Robert B. Wasserbach
County Auditor

To: Yvonne Gordon

From: Bob Wasserbach, Auditor

Subject: Information Requested from Bidders on Construction Contracts

Date: February 3, 2012

Issue Presented

You have asked us for our guidance on the County's idea of having a bidder on a construction contract provide a letter from its CPA or financial institution which verifies that, based on the CPA's review of the company's most recent financial statements, it is the CPA's opinion that the bidder is financially stable such that it would be able to perform the contract if awarded.

You asked us for our opinion on whether this is a fair request to make to a CPA or financial institution.

Opinion

We do not believe it is fair or viable to ask a CPA or a financial institution to provide a letter which verifies that, based on the CPA's (or financial institution's) review of the company's most recent financial statements, it is the CPA's opinion that the bidder is financially stable such that the bidder would be able to perform the contract if awarded. We say this for the following reasons:

- A financial institution can only confirm the assets which the company holds at that institution. It does not know (except for debts at that institution) about the liabilities of that company nor does it know enough about the company's business to provide a well-informed opinion of the company's financial stability. The financial institution would be taking on a great risk and potential liability were it to do so.
- The purpose of a financial statement audit performed by a CPA is to opine on whether the company's financial position as of a specific date, as well as its results of operations for the accounting period ending on that date, are fairly presented in accordance with generally accepted accounting principles. The CPA is not providing an opinion on the company's financial stability. It is up to the readers of the company's financial statements to make that determination. Additionally, the CPA is being requested to provide assurance to New Castle County, whom they are not contracted with to provide the requested services. Therefore, it's not only risky to the CPA but also probably prohibited.
- It is our understanding that the bonding company analyzes the company's financial statements and provides a bid bond which verifies the contractor is fiscally viable to carry out the contract. They also provide a Performance Bond which insures the project's completion.

Alternatives

We surveyed some other municipalities and asked them about their practices regarding this issue. Management may want to consider one or more of the following alternatives to its current requirement. We'd be happy to discuss our survey and these alternatives with you.

- There is an auditing standard on "going concern." If a CPA has "substantial doubt" about a company's ability to continue as a "going concern", the CPA is required to disclose this. The "going concern" principle relates to an entity's ability to remain in business for a period of time subsequent to the period being reported on. Entities are presumed to be able to remain in business for a period up to one year after the period being reported on unless there is specific disclosure to the contrary. If Procurement and/or Special Services, in reviewing the audited financial statements, does not see a "going concern" disclosure, it can surmise that the company at least has the ability to remain in business for a period of up to one year from the date being reported on.
  - ➢ Procurement and/or Special Services could ask the CPA to sign a statement that, as of the date of the most recent audit, there were no "going concern" issues. However, a CPA may not be willing to sign such a statement since, in essence, the CPA has already done this by <u>not</u> making a "going concern" disclosure in the audited financial statements.
- Procurement and/or Special Services could formulate its own financial analysis spreadsheet, input numbers from the company's financial statements into this spreadsheet, and perform its own financial analysis to determine financial stability. If the company has provided prior years' financial statements, Procurement and/or Special Services could look at trends in the key ratios. Perhaps the Finance Department or the County Auditor's Office could help in the development of such a spreadsheet.
  - ➢ The City of Denver has a Prequalification Board that assesses a company's financial health. The Board, comprising nine members, reviews whether contractors have the required expertise and, if so, assigns a financial limit based on experience and financial strength. The Prequalification Board is comprised of City Employees with expertise in making these judgments on City contractors. (Note: I have attached a City of Denver audit report that provides more information on this Board.)
- Procurement and/or Special Services could, to determine financial stability, (1) run a credit check on the company to see if it's paying its bills, and/or (2) run a Dunn & Bradstreet report (or other available reports) on the company and use that data to determine if the company is viable and able to meet its obligations.
- Establish a contingency fund (retainer) to ensure that, if the contractor doesn't finish the job, the County has funds to hire someone to finish the project.