



Construction & Real Estate Community Launch

TUESDAY, 24 SEPTEMBER 2019

Supported by:





Programme

18:00	Registration and Networking
18:15	Chair's Opening Remarks David Franklin, Director, Communities, ICAEW
18:20	Headline Partner Opening Remarks Brendan Sharkey, Head of Construction & Real Estate, Partner, MHA MacIntyre Hudson
18:40	ICAEW Construction Audit Insights Report Phil Joyce, Managing Director, The Orange Partnership
18:55	Specific project issues identified Mike Thompson, Board Member, Specialist Engineering Contractors' Group
19:20	QS Issues Alan Muse, Global Director of Built Environment, RICS
19:35	Panel Discussion
20:05	Drinks reception
21:00	Event Close



In association with...



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As a firm of accountants, tax and business advisers, we work in partnership with clients ranging from entrepreneurs and individuals to multi-national corporations. We work together to navigate an ever-changing business world and proactively identify the opportunities that tomorrow presents. Leveraging our national network of offices, we offer a comprehensive range of financial and business strategy services to clients across the UK, enabling them to achieve profitable growth and build sustainable long-term success.

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Our agile and responsive approach means we are always on hand to have the right conversations about with clients at the right time, allowing us to identify their goals and business needs both now, and in the future.

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Speaker biography

Brendan Sharkey, FCA, Head of Construction & Real Estate, Partner, MHA MacIntyre Hudson

Brendan has over thirty years of dedicated service to MHA MacIntyre Hudson, Brendan has worked with a wide range of businesses including quoted companies, as well as owner managed businesses from a large cross section of sectors. His primary focus is on business assurance where he believes audits should provide value and a platform for good advice. Brendan's aim is to understand a client's goals and help them achieve them. He believes that everyone is capable of change and the key is to create or uncover the desire to do so.

Improving accounting for projects

By Brendan Sharkey
Partner – MHA MacIntyre Hudson



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Construction Contracts

- The quality of financial reporting has been questioned given
 - Valerie Patisserie
 - Carillion
- It's becoming common-place for companies to announce 'accounting errors' e.g.
 - Tesco's
 - Eddie Stobart Logistics
- Companies have been prosecuted for cartels in price fixing – uncompetitive tendering

Can anyone ever be sure that the financial status of a long term project is known and understood?

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FRS 102 Accounting Requirements



“23.14 – when the outcome of a transaction..... can be estimated reliably, an entity shall recognise revenue associated with the transaction by revenue to the stage of completion...”

All 4 conditions need to be satisfied:

- A. The amount of **revenue** can be measured reliably
- B. It is probable that the **economic benefits** associated with the transaction will flow to the entity
- C. The **stage of completion**.....can be measured reliably
- D. The **costs incurred**.....and the **cost to complete** can be measured reliably.

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Key stakeholders



- Client
- Project manager
- FD
- Directors
- Shareholder
- Auditor
- HMRC
- Bank/Financier

All have different goals and drivers

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Different drivers



One Example

Compare a Project Manager (PM) and a Finance Director (FD)

PM has to

- deliver the project
- to price agreed
- in the time agreed

FD has to ensure

- the project is delivered as above
- the financial reports are prepared in accordance with accounting standards
- appropriate judgement has been exercised
- Valuations are valid BUT
- the reporting cycle may not be consistent with the project completion milestones

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Different drivers



How can the FD be sure that they are correctly accounting for a project?

What about:–

- Variations
- Delay
- Disputes
- Joint ventures with different year ends

How can an auditor be sure:-

- The reported outturn reflects the current value of a project?
- Profit has not been anticipated?
- That the data is complete?
- Appropriate judgement has been used?
- The price is not being disputed by the client?

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War stories



Case study 1

The project manager had health problems and was not in control of the project costs – failed to record and agree variations, subsequently disputed and majority went unpaid.

Case Study 2

Large project - 3 phases split into several components. Poor allocation of costs meant the third phase has costs which should have been booked to phases 1 and 2. Result – overstatement of profit in earlier years.

Case Study 3

Design & Build project – not a normal type of contract for the company. Estimator out of their depth; didn't understand the intricacies of the project and greatly underestimated costs – no project oversight.

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**"Coming together is a beginning,
staying together is progress,
and working together is success."**

– Henry Ford



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Thank you for listening

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Speaker biography

Phil Joyce, Managing Director, The Orange Partnership

Phil Joyce is the Managing Director of The Orange Partnership, a Chartered Accountancy practice he set up 14 years ago with his partner Darren Ward to provide specialist accounting and forensic audit services to the construction sector. Over the years he has developed a unique concentration of expertise in audit and commercial knowledge which he uses to help clients delivering major construction programmes. Through The Orange Partnership, Phil has worked on contracts of between £0.5m and £40bn to provide clients with confidence that they are receiving value for their spend and not being exposed to unnecessary risks.



THE ORANGE PARTNERSHIP

Chartered accountants in construction and major contracts

Phil Joyce - MD



Audit Insights

Auditors bringing their knowledge of market sectors and business issues for the benefit of wider stakeholders

Bidding for lasting value

- Sustainable profits are based on the right price
- Some companies price to reflect true cost
- But some bid to win the job
- Unforeseen changes can quickly turn small profits into losses, and make it difficult to return to profitability

Delivering for success

- Financial rigour applied to key estimates and judgements throughout the project
- Financial information and analysis can determine a project's success
- Form strong delivery teams where project managers work closely with finance/commercial teams

Rebuilding confidence through increased transparency

- Poor or unexpected results caused by a lack of internal transparency
- Executive management and boards need to ensure the tone from the top encourages transparency
- Without early reporting of issues, projects are less likely to remain on track
- Problems become more significant

Getting fit for the future

- Government can help to build confidence
- The Government will need to commit to specific timings
- Businesses need to create a pipeline of future young talent
- The sector also needs to consider how it can attract more women and ethnic minorities

Feedback

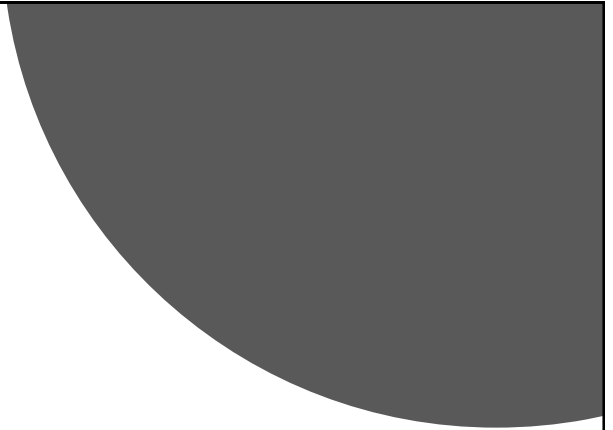
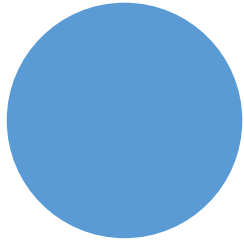
- Inadequate capital base for the main contractors
- Constant deskilling of the client side
- Fractured supply chains
- Good practice undermined by cost constraints
- The importance of estimators



Speaker biography

Mike Thompson, Board Member, Specialist Engineering Contractors' Group

Mike worked for 25 years as FD and MD of medium and large sub-contracting companies in the electrical and communications side of the construction sector, having also previously audited several construction companies in the UK and overseas. He currently sits on the board of the Specialist Engineering Contractors' Group. The group represents the interests of 60,000 firms employing over 300,000 people providing over 35% of the value of construction work in the UK and is very active in efforts to improve the payment environment on the security of payment through the supply in construction chain.



The Construction Sector

An Underestimated
Area of Risk

Mike Thompson BA FCA

Background

- Failure in construction companies has been widespread since the early 90s – since balance sheets were reduced and ROSF became more critical
- Companies now lack the financial firepower to withstand shocks and rely on their supply chain to fund their working capital
- The sector is getting worse in behaviour - Keith Cochrane the interim CEO of Carillion in evidence to the Commons BEIS committee was proud that it operated an “asset light model”
- Recent studies including by the ICAEW have shown slow payment to be an increasing problem

Issues in construction

- Reduced client knowledge leads to inadequate specifications against which to bid leading to lots of downstream variations - Where does design risk lay?
- Fractured supply chain because of specialist skills usually provided by sub-contractors
- Estimating is difficult – lots of unknowns
- Dependent on a lot of sequential tasks – delays in one lead to delays across the others
- Measurement of jobs is judgemental and open to interpretation

Results of these issues

- Unaligned objectives between parties on a site
- Confrontational relationships between parties
- Scope for manipulation and misunderstanding of the financial state of contracts and consequent pressure to report better figures than justified

Accounting and finance – what you should have at the outset

- Deep and meaningful relationship with QS team
- Oversight of bid margin
- Clear contract estimate showing timescales and milestones (stages of completion)
- Project cashflow showing what will be needed as the project progresses. This will include invoicing deadlines and payment dates from the customer
- Key contractual terms

Accounting and finance – what you must have as the project progresses

- Monthly commentary from QS team showing update against project plan, stage of completion, costs to complete vs revenue to complete, variations agreed and the expected outcome on those not agreed, potential upside vs potential downside
- Same issues in relation to the supply chain for all cost areas including variations agreed and those not agreed.

Accounting and finance – how you treat the information you get

- Track the project updates to see how consistent they are
- Review Project expected outcomes to see how they change over time and compare it to the cashflow and against the cashflow model. Challenge why cash is not coming in. Take an oversight of sub-contractor claims on projects
- Review the level of contract WIP and challenge if it is increasing more than expected – a good indication that claims and variations might not be sustainable
- Do not recognise revenue on contracts where variations are not being agreed
- Go and see a selection of project sites while work is under way. See for yourself if the explanations make sense. Keep going back if you are unconvinced

What should professionals do?

- Ensure clients have these systems in place
- Spend time looking at them in detail and challenging the figures shown in them
- Visit the sites
- Look at trends and results over longer periods and see how contract results tend to change
- Ensure that contract profits generally increase over time and not generally decrease
- Follow the cash

A brief look at Carillion

- Declared revenues each year 2011 – 2016 between £4bn and £5.2bn (£5bn in 2011 and £5.2bn in 2016)
- Total declared profits over that period £782m
- Dividends paid over that period £463m
- Net assets go from £1bn to £700m (substantial pension fund write down), but otherwise consistent net asset levels
- Debt increased from £200m to £575m (and then to £900m as the group folded)
- Value of live contracts held in the balance sheet went from £3.9bn to £6.1bn

Summary of sector structural risks

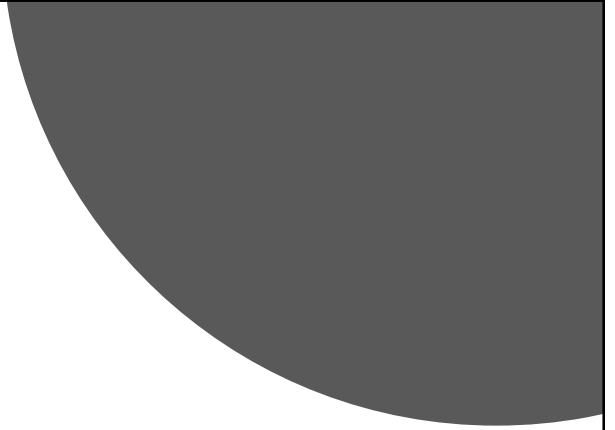
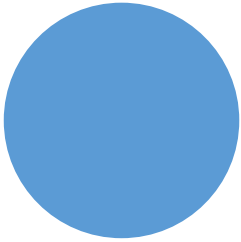
- Inadequate working capital
- Overly tight bidding margins
- Cashflow depends on not paying supply chain until funds received from the employer
- Contractual risk from mismatch between main and sub-contracts leading to responsibility gaps
- Domino effect of insolvencies through the supply chain
- Risk is present throughout all levels of the sector

Suggested solutions – short term

- Mandate the use of project bank accounts (PBAs)
- Mandatory placing of retentions in trust so that the tier 1 contractors can no longer have access to those funds to prop up their cashflow
- T1 contractors would then have to boost their balance sheets in order to be able to fund contracts and this would also help reduce insolvency risks
- Tender lists to be restricted to good payers with strong balance sheets

Suggested solutions – longer term

- Move away from main contractors employing the whole supply chain and move back to clients playing a more active role in the project – it will mean they have to get their side of the contract right, rather than just passing risk down the chain



Thank you



Speaker biography

Alan Muse, Global Director of Built Environment, RICS

Alan has over 30 years' experience in construction, specializing in the project and cost management of schemes up to £4 billion. Overseas experience includes spells in both the Middle East and East Asia. Since joining the RICS in May 2011, Alan has been involved in all aspects of the RICS response to the UK government construction strategy. Also, he leads international construction and BIM initiatives within the RICS including the development of skills, training and guidance for RICS members. Finally, as a Global Director in Professional Groups he liaises with Chartered Surveyors on general matters of international standards development, international construction policy and global education and training.



Managing risk: QS issues

Alan Muse FRICS
Global Director of the Built Environment, RICS

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**Construction
is a team
game....**





Let us have a collaborative conversation....

- QS role
- Issues
- Standards and competencies
- Wider initiatives
- Bringing it all together



QS role....

- Clients, consultants and contractors
- RICS qualification
- New challenges



Lower costs

33%

reduction in the initial cost of construction and the whole life cost of built assets

Faster delivery

50%

reduction in the overall time, from inception to completion, for newbuild and refurbished assets

Lower emissions

50%

reduction in greenhouse gas emissions in the built environment



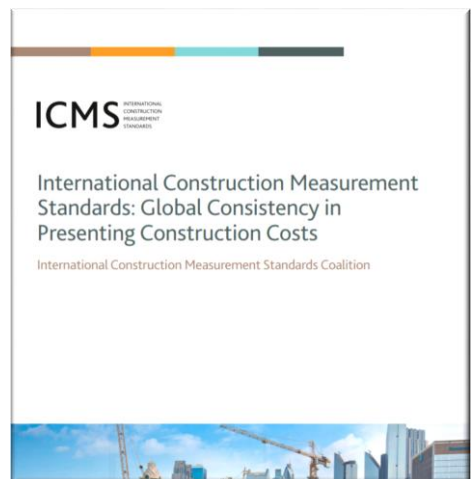
Issues....

- Cost prediction
- Procurement
- Claims
- Business models
- Complexity



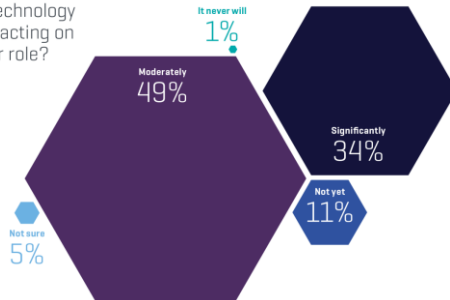
Standards and competencies....

- Collaborative data standards
- Black Book
- Technology: profession interface
- Future of the profession

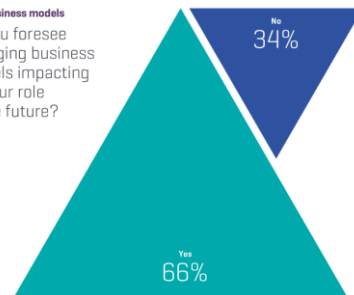


We are also looking to the future....

The changing role of an RICS qualified professional
Is technology impacting on your role?

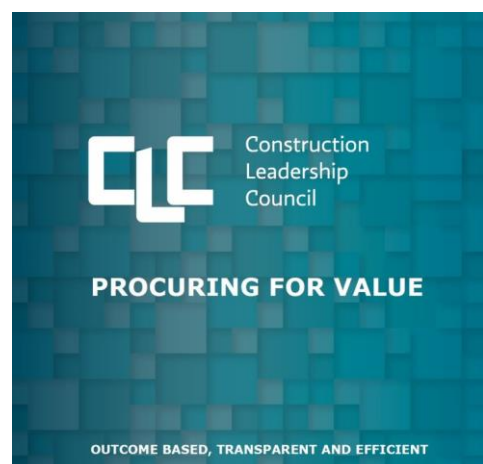


New business models
Do you foresee changing business models impacting on your role in the future?



Wider initiatives....

- Grenfell
- Carillion
- Procure for Value
- Centre for Digital Built Britain
- Fair payment



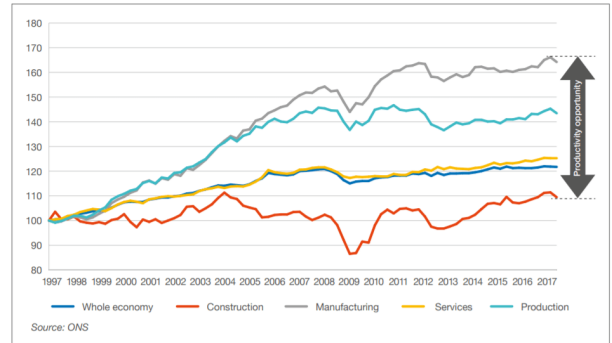
Bringing it all together.....

Breaking down the barriers

- between value and cost
- between design and cost
- between business and project finances

Professions in the 21st century

Chart 1: Productivity Growth – Output per worker (1997=100)



Thank you for listening

Any questions?



