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FINANCIAL REPORTING COUNCIL

FRED 50 – RESIDENTIAL MANAGEMENT COMPANIES' FINANCIAL STATEMENTS

Response by

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11th NOVEMBER 2013

Reponse to Question 1:

Do you agree with the proposed draft FRC abstract 1 and consequential amendments to the FRSSE? If not, why not?

We do not agree with the proposals and our comments are sent out below:

1. Definitions

Point 3 states that service charges are amounts payable by a tenant to a residential management company in respect of services, repairs, maintenance, insurance, improvements or costs of management and the amounts may vary according to the costs incurred or to be incurred.

Our comment to this is that although the term "tenant" is strictly speaking correct where there is a lease in place, it also implies that there is a landlord and tenant relationship which is very often not the case. In almost all of the companies that we deal with, the directors of the company are the same people as the owners of the flats in the residential block. Therefore, in theory, as there is a lease in place, they are strictly speaking tenants but in cases where they are all the same people, we would prefer to use the word "residents" rather than "tenants" The accounting policy note in all our RMC accounts states that the 'income of the company consists of ' management fees payable by the residents 'and we never use the word "tenants".

2. Residential Management Transactions

Point 4

We completely agree with this and it was something that was not included in the original exposure draft in connection with these types of companies but it is quite fundamental as to how they operate. Even where there is a managing agent involved with organising the repairs/maintenance of a block of flats, the individual invoices and the liability to pay those invoices rests solely with the company rather than the managing agents, if there are any.

Point 5

We don't agree with point 5 because it makes little sense to not show the reserves that any prudent company builds up within its own organisation. Many of these residential management companies (RMCs) try to build up reserves to minimise the burden of large items of expenditure from being charged in any one year. This would be very unfair on the people living in the flats at the time of such major expenses as roof repairs and even in some cases outside decorating can be hugely expensive. Some RMCs add a certain amount on every year to their management charges to build up a fund and others just generally try to build up funds out of the surpluses that they might make each year. All of them regard the building up of reserves as being an essential and fundamental part of running their own company. Therefore, to try to explain to them that although the money held in the bank account is all in the company name but it doesn't actually belong to the company at all and therefore we need to remove it from our balance sheet makes little sense. I have tried to explain this potential situation to my clients but they find it quite incomprehensible.

Point 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! A trust situation would exist where there is an external landlord collecting contributions who might otherwise mix the funds with his own or those of other properties. Protection of "tenants" in those situations is important and was one of the main purposes of and need for Section 42 L. & T. A. 1987.

Point 7

If the accounts are dealt with on a normal basis whereby income counts as income i.e. the management charges receivable and the expenses are shown in the Income and expenditure account and the balance sheet shows the reserves, then point 7 becomes irrelevant.

Point 8

If there could be some exemption for companies where the owners of the flats are the same as the tenants then this statement (a) would not be required but a modified statement perhaps disclosing that because the tenants and the owners are the same people, they are exempt from certain requirements of the L & T Act 1987 might be an acceptable compromise. It would be helpful if the FRC could give us guidance as to wording that would be acceptable for cases of this sort. This also applies to section (b) of note 8.

Reponse to Question 2:
The time frame mentioned in the report would seem to be acceptable but hopefully the above amendments can be accepted so all that would be required would be a note in the accounts

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Our experience in practice

I have been in practice for over 30 years and we currently deal with approximately 40 RMCs. Some of these are run by the directors themselves who arrange all the contracts with gardeners, maintenance people etc and other use managing agents. When I first started my practice 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.

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.

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. 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 !!...where is the logic in that?

There is reference in the draft FRC about the need for showing the detailed expenditure and for all small practitioners, this is somewhat stating the obvious because in all of these companies and most other small trading companies, the only page that the clients are really interested in is the detailed back page. This is not filed at Companies House but is always prepared in small companies to give them the directors, the detail as to their income and their expenditure. Obviously this is summarised in the statutory balance sheet and P&L in the front part of the accounts along with the notes but to most people who aren't accountants, the back page is the most interesting and in the case of the RMCs, it is absolutely essential that they have this back page. Nobody would ever prepare a set of accounts without including that detail. The accounts are circulated to all the owners of a block of flats and generally all of them are also directors of the company but sometimes there are just a few directors and other owners are not on the "board" but you can be absolutely certain that they will all comment, will all attend the AGM and will all query any items of expenditure that they are not happy about.

The above paragraph sets out a completely different situation to a property that might be owned by a landlord with all of the residents being tenants.

At the AGMs for most of these small companies, there is also concern voiced regularly about building up reserves and to try and explain to these people who run their own companies extremely well, that the money the company owns is not part of the company at all but has to be held in a statutory trust, makes no sense where they themselves are in control of all of the money, all of the decisions and all of the reserves.

You may or may not receive a lot of comments about the draft FRC abstract but if you don't receive a large response from a number of general practitioners, please don't assume that there is no interest. Last summer when the UITF were discussing this very same subject, and there was a deadline approaching for comments, I happened to be on an accounting update course and asked all the people on the course (about 50 people) if they knew that they had to submit a response by that particular deadline and nobody knew about it. I also did a straw poll as to whether or not any of them were interested and I would say that 75% of the people were interested, were most upset by the proposals and promised to respond. Everybody who I know who deals with small RMCs feels exactly the same way and I have never personally felt as strongly about anything in all the years that I have been in practice. I was alerted to this deadline by some other interested colleagues and the SPA but many practitioners will not be aware of the deadline which is a shame. This is due largely to poor circulation of relevant events such as this from the various accountancy bodies

Please could you look at the responses you have received from small practitioners and please could some common sense approach be applied to all of this. These companies have existed in many cases for a large number of years, have dealt with their affairs very prudently and to insist upon changes when they must themselves have rights as directors of their own companies is not doing the accountancy profession any good at all and I dread having to tell them all that we have to make changes which to me make absolutely no sense whatsoever.

I look forward to hearing from you all in due course and thank you for taking the time to read my comments.

Chris

Mrs Chris Braidwood

PS Throughout this report I have referred to Flats and blocks of flats .This was for ease of reference and consistency but I am well aware that not all RMC's are blocks of flats. We have a variety of situations in our client base including some large old mansions subdivided into flats, various groups of houses on the same estate, various small blocks within an estate etc but the same points as set out above apply to all of them.