

## Research briefing

### Introduction

Since 1996, where a UK commercial lease failed to include specific provisions outlining the financial reporting, management, administrative, and audit processes for managing the service charge process, the practical “best practice” guidance came from a non-mandatory “voluntary” RICS Code of Practice, *Service Charges in Commercial Property* (RICS, 2014). However, in 2018, the RICS published a Professional Statement, *Service Charges in Commercial Property* (RICS, 2018), that introduced an array of mandatory and best practice requirements for service charge managers to adopt and comply with. The Professional Statement was effective for service charge years commencing on or after 1 April 2019, so RICS Members and regulated firms should now be producing and publishing accounting documents that comply with its requirements.

From the perspective of an RICS member, failure to comply with the mandatory obligations of the Professional Statement may result in “legal and/or disciplinary consequences...[and] may lead to a finding of negligence against a surveyor (RICS, 2018, Section 1.1 p. 7)”. In contrast, departure from the statement’s “best practice” requirements may be permitted “for justifiable reasons” (RICS, 2018, Section 1, p.7). In addition, the requirements of the professional statement cannot override the legal requirements of the lease, but when interpreted in conjunction with it, can help to identify the best way to provide services in accordance with the lease.

When interpreting the RICS Professional Statement it is important to distinguish between its “must” and “should” requirements, which are classified as the “mandatory” and “best practice” provisions, respectively. However, due to the way the professional statement is written and structured, it can be difficult to clearly identify what is “mandatory” rather than “best practice”, since some requirements are discussed then reintroduced using different wording, and some information to be disclosed is neither described as either a “must” or a “should”. While the issue of language is potentially problematic and deserves further investigation, the more important research question posed here is:

*Are managing parties producing service charge accounting documents that comply with the new presentation and disclosure requirements of the RICS Professional Statement?*

Based upon a review of 20 recently published annual statements of service charge expenditure provided to Bellrock Property and Facilities Management Ltd (Bellrock), this briefing paper provides some initial thoughts and observations as to whether annual service charge accounting statements for UK multi-let office buildings comply with select requirements of the 2018 RICS Professional Statement, *Service Charges in Commercial Property* (RICS, 2018).

### Assessing compliance with the 2018 Professional Statement: the Metrics

After evaluating the Professional Statement, the researchers identified a series of 17 “must”, “should” and “other” compliance metrics that both captured the main accounting and administrative requirements of the Professional Statement and could be identified via an unbiased, “binary” review (i.e. “yes” it is included, or “no” it is absent manner) of the content within the annual service charge accounts. As the leases for many properties do not require the creation of a sinking or reserve fund, no metrics were included to measure the accounting requirements in this area. Each of the 17 metrics are explained in more detail in Table 1 below.

The metrics include four “musts”, 12 “shoulds”, and one “other” requirement as per the language used within the Professional Statement. As the one “other” requirement included within the Professional Statement (“Openness and transparency can be further enhanced by the inclusion of a balance sheet or cash reconciliation”) is neither a must or a should, each property’s annual service charge accounts are ranked out of a total compliance score of 16 (i.e. the four “musts” and 12 “should”), with separate reporting of compliance with the one “other” requirement.

# Accounting Compliance with the 2018 RICS Professional Statement, *Service Charges in Commercial Property* (RICS, 2018): Initial Thoughts and Findings



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**Table 1 Metrics for assessing service charge accounting compliance with the RICS Professional Statement**

No.	Requirement	Must / Should	Measurement
1	The Professional Statement requires that fees be set on a fixed-price basis (Section 4.1.3.2, page 14)	Must	Binary coding - Yes/no
2	Ensure that a service charge apportionment matrix for the property is provided annually to all tenants. Clearly shows the basis and method of calculation, and the total apportionment per schedule for each unit within the property. (Section 4.2.4, page 18)	Must	Binary coding - yes/no
3	Service charge monies must be held in one or more discrete [or virtual] bank accounts (Section 4.5, page 22)	Must	Clear statement - yes/no
4	Interest earned on service charge accounts must be credited to the service charge account after appropriate deductions have been made (Section 4.5.10, page 27)	Must	Binary coding based upon evidence - yes/no
5	Timeliness - Detailed statements of actual expenditure, together with accounting policies and explanatory text, should be issued within four months of the service charge year end (Section 4.5.12, page 27-28)	Should	Binary coding - yes/no
6	Industry Standard Cost Classifications should be used in reporting budget and actual expenditure. As a minimum acceptable level of reporting, service charge budgets and statements of actual expenditure should be prepared at cost class level (Section 4.5.5, page 25)	Should	Cost classes Binary coding - yes/no
7	and cost category level (Section 4.5.5, page 25)	Should	Cost category Binary coding - yes/no
8	Service charge accounts should include a comprehensive list of accounting policies and principles including: whether the accounts are prepared on an accruals or where permitted, the cash basis (Section 4.5.1, page 23)	Should	Clear statement of whether accounts are prepared on an accrual or cash basis Yes/no
9	Where the accounts are prepared on an accruals basis, they should be accompanied by a schedule of opening and closing prepayments and accrued expenses (Section 4.5.6, page 26)	Should	Binary coding – yes/no
10	An analysis of any material variances between budget and actual expenditure, with a detailed commentary to explain trends and variances where significant (section 4.5.2, page 23)	Should	Binary coding – yes/no
11	Other information includes: A statement detailing how insurance claims are accounted for (Section 4.5.2, page 23)	Should	Clear statement on insurance claims – yes/no
12	Other information: Whether the owner has waived the exemption to charge VAT (opted to tax) (Section 4.5.1, page 23)	Should	Statement of whether owner has waived exemption to charge VAT Yes/no
13	The accounts should be approved by or on behalf of the landlord as complying with the following statements: the accounts produced represent the actual expenditure incurred by the owner in supplying the services to the building (section 4.5.3.2, page 23) and	Should	Clear statement – yes/no
14	That the expenditure the owner is seeking to recover is in accordance with the terms of the leases and where practicable, the provisions of the professional statement (section 4.5.3.2, page 24)	Should	Clear statement – yes/no
15	The approver should be an appropriately qualified and competent person with experience in dealing with service charges. The status of the person and the capacity in which they are acting should be made clear (section 4.5.3.2, p. 24)	Should	Clear statement of status and capacity – yes/no
16	Annual statements of service charge expenditure should be supported by an independent review of service charge accounts, such as specified with the ICAEW Technical Release (Section 3, principle 13, page 11)	Should	Includes an Independent Accountants' report – yes/no
17	Openness and transparency can be further enhanced by the inclusion of a balance sheet or cash reconciliation (Section 4.5.4, page 24)	Other	Binary coding – yes/no



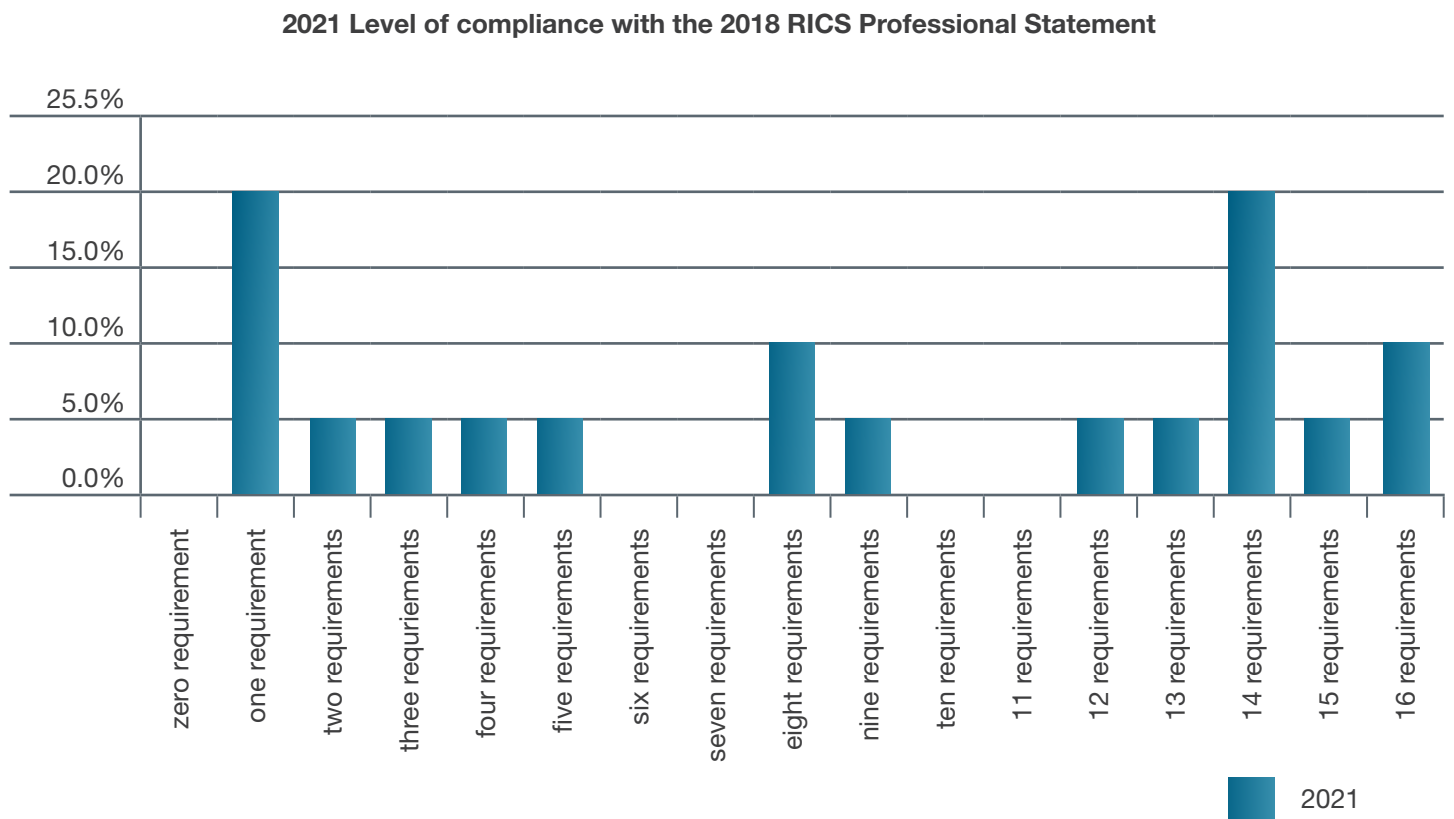
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**Methodology and Findings**

The accounting certificates analysed were selected randomly from the data available to Bellrock, and included documents prepared by a range of managing parties. The overall compliance results for the 20 UK multi-let office properties are illustrated in Figure 1.

While it is difficult to generalize from such a small sample, it is clear that compliance varies widely. Only two documents fully complied with all 16 requirements. Nine documents complied with at least 12 of the 16 requirements, and eight others complied with five or fewer metrics. Overall, compliance levels appear similar to those found with the previous RICS Code, with some managing parties trying hard to comply, while others have much work to do.

**Figure 1: Office Compliance with the 16 ‘Must’ and ‘Should’ Metrics**





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**Table 2 RICS Professional Statement - 16 Must & Should requirements for Annual Service Charge Accounts**

Requirement	Must / Should	Compliance out of 20	
		No.	%
1. Fixed Management Fee	Must	12	60
2. Apportionment matrix is provided for each unit in the property	Must	11	55
3. Statement that service charge monies are held in one or more discrete bank accounts	Must	7	35
4. Interest earned credited to the service charge account	Must	11	55
5. Timeliness Compliant (date) - annual accounts produced within four months of year end	Should	9	45
6. Cost Classes Used	Should	12	60
7. Cost Categories Used	Should	14	70
8. Statement that accrual accounting or cash basis used	Should	12	60
9. Schedule of accruals and prepayments	Should	10	50
10. Description of variances	Should	16	80
11. Statement about how insurance claims are accounted for	Should	5	25
12. Statement about whether owner has waived exemption to charge VAT	Should	14	70
13. Statement that accounts represent the actual expenditure incurred in supplying services	Should	12	60
14. Statement that amounts seeking to be recovered are in accordance with the lease and where practicable the PS	Should	5	25
15. Approver should be an appropriately qualified and qualified person. Status of person should be made clear	Should	11	55
16. Accounts should be supported by an independent review in line with ICAEW Technical Release	Should	10	50

When assessing the results in Table 2, it is disappointing to note that there was less than 60% compliance for any of the four “must” requirements (Metrics 1-4 in Table 2). While three of these “must” metrics are specifically listed under the Professional Statement’s list of “mandatory” requirements (RICS, 2018, p.9), the document also “requires that [management] fees be set on a fixed-price basis” (RICS, 2018, p.14) so this metric is also assessed as a “must” rather than merely a “should”. In addition, the failure to comply with certain of the 16 requirements, such as “Statement that accrual accounting used” (Metric 8), and the requirements to certify that the accounts represent actual expenditure incurred in supplying services in accordance with the lease (Metrics 13 and 14), are more critical for determining whether the accounts provide “true and fair” and useful information for occupiers. The results for these metrics are especially disappointing, since they are required in order to enhance the comparability and quality of the resultant accounting information. Furthermore, many of the other accounting requirements, such as providing the financial statements within four months of the year end (Metric 5) and utilizing industry specific cost classes and categories (Metrics 6 and 7), should not be too onerous for professional managing parties to comply with.

In terms of the 17th metric, the inclusion of a balance sheet, no document included such an accounting statement, which is extremely disappointing as a balance sheet provides transparency as to the magnitude of end-of-period assets, liabilities, and reserves. In addition, the provision of a balance sheet will benefit the auditing process and assist greatly during the handover of the service charge accounts to a new agent.

In summary, these preliminary results suggest that some managing parties are failing to universally adopt all aspects of the RICS Professional Statement, and that the RICS itself needs to do more to foster the take up of both the mandatory and “best practice” requirements of its new regulation. The results also highlight the value of ongoing compliance monitoring for all industry parties, as the data clearly identified where current annual service charge accounts must be improved.



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### Implications and Future Research

The analysis of compliance with the service charge requirements of the 2018 RICS Professional Statements will be continued in the forthcoming SCOR for Offices 2021, and SCOR for Shopping Centres 2021. These publications will include a larger compliance dataset, which will further highlight the issues facing the UK service charge industry and the areas the RICS needs to provide support on.

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### References

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