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Mei Ashelford
Financial Reporting Council
Aldwych House
71-91 Aldwych
London
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Dear Sirs

DOCUMENT: FRED 50 Draft FRC Abstract 1: Residential Management Companies' Financial Statements

We appreciate that this response has not met your deadline but should welcome the opportunity to add our comments to those you have already received.

Firstly, our understanding is that new s42A Landlord and Tenant Act 1987 has yet to be enacted so that there is no requirement to keep service charges in a designated account and that there are therefore no criminal or money laundering considerations where the monies are simply in an ordinary bank account of a landlord or service charge company.

We note the affirmation that a residential management company acts as principal and should recognize the income and expenditure in its profit and loss account. In our view this is non-contentious although there would be a minority of companies which have endeavoured to remain dormant for the purposes of statutory accounts; Companies House have been seen to encourage this.

However the recommendation regarding the exclusion from the balance sheet of 'the cash balance and other assets' has caused consternation.

Whilst the sums received by way of service charges must be held in statutory trust even the ICAEW in its Technical Release TECH 03/11 warns that 'if service charge monies are held in the bank account of the RMC or RTM, they may be taken as the company's assets in any liquidation'.

As the company is acting as principal it would sue for unpaid service charges in that capacity and until monies representing receipts of service charges are paid into a designated trust bank account they are at risk to creditors of the company in a liquidation; they should therefore appear as assets of the company in its balance sheet. Of course the trust beneficiaries would have rights to trace trust funds under common law and equity.

Contd

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The question then becomes: What liability should be shown in the balance sheet?

We considered two possible options:

1. The funds are owed to the trust and may be considered to simply be a loan, and
2. The surplus funds would be matched by a provision for future maintenance.

Ignoring the legal aspect, option 2 could give rise to tax consequences if any deduction for future expenditure were disallowed and there might be an undesirable responsibility on the directors to produce true and fair accounts in which a provision for future repairs did not equate to the sums levied by service charges.

From a legal viewpoint, whilst, in all cases, it is necessary to study the leases involved when preparing the accounts of a residential management company and it might be a requirement under the lease to levy service charges in order to accurately reflect the time apportionment of maintenance expenditure to be incurred in a future period (build up a sinking fund) this would not imply that the company is required to make a provision in its accounts for such future expenditure. Provisions for future repairs may need to be made by a tenant but would not normally by a property owner.

Therefore service charge monies forming part of a sinking fund and subject to a s42 statutory trust **so far as not held in a separate designated account** should be recognized in the balance sheet of a residential management company and matched by a current liability reflecting a loan from the trust. Any interest received on funds held on deposit would not appear in the profit and loss account of the company but would be accounted for to the trust.

Yours faithfully

Kevin Preston
Director