

The new *Strata Property Act* is overwhelming. Each month we attempt to inform and educate you on different provisions and we hope this process is helpful. If you need a copy of previous bulletins please feel free to ask your property manager. If you have joined your strata council in recent months you should obtain a copy of previous bulletins as they are most useful. The content of these bulletins does not purport to offer legal opinions or advice. You should retain and consult with legal professionals.

#### FEATURES THIS MONTH

- Investment Income – Guest Article by David Reid, CGA
- Borrowing from the CRF: How to Report It
- Payments to Strata Council Members

## INVESTMENT (INTEREST) INCOME

By David Reid, CGA

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The Strata Property Act clearly states in section 95(3) that investment income generated by the contingency reserve fund belongs to the contingency reserve fund. The Act is silent on the treatment of other investment income. There is no mention as to how investment income earned by funds attributable to the operating fund or a special project fund is to be treated. From a pragmatic perspective, it makes sense that investment income generated by the operating fund or a special project fund would be allocated to the fund responsible for generating that income, ergo back to the operating fund and/or the respective special project fund.

This perspective is partially supported by the CICA Handbook (Canadian generally accepted accounting principles). Section 4410.70 deals with the recognition of investment income for 'Not for Profit Organizations' which a strata corporation by virtue of the CICA's Emerging Issue Committee Abstract number 95 dated December 6, 1999, is. Section 4410.70 states:

An organization should recognize:

- (a) net investment income that is not externally restricted in the statement of operations in the *general fund*.
- (b) Externally restricted net investment income that must be added to the principal amount of resources held for endowment in the statement of operations in the endowment fund; and
- (c) Other externally restricted net investment income in the statement of operations in the appropriate restricted fund or, if there is no appropriate

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restricted fund, in the general fund on the same basis as that described in paragraph 4410.65 (that is in accordance with the deferral method).

To reiterate, the Strata Property Act externally imposes restrictions on investment income earned by a contingency reserve fund. The CICA handbook tells us that investment income not restricted externally is attributable to the general fund (read operating fund for strata corporations). In other words investment income earned by a strata corporation that is not specifically attributable to the CRF *is* to be allocated to the operating fund.

A strata corporation has the power to modify this by passing appropriate bylaws or incorporating into  $\frac{3}{4}$  vote resolutions an internally restricted allocation of non-contingency reserve investment income to something other than the operating fund. For example, a strata corporation undertaking a significant project may decide that any investment income earned on the monies collected for that project is allocated to that project, not the general fund. However, in the absence of a bylaw or appropriate wording in the  $\frac{3}{4}$  vote resolution dealing with the proposed project, investment income earned by the project's cash *must be* allocated to the operating fund.

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**David Reid is a Certified General Accountant with the Richmond firm of Reid Hurst Nagy. The firm does "hundreds" of strata audits, reviews and opinions each year.**

## BORROWING FROM THE CONTINGENCY RESERVE FUND

### How To Report it on the Financial Statement

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There is nothing new about borrowing money from the Contingency Reserve Fund. Strata corporations have been doing this for the last 30 years but the new *Strata Property Act* now provides for some very important procedures. The process is widely misunderstood and we hope that this article will shed some light on the topic.

First, a little history. Why did the legislation change? Before the new *Strata Property Act* became law, a strata corporation was not required to have separate "bank" accounts for the Operating Fund, the Contingency Reserve Fund or any other fund that might have been required from time to time such as a Building Envelope Remediation Fund, a Painting Fund, etc. Imagine then, a strata corporation with only one bank account and, from that bank account, all bills were paid whether or not the expenses related to the operating budget for the current year or for any of the other funds including the CRF. Many strata councils would spend money on various projects based on the amount of cash available in its single bank account. Reference to the balance sheet of the financial statement, which would identify the amount belonging to the Contingency Reserve Fund, was often overlooked with the result that, after a period of years, the strata corporation would be showing "a balance" in its Contingency Reserve Fund but, in fact, there would be no money to back up this balance. The money was effectively spent on annual operating expenditures. (We hasten to add that this scenario is in reference to strata corporations throughout BC, not VCS clients.)

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The provincial government was inundated with complaints by condo homeowners whose strata councils had fallen into this trap leaving their strata corporations without any CRF money. As a result, the legislation was changed so that the strata corporation now has to have separate bank accounts for the Operating Fund and the Contingency Reserve Fund. The idea here is that, by having separate accounts, the old problem would not reoccur. To a large extent, this has worked favorably; however, there are still some practical problems.

From time to time a strata corporation will, in fact, run short of money in its Operating Fund. Some strata corporations enjoy the luxury of having an Operating Fund surplus, but most strata corporations spend all their revenues in a given year and there is usually very little left over as accumulated operating surplus. This has been particularly evident in the last few years with the significant rise in gas costs and insurance premiums.

Let us assume that a strata corporation at the end of a fiscal year, lets say December 31<sup>st</sup>, has \$1,000 in its operating fund bank account. In January there are the normal operating expenses but, because it is wintertime, the gas costs are very high. Also, the annual premium for the insurance policy has to be paid in January and that in itself causes a huge draw on the operating revenues for the month of January. The bottom line is that there is not enough money in the Operating Fund bank account to pay all these invoices so the strata corporation then borrows money from its Contingency Reserve Fund bank account.

Operating Fund Cash Balance

Contingency Reserve Fund Cash Balance

- Dec. 31<sup>st</sup>

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	Closing Balance	\$1,000	\$15,000
•	Jan. 1 <sup>st</sup> Opening Balance	1,000	15,000
•	Revenue (strata fees)	<u>6,000</u>	\$ <u>600</u> (allocation)
	Total Cash	7,000	\$15,600
•	Expenses for January Shortfall	<u>10,000</u> (3,000)	
•	Loan from CRF	<u>3,000</u>	<u>(3,000)</u> Loan to Op. Fund
•	Jan. 31 Closing Balance	\$ Ø	\$12,600 Cash Balance

*Note that the equity balance of the CRF does not change. It remains at \$15,600 but the cash balance is \$12,600.*

Borrowing from the Contingency Reserve Fund is permitted by the *Strata Property Act*. Section 95, Management of Contingency Reserve Fund, says at subsection 4:

*"Despite subsection (2), the strata corporation may lend money in the Contingency Reserve Fund to the Operating Fund as permitted by the Regulations."*

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Regulation 6.3, Management of Contingency Reserve Fund, states:

- "(1) For the purposes of section 95 (4) of the Act, the strata corporation may only lend money in the contingency reserve fund to the operating fund if both of the following conditions are met:*
- (a) the loan is to be repaid by the end of that fiscal year of the strata corporation;*
  - (b) the loan is for the purpose of covering temporary shortages in the operating fund resulting from expenses becoming payable before the budgeted monthly contributions to the operating fund to cover these expenses have been collected.*
- (2) The strata corporation must inform owners as soon as feasible of the amount and purpose of any loan made under this section."*

If the borrowing of the CRF money occurs in the first month of the fiscal year, such as the example cited above, the strata corporation has virtually 12 months to repay the loan. In the event that the loan takes place near the end of the fiscal year, which does happen from time to time, it is unlikely that the strata corporation would be able to meet the requirement of the Regulations. From a strictly technical standpoint, a strata corporation would be in violation of the *Act* if it did not raise sufficient revenues, i.e., a special levy on the owners, to repay the loan. Most strata corporations simply budget, in the subsequent year, an adequate amount to repay that loan and while, technically, this does not meet the letter of the law, it does certainly meet the spirit of the law.

From a reporting standpoint, when the Operating Fund borrows money from the Contingency Reserve Fund, the receivable is reflected on the

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Contingency Reserve Fund's balance sheet as a loan receivable from the Operating Fund; and on the Operating Fund's balance sheet as a loan payable to the Contingency Reserve Fund. Some strata councils get very upset when they see this line entry on their financial statements and they often fire in a missile saying "*Who authorized you to make this loan?*" Good question indeed; however, it is not a matter of authorizing the loan because, in fact, the management company has no choice but to make the transfer in order to pay current invoices. Without making that transfer, current invoices such as the gas bill and the insurance premium would not be paid and, of course, that would not be acceptable. More to the point, strata councils whose financial statements reflect such loans should be cognisant of the very tight cash situation of their strata corporations and unnecessary spending should be curbed or deferred. If the situation is really critical (as it sometimes is if the strata corporation is facing huge costs to operate), a Special General Meeting of the corporation should be called and the owners asked to authorize a special levy.

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## PAYMENTS TO STRATA COUNCIL MEMBERS

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Section 34 of the *Strata Property Act* states:

*Approval of council member remuneration*

*Any remuneration paid to a member of council for the member's exercise of council powers or performance of council duties must be approved in advance of payment*

- (a) *in the budget,*
- (b) *in the bylaws, or*
- (c) *by a resolution passed by a 3/4 vote at an annual or special general meeting.*

Note the words "for the member's exercise of council powers or performance of council duties". It is clear that the section does not apply to:

- reimbursement of expenses such as parking, cell phone, etc.; or
- a contractual arrangement between the strata corporation and the member.

It does apply to such things as:

- overseeing a contractor's work;
- attending council meetings;
- attending to other council business such as visiting the management company to review financial statements, etc.

The *Act* does not say the member cannot be paid. What it says is that two things must occur first:

1. The money has to be in the budget.
2. The approval is either sanctioned by a bylaw or by a ¾ vote.

Although it is rare to see council members get paid, meeting the first requirement is generally not a big deal. Often the amount claimed is relatively small and can be "absorbed" by the budget. The real problem is with the second requirement. The wording is clear but we sometimes see councils "authorize" payments to a member stating that "we approved it at the last council meeting". A council meeting is not a Special General Meeting.

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