

COMMERCIAL PROPERTY SERVICE CHARGE SEMINAR

Change we can all believe in

SERVICE CHARGES WITHIN THE UK OFFICE MARKET: EVIDENCE ON ACCOUNTING PRACTICE, COMPLIANCE AND DISCLOSURE

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managing service charges



The Approach to the Kingston Report

- Accepted views:
 - “Anecdotal” (RICS)
 - Sectoral problem e.g. retail
 - Economic conditions i.e. ‘Credit Crunch’
 - OSCAR and Loughborough databases
- Methodology
 - Rigorous method
 - Representative, original, empirical evidence



The Kingston Report's Findings:

- Willing and unwilling landlords
- Interested and disinterested tenants
- Compliant and non-compliant managing agents

- Opaque and inconsistent accounting
- Insufficient levels of accounting disclosure
- Lack of transparency, cooperation and communication



The Accounting Requirements of the Code

- an annual budget of likely service charge expenditure one month prior to commencement of the service charge year
- certified accounts within four months of the end of the service charge year, that provide a consistent, detailed and comprehensive summary of items of expenditure with full explanations of material variations against the budget.
- narrative explanation and disclosures about significant individual costs and variances from previous year's budget/accounts
- the use of standard cost codes and a clearly defined apportionment basis
- disclosure on interest earned on service charge monies
- disclosure of the calculation basis for any sinking, replacement or reserve fund contribution and the items to which it relates.
- disclosure on contributions to and expenditure from sinking, replacement and reserve funds, together with the opening and closing balances and the amount of interest earned and tax paid in the relevant period.



What should we expect of accounting data?

Figure 1: The Qualitative Characteristics of Financial Information

<p>Understandability Should be readily understandable (assumes that users have reasonable knowledge and a willingness to study the information)</p>	<p>Relevance Should be capable of influencing users' decisions (if information is not material, it is not relevant)</p>	<p>Reliability Should be a complete and faithful representation, neutral and prudent</p>	<p>Comparability Should be timely and prepared on a consistent basis so users can make comparisons</p>
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Adapted from IASB (1989)



The Accounting Issues

- Timeliness of the accounting information
- Accuracy of the accounting information
- Quality of the accounting information
- Disclosure on sinking funds
- Sign off procedures and obligations



Timeliness of accounting information

“Your heart sinks when you get service charge balancing accounts that are three or four years out of date or even longer”

Table 1		2007		2008		Change
Timeliness of Accounting Data		No	%	No.	%	
Budgets arriving 1 month <i>prior</i> to start of period		3	7.0%	16	23.2%	16.2%
Budgets arriving <i>within</i> 1 month of start of period		22	51.2%	42	60.9%	9.7%
Budgets arriving <i>within</i> 3 months of start of period		29	67.4%	53	76.8%	9.4%
Budgets arriving <i>within</i> 9 months of start of period		38	88.4%	65	94.2%	5.8%
Budgets arriving <i>within</i> 12 months of start of period		40	93.0%	67	97.1%	4.1%
Budgets arriving <i>after</i> 12 months of start of period		3	7.0%	2	2.9%	-4.1%
Total budgets examined		43		69		
Certificates arriving within 4 months of end of period		30	41.7%	11	61.1%	19.4%
Certificate arriving over 4 months <i>after</i> period end		42	58.3%	7	38.9%	-19.4%
Total certificates examined		72		18		

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Accuracy of accounting information

“The level of disclosure is appalling. In fact the whole of the accounting process in property is appalling”

Table 2 Accuracy of Service Charge Budgets	2007		2008		Change
	No	%	No.	%	
Budgets within +/-2% of actual service charge	17	15.3%	4	14.8%	-0.5%
Budgets <i>exceeding</i> +2% of actual service charge	59	53.2%	14	51.9%	-1.3%
Budgets above -2% of actual service charge	35	31.5%	9	33.3%	1.8%
Budgets 10% or more <i>above</i> actual service charge	40	36.0%	8	29.6%	-6.4%
Budgets 25% or more <i>above</i> actual service charge	24	21.6%	4	14.8%	-6.8%
Budgets 10% or more <i>below</i> actual service charge	18	16.2%	6	22.2%	6.0%
Budgets 25% or more <i>below</i> actual service charge	8	7.2%	2	7.4%	0.2%
Total budgets examined	111		27		

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Quality of the accounting disclosure

“Nine times out of ten, maybe more than that, we have to interrogate it, ask for information.”

Table 3: Accounting Compliance Levels Comparative Analysis of Disclosure Metrics		2007		2008		Change
		No	%	No.	%	
Certificates providing a clear apportionment basis	70	35.4%	22	36.1%	0.7%	
Total certificates examined	198		61			
Certificates mentioning a fixed management fee	47	34.6%	19	55.9%	21.3%	
Total certificates examined	136		34			
Certificate including interest on service charges	62	31.0%	26	42.6%	11.6%	
Total certificates examined	200		61			

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Accounting for sinking funds

“We don’t even know sometimes what’s in the fund. There is limited transparency”

“What some landlords seem to forget is that this is actually tenant’s money”

Table 4: Accounting Disclosures for Sinking Funds & RICS Code 22 Forward Funding	2007		2008		Change
	No.	%	No.	%	
Budgets including RICS Code 22 Forward Funding	32		36		
Certificates including RICS Code 22 Forward Funding	20		4		
Total documents examined	52		40		
Certificates deemed to be clearly referring to a "sinking fund"	7	35.0%	2	50.0%	15.0%
Disclosure of balance & movements on sinking fund	0	0.0%	0	0.0%	0.0%
Additional Disclosure for the sinking fund	0	0.0%	0	0.0%	0.0%
Disclosure of interest earned on sinking fund	0	0.0%	0	0.0%	0.0%
Total certificates examined	20		4		

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Additional Disclosure for the sinking fund	0	0.0%	0	0.0%	0.0%
Disclosure of interest earned on sinking fund	0	0.0%	0	0.0%	0.0%
Total certificates examined	20		4		



Conclusions of the Kingston Report

- The Role of the RICS:
 - Monitoring and benchmarking of compliance
 - Regulation?
 - ‘Badging’ for excellence
- The Code itself
 - More specific accounting guidance e.g. examples of Code compliant accounting statements



Change to believe in?

- Compulsory (independent) financial audit of accounts
- Standardised statements of procedure, confirming that:
 - Accounts are prepared in accordance with relevant accounting policies, providing a ‘true and fair’ reflection of transactions
 - Expenditure is lease compliant
 - And whether Code compliant
- Third party verification of ‘value for money’