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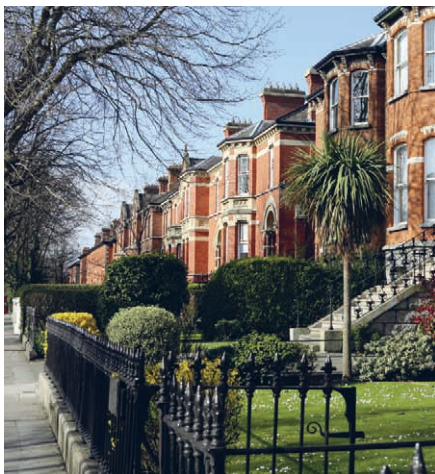
# Audit of Owners' Management Companies

In this article Colm Divilly examines the issues arising in the audit of the financial statements of an owners' management company that is responsible for the common areas of an apartment complex.

An owners' management company (OMC) is a company established for the purposes of becoming the owner of the common areas of a multi-unit development and the management, maintenance and repair of such areas. While the activities and transactions of such companies can be limited, these entities raise a number of significant audit issues. This article is focused on examining the issues arising in the audit of the financial statements of an OMC that is responsible for the common areas of an apartment complex. The issues that require consideration in the audit of an OMC that is responsible for the common areas in a traditional housing estate will vary and should be examined in the context of the role of the OMC in such an estate. The following are some of the issues requiring consideration when planning an audit of an OMC.

## Issues to consider

- The Auditor must understand the key phases in the evolution of an OMC. We can refer to these phases as (i) the developer-only phase (the period before any properties in the development are sold); (ii) the developer-and-owners' phase; (when some but not all the properties are sold) (iii) the owners only phase. The potential for conflicts of interest are greater in the "developer-and-owners' phase" and hence the audit risk is higher in this phase.
- The auditor must understand the legal structure of which the OMC is a part. The company will be a party to legal agreements dealing with the ownership of the properties in the complex under management. The Auditor must read and understand the legal agreements that set out the role, responsibilities and obligations of the OMC.
- The auditor must establish who has legal title to the common areas in the development. Normally, the developer will have transferred legal title to the OMC on completion of the development. Since the passing into law of the Multi-Unit Development Act 2011 (MUD Act), the developer should by now have transferred legal title to the OMC. If this has not happened the auditor will need to consider the implications of this for the audit. Where the transfer has not taken place, the auditor should consider the adequacy of the disclosure of this matter in the financial statements. Failure to transfer the common areas to the company may also have implications for the right of the OMC to charge management fees, as under the legal agreements governing the ownership of the residential units the developer may be responsible for the management of the common areas until the common areas are transferred.
- A suitable revenue recognition policy will be required for both management fees and sinking fund contributions. In accordance with Financial Reporting Standard No. 5, management fees should be recognised as income when the company provides the property management service and has earned the right to the consideration in exchange for its performance of the property management service. Where the company bills the members in advance of delivery of the service, it would recognise a liability equal to the amount received in advance, representing its obligation under the contract.
- In accordance with Section 19 of the MUD Act 2011, the company is required to establish a sinking fund to fund non routine maintenance and other non-routine costs that may arise from time



to time. This fund was to be established within 3 years of sale of the first unit or 18 months from the commencement of the Act, whichever date is the later. These funds must be held in a separate designated account. The auditor needs to consider the implications for the audit if such a fund is not established.

- Consideration must also be given to the adequacy of the sinking fund. An inadequate sinking fund could result in the company not having sufficient resources to meet its obligations and create uncertainty over the ability of the company to continue to operate as a going concern.
  - Where your firm acts for the developer of the apartment complex and for the OMC, there is a perceived threat to the independence and objectivity of the auditor. This threat should be addressed by the auditor and suitable safeguards applied. If no suitable safeguards exist that can reduce the threat to an acceptable level, the auditor should resign.
- In some situations, the OMCs may not have adequate financial resources to meet their obligations into the future.
- An auditor must consider the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and modify the audit report where necessary.
- The auditor should address the tax status of the OMC. The Revenue Commissioners may have agreed that as the company is established to provide a management service on a not for profit basis, that the OMC is exempt from corporation tax on any operating surplus. In such situations the auditor should inspect the confirmation from the Revenue Commissioners of the exemption.

### Implications of an OMC limited by guarantee

- The majority of OMCs are companies limited by guarantee of the members. This has the following implications:
  - A cash flow statement will be required in the financial statements.
  - Full financial statements will have to be filed with the annual return.
  - The company will not be able to avail of audit exemption.
  - The audit report will be addressed to the members of the company and not shareholders.
  - As the OMC does not have a share capital, the auditor does not report on the existence or not of a financial situation as referred to in Section 40 of the Companies (Amendment) Act 1983.
  - The financial statements and note should clearly disclose the fact that the company is limited by a guarantee of the members and the details of the guarantee.
  - The standard audit engagement letter issued to corporate clients should be amended in relation to the above matters.
  - A company limited by guarantee of the members must have a minimum of seven members. The auditor should review the register of members to confirm that the register is maintained and that the company has adhered to the above requirement.
- Because of the nature of a multi-unit development, a block insurance policy will normally be put in place to provide adequate insurance cover for the building. The auditor should undertake an insurance review as a standard audit procedure.

- Familiarity of the auditor with the MUD Act is important. International Standard on Auditing (UK and Ireland) 250 requires the auditor to consider the compliance of the OMC with laws and regulations. In the context of the audit of an OMC, the MUD Act will be a key law that requires consideration. It should be borne in mind that not all of the MUD Act applies to all multi-unit developments. Please refer to the scope section of the Act to establish what sections of the Act apply to the company you are auditing.
  - The directors of the company and the company are responsible for the company's compliance with the provisions of the MUD Act 2011 and in particular for the preparation and furnishing to each member of the company an annual report which complies with section 17(2) of the MUD Act. The annual accounts of the company are not equivalent to the report required under section 17(2) of the MUD Act 2011. There should be clarity on who is responsible for this report. The inclusion of a paragraph in the audit engagement letter confirming that the company is responsible for Section 17(2) report is advisable.
- The ODCE has recently re-published a publication titled **"COMPANY LAW HANDBOOK ON RESIDENTIAL PROPERTY OWNERS' MANAGEMENT COMPANIES ("MANAGEMENT COMPANIES")**. The booklet provides a good overview of the company law matters pertaining to such companies and is essential reading for all auditors of property management companies.

### CPA launch audit programmes for Property Management Companies

Adding to its suite of efficient and effective audit programmes CPA has launched an audit programme specifically tailored for your Property Management Company clients. These clients present specific challenges as explored in this article and the programmes have been designed to deliver clear expert guidance through the provision of easy to use and comprehensive audit programmes, sample template letters, sample financial statements and disclosure checklists etc.

For further details please visit the CPA website or contact the CPA Professional Standard's Department at 01-4251040.