

Fact Sheet 3

Service charge accounting

Clarification of proposed changes to service charge accounting

The Accounting Council, which has recently replaced the Accounting Standards Board (**ASB**), is to consider whether further guidance is required in order to introduce the mandatory disclosure of service charge transactions in the statutory accounts of Residents' Management Companies (**RMCoS**) and Right to Manage Companies (**RTMCoS**).

The ASB, under the auspices of the Urgent Issues Task Force (UITF), issued on 10 May 2012 a draft consultation document, Information Sheet 92, with a view that once the consultation period ended the details of Information Sheet 92 would be adopted as best accounting practice by the accounting bodies for statutory accounts periods ending after 31 December 2012.

The Association of Residential Managing Agents (ARMA) and the Institute of Chartered Accountants in England and Wales (ICAEW) have opposing views as to whether the proposed changes should be implemented.

The ICAEW's view is that RMCoS and RTMCoS must disclose service charge transactions in their statutory accounts since they invariably act as principal when any service charge expenditure is incurred. ARMA, however, considers that this is unnecessary because the service charge funds are held in trust and should not be reflected in the statutory accounts.

It is uncertain as to when the Accounting Council will give, indeed whether they will give, further guidance since the UITF was disbanded on 2 July 2012. Until such time as further guidance is given there is considerable uncertainty amongst RMCoS and RTMCoS alike who are seeking to understand how the new changes could affect their accounting disclosures.

LEGAL ADVICE:

Counsel's opinion provided to the ICAEW stated that RMCoS and RTMCoS (and any other landlord) can be considered as the 'principal' for service charge expenditure but this fact was not important in this context. However, what was important was the creation of a trust by s42 of the Landlord & Tenant Act 1987. The trustee relationship, together with the limits set by leases on the use of service charge monies, means that an RMCo cannot make use of the service charge monies for its own purposes, only deploy them.

CLARIFYING THE ICAEW'S AND ARMA'S VIEWS:

The ICAEW's view is that because an RMCo is the 'principal' when any service charge expenditure is incurred, it must disclose this expenditure in its statutory accounts to Companies House. ARMA disagrees with the ICAEW's response and has previously submitted its own opposing views to the Accountancy Standards Board and to ICAEW.

Following a meeting between ARMA and ICAEW in October 2012, ICAEW confirmed that it had no intention of revisiting Tech 03/11 on service charge accounting guidance and understood the importance of following the requirements of leases. However, the ICAEW remains convinced that service charge income and expenditure should appear in the statutory accounts of RMCos and RTMCos as well as some balance sheet entries.

ARMA still asserts that there is no need for such disclosures to become mandatory since the service charge monies are held in trust, and it is not necessary to report them in the statutory accounts.

A FURTHER CONSIDERATION FROM ARMA:

ARMA has highlighted that if the ICAEW pursues the introduction of this regulation for RMCos, it may also support the same approach for freehold owning companies or other companies named in 3-party leases. ARMA is concerned that this would create practical problems for a landlord with varying year end dates for different schemes and different managing agents for a portfolio of schemes.

FINAL DECISION:

The Accounting Council has already received a number of consultation responses from other parties and, it is hoped, will give final guidance to the accounting bodies so as to avoid the current uncertainty with regard to accounting disclosures for RMCos and RTMCos. No indication as to when any additional guidance will be provided has been given. In the meantime preparers of statutory accounts for RMCos and RTMCos need to be vigilant as to any changes.

Accounting for residential service charges in the property industry is a specialised area that requires strong expertise and understanding of the sector. For further clarity of the draft abstract and specialist advice in this area please contact:

Nick Bullen on nickb@whitleystimpson.co.uk or **01295 270200**

Whitley Stimpson accepts no liability to any person for any inaccuracy in any of the information on this fact sheet. Contact Whitley Stimpson for specialist advice in this area.