How a Good Construction CPA Can Help Contractors Obtain More Surety Credit

By Emilio Alvarez

Sureties are almost always the largest extenders of credit to construction contractors. This credit—always open-ended, and in many cases unsecured—is reserved for those who meet certain criteria, such as presenting complete and accurate financial information on a timely basis.

Financial Statements
A contractor’s financial statements should be prepared in compliance with the American Institute of Certified Public Accountants’ Statement of Position 81-1 and should include job schedules for completed and in-progress contracts.

These financial statements are only as good as the credibility and reputation the preparer has with the surety with regard to honesty in presentation, knowledge of the construction industry and the Generally Accepted Accounting Principles for construction contractors. This additional level of competence is the greatest contribution a good construction CPA makes to clients in the process of obtaining surety credit.

Bonding Discipline
Along with the financial statements, a CPA can help a contractor increase surety capacity by emphasizing bonding discipline. It is not very popular to tell a contractor to leave the profits in the company or to refrain from pursuing endeavors that sureties feel may be conducive to problems. Even more difficult is telling a contractor not to make purchases that would consume badly needed working capital.

For example, in a 5 percent bonding scenario, $1 of profit left in the company (as opposed to distributing it to the stockholder) produces $20 of additional bonding availability that, if moved one and a half times in a year, produces $30 of additional work. At 10 percent gross profit, this produces an additional $3 of profit.
Nowhere can a contractor get a better deal than in the opportunity to invest in and triple the money in a year.

**CASH FLOW**
Cash flow is king. Accordingly, a CPA should advise a contractor on cash flow issues, from the collection of receivables to the advantages of a schedule of values that allows for money to flow in faster. Poor cash flow usually signals the beginning of trouble.

The issue of cash flow ties directly to underbillings, and a CPA’s assistance in detecting and understanding the possible causes of the underbillings, their effect on cash flow and the available solutions, is invaluable. And, the proper presentation of the underbilled situation is extremely important to the surety in its underwriting efforts.

Contractors that need large amounts of equipment find themselves in the situation in which renting the equipment may not make financial sense and purchasing it uses up working capital that forms the foundation for bonding capacity. Advice and guidance on how to finance this transaction so the largest portion possible is long-term debt and not part of the computation of working capital is another instance when CPAs are instrumental in assisting their clients in obtaining more surety capacity. This is true not just in the purchasing of new equipment, but also in the refinancing of existing equipment to convert the equity in the equipment into working capital.

Although the goals of the contractor’s bank and surety may sometimes appear mutually exclusive, providing detailed information to both parties and disseminating information on a contractor’s financial statements increase the probability of more adequate lines of credit which, in turn, facilitates more surety capacity.

**TAXES**
Another area of opportunity for a CPA to assist a contractor in obtaining additional surety capacity is taxes. Under certain circumstances, contractors can use methods of revenue recognition that allow companies to postpone paying income taxes while maintaining the percentage-of-completion method of revenue recognition for financial statement purposes. This postponement can provide additional, although temporary, cash flow and provide the basis for some additional surety credit.

**CONTINUITY PLAN**
Sureties also need the reassurance that, if anything happens to the owner who is indemnifying them, then a plan of continuity exists whereby others complete all the work in progress without any interruptions. Construction CPAs, working with the contractor’s attorney, get involved in the production of the continuity plan.

In the end, successful contractors treat their sureties as partners, and the CPAs that play a role in the process help their clients obtain the maximum surety credit.

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