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# AUDITING FRAUD II

## PROPERTY PROBLEMS

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# AUDITING FRAUD II

## PROPERTY PROBLEMS?

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### WHAT SHOULD AN PROPERTY AUDIT COST?

- Property fees based on fees/assets rather than fees/turnover.
- Developers typically 0.8 to 4.0 basis points, asset managers 0.5 to 3.0 basis points
- Asia audit extremes: Poly Real Estate vs Guangzhou R&F, Australian REITs

### ACCOUNTING RED FLAGS

- 240 Asian companies with US\$1bn+ market cap examined on 11 accounting ratios
- Tests based on: Investments in Related Companies, Customer Deposits, Inventory, Work In Progress, Receivables, Prepayments, Intangibles, Capitalised Interest & Deferred Tax Liabilities
- The 54 companies with 4+ flags underperformed by 37% over the last three years

### MINING THE DATA

- China, China, China. The really bad news is all in China
- Most Chinese companies with a market cap over US\$1bn score badly i.e. 4+ flags
- All 4+ flags are Chinese, except Guocoland, Oxley, IJM land and High Wealth
- Co.s with single issues, Filinvest, Lippo, NTT Urban, CapitaMalls, Tokyu Fudosan



# AUDITING FRAUD II

## NO SCANDALS YET

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NO ONE HAS COLLAPSED SO FAR...

- Rising property prices & volumes may have helped to hide problems
- But the number companies with lots of red flags suggest it is just a matter of time
- Unqualified audits should not provide any comfort as the due diligence looks limited

ASSET BASED COMPANIES SHOULD BE EASIER TO AUDIT AND SO FEES LOWER

- In many countries, legal title for property is easy to establish and of public record
- Local bank loans mostly require proof of title & purchases are from government
- Economies of scale as a building values should not alter the auditing time

BUT DEVELOPERS ARE VULNERABLE AND AUDITS ARE TOO CHEAP TO BE RELIED ON

- Excessive inventories raise funding risks and magnify pricing risk
- Customer deposits, Prepayments, Intragroup relationships increase opacity
- China Vanke (7), Yuexiu (7), China Fortune (6), Risesun Real (6) and Shenzhen Investment (6) all raise plenty of flags but have low or extremely low cost audits.



# AUDITING FRAUD II

## EXTREMELY CHEAP AUDITS

### ASIA'S LOWEST AUDITING FEES

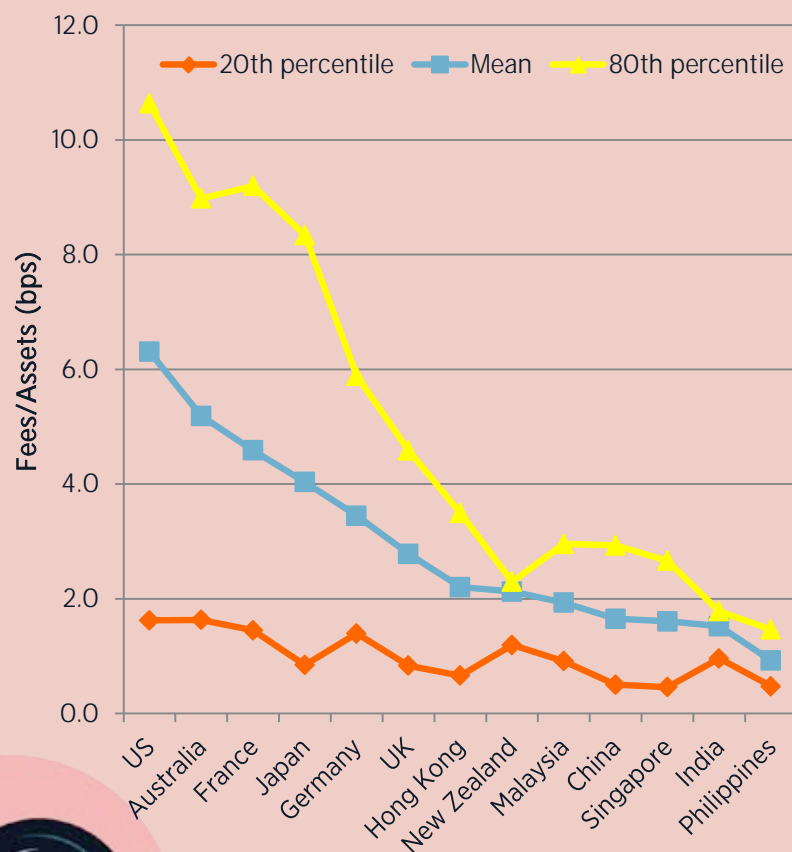
Name	Ticker	Industry	Market cap. (US\$bn)	Total Assets (US\$m)	Audit Fee (US\$)	Audit cost (Bps)
Poly Real Esta-A	600048 CH	R.E. Development	8.2	51,870	276,525	0.05
China Res Land	1109 HK	R.E. Development	10.9	36,338	433,050	0.12
Ascendas Real Es	AREIT SP	Industrial REITs	4.5	5,847	69,915	0.12
China Fortune-A	600340 CH	Diversified R.E.	5.5	12,242	162,662	0.13
China Vanke Co-B	200002 CH	R.E. Development	13.5	79,176	1,382,626	0.18
Nanjing Gaoke-A	600064 CH	Diversified R.E.	860	2,622	48,799	0.18
Belle Corp	BEL PM	R.E. Development	1,431	711	23,579	0.32
<b>Special Mention</b>						
Newtime Infrastr	NIL IN	R.E. Development	0.1	17	704	0.38
Swan Energy Ltd	SWAN IN	R.E. Development	0.2	211	4,137	0.20
Amfirst Reit	ARET MK	Office Reits	0.2	420	6,467	0.15



# AUDITING FRAUD II

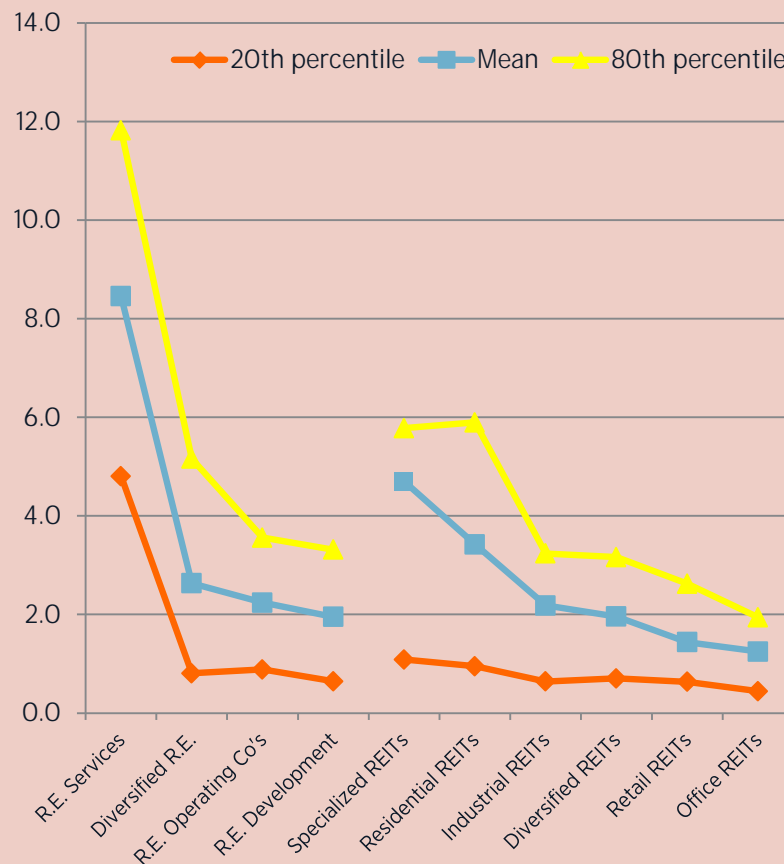
## AUDITING COSTS AROUND THE WORLD

### Audit costs by Country



Source: Bloomberg and GMT Research

### Audit costs by Industry



Source: Bloomberg and GMT Research



# AUDITING FRAUD II

## AUDIT FEE BENCHMARKS

### CONTRASTING FEES IN THE PROPERTY INDUSTRY

Country	Name	Ticker	Market cap (US\$bn)	Total Assets (US\$bn)	Audit Fee (US\$)	Audit Fee (Bps)
China	Guangzhou R&F	2777 HK	4.0	23.1	1,530,000	0.67
China	Poly Real Estate	600482 CH	8.2	51.8	280,000	0.05
Australia	Dexus Property	DXS AU	5.7	7.1	2,720,000	3.41
Australia	CFS REIT	CFX AU	5.7	7.9	760,000	0.85

### FEE BENCHMARKS

- Normal fee range 0.75-3.0 basis points of Assets
- Fewer extremes and generally tighter ranges compared to industrial companies
- 22% of companies in Asia are in the Low category



# AUDITING FRAUD II

## CALCULATING NINE RED FLAGS

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### ACCOUNTING RATIO SCORING REQUIREMENTS

- |   |     |
|---|-----|
| • Investments in Related companies/Equity > | 20% |
| • Customer Advances reduce Net Debt by >    | 30% |
| • Pre-Sales/Turnover>                       | 50% |
| • Inventory days >                          | 730 |
| • Work In Progress/Total assets >           | 30% |
| • Receivables - days >                      | 60  |
| Or as a % of Equity >                       | 20% |
| • Prepaid Expenses/Equity >                 | 20% |
| • Intangibles/Equity >                      | 20% |
| • Capitalised Interest/Equity >             | 20% |
| • Deferred Taxes/Equity >                   | 15% |
| • Unrealised profit/Equity >                | 30% |

Multiple problems should equate to extra due diligence





# AUDITING FRAUD II

## RED FLAGS MATTER TO INVESTORS...

### 4+ FLAGS COMPANIES UNDERPERFORM

Red Flags	0	1	2	3	4	5	6	7
Stock performance over 3 years								
Equal weight	24%	29%	20%	(11%)	(21%)	(25%)	(27%)	(7%)
Cap. Weighted	29%	41%	39%	(14%)	(14%)	(7%)	(8%)	10%
No of companies	43	39	29	24	25	21	10	6
Performance over 1 year								
Equal weight	(7%)	(5%)	(6%)	(9%)	(14%)	(22%)	(21%)	(16%)
Cap. Weighted	(4%)	(4%)	(5%)	(15%)	(20%)	(17%)	(10%)	(28%)
No of companies	51	49	33	27	24	24	11	6





# AUDITING FRAUD II

## ...BUT NOT TO COMPANY AUDITORS

### HIGH FLAGS AND LOW FEES

Name	Ticker	Industry	Mkt Cap (US\$bn)	Red Flags	Audit Fee (Bps)
China Vanke Co	200002 CH	Real Estate Development	14.3	7	0.18
Yuexiu Property	123 HK	Diversified Real Estate Activities	1.8	7	0.80
China Fortune	600340 CH	Diversified Real Estate Activities	5.5	6	0.13
Risesun Real	002146 CH	Real Estate Development	3.3	6	0.21
Shenzhen Invest.	604 HK	Diversified Real Estate Activities	1.7	6	0.68
Thaihot Group	000732 CH	Diversified Real Estate Activities	1.4	5	0.20
Shang Shimao-A	600823 CH	Real Estate Development	1.6	5	0.23
China Merchant-B	200024 CH	Real Estate Development	4.5	5	0.26
Jinke Properties	000656 CH	Real Estate Development	1.3	5	0.27
Financial St-A	000402 CH	Real Estate Development	2.9	5	0.30
Beijing Capital	600376 CH	Real Estate Development	1.6	5	0.30



# AUDITING FRAUD II

## THE SHORTLIST

### 33 COMPANIES HAD MULTIPLE PROBLEMS AND LOW FEES

Name (Ticker)	Name (Ticker)	Name (Ticker)
China Vanke (200002 CH) - 7	Shenzhen Invest (604 HK) - 7	Carnival Group (996 HK) - 7
Hopson Dev (754 HK) - 7	Evergrande Real (3333 HK) - 6	China Fortune (600340 CH) - 6
Risesun Real (002146 CH) - 6	Franshion Ppt (817 HK) - 6	Shang Shimao (600823 CH) - 6
Thaihot Group (000732 CH) - 6	Beijing Capital (600376 CH) - 5	China Merchant (200024 CH) - 5
Country Garden (2007 HK) - 5	Financial St-A (000402 CH) - 5	Greattown Hldg (900940 CH) - 5
Jinke Prop. (000656 CH) - 5	Kaisa Group Hold (1638 HK) - 5	Poly Property (119 HK) - 5
Shui On Land Ltd (272 HK) - 5	Sunac China Hold (1918 HK) - 5	Guocoland Ltd (GUOL SP) - 6
China Res Land (1109 HK) - 4	Poly Real Esta (600048 CH) - 4	Longfor Prop. (960 HK) - 4
Shang Lujiazui (600663 CH) - 4	Macrolink Real (000620 CH) - 4	Hangzhou Binj. (002244 CH) - 4
Suning Univ. (000718 CH) - 4	Beijing Urban (600266 CH) - 4	Yinyi Real Est. (000981 CH) - 4
Hang Lung Group (10 HK) - 4	Kerry Properties (683 HK) - 4	Dif Ltd (DLFU IN) - 4

OVER HALF OF THE COMPANIES THAT RAISED 4 OR MORE RED FLAGS



# AUDITING FRAUD II

## RED FLAG 1: INVESTMENTS IN RELATED CO.S

SCORED WHEN INVESTMENTS IN RELATED COMPANIES ARE > 20% OF EQUITY

Investment in associates/unconsolidated related companies can be used to disguise leverage and move profits/losses from one company to another

Short Name	Ticker	Industry	Mkt cap (US\$bn)	Investment as % of equity	Audit Fees (bps)	Audit Fee Range
Westfield Group	WDC AU	Retail REITs	21.1	102%	3.2	High
Capitamalls Asia	CMA SP	Real Estate Operating Co.	6.9	93%	0.5	Low
Ruentex Develop.	9945 TT	Real Estate Development	2.1	92%	N/A	N/A
Capitaland Ltd	CAPL SP	Diversified Real Estate	10.3	89%	0.6	Low
Charter Hall Group	CHC AU	Diversified REITs	1.4	77%	5.3	High
KWG Property	1813 HK	Real Estate Development	1.5	74%	0.7	Normal
Westfield Retail	WRT AU	Retail REITs	8.8	67%	0.8	Normal
Central China	832 HK	Real Estate Development	0.6	63%	1.5	Normal
Goodman Group	GMG AU	Industrial REITs	8.1	59%	2.2	Normal
Sunac China Hldg.	1918 HK	Real Estate Develop.	1.5	58%	0.5	Low



# AUDITING FRAUD II

## RED FLAG 2: IMPACT OF DEPOSITS ON NET DEBT

SCORED IF CUSTOMER DEPOSITS LOWER NET DEBT BY MORE THAN 30%

Customer prepayments and deposits, if sufficiently large, can distort the balance sheet and disguise liquidity issues

Name	Ticker	Industry	Mkt Cap US\$bn	Net Debt with Deposits	Net Debt without Deposits	Audit cost (bps)	Audit range
Longfor Prop.	960 HK	R.E. Develop.	6.8	39%	<b>64%</b>	0.3	Low
Hangzhou Binj	002244 CH	R.E. Develop.	1.3	49%	<b>77%</b>	0.3	Low
China Fortune	600340 CH	Div. Real Estate	5.5	55%	<b>87%</b>	0.1	Low
China Vanke C	200002 CH	R.E. Develop.	14.3	38%	<b>72%</b>	0.2	Low
Kaisa Group	1638 HK	R.E. Develop.	1.5	47%	<b>72%</b>	0.5	Low
Suning Universal	000718 CH	Div. Real Estate	1.3	45%	<b>71%</b>	0.4	Low
Aeon Mall Co	8905 JP	R.E. Op. Co.	5.6	30%	<b>45%</b>	0.7	Low
China Overseas	81 HK	R.E. Develop.	1.3	40%	<b>55%</b>	0.4	Low
Country Garden	2007 HK	R.E. Develop.	7.8	46%	<b>70%</b>	0.3	Low
Franshion Ppt	817 HK	Div. Real Estate	2.7	42%	<b>57%</b>	0.4	Low

\*Companies are ranked in order of the change in Net Debt



# AUDITING FRAUD II

## RED FLAG 3: PRE-SALES AS A % OF TURNOVER

SCORED IF PRE-SALES ARE GREATER THAN 50% OF TURNOVER

Excessive Customer Prepayments and Deposits may be used to fund unrelated projects allowing the company to overextend itself

Name	Ticker	Industry	Mkt Cap (US\$bn)	Deposits as a % of Turnover	Audit Fees (Bps)	Audit Fee Range
Filinvest Dev	FDC PM	R.E. Development	1.1	<b>334%</b>	N/A	N/A
Carnival Group	996 HK	R.E. Operating Co.	1.0	<b>231%</b>	0.6	Low
Zhongtian Urban	000540 CH	R.E. Development	1.1	<b>202%</b>	0.7	Normal
Hangzhou Binj-A	002244 CH	R.E. Development	1.4	<b>180%</b>	0.3	Low
China Fortune-A	600340 CH	Diversified Real Estate	5.3	<b>178%</b>	0.1	Low
Beijing Capital	600376 CH	R.E. Development	1.5	<b>171%</b>	0.3	Low
Sunshine City	000671 CH	R.E. Development	1.3	<b>171%</b>	0.9	Normal
Commodities City	600415 CH	R.E. Development	2.4	<b>161%</b>	0.8	Low
Kaisa Group Hldg	1638 HK	R.E. Development	1.5	<b>152%</b>	0.5	Low
Beijing Urban-A	600266 CH	R.E. Development	1.3	<b>142%</b>	0.3	Low



# AUDITING FRAUD II

## RED FLAG 4: EXCESSIVE INVENTORY

SCORED WHEN INVENTORY EXCEEDS 730 DAYS TURNOVER

Two years inventory should allow for construction time so anything over this is a worry

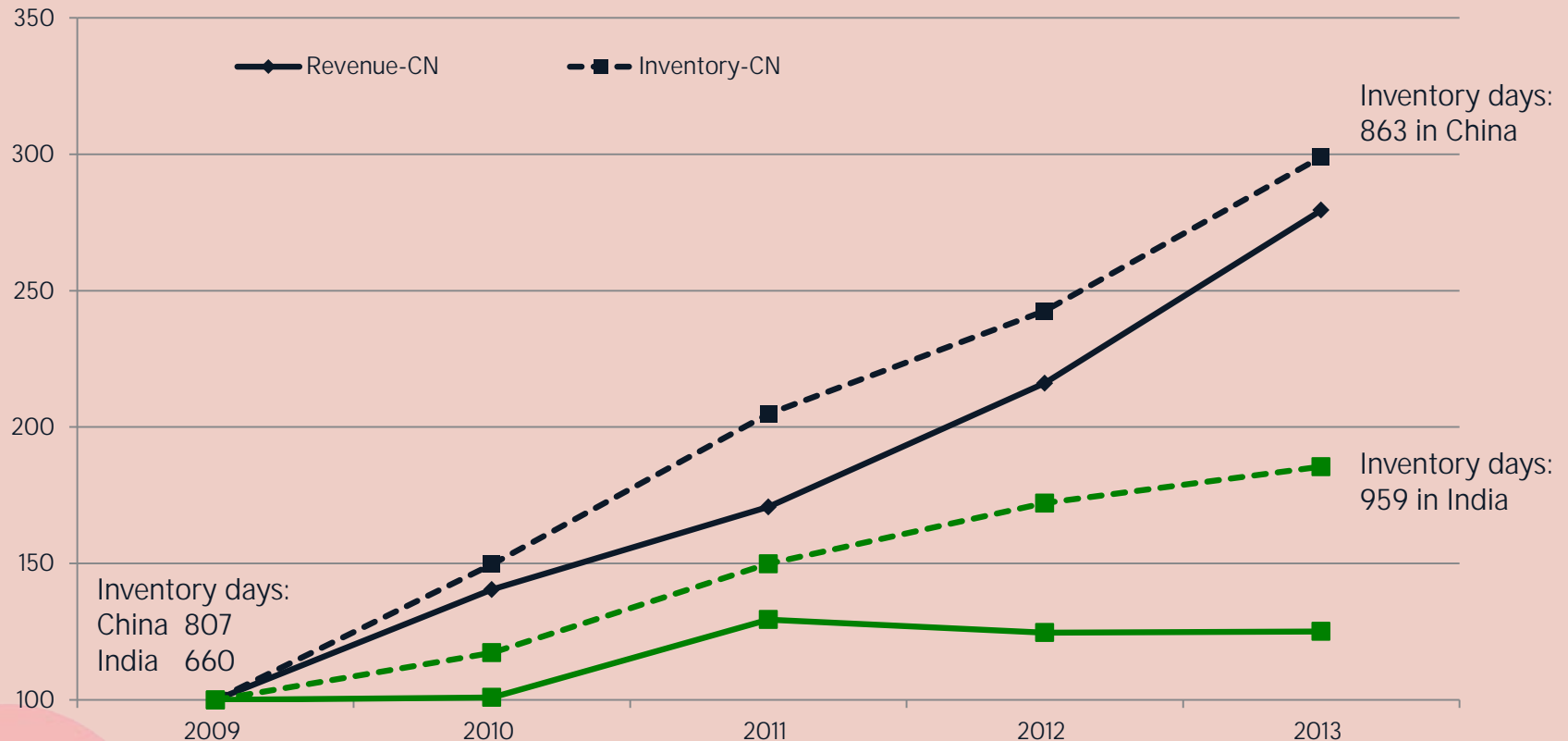
Name	Ticker	Industry	Mkt Cap (US\$bn)	Inventory days	Audit Fee (Bps)	Audit Fee Range
Guocoland Ltd	GUOL SP	Real Estate Development	2.1	2,601	0.4	Low
Oceanwide Hold-A	000046 CH	Diversified Real Estate	3.3	2,283	N/A	N/A
Beijing Capita-A	600376 CH	Real Estate Development	1.6	1,993	0.3	Low
Shang Lujiazui-A	600663 CH	Diversified Real Estate	4.4	1,963	0.5	Low
Hopson Dev	754 HK	Real Estate Development	2.0	1,785	0.4	Low
Cheung Kong	1 HK	Real Estate Development	40.2	1,712	0.2	Low
Shanghai Chent-A	600649 CH	Real Estate Development	3.2	1,709	N/A	N/A
China Enterprise	600675 CH	Real Estate Development	1.4	1,682	0.6	Low
Keppel Land Ltd	KPLD SP	Real Estate Development	4.3	1,598	0.7	Low
Thaihot Group -A	000732 CH	Diversified Real Estate	1.4	1,569	0.2	Low



# AUDITING FRAUD II

## INVENTORY ISSUES – INDIA/CHINA, 2009-2012

Inventories are large and still growing faster than revenues (up 3x in China)



Inventory and Revenues rebased to 100 in 2009

Source: Bloomberg and GMT Research

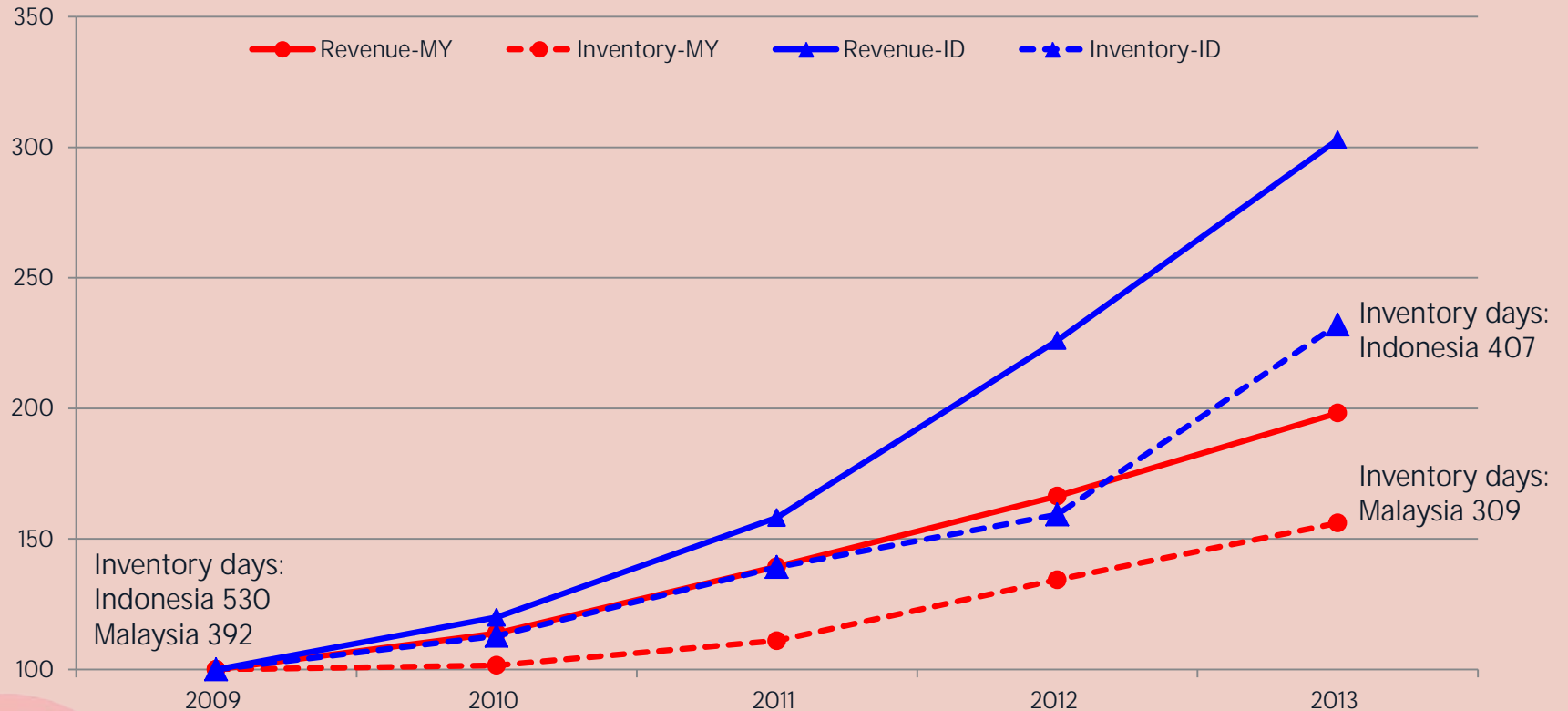




# AUDITING FRAUD II

## LOOKING HEALTHIER - MALAYSIA/INDONESIA

Revenue grows faster than inventory so inventory days fall



Inventory and Revenues rebased to 100 in 2009

Source: Bloomberg and GMT Research



# AUDITING FRAUD II

## RED FLAG 5: HIGH WIP AS A % OF ASSETS

SCORED WHEN WORK IN PROGRESS EXCEEDS 30% OF TOTAL ASSETS

Picks up completion risk for both developer work in progress and investment projects

Name	Ticker	Industry	Mkt Cap (US\$bn)	Inventory days	Audit Fee (Bps)	Audit Fee Range
Pruksa Real Esta	PS TB	Real Estate Development	1.6	87%	N/A	N/A
Oceanwide Hold-A	000046 CH	Diversified Real Estate	3.3	75%	N/A	N/A
Suning Universal	000718 CH	Diversified Real Estate	1.3	71%	0.4	Low
China Vanke Co-B	200002 CH	Real Estate Development	14.3	65%	0.2	Low
Sunshine City -A	000671 CH	Real Estate Development	1.4	64%	0.9	Normal
Yanlord Land Gro	YLLG SP	Real Estate Development	1.7	63%	0.9	Normal
Thaihot Group -A	000732 CH	Diversified Real Estate	1.4	61%	0.2	Low
Beijing Urban-A	600266 CH	Real Estate Development	1.3	60%	0.3	Low
Yinyi Real Est-A	000981 CH	Real Estate Development	1.1	59%	0.6	Low
Jinke Properti-A	000656 CH	Real Estate Development	1.3	59%	0.3	Low



# AUDITING FRAUD II

## RED FLAG 6: EXCESSIVE RECEIVABLE DAYS

SCORED WHEN RECEIVABLES EXCEED 60 DAYS TURNOVER OR 20% OF EQUITY

Excessive receivables expose the company to undue credit risks.

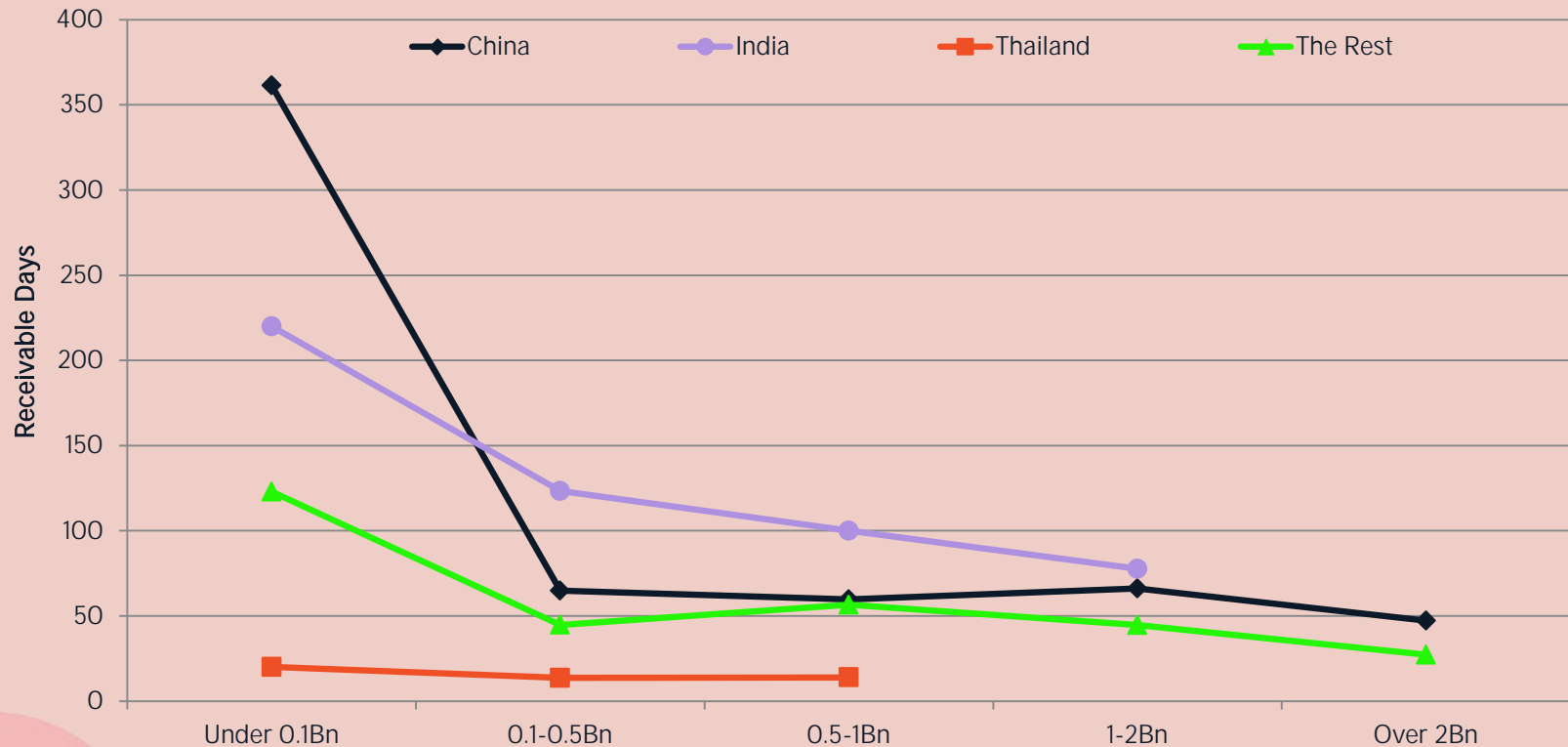
Name	Ticker	Industry	Mkt Cap (US\$bn)	Receivable days	Audit Fee (Bps)	Audit Fee Range
Oxley Holdings	OHL SP	R.E. Development	1.8	567	1.0	Normal
Renhe Comm.	1387 HK	R.E. Operating Co.	1.1	519	3.1	Normal
Vista Land & Life	VLL PM	R.E. Development	1.2	336	1.7	Normal
Shang Zhangjia	600895 CH	Diversified Real Estate	1.6	331	0.9	Normal
Unitech Ltd	UT IN	R.E. Development	1.3	232	1.6	Normal
Megaworld	MEG PM	R.E. Development	3.4	231	0.5	Low
Fragrance Gp	FRAG SP	R.E. Development	1.2	210	0.8	Normal
Shanghai Indus	600748 CH	R.E. Development	1.2	187	0.5	Low
China Merchant	200024 CH	R.E. Development	4.5	180	0.3	Low
E-House China	EJ US	Real Estate Services	1.4	178	10.1	Normal



# AUDITING FRAUD II

## RECEIVABLE ISSUES – INDIA/CHINA

Small companies suffer the most but Thailand has learnt from the crisis



Source: Bloomberg and GMT Research

Source: Bloomberg and GMT Research



# AUDITING FRAUD II

## RED FLAG 6: HIGH RECEIVABLES AS % OF EQUITY

SCORED WHEN RECEIVABLES EXCEED 60 DAYS TURNOVER OR 20% OF EQUITY

It seems unusual that a property company should be extending vendor credit

Name	Ticker	Industry	Mkt Cap (US\$bn)	Receivables as a % of equity	Audit Fee (Bps)	Audit Fee Range
Tianjin Jin	000897 CH	Real Estate Development	1.3	79%	0.9	Normal
Lend Lease Gp	LLC AU	Diversified Real Estate	7.1	51%	5.9	High
China Vanke Co	200002 CH	Real Estate Development	14.3	49%	0.2	Low
Risesun Real	002146 CH	Real Estate Development	3.3	47%	0.2	Low
China Fortune	600340 CH	Diversified Real Estate	5.5	41%	0.1	Low
Sunshine City	000671 CH	Real Estate Development	1.4	40%	0.9	Normal
Zhongtian Urban	000540 CH	Real Estate Development	1.1	36%	0.7	Normal
Gemdale Corp	600383 CH	Real Estate Development	5.9	35%	N/A	N/A
Cifi Holdings	884 HK	Real Estate Development	1.1	33%	1.2	Normal
Beijing Capital	600376 CH	Real Estate Development	1.6	31%	0.3	Low



# AUDITING FRAUD II

## RED FLAG 7: EXCESSIVE PREPAID EXPENSES

SCORED WHEN PREPAID EXPENSES EXCEED 20% OF EQUITY

Prepaid expenses allow room for fraud and exposes the company to credit risks

Name	Ticker	Industry	Mkt Cap (US\$bn)	Pre-payment as a % equity	Audit fee (Bps)	Audit Fee Range
Sunshine City -A	000671 CH	Real Estate Development	1.4	<b>208%</b>	0.9	Normal
Thaihot Group -A	000732 CH	Diversified Real Estate	1.4	<b>124%</b>	0.2	Low
Zhuguang Holding	1176 HK	R.E. Operating Co.	1.3	<b>82%</b>	1.6	Normal
Evergrande Real	3333 HK	Real Estate Development	6.4	<b>82%</b>	0.4	Low
Unitech Ltd	UT IN	Real Estate Development	1.3	<b>63%</b>	1.6	Normal
Risesun Real -A	002146 CH	Real Estate Development	3.3	<b>58%</b>	0.2	Low
Hangzhou Binj-A	002244 CH	Real Estate Development	1.3	<b>45%</b>	0.3	Low
Greattown Hold-B	900940 CH	Real Estate Development	1.3	<b>40%</b>	0.5	Low
China Vanke Co-B	200002 CH	Real Estate Development	14.3	<b>37%</b>	0.2	Low
Carnival Group	996 HK	R.E. Operating Co.	1.0	<b>37%</b>	0.9	Low



# AUDITING FRAUD II

## RED FLAG 8: LARGE INTANGIBLES

SCORED WHEN INTANGIBLES EXCEED 20% OF EQUITY

Goodwill and Intangibles rely on too much managements assessment of their value.  
Moreover what sort of intangibles does a property company need/create?

Name	Ticker	Industry	Mkt Cap (US\$bn)	Intangibles / Equity	Audit Fee (Bps)	Audit Fee Range
Tokyu Fudosan	3289 JP	Diversified Real Estate Activities	4.9	32%	N/A	N/A
Lend Lease Grp.	LLC AU	Diversified Real Estate Activities	7.1	29%	5.9	High
Belle Corp	BEL PM	Real Estate Development	1.4	29%	0.3	Low
Industrial & Infra.	3249 JP	Industrial REITs	1.4	27%	N/A	N/A
Mori Hills Inves	3234 JP	Office REITs	1.9	24%	N/A	N/A
E-House China	EJ US	Real Estate Services	1.4	23%	10.1	Normal
Japan Hotel Reit	8985 JP	Hotel & Resort REITs	1.2	22%	N/A	N/A
Daikyo Inc	8840 JP	Real Estate Development	1.7	21%	5.2	High





# AUDITING FRAUD II

## RED FLAG 9: CAPITALISED INTEREST

SCORED WHEN CAPITALISED INTEREST EXCEEDS 10% OF EBITDA & 20% OF EARNINGS

Capitalising interest improves profits, boosts asset values and disguises credit issues

Name	Ticker	Industry	Mkt Cap (US\$bn)	Capitalised interest/ EBITDA	Earnings effect w/o capitalising	Audit Fee (Bps)	Audit Fee Range
Hopson Dev.	754 HK	Real Estate Dev.	2.0	75%	(83%)	0.4	Low
KWG Property	1813 HK	Real Estate Dev.	1.7	67%	(61%)	0.7	Normal
Lippo Karawaci	LPKR IJ	Real Estate Dev.	2.2	55%	(81%)	N/A	N/A
Evergrande Real	3333 HK	Real Estate Dev.	6.4	41%	(61%)	0.4	Low
Kaisa Group	1638 HK	Real Estate Dev.	1.5	39%	(69%)	0.5	Low
Financial St-A	000402 CH	Real Estate Dev.	2.9	38%	(62%)	0.3	Low
Sino Ocean	3377 HK	Real Estate Dev.	3.9	36%	(55%)	1.0	Normal
Sunac China	1918 HK	Real Estate Dev.	1.5	32%	(61%)	0.5	Low
Goodman Group	GMG AU	Industrial REITs	8.1	30%	(59%)	2.2	Normal
Beijing North-H	588 HK	Real Estate Dev.	1.3	29%	(64%)	1.9	Normal



# AUDITING FRAUD II

## RED FLAG 9: CAPITALISED INTEREST

SCORED WHEN CAPITALISED INTEREST EXCEEDS 10% OF EBITDA & 20% OF EARNINGS

Capitalising interest costs makes these companies look profitable

Name	Ticker	Industry	Mkt Cap (US\$bn)	Capitalised interest/ EBITDA	Earnings effect w/o capitalising	Audit Fee (Bps)	Audit Fee Range
Shui On Land	272 HK	Real Estate Dev.	2.1	100%	Turns to loss	0.5	Low
Guocoland Ltd	GUOL SP	Real Estate Dev.	2.1	100%	Turns to loss	0.4	Low
Beijing Capita-A	600376 CH	Real Estate Dev.	1.6	100%	Turns to loss	0.3	Low
Glorious Propert	845 HK	Real Estate Dev.	1.1	100%	Turns to loss	1.9	Normal
Poly Property	119 HK	Div. Real Estate	1.6	62%	Turns to loss	0.7	Low
Stockland	SGP AU	Diversified REITs	8.2	31%	Turns to loss	2.1	Normal



# AUDITING FRAUD II

## RED FLAG 10: HIGH DEFERRED TAX

SCORED WHEN LONG TERM DEFERRED TAX EXCEEDS 15% OF EQUITY

Long term deferred tax liabilities are created when unrealised profits are booked due to revaluations, intra group asset transfers, different tax and accounting depreciation rates or capitalisation of interest

Name	Ticker	Industry	Mkt Cap (US\$bn)	Deferred Tax/ Equity	Audit fee (Bps)	Audit Fee Range
Wanda Comm.	169 HK	R.E. Development	1.3	<b>102%</b>	1.9	Normal
Sunac China	1918 HK	R.E. Development	1.5	<b>48%</b>	0.5	Low
Mitsubishi Estat	8802 JP	Diversified Real Estate	32.8	<b>39%</b>	0.6	Low
NTT Urban Dev	8933 JP	R.E. Operating Co.	2.9	<b>34%</b>	0.8	Low
Tokyo Tatemono	8804 JP	Diversified Real Estate	3.8	<b>24%</b>	1.3	Normal
Zall Development	2098 HK	R.E. Development	1.2	<b>23%</b>	1.3	Normal
Yuexiu Property	123 HK	Diversified Real Estate	1.8	<b>22%</b>	0.8	Normal
China South	1668 HK	Diversified Real Estate	3.1	<b>22%</b>	1.0	Normal
Tian An China	28 HK	R.E. Development	1.2	<b>20%</b>	2.0	Normal
Nomura Real Est.	3231 JP	Diversified Real Estate	3.5	<b>20%</b>	1.3	Normal



# AUDITING FRAUD II

## RED FLAG 11: LARGE UNREALISED PROFITS

SCORED WHEN UNREALISED PROFITS EXCEED 30% OF EQUITY

Unrealised profits are the counterparty to Deferred tax. With 15% to 40% tax rates in Asia, the ratio of tax to implied profit varies a lot. For a developer, large unrealised profits as a % of book value questions the real level of operating profit.

Name	Ticker	Industry	Mkt Cap (US\$bn)	Unrealised Profit/ Equity	Audit fee (Bps)	Audit Fee Range
Wanda Comm.	169 HK	R.E. Development	1.3	<b>307%</b>	1.9	Normal
Carnival Group	996 HK	R.E. Operating Co.	1.0	<b>143%</b>	0.9	Low
Sunac China	1918 HK	R.E. Development	1.5	<b>143%</b>	0.5	Low
Hang Lung Gp	10 HK	Div. Real Estate	7.4	<b>85%</b>	0.6	Low
Zall Dev.	2098 HK	R.E. Development	1.2	<b>68%</b>	1.3	Normal
Yuexiu Property	123 HK	Div. Real Estate	1.8	<b>67%</b>	0.8	Normal
China South	1668 HK	Div. Real Estate	3.1	<b>66%</b>	1.0	Normal
Renhe Comm.	1387 HK	R.E. Operating Co.	1.1	<b>65%</b>	3.1	Normal
Mitsubishi Estat	8802 JP	Div. Real Estate	32.8	<b>63%</b>	0.6	Low
Tian An China In	28 HK	R.E. Development	1.2	<b>61%</b>	2.0	Normal



# AUDITING FRAUD II

## CONCLUSIONS

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### EXTREME FEES SHOULD RAISE CONCERN

- The “Normal” range for property companies is 0.75-3.5 basis points of asset value
- Low fees suggest inadequate due diligence
- Very high fees should make you wonder why

### SO SHOULD MULTIPLE FLAGS AND NORMAL FEES

- Lots of problems should attract auditing scrutiny, raising fees
- The 30 companies with problems and low fees are clearly an issue
- But lots of flags and “normal” fees should encourage investors to ask questions

### INVESTING ON THE BACK OF EXTREME AUDITS IS A LEAP OF FAITH

- Low fees rely on superb systems, management transparency and honesty
- High fees mean ignoring obvious problems or the possibility of something hidden
- Either way, it is time to dig around



# AUDITING FRAUD II

## LIST OF APPENDICES

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### DATA IN DETAIL

- Audit costs by Industry around the world
- Audit costs by Country
- Four or more Red Flags with “Low” Audit Fees
- Four or more Red Flags with “Normal” Audit Fees
- Email [Robert@GMTResearch](mailto:Robert@GMTResearch) for the spreadsheet covering stocks in Asia, red flag scores and accounting fees



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