UPPER TRIBUNAL (LANDS CHAMBER)

UT Neutral citation number: [2021] UKUT 10 (LC)
UTLC Case Number: LRX/85/2020

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT – SERVICE CHARGES – requirement for certification of leaseholder's liability by Chartered Accountant – whether factual findings by Chartered Accountant sufficient – whether audit required – appeal dismissed

AN APPEAL AGAINST A DECISION OF THE FIRST TIER TRIBUNAL (PROPERTY CHAMBER)

BETWEEN:

POWELL & CO INVESTMENTS LIMITED

Appellant

and

MS ELZA ALEKSANDROVA
DR MARIO ALEXANDER

Respondents

Re: Flat 3,
43 Grand Parade,
Brighton

Determination on written representations

The following cases are referred to in this decision:

Token Construction Co Ltd v Charlton Estates Ltd (1973) 1 BLR 48, CA

Urban Splash Work Ltd v Ridgway [2018] UKUT 32 (LC)

Introduction

1. This appeal is about the sufficiency of a statement by a Chartered Accountant concerning service charges payable by the respondents to the appellant under the lease of a flat at 43 Grand Parade, Brighton.

2. The appeal is from a decision of the First-tier Tribunal (Property Chamber) (FTT) on an application by the respondents under section 27A, Landlord and Tenant Act 1985 for the determination of their liability to pay the service charges billed by the appellant for the year ending June 2019.

3. In a decision handed down on 22 July 2020 the FTT dismissed a series of challenges by the respondents to those charges but held that no sum was yet payable because the accounts produced by the appellant's accountant in support of the charges had not been certified by a Chartered Accountant, as the FTT considered they ought to have been to satisfy the contractual requirements of the lease. The accounts were instead certified by the appellant's managing agent but included a factual report by a firm of accountants based on a limited review of material provided to them by the managing agents. The report confirmed the consistency of the accounts with those records.

4. The FTT granted permission to appeal. There had been considerable discussion at the hearing about the form the required certificate should take that, and the FTT thought it was arguable that the accountant's factual report was sufficient compliance with the lease to trigger the respondents' liability to pay the disputed charges.

5. Concise written submissions in support of the appeal were supplied by Mr Sean Powell, a director of the appellant. Rather lengthier submissions on behalf of the respondents were provided by Ms Aleksandrova**.** These included copies of service charge statements of account prepared on behalf of a previous owner of the building which included a certificate by a Chartered Accountant.

The relevant facts

6. 43 Grand Parade is a substantial Victorian house which has been converted into 5 self-contained flats each of which is let on a long lease. The Lease of Flat 3, which is now vested in the respondents, was granted on 9 May 1987 for a term of 99 years which was subsequently extended to 999 years in July 2007 at about the time Ms Aleksandrova acquired the lease.

7. The appellant purchased the freehold of the building in December 2016 and has been in dispute with the respondents over service charges in each subsequent year.

8. The Lease of Flat 3 contains a conventional service charge provision at clause 3(2) by which the lessee covenanted to pay 18% of the annual costs expenses and outgoings incurred by the lessor in complying with its obligations in the Fourth Schedule as

supplemented by provisions in the Fifth Schedule. It also includes a recital that the other flats in the building were to be demised on substantially the same terms.

9. Clause 3(2)(ii) of the Lease explained how the service charge was to be calculated and paid, as follows:

> "The service charge shall be calculated and paid in accordance with the following provisions:
>
> (a) [two half-yearly payments on account]
>
> (b) on or as soon as possible after the twenty fourth day of June in each year the respective annual costs expenses and outgoings of the matters referred to in sub-clause (i) of this clause shall be calculated and if the Lessee's share of such annual costs and expenses and outgoings under the provisions hereinbefore contained shall fall short of or exceed the aggregate of the sums paid by him on account of his contribution the Lessee shall forthwith upon production of a certified account pay to or shall be refunded by the Lessor the amount of such shortfall or excess as the case may be notwithstanding any devolution of the Lease to the Lessee for the time being subsequent to the commencement of the accounting period to which such shortfall or excess (as the case may be) relates
>
> (c) [interest]
>
> (d) the liability of the Lessee under the provisions hereinbefore contained shall be certified by a Chartered Accountant to be appointed by the Lessor."

10. The Fifth Schedule contained a list of the expenditure and other matters to which the Lessee was to contribute through the service charge. These included, at paragraph 4(b), "Accountants' fees for the preparation of the yearly statements and any other work necessary in connection with the expense accounts".

11. The 2019 accounts contained an income and expenditure account and a service charge balance sheet showing assets and reserves. The income and expenditure account recorded total expenditure for the year ended 24 June 2019 of £11,850.57 (of which the respondents' 18% share would be £2,133.10, although this was not stated in the accounts).

12. The only certificate in the 2019 accounts was from the managing agent, Powell & Co Management Ltd. Mr Powell explained to the FTT that his office produced the initial accounts which were then forwarded to his accountants, Z Group, "to produce proper service charge accounts".

13. The certificate on the accounts signed by Mr Powell was dated 22 May 2020 and stated that the managing agent was responsible for the production of the service charge certificate for that year. It purported to confirm that the certificate was produced in compliance with the terms of the lease and then concluded with the following statement:

> "We hereby certify that, according to the information available to us, the attached statement of service charge expenditure records the true cost to the landlord for providing services to the property for the year."

14. The service charge accounts also contained a one-page document headed "Accountant's report of factual findings". This report was addressed to the managing agents and stipulated that the accountants did not accept responsibility to anyone other than the managing agents for their work. The report recorded that an audit of the service charge accounts was not required under the Lease and stated that the accountants had performed certain specified procedures in order to provide a report of factual findings about the service charge accounts that the managing agents had issued. Those procedures were described as follows:

> "1) 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 managing agents.
>
> (2) We checked, based on a sample, whether entries in the accounting records were supported by receipts, other documentation or evidence that we inspected."

15. The report continued that, because the procedures undertaken did not constitute either an audit or a review in accordance with international standards, the accountants "did not express any assurance on the service charge accounts other than in making the factual statements set out below", namely that:

> "(a) With respect to item 1 we found the figures in the statement of account to have been extracted correctly from the accounting records.
>
> (b) With respect to item 2 we found that those entries in the accounting records that we checked were supported by receipts, other documentation or evidence that we inspected."

The accountant's report was not signed by any named individual but included in manuscript, the name of the appellant's firm of accountants, Z Group.

The FTT's decision

16. The FTT's relevant conclusion is at paragraph 40 of its decision. It referred to the terms of the lease and to Tech 03/11, a technical guidance note prepared by the Institute of Chartered Accountants of England and Wales on accounting and reporting in relation to service charge accounts. It continued:

> "What is clear is that there is an obligation under the terms of the lease for the accounts to be certified by a Chartered Accountant. Tech 03/11 refers to this being a possibility. The Tribunal accepts that unless it is a requirement of the lease then generally certification by an accountant may not be undertaken. Under this lease it is a requirement. This tribunal determines that the accounts

> produced by the accountant do not include a certificate of a Chartered Accountant as required under clause 3(2) of the lease. The report is not a certificate and the accountants could provide the same to satisfy the lease terms."

The FTT then considered challenges to the cost of works and concluded in paragraph 47 that the costs billed were reasonable "and subject to certified accounts being issued will be payable."

Submissions on the appeal

17. In his grounds of appeal Mr Powell submitted that the accounts produced by Z Group were a sufficient certificate to satisfy the requirements of the Lease. He suggested that the provision of any more detailed certificate would entail employing auditors to audit the accounts, which would be considerably more expensive. The accounts themselves were very simple and the sums involved did not justify detailed scrutiny by an auditor. All that the lease required was that "a firm of Chartered Accountants looked over the paperwork to confirm that everything was in order". Mr Powell said that the other leaseholders in the building were perfectly content with the form of the accounts and would not welcome an additional charge or more complex accounts and detailed scrutiny.

18. In a letter which Mr Powell attached to his submissions Z Group explained that it was standard practice for service charge accounts to include an accountant's report, and that "an accountants report and an accountants certificate are for all intents and purposes one and the same thing, the only difference being their name." Guidance from the ICAEW was said to prevent Z Group from changing the name of its report to describe it as a certificate. It was suggested that additional costs of around £400 per leaseholder would be incurred to audit the accounts.

19. In her submissions Ms Aleksandrova argued that the accounts were required to be certified by a Chartered Accountant as they had been before the appellant acquired its interest in the building. She produced examples of balance sheets and accounts from 2013 and 2014, which included a statement that they were "signed as certified" by a named Chartered Accountant. They also included a report of factual findings in a similar form to that provided by Z Group for the 2019 accounts, containing the same warning that the accountants did not express any assurance on the service charge accounts other than those contained in the factual statements which they set out. The report included an additional statement, missing from Z Group's statement, that the service charge monies shown in the balance sheet reconciled to the bank statement for the account in which the funds were held. It also omitted the limitation of liability.

20. Ms Aleksandrova also produced letters from other firms of accountants offering to provide certified accounts much more cheaply than Z Group had suggested.

Discussion

21. In *Urban Splash Work Ltd v Ridgway* [2018] UKUT 32 (LC), after reviewing a number of cases about the certification of service charge accounts the Tribunal reiterated (at [77]) the fundamental but unsurprising proposition that in every case the function and significance of the certificate will depend on the terms of the agreement.

22. The same is true of the form of a certificate. In *Token Construction Co Ltd v Charlton Estates Ltd* (1973) 1 BLR 48, CA, the issue was whether a letter written by an architect had been a certificate validly granting an extension of time under a building contract. Roskill LJ said:

> "Though neither condition 2(e) nor condition 16 … prescribes any form in which the architect is to grant any extension or to certify his opinion, it is, in my judgment, essential that, while the architect is left free to adopt what form of expression he likes for the grant or certificate, as the case may require, he must do so clearly so that the intent and substance of what he does is clear. The court should not be astute to criticise documents issued by an architect merely because he may not use the precise language which a lawyer might have selected in order to express a like determination, but whilst this amount of latitude is permissible, it cannot extend to the court's treating as due compliance with contractual requirements documents which, however liberally interpreted, do not plainly show that they were intended to comply with, and, fairly understood, do comply with those contractual requirements."

23. This passage suggests that not only must a certificate be clear, but it must have been intended to comply with the requirements of the particular contract, and must in fact comply with those requirements.

24. The general function of a certificate is to provide confirmation of facts relevant to the obligations of a party under a contract. Where the certificate is provided by a third party, as is often the case where the certificate concerns service charges payable under a lease, it is also intended to provide an assurance to the paying party that an independent person, usually with some relevant professional qualification, has satisfied themselves that the facts being certified are true.

25. What does the lease require in this case?

26. Clause 3(2)(ii)(b) first requires that "the respective annual costs expenses and outgoings … shall be calculated". The clause does not say by whom those costs and expenses are to be calculated.

27. Next, the clause requires that the Lessee's share of the annual costs (the 18% referred to in clause 3(2)(i)) should be compared to the aggregate of the sums paid by the lessee on account. It is only if the Lessee's share of the costs and expenses exceeds the sums paid on account that any further payment is required.

28. The Lessee's obligation to make a further payment is not triggered simply by an excess of their share of the costs and expenses over the sums paid by them on account. The payment

(or any refund, if payments made on account exceed the Lessee's share) is to be made "forthwith upon the production of a certified account", so that the obligation to pay does not arise until that certified account is produced. It is not clear at this stage what exactly this account is to certify but that is put beyond doubt by clause 3(2)(d): it is "the liability of the Lessee under the provisions hereinbefore contained" which is to be "certified by a Chartered Accountant to be appointed by the Lessor."

29. The lease therefore makes the Lessee's obligation to pay any shortfall between their share of the costs and expenses and their payments on account conditional on an account of that liability being certified by a Chartered Surveyor. The lease does not require that the annual service charge accounts themselves be certified, but that the amount of the Lessee's liability be certified. That requires consideration of the Lessee's 18% share of the total expenditure and the Lessee's payments on account, and certification of the difference between the two.

30. It follows that the FTT's statement that there is an obligation under the terms of the lease for the accounts themselves to be certified by a Chartered Accountant is not strictly correct. Of course, before certifying the amount of the Lessee's liability, a Chartered Accountant may consider that it is necessary that they first satisfy themselves of the accuracy of the accounts recording the total expenditure. But the Lease does not prescribe exactly what steps must be taken by the Chartered Accountant before certifying the Lessee's liability. Those steps are left to the judgment of the accountant appointed by the Lessor to perform the task of certification.

31. There is no document in this case which purports to certify the liability of the respondents under clause 3(2)((ii). Z Group's report of its factual findings does not refer to the liability of any individual lessee, nor does the managing agent's certificate which refers only to the service charge expenditure. The certificate contemplated by the Lease is a bespoke document for each lessee, showing their individual liability, and it appears no such document has ever been certified.

32. I therefore agree with the FTT's conclusion that the costs incurred by the appellant which it found to have been reasonably incurred are not yet payable. I disagree that those costs will become payable when the service charge accounts alone are certified. What is missing is an account, certified by a Chartered Accountant, stating the individual Lessee's share of total expenditure, the payments made on account, and the resulting shortfall or surplus. Once that document is provided (with the necessary statutory information) the respondents will "forthwith" be required by clause 3(2)(ii)(b) to pay the certified amount.

33. The letter from the appellant's accountants, Z Group, to which Mr Powell referred in his submissions, suggested that they would only be able to certify the service charge accounts if they carried out an audit. I should make it quite clear that the lease does not require that the service charge accounts be audited; it requires that the individual lessees' liability be certified.

34. Nor does Tech 03/11, the guidance produced by the ICAEW on accounting and reporting in relation to service charges, require that service charge accounts be audited before they

can be certified. On the contrary, in paragraph 2.8 and again in paragraph 3.1.1 the authors recognise the primacy of the lease:

> "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."

> "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."

> "3.2.1 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 carried out when not required by the lease, 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."

35. It is clear, therefore, that the accountancy profession does not consider that an audit is a essential precursor to certification of accounts or other forms of service charge document. In some cases an audit may be necessary because the lease requires one. In other cases, as a matter of professional judgment, an accountant instructed to provide the necessary document may consider that they cannot certify the matters stated in the document as being correct without carrying out an audit. In this case, there is no such requirement in the lease.

36. Although the report of factual findings provided by Z Group is the normal arrangement where the lease does not specify the form of examination of the accounts, and was appropriate for this building, the document was deficient because it did not certify the liability of the individual leaseholders as required by the lease. The appeal is therefore dismissed.

Martin Rodger QC,

Deputy Chamber President

18 January 2021