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[www.hmrc.gov.uk](http://www.hmrc.gov.uk)

Dear Ms Ashelford

**FRED 50**  
**Draft FRC Abstract 1**  
**Residential Management Companies' ("RMC") Financial Statements and**  
**Consequential Amendments to the FRSE ("FRED 50")**

Thank you for the opportunity to comment on this Financial Reporting Exposure Draft. We would be happy to discuss any of the points raised in this letter if you so wish.

**Our perspective**

1. HM Revenue & Customs (HMRC) administers and collects tax in the United Kingdom. In doing so, we use the financial statements of most businesses in the UK, and a number of overseas businesses. The managers and owners of those businesses directly use the numbers reported in financial statements as the basis of their corporate or personal tax liabilities. We check those numbers and the tax liabilities based on them, and we use many of the disclosures in financial statements to help us to check those and other tax liabilities.
2. In the UK, it has long been the case that the starting point for most businesses for calculating a business's corporate or income tax liability is its commercial profit. It is now enshrined in UK tax law that the starting point for taxable business profits is the "profit prepared in accordance with Generally Accepted Accounting Practice" (GAAP).
3. HMRC's direct interest is with a reliable measure of commercial profit, or profit before tax, which businesses can use to measure their liability to corporate or income tax. HMRC also uses the information disclosed in financial statements to check entities' returned tax liabilities.

## General comments

4. HMRC has published guidance on the current situation of the taxation of profits of RMCs, available at [www.hmrc.gov.uk/manuals/pimmanual/PIM1070.htm](http://www.hmrc.gov.uk/manuals/pimmanual/PIM1070.htm)<sup>1</sup> which states '*under correct accountancy principles, it will not usually be correct to include in the computation of profits sums to which the landlord is not beneficially entitled*'. If the FRC issues its Abstract as proposed, on first glance this will need to be amended. Clearly it would need some thought, but it would appear that the sums to which the RMC had become beneficially entitled and were reported as income may be taxable. It is not clear to us at this point whether this would have arisen from a change of accounting policy or the correction of an error.
5. We have concerns, noted below, as to the scope of the proposed Abstract, and also its timing.

## Answers to specific questions

### Question 1:

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

6. We note that the proposed accounting relies fundamentally on the separate Counsels' Opinions being correct in that the RMC is always acting as a principal in transactions with third party suppliers.
7. In the light of these two opinions, it is our understanding that FRED 50 proposes fundamentally that<sup>2</sup>:
  - a) In its transactions with third parties, the FRC believes that the RMC acts as a principal, such that every RMC will always bring all transactions into account; and,
  - b) However, service charge monies received by the RMC are held on trust and are therefore not to be reported in its balance sheet until "drawn down" to pay an obligation (and there should be no offsetting between income/ cash and expenditure/ liability). The FRC proposes that such cash should be disclosed in a note.

### Restriction of scope and analogous transactions

8. The scope of FRED 50 is restricted to service charges over which s42 of the LTA imposes a statutory trust. However, paragraph 4 of the proposed abstract is stated much more widely in that it states that an RMC '*acts in the capacity of principal (not agent) when transacting with third party suppliers in the management and arrangement of maintenance of a property*'. Paragraph 7 of the introduction has a similar statement and both appear to be far wider than the restricted scope in paragraph 1.
9. As currently stated, it would appear that the FRC's proposal in respect of 7(a) above is the FRC's view of any situation where any party acts in such a capacity. It is our experience that a much wider range of entities take an alternative view of this. We are concerned that, unless qualified or limited, an Abstract with the terms of FRED50 paragraph 4 may have a much wider impact.

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<sup>1</sup> Property Income Manual PIM 1070 – Income Chargeable: Flat Management Companies

<sup>2</sup> Para 4-7 and Proposed amendment to the FRSE 2008 paras 3.10 - 12

10. We also believe that it makes most sense to read FRED50 paragraph 4 as reporting the FRC's view of the current situation. As such, it is not clear to us whether the FRC is stating that an alternative practice was wrong (that is, an error) or whether it is acknowledging valid past practices, but that in future there is only one standard practice (that is, a change of accounting policy).
11. We believe that it is commonly acknowledged that many entities have not been reporting transactions through their profit and loss accounts, and will have to do this differently in the future. Whether this represents the correction of an error or a change of accounting policy will be of widespread concern because the effects, both in respects of preparation of accounts (Prior period adjustment, Defective accounts regime, dormancy) and taxation, are different. It is important that the FRC clarifies this in the wording of its Abstract.

#### Impact on preparers of the RMC financial statements

12. The proposals remove what is a common accounting practice for RMCs, so common as to be the only practice identified in our current guidance. The preparers of accounts for such entities are likely, on the whole, to have less access to technical accountancy resources and may therefore not appreciate the ramifications of the proposals and the accounting and tax adjustments needed.
13. We would prefer that proposals, particularly those flowing from paragraph 4 of FRED50 are expressed in a direct and straightforward way such that non-technical preparers might be able to complete a set of financial statements without reference to additional technical accountancy resources. We feel that further guidance is likely to be required on the practical application of the principles set out within FRED 50 to make it clear that:
  - a. Service charge expenses are recognised as they are incurred (ie, on an accruals basis) and an equal entry is recognised as income, representing amounts "drawn down" from service charge monies received from tenants to cover these expenses.
  - b. Creditors will represent amounts due to third party suppliers for service charge expenses incurred during the period. An equal debtor balance will be shown representing amounts due from service charge monies held in trust to cover these costs.
14. Even with additional guidance, we question whether the resulting RMC accounts will meet the needs of potential users. We would expect most tenants to be more interested in the statements required by the LTA and that potential suppliers would be more likely to be the main users of the RMC statutory accounts. If so, the most likely key information suppliers might need is the cash available to meet the liabilities to be incurred in the proposed supply (either cash available or cash that can be collected from tenants). However, this key information would not be on the balance sheet at all but disclosed in a note. Neither would there be any disclosure as to the potential income available from tenants, either annually or to meet exceptional demands.

#### Interaction with Micros Regs and Accounting Directive

15. It is likely that the majority, if not all, of RMCs would qualify as Micro companies under current proposals to introduce simplified financial reporting requirements for very small companies<sup>3</sup>.
16. The FRC's proposals do not specify whether service charge income drawn down will be "turnover" or "other income" of an RMC in the SI2008/409 or Micros Regs formats. This

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<sup>3</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/237045/bis-13-1124-simpler-financial-reporting-for-micro-entities.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/237045/bis-13-1124-simpler-financial-reporting-for-micro-entities.pdf)

might lead to uncertainty about whether a company would qualify as a micro company.

17. In addition, the Micros Regs provide that accounts prepared in accordance with the requirements in the Regs must be deemed to give a true and fair view of the financial position of the company, and neither BIS nor the FRC is able to add to the disclosure requirements therein. It is therefore difficult to see how FRC would be able to require, or even guide, companies to make the disclosures of cash held, ability to collect service charge monies from tenants (or not), or any reconciliation to service charge accounts. As a result, the accounts that will, for the most part, be produced are quite likely to not include the item most potential creditors would wish to see and could well be thought to be misleading in those circumstances.
18. The EU's Accounting Directive, which will in due course have to be implemented in the UK contains a similarly limited disclosure regime for Small companies, not just Micros, and so even if there are some RMCs that are Small but not Micro, when the Accounting Directive is effective RMCs reporting under the Small company rules will face similar issues.

Amendment to accounting standards

19. The consequential amendment to accounting standards only appears to affect the FRSSE 2008, rather than FRSSE 2015, which would be the applicable version at the proposed effective date.

*Question 2:*

*Do you agree with the proposed effective date? If not, why not?*

20. At first glance, it seems sensible for the effective date of implementation to coincide with the mandatory effective date for FRS102. However, as most, if not all RMCs, would be Micro or Small companies, which do not have to follow FRS102 (because they can adopt the FRSSE), we wonder if the proposal should be delayed until the impact of the Micro Regs can be established; in any case there seems little need to couple the proposal to the FRS102 effective date.

Yours sincerely



**Matt Blake, FCA**  
Commissioners' Advisory Accountant