

PRACTICE NOTES FOR QUANTITY SURVEYORS

Cost Control and Financial Statements

Preface

A Working Committee with representatives of the Hong Kong Institute of Surveyors, the Association of Consultant Quantity Surveyors and the Hong Kong Construction Association was set up in October 2010 to establish a set of Practice Notes for the benefit of Quantity Surveying professionals in Hong Kong.

The Practice Notes are not intended to promulgate a standard of practice, but rather to produce some basic guidelines for the following core practices :

1. Tendering
2. Cost Control and Financial Statements
3. Valuation for Interim Payment Certificates
4. Valuation of Variations
5. Handling of Contractual Claims
6. Settlement of Final Account

As different client organisations will have their own procedures and requirements, the Practice Notes, which are prepared mainly for private sector projects using the HKIA/HKIS Standard Forms of Building Contract, should be adapted as appropriate.

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Cost Control and Financial Statements

1. Nature and purpose

A Financial Statement is a periodic cost report which shows the financial status of a project at regular intervals during the construction stage. It gives necessary cost information to the Employer, Architect and other relevant parties to enable the project team to control the cost of the project.

2. Importance

The necessity and growing importance of the provision of periodic cost reports for cost control purposes are due to the following factors :-

- (a) The growth in size and complexity of projects and high cost involved.
- (b) Where, in order to gain time, construction of projects sometimes start without adequate planning and preparation.
- (c) Where the Employer is the Government or a public body, and a funding arrangement has been adopted. It is imperative that the final cost of a project must be kept within the approved budget.
- (d) The incessant fluctuation in construction cost in volatile years.

3. Role of Quantity Surveyor

Cost control is one of the core services provided by Quantity Surveyors within the construction industry. The basic objectives are to demonstrate good value for money for clients, achieve the required balance of expenditure between the various components / elements of

the project, and keep the final expenditure within the Clients' approved budget.

Quantity Surveyors regularly prepare cost reports (financial statements) in the form of a summary of the estimated final contract sum taking into account the cost implications of issued variations, anticipated variations, possible claims for loss and/or expense and, where appropriate, fluctuations in the costs of labour and/or materials. This allows the Employer, Architect and Project Team to have an up-to-date assessment of the financial state of the project to enable them to take any necessary measures to control cost or redirect the project if required.

In the preparation of financial statements, the Quantity Surveyor should work closely with the Architect and other Consultants so that all the information that would affect the project costs is passed to the Quantity Surveyor without delay and misunderstanding.

4. Format

The format of a financial statement is largely dependent upon the Employer's requirements.

For those Employers who would like to know the up-to-date contract sum as well as the estimated final contract sum, a running total should first be calculated without taking into account the contingency sum for further variations or the forecast of value of fluctuations to give the up-to-date contract sum. The contingency sum for further variations and the forecast of value of fluctuations are then added to the up to date contract sum to give the estimated final contract sum.

5. Contract details and information

The statement number and the date up to which the financial statement is prepared are given to indicate the period the financial statement is related to. Such information is important to avoid confusion with a periodic report which is prepared at regular intervals.

The contract details should be listed to give the basic project information. These include the Contract Title, Contract Number, Contract Period, Date of Commencement, Date for Completion, the name of the Employer and the Contractor.

6. Financial adjustments

To arrive at the Estimated Final Contract Sum for the project, the Original Contract Sum is first listed, and then adjustments made for the following items.

a) Omission of Provisional Sum for Contingencies

The Provisional Sum for Contingencies, which has been included in the Contract Sum to cover the cost of variations and of works which could not be entirely foreseen at the time the tender documents are issued, is first omitted from the Contract Sum.

b) Adjustment of P.C. Sums

The Prime Cost Sums, which have been included in the Contract Sum to cover the cost of works or services to be executed by Nominated Sub-Contractors or for materials or goods to be obtained from Nominated Suppliers, are adjusted after the award of such Nominated Sub-Contracts or Nominated Supply Contracts. The profit on the respective P.C. Sums should also be adjusted.

For Nominated Sub-Contracts or Nominated Supply Contracts which have not been awarded, the original Prime Cost Sums should be listed to give information to the Client and Architect of the sums that are subject to adjustment when the contracts have been awarded.

c) Adjustment of Provisional Quantities, Provisional Sums and P.C. Rates

Adjustments should be made for works measured as Provisional Quantities or allowed by way of Provisional Sums or P.C. Rates when the details of these works are finalised. If these adjustments cannot be made due to lack of information, a note should be made and a brief description given next to the various sums allowed for to indicate the extent of sums subject to further adjustment.

The remeasurements should be commenced as soon as the majority of the necessary information is available so that an estimate of the final cost effect can be calculated at the earliest possible date.

d) Variations

All the instructed variations should be measured and adjustments made to the Contract Sum. If time does not allow for detailed measurement of all the issued variation orders at the time the financial statement is prepared, estimates should be made to show the cost effect of the unmeasured variations on the Contract Sum. The number of variation orders for which estimates are prepared should be kept to a minimum to increase the accuracy of the financial statement.

A note should be included against each instructed variation to show whether it has been measured and the value agreed with the Contractor, has been measured but is not yet agreed or is estimated only. Such information is important to show the degree of accuracy and finalisation of the estimated final contract sum as the more instructed variations that have been measured and agreed with the Contractor, the more accurate will be the estimated final Contract Sum.

For those variation orders that have been measured but not yet agreed with the Contractor, a contingency should be included in each variation order to allow for future negotiation and agreement. The amount of this contingency will be affected by the number of 'Star rates' included in the calculation or whether there are special working conditions that would result in extra expense to the Contractor.

Quantity Surveyors should try to identify which variations are major and which are minor. Special attention should be given to variations with a major cost effect.

e) Instructions confirmed by the Contractor but for which Architect's Instructions have not been issued

In accordance with the Conditions of Contract, any verbal instructions of the Architect will have contractual effect if it is confirmed in writing by the Contractor within seven days, and if not dissented from in writing by the Architect to the Contractor within seven days from receipt of the Contractor's confirmation. Therefore, the cost implication of any such confirmed instruction should also be included in the financial statement. As with Instructed Variations, each such confirmation should have a note to show whether it has been measured and the value agreed with the Contractor, has been measured but is not yet agreed or is estimated only.

- f) Anticipated Variation Works for which no instructions have been issued

The cost effect of any proposed variation works which are under consideration should be included in the financial statement.

The cost of such anticipated variations are usually estimated based on preliminary sketches and information from the Architect. Such sketches and information will probably change as the design of the anticipated variations develops and requirements change. Hence it is important that the information on which the estimate has been based should be clearly spelt out in the description of each anticipated / proposed variation item in the financial statement to avoid any misunderstanding. The Quantity Surveyor should work closely with the Architect to ensure that the most updated information is being used in the estimate.

Before commencing the preparation of each financial statement the Architect should be asked whether any anticipated variations included in the last financial statement are going to be dropped. If any anticipated variations are no longer required they must be deleted from the upcoming financial statement. Attention should also be paid to those anticipated variations which have been covered by formal instructions since the last financial statement. Such items should be deleted from the anticipated variation works section to avoid double counting their cost effect.

- g) Contingency for further variations during the remainder of the Contract

A contingency sum should be included in the financial statement for possible further variations during the remainder of the Contract. The amount allowed should relate to the stage of construction work and the amount of works which still cannot be entirely defined or detailed. Discussions should be held with the Architect before any contingency allowance is made.

- h) Provisional assessment of amount of direct loss and/or expense resulting from disturbance to the regular progress or works

In accordance with the Conditions of Contract, the Contractor is entitled to be reimbursed for any direct loss and/or expense by reason of the regular progress of the works having been materially affected by the listed events in the Contract. An amount should be allowed in the financial statement where such loss and/or expense has been incurred and a provisional assessment should be made if the actual amount cannot be calculated due to inadequate information.

- i) Adjustment of Labour and / or Material Fluctuation Allowance

The Provisional Sum allowed for fluctuations in labour and / or material costs in the original contract sum is first omitted. An amount is then added back for the actual amount of fluctuations incurred plus a forecast of the amount of fluctuations likely to be incurred during the remainder of the contract. This is assessed based on the past trend of fluctuations.

- j) Rejected Claims

It may also be worthwhile to advise the Employer of the amounts of any major claims from the Contractor which are in dispute or have been rejected by the Consultants in case the Contractor is able to substantiate these claims at a late date. The amount of these claims should not be included in the estimated final cost but should be given separately for information only.

- k) Certified gross value for payment

The amount of the certified gross value for payment up to the date of the financial statement is listed for the Employer's cash flow planning by comparing his current financial commitment and the estimated final financial commitment.

7. Mechanical and Electrical works

Where the Mechanical and Electrical (M&E) consultants have been employed to deal with the financial aspects of the M&E works in the project, the financial report in respect of the M&E works will usually be prepared by these consultants. The Quantity Surveyor should collect this cost information from the M&E consultants for incorporation into the financial statement.

8. Submission of financial statements

It is advisable to include an Architect's report section in the financial statements and to send the draft financial statements to the Architect for review with regard to funding approval and allocation, extension of time and liquidated damages, etc. before forwarding the final version to the Employer. Any items which are in doubt or are very significant should be drawn to the attention of the Architect in the covering letter.

The financial statement should be arithmetically checked before it is sent out to the Architect.

9. Project cost review statement

Apart from the monthly financial statement described above, which is for individual contracts, an overall project cost review statement may be required by the Employer to show the financial state of the whole project which may consist of several contracts. The preparation of the project cost review statement is effected by combining the financial statements for each individual contract in the project and is usually prepared quarterly or half-yearly.



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