

PRACTICE NOTES FOR QUANTITY SURVEYORS

Cost Control and Financial Statements

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PREFACE

A Working Committee with representatives of The Hong Kong Institute of Surveyors, Association of Consultant Quantity Surveyors and 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:

Name of Practice Notes	Latest Version
Pre-contract Estimates and Cost Plans	October 2016 *
Procurement Strategy	July 2021 ^
Tendering	November 2012 *
Cost Control and Financial Statements	September 2021 *
Valuation for Interim Payment Certificates	August 2014 *
Valuation of Variations	November 2012 *
Contractual Claims	November 2012 *
Final Accounts	November 2012 *

* jointly prepared by The Hong Kong Institute of Surveyors, Association of Consultant Quantity Surveyors and Hong Kong Construction Association with input from Architectural Services Department and Hong Kong Housing Authority

^ jointly prepared by The Hong Kong Institute of Surveyors and Association of Consultant Quantity Surveyors

As different employer 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. Employers should consult professional quantity surveyors for advice to suit the specific requirements of individual projects.

The members of the Working Committee who updated the Practice Notes for the Cost Control and Financial Statements are:

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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 the employers, achieve the required balance of expenditure between the various components / elements of the project, and keep the final expenditure within the Employers' 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 Employer 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 of 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. ARCHITECT'S INSTRUCTION PRE-APPROVAL (AI PRE-APPROVAL)

To provide better cost control of a project, a cost estimate of a proposed Architect's instruction for changes could be prepared for approval by the Employer before the said instruction is formally issued. The cost estimate can help the Employer and the Project Team realize the financial impact to the project and hence make decisions on whether the proposed changes may be adopted, adjusted or cancelled. This process is of particular importance for projects having tight budgets.

The purpose of AI Pre-approval is to provide a rough estimate of the financial and time impacts of the proposed changes to the Employer for decision making. It should not be mixed up with the valuation of variations which is a detailed assessment of the cost of the changes instructed, and the Employer should be reminded of this purpose.

The cost estimate for the proposed changes under an AI Pre-approval must be completed as soon as possible in order not to delay the decision making and, if the changes are desired (and unavoidable), issuance of the formal Architect's instruction.

It may be possible that the proposed changes are cancelled or adjusted if the cost estimate is beyond the expected budget of the Employer. It is not desirable to wait till the proposed changes are finalized (e.g., in terms of detailed drawings) before commencing the cost estimate, as this may create unnecessary abortive work to the Project Team. Estimating based on preliminary ideas of the proposed changes would mean that the cost estimate can only be approximate.

When new rates are to be used, appropriate allowances should be included in the cost estimate to cater for deviations in the market rates but should be within a reasonable range. There may also be circumstances of some cost elements not readily perceived at the time of the change proposed but may eventually be part of the additional cost claims by the Contractor.

On the other hand, the Employer would see the cost estimate for the proposed changes under an AI Pre-approval as the upper limit not to be exceeded. As such, the cost estimate should only be a quick and rough indication of cost but sufficient enough with buffers to cover the above circumstances to serve as a budgetary allowance, which is more important than emphasizing on trivial accuracy. It is not necessary to estimate in detail, which will cause delay in making decisions and issuance of the formal Architect's instruction.

Instead of spending unnecessarily long time to carry out detailed cost estimate for the proposed changes under an AI Pre-approval, it is more meaningful to spend the time saved to settle the variations with the Contractor, which will give a more definite outcome for cost control.

Method applying approximate quantities and composite rates should be adopted in preparing cost estimates for the proposed changes under an AI Pre-approval and the Quantity Surveyor should focus on items with substantial cost implication with reasonable round-up in Net Addition and round-down in Net Omission, with buffers for deviations within a reasonable range.

The Quantity Surveyor should communicate with the relevant design consultant(s) to sort out all ambiguous issues under a proposed change, make and state all necessary assumptions/exclusions in the cost estimate for an AI Pre-approval. For changes under an AI Pre-approval involving new rates, the Contractor can be requested to provide quotations for information.

Different employers may have different forms for AI Pre-approval. In general, the AI Pre-approval Form should normally include the following information:

- (a) Reference No. (preferably of the same no. of the Architect's Instruction to be subsequently issued)
- (b) Project particulars (project number, project and contract title)
- (c) Description of the proposed Architect's Instruction
- (d) Drawings related to the Architect's Instruction
- (e) Reasons for justifications of the Architect's Instruction
- (f) Indicative cost estimate and/or time impact of the Architect's Instruction
- (g) Signature boxes for the Architect and/or design consultant(s)
- (h) Signature/Approval box for the Employer
- (i) Date of approval by the Employer

8. 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.

9. 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.

10. 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.



September 2021