How To Get A Bond?

The Surety & Fidelity Association of America

Serving the Industry Since 1908

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www.surety.org

How To Begin

Because most surety companies distribute surety bonds through the agency system, the first step is to contact a professional agent or broker, also known as a surety bond producer, who specializes in contract surety. A professional surety bond producer guides the contractor through the bonding process, helps establish and foster a business relationship with a surety company, and assists in managing the contractor's surety capacity.

A professional surety bond producer can offer sound business advice and technical expertise, such as contract document review. The producer can introduce the contractor to other professionals or consultants when appropriate.

After meeting with the contractor and gaining an understanding of the firm's business and needs, the producer tailors the contractor's submission for the specific requirements of the surety company. The producer then submits the account to a surety company best matched to the contractor's profile and needs. It is important to recognize that all surety companies are not the same. For example, some specialize in large contractors, some in middle markets, and others in emerging contractors. If necessary, the producer can guide the contractor through a formal presentation and meeting with the surety company. The producer is an essential link between the contractor and the surety company and should maintain communications with both.

Bond Rates

Surety bond premiums vary from one surety to another, but can range from 0.5% to 3% of the contract amount, depending on the size, type and duration of the project and the contractor. Typically, there is no direct charge for a bid bond. In many cases, a performance bond incorporates the payment bond and a maintenance period.

The contractor includes the bond premium amount in the bid and the premium generally is payable upon execution of the bond. If the contract amount changes, the premium may be adjusted for the change in contract price. Contract surety bonds are a wise investment— protecting public owners, private owners, lenders, and prime contractors from the potentially devastating expense of contractor and subcontractor failure.

Availability of Surety Bonds

Surety bonds are available to contractors of all sizes. It is true that not every contractor has the credit history, experience, and financial capacity to obtain bonds or may not qualify for as much bonding as it might wish. Nevertheless, it is the intent of the surety bond industry to judge all applicants for bonding on their merit regardless of size.

In fact, a number of surety bond companies specialize in marketing bonds to small contractors. In addition, several major surety bond companies have initiated programs to bond more small contractors. Many surety bond companies have designed special strategies that encourage their producers and underwriters to seek small contractor business.

Many surety companies offer fast-track programs designed for small or emerging construction contractors that are just getting into public bidding and have smaller surety bond needs. The application process is simplified and requirements for obtaining a bond are less stringent through these programs.

Government also is playing a role in making surety bonds available. To maximize the opportunities for small contractors that want to take on bonded work, the federal government and some of the states have implemented special programs to enable surety bond companies to write bonds for small contractors that do not qualify for bonds under the companies' normal underwriting standards.

Since the early 1970s, the Small Business Administration (SBA) has operated its Surety Bond Guarantee Program, which provides surety bond companies with partial repayment against loss stemming from bonds they would not normally provide. With the help of the SBA program, small contractors have performed more than $1.4 billion of contracts per year as of FY 2017.

SBA
U.S. Small Business Administration

Financial Statements

Depending on how long the contractor has been in business, the surety will request fiscal year-end statements for at least the past three years and may require a financial statement audited by a certified public accountant (CPA). Financial statements typically include the following:

- Accountant's opinion page—discloses whether the statements were prepared according to audit, review, or compilation standards.
- Balance sheet—shows the assets, liabilities, and net worth of the business as of the date of the statement. This helps the surety company evaluate the working capital and overall financial condition of the company.
- Income statement—measures how well the business performed. The surety analyzes each item, including gross profit on contracts, operating profit, and net profit before and after tax provisions.
- Statement of cash flow—discloses the cash movements from operating, investing, and financing activities.
- Accounts receivable and payable schedules— should reflect aging.
- Schedules of contracts in progress and contracts completed—show the financial performance of each contract and provide insight into the potential for future earnings from contracts in progress. This should tie into the balance sheet.
- Schedule of general/administrative expenses— may reveal how well overhead expenses are controlled and managed.
- Explanatory footnotes—qualifications made by the accountant.
- Management letter—conveys the CPA's findings, observations, and recommendations about the contractor's business. Not all CPAs provide management letters.

Quality of Financial Statements

Financial statements are only as good as the accountant preparing them. That is why it is important to select a CPA who is knowledgeable about construction accounting and the American Institute of Certified Public Accountants' Audit Guide for Construction Contractors. Sureties prefer, and at certain levels require, audited fiscal year-end statements, but there are occasions when a surety may accept a review or compilation statement.

An audit verifies relevant items in the financial statement with internal and external investigations of their accuracy. The accountant certifies that the financial statement is presented in accordance with generally accepted accounting principles.

A review statement, which does not require the outside verification present in an audit, consists principally of a thorough review of the contractor's financial records and the application of certain analytical procedures to the financial data. Although narrower in scope than a full audit, the review does provide some limited assurance about the financial statements.

A compilation, however, provides little or no assurance of the credibility of the figures presented and would typically be accepted only for interim statements. In general, statements prepared by the contractor's staff are not acceptable to sureties because they are difficult to verify and lack the approval of an independent auditor. While sureties may offer modest programs based on review or compilation statements, audited financial statements are most often required, especially for larger work programs.

Accounting Methods

Complete and accurate accounting systems are extremely important to surety companies. The American Institute of Certified Public Accountants' (AICPA) Audit Guide for Construction Contractors recommends the percentage-of-completion accounting method, which is also preferred by most sureties. The percentage-of-completion method best represents a contractor's financial condition and most accurately measures results of work performed during the accounting period. The percentage of contract values recognized as revenue typically is done on a cost-to-cost percentage-of-completion method.

Depending on the time elapsed since the last fiscal year-end statement, the surety may ask for an interim financial statement every three or six months to show how the current year is progressing. Contractors also need to prepare a quarterly schedule of work in progress. This schedule should list each job by name and include:

- Total contract price
- Approved change orders
- Amount billed to date
- Cost incurred to date
- Revised estimate of the cost to complete
- Estimated final gross profit
- Anticipated completion date

The format of this exhibit and the amount of information required varies among surety companies and almost always is required in connection with the full CPA reports.

Role of a Surety Bond Producer

Most surety bonds are issued through surety bond producers (or agents) who are knowledgeable about the surety and construction industries. Surety bond producers work in agencies that specialize in surety bonds or in insurance agencies that have a sub-specialty in surety bonds. The professional surety bond producer maintains a business relationship with several surety companies, which enables the producer to match a contractor with an appropriate surety company.

The surety bond producer assists a contractor in obtaining surety bonds, and provides business advice, management consulting, and technical expertise. The producer is an integral part of the contractor's external advisory group, which may also include attorneys, lenders, and CPAs. By using specialized knowledge of the construction industry, the producer assists the contractor in preparing for the surety company's rigorous prequalification process. A good surety company and surety bond producer can help a contractor maintain and increase its surety capacity.

Contact information for producers specializing in surety bonds can be obtained from the **National Association of Surety Bond Producers (NASBP)**, (202) 686-3700; **www.nasbp.org**. NASBP members adhere to professional standards that demonstrate professionalism, expertise, and innovation in surety bonding.

Surety Company Underwriter

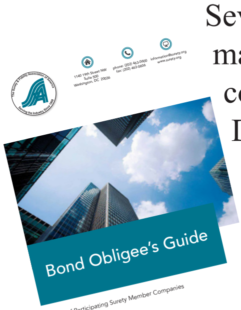
Once the surety bond producer collects all the necessary information, he or she submits it to a surety company underwriter. The underwriter takes an in-depth look at the contractor's entire business operations and must be satisfied that the contractor is capable of completing the project.

The underwriter may request a meeting with the contractor to form his or her opinion and obtain additional information. For example, the underwriter may want more information on the single job size and aggregate workload for all projects, bonded or not, in the contractor's current and projected work program. If the contractor wants to bid on a larger-than-usual project, the underwriter will want to know whether it is prudent for the contractor to undertake it from a risk/reward standpoint, how it fits into the current work program, how the project will be financed, and a projection of the return.

Although it may seem as if surety underwriters focus on the contractor's finances and financial structure, they are also interested in other elements of the contractor's business.
The contractor's organization, track record, and approach to a job, once established, are not generally questioned with frequency if the contractor's results are consistent. However, should there be significant changes in ownership or key personnel or the contractor decides to move into a different type of construction or geographic area, this information should be shared with the surety along with any other changes in the contractor's capabilities or the way the contractor conducts business.

The contractor's financial situation fluctuates from day to day, from job to job, and consequently is the area that is subject to the greatest scrutiny. When applying for bonds, the contractor must be aware that, once the surety is satisfied as to the technical ability to perform, it will then review the financial results of performance and translate that into a decision on the firm's present and future ability to pay bills, finance additional undertakings, and accept or mitigate risk. The numbers are the scorecard that tells all parties how well the contractor is performing.

Verify Your Bond



Several resources are available to ensure your bond is from a legitimate source. You may contact your state's insurance department to verify that the surety is a legitimate company, licensed to issue surety bonds in that state; you may review the U.S. Department of Treasury's List of Approved Sureties Department Circular 570 (for federal projects); and you also may verify the strength of the surety company through a private company such as A.M. Best, which issues financial strength ratings that measure the company's ability to pay claims. Furthermore, The Surety & Fidelity Association of America has a Bond Obligee Guide, designed to serve those that want to verify the authenticity of the surety bonds presented to them. SFAA also provides a Bond Authenticity Model Inquiry Form on its website. You should undertake these steps to verify your bond protection early, preferably before signing the contract.

Maintain the Surety Relationship

To maintain and increase surety capacity, it is important for a contractor to develop and maintain an ongoing relationship with the underwriter and producer. Developing a relationship requires commitment, trust, and, above all, communication. Maintaining the relationship through open communication and timely reporting on the company's financial condition and job status builds trust with the surety.

Maturing into a growing partnership requires teamwork and an organized effort among the contractor, the surety underwriter, and the surety bond producer. There may be difficult times, and the surety may not always be willing to extend the surety capacity the contractor would like, but maintaining a relationship with the surety company builds trust and increases the surety's commitment to the contractor over time.

Even after all the information is provided to the surety, there is no guarantee it will result in approval. The bond will be approved only if the surety is confident the con- tractor is qualified to perform the contract and work program successfully and has the financial capacity to withstand the numerous risks involved in the construction business. The decision to seek surety bonds should be based on long-term considerations. To obtain bonds, some changes in the way a contracting firm does business may be necessary, and these changes could have associated costs and benefits.

Commitment

The surety company expects the contractor to perform its contractual obligations under the bond. Surety companies usually require a demonstration of commitment from the construction company's owners through personal and/or corporate indemnity.

The indemnity agreement obligates the named indemnitors to protect the surety company from any loss or expense incurred by the surety on behalf of the contractor. For example, these losses and expenses caused by the contractor's failure to fulfill its bonded obligation on the project are recoverable under the indemnity agreement. This gives the surety company some assurance that the contractor will stand fast in the face of problems and use its talent and financial resources to resolve any difficulties that may arise in the performance of the bonded work.

Surety companies stand behind the commitments undertaken by a contractor through a bonded contract. The contractor is primarily responsible to fulfill the contract's obligations and the surety's obligations are secondary to the contractor's. Surety bond premiums are service fees for the surety's expertise, underwriting services, and financial backing.

After the bonds are written, the surety continuously evaluates the overall performance and financial position of the contractor. Adverse changes may cause the surety to reduce or terminate the bonding program, whereas positive results may serve as the basis for an increase in surety capacity.

Surety and fidelity bonds: Protecting consumers, taxpayers and businesses.

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