

Gordon Whelan

associates

Chartered Accountants

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Comments on FRED50 Draft FRC Abstract 1

INTRODUCTION

Gordon Whelan Associates Limited is a firm of Chartered Accountants based in Hampshire. We specialise in the certification of Service Charge accounts and also provide consultancy services to Managing Agents and directors of Resident Management Companies. This accounts for approximately 60% of our revenues and so we have a keen interest in matters which affect the Residential Property Management sector.

OUR POSITION

We believe that statutory accounts are not the best way to present Service charge accounting information. Due to the complexities of service charge accounting and the different requirements of the users of the information we feel that service charge accounts can never be satisfactorily presented within a statutory accounting framework.

We strongly support TECH03/11 and believe that it has made an important contribution to raising standards in accounting for service charges. We are extremely concerned that the proposals in FRED50 and the on-going debate about RMC financial statements is undermining TECH03/11 and damaging the perception of the accountancy profession within the sector.

COMMENTS ON FRED50

We find many of the arguments used to support FRED50 to be unconvincing. However, we acknowledge that the exposure draft presents a potential solution to the Agent / Principal argument that now must be resolved. Our main criticisms of FRED50 are that,

- a) it fails to address more complex situations in RMC accounts
- b) the true and fair argument put forward to support the proposals is weak and difficult to support

- c) it does not recognise the relevance of the potential cost implications of following the proposals.

Failure to address complex situations

Examples of the more complex situations that FRED50 does not attempt to address includes,

- a) circumstances where the RMC receives other sources of income such as ground rents or income from the sale of leaseholds
- b) the tax position when service charge transactions are mixed in with revenues and expenditures that only relate to the company
- c) expenses incurred by the company that are not recoverable under the terms of the lease of the property
- d) the position when company funds are mixed with service charge funds
- e) non-coterminous year ends between the year end stated in the lease and the company's year end.

The ICAEW response to UITF92 suggested that more complex issues should be tackled at a later date through sector guidance. We disagree with this approach because it will prolong the debate about RMC financial statements. We also feel that a satisfactory outcome can never be achieved if RMC's are permitted to use statutory accounts to present service charge expenditure.

“True and Fair “

The argument that the proposals in FRED 50 are justified because they will result in a “True and Fair” view will be a difficult argument to sell to many non accountants and Industry experts. We believe most parties will find the proposals incomprehensible and particularly the treatment of matching income against expenditure in the Profit and Loss account.

Cost of implementation

The exposure draft, on page 8 and page 15, states that the true and fair view overrides the additional costs that will be incurred by RMC's in preparing accounts under FRED50. We consider these statements to be complacent and to show a lack of understanding of the environment in which RMC companies operate. These companies are usually non trading companies and are set up with sole purpose of managing the properties effectively. Directors of Resident Management Companies are coming under increasing pressure to keep costs down and all parties will be reluctant to incur additional costs just to meet technical accounting requirements. The accountancy profession needs to keep in mind the political implications of adopting policies which result in increased costs on households.

Conclusion on FRED50

We do not agree with the cost / benefit analysis included in FRED50. We believe that the exposure draft fails to address the complexity of the issues arising from the proposals and that it will fail to provide useful information and consistency in reporting. On the contrary, we think it will create confusion and undermine TECH03/11 and result in increased costs without achieving the declared benefits.

However, we do recognise that the legal opinion that RMC's always act as principals in transactions with third parties now needs to be addressed. As a result of this we fully agree that the filing of dormant company accounts for these companies is no longer appropriate.

OUR PROPOSAL

Our proposal is that expenditure is included in the Profit and loss account of the company but in the form of a single line entry. A matching amount for income will be included so that the solution of FRED50 is effectively retained. The disclosure requirement of cash held in trust would also be retained. We have attached a template of how the accounts might look for the company in these circumstances (Appendix 1). The inclusion of ground rents and other sources of income in the accounts and the tax charge can also be readily accommodated in these accounts if the circumstances require (see Appendix 2). The complex issues we referred to earlier can all be overcome as long as statutory accounts are not used to replace service charge accounts prepared under TECH03/11.

As these accounts can be prepared by inserting two figures (total expenditure incurred with third party suppliers in the year and disclosure of trust bank balance at the year end) into a template then the costs of producing the statements should be minimal. Provided that the detailed profit and loss account is not used to convey detailed service charge transactions then we are happy to support FRED50.

The advantages of this approach are that the thrust of FRED50 is retained and the Principal / agent controversy is overcome but without significantly increasing the costs of implementation. It also ensures that TECH03/11 retains its status as best practice guidance for Service Charge accounts.

Subject to the above caveat we agree with the proposed effective date.

A handwritten signature in black ink, appearing to read 'Gordon Whelan', with a long, sweeping horizontal stroke extending to the right.

Gordon Whelan ACA FCCA AIRPM

On behalf of Gordon Whelan Associates Limited

APPENDIX 1.

Registered number

xxxxxxx

XXX Management Company Limited

Private Company Limited by Guarantee

Report and Accounts

31 December 2014

XXX Management Company Limited
Report and accounts
Contents

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Profit and loss account	3
Balance sheet	4
Notes to the accounts	5

XXX Management Company Limited
Company Information

Directors

XXXXXXXXXXXXXXXXXX

Secretary

XXXXXXXXXXXXXXXXXX

Registered office

XXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXX

XXXXXX

Registered number

XXXXXX

XXX Management Company Limited
Directors' Report

The directors present their report and accounts for the year ended 31 December 2014.

Principal activities

The company is not a trading company. The company's principal activity during the year continued to be the maintenance and management of the property at xxxxxxxxxxxxxxxx

As part of the management of the property, service charges are collected from lessees to meet the costs of managing and maintaining the property. Service charges are held in trust for the benefit of the lessees.

The company recognises service charge expenditure arising from the management and arrangement of maintenance of the property in its profit and loss account. The company also recognises income in the profit and loss account by drawing from the service charge monies an amount of money to meet the expenditure incurred by the company on behalf of the lessees.

Directors

The directors who served during the year was as follows:

xxxxxxxxxxxxxxxxxx

Small company special provisions

The report of the directors has been prepared in accordance with the special provisions relating to companies subject to the small companies regime within Part 15 of the Companies Act 2006.

This report was approved by the board on

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xxxxxxxxxxxxxxxxxx

Director

XXX Management Company Limited
Profit and loss account
31 December 2014

	Notes	2014 £	2013 £
Other Income			
Funds collected to discharge obligations under lease	2	5,000	6,000
Expenditure incurred to discharge obligations under lease		(5,000)	(6,000)
Operating profit and profit on ordinary activities before tax	3	-	-
Tax on profit on ordinary activities	5	-	-
Profit for the financial year		-	-

XXX Management Company Limited
Balance Sheet
as at 31 December 2014

	Notes	2014	2013
		£	£
Current assets			
Other debtors	5,000	6,000	
	<u>5,000</u>	<u>6,000</u>	
Creditors: amounts falling due within one year	(5,000)	(6,000)	
Net current assets		-	-
Total assets less current liabilities		-	-
Net assets		-	-
Capital and reserves			
Profit and loss account		-	-
Shareholder's funds		-	-

These accounts have been prepared in accordance with the special provisions relating to small companies within Part 15 of the Companies Act 2006 and with the Financial Reporting Standard for Smaller Entities (effective April 2008).

The company is entitled to exemption from audit under Section 477 of the Companies Act 2006.

The members have not required the company to obtain an audit of its financial statements for the year ended 31 December 2014 in accordance with Section 476 of the Companies Act.

The directors acknowledge their responsibilities for ensuring that the company keeps accounting records which comply with Sections 386 and 387 of the Companies Act 2006 and for preparing accounts which give a true and fair view of the state of affairs of the company at the end of the financial year and of its profit and loss for the financial year in accordance with s394 and s395 and which otherwise comply with the Companies Act 2006 relating to financial statements, so far as applicable to the company.

Signed by

XXXXXXXXXXXXXXXXXX

Director

Approved by the board on

XXX Management Company Limited
Notes to the Accounts
for the year ended 31 December 2014

1 Accounting policies

The accounts have been prepared under the historical cost convention and in accordance with the Financial Reporting Standard for Smaller Entities as amended (effective April 2008).

Service charges raised and expenditure

The company is responsible for the management of the property at xxxxxxxxxxxx, xxxxxxxx, xxxxxxxx. The company collects service charges from lessees in order to fund expenditure incurred in the management of the property. These service charge funds are held in trust for the lessees as required by the Landlord and Tenant Act 1987.

During the year the company incurs expenditure in fulfilling its obligations under the lease for the property. The total costs incurred are recorded in the company's profit and loss account as funds collected from lessees to discharge obligations under the lease.

To meet these obligations the company draws from service charge funds held in trust on behalf of the lessees.

A detailed summary of expenditure incurred in the period is available to the lessees of the property under the terms of the lease and is prepared under best practice guidance for the preparation of Residential Service Charge Accounts (TECH03/11).

2 Cash at bank

Unspent amounts of service charges held in the company's bank account are held by the company on trust in accordance with s.42 of the Landlord and Tenants Act 1987.

At the year end the amount of funds held in trust was £xx,xxx (2011 - £xx,xxx).

3 Share Capital

The company is a company Limited by Guarantee and as such does not have an issued share capital. In the event of a winding up the members have guaranteed to contribute towards the assets of the company.

APPENDIX 2.

Registered number
xxxxxxx

(COMPANY HAS OTHER SOURCES OF INCOME)

XXX Management Company Limited

Private Company Limited by Guarantee

Report and Accounts

31 December 2014

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This report was approved by the board on

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Director

XXX Management Company Limited
Profit and loss account
31 December 2014

	Notes	2014 £	2013 £
Other Income			
Funds collected to discharge obligations under the lease	2	5,000	6,000
Ground rents received		1,250	1,250
Gross profit		<u>6,250</u>	<u>7,250</u>
Expenditure incurred to discharge obligations under the lease		(5,000)	(6,000)
Administration fees		(80)	-
Operating profit and profit on ordinary activities before tax	3	<u>1,170</u>	<u>1,250</u>
Tax on profit on ordinary activities	5	(234)	(250)
Profit for the financial year		<u>936</u>	<u>1,000</u>

XXX Management Company Limited
Balance Sheet
as at 31 December 2014

	Notes	2014	2013
		£	£
Current assets			
Other debtors		5,000	6,000
Cash at bank and in hand	2	<u>2,170</u>	<u>1,250</u>
		7,170	7,250
Creditors: amounts falling due within one year		<u>(5,234)</u>	<u>(6,250)</u>
Net current assets		<u>1,936</u>	<u>1,000</u>
Total assets less current liabilities		<u>1,936</u>	<u>1,000</u>
Net assets		<u>1,936</u>	<u>1,000</u>
Capital and reserves			
Profit and loss account		1,936	1,000
Shareholder's funds		<u>1,936</u>	<u>1,000</u>

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