

# **BEE and the revised codes of Good Practice: how this directly and indirectly affects payroll**



**MOLENAAR & GRIFFITHS** INC.

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ATTORNEYS, NOTARIES AND CONVEYANCERS

# Topics For Discussion

- 1. Revised Codes of Good Practice in general
- 2. Focus on Ownership
- 3. Enterprise and Supplier Development
- 4. Direct and Indirect effect of Revised Codes on Payroll

# B-BBEE LEGISLATION

- Broad Based Black Economic Empowerment Act (53 of 2003)
- The Codes of Good Practice on Broad-Based Black Economic Empowerment
  - Applicable to all businesses that do not fall within the ambit of a sector specific code or charter
- Sector specific codes or charters
  - Mining Charter - Code of Good Practice.
  - Tourism Sector Code
  - Construction Sector Code
  - Forestry Sector Code
  - Transport Sector Code

# **B-BBEE LEGISLATION**

- CA Sector Code
  - Property Sector Code
  - ICT Sector Code
  - Financial Services Sector Code
  - Agri-BEE Sector Code
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- Revised Codes of Good Practice

# Compliance Requirements

- The B-BBEE rating requirements depend on the following two components, namely:
  - The business sector in which a business is involved; and
  - The annual turnover of a business.
- For all businesses that do not fall within a sector specific code or charter, the following measurement requirements apply:
  - For an annual turnover of **less than R5 000 000.00 (Five Million Rand)**, businesses without black ownership automatically qualifies as an Exempt Micro Enterprise (“EME”) with an automatic Level 4 B-BBEE rating. Where an EME has 51% or more black ownership, it automatically qualifies for a Level 3 B-BBEE rating.

# Compliance Requirements

- For an annual turnover in **excess of R5 000 000.00 (Five Million Rand)**, but **less than R35 000 000.00 (Thirty Five Million Rand)**, a business is classified as a Qualifying Small Enterprise (“QSE”) that has to complete a B-BBEE scorecard and comply with **4 of the potential 7 elements** of the Generic Scorecard.
- For an annual turnover in excess of **R35 000 000.00 (Thirty Five Million Rand)**, it has to comply with all 7 elements of the generic B-BBEE scorecard. The 7 elements are as follows:

# 7 Elements of Scorecard

- Ownership
- Management Control
- Employment Equity
- Skills Development
- Preferential Procurement
- Enterprise Development
- Socio-Economic Development

# Revised Codes of Good Practice

- These revised Codes of Good Practice (COGP) are now in force for those who elect to use them. This will become compulsory from **30 April 2015** for all non-sector Code BEE measurement.
- Number of elements on the Generic Scorecard are reduced from 7 to 5.

<b>BEE Element</b>	<b>Element Weight</b>
<b>Ownership</b>	<b>25</b>
<b>Management Control</b>	<b>19</b>
<b>Skills Development</b>	<b>20</b>
<b>Enterprise &amp; Supplier Development</b>	<b>40</b>
<b>Socio-Economic Development</b>	<b>5</b>
<b>Total</b>	<b>109</b>
<b>With Bonus Points</b>	<b>118</b>

# Revised Codes of Good Practice

- Enterprise Development and Preferential Procurement is now combined to create an Enterprise and Supplier Development element.
- Management Control and Employment Equity are combined to form one element.
- Threshold for EME's have been increased from R5million to R10million
- Threshold for QSE's have been increase from R35million to R50million, therefore the bracket will be between R10 million and R50million
- Threshold for Generics have been increased to above R50million

# Revised Codes of Good Practice

- All entities (except EME's) will need to comply with all 5 elements of the scorecard – no longer a choice to comply with only some elements.
- 40% Subminimum requirements for Ownership, Skills Development and Enterprise and Supplier Development (“Priority Elements”).
  - Generic entities will need to comply with all 3 priority elements;
  - QSE's will need to comply with at least 2 priority elements – Ownership is compulsory.
- Entities that do not meet the subminimum requirements for priority elements will be penalized as follows:

# Revised Codes of Good Practice

- **Generic** - Not meeting a minimum 40% under all of the three Priority Elements will result in the Status Level being discounted by one level.
- **QSE** - Not meeting a minimum 40% under Ownership and either of the other two Priority Elements will result in their Status Level being discounted by one level.

# Revised Codes of Good Practice

B-BBEE Status	Old codes points	New codes points	B-BBEE Recognition Level
Level One	≥100	118	135%
		100	
Level Two	99	99	125%
	85	95	
Level Three	84	94	110%
	75	90	
Level Four	74	89	100%
	65	80	
Level Five	64	79	80%
	55	75	
Level Six	54	74	60%
	45	70	
Level Seven	44	69	50%
	40	55	
Level Eight	39	54	10%
	30	40	
Non-Compliant	<30	<40	0%

# Focus on Ownership

- Under the Revised Codes, Exempt Micro Enterprises with 51% or more black ownership automatically obtains a B-BBEE Level 2 status.
- Exempt Micro Enterprises with 100% black ownership automatically obtain a B-BBEE Level 1 status.
- Under the Revised Codes the enhanced recognition for black ownership now also applies to Qualifying Small Enterprises and a Measured Entity with 51% or more black ownership will also automatically be a Level 2 contributor and with 100% black ownership it will automatically qualify for a Level 1 status.

# Focus on Ownership

- By complying with these ownership requirements even Qualifying Small Enterprises can obtain a good B-BBEE status without having to comply with all the other elements.
- Black ownership as element of the BEE scorecard must be distinguished from Management and Control, which deals with the management of businesses.
- Having a black person as shareholder in a company for instance, does not mean that the said person must also serve on the board of directors of a company and *vice versa*.

# How is Ownership Measured?

Category	Ownership Indicator	Weighting Points	Compliance Target
<b>Voting Rights</b>	Exercisable voting rights in the Measured Entity in the hands of black people	4	25% + 1 vote
	Exercisable voting rights in the Measured Entity in the hands of Black Women	2	10%
<b>Economic Interest</b>	Economic Interest of black people in the Measured Entity	4	25%
	Economic Interest of black women in the Measured Entity	2	10%
	Economic Interest of the following Black Natural People in the Measured Entity	3	3%
	<ul style="list-style-type: none"> <li>- Black Designated Groups</li> <li>- Black participants in Employee Ownership Schemes</li> <li>- Black beneficiaries of Broad Based Ownership Schemes</li> <li>- Black participants in co-operatives</li> </ul> New Entrants	2	2%
<b>Realisation Points</b>	Net value	8	
<b>TOTAL POINTS: 25</b>			

# How is Ownership Measured?

- In order to have valid black ownership in a business, irrespective of the form of a business (eg. Company, close corporation etc.) the founding documents and agreements regulating that ownership must not restrict the right of the black person to –
  - Exercise the number of votes attached to the percentage of equity held by the black person; and
  - To receive dividends or similar distributions in proportion to percentage of equity held by the black person.

Such interference could be seen as fronting if the business attempts to obtain the full points for the percentage equity held by the black person, while restricting the actual voting rights or dividends payable to the black person.

# Realisation Points

- Ownership fulfilment occurs on the release of the black person from all third-party-rights arising from financing their ownership transaction with the Measured Entity. These rights include any legal or commercial right that restricts, withholds or defers any benefit associated with the ownership of equity in the said business (such as dividends that are ceded to a financier for repayment of a loan).
- A business can score a potential 8 points on the ownership element of the B-BBEE scorecard if ownership fulfilment occurs. If ownership fulfilment does not occur, the business loses out on the realisation points.
- For transactions where the acquisition of equity in the business is payable over a period of time, the following ownership percentage targets have to be met in order for the business not to lose realisation points:

# Realisation Points

- 10% after the first year that the equity interest was obtained;
- 20% after the second year that the equity interest was obtained;
- 40% from the first day of the third year after the equity interest was obtained to the last day of the fourth year after the equity interest was obtained;
- 60% from the first day of the fifth year after the equity interest was obtained to the last day of the sixth year after the equity interest was obtained;
- 80% from the first day of the seventh year after the equity interest was obtained to the last day of the eighth year after the equity interest was obtained;
- 100% from the first day of the ninth year after the equity interest was obtained to the last day of the tenth year after the equity interest was obtained.

# Ownership Structures

- The most general forms in which businesses conduct their operations are the following :
  - Sole proprietorships;
  - Partnerships;
  - Companies;
  - Close corporations; and
  - Business trusts.
- There are various commercially sensible black ownership structures that existing businesses can implement, including participation in the ownership of a business by its employees through an employee trust.

# Ownership Structures

- In many instances the black owners of a business, including employees, do not have funds to purchase equity interests in a business. Under the Codes of Good Practice the following is possible-
  - To structure an ownership transaction to make financial sense, not giving the business away;
  - Payment of equity to be made over a period of time, in many instances through dividends received on the equity;
  - To put good safeguards in place to protect the interests of all the stakeholders; and
  - To put a clean “exit strategy” in place should the relationship between the parties or the transaction not work.

# Enterprise and Supplier Development

- This element combines the current Preferential Procurement and Enterprise Development elements into a single supplier orientated element.
- It contributes 44 points (37% of the total scorecard)
- Recognition of supplier spend is restricted to those suppliers who hold an “Empowered Supplier” status.
- The definition of “Value Added” suppliers falls away and the Empowered Supplier Status will now appear on the BEE Certificate.

# Enterprise and Supplier Development

- **To become an Empowered Supplier a Supplier must:-**
- Be B-BBEE compliant
- A good citizen meeting all regulatory requirements (DOL reports, VAT and Tax clearance etc)
- Achieve 3 out of the following 4 activities (1 of the 4 only for a QSE):-
  - 1) Procures 25% of cost of sales in South Africa;
  - 2) Allocates 50% of new job creation to black people;
  - 3) Achieves 25% transformation of raw material/beneficiation (local manufacturing and assembly etc);
  - 4) Spends at least 12 days per annum assisting black EMEs and QSEs to increase their operational or financial capacity.

# Enterprise and Supplier Development

- EMEs and Start-up are deemed to be Empowered Suppliers.
- The 40% minimum with its one BEE status level discount implication applies to this element. It applies to all 3 sub-elements, excluding bonus points associated with ED&SD
- Targets reward spend with small and black owned suppliers
- Enterprise Development beneficiaries are restricted to EMEs and QSEs that are more than 50% black owned

# Enterprise and Supplier Development

Criteria	Points	Target
<b>Preferential Procurement as % of TMPS</b>		
BEE Procurement Spend with Empowering Suppliers	5.00	80.00%
Procurement Spend with Empowering Suppliers qualifying as QSEs	3.00	15.00%
Procurement Spend with suppliers qualifying as EMEs	4.00	15.00%
BEE Procurement Spend with Empowering Suppliers Min 51% black owned	9.00	40.00%
Procurement Spend with Empowering Suppliers Min 30% black women owned	4.00	12.00%
<b>Bonus Points</b>		
B-BBEE Procurement with Designated Group suppliers Min 51% black owned	2.00	2.00%
<b>Enterprise and Supplier Development as a % of NPAT</b>		
Supplier Development contributions	10.00	2.00%
Enterprise Development contributions and Sector specific Programmes	5.00	1.00%
<b>Bonus Points</b>		
Graduation from Enterprise Development to Supplier Development beneficiary	1.00	Yes
Jobs created by Supplier and Enterprise Development initiatives	1.00	Yes
<b>Total</b>	<b>44.00</b>	

# Direct Effect on Payroll

- Exempt Micro Enterprises with an annual turnover below R10 000 000.00 will automatically qualify for a level 4 B-BBEE status without having to comply with any elements of the B-BBEE scorecard.
- Qualifying Small Enterprises with an annual turnover between R10 000 000.00 and R50 000 000.00 no longer have a choice to only comply with some elements on the B-BBEE scorecard and must be measured on all 5 elements of the scorecard.
- Qualifying Small Enterprises must comply with the 40% sub-minimum target for Ownership and either of the following elements:
  - Skills Development; or
  - Enterprise and Supplier Development (which includes Preferential Procurement)

# Direct Effect on Payroll

- Generic Enterprises with an annual turnover above R50 000 000.00 will be measured on all 5 elements of the B-BBEE scorecard and each Generic Enterprise must comply with the 40% sub-minimum targets set for the following elements:
  - Ownership;
  - Skills Development; and
  - Preferential Procurement and Supplier Development.
- Higher pressure on measured entities to obtain B-BBEE scorecard points, as the same amount of points under the old scorecard will result in a lower B-BBEE status level.

# Indirect Effect on Payroll

- To maximise Preferential Procurement points (20 points on scorecard) for their clients, Payroll businesses will have to ensure that their clients get at least 100% recognition for every rand that they spend on Payroll, which will require a Level 4 B-BBEE status on the part of Payroll.
- To be able to get recognition for Preferential Procurement purposes, measured entities conducting payroll business will have to become an Empowered Supplier if it is a QSE or Generic business.

# Indirect Effect on Payroll

- The Revised Codes seem to favour small black owned businesses and start-up enterprises
- Having black ownership in a small to medium sized business could, from a B-BBEE point of view, provide such businesses with a competitive advantage
- Larger Payroll businesses may have to consider substantial changes to their current business models in order to remain on their current B-BBEE compliance levels and to obtain greater compliance levels

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