

FPRA
FEDERATION OF PRIVATE
RESIDENTS' ASSOCIATIONS

THE VOICE OF LEASEHOLDERS

Representing Residents' Associations, Residents' Management
Companies, Right to Manage Companies and similar groups

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Wednesday, 11 December 2013

Dear Sirs,

RESPONSE TO FRC FRED 50

The Federation of Private Residents' Associations ("FPRA") welcomes the opportunity granted to it by the FRC to comment on FRED 50 Draft FRC Abstract 1 ("FRED 50") after the closing date for comments.

Unfortunately it only became aware of the existence of FRED 50 early in November and thus has not had time to consult widely among its membership.

The FPRA is the national non-profit organisation in England and Wales representing the interests of long-lease holders which we do via residents associations, resident's management companies, flat management companies, right to manage companies, commonhold associations and similar groups.

We effectively bring together the views of hundreds of other groups in England and Wales on issues that affect our members and leaseholders generally. We have some 550 member associations, the majority having around twenty leaseholders but with a few with nearly a thousand. Some manage their estates themselves, others employ Managing Agents. Probably about half of our member associations own the freeholds of their estates.

Generally, leaseholders and RMCs rely on external accountants (or Managing Agents) for the preparation of their statutory accounts and their service charge accounts. Where they manage their estates themselves, typically one of the Leaseholders will be Treasurer, keeping records of income and expenditure. Leaseholders themselves want to know what has been spent, and how, and (where the Lease permits) that there are reserves to meet expected future expenditure. Changes to presentation are, generally, not well received.

For this reason we hope that FRED 50, in its final form, will put an end to the uncertainty surrounding service charge accounting since at least the Commonhold and Leasehold Reform Act 2002.

Leases take many forms and there are many different provisions for the collection of, accounting for, and certifying of, service charges. Some leases have been well drafted, many are poorly drafted and some contain provisions relating to services charges which are quite impractical. FRED 50 needs to be applicable in all situations within its scope.

- 1 FPRA hopes that the final version of FRED 50 will bring stability to the subject and endure if and when regulations are made under S 21 (4) of the Landlord and Tenant Act 1985 (as amended by S 152 of the Commonhold and Leasehold Reform Act 2002).
- 2 FPRA urges the FRC to ensure that the needs (including the need to understand the document) of the primary users of the Accounts (the Leaseholders) are satisfied by the final version of FRED 50. There can not be a true and fair view in a fog.
- 3 Any increase in the cost of preparation of Accounts caused by the introduction of FRED 50 must be fully justified by the improvement in the information provided.

FPRA disagrees with proposed draft FRC Abstract 1 and Consequential Amendments to the FRSSE for the reasons set out below.



4 FRED 50 paragraph 1

We note that the scope of FRED 50 excludes those RMCs on which Section 42 of the Landlord and Tenant Act 1987 does not impose a statutory trust. Whilst that is entirely reasonable it does introduce another issue which requires resolution and which is discussed at 16 below.

5 FRED 50 paragraph 2

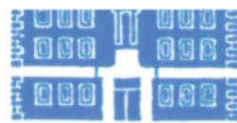
No reason is given for using the term "Residential Management Company"; if this was a deliberate change from the generally accepted term "Residents' Management Company" it would be helpful to know why. If it was not a deliberate change the generally accepted term should be used.

6 The definition of "Residential Management Company" differs from that in the ICAEW's Technical Release 11/03 ("TECH 11/03") for Residents' Management Companies by the addition of "to whom service charges are payable". Paragraph 2(a) of Appendix B to TECH 11/03 seems to suggest that the extra words add nothing but we are uncertain on the point.

7 The words "*and manages and arranges management*" may seem to exclude those who employ a Managing Agent. Would "and manages ~~or~~ arranges management" be an improvement?

8 FRED 50 paragraph 3

The definition of Service Charges might be improved if it started "Service charges are amounts (howsoever described in the lease) . . ." since many leases use other terms.



9 FRED 50 paragraph 4

We agree that RMCs act as principal, not agent, in transactions relating to service charges but consider that the implications where a Managing Agent is involved need to be clarified.

10 FRED 50 paragraph 5

The exclusion from balance sheets of cash and other assets held under statutory trust is going to confuse most leaseholders. Statutory accounts are primarily for their benefit and, while the interests of other users of the accounts (such as those who may supply credit to the RMC or HMRC) need to be taken into account, we hope that the FRC will think carefully before imposing a solution which will not be understood by the primary users. A possible solution is offered at 19 below.

11 FRED 50 paragraph 6

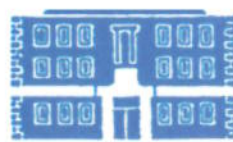
FRED 50 uses the terms "profit and loss". RMC's have money from two sources. The profit and loss account shows only those funds accrued in the course of any business. The income and expenditure account shows the Trust funds which it holds as Trustee but does not own.

12 FRED 50 paragraph 7

We agree that there should be no such offsets.

13 FRED 50 paragraph 8

See 16 and 19 below.



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14 FRED 50 paragraph 9

We welcome the opportunity for early adoption but understand that there may be difficulties in the proposed commencement date (for accounting periods starting on or after 1 January 2015). If the proposed accounting provisions for "micro organisations" are introduced before then many RMCs will be encouraged by their accountants to take advantage of those provisions. We understand that those who take advantage of these micro accounting provisions will avoid the matters dealt with in FRED 50. That is not an argument against persevering with establishing the proper regime for RMC accounting (which FRED 50 sets out to do).

15 Consequential Amendments to FRSSE 2008

We are not competent to comment on these amendments but observe that FRSSE 2008 is expected to be replaced by FRSSE 2015 on FRED 50's proposed commencement date. Should not the consequential amendments be to FRSSE 2015?

16 Statutory Trusts

TECH 11/03 brought to our attention the possibility that some RMCs might, unwittingly, be Fully Mutual Housing Associations ("FMHAs") since, prima facie, they satisfy the definition in Section 1(2) of the Housing Associations Act 1985. (The submission to you from Harrison, Latham & Co obliquely refers to this, as may that of John Harrild and of KPMG.) We need to ascertain the reason the Government decided to make this exclusion and to study its implications for affected RMCs but raise it here because of the disclosure required by FRED 50's paragraph 8a. As has now been exposed, many RMCs may, incorrectly, have been asserting in their statutory accounts that their company is dormant. They (especially those owning their freeholds) now need to be warned against incorrectly asserting that their service charge funds are held under statutory trust.

Although, by definition, they are not within the scope of FRED 50, it is worth mentioning that FMHAs should state the fact of their status in their Accounts (or Directors' Report) in explanation of their not being subject to the statutory trust.

17 Accrual Accounting

The submission you have received from KPMG expects service charge accounting to be on a "normal accruals accounting basis" and cites insurance premia as an example of expenses which should be accounted for on the accruals basis. In our opinion accrual accounting should only be applied where justified by the circumstances. An insurance premium, once paid, is unlikely to be refunded pro rata if the policy is cancelled by the policy-holder and, usually, is payable in a lump sum. Leaseholders will treat it as an expense at the point of payment and not readily understand part of it appearing in one year's accounts and part in the following year's. On the other hand, accrual accounting for the cost of a full tank of heating oil where half the oil has not been burnt at the year end will be understood.

If "normal accrual accounting" is to be imposed, are regular but infrequent expenses such as external redecoration, flat-roof renewal or tree surgery to be accounted for on this basis?

Paragraph 2.1 of TECH 11/03 notes that Section 21(5) Statements do not require accrual accounting though in paragraph 2.2 the accruals basis is recommended. Were FRED 50 to require it for the statutory accounts there could potentially be a difference in the expenditure reported in the two accounts - another potential source of confusion.

18 Cost

Although mentioned in the Impact Assessment and the Case Studies, cost does not seem to have been a consideration in the preparation of FRED 50. For many RMCs the cost of preparing and certifying their accounts is a significant expenditure and anything adding to it is to be regretted.

19 Are two sets of Accounts required?

Some leases require "full" service charge accounts (with or without a balance sheet) and, for RMCs with such leases, unless a means can be found to align the statutory and service charge accounts, two sets of accounts will be required under FRED 50. For those RMCs where the leases require merely an accountant's certificate of the amount of service charge, it should be practical to include in the statutory accounts sufficient information on the service charge expenditure to avoid the need for separate sets of accounts. The stumbling block might be FRED 50's insistence that service charge cash balances be excluded from the balance sheet. Though the logic behind this requirement is understood, the relegation of the cash balance to a note is a radical departure from conventional balance sheet presentation. Does the radical change need to be this one? It would be equally radical to include such cash in the balance sheet but with a note explaining that £n of the cash was held on statutory trust and not available to the company other than for service charge expenditure. We think that the possibility of doing things this way round should be explored since it would result in much more normal-looking (and thus less confusing) accounts and might avoid the need for two sets of accounts. Since the FRC is responsible for setting Accounting Standards, presumably it could authorise such a change if it so wished.



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Where separate Statutory and Service Charge accounts are prepared, the suggestion that there should be a single line entry in the Statutory expenditure account, representing the total Service Charge expenditure during the (reporting) year, with a matching figure in the income account, seems simple and effective.

- 20 The absence of worked examples from FRED 50 makes it difficult for non-accountant readers to interpret the Case Studies. Please provide worked examples. These should include examples of the more complex situations such as those where the service charge funds are negative, where there is a substantial sinking fund and those where the accounting year is not coterminous with the service charge year.

We are happy to answer any questions about our submission and to participate further in the process.

Yours faithfully

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Richard Williams
Vice Chairman for FPRA