RESIDENTIAL SERVICE CHARGE ACCOUNTS

GUIDANCE* ON ACCOUNTING AND REPORTING IN RELATION TO SERVICE CHARGE ACCOUNTS FOR RESIDENTIAL PROPERTIES ON WHICH VARIABLE SERVICE CHARGES ARE PAID IN ACCORDANCE WITH A LEASE OR TENANCY AGREEMENT

Guidance prepared by a joint working group comprising representatives of the Association of Chartered Certified Accountants, ICAEW, the Institute of Chartered Accountants of Scotland, the Association of Residential Managing Agents and the Royal Institution of Chartered Surveyors.

*This Technical Release has not been updated since its release and references to many external materials are out of date. We are likely to issue an updated version in 2021. In the meantime, users should interpret the guide and adapt outputs as may be necessary to reflect current circumstances. In particular, users should construe with reference to current auditing and accounting standards and publications of RICS and other bodies referred to.
CONTENTS

Foreword and summary

1. INTRODUCTION
   1.1 Scope of this guidance
   1.2 Landlord company statutory accounts
   1.3 Definitions of terms used in this guidance

2. PREPARATION OF SERVICE CHARGE ACCOUNTS

3. REPORTING ON SERVICE CHARGE ACCOUNTS
   3.1 Audit
   3.2 Engagement to deliver a report of factual findings
   3.3 Reporting under s21, Landlord and Tenant Act 1985

4. TAX TREATMENT OF SERVICE CHARGES

APPENDICES

(A) The law governing residential variable service charges
(B) Points on which legal opinion has been obtained
(C) Illustrative example service charge accounts
(D) Comparison of audit to an engagement to report on factual findings
(E) Procedures for undertaking an audit of service charge accounts
(F) Work programme for making a factual report on service charge accounts
(G) Paragraphs for engagement letters
(H) Example paragraphs for a representation letter from landlord/managing agent
to the reporting accountant
(I) Example reports on service charge accounts
(J) Qualifications for reporting on service charge accounts
(K) Section 21 requirements
FOREWORD AND SUMMARY

The following is a statement of the law and professional best practice applicable to residential leasehold properties on which variable service charges are paid by the leaseholders in accordance with their leases to cover the cost of providing services, repairs, maintenance, improvement, insurance or management.

There is no statutory requirement for the routine preparation and content of service charge accounts but the accounts should comply with the provisions of the lease/tenancy agreement as otherwise there may be difficulty in recovering the expenditure.

Where the property is managed by agents who are members of the Royal Institution of Chartered Surveyors (RICS) or of the Association of Residential Managing Agents (ARMA), the rules of those bodies require members to adhere to the following practice, which is based on the RICS Service Charge Residential Management Code (the Code). However, the provisions of the Code apply more widely than just to professional agents. Except where the context dictates otherwise, all the requirements in the Code are upon the manager (who may be the landlord, a managing agent, residents’ management company, right to manage company or another – see paragraph 1.11 of the Code). Although the fact that the Code is backed by Statutory Instrument (SI 2009/512) in England does not have the effect of making a breach of the Code a criminal offence or create civil liability, the contents of the Code may be used in evidence and taken into account, if relevant, in court and tribunal proceedings.

The following is a summary of the best practice in this guidance.

- If the lease/tenancy agreement sets out the way in which service charges are to be accounted for, who shall certify or approve the accounts, the costs that can be recovered and the periods of time for which accounts should be prepared, then the requirements of the lease must be followed.
- Service charge monies paid by lessees are trust monies and should be held in ring fenced designated bank accounts (s42, Landlord and Tenant Act 1987).
- A landlord or managing agent need not have a separate bank account for each property/scheme unless the lease requires one. But the funds for each property or scheme must be separately identifiable as it is a breach of trust to use service charge monies from one property/scheme to pay the bills of another or of the landlord.
- All lessees paying variable service charges should receive an annual service charge statement from their landlord or residents’ management company (RMC) (including right to manage companies (RTMCo)) within six months of the end of the accounting year.
- The annual statement should include an income and expenditure account and a balance sheet and be prepared on an accruals basis. This guidance includes an illustrative example of a service charge statement (Section 2).
- All annual statements of account should be subject to an examination by an independent accountant before issue to lessees (Section 3).
- This Technical Release provides guidance on the two alternative types of examination that may be undertaken by the independent accountant depending upon the terms of the lease. The type of engagement, which should be agreed between the accountant and the client landlord, RMC or their agent, will depend on the terms of the lease and should be proportionate to the size and nature of the property/scheme.
- If the service charge statement is prepared on behalf of an RMC or RTMCo then it should be a separate statement to the annual accounts for the company required to be filed at Companies House.

This Technical Release is based on the second edition of the Code published in 2009, which only applies to residential long leasehold or tenancy agreements (other than retirement housing) in England. However, the guidance set out in this Technical Release is likely to be of assistance to those preparing service charge accounts for properties in Wales and for private retirement properties in England. Although the second edition of the Code has not been adopted by the Welsh Assembly, the sections in the first edition regarding accounting for service charges and auditing are substantially the same. In the case of leasehold residential properties that are designed and designated for retired older people, separate codes of practice have been published by the Association of Retirement Housing Managers (ARHM) stating that it is best practice to provide regular statements of account to leaseholders and to arrange for these to be audited if the costs are recoverable, but without providing guidance on either accounts or audit.

Further information about the current legal provisions in Wales and for leasehold retirement housing is provided in Appendix A.
1. INTRODUCTION

1.1 Scope of this guidance
The words in **bold type** in this section are defined in section 1.3 below.

1.1.1 **Variable service charges** on a residential property are payable by the **tenants/leaseholders/lessees** of that property to a person who has a legal or contractual obligation to provide services, repairs, maintenance, improvement, insurance or management. That person may be the owner (freeholder) of the property or a superior leaseholder or a **residents’ management company (RMC)** or **right to manage company (RTMCo)** or similar, and is referred to in the legislation as the **landlord**.

1.1.2 Whatever the nature of the landlord entity (eg, the landlord can be an individual, a partnership, a company or an industrial and provident society), if that person is entitled under the terms of a lease to levy variable service charges on residential property, it is subject to the provisions of the Landlord and Tenant Acts (LTAs) 1985 and 1987 in relation to accounting for service charges. Therefore, this guidance is relevant to lessee-owned companies such as RMCs, as well as to large for profit companies and registered providers of social housing.

1.1.3 This guidance covers the preparation of **service charge accounts** for issue to the **tenants/leaseholders** of residential properties and considerations for independent accountants’ reports on **service charge accounts**.

1.1.4 This guidance and the examples of accounts and accountants’ reports relate to properties that are residential only. A number of residential properties form part of a mixed development, such as a block of flats over shops or offices, sharing services such as heating and maintenance of common parts. The terms of residential and commercial leases relating to service charges are different and the variable service charge provisions of LTA 1985 and LTA 1987 only apply to residential property.

1.1.5 Allocating and accounting for variable service charges in mixed properties are outside the scope of this guidance. ICAEW has agreed to work with the Royal Institution of Chartered Surveyors (RICS) and the Association of Residential Managing Agents (ARMA) on guidance that is being developed on mixed use developments. Service charges on commercial properties are already covered by standard industry cost classifications, set out in **Service charges in commercial property** issued by RICS (the commercial code of practice), designed to maintain consistent industry standards and to facilitate benchmark comparison. Depending on the circumstances, **RMCs** with a substantial commercial element may decide to have regard to the RICS standard cost class and category headings set out in the commercial code of practice.

1.1.6 If practitioners need guidance on accounting for service charges in mixed blocks, RICS has published two booklets:
- an information paper on *Apportionment of service charges in mixed use developments* (August 2009);

1.2 Landlord company statutory accounts

1.2.1 Where the landlord is an **RMC** or **RTMCo** or similar, service charge monies are subject to a statutory trust. Trust monies do not belong to the RMC/RTMCo and so should not be included as an asset in the **statutory accounts** of the RMC/RTMCo.

1.2.2 The treatment of transactions relating to service charges in the RMC’s/RTMCo’s statutory accounts and therefore by extension to the statutory accounts of investor landlords is subject to debate. It is not disputed that service charge monies are received on trust but the consequences of this in accounting for the transactions settled from such funds have yet to be clarified.

1.2.3 If service charge transactions are included in the statutory profit and loss/income and expenditure account of the RMC/RTMCo, the account should reflect the economic substance of the transactions. The account should be prepared in accordance with Schedule 1 to the applicable Accounts and Reports Regulations (SI 2008/409 for small companies and groups; SI 2008/410 for large and medium-sized companies and groups).

1.2.4 The question of whether service charge transactions should be included in the landlord company’s statutory profit and loss/income and expenditure account has been referred to the Urgent Issues Task Force. Separate guidance and examples for the treatment of service charge transactions in RMC/RTMCo statutory accounts will be issued when the underlying principles have been agreed.
1.3 Definitions of terms used in this guidance

Landlord
The person or company which owns and rents or leases a flat or house. The person or company may own the freehold or may have a superior leasehold interest in the property themselves. The definitions in s30, LTA 1985 state that ‘in the provisions of this Act relating to service charges “landlord” includes any person who has a right to enforce payment of a service charge’. This will include RMC or RTMCo companies as defined below.

Leaseholder/lessee/tenant
The term ‘tenant’ is used in the legislation to describe any person (physical or legal) who owns the leasehold interest in the property in question (flat or house) and is liable to pay the service charge under the terms of the lease. For the purposes of consistency, therefore, this guidance will also use the term ‘tenant’ to include anyone who is a leaseholder, lessee, or tenant, when reference is made in the context of legislative provisions. In more general contexts, the term ‘leaseholder’ will be used.

Residents’ or tenants’ association/ recognised tenants’ association
A group of tenants with or without a formal constitution or corporate status is called a ‘residents’ association’. It is also possible to have a residents’ association ‘recognised’ by law and with a formal constitution. This is known as a ‘recognised tenants’ association’ which applies where a residents’ association successfully gains formal recognition from the landlord or a rent assessment panel. Formal recognition confers extra rights and in some circumstances allows the secretary of the association to act on behalf of individual tenants.

Residents’ management company (RMC)
An organisation which may be referred to in the lease, which is responsible for the provision of services, and manages and arranges maintenance of the property, but which does not necessarily have any legal interest in the property. As the term implies, all or most of the members of RMCs will be leaseholders. In this guidance the term landlord includes RMCs and RTMCos.

Right to manage company (RTMCo)
A company with a specific Memorandum and Articles created by the Commonhold and Leasehold Reform Act 2002 enabling qualifying tenants of the building they live in to take on the management without proving their existing manager is at fault. The RTM Companies (Model Articles) (England) Regulations 2009 (SI 2009/2767) introduced model Articles for RTMCos formed on or after 9 November 2009. From 1 October 2010 the new Articles take effect for all RTMCos formed before 9 November 2009 whether or not they are formally adopted. Right to manage is particular to leasehold flats and maisonettes, but not to leasehold houses or estates. Different regulations apply in Wales but the effect is the same.

Service charge/variable service charge
Where an amount is payable by a tenant in respect of services, repairs, maintenance, insurance, improvements or costs of management, and the amount may vary according to the costs incurred or to be incurred, this is called a ‘variable service charge’. If the service charge is fixed under the terms of the lease or tenancy agreement eg, as part of rent payable by the tenant, this is referred to as a ‘fixed service charge’. The service charge provisions of LTA 1985 and LTA 1987 do not apply to fixed service charges.

Service charge statement/service charge accounts
The statement or statements prepared to account for service charges. Often the lease/tenancy agreement will set out the way in which service charges are to be accounted for, the costs that can be recovered and the periods of time for which accounts should be prepared. There is no statutory requirement for the routine preparation and content of service charge accounts but the accounts should comply with the provisions of the lease/tenancy agreement as otherwise there may be difficulty in recovering the expenditure.

Service charge monies
This is the money paid by the tenants in respect of variable service charges.

Service charge relevant costs
Relevant costs are defined by s18(2), LTA 1985 as ‘the costs or estimated costs incurred or to be incurred by or on behalf of the landlord, or a superior landlord, in connection with the matters for which the service charges is payable’. Section 18(3) goes on to say that ‘(a) “costs” includes overheads, and (b) costs are relevant costs in relation to a service charge whether they are incurred, or to be incurred, in the period for which the service charge is payable or in an earlier or later period’. The lease determines the matters for which the service charge is payable.

Statutory accounts (RMC and similar)
The accounts of the RMC or RTMCo or other landlord that is a company, which must be prepared in accordance with the Companies Act 2006.

Tenant
See leaseholder definition above.
2. PREPARATION OF SERVICE CHARGE ACCOUNTS

2.1 There is no recognised accounting framework for the service charge statement. Section 21(5), LTA 1985 sets out the requirements for a summary of costs prepared in accordance with a request made by a lessee under s21(1), but the requirements do not equate to accruals based accounting and there is no requirement for any sort of balance sheet.

2.2 This guidance recommends that service charge accounts are prepared on the accruals basis and the accounts should include a balance sheet for the service charge fund as well as an income and expenditure account and explanatory notes. As a minimum, where service charge monies are held on trust, the records must be capable of showing the amount held at bank for an individual property/service charge scheme, and the amounts demanded and paid in advance by or due from each lessee. In some instances, however, the lease will require the accounts to be prepared on a cash basis.

2.3 The service charge statement will always need to include details of the costs incurred in the accounting period in relation to the property in accordance with the property lease(s).

2.4 The service charge statement will also normally need to include notes to explain the figures, for example any movements on reserves representing costs not included in the income and expenditure account.

2.5 Current legislation does not state how soon the annual statement of accounts for service charges should be produced and issued to leaseholders after the year end. There may be a date in the leases or a statement such as that the information should be produced ‘as soon as practical’. However, landlords and agents need to be aware of s20B, LTA 1985 which sets limits on the recovery of expenditure on services incurred more than 18 months before the relevant costs are demanded from the lessees. Further, where a tenant requests a summary of costs in accordance with s21, LTA 1985, the landlord must provide the summary within one month of the request or within six months of the end of the accounting period in question, whichever is the later. It is therefore best practice to issue the service charge statement within six months of the accounting year end.

2.6 There is no statutory requirement for comparatives. However, some leases require comparative figures to be given and in any case it is good practice and helpful to users of the accounts if prior year numbers and/or budgeted figures are included.

2.7 It is good practice to include a note if any of the service charge transactions are with a director or associate of a director of the landlord or the managing agent, for example if a director or person connected with the director is paid for carrying out maintenance work or preparing the company and service charge accounts.

2.8 The service charge statement should include any certificates, statements and signatures by or on behalf of the accountant, landlord or agent that are required by the lease. In some cases, the lease may also require a separate certificate or signed declaration as to the amount payable by individual lessees. Care should be taken to ensure that any certificate or statement follows the exact terminology used in the lease. If there is no such requirement, it is good practice for the landlord or agent, as applicable, to sign and date the statement to confirm approval of the accounts.

2.9 An example of service charge accounts is included in Appendix C.
3. REPORTING ON SERVICE CHARGE ACCOUNTS

3.1 Audit

3.1.1 As explained in the Foreword and Summary, the lease is the contract for the administration of service charges and if it refers to an audit then in principle an audit should be carried out.

3.1.2 Many leases contain requirements for service charge accounts to be prepared for each year and audited. The terminology governing annual statements of account, particularly in older leases, may be quite general, and auditing standards and practice have changed fundamentally since the Auditing Practices Committee was established by the Consultative Committee of Accountancy Bodies (CCAB) in 1976, leading to the publication of the first Auditing Standards and Guidelines in April 1980. The work effort required by current generally accepted auditing standards is unlikely to be what was anticipated when leases were drawn up, especially where the original lease dates back many years.

3.1.3 In practice, therefore, there is scope for the landlord or managing agent to consider whether the terms in the lease may be construed according to the meaning given to those terms at the time when the lease was drawn up. Whereas the term ‘audit’ in a lease made before 1980 would not have involved any particular procedures beyond those needed to assist in the preparation of the accounts, for an auditing professional or other qualified, practising accountant to state now that an audit has been undertaken requires the professional to follow generally accepted auditing standards.

3.1.4 Where a lease that has been drawn up since 1980 refers to an audit then this is what should be undertaken. A decision to procure another type of examination could be challenged by a lessee and if the case were taken to a leasehold valuation tribunal, the landlord/agent might fail to recover service charges on this basis. If an audit is specified in the lease, but it is considered to be disproportionate to the circumstances of the property (for example a relatively small property where the lessees are all members of the RMC), it may be possible for the landlord/managing agent to secure lessee buy-in by explaining the alternatives and relative costs to the lessees so that they have the opportunity to raise objections before procuring another form of examination. However, in many cases this may not be practical and in legal terms an agreement with a majority of lessees is unlikely to displace the specific requirements of the lease.

3.1.5 If the terms of the lease require, or are construed as requiring, an audit, or the landlord or managing agent requires an audit to be carried out, International Standard on Auditing 800 (ISA 800) Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks, provides a framework for the audit of service charge accounts prepared in accordance with this guidance. Guidance on the application of ISA 800 to the audit of service charge accounts is included at Appendix E.

3.2 Engagement to deliver a report of factual findings

3.2.1 If the lease does not specify that an audit is to be undertaken, or if the landlord has construed the lease as allowing a form of engagement other than an audit, the alternative form of engagement set out in this guidance is an examination resulting in a report of factual findings on the service charge accounts. Appendix D compares the two alternative forms of examination giving factors that the landlord or managing agent might consider in deciding what type of engagement is most appropriate to the circumstances of the property. If an audit is specified in the lease, but it is considered to be disproportionate, the extra cost (over that of an engagement to provide a report of factual findings) might not be recoverable through the service charge. If the form of examination is not specified in the lease, therefore, the normal arrangement is to engage an accountant to make a report of factual findings, although there may be circumstances where an audit is appropriate.

3.2.2 Appendix F sets out a work programme for the conduct of an engagement to report on factual findings in relation to the service charge accounts. Procedures can be added if the landlord or managing agent wishes. Procedures can be omitted if they are not applicable in the circumstances of the individual property.

3.2.3 The work programme assumes that the service charge accounts are prepared by the landlord or managing agent on the landlord’s behalf. In practice, for many RMCs, the reporting accountant may be engaged to prepare the service charge accounts from accounting records maintained by the landlord/agent as well as providing the independent accountant’s report. In this case, some of the procedures contained in the programme will be covered in the course of the accounts preparation work.
3.2.4 The reporting accountant need not be a registered auditor. However, under the rules of the professional accountancy bodies that issue this guidance, a member undertaking this work must hold a practising certificate and must comply with the body’s Professional Indemnity Insurance Regulations. In addition, the member must show integrity and objectivity and have the necessary competence for the assignment, in accordance with the body’s Code of Ethics. Appendix J sets out the qualifications for undertaking reporting engagements in accordance with this guidance. The reporting accountant should be independent (which means not an employee or director or associate) of the landlord/managing agent or any associated company of the landlord or agent.

3.3 Reporting under section 21, Landlord and Tenant Act 1985

3.3.1 A specific request has to be made by a lessee under s21 for a summary of relevant costs. This guidance does not include procedures for reporting in accordance with s21(6) but Appendix K contains a short explanatory note. Section 21 reports must be made by a registered auditor.
4. TAX TREATMENT OF SERVICE CHARGES

4.1 So far as the tax treatment of service charges is concerned, Parts 10.12 to 10.14 of the RICS Service Charge Residential Management Code (the Code) deal with the corporation tax treatment of service charges. If the statutory trusts apply without any modification, HMRC have confirmed that, in its view, so long as the trust terms are observed, the receipt of service charge payments subject to the section 42 trusts will not give rise to any tax liability in the hands of the payee.

4.2 With effect from 06 April 2007, any investment income accrued on the service charge trust fund (normally bank interest) is chargeable at the standard rate of income tax (see page TSEM5710 in HMRC’s Trusts, Settlements and Estates Manual). Where tax at the standard rate is deducted at source from interest credited to the service charge account, HMRC have indicated that they will not require a trust and estate self assessment return to be completed, although this has not been confirmed as a matter of formal practice. It will therefore reduce administration if arrangements are made to have basic rate tax deducted at source from interest earned on service charge monies. Income that belongs to the RMC, such as ground rent, is not part of the variable service charge and is not subject to the section 42 trust provisions. It will, instead, fall within the scope of corporation tax.

4.3 Where landlords do have transactions in their own right, the tax treatment depends on the nature of the income and/or expenditure and whether the principle of mutuality applies to non-service charge transactions between a company and its members where the members of the company and the leaseholders are identical.

4.4 An overview of the VAT treatment of service charges is given in HMRC Land and Property Notice 742 (PN742). The general principle is that service charges relating to the upkeep of common areas of an estate of dwellings, or the common areas of a multi-occupied dwelling, are exempt from VAT so long as they are required to be paid by the leaseholder or tenant to the landlord under the terms of the lease or tenancy agreement. This is because the service charge is normally seen as further consideration for the single supply of exempt domestic accommodation. Exempt does not mean that there is no VAT payable for services. It means that there will not be VAT added on to the total cost of services that makes up the service charge. The cost of services incurred which make up the service charge will have VAT payable if the supplier is VAT registered and the landlord cannot recover that VAT. It should be noted that where a management fee (eg, managing agents’ fees) is recoverable under the lease from the residents then it will include a VAT element as it relates to a taxable supply of services made to the landlord (see PN742 para 12.5). The same principle applies to any other service charge relevant cost that bears VAT.
APPENDIX A: THE LAW GOVERNING RESIDENTIAL VARIABLE SERVICE CHARGES

1. The primary driver for the operation of variable service charges for a residential property is the lease, which is the legally binding contract between the leaseholder/lessee and the landlord/lessor and, if applicable, a third party such as an RMC. It is essential that the requirements of leases regarding service charge costs and accounts are followed. Lessees can challenge the reasonableness and payability of service charges at Leasehold Valuation Tribunals. One established reason for tribunals to decide that service charges are not payable is that the service charge accounts did not conform to the requirements of the lease. If the lease requires for example a certificate by the landlord, the landlord’s agent, the landlord’s accountant or the landlord’s surveyor to accompany the service charge accounts, then that is what must be done. A statement by the reporting accountant will not generally in itself suffice to prove payability with such leases if the charges are challenged.

2. The main statutory provisions for regulating variable service charges are contained in LTA 1985 and LTA 1987, which provide a framework to support tenants’ rights under their leases. The Commonhold and Leasehold Reform Act (CLRA) 2002 contained provisions to update parts of both LTA 1985 and LTA 1987 but the sections relating to accounting for and reporting on variable service charges (mainly s21, LTA 1985), and the holding of service charge contributions in a designated bank account (new s42A, LTA 1987) have not yet been implemented and it seems unlikely that they will be in the near future.

3. This means that the original provisions of s21, LTA 1985 (Request for summary of relevant costs by a lessee) and s42, LTA 1987 continue to apply. Under s21(1), LTA 1985, a tenant (or Recognised Tenants’ Association) may request the landlord to provide a summary of service charge costs.

4. The legislation does not contain any requirements for regular service charge accounts and therefore no provision for the form or content of such accounts. If the lease does not state what information is to be included in the service charge accounts, s21(5), LTA 1985 sets out the information that would be required if a summary of costs were requested by a lessee under s21(1). The requirements in s21(5) do not equate to accruals-based accounts and there is no requirement for a balance sheet or comparative figures.

5. Section 42, LTA 1987 requires service charges to be held in trust except where the landlord is an exempt landlord as defined by s58, LTA 1987. RMCs do not generally qualify as exempt landlords (Appendix B(1)).

6. For the purpose of s42, 1987 ‘service charge’ means an amount payable by a tenant of a dwelling as part of or in addition to rent:
   (a) which is payable, directly or indirectly, for services, repairs, maintenance, improvements or insurance or the landlord’s costs of management, and
   (b) the whole or part of which varies or may vary according to the relevant costs.

   The relevant costs are the costs or estimated costs incurred or to be incurred by or on behalf of the landlord, or a superior landlord, in connection with the matters for which the service charge is payable. For this purpose ‘costs’ includes overheads, and costs are relevant costs in relation to a service charge whether they are incurred, or to be incurred, in the period for which the service charge is payable or in an earlier or later period.

   For the purposes of s42, LTA 1987, the term ‘service charge’ does not include service charges payable under the terms of a tenancy which is regulated by the Rent Act 1977, unless the rent is registered as a variable rent on the basis that service charges are payable which vary according to the costs payable from time to time.

7. Where a section 42 trust is established, the trustee is the legal payee, which is the RMC or other landlord. Under s42(1), LTA 1987, service charge monies must be held as either a single fund or in two or more separate funds.
Banking arrangements for service charge monies

8. Section 42, LTA 1987 requires service charge monies from variable service charges to be held in trust (except for social landlords). It does not specify what this would mean in practice. Although s42, LTA 1987 does not explicitly require service charge monies to be held in a separate trust or ‘client’ bank account, it does impose a statutory trust on the person to whom service charges are paid and that person will be liable for any breach of the trust. For example if service charge monies are held in the bank account of the RMC or RTM, they may be taken as the company’s assets in any liquidation following a company insolvency and the directors of the company could be personally liable for the breach of trust.

9. The Code sets out what is best practice for all landlords, managing agents, RMCs and RTMs. Part 10.8 states that service charge funds for each property should be identifiable and either be placed in a separate bank account, or in a single client/trust account where the accounting records separately identify the fund attributable to each property.

10. It is therefore best practice for landlords or their agents to open a separate bank account for each property/development. That bank account should have the word ‘trust’ or ‘client’ or the name of the property in its title. For example Hazel Court RMCo Limited Trust Account.

11. If the funds for more than one property are kept in the same bank account by a landlord or agent, that too must be a trust or client account. If the funds for more than one property are kept in a single account, a schedule of all balances therein will be needed (ideally bank statements for each balance would be capable of being generated by the bank itself) and a check made to ensure the bank recognises all relevant accounts as ring fenced.

12. Landlords and agents should note that it is a breach of trust to use funds from one property to ease the cash flow of another. Opening separate bank accounts for each one is the best way to prevent misuse of service charge monies.

13. There is no requirement in the Code to open separate bank accounts for reserve funds apart from current service charge monies unless the lease requires it or a client/landlord prefers this arrangement.

14. The Code Practice of the Association of Retirement Housing Managers provides similar advice for retirement leasehold schemes in paras 2.8 to 2.11.

The applicability of this guidance to Wales

15. Landlord and Tenant law applicable to variable service charges is the same in Wales as in England (but not in Scotland or Northern Ireland) so s42, LTA 1987 applies.

16. The first edition of the RICS Service Charge Residential Management Code of Practice was approved for use in Wales. The second edition, effective from April 2009, has not been approved by the National Assembly. However, in all respects the sections in the first edition regarding accounting for service charges and auditing are the same. So the Code applicable in Wales recommends an audit unless the costs of an audit cannot be recovered under the terms of the leases. If there is no reference to an audit in the relevant leases it would be prudent not to undertake an audit but to follow the alternative set out in this guidance.

The Association of Retirement Housing Managers (ARHM) Code of Practice

17. The ARHM Code applies to specialist retirement housing schemes sold on long leases. It does apply to social and private sector landlords; it does not apply to rented sheltered housing in the social sector. The ARHM Code has been approved for use in England and Wales.

18. Paragraph 2.19 of the ARHM Code states that ‘The regular statement of account should include an income and expenditure account for each scheme and a balance sheet showing any reserve funds held together with the aggregate amount standing to the debit or credit of the scheme.’

19. With regard to certification or audit of the statement of account, paras 2.23 to 2.27 include the following statements:

   ‘Managers should have service charge accounts audited by a suitably qualified accountant (as defined by s28 of the 1985 Act) unless the cost of that audit is irrecoverable under the terms of the lease.

   ‘Where the cost of an audit is not recoverable under the terms of the lease the manager should arrange for the statement of accounts to be certified by a qualified accountant.’

20. The ARHM announced in September 2011 that it intended to review its Code of Practice. The position in the current ARHM Code is that an audit would be the norm unless its cost was irrecoverable under the terms of the lease. So if there is no reference to an audit in the relevant leases it would be prudent not to undertake an audit but to follow the alternative set out in this guidance.
APPENDIX B: POINTS ON WHICH LEGAL OPINION HAS BEEN OBTAINED

1. Can a Residents’ Management Company (RMC) be exempt from the statutory trust provisions in section 42, Landlord and Tenant Act 1987 on the grounds that it is a Fully Mutual Housing Associations (FMHA)?

Counsel advised that RMCs that are not freeholders or superior leaseholders are generally not exempt from the statutory trust. The definition of ‘fully mutual’ in s1(2), Housing Associations Act (HAA) 1985 provides that its rules of association limit membership to ‘tenants and prospective tenants of the association’. This requires a relationship of landlord and tenant. Unless the RMC has ‘tenants’, it cannot be a FMHA.

2. What are the consequences of service charge monies’ being held on trust?

(a) Who is or are the trustees?

The legal payee is the trustee. The legal payee will be the RMC if it is ‘the landlord or other person to whom any such charges are payable by those tenants … under the terms of their leases’ as defined in s42(1), LTA 1987. The legal payee is the landlord even if the service charges are physically paid to another person, for example a managing agent.

(b) Does the existence of an express, implied or statutory trust establish the service charge fund as a separate entity?

The trust fund is a pool of money: it has no separate legal personality.

(c) Does the existence of an express, implied or statutory trust result in the company’s having the ability to ‘deploy’ but not the ability to ‘enjoy’ service charge monies?

Yes. The company does have the ability to ‘deploy’ but not to ‘enjoy’ the funds under its control.

As well as giving advice on the above points, Counsel has reviewed TECH 03/11 prior to publication and confirmed that he is content with the guidance it contains.
### ABC Property Service Charge Income and Expenditure Account

For the year ended 31 March 20xx

<table>
<thead>
<tr>
<th>Notes</th>
<th>20xx</th>
<th>20ww</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income relating to the period</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Service charges</td>
<td>24,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Gross interest</td>
<td>156</td>
<td>234</td>
</tr>
<tr>
<td>Less tax</td>
<td>2</td>
<td>(31)</td>
</tr>
<tr>
<td>Other income [give details if applicable]</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>Total income receivable</strong></td>
<td>24,125</td>
<td>20,187</td>
</tr>
<tr>
<td><strong>Expenditure relating to the period</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Repairs and maintenance:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General repairs and maintenance</td>
<td>2,124</td>
<td>2,153</td>
</tr>
<tr>
<td>Lift repairs and maintenance etc.</td>
<td>1,425</td>
<td>934</td>
</tr>
<tr>
<td>Cleaning</td>
<td>2,449</td>
<td>2,355</td>
</tr>
<tr>
<td>Major works:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>External decoration</td>
<td>–</td>
<td>12,500</td>
</tr>
<tr>
<td>Lift works (new lift suspension ropes)</td>
<td>9,000</td>
<td>–</td>
</tr>
<tr>
<td>Grounds maintenance:</td>
<td>1,213</td>
<td>1,056</td>
</tr>
<tr>
<td>Utilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity and lighting</td>
<td>1,193</td>
<td>1,146</td>
</tr>
<tr>
<td>Water</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Professional fees:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Independent accountant’s fee</td>
<td>350</td>
<td>300</td>
</tr>
<tr>
<td>Accountancy costs</td>
<td>700</td>
<td>700</td>
</tr>
<tr>
<td>Managing agent fees</td>
<td>2,400</td>
<td>2,200</td>
</tr>
<tr>
<td>Insurance – Buildings[/Terrorism]</td>
<td>2,209</td>
<td>2,112</td>
</tr>
<tr>
<td>General expenses</td>
<td>482</td>
<td>55</td>
</tr>
<tr>
<td>Transfer to Roof fund(^3)</td>
<td>4,000</td>
<td>2,500</td>
</tr>
<tr>
<td><strong>Total expenditure(^4)</strong></td>
<td>27,645</td>
<td>28,111</td>
</tr>
<tr>
<td><strong>Deficit(^5)</strong></td>
<td>£(3,520)</td>
<td>£(7,924)</td>
</tr>
</tbody>
</table>

1 The headings and level of detail in these accounts are for illustration only and in practice will depend on the terms of the lease and the information needs of the lessees.

2 Interest earned on reserve funds may be credited to the fund rather than to the I & E account.

3 The term used for transfers to reserves will need to reflect the provisions of the lease to ensure that it is allowed as relevant expenditure. Where there are several reserve funds, the transfer or payment should be shown separately for each fund either on the face of the income and expenditure account or in the notes. The terminology will need to be consistent with the lease in order for the item to be treated as relevant (allowable) expenditure for service charge purposes.

4 Whether or not, and where, any subtotals are drawn will depend on the terms of the lease and normal practice for the property. For example, where the lease specifies reserves for major expenditure, transfers to these reserves are treated as relevant expenditure for the purposes of the lease.

5 Most leases do not allow deficits on the income and expenditure account to be funded from a contingency fund or similar reserve. Instead, any deficit or surplus is treated as an amount owed, respectively, by or to lessees and will be added to/subtracted from future service charges.
### ABC PROPERTY SERVICE CHARGE BALANCE SHEET at 31 March 20xx

<table>
<thead>
<tr>
<th>Notes</th>
<th>20xx</th>
<th>20ww</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deficit recoverable from lessees[6]</td>
<td>3,520</td>
<td>7,924</td>
</tr>
<tr>
<td>Debtors</td>
<td>3</td>
<td>4,578</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>4</td>
<td>49,170</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td></td>
<td>57,268</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(4,745)</td>
<td></td>
<td>(4,356)</td>
</tr>
<tr>
<td><strong>Net assets</strong></td>
<td></td>
<td>£52,523</td>
</tr>
<tr>
<td><strong>RESERVES:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Roof fund[7]</td>
<td>6(a)</td>
<td>19,000</td>
</tr>
<tr>
<td>General reserve</td>
<td>6(b)</td>
<td>33,523</td>
</tr>
<tr>
<td><strong>Balance at 31 March 20xx</strong></td>
<td></td>
<td>£52,523</td>
</tr>
</tbody>
</table>

This statement of account was approved by (name) for the [landlord]/[managing agent] on (date) and signed [on behalf of the landlord/managing agent] by [Name]

**Notes for users of guidance:**

The balance sheet should include any statements and signatures by the landlord or agent required by the lease. If there is no such requirement, it is good practice for the landlord or agent, as applicable, to sign the balance sheet to confirm approval of the accounts. An alternative is to issue the signed and dated representation letter from the landlord/managing agent with the statement of account.

There is no statutory requirement as to the form or content of the balance sheet. For the purposes of this example, the Companies Act format has been used. As with the service charge income and expenditure account, the information can be given in any format and level of detail that the leaseholders/members of the company find most useful.

There is no statutory requirement for comparatives. However, it is good practice and helpful to users of the accounts if prior year numbers and/or budgeted figures are included and some leases require comparative figures to be given.

---

[6] See footnote 5 above. The deficit recoverable from lessees is the excess of expenditure over income receivable in the year. If income receivable exceeds expenditure then the excess is included in creditors.

[7] See footnote 3 above. The title of the reserve and the purpose for which it is established will depend on the terms of the lease.
NOTES TO THE SERVICE CHARGE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 20xx

1. Accounting policies

1.1 The accounts are prepared [in accordance with the provisions of the lease] [and] on the accruals basis.

1.2 [Details of any material accounting policies not covered by 1.1 eg, (if applicable and not covered by the lease) tangible fixed assets and depreciation and reserves/funds.]

2. Tax provided on bank interest received

Service charge monies are held on trust in accordance with section 42, Landlord and Tenant Act 1987. Interest earned on service charge monies held on deposit is taxable at the basic rate of income tax. The rate of tax applied to interest received during the year was 20% (20ww: 20%).

3. Debtors

<table>
<thead>
<tr>
<th></th>
<th>20xx</th>
<th>20ww</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service charges owed</td>
<td>3,300</td>
<td>–</td>
</tr>
<tr>
<td>Prepayments</td>
<td>1,278</td>
<td>1,228</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£4,578</strong></td>
<td><strong>£1,228</strong></td>
</tr>
</tbody>
</table>

4. Bank account

Service charge money was held in trust at [name of bank and address] under the title [bank account name and number].

5. Creditors

<table>
<thead>
<tr>
<th></th>
<th>20xx</th>
<th>20ww</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable on bank interest received gross</td>
<td>31</td>
<td>47</td>
</tr>
<tr>
<td>Other creditors</td>
<td>865</td>
<td>771</td>
</tr>
<tr>
<td>Accruals</td>
<td>3,849</td>
<td>3,538</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£4,745</strong></td>
<td><strong>£4,356</strong></td>
</tr>
</tbody>
</table>

6. Reserve funds

The roof fund has been established to provide funds to meet the costs of major repairs and scheduled works to the roof of the property.

The general reserve has been established to meet the cost of large, non-regular repair and maintenance work. The present level of the fund may prove insufficient, given the substantial costs incurred this year and last and the uncertainty as to when further such costs may arise.9

Any shortfall in these funds resulting from expenditure incurred will be charged to the Income and Expenditure account in that year.

8 If applicable, service charges owed should be split between lessees and landlord to accommodate events such as voids.

9 An alternative treatment is to show major non-recurring expenditure in the note as a movement on the reserve fund, rather than on the face of the I & E account.
6. Reserves (continued)

6(a) Roof fund

<table>
<thead>
<tr>
<th></th>
<th>20xx</th>
<th>20ww</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance Brought Forward</td>
<td>15,000</td>
<td>12,500</td>
</tr>
<tr>
<td>Transfer from Income and Expenditure account&lt;sup&gt;10&lt;/sup&gt;</td>
<td>4,000</td>
<td>2,500</td>
</tr>
<tr>
<td>Balance Carried Forward</td>
<td>19,000</td>
<td>15,000</td>
</tr>
</tbody>
</table>

6(b) General reserve

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance Brought Forward</td>
<td>33,523</td>
<td>33,523</td>
</tr>
<tr>
<td>Transfer from Income and Expenditure account&lt;sup&gt;10&lt;/sup&gt;</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Balance Carried Forward</td>
<td>33,523</td>
<td>33,523</td>
</tr>
</tbody>
</table>

7. Transactions with directors of ABC Residents’ Management Company Limited

During the year AB carried out general maintenance and gardening work on the property, for which he was paid £500 and £300 respectively (20ww: £450 and £300). These amounts are included as part of the relevant costs in the Income and Expenditure account.

<sup>10</sup> See footnote 3 to Service Charge Income and Expenditure account: terminology should reflect provisions in lease for transfers to reserves in order to qualify as relevant costs for service charges.
APPENDIX D: COMPARISON OF AUDIT TO AN ENGAGEMENT TO REPORT ON FACTUAL FINDINGS

1. Unless the costs cannot be recovered, service charge accounts should be subjected to examination by an independent accountant, qualified as set out in Appendix J.

2. Subject to the terms of the lease, as explained in section 3 of this guidance, the alternative forms of examination considered most suitable for service charge accounts are audit and an engagement to provide a factual report of findings. The following paragraphs describe the key features of the two types of engagement and the differences between them.

3. The procedures to be undertaken in an audit are governed by International Standards on Auditing (ISAs). The purpose of the audit is to enhance the degree of confidence of intended users in the accounts by the expression of an opinion on whether the accounts are prepared, in all material respects, in accordance with the stated accounting principles. As a basis for the auditor’s opinion, ISAs require the auditor to obtain a high level of assurance – that is, evidence-based – that the accounts as a whole are free from material misstatement, whether due to fraud or error.

4. ISAs set rigorous standards for the planning, conduct and recording of audit work. The time needed to complete an audit is much greater than that needed to check a specified number of items and make a factual report of findings. The objective of an audit is to give an opinion that gives a high level of assurance about the accounts. The audit report is expressed in terms of a professional judgement that the accounts are prepared, in all material respects, in accordance with the stated accounting policies.

5. There is a level below which it is not possible for a fee to be charged that covers the cost of the auditor’s time and other resources used when an audit is carried out in accordance with ISAs. To be recovered from the service charge, the audit fee must be divided between the lessees, so that the fewer the number of dwellings in a property, the higher will be the cost of audit per dwelling.

6. The more long leasehold dwellings that are contained in a property or service charge scheme, the lower will be the cost of the audit to each lessee. The larger the property, the less likely it is that all or a significant proportion of lessees will be actively involved in the management. It is also likely that larger blocks will include commercial properties with some shared services so that the allocation of shared costs to residential and commercial lessees may be complicated. The larger the property, therefore, the more likely it is that an audit will be appropriate, to reassure lessees that they can place reliance on the service charge accounts.

7. A statement of factual findings is based on relatively limited procedures and does not require the same exercise of professional judgement, so is less expensive than an audit. This form of examination is appropriate for the service charge accounts of a small property containing relatively few dwellings and where lessees are actively involved in the management of the property, unless the lease requires, or is construed as requiring, an audit to be carried out.

8. Although a report of factual findings does not express the assurance that would follow from an audit or a review made in accordance with applicable International Standards, the statement gives comfort that the items listed in the report have been checked by a qualified accountant independent of the landlord/managing agent.
APPENDIX E: PROCEDURES FOR UNDERTAKING AN AUDIT OF SERVICE CHARGE ACCOUNTS

Where an audit is required, it should be carried out in accordance with International Standard on Auditing (ISA) 800 Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks. A copy of ISA 800 may be downloaded from the IFAC website: http://web.ifac.org/download/a041-2010-iaasb-handbook-isa-800.pdf

As its title indicates, ISA 800 only covers the special considerations arising from the application of ISAs to special purpose accounts and does not deal with the general requirements of Ethical Standards, the International Standard on Quality Control (ISQC) 1 and ISAs that auditors are required to apply to all audit work.

ISA 800 explains that the objective of the auditor, when applying ISAs in an audit of financial statements prepared in accordance with a special purpose framework, is to address appropriately the special considerations that are relevant to:
(a) the acceptance of the engagement;
(b) the planning and performance of that engagement; and
(c) forming an opinion and reporting on the financial statements.

The table below shows how ISA 800 can be applied to the audit of service charge accounts. Audit programmes should be adapted accordingly.

1. General procedures

<table>
<thead>
<tr>
<th></th>
<th>Yes/No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>The acceptance of the engagement</td>
<td></td>
</tr>
</tbody>
</table>

ISA 800 explains that ISA 210 requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements. In an audit of service charge accounts, therefore, the auditor is required to obtain an understanding of:
(a) the purpose for which the service charge accounts are prepared;
(b) the intended users; and
(c) the steps taken by the client (landlord or managing agent) to determine that the applicable financial reporting framework is acceptable ie, the accounts are prepared on the accruals basis, and reflect the requirements of the lease and any additional accounting policies specified in the notes.

The purpose of the service charge accounts is to show lessees how the money that they have paid by way of variable service charges has been spent.

The intended user of the report is the landlord or managing agent. The purpose of the report is to provide reasonable assurance to the RMC or managing agent as to whether the service charge accounts have been prepared in all material respects in accordance with the stated accounting policies or framework. The RMC or managing agent in turn attaches the report to the service charge accounts that are sent to all lessees.

ISA 800 explains that, in the case of special purpose financial statements, the financial information needs of the intended users are a key factor in determining the acceptability of the financial reporting framework applied in the preparation of the financial statements.

The applicable financial reporting framework in the case of service charge accounts can be the accounting policies developed by the RMC or managing agent to reflect the circumstances of the property concerned. In that case, the accounting framework will be presumed acceptable for that purpose if the RMC or managing agent follows an established and transparent process involving deliberation and consideration of the views of lessees.

The auditor should also consider whether the accounting policies applied are consistent with the recommendations of this guidance.
2. Considerations when planning and performing the audit

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>ISA 200 requires the auditor to comply with all ISAs relevant to the audit. In planning and performing an audit of the service charge accounts, the auditor shall determine whether application of the ISAs requires special consideration in the circumstances of the engagement</td>
</tr>
<tr>
<td>2.2</td>
<td>ISA 315 requires the auditor to obtain an understanding of the entity’s selection and application of accounting policies and evaluate whether these are appropriate for the circumstances of the property and consistent with any accounting provisions contained in the lease and the policies usually adopted for the preparation of service charge accounts.</td>
</tr>
</tbody>
</table>

3. Planning procedures

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>Develop an overall strategy for the scope, emphasis, timing and conduct of the engagement, and an engagement plan, consisting of a detailed approach for the nature, timing and extent of evidence gathering procedures to be performed and the reasons for selecting them.</td>
</tr>
</tbody>
</table>

Design and document procedures for gathering evidence as to whether the service charge accounts are free of material misstatement. Professional judgement and the exercise of professional scepticism is needed in evaluating the quantity and quality of evidence to be obtained, and thus its sufficiency and appropriateness, to support the opinion expressed in the accountant’s report.

Consider the reliability of the information to be used as evidence, for example photocopies, facsimiles, filmed, digitised or other electronic documents, including consideration of controls over their preparation and maintenance where relevant.

Link the procedures adopted to the identified risks that the service charge accounts may be materially misstated, using a combination of inspection, observation, confirmation, recalculation, re-performance, analytical procedures and inquiry. Such further procedures may involve substantive procedures, including obtaining corroborating information from sources independent of the landlord/managing agent.

Consider in particular and document:

- the terms of the engagement;
- the possible sources of evidence, including own accounts preparation work if applicable;
- the terms of the lease(s) governing the property;
- the identity and relationships of key parties eg, freeholder, head leaseholder, management company, agent and lessees;
- details of the property eg, purely residential, mixed freehold/leasehold or mixed commercial/residential, the size of the property and how it is managed;
- the accounting and record-keeping system including system for preparing service charge accounts;
- the risks that the service charge accounts may be materially misstated due to fraud or error, and what form any misstatement might take;
- the overall approach and detailed procedures in response to the assessed risks, to minimise the risk that the service charge accounts will be materially misstated;
- who are the intended users of the report and underlying service charge accounts and their needs, in order to set materiality and assess the presentation of information in the accounts.

Keep the plan under review throughout the engagement. Update it if unexpected events, changes in conditions, or the evidence obtained from the results of evidence-gathering procedures indicate a need to revise the planned nature, timing and extent of the detailed procedures.
4. Performing the audit

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th>Yes/No</th>
<th>N/A</th>
</tr>
</thead>
</table>
| 4.1 | Obtain evidence about the figures in the service charge income and expenditure account to cover:  
• occurrence – transactions and events that have been recorded have occurred and pertain to the maintenance of the property in accordance with the lease(s);  
• completeness – all transactions and events pertaining to the maintenance of the property in accordance with the lease(s) that should have been recorded, have been recorded;  
• accuracy – amounts and other data relating to recorded transactions and events have been recorded at the correct amounts;  
• cut-off – transactions and events have been recorded in the correct accounting period; and  
• classification – transactions and events have been recorded in the proper nominal accounts. |   |   |   | |
| 4.2 | Obtain evidence about account balances at the period-end date to cover:  
• existence – recorded assets, liabilities and funds exist;  
• rights and obligations – the recorded balances pertain to the service charge fund as arising from transactions and events pertaining to the maintenance of the property in accordance with the lease(s);  
• completeness – all assets and liabilities arising from transactions and events pertaining to the maintenance of the property in accordance with the lease(s) that should have been recorded, have been recorded;  
• valuation and allocation – assets, liabilities and funds are included in the service charge accounts at appropriate amounts. |   |   |   | |
| 4.3 | Where expenditure represents an allocation of an expense across one or more service charge schemes, obtain written confirmation from the landlord or managing agent that the allocation is in accordance with the lease(s). |   |   |   | |
| 4.4 | ISA 550 requires the auditor to obtain an understanding of related party relationships and transactions (ie, those involving the directors of the RMC and the managing agent, if applicable), irrespective of whether the applicable financial reporting framework establishes specific disclosure requirements. This is so that the auditor can recognise fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud, and to conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions, achieve fair presentation. |   |   |   | |
| 4.5 | Obtain written confirmation from the landlord or managing agent:  
• that all expenditure, including on long-term agreements and transfers to reserve funds, is in accordance with the provisions of the lease(s); and  
• that applicable consultation requirements in relation to any qualifying long-term agreements or major works have been complied with and that all relevant costs have been accurately included in the expenditure for the accounting period, as if expenditure is not in accordance with the provisions of the lease(s) or applicable consultation requirements have not been complied with, the relevant expenditure may not be recoverable through the service charges. |   |   |   | |
| 4.6 | Consider whether the service charge accounts provide a fair summary that is appropriate for the needs of the intended users, are based on good practice guidance published by the accountancy bodies and, if applicable, contain the information or statements specified by the lease(s). |   |   |   | |
5. Forming an opinion and reporting considerations

| 5.1 | The auditor is required to apply the requirements of ISA 700, which sets out the basic elements that should be included in the audit report. In the case of an auditor’s report on special purpose financial statements:

(a) The auditor’s report is required to describe the purpose for which the financial statements are prepared and, if necessary, the intended users, or refer to a note in the special purpose financial statements that contains that information; and

(b) If the RMC/managing agent has a choice of financial reporting frameworks in the preparation of such financial statements, the explanation of the RMC’s/managing agent’s responsibility for the financial statements is required to make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

The audit report is also required to alert readers that the accounts are prepared in accordance with a special purpose framework. Therefore the auditor’s report on service charge accounts is required to include an Emphasis of Matter paragraph alerting users of the auditor’s report that the service charge accounts are prepared in accordance with a special purpose framework and that, as a result, the accounts may not be suitable for another purpose.

If the reporting accountant is not a registered auditor, this fact must be made clear in the details accompanying the auditor’s signature on the audit report.

An example report containing these elements is given in Appendix I. | Yes/No N/A |
APPENDIX F: WORK PROGRAMME FOR MAKING A FACTUAL REPORT ON SERVICE CHARGE ACCOUNTS

These represent minimum procedures that should be followed if they are applicable. The managing agent/landlord may agree additional procedures with the reporting accountant. Where the reporting accountant is involved in preparing the service charge accounts many of the following procedures are likely to be covered by the accounting work already undertaken.

General procedures

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Yes/No N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Obtain a copy of the lease or leases governing the administration of the property. Summarise the expenses that may be charged to the tenants under the terms of the lease(s), including any payments towards reserves, or, if the landlord or managing agent has prepared such a summary, check the summary to the underlying lease(s).</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>If the service charge accounts are prepared by the landlord or managing agent, obtain a copy of the accounts and agree the figures on each line to the landlord’s or agent’s accounting records to check that they derive from the accounting records, that there is no double counting, and that no figures in the accounting records are omitted from the service charge accounts. Check the addition of the service charge statements and any supporting schedule(s) of service charges and relevant costs.</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>If the service charge accounts are prepared by the landlord or managing agent, ascertain how the service charge accounts are compiled from the accounting records and what controls are in place to ensure their accuracy.</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Compare the service charge accounts to the previous year or budgeted expenditure, as appropriate, to identify variances that could indicate an error. Where variances are due to errors, bring these to the attention of the landlord or agent so that adjustments can be made.</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>If service charge statements have previously been provided to the tenants, agree the brought forward balances in the current year accounts to the service charge statement issued for the previous period. These balances are likely to include carried forward surpluses or deficits on the previous period’s service charge statement, together with closing balances on reserve fund accounts.</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>If required by the lease, ensure that the service charge accounts contain a prominent certificate or statement signed by the party required to do so by the lease. Similarly, if required by the lease, ensure that the accounts include a certificate of sums payable by individual lessees. Even if such a declaration is not required by the lease, a formal statement along these lines helps to clarify the respective responsibilities of the landlord/agent and reporting accountant in relation to the statement of account.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td></td>
</tr>
</tbody>
</table>
| 7. | Obtain a schedule of all service charges demanded by the landlord during the year either in the form of a budget or a schedule prepared by the landlord/managing agent, showing all charges demanded from each tenant.  
   1. Check that all units paying variable service charges within the property are included in the schedule of income.  
   2. Compare the schedule of service charges with income recorded as received and banked. Where differences are identified check there are valid reasons.  
   The collection of service charge debts is the responsibility of the landlord/managing agent and in principle bad debts should not be a charge to the service charge account unless the lease terms allow this. However, it may not be possible to enforce payment of debts without incurring costs and if those costs cannot be recovered from the tenant concerned, there may be scope for including them in service charge expenditure. Some leases specifically allow the costs of debt collection to be a cost against service charges.  
   With regard to void periods, on most new leasehold and rented developments the landlord or developer of the property is expected to pay voids, even though there may well be no reference in leases to this requirement. Otherwise the tenants may be required to pay an apportionment of service charge that is not in accordance with their leases. Even if the developer becomes insolvent, it is clearly in the interest of any buyer to ensure that the insolvency practitioner has paid service charges for void periods prior to the sale. With regard to voids on existing fully occupied rented developments, the landlord would be expected to pay the equivalent service charge for the void period. With regard to existing fully occupied leasehold developments voids should not arise because the lessee pays the service charge until the lease is assigned.  
   8. Where other income is recorded, if the amounts are in excess of 5% of total expenditure for the year, agree the figure or a sample of component entries to supporting documentation to check accuracy and description of record.  
   9. **Either:** check all expense categories accounting for 10% or more of total expenditure excluding any transfers to funds or such lower percentage requested by the landlord/managing agent to ensure that more items are checked; or check the five highest expense categories excluding any transfers to funds. Depending on the nature of the expense, either check recorded expenditure against documentation showing a total sum (eg, contract for work carried out or services provided, payroll summary of employee costs or managing agent’s fee based on contract), or, for a selection of items recorded as expenditure in the year, agree to supporting documentation and consider whether the expenditure has been correctly analysed in the service charge account and accurately recorded.  
   10. For all expense categories selected above, check that invoices received or paid after the year end and any prepayments and accruals have been correctly accounted for, in accordance with the stated basis of accounting.  
   11. Where expenditure represents an allocation of an expense across one or more service charge schemes, or across multiple schedules within a scheme, obtain written confirmation from the landlord or managing agent that the allocation is in accordance with the lease(s).  
   12. Obtain written confirmation from the landlord or managing agent that all expenditure, including on long-term agreements and transfers to reserve funds, is in accordance with the provisions of the lease(s), that applicable consultation requirements in relation to any major works have been complied with and that all relevant costs have been accurately included in the expenditure for the accounting period.  
   13. Where expenditure has been incurred which has been debited to a reserve fund, select a sample of expenditure items and agree to purchase invoices, ensuring that the invoice details show the expense to have been in respect of works carried out or services provided to the property or service charge scheme to which the service charge information relates. Obtain written confirmation from the landlord or managing agent that the amounts have been accurately reflected in expenditure on the reserve fund.  
<p>| Yes/No | N/A |</p>
<table>
<thead>
<tr>
<th></th>
<th>Balance Sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>14.</td>
<td>Agree any recorded bank balances to the bank account balance(s) maintained by the landlord/managing agent. If the account is held by a managing agent in a single client account with funds from other properties, the agent’s records must be capable of showing the balance pertaining to each property or service charge scheme. Where a reconciliation is required in order to agree the balance to the balance per the bank statement check that reconciling items represent valid reconciling items such as cheques received or paid out not cleared at the year end.</td>
</tr>
<tr>
<td>15.</td>
<td>For other headings on the balance sheet, prepare or obtain a listing of items within any balance that exceeds 5% of the expenditure for the year and agree the highest value item within each list to appropriate documentation that supports the description and accounting treatment of the balance in question.</td>
</tr>
<tr>
<td>16.</td>
<td>Check that any service charges paid in advance or arrears recorded on the balance sheet are consistent with receipts in the period and balances brought forward, through the preparation or checking of a service charge control account.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Yes/No N/A</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>17.</td>
<td>Summarise the results of testing in a report to the landlord/managing agent and tenants. An example report is included in Appendix I to this Guidance Note. Where exceptions have been noted as a result of the testing above, a clear summary of the exceptions should be set out including the monetary amounts involved.</td>
</tr>
</tbody>
</table>
APPENDIX G: PARAGRAPHS FOR ENGAGEMENT LETTERS

General

In view of the importance of ensuring that there is no misunderstanding about the work to be undertaken, reporting accountants are advised to consider the following points when agreeing terms of engagement:

- engagement letters should indicate the reasons for, and objective of, the engagement;
- engagement letters should clearly indicate that the work to be undertaken is not an audit and that (if this is the case) the firm does not have the Registered Auditor status required for such audits;
- engagement terms should specify to whom the report is to be made available, that it should not be made available to any other individual without the firm's consent; and

The report should fully describe the scope of the work and, unless an audit is being carried out, it should avoid use of the word 'audit' except to clarify that this word does not apply to the engagement undertaken.

The engagement letter will normally be addressed to the directors of the RMC or to the managing agent, depending on which engages the reporting accountant. The references to addressee in the letter should be adapted accordingly.

The following paragraphs are designed to be included in the standard letter of engagement used by the firm, in the client-specific section of the engagement letter that sets out the details the services to be provided. The terms will need to be adapted to the requirements of the lease and any special provisions agreed with the landlord and/or managing agent. If carrying out either an audit or an engagement to provide a report of factual findings, the firm may wish to obtain positive written confirmation that no tenant/recognised tenants’ association has requested a summary of costs in accordance with section 21, Landlord and Tenant Act 1985. The terms and conditions of business attaching to an engagement governed by the engagement letter are a matter for individual firms and are not covered in this guidance.

A list of bodies whose members may conduct reporting engagements in accordance with this guidance is set out in Appendix J.

1. ENGAGEMENT TO UNDERTAKE AN AUDIT IN ACCORDANCE WITH ISA 800

To the [Landlord]/[Board of Directors of RMC]/[Name of managing agent] of (property)]

Dear.....................................

Re: (property)

You consider that the lease [requires]/[is construed as requiring] an audit. This letter and the attached terms of business dated (date) set out the basis on which we are to provide an audit report on the service charge accounts for (property) and your and our respective responsibilities.

1 Your responsibility for the preparation of the service charge accounts.

1.1 You have undertaken to make available to us, as and when required, all the accounting records and related financial information, including minutes of management meetings, which we need to do our work. You will provide us with all information and explanations relevant to the preparation of the service charge statement, and you will disclose to us all relevant information in full.

1.2 You are responsible for ensuring that, to the best of your knowledge and belief, the information relating to the preparation of the service charge accounts, is accurate and complete.

1.3 You will approve and sign the service charge accounts to acknowledge responsibility for the statement.

1.4 You are responsible for ensuring that the property is maintained in accordance with the terms of the lease and that service charge monies are safeguarded as held on trust for the leaseholders in accordance with section 42, Landlord and Tenant Act 1987.
2. Our responsibilities as auditors

2.1 We shall conduct our work in accordance with the guidance for an audit of service charge accounts contained in Residential Service Charge Accounts, published by (relevant accountancy body). This means planning and performing our examination so as to obtain all the information and explanations which we consider necessary in order to provide us with sufficient evidence to give reasonable assurance that the service charge accounts show a fair summary of the costs relating to [property] and are sufficiently supported by accounts, receipts and other documents which have been made available to us. Because the service charge fund does not constitute an entity and the service charge statement does not constitute historical financial information prepared in accordance with an agreed accounting framework, we shall not evaluate the overall adequacy of the presentation of the information which would be required if we were to express an opinion under International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board.

2.2 As part of our normal procedures we may ask you to confirm in writing any information or explanations given to us orally during our work.

3. Additional responsibilities

3.1 We have agreed to carry out the following accounting and other services on your behalf:
(a) prepare the service charge statement from the accounting records maintained by you;
(b) other.

4. Limitation of liability

4.1 We will provide services as outlined in this letter with reasonable care and skill. Our liability to you is limited to losses, damages, costs and expenses caused by our negligence or wilful default. However, to the fullest extent permitted by law, we will not be responsible for any losses, [penalties, surcharges, interest or additional tax liabilities] where you or others supply incorrect or incomplete information, or fail to supply any appropriate information or where you fail to act on our advice or respond promptly to communications from us [or the tax authorities].

4.2 You will not hold us [our] [principal][s] [director][s] [and staff], responsible, to the fullest extent permitted by law, for any loss suffered by you arising from any misrepresentation (intentional or unintentional) supplied to us orally or in writing in connection with this agreement. You have agreed that you will not bring any claim in connection with services we provide to you against any of our partners or employees personally.

4.3 Our work is not, unless there is a legal or regulatory requirement, to be made available to third parties without our written permission and we will accept no responsibility to third parties for any aspect of our professional services or work that is made available to them.

5. Communicating with you

6. Agreement of terms: commencement and period of engagement and signatures of parties
2. **ENGAGEMENT TO PROVIDE AN ACCOUNTANT’S FACTUAL REPORT OF FINDINGS ON SERVICE CHARGE ACCOUNTS**

The following paragraphs are for inclusion in an engagement letter where the reporting accountant has agreed to undertake an examination based on the procedures set out in Appendix F of this guidance.

To the [Landlord]/[Board of Directors of RMC]/[Name of managing agent] of (property)

Dear.....................................

Re: (property)

You consider that the lease [does not require]/[is construed as not requiring] an audit. This letter sets out the basis on which we are to report on the service charge statement for (property) for the year ended (date), [as required by the lease] and the respective responsibilities of ourselves (the Accountant) and the Landlord.

1 Your responsibility for the preparation of the service charge statement

1.1 You have undertaken to make available to us, as and when required, all the accounting records and related financial information, including minutes of management meetings, which we need to do our work. You will provide us with all information and explanations relevant to the preparation of the service charge statement, and you will disclose to us all relevant information in full.

1.2 You are responsible for ensuring that, to the best of your knowledge and belief, the information relating to the preparation of the service charge statement, is accurate and complete.

1.3 You will approve and sign the service charge statement to acknowledge responsibility for the statement.

1.4 You are responsible for ensuring that the property is maintained in accordance with the terms of the lease and that service charge monies are safeguarded as held on trust for the leaseholders in accordance with section 42, Landlord and Tenant Act 1987.

2 Our responsibilities as reporting accountants

2.1 We shall conduct our work in accordance with the guidance for a report of factual findings contained in *Residential Service Charge Accounts*, published by [relevant accountancy body]. The list of procedures performed and details of any sampling used in the course of the work will be provided upon request from the Landlord. [Such provision may include publication on a website.]

2.2 The work to be undertaken is not a statutory audit carried out under International Standards of Auditing (UK and Ireland) in accordance with the requirements of the Companies Act 2006 [and the Accountant does not have the Registered Auditor status required for such audits].

2.3 While the Accountant will perform the agreed procedures with reasonable skill and care and will report any misstatement, frauds or errors that are revealed by enquiries within the scope of the engagement, the Accountant’s work should not be relied upon to disclose all misstatements, frauds or errors that might exist.

2.4 The Accountant accepts that, whether or not the Landlord meets the applicable obligations under the lease, the Accountant remains under an obligation to perform the work with reasonable care. The failure by the Landlord to meet its obligations under the lease or to provide such assistance as the Accountant requires may cause the Accountant to be unable to provide the report in the agreed terms. In circumstances where the Accountant is unable to provide a report the Accountant may withdraw from the engagement.

2.5 The Accountant has a professional responsibility not to allow their name to be associated with financial information which they believe may be misleading. Therefore, although they are not required to search for such matters, should they become aware, for any reason, that the financial information may be misleading, they will discuss the matter with the Landlord with a view to agreeing appropriate adjustments and/or disclosures in the financial information. In circumstances where adjustments and/or disclosures that the Accountant considers appropriate are not made or where the Accountant is not provided with appropriate information, and as a result they consider that the financial information is misleading, they will withdraw from the engagement.

2.6 As part of our normal procedures we may ask you to confirm in writing any information or explanations given to us orally during our work.
3. Additional responsibilities

3.1 We have agreed to carry out the following accounting and other services on your behalf:

(a) prepare the service charge statement from the accounting records maintained by you;
(b) other.

4. Limitation of liability

4.1 We will provide services as outlined in this letter with reasonable care and skill. Our liability to you is limited to losses, damages, costs and expenses caused by our negligence or wilful default. However, to the fullest extent permitted by law, we will not be responsible for any losses, [penalties, surcharges, interest or additional tax liabilities] where you or others supply incorrect or incomplete information, or fail to supply any appropriate information or where you fail to act on our advice or respond promptly to communications from us [or the tax authorities].

4.2 You will not hold us [our] [principal][s] [director][s] [and staff], responsible, to the fullest extent permitted by law, for any loss suffered by you arising from any misrepresentation (intentional or unintentional) supplied to us orally or in writing in connection with this agreement. You have agreed that you will not bring any claim in connection with services we provide to you against any of our partners or employees personally.

4.3 Our work is not, unless there is a legal or regulatory requirement, to be made available to third parties without our written permission and we will accept no responsibility to third parties for any aspect of our professional services or work that is made available to them.

5. Communicating with you

6. Agreement of terms: commencement and period of engagement and signatures of parties
Dear Sirs

[Property name] service charge statement for the year ended (date)

I/we have determined that an audit of the service charge accounts in accordance with International Standards on Auditing is/is not required under the terms of the lease for (property).

I am/we are responsible [under the terms of the lease(s) for (property)] for preparing the service charge statement of account for the year ended (date) set out on pages  to . I am/we are responsible for ensuring that the financial management of the service charges is sound and that there is an effective system of internal control which facilitates the proper use of the service charges and which includes arrangements for good management of the building and all communal grounds for which I/we have responsibility in accordance with the terms of the lease.

No leaseholder has made a request for a written summary of relevant costs in relation to the service charges payable or demanded as payable in the period in accordance with section 21 of the Landlord and Tenant Act 1985.

I/we confirm that all relevant costs included as expenditure in the service charge information, [including payments to reserve funds,] is a proper charge to the property and is in accordance with the underlying lease(s). [I/we have complied with the provisions of section 20 of the Landlord and Tenant Act 1985 in relation to [long-term expenditure] [and] [major works as defined by the legislation.]] [The schedule that I/we have prepared, of relevant expenditure applicable to different leases within the property and the allocation of this expenditure to individual tenants, is an accurate summary of all the lease agreements relevant to [property]]11.

All the accounting records have been made available to you for the purpose of your engagement and all the transactions relating to service charges have been properly reflected and recorded in the accounting records. Any significant matters of which we consider you ought to be aware have been brought to your attention.

[The schedule that I/we have prepared of all service charges receivable by the landlord during the year is an accurate record of the charges payable by each tenant/leaseholder in accordance with their lease.] [The balances shown as owed to/by each tenant in respect of service charge demands at the beginning and end of the year are derived from the accounting records.]

[The allocation of [details of expense] across [service charge schemes] including that relating to the above property is in accordance with the lease(s)]12.

[The charge to [reserve fund/reserve account] is in accordance with the provisions of the lease(s) and the amounts have been accurately reflected in the [reserve fund/reserve account]]13.

[All service charge monies are held separately from the landlord’s/company’s money on trust in accordance with section 42 of the Landlord and Tenant Act 1987 in designated accounts with (bank name(s)) and the balances reconciled to the fund balance(s) shown on page xx of the statement of account].

11 For use where there is more than one lease governing the service charges applicable to the property.
12 For use where expenditure represents an allocation of an expense across one or more service charge schemes.
13 For use where expenditure, such as sinking fund charges, has been incurred.
Additional paragraphs if an audit is required:

[We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (Audit engagements only: ISA 240)]

[We have disclosed to you the identity of the entity’s related parties and all the related party relationships and transactions of which we are aware. (Audit engagements only: ISA 550)]

Final paragraph for both forms of engagement

We confirm that the above representations are made on the basis of enquiries of management and staff with relevant knowledge and experience (and, where appropriate, of inspection of supporting documentation) sufficient to satisfy ourselves that we can make the above representations to you.

Yours faithfully

………………………………………………..
(Signature on behalf of Landlord/Managing Agent)

……………………………………
Date
APPENDIX I: EXAMPLE REPORTS ON SERVICE CHARGE ACCOUNTS

1. Audit report in accordance with ISA 800

Independent auditor’s report to the landlord/managing agent of (property)
We have audited the accompanying service charge accounts for (property) for the [year]/[period] ended [date], which comprise the statement of service charge income and expenditure account, balance sheet as at [date], and related notes. The accounts have been prepared in accordance with the accounting policies set out in Note 1 to the accounts.

Landlord/managing agent’s responsibility for the accounts
The landlord/managing agent is responsible for the preparation of these accounts in accordance with the terms of the lease(s), and for such internal control as the landlord/managing agent determines is necessary to enable the preparation of accounts that are free from material misstatement, whether due to fraud or error.

Auditor’s responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of the accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made, as well as evaluating the overall presentation of the accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the service charge accounts of (property) for the year ended [date] are prepared, in all material respects, in accordance with the accounting policies set out in Note 1 to the accounts.

Basis of accounting and restriction on distribution and use
Without modifying our opinion, we draw attention to Note 1 to the accounts which describes the basis of accounting. Our report has been prepared pursuant to the terms of our engagement letter and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely upon this report by virtue of our engagement letter or has been expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

…………………………………………….Signed   ………………………… Date
Name/Firm’s name & qualification
Address

14 The position and wording of this paragraph and sub-heading are based on Illustration 1 in the Appendix to ISA 800. The paragraph and heading are required by paragraph 14 of ISA 800, which states that “The auditor’s report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the auditor’s report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. The auditor shall include this paragraph under an appropriate heading.” The wording is not prescriptive so the text from the second sentence onwards may be adapted to wording used by the auditor in other audit reports or based on that in the second paragraph of the following example report of factual findings.
2. Accountant’s report of factual findings to the landlord\(^\text{15}\) of (property)

You have stated that an audit of the service charge accounts in accordance with International Standards on Auditing is not required under the terms of the lease for (property). In accordance with my/our engagement letter dated (date), I/we have performed the procedures agreed with you and enumerated below with respect to the service charge accounts set out on pages ... to ... in respect of (property) for the year ended (date) in order to provide a report of factual findings about the service charge accounts that you have issued.

[This report is made to the landlord for issue with the service charge accounts in accordance with the terms of my/our engagement. My/Our work has been undertaken to enable me/us to make this report to the Landlord and for no other purpose. To the fullest extent permitted by law, I/we do not accept or assume responsibility to anyone other than the Landlord for my/our work or for this report.]

**Basis of report**

My/Our work was carried out having regard to [TECH 03/11\(^\text{16}\)] *Residential Service Charge Accounts* published jointly by the professional accountancy bodies with ARMA and RICS. In summary, the procedures I/we carried out with respect to the service charge accounts were:

1. I/we obtained the service charge accounts and checked whether the figures in the accounts were extracted correctly from the accounting records maintained by or on behalf of the landlord;
2. I/we checked, based on a sample, whether entries in the accounting records were supported by receipts, other documentation or evidence that I/we inspected; and
3. I/we checked whether the balance of service charge monies for this property shown on page xx of the service charge accounts agreed or reconciled to the bank statement(s) for the account(s) in which the funds are held.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing (UK and Ireland) or International Standards on Review Engagements, I/we do not express any assurance on the service charge accounts other than in making the factual statements set out below.

Had I/we performed additional procedures or had we performed an audit or review of the financial statements in accordance with International Standards on Auditing (UK and Ireland) or International Standards on Review Engagements, other matters might have come to my/our attention that would have been reported to you.

**Report of factual findings:**

(a) With respect to item 1 I/we found the figures in the statement of account to have been extracted correctly from the accounting records [except as noted below].

(b) With respect to item 2 I/we found that those entries in the accounting records that we checked were supported by receipts, other documentation or evidence that I/we inspected [except as noted below].

(c) With respect to item 3 we found that the balance of service charge monies shown on page xx of the service charge accounts agrees or reconciles to the bank statement for the account(s) in which the funds are held.

[Detail any exceptions found in the course of the work]

……………………………………………………………Signed …………………………… Date

Name/Firm’s name & qualification

Address

\(^{15}\) The report will be made to the managing agent and other references changed accordingly if the agent, not the RMC, has engaged the reporting accountant.

\(^{16}\) Title will be that given by the issuing accountancy body to which the reporting accountant belongs.
Accountants appointed to carry out a reporting engagement in accordance with this guidance must be members of the following recognised supervisory bodies for company auditors (as defined by companies legislation currently in force) who are entitled under the rules of the body to which they belong to engage in public practice:

- Association of Authorised Public Accountants
- Association of Chartered Certified Accountants
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants in Ireland
- Institute of Chartered Accountants of Scotland

Where an accountant has been engaged to make a report in accordance with s21, LTA 1985, the accountant must be a registered auditor (see s28, LTA 1985).

The accountant should be independent of the landlord and managing agent – see paragraph 3.2.4.
APPENDIX K: SECTION 21 REQUIREMENTS

As explained in Section 2 of this guidance (preparation of service charge accounts), there is no statutory requirement to prepare service charge accounts every year. However, whether or not accounts are prepared annually and an independent examination arranged, the tenants or secretary of a recognised residents association of a property may request a summary of relevant costs in accordance with the provisions of s21, LTA 1985. Further, if the relevant costs are paid by the tenants of more than four dwellings, this summary must be reported on by a registered auditor. The definition of auditor in s28, LTA 1985 suggests that the auditor must be an individual rather than a firm.

Requests are rarely received because most landlords and agents prepare service charge accounts as a matter of course. In addition, some managing agents base their service charge accounts on the provisions of section 21 and engage a registered auditor to provide a report (which may also be based on section 21). Provided that the nature of the engagement and form of report comply with the terms of the lease, such an arrangement should satisfy the requirements of s21, LTA 1985 if a summary of relevant costs is requested.

This guidance is not intended to cover accounts prepared under s21, LTA 1985 or the accountant’s report thereon: the following paragraphs are provided for information only.

Section 21 requirements

1. Part 10.17 of the Code explains that s21, LTA 1985 requires the summary provided in response to a tenant’s request to cover all costs incurred by the landlord for works and services, etc, showing how they are reflected or will be reflected in demands for service charges. The reasonable cost of preparation of the summary and its certification is properly chargeable to the service charge account.

2. Section 21(5) requires the summary to distinguish between (a) items/costs for which no payment has been demanded of the landlord within the period to which the summary relates; (b) items/costs for which payment has been demanded of the landlord but not paid within that period; and (c) for which the landlord has paid within that period. (In practice, (a) and (b) can usually be equated to accruals and creditors respectively, but there have been cases where tribunals have held to a different interpretation.)

3. Section 21(5) also requires the summary to include the total of any money received by the landlord for service charges and still standing to the credit of the tenants paying these charges at the end of the period, and any costs which relate to works for which grants have been or will be paid and show how they have been reflected in the service charge demands.

4. Finally, s19(2), LTA 1985, requires that, when a tenant has paid service charges in advance, the amount payable must be reasonable and the landlord must repay any excess paid, or deduct it from subsequent charges, as the lease directs once the costs have been incurred. Advance payments and actual expenditure should be presented clearly.

5. Section 21(6), LTA 1985 requires that, if the service charges in respect of which a tenant has required the landlord to supply a written summary of costs incurred are payable by the tenants of more than four dwellings, the summary must be certified by a qualified accountant as:

   (a) in his opinion a fair summary complying with the [requirements] of subsection (5) (of section 21); and
   (b) being sufficiently supported by accounts, receipts and other documents which have been produced to him.

6. Section 28, LTA 1985 defines ‘qualified accountant’ as a registered auditor. A registered auditor is disqualified from acting as the qualified accountant if he or she is connected with the landlord or agent acting for the landlord eg, if he or she is an officer, employee or partner of the landlord or agent or person connected with the landlord or agent.

7. The legislation does not state to whom the accountant’s report should be addressed, so it can be addressed to the landlord, or the leaseholders/tenants, or to both.

8. Leaseholders often misunderstand what assurance is being given in section 21 accountant’s report, particularly because it is given by a registered auditor. It may, therefore, be helpful to add an explanatory paragraph to the section 21 report, to the effect that the work undertaken was not an audit in accordance with auditing standards.
EXAMPLE REPORT UNDER SECTION 21(6), LANDLORD AND TENANT ACT 1985

Independent accountant’s report to the landlord/managing agent of [property]

In accordance with my engagement letter dated [date], I have examined the service charge statement of account set out on pages … to … in respect of [property] for the year ended [date] together with the books and records maintained by [Landlord/Managing Agent] in so far as they relate to [property].

This report is made to the Landlord for issue with the service charge statement in accordance with section 21 of the Landlord and Tenant Act 1985. My work has been undertaken to enable me to make this report to the Landlord [and tenants as a body] and for no other purpose. To the fullest extent permitted by law, I do not accept or assume responsibility to anyone other than the Landlord for my work or for this report.

Under the terms of this engagement, I am not required to, and did not, form any opinion as to either the reasonableness of the costs included within the service charge statement or the standard of the services or works provided.

Respective responsibilities of the landlord and independent accountant

Under the Landlord and Tenant Act 1985, the Landlord is responsible for the preparation of this service charge statement in respect of the costs in respect of [property]. [The Managing Agent has undertaken responsibility for the preparation of the service charge statement on behalf of the Landlord]. It is my responsibility to form an independent opinion, based on my examination, on the service charge statement and to report my opinion [exclusively] to the Landlord [and tenants]/Managing Agent.

Basis of opinion

I planned and performed my examination so as to obtain all the information and explanations that I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the service charge statement is a fair summary of the costs relating to [property] and is sufficiently supported by accounts, receipts and other documents which have been made available to me. In view of the purpose for which this service charge statement has been prepared, however, I did not evaluate the overall adequacy of the presentation of the information which would have been required if I were to express an audit opinion under International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board.

Certificate

I certify that:

(a) In my opinion the service charge statement is a fair summary complying with the requirements of section 21(5) of the Landlord and Tenant Act 1985.

(b) The summary is sufficiently supported by accounts, receipts and other documents which have been produced to me.

......................................
Signed
Registered auditor
[Date]
[Address]