

A Consultation Paper on Regular Statements of
Account and Designated Client Accounts
Summary of responses



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Introduction

This document provides a summary of the responses received to the Consultation Paper on **Regular Statements of Account and Designated Client Accounts**, which was published in July 2007.

This paper put forward a number of proposals for the implementation of sections 152 and 156 of the Commonhold and Leasehold Reform Act (the 2002 Act), which will impose requirements upon landlords in connection with accounting for and the holding of service charge monies. This followed earlier consultations covering these sections and an announcement that we would not be implementing s152 in its current form¹.

This paper contains a breakdown of the numbers of responses received, and an indication of some of the comments made but does not purport to give a full account of all of the suggestions or comments made. It would not be possible to do so in this document because of the large number of suggestions received, and the range and complex nature of the issues discussed. In addition, it should be noted that not all of the respondents commented on or responded to every question raised as part of the consultation exercise. This includes where certain proposals only applied to certain sectors and so the total responses received to each question differ.

Representative and other bodies

A number of responses have been received from representative, trade and other bodies. While these have been counted as a single response, we recognise that they are representative of wider held views.

Next steps

The responses have been fully considered and the primary legislation will be amended as necessary and work taken forward on the detailed requirements to be included in regulations.

¹ ODPM News Release 2005/0156 Accounting for Service Charge Monies: The Way Forward

Copies of the summary

The summary is available on the Communities and Local Government website at www.communities.gov.uk or from:

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Total Number of Responses Received

We received a total of 99 responses to the consultation exercise.

Breakdown

An indication of the type of respondents is set out in the table below. While we have, where possible, identified the occupation or type of respondent it should be noted that some have been grouped for statistical purposes (e.g. local authorities and ALMOs).

Occupation/type of Correspondent	No of Responses
Individual Leaseholder	18
Property Management Companies	9
Residents' Management Company	4
Surveyors	3
Accountants	3
Local Authorities & ALMOs	20
Registered Social Landlords	16
Representative/trade/other organisations	21
Others (unidentified)	5
Total	99

Government, public, trade, professional and other representative organisations

The following is an alphabetical list of those respondents who were identified as being government, public, trade, professional and other representative organisations. The list is in alphabetical order and is only intended to give an indication of the types of organisations that have responded and there may be other respondents who believe that they should be listed here.

Regardless of whether an individual body or organisation has been identified below, all responses received to the consultation paper have been carefully considered when deciding on the way forward.

Advice in Mediation Service (AIMS)

Association of Chartered Certified Accountants (ACCA)

Association of Residential Managing Agents (ARMA)

Association of Retirement Housing Managers (ARHM)

Audit Commission

British Property Federation (BPF)

Campaign for the Abolition of Residential Leasehold (CARL)

Chartered Institute of Public Finance & Accounting (CIPFA)

Federation of Private Residents' Associations (FPRA)

Housing Corporation

Institute of Chartered Accountants in England & Wales (ICAEW)

Institute of Chartered Accountants of Scotland (ICAS)

Leasehold Advisory Service (LEASE)

Local Government Association (LGA)

London Councils

London Leaseholders' Network

National Housing Federation (NHF)

Norwich Leaseholders' Association

Residential Property Tribunal Service (RPTS)

Royal Institution of Chartered Surveyors (RICS)

Sutton Leaseholders' Association

Responses

What follows is a summary of the responses to the different proposals put forward in the consultation paper. However, as previously mentioned, not all of the respondents commented on or responded to every question raised as part of the consultation exercise.

Regular Statement of Account to be provided to service charge payers (Section 152 of the Commonhold and Leasehold Reform Act 2002).

Tenants of Associated Dwellings

Proposal 1

It is proposed that the legislation should allow the regular statement of account to deal with some or all of the service charge costs payable by the tenant and the tenants of dwellings associated with his dwelling rather than just the shared costs.

Of the 37 respondents who commented specifically on this proposal, 30 welcomed the flexibility that it provided over the range of service charge costs that could be included in a statement and the benefits this provided in terms of the reduction in the number of statements required. The others whilst not expressing opposition to it raised a number of issues. A number of respondents stressed the need for expenditure to be broken down sufficiently to show the costs that the individual lessee contributes to although there was some concern from 4 respondents about the potential complexity and length of the statement for larger schemes.

We are minded to proceed with this proposal and this will include a requirement for expenditure to be broken down sufficiently to show those costs that the recipient service charge payer is required to contribute towards.

Content of the Regular Statement of Account

Proposal 2

We do not propose to prescribe the exact format of the statement of account and are prescribing the content in a way that allows greater flexibility in how the information can be presented. We will require it to be prepared on an accruals basis under the historical cost convention and for it to be legible in a typewritten form of at least 10 point.

Details of the proposed content for the regular statement of account to be supplied by all landlords other than local authorities and registered social landlords (RSLs) are set out in Annex A (to the consultation paper) together with a sample set of accounts.

There were 32 respondents who made comments on this proposal. Amongst these a significant number (24) broadly supported the approach being adopted. There was widespread support for not prescribing the exact format of the statement and for allowing flexibility in how the information can be presented. Some specific suggestions were made for additional information to be supplied including previous years' figures and the proportions or contributions that each service charge payer contributes to the heads of expenditure identified in the statement. It was also proposed that any insurance commission paid to a landlord for placing the buildings insurance should be identified.

A number of respondents raised issues with the requirement to identify and show separately items of expenditure representing 10% or more of total expenditure.

These concerned the additional time and costs involved after the accounts had been drafted and potential difficulties with defining adequately 'single items of expenditure'. Other issues raised concerned the potential for duplication alongside specific lease requirements and suggestions for allowing greater flexibility in the allocation of specific costs to the prescribed expenditure headings. The issue of identifying and defining items of expenditure as improvements was also raised.

We feel that the overall proposal should provide the flexibility required to reasonably accommodate the range of different approaches currently adopted for identifying categories of expenditure. This flexibility should also mean that duplication of information provided to tenants is kept to a minimum. Whilst we are not inclined to prescribe the additional content proposed above, (this and other information can be supplied on a voluntary basis), the final content of the statement is still to be decided. This includes not requiring any insurance commission received by the landlord to be identified on the basis that it is not a service charge item. However it is our view that there is a case for not insisting on individual items of expenditure that are over the 10% threshold being identified and that improvements could properly be incorporated into repairs and maintenance expenditure without being separately identified.

Proposal 3

It is proposed that the prescribed content for the statements of account to be provided by local authority landlords is modified in order to take account of the particular way in which they are required to account for expenditure on their housing stock and ensure that service charges are provided with relevant information at a reasonable cost. This will include prescribed details of the overall expenditure that they are required to contribute towards through their service charges together with an individual statement of account.

The prescribed content for the local authority statement including the individual statement is included at Annex B (of the consultation paper) together with a sample set of accounts.

The 20 Local authorities and ALMOs who commented on this proposal generally welcomed the proposal for them to be able to provide a modified form of statement. Whilst most of the other 16 respondents who commented, including local authority lessees, accepted the underlying reasons for the concession they were fairly equally divided amongst those who supported the proposal and those who felt that all service charge payers should receive the same information. Amongst local authority respondents, concerns were raised about how to accommodate those charges such as heating and insurance that are not incurred at a block or estate level. It was also suggested that the statement should show more clearly how the expenditure it detailed was reflected in the charges levied on the individual lessee. There were also some concerns expressed about local authorities having to change systems and incur additional costs in order to produce a statement that may not supply any more information than is presently provided.

We are minded to proceed with this proposal. As stated in the Consultation Paper, the reason for allowing local authority landlords to supply a modified form of statement of account is to ensure that relevant accounting information is provided at a reasonable cost, and this principle was accepted by the majority of those who commented. In addition as stated in the Consultation Paper and the response to Proposal 2 above, our view is that whilst ensuring that a minimum amount of information is received, there is sufficient flexibility within the proposals to reasonably accommodate a range of existing procedures and approaches to service charge accounting. This should avoid unnecessary disruption and cost although regard will be had to the need to establish the link suggested between the expenditure outlined in the statement and the charges for the individual lessee. We will discuss the detailed requirements for the statement with the Social Sector Working Party.

Proposal 4

It is proposed that local authorities are able to provide a separate statement of account for capital expenditure.

The comments of the 25 respondents on this proposal were generally in line with those they made in relation to the previous proposal. While most of the 14 local authorities who responded supported the proposal those responding from outside the sector were divided on the principle of allowing local authorities to provide a modified form of statement. Of the 3 RSLs who responded, 2 felt that the same option ought to be available to their sector. Questions were also raised and suggestions made about the definition of the expenditure that can be dealt with in this separate statement, its exact format and when it should be provided.

We are minded to proceed with this proposal and following consideration of these responses our view is that the separate statement where provided should cover 'qualifying works' as defined under section 20 of the Landlord and Tenant Act 1985 (service charge consultation requirements). It should also be provided within 6 months of the receipt by the local authority or ALMO on its behalf, of final invoices for the work. It is intended that the statement should break down costs as required for other expenditure including identifying the actual costs that the individual service charge payer is required to contribute towards and be supported by an accountant's report. Finally an individual statement of account should also be provided as for other expenditure.

Proposal 5

It is proposed that the prescribed content for statements of account to be provided by RSLs is also modified in the same way as for local authority landlords although they would be expected to provide the same statement as for private sector landlords where it would be appropriate to do so.

The 12 respondents who commented by or on behalf of RSL landlords overwhelmingly welcomed the flexibility to be able to provide the modified form of statement to take account of the tenure profile of their housing stock and the way that expenditure on it is administered. The other 14 respondents who commented were fairly equally divided between those who agreed or disagreed with the proposal although a number of the latter group could appreciate the underlying reasons for it. Overall many of the respondents emphasised the need for clarification and guidance on when RSLs would be expected to produce which type of statement with some suggestions being made on the issue.

Those in the RSL sector raised queries about whether different approaches could be accommodated. These included producing the modified form of statement for all tenants and lessees or producing the more detailed statement for lessees and the modified statement for tenants in order to avoid producing different statements for lessees in different blocks. A number raised the issue of the difficulties that would arise in having to produce an individual statement for tenants that separated out service charges from rent.

We are minded to proceed with this proposal and we will discuss with the RSL sector where necessary the question of when it might be most appropriate to produce either form of statement to ensure that relevant accounting information is provided to service charge payers at a reasonable cost. This flexibility means that the tenants will be able to see how the expenditure that they contribute towards is reflected in the service charges that they are required to pay by use of the most appropriate statement depending on the circumstances.

Proposal 6

It is proposed that the summary of the rights and obligations of tenants of dwellings in relation to service charges need not be supplied with the regular statement of account although there should be a reference in the statement to the right to receive the summary with each demand for service charges.

Of the 40 respondents who commented on this proposal all but 4 either gave it full or qualified support. Many of those giving qualified support added that it would be better for the summary to be supplied with the annual statement (rather than with service charge demands) or alternatively when there is a change of service charge payer and this was also the general view of the 4 who did not support the proposal.

We are minded to proceed with this proposal which we consider will ensure that a summary of rights and obligations is received by service charge payers when it is most needed on the receipt of a demand without imposing disproportionate costs upon landlords and service charge payers. Therefore we do not intend to take up the alternative suggestions put forward.

Proposal 7

It is proposed that an accountant's report must be supplied alongside the statement of account subject to specified exceptions (see below). This will contain certain prescribed statements of fact to indicate that checks have been carried out on the information in the statement of account. The accountant will provide the report having regard to the relevant approved guidance.

This proposal produced a significant number (57) of responses with 19 respondents largely supporting without any real qualification the approach being put forward and 9 opposing it firmly, half of these being local authorities. The other respondents put forward varying degrees of support and a range of different issues and suggestions. A number of respondents suggested that the final paragraph of the proposed report as a disclaimer in respect of the matters that it could not be relied upon, would significantly reduce its value to service charge payers. Others were concerned about whether the interests of those service charge payers would be adequately protected where the accounting procedures underlying the report were agreed between the accountant and landlord. Some were unclear as to the level of assurance being provided and raised the issue of potential duplication where specific auditing or other requirements were included in leases. Some respondents suggested that the accountant should be required to make factual statements of compliance with the requirements of the legislation including the new section 42A.

A number of social sector landlords raised concerns about the cost of the report although in some cases there may have been an assumption that a report would always be required for each block. The value of the report was also questioned in the light of existing regulation and audit that they (local authorities and RSLs) are subject to, with some reserving further comment until having sight of further developed procedures.

We are minded to proceed with the 'agreed upon procedures' approach being proposed. It is felt that this offers the best way of meeting a number of objectives. These are providing greater consistency and clarity for all concerned about the work to be carried out by a reporting accountant, whilst at the same time allowing flexibility to properly accommodate a range of different circumstances. It is also considered that the guidance to be agreed with and issued by the relevant accountancy bodies to their members should ensure that the accountant will agree with the landlord to undertake what are appropriate and sufficient procedures in the particular circumstances of each case. Further thought will be given to the final detail of that guidance. It is felt that to require an audit in all cases would not be desirable and involve disproportionate costs being incurred. We also consider that a report on the statement of account should be required from all landlords subject to certain specific exemptions dealt with below and that the accountant should not nor could not be expected to provide an opinion on compliance with legislation or upon the reasonableness of the charges.

It is the intention that where the lease requires work to be carried out that constitutes a higher standard than that required of the legislation (e.g. an audit), that this would satisfy the legislative requirements. Some further work is still required before the requirements for the form of the report and the underlying procedures which will be set out in regulations are finalised.

Proposal 8

It is proposed that the definition of a qualified accountant, who will be able to provide a report on a statement of account, will be amended so that it covers all accountants who are members of recognised supervisory bodies for company auditors.

Of the 37 respondents who commented, 23 agreed with the proposal and only 4 suggested alternatives whilst others raised issues or questions about the independence of the accountant generally or in particular situations.

We are minded to proceed with this proposal. We consider that this will ensure that those who are entitled to be appointed as reporting accountants will have the necessary independence, training and be subject to the necessary degree of supervision and monitoring by the appropriate accounting body. It will also mean that members of CIPFA will be able to provide a report to local authority landlords.

Proposal 9

It is proposed that an exception would apply from the requirement to provide an accountant's report where the service charges dealt with in the statement do not exceed £5000 in total.

Of the 56 respondents who commented on this proposal 19 supported it or the wider rationale of avoiding unnecessary costs whilst the others contained a wide range of different views and alternative suggestions, or sought clarification on how it would apply in practice.

Whilst some felt that £5000 was too low, others pointed out that it could be too high where there were only a few leaseholders and that it was in such buildings that abuse was likely to be more prevalent. A number of respondents stressed the need with a financial limit for the ability to update the figure. Others suggested particular exemptions such as 4 or fewer dwellings (as in the current legislation) or one based on a particular cost per dwelling or a proportion of the cost of the service charge in question.

Alternatively it was proposed that an exemption should be available where all service charge payers agreed or where they were also members of the freehold company/management company. Some respondents were of the opinion that it would not be helpful to tenants to provide a report one year and not the next, and that it would be easier to provide the report in all cases rather than going through the process that would be necessary in each case of deciding whether a report was necessary.

There was no clear consensus on what any exemption should be based upon, and it is difficult to provide an exemption that would be appropriate in all the different range of circumstances found. However we consider that in order to avoid disproportionate costs being incurred there is a case for providing for an exemption where the service charge expenditure dealt with in the statement does not exceed £5000 in total.

We are minded to proceed with this proposal but in addition we have concluded that the exemption should also be available where the information in the statement deals with the service charges and relevant costs associated with 4 or fewer dwellings.

Proposal 10

It is proposed that the first accounting period for the regular statement of account will commence on the day after the end of the accounting period being operated when the new provisions come into force. However a default provision will be included under which the first accounting period must commence at the latest, 12 months after the commencement date.

There was almost total acceptance of this proposal amongst the 29 respondents who commented. Some of the additional suggestions received concerned the lead in period to enable the necessary preparatory work, including IT changes, to take place. Some local authority respondents sought clarification about how the first and subsequent accounting periods would operate in relation to the separate major works statement. As stated in the response to proposal 4 it is considered that it should be provided within 6 months of the receipt by the local authority or ALMO on its behalf, of final invoices for the work.

We are minded to go ahead with these proposals for the first accounting period.

Proposal 11

It is proposed that a summary (under existing section 21) can be requested for the last accounting period that was completed before the commencement of the first accounting period under the new provisions. This right will continue to be available for a period of a year after the end of the accounting period in question. The request should be complied with within one month of the request or six months of the end of the relevant twelve month period, whichever is the later. Section 22 of the 1985 Act then provides that a request can be made within six months of the receipt of the summary for reasonable facilities to inspect and take copies of accounts, receipts and other documents supporting the summary.

Amongst the 21 respondents who commented on this particular proposal there was once again almost total support, although one respondent did suggest that the current rights of inspection of supporting documents needed amending.

We are minded to proceed with this proposal. We are not convinced that the current rights of inspection to which this proposal refers should be amended in light of the revised rights of inspection that will apply to the requirement to provide a regular statement of account.

Chapter 4 – Service charges to be held in separate account (Section 156 of the 2002 Act (New section 42A of the Landlord and Tenant Act 1987))

Proposal 1

We propose amending section 156 of the 2002 Act to continue to allow the payee to hold a number of different trust funds in the same account. This would not prevent them from maintaining separate accounts for each fund if they choose to do so. In order to achieve this, we propose removing section 42A(2)(b) which states that no other funds are held in the account.

All of the proposals in Chapter 4 do not apply to local authorities and RSLs and so generally there were no comments made on them by respondents from those sectors. Of the 23 respondents outside of those sectors who did comment, 20 supported the proposal or accepted it with some qualifications. A number of these felt that it (along with the other associated proposals) achieved a good balance between transparency and avoiding the incurring of excessive costs. Amongst those who didn't support the proposal there was a view that monies held in accounts should be limited to those for the same estate. They also had concerns that it amounted to a weakening of the original policy. Although not specifically consulted upon, both in response to this proposal and more generally a number of respondents expressed views about the suitability of the enforcement mechanisms. Some queried whether they were sufficient and others considering them to be too severe.

We are minded to proceed with this proposal. Our view remains that this proposal in conjunction with the other associated proposals relating to the regular statement of account, would be the most effective way of achieving a workable balance between delivering transparency about service charge monies held and not imposing disproportionate costs on landlords and ultimately service charge payers. The enforcement mechanisms, namely the ability for tenants to withhold service charges where the money is not being held correctly, and/or a summary offence having been committed (on conviction) which is subject to a fine of up to £2,500, are regarded as appropriate and sufficient in the circumstances.

Proposal 2

For the avoidance of doubt we propose clarifying in legislation that only monies received in relation to service charges or relevant costs are held in the account (including any other monies received in respect of the service charges or relevant costs, such as grants for works etc). Monies received which are not service charges, such as ground rent or administration charges for example must not be held in the account.

Half of the 16 respondents who commented upon this proposal endorsed it as an appropriate means of achieving the overall objective of providing transparency whilst avoiding imposing disproportionate costs. A number of others raised specific practical issues about the necessity of allowing cheques including sums other than for service charges to be paid into a clearing account and for non service charge amounts then being transferred out into another account. The alternative would be for payees having to try and ensure that separate cheques were provided to cover ground rent and/or administration charges. Some respondents also stressed the need to allow landlords to provide cash loans to

cover shortfalls in funds where necessary consisting of for example ground rent payments, and to use accounts which are administered electronically known as virtual accounts.

We are minded to proceed with this proposal. As has been indicated previously it is our view that until any cheque received by a payee has been cleared then the funds that it represents are not held. It is only at the point of cheque clearance that a landlord payee would be required to comply with the requirements of the legislation. Therefore our view is that the combined cheques could either be paid into a separate account with the service charge elements being transferred into the relevant designated account upon clearance or vice versa. Further a landlord/manager would be able to provide a loan if considered although this would need to be administered through a separate account, and that virtual accounts would be permitted as long as they were able to comply with the other specific requirements for the designated client accounts.

Proposal 3

We propose giving tenants the right to request and receive all the statements of account and reports that are required to explain the balance of service charge monies being held in the designated client account into which that tenant's service charges are paid. Further we propose that there will be a requirement that all those statements of account must have the same accounting periods (as defined under section 152 of the 2002 Act) and should include the overall balance held in the relevant designated client account. We also propose giving those leaseholders inspection rights (as they have for their own statements).

10 out of the 13 respondents who commented upon this proposal supported it. The additional comments including those of respondents who did not express explicit support concerned questions about data protection issues arising from the disclosure of information about the accounts of other service charge payers. A question was also raised about the adequacy of supporting inspection rights in relation to supporting documentation.

We are also minded to proceed with this proposal which we consider is an integral part of the overall scheme being put forward that seeks to provide sufficient transparency in relation to service charge monies at a proportionate cost to all concerned. Our view is also that the overall proposals do not create any significant data protection issues and are consistent with the legislation in this area. Further that the inspection rights available will provide access to documentation such as relevant bank statements.

Proposal 4

We propose that where an accountant's report is required under section 152 for any or all of the statements of account that deal with monies held in a single designated client account, the accountant must consider all the statements together. If he is unable to report that any one of the statements of account complies with the requirements as specified in section 152 any or all of the tenants may withhold their service charge if they wished to do so, because doubt would have been cast over the account as a whole. In addition, in order for this to work effectively the exceptions from the requirement to provide an accountant's report as set out in Proposal 9 in Chapter 3 of the paper will not apply in such cases.

There were 15 respondents who specifically commented on this proposal and of these, 13 expressed support for it. One respondent commented that it would be unreasonable for all the service charge payers concerned to be able to withhold monies where an accountant provided reports for a number of statements of account dealing with large sums of money but was unable to do so for just one statement covering a relatively insignificant amount. Another also had concerns about data protection issues as raised for the previous proposal, and for the burdens involved in requiring a large manager to operate the same year end for a large number of different accounts, and suggested an alternative procedure whereby approved managers could provide the accountant with a report confirming the reconciliation of the account.

Once again we are minded to proceed with this proposal. We consider that together with the overall scheme being proposed, it constitutes a proportionate and reasonable approach to providing a sufficient degree of transparency in relation to service charge monies and does not create any significant data protection issues.

Costs of compliance

Comments were also sought on the costs of compliance resulting from the amended proposals above. While some costs were identified little consistent costing information was provided in response to the consultation for the cost of compliance with the proposals, although many respondents indicated that any such costs were not considered to be significant.

While some costs were provided by some respondents this did not elicit any further information that could reasonably be applied on a more general basis to allow costs of a reliable nature to be narrowed down further, either at organisation or individual level. This was particularly so in respect of any possible additional costs bearing in mind that the majority of payees and tenants that are affected by this measure are likely to already be incurring some costs where service charge information is already supplied, either in connection with terms of leases, existing legislation, compliance with a relevant Code of Practice or general agreement.

However, we believe that the aforementioned proposals should reduce and mitigate the costs compared with the original 2002 Act proposals.