

# KELLY + PARTNERS

CHARTERED ACCOUNTANTS

15<sup>th</sup> December 2016

Consumer Property Law Review  
Policy and Legislation Branch  
Consumer Affairs Victoria

By email: [consumerpropertylawreview@justice.vic.gov.au](mailto:consumerpropertylawreview@justice.vic.gov.au)

To whom it may concern

## Submission by Kelly + Partners

### Options Paper 1: Options for reform of the Owners Corporations Act 2006

#### Question 37: Which option, and why, represents the most appropriate way to differentiate the level of regulation of owners corporations according to size?

In response to Question 37 of the Consumer Property Law Review we refer to page forty-four, particularly paragraph six of the issues paper, which states:

*“These measures are designed to respond to the feedback that the current ‘lighter touch’ approach to the regulation of owners corporations with less than 100 lots or annual fees of \$200,000 is not working.”*

#### Improved Governance

Kelly + Partners agree that the current ‘light touch’ approach needs to be reviewed. Broadening the application of mandatory independent audits (which previously only applied to Prescribed Owners Corporations) will result in a greater level of assurance and therefore, we believe, improve and increase the confidence in the financial reporting of owners corporations.

Victoria does not currently require formal licensing for owners corporation managers and has no mandated owners corporation trust account reporting requirements, both of which we understand are included in this legislative review. It is our opinion that implementing these measures and broadening the application of mandatory independent audits of owners corporations will improve the governance of this significant sector of the Victorian economy.

In considering the proposed tiered structure in Table 1 as it relates to independent audits we comment as follows:

1. Tier 1 - No further comment as we believe mandatory audits of owners corporations comprising more than 51 lots will significantly improve governance and assurance.
2. Tier 2 - in our opinion, an independent audit is preferable to an independent review.

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Australian Auditing Standard ASRE 2400 *Review of a Financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity* governs the conduct of review engagements. While the review process is primarily limited to enquiry and analytical procedures, which are generally less time-consuming than substantive audit procedures, the assurance practitioner is still required to obtain an understanding of the entity's accounting systems, accounting records and internal control as they relate to the preparation of the financial statements.

As a result, for smaller entities the time required for a review will be similar to an audit, but the level of assurance provided by a review report is significantly less than an audit report.

In our experience, independent reviews may be appropriate where

- the cost of an audit is significantly greater than an independent review; and
- the entity is structured in a manner that provides a level of confidence in the controls over the financial reporting process.

As there is unlikely to be a significant difference between the cost of an independent audit and an independent review for owners corporations comprising between 10 and 50 lots, we believe an independent audit is affordable and provides significantly greater assurance.

Alternatively, the adoption of a monetary threshold for mandatory audits of Tier 2 owners corporations could be considered. We recommend a more clearly defined monetary threshold of \$200,000 (which is the current monetary requirement for Prescribed Owners Corporations) be applied. Please refer to our commentary below.

3. Tier 3 - for owners corporations in this category we consider an independent audit should only be required where the monetary threshold is exceeded.

## **Monetary Threshold**

In our opinion, the lot-based threshold should be supplemented by a monetary threshold for determining whether an independent audit of an owners corporation is required. The *Owners Corporation Act 2006* requires mandatory audits for Prescribed Owners Corporations only, being owners corporations which levy annual fees in excess of \$200,000 in a financial year or consisting of more than 100 lots.

We submit that the monetary threshold should remain at \$200,000, but should be defined as being the sum of

- total owners contributions (including special levies) raised for the year, regardless of whether or not they have been paid;
- any income of the owners corporation from any other source (this will include defect settlements, insurance receipts, income from common property such as from rentals including telecom towers etc); and
- any cash balances (deposits, bank and investment accounts) held by an owners corporation at the commencement of the year.

The above elements of the monetary threshold are similar to those contained in the recently released NSW legislation *Strata Schemes Management Act 2015* and *Strata Schemes Management Regulation 2016*, which we believe will significantly improve the governance and financial reporting of strata plans in NSW.

A monetary threshold will ensure that smaller owners corporations (as defined by lot size) will require an independent audit where significant monies are raised and cash held. Without such a monetary threshold a Tier 2 owners corporation could raise levies that match or exceed a Tier 1 owners corporation, yet be free from similar levels of scrutiny.

### **Inherent Risk In Low Regulatory Environment**

While we acknowledge that issues relating to the regulation of owners corporation managers, including licencing and the management of money held in trust, are addressed in the issues paper, we believe that strengthening the mandatory independent audit requirements is an appropriate response to improving financial governance.

In summary, we submit that the mandatory audit provisions should include the following:

1. The proposed Tier system described by Table 1 of Option 14A of the Options Paper.
2. For Tier 2 owners corporations:
  - replace the proposed obligation for an independent review with an independent audit; or
  - apply the monetary threshold referred to above for determining the application of the mandatory audit requirements.
3. For Tier 3 owners corporations apply the monetary threshold referred to above for determining the application of the mandatory audit requirements.

Thank you for the opportunity to contribute to the Consumer Property Law Review process.

Yours faithfully,



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