

CONTRACTOR FINANCIAL STATEMENT GUIDE

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This guide explains how surety underwriters evaluate contractor financial statements. Whether you are preparing for your first bond application or working to grow an existing program, understanding what the surety sees when they open your financials will help you present your business in the strongest possible light. Share this guide with your CPA so they understand what the surety needs.

THE FOUR FINANCIAL METRICS SURETIES CARE ABOUT MOST

1. Working Capital

Current assets minus current liabilities. This is the starting point for most bonding capacity calculations. Many sureties use a working capital multiplier, typically 10x to 15x, to set your aggregate bonding limit. A contractor with \$500,000 in working capital might receive \$5 million to \$7.5 million in aggregate capacity. Growing working capital is the most direct path to higher bonding limits.

2. Net Worth

Total assets minus total liabilities. The surety uses net worth as a measure of long-term stability and as a backstop against losses. Growing net worth, driven by retained earnings rather than asset revaluation, signals a healthy business that is building equity over time.

3. Profitability

Consistent profitability demonstrates that you can estimate accurately, manage costs, and operate efficiently. One bad year can be explained with context. Two consecutive loss years is a serious red flag that will limit capacity or trigger a full program review by the surety.

4. Cash Flow

The surety looks at actual cash movement, not just reported profits. A contractor can be profitable on paper but cash-poor if receivables are slow, retainage is high, or overbillings are masking cash flow problems. Strong operating cash flow gives the surety confidence in your ability to fund bonded projects.

FINANCIAL RATIOS SURETY UNDERWRITERS CALCULATE

Current Ratio (Current Assets / Current Liabilities)

Measures short-term liquidity. A ratio above 1.0 means you have more current assets than current liabilities. Most sureties want to see 1.2 or higher. Below 1.0 is a red flag.

Debt-to-Equity Ratio (Total Liabilities / Net Worth)

Measures leverage. Lower is better for bonding. A ratio above 3.0 signals heavy leverage that reduces the financial cushion available for bonded work. Below 2.0 is generally favorable.

Revenue-to-Working-Capital Ratio

Measures how efficiently you are using your working capital to generate revenue. If this ratio is too high, the surety may conclude you are growing faster than your financial base supports, which increases risk.

Backlog-to-Working-Capital Ratio

Measures how much uncompleted work you are carrying relative to your working capital. A high ratio suggests you may be overextended. The surety uses this to evaluate whether your current workload is sustainable.

CPA ASSURANCE LEVELS AND THEIR IMPACT ON BONDING CAPACITY

Compiled Statements

The CPA organizes and formats your financial data but does not independently verify it. The lowest level of assurance. Acceptable for small bond programs, typically up to \$500,000 to \$1 million in single job capacity.

Reviewed Statements

The CPA performs analytical procedures and inquiries that provide limited assurance the financials are free of material misstatement. The standard for mid-size programs, generally \$1 million to \$5 million in single job capacity. This is where most growing contractors should be.

Audited Statements

The CPA performs detailed testing and verification. The highest level of assurance, required for large programs. Audited financials carry the most credibility and support the highest capacity. If your program is growing and you are still on reviewed statements, discuss the transition with your CPA and bond agent.

Key Takeaway:

Moving from compiled to reviewed, or from reviewed to audited, is one of the most impactful changes you can make for your bonding capacity. The cost of the higher assurance level is almost always justified by the increase in bonding capacity it supports.

THE TAX MINIMIZATION VS BONDING CAPACITY TRADEOFF

This is one of the most important conversations you can have with your CPA. Aggressive tax minimization strategies that reduce reported income and equity can directly limit your bonding capacity.

The surety underwrites based on what your statements show, not what the numbers could have been under different accounting treatment. If you have structured your financials to minimize taxable income through accelerated depreciation, maximized deductions, or other legitimate strategies, the reported numbers may not reflect your true financial strength.

This does not mean you should pay more taxes than necessary. It means your tax strategy and your bonding strategy need to be considered together. A contractor who saves \$50,000 in taxes but loses \$2 million in bonding capacity has not made a good tradeoff.

Best Practice:

Have your CPA, your bond agent, and you sit down together before year-end to discuss how tax decisions will affect your bonding capacity. This three-way conversation produces better outcomes than making tax decisions in isolation.

WHY PERCENTAGE-OF-COMPLETION (POC) ACCOUNTING MATTERS

Sureties strongly prefer percentage-of-completion accounting for contractors with bond programs. Under POC, revenue and costs are recognized proportionally as work progresses, giving the surety the most accurate picture of your financial position at any point during the year.

Cash basis and completed-contract methods can create significant distortions. A contractor who completes a large project in December but does not receive final payment until January will show very different numbers depending on the accounting method. POC smooths these distortions.

If you are on cash basis or completed-contract and your bond program is growing, transitioning to POC is one of the most impactful recommendations your CPA can make. The transition requires planning, particularly around the work-in-progress schedule that drives POC revenue recognition, but the bonding benefit is substantial.

COMMON FINANCIAL STATEMENT ISSUES THAT LIMIT BONDING CAPACITY

Excessive owner distributions.

Taking too much profit out of the business reduces retained earnings, working capital, and net worth. The surety sees a business that is not retaining the capital needed to support bonded work.

Aged receivables.

Receivables over 90 days are often discounted or excluded from the working capital calculation. If a significant portion of your receivables are old, your effective working capital is lower than it appears.

Excessive overbillings.

Billing significantly ahead of work completed suggests you are using project funds to finance operations. This is one of the most common red flags on a contractor's financial statements.

Inconsistent profitability.

Wide swings in profitability from year to year signal estimating problems or poor cost management. Sureties prefer a steady upward trend over a boom-and-bust pattern.

Related-party transactions.

Loans to officers, transactions with related companies, or intercompany balances create questions for the underwriter. If these exist, make sure they are clearly disclosed and easily explained.

Late financial statement delivery.

Sureties expect year-end financials within 90 to 120 days of your fiscal year end. Consistent late delivery signals disorganization and leaves your bond agent without current data when you need a bond.

HOW TO PRESENT YOUR FINANCIALS FOR THE BEST BONDING OUTCOME

Use a construction-focused CPA.

A CPA who understands construction accounting, POC, and WIP schedules will prepare statements in the format sureties expect. A generalist CPA may deliver technically correct statements that do not tell your story well.

Submit a complete package.

Financial statements, WIP schedule, completed project list, bank reference letter, and personal financial statements for all owners. A complete package gets reviewed faster and gets better results.

Provide context for unusual items.

If you had a bad year, a large write-off, or an unusual transaction, include a brief narrative explaining what happened and what you are doing about it. The bond agent can use this context when presenting your file.

Submit on time.

Deliver financials within 90 to 120 days of fiscal year end. If your CPA needs more time, communicate the timeline to your bond agent so they can set expectations with the surety.

Plan year-end with bonding in mind.

Before year-end, discuss with your CPA and bond agent how tax decisions, distributions, and accounting treatment will affect your bonding capacity. Make these decisions together, not in isolation.

Need help understanding your financials from a bonding perspective?

Call Grit Insurance Group at (801) 505-5500 or email Surety@gritinsurance.com. We will review your financial statements, explain what the surety will see, and help you develop a plan to strengthen your position.