

29th August 2018

Owners Corporations Regulations 2018 RIS Submissions
Policy and Corporate Services
Consumer Affairs Victoria
GPO Box 123
MELBOURNE VIC 3001
Delivered by email: cav.consultations@justice.vic.gov.au

Dear Mr Cohen,

RE: PROPOSED OWNERS CORPORATIONS REGULATIONS 2018 RIS

This submission is confined to the Audit of prescribed Owners Corporations (acknowledged as an existing requirement) and the current proposal to require financial statements to be presented in accordance with the Australian Accounting Standards [AAS].

As a previously practicing Chartered Accountant and now Owners Corporation Manager, I perceive the impact on operations of all Owners Corporation Managers but more importantly the financial impost to Owner Corporations has been under estimated.

To address the audit cost, currently the audit of a large Owners Corporation (>150 lots and >\$300,000.00 in annual fees) is in excess of those set out in Appendix A: Table 15. Further, this does not consider the impact that further defining the accounting treatment through use of AAS will have on the detail of the audit to assess compliance.

What is the intent of an audit:

Prima Facie, the intent behind an Audit is to provide assurance to the lot owners that the financial statements are free from material misstatement. To ascribe an understanding of the lot owners with whom we work, this would be that the ‘the financial reports only contain the transactions that relate to our owners corporation for this year’. If we consider the true implications of this, and the nature of the cash collections to fund the operations of a Strata Community, auditing and presenting financials on a cash basis would be the most relevant, therefore the application of APES 310 as prescribed in paragraph 1.3 *Members in Public Practice in Australia shall follow the mandatory requirements of APES 310 when they Deal with Client Monies or when they act as an Auditor of Client Monies*.

However, due to the requirement to account for annual fees levied but not yet collected, the Strata industry has an alternate hybrid methodology that it employs in the preparation of financial statements, the “modified cash basis”.

The current “modified cash basis” that we teach within the *A100 – Introduction to Strata Management* conducted by the Strata Community Association, whilst not strictly an accounting concept with which I agree, is reasonably the most insightful reporting methodology for the recipients of the financial statements. It enables current or prospective Lot Owners to understand the revenue that ought to have been collected in the year, and the monies disposed of within the year, resulting in a net position of what the owners reasonably have available to apply to expenditure in the future.

Should the AAS be applied, the understanding by the intended recipient, whom may have little or no financial literacy, is likely to be limited if any. Fundamentally, this is due to the temporal timing differences between the collection of fees from the annual budget, the actual outflow of cash and the subsequent accrual reporting

prepared in accordance with AAS. It is likely that the desire for understanding will decrease and Lot Owners will likely only look at the cash at bank figure(s).

Potential impacts from the application of AAS:

Harmonisation with IASB for leases with the proposed amendments to AASB 16: Leases that is proposed to take effect from 2019. A common asset lease found in larger Owners Corporations is gym equipment. This will require the gym equipment to be brought to account as an asset of the owners corporation, with the lease liability fully reflected on the balance sheet discounted to present value of the future lease payments. Practically, this will not be an accounting process that the current software can execute, nor is it likely that without creating an unrealistic cost of development, will it be able to deliver.

Further, the application of AASB 116: Property, Plant & Equipment and AASB 13: Fair Value Measurement will cause confusion in respect of the presentation of financial statements. The application of these standards are likely to create balance sheet items, including reserves that do not enhance understanding for the users of the financial statements.

Should the above standard be applied, conflict with the Maintenance plan proposed under the Regulations may arise, causing complication in the provision of an audit opinion and interpretation.

The significantly increased workload to assess compliance with the AAS will not in itself create greater assurance or protections beyond the current audit requirements. It will also require retrospective application of the standards and therefore re-preparation of prior year financial reports to ensure accuracy, compliance and consistency of presentation of financial records.

Impact to Management Companies:

Whilst I believe the application of better accounting knowledge is appropriate throughout all industries, the application of AAS is likely to trigger one of two outcomes:

1. The cost of employing a duly qualified and experienced accountant to prepare financial reports for presentation to the Auditor in accordance with AAS will increase the cost of service delivery beyond the considered level in the Regulatory Impact Statement;
2. The cost of engaging a duly qualified accounting firm to prepare financial reports for presentation to the Auditor in accordance with AAS will increase the cost of service delivery beyond the considered level in the Regulatory Impact Statement.

In addition to the costs incurred by the current managers, there is insufficient oversight of Business Licencing Authority [BLA], CAV and other regulatory bodies to govern monitor the preparation and compliance. If we look to the Incorporated Associations Reform Act 2012, financial statements are required to be lodged. This provides a mechanism to mitigate the non-compliance.

Where this mechanism does not exist within the Owners Corporation Act 2006 [OCA] or the Owners Corporations Regulations 2018 [Regulations], we are likely to encounter rogue service providers unable to comply and therefore not achieving the desired outcome.

Further, it is likely that the amendments to the software may adversely impact the preparation of financial reports for non-prescribed Owners Corporations.

Currently, CAV & BLA have no minimum educational requirements or barriers to entry to operate as Strata Managers. Accordingly, the application of AAS may cause further confusion and non-compliance with the requirements of the OCA and Regulations through a lack of knowledge, awareness or capacity of managers operating in this market.

As a business with Owners Corporations with a financial year ending 31 December, we will be required, with less than 1 month's notice, be required to prepare AAS compliant financial reports. Currently our software is not capable of accounting for items in the manner required, with the expectation that we are able to convene and conduct a timely Annual General Meeting in early 2019 only facilitates no more than 7 months from date of submission, to achieve compliance and have a full redevelopment of our software and historical financial reports.

Recommendation:

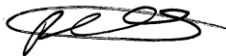
Enhancing the requirements and methodology for the preparation and presentation of financial reports prepared by Owners Corporations is a positive move in respect of consistency. However, it is imperative that the financial reports remain understandable to the non-financially literate users whom will receive them.

As an experienced accountant and strata manager, and having consulted with a registered Company Auditor, the imposition of AAS will simply increase the cost and create confusion. However, consistent with the current auditing requirements and Practice Guidelines issued by SCA Vic, I would support the mandate requiring reporting on an accruals basis for all Owner Corporations.

The requirement to prepare financial reports in accordance with AAS will not in itself improve the governance, mitigate fraud and reduce loss. There is a broader strategy of creating barriers to entry and minimum education requirements required to facilitate these outcomes.

It would be prudent to abstain from legislating/regulating an onerous task that is unlikely to deliver the desired outcomes without further engagement from software providers, owners and auditors.

Yours sincerely,



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