

Ignore taxation.

1 REPROP

1.1 Reprop: Background

Remmie Properties Ltd ('Reprop') is a company that develops new properties in suburban areas across South Africa. It is listed on the Johannesburg Stock Exchange and focuses on large metropolitan areas such as Tshwane, Cape Town and Nelson Mandela Bay. Reprop does not retain ownership of the properties but transfers ownership to a new homeowner as each property is completed. The land in the estate which is not developed as housing and sold to homeowners is community land which contains all the communal facilities.

With the increase in crime rates, challenges with municipal service delivery and issues with electricity, Reprop decided to take advantage of the surge in the demand for gated community estates with sustainable water and electricity solutions by developing an estate on a piece of land it owns in Tshwane. Through this venture, Reprop can enter a new market of buyers looking for this type of lifestyle.

1.2 Development of Spark-of-Afrika

In 2021, Reprop commenced development of Spark-of-Afrika, an estate built to accommodate 100 homes, with erf (stands) ranging from 800 to 1 800 m² per property. Homeowners receive full ownership title in the homes that they purchase within the estate. The Spark-of-Afrika estate includes a clubhouse with a gym, a restaurant and a communal swimming pool as well as a park. The clubhouse, gym and restaurant have state-of-the-art equipment requiring competent staff to operate and maintain it. The estate also has 24-hour security guards at the entrance to the estate, in addition to patrols to enhance residents' security and limit unauthorised entry into the estate.

As Reprop will not retain ownership of Spark-of-Afrika, it registered the Spark-of-Afrika Homeowners Association NPC ('the Spark-HOA') as a non-profit company. On 1 January 2023, by which time 25 homes had been purchased in the estate, Reprop transferred ownership of the common areas to the Spark-HOA.

All common areas and improvements, such as roads, streetlights and gardens on the exterior of each stand, including the clubhouse, gym, swimming pool, restaurant and park, are the property of the Spark-HOA and not the homeowners. Upon the transfer of assets from Reprop to the Spark-HOA, a valuation of the common property was performed, and it was valued at R26,15 million.

1.3 Reprop: Auditors

Reprop has a 31 December financial year end and prepares its financial statements in accordance with IFRS[®] Accounting Standards (IFRS). At the annual general meeting (AGM) held in June 2024, the chief executive officer (CEO) announced that he had appointed JEM Inc. as the registered auditors for the financial year ending 31 December 2024 (FY2024). JEM

Inc. is a small established firm with two registered audit partners, two audit managers and ten trainee accountants, all operating from an office in Durban. The CEO decided that a change in auditors, from one of the biggest audit firms in South Africa, was necessary after a dispute with the prior engagement partner. JEM Inc. presented its engagement letter to Reprop, which it signed without any amendments or restrictions, on 2 July 2024.

1.4 Reprop: Municipal billings

The financial statements of Reprop for FY2024 includes a material disclosure note of a R1 million contingent liability with a very vague description. When the audit manager of JEM Inc. requested further details on this amount, the chief financial officer responded as follows:

This amount is due to historic municipal underbilling for the Spark-of-Afrika water and electricity usage during the development phase in 2021 and 2022. Since the commencement of the development of Spark-of-Afrika, the municipal accounts have not reflected any water or electricity usage. We have not performed any estimates / calculations in the past but feel it should be disclosed now and therefore we did a calculation for the water and the electricity to support our disclosure amount. In performing this calculation, we multiplied the water and electricity usage according to the bulk meters we could identify by the rate for 2021 and 2022. As the Spark-HOA obtained ownership of the common property on 1 January 2023, Reprop did not need an estimate for FY2023 or FY2024. The municipality is so inefficient that we have decided not to report this issue – it is unlikely we will find anyone helpful to assist anyway. I am sure they will decide to issue a backdated account to Reprop at some stage. If so, we know someone who can help make this problem disappear. We have just estimated the amount payable for the period from commencement of construction until the common property was handed over to the Spark-HOA.

2 THE SPARK-HOA

2.1 The Spark-HOA: Background

Homeowners who purchase a home within Spark-of-Afrika automatically become members of the Spark-HOA and can access all amenities. They participate in its governance and have the right to nominate and vote for the appointment of the directors of the Spark-HOA.

Reprop established a memorandum of incorporation (MOI) and membership rules for the Spark-HOA, which are enforced upon all members. The provisions of the MOI stipulate that the Spark-HOA should have a functioning audit committee and that the Spark-HOA is subject to an audit. In addition, the Spark-HOA exercises control over the provision of services, such as maintenance of common areas, hiring clubhouse and security staff, appointing contractors to carry out services within the estate, and collecting the monthly levies that each homeowner is obligated to pay. The monthly levies from members of the Spark-HOA are used to finance common property expenses such as salaries, security, garden upkeep, facility improvements and payments for water and electricity usage on common property. Homeowners are responsible for the water and electricity payments related to their own properties.

2.2 The Spark-HOA: Strategy and governance

The members of the Spark-HOA appointed the following individuals to serve on the board of directors:

Name	Portfolio	Occupation
Mr Joe Budden	Chairman of the board	Entrepreneur
Mr Archie Fernando	Audit and finance	Accounting teacher
Ms Ashley Adams	Human resources	Insurance agent
Ms Lebo Sekoto	Properties	Supply chain manager
Mr Francois de Kok	Legal	Lawyer
Mr Simon Carter	Facilities management	Film director

The directors are not remunerated for their work in this capacity.

The Spark-HOA is governed by the Companies Act and the Community Schemes Ombud Service Act. While adherence to the King IV Report on Corporate Governance is not mandatory for homeowners' associations, the Spark-HOA applies its principles and recommended practices as it provides guidelines on good governance, ethical leadership, risk management, financial management, and owner engagement.

The MOI contains the following provisions:

- The directors cannot approve contracts exceeding R250 000 without the approval of the majority of the Spark-HOA members;
- All improvements to the clubhouse and common areas can only be made following approval at an AGM;
- A stringent process must be followed for the appointment of new contractors, and this is to be enforced by the facilities management portfolio owner in consultation with the board and members of the Spark-HOA;
- The directors are accountable to the Spark-HOA members; and
- Details of emergency expenditure must be circulated to the members for approval by means of a resolution.

The Spark-HOA's strategic goals are focused on maintaining property values, fostering a community spirit and ensuring that Spark-of-Afrika remains a desirable place to live. The goals are as follows:

- 1 *Maintaining and enhancing property values:* Enforcing rules and regulations regarding property upkeep, landscaping and exterior modifications to ensure a uniform and attractive appearance of homes and common areas. Proper maintenance and improvement of the clubhouse and other common areas to enhance community appeal and functionality.
- 2 *Financial stability and transparency:* Establishing and managing the annual budget, ensuring sufficient reserve funds for future repairs and improvements, and conducting regular audits of annual financial statements. Implementing effective systems for collecting levies to ensure that financial resources are available for ongoing and future projects.
- 3 *Community engagement and communication:* Maintaining open lines of communication with members through newsletters, a website, social media and regular meetings to keep them informed about the Spark-HOA activities, decisions and community events.

- 4 *Safety and security:* Ensuring a safe living environment by implementing and maintaining safety measures such as security patrols and proper lighting in common areas. Developing and promoting preparedness plans for natural disasters and other emergencies.
- 5 *Regulatory compliance and governance:* Ensuring adherence to the Spark-HOA's covenants, conditions and restrictions, as well as national and municipal laws. Providing ongoing training and resources for board members to ensure effective governance and decision making.
- 6 *Sustainability and environmental stewardship:* Promoting environmentally friendly practices such as recycling programmes, water conservation and using sustainable materials in community projects. Encouraging energy-efficient upgrades and practices among homeowners and in common areas to reduce the community's environmental footprint.

The following is an extract of the minutes of the AGM:

MINUTES OF THE SPARK-HOA AGM HELD ON 4 JUNE 2024	
Present	93 units in person or by proxy (as per the signed attendance register)
By invitation	Ms Sarah Lessing (external auditor)
1	Welcome
2	Election of chairperson Mr Joe Budden was elected as the chairperson of the meeting.
3	Minutes of previous meeting
4	Auditors The Spark-HOA has a 31 December financial year end and prepares its financial statements in accordance with IFRS. The Spark-HOA was audited by L&P Registered Auditors Inc. ('L&P RA') in 2023. Mr Budden emphasised that the audit engagement partner, Ms Sarah Lessing CA(SA), RA, is familiar with the operations of the Spark-HOA since she was the designated auditor on the engagement in the previous year. Mr Budden feels that the Spark-HOA audit is not mandatory because the company is a non-profit company, and the audit is only undertaken because of the MOI. Mr Budden accordingly believes there would not be an issue with the re-appointment of L&P RA. The members approved the re-appointment of L&P RA to audit the Spark-HOA for FY2024.
5	Finance portfolio The chairman of the board raised concerns about the late payment of levies and annual financial statements not being approved on time due to late preparation. In addition, some members complained that they were not receiving levy statements and correspondence on time. Consequently, the members at the meeting resolved that a new director be appointed for the finance portfolio as it appears that Mr Fernando, who was not present at the meeting, is disinterested in his role. All members voted in favour of appointing Ms Carol Senande, a newly qualified CA(SA), as the director in charge of the finance portfolio.

	The board appointed L&P Prop (Pty) Ltd ('L&P Prop'), a property management company and a subsidiary of L&P RA., to prepare the annual financial statements on time on behalf of the Spark-HOA. Mr Budden assured the members that although L&P Prop is a subsidiary of L&P RA, the audit company is totally separate from L&P Prop.
6	<p>Contract services</p> <p>The chairman informed members that he approved a new garden service contractor and appointed a new security company as of 1 January 2024. He believes they both have thus far been offering far better services than the previous contractors.</p>
7	Closing

After the AGM Carol established that her role would include the timely collection of levies from members as well as review of annual financial statements, preparation of annual budgets, and approval of expenses. Carol discovered that the board of directors has been making questionable decisions. Carol fears that the role of the board chairperson has not been executed with the necessary diligence and care. Joe was the first to purchase a home in the estate and ensures that he is involved in all decision making so that all portfolios are coordinated and that the Spark-HOA complies with the MOI and membership rules as per his interpretation. Joe takes pride in his influence on the board.

In addition, the appointment of the new contractors posed the following concerns to Carol:

- 1 The contractor responsible for gardening services and upkeep of common areas, Joey Budden, is the first-born son of Joe. Joey and his father are both involved in the operations of the garden services company.
- 2 Joe insisted on a change in the security company without providing reasons. The new security company quoted the Spark-HOA an annual fee of R1,5 million, which is 13% higher than the fee charged by the previous security company.
- 3 The facilities management director also told her that neither one of the contractors meets the minimum B-BBEE requirements, despite this being stipulated in the Spark-HOA's contractor appointment protocols.

The properties director noted that she had a problem with some improvements that had been made on the common areas that were not necessary. Some of the contractors appointed for these improvements had not been approved in terms of the contractor appointment processes and the directors (apart from Joe) were also of the opinion that these had been wasteful expenditures. The appointment of these contractors was not included in the minutes of the directors' meetings. However, for fear of challenging Joe, these contractors were accepted, and the related expenses were incurred. Carol discovered that these contractors had been approved via a message in the board of directors' WhatsApp chat group.

2.3 The Spark-HOA: Solar and water backup solutions

At the time of the 4 June 2024 AGM, none of the homes in the Spark-of-Afrika estate had solar or water backup solutions. The board of the Spark-HOA was tasked by the homeowners with performing a viability assessment of solar and water backup solutions for individual home use. Critical considerations would be whether these solutions should be procured under the Spark-HOA or procured independently by the homeowners. All solutions are to be purchased and ready for use on 1 July 2025.

The properties director approached a trusted supplier of solar and water backup solutions, who provided the following quotations for different solar and water packages for individual home use:

Package	Notes	Price per package
		R
Solar solution		
Mini-solution	1	93 500
Grow-solution	1	155 000
Plus-solution	1	245 000
Water solution		
Starter 5 000 litre	2	33 920
Combo 10 000 litre	2	56 800

Notes

- 1 The solar packages all include solar panels, lithium batteries and hybrid inverters, but differ in quantity and type of product. The price also includes the installation of these solutions at individual homes. Homeowners will be able to add solar panels to the packages at their own cost at any time, should they wish to do so.
- 2 The water packages all include water tanks, pumps, UV lights and water filters but differ in size and type of product. The price of water packages includes the installation at individual homes. These are connected in such a way that homeowners can make 100% use of rainwater while the water tanks are full but can also fill tanks with municipal water from the main water lines if necessary.

2.3.1 Procurement of solar and water solutions under the Spark-HOA

The supplier offered a discount of 15% on each solution package if the Spark-HOA procures water and solar solutions for use by homeowners who elect to participate (all quoted prices provided are before the 15% discount). All installations will be completed by 30 June 2025.

On completion of the installations on 1 July 2025, the Spark-HOA will pay for the water and solar solutions. An additional special monthly levy, which will be over and above the standard ordinary monthly levy, will be payable by homeowners who elect to participate in the procurement under the Spark-HOA option. The special monthly levy will cover the installation, insurance and maintenance of the package chosen and will be introduced for a period of three years, starting on 1 July 2025. The special monthly levy will be based on the type of solar and water solution package that is installed at each of the owner's homes:

Package	Special monthly levy
	R
Solar solution	
Mini-solution	3 500
Grow-solution	4 800
Plus-solution	7 200
Water solution	
Starter 5 000 litre	960
Combo 10 000 litre	1 500

A survey was carried out on the types of solar and water solution packages homeowners would consider. From the survey it was estimated that 20 homeowners would prefer the Plus-solution solar package, 60 the Grow-solution and 18 the Mini-solution. The remaining two homeowners indicated that they did not want a solar solution. In the case of the water solutions, there is an 80% probability that 60 homeowners would opt for the Combo 10 000 litre, while 40 homeowners would opt for the Starter 5 000 litre. However, there is a 20% probability that only 35 homeowners would opt for the Combo 10 000 litre and 65 for the Starter 5 000 litre.

The Spark-HOA will take out insurance for the water and solar solution packages for a period of three years, commencing on 1 July 2025. After this period these costs will be for each homeowner's own account. The insurance company offered a special quotation that would cover all the water and solar solutions purchased by the Spark-HOA. This entailed a monthly premium of R750 for each solar solution package and R350 for each water solution package, irrespective of the type of water or solar package procured. The quotation stipulated an annual increase of 8% in the insurance premiums.

A maintenance company will be contracted to perform annual services and maintenance on the installed water and solar solutions for the three-year period starting 1 July 2025. After this period these costs will be for each homeowner's own account. The maintenance company will charge the Spark-HOA a standard base fee per annum for servicing all the solutions, while a variable tariff will be charged per maintenance hour for general repairs. The variable per hour tariff will be at a certain rate for the first 100 maintenance hours worked, after which it will decrease to a lower variable per hour tariff for any hours in excess of 100 maintenance hours worked for the remainder of the three-year contract (i.e., variable hours are considered on a cumulative basis over three years).

The average total annual service and maintenance fees payable by the Spark-HOA per the contract based on different estimated maintenance hours used in the first year starting on 1 July 2025 are as follows:

Total annual service and maintenance bill	Estimated maintenance hours used
R	
275 000	50
290 000	80
322 500	150
367 500	250

It is estimated that homeowners will use 25 maintenance hours in total in the first contractual year, 55 maintenance hours in the second and 85 maintenance hours in the third. An inflationary annual increase of 4% is expected for both the fixed and variable portion of the maintenance cost.

2.3.2 Independent procurement of solar and water solutions by the homeowners

If the Spark-HOA does not procure water and solar solutions for the homeowners, the homeowners will have the option to procure these solutions independently.

The second part of the survey, on independent procurement, showed that between 70% and 90% of the current homeowners will indeed be interested in procuring solutions independently. However, not all will procure solutions right away, predominantly due to individual cash flow constraints, and installations will be done over the next five years.

2.4 The Spark-HOA: Sustainability and environmental performance forecast

The Spark-HOA expects a sharp decrease in the purchase of both electricity and water from the municipality if it procures electricity and water solutions for the homeowners to be installed on 1 July 2025 for two reasons: (1) because of the self-generation and storage by homeowners, and (2) because homeowners will become more environmentally conscious. This sharp decrease is expected to reduce and normalise to a steady trend over a longer term of usage as homeowners reach optimal levels of self-generation and storage.

The following annual information forecast was based on expected homeowner behaviour and the assumption that the Spark-HOA will procure solar and water solutions from 1 July 2025:

	FY2025 Actual	FY2026 Forecast	FY2027 Forecast	FY2028 Forecast
Average electricity consumption per home per month	1 200 kWh	1 150 kWh	850 kWh	750 kWh
Average electricity purchased (from the municipality) per home per month	1 200 kWh	935 kWh	400 kWh	290 kWh
Average water consumption per home per month	25 kilolitres	25 kilolitres	20 kilolitres	18 kilolitres
Average water purchased (from the municipality) per home per month	25 kilolitres	10 kilolitres	8 kilolitres	6 kilolitres
Homes using recycling programmes	60	65	75	80

2.5 The Spark-HOA: Financing

If the Spark-HOA decides to fund the solar and water backup solutions, the board of directors, including Carol, have proposed the following options to raise funds for this acquisition:

Option 1

Arrange a secured loan using the clubhouse as collateral to source additional funds from financial institutions. The loan will have the following terms:

Principal amount	R17,4 million
Effective annual interest rate	Prime less 1%
Term	3 years

The principal amount together with interest will be repaid in three equal annual instalments, with the first repayment due on 30 June 2026.

Attorney and upfront loan fees will amount to 4% of the total loan amount.

Option 2

Source a sustainability-linked loan from SusBank. SusBank is willing to extend a loan of R17,4 million for a three-year term. The principal will be repayable at the end of the loan term at a premium of 10%. Interest is payable annually, with a year 1 interest rate of 9,5%. For years 2 and 3, the year 1 interest rate will decrease by 15% for each year in which all the following conditions are met:

Average electricity consumption per home	15% annual decrease
Average water consumption per home	20% annual decrease
Homes using recycling programmes	15% annual increase

Attorney and upfront loan fees will amount to 2% of the total loan amount.

Option 3

Use the cash reserve balance which is intended to be used by the Spark-HOA on future repairs, maintenance and improvements on common areas property, to fund the balance required for the initial investment in the solar and water backup solutions. The cash reserve balance is currently earning interest of 6% per annum.

2.6 The Spark-HOA: Additional information

- 1 The weighted average cost of capital of the Spark-HOA is 15%.
- 2 The South African prime rate is 11,75%.

INITIAL ASSESSMENT OF COMPETENCE, JUNE 2025

PROFESSIONAL PAPER 3

This paper consists of one scenario and two required parts.
Answer each required part in a separate answer book.

PAPER 3 PART I – REQUIRED		Marks	
		Sub-total	Total
(a)	Discuss, with reference to section 1.3 (Reprop: Auditors), the matters JEM Inc. should consider regarding its appointment as the auditors of Reprop for FY2024. <i>X1: Communication skill – logical argument</i>	12 1	 13
(b)	With reference to section 1.4 (Reprop: Municipal billings) – (i) discuss the risks of material misstatement at the assertion level for the contingent liability of Reprop in FY2024; and (ii) formulate substantive tests of detail procedures to verify the existence, accuracy, valuation and allocation, and presentation, of the contingent liability of Reprop for FY2024.	6 13	 19
(c)	Discuss, with reference to section 1.4 (Reprop: Municipal billings), the ethical concerns related to Reprop's decision on the municipal underbilling. <ul style="list-style-type: none"> Do not discuss any aspects related to the SAICA or IRBA Codes of Professional Conduct. 	6 6	 6
(d)	Discuss any concerns you may have with regard to the Spark-HOA's compliance with the Companies Act. <ul style="list-style-type: none"> Do not discuss any concerns related to section 45 of the Companies Act. Do not discuss any concerns related to the composition of the audit committee. <i>X1: Communication skill – clarity of expression</i>	13 1	 14
(e)	Discuss Carol's professional responsibility relating to the information that she discovered at and after the AGM of the Spark-HOA. <i>Y6: Ethical reasoning</i>	11 1	 12
Total for part I			64

INITIAL ASSESSMENT OF COMPETENCE, JUNE 2025

PROFESSIONAL PAPER 3

This paper consists of one scenario and two required parts.
Answer each required part in a separate answer book.

PAPER 3 PART II – REQUIRED		Marks	
		Sub-total	Total
(f)	<p>Critically evaluate whether the decisions of the board of directors of the Spark-HOA align with its strategic objectives.</p> <ul style="list-style-type: none"> Do not discuss sustainability and environmental strategic goals. Do not discuss regulatory compliance and governance issues. 	9	9
(g)	<p>Perform a net present value analysis and conclude on whether the Spark-HOA should undertake to procure solar and water solutions under the Spark-HOA based on the information in the scenario.</p> <ul style="list-style-type: none"> Assume for calculation purposes that all cash flows occur at the end of the year. Do not consider the impact on the homeowners of savings in electricity and water costs. Do not include the effect of the financing of the project. <p><i>Y4: Decision making</i></p>	20	21
(h)	<p>Evaluate the performance forecast of the Spark-HOA in line with its sustainability, environmental stewardship and strategic goals.</p> <ul style="list-style-type: none"> Assume that the water and solar solutions are procured under the Spark-HOA. Base your evaluation on relevant non-financial performance indicators. <p><i>X1: Communication skill – logical argument</i></p>	9	10
(i)	<p>Write a report to the board of directors of the Spark-HOA, in which you advise it on the best option for financing the solar and water backup solutions.</p> <ul style="list-style-type: none"> Assume that the sustainability-linked loan conditions in option 2 of section 2.5 (The Spark-HOA: Financing) are met. Assume that the water and solar solutions are procured under the Spark-HOA. <p><i>X1: Communication skill – layout and structure</i></p>	15	16
Total for part II			56
TOTAL FOR THE PAPER			120

