the dti

THE CODES OF GOOD PRACTICE ON BROAD BASED BLACK ECONOMIC EMPOWERMNT – PHASE ONE

A Guide to Interpreting the First Phase of the Codes

Chapter One: Background to, Intention & Application of, the Codes of Good Practice

Introduction

This guide has been developed as an interpretation aid for non-specialists seeking to gain further clarity and understanding into the first phase of the Codes of Good Practice ('the Codes'). This includes an interpretation on each of Codes 000, 100 and 200 on the Legislative and Regulatory Framework, Ownership and Management, respectively, as well as interpretations of individual statements. *This guide should not be viewed as a replacement for the content of the Codes, but rather it should be read in conjunction with each Statement, as a means of further clarification.*

The Purpose of the Codes of Good Practice

Before the release of the Strategy on Broad-Based BEE[1], there existed no framework for the measurement of broad-based BEE. The Strategy provided the outline of a broad-based scorecard, together with weightings, but did not contain detail on measurement principles and the application of the scorecard.

By the beginning of 2004 when the BEE Act was promulgated, numerous sectors of the economy had drafted industry charters on BEE and transformation. Whilst some contained scorecards loosely based on the broad-based scorecard contained in the Strategy, others were merely written undertakings of commitment to transformation. In addition, several of these charters were drafted prior to the release of the Strategy and stakeholders therefore had little point of reference in terms of broad-based elements and weightings. Furthermore, it became evident that other pertinent issues surrounding the measurement of BEE needed to be addressed to further accelerate the transformation process.

Summary of Obstacles, Implications, Solutions presented by the Codes and Relevant Statements:

[1] *South Africa's Economic Transformation: A Strategy for Broad-Based Black Economic Empowerment*

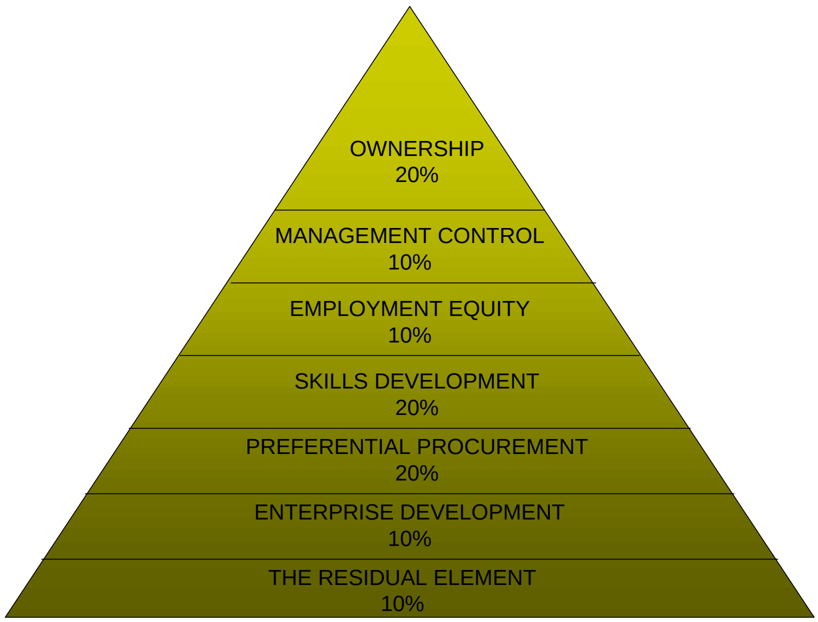
Historical BEE Implementation Obstacles	Implications	Solution presented by the Codes of Good Practice	Applicable COGP Statements
Lack of uniform framework for the recognition and measurement of BEE	Created confusion as the same BEE initiatives or transactions may have received different BEE recognition by different organs of state, business entities and verification agencies	Standardisation of BEE recognition and measurement principles to provide clarity	**Primary**: Statement 000 **Secondary**: Codes of Good Practice in general
Extensive delays in BEE implementation due to differences in interpretation	Sectors were often locked in contentious debates around certain aspects of BEE, thereby delaying the implementation of broad-based BEE initiatives	Standardisation of BEE recognition and measurement principles to provide clarity	**Primary**: Statement 000 **Secondary**: Codes of Good Practice in general
Disparity in definitions and targets in charters and other BEE requirements	Different charters introduced definitions, targets and processes which may have diluted or negated the impact of the Strategy and circumvented the principles of the BEE Act	Specification of the requirements for the development and recognition of industry charters (reducing disparity in principles and definitions as a result of industry charters)	**Primary**: Statement 000 **Secondary**: Codes of Good Practice in general
Status of transformation charters was unclear	Confusion and delays in BEE implementation resulted since companies were uncertain as to the status and application of charters	Specification of the requirements for the development and recognition of industry charters	**Primary**: Statement 010
No BEE verification standards or benchmarks across different BEE verification agencies	The lack of accreditation of BEE verification agencies based on strict standards and criteria meant that any entity operating as a verification agency could perform BEE verification work and could issue verification certificates	Provision of criteria and standards to be followed by verification agencies. The Codes also provide for an accreditation body to accredit only those agencies which meet the required standards, thereby ensuring standardisation, comparability and validity of verification certificates issued by accredited agencies	**Primary:** Statement 020
Lack of underlying economic substance to many BEE transactions	Many BEE transactions boasted high percentage levels of legal black ownership, but often the actual economic benefits accruing to black shareholders proved to be significantly lower	Provision of a balanced ownership scorecard which measures net economic interest in the hands of black people	**Primary:** Statement 100
Fronting due to lack of implementation guidelines	Lack of understanding of BEE and its elements often resulted in fronting and meant that fronting was more difficult to detect	Provision of definitions, principles and processes to identify and report on fronting practices	**Primary**: Statement 100 **Secondary:** The Codes of Good Practice in General
Black board members tended not to be involved in the implementation of strategic decisions	Often, black board members were only appointed in non-executive positions and were therefore not involved at an operational level in the implementation of strategic overall and financial management decisions	Management scorecard place emphasis on black representation at senior executive levels	**Primary:** Statement 200

History & Legal Framework

When the shortcomings of narrow-based black economic empowerment[2] (BEE) became apparent towards the end of the 1990s, a need emerged for a more inclusive approach to empowerment that would begin to narrow the divide between the first and second economies by putting mechanisms in place to accelerate the entry of black people into the first economy. This approach became known as broad-based black economic empowerment (B-BBEE).

[2] Black economic empowerment by means of the elements of ownership and management exclusively

Subsequently, the Department of Trade and Industry's (dti) ***Strategy for Broad-Based BEE*** not only defined broad-based BEE and the transformation imperative but outlined the first broad-based scorecard comprising the seven elements of broad-based BEE. The seven elements and their respective weightings out of 100 are depicted below, as per the Strategy and the Generic Scorecard contained in the Codes:

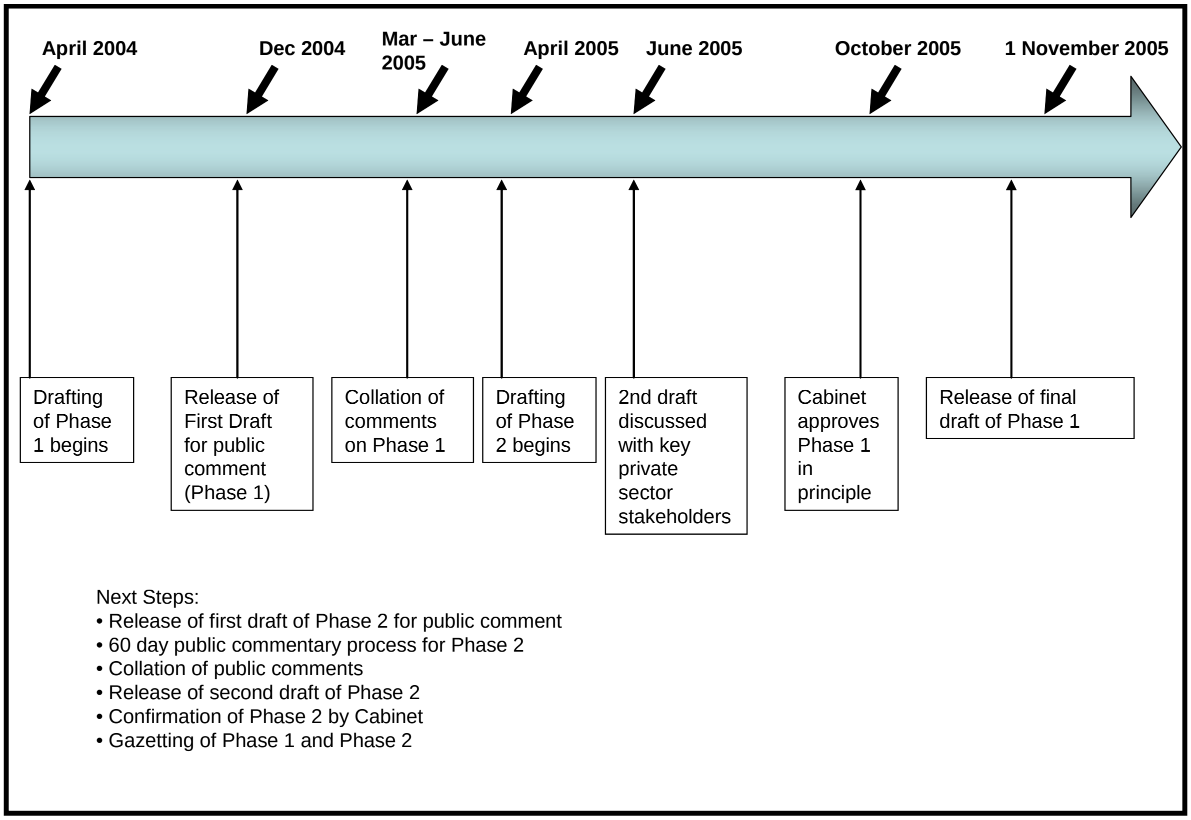


The Strategy was followed by the **Broad-Based BEE Act No. 53 of 2003** (BEE Act), which was promulgated in January of 2004. In section 10, the Act outlines government's leverages for the implementation of broad-based BEE, meaning that organs of state and public entities must take an entity's BEE status into account when:

- determining qualification criteria for the granting of licences and concessions
- developing and implementing a preferential procurement policy
- determining qualification criteria for the sale of state-owned enterprises
- developing criteria for entering into partnerships with the private sector

The BEE Act (abbreviated in the Codes and defined as "the Act") is an enabling framework that allows for the development of the **Codes of Good Practice.** The Codes provide a standard framework for the measurement of broad-based BEE across all sectors of the economy. This means that no industry will be disadvantaged over another when presenting their BEE credentials. This can occur when a very stringent transformation charter is applied to one entity, whilst a transformation charter with far more lenient measurement criteria, is applied to another. Statement 010, which provides guidelines for the alignment of transformation charters to be gazetted as Codes of Good Practice, will ensure that even when different gazetted charters are applied to different entities presenting their BEE credentials, neither of the entities will be unfairly disadvantaged over the other because of the application of a more stringent industry charter. The intention of the Codes of Good Practice is therefore to level the playing field for all entities operating within the South African economy by providing clear and comprehensive criteria for the measurement of broad-based BEE.

The Development Process



The development process began in April of 2004, with the drafting of the first phase of the Codes of Good Practice. This first phase includes:

- Code 000 on the legislative and regulatory framework of BEE
  - Statement 010 on the gazetting of transformation charters
  - Statement 020 on the accreditation of BEE verification agencies
- Code 100 on ownership
  - Statement 101 on the sale of assets
- Code 200 on Management Control.

As required by the BEE Act, the first phase was released for a 60-day public commentary period in December 2004. Following requests by the stakeholders in various sectors of the economy, the commentary period was extended to 7 March 2005. A total of 350 comments were received from corporates, SMMEs and individuals. Based on these comments, a subsequent draft document was discussed with selected private sector stakeholders who had provided substantial input during the commentary process. These discussions took place on 24 June 2005 in the presence of the Minister of Trade and Industry. The presentation of this second draft elicited further input from corporates, strategic sector representatives and business groupings and produced further amendments that were incorporated in the final draft approved by Cabinet in October 2005.

The drafting of Phase Two of the Codes, dealing with the remaining five elements of the Generic Scorecard, as well as other pertinent issues such as the measurement of SMMEs and the matter of fronting, began in April 2005. Phase

Two will undergo a 60-day public commentary period before its finalisation. Thereafter, gazetting of the Codes of Good Practice will take place once both phases one and two have been finalised, which will occur in 2006.

The table below, reproduced from Statement 000, provides a detailed guide to the content of the Codes:

Code number range	General subject matter
Code 000	**Framework** for the measurement of broad-based black economic empowerment
Code 100	Measurement of the **ownership** element of broad-based black economic empowerment
Code 200	Measurement of the **management control** element of broad-based black economic empowerment
Code 300	Measurement of the **employment equity** element of broad-based black economic empowerment
Code 400	Measurement of the **skills development** element of broad-based black economic empowerment
Code 500	Measurement of the **preferential procurement** element of broad-based black economic empowerment
Code 600	Measurement of the **enterprise development** element of broad-based black economic empowerment
Code 700	Measurement of the **residual** element of broad based black-economic empowerment
Code 800	**Sector Codes** as defined in Code 1000 Statement 1000
Code 1000	Measurement of broad-based black economic empowerment for **qualifying small enterprises**

KEY:

- Phase One
- Phase Two
- Charters gazetted as Sector Codes, to be included as and when gazetting of charter takes place, after the gazetting of the Phases One and Two of the Codes

Further statements not presently included in either the first or second phases of the Codes may be issued from time to time. In such cases, these statements will be included under the relevant Code series. For example, the issue of ownership amongst multinationals will be dealt with in a statement other than Statement 100, and will be contained under Code 100 on Ownership after the obligatory 60 day commentary period specified in the BEE Act.

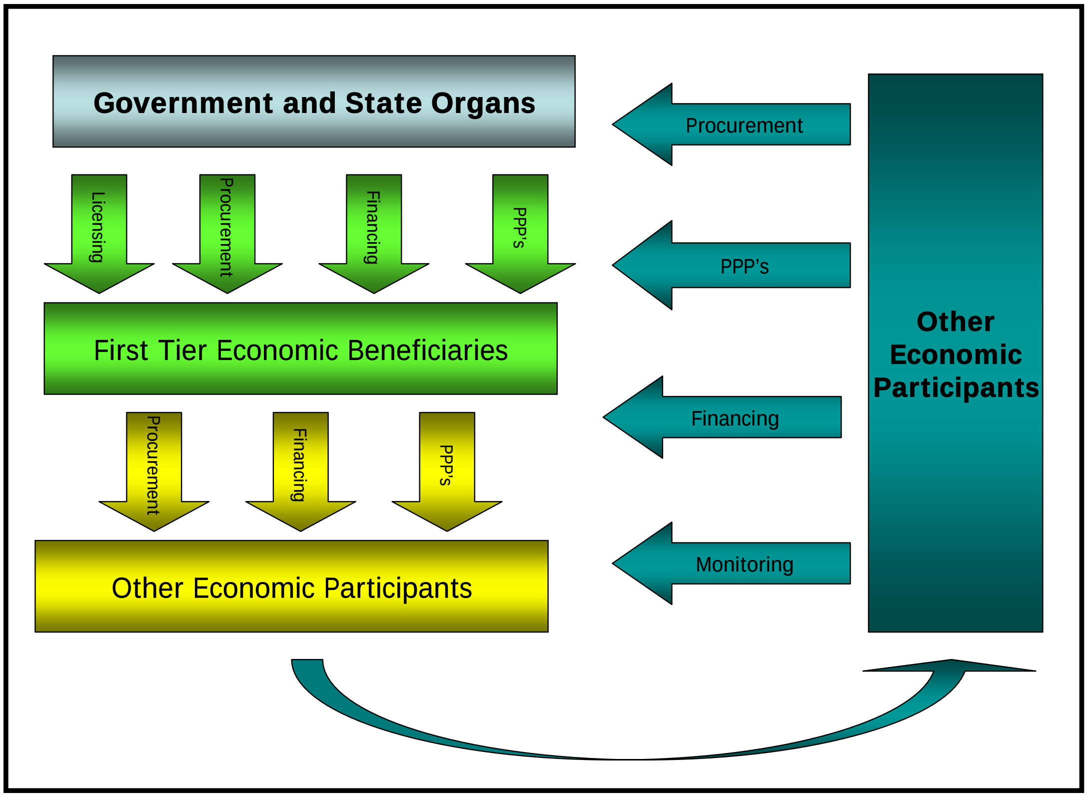
Who do the Codes apply to?

Once gazetted, the Codes of Good Practice will be binding on all organs of state and public entities. This means that, as per section 10 of the BEE Act, government must apply the Codes when entering into decisions affecting the following areas:

- procurement
- licensing and concessions

- public private partnerships ('PPP's')
- the sale of state-owned entities

Implementation Levers for the Application of the Codes:



By deduction, private sector enterprises must apply the Codes should they wish to interact with organs of state and public entities in one or more of the interactions described above, such as tendering for business, applying for licences and concessions, entering into PPPs and purchasing state-owned assets.

Furthermore, private sector enterprises are encouraged to apply the Codes of Good Practice in their interactions with one another for two reasons. First, enterprises should apply the Codes because preferential procurement will effectively impinge on most private sector enterprises throughout the chain of supplier, from the first tier suppliers to government, downwards. Second, all industry charters wishing to be gazetted as Codes of Good Practice will be required to align themselves with the Codes for the purposes of gazetting by the Minister of Trade and Industry. Therefore, those enterprises applying industry charters that have not yet been gazetted may be required to alter their means of measurement once these charters have been gazetted.

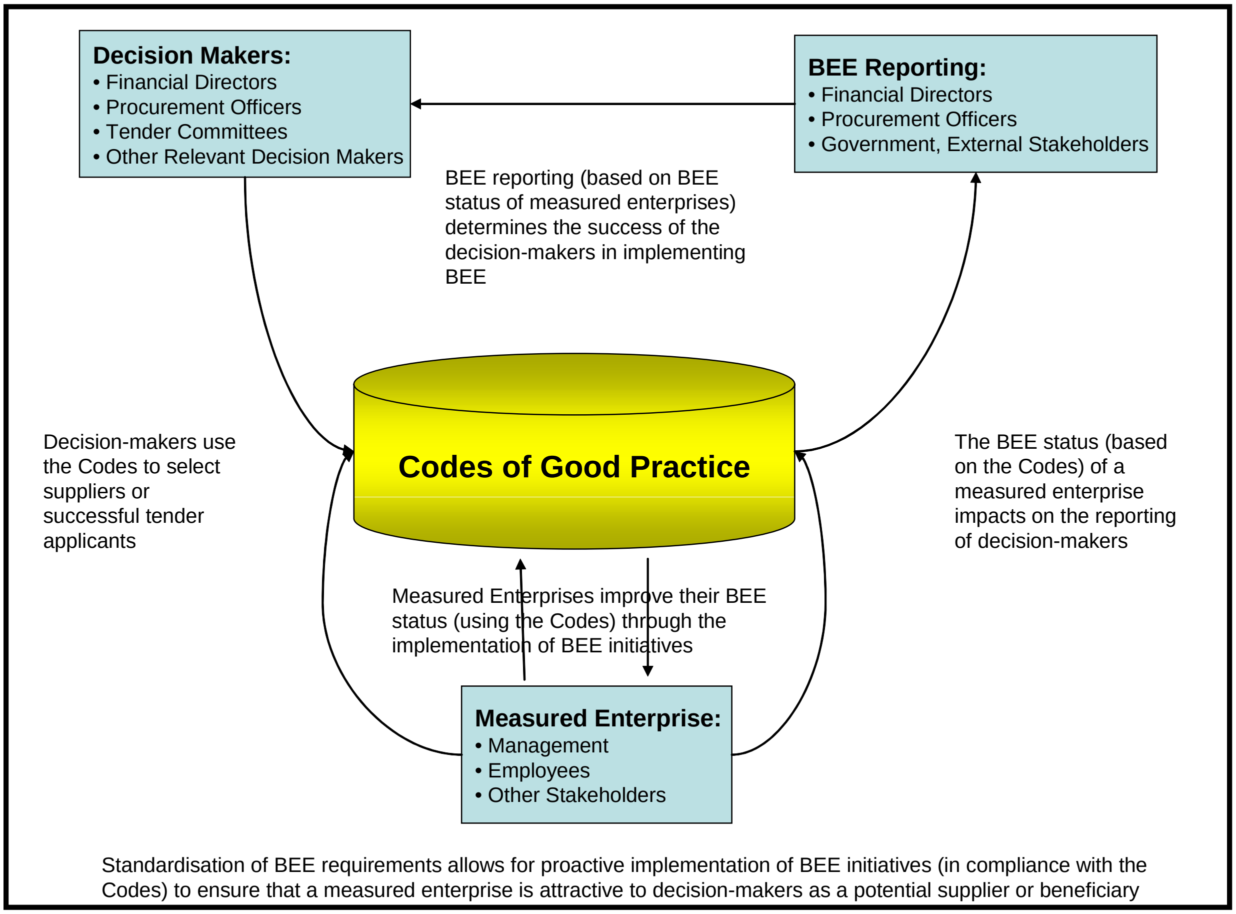
How will the Codes be applied?

Based on the implementation levers highlighted above, the Codes of Good Practice will be important for decision-makers when making and reporting on economic decisions. The following example will demonstrate how the Codes will be implemented by such decision-makers when:

- reporting BEE spend and initiatives
- making economic decisions based BEE criteria

- selecting and implementing BEE initiatives

As a result, the Codes of Good Practice will be very important to the management of enterprises interacting with both public and private sector entities that make their decisions based on the Codes.



Applying the Codes of Good Practice to an enterprise simply means that an enterprise will be measured in accordance with the Generic Scorecard, contained in Statement 000. In other words, the measured enterprise's BEE status will be measured according to the targets and weightings contained in the Generic Scorecard[3], as well as the measurement principles contained in each of the corresponding Statement. A measured enterprise will receive a score out of 100, which will confer upon it a corresponding BEE status according to its BEE contributions.

Example: Application of the Codes by a Decision-Maker

The procurement officer of a public sector entity is considering a tender. Assuming that pricing, quality and other factors are similar across the three potential suppliers, the final decision will be based BEE credentials.

The BEE scorecards of three competing enterprises are as follows:

- **Company X**: with a verified BEE status in terms of the Generic Scorecard, as contained in Statement 000, of **55%**
- **Company Y**: with a verified BEE status in terms of the Generic Scorecard, as contained in Statement 000, of **78%**

[3] Targets in Generic Scorecard are subject to change for elements contained in Phase Two. Weightings, however, will remain unchanged

- **Company Z**: a black majority owned enterprise, with a verified BEE status in terms of the Generic Scorecard, as contained in Statement 000, is **55%**

The table below depicts the enterprise's weighted score per element (i.e. the score achieved after multiplying each indicator's raw score by the corresponding indicator weighting and summing the results for each element):

ELEMENT	WEIGHTING	COMPANY X: WEIGHTED SCORE	COMPANY Y: WEIGHTED SCORE	COMPANY Z: WEIGHTED SCORE
Ownership	20%	12%	18%	21%
Management Control	10%	5%	9%	5%
Employment Equity	10%	7%	8%	8%
Skills Development	20%	12%	15%	5%
Preferential Procurement	20%	11%	12%	9%
Enterprise Development	10%	0%	6%	0%
Residual	10%	8%	10%	7%
TOTAL	**100%**	**55%**	**78%**	**55%**

Assuming the Procurement Officer awarding this tender is working towards the achievement of a set preferential procurement target, s/he will have to identify the BEE recognition levels of the three suppliers when making this economic decision. The following table, as contained in Statement 000, provides specifies BEE procurement recognition levels for the procurement officer:

The BEE scores of the three enterprises in this example mean that each enterprise enjoys a corresponding BEE procurement recognition level, as illustrated by the colour code in the table below:

BEE Status	Qualification	BEE procurement recognition level
Level One Contributor	≥100 points on the Generic Scorecard	135%
Level Two Contributor	≥85 but <100 points on the Generic Scorecard	125%
Level Three Contributor	≥75 but <85 on the Generic Scorecard	110%
Level Four Contributor	≥65 but <75 on the Generic Scorecard	100%
Level Five Contributor	≥55 but <65 on the Generic Scorecard	80%
Level Six Contributor	≥45 but <55 on the Generic Scorecard	60%
Level Seven Contributor	≥40 but <45 on the Generic Scorecard	50%
Level Eight Contributor	≥30 but <40 on the Generic Scorecard	10%
Non Compliant Contributor	<30 on the Generic Scorecard	0%

BEE Procurement Recognition: Company X

As a Level Five Contributor, if the procurement officer selects company X, s/he will recognise only 80c for every R1 spent with Company X. In other words, if the officer spends R10 million with Company X in the year under measurement, his/her department will recognise R8 million of that spend when reporting on preferential procurement.

BEE Procurement Recognition Levels: Company Y

In comparison, Company Y is a Level Three Contributor. Statement 000 provides for enhanced BEE procurement recognition levels when procuring from enterprises that are Level One, Two or Three Contributors, as per the

Generic Scorecard. This means that Company Y will enjoy enhanced procurement recognition: i.e.: for every R1 spent with Company Y by its clients, the procurer may recognise R1.10. In other words, if the officer spends R10 million with Company Y in the year under measurement, his/her department will recognise R11 million when reporting on preferential procurement.

Enhanced BEE Procurement Recognition Levels: Company Z

In addition, an inherent bonus system has been provided for in Statement 000 for procurement from enterprises which are more than 50% black-owned (or majority black-owned enterprises) in that such enterprises may be ‘promoted’ one level in terms of their BEE status, provided that the enterprise has also achieved the full seven points under the net equity interest component of the Generic Scorecard.

As a result, although Company Z, (a company in which black people hold 100% of the exercisable voting rights and 100% of the economic interest owned AND which has achieved all seven net equity interest points in accordance with Statement 100) scores 55 points on the Generic Scorecard (the same as Company X), it is promoted from a Level Five Contributor to a Level Four Contributor. This means that the procurement officer will be able to claim R 1 for every R 1 spent with Company Z, instead of only 80c for every rand as is the case with Level Five Contributors. In other words, if the officer spends R10 million with Company X in the year under measurement, his/her department will recognise the full R10 million when reporting on preferential procurement.

Resulting Economic Behaviour

The selection of Company Y, the Level Three Contributor, will ensure that the procurement officer receives the most recognition for his/her spend through this tender. It will also act as an incentive to Company X and Company Z to implement further BEE initiatives to ensure that they will be more competitive in future tenders.

Comparative Reporting Effects of BEE Procurement Spend:

Assuming that the procurement officer in the above example spends R 10 million on goods and/or services from Company X, Company Y and Company Z respectively, as well as R 50 million from another company, Company A, non-BEE compliant entity, the officer’s BEE reporting will be as follows:

Supplier	BEE Score	Level Contribution	BEE Recognition Level	Total Spend	BEE Spend
Company X	55%	Level 5	80%	10,000,000	8,000,000
Company Y	78%	Level 3	110%	10,000,000	11,000,000
Company Z	55%	Level 4 (Promoted)	100%	10,000,000	10,000,000
Company A	15%	Non-Compliant	0%	50,000,000	0
Total				**80,000,000**	**29,000,000**

The BEE procurement percentage for the procurement officer will be calculated as follows:

= BEE spend/ total procurement spend

= 29,000,000/80,000,000 = 36.3%

The procurement officer receives full and enhanced recognition for procurement from Company Y and Company Z, whilst s/he receives 80% recognition for his/her spend with Company X and no recognition whatsoever for his spend with Company A. In order to improve his/her spend to reach target, s/he will prefer to procure from Company Y and Company Z and similar BEE contributors and may reduce his spend with Company A and Company X over time (unless they transform). This behaviour will then encourage companies to maintain and improve on their BEE status to become more competitive.

Conclusion:

The overall purpose of the Codes of Good Practice is to provide certainty with respect to BEE recognition and measurement, in order that BEE initiatives may be implemented in such a way that economic substance takes precedence over form, that there exists just comparability between the BEE statuses of different entities and that competition with respect to BEE contribution levels takes place. In so doing, this will begin to ensure that BEE is implemented across the value chain, thereby facilitating access to the mainstream economy for more black people.

Chapters Two to Four: Code 000 – Framework for the Measurement of Broad-Based Black Economic Empowerment

Chapter Two: Statement 000 – The Organisation of the Codes of Good Practice, the Elements of Broad-Based Black Economic Empowerment and the Generic Scorecard

Introduction

Statement 000 resolves certain fundamental and key issues surrounding broad-based BEE and the application thereof, by outlining the framework in which the measurement of broad-based BEE must take place. This includes an interpretive paragraph on misrepresentation or circumvention.

Overview & Objectives

- Provides Code references for each of the seven elements of B-BBEE
- Lays down certain fundamental principles with respect to substance over form and provides guidance on what constitutes misrepresentation in terms of BEE
- Assigns BEE statuses attached to an entity's corresponding broad-based score, as well as to the corresponding BEE procurement recognition level
- Explains the transitional period for the optional application of narrow-based measurement principles
- Specifies the duration of the Codes

Interpretation Principles

These interpretation principles outline key principles with respect to fronting - the key principle being that substance must always take precedence over form. In addition, key generic measurement principles are provided. They are as follows:

1. ***Measurement of BEE principles is based on the actual level of compliance at the date of measurement****:*
   This means that the BEE status of an enterprise is determined as a snapshot at a point in time.
2. ***Supporting evidence or documentation is required for the substantiation of BEE contributions****:*
   All claims with respect to BEE contributions made by a measured enterprise must be supported by evidence or documentation. No recognition in the form of points on the Generic Scorecard will be given for claims that are unsubstantiated by evidence. The evidence will be evaluated during the verification process by an accredited verification agency prior to any recognition of reported BEE initiatives.
3. ***Disqualification for misrepresentation****:*
   Should an enterprise be found to misrepresent its BEE status, the enterprise will forfeit any points for any BEE contributions and its entire scorecard will be disqualified.
4. ***Fronting to be reported to the Minister of Trade and Industry:***

Following specific sets of procedures, procurement officers and verification agencies are obliged to report incidences of fronting or circumvention of the principles of the BEE Act, to the Minister of Trade and Industry.

Organisation of the Codes, the Elements, the Generic Scorecard

In addition to providing code references for the seven elements of broad-based BEE, references are provided for transformation charters gazetted as sector codes, which will be contained under Code 800, as well as for statements to be contained under Code 1000 for the measurement of SMMEs which are classified as "qualifying small enterprises".

Code 800 allows for charters to become legally binding thereby enabling sectors to focus on some of the unique characteristics of individual industries when implementing BEE, whilst Code 1000 provides recognition for the unique environment faced by SMMEs.

BEE Statuses and Procurement Recognition Levels

Statement 000 outlines what each of the seven elements measures in essence (paragraph seven), before going on to summarise the corresponding weightings for these seven elements and consequently interpreting an enterprise's score on the Generic Scorecard by assigning it a corresponding BEE status (paragraph eight).

An enterprise is measured out of 100 BEE contribution points, which will determine that enterprise's contribution level. The highest possible contribution level is Level One, for entities that score over 100% (this may be achieved by obtaining bonus points), whilst the lowest recognition level is Level Eight, for entities that score 30% to 40% on the scorecard. The status of "Non Compliant Contributor" is assigned to those enterprises that score less than 30% on the scorecard.

For ease of reference, the table in paragraph 8.2.2 of Statement 000, is reproduced here:

BEE Status	Qualification	BEE procurement recognition level
Level One Contributor	≥100 points on the Generic Scorecard	135%
Level Two Contributor	≥85 but <100 points on the Generic Scorecard	125%
Level Three Contributor	≥75 but <85 on the Generic Scorecard	110%
Level Four Contributor	≥65 but <75 on the Generic Scorecard	100%
Level Five Contributor	≥55 but <65 on the Generic Scorecard	80%
Level Six Contributor	≥45 but <55 on the Generic Scorecard	60%
Level Seven Contributor	≥40 but <45 on the Generic Scorecard	50%
Level Eight Contributor	≥30 but <40 on the Generic Scorecard	10%
Non Compliant Contributor	<30 on the Generic Scorecard	0%

For the purposes of preferential procurement, each BEE status band (Levels One to Eight) is assigned a corresponding BEE procurement recognition level. This represents the proportion of spend which a decision maker can claim for interacting with a measured enterprise. For example, if a procurement officer procures from a Level Five Contributor, s/he can claim 80 cents in every Rand spent with that entity, as BEE procurement spend. The procurement officer's BEE recognition level, however, drops to 50 cents in every Rand when procuring from a Level Seven Contributor and increases to R 1.25 for every Rand spent with a Level Two Contributor).

Enhanced BEE Procurement Recognition Levels

A measured enterprise which procures goods and services from Contributors in Levels One, Two and Three, will enjoy enhanced recognition: i.e.: for every R1 spent with a Level One Contributor, the procurer may recognise R1.35 as BEE procurement.

In addition, an inherent bonus system has been designed for procurement from enterprises which are more than 50% black-owned in that such enterprises may be promoted one level in terms of their BEE status – i.e. a 51% black-owned enterprise which scores 65% on the Generic Scorecard, may jump from being a Level Four Contributor, to being classed as a Level Three Contributor. However, this only applies in cases where black people hold more than 50% of the exercisable voting rights and economic interest, and where the full seven net equity points have been earned, all in accordance with the measurement principles contained in Statement 100 on ownership.

Verifying BEE Contributions

When interacting with the private sector (through procurement, issuing of licences, PPPs, organs of state and public entities must insist that private sector enterprises prove their BEE status by providing a verification certificate from an accredited verification agency. Private sector enterprises are encouraged to do the same for the purposes of procurement and supply. Failure to do so can impact on the validity of a private sector entity's verification certificate when it interacts with government. For example, if Company A wishes to interact with government, its preferential procurement score cannot be accurately determined if its own suppliers have not been verified. This will impact on the overall BEE score (and potentially the BEE status) of Company A.

The Transitional Period and the Duration of the Codes

In recognition of the fact that many enterprises are still applying narrow-based or similar evaluation[4] mechanisms, the Codes allow for the continuation of narrow-based evaluation until the end of the twelfth month of the publication and gazetting of Code 000. This is to allow all reporting entities the opportunity to initiate the reporting of BEE contributions using the Codes from the first reporting period that will begin subsequent to the release of the Codes. Notwithstanding the latter, broad-based evaluation is encouraged to continue, or to begin, prior to the completion of the transitional period.

If an enterprise elects to be measured on narrow-based principles during the transitional period, the sum of the measured enterprise's score for ownership and management will be multiplied by a factor of 1.92.

In other words, the measured enterprise's **narrow-based score** will be calculated as follows:

= sum of scores for ownership & management elements X 1.92

Unless a Code is amended, substituted or repealed as allowed for in section 9 of the BEE Act, the Codes will be reviewed after a period of ten years, following the gazetting thereof.

[4] An entity's BEE status is evaluated according to ownership and management control exclusively

Chapter Three: Statement 010 – Guidelines for the Development and Gazetting of Transformation Charters

Introduction

As the second wave of transformation began to gain momentum in South Africa in 2001, various sectors of the economy began drafting documents of intent that summarised each sector's commitments with respect to transformation. These became known as sector transformation charters.

There was, however, no overall framework against which to benchmark the individual charters during their development and no guidance on the level and extent of involvement by stakeholders. In the absence of such a framework, there may have existed substantial differences between these sector charters.

Section 12 of the BEE Act of 2003 provided some guidance with respect to the composition of what the Act termed, 'transformation charters'. In terms of the BEE Act, sector transformation charters are commitments by a sector to accelerate BEE and are gazetted for information purposes only. Nonetheless, there existed a need for a more comprehensive regulatory framework to guide the development of transformation charters developed in terms of section 12, as well as those charters developed to be gazetted as Codes of Good Practice. Statement 010 provides such a framework.

Overview & Objectives

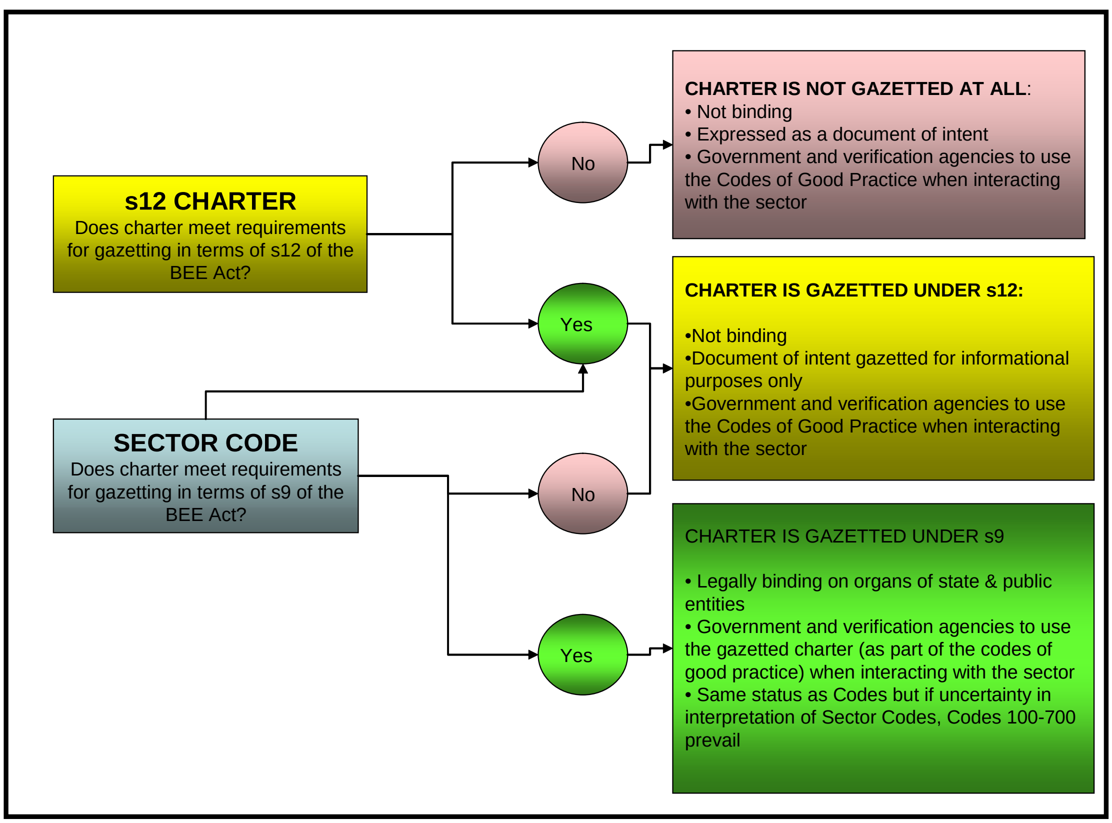
- Provides guidelines on the drafting of transformation charters (those applying to be gazetted in terms of s12 and those applying for the sector charter to be converted and gazetted as a Sector Code of Good Practice in terms of s9 of the BEE Act)
- Provides guidelines on the process to be followed for the gazetting of transformation charters
- Explains the status of transformation charters gazetted in terms of section 12
- Explains the status of transformation charters which are converted and gazetted as Sector Codes of Good Practice in terms of section 9 (charters gazetted as Codes of Good Practice)
- Provides guidelines for constituting Charter Councils in Annexe 010

The Status of Transformation Charters Gazetted in Terms of s12 and the Status of Sector Codes of Good Practice Gazetted in terms of s9

The BEE Act provides for the drawing up of industry charters that may be gazetted in terms of either section 9 or section 12 of the Act:

Sector Codes (s9 of BEE Act)	*Transformation Charters (s12 of BEE Act)*
• Gazetted as Codes of Good Practice to be contained in Code 800	• Gazetted for informational purposes only • s12 charters are expressions of the industry's commitment to transformation
• Same legal status as the Codes of Good Practice, therefore binding on organs of state and public entities in their interactions with the sector, as provided for in section 10 of the BEE Act	• No legal status, therefore not legally binding on organs of state or public entities
• Private sector enterprises are encouraged to apply the Codes of Good Practice (including Sector Codes, if applicable) in their interactions with one another, as espoused in Code 000	• Private sector entities must apply Codes 100 – 700 or Code 800 should they wish to interact with organs of state and/or public entities and are furthermore encouraged to do the same in their interactions with one another

Implications for the Gazetting of Transformation Charters under section 12 & Sector Codes under section 9:



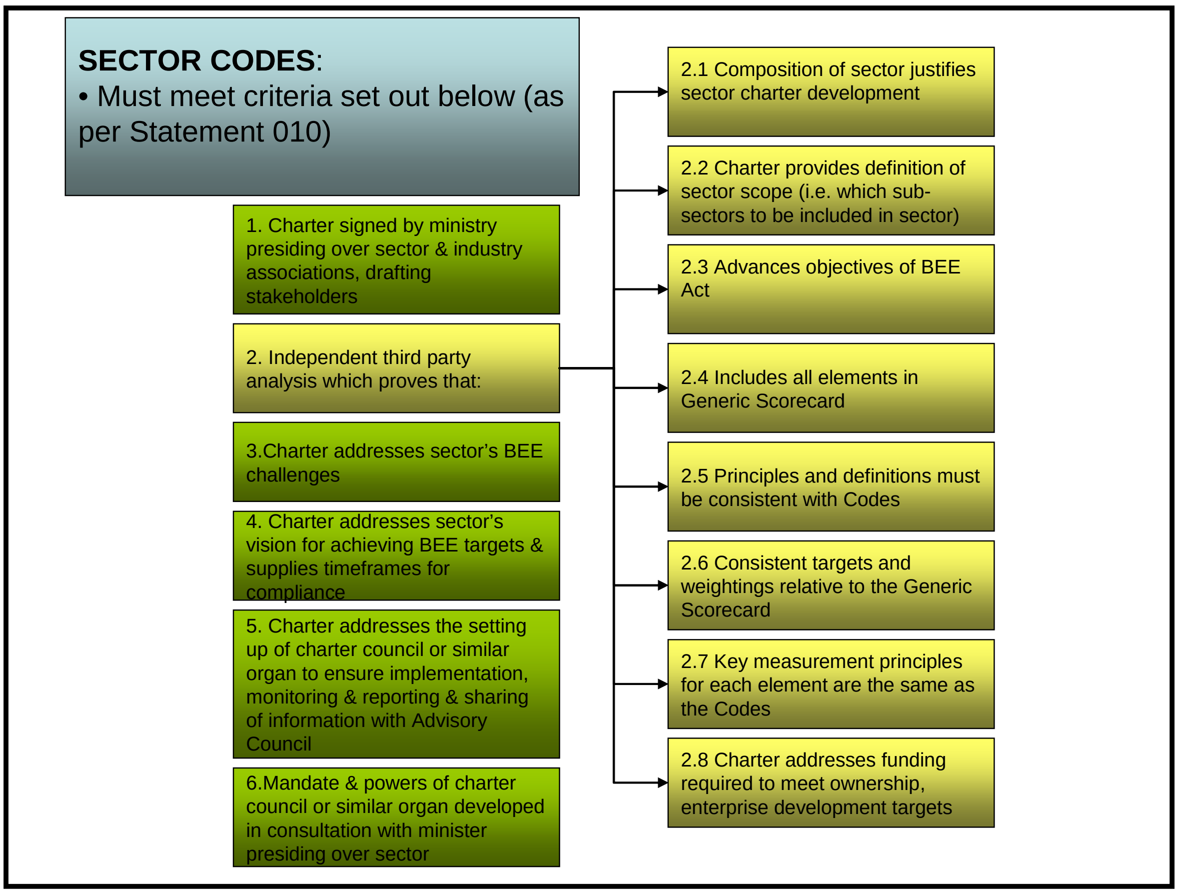
Procedure for the Gazetting of Transformation Charters in Terms of s12 of the BEE Act

Transformation Charters to be gazetted in terms of section 12 of the BEE Act must simply meet the following two criteria, as outlined in the Act:

- The charter must be sufficiently consultative in that it must have been developed by the sector's major stakeholders
- The charter must advance the objectives of the BEE Act

Procedure for the Gazetting of Transformation Charters as Sector Codes of Good Practice

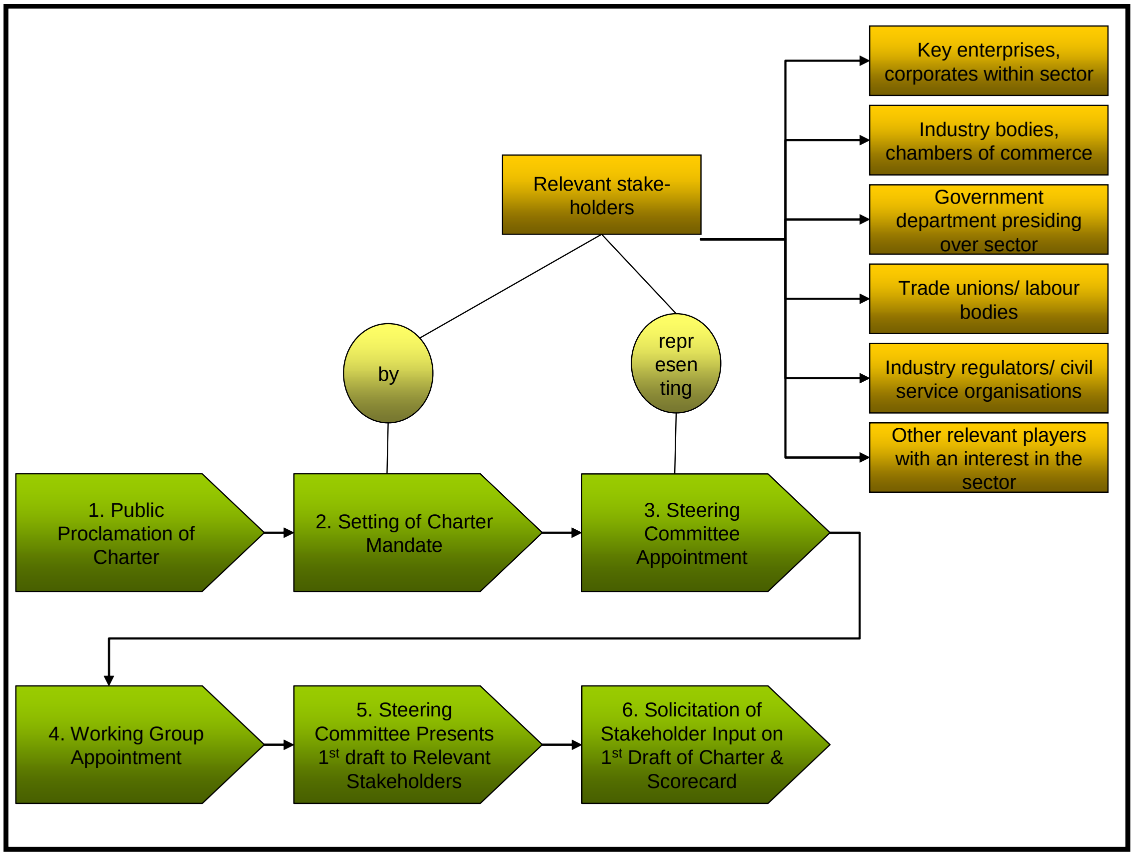
Since transformation charters gazetted in terms of section 9 of the BEE Act, become Codes of Good Practice and are therefore legally binding on organs of state and public entities, the procedure for gazetting these is far more stringent than that of s12 charters:



Enterprise BEE Plans

Enterprise BEE plans are mission statements to achieve transformation by individual entities. These are voluntary company-specific commitments to BEE and may not be used for the purposes of measuring an entity's BEE status, save for internal assessment purposes.

Recommended Model for Drawing up a Transformation Charter (Annexe 010-A)



Chapter Four: Statement 020 – The Approval, Accreditation and Regulation of BEE Verification Agencies

Introduction

South Africa's transformation process began as a government driven initiative which was later followed by certain players within big business through the conclusion of BEE deals, as part of the first wave of BEE in the late 1990s.

However, during this period, there existed no basis upon which such deals, or indeed, other BEE initiatives, could be evaluated and compared. The lack of a standard measure often led to conflicting and contradictory decisions regarding BEE. Recognising BEE as a business imperative by the private sector led to the emergence of BEE verification agencies. The role of the verification agency is to ensure that a measured entity's BEE contributions are verified, and that the entity's reported BEE status is valid and accurate.

In the absence of a framework for measurement and an industry watchdog to monitor verification agencies, different verification agencies formulated and employed different verification methodologies and standards. The result has been an inconsistency in the substance of BEE verification which potentially advantages entities verified by agencies employing less stringent verification criteria, and erodes the ability of the verification agencies to introduce transparency and uniformity in the verification and reporting of BEE.

To enhance the quality and standards of the BEE verification and reporting process, Statement 020 provides for the setting up of a BEE verification accreditation body, to accredit only those verification agencies which meet the criteria outlined in Statement 020, thereby ensuring that standards are uniform and enabling government and the private sector to rely on verification certificates issued by accredited agencies.

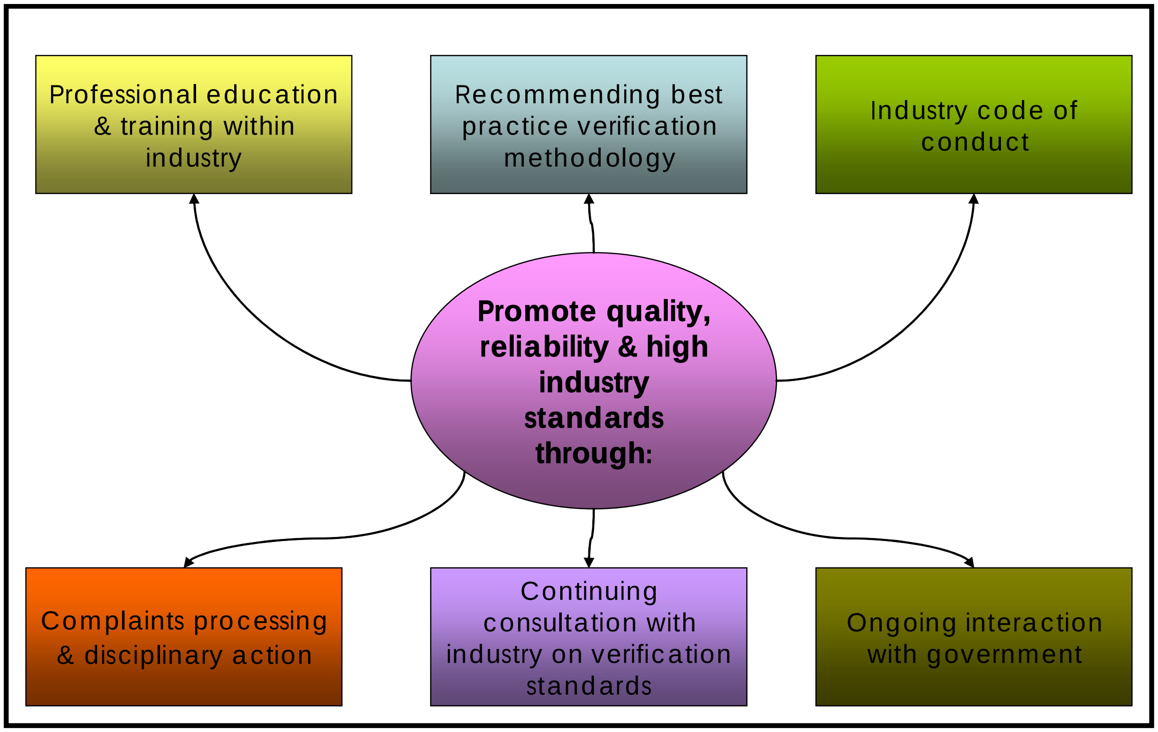
Overview & Objectives

- Specifies qualification criteria and the procedure to be followed for the accreditation of BEE verification agencies
- Outlines standards for conducting BEE verification by verification agencies
- Outlines the role of an industry body to work together with the government's accreditation body

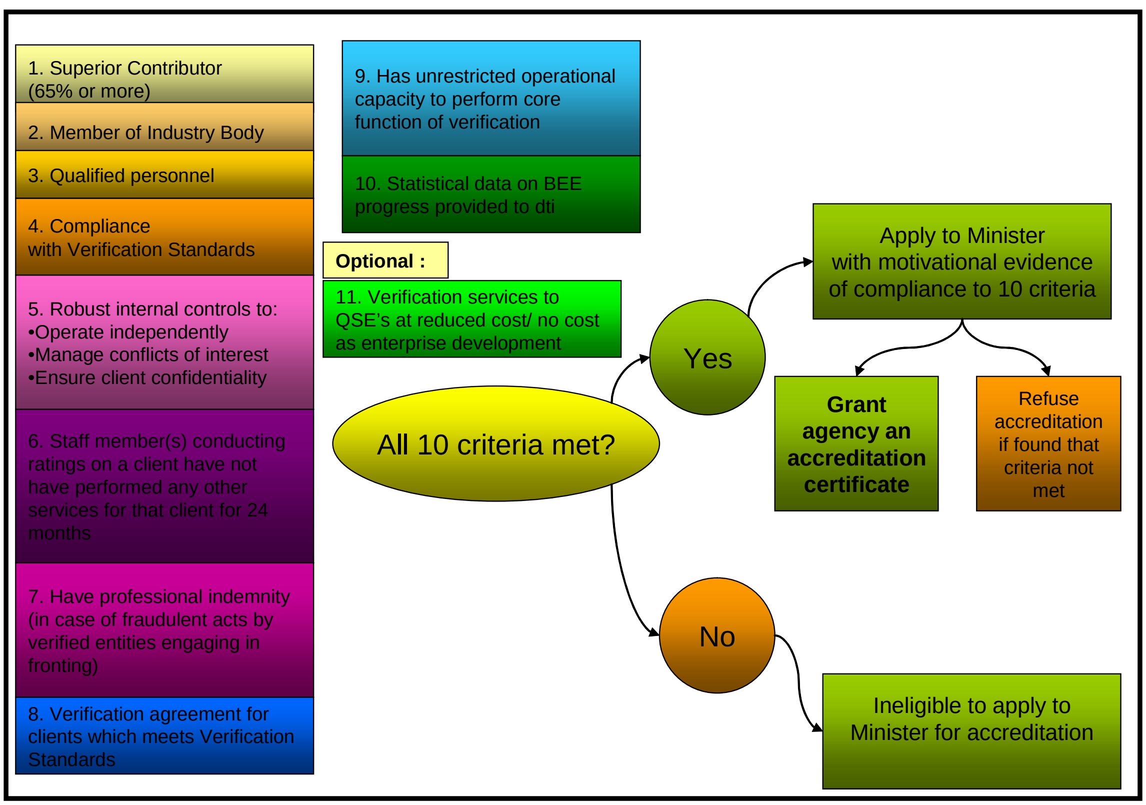
Verification Standards

The Minister of Trade and Industry must ensure that verification standards be developed by the accreditation body, in consultation with the industry body. In effect, these standards will, *inter alia,* be employed to determine the accreditation status of a verification agency, and to enhance the quality and standards of the verification agency as a whole.

Responsibilities of the Industry Body for BEE Verification



Criteria and Process for the Accreditation of Verification Agencies

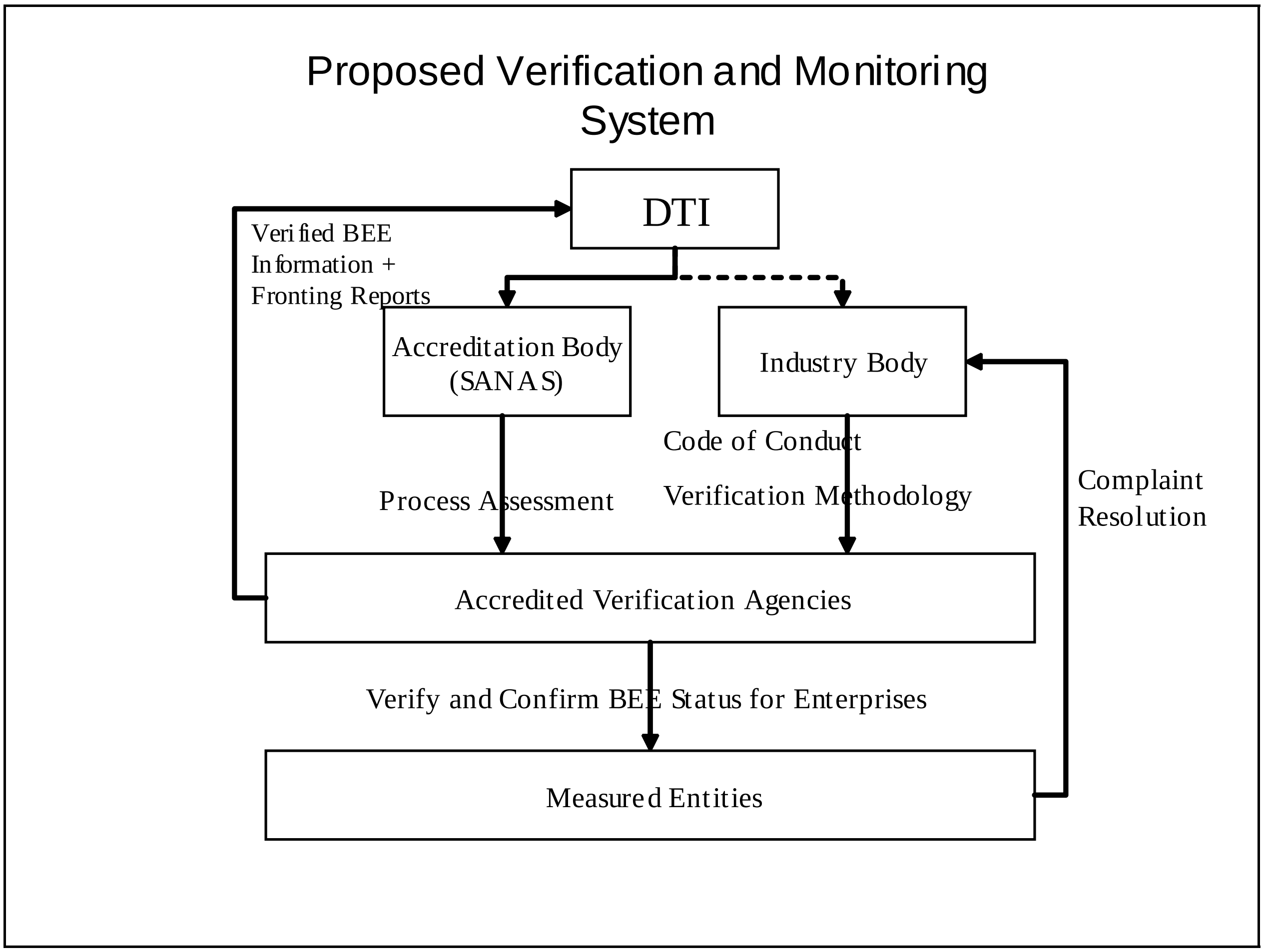


Industry Body for BEE Verification Agencies

Statement 020 encourages the development of an industry body for the BEE verification industry. The industry body must have representation by the following parties for recognition by the Minister of Trade and Industry:

1. Verification agencies
2. Minister of Trade and Industry (i.e.: **the dti** representation)
3. The industry accreditation body

In addition, the industry body must promote minimum verification standards as developed by the accreditation body and must function as a quality control vehicle. The diagram below illustrates the responsibilities that the industry body must include in its mandate:



Chapters Five to Six: Code 100 – Measurement of the Ownership Element of Broad-Based Black Economic Empowerment

Chapter Five: Statement 100 – The General Ownership Scorecard and the Recognition of Ownership Arising from the Sale of Equity Instruments

Introduction

Transactions which were concluded during the first wave of BEE in the late 1990s began to reveal that transformation of the nature of BEE deals themselves was required. In particular, the need to address the following issues with respect to some BEE transactions, was revealed:

- The lack of participation by black women in BEE consortia
- The reversion of black equity into the hands of the original white owners, following the collapse of BEE deals, owing to onerous structuring and repayment terms
- The fact that often the BEE ownership status of entities was inflated when compared to the actual economic benefits flowing to the black beneficiaries, since economic benefits were often eroded by financing restrictions
- The lack of participation by broad-based beneficiaries such as black rural dwellers, black unemployed people, black workers, black disabled and impoverished black communities (included in the definition of black designated groups)
- The fact that deals were primarily concluded amongst a select number of BEE personalities since there was no incentive for companies to look beyond these prominent black players
- Fronting

Statement 100 aims to address all of these issues by providing specific incentives in the ownership scorecard to ensure participation by black women, black designated groups and new entrants and to ensure that only real economic interest in the hands of black people is measured.

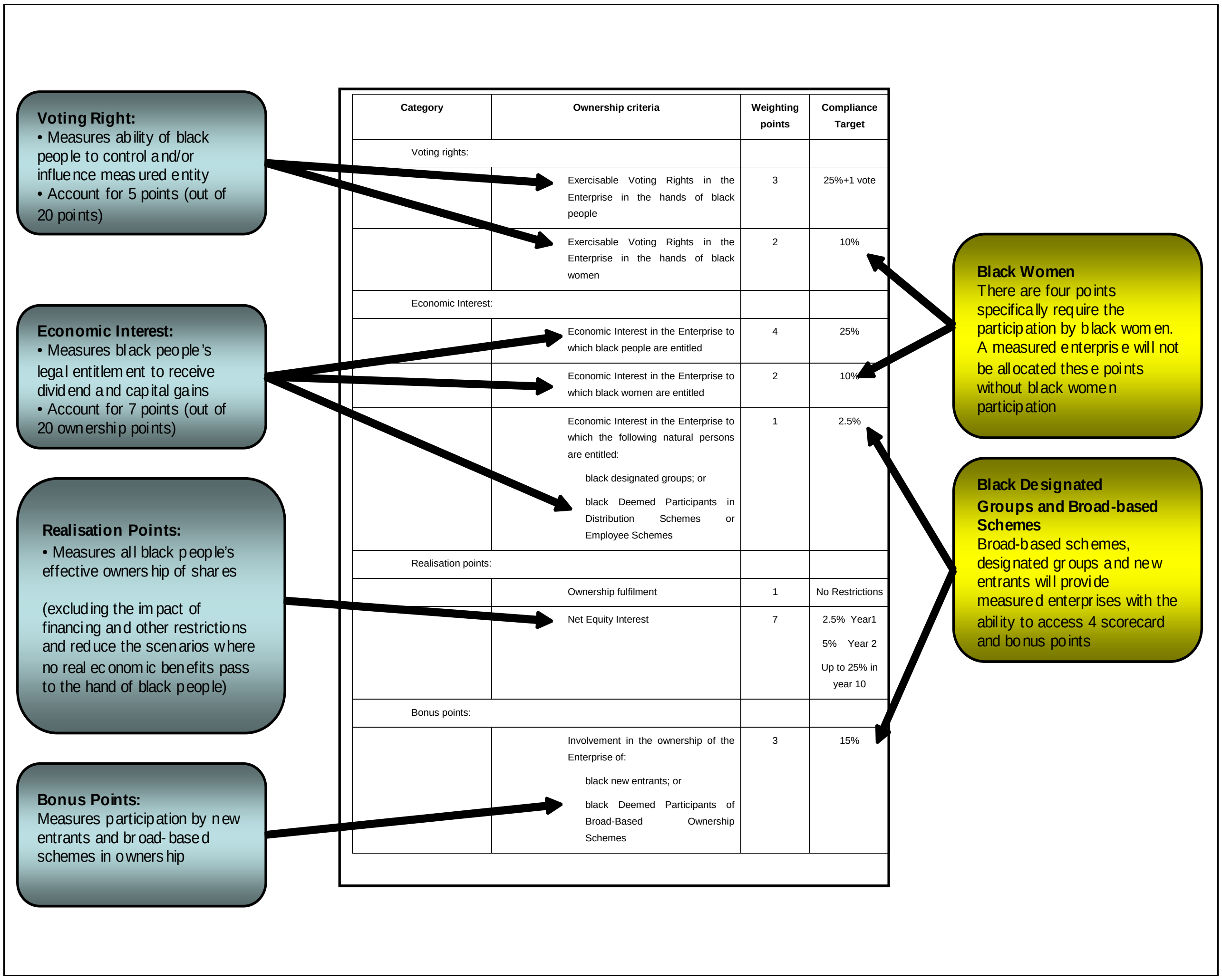
Overview & Objectives
• To measure the extent of real black ownership of a measured enterprise, by means of an ownership scorecard

Components of the Ownership Scorecard

In order to measure the extent of black ownership participation, the ownership scorecard measures the different rights normally attached to ownership. These rights are:

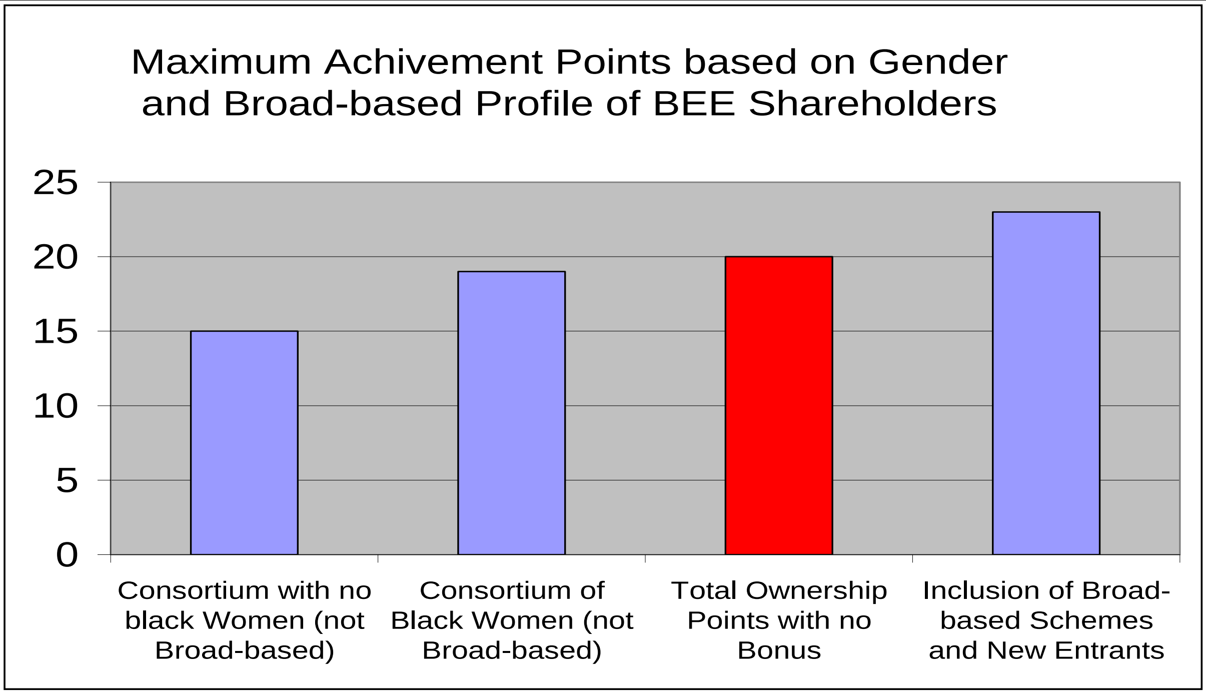
- **Control:** Control of the Enterprise, through the exercise of voting rights at shareholder meetings
- **Economic Interest**: The entitlement of black people to dividends, capital gains and other economic rights of shareholders
- **Net Equity Interest:** The accumulated net economic interest in the hands of the black shareholders, after the deduction of monies owed by these black shareholders.

How the Scorecard Resolves the Issues Surrounding BEE Transactions:



Category	Ownership criteria	Weighting points	Compliance Target
Voting rights:			
	Exercisable Voting Rights in the Enterprise in the hands of black people	3	25%+1 vote
	Exercisable Voting Rights in the Enterprise in the hands of black women	2	10%
Economic Interest:			
	Economic Interest in the Enterprise to which black people are entitled	4	25%
	Economic Interest in the Enterprise to which black women are entitled	2	10%
	Economic Interest in the Enterprise to which the following natural persons are entitled: black designated groups; or black Deemed Participants in Distribution Schemes or Employee Schemes	1	2.5%
Realisation points:			
	Ownership fulfilment	1	No Restrictions
	Net Equity Interest	7	2.5% Year1 5% Year 2 Up to 25% in year 10
Bonus points:			
	Involvement in the ownership of the Enterprise of: black new entrants; or black Deemed Participants of Broad-Based Ownership Schemes	3	15%

The ownership scorecard provides specific recognition of ownership participation by black women or black designated groups. As a result, a measured enterprise will only achieve full ownership points if there is equity participation by black women and black designated groups or broad-based schemes in its ownership structure.



The scorecard aims to ensure that a measured enterprise will consider its black shareholders' ownership rights and their status when structuring a transaction to introduce black ownership or when formulating a new enterprise with black owners.

Key Definitions and Principles:

The term "**black people**" includes all African, Coloured or Indian persons who are South African citizens by birth or by descent or who were naturalised prior to the commencement of the constitution in 1993. In addition, the term also includes black people who became South African citizens after the constitution's commencement but who would have been able to be naturalised prior to this, were it not for the Apartheid laws that prohibited naturalisation of certain persons.

This means that an African, Coloured or Indian person who was not a South African citizen before the commencement of the constitution in 1993 but who would have been entitled to apply to be naturalised prior to 1993, will also be considered a black person and therefore a beneficiary of BEE.

"**Flow-through and modified flow-through principles**" are included to ensure that the objectives of BEE will not be circumvented through complex funding structures. The flow-through principles trace ownership measurement through the chain of ownership to the black natural person(s). The modified flow-through principle allows for the participation of non-BEE funders at one tier of ownership. A measured enterprise can elect to apply the modified flow-through principle at any tier in a chain of ownership, but limited to one tier only.

"Control Principle" is applied in a chain of ownership to allow for the recognition of voting rights, or legal, ownership by the ultimate black shareholder(s) of the company. When this is applied during the calculation of the legal ownership, **all** the entities in the chain of ownership with over 50% black voting rights are considered to be 100 % black.

"**Exclusion Principle**" allows for ownership by organs of state or public entities to be excluded from the calculation of ownership. The exclusion principle means that an entity with ownership by government will not be rewarded or penalised for its state ownership.

"Net Equity Interest" is the value of the part of the business that the black shareholder owns, less any outstanding financial obligations that financed the purchase of his/her share of the business, as a percentage of the current value of the company.

"Ownership Fulfilment" refers to any conditions that might prevent the black shareholder from achieving his/her full net equity interest.

"**Black Ownership by Trusts, Broad-based Schemes and Debt Financing Instruments**": The statement provides detailed requirements for the recognition and measurement of trusts, broad-based schemes and debt financing instruments as black ownership.

The Process to Measure Ownership:

1. Identify the entitlement of black people to exercise voting rights through an evaluation of the shareholders agreement or other relevant agreements
2. Identify any restrictions on black people to receive economic interest in the form of dividends and capital gains. Examples include the right of vendors to acquire the equity at non market related prices at a future date
3. Calculate net equity interest based on the relevant formulae
4. Determine whether the measured enterprise is able to claim additional points as a result of the introduction of new entrants and/or broad-based schemes
5. Sum the total ownership points in the enterprise and multiply by the 20% weighting for ownership

Application of the Modified Flow-Through Principle:

The modified flow-through principle was introduced to provide companies and black shareholders of companies with some relief when it comes to the use of external non-BEE funding or the introduction of non-BEE technical partners into its chain of ownership. The following section provides a step-by-step guide on the application of the principle when measuring black ownership:

Applying the Modified Flow-Through:

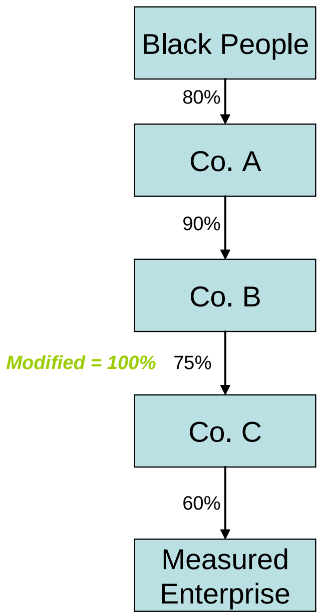
- *Step 1*: Determine the ownership percentage at all ownership tiers using the normal flow-through
- *Step 2*: Identify ownership tiers that are black majority owned (where the ownership exceeds 50% by BEE parties, under the normal flow-through)
- *Step 3*: Elect one black majority owned tier for the application of modified flow-through (the calculation favours the application over the tier with the lowest BEE shareholding)
- *Step 4*: Recalculate the black ownership of the measured enterprise, after taking into account the converted ownership tiers (where black ownership is converted to 100% at one selected tier only)

Notes:

- *The modified flow-through cannot be applied onto the measured entity itself (even if it is a black majority owned company)*
- *The modified flow-through and control principles only apply to companies (and not to trusts or other forms of enterprises)*
- *When working with complex ownership structures, the modified flow will only be applied when the specific chain of ownership of the measured enterprise consists of black majority owned companies*

The following examples further illustrate how this principle can be applied when determining the ownership of measured enterprises:

Modified Flow Through



Step 1: Determine ownership percentage (under normal flow through)

- Co. A = 80.0%
- Co. B = 80% * 90% = 72.0%
- Co. C = 80% * 90% *75% = 54.0%
- Co. D = 80% * 90% *75% * 60% = 32.4%

Step 2: Identify ownership tiers which are black majority owned (where black ownership exceeds 50%) under the normal flow-through

- Ownership tiers available for conversion include Co .A (80%), Co. B (72%), Co. C (54%)
- Note that even if the ownership for the measured enterprise exceeds 50%, it is excluded from the application of modified flow-through

Step 3: Elect one of the black majority owned ownership tiers for conversion under the modified flow through

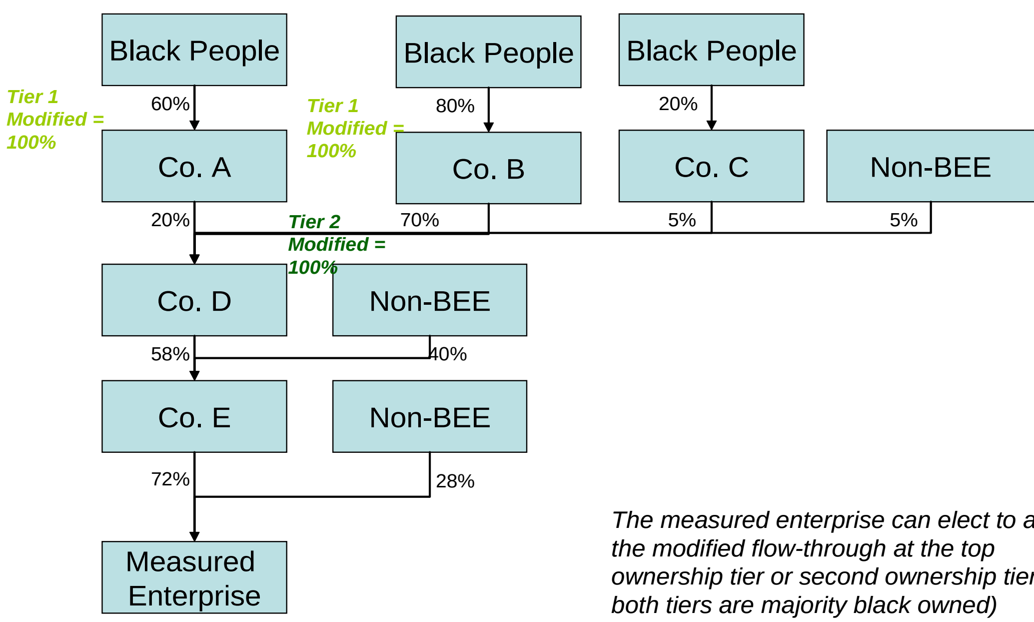
- Application of Modified Flow-Through at Co. C

Step 4: Recalculate ownership under the modified flow-through

- Black Ownership of Measured Enterprise = 80% * 90% * ***100%*** * 60% = 43.2%

(The application of modified flow-through allows for one tier of financing by non-BEE investors investing in BEE enterprises, to be recognised)

Modified Flow Through (Complex Transaction)



The measured enterprise can elect to apply the modified flow-through at the top ownership tier or second ownership tier (as both tiers are majority black owned)

Application of Modified Flow-through on Complex Transactions

- ***Step 1: Determine ownership percentage (under normal flow through)***
- Tier 1:
  - Co. A = 60.0%
  - Co. B = 80.0%
  - Co. C = 20.0%
- Tier 2:
  - Co. D = (60%*20%) + (80%*70%) + (20%*5%) = 69.0%
- Tier 3:
  - Co. E = 69% (Co.D) * 60% = 41.4%
- Measured Enterprise
  - Measured Enterprise = 41.4% (Co.E) * 72% = 29.8%

- ***Step 2: Identify ownership tiers which are black majority owned (where black ownership exceeds 50%) under the normal flow-through***
- Ownership tier available for conversion include:
  - Tier 1: Co.A (60%) and Co.B (80%)
  - Tier 2: Co.D (69%)
- Note that even if the ownership for the measured enterprise exceed 50%, it is excluded from the application of modified flow-through

- ***Step 3: Elect one of the black majority owned ownership tier for conversion under the modified flow through***
- Application of Modified Flow-Through at Tier 1:
  100% * 20% *58% *72% + ***100%*** * 20% *58% *72% + 20% * 5% * 58% * 72% = **38%**
- Application of Modified Flow-Through at Tier 2:
  60% * 20% * 20% *58% *72% + 80% * ***100%*** * 58% *72% + 20% * 5% * 58% * 72% = **38.8%**
  (Note that the only ownership chain in tier 2 that can be modified is Co.B's ownership in Co.D, as it is the only chain which is black majority owned)

- ***Step 4: Recalculate ownership under the modified flow-through***
- Black Ownership of Measured Enterprise = **38.8%**
  (election of modified flow-through at Tier 2)

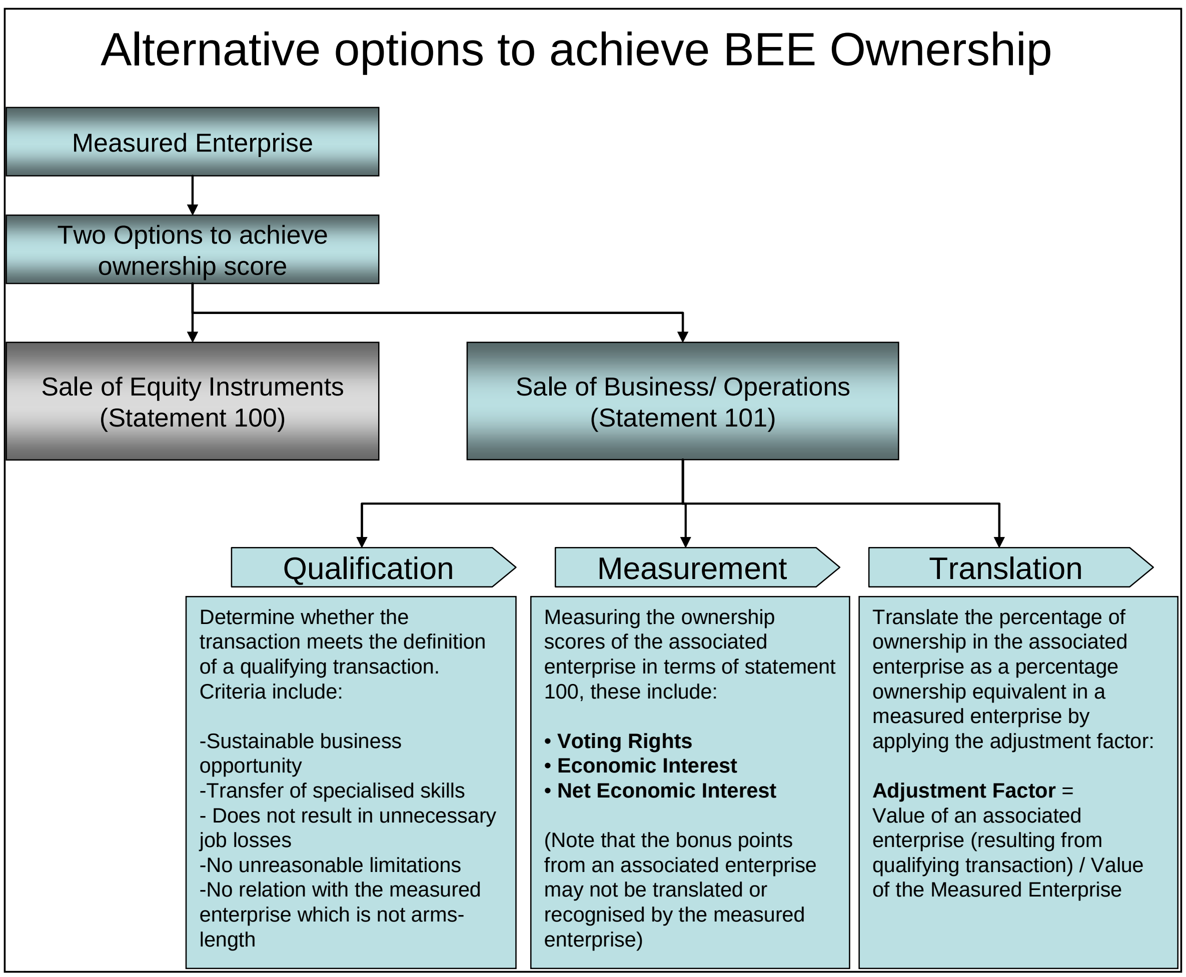
Chapter Nine: Statement 101 – The Recognition of Ownership Contributions Arising from the Sale of Businesses/Assets in Qualifying Transactions

Overview & Objectives

- To provide the sale of businesses or assets as an alternative option other than the sale of equity for the measured enterprise, to achieve ownership points on the ownership scorecard

In addition to achieving ownership recognition through the acquisition of equity shareholding by black people, an enterprise can also achieve BEE ownership recognition through the disposal of businesses and assets.

Statement 101 provides an alternative avenue for black people to acquire ownership and control of enterprises and economic resources. This statement defines the specific requirements for a *Qualifying Transaction*, resulting in the disposal of assets or businesses to an *Associated Enterprise*, as well as the way in which ownership points can be measured and recognised.



Key Principles

1. Qualifying Transaction and Associated Enterprises

A measured enterprise will only be able to claim ownership contribution through sale of businesses and assets if the sale is recognised as a *Qualifying Transaction*. This requires the transaction to result in:

- The creation of *sustainable businesses or business opportunities* for black people; and
- The transfer *specialised skills* or productive capacity to black people; and
- An associated enterprise which has *no unreasonable limitations* and *no operational outsourcing arrangements* with the Measured Enterprise that were not concluded on a fair and reasonable basis

2. Ownership Equivalency and the Adjustment Factor

In order to ensure that the assets/businesses disposed of by a measured enterprise to a black associated enterprise is sizable and sustainable, the measured enterprise will have to apply an adjustment factor when measuring the ownership contribution from the sale of assets or businesses.

The Adjustment Factor is measured as the value of the Associated Enterprise (as at the date of measurement) divided by the value of the Measured Enterprise (as at the date of measurement). The value of the associated enterprise will exclude the value introduced by another measured enterprise through separate qualifying transactions.

The ownership percentage equivalent which the measured enterprise can claim from an associated enterprise is as follows:

*Voting Rights of an Associated Enterprise (measured in terms of Statement 100) * Adjustment Factor = Equivalent Voting Rights in the Measured Enterprise*

*Economic Interest of an Associated Enterprise (measured in terms of Statement 100) * Adjustment Factor = Equivalent Economic Interest in the Measured Enterprise*

*Deemed Current Value (for the calculation of Net Equity Interest) of the Associated Enterprise (measured in terms of Statement 100) * Adjustment Factor = Equivalent Deemed Current Value in the Measured Enterprise*

The primary implications of the adjustment factors are as follows:

- The measured enterprise can recognise the equivalent ownership percentage as represented by the associated enterprise, e.g. if the associated enterprise represents 10% of an enterprise's assets, the measured enterprise can recognise roughly 10% of the black ownership in the associated enterprise as a percentage equivalent
- As a result, the measured enterprise is encouraged to further develop and expand the associated enterprise, as the extent of BEE recognition depends on the sustainability and success of the associated enterprise
- The measured enterprise which sells inferior or unsustainable assets to black associated enterprises will not enjoy significant BEE recognition, and will lose BEE recognition as soon as the associated enterprise deteriorates or collapses
- A measured enterprise whose associated enterprise grows and expands in value, will be able to recognise a higher ownership percentage equivalent from that associated enterprise

3. Measurement Principle

Except for the application of the adjustment factor and the recognition criteria for qualifying transactions, the same measurement principles for ownership in Statement 100 will apply when measuring the ownership of an associated enterprise.

4. Other Notes:

- It must be noted that only the enterprise that sells its assets benefits from ownership recognition through a qualifying transaction, the benefit will not flow through to its subsidiaries or co-subsidiaries
- A transaction recognised as a qualifying transaction and where ownership has been claimed by the measured enterprise will not qualify for the recognition under the enterprise development segment of the scorecard
- The statement also raises the concerns that a qualifying transaction may be implemented to establish a front for the measured enterprise, in cases where the associated enterprise is not sustainable or cannot operate without significant reliance on the measured enterprise, it will not be recognised under statement 101

Chapter Seven: Code 200 – Measurement of the Management & Control Element of Broad-Based Black Economic Empowerment

Statement 200 – The General Recognition of Management Control

Introduction

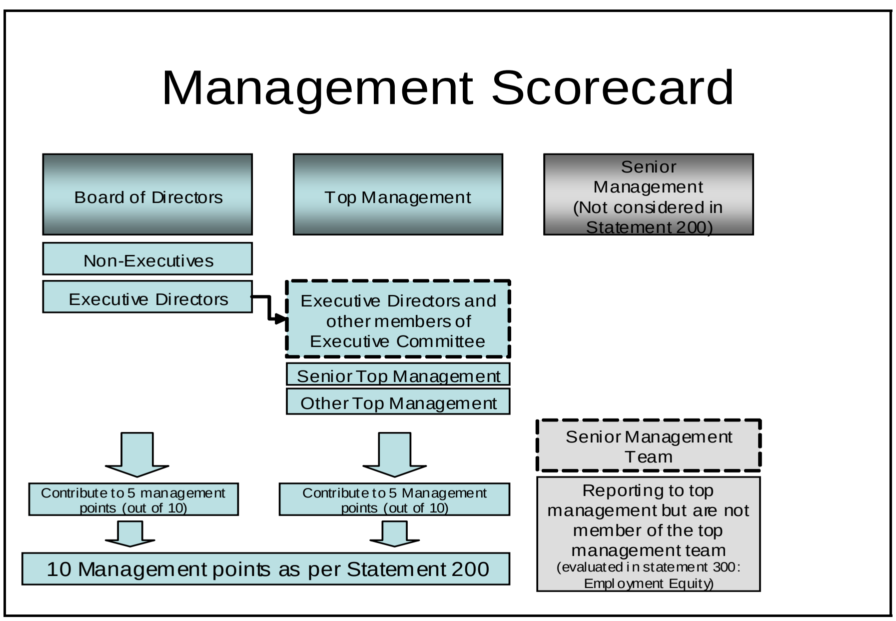
The Management Control element of the Generic Scorecard aims to address certain key issues surrounding black management and control of enterprises. These issues include:

- **Representation of black people at executive board level:** Statement 200 provides incentives for the representation of black people as executives, rather than as non-executives to reverse this trend of companies hiring black people as non-executives only
- **Representation by black owners:** Black shareholders should exercise control commensurate with their shareholding
- **Involvement of black people in daily operations and strategic decision-making at the most senior level:** Black people should also be in charge of and drive the implementation of operational and strategic decisions
- **Black people represented in key financial and overall management positions:** The tendency of placing black people purely in marketing or human resources director roles, rather than in key financial and overall management positions such as chief executive officers and chief financial officers, should be reversed

Overview & Objectives

- To measure the extent of control exercised by black people within the measured enterprise

The Management Scorecard



Management control criteria	Weighting points	Compliance Target
5.1 Board participation:		
5.1.1 Percentage of exercisable Voting Rights held by Members of the Board who are black people to the total of all Voting Rights exercised by all members of the Board	3	50%
5.1.2 Executive Members of the Board who are black people	1	50%
5.1.3 Executive Members of the Board who are black women	1	25%
5.2 Top Management participation:		
5.2.1 Percentage that Senior Top Management who are black people constitute of the total number of Senior	2	40%
Top Management		
5.2.2 Percentage that Senior Top Management who are black women constitute of the total number of Senior Top Management	1	20%
5.2.3 Percentage that Other Top Management who are black people constitute of the total number of Other Top Management	1	40%
5.2.4 Percentage that Other Top Management who are black women constitute of the total number of Other Top Management	1	20%
5.3 Bonus points		
5.3.1 Percentage that black people who are Independent Non-Executive Board Members constitute of the total number of Independent Non-Executive Board Members	1	40%

The Difference between Senior Top Management and Other Top Management:

Senior Top Management	Other Top Management
• Appointed by the board	• Appointed by the board
• Operationally involved in day-to-day management of entity	• Operationally involved in day-to-day management of entity
• Individual responsibility for OVERALL and/or FINANCIAL MANAGEMENT of the enterprise	• Individual responsibility for THEIR PARTICULAR AREA OF RESPONSIBILITY within the business
• Actively involved in development and/or implementation of the enterprise's strategy, including the OVERALL strategy	• Actively involved in development and/or implementation of the enterprise's strategy insofar as it relates to THEIR PARTICULAR AREA OF RESPONSIBILITY
• Common examples: CEO; Chief Operating Officer; Chief Financial Officer	• Possible examples (will vary from one enterprise to the next): Human Resources Director; Marketing Director; Strategic Director for the Measured Enterprise; other members of the executive committee

Management Control vs. Employment Equity:

- Although senior and top managers are employees and referred to as such, any employee classified under management control, will not be accounted for under the employment equity element, and vice versa
- In other words, if any employee who is categorised as senior management as per the EEA9 schedule is included in top management (either senior top management or other top management) under the management, this employee will not be accounted for under the measured enterprise's employment equity element for the year under measurement
- In other words, no "double counting" of employees is permitted

__NB__: The definition of "__employee__" is included in Statement 200 since all staff members on the payroll of an enterprise, INCLUDING executive directors (but excluding non-executive directors) are referred to as "employees". This means that employees who fall into the relevant categories such as "senior top management" and "other top management" are included in Management Control and NOT in the Employment Equity element.

Top Management includes "Senior Top Management" and "Other Top Management":

- "Top Management" is a collective term for Senior Top Management and Other Top Management, despite the fact that the EE Act does not contain these sub-categories
- Despite the fact that the EE Act contains a category for "Top Management", this is measured under Management Control and NOT under Employment Equity

Enterprises which make no distinction between Top Management and Senior Management

Schedule EEA9 contained in the Employment Equity Act is reproduced here, for ease of reference. Essentially, only "Top Management" should be measured under Management Control, but inclusion of senior management under Management Control is allowed in certain cases, as described below:

Equivalent occupational levels

Semantic Scale	Paterson		Peromnes	Hay	Castellion
Top management	F	F	1++ 1+		14
Senior management	E	E UPPER E LOWER	1 2 3	1 2	13

- For ease of reporting, in cases where enterprises make no distinction between top management and senior management when reporting in terms of the Employment Equity Act, the enterprise may include senior management in its figures for management control

However, such an enterprise may not ALSO then include senior management figures under the employment equity element – this would amount to double counting.