Service Charge Operating Report *for* Retail

2016

SCOR for RETAIL

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1. SERVICE CHARGE BENCHMARKING METHODOLOGY – PROFESSOR ANDREW HOLT

The Service Charge Operating Report (SCOR) for Retail is produced from data provided to Property Solutions (UK) Limited (PSL) by an array of contributing parties, including a number of commercial landlords such as British Land. This varied data provides an unbiased and representative dataset, which this year incorporates service charge information from 74 unique landlords and 38 unique managing parties within the commercial retail service charge sector across the UK.

While having a representative data source is crucial, it is also vital that information is collected and analysed in a neutral manner, free from researcher bias and inaccuracy. In terms of data collection, all SCOR data is obtained from the actual service charge budgets and reconciliation statements (service charge certificates) provided to commercial occupiers by managing parties. Supplementary information, such as that contained within covering letters and additional attachments, is also reviewed where it is relevant to the analysis. As data is hand collected by the research team from actual service charge documents, there is no potential for third-party bias in terms of manipulation or selective-exclusion of documents. Furthermore, for each part of SCOR's benchmarking analysis, all available service charge data for a given period is included, unless the underlying source document is incomplete or a random sample is used.

In terms of analysis, content analysis is used to derive both the service charge cost and Royal Institute of Chartered Surveyors' (RICS) Code of Practice - Service Charges in Commercial Property (Code) compliance results. For the compliance analysis, all available service charge reconciliation certificates for the latest SCOR year are used. Unlike the cost analysis, the processing of the compliance data often requires some degree of subjective interpretation on behalf of the research team. In practice, the potential for bias in this type of work is remote as it requires limited interpretation by the researcher.

As the service charge costs for buildings within the SCOR dataset vary widely and their values are skewed, the usefulness of mean results are limited and the use of standard deviations suspect. As a result, SCOR uses the median to measure central tendency within both the single-period and longitudinal cost data, as it is relatively unaffected by skewed distributions and outliers.

While the majority of SCOR's data collection and analysis is performed by a research team at PSL, the work is closely monitored by an independent academic supervisor. I have proudly held this position since the inception of the SCOR Report and have helped to establish its methodology, annually verifying the neutrality and independence of the reported results. As part of this verification process, during the preparation of each year's report, the academic supervisor conducts a comprehensive audit of the data collection, analysis and archiving process. In terms of data verification, a random sample of the documents used for SCOR's cost and compliance analysis are selected in order to determine the accuracy of the data input, analysis and results.

2. FINDINGS AND ANALYSIS

2.1. Cost benchmarking of the most recent year

Detailed cost analysis was undertaken for a sample of 94 shopping centres, and Table 1 and Figures 1 & 2 provide descriptive information about the dataset.

Years of expenditure	No. of centres	No. of unique landlords	No. of unique managing parties	Total area (sq. ft.)	Total cost (£)
2015-2016	94	74	38	45,949,184	289,445,380

Table 1. Characteristics of the dataset used for the 2016 cost analysis

Figure 1. Property sizes (in sq. ft.) of all the shopping centres in the dataset

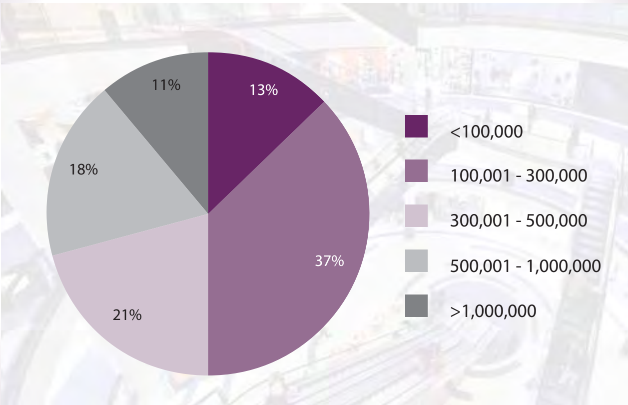
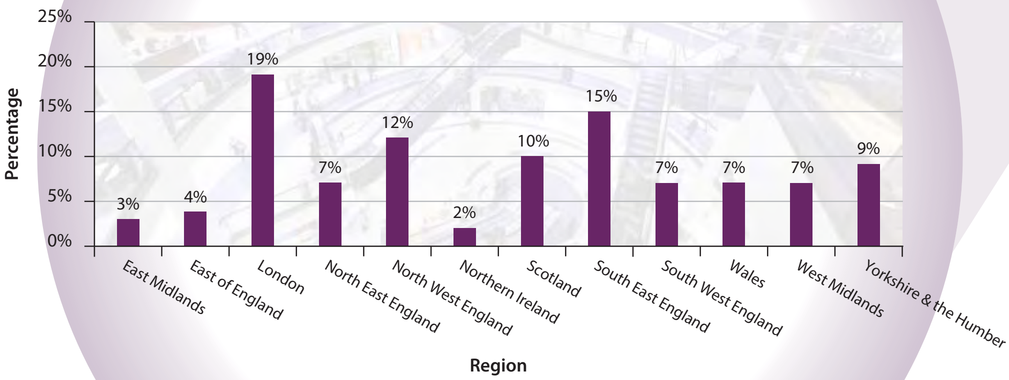


Table 1 and Figures 1 & 2 highlight that a range of property sizes from a geographically diverse group of locations were analysed this year. Although fewer centres were included in the dataset this year (94 compared to 99), the total floor area and aggregate service charge liability reviewed were higher.

"This year's data incorporates service charge information from 74 unique landlords and 38 unique managing parties within the commercial retail sector across the UK."

Figure 2. Geographic representation of the shopping centres in the dataset



Detailed cost benchmarking information for the entire sample is shown in Table 2. Table 3 provides cost information for centres located in both London and the Rest of the UK (Table 3), and Table 4 analyses the costs for covered or open/part covered centres.

Cost Category	Lower Quartile	Median	Upper Quartile
	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.
Management fees	0.26	0.39	0.50
Site management resources	0.50	0.72	1.05
Electricity	0.22	0.30	0.51
Gas	0.02	0.04	0.08
Security	0.76	0.98	1.31
Cleaning & environmental	0.70	1.03	1.43
Mechanical & electrical (M&E) services	0.20	0.36	0.67
Lifts & escalators	0.05	0.09	0.16
Fabric repairs & maintenance	0.18	0.34	0.60
Marketing and promotions	0.13	0.26	0.47
Other categories	-	-	-
Total	**4.00**	**5.22**	**6.91**

Table 2. Select service charge costs at all shopping centres

Table 2 illustrates that of the total service charge cost, the most expensive cost related to the overall management of the building, such as the Management Fee or the Site Management Resources, which in total represented just over 20% of total cost. Security and Cleaning & Environmental costs each also represented approximately 20% of total cost. With Utilities costs, M&E Services and Fabric Repairs & Maintenance accounting for between 5% and 10% of the total these costs make up the bulk of the remainder.

The three most expensive cost categories are those that are most susceptible to rises in labour costs, and with the projected rises in the National Living Wage (and its version in the capital the London Living Wage) it would be prudent to expect these costs to rise over the next few years. The trends over time in service charges will be examined in the longitudinal cost benchmarking section of this report.

Cost Category	Lower Quartile		Median		Upper Quartile	
	London	Rest of the UK	London	Rest of the UK	London	Rest of the UK
	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.
Management fees	0.42	0.24	0.52	0.33	0.63	0.44
Site management resources	0.67	0.50	0.96	0.66	1.19	1.03
Electricity	0.31	0.18	0.46	0.28	0.69	0.48
Gas	0.01	0.02	0.06	0.04	0.09	0.08
Security	1.18	0.68	1.40	0.92	1.77	1.24
Cleaning & environmental	0.95	0.68	1.18	1.01	1.90	1.32
Mechanical & electrical (M&E) services	0.25	0.20	0.55	0.34	0.82	0.57
Lifts & escalators	0.05	0.04	0.12	0.09	0.14	0.16
Fabric repairs & maintenance	0.17	0.18	0.28	0.34	0.62	0.56
Marketing and promotions	0.02	0.15	0.23	0.26	0.52	0.46
Other categories	-	-	-	-	-	-
Total	**5.32**	**3.98**	**6.63**	**4.86**	**8.72**	**6.47**

Table 3. Select service charge costs at shopping centres located in London (total centres: 19) and in the Rest of the UK (total centres: 75)

As in previous years, the figures in Table 3 indicate that shopping centres in London incur higher costs when compared to locations outside the capital. The gap seems to be closing though with costs in London only circa one-third higher than in the Rest of the UK compared to just over 50% higher last year. This can, however, be attributed to 3 main cost categories where the uplift between London and the Rest of the UK is more marked; Management Fees, Electricity and Security. These three categories are still nearer the 50% uplift mark as compared to the Rest of the UK.

Occupiers in covered shopping centres incurred higher costs than those in open/part-covered centres as illustrated in Table 4. Understandably the cost categories that contribute to the greatest extent to this difference were Utilities, Cleaning and M&E Services. Security costs appear least affected by whether a shopping centre is covered or not.

Cost Category	Lower Quartile		Median		Upper Quartile	
	Covered	Open/Part Covered	Covered	Open/Part Covered	Covered	Open/Part Covered
	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.
Management fees	0.30	0.24	0.40	0.30	0.50	0.44
Site management resources	0.51	0.39	0.80	0.59	1.10	0.77
Electricity	0.23	0.10	0.36	0.23	0.58	0.28
Gas	0.02	0.01	0.04	0.02	0.08	0.07
Security	0.76	0.76	1.01	0.91	1.38	1.19
Cleaning & environmental	0.84	0.42	1.11	0.70	1.52	1.01
Mechanical & electrical (M&E) services	0.25	0.14	0.42	0.20	0.68	0.51
Lifts & escalators	0.05	0.04	0.10	0.06	0.16	0.13
Fabric repairs & maintenance	0.20	0.13	0.37	0.21	0.70	0.33
Marketing and promotions	0.15	0.00	0.29	0.19	0.53	0.30
Other categories	-	-	-	-	-	-
Total	**4.33**	**3.08**	**5.53**	**3.71**	**7.81**	**5.77**

Table 4. Select service charges for shopping centres that are Covered (73) and Open/Part-Covered (21)

> “...the most expensive cost relates to the overall management of the building – incorporating the Management fee and Site management resources – which represent just over one fifth of the total cost.”

2.2. The effect of total property area on service charges

Cost Category	London		Rest of the UK	
	<300,000 sq. ft. (11 centres)	>300,000 sq. ft. (8 centres)	<300,000 sq. ft. (33 centres)	>300,000 sq. ft. (42 centres)
	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.
Management fees	0.56	0.48	0.35	0.33
Site management resources	0.96	0.99	0.68	0.64
Electricity	0.35	0.58	0.28	0.28
Gas	0.02	0.07	0.08	0.03
Security	1.50	1.30	1.03	0.88
Cleaning & environmental	1.11	1.47	1.02	0.97
Mechanical & electrical (M&E) services	0.55	0.46	0.28	0.41
Lifts & escalators	0.08	0.13	0.10	0.09
Fabric repairs & maintenance	0.28	0.43	0.39	0.33
Marketing and promotions	0.27	0.20	0.25	0.27
Other categories	-	-	-	-
Total	**5.68**	**6.06**	**5.03**	**4.47**

Table 5. Median select service charge costs at shopping centres classified by total property size and geographical location

Theoretically, larger properties may offer economies of scale when it comes to cost per sq. ft. for certain types of cost. However, in London, larger properties reported a higher median service charge cost per sq. ft. than smaller centres. Nonetheless, in the Rest of the UK, larger properties had comparatively lower median costs per sq. ft. than smaller properties.

Table 6 shows the results split not along geographical lines but on whether the centre is covered or not. The results do not demonstrate economies of scale taking effect across the board as the larger centre size does not result in lower unit service charge costs. In covered centres, however, the greater the area the less the service charge rate in £ per sq. ft. but in open or part-covered centres the larger the property the higher the median service charge rate.

Cost Category	Covered		Open/Part-Covered	
	<300,000 sq. ft. (30 centres)	>300,000 sq. ft. (43 centres)	<300,000 sq. ft. (14 centres)	>300,000 sq. ft. (7 centres)
	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.
Management fees	0.45	0.34	0.28	0.35
Site management resources	0.93	0.65	0.57	0.77
Electricity	0.38	0.36	0.17	0.28
Gas	0.07	0.03	0.04	0.02
Security	1.26	0.92	0.93	0.85
Cleaning & environmental	1.17	1.09	0.68	0.71
Mechanical & electrical (M&E) services	0.47	0.39	0.20	0.51
Lifts & escalators	0.12	0.09	0.06	0.09
Fabric repairs & maintenance	0.39	0.35	0.24	0.13
Marketing and promotions	0.30	0.26	0.18	0.19
Other categories	-	-	-	-
Total	**5.66**	**4.76**	**3.59**	**4.06**

Table 6. Median select service charge costs at centres classified by total property size and whether they are Covered or Open/Part-Covered

Cost Category	Rest of the UK - Covered		
	<200,000 sq. ft. (16 centres)	200,000 sq. ft. - 400,000 sq. ft. (16 centres)	>400,000 sq. ft. (27 centres)
	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.
Management fees	0.50	0.32	0.33
Site management resources	1.01	0.61	0.62
Electricity	0.46	0.28	0.36
Gas	0.07	0.02	0.03
Security	1.52	0.97	0.85
Cleaning & environmental	1.31	0.87	1.17
Mechanical & electrical (M&E) services	0.54	0.32	0.44
Lifts & escalators	0.17	0.07	0.09
Fabric repairs & maintenance	0.39	0.45	0.33
Marketing and promotions	0.24	0.26	0.29
Other categories	-	-	-
Total	**5.95**	**4.43**	**4.74**

Table 7. Median select service charge costs at Covered shopping centres located in the Rest of the UK classified by property size

Table 7 provides detailed analysis of the costs of covered shopping centres located outside of London. Altogether the largest centres had lower median costs than smaller properties, those centres in the middle of the range had the lowest overall costs. A larger dataset is needed to fully investigate the presence and significance of economies of scale, but it appears that occupiers in larger properties do benefit from size-related cost efficiencies.

2.3. Longitudinal cost benchmarking

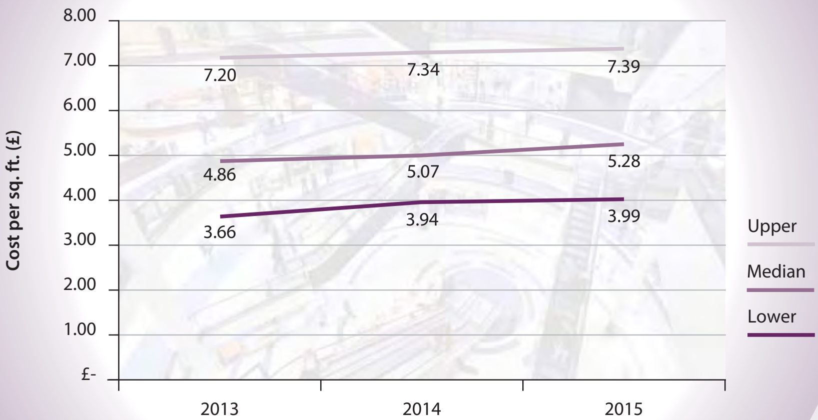
A longitudinal cost analysis over three continuous years (2013-2015) was also conducted for 69 of the 94 shopping centres within the sample. We believe this longitudinal year-on-year analysis is essential for understanding the changing nature and magnitude of service charge costs.

Years	No. of centres	Type of documents	Total service charge cost for the year 2016 (£)	Total floor area (sq. ft.)
2013-2015	69	Certificates of expenditure/budgets	229,295,016	34,826,436

Table 8. Characteristics of the dataset used for the longitudinal cost analysis

Overall, the total cost per sq. ft. increased over the three years. The median cost per square foot rose by 8.6% from 2013 to 2015, with the lower quartile and the upper quartile increasing by 9.0% and 2.6% respectively.

Figure 3. Service charge costs for the longitudinal dataset 2013-15



Cost Category	2013	2014	2015
	£ per sq. ft.	£ per sq. ft.	£ per sq. ft.
Management fees	0.36	0.40	0.39
Site management resources	0.74	0.79	0.78
Electricity	0.28	0.32	0.31
Gas	0.05	0.06	0.05
Security	0.99	0.99	1.01
Cleaning & environmental	0.94	1.02	1.03
Mechanical & electrical (M&E) services	0.30	0.36	0.37
Lifts & escalators	0.07	0.09	0.10
Fabric repairs & maintenance	0.37	0.37	0.36
Marketing and promotions	0.29	0.29	0.29
Other categories	-	-	-
Total cost	**4.86**	**5.07**	**5.28**

Table 9. Median select service charge costs for the longitudinal dataset 2013-15

> “The median cost per square foot rose by 8.6% from 2013 to 2015 in the sample of 69 centres.”

When comparing the results for the same ten cost categories analysed in the main cost analysis, the costs increases over the three years are interesting. Between 2013 and 2014 several cost categories saw an increase whereas many of the selected categories decreased between 2014 and 2015. This makes it necessary to look at those cost categories not reported upon and we found that Major Works showed a £0.15 per sq. ft. increase in its median cost between 2014 and 2015 thus alone accounting for much of the overall increase. Again, with the rise in wages expected to affect categories that have a large employee salary element such as Cleaning, we expect to see a rise in the overall level of service charge expenditure over the coming years. Challenging economic circumstances surrounding the uncertainty in the run up to the Brexit referendum may account for landlords and their managing parties working hard to keep costs low.

		2013	2014	2015
		£ per sq. ft.	£ per sq. ft.	£ per sq. ft.
London	**Lower Quartile**	5.01	5.04	5.40
	Median	7.47	7.32	7.17
	Upper Quartile	8.91	8.40	8.98
Rest of the UK	**Lower Quartile**	3.62	3.87	3.91
	Median	4.67	4.69	4.80
	Upper Quartile	6.15	6.41	6.56

Table 10. Service charge costs for shopping centres in London (14) and the Rest of the UK (55) during 2013-15

The figures in table 10 show that service charge costs in the Rest of the UK have risen whilst the picture in London is different with the median dropping even though the lower and upper quartiles increase, which indicates a reduced spread of service charge costs across the lower half of properties in the capital.

		2013	2014	2015
		£ per sq. ft.	£ per sq. ft.	£ per sq. ft.
Covered	Lower Quartile	4.25	4.49	4.57
	Median	5.43	5.64	5.66
	Upper Quartile	7.40	7.72	7.82
Open/Part-Covered	Lower Quartile	2.90	2.99	3.09
	Median	3.66	3.70	3.80
	Upper Quartile	4.56	4.32	4.68

Table 11. Service charge costs for Covered (55) and Open/Part-Covered (14) shopping centres during 2013-15

As Table 11 illustrates, during 2013-15, covered and open/part-covered centres reported similar yearly cost increases. These results suggest that whether a centre is covered or not does not appear to impact the overall annual increase in service charge costs.

> In order to ease comparison between centres it is vital that service charge certificates use the Cost classes and categories prescribed by the RICS Code; although only 63% and 53% respectively of the documents analysed this year did so.

3. RICS CODE COMPLIANCE

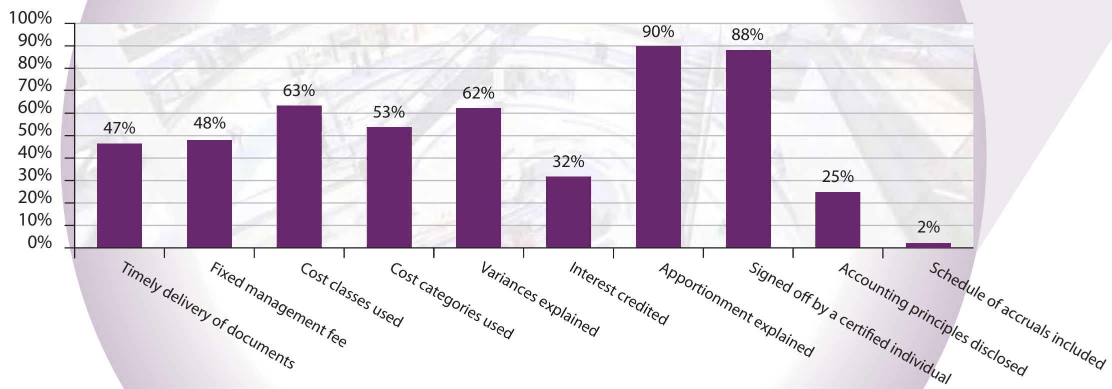
3.1. Code compliance 2016

This section provides information about compliance with selected accounting requirements of the RICS Code in relation to the preparation and issuing of service charge documents, based upon a sample of 60 service charge certificates.

No. of documents	Years	Type of documents	No. of unique landlords	No. of unique managing parties
60	2015-2016	Certificates	30	26

Table 12. Characteristics of the dataset used for the 2016 Compliance analysis

Figure 4. RICS Code compliance results as per accounting requirements



As Figure 4 illustrates, SCOR analyses compliance with ten specific accounting requirements from the 3rd edition of the RICS Code (RICS, 2014). This year, certificates scored highly on the following two requirements: **Signed off by a certified individual** and having **Apportionment explained.**

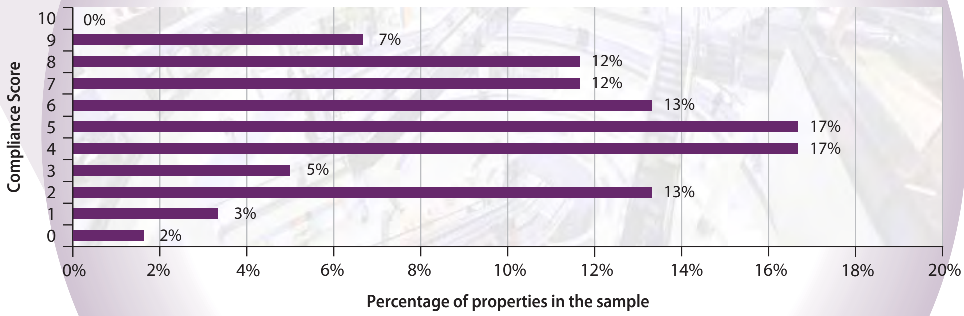
Of the other eight requirements, overall compliance levels were mixed. For the **Timely delivery of documents**, **Fixed management fee**, **Cost classes used**, **Cost categories used** and **Variances explained**, compliance ranged from 47-63%. While the Code specifies that certificates should be issued no more than four months after the end of the accounting period, less than half of documents were issued within this timeframe. The Code also states that **management fees** should be a fixed charge, rather than a percentage of the total service charge liability. However, only less than half of the certificates included information that clearly indicated that the management fee charged was fixed. In terms of the explanation of cost variances, 61.7% of certificates achieved this by supplying the necessary disclosures and explanation.

In order to provide comparative cost information, it is vital that a certificate uses the **Cost Classes and Cost Categories** prescribed by the Code, although only approximately 63% and 53% of total documents, respectively, actually did this. These results indicate that a substantial number of retail locations are failing to use appropriate cost classifications, thereby making cost comparisons difficult. As these accounting requirements were introduced by the RICS Code in 2006, progress is urgently needed in this area to provide increased cost transparency and comparability across the retail service charge sector.

The compliance results for **Interest credited** and the **Disclosure of accounting principles**, were 32% and 25%, respectively. While interest rates are currently low, certificates should still disclose whether interest is being earnt and credited to the service charge account. The RICS Code requires that disclosure be made about whether a certificate is prepared on an accruals or cash basis, so the relatively low level of compliance in this area is a concern, as it prevents an occupier from knowing whether any prepayments or accrued amounts are included within the statement of annual expenditure.

The **Listing of accruals** requirement was introduced in 2014 by the 3rd edition of the RICS Code, and while a number of certificates did attempt to comply with its direction, just one provided a clear, transparent, and understandable, listing of accrued and prepaid expenditure. This issue will be discussed in more detail later in this report.

Figure 5. RICS Code compliance results as per service charge certificate aggregate compliance score



A "Compliance Score" between 0 and 10 was assigned to each certificate based upon the extent to which each individual document complied with each of the Code's ten accounting requirements.

Just 30% of the sample achieved a Compliance Score of 7 or more, with 77% of certificates achieving a score of 4 or more. It is concerning that 40% of all certificates in the sample scored less than a 5. This means that 2 out of every 5 certificates complied with less than half of the ten requirements set out in the Code. The median Compliance Score in the sample is a 5 and the most concerning point is that if we compare the data to the 7 requirements listed in the original 2006 RICS code, then only 8 of the 60 certificates are fully compliant.

We would again call for increased attention to the RICS Code in order to promote best practice, uniformity, fairness and transparency in the management and administration of service charges.

3.2. Longitudinal compliance analysis

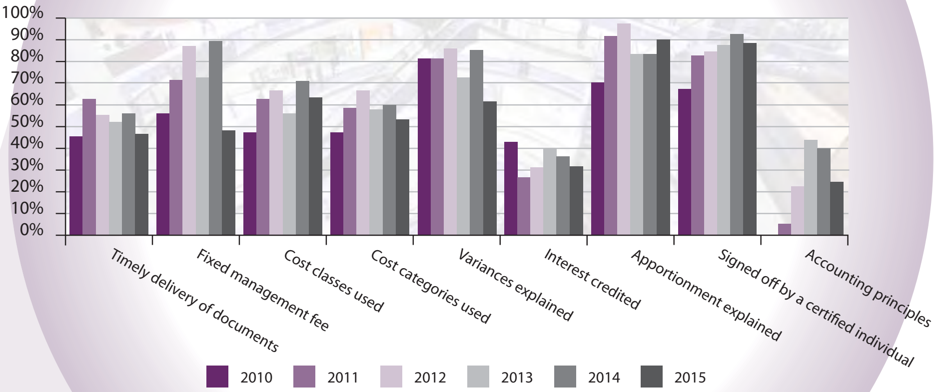
Since its inception, three editions of the Code have introduced stringent requirements for the preparation of service charge certificates and budgets in order to improve their presentation quality, usefulness, information content and transparency.

SCOR has monitored the level of industry compliance with the accounting requirements of the 2006, 2011 and 2014 versions of the Code, which included seven, nine and ten specific elements, respectively. Figure 6 illustrates the yearly levels of compliance with each of the nine accounting requirements of the 2011 Code during the period 2010-2015. Each year SCOR comments upon the trends in our compliance scores and an important distinction between this longitudinal comparison and that found earlier in the Cost Analysis section must be emphasised. This compliance does not follow the same locations through from year to year but rather looks to increase the number of locations in the sample, consequently there can be churn in the locations included year on year; between this year and last year, the compliance data has seen a churn rate of c. 50%.

The Code compliance results over the period 2010-2015 taken as a whole support the idea that the introduction of the Code has caused an improvement in the standards of service charge accounts reporting. Higher levels of compliance have been maintained in two of the criteria; the certificates having their **Apportionment explained** and being **Signed off by a certified individual**. Unfortunately, the other eight requirements have seen a levelling off in their compliance scores and we would continue to call for increased efforts on the side of landlords and their managing parties to push for greater compliance with the requirements of the Code for the benefit of their customers the tenants.

Despite the two requirements mentioned in the previous paragraph keeping around the 80% - 90% compliance mark, the results of the first five requirements – **Timely delivery of documents**, **Fixed management fee**, **Cost classes used**, **Cost categories used** and **Variances explained** - are now hovering around the 50% - 60% mark and the concern is that these have seen a drop in recent years.

Figure 6. Six year compliance with nine accounting requirements of the 2011 RICS Code



As was the case in the Office SCOR earlier this year, the **Timely delivery** of the certificates may be due to the extra care being taken by those preparing the accounts, although in this Retail compliance study the accounts have not improved in other areas, and so this possible reason is moot. All certificates clearly stating that the **Management fee is fixed** (unless the lease(s) stipulates otherwise) is an achievable goal and simply requires a comment to this effect. The use of the correct **Cost classes** and **cost categories** has been discussed at length previously in this report and in earlier versions of SCOR. There are a relatively small number of accountants being used to sign off service charge accounts and we have found that some have their own template for preparing the accounts (of smaller locations) and these do not adopt the Code compliant Cost classes and categories. This would also be an easy fix were these entities to convert their templates to be Code compliant. The drop in **Variances explained** is harder to explain as this would seem to be a requirement not only in relation to the Code but the tenants themselves requiring explanations as to why costs were not as budgeted for a given period. The **Disclosure of accounting principles** is another of the requirements that would seem to be a case of simply making a statement as to what basis the accounts are prepared upon.

3.3. Pockets of best practice: Listing of accruals and prepayments

While an increasing number of certificates now state whether the accounts are prepared on an accruals basis, this year's compliance results suggest that there is confusion about how to provide transparent disclosures for accrued and prepaid expenses, and what types of costs should be included as part of "accrued" expenses. In line with generally accepted accounting practice, the 3rd edition of the RICS Code states that accruals "are expenses for goods and services actually incurred in a period for which no invoice has been received at the period end", and "large round sum provisions included to spread the cost of significant works over a period of time are not accruals as they do not represent a liability at the end of the period" (RICS, 2014, p. 50).

Despite the Code's guidance, a number of the retail certificates mix up accruals with provisions for anticipated future expenditure when disclosing information about accrued and prepaid expenses. To illustrate the extent of the problem, the following two examples of deficient disclosure for accrued expenses were found repeatedly within this year's compliance analysis:

- *At year end there are amounts totalling £xx which have been provided for in the service charge expenditure. These allowances have been made to account for expenditure where invoices have not been received.*
- *At year end date there are amounts totalling £xx which have been provided for in the service charge expenditure, either in the year or in previous periods. The provisions have been made to account for expenditure where invoices have not been received.*

At first glance, these disclosures may appear sufficient, especially to the non-accountant. However, it is unclear as to whether the amount simply relates to accrued expenses, or includes provisions for long-term future expenditure. In addition, only a single total figure is disclosed, with no accompanying listing of itemised accrued expenses and prepayments.

As the RICS Code provides clear guidance for distinguishing between 'accruals' and 'provisions', and now requires that a schedule of accruals and prepayments should accompany the service charge accounts. It is surprising that most managing parties are failing to follow these 'best practice' accounting standards. In terms of the 60 certificates analysed this year, only one provided adequate disclosures for accrued, prepaid, and long-term expenditure provisions. An illustrative example of Code-compliant accounting disclosures for these expenses is provided below, and shows that this information can be presented in a concise and readable manner.

Illustrative example: disclosures for accrued expenses and prepayments

White House: Notes to the Service Charge Accounts for year ended 31/12/2015

1. **Accounting principles**
   The accounts are prepared on an accruals basis with the following exception:
   - Major works includes expenditure of £20,000 for works that have not yet commenced. These works were delayed due to poor weather, and will be completed in the next fiscal period.

2. **Accrued expenses at 31/12/2015**
   Accruals have been included in the service charge accounts as follows:

Schedule	Cost category	Amount £
1	Electricity	500
1	Major works	700
1	Accounting fees	600
Total		**1,800**

3. **Prepayments at 31/12/2015**
   Prepayments have been included in the service charge accounts as follows:

Schedule	Cost category	Amount £
1	Site management resources	300
1	All risks insurance cover	500
1	Engineering insurance	900
Total		**1,700**

4. **Forward funding**
   A forward funding contribution of £30,000 was charged to the service charge accounts during 2015. This amount was collected in accordance with the lease, and relates to a sinking fund maintained for the replacement of the lobby elevators in 2025. The movements on the sinking fund account during 2015 were as follows:

Sinking fund for lobby elevators	Amount £
Opening balance at 1/1/2015	10,000
Contributions	30,000
Income received	500
Expenditure	-
Total	**40,500**

“There is a clear need for improvement in terms of the assurances being provided by current sign-off statements, especially as certification is often achieved through the provision of an independent accountant’s report within the published certificate.”

While overall sign-off levels are relatively high within certificates prepared in the retail sector, the type of certification varies, generally being limited to whether a certificate provides an accurate record of service charge expenditure, and often silent as to whether the expenditure being recovered is in accordance with the lease. There is a clear need for improvement in terms of the assurances being provided by current sign-off statements, especially as certification is often achieved through the provision of an independent accountant’s report within the published certificate. In 2014, the Institute of Chartered Accountants in England and Wales (ICAEW) issued TECH 09/14BL Accountants' Reports on Commercial Property Service Charge Accounts (ICAEW, 2014) to establish best practice in the conduct of any Review Engagement for preparing a report on the annual statements of service charge expenditure, thereby ensuring greater consistency in assurance procedures and reporting. The Technical Release's guidance was effective for periods starting on or after 1 April 2014, although earlier implementation was encouraged. While it is too early assess the impact of this Technical Release in improving the assurances provided by independent accountants' reports, the new guidance has the potential to increase the overall quality of service charge accounting. We therefore intend to introduce reporting of compliance with this regulatory requirement in future years.

As the RICS is yet to provide benchmarking data on Code compliance, SCOR for Retail's annual compliance results provide the sector with invaluable data about current levels of Code compliance. The results show that the quality and consistency of certain financial reporting practices for commercial service charges remain poor. Full compliance with the Code's accounting requirements in the retail sector appears some way off and, given that the RICS emphasises the Code as having the status of a guidance note, this raises the question of whether voluntary adoption works, even with the added weight of the legal protection it offers against negligence claims.

4. RECOMMENDATIONS

Based on the analysis and findings presented in this report, our recommendations are summarised below:

- Occupiers should review service charge budgets and certificates in detail, especially when the costs incurred are higher than the industry average featured in this report.
- Overall accounting transparency remains inconsistent, therefore thorough attention to the RICS Code of practice is recommended in order to improve general standards and reduce the likelihood of disputes.
- Landlords would benefit from external, independent scrutiny of the service charge accounts prior to enlisting the services of an accountant. This would verify that the costs included are in compliance with the lease(s) in place and the service contracts in operation.

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Service Charge Operating Report *for*

RETAIL 2016

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Should you have any questions, would like to discuss any aspects of this report or are interested in participating in future studies please contact:

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