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To: UKFRS@FRC.org.uk

Ms Ashelford
Financial Report Principal
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22 August 2013

Dear Ms Ashelford

FRED50

We refer to FRED50 issued in August 2013 and the invitation to comment contained thereon. We have reviewed the draft abstract and note the requirements included. It is certainly welcomed that we appear to be moving closer to a conclusion in this respect as this area has given significant problems in relation to explaining the state of play that has been highlighted for almost 3 years to clients.

Having reviewed the abstract the following questions have come to light. We would stress that these are not the only points that may be identified but only those that have come to our attention at this point in time based on our understanding of the abstract.

1 The conclusion of the abstract appears to be that two sets of accounts will be required being the service charge accounts as distinct from that of the management company itself. The abstract states on the Consultation Stage Impact Assessment on page 16 (paragraph 6) that there will be minimal additional costs in applying these new requirements. The abstract however has not identified what is meant by “minimal additional costs”, in particular we note as follows:

a It is our estimate that for a relatively simple service charge account (and one that does not have the issues detailed below) and related RMC the additional costs of dealing with matters in this manner may be in the region of £150-£250 plus VAT. Whilst in absolute terms some (but not all) people would consider such an amount to be minimal this is not necessarily the case in relative terms when the costs of preparing service charge accounts at present has often been in the region of £450 plus VAT.

b It is possible that a RMC does not have the same year end as the service charge account for the block it manages. Furthermore, it is possible, as identified by the abstract at paragraph 8b of the Residential Management Companies Financial Statements section on page 6 that a RMC might manage more than one trust. Those trusts will not necessarily have the same accounting year end. In such a situation it is highly unlikely that "there will be minimal additional costs incurred in applying the new requirements" (page 16, Consultation Stage & Practical Assessment, paragraph 6) as it will be necessary to split the year's figures for at least one of those trusts.

c You have stated that the expenditure will be easy to extract from the service charge account. This does not however take into account possible differences in accounting treatment. The service charge accounts must be prepared using any accounting principles and bases defined within the lease, whereas the statutory accounts must be prepared in accordance with accounting standards (most probably the FRSSE) these two bases will not necessarily be the same and that being the case will give rise to further adjustments being required.

2 The abstract is unclear in relation to cash balances. Is it the intention that regardless of whether or not the bank account is held as a client/trust it should not be disclosed within the Balance Sheet entries. For example if the bank balance actually reflects monies owed to creditors would it be necessary to include within the balance sheet a debtor representing the service charge balance due that is actually held within the bank account that is held by the company as principle anyway. Furthermore if the funds are held within a single bank account which contains not only amounts received from tenants by way of service charges but also balances of funds that belong to the company such as say ground rent, are you stating that part of the bank balance, but not all should be included in the balance sheet. Notwithstanding this, from the banks perspective, the whole of the balance is an asset of the RMC.

3 It also appears that the guidance does not consider the position should the bank account be overdrawn. Would this be reflected as an overdrawn bank account not so disclosed within the balance sheet at all? If it is not to be on the balance sheet how would the balance be disclosed.

4 Whilst the draft consequential amendments to the FRSSE states that the RMC shall recognise the relevant service charge expense in the profit and loss account, it does not identify at where this should be disclosed within the profit and loss account. Furthermore the same applies in relation to the income. This needs to be clarified. If the income relates directly to the expenditure incurred being either the whole or a significant part of the raison d'être of the RMC, surely it is turnover? If this is the case, is it correct that the expenditure is all cost of sales as it directly relates on a pound for pound basis to the income?

On the other hand can the income really be disclosed as turnover at all, if it is merely a reimbursement of the expenditure incurred.

5 The draft consequential amendments to the FRSSE on page 7, defines a management company (paragraph 1c). It appears that this definition applies not only to limited companies

that have been set solely for the purpose of managing a single block of flats or estate, but also for those many landlords who as a consequence of the terms of the lease (and where the tenants have not exercised their right to manage) are responsible for the services for a number of block flats and whom manage and arrange maintenance of those properties. This being the case it will give rise to significant implications for such landlords, some of whom own hundreds of properties and amongst other matters under the disclosure requirements (in draft) are obliged to disclose the cash balance being held for each trust/block of flats. This could run to hundreds if not thousands of lines.

Furthermore in this respect the question of disclosure of the expenditure and income must be raised again. There is however, a possible distinction between landlord companies and other residential management companies. In respect of RMC's the service charge expenditure is usually the whole of those companies reason for existence. In respect of the landlord companies I have described, the reimbursement of the service charge expenditure is merely ancillary to the business of property investment and the income in relation thereto.

6 In paragraph 39 to FRED30 you have included a clarification as to why an RMC differs in some respects from a pension scheme. The difference has been identified on the basis that an RMC carries risks and rewards whereas a pension scheme does not. The whole concept of risk and reward should be considered in the light of the purpose of the vehicles being used. A RMC serves no commercial purpose whatsoever and ultimately the risk and reward is actually born by the tenants/flat owners. Not withstanding this they are not truly risks, merely those tenants/flat owners fulfilling their obligations for funding the ongoing maintenance of the development they occupy, the company itself does not receive any reward. The company is merely receiving reimbursements of amounts expended.

Finally we would make very strong reference again to the assertion by the FRED that this approach will not cause significant impact on the cost of preparing such accounts. This is not necessarily the case and it appears to be that, although certain extremely technical aspects have been considered when arriving at the opinion the overall bigger picture appears to have been ultimately overlooked. Often these companies are managed by the flat owners themselves or by managing agents who those flat owners instruct. The proposed approach gives added complexity and confusion to the users of those accounts who are not only the directors and shareholders of the company but also, more often than not lay people. We fail to see how the best interest of those users are being served in any matter whatsoever by this added layer of reporting. It appears that the FRED has been drafted considering those specific technical matters but whilst ignoring substance over legal form.

We accept there are perhaps no single perfect solution to the questions that have been raised, but that being the case maybe a number of options should be made available for directors to consider when arriving at the conclusion as to what format would best serve the purpose of these accounts themselves, that could include the option of either taking the approach laid out by FRED 50 (subject to any modifications as a result of our comments above or those of other parties) or for the statutory accounts to follow that recommended in Tech 03/10 which recognises not only the practicalities involved in relation to these accounts but also that these monies are being expended through the service charge account and on behalf of the tenants.

We would welcome you considering our above points and would ask for you to provide a response in relation to the areas that we consider require clarification.

We look forward to hearing from you in due course.

Yours faithfully

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