



FEATURES THIS MONTH

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1. HOW SAFE ARE YOUR STRATA FUNDS?

Did you see the front page story, *Vancouver Sun* (Friday, December 12, 2004) "*Accounting watchdog confesses to bilking clients*"?

"The Sun has learned about 20 clients have together lost well in excess of \$1 million, and those figures may increase as the investigation proceeds."

The money referred to in this article is strata corporation money. The "watchdog" was a governor of the Certified General Accounts Association of BC. She, Jo F. Coffey, operated a strata management agency which serviced a number of strata corporations in the Vancouver area and on the Sechelt peninsula.

We thought that, following such a startling story, our office would receive calls from our strata councils and/or your owners to enquire whether or not your strata corporation funds are safe. Hmm. Not a single call. You certainly are a trusting lot, but it does raise a question as to whether or not you should be so confident that nothing like this could possibly happen at VCS. After all, VCS is a well-known, "high-end" type of management company and it simply would not be possible to have strata funds disappear. Right? Read on.

Do you recall last year's story about Pat Derrick Management Ltd. - a Kelowna based strata management company that was the focus of a criminal investigation after the loss of over \$1 million of strata funds? Although the company was never charged, an employee pled guilty to theft. It seems that stealing strata corporation money is becoming more common, and apparently not all that hard to do. Interestingly too, is that the people who are at the leading edge of this new crime are "white collar" professionals, not some low-life street criminals. Pat Derrick Management Ltd. was licensed under the Real Estate Act of BC. Ms. Coffey was a governor of the Board of Directors of the CGA Association of BC. So much for professional designations and may we take this opportunity to warn you once again that within the next year the government of BC will be requiring strata management companies to be licensed under the Real Estate Act of BC. The purpose is to give you protection. Ha ha. Competence can be affected by licensing, at least in theory, but honesty cannot.

Anyway, here dear clients is how strata management companies can steal your money. It is a bit of a pyramid type of scheme which means that eventually the scheme fails but, just the same, it can be played out for a very long time before anyone twigs onto the scheme and asks questions which ultimately lead to the exposure of the grand larceny.

Here are, illustratively, ten strata corporations with varying amounts of cash holdings:

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Each strata corporation has its own "bank" account, although it is common to see strata corporations with more than one "bank" account. In fact, the more money a strata corporation has, the more likely you will find multiple bank or credit union accounts as well as various investment certificates at a wide range of financial institutions. Many strata corporations have huge amounts of money either because they are prudently building up their contingency reserve funds or because they are financing a leaky condo repair project or some other major repair program. The total money could be in the hundreds of thousands of dollars or even millions. The more money on hand, the more multiple accounts exist, and the more complex becomes the reporting format from the management company. Ironically, the strata corporations with very limited financial resources are generally free from risk. It is when strata corporations have lots of money spread out in various locations that it becomes easier to defraud the client.

Let's say that ABC Management (a fictitious name for the purpose of this article) takes \$10,000 from strata corporation client 1. The client receives a financial statement that accounts for all money but of course the financial statement is falsified to not report the \$10,000 which was stolen. The client is none the wiser. Always remember that a financial statement is only a piece of paper with a bunch of numbers entered onto it by the management company. You have no way of knowing that it is, in fact, truthful.

ABC Management gains confidence that its defrauding scheme is effective so it goes to strata corporation 2 and takes \$15,000 from its coffers. Now, once in a while ABC needs to cover its tail because someone at a strata council asks some questions. In order to satisfy such enquiries,

let's say from strata , ABC simply scoops/transfers \$10,000 from strata to strata .
Problem solved.

This shell game can go on and on for months and years before anyone catches on. In the case of Pat Derrick Management Ltd., the accounting clerk who perpetrated the fraudulent scheme had money flowing around from one account to another to such an extent that auditors appointed by the investigators were unable to piece it back together. Sloppiness on the part of the accounting clerk was what ultimately did her in. A half-decent excel spreadsheet would have made the larceny much easier to manage and keep safe from prying eyes. Nevertheless, so much money was shuffled around even investigative audits were unable to reconstruct the actual amounts misappropriated.

In some cases in the Kelowna situation, a few strata council members asked for bank reconciliations to accompany the financial statements. The idea was that, if a financial statement shows "bank balance: \$10,952.13", the reconciliation would have to show the same amount. A bank reconciliation document is a routine method used by accountants to verify the balance purported on financial statements. In the case of the Kelowna accountant, the bank reconciliations were provided but, the numbers were altered so as to make them match the financial statements. The clients therefore saw the same amount of money reported on the monthly financial statements as was shown on the bank reconciliations. What the clients really needed in addition to the bank reconciliations was a copy of the actual bank statement. Indeed, even a copy can be falsified by use of white-out, so the actual original bank or credit union statement is the only way to verify that the financial statement is truthful.

We are often asked by council members who are appointed as Treasurers of their councils what their duties and roles are in this capacity. Typically, the response and general impression of the role of Treasurer is "to closely review the monthly financial statements, to match disbursements recorded on the statement with invoice copies, to ask the agent important questions and so on". Although that is true, the correct answer is that the role of the Treasurer is to verify that the money purported on the financial statement is in actual fact the identical amount in the bank, credit union and/or investment vehicles. A Treasurer should ensure that your strata corporation's money is safe, ie. not stolen.

At VCS, we have over 200 clients. Count the boxes . . . , . . . , . Some of our clients, about 20%, do ask for and receive the monthly bank reconciliations accompanied with copies of the bank/credit union statements. We can only hope that these clients are reading this material to make sure it is accurate, ie. truthful. The remaining 80% of our clients are simply taking "our word for it" that what is shown on the financial statement is truthful. It is, but you don't know that. Considering that we have so many clients and that we are entrusted with tens of millions of dollars of your money, and considering that it is so easy to steal your money, perhaps you should consider the implications of this article.





2. WHAT YOU NEED TO KNOW ABOUT AN EARTHQUAKE

1. You are on your own. Do not count on your strata council or management company for assistance.
2. There is not a supply of food, water, blankets or other survival provisions stored anywhere on the property. You are on your own.
3. If there is natural gas service to your strata corporation there is no plan for shutting off the gas supply.
4. There are no arrangements for alternate living quarters if you are unable to return to your strata lot. You are on your own.
5. Depending on the severity of the earthquake, you may not be able to telephone/email the management company for assistance.
6. The contents of your strata lot, your automobile(s) and other personal property are not insured by the strata corporation. If you have made improvements to your strata lot, such improvements or betterments are not insured by the strata corporation either.
7. The strata corporation is insured for earthquake damage; HOWEVER, there is a deductible which means that there is no coverage for damages within that deductible. Generally the deductible is 10% of the value of the strata corporation although in some instances (ie. Richmond) the deductible could be 15% or 20% of the value of the property. In most cases this will amount to millions of dollars. Your strata corporation does not have reserve funds available to meet such a huge deductible. Repairs will have to be funded by one or more special levies. These could be substantial.
8. There is NO government plan or fund to assist either you or your strata corporation. You are on your own.

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While it would be nice to hear that there are plans and that there is a safety net, your strata council and VCS bring you the above information in an effort to alert you to the reality of an earthquake scenario. Accordingly, you need to develop your own personal plans for survival. Like many people, you will not be adequately prepared and that is "human nature". Please remember, however, that "You are on your own" is the only rule that counts.

3. IMPROVING CURB APPEAL

There is nothing in the *Strata Property Act* that requires a strata corporation to devote any time, effort or money to “make the place look better,” i.e. to improve its curb appeal. Yet, in reality, all our client strata councils do, in fact, very much fulfill their monthly roles keeping in mind the desirability of beautifying their properties, thereby enhancing the overall value of each owner’s investment. It is good common sense.

The problem, as always, is that it takes money to achieve these objectives. The only source of money is essentially strata fees and there is already enough pressure from the owners to keep fees from rising. Existing strata corporations are competing with many brand new strata corporations where everything is shiny and unspoiled. Additionally, the strata fees in new developments are generally much lower than in existing strata corporation properties. This is Artificially Low v. Reality - a really difficult hurdle to overcome.

Many strata lot owners in existing properties are upgrading interiors. We have seen an extraordinary increase in recent years of owners wanting to remodel the interiors, install hardwood flooring, etc. These are very positive steps which increase the value of individual strata lots and that benefits all owners. Buyers today are smarter than they used to be 10 or 15 years ago. Today they ask to read minutes and financial statements and the leaky condo crisis has taught them to keep their heads up for major special assessments. Nevertheless, most buyers are still principally driven by affordability, location in relation to schools and transportation, amenities and cosmetic appeal - ie. “curb appeal”.

Strata councils can undertake steps such as the following to enhance curb appeal:

- Keep the property clean and tidy
- Use landscaping, including flowers, to give instant attractive eye contact
- Upgrade lobbies, elevator cabs and other entry areas to look modern
- Replace common area carpets or damaged tile floor frequently
- Monitor storage of personal effects on balconies or patios. Enforce the bylaws in order to prevent the junky, cluttered look

- Produce professional quality minutes, financial statements and bylaws

No doubt you can think of other things that can be done at your strata corporation to enhance its beauty. Some aspects, such as enforcing bylaws and having good custodial services do not cost money. Other aspects do require funding and this places pressure on the annual budget. Owners always resist increased strata fees so it is vital to do a "sell job". Get them to understand that improvements and upgrades are of benefit to them either at resale if that's the plan, or just in terms of increased investment equity for the long-term residents.

From where we sit, it is our observation that our clients are all in favour of curb appeal. Keep up the good work folks.

HAPPY NEW YEAR





4. MINUTES: THE DEADLINE

Bylaw 19 of the Schedule of Standard Bylaws of the Strata Property Act states:

“The council must inform owners of the minutes of all council meetings within 2 weeks of the meeting, whether or not the minutes have been approved.”

VCS does not take issue with the concept. We do recommend, however, that you amend the bylaw to change “2 weeks” to “5 weeks”. There may be times when for very good reason circulating minutes cannot or should not be done within two weeks.

5. COUNCIL MEMBERS STANDARD OF CARE

Section 31 of the *Strata Property Act* states:

Council member's standard of care

31 In exercising the powers and performing the duties of the strata corporation, each council member must

- (a) Act honestly and in good faith with a view to the best interests of the strata corporation, and*
- (b) Exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances.*

At first blush, it is highly likely that virtually all owners elected to their strata councils would endorse the concept offered by Section 31. Indeed, VCS is unaware of any court cases or arbitrations that have dealt with violations of this statutory requirement. This is, of course, a good thing but an occasional reminder about this section is also a good thing.

The Act does not require you to be an expert. It does not require you to be a lawyer or engineer. It simply requires you to act honestly and in good faith which means that you must make your best efforts, openly, to do the right thing. At times that might mean obtaining engineering advice or retaining legal counsel. It also means following that advice if appropriate.

Here is an example. Let us say that a strata council embarks on a certain course of action but in the process receives advice from its legal counsel that the council is or may be in violation of the *Strata Property Act*. The council chooses to dismiss the legal advice as mere opinion which they do not like or support. Their agenda is set firmly in an opposite direction. Meanwhile an owner in the strata corporation states her opposition to the strata council's course of action and backs up her point of view with a solid legal opinion obtained by her at her expense. The council, again, sets aside the "free" legal advice as mere opinion which can be ignored.

Is this strata council acting honestly and in the best interests of the strata corporation? The course of action now charted by the council seems destined for very rocky shores and in all

likelihood will cost the strata corporation significant sums in legal defence costs, possible awards and so on. Can this be said to be acting in the best interests of the owners? It is hard to say and, to date, there have been few (if any) cases to look to for guidance.

The best advice we can give at this time is to apply the “smell test”. We concede that this is not very scientific but the point is that, in the absence of court precedents, there is not much to go on. It comes down to using your best judgment and relying on your professional advisors - even if it is advice contrary to your pre-set agenda.

Note Section 3 of the *Strata Property Act*

Responsibilities of strata corporation

3 *Except as otherwise provided in this Act, the strata corporation is responsible for managing and maintaining the common property and common assets of the strata corporation for the benefit of the owners.*

Note Section 4 of the *Strata Property Act*

Strata corporation functions through council

4 *The powers and duties of the strata corporation must be exercised and performed by a council, unless this Act, the regulations or the bylaws provide otherwise.*



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6. CASE LAW UPDATE

A recent decision of the B.C. Court of Appeal is of interest to condominium owners in strata complexes that are comprised of more than one "type" of strata lot.

On November 4, 2004 our Court of Appeal rendered its decision in the matter of Coupal v. Strata Plan LMS-2503. Jocelyn Coupal and a group of her fellow owners had commenced an action against their strata corporation, the purpose of which was to try to have their strata lots exempted from substantial special levies necessitated when other strata lots in the complex became "leaky".

Strata Plan LMS-2503 is a strata corporation comprised of 88 strata lots. Twelve of these are contained within a heritage building constructed in 1912 according to now antiquated building codes and no longer practiced building techniques and methods. Apparently, Ms. Coupal and her fellow litigants owned these strata lots and they did not leak. Conversely, the designers, planners and builders responsible for the much more recently completed remaining 76 units unfortunately took a more modern approach. In short, they collectively produced a leaky condo.

As the Court of Appeal put it: 'An important question for many British Columbians is: "Who pays for the costs of repairing a "leaky condo?" Before the *Strata Property Act* (the "SPA") came into force on July 1, 2000, the general scheme under the *Condominium Act* was that common expenses of a strata corporation were allocated to different "types" of strata lots. Under the SPA, the general scheme is that common expenses are shared proportionately by all the owners, without reference to "types" of strata lots.'

Quoting Mr. Justice Bauman from the LMS-1537 v. Alvarez case with approval, the Court said: 'The general rule under the SPA is that within a strata corporation, "you are all in it together". That is, the general scheme of the SPA is that expenses are allocable in the proportion that the "unit entitlement" of a strata lot is of the unit entitlements of all strata lots in the strata corporation. The SPA and its regulations do not permit the allocation of expenses raised by special levy to different types of strata lots unless:

- (a) The strata corporation has by a unanimous vote agreed to use a different formula for the allocation of contributions to the operating fund and contingency reserve fund, other than those set out in section 99 and the regulations (SPA s. 100);
- (b) The strata corporation has by unanimous vote established a "fair division" of expenses for that particular levy (SPA s. 108(2)); or
- (c) "Sections" have been created under Part 11 of the regulations (SPA s. 195).'

In this case none of these steps had been taken, so the Court found that special levies approved by LMS-2503 after the effective date of the SPA had to be contributed to by all strata lots on the basis of their proportionate unit entitlement.

The Court noted that there are transitional provisions in the SPA which allow for the continued allocation of certain costs on the basis of "types" of strata lots, where that was being done already pursuant to the *Condominium Act*. However, in order for that to apply, specific procedures had to be followed and LMS-2503 had not done so. The owners of strata lots in the water tight heritage building, therefore, had to contribute to special levies passed to repair the leaky strata lots that comprised the balance of the strata corporation.

In short, since a unanimous resolution changing the basis on which strata corporation costs are allocated is unlikely to be passed, the only real option available now to effect any such a change would appear to be to create sections. The SPA allows for sections to be created in basically three different situations, namely;

- (1) Where a strata corporation is comprised of non-residential and residential strata lots;
- (2) Where there are non-residential strata lots that are used for significantly different purposes (such as retail, office and restaurant, for example); and

- (3) Where the strata corporation has different "types" of residential strata lots. "Types" in this context are defined in section 11.1 of the Regulations to the SPA to be:
- (a) Apartment-style strata lots,
 - (b) Townhouse-style strata lots and
 - (c) Detached houses.

So, presumably the owners of LMS-2503 could create one section comprising the heritage building and one comprising the other strata lots to enable them localize responsibility for certain expenses, in the future. Sections apparently cannot be created, however, for different "phases" in a strata corporation unless, of course, the strata lots in such phases are of different "types."

7. CONTRACTS – AN OUNCE OF PREVENTION

Contracts for services such as painting, landscaping, window replacement and other similar services are a daily part of life for strata corporations. As a result, they have been for VCS too for some 25 years. During that time we have developed some "standard form" agreements and cover letters that are commonly used to outline the basic parameters of the services to be provided by a given contractor to a strata corporation client of ours. This is done only as a service to our strata corporation clients, and should never be taken to imply that we hold these agreements out to be perfectly suitable or appropriate for the intended purposes. These are laymen's agreements. These may be no more than the written equivalent of a handshake. If things go well, everyone is happy. If things go wrong, then any such agreement may prove to be quite inadequate. This hasn't happened yet, but one never knows when it might.

The point here is that VCS does not give our clients legal advice. Needless to say, we are not qualified to do so. Such advice must come from your own lawyers. Councils must decide if saving a little money by using one of our standard form agreements is appropriate in the circumstances each time a contract for services is to be entered into. Getting a lawyer to prepare, or at least review, each such agreement is another form of insurance. Yes, it costs money, but with that comes a level of comfort and security that is not otherwise available. This is especially so in this day and age of increased litigiousness.

On this topic, another thing to keep in mind is timing. By way of illustration, we saw a case some years ago where the strata corporation made the right decision - they went to a lawyer - but they made it at the wrong time - they went **after** the tendering process was complete and the terms and conditions on which the successful bidder had won the contract were therefore already agreed on. It is, of course, the terms and conditions themselves that are important, rather than the way in which one types and organizes them in a written agreement. VCS has great typists, as do all strata corporations no doubt, but they aren't lawyers.

Think about it, and remember the metric doctor's advice: 28.349 grams of prevention is worth 453.592 grams of cure.

