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Tax and business advisors

A FIST FULL OF DOLLARS

Ladies and Gentlemen,

I am grateful to the chairman for allowing an accountant to intrude on what is perhaps considered to be the lawyers' domain.

I would briefly like to put a perspective from the view of the reporting accountant. My firm acts for about 500 entities across London and the South East ranging from a block of, say, 10 flats to what is a multi-sector village of mixed development, including leaseholds, freeholds, and commercial premises. About 90% are managed by about 40 managing agents and 10% self- managed.

Firstly may I begin by stating the obvious:

- An Englishman's home is his castle, but in recent times that castle is more and more likely to be a leasehold property. And this type of property is likely to be the fastest growing housing sector for years to come.
- It follows that the property is likely to be a flat or apartment which is part of a block and therefore to maintain that block all residents have to contribute to its maintenance. I stress this is a person's home and monies spent on it are therefore critical. Thus service charges are very important. And the accounts are one of the key means of giving the residents a picture of what has been going on.

Since 1971 when I prepared my first set of service charge accounts, I have seen many changes to a variety of issues (apart from the introduction of legislation):

- The continuing introduction and updating of various codes of practice e.g. the RICS Code of Practice – BUT they are only codes
- The formation of ARMA who have created standards for their members to work with – BUT it is only just over 20 years old and still growing teeth.
- These standards and codes encourage the emphasis on having SCA funds in a designated trust fund account and the awareness of timescales and procedures for SCA preparation

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- The improvement in the drafting of leases – that most fundamental of documents - we have spent many a happy hour trying to understand some of the intentions of leases. Accountants trying to be lawyers is only slightly less scary than lawyers trying to be accountants. Even now many leases include the phrase "the auditor shall certify"…….the auditor does no such thing! He forms an opinion. Furthermore the meaning of audit has changed, and to the accountancy profession it means using international auditing standards which are not appropriate to service charge accounts.

But by and large at one level some things move with the times.

HOWEVER – what happens when things don't follow the "right" path? What happens when the landlord doesn't prepare accounts within the required timescale, appears to disregard the proper ownership of funds and where the managing agent is not a member of ARMA and does not have professional standards?

What can leaseholders rely on to protect their interests and how robust is the legislation?

The Landlord & Tenant Act 1985 had something to say about accounts preparation, and it was subsequently to be amended by the Commonhold and Leasehold Reform Act 2002.

As you know the CLRA 2002 was not implemented in full. S152 to 156 were left out. So we are left with S21 of LTA1985 which says in effect that a tenant can request the landlord to supply him with a summary of costs incurred. It goes on to say that the landlord shall comply within certain time limits. It describes (in 1970s style) how the statement of account shall be compiled, and that the summary shall be certified (!) by a qualified accountant – who reassures the tenant that it is "sufficiently supported by accounts, receipts and other documents produced to him".

What might have improved if the 2002 act had been implemented?

S152 starts "The landlord MUST supply to each tenant……."

Well that was a start……

S156 tried even harder – SC contributions must be held in designated accounts and tenants can inspect the documents evidencing that this has been complied with.
LTA 1987 S42b even says it is an offence if not complied with! Wow!

The legislation also concentrates on the expenditure. This is fine but in my experience, equally important is the resulting balance sheet. How much money is there? What is owed?

And here we have another possible problem. I was dismayed to read the case of Di Marco v Morshead Mansions Ltd (2014) where, in the Court of Appeal there was a discussion of what the meaning of "incurred" was. In his judgment Mr Justice Warren appeared to disregard best practice of accruals accounting as stated in the RICS code. He decided that a cost is incurred when the obligation to pay actually arises.

Without going into this further, it will cause many issues in the years to come.

Instead of implementing the rest of CLRA 2002, the ICAEW, RICS, ARMA and other bodies were charged with coming up with some technical guidance to assist the relevant parties, and one of my firm's partners was part of the committee which helped to produce TECH 03/11.

A very helpful document - but it is only guidance and best practice albeit backed by statutory instrument in England but breach of which is not a criminal offence or creates a civil liability. We need some legislation with teeth!

So, in the rest of my short time available, what is happening in the real world? Many have moved with the times and the spirit of the absent legislation. I actually think the reputable managing agents have a lot to do with this.

Originally I was going to say that at the small end we do not encounter many problems. But only last week we were presented with a freeholder who owns the freehold of five unrelated blocks of flats who has formed his own managing agency and contrived to collect the service charges and huge reserves for major works and transferred half a million pounds to his other companies to prop up their balance sheets at his year end before transferring the money back again. Unusual in my experience.
It is in London that we are experiencing some very worrying situations. And there is no reason to suppose other major cities are different.

We are presently acting for a number of very large blocks in London where no service charge accounts have been produced for at least four years, and where service charge demands total at least £2m per year and the freeholder is reluctant to provide any information whatsoever.

In one instance the freeholders' lawyers have had a field day with the meaning of "accounts, receipts and other documents".
After much delay and obfuscation we attended the office of the managing agent (created by the landlord and not a member of ARMA). We had provided a checklist of those things we wished to see. We were presented with 10 lever arch files of invoices, a set of heavily redacted bank statements with entries blanked out and where the inference was that monies were being transferred out to other unauthorised bank accounts. And no SCAs at all. So cynical – and a farce.

I might add that many of the costs were paid to companies owned by the freeholder – at dubious margins.

So much for accounts, receipts and other documents.

In another instance a surveyor has been appointed under the housing act and we are the reporting accountants acting on his behalf. He has received so many aggressive letters from the freeholder's lawyers asking for, amongst other things, confidentiality agreements to be signed that he has asked to withdraw.

Another case involves the freeholder, who operates one half of a large building for commercial purposes is allegedly using residents service charges who occupy the other half, to fund the entire building.

I am sure this is the tip of a large iceberg.

The procedure for bringing the freeholder to account is a tortuous process involving A FIST FULL OF DOLLARS to yet more professionals via First Tier Tribunals. Why should residents have to go to such expensive lengths to find out what has happened to their money? It should not be.

Better, more direct legislation is required, in plain English, with better definitions, with realistic penalties for non-compliance. And if I may steal another title from the next topic not to force residents to pay A FEW DOLLARS MORE every time they have a problem

In recent weeks the Governor of the Bank of England and the Chancellor have joined forces to clean up the City. I think this is another area to which the same applies. Perhaps we need Clint Eastwood and THE MAN WITH NO NAME.

Thank you.

Nick Hunwick
9 July 2015