

## THE BROAD-BASED BLACK ECONOMIC EMPOWERMENT

### PRACTICE GUIDE 01 of 2017

#### ENHANCED RECOGNITION STATUS FOR EXEMPTED MICRO-ENTERPRISES AND QUALIFYING SMALL ENTERPRISES THROUGH APPLICATION OF THE MODIFIED-FLOW THROUGH PRINCIPLE

1. The Broad Based Black Economic Empowerment Commission (“B-BBEE Commission”) is an entity established by the Broad-Based Black Economic Empowerment Act 53 of 2003 as amended by Act 46 of 2013 (“the Act”), to oversee the implementation of the Act, which includes provision of explanatory notices, non-binding advisory opinions and clarification services to improve the understanding of the Act.
2. This Practice Guide is issued as a non-binding guide purely to assist with the interpretation to ensure consistency in the application of the Act. Should this Practice Guide not be clearly applicable to your specific set of facts at any given time, you are advised to approach the B-BBEE Commission for a non-binding advisory opinion, which will be more specific to your set of facts.
3. This Practice Guide does not constitute a legal document or a ruling of the B-BBEE Commission on the issue concerned. Further, although this Practice Guide is not binding on the B-BBEE Commission, it does set out the approach that the B-BBEE Commission is likely to take on any matter relating to the recognition of third party procurement spend for consistency.
4. Section 9 (1) of the Act empowers Minister of Trade and Industry to issue Codes of Good Practice (“the Codes”) on broad-based black economic empowerment (“B-BBEE”) to promote the purposes of the Act. The Codes as amended are underpinned by the need to drive inclusive economy, and must at all times be interpreted and applied in a manner that is consistent with the objectives and purposes of the Act, and in compliance with the Constitution.

5. B-BBEE is an integrated coherent framework that seeks to advance the economic transformation of South Africa and bring about significant increase in the number of black people that manage, own and control the country's economy. The form in which economic transformation is realised is guided by the B-BBEE Act with the Codes guiding the implementation to achieve the outcome, not to aid measured entities to circumvent the B-BBEE Act.
6. The five elements of B-BBEE adopted in the Codes each have a specific purpose and together provide an integrated intervention to empower black people as envisaged in the B-BBEE Act. The purpose of the ownership element is to ensure that black people own and/or control enterprises and productive assets in a manner that is sustainable and promotes as well as preserve corporate governance principle that underpin the Companies Act, 2008 (Act No. 71 of 2008).
7. B-BBEE ownership comprises of excisable voting rights, economic interest and net value in the hands of black people as a result of direct or indirect participation in the measured entity. The measured entity will on an annual basis recognise points for as long as the black shareholders still hold rights of ownership in the entity. It is the responsibility of the measured entity to submit appropriate information during the verification process to enable the assessor to carry out factual valuation to determine a B-BBEE ownership score. This assessment aims to determine both factual and legal ownership aspects.
8. Further, the ownership scorecard for practical reasons permits the measured entity to, in promoting ownership and management of new or existing enterprises by black people, recognise various types of equity principles that entities can apply in order to comply with the ownership scorecard. One other principle is the modified-flow through principle.
9. In terms of Code Series 100, an entity may apply the modified-flow through principle to determine black ownership, where in the chain of ownership structure black people have a flow-through level of participation of at least 51%, then only once in that entire ownership structure of the entity such black participation may be treated as though it were 100%.
10. The Codes have defined a 51% black owned entity as an entity where a) black people hold at least 51% of the exercisable voting rights as determined under Code Series 100; b) black people hold at least 51% of the economic interest as determined under Code Series 100; and c) has earned all the points for Net Value under Code Series 100.
11. The Minister of Trade and Industry as the custodian of the B-BBEE Policy in its efforts to reduce the cost of compliance on micro and qualifying small businesses in South Africa has relieved black owned and controlled Exempted Micro-Enterprise (EME) and Qualifying Small Enterprise (QSE) from B-BBEE verification. Such entities are only required to obtain a sworn affidavit on an annual basis or a Companies and Intellectual Property Commission (CIPC) certificate in the case of an EME proving their B-BBEE Status.

12. The introduction of this intervention brought about an exception to the extent to which entities can rely on the modified flow through principle to calculate black ownership. It is our view that this limits the calculation of 51% and 100% black ownership for EMEs and QSEs only through the application of the flow through principle, in line with the B-BBEE objectives outlined in section 2 of the B-BBEE Act.
13. While we do recognise that the Codes have not explicitly provided limitations of the applications of the modified flow through principle in claiming the enhanced recognition status for black owned and controlled EMEs and QSEs, it must not be applied to circumvent the policy objectives. Therefore, it is the effect of the application of the principle that in our view limits its application to the extent that it would undermine the objectives of the Act.
14. Therefore, the B-BBEE Commission in accordance with the requirements to advise on the interpretation of any provision of the Act as per section 13F(1)(a) and (3)(b) (ii) of the B-BBEE Act, hereby concludes that the modified flow through principle cannot be used to benefit from the enhanced recognition status reserved for 51% and 100% black owned EMEs and QSEs. Any contrary advice would be regarded as a misrepresentation of Entity B's B-BBEE status which is an offence in terms of section 13O (1) (a) of the Act.
15. All verification professionals have a responsibility and duty to provide entities with proper advice and guidance, including the implementation of this guide for the determination of the B-BBEE status of entities in a manner that upholds B-BBEE objectives.
16. In terms of section 13O (2) a verification professional, procurement officer or any official of an organ of state or public entity who becomes aware of the commission of, or attempt to commit, any offence referred to under section 13O (1) and fails to report it, is guilty of an offence.
17. In terms of section 13F (1) (d) read with section 13J of the Act, the B-BBEE Commission has the power to investigate, either on its own initiative or in response to a complaint received, any matter concerning B-BBEE.
18. If an entity is found to have violated the Act, an entity could be fined up to 10% of its annual turnover, and individuals involved could be imprisoned for up to 10 years, and / or fined. Specifically, an offence under section 13O (2) could lead to imprisonment of up to 12 months, or a fine, or both the fine and imprisonment.

19. This Practice Guide is issued as a guide purely to assist with the interpretation and application of Code Series 000 and 100 with regard enhanced recognition to black owned and controlled EMEs and QSES, and as indicated, it does not constitute a legal document or ruling of the B-BBEE Commission.
20. This Practice Guide may be updated anytime by the B-BBEE Commission if there are any material changes arising from developments in the application of Code Series 000 and 100. In such an instance, an amended version will be published to replace this one.
21. For any queries or further clarity on this Practice Guide, kindly feel free to contact us at the following contact details:

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