of work in progress, showing overbillings and underbillings that foot to the items shown on the balance sheet. The statements must also contain a schedule of completed contracts so that the gross profits shown on that schedule and the work-in-process schedule foot to the gross profits shown on the income statement. The statements must contain a reconciliation of the equity section, a statement of cash flows, a schedule of general and administrative expenses, and a schedule of construction costs.

The standard of disclosure should be very high, so that if an analyst has a question on any number in the financial statements, it will be answered by the notes.

Bond companies prefer an aging of accounts receivable and accounts payable as of statement date, as well as, on reviewed-quality financial statements, a schedule of cash.

**Personal financial statements:** All stockholders should prepare, as of fiscal year-end, personal financial statements in support of the corporation. In the preparation of personal financial statements it is important that all mortgage balances, bank accounts, credit card bills, loans to family, auto loans, etc., be reported exactly.

It is particularly important in the preparation of personal financial statements that any financial interactions with the corporation be shown exactly on the corporate statement and the personal statement, so that they will cross-relate.

**Organizational chart:** The bond company likes to know how the company is organized. An organizational chart, detailing functions and responsibilities of each employee, is very useful.

**Resumes:** Resumes on key employees in the contracting organization are very helpful. Resumes should be prepared to show each person's experience, growth in responsibility, and accomplishments.

**Cost accounting system:** A brief two-paragraph description of the contractor's cost accounting system tells the bond company a great deal about the management of the construction firm. Areas that should be covered include:

- The fact that the cost accounting system is integrated with the general ledger;
- How labor burden and other indirect costs are costed into jobs;
- How equipment costs are costed into jobs; and
- A confirmation that the costs are kept exactly the same way as the job is bid. The bond company will also appreciate comments concerning how pay item unit costs or CSI breakdown costs are displayed next to the budget, to demonstrate how management decisions in running the job are made.

**Bank relationship:** A letter from the contractor's bank outlining the depository relationship as well as any credit relationship is very helpful. In describing the credit relationship, the bank should disclose the amount of credit that is available to the contractor, how that credit is available to the contractor, and how that credit is secured by the bank. Copies of the note and the security agreement are also helpful.

**Corporate continuation:** Many contractors have "buy and sell" agreements and, if available, are very helpful to the bond company. "Buy and sell" agreements are traditionally funded by life insurance policies.

A complete description of that policy should be provided to the surety. Often in cases where buy and sell agreements are not appropriate, corporately owned life insurance will operate as a stopgap measure. In describing the life insurance that the corporation owns on a stockholder, the following information should be developed:

- Insurance company and policy number;
- Policy amount and plan (term, ordinary whole life, universal life, etc.); and
- Owner and beneficiary.

**Corporate plan:** Many contractors have a formal strategic plan. In the absence of such a plan, a brief report detailing where the construction firm is, where it is going, and the plan to get there is very helpful to the bond company.

**Corporate history:** The history, growth, and development of the contracting firm tell a powerful story to the bond company. Some care should be used in developing the corporate history so that it shows the construction firm at its best.

**Work history:** A list of the larger contracts that have been completed by the construction firm, by itself, tells an important story. In developing this list, describe the job, and include completion date, owner's contact information, and contract price.

**Credit references:** A list of the larger suppliers is a very helpful tool. When developing this list, show the name of the supplier, credit manager, address and phone number, and an indication as to the approximate amount purchased from that supplier each year.

In preparing this material for the bond company, remember that you never get a second chance to make a good first impression. Attention to professionalism is a very important ingredient.

Each surety company also requires a contractor's questionnaire. An industry-standard contractor questionnaire is available from the National Association of Surety Bond Producers (NASBP). Please call (202) 686-3700.

It should be noted that information developed on the questionnaire, and in the accumulation of materials, only starts the reviewer on his or her appraisal. This information will allow the surety bond underwriter to pinpoint what is not known and allow for development of the additional information needed for personal interviews with the contractor.

An experienced surety bond producer will be able to "pre-ask" most of those questions that become apparent from review of the material so that when the contractor meets with the surety company underwriter, most of the conversation will be a review of the material presented.

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