

JH/MS

11 November 2013

Financial Reporting Council  
Aldwych House  
71-91 Aldwych  
LONDON  
WC2B 4HN

Dear Sir[s]

**Fred 50 – Residential Management Company’s Financial Statements**

I have acted on behalf of Residents Management Companies since 1980 working originally as a manager with a top ten firm of accountants and since 1984 as a sole practitioner. Over the years I have noticed the increase in the number of RMCs being dealt with as blocks of flats have been constructed and also residents/leaseholders have taken on board the management of the properties into their own responsibility through Right to Manage Companies. I have noticed that whereas in the 1970s flats were managed on a landlord and tenant basis throughout the 1980s onwards builders have commenced the financial affairs of residential blocks of flats by forming a purpose built resident management company and have used this as the vehicle through which the management and maintenance of the property is conducted. The members of these management companies are invariably the leaseholders of the properties for which the management is undertaken.

The history surrounding the enactment of the Landlord and Tenant Acts was that of providing security for lessees in landlord and tenant situations that existed before the 1980s where some unscrupulous landlords would utilise service charge monies incorrectly or without due accord to the wishes of the leaseholders. Due to these situations the Landlord and Tenant Act created a “statutory trust” in order to secure the funds built up and in the hands of the freeholder.

I am totally in favour of the concept of statutory trust for those situations where a landlord is directly involved in the management of a property, however, for resident management companies this situation does not exist. The resident management company together with the leaseholders are contracted together through the lease to pay service charges to the resident management company and for that RMC to maintain and manage the common areas of the property on behalf of the leaseholders. As the leaseholders are directors/members of the company and the directors have to abide by the Articles and Memorandum of Association which in the case of RMCs is written to ensure that the company acts as a resident management company abiding by the lease the directors are duty bound to act in the best interests of the leaseholders and also to administer the terms of the lease. Under these situations I cannot understand why a statutory trust is necessary to secure the interests of the leaseholders/members of the RMC as they are fully in control of the activities of the RMC and the assets which have been build up within that vehicle. Both landlord and tenant law and company law gives the members/leaseholders ample ability to counter any wrongdoing within the company by directors through the minority shareholder procedures and with recourse to the leasehold valuation tribunal.

I agree with the statement in FRED 50 that these companies act as principal and in fact I have always treated resident management companies as acting as principals. I have mentioned earlier the lease creates a contract between the leaseholder and the resident management company to pay service charge and to have that service charge expended under the terms of the lease to manage and maintain the common areas.

I do not understand how FRED 50 wishes accountants to disclose monies held. I have always shown balances of monies and debtors as being assets of the company and in fact in certain areas of FRED 50 it would appear to state this. Then it contradicts itself in other paragraphs stating that the company should not disclose monies held on trust. How can the balance sheet balance without the inclusion of all assets and liabilities?

If such companies, where the members are leaseholders and referring back to my earlier statements regarding the lack of necessity for a statutory trust in an RMC should it not be possible to refrain from declaring that the monies held within the balance sheet as being held on trust and reserve this statement for non-RMC accounts.

Some properties receive income from outside sources such as telephone radio masts etc and have had that income for many many years and those funds have been built up within a company's bank account. If statements of monies held in trust are to be made within the accounts of a limited company how will we as accountants calculate how much of that money is actually in trust and how much is non-trust monies being derived from non-service charge income. It might be impossible to determine what expenses should have been deducted from those non-service charge incomes in order to arrive at a figure of non-trust monies held at the balance sheet date.

Also where a levy is raised in order to improve the position of a company which can be approved at an annual general meeting or by the directors are these single one-off charges to be treated as service charge or non-service charge income and how are any balances to be shown in the balance sheet.

I have been unable to determine whether or not service charge debtors are to be treated as amounts within the trust from the wording in FRED 50 and if these amounts are to be treated as trust assets this would appear to be contrary to the contract created by the lease by which the RMC is empowered as a principal to charge the leaseholders a service charge rendering the service charge debtors as a contractual debt, the company having acted as a principal.

Am I correct in my understanding that in the FRSSEE at 3.11 the FRED states that "cash and other assets should not be recognised in RMC balance sheet". If this is correct how does a balance sheet balance.

If expenditure is incurred by an RMC as a principal and based on the contractual relationship created by the lease service charge income is being charged to the leaseholders as a principal it must follow on that any balance of this income minus expenditure should be treated as full assets of the company and not under trust and that the trust status relates purely to landlord and tenant situations.

In summary:-

- 1/ I agree that an RMC trades as a principal.
- 2/ I consider that all cash and other assets should be shown in the RMC balance sheet.
- 3/ I do not agree that a note should be made in the accounts that the monies are held on trust.

Yours faithfully

**for JOHN HARRILD & CO.,**

**JOHN HARRILD**

Encs

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