

I am writing to you in my capacity as a director of a Residential Management Company Limited (say XRSMLtd).

About 24 years ago a development of nine flats began. Leases of 999 years duration were drawn up. There were three parties in each lease. The purchaser, the head landlord (DP Ltd) and the management company (XRSMLtd). Both Ltd companies were registered at Companies House. When DP Ltd went into liquidation about 15 years ago the management company XRSMLtd acquired the Freehold, along with the rights and duties laid down in the lease of DP Ltd.

Thus it became responsible under the lease in its own name of XRSMLtd for the obligations of both DP Ltd as well as its continuing managing function, a likely situation in many RSMs.

It has carried out both responsibilities under the name of XRSMLtd. Each leaseholder holds one share in the company and is entitled under Articles to be a director. Eight of the nine shareholders have exercised this right.

For past financial years to 31 March 2011, one set of accounts had been produced each year by a chartered accountant. All transactions were passed through those accounts ending each year with one P&L account and one composite Balance Sheet.. However, in the first of the last two years the directors did them in house following the pattern of previous years, and in the second a new chartered accountant has produced two accounts one for the landlord XRSMLtd confined to a Balance Sheet showing only the shareholding, nine £1 shares, and the other containing all transactions in the name of "Property Company", not the Ltd Co.

It appears from legal opinion that XRSMLtd has to recognise that although its books include everything in the one record it has to separate the financial transactions of its management responsibility(as a Trust) from those of it acting as the Landlord. The lease is clear; before it took over the headlease, XRSMLtd, as the Management Company, received the Service Charges and paid out from those receipts Expenses under lease provisions. We understand these transactions both of income and expenditure are Trust property and now have to be accounted for separately, distinguishing what the company does as Trustee as opposed to anything it does as Landlord. The lease also of course includes terms governing the responsibilities of the landlord. Thus the respective financial obligations of the Trustee and the landlord are mixed together in the various terms of the one lease.

So we have one Limited Company with one source of income, the service charges, carrying out two sets of transactions, each batch of which demands different treatment under separate hats.

FRED has been issued to allow the situation to be sorted for the Landlord company and to provide the blueprint for future accounting of that landlord company.

I understand the guidance is that the service charges are the income of the Trust. Thus that income must be excluded from the landlord's Ltd company accounts. But transferred to the landlord's accounts will be so much of the service charges needed to meet expenses of maintaining the nine flats under their leases. Any sums not so transferred will remain with the Trustee company.

What of the expenses outlaid in maintenance. I understand these are to be shown and detailed in the Landlord's Ltd company accounts, albeit not exceeding in total the sum transferred from the Trust. All payments will be shown in the Trust Accounts of XRSMLtd. Does this mean that once the Trust has laid out money on expenses paid by the landlord then the trust fund has completely relinquished responsibility for the money so transferred?

We do not know precisely what reasoning is contained in the counsels' opinions, and it would have been useful if their rulings could have been included in the consultation document..



Some problems can be foreseen. Three examples :

1. Payments which initially have to be funded by the Landlord, even though the lease stipulates that the costs can be recovered under the lease from the leaseholder.

eg. Legal costs to defend an injunction applied for by a leaseholder against the Landlord,

or where the landlord applies for Tribunal determination of breaches of the lease in contemplation of Section 146 proceedings .

In both cases initial costs have to be funded by the landlord before recovery from the leaseholder is attempted. . Our directors have the assurance of their solicitor that the lease provides for these expenses to be initially paid out of the Trust fund.

2. Insurance premiums to protect the Directors against personal legal action. At present these, too, are paid out of Trust funds

The overlap within the lease of the Trustee's and the landlord's expenditure must surely occur in many similar lease situations. The advice as set out in FRED will probably demand much legal consultation being imposed upon directors of the landlord company.

How should recoveries of the costs in 1. and 2. be displayed in the landlord's accounts?

Will the cost of such consultation and other similar costs continue to be met out of the Trust fund?

Has the consequential cost of legal advice to sort out the mingling of Trustee and landlord costs been thoroughly considered by FRED ?

3. Where a leaseholder has caused damage to communal parts but refuses before repairs are done to admit his liability, the cost of those repairs has to be met by the landlord company. Money will be transferred by the Trust to the Landlord to enable him to make payment. When the landlord recovers the money from the offender does it have to go back into the fund? Whilst the lease provides for such the payments to be made by the landlord, it naturally may not always state whether the recoveries have to be placed back in the trust fund.

Once the sums have left that fund, can the landlord retain recoveries to meet similar expenditure in future, and not replace them within the Trust fund?

Where a group of residents have complete control of their Limited company, equally as shareholders, directors, and controllers of the Trust, to have to address their actions under separate hats and to split income and expenses, each within the same lease, seems a tortuous method of accounting.

What may be imposed upon many persons holding or purchasing a residential flat is a system which will seem to a large number of them as quite unnecessary. Moreover it will be incumbent upon lawyers to ensure their clients fully understand their situation now, or upon purchase.

Far better it would seem to be if just one Ltd Co. account can be produced each year. Within that account cannot sufficient safeguard be inserted to ensure that actions of the Trust company are clearly distinguished and the accounting certificate so framed to meet existing legal requirements?.