# Contractors Surety Briefing for 2011

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# Surety Industry Status

- Fortunately, the financial challenges of 2008, 2009 & 2010 have not visibly impacted the Surety Industry as they have the Banking Sector
- Continued profitability and strong balance sheets are demonstrated by the major Surety players
- Concerns of a sluggish construction recovery and the trickle down impact

# What Drives Your Bonding Capacity?

- Protecting the strength of your balance sheet
- Real Working Capital vs. Synthetic Working Capital
- Expect discounting of your 90 day receivables
- Debt to Net Worth:
  - What percentages are now acceptable?
  - Sureties are very interested in your banking relationship
- Equity Management in this economy:
  - Conservative distributions
  - If unprofitable, pressure for NO distributions

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# Communicating Your Financial Condition

- Surety support requires their understanding of your business objectives relative to your resources and constraints
- Timely Interim Financials, clean and accurate
- Utilize a Construction-Oriented Accounting Firm:
  - Timely delivery and discussion of your Financial Statements
- Discuss with your Surety Agent how the Surety companies might respond to dividends, stock re-purchases or changes in the capital structure

# Surety Manager Discussion Topics

- Your interim balance sheet and the profitability in your backlog makes your bonding capacity possible
- Communicate early as you explore:
  - New geography
  - Labor markets
  - New niches
  - New technology
  - Business risks (energy)
  - Construction challenges
- Firms bidding work without adequate consideration of:
  - Depreciation
  - Overhead

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# Warranty Bonding Issues

- Warranty requirements of 5-7 years have created the following concerns:
  - Most Sureties don't have reinsurance beyond (5) years, therefore, only the strongest contractors will be allowed to bid with any degree of frequency
  - A build up of warranted work creates a contingent liability that could compromise the contractor
  - Are your financials strong enough?

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# Warranty Bonding Issues

Continued..

- What is being bonded?
  - i.e. top surface of asphalt, $ amount or % of cost
- What is the warranty review process to be utilized by INDOT?
- Ohio has stopped requiring (7) year bonds

# Accounting Issues of Concern

- How will historical profit-fade be applied to your backlog's forecasted profit?
- How will your historical collection success be applied to the 90 day or older receivables?
  - Can your Project Owner pay?
- Leasing arrangements and the impact on your net worth
- Multi-Employer Pension Liabilities:
  - Will FASB/IFRS force contractors to post or disclose a withdrawal/terminal liability accrual, years ahead of the actual event?

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# Performance Obligation Accounting vs. Percentage of Completion Accounting

- The good news is implementation has been delayed and the comment period has been expanded
- Simply stated, Performance Obligation Accounting delays the matching of revenue and expense until you can turn over a completed obligation to the customer
- Few contracts lend themselves to distinct start & stop obligations
- Instead, most contractors utilize efficiencies, optimization techniques and economies of scale to blend numerous obligations into a completed project

# Performance Obligation Accounting vs. Percentage of Completion Accounting

Continued…

- If the performance obligation is **<u>only</u>** satisfied when the transfer occurs, many in this room would not recognize profitability until the contract is fully completed
- We believe the majority of Banks and Sureties would require the utilization of Performance Obligation Accounting **<u>and</u>** retain Percentage of Completion Accounting:
  - Determine profitability on work completed
  - Determine the forecasted profitability in the uncompleted backlog



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