

Fact Sheet 2

Service charge accounting

Clarification of proposed changes to service charge accounting

The Urgent Issues Task Force published a draft abstract (10 May 2012) regarding the accounting treatment of residential management companies (**RMC**) when they deal with transactions for tenants.

This is now open for consultation until 13 June 2012 and will apply to accounting periods ending after 31 December 2012 although early adoption is permitted.

The draft abstract follows a request from the Institute of Chartered Accountants in England and Wales (**ICAEW**) to consider the treatment of transactions relating to residential service charges in the financial statements (statutory) accounts of RMC.

There is currently widespread confusion as to what transactions should be recorded in RMC financial statements with variation demonstrated throughout the industry.

LEGAL ADVICE:

Legal counsel has been received by ICAEW, advising that irrespective of whether a RMC was acting as a landlord or agent, the cash balance representing contributions received from lessees in accordance with the terms of their leases and held by a RMC under S.42, Landlord & Tenant Act 1987, is held on statutory trust and is not an asset of the company.

OBJECTIVES SET FOR THE DRAFT ABSTRACT:

- Assisting RMC to recognise which transactions need including in financial statements by helping them to recognise whether they are acting as principal (landlord) or agent.
- In addition to RMC recognising their position, it is important for those who enter into a financial agreement with them, including residents and creditors, to know the RMC position.
- Preparation for statutory duties – this confirms that money collected as service charges, need to be held in a statutory trust on behalf of the tenants under Section 42 Landlord & Tenants Act 1987.
- Protecting tenants needs and those who use RMC financial statements by disclosing where tenants can get information on transactions that have occurred.

THE DRAFT ABSTRACT EXPLAINED:

The accounting treatment should follow an assessment of whether the RMC is acting as an agent or principal in the transactions that it enters in to. Guidance in the area is given in FRS 5 and in most cases the RMC is likely to be acting as an 'undisclosed agent' on behalf of tenants.

HOW IS THE ABSTRACT APPLIED TO A PRINCIPAL OR UNDISCLOSED AGENT?

The accounts for the RMC should recognise the costs that it has incurred on behalf of the tenants, as these contracts are a legal liability. If acting as an undisclosed agent, the RMC has entered in to a contract with the supplier and has a legal liability to make the payment. The RMC also has the right to recover the costs from a trust account held on behalf of the tenants.

Under this proposal the turnover of the RMC is the amounts recovered from the trust for the services that it has contracted for. The trust account is not an asset of the company so the balance sheet would show the amount recoverable as either cash in its bank account or debtor.

HOW IS THE ABSTRACT APPLIED TO AN AGENT FOR THE TENANTS?

If the RMC is acting as the agent, it must be disclosed to any supplier. The accounts would show no transactions undertaken on behalf of the tenants but would disclose any commission earned for dealing with the transactions.

If no commission is charged it is possible that the RMC would meet the Companies Act definition of dormant and so could prepare dormant accounts. The draft abstract says that the accounts should disclose where the tenants can get information on the transactions that have occurred and been dealt with by the RMC as their agent.

JUNE DEADLINE:

The draft abstract is now open for consultation until the 13th June 2012 and there will undoubtedly be further discussion before an overriding decision is made.

When taking into consideration the legal aspects as well as accountancy requirements, the draft abstract provides increased practice guidance giving greater clarity to this topical subject.

Accounting for service charges in the property industry is a specialised area that requires expertise and an 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. The draft abstract has been prepared by the Urgent Issues Task Force (10 May 2012). Contact Whitley Stimpson for specialist advice in this area.