

CHIEF OMBUD'S CIRCULAR NO: 1 OF 2017

ON THE

IMPLEMENTATION OF THE SECTIONAL TITLES SCHEMES MANAGEMENT ACT (ACT NO 8 OF 2011) AND THE SECTIONAL TITLES SCHEMES MANAGEMENT REGULATIONS, 2016

1. Objective of the Circular

The objective of the Circular is to provide operational guidelines and clarity on the implementation of the Sectional Titles Schemes Management Act (Act No 28 of 2011) (STSMA) and the Sectional Titles Schemes Management Regulations (2016) (the Regulations). The Circular is not intended to amend, replace, override or supersede the STSMA and the Regulations.

2. Commencement of the STSMA and the Regulations

The STSMA and the Regulations became effective on 7 October 2016. There are no transitional provisions provided in the STSMA and the Regulations.

3. Implementation of STSMA and the Regulations

3.1 Reserve Funds

3.1 Section 3 of the STSMA requires a body corporate to establish a reserve fund to cover the cost of future maintenance and the repairs to the common property.

3.2 Regulation 2 states the requirements for the minimum amount for the reserve fund. The minimum amount of the annual contribution to the reserve fund budget 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.*

3.2 The requirement to keep and maintain a reserve commences from the ensuing financial year after the proclamation of the Act and the Regulations. The budget to be tabled at the annual general meeting (AGM) that falls immediately after the proclamation of the Act and the Regulations must include provision for the contribution towards the reserve fund. It is not a requirement that the body corporate must have a reserve fund at the first AGM after the proclamation of the Act. To illustrate, if a body corporate has a financial year-end of 31 March, the budget for the 2016/2017 financial year would have been approved at its previous AGM. Therefore, the body corporate would not have a reserve fund, as contemplated in Regulation 2, in place at the end of its financial year on 31 March 2017. However, it would be required to budget for a reserve fund and comply with all other related requirements with respect to its 2017/2018 financial year commencing on 1 April 2017.

3.3 The Community Schemes Ombud Services (CSOS) has taken note that this requirement might cause financial burden to Sectional Titles Schemes (Schemes), in light of the provisions of Rule 21(b), which limits the maximum increase on the annual contribution to 10% at the end of the financial year to take account of the anticipated increased liabilities of the body corporate, until the contributions for the ensuing financial year are determined and finalised as part of the approval of that year's budget. In this regard, schemes that are unable to reach the regulated threshold may approach CSOS with a plan on how they anticipate to reach the maximum threshold for approval by the Chief Ombud. The plan must include the annual contribution that will be made into the reserve funds until the threshold is met.



4. Rules

- 4.1 Section 29 of the STSMA states that the Rules prescribed under the Sectional Titles Act (Act No 95 of 1986, which has been replaced by the STSMA) must continue to apply to new and existing schemes until the Minister of Human Settlements (the Minister) has made regulations prescribing management rules and conduct rules (which are now in place in terms of the STSMA and the Regulations).
- 4.2 The implication of section 29 is that the prescribed management rules and conduct rules will automatically apply to all community schemes, until the prescribed management rules and conduct rules are substituted, amended or repealed in terms of section 10(2).
- 4.3 Section 10(2) states that the management rules can be substituted, amended or repealed by the developer or by unanimous resolution of the body corporate. The conduct rules can be substituted, amended or repealed by the developer or by special resolution of the body corporate.
- 4.4 The commencement of the substitution, amendment or repeal of a rule/rules comes into effect after approval by the Ombud (i.e. on the date of the issuing of a certificate as contemplated in section 10(5)(c)).
- 4.5 The substitution, amendment or repeal of a rule/rules must be reconcilable with the provisions of the prescribed management rules and conduct rules, STSMA the Constitution of the Republic of South Africa, the Community Schemes Ombud Service Act, 2011 (Act No 9 of 2011), any other applicable legislation and the relevant By Laws. The substitution, amendment or repeal of a rule/rules will not be approved by the Ombud, if the Ombud believes it is not reasonable and appropriate for the scheme.
- 4.6 When a sectional title register is opened, the developer must, if the prescribed management and conduct rules are adopted, file with CSOS an affidavit confirming the adoption, and the Ombud will issue the certificate confirming same.

5. Certain Annual General Meeting (AGM) Requirements and their Effect

- 5.1 In terms of **Management Rule (MR) 17(1)** of the management rules, a body corporate is required to hold an AGM within four months of the end of its financial year. In terms of **MR 17(6)(j)** the following will, *inter alia*, form part of the business to be concluded at an AGM:



(iv) Approve the budgets for the administrative and reserve funds for the next financial year

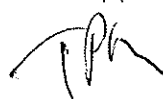
(v) Consider the annual financial statements

(vi) Appoint an auditor to audit the annual financial statements, unless all the sections in the scheme are registered in the name of one person

- 5.2 **MR 17(6)(j)(iv)** must be read in conjunction with Regulation 2 that prescribes certain minimum amounts for the reserve fund in the context of the budgeted contribution to the reserve fund for a financial year being budgeted for, as well as **MR 24** that addresses, amongst other matters, the establishment and maintenance of both an administrative fund and a reserve fund. These funds would in the normal course of business be managed in accordance with the approved budgets. Budgets are set and approved for the ensuing financial year and are executed during that particular financial year.
- 5.3 The financial statements that are required to be considered in terms of **MR 17(6)(j)(v)** would be those relating to the recently concluded financial year. Apart from considering these financial statements, members would normally also consider any requirements for the financial statements for the ensuing financial year, for example, the basis of preparation of the financial statements and the audit of the financial statements.
- 5.4 The auditors to be appointed in terms of **MR 17(6)(j)(vi)** would be appointed for the ensuing financial year to conduct an audit as contemplated in **MR 26(4)** and **26(5)**.
- 5.5 Consequently, Regulation 2 and **MRs 24(2), 24(3), 24(5), 26(1)(d), 26(1)(e), 26(4)** and **26(5)** will be effective for the financial year of a body corporate commencing on or after 7 October 2016, provided that the immediately preceding financial year must be concluded in all respects in accordance with the management rules of the body corporate that applied during that financial year, including but not limited to the audit of the body corporate's annual financial statements.

6. Financial Reporting Framework and Auditing Pronouncements

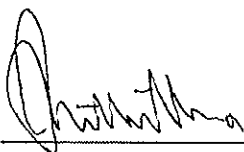
- 6.1 **MR 26(5)(b)** requires that the audit of a body corporate's annual financial statements need not be carried out in accordance with any recognised financial reporting framework of guidelines for financial accounting. This rule must be read in the context of the entire **MR 26(5)** that requires the performance of the audit of a body corporate's annual financial statements by an independent auditor within the meaning of the Auditing Profession Act (Act No. 26 of 2005) (the APA).



- 6.2 In terms of section 1 of the APA, "audit" includes an audit of financial statements carried out with the objective of expressing an opinion as to their fairness or compliance with an identified financial reporting framework and any applicable statutory requirements, and the auditor must, in the performance of an audit, comply with those standards, practice statements, guidelines and circulars developed, adopted, issued or prescribed by the Independent Regulatory Board for Auditors (IRBA) (defined as "auditing pronouncements" in the APA).
- 6.3 As to the reference to "financial reporting framework" in MR 26(5)(b) the body corporate may decide which financial reporting framework would be applied in the preparation of its financial statements (i.e. no particular framework has been prescribed). The body corporate may decide to prepare its financial statements in accordance with any recognised financial reporting standards, or may use a basis of accounting as determined by the body corporate (i.e. an entity-specific basis of accounting). In terms of performing the audit of those financial statements in accordance with the prescribed auditing pronouncements, the auditor would have to determine whether the financial reporting framework applied in the preparation of the body corporate's financial statements is acceptable.
- 6.4 Irrespective of the financial reporting standards or basis of accounting that the trustees of the body corporate decide to apply, the body corporate's financial statements are also required to comply with the additional financial reporting provisions in terms of MR 26(1).

7. Commencement of the Circular

This Circular 1 of 2017, will commence on date of signature hereof and will remain effective until amended, substituted, withdrawn or repealed.



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CHIEF OMBUD

DATE: 17/03/2017

