

Many people have the impression that obtaining a surety bond or dealing with a bonding company is about as pleasant as entertaining your mother-in-law. But the mystique attached to bonds is not as unreasonable as they have been portrayed.

Simply put, a bond is a guarantee of the performance of an obligation. In it, one party guarantees to a second party the performance of an undertaking or obligation by a third party.

Historically, guarantees were given by individuals until the 1870s when corporations began issuing such guarantees for a fee. The entrance into this field by corporations was a logical step since going to a friend and asking him to guarantee something obviously is embarrassing, particularly if he refuses. In addition there was always the question of the adequacy of the guarantor.

Today, bonds are required by federal, state, county and municipal governments to protect taxpayers dollars particularly in the area of the construction of government financed projects. The cost of these projects represents an expenditure of billions of dollars every year. To spend this money without guarantees that those receiving it will perform would border on the criminal. Owners in the area of the private sector of construction require bonds to protect their investment in their projects. Finally, subcontractors and suppliers rely on labor and material payment bonds as a guarantee that they will be paid for work they do and goods they supply.

A surety bond is a written instrument by which two parties, namely the principal and the surety, become obligated to a third party, the obligee, for the payment of a sum of money, not to exceed the bond amount, if the obligation set forth in the bond is not fulfilled. It is a contract resting on an underlying contract or obligation.

This is not insurance. Many people tend to equate surety and insurance as being the same thing because insurance companies are the major writers of surety bonds. This is due to the fact that insurance companies have the financial strength to put at risk. By virtue of their financial strength and their having been in the business of exten-

BONDS AND BONDING

By JOHN J. CURTIN, JR.*

Inside Report From A Surety Specialist

ding surety guarantees, insurance companies are the only corporate entities with the staff and the expertise to properly evaluate a surety situation.

There are several major distinctions between surety and insurance. Basically, they are in the area of definition and approach. A surety bond is an extension of credit. It is a financial institution pledging its assets on behalf of someone else who does not possess those assets. While surety bonds are a pledging of assets they are undertaken with the idea that the pledge will not have to be honored because they have evaluated the obligation and are confident that it will be completed properly. On the other hand, insurance contracts presuppose loss. An insurance company knows that out of every dollar it takes in in premium a certain percentage of that dollar will be paid out in losses.

How is a bond obtained? The first step is to talk to a surety agent. He should do the initial investigation and make the submission to a company which best fits the situation. This is important because companies, while they all adhere to the same basic set of principles, vary in their interpretation of those principles and in their personnel. A good agent will generally be aware of which companies fit your situation best and will go directly to those companies.

A surety is going to analyze each case differently and make its decision on the facts presented but the basis of the decision will be the people involved more than any other single factor.

Basically, from the point of view of the information desired by a surety all we have to do to anticipate their questions is to remember what they are doing. In most cases a surety is being asked to guarantee the performance of a contractual obligation and the payment of bills incurred in the course of that contract. Therefore, it is logical for a surety to look at your ability to perform and to pay. Superimposed on these two areas is a determination that the seeker of surety credit possesses integrity.

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* The author is a member of the surety staff of the Francis H. Curtin Insurance Agency, Inc., Cambridge, Mass. He is also regional vice president of the National Association of Surety Bond Producers and treasurer of the Surety Underwriters Association of Mass.

Trees (from page 54)

the capsules when inserted will be situated in the sapwood with the head of the capsules flush with the cambium. This will allow the iron citrate to be dissolved in the sap and translocated to the leaves. Capsules inserted during the early stages of growth have produced positive results in 10 days or less.

Information for the correction of manganese deficiency is not as readily available since Mn deficiency of ornamental trees is not too common. But the use of manganese sprays has been effective in "greening up" the foliage. However, the use of manganese chelates injected into the soil in the spring should produce more lasting results.

Trees in well maintained turf areas are probably not starving to death. But in areas where turf is being irrigated with water that has a high pH, it is possible that certain species of trees may be lacking in iron or manganese. These deficiencies can be corrected by the use of Fe or Mn chelates or by inserting iron-containing capsules into the trunks of trees.

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In order to satisfy itself that you can perform a surety must inquire into and satisfy itself as to your:

1. **Background and history**
2. **Your organization**
3. **Your equipment or the availability of equipment**
4. **Your business acumen**
5. **The adequacy of your professional, i.e. legal, accounting, etc., advice**
6. **Your cost records and internal accounting system**

Similarly, in reviewing your ability to pay your bills the surety must satisfy itself as to:

1. **Your credit history or how you have paid your bills in the past**
2. **Your available bank credit**
3. **Your corporate or personal finances**

Since your ability to perform, once questioned, is rarely tested on a regular basis the emphasis in the long run rests on your continuing ability to pay your bills and finance new work. The more financial data you furnish a good surety the more confidence you will engender.

For instance, your fiscal finan-

cial reports are going to carry more weight than your interim financial reports. There are a lot of reasons for this but it all boils down to the fact that if you have really made a profit you will have to pay a tax on it. If you are paying taxes you are making money. Now, there are four methods of recognizing income, namely:

- Cash
- Accrual
- Percentage of Completion
- Completed Contract

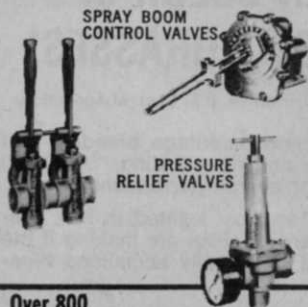
You can be on one method for taxes and another for credit. This is fine. But at the end of your fiscal year the surety can review your reported and unreported profits, determine what tax might be due on your unreported profit and arrive at an honest net worth or working capital for your company. The figure which they arrive at should not be what determines the amount of surety credit you receive but it will help them to determine your ability to pay your bills and finance new work.

Scheduling in a financial statement is almost a prerequisite since

(continued on next page)

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BONDS (from page 56)

the supporting schedules tell what goes into the make up of the balance sheet items. And, if we had to pick out one schedule in particular as being most important we would pick a schedule of work in process which tells what profits have been earned on jobs, what the status of the job is and what profits are yet to be earned.

The final item a surety must consider in evaluating a surety case is the job itself. What is the job? Is it in line with what you normally do? Can you finance it? How much of the work will be done by subcontractors? How much of the work is straight material purchase? How are you to be paid? How does the scheduling of the work fit in with your other work?

Some general do's and don'ts in dealing with sureties and in the conduct of your business:

1. Use good professional outside help and let your outside advisors help each other for your benefit.
2. Value your surety just as you would your bank.

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3. Communicate with your surety. Keep them informed and if you do not like what they tell you ask questions. Both of you will probably learn something.
4. Cooperate with your surety.
5. Dedicate yourself to generating profits and to the growth of your company. Don't bleed the company. Let it grow.

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