



*...Strength in Numbers*

## The Society of Professional Accountants

By email to: [ukfrs@frc.org.uk](mailto:ukfrs@frc.org.uk)

11 November 2013

To: Mei Ashelford  
Financial Reporting Council  
Aldwych House  
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Dear Sir/madam

### **Re: FRED 50 – RESIDENTIAL MANAGEMENT COMPANIES' FINANCIAL STATEMENTS**

The Society of Professional Accountants welcomes the opportunity of commenting on this consultation and herewith is our response for your consideration.

Please let us know if you would like to discuss with us any aspect of our reply.

PLEASE ACKNOWLEDGE RECEIPT OF THIS RESPONSE.

Yours sincerely

Peter J D Mitchell  
Chairman

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**FINANCIAL REPORTING COUNCIL**

**FRED 50 – RESIDENTIAL MANAGEMENT COMPANIES' FINANCIAL STATEMENTS**

**Response by**

**THE SOCIETY OF PROFESSIONAL ACCOUNTANTS**

**11 NOVEMBER 2013**

**PETER J D MITCHELL, FCA, FCCA, CHAIRMAN**

## **FRED 50 – RESIDENTIAL MANAGEMENT COMPANIES’ FINANCIAL STATEMENTS**

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## **FRED 50 – RESIDENTIAL MANAGEMENT COMPANIES' FINANCIAL STATEMENTS**

### **1. BACKGROUND TO THE SOCIETY OF PROFESSIONAL ACCOUNTANTS**

- 1.1 SPA is a wholly independent society of small practitioners holding a qualification issued by a recognised professional accountancy Institute. It was formed in early 1996 and currently there are some 1400 principals in 1000 member practices. Our members provide accountancy and taxation services to an estimated 150,000 private businesses and around 450,000 individuals. Of the private businesses around 50% are unincorporated and where most do not have employees.
- 1.2 The Society's stated policy is to promote and improve the relationship between members and their Institutes by providing constructive criticism together with practical proposals for improvements. Further to provide commentary and proposals to other authorities influencing members' practising environment.
- 1.3 SPA has previously made submissions on small businesses limited company activities to the DTI on Audit Exemption levels, to the Accountancy Standards Board on Financial Reporting Standards for Small Entities (FRSSE), to the DTI on Modern Company Law 'Developing the Framework', to the Chancellor of the Exchequer concerning individual tax payers on 'Advancing Self Assessment Tax Return Filing Dates', and to HM Revenue and Customs on various tax and NI consultations impacting on small practices and their clients including Simpler Income Tax for the Simplest Small Businesses and Securing Compliance with Real Time Information – Late Filing and Late Payment Penalties.

## FRED 50 – RESIDENTIAL MANAGEMENT COMPANIES’ FINANCIAL STATEMENTS

### 2. RESPONSE TO QUESTION POSED

- 2.1 The Society of Professional Accountants (SPA) welcomes the opportunity of commenting on Fred 50, Draft FRC Abstract 1, Residential Management Companies’ Financial Statements and Consequential Amendments to the FRSSE.
- 2.2 SPA has several members who are qualified Chartered Accountants and are Agents for clients with Residential Management Companies (RMCs). Their combined experience of RMCs is considerable, and they all feel strongly that the proposed draft is focussed on larger companies and is not viable for smaller companies – which may have been totally overlooked.
- 2.3 Their combined views and reasoned arguments are represented in the two responses below. SPA urges you to take their views on board as to why **it will not work for the smaller RMC’s described and, at the very least, to include exemptions for these.** Summed up in this extract from one of the attached responses:

“Those who have worked on the Draft have perhaps only dealt with large companies and ones with ‘real’ landlords whereas all of the RMC’s that we and most small practitioners are involved with are ones where the ‘tenants’ are exactly the same people as the owners of the Companies so PLEASE can some exemption be allowed for these types of Companies.”

#### Question 1:

Do you agree with proposed draft FRC Abstract 1 and Consequential Amendments to the FRSSE? If not, why not?

NO – Please see responses below – contact details are provided and they would be pleased to discuss any aspect of their response.

## RESPONSE 1

From Victor Kirby FCA, email: [victorkirby@hotmail.com](mailto:victorkirby@hotmail.com), Tel: 020 8559 1660

### OBSERVATIONS re FRED 50

1. Reference in Scope (page 5) is to profit or loss for a period. We always refer to income and expenditure – as RMC's are non-profit-making and operate on a mutuality basis. A profit would suggest a possible taxable element (e.g. if a surplus?).
2. (Page 5.5) - The cash balance and other assets are not co's assets and should not be recognised in the co's Balance Sheet.  
(How does it balance then?).
3. (Page 5.6) - The income and expense shall not be offset. (What does this mean?). Similarly in 7 - where a receivable and payable arise from a single transaction and exist at the end of the period, these balances shall not be offset. (What does that mean?). This is taken from FRSE 3.12 and 3.13.
4. The accounts must state that the RMC acts as a Trustee (FRSE 3.14). Generally, trustees have a potential personal liability. How does a company fulfil this obligation? Will its directors be potentially personally liable and how will residents/owners be encouraged to accept these (unpaid) positions with such a burden on them? Entity B example, page 18, makes it clear that a statement regarding the fact that the company acts as a trustee will be required.
5. My copy of the FRSE seems to exclude (incongruously?) parts of 37 b) and 37 c) i.e. the last line of 37 b) and first line of 37 c) including the left hand 37 c). Is the whole of 37 c) excluded and the last line of 37 b) or is this a printer shadow at my end?
6. The RMC's have historically always taken the income as being its income and a "trust situation" should, therefore, be unnecessary, where the contributors are the same as the owners of the company and in control of its own funds, which is the whole purpose of forming an RMC? Indeed, there is no "landlord" other than the company itself so the tenants (owners) and company are effectively one and the same! An external trust situation presumably applies where a managing agent holds the funds outside of the company, since it is not "their" money and they should have a separate client's account for each property, as agents. However, even in such a case, it is common practise for the company to account for the income and expenditure in its accounts, in the usual way, as it should, since it is the principal, as has now been established. A trust situation presumably also applies where there is an external landlord collecting contributions and might otherwise mix the funds with his own or those of other properties, as some agents sometimes also did, which I believe was the whole purpose of and need for Section 42 L. & T. A. 1987.

Quite frankly, the current status quo and accepted practise (for at least the last 40+ years, to my knowledge) whereby the RMC fully accounts for contributions received and outgoings (via its Income and Expenditure account and usual Balance Sheet entries) whether held on its behalf by an agent or in its own bank account, should be continued. I suspect this would be to everyone's relief (residents/owners, who understand the usual company statutory accounts and are used to them, particularly if they are in business). It would make the FRSE quite straightforward if there was an exemption e.g. "an RMC, in

view of its constitution, can be deemed to be not acting as Trustee and can continue to account for income payable to it, as its asset (but held, of course, for the benefit of its shareholders/members) and reported, as is established practise, in the Balance Sheet.” See 7. following. By allowing such an exemption, I believe the FRC could avert what I see as the otherwise next problem area we will see, which will be the question of whether the volunteer directors of RMC’s may now be potentially personally liable under trust law, despite having become part of a limited company structure intended to protect them and the other owners personally. It is clearly important for us to remember that the whole purpose of Landlord and Tenant legislation is to protect the tenants primarily and I foresee more problems being potentially created with the current proposed approach. If volunteer directors are not forthcoming in future, the whole RMC ethos would become unworkable, of course.

7. The companies we act for have had their leases developed over many years and usually refer to the amounts receivable as “maintenance contributions” and the leases define how these are to be utilised. These are akin to service charges and the protections afforded by the L. & T. A. 1985 and C. & L. R. A. 2002 are, therefore, deemed to apply. However, they are not called service charges, as it has historically been considered that the company is to function like any other and its income and expenditure are to be fully recorded by it and not treated as trust income. Is there scope in the FRSSE to have a statement in the RMC’s accounts, to the effect that “the company does not consider that it holds maintenance contributions received as being in trust and, accordingly, that the provisions of Section 42 L. & T. A. 1987 are deemed not to apply to it,” rather than (or as an option with) the statements in 3.14 of the FRSSE? The key issues, Scope 15 (page 10), would suggest this might be a feasible option?
8. As regards item 20), on page 11, I would suggest that the statutory accounts (drawn up as historically) and with a detailed addendum “income and expenditure account” (we include a “Management Statement” setting out the costs, totalling to the total income) actually provides more useful and transparent information than “service charge accounts” produced under Sections 21 to 22 L. & T. A. 1985).
9. Is 22, page 11, suggesting that we may now be required to produce both statutory company accounts and service charge accounts, if requested under LTA 1985? Item 21 on page 11, refers to the preparation of service charge accounts, in accordance with the guidance in the ICAEW Technical Release 03/11 “Residential Service Charge Accounts”. Was this not withdrawn? The last paragraph of Entity B example, page 18, seems to intimate this possible requirement also?
10. There appears to be no reference to the requirement to accumulate reserves for anticipated expenditure and how to account for this?

## RESPONSE 2

From Christine Braidwood FCA, email: [info@chrisbraidwood.co.uk](mailto:info@chrisbraidwood.co.uk), Tel 01737 843034

1. I would particularly like to re-enforce the point that like Victor and many other practitioners the majority of the RMC's that we deal with are ones where all the residents own their properties and they all see copies of the accounts (which always include a detailed income and expenditure page at the back). The normal procedure is that a handful of them are directors but all come to the AGM's, all discuss the issues affecting their flats and all want the Company to build up a certain amount of reserves to enable any big expenditure to be spread over a number of years. They might decide to save up for Roof repairs, new drains or other major items and it was disappointing to find no references to building up reserves at all in Fred 50. To try to tell the owners of the flats that the Company they are all a part of is not able to hold the reserves but that they have to be held in a statutory trust just makes no sense in these cases as they are all in control of the money.
2. To the majority of flat owners the only reference to being a tenant is because many of the flats are purchased as leasehold ones with varying long leases, mostly 99 years. We do actually have one with 999 years ...it is a big old mansion converted to flats and a few miles away is a similar building which is a split freehold. They all have exactly the same set up with the RMC keeping the maintenance contributions (like Victor we usually call them that rather than service charges) they both try to build up reserves and had big roof expenditure recently. Under the FRED 50 I would be able to show the reserves in one RMC on the balance sheet and on the other one I would presumably have to have a balance sheet with nothing on it and a note...or does FRED 50 suggest we have the same Balance Sheet with just a note explaining the money is held in a Trust?
3. I understand that there needs to be a Trust situation where there is a proper Landlord and tenant relationship but it seems as though the Fred 50 only exempts freeholders (Page 11 no 15 ) whereas I don't think a Landlord/Tenant situation does arise when there is **no Landlord** as in nearly all these types of cases. Perhaps some sort of exemption should be looked at for RMC's where the flat owners are the same people as the directors of the Company.
4. One of my colleagues raised a point about the L & T act being introduced to protect tenants at a time when there were far fewer RMC's set up and my comment to that is that when I first started practice (a while ago!) we had hardly any RMC companies but quite a few simple residents associations....we have none of these now as they all converted to being RMC's, partly due to the fact that no one has any time now to collect the contributions from the other residents and pay the gardener etc. but also because they wanted to remove any personal liability if anything went wrong so having their own company with a guarantee of perhaps a pound as the vehicle to deal with exactly the same matters was the much preferred option and it has now become the normal arrangement. Often the initial company is even being set up by the property developers before people have purchased their flats. An RMC is a perfect solution for owners being able to save up money on a regular basis for major items so the burden does not fall all in one year as that would be so unfair on owners who had perhaps just purchased their properties or indeed ones who have just sold them thus escaping any big costs altogether. I realise this is simplistic as no doubt if there was a major problem the cost of major work might be reflected in the price of the property but that would be of no comfort to anyone else. Apart from saving up for major items the RMC is an ideal way to deal with all those joint costs



5. Regarding the comments in FRED 50 it is unclear whether any of these simple points have been considered. Those who have worked on the Draft have perhaps only dealt with large companies and ones with 'real' landlords whereas all of the RMC's that we and most small practitioners are involved with are ones where the 'tenants' are exactly the same people as the owners of the Companies so PLEASE can some exemption be allowed for these types of Companies
6. The question of whether this type of company should have its accounts dealt with differently if their affairs are managed by an agent also needs considering. In my view the exemption should apply to all companies where there is no 'real' landlord .We deal with quite a number of these companies where their affairs are managed by an agent but the Company accounts are dealt with the same way. In all cases the invoicing from suppliers is in the name of the Company so it is the Company that would have the liability to pay those expenses and not the managing agent .These should therefore appear on the Profit and loss (Income and Expenditure) accounts for the Company and it was pleasing to see that EVENTUALLY this point was accepted in the previous deliberations. The Balance sheet and how that should be presented seems to now be the main problem but in simple terms it should not be a problem at all. It represents prudent reserves approved by the Directors who all agree on the level of reserves themselves and the money should be correctly kept in their own company. Surely the directors of a company which operates the management of a block of flats that they own have the right to decide how their affairs are dealt with. It is extraordinary how such a simple thing that has worked so well for so long should now need to be altered to something that mentions theoretical Statutory Trusts and complications with the landlord and tenant act which are not relevant to these owner owned properties.
7. I do hope that sense can now prevail and a suitable recommendation put forward that all accountants can abide by. It also needs to be explainable to our clients who have mostly been quite bewildered by all of this!

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