

The Importance of Financial Statements

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Many contractors dread putting together and maintaining financial statements. The process can be time consuming and expensive but it is vital for a contractor that will be performing bonded work. We have put together information to help a contractor understand what information needs to be included and to help determine what scope of engagement is for their business

Scope of Financial Statements

Internally Prepared Statements or "In House"

Every contractor should have the ability to produce in house statements. In reality, contractors needing bonds \$300,000 or less will likely not need to provide any statements. For smaller bonds \$500,000 and under, the bond company may only require in house statements to write the bond. On larger bonds, the underwriter will typically request in house statements if it has been more than 6 months since CPA prepared statements have been completed. For the construction industry, there are many software packages that can be used but at a minimum, the statements should contain the following:

- Balance Sheet
- Income Statement (sometimes referred to as Profit and Loss or P&L)
- Schedule of Contracts in Progress
- Schedule of Completed Contracts
- An Accounts Receivable Aging

We will discuss what these mean and their importance later in subsequent articles.

CPA Prepared Statements

Compilation Statements (Compilations)

Many bond companies will write bonds up to \$1 million dollars with a compilation statement and some will go even higher depending on the contractors' other strengths. A compilation uses data provided by the business owner and puts them into financial statement format. It expresses no statement of assurance from the CPA. The chief advantage of these statements is that the cost for obtaining a compilation is much less. Infrequent bond users and contractors that do not need larger bonds will find compilations advantageous

Reviews

A Review is appropriate for many contractors looking to obtain bonds between \$1 million to \$5 million. Reviews consist of performing analytical procedures and inquiries that are aimed at expressing assurances that the financial statements conform to Generally Accepted Accounting Principles (GAAP). A review does not include consideration for internal controls and does not express an accountant's opinion. Many frequent bond users and midsized contractors select reviews because it is the minimum level of engagement accepted by many bond companies.

Audit

An audit is the scope of engagement preferred by bond companies. During an audit, a CPA performs analytical reviews, test balances and procedures, looks at the contractor's internal controls, etc. The audit also involves verifying amounts with outside parties such as banks, suppliers, contract holders and management. An audit is significantly more detailed than a review and provides outside parties with more confidence in the financials. As such, an audit is more expensive than a review or compilation. Larger contractors, heavy bond users and contractors looking to increase their bond capacity should consider getting an audit.

Scope of financial statement selection is an important decision to every contractor who is doing bonded work. For most contractors the goal is to be able to have the bond capacity that they need while keeping their expenses low. As you can see, there is no single solution for every contractor and this decision should be discussed with your bond agent and CPA.