

## **Capital of nature or capital punishment**

**By Clint Riddin**

The term capital in accounting terminology usually refers to expenditure which relates to purchasing or investing in or acquiring property, plant or equipment which is then used in the production of income, in other words, to make money.

However, whilst the running of the finances of a body corporate should be based on sound financial principles and good governance, the nature of a body corporate is not to run at a profit and so no investment in assets which are used to generate income takes place; **the objective is to generate reserves and funds.**

To better debate the treatment of capital expenditure in the books of a body corporate, it is necessary to look at the definition of an asset, for which a number exist; but in essence it must be cash or be capable of being converted to cash or from which future economic benefits will flow.

So there are instances where a body corporate may spend money on what in some instances would be treated as capital expenditure and be shown in the balance sheet of an enterprise, in sectional title bookkeeping, the practice is to expense the transaction.

An example of this is where the body corporate electrifies the perimeter wall, in a business this would be accounted for as an asset, as it would be protecting property and plant used in the production of income, and depreciated over the useful life of the asset and the tax deduction also treated accordingly. However, in sectional title there is no income producing asset being protected.

Given the abridged definition of an asset above, it must also be noted that bodies corporate are taxed differently to business enterprises and so the treatment of expenditure which normally would be considered capital by SARS is not treated as such in sectional title, which further supports the argument as to the accounting treatment of “capital” transactions.

One of the aims in sectional title accounting is to have the funds and reserves position be as closely supported by cash in the bank as is possible; this keeps evaluating the finances and financial well-being of the scheme easy, especially for non-accounting minded owners who usually make up the majority of owners.

As an example, if a body corporate had reserves of R1 million supported by R1 million in cash and the electrification of the perimeter fence in our reference above costs R500,000 and if there are no other transactions, the bank balance after paying for the fence will be R500,000.

If the fence is capitalised to the balance sheet per business accounting practice, and depreciation is say R50,000, again in the absence of other transactions, the reserves

would be decreased by R50,000 to R950,000 but the bank balance is R500,000. This often leads to the lay person questioning what has happened to the money. However, if the transaction is expensed, the reserve position is now R500,000 and so is the bank.

Having regard to the treatment of capital purchases argument, there are occasions where a body corporate will reflect capital assets on its balance sheet, for example if the body corporate owns immovable property such as a supervisor's flat or a clubhouse. Here the normal accounting treatment of the asset will take place.

In essence, it is contended that there needs to be a departure from accounting practice in sectional title bookkeeping for good reason; whether it is because of the debate surrounding the definition of an asset, or the meeting the needs of the users of financial reports, a different approach is necessary.

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