

THE SECTIONAL TITLE INDUSTRY IN SOUTH AFRICA: PERSPECTIVES OF ACCOUNTING AND AUDITING PRACTITIONERS

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Abstract

Sectional title property plays an important role in addressing the high priority housing problem in South Africa. Very little research has so far been done on the South African sectional title industry from an accounting and auditing perspective. Furthermore, sectional title legislation is often contradictory and confusing. Sectional title owners are also putting pressure on costs, bringing about unique industry challenges. These aspects do, however, provide ample opportunity for research.

The aim of this article was to provide an overview of practical problems experienced by accounting and auditing practitioners regarding risks, auditing- and accounting-specific problems relating to sectional title.

The literature review covered the main legal aspects relating to accounting and auditing matters of sectional title schemes, paving the way for an empirical study performed on the sectional title industry in South Africa by way of interviewing a sample of key role players in the industry.

The empirical results revealed significant contradictory and confusing aspects and uncertainties in the industry. Various problems and concerns were addressed and practical recommendations were made that can be of assistance to owners, trustees, managing agents, accountants and auditing professionals. The findings can also be used as a valuable basis for further research.

Keywords: Sectional Title, Sectional Titles Act, Sectional Title Management, Sectional Title Schemes, Sectional Title Budget, Trustees, Body Corporate, Trust Money, Accounting, Auditing, Accounting Profession, Auditing Profession

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This article is the first in a series of three which will be published on the subject matter

1. Introduction

The research findings in this article form part of the results of an extensive study done on the sectional title industry in South Africa, performed in fulfilment of a Magister degree in Accounting. This article is the first in a series of three articles highlighting the research findings.

This article will commence by giving a brief background and overview of the sectional title property industry in South Africa. The problem statement and aim of the article will then be discussed, followed by the research methodology. The next section will deal with a brief literature review. A discussion of the empirical findings will then be done under eight different sub-sections, followed by a conclusion and possible recommendations.

1.1. Background and Overview of the Sectional Title Property Industry in South Africa

Before the early 1970's, the concept of sectional ownership was not recognised in South Africa. It was impossible to obtain full ownership rights to a section of a building such as an apartment. Woudberg (1999) and Van der Merwe (2010) give an overview of the legislative history of sectional title property in South Africa. In South African law, the maxim *superficies solo cedit* was taken over from Roman Dutch law (an ultimately Roman law), in terms of which a landowner was also considered to be the owner of any building erected on the land, and a building was seen as a single unit (Van der Merwe, 2010, pp. 15-16; Pienaar, 2010, p. 22). Ownership consisted of the entire building, which could not be bought in separate parts. This means that South African law did not recognise separate ownership in a building or parts of that building apart from the ownership of the land on which the building was built (Van der Merwe, 2010, pp. 15-16; Woudberg, 1999, p. 3). (See also Shrand (1972, p. 1)).

Legal systems around the world were compelled to consider the institution of legislation on sectional ownership, and South Africa was no exception. The

Sectional Titles Act came into being in 1971, and this enabled homeowners to purchase a section of a building, such as an apartment, with full ownership rights on that section (Van der Merwe, 2010, pp. 15-16; Woudberg, 1999, p. 3; Shrand, 1972, p. 1; Nel, 1999). (See also Paddock (2008, pp. 1-3).) The Sectional Titles Act No. 66 of 1971 was later replaced with the Sectional Titles Act No. 95 of 1986 (Van der Merwe, 2010, pp. 15-16). The Sectional Titles Act 95 of 1986 has been amended by Act No. 11 of 2010, which was published in the Government Gazette on 7 December 2010. The Sectional Title Schemes Management (STSM) Act 8 of 2011 was gazetted and signed by the President in mid-2011. The STSM Act does not repeal the original Sectional Titles Act 95 of 1986 (as amended), but does repeal and/or amend certain provisions thereof. However, by the middle of 2013 the STSM Act was still not operational (Padayachee, 2012, p. 1; Ed., 2012, p. 1).

1.2. Background to the Article

The Sectional Titles Act contains several regulations, sections and rules relating to accounting, auditing and financial statements. Even though the legislation relating to sectional title property has been in place for more than 40 years, library, archive and internet searches revealed that very little academic research has so far been done on sectional titles in South Africa. The academic research identified was mostly postgraduate research in the fields of law, cost accounting, taxation and regional planning, meaning that no academic research has been done specifically from an accounting and auditing perspective to date on the sectional title industry in South Africa.

2. Problem Statement and Aim of the Article

Accounting and auditing practitioners encounter various practical challenges when performing accounting and assurance services for sectional title clients. Against the above-mentioned background, the aim of the article is to give an overview of practical problems experienced from an accounting and auditing perspective regarding risks associated with sectional title as well as auditing- and accounting-specific problems relating to sectional title. Possible solutions recommendations will also be suggested in this regard.

3. Research Methodology

The research design was developed to address the research problem stated above. The research consists of a brief literature study, followed by a qualitative empirical study.

The literature study in this text commenced with detailed searches done by research specialists at the academic libraries at the Central University of

Technology, Free State and the University of the Free State as well as the Archive for Contemporary Affairs at the University of the Free State. The searches identified various possible literature sources, including books, articles, theses, dissertations, internet sources and professional and institutional publications.

Flowing from the literature study, an investigation into current practices and challenges in the sectional title industry was undertaken. A qualitative research strategy was followed and the study was done by way of standardised interviews with accounting and auditing practitioners involved in the sectional title industry limited to the Bloemfontein area in South Africa.

The exact population of the participants was difficult to determine, due to various factors. There are many auditing and accounting practitioners who is not involved/do not want to get involved in assurance services for sectional title schemes. The reasons why they prefer not to be involved differ from firm to firm. Some practitioners, for instance, do not want to get involved in this type of work due because they perceive the risk to be too high. Others claim that the audit and/or accounting fees attached to the work are so low that it does not make financial sense to accept sectional title clients. Practitioners in some of the larger firms state that it is firm policy not to get involved in work on such a small scale.

In order to address this practical challenge, the authors undertook extensive consultation among role players in the industry. After the consultation process, a joint decision was made to include five respondents and it was also jointly decided which five respondents were to be chosen. In view of clarity, the decision making process will be briefly discussed.

The five accounting and auditing professionals interviewed were selected after extensive enquiry from various managing agents and chairmen of trustees of bodies corporate in Bloemfontein. Factors such as knowledge of and experience in the industry as well as the number of clients of the accounting and auditing practitioners played a role in the choice of the five respondents that were eventually chosen. The sample was selected to represent two large accounting and auditing practitioners (having more than 100 schemes as clients), two medium- sized practitioners (having between 30 and 100 schemes as clients) and one small practitioner (having less than 30 schemes as clients). All of the accounting and auditing practitioners are established firms in Bloemfontein specialising in, amongst others, accounting and auditing of sectional title schemes. Four of the five practitioners interviewed are senior partners in their firms who are extensively involved with their sectional title clients on a day-to-day basis. The remaining interviewee is a senior staff member in the auditing division responsible solely for sectional title work. The total number of sectional title clients for

which these five practitioners do accounting and auditing work amount to more than 550.

In order to address the research problem of the article, a research questionnaire was developed as a measurement instrument in order to structure the interviews. The questionnaire was designed to structure the interview process, and ensure consistency of the coverage of questions between the interviewees. A formal cover letter from the authors explaining the purpose of the interviews and addressing the terms of confidentiality was sent to all interviewees before the interviews. Due to restrictions on the length of articles, the questionnaire was not attached to this article. It is, however, available upon request.

Various aspects from available literature (including Clough and Nutbrown (2002, p. 122), Coldwell and Herbst (2003, pp. 54-57), Henning, Van Rensburg and Smit (2004, pp. 53-55) and Howard and Sharp (1983, pp. 124-133) and scholar Els (2007, pp. 222-228) were taken into account in developing the questionnaires and conducting the interviews. The purpose and format of the interview was explained beforehand and the interviewees were asked for permission to document the interview by way of taking notes. All questions were kept as neutral as possible and only one question was asked at a time. Attention was paid to the clarity, language and formulation of questions, leaving no room for ambiguity. The order of the questions allowed for a logical flow of thought. The questionnaires including a variety of questions – closed as well as open-ended and using Likert scales where applicable. Furthermore, enough room was left for comments and motivations of answers, and encouraging additional responses.

4. Literature Review

4.1. Introduction

During the course of the literature review, the authors identified several regulations, rules and sections in the Sectional Titles Act and related publications that contain wording which is not in accordance with accepted accounting terminology. Various instances of unclear and contradictory pieces of legislation and literature were also identified. It should, however, be noted that a full legislative analysis falls outside the scope of this article and will be dealt with by the authors in a subsequent research output.

This section of the article will introduce the concepts relating to auditing and accounting as per the Sectional Titles Act and highlight some practical issues identified in related literature.

4.2. Sectional Titles Act Requirement

The Sectional Titles Act deals with auditing and assurance in Prescribed Management Rule (PMR) 40 of the Act, the wording of which is as follows:

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. (Own emphasis.)

As per the emphasis above, there are four aspects in this Rule which should be taken note of. The first aspect is the fact that the heading of PMR 40 in Annexure 8 refers to the concept of “Audit”. The second aspect is the “appointment of an auditor to hold office”; the third is the concept of the “accounting officer” in cases of a scheme consisting of less than ten units; and the fourth aspect involves the required “signing of the financial statements.”

Currently available publications on sectional titles also do not give any further guidance on auditing other than what is stated in the Act. Paddock’s Sectional Title Survival Manual (2008, pp. 10-1) as well as Pienaar’s publication on Sectional Titles (2010, pp. 163, 169)) simply gives the prescriptions of the Act word for word. Constatas and Bleijs (2009, p. 100) state that bodies corporate should be managed like businesses “...and every business should be audited every year...” to ensure accountability to the members from the side of the body corporate. Van der Merwe (2010, p. 14.2.5.3) also shares this viewpoint, arguing that the financial statements of the trustees must be audited and signed by the auditor or the accounting officer, as the case may be”

On the South African Institute of Professional Accountants (SAIPA) Technical website (SAIPA, 2012) the question is raised as to whether a SAIPA member may sign off the financial statements of a body corporate consisting of 12 units. SAIPA answers the technical question by quoting PMR 40 from the Sectional Titles Act.

On the website of South African Institute of Chartered Accountants (SAICA) (SAICA, 2011) the following very specific technical question is posed:

“What type of assurance / audit report / review is required for Body Corporates under the Sectional Titles Act 95 of 1986? The Act just says that the auditor / accounting officer must “sign the financial statements”. What does this mean? Is an audit of this type of entity required by law? What type of audit / assurance report / review is required?” (Sic)

The following answer is given:

“If there are 10 or more units, an audit is required. As this is clearly spelt out, it seems that no audit is required if there are less than 10 units – only

the accounting officer need sign the financial statements..."

The technical department representative then concludes by quoting PMR40 from the Act.

In practice, however, it often happens that the auditor of a sectional title scheme is responsible for both the preparation of the financial statements as well as for the audit thereof. This was evidenced by the results of the empirical study detailed below.

4.3. Practical Problems Identified

4.3.1. Governance of Bodies Corporate

As pointed out by PricewaterhouseCoopers (2010, p. 3) and Le Roux (2010, pp. 8-9), the principles of good governance applies to all smaller enterprises, despite a lack of formal "corporate" structures. Small enterprises, including the trustees and bodies corporate of sectional title schemes, do not operate independently from their stakeholders. The fundamentals of good corporate governance are as applicable to the trustees and members of the bodies corporate of sectional title schemes as it is to large corporate entities. These fundamentals include, amongst others, transparent stakeholder engagement, accountability, responsible leadership, sound ethical foundations, the governance of risk, compliance with laws and regulations, good stakeholder relations and sustainable organisational performance (KPMG, 2012, p. 9). (See also PricewaterhouseCoopers (2010, pp. 2-3) and Le Roux (2010, p. 69)).

The problem with many sectional title schemes is that bodies corporate are not being run like "businesses" (Constas & Bleijs, 2009, pp. 26, 98; Pincus, 2004, p. 18), and that members are reluctant to be appointed as trustees and become involved in the leadership and management of schemes (Constas & Bleijs, 2009, p. 34). Being a trustee is often seen as a "thankless job" which is usually done for little or no remuneration (Constas & Bleijs, 2009, p. 37; Ozynski, 2007, p. 18). (See also Paddock (2008, pp. 10-4).)

4.3.2. Management Competence of Members and Trustees

Many members and trustees are not equipped with the necessary skills and knowledge to be able to manage the scheme in a sustainable manner and make informed decisions on important matters (Nel, 1999, pp. IV-VI; Constas & Bleijs, 2009, p. 26; Maree, 2011, p. 3). This results in many trustees acting without having the necessary skills and not being fully aware of their duties and obligations (Nthite, 2005, p. 16; Pienaar, 2010, p. 185). This is in sharp contrast with the responsibilities of the trustees in terms of the principle of responsible leadership (Maree, 2011, p. 3). Owners are also increasingly demanding that trustees better understand their duties

and remain up to date with the amendments to the Act (Ed, 2006, p. 2).

4.3.3. Cash Flow Problems

Rising costs and non-payment of levies is a widespread problem among sectional title schemes (Van Noort, 2007, p. 10; Wilson, 2006, p. 22; Pincus, 2004, p. 18; Maree, 2010). (See also Muller (2009, p. 42), Maree (2009, pp. 19-20) and Nthite (2005, p. 16).) Various sectional title schemes around the country are faced with serious cash flow problems and many are operating under insolvent circumstances (Sectional Title South Africa, 2010; Bauer, 2012; Constas & Bleijs, 2009, p. 113). According to research done in 2010 by Santam, approximately 20% of individual sectional title units are behind on their levy payments at any given time (Maree, 2010).

4.3.4. Managing Agents

The above-mentioned risk of cash flow problems are not the only risk trustees are faced with. The responsibilities involved with being a trustee are onerous and the Act is cumbersome. Many trustees have time constraints, and they are faced with difficult decisions for which they do not necessarily have sufficient time available to give it the proper attention required. For this reason there is an ever increasing risk involved in being a trustee. This inevitably leads to situations where trustees appoint managing agents to execute the administration and fulfil certain management functions on behalf of the trustees and body corporate of the sectional title scheme. In terms of the Sectional Titles Act, the members of the body corporate hand over an enormous responsibility to the trustees of a sectional title scheme (Constas & Bleijs, 2009, pp. 34, 42; Woudberg, 1999, p. 45; Pienaar, 2010, pp. 184-185). Managing agents are usually professional persons or firms with the necessary skills and knowledge to perform the management and administration of a scheme

It is important to note that by appointing a managing agent, the trustees are not absolved of their duties, powers and responsibilities (Constas & Bleijs, 2009, pp. 42-47). In terms of the principles of good corporate governance, trustees can delegate certain functions to managing agents (Pienaar, 2010, p. 180), but cannot avoid their ultimate responsibilities, nor completely delegate them. The King Code states very clearly that the board "*should delegate certain functions to well-structured committees but without abdicating its own responsibilities*" (Institute of Directors in Southern Africa, 2009, p. 46). In terms of sectional titles, the trustees must answer to the members of the body corporate and are therefore under increasing pressure to become more transparent, accountable and responsible (KPMG, 2012, p. 8). It can also happen that some trustees act in a manner that is dishonest or grossly negligent

(Constas & Bleijs, 2009, p. 35), resulting in more frequent instances of owners taking trustees to court for fraud or poor performance (Ed, 2006, p. 2).

4.3.5. Trust Money

Another important fact to note is that the body corporate of a sectional title scheme is entrusted with trust money in the form of levy contributions from all owners to establish a fund that is sufficient to pay for all expenses of the scheme (Constas & Bleijs, 2009, pp. 107-108). The fact that trust money is dealt with on a day-to-day basis further emphasises the importance of applying principles of good governance. In practice, many owners fend against increasing levies (Pienaar, 2010, p. 158). Especially in times of economic crisis and rising inflation, the levy income of bodies corporate may be put under a lot of pressure and this can increase cash flow problems in a sectional title scheme (Muller, 2009, p. 42). The trust money involved in sectional title schemes further emphasises the vital importance of the fiduciary responsibilities of the trustees and the managing agents involved (KPMG, 2012, p. 84; Pienaar, 2010, pp. 177-178). Mervyn King (2006, pp. 29-30) also sums this up by stating:

“The director has to be a good steward of the company’s assets. He should ensure that the company utilises its assets as if they were the assets of his own family, of which he is the head.”

4.4. Conclusion

From the above it is clear that the Sectional Titles Act requires accountants and auditors to perform certain functions. Furthermore, available literature identifies various challenges from a business perspective, including governance, competence, cash flow risks, problems with managing agents and trust money. As discussed in the section dealing with the research methodology, a questionnaire was developed and interviews were held with five accounting and auditing practitioners. The results of the empirical findings will be discussed in the following section.

5. Empirical Findings

5.1. Introduction

As mentioned above, this section will deal with the results of the information from the questionnaires and interviews with accounting and auditing practitioners. These aspects will be discussed under the following headings: clients and services, problems experienced, risks, training and staff, trustees, managing agents and fees.

5.2. Clients And Services

The five accounting and auditing practitioners interviewed had varying numbers of sectional title schemes as clients. The number of sectional title clients of the practitioners was 10, 30, 63, 132 and one practitioner had more than 300 clients.

Three of the five (60%) practitioners stated that their sectional title clients require them to prepare the financial statements as well as perform the audit. One of these practitioners completes additional tax returns for approximately 2% of their sectional title clients. One of the five (20%) practitioners stated that approximately 80% of their clients require them to prepare the financial statements as well as perform the audit, while 20% of the clients want only an audit done. This practitioner also provides additional business advice to approximately 10% of their sectional title clients, and assists with the preparation of budgets for more or less 20%. One of the five (20%) practitioners stated that approximately 90% of their clients require them to prepare the financial statements as well as perform the audit, while 5% of the clients want only accounting work to be performed and another 5% of the clients want only an audit done. This practitioner also provides additional business advice to approximately 10% of their sectional title clients, and assists with the preparation of budgets for more or less 20%.

Regarding the time spent compiling financial statements and performing audits, the responses of the practitioners differed significantly. The table below summarises their responses:

Table 1. Summary of average time spent by practitioners compiling financial statements and performing an audit of a sectional title scheme

	Practitioner				
	A	B	C	D	E
Compiling financial statements of a sectional title scheme:	2 hours	3 to 8 hours	2 hours	15 hours	16 hours
Auditing of a sectional title scheme:	6 hours	20 to 36 hours	14 to 18 hours	10 hours	16 to 40 hours

Only one of the five (20%) practitioners said that they regularly attend the annual general meetings (AGM) of their sectional title clients. The practitioner said that he attends, on average, the first 15 to 30

minutes of the AGM in order to present the annual financial statements to the members of the body corporate. Two of the five (40%) practitioners said that they attend the AGMs of approximately 5% to

10% of his sectional title clients, but only if they are specifically asked to do so. The other two (40%) practitioners stated that they never attended any AGM.

All five (100%) of the practitioners interviewed were of the opinion that the auditing of the financial statements adds value to sectional title schemes. One practitioner stated that audits are important, because it gives a form of assurance to the generally ignorant and uninformed trustees and members of bodies corporate. Another practitioner said the fact that trust money is involved makes an audit absolutely essential. One of the practitioners mentioned that audits are imperative because it will indicate whether the managing agents are doing their work in terms of debt collection and keeping to budgeted amounts.

Three of the five (60%) practitioners are of the opinion that a full audit is the most applicable way of providing assurance to a sectional title scheme. The other two (40%) practitioners also felt that an audit is applicable, but they mentioned that the possibility of Agreed-upon Procedure Engagements or Independent Reviews can also be investigated. These practitioners stated that there are still many grey areas regarding Independent Reviews, and that alternatives to full audits may not necessarily result in cost savings for the client.

A very important observation was made regarding accounting standards. During the interviews, the practitioners were asked which accounting standards they deem to be the most applicable in compiling the annual financial statements of bodies corporate, with the options being IFRS, IFRS for SMEs, a custom-made standard or another alternative. All of the practitioners (100%) were of the opinion that a specific standard should be developed for sectional title schemes, as it is a very unique and highly specialised industry. They all felt that neither IFRS nor IFRS for SMEs is applicable to bodies corporate. This is certainly a finding that the accounting professional bodies in South Africa should take note of.

The above finding also corresponds with the opinions of several authors regarding accounting for small and medium-sized entities (SMEs). In a 2011 CIMA technical update, Fernando (2011) argues that implementing full IFRS requires lots of management time, staff training, and specialist consultations to ensure full compliance. This burden is too heavy for most SMEs to bear. (See also SAICA (2010, p. i).) Van Wyk and Rossouw (2009, pp. 99-101) share the opinion. They mention that applying full IFRS do not result in useful and cost-effective information being provided to the users of the financial statements of SMEs, irrespective of their legal form. They argue that these users do not need all the detailed and complex information provided by general purpose financial statements. (See also Stainbank (2008, pp. 1-3).)

Two of the five (40%) practitioners mentioned that they are uncertain of the accounting treatment of certain transactions in the sectional title industry, such as the capitalisation of assets, treatment of certain Value-Added Tax (VAT) components and allocation of repair and maintenance payments. The practitioners are of the opinion that additional guidance is needed from the accounting professional bodies, similar to the guidance available to non-profit entities.

5.3. Problems Experienced

According to all of the practitioners, one of the biggest problems experienced with the accounting and auditing of sectional title schemes is problems with municipal accounts. Three of the five (60%) practitioners mentioned that account estimates, corrections on statements and incorrect allocations between water and electricity on statements caused problems when doing accounting and audit work. It also makes it very difficult to perform analytical procedures on the account balances.

According to three of the five (60%) practitioners, bodies corporate put pressure on accounting and audit fees. This results in restrictions on the scope of the work, due to limited time available. They also mentioned that many trustees and managing agents have a misperception of exactly what an audit entails and the amount of work involved to complete an audit. This is, perhaps, a classic example of the “audit expectation gap”. There is a distinct difference between what the audit profession perceives their objectives to be, and what the public expects from an audit, or “thinks” that the auditor does (Sikka, Puxty, Willmott, & Cooper, 1998, p. 302; Koh & E-Sah, 1998, pp. 148-149; Wolf, Tackett, & Claypool, 1999, pp. 468-469). Lubbe (1990, p. 8) explains that the core of the expectation gap between the profession and the client (‘client’ specifically referring to outside stakeholders) lies between the risk that the auditing profession is prepared to accept in respect of annual financial statements and the confidence which clients search for in the statements.

Regarding information received, three of the five (60%) practitioners felt that a big part of information and source documents received from trustees and managing agents are incomplete or not detailed enough, which complicates the process of preparing financial statements. They also remarked that some managing agents capture accounting information according to the cash-flow basis of accounting, and information often has to be converted to principles of accrual accounting.

One of the five (20%) practitioners mentioned that bodies corporate changing from one managing agent to another or from one audit firm to another creates problems. According to the practitioner this happens often, as trustees do “managing agent-hopping” or “auditor-hopping” from year to year in

order to try to save money. As a result of poor communication to owners and tenants, fees are still paid over to the old managing agent, and some managing agents refuse to hand over the control of the body corporate's bank account after changing to another agent. Verifying opening balances of accounts and financial statements can also become problematic.

One of the five (20%) practitioners mentioned one of the frustrations experienced is that there is not sufficient continuity amongst the staff of managing agents, and as soon as a person is familiar with a particular body corporate and auditor, they leave the employment of the managing agent.

One of the five (20%) practitioners commented that there is uncertainty regarding the format and level of detail required in the financial statements of bodies corporate. The practitioner mentioned that no guidance is given by the accounting professional bodies regarding this.

Regarding time constraints, four of the five (80%) practitioners stated that there are certain times of the year that they experience bottle-neck situations with sectional title clients. The four practitioners mentioned that bottle-neck situations usually occur around February and June each year, and according to them, the main reason is that managing agents do not send the financial information through to them on time. The other practitioner stated that he does not have many sectional title clients, and therefore, does not experience any timing problems.

Two of the four (50%) practitioners who experience timing problems said that moving the financial year-ends of bodies corporate could be a solution to the problem. They mentioned that it is a great practical challenge and, therefore, they are not in favour thereof. The other two practitioners said that managing agents should improve their service and have financial information available sooner after year-end in order to solve the said problem.

Two of the five (40%) practitioners said that they never experienced any problems with the South African Revenue Service (SARS) regarding their sectional title clients. One of the five (20%) practitioners stated that the SARS staff is not up to date with the current tax legislation governing bodies corporate. Two of the five (40%) practitioners mentioned that they sometimes experience problems when SARS has to pay out money to their clients and that sectional title client's tax returns are sometimes handed in late, mainly due to the bottle-neck situations mentioned above.

5.4. Risk

One of the five (20%) practitioners viewed the risk of auditing sectional title schemes as very low, compared to auditing clients in other industries. The practitioner mentioned that sectional title audits are very easy and not complex. Two of the five (40%) practitioners viewed the risk of auditing sectional title

schemes as relatively low to moderate, compared to auditing clients in other industries.

One of the five (20%) practitioners viewed the risk of auditing a sectional title schemes as moderate to high, compared to auditing clients in other industries. The practitioner stated that some sectional title clients, such as combined residential and commercial schemes have complex structures and challenging tax calculations. The practitioner also mentioned that due to the fact that there is trust money involved, great care has to be taken during the audit of bodies corporate. He stated that cost pressures and resulting time constraints make it difficult to perform all the procedures required by the auditing standards, which increases the risk.

One of the five (20%) practitioners viewed the risk of auditing a sectional title schemes as high, compared to auditing clients in other industries. The practitioner stated that segregation of duties is a big problem in sectional title schemes, and creates opportunity for fraud. He also mentioned that there is often no clear audit trail available to provide evidence of transactions. The practitioner is of the opinion that large amounts of trust money involved in sectional title schemes increases the risk of auditing such clients. He mentioned that it is difficult to perform all the necessary risk assessment procedures, due to time constraints when auditing sectional title clients.

An interesting observation was made when comparing the above risk assessment with the time spent by the practitioners in Table 1 (see section 5.2. above). The higher the practitioner perceived the risk of a sectional title audit to be, the more time they spent on the audit of sectional titles. The practitioners who perceived the risk of sectional title audit to be low spent the least number of hours auditing sectional title schemes, compared to the other practitioners.

As part of the interviews, the practitioners were asked what they perceived to be the greatest risks related to the audit of sectional title schemes. Three of the five (60%) practitioners stated that cut-off of debtors and creditors are a great risk, as it is not always easy to determine correct balances at year-end. The practitioners mentioned that invoices from local authorities for water and electricity often results in problems with cut-off, due to incorrect estimates on statements, and statements being delivered late. Three of the five (60%) stated that collectability of debtors is a great concern. The practitioners stated that it is very difficult for them to determine provisions for doubtful debt and that in some cases it raises red flags regarding going concern.

A serious concern that was raised by all (100%) of the practitioners is the practice of some managing agents to use one trust account in which all of the funds of the bodies corporate managed by them are deposited. According to the practitioners interviewed, some managing agents refuse to issue the auditors with a bank statement of the large ("only") trust account due to the fact that it contains, as the

managing agents put it, “confidential” information of other bodies corporate. These managing agents are only willing to provide the auditors with their own summary of the bank account and transactions of the body corporate under audit.

It was mentioned that many unallocated deposits relating to a specific body corporate which was deposited into the managing agent’s “pool” trust account remain unnoticed and unallocated due to the fact that the information is not made available to the auditors. The practitioners were of the opinion that it is virtually impossible to reconcile the bank balances with the little information that is provided to them. They also mentioned that the interest accrued on this large trust account is never allocated to the individual bodies corporate, and that the managing agent is the sole beneficiary thereof. All of the practitioners stated that they do not feel comfortable with this practice, and they would rather see managing agents open a separate bank account for each body corporate. The question to be asked here is whether the handling of the interest received as “income” of the managing agent is not against the legal aspects of the handling of “trust money”.

One of the practitioners interviewed also mentioned that they do not get sufficient co-operation from financial institutions when it comes to the audits of bodies corporate, to such an extent that they do not even ask for bank confirmations any more. He stated that it takes several weeks to obtain a bank confirmation and in many cases requests are ignored by banks. It is also impossible for the financial institutions to split the above mentioned trust accounts into the relevant sections dealing with the individual bodies corporate.

In conclusion it seems that the handling of “trust” money by managing agents is a matter which accounting and auditing practitioners should be well aware of. Usually, interest “earned” on trust funds should not accrue to the managing agent, but to the

bodies corporate. This is a serious aspect that should be taken note of by the industry.

5.5. Training And Staff

Four of the five (80%) of the practitioners interviewed were of the opinion that they are up to date with the latest requirements of the Sectional Titles Act. The remaining practitioner said that he is not up to date.

None of the practitioners provide any form of formal training for their staff members. Three of the five (60%) practitioners mentioned that they have only one experienced staff member responsible for the accounting and auditing of their sectional title clients. That person did not undergo any sectional-title-specific training. If such a staff member leaves the employment of the firm, he/she will have to provide on-the-job training to a junior member who will take over his/her work.

All of the practitioners (100%) stated that it would be very useful if a good basic training course can be made available covering the legal, accounting and auditing aspects surrounding sectional title. One practitioner stated that the reason for formal training not being given is the fact that developing such a training course in an audit firm is time consuming and very expensive. He also mentioned that they do not always get a high “return on training investment” due to the high turnover of staff. Another practitioner mentioned that good training is not only important for the staff of the audit firms, but also for the staff of managing agents. He said that some managing agents employ staff members to do accounting or capturing work, who are not qualified or skilled to do the work.

As part of the interviews, the practitioners were asked about the average post level or qualification of the staff members doing work on their sectional title clients, which resulted in varying responses. The figure below is a summary thereof:

Table 2. Summary of average post level or qualification of staff members compiling financial statements and performing an audit of a sectional title scheme

	Practitioner				
	A	B	C	D	E
Compiling financial statements of a sectional title scheme:	2 nd year trainee or higher	3 rd year trainee or higher	1 st year to 3 rd year trainee	3 rd year trainee or higher	Manager with at least SAIPA qualification, assisted by 2 nd year trainee
Auditing of a sectional title scheme:	2 nd year trainee or higher	Trainee with at least a B.Com (Acc) qualification	1 st year to 3 rd year trainee	3 rd year trainee or higher	Manager with at least SAIPA qualification, assisted by 2 nd year trainee

An interesting observation was made when comparing qualification levels of staff in Table 2 above with the practitioners’ perceived risk of sectional title audit as mentioned in Table 1 of section 5.2. The practitioners who perceived the risk of sectional title audit to be low used staff members at a

lower post grade to do the work on sectional title clients, compared to the other practitioners. The higher the practitioner perceived the risk of a sectional title audit to be, the higher the post level and qualification of the staff members used to do the work.

5.6. Trustees

The practitioners had different opinions on the optimal number of trustees that would result in a well-functioning board of trustees. One practitioner stated that it depends on the size of the scheme, but that there must be no more than 5 trustees on the board. Another practitioner is also of the opinion that it depends on the size of the scheme, but anything between 3 and 7 trustees would be sufficient, as long as it is an uneven number to prevent a deadlock in voting. One practitioner felt that at least 3 trustees are necessary for a well-functioning board, while the remaining two practitioners prefer 4 and 5 trustees, respectively.

One alarming observation was that four of the five (80%) practitioners are of the opinion that the average chairman of a board of trustees does not have sufficient skills and knowledge to act as chairman.

5.7. Managing Agents

When asked whether they thought that the average managing agent has the necessary skills and competence to act as such, only two of the five (40%) practitioners agreed. Another two of the five (40%) practitioners were of the opinion that the managing agents they came into contact with were not knowledgeable and did a poor job, while the remaining one practitioner (20%) said that he was unsure. He said that some managing agents are doing good work, while the skills and competence of others are sub-standard. One practitioner also mentioned the fact that many managing agents have no idea how the budgeting process works and how to prepare a budget. He stated that amounts are simply adjusted with inflation year after year.

5.8. Fees

The practitioners take different measures into account when determining their fees. Two of the five (40%) practitioners mentioned that quality of information received from the managing agent, as well as their relationship with the managing agent, plays an important role in determining their fees. Fees would be higher if they are not familiar with the managing agent, or if they experiences problems or received sub-standard information from the managing agent in the past. Two of the five (40%) of the practitioners stated that the more complex the transactions of the scheme is, and the more hours they need to spend completing the work, the higher the fees would be. One of the five (20%) practitioners commented that they determine their fees based on a minimum fee of R1 500 plus an additional amount based on the number of units in the scheme.

One of the five (20%) practitioners made the remark that they would initially do the work of a body corporate for a much lower fee, if they can possibly

gain good exposure and attract additional clients from the assignment. Two of the five (40%) practitioners said that they would charge a higher fee if the necessary information is not readily available to enable them to complete the work.

6. Conclusion

Accounting and auditing practitioners encounter various practical challenges when performing accounting and assurance services for sectional title clients. The literature review identified various challenges for bodies corporate from a business perspective, including governance, competence, cash flow risks, problems with managing agents and trust money.

From the results of the interviews with the industry role players, various concerns were identified. The main concerns were uninvolved and uninformed owners, difficulties with municipalities and developers, financial pressures and problems with debt collection. The accounting and auditing practitioners also had concerns about staff continuity at managing agents and the use of one managing agent's bank account for the cash transactions of a number of bodies corporate. The practitioners also had various accounting-related questions on which they need clarity from their professional bodies. All of the role players were of the opinion that auditing the financial statements of bodies corporate adds value and should be continued. A further conclusion that was drawn was that many of the auditing-related issues probably stem from the expectation gap. There is a distinct difference between what the audit profession perceives their objectives to be, and what the sectional title role players, and even the legislator, expects from an audit, or "thinks" that the auditor does.

In the following article in the series, the perspectives of managing agents of bodies corporate will be explored.

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