
The Annual Operating Budget

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The annual operating budget for the upcoming year is a document presented at the annual general meeting each year for approval. If you are a Council member you have worked hard to consider all the anticipated spending for the next year and you are confident that the expenditures proposed are needed to operate the Strata Corporation in the next year. If you are an owner, you are focused on how much more your strata fees are going to be in the next year. A decision has to be made by all the owners, so how do you decide? What should you be considering? This article will discuss how budgets are prepared and how to read the budget with understanding so that a good decision can be made.

REQUIREMENTS

The Strata Corporation must prepare a budget for the upcoming fiscal year for approval by a resolution to be passed by a majority vote at each annual general meeting (Strata Property Act 103 (1)). The regulations spell out what information must be in the budget:

- estimated expenditures out of the operating fund, itemized by category of expenditure;
- the total of all contributions to the operating fund;
- the total of all contributions to the contingency reserve fund;
- each strata lot's monthly contribution to the operating fund;
- each the opening balance in the operating fund and the contingency reserve fund;
- the estimated income from all sources other than strata fees, itemized by source;
- each strata lot's monthly contribution to the contingency reserve fund;
- the estimated balance in the operating fund at the end of the fiscal year;
- the estimated balance in the contingency reserve fund at the end of the fiscal year.

These are the basic requirements pursuant to the Strata Property Act (SPA) and Regulations but this is not enough guidance to know what should be in the budget and how much money will likely be spent for each line item in the budget.

PREPARING THE BUDGET

Before beginning, it is important for Council to have good clear objectives to guide the budget-setting process. This is necessary to avoid long-term problems which often result from having the wrong objectives. For instance, if Council's objectives are having strata fees as low as possible and with no increases, that may well be attainable for several years in a row but will ultimately result in a large, unexpected increase or to a dreaded special levy to fund an operating deficit or undertake special projects necessary because required maintenance was either not done or stalled off in order to keep strata fees at the same level.

The common property being maintained are long-term assets and even though the budget being prepared is for one year, Council should also consider the long-term maintenance of the common property.

From my perspective, simply 'the protection and maintenance of the value of the property' is a great overall objective that should result in:

- a modest, small-percentage fee increase each year;
- some tolerance in the budget for unforeseen issues;
- maintenance projects undertaken when needed;
- annual contributions to the Contingency Reserve Fund in accordance with the depreciation report; and

- special levies only for funding specific projects or enhancing reserve funds needed to address the depreciation report.

Utilities, maintenance and repairs

The next step is to assign values to the individual line items in the budget. For line items such as electricity, gas, garbage, and other utilities, the same as the previous year plus inflation will normally be appropriate. This is called **incremental budgeting**, where the previous few year's actual numbers are used plus any expected inflationary increase.

For the various repairs and maintenance line items, incremental budgeting is only partially appropriate. Regular routine maintenance that occurs every year can be incrementally budgeted, but any special maintenance projects that might be done less frequently or on an as-needed basis should be budgeted based on estimates of the work to be done. This is called **zero-based budgeting** where the budget is built up from zero each year based on estimates for the projects Council wants to undertake. To keep strata fees consistent with only inflationary increases each year, less frequent or as-needed projects should be spread over several years. For instance, if driveways need to be attended to every 2 years, and landscaping upgrades are also required every 2 years, Council could schedule the driveways in the current year and the landscaping next year.

The budget should also include a provision for those bills that tend to come in unexpectedly or that can vary drastically from year to year – things like snow removal, insurance deductibles, and 3 year insurance appraisals.

Contingency Reserve Fund (CRF)

Finally, the appropriations to the Contingency Reserve Fund need to be determined. The Strata Property Act requires if the amount of money in the Contingency Reserve Fund at the end of any fiscal year after the first annual general meeting is less than 25% of the total contribution to the Operating Fund for the fiscal year that has just ended, the annual contribution to the Contingency Reserve Fund for the current fiscal year must be at least the lesser of:

- 10% of the total contribution to the Operating Fund for the current fiscal year; and

- the amount required to bring the Contingency Reserve Fund to at least 25% of the total amount budgeted for the contribution to the Operating Fund for the current fiscal year.

If the balance in the Contingency Reserve Fund at the end of any fiscal year after the first annual general meeting is equal to or greater than 25% of the annual budgeted contribution to the Operating Fund for the fiscal year that has just ended, additional contributions to the Contingency Reserve Fund may be made as part of the annual budget approval process after consideration of the depreciation report, if any, obtained under section 94 of the *Strata Property Act*.

Once the planned and unexpected expenditures and the contributions to the required contributions to the Contingency Reserve Fund are all budgeted, the funding needs to be considered. Start by listing separately and budgeting the estimated income from all sources other than strata fees. As a general rule, I recommend that late fees and bylaw fines should not be budgeted but still should be shown on a separate line.

Operating Fund

Next, the Operating Fund balance should be considered. Pursuant to the Strata Property Act, the previous year's operating fund surplus can be:

- transferred into the contingency reserve fund;
- carried forward as part of the operating fund, as a surplus; or
- used to reduce the total contribution to the next fiscal year's operating fund.

If the Operating Fund is in a deficit position, the deficit must be eliminated during the next fiscal year. The Operating Fund balance can have a major impact on strata fees because a deficit and any amount not funded by ancillary income (income other than strata fees, such as strata suite rent, parking, interest, bylaw and late payment fees) and the previous year's surplus in the Operating Fund has to be funded by strata fees.

When Operating Fund is in a deficit position

When the previous year's Operating Fund is in a deficit position, Council has no choice but to eliminate the deficit in the next fiscal year either by increasing strata fees or by way of a special levy. I do not recommend eliminating a deficit by transferring funds from the

Contingency Reserve Fund as those funds may be needed for emergencies or to prevent a loss.

When Operating Fund is in a surplus position

When the previous year's Operating Fund is in a surplus position, Council can utilize all or portions of the surplus for one or more of the above options allowed by the *Strata Property Act*. Council can utilize all or a portion of the surplus to do things like:

- transfer to the Contingency Reserve Fund for depreciation report funding;
- keep strata fees the same as the previous year;
- reduce strata fees;
- fund a special project in the year budget without raising strata fees;
- fund large annual expenses that occur early in the fiscal year (eg. Insurance); or
- prevent the operating fund from going into a deficit in the event of unusual or unplanned expenditures.

After considering ancillary income and the previous year's operating fund surplus or deficit, the remainder has to be funded by strata fees. This is a simple mathematical calculation that is allocated to each unit based on unit entitlement.

Unfortunately, a lot of owners base their decision on whether to approve the budget strictly on whether there is an increase in their strata fees. To 'sell' the budget, Council should communicate their objectives when presenting the budget for approval. This will help to rationalize the expenditures and take the focus off the magnitude of the fees. Owners will readily fund a budget that is well thought out and works toward clear short and long-term objectives.

READING AND UNDERSTANDING THE BUDGET

Figure 1 is a sample basic budget proposal that you might see at your Annual General Meeting (AGM). Council has worked hard to propose a budget that is in accordance with their objectives and now it is up to you to consider the budget, suggest modifications, and ultimately approve or reject the proposed budget.

I have assumed that the AGM is just around the end of the fiscal year and that not all the actual figures are available yet. The 'probable' column is Council's best estimate of what the actual results will look like. If your AGM is a month or so after the fiscal year end, the

'probable' column will likely be labelled 'actual' since all figures for the previous year will be known. Notice the columns included:

- the first column is the previous year's annual budget that was approved at the last AGM;
- the second column is the estimated actual for the previous year;
- the third column is the proposed budget for the next fiscal year; and
- the fourth column is not usually presented but is included in figure 1 to indicate the budgeting method used.

So, let's take a look at the budget and make some quick observations:

- strata fees will be exactly the same as the prior year (\$519,355);
- there was a deficit in the Operating Fund at the start of the year (-\$12,659);
- there is an excess of revenue over expenditures in the current year that is large enough to take away the opening deficit and have a modest positive balance at the end of the current fiscal year (\$9,295);
- Council is proposing to carry the current fiscal year positive balance into the next fiscal year (\$9,295);
- Council has budgeted for an insurance deductible, legal fees and snow removal even though there were no expenditures in these categories in the current fiscal year – these expenditures are only if needed;
- There is a fairly big increase to the HVAC and repairs and maintenance categories; and
- The appropriations to the Contingency Reserve Fund are the same as the current year (\$50,000).

THE OWNERS, STRATA PLAN NO SAMPLE PROPOSED BUDGET FOR THE YEAR DECEMBER 31, 2017

	2016 Budget \$	2016 Probable \$	2017 Proposed \$	METHOD
INCOME				
6000 Strata fees	519,355	519,355	519,355	
6010 Fines	-	400	-	
6015 Interest income	1,000	750	700	I
6020 Parking	2,000	1,915	2,000	C
Total income	522,355	522,420	522,055	
EXPENDITURES				
GENERAL				
8000 Audit	4,400	4,650	4,700	I
8010 Insurance/appraisal	46,000	45,223	46,000	I
8012 Insurance deductible	5,000	-	5,000	C
8015 Legal	2,500	-	3,000	Z
8020 Management fees	24,336	24,336	24,336	C
8070 Postage, photocopying and supplies	3,500	3,655	3,700	I
	85,736	77,864	86,736	
BUILDING				
8115 Electricity	39,000	37,500	38,000	I
8120 Elevator	27,600	30,100	30,000	I & Z
8110 Garbage and recycling	30,500	30,200	30,500	I
8125 Gas	42,000	40,206	41,000	I
8130 Janitorial	36,000	34,565	36,000	C
8140 Plumbing	5,500	2,416	5,500	Z
8145 Fire system	4,600	5,685	6,000	I
8150 HVAC	21,000	23,420	32,500	I & Z
8200 Repairs and maintenance	78,960	76,228	81,500	I & Z
8210 Water/sewer/recycling	61,000	59,356	61,000	I
	346,160	339,676	362,000	
GROUNDS				
8140 Landscaping	18,000	26,503	22,814	I
8150 Irrigation	6,800	6,423	6,800	I
8160 Snow removal	3,000	-	3,000	Z
	27,800	32,926	32,614	
Total Operating Fund Expenditures	459,696	450,466	481,350	
Appropriations to the Contingency Reserve Fund	50,000	50,000	50,000	DR & SPA
Total Expenditures and Appropriations	509,696	500,466	531,350	
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES AND APPROPRIATIONS FOR THE YEAR				
OPERATING FUND BALANCE [SURPLUS (DEFICIENCY)]	12,659	21,954	(9,295)	
Balance, beginning of the year	(12,659)	(12,659)	9,295	
Balance, end of the year	-	9,295	-	

Method Legend: I - Incremental Z - Zero-based C - Contract DR - Depreciation Report SPA - Strata Property Act

Approve or not approve – ask more questions!

So, it looks okay and there is no increase in strata fees.....approved I guess???

Not so fast.....for me, I need to know more! I want to know Council's objectives when preparing the budget – both in the short and long-term. I want to know why the large increases in the HVAC and repairs and maintenance categories because I want to know if maintenance projects are being done as needed or if required maintenance is being stalled off. I want to know if the \$50,000 appropriation to the CRF is enough to be in compliance with the SPA requirements and fund the depreciation report. I want to know if any special levies to fund the depreciation report are planned. Really, I want to know if this budget protects and maintains the value of my property both in the short and long-term without special levies.

If Council does not state their short and long-term objectives during the budget presentation, ASK! Questions like these are appreciated by Council and by other owners. You need this information to make a sound decision to approve the budget.

Leo Van Wensem is a Director with RHN Chartered Accountants. For more information please visit their website at: www.rhncpa.com