

## **Sectional Titles and Community Scheme Ombud**

### **Frequently asked questions**

**Please note:**

1. *Every effort is made to ensure that the information in this frequently asked questions document is correct. Nevertheless, the information is given purely as guidance to assist with particular problems relating to the subject matter and SAICA will have no responsibility to any person for any claim of any nature whatsoever which may arise out of or relate to the contents of this guide.*
2. *The information provided in this document does not constitute legal advice and should be read in that context.*
3. *Where the document suggests a particular view, such a view is based on SAICA interpretation at that particular time, of the legislation and regulations concerned. Although SAICA has consulted widely, it is possible that a different view may ultimately be followed in practice; for example, in instances where the Community Schemes Ombud Service (CSOS) or the Department of Human Settlements provide specific guidance.*

#### *Introduction*

The Sectional Titles Schemes Management Act, No. 8 of 2011 (“STSMA”) and the Sectional Titles Schemes Management Regulations, 2016 (“STSM Regulations”) were signed by the President with an effective date of 7 October 2016.

The Community Schemes Ombud Service Act, No 9 of 2011 (“CSOS Act”) and the Regulations on Community Schemes Ombud Service, 2016 (“CSOS Regulations”) were signed by the President with an effective date of 7 October 2016.

With the immediate implementation of both Acts and related Regulations various questions have been asked by members.

This list of frequently asked questions has been compiled to assist SAICA members in the interpretation of the STSMA and CSOS Act requirements.

The reference to Rules in this document refers to the Management Rules in Annexure 1 of the Sectional Titles Schemes Management Regulations, 2016.

The Community Scheme Ombud Services (“CSOS”) also published an advisory note, dated 5 October 2016: *Publication of the CSOS and STSMA Regulations* and Chief Ombud’s Circular 1 of 2017, dated 16 March 2017 on the *Implementation of the Sectional Titles Schemes Management Act and the Sectional Titles Schemes Management Regulations*.

## **SECTIONAL TITLES SCHEMES MANAGEMENT ACT (STSMA)**

1. **With the effective date of the STSMA being published as the 7<sup>th</sup> of October 2016, is there any transitional provisions?**

No, the STSM Regulations, 2016 does not contain any transitional provisions but the STSMA includes a requirement in section 10(12) which states that any rules made under the Sectional Titles Act, 1986 are deemed to have been made under this Act. Section 21 of the STSMA states “Rules prescribed under the Sectional Titles Act must continue to apply to new and existing schemes until the Minister has made regulations prescribing management rules and conduct rules referred to in section 10(2) of this Act”. Therefore as the Minister has now made the regulations prescribing management rules and conduct rules they will apply with immediate effect.

The Department of Human Settlements and the CSOS have confirmed that the Rules in the STSM Regulations, 2016 apply with immediate effect and this renders the previous Regulations made in terms of the previous Act (Sectional Titles Act, No 95 of 1986) unenforceable. The Department also confirmed that there should be no deviations from the provisions of the current STSMA and its subordinate legislation (regulations).

Therefore all body corporates and not just newly registered body corporates automatically adopted the Management Rules as per the Regulations, 2016 with effect of 7 October 2016.

For completeness the Rules should be noted at the AGM to ensure that all members / owners are aware of the amended Rules (Rule 17(6)(k)).

2. **The Sectional Titles: Collected Regulations stated the following in the Rules, included in Annexure 8 (i.e. under the previous Act): “40. Audit At the first general meeting and thereafter at every ensuing annual general meeting, the body corporate shall appoint an auditor to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting: Provided that where a scheme comprises less than 10 units, an accounting officer may be appointed for that purpose and the auditor or accounting officer, as the case may be, must sign the financial statements.” Is this requirement still applicable?**

No, Rule 26(4) states the following:

*“26(4) Unless all the sections in the scheme are registered in the name of one person, the body corporate must present audited financial statements to a general meeting for consideration within four months after the end of the financial year.*

Therefore based on the changes all body corporates must present audited financial statements and would therefore require an audit of its annual financial statements, unless all the sections /units in the scheme are registered in the name of one person.

**3. Can a registered auditor compile the annual financial statements and perform the audit of the annual financial statements?**

No, the registered auditor cannot compile the annual financial statements and perform the audit of the said financial statements. Section 290.165 of the Code of Professional Conduct for Registered Auditors (“Code”) specifically states that providing an audit client with accounting and bookkeeping services, such as the preparation of accounting records or financial statements, creates a self-review threat if the firm subsequently audits the financial statements.

The Code continues to refer to audit clients that are not public interest entities and audit clients that are public interest entities.

Also refer to question 5 which discusses the independence requirements in the STSM Regulations.

**Extract from the Code of Professional Conduct for Registered Auditors**

**Audit Clients that are Not Public Interest Entities**

290.168 The firm may provide services related to the preparation of accounting records and financial statements to an audit client that is not a public interest entity where the services are of a routine or mechanical nature, so long as any self-review threat created is reduced to an acceptable level. Services that are routine or mechanical in nature require little to no professional judgment from the professional accountant. Some examples of such services include:

- Preparing payroll calculations or reports based on client-originated data for approval and payment by the client.
- Recording recurring transactions for which amounts are easily determinable from source documents or originating data, such as a utility bill where the client has determined or approved the appropriate account classification.
- Recording a transaction for which the client has already determined the amount to be recorded, even though the transaction involves a significant degree of subjectivity.
- Calculating depreciation on fixed assets when the client determines the accounting policy and estimates of useful life and residual values.
- Posting client-approved entries to the trial balance.
- Preparing financial statements based on information in the client-approved trial balance.

In all cases, the significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Arranging for such services to be performed by an individual who is not a member of the audit team; or
- If such services are performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the work performed.

## **Audit Clients that are Public Interest Entities**

### **General Provisions**

290.169 A firm shall not provide to an audit client that is a public interest entity accounting and bookkeeping services, including payroll services, or prepare financial statements on which the firm will express an opinion or financial information which forms the basis of the financial statements.

290.170 Despite paragraph 290.169, a firm may provide accounting and bookkeeping services, including payroll services and the preparation of financial statements or other financial information, of a routine or mechanical nature for divisions or related entities of an audit client that is a public interest entity if the personnel providing the services are not members of the audit team and:

- The divisions or related entities for which the service is provided are collectively immaterial to the financial statements on which the *registered auditor* will express an opinion; or
- The services relate to matters that are collectively immaterial to the financial statements of the division or related entity.

#### **4. Does audit partner rotation apply to the registered auditors of the body corporate?**

No, there are no audit partner rotation requirements in the STSMA. Registered auditors will however need to refer to the Code. Section 290.148 – 290.171 specifically deals with Long Association of Senior Personnel (Including Partner Rotation) with an Audit Client and Section 290.25 and 290.26 deals with Public Interest Entities (amended with effect from 1 July 2016).

#### **5. The STSM Regulations, 2016 in the Management Rules in Annexure 1 has also included certain independence requirements and states in Rule 26(5) that the audit of the body corporate's annual financial statements must be "carried out by an independent auditor who has not participated in the preparation of the annual financial statements or advised on any aspect of the accounts of the body corporate during the period being reported on". Does this requirement refer to the individual auditor?**

Rule 26(5)(a) requires that the audit of a body corporate's annual financial statements must be carried out by an independent auditor who has not participated in the preparation of the annual financial statements or advised on any aspect of the accounts of the body corporate during the period being reported on. The term "independent auditor" has not been defined in the Regulations. "Auditor" is defined in Rule 2(1)(c) as a person accredited to perform an audit in terms of the Auditing Professions Act, 2005 (Act No. 26 of 2005).

The term "Registered Auditor" has also been defined, although the term is not used in the STSM Regulations or in the Management Rules (refer to Rule 2(1)(n)). It means a person as defined in terms of the Auditing Profession Act, 2015 (Act No. 26 of 2005).

Taking into account the intention of the legislation as pertaining to the independence of the auditor from the person or entity or agent or consultant that prepares /compiles the body corporate's annual financial statements and advises the body corporate in this regard, the reference to "independent auditor" is interpreted to refer to the *individual* registered auditor designated as the auditor that is responsible and accountable for the particular audit.

As regards to whether a compiler of the financial statements of a body corporate and the auditor of those financial statements can be two qualifying professionals from the same firm, the answer is yes.

**6. Can the compiler of the financial statements of the body corporate and the registered auditor be from the same firm?**

Yes, the compiler and the registered auditor of the financial statements can be two qualifying professionals from the same firm, but registered auditors / firms should also refer to the relevant requirements in the Code (and refer to question 3, above).

**7. Section 3 of the STSMA requires a body corporate to establish a reserve fund and an administrative fund. Do these funds need to be in separate bank accounts?**

Yes, Rule 26(1)(b) states that a body corporate must keep separate books of account and bank accounts for its administrative and reserve funds referred to in section 3(1)(a) and (b) of the STSMA.

**8. Section 3 of the STSMA requires a body corporate to establish a reserve fund to cover the cost of future maintenance and the repair of common property. How is the reserve fund calculated?**

STSM Regulation 2 states the requirements for the minimum amount required for the reserve fund. The minimum amount of the annual contribution to the reserve fund budget for must be determined as follows:

- *If the amount of money in the reserve fund at the end of the previous financial year is less than 25 per cent of the total contributions to the administrative fund for that previous financial year, the budgeted contribution to the reserve fund must be at least 15 per cent of the total budgeted contribution to the administrative fund;*
- *if the amount of money in the reserve fund at the end of the previous financial year is equal to or greater than 100 per cent of the total contributions to the administrative fund for that previous financial year, there is no minimum contribution to the reserve fund; and*
- *if the amount of money in the reserve fund at the end of the previous financial year is more than 25 per cent but less than 100 per cent of the total contributions to the administrative fund for that previous financial year, the budgeted contribution to the reserve fund must be at least the amount budgeted to be spent from the administrative fund on repairs and maintenance to the common property in the financial year being budgeted for.*

The CSOS has indicated that the requirement to keep and maintain a reserve fund commences from the ensuing financial year after the proclamation of the STSMA and the STSM Regulations.

To therefore reach the minimum amount required for the reserve fund in some cases the current contributions will not be enough and body corporates need to take note of Rule 21(3)(a)'s requirements to approve a special contribution.

Please refer to **Chief Ombud's Circular 1 of 2017** on the *Implementation of the Sectional Titles Schemes Management Act and the Sectional Titles Schemes Management Regulations*.

**9. Section 10(2) of the STSMA states that the management rules can be substituted, amended or repealed by the developer or by unanimous resolution of the body corporate. Can body corporates therefore remove the audit requirement and any other requirements in the rules as there is no statement that says that certain requirements cannot be removed?**

According to Section 10(2) of the STSMA, rules can be changed by either the developer or the body corporate and must be submitted to the chief ombud for approval. The chief ombud must issue a certificate if the substitutions, additions, amendments or repeal is reasonable and appropriate to the scheme.

When the developer submits an application for the opening of a sectional titles register the developer may substitute, amended or withdraw management rules numbers 5(2) & (3), 7, 8(1) & (2) and 12 and may add management rules that are not inconsistent with any other management rules.

The body corporate may by unanimous resolution add, amend or repeal the management rules provided that at the time of the amendments at least 30% of the units in the scheme have been transferred to owners.

The STSMA defines a unanimous resolution as follows:

"..... means a resolution –

- (a) passed unanimously by all the members of the body corporate at a meeting at which
  - 
  - (i) at least 80% calculated both in value and in number, of the votes of all the members of a body corporate are present or represented; and
  - (ii) all the members who cast their votes do so in favour of the resolution; or
- (b) agreed to in writing by all the members of the body corporate."

Therefore body corporates can amend the rules but the changes will have to be approved by the chief ombud (Section 10(5)(b) and (c)), who will evaluate the reasonableness of the changes as well as the consistency with other management rules.

**10. In some cases very small body corporates, such as 2 to 5 units might believe that the management rules are very onerous to their continued financial existence, for example, the audit requirement, minimum reserve fund requirements and issues relating to annual general meetings.**

As question 9 referred to the changing of management rules, body corporates can when submitting their rules for approval amend the rules and include a motivation for requesting an exemption / relief of certain provisions.

**11. When must the annual general meeting (“AGM”) be held?**

The body corporate must hold an AGM within 4 months after the end of the financial year, unless all members waive the right to a meeting and consent in writing to the motions that must be transacted at the AGM (Rule 17 (2) and (3)).

**12. When must the audited financial statements be completed?**

The body corporate must present the audited financial statements to a general meeting within 4 months after the end of the financial year (Rule 26(4)).

**13. Is there a prescribed financial year for body corporates?**

The financial year of a body corporate established after 7 October 2016 must be from 1 October to 30 September every year, unless the body corporate resolved otherwise in a general meeting (Rule 21(1)).

**14. Can the levy (contributions) by members be increased?**

Yes, Section 3(1)(e) of the STSMA states that the body corporate must determine the amounts to be raised for the administrative fund, the reserve fund and other expenses. Section 3(1)(f) then states that the body corporate must raise the amounts required by levying contributions from owners. Rule 21(3) sets out that the body corporate may on the authority of a written trustee resolution

- (a) levy a special contribution to meet a necessary expense that cannot be delayed until provided in the following year’s budget;
- (b) increase the contributions by a maximum of 10% at the end of the financial year to take into account certain increased liabilities until the members receive notice of contributions due the following year. The trustees must however inform members of these requirements by providing them with the relevant notice.

### **15. Can the trustees charge interest on late payments?**

Yes, the rules states that the body corporate can charge interest on any overdue amount payable by a member of the body corporate not exceeding the maximum rate of interest payable per annum under the National Credit Act, 2005 compounded monthly in arrears. (Rule 21(3)(c)).The previous rules allowed body corporates to charge interest at their own rates.

### **16. What is a trustee report?**

The STSM Regulations requires the trustees to report on their activities and duties in terms of Rule 17(6)(j)(i) at the annual general meeting.

Rule 22(4) require trustees to report the extent to which the approved maintenance, repair and replacement plan has been implemented at the AGM.

Rule 26(1)(f) requires the body corporate to prepare a report adopted by the trustees to be presented at the AGM reviewing the affairs of the body corporate during the financial year.

### **17. Is there a minimum retention period of documents?**

The STSM Regulations requires the body corporate to retain all books of accounts and financial records for a period of six years after completion of the transactions, acts or operations to which they relate (rule 26(3)).

### **18. The STSM Regulations has certain specific requirements from the auditor in rule 26(5)(c) which requires that the auditor must include opinions as to whether or not:**

*(i) the annual financial statements accurately reflect the financial position of the body corporate for the financial year under review, with such qualifications and reservations as the auditor considers necessary;*

*(ii) the body corporate has complied with the accounting requirements set out in rules 21, 24 and this section, with a specific description of any failure to comply with such requirements;*

*(iii) the books of account of the body corporate have been kept and its funds have been managed so as to provide a reasonable level of protection against theft or fraud; and*

*(iv) the financial affairs of the body corporate appear to be effectively managed;*

SAICA and IRBA have been engaging the Community Schemes Ombud's office with regards to these requirements and released guidance to assist registered auditors on how to deal with these requirements. Please refer to the SAICA Communication: Auditor Opinions required in terms of Management Rule 26(5)(c) of the Sectional Titles Schemes Management Regulations, 2016.

**19. The STSMA has new rules for body corporates. What must registered auditors report in their audit report when some of these requirements are not dealt with due to the timing of the effective date of the STSMA and the fact that there were no transitional provisions?**

SAICA and IRBA have been engaging the Community Schemes Ombud's office with regards to these issues. SAICA released Communication – *Auditor Opinions in terms of Management Rule 26(5)(c) of the Sectional Titles Schemes Management Regulations, 2016 (March 2017)* in conjunction with the **Chief Ombud's Circular 1 of 2017** on the *Implementation of the Sectional Titles Schemes Management Act and the Sectional Titles Schemes Management Regulations*.

**COMMUNITY SCHEMES OMBUD SERVICE ACT (CSOS)**

**20. A community scheme in the CSOS Act is defined as follows:**

*means any scheme or arrangement in terms of which there is shared use of and responsibility for parts of land and buildings, including but not limited to a sectional titles development scheme, a share block company, a home or property owner's association, however constituted, established to administer a property development, a housing scheme for retired persons, and a housing co-operative as contemplated in the South African Co-operatives Act, 2005 (Act No. 14 of 2005) and "scheme" has the same meaning;*

**Does this definition include:**

- **commercial buildings;**
- **retirement homes with life benefits;**
- **conservancies, and**
- **gated communities?**

The definition will include commercial buildings and retirement homes and even retirement homes with life benefits.

In SAICA's discussion with the ombud's office it would seem as if the CSOS Act will not apply to conservancies.

The CSOS Act will also not apply to gated communities as the land in question in a gated community belongs to the municipality.

Members will however have to apply the definition on a case by case basis, referring to their particular circumstances.

## **21. Are there any registration requirements?**

The CSOS Act requires all community schemes to register (Regulation 18(3)) with the ombud's office within 30 days of the effective date of the Act, community schemes therefore had to have registered by 5 November 2016.

Form CS 1 needs to be completed and it sets out additional documents that need to be submitted, including a schedule of levies payable and annual financial statements.

From CS 1 in section 5 states that a copy of the audited annual financial statements needs to be attached – section 59(b)(ii) of the CSOS only requires community schemes to have annual financial statements and there is no audit requirement. Therefore only schemes that require an audit need to submit audited annual financial statements.

## **22. Are there any other requirements?**

- The CSOS Act requires all community schemes to submit an annual return in the prescribed form (Section 59(b) and Regulation 18(1)) within 4 months after the year end by completing Form CS 2

Form CS 2 needs to be completed and it sets out additional documents that need to be submitted, including a schedule of levies payable and audited annual financial statements, where the scheme is required to prepare audited annual financial statements.

- The CSOS Act requires that the chief ombud may by written notice require a community schemes to submit certain governance documentation (Regulation 16) within 90 days of after the establishment of a community scheme in terms of any applicable law or within 90 days after the coming into operation of this Regulations, therefore by 5 January 2017.

## **23. Why is the levies payable by community schemes to the CSOS?**

The levies is required for the creation and upkeep of the CSOS office.

The levies payable by community schemes is set out in the Community Schemes Ombud Service Regulations: Levies and Fees, 2016.

## **24. What is the levies payable by community schemes**

The levies are calculated by using a formulae of the lesser of R40 or 2% of the amount by which the levy charged by the scheme exceeds R500 (Regulation 11(3)). Therefore community schemes with levies less than R500 per unit is exempt from paying levies.

## **25. When must the levies be paid by community schemes**

The Community Schemes Ombud Service Regulations: Levies and Fees, 2016 is effective 90 days from date of publication (Regulation 5). It was published on 7 October 2016 and is therefore effective from 5 January 2017. The levies need to be collected by the schemes on a monthly basis from the owners and paid over on a quarterly basis. The first quarter would therefore be end of March 2017 and the levies would be due by 5 April 2017.

**26. The CSOS Act requires that every community scheme must take out fidelity insurance. Is there any minimum requirements?**

In terms of Regulation 15(3) the minimum amount of fidelity insurance is the total value of the community schemes investments and reserves at the end of the last financial year plus 25% of the community scheme's current year's operational budget.

**27. Does existing insurance policies already include sufficient cover for those issues required to be covered by the CSOS?**

A community scheme does not need to take out fidelity insurance if that insurable person has proof that the monies of the community scheme is covered by fidelity insurance that complies with the requirements and that the insurer has noted the community scheme's interest and has agreed not to cancel the cover without notice (Regulation 15(5)).