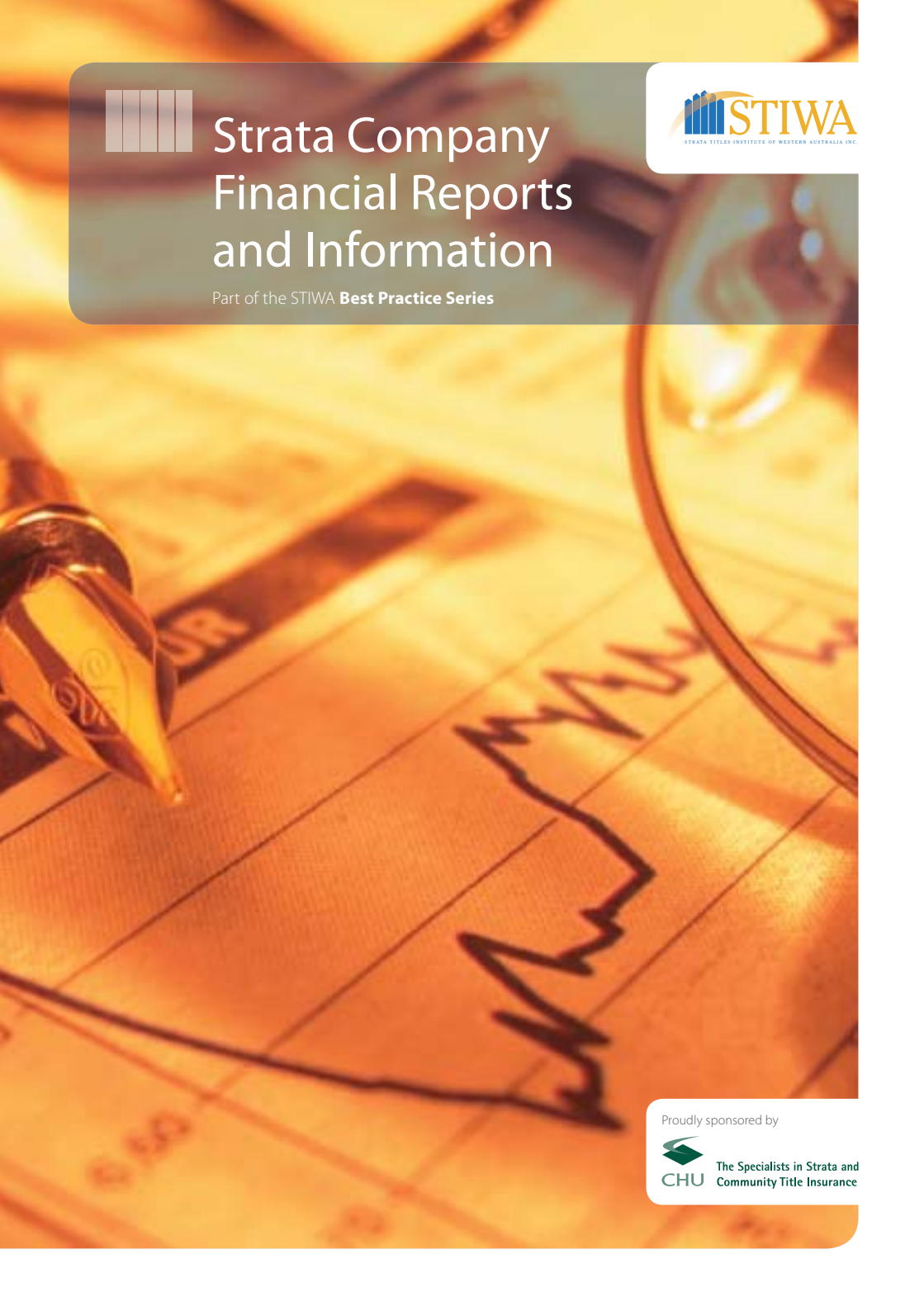




Strata Company Financial Reports and Information

Part of the STIWA **Best Practice Series**



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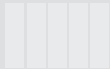


This booklet is one of three in the Best Practice Series dealing with the relationship between strata company managers and their client strata companies. You are encouraged to obtain and consider the contents of all three booklets.

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Purpose of this booklet

This booklet provides strata company managers and their client strata companies with guidelines as to the type and frequency of financial reports and information which should be available and provided. These guidelines are of a general nature and individual strata management firms may use a different format of presentation and strata companies may require the information to be presented in a specific manner.

The information provided is based on current generally accepted accounting standards and conventions which can be applied to the financial affairs of a strata company constituted by the Strata Titles Act 1985 (WA) **(Act)** using a double entry accrual bookkeeping system to record those transactions.

2 lot schemes are exempt from certain requirements of the Act unless they wish to comply and 3-5 lot schemes are able to exempt themselves from those same requirements. [s36A & 36B] This booklet does not differentiate for those exemptions. In this booklet, unless otherwise stated, a reference to by-laws is a reference to the by-laws contained in Schedule 1 & 2 to the Act.

Reference should also be made to other booklets in this series "Role of the Strata Company Manager" and "Appointment of a Strata Company Manager". The Guides are available from the STIWA office or are free to download in PDF file format from the STIWA website at www.stiwa.com.au.



Financial status of a strata company

A strata company is a unique form of body corporate which is not subject to Australian Corporations' Laws but it is, nonetheless, a legal entity carrying on an enterprise and is subject to Australian tax laws. The income tax law principles are set out in the Australian Tax Office document IT2505.

The primary source of income of a strata company is derived from the levied contributions of lot proprietors (**Owners**) For income tax purposes this income is treated as "mutual income" and not assessable to income tax. Other income may not be treated that way. It is therefore important to clearly identify and separate the various income streams.

A strata company is able to borrow and invest money and may do and suffer all things as are necessary for or incidental to the purposes for which it is constituted.

Owners are not concerned with obtaining a financial return from their equity or contributions to the strata company's funds. They are more interested in preserving the value of their investment and ability of the company to meet its obligations and perform its functions, duties and the powers from a sound financial position.



Financial management requirements

The Act and the standard Schedule 1 by-laws require that the following financial matters be established, notified, recorded, kept or prepared as is applicable and, as is relevant, be available for inspection by authorised parties and reported to the Council, Treasurer or all members.

- » Keep proper books of account. [s35]
- » Prepare an annual statement of accounts in respect of each financial year [s35]
- » Establish a sufficient fund for administrative expenses [s36]
- » Establish a discretionary reserve fund [s36]
- » Prepare a budget of estimated expenditure from the administrative fund for the ensuing year [s47]
- » Prepare a provision for likely future costs to be funded by the reserve fund [s36]
- » Prepare a funding proposal for levying contributions in respect of the administrative and reserve funds for the ensuing financial year [s36]
- » Notify each proprietor, or mortgagee in possession of a lot, of levied contributions [By-laws]
- » Record the amounts received against levied administrative or reserve fund obligations and other sources [s35]
- » Pay any insurance premiums and other financial obligations of the company from the administrative fund [s36]
- » Receive and record security deposits for any sub-metered utilities [By-laws]
- » Borrow money and secure those borrowings [s37]
- » Invest surplus money held in either the administrative or reserve funds [s37]



The Treasurer or the Council also have a duty to manage the following financial functions as required by the Act or a resolution of the strata company:

- » Comply with any restriction on the power to undertake expenditure in any one case [s47]
- » Notify all proprietors and first mortgagees of the purpose and amount of proposed un-budgeted expenditure as provided for in section 47(3) of the Act
- » Calculate the amount of simple interest payable on unpaid contributions [s36]
- » Recover a proprietors debt to the company pursuant to section 36(1)(d) of the Act
- » Recover from any proprietor any other sum of money due and unpaid [s36]
- » Compromise any action for the recovery of money from a proprietor [s36]

Most dedicated strata management computer software use the **accrual** method of accounting which is the preferred method of presentation and analysis of the real financial strength of a strata company. In contrast to cash accounting methodology the accrual method takes account of moneys received and paid as well as moneys owed and owing which properly relate to the financial period under review. This allows the owners to accurately assess the true financial health of their strata company.

Books of account

A strata company must keep proper books of account in respect of moneys received or expended showing those items in respect of which the moneys were received or expended. [s35(1)(f)]

There is no definition or further explanation in the Act of what comprises “proper books of account”. Generally such terms are taken to mean that the receipts and payments transactions are categorised by reference to a chart of accounts which identify the source of income and the recipient of expenditure. In smaller strata companies these may be very simple documentary records while in larger companies the accounts can be far more complex.

The elements of books of account are classified into five broad elements:

- » Income — operating and other revenue
- » Expenditure — operating business expenses
- » Assets — cash or cash equivalents, debtors, any personal property of the company and any GST credits
- » Liabilities — borrowings, trade creditors and tax/GST payable
- » Equity — the mutual net assets of the owners i.e. assets less liabilities

These 5 elements, when properly employed, provide an accurate and structured representation of the financial performance and position of the company.

If the strata company has established a reserve fund the transactions affecting that fund must be kept and accounted for separately. The money accumulated in a reserve fund is not available to meet current obligations unless the strata company has authorised its transfer to the administrative fund from where all financial obligations are discharged.



Statement of accounts

A strata company must cause to be prepared from its books of account, a proper statement of accounts in respect of each period commencing on the date of registration of the strata/survey-strata plan, or, the date up to which the last previous such statement was prepared and ending on a date not earlier than 2 months before each annual general meeting. [s35(1)(g)] This requirement applies equally to the administrative and reserve funds.

Again there is no definition or further explanation in the Act of what comprises a proper statement of accounts. Best practice is to provide an **Income and Expenditure Statement**, which is an annual historical summary of each income (receipts) and expense (payments) ledger account for the period under review. See also the section headed Income & Expenditure Statement below.

Some transactions are not recorded as either income or expenditure because they are to do with the acquisition or disposal of assets, or, the incurring or discharge of liabilities. These transactions are more properly recorded as **Balance Sheet** assets and liability changes. The Balance Sheet sets out the financial position of the strata company on the date of the ending period covered by the Income and Expenditure Statement. See also the section headed Balance Sheet below.

There is no requirement in the Act or the default by-laws for the books or statement of accounts to be formally audited. The records should still present a “true and fair view” of the financial position of the company. Larger strata companies often have their accounts independently audited and provide the Auditors report to members.

Financial Reports

Financial reports give an overview of the financial position of the company and are prepared and presented for the consideration of owners at each annual general meeting. They present information in a manner that provides relevant, reliable and understandable information to those who have a use for that information. Current accounting standards require that annual financial reports disclose comparative information in respect of at least the previous period for all amounts reported in respect of the current period. That comparability enables the owners and others to identify trends in financial performance and position.

The purpose of financial reports is to inform **owners** in respect of:

- » The historical financial performance for a specified **period** in the form of an Income & Expenditure Statement; and,
- » The financial equity or owners funds in the strata company and any changes in the financial strength of the company at a specified **date** expressed in a Balance Sheet.

Financial reports must be readily understandable by users employing a reasonable degree of diligence to review the information provided. Those providing these reports must be able to explain and discuss the terminology, effect and consequences of the information. Any accounting policies which are relevant to understanding the reports should be disclosed as a note to the relevant report.

Such reports are usually referred to collectively as **the Financial Statements** and should be relevant to those they are meant to inform. The relevance and materiality of information provided to owners in the Financial Statements is an important factor in the presentation. Too often at general meetings there is great debate over minor amounts, but little or none about a significant increase in the levy of contribution on owners.

It is also important that the Financial Statements be prepared and distributed quickly. The Act requires that they be in respect of a period ending not more than two months before being considered at the annual general meeting.

For the reasons discussed earlier separate reports are provided in respect to both the administrative and any reserve fund established by the strata company.

The **Treasurer** or **Council** may also require more regular reports and information and these are dealt with in more detail under the later heading of Financial Reports to the Treasurer or Councillors.

Income & Expenditure Statement

The Income and Expenditure Statement may sometimes be headed as profit and loss, financial performance or receipts and payments reports. Whatever the title, they are a summarised statement of the accounts from the “books of account” of the strata company. They report the total income and then the total expense as recorded in the books of account which are related to the financial period under review. Typically the difference between total income and total expenditure is shown as an income surplus or deficit for the year.

These summarised accounts need to be capable of comparison with the prior year’s results and the current years adopted budget. These comparisons allow owners to form an opinion as to the overall financial performance of their company and to identify trends or anomalies which might require further explanation or corrective action. They also provide a basis for objective consideration of the proposed budget of estimated expenditure for the coming financial year.

If there is both an administrative fund and a reserve fund there would be a separate Income and Expenditure Statement for each fund.

Some strata companies provide explanatory notes where there has been a material variation from budgeted income or expenditure. These notes serve to minimise the need for time consuming discussion of such matters at the annual general meeting.

An income and expenditure statement does not provide a complete picture of performance unless it is reviewed in conjunction with the Balance Sheet.



Balance Sheet

The Balance Sheet is a report of the financial position of the company on a particular date. It is a “snapshot” of the financial condition of the company at that balance date.

The accepted order of presentation of the Balance Sheet information is assets, liabilities and then owner’s equity/funds displayed as a single column list.

Assets

Include cash at bank or cash equivalents such as term deposits, accounts receivable such as unpaid levied contributions, any personal property of the company and perhaps GST credits.

Less,

Liabilities

Include accounts payable to trade and service providers, accrued expenses such as for work done but not invoiced to the strata company at balance date, any borrowings or tax/GST payable.

Equals,

Owners Equity/Funds

Includes the previous Balance Sheet total of owner’s equity/funds plus or minus the surplus or deficit for the past financial year (as shown in the Income and Expenditure Statement).

If there is both an administrative fund and a reserve fund these would be shown as a separate Balance Sheet or in a Consolidated Balance Sheet as different sets of headings and figures in respect of assets, liabilities and equity. It would be unusual for a strata company to differentiate between current and long term assets or liabilities.

Financial planning

The accounts of the strata company, the financial reports and statements referred to above are all based on historical information. Of equal importance is the planned future expenditure of the strata company and the income required to fund its operations.

As a means of differentiating between the obligatory administrative fund [s36(1)] and the discretionary reserve fund [s36(2)] it is appropriate to refer to the estimate for the administrative fund as a **Budget** and any estimate for a reserve fund as a **Provision**.

This allows attention to be focused on the immediate meeting of the budgeted costs of obligations from the administrative fund separately from the need to provide for non-routine expenses likely to occur at some future time.

The first recognises the duty to meet the immediate financial obligations whereas the second exercises the power to create a reserve and make provision for future contingent costs.

The planning process does not have to be technically complex and is not prescribed by the Act. It does need to follow a logical pattern of investigation, evaluation and calculation.

Financial planning does not end with the preparation of a Budget or Provision. The strata company also must take account of its cash flow and funding requirements which in turn can be affected by whatever “cushion” of working capital is available at the commencement of the period and the known timing of certain receipts and payments. See later sections on budgets, provisions and working capital.



Budget of Estimated Administrative Fund expenditure

A Budget is defined as an “An itemised plan of estimated expenditure for a defined future period of time.”

The Council, usually with considerable input from the strata company manager, is required to prepare and submit a Budget of estimated expenditure for the next financial year for the consideration and adoption by owners at the annual general meeting.

Subject to projected changes to reported historical costs, an itemised estimate of the future annual expenditure will enable the strata company to recognise administrative funding requirements to meet the planned expenditure as evidenced by the adopted Budget.

That estimate will take into account such things as:

- » Historical cost of recurring expenses inclusive of GST
- » Non-recurring expense such as completed major projects
- » Proposed new major projects
- » Known changes to costs based on information received
- » Major projects to be funded from accumulated reserve funds
- » Contingency for unexpected costs or working capital needs

The budgeting process should be commenced well in advance of the relevant annual general meeting to ensure that due consideration can be given to all of the elements. Sufficient time should be allowed for the obtaining of any necessary information, quotations or cost estimates.

The budget should be in such written form as will facilitate communication and understanding of what is proposed.

The effect of GST on the budget is the same whether or not the strata company is registered for GST. This is because the strata company pays GST on acquisitions of taxable goods or services and the owners are the consumers who fund and ultimately bear the cost of the GST.

Where any item or category is deleted, added or significantly differs from the previous period it is very helpful to prepare and provide explanatory notes about the assumptions that have been made.

Some simple statement of the basis of estimation gives planning credibility to the numbers and demonstrates that someone has actually considered them. This can be provided as either a note to the budget or a separate schedule of budget assumptions.

Owners can amend the Budget to increase or decrease individual items after debate at the annual general meeting. Provided that adequate consideration has been given to the itemised estimates it would be unwise for the Council to allow, without challenge, an unsubstantiated change to any part of the budget.

At some point in time the strata company will resolve to carry out the works for which the reserve fund, or at least part of it, was established and has been funded. Implementation of that decision establishes an obligation to incur expense and this will be included in the administrative fund Budget for that period. Previously accumulated reserve funds must be transferred to the administrative fund, from which all obligations are met. This requires a further and separate resolution authorising transfer of those reserve fund moneys to the administrative fund.

It is the budget which authorises the Council to incur and meet financial obligations which were agreed by the owners as a reasonable estimate of what financial resources will be needed to meet the fixed and variable costs of performance of the duties, powers and function of the company over the next financial period.



Provision for accumulation of reserve funds

Care must be exercised in maintaining the separate recording and reporting integrity of administrative and reserve fund receipts and payments. Section 36(2) (a) of the Act refers to major expenses of the strata company likely to arise in the future. A reserve fund Provision is defined as “The best present estimate of the cost of a liability likely to arise in the future.”

It is advisable for the strata company to prepare a life cycle analysis for major common property assets such as, building structures, lifts, roof, driveways and car-parks, paint and similar depreciating assets or improvements which are the ultimate financial responsibility of the strata company and provide benefit or amenity to present and future owners.

This will usually require an appraisal and report from a suitably qualified professional such as a structural engineer, quantity surveyor, tradesman or component supplier. The report should include the current cost of carrying out the required work. These cost estimates should be reviewed at planned regular intervals relevant to the estimated life cycle of the component. The estimated cost of such works should be reviewed each 5 years or such lesser period as is appropriate.

The reserve fund Provision is not “an itemised plan of estimated expenditure for a defined period of time” as is the case for the administrative fund Budget. In a reserve fund the strata company is providing for an accumulation of money for the medium to long-term major costs which are not of a routine nature. The Provision should include the GST at the current rate and the levy of contributions should be set to raise the current proportion of the GST-inclusive cost.

Owners are able to amend the proposals and increase or decrease individual items after debate at the relevant general meeting. If the estimates are based on sound assumptions and professional advice it will be difficult to argue for an amendment to the Provision proposed by the Council.



Working capital and the funding proposal

The term working capital is used to describe the amount of money that is readily available for the purchase of goods and services, payment of wages and other current operating costs from the administrative fund. It is a measure of both the financial efficiency of the company and its short term financial health.

The strata company must have a working capital and cash flow budget which ensures that sufficient funds are available, as and when required, to meet the anticipated obligations during the financial period covered by the Budget period, usually 12 months.

The three factors which have effect are:

- » The cash available at the beginning of the period
- » The projected timing of receipt of levied contributions or other known sources of income
- » The expected timing of payment of expenses

The strata company is required to have sufficient funds to meet its administrative expenses, insurance premiums and other obligations. Having prepared and communicated a Budget for the consideration of the annual general meeting the Council should also prepare a funding proposal which takes account of available cash resources. It is by this funding proposal that the Council will propose, as a separate agenda item, the levy of contributions to raise a specific total sum during the period for the administrative fund. That amount may be more, less than, or the same as the total estimated expenditure for the period.



For example, if the operating funds held by the strata company provide adequate working capital then the suggested levies would usually equal the estimated budgeted expense. But, if there was a shortage or oversupply of those cash resources, the suggested levy might be more or less than the estimated expenses.

Each strata company should evaluate what short, medium and long-term financial obligations it has, or is likely to have for maintenance, insurance and other operating expenses.

For example a strata company for a survey-strata scheme with minimal common property may only need to insure for minimal replacement value, legal liability and workers compensation cover attached to an “above and below ground” common property improvements insurance policy, plus incidental administrative costs.

However, a strata company for a multi storey residential or commercial development may have a quite complex and detailed Budget of estimated expenditure for the coming year as well as Provisions for major building repair or replacement, insurance and administrative costs.

The information provided to the Treasurer or the Council will generally be much more detailed and supplied more often than that provided to owners annually.

Information which is helpful in the micro-financial management process could include:

- » Interim Income and Expenditure Statements and Balance Sheets for the Administrative and Reserve Funds
- » Levy positions report showing the status of owners levy payments, both prepaid and in arrears
- » Debt collection and recovery action status
- » Unpaid creditor invoices and works not yet invoiced
- » Works or services “in progress” for which payment will be necessary in the immediate future
- » Cash availability
- » Detailed income and expenditure transaction list or audit trail
- » Budget versus actual income/expenditure comparison for the current financial year to date
- » Trial Balance of the ledger.

These are financial management reports which enable the Treasurer or Council to responsibly authorise payments, delay undertaking of new works or seek further contributions. These reports would not ordinarily be provided to owners.

The Strata Titles Institute of Western Australia (STIWA) is the peak industry body for people and organisations working in the strata titles profession and associated industries in WA.

Our mission is:

“To be acknowledged as the foremost industry forum of professionals which establishes and mutually recognises members’ competency, integrity and practise standards, and promotes public confidence in the strata titles profession within Western Australia”.

Our members represent a wide range of industry sectors including strata company managers, surveyors, financial and insurance service providers, conveyancers, solicitors, real estate agents, property and strata title consultants.