SEMINAR 24 AUGUST 2015

- Monday 24th August 2015

  08.00HRS TO 09.00HRS

VENUE : CBRE

`C-BAR`

Henrietta House

Henrietta Place

W1G 0NB

- SUBJECT

  ACCOUNTS

  How to read them - How is property treated

  45 mins + 10 mins questions

SEMINAR BY DOUG STEVENS TO 1st & 2nD YEAR GRADUATES

DELIVERED AS A POWERPOINT PRESENTATION

- **ACCOUNTS**
- How to read accounts. How is property accounted for.
- **PART OF APC   Mandatory to Level 1**
- Accounting principles and procedures
- Level 1   Demonstrate knowledge and understanding of accounting concepts and the format and preparation of management and company accounts, including profit and loss statements, cash flow statements and balance sheets
- Examples of knowledge comprised within this level are:
- • An awareness of the Generally Accepted Accounting Principles (GAAP) relevant to the candidate's geographical area of experience and how property is treated in an entity's accounts
- • An awareness of International Accounting Standards (IAS), broadly how IAS vary from National GAAP and how property is treated in an entity's accounts prepared under IAS
- • An understanding of an entity's financial results and basic accounting principles including balance sheets, profit and loss and cash flow statements
- • An understanding of the role of the Auditor.

ACCOUNTS

- WHY IS IT RELEVANT TO YOU IN PRACTICE ?
- In the following areas covenant strength is very important

- LETTINGS – new tenant
- Impacts on security & value
- MANAGEMENT assignment/underletting
- informs decision as to consenting alienation
- VALUATION covenant strength impacts on value
- highly relevant especially for security/loan purposes
- INVESTMENT blue chip v mickey mouse
- Significant differential in pricing

ACCOUNTING STANDARDS – `*acronym city*`

- **GAAP** GENERALLY ACCEPTED ACCOUNTING PRINCIPLES
- **SORP** STATEMENTS OF RECOMMENDED PRACTICE
- **SSAP** STATEMENTS OF STANDARD ACCOUNTING PRACTICE
- **FRC** FINANCIAL REPORTING COUNCIL **IFRC** International FRC **IFRS**
- **IAS** INTERNATIONAL ACCOUNTING STANDARDS **IASB** IAS Board
- ACCOUNTING STANDARDS VARY COUNTRY TO COUNTRY
- ACCOUNTING STANDARDS VARY BY COMPANY SIZE – Public v Private
- ACCOUNTING STANDARDS ARE REGULARLY CHANGED/UPDATED
- UK GAAP will incorporate more IFRS during 2015 – some still to be agreed

GAAP IFRC (IFRS) IAS (IASB)

- **GAAP** Generally Accepted Accounting Practice in the UK (UK GAAP) is the body of accounting standards and other guidance published by the UK's Financial Reporting Council (FRC). A new financial reporting framework in the UK is effective from 1 January 2015.
- **IFRS** International Financial Reporting Standards. A set of international **accounting** standards stating how particular types of transactions and other events should be reported in financial statements. **IFRS** are issued by the International **Accounting** Standards Board (IASB)
- **IAS** International Accounting Standards
- **IAS 16 IAS 17 & IAS 40 are property related**

COMPANIES ACT 2006

- COMPANIES ACT 2006 Applies to all corporate entities
- MAJOR CHANGES INTRODUCED FOLLOWING EU DIRECTIVE IN 2005 TO HARMONISE ACCOUNTING STANDARDS BETWEEN EU COUNTRIES
- The Companies Act 2006 in conjunction with other statutes and case law, lays down a minimum core of mandatory rights for shareholders, employees, creditors and others by which all companies must abide.
- It also dictates that quoted (public) and unquoted (private) companies must submit annual accounts and summary financial statements
- Financial statements are a collection of reports about an organization's financial results, financial condition, and cash flows. They are useful for the following reasons:
- To determine the ability of a business to generate cash, and the sources and uses of that cash.
- To determine whether a business has the capability to pay back its debts.
- To track financial results on a trend line to spot any looming profitability issues.
- To derive financial ratios from the statements that can indicate the condition of the business.
- To investigate the details of certain business transactions, as outlined in the disclosures that accompany the statements.

ACCOUNTS

- Publicly listed companies must submit full accounts and these often include non-accounting matters, ie mission statements, corporate social responsibility.
- All UK based private limited company must submit accounts annually.
- However small UK based companies are only required to submit abbreviated accounts - these do not include all the detail required to fully assess the strength of the company.
- Company accounts provide 3 main statements:
- PROFIT AND LOSS
- CASH FLOW STATEMENT
- BALANCE SHEET

Continued

- PROFIT & LOSS
- The company's trading activity is recorded on the Profit and Loss statement.
- This records how much has been sold by the company and it's administrative costs.

EXAMPLE	£'000`s		
Sales	100		
Cost of sales	(40)		
Gross profit	60	Gross margin	60%
Admin expenses	(30)		
Depreciation	(10)		
Interest	(5)		
Profit before tax	15	Net margin	15%
Tax	(5)		
PROFIT AFTER TAX	**10**		

Notes on the profit and loss account

Sales	**Revenue or turnover**
Cost of sales	Cost of goods sold for a retail business Materials Labour Frequently businesses have no cost of sales as there are no costs which directly vary with the level of sales. For instance in a software development business the software can be sold either once or a million times without affecting the development cost.
Gross profit	Sales less cost of sales.

NOTES TO PROFIT & LOSS

Gross margin

Gross profit divided by the sales. A high gross margin is desirable. NB Gross margin does not change when sales increase or decrease. An increase in gross margin can be achieved either by an increase in sales price or a decrease in costs of sale.

Administrative expenses

The administrative expenses include:

- Rent
- Insurance
- Staff costs (except direct labour)
- Utilities

Continued

Depreciation

Depreciation is the profit and loss account cost of fixed assets.

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A fixed asset will wear out or become outdated so over the period of its life. This is achieved via a depreciation charge which is made to reduce the value of the fixed asset in the balance sheet and include the depreciation cost in the profit and loss account

Communications business - small profits or losses because depreciation charge for the investment made in their cable network. Making a cash profit but not an accounting profit

Continued

Interest paid	This represents interest paid on loans. So in analysing a business sometimes the interest paid will be added back to the profit before tax to show a profit before interest and tax. Peacocks went into administration after incurring significant losses. The company was generating profits before interest and tax which showed that it was a viable business. However after interest the business was making a significant loss - it had borrowed too much money and was overgeared
Net Profit	Profit before or after tax
Net Margin	A key indicator of the overall performance of a company against expected industry standards. Different industries expect very different net margins. For instance a good retail margin is 5%. In investment banking it might be closer to 30%. There are a large number of factors affecting net margin - all those affecting gross margin plus the fact that an increase in volume of sales will increase the net margin because some costs are fixed.
Tax	Corporation tax

Cash Flow Statements

- Cash flow statements report *cash* generated and used during specified period (ie, monthly quarterly)

- The statement of cash flows is used to record and analyse the companies performance -;.

1. The cash from operating activities is compared to the company's net income.

2. If the cash from operating activities is consistently greater than the net income, the company is doing well.

3. If the cash from operating activities is less than net income the company has a problem as it is not converting net income into cash. CASH IS KING

4. The cash flow statement identifies the cash that is flowing in and out of the company.

5. If a company is consistently generating more cash than it is using, the company is in a strong enough position to -; reduce debt - pay/ increase its dividend - expand - buy another company.

6. Financial models are often based on cash flow statements.

- The constituent elements are -;

Cash Flow continued

- A cash flow statement is divided into three sections:
- **Cash flow from operating activities** - cash inflows and outflows resulting from day-to-day business operations, including the collection of cash from sales and payment of expenses.
- **Cash flow from investing activities** - result from the purchase or sale of the business's non-current assets, that is, assets owned for longer than 12 months.
- **Cash flow from financing activities** - Financing activity that changes the long-term financing structure of the business, ie paying off debt, directors loans.

Cash Flow Statement

- **STATEMENT OF CASH FLOWS**
- £ 000`s
- Cash flow from operating activities £
- Receipts from customers £
- Payments to suppliers £
- Payments to employees £
- Interest payments - £
- Interest received £
- Taxes paid - £
- **NET CASH FLOW FROM OPERATING ACTIVITIES** £ Total of above figures £ 000`s

Cash Flow Statement continued

CASH FLOW FROM INVESTING ACTIVITIES			£,000`s
Purchases of equipment	£		
Purchases of property	£		
Proceeds from sale of equipment	£		
Proceeds from sale of property	£		
Net cash flow from investing activities	£	Total of above figures	£,000`s
CASH FLOW FROM FINANCING ACTIVITIES			£,000`s
Proceeds from borrowings	£		
Payments of borrowings (repayment of principal)	£		
Investment into business	£		
Drawings from business investment	£		
Net cash flow from financing activities	£	Total of above figures	£,000`s
NET INCREASE (DECREASE) IN CASH HELD		Total of above 3 total figures	£,000`s
Cash at beginning of period	£		
Cash at end of period	£	**NET INCREASE CASH**	**£,000`S**

Balance Sheet

Balance Sheet
As at 31st March 2009

Assets		
Fixed Assets	10000	
Intangible Assets	5000	
		15000
Current Assets		
Bank	1000	
Stock	500	
Debtors	2000	
		3500
Total Assets		18500
Less		
Creditors falling due in one year		
Creditors	3000	
Loan	500	
		3500
Creditors falling due after one year		
Loan		2000
		5500
Net Assets		**13000**
Capital and reserves		
Issued share capital		2000
Retained Profits		11000
		13000

Balance Sheet explained

- TANGIBLE FIXED ASSETS include:
  - Land
  - Premises
  - Plant & equipment
  - Fixtures and fittings
  - Motor vehicles
- INTANGIBLE FIXED ASSETS include:
  - Purchased intellectual property e.g. trademarks
  - Goodwill on the acquisition of a business
- Fixed assets are initially stated at their purchase price then they are "written down "value" , ie, cost less accumulated depreciation.

Balance Sheet continued

- CURRENT ASSETS   Assets which are either cash or can be readily converted to cash
- Cash at bank
- Trade & other debtors   ie, how much is owed to company – o/s invoices
- Stock
- Prepayments & Accruals - payments and receipts which overlap accounting period
- CURRENT LIABILITIES Liabilities payable within one year.
- Bank overdraft
- Short term bank loan
- Trade creditors   ie, how much does the company owe - o/s bills
- Accruals
- Deferred income

Balance Sheet explained

- LONG TERM LIABILITIES Liabilities due after one year, ie bank loan. For annual statutory accounts a bank loan will be split into the amount that is repayable within the next year as a current liability and the amount repayable after that time as a long term liability
- CAPITAL & RESERVES The financing of the business - share capital and the retained profits. The share capital represents the amounts originally paid for shares issued by the business. One share minimum - £100 share capital (each share is 1%)
- The retained profit is the cumulative profits of the business as calculated from the sum of the retained profits of the business over the period of its operation.
- DIVIDENDS Dividends are paid out of profit after tax. The dividend account acts as part profit and loss account and part balance sheet account. It does not affect any element of the trading profit or the profit chargeable to corporation tax. Once the dividend is paid the remaining amount is the retained earnings. This is the amount transferred to the balance sheet. Public Co pays to reward investors. Private Co pays to save tax.
- Balance Sheet shows the book value of the company. BUT the true value may be different because assets including property might not be valued at current level or fixed assets - plant and machinery might be depreciated at the wrong rate.
- Balance sheet might not provide a figure for goodwill - the value of the company's profit generating

IAS 16 PROPERTY ACCOUNTING

- **IAS 16 PROPERTY PLANT EQUIPMENT Owned by the Company**
- **Ie, freehold property, lifts, escalators, air con**
- According to IAS 16, land and buildings are separable assets and are accounted for separately, even when they are acquired together.
- Land has an unlimited useful life. It is valued at cost and is not depreciated.
- Buildings have a limited useful life. They are initially accounted at cost but like plant they are depreciable assets.
- The depreciable amount (cost less residual value) should be allocated on a systematic basis over the asset's useful life.
- The residual value and the useful life of an asset should be reviewed at least at each financial year-end.
- Property, Plant and Equipment requires impairment testing and, if necessary, recognition for property, plant, and equipment. An item of property, plant, or equipment shall not be carried at more than recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.
- **IAS 16** defines **fair value** as 'the amount for which an asset could be. exchanged between knowledgeable, willing parties in an arm's length transaction`

IAS 17 LEASES

- **IAS 17 LEASES Where the Company holds assets on leases**
- **Ie, property, photocopiers.**
- When a lease includes both land and buildings elements, we should assess the classification of each element as a finance or an operating lease separately.

  In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life, which makes most of the land elements operating leases.
- A building held on a lease with open market or RPI rent reviews is defined as an operating lease – the actual rent cannot be predicted over it`s life or lease term and so it is the actual rent payable that is accounted for.
- A building held on a lease with fixed uplifts is defined as a finance lease – the total rent roll for the lease is known and so is averaged over the lease term and that yearly figure is accounted for.

IAS 40 INVESTMENT PROPERTY

- **IAS 40** defines investment property as: Property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both,
- When a property interest held under an operating lease is classified and accounted for as an investment property, IAS 40 overrides IAS 17 by requiring that the lease is accounted for as if it were a finance lease.
  - Option: Both land and buildings elements are measured at cost and presented under investment property in the statement of financial position. No depreciation is required for the land element but is required for the buildings element.
  - Option: Both land and buildings elements are measured at fair value and presented under investment property in the statement of financial position. No depreciation is required for either the land element or buildings element.
- Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

ROLE OF AN AUDITOR

- Understanding the operations, financial reporting procedures of the Company
- Evaluating and understanding the internal control system
- Identifying variances in account balances or classes of transactions and analysing procedures on expected or unexpected
- Checking documents to support account balances or transactions
- Witnessing inventory count where appropriate
- Confirming accounts receivable and other accounts with a third party
- Providing advice for improving financial reporting and internal controls to maximize a company’s performance and efficiency.
- Auditors DO NOT take responsibility for the financial statements on which they form an opinion. The responsibility for financial statement presentation lies squarely in the hands of the company being audited.
- Auditors DO NOT –
- - assume the role and duties of management
- - authorise or execute transactions on behalf of a client
- - assume custody of client assets, or maintain clients bank accounts

BRIEF SUMMARY OF SEMINAR

- UK GAAP WILL DURING 2015 BECOME MORE ALIGNED TO IAS – MORE DISCLOSURE
- IAS `s 16, 17 & 40 ARE THE KEY ACCOUNTING STATEMENTS FOR PROPERTY & LEASES
- QUOTED (plc) Co`s MUST REPORT FULLY AUDITED FINANCIAL STATEMENTS
- UNQUOTED (private) Co`s CAN STILL SUBMIT ABBREVIATED ACCOUNTS
- SMALLER UNQUOTED CO`S NOT REQUIRED TO HAVE ANNUAL AUDIT
- AUDITORS FOLLOW GAAP & IAS & IFRS BUT STILL HAVE SOME LATITUDE WHEN PRESENTING QUOTED ACCOUNTS AND MUCH LATITUDE WHEN PRESENTING UNQUOTED ACCOUNTS
- ACCOUNTS 3 main financial statements – PROFIT & LOSS - CASH FLOW - BALANCE SHEET
- AS VALUER INVESTMENT ADVISOR OR ASSET MANAGER ASSESSMENT OF COVENANT IS IMPORTANT
- CASH FLOW STATEMENT MORE INFORMATIVE AS TO HEALTH OF SMALL/UNQUOTED COMPANY
- IS COMPANY SHOWING SALES OR MARGIN OR CASH PROFIT GROWTH
- IF A SPECIALIST PROPERTY COVENANT STRENGTH IS EVEN MORE IMPORTANT