

BUSINESS ACCOUNTING & FINANCE FOR SURVEYORS IN HONG KONG

Sr Benny K B Kwok

BSc MBA CTA CPA(Practising) FCA MCIQB MHKIS MRICS

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The Hong Kong Institute of Surveyors

Surveyors Learning Centre

Room 1207, 12/F, Wing On Centre

111 Connaught Road Central, Hong Kong

Business Accounting & Finance for Surveyors in Hong Kong

IMPORTANT NOTES

The materials of this seminar are intended to provide general information and guidance on the subjects concerned.

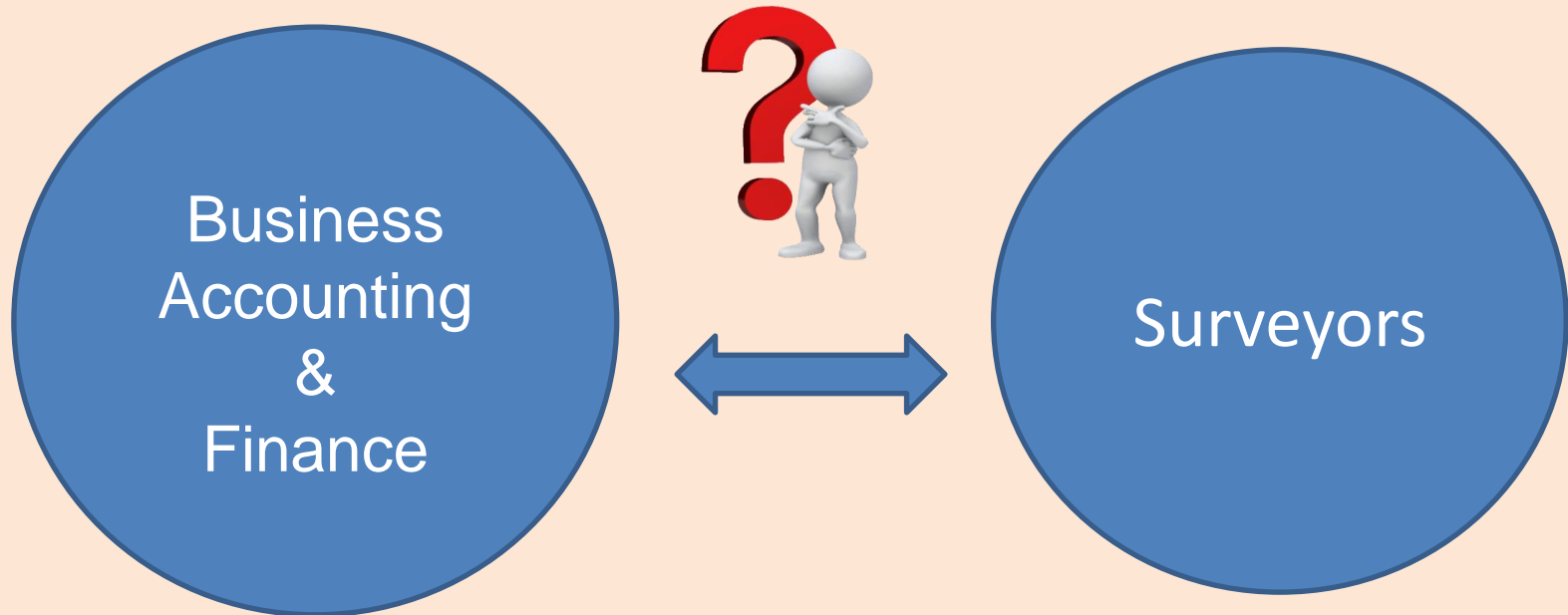
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Examples of relevant applications of business accounting and finance by surveyors

- Building Management Ordinance (Cap 344)
 - Section 27: Accounts of Corporation
 - Schedule 5: Annual Budget
 - Schedule 6: Accounts
 - Schedule 7: Mandatory Terms in Deeds of Mutual Covenant

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Examples of relevant applications of business accounting and finance by surveyors

- Companies Ordinance (Cap 622)
 - Section 373: Company must keep accounting records
 - Section 375: Directors may obtain copies of accounting records during inspection
 - Section 376: Form of accounting records
 - Section 377: How long accounting records to be preserved
 - Section 379: Directors must prepare financial statements
 - Section 380: General requirements for financial statements
 - Section 388: Directors must prepare directors' report

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Examples of relevant applications of business accounting and finance by surveyors

- Lands Resumption Ordinance (Cap 124)
 - Sections 10(2)(d) and 10(2)(e)(i):
Determination by Tribunal of Compensation payable by Government
- Quantum assessment of losses of assets, stocks or inventories
- Calculation of liquidated damages in contracts

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Examples of relevant applications of business accounting and finance by surveyors

- Business valuation for corporate transactions of equity interests between shareholders
- Cost estimate for employers to compile preliminary cost plans or for contractors to prepare tenders
- Preparation / assessment of interim payment applications and final accounts

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Overview of:

- Financial statements
- Financial reporting framework
- Accounting ratios
- Audit reports
- Business valuation
- Budgets
- Internal controls
- Costs

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FINANCIAL STATEMENTS

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Components of Financial Statements

Building Management Ordinance (Cap 344) Section 27 <u>Note (a)</u>	Predecessor CO (Cap 32) Section 122	New CO (Cap 622) Section 380 <u>Note (b)</u>	HKAS 1 <u>Note (c)</u>
Balance sheet	Balance sheet	<i>“true and fair view of the financial position”</i>	Statement of financial position
Income & expenditure account	Profit & loss account	<i>“true and fair view of the financial performance”</i>	Statement of profit or loss and other comprehensive income Statement of cash flows Statement of changes in equity Notes to financial statements

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Note (a): BMO

Section 27 (Accounts of corporation) of the BMO states that “... a management committee shall maintain proper books or records of account and ... financial statements ... The financial statements ... shall include: (a) an **income and expenditure account** which gives a true and fair view of the financial transactions of the corporation for the period to which it relates; and (b) a **balance sheet** which gives a true and fair view of the financial position of the corporation as at the date to which the income and expenditure account is made up ...”

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Note (a): BMO

Refer to examples of income and expenditure account, balance sheet and notes to the accounts



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Note (b): CO

Section 380 (General requirements for financial statements) of the CO states that “(1) *The annual financial statements for a financial year: (a) must give **a true and fair view of the financial position** of the company as at the end of the financial year; and (b) must give **a true and fair view of the financial performance** of the company for the financial year ...*”

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Note (c): HKAS 1 & other references

Statement of Financial Position

A financial snapshot of assets, liabilities and equity at a particular point in time, and an indication of the creditworthiness and financial strength of an organization.

Generally listing out what an organization owns or controls and those that the organization owes or is obliged to pay.

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Note (c): HKAS 1 & other references

Statement of Financial Position

Accounting Equation : $\text{Assets} - \text{Liabilities} = \text{Equity}$

Current vs non-current distinction for all assets and liabilities

- Property, plant and equipment
 - Deposits
 - Inventories
 - Trade and other receivables
 - Cash at bank and in hand
 - Trade and other payables
 - Provisions
 - Share capital / general fund / contingency fund
 - Accumulated surpluses / reserves
-
- Assets**
- Liabilities**
- Equity**

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Note (c): HKAS 1 & other references

Statement of Profit or Loss and Other Comprehensive Income

A financial camcorder or score-sheet showing the flows of resources and their net results during an accounting period, and an indication of the viability and financial performance of an organization

Generally reporting an organization's revenue, gain, cost, expense and other items

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Note (c): HKAS 1 & other references

Statement of Profit or Loss and Other Comprehensive Income

Accounting Equation :

Assets – Liabilities = Equity

Equity = Share Capital + Reserve

Reserve ~ Surpluses / profits in current year plus those undistributed and brought forward from previous years



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Note (c): HKAS 1 & other references

Statement of Profit or Loss and Other Comprehensive Income

Classification by function or by nature

- Revenue / sales / turnover
- Cost of sales
- Gross profit
- Other income
- Distribution costs
- Administrative expenses
- Finance costs
- Other expenses
- Surplus / profit before tax
- Tax
- Surplus / profit after tax / profit for the year

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Note (c): HKAS 1 & other references

Statement of Cash Flows

A financial camcorder showing the flows of cash and their net results during a particular period

Statement of Changes in Equity

A reconciliation between opening and closing balances of equity during a particular period

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Note (c): HKAS 1 & other references

Notes to Financial Statements

- Basis of preparation and compliance with HKFRS
- Significant accounting policies
- Supporting information for items presented in the other four components of financial statements
- Other disclosures, e.g. directors' emoluments, auditor's fee, financial instruments, contingent liabilities, related parties' transactions and events after the end of reporting period

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FINANCIAL REPORTING FRAMEWORK

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Financial reporting frameworks in Hong Kong

HKFRS

HKFRS for Private Entities (“HKFRS-PE”)

Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (“SME-FRS”)

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Refer to the list of HKFRSs and HKASs

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Financial reporting frameworks in Hong Kong

HKFRS

- For all general purpose financial statements towards the common information needs of a wide range of users
- Listed companies
- 17 HKFRS and 28 HKAS
- Convergence of HKFRS with International Financial Reporting Standards
- Members of HKICPA to follow HKFRS

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Financial reporting frameworks in Hong Kong

HKFRS-PE

- As a financial reporting option for companies which:
 - Do not have public accountability; and
 - Publish general purpose financial statements for external users.
- Simplified version of HKFRS, and having approx 400 pages

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Financial reporting frameworks in Hong Kong

SME-FRS

- As an optional reporting exemption under the Companies Ordinance for certain private companies and companies limited by guarantee which satisfy the conditions set out in s359 of the Companies Ordinance (i.e. passing 3 sets of size tests)
- Not for banking, insurance and some regulated businesses
- Reduced and simplified contents, and having approx 120 pages

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HKFRS-PE applicable to IO's/OC's financial statements?

Under the BMO, IO's/OC's financial statements which give a true and fair view of the financial transactions and financial position.

The IO/OC may hold and manage resources entrusted to it by property owners who may not be actively involved in the management of the building.

Therefore, it seems that the above situation does not expressly make the OC publicly accountable and an OC, in general, is generally a Private Entity by its nature provided there are no other specific facts and circumstances that make the OC to be publicly accountable.

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Financial reporting frameworks in Hong Kong

Other mandatory requirements

- Companies Ordinance
- Inland Revenue Ordinance
- Listing Rules / GEM Rules
- Building Management Ordinance, Banking Ordinance, Insurance Companies Ordinance, ... etc

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Financial reporting frameworks in Hong Kong

Regulators

- Government of the HKSAR
- Stock Exchange
- SFC (Securities & Futures Commission)
- HKICPA
- FRC (Financial Reporting Council)
- HKIA (Hong Kong Insurance Authority)
- HKMA (Hong Kong Monetary Authority)

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ACCOUNTING RATIOS



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Accounting ratios

The proportional relationship between two or more items from an organization's accounts or financial statements, expressed in terms of numbers or percentages

Generally focusing on certain key aspects of an organization's financials, e.g. profitability, solvency, efficiency and stability, and revealing the meaning and significance from figures which are not readily apparent from financial statements

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Accounting ratios

- Current ratio
= Current assets / Current liabilities
- Debtor turnover days
= 365 days x Average receivables / Revenue
- Inventory turnover days
= 365 days x Average inventories / Costs of sales
- Creditor turnover days
= 365 days x Average payables / Purchases

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Accounting ratios

- Interest coverage
= Profit before interest expenses / Interest expenses
- Profit margin
= Profit / Revenue
- Return on equity
= Profit / Equity

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AUDIT REPORTS



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How is the auditor appointed and what is the work of the auditor?

Under the BMO, the auditor is appointed by a resolution passed at a general meeting. The work of the auditor includes:

- examining, on a test basis, the books and records;
- assessing significant estimates and judgements made by the MC or the professional property manager in the preparation of the financial statements;
- assessing whether the financial statements are free from material misstatement; and
- reporting as to whether the financial statements give a true and fair view of the financial transactions and financial position of the OC.

The audit does not include:

- investigations into specific areas of the books and records, and financial statements of the OC (other than that necessary for the purpose of audit);
- giving advice on internal controls and tendering procedures;
- internal control review; and
- tax advisory service.

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Auditor

An external or statutory auditor is an independent professional who, under the Professional Accountants Ordinance (Cap 50), is qualified to conduct audit and to issue audit opinion

An internal auditor is part of an organization in charge of evaluating the effectiveness of internal controls and conducting the value-for-money reviews

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Refer to the list of auditing standards



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Audit report

A report prepared and issued by an auditor in respect of his opinion on certain financial statements in the context of the applicable financial reporting framework

Generally setting out the nature of an audit, the responsibilities and the audit opinion

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Audit report (cont'd)

- HKSA 700: Forming an opinion and reporting on financial statements (refer to example)
- HKSA 701: Communicating Key Audit Matters in the Independent Auditor's Report
- HKSA 705: Modifications to the opinion in the independent auditor's report

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Audit report (cont'd)

- HKSA 706: Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report
- HKSA 710: Comparative information – corresponding figures and comparative financial statements
- HKSA 720: The auditor's responsibilities relating to other information

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Structure of audit report

- Title
- Addressee
- Auditor's Opinion
- Basis for Opinion
- Going Concern
- Key Audit Matters
- Other Information
- Responsibilities of Directors for the Financial Statements
- Auditor's Responsibilities for the Audit of the Financial Statements
- Name of the Engagement Partner
- Signature of the Auditor
- Auditor's Address
- Date of the Auditor's Report

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Audit opinion

- Audit opinion may be unmodified, or modified in three possible ways:
 - Qualified opinion;
 - Adverse opinion; and
 - Disclaimer opinion

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BUSINESS VALUATION



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Business valuation

An act or process of determining the value of a business or its ownership interest by assessing the price that a hypothetical buyer would pay for the business under a given set of circumstances

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Business valuation

- Income approach
- Market approach
- Cost approach

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IVS 200: Businesses and Business Interests

Businesses can take many forms, such as corporations, partnerships, joint ventures and sole proprietorships.

The value of a business may differ from the sum of the values of the individual assets or liabilities that make up that business.

When a business value is greater than the sum of the recorded and unrecorded net tangible and identifiable intangible assets of the business, the excess value is often referred to as going concern value or goodwill.

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IVS 200: Businesses and Business Interests

Valuations of businesses are required for different purposes including acquisitions, mergers and sales of businesses, taxation, litigation, insolvency proceedings and financial reporting.

Business valuations may also be needed as an input or step in other valuations such as the valuation of stock options, particular class(es) of stock, or debt.

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IVS 200: Businesses and Business Interests

Income approach

Businesses may be valued using a single cash flow scenario or multi-scenarios, particularly when there is significant uncertainty as to the amount and/or timing of future cash flows

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IVS 200: Businesses and Business Interests

Market approach

3 most common sources of data are:

- (a) public stock markets in which ownership interests of similar businesses are traded,
- (b) the acquisition market in which entire businesses or controlling interests in businesses are bought and sold, and
- (c) prior transactions in shares or offers for the ownership of the subject business.

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IVS 200: Businesses and Business Interests

Cost approach

Applicable when:

- (a) the business is an early stage or start-up business where profits and/ or cash flow cannot be reliably determined and comparisons with other businesses under the market approach is impractical or unreliable,
- (b) the business is an investment or holding business, in which case the summation method is used, and/or
- (c) the business does not represent a going concern and/or the value of its assets in a liquidation may exceed the business' value as a going concern.

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Income approach

Present value of the business = V_0

$$V_0 = \frac{FCFF_1}{(1 + WACC)^1} + \frac{FCFF_2}{(1 + WACC)^2} + \dots$$
$$= \sum_{t=1}^{\infty} \frac{FCFF_t}{(1 + WACC)^t}$$

FCFF = Cash flows to all debt and equity investors

WACC = Weighted Average Cost of Capital

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Market approach

Market / fair value of a business

= Maintainable profit x Capitalisation rate

i.e. to capitalise a sustainable level of profits into value.

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Maintainable profit

Possible adjustments to audited financial statements:

- Non-recurring items
- Inconsistent basis of preparation
- Non-operating items
- Non-economic items

Capitalisation rate or multiple

- P/E
- EV/EBIT
- EV/EBITDA

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BUDGETS

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Budget

An itemized listing of the amounts of estimated revenue, along with the amounts of estimated costs and expenses which will be incurred in obtaining those revenue during a given period of time

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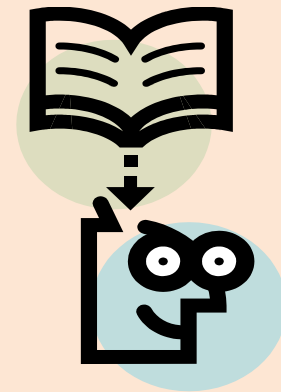
Budget

- a detailed plan of action for an upcoming period, quantified in money
- translating the overall objectives and strategies into detailed plans of action
- for the whole entity (sales forecasts, KPIs, SLAs, ...materials/production budgets, payroll budgets, cash budgets, ...)
- for a sub-unit within the entity (a department, a machine, a property, ...)
- short-term vs long-term

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Types of Budgets

- Incremental budgets
- Zero-based budgets
- Fixed budgets
- Flexed budgets



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Benefits of budgeting

- focus on overall objectives
- planning mechanism
- motivation
- means of communication
- co-ordination of activities
- expenditure authorisation
- performance measurement
- budgetary controls

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Budgetary controls

One of the many types of internal controls

- Cost centre, profit centre and investment centre
- Budget preparation
- Recording of actual results (as part of book-keeping)
- Comparison between budget and actual results
- Calculation of variances
- Interpretation of variances

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INTERNAL CONTROLS



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Internal Controls

- The process designed, implemented and maintained by an organization to provide reasonable assurance about the achievement of its objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations
- Five components under HKSA are:
 - Control environment;
 - Risk assessment process;
 - Information system;
 - Control activities; and
 - Monitoring of controls.

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Controls over inventories

- Inventory records
- Physical controls
- Periodic stocktaking
- Inventory management – orders to replenish inventories
 - holding costs vs ordering costs
 - JIT – Just-in-time

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Quantum assessment of losses of inventories

- Supporting insurance claims
- Refer to “*Quantum Assessment of Losses of Inventories by Forensic Accountants*”, concurrently published by Actuarial Society of Hong Kong, Chartered Institute of Building, HKICPA and Institute of Chartered Accountants in England & Wales in 2013-14

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Quantum assessment of losses of inventories

- Physical stocktake
 - Roll-forward
 - Perpetual inventory system
- Direct**
- Observable financials
 - Observable correlations
 - Calculation to assess the unknown value
(i.e. value of lost inventories)
- Indirect**

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Controls over fixed asset

Fixed assets register

- A register recording capital expenditure
- Date
- Description
- Serial / make number
- Amount
- Location

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COSTS



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Capital Expenditure

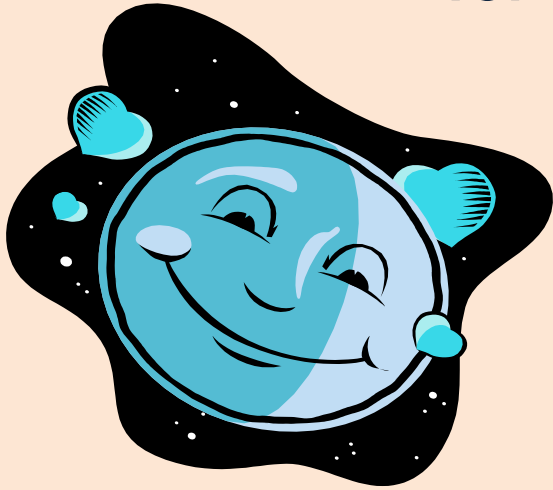
- Long-term benefits to the entity
- Long-term costs to the entity (asset life cycle)

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Revenue Expenditure

- Fixed costs – remaining at the same amount regardless of how much or how little work is done
- Variable costs – varying in proportion to the changes in volume or activity
- Direct costs - traceable to an object to which the costs are to be determined
- Indirect costs - not traceable to a department, a product, an activity or a customer

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THANK YOU

for your attention and sharing

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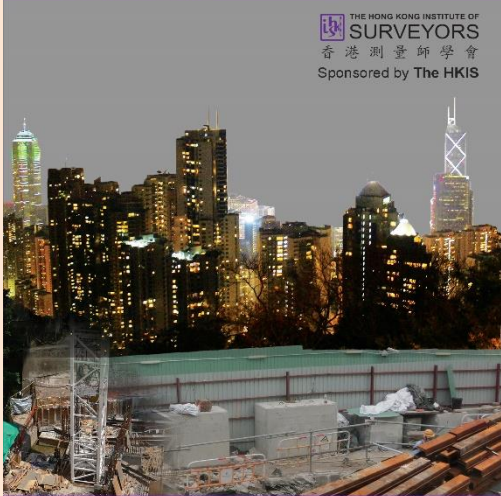
We hope that you have obtained an overview of the following topics and how they might relate to your work as surveyors in Hong Kong.

- Financial statements
- Financial reporting framework
- Accounting ratios
- Audit reports
- Business valuation
- Budgets
- Internal controls
- Costs



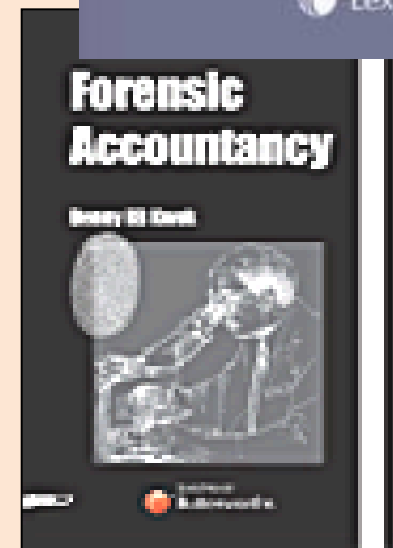
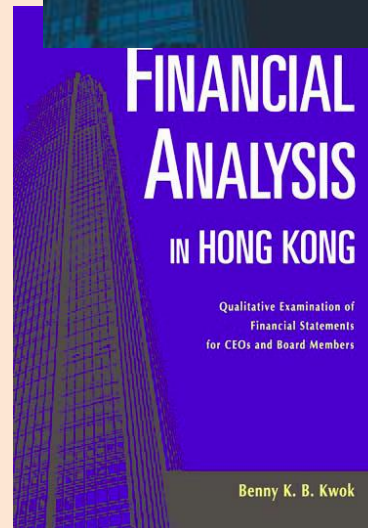
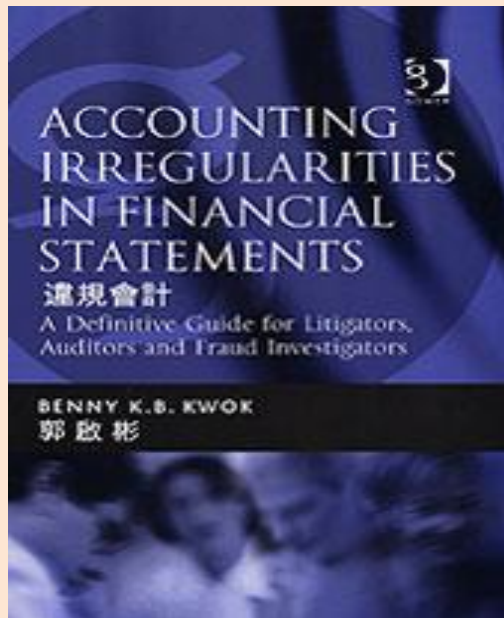
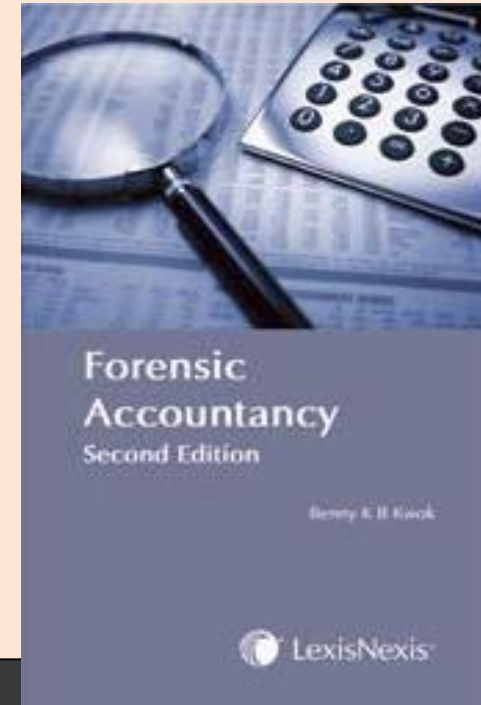
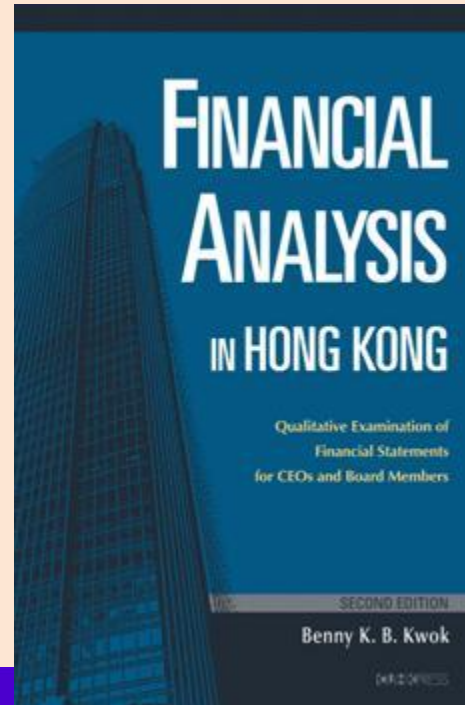
Business Terms & Phrases for Surveyors, Engineers & Facilities Managers in Hong Kong
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Further References





Sr Benny K B Kwok

BSc MBA CTA CPA(Practising) FCA MCIOB MHKIS MRICS

BENNY K B KWOK FORENSIC EXPERT

Tel : (852) 2111 1867 / (852) 3157 6297

Email: Expert@Forensic.HK / Forensic@Accountant.com

Web : www.Forensic.HK



QUESTIONS

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by

Sr Benny K B Kwok

BSc MBA CTA CPA(Practising) FCA MCIQB MHKIS MRICS

Wednesday 27 June 2018