15 April 2013

Our ref: ICAEW Rep 59/13

Association of Retirement Housing Managers
Southbank House
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London SE1 7SJ

By email: arhmconsultation@gmail.com

Dear Sirs

Consultation on a revised version of the Code of Practice for private retirement housing in England

ICAEW welcomes the opportunity to comment on the consultation draft revised *Private Retirement Housing Code of Practice - England* (draft revised Code) published by the Association of Retirement Housing Managers on 08 February 2013, a copy of which is available from this link.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

This response reflects consultation with the ICAEW Business Law Committee which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

General points

1. As joint issuers of the publication *Residential service charge accounts* (Tech 03/11) with the Association of Chartered Certified Accountants (ACCA), the Institute of Chartered Accountants of Scotland (ICAS), the Association of Residential Managing Agents (ARMA) and the Royal Institution of Chartered Surveyors (RICS), ICAEW has concentrated on the accounting and review provisions in the draft revised Code. We do not comment on the practical administrative and management provisions of the draft revised Code and we have not responded to the specific questions in Part B of the Code consultation reply form.

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2. There appears to be a tendency to reinvent the wheel and state in different words material that is already contained in the Residential Management Code published by RICS and in Tech 03/11. The copyright of Tech 03/11 is owned by the issuing bodies, whose permission must be obtained from in writing by persons wishing to reproduce or redistribute any of the material it contains, but the five issuing bodies agree that it is reasonable for ARHM to use text from Tech 03/11 in the proposed new publication wherever it is relevant, so that it is not necessary for users to refer to two or three separate publications. If reference is made to Tech 03/11, it should be described as a joint publication of the three accountancy bodies, ARMA and RICS.

Application of Landlord and Tenant legislation

3. The draft revised Code does not make it clear enough to what extent and when the Landlord and Tenant Acts of 1985 and 1987 ('LTA 1985', 'LTA 1987') apply. The definition of 'Service charge' on page 8 quotes the definition of 'Service charge' in section 18(1) LTA 1985 but crucially omits some of the words from s.18(1)(b), which refers to '[an amount] the whole or part of which varies or may vary according to the relevant costs …'. If the guidance were clear about what are 'service charges' for the purpose of the Landlord and Tenant Acts, the respective rights and responsibilities of the landlord (or manager, on behalf of the landlord) and lessees would also be clear. This in turn would clarify the requirements for the landlord's own accounts and for the provision of information to lessees and safe custody of service charge money.

4. The Code needs to distinguish between LTA service charges and other charges that may be provided for by the terms of the leases. Chapter 23.6 (first such numbered paragraph) headed 'Care Services Charges and Service Charges' states simply that 'Managers should distinguish clearly between charges for care services and service charges as defined by the Landlord and Tenant Act 1985 S18.' We did not see any reference to 'charges for care services' in the definitions section of the Code, nor any mention earlier than Chapter 23, let alone an explanation of the importance of the distinction. Charges for care services are income of the provider and are not subject to the provisions of the Landlord and Tenant Acts.

Definitions

5. We recommend that the following definitions in the introductory section be expanded but also made tighter:

- Landlord – this needs to include reference to s.30, LTA 1985 because of the importance of the residential service charge provisions;
- Lease – the importance of the lease for determining what are the relevant costs that may be recovered through service charges should be included;
- Resident Management Company (RMC) – the reference should be to 'Residents' Management Company' (the reference in the 'Right to Manage Company' definition also needs to be corrected). The word 'only' is in the wrong place in the first sentence and does not convey the right meaning. RMCs exist in which not all leaseholders are members or shareholders, although some leases include a requirement for the leaseholder to be a member of the RMC. A definition such as that contained in Tech 03/11 might be better; and
- the definition of 'service charge' needs to be expanded to distinguish service charges as defined by s. 18 LTA 1985 from other charges that are not subject to Landlord and Tenant legislation such as charges for care services and possibly charges for special services.

Protection of Service Charge Monies

6. We recommend that Chapter 4 make clearer the distinction between service charge monies – which are subject to the trust provisions of s.42, LTA 1987 unless the person entitled to receive the monies is a registered provider - and payments by lessees or residents for care services, which belong to the person providing the service, and which are not subject to the Landlord and Tenant legislation. Chapter 4.1 refers to 'other monies held including any ground rents" but ground rents are less likely to apply – or are likely to be for a lesser amount – than charges for care services or other special services. It is not clear from the text of the draft revised Code whether or not charges for special services (Chapter 6) constitute service charges. It may even be that some special services fall within the definition of variable service charges, and others do not, depending on the terms of the underlying lease. Paragraph 12.1 ('The terms of the lease will govern the frequency and method of service charge and ground rent collection and payment') suggests that charges for special services all fall within the variable service charge. Further guidance and illustrations on this point would be helpful.

7. We consider that the draft revised Code goes beyond current legal requirements in saying that separate accounts must be opened for each scheme. The proposed requirement is based on Commonhold and Leasehold Reform Act 2002 (CLARA) provisions that have not yet been implemented, and that may not be implemented. Requiring a separate bank account for each scheme may place an unnecessary administrative burden on entities that are responsible for more than one scheme and that may operate a single client bank account in which funds for all properties can be placed. We therefore recommend that, subject to permission, the provisions for protecting service charge monies be based on, or even reproduced from, the RICS Residential Management Code, which we understand is currently being redrafted.

Chapter 5 Service Charge Accounts

8. Paragraph 5.1 states that 'All managers should provide an annual service charge account to every lessee within 6 months of the end of the financial year'. While it is certainly desirable for annual service charge accounts to be provided to every leaseholder as soon as possible after the end of the relevant financial year, there is no statutory requirement for such accounts to be provided within six months. We therefore recommend that a sentence be added to explain the '18 month rule' in s.20B, LTA 1985. S.20B(1) states that 'If any of the relevant costs taken into account in determining the amount of any service charge were incurred more than 18 months before a demand for payment of the service charge is served on the tenant, then [if the tenant has not been informed in writing that the costs had been incurred and would be included in the service charge] the tenant shall not be liable to pay so much of the service charge as reflects the costs so incurred'.

9. The reference to Tech 03/11 in paragraph 5.2 of the draft revised Code is wrong: Tech 03/11 is a joint publication by the three named accountancy bodies, RICS and ARMA (our paragraph 1 above).

10. We are not sure what is meant by paragraph 5.3 of the draft revised Code, which states that 'the service charge account should include a note to explain the provision of any reserves held, the amount held in cash and any debtors that mean the reserves are not fully funded'. Tech 03/11 recommends in paragraph 2.2 that the service charge accounts should be prepared on accruals basis and should include a balance sheet for the service charge fund as well as an income and expenditure account and explanatory notes. The paragraph goes on to state that 'where service charge monies are held on trust, the records must be capable of showing held at bank for an individual property/service charge scheme, and the amounts demanded and paid in advance by or due from each lessee.'

11. We consider that it would be helpful to leaseholders if the Code recommended that service charge accounts include comparative figures, either the prior year's actual expenditure incurred, or the current year's budgeted expenditure, or even both.

12. We recommend that the second paragraph 5.3 (as numbered) be expanded to make clear that, where there are no transactions and balances that 'belong' to the RMC or other 'landlord' company, and all the leaseholders of the dwellings are members of the company, it may be an unnecessary expense to prepare two separate sets of accounts. In the Memorandum of comment submitted by ICAEW in response to the UITF Information Sheet 92 on residents' management companies' financial statements, we highlighted the view of many practitioners that the production of separate service charge accounts is unduly burdensome. On the other hand, it is possible that for Retirement Home properties there will normally be services and charges other than those covered by the LTAs, or leaseholders who are not members of the RTM/RTMCo: in this case separate Companies Act accounts will be needed. More and clearer definitions at the outset will make it clearer which figures belong in which accounts.

13. Paragraphs 5.4 to 5.6 need to be expanded to put the terms 'surplus' and 'deficit' in context. In the experience of our members working in this sector, there is a lot of confusion about surpluses and deficits on service charges demanded, particularly where the 'landlord' is a RMC or similar. The basic principle of the legislation is that service charges may only be demanded in respect of relevant expenditure that has been incurred. If the demand exceeds expenditure incurred, then the excess should be repaid to the leaseholder or carried forward to reduce the amount of the next demand. If relevant expenditure incurred is more than the service charge demanded, then the excess can be recovered from the leaseholder or, again, carried forward and added to the next service charge demand. Only if the lease allows may a sum be included in the service charge demand that can be set aside in a fund for future expenditure, for example for periodic major repairs or maintenance. Unless there is clarity on what the terms mean, there is a risk that a surplus or deficit arising on the service charge account may be treated as part of the RMC's reserves.

14. We are concerned that paragraphs 5.7 and 5.8 could be misinterpreted as they lack explanation and context. The point is that, if an examination in a form other than that prescribed by the lease is procured, then the cost of the work undertaken may not be recoverable through the service charge. On the other hand, if an audit is undertaken when the cost is clearly unnecessary and disproportionate to the circumstances, then the cost won't be recoverable either. We recommend that these paragraphs be expanded, possibly using text from section 3 of Tech 03/11.

15. Paragraph 5.9 should refer to International Standard on Auditing 800 (ISA 800) rather than ISO 800. The title of ISA 800 is *'Special considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks'*. We should point out that members of the three issuing accountancy bodies are expected to follow the guidance in Tech 03/11 as a matter of good practice, but that the conduct of engagements to report on the service charge accounts of retirement housing schemes in accordance with the draft revised Code is not restricted to the accountants holding the qualifications listed in Appendix J to Tech 03/11. The only circumstances in which the law defines the qualification required for the reporting accountant are when a report is to be made in accordance with s. 21 LTA 1985, when the reporting accountant must be a registered auditor.

16. We recommend that paragraphs 5.10 to 5.14 simply state leaseholders' rights under Landlord and Tenant legislation. There is no difference in law to leaseholders' rights of access to information whether the landlord is an RMC or RTMCo or whether a manager or managing agent has been appointed. There will be different rights of access in respect of non-LTA charges, because these are not covered by the legislation.

17. Paragraph 5.14 may need to be modified as the current wording appears to be at odds with that in paragraph 5.7: the form of external scrutiny depends on the terms of the lease, irrespective of the

constitution of the landlord. If the lease requires, or is construed as requiring, an audit, then that is what the RMC or RTMCo should procure. However, it is worth noting the comments in paragraph 3.1.2 of Tech 03/11 about the interpretation of references to 'audit', as follows: '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.'

Chapter 9 Consultation with Leaseholders

18. We agree that the manager and leaseholders should meet at least annually to discuss matters such as the service charge accounts and budgets. However, whether or not the landlord is a RMC or similar has no effect on the obligation to consult leaseholders (paragraphs 9.4 to 9.9). A company AGM is not the forum for such consultation, though the AGM can be used as a means of getting leaseholders together, for example by having the business of the AGM first, then having a leaseholders' meeting following on. Paragraph 9.9 implies that consultation is a matter for decision by or agreement with the directors of a RMC/RTMCo. This is not the case: the requirements for consultation in relation to service charge expenditure are set out in the LTA 1985. It might be better if the heading for this section and paragraphs omitted the adjective 'general' and did not distinguish between RMC/RTMCo managers/landlords and other entities, so as to avoid confusion with company law and general meetings of members of a company.

19. Paragraphs 9.11 to 9.22 refer to 'qualifying works', which are not defined in the document. It is left to users to work out from the context that qualifying works are those subject to LTA 1985. We recommend that a paragraph be added to explain what qualifying works are.

I trust that these comments are helpful but please do not hesitate to contact me if you have any questions.

Yours sincerely

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