

Guidelines on Complex Structures & Transactions, and Fronting (Previously Statement 002)

Introduction

This document combines the key topics surrounding Broad-based Black Economic Empowerment (B-BBEE) and its implementation.

- Section A: Complex Structures & Transactions
- Section B: Fronting

SECTION A: COMPLEX STRUCTURES & TRANSACTIONS

Introduction

The organisational structures of businesses are not always simple. Some entities have complex structures involving holding companies, subsidiaries, and associate companies. Some entities may be involved in joint ventures. This document provides entities with guiding principles for the measurement of these complex structures and, in addition, seeks to address the following issues:

- **Claiming recognition of B-BBEE transaction at different levels within a group structure**
- **Sharing of administrative and infrastructure costs amongst different subsidiaries and divisions**
- **Subsidiaries and divisions of companies operating in different sectors**

Overview & Objectives

- Provides guidelines on how complex structures and transactions should be measured, specifically with respect to the measurement of group structures, divisional structures, related enterprises and unincorporated joint ventures
- To ensure that B-BBEE contributions across complex structures are justly measured by preventing inaccurate recognition
- To allow for consolidated contributions to elements such as enterprise development and socio-economic development
- To give subsidiaries and divisions operating in different sectors of the economy to their holding company guidance on how to determine their score on the B-BBEE scorecard

Please note that the term 'complex structures' is used in this guide as a collective term, which includes group structures, divisional structures, related enterprises and unincorporated joint ventures.

Key measurement principles

The underlying objective of this section is to provide complex structures with the flexibility to choose between two types of B-BBEE scorecards. The two types of B-BBEE scorecards are as follows:

- **Measured Entity level B-BBEE scorecard**

Issued for one entity or part thereof only (e.g. a division in a divisional structure or a subsidiary in a group structure), without measuring any contributions by another entity or part-entity within the group/divisional structure that may be performed at a central location within the structure.

- **Consolidated B-BBEE scorecard**

A consolidated B-BBEE scorecard includes the measurement of contributions across more than one entity within a group/divisional structure.

During the tendering process where subsidiaries are the ones tendering for a contract, the procurement officers may require that the tendering subsidiary provide its own B-BBEE scorecard as opposed to a group consolidated attribution B-BBEE scorecard. In these instances this document provides guidelines on how various contributions to B-BBEE within the group structure can be attributed to the subsidiary company tendering for the contract.

There may be instances where subsidiaries within a group fall within a sector that has a Sector Charter gazetted as a Sector Code under the B-BBEE Act. In these instances a subsidiary is expected to comply with its sector code, especially as it competes with companies in its own unique sector. The subsidiary would also have the ability to attribute contributions within the group structure to its own B-BBEE contributions, provided there is a reasonable method for such attribution

B-BBEE Scorecard Options for Group Structures

Companies forming part of a group structure may obtain:

1. One consolidated B-BBEE scorecard for the holding company and its subsidiaries; or
2. Measured entity level B-BBEE scorecards for the holding company and each of its subsidiaries

Conditions applicable to consolidated B-BBEE scorecards for group structures

1. The B-BBEE scorecard must list the names of the holding company as well as all subsidiaries which the B-BBEE scorecard pertains to;

2. Ownership score: only the holding company's B-BBEE ownership contributions count as measured in accordance with statements 100 or 103 as well as points arising from the sale of equity instruments in its subsidiaries in accordance with Statement 102
3. Management control score (board only): only black members on the board of the holding company can count towards the score for black board participation
4. Management control/ employment equity score (top management and owner-managers only): calculation of the score for these aspects must measure black representation in the holding company as well as all measured subsidiaries
5. Skills development score: calculation of the score for this element must measure skills spend by the holding company as well as all measured subsidiaries
6. Enterprise development score: calculation of the score for this element must measure enterprise development spend by the holding company as well as all measured subsidiaries
7. Socio-economic development score: calculation of the score for this element must measure socio-economic development spend by the holding company as well as all measured subsidiaries
8. Preferential Procurement score: calculation of the score for this element must measure procurement spend by the holding company as well as all measured subsidiaries. *Note that intra-group procurement in group structures cannot be counted as B-BBEE procurement*

Conditions applicable to Measured Entity Level BEE scorecards for group structures

Only the compliance levels or contributions of the Measured Entity in question may count towards the overall score of the Measured Entity

B-BBEE Scorecard Options for Divisional Structures

Companies forming part of a divisional structure may obtain:

1. One B-BBEE scorecard for the entire divisional structure in question with its divisions; or
2. A B-BBEE scorecard for one or more of the divisions or business units in the divisional structure.

Conditions applicable to Measured Entity Level B-BBEE scorecards for Group Structures

1. The B-BBEE scorecard must list the details of the divisional structure and the company to which the division/ business unit belongs;
2. Ownership score: only the B-BBEE ownership contributions of the company to which the measured division/ business unit belongs count for measurement purposes. Contributions that count are those measured in accordance with Statements 100 or 103 as well as points arising from the sale of equity instruments in its subsidiaries in accordance with Statement 102

3. Management control score (board only): only black members on the board of the company to which the measured division/ business unit belongs can count towards the score for black board participation
4. Management control/ employment equity score (top management and owner-managers only): calculation of the score for these aspects must measure black representation in the measured division/ business unit only
5. Skills development score: calculation of the score for this element must measure skills spend by the measured division/ business unit only
6. Enterprise development score: calculation of the score for this element must measure enterprise development spend by the measured division/ business unit only
7. Socio-economic development score: calculation of the score for this element must measure socio-economic development spend by the measured division/ business unit only
8. Preferential Procurement score: calculation of the score for this element must measure procurement spend by the measured division/ business unit only. *Note that incomes to an entity level B-BBEE scorecards for divisions, intra-group procurement with the enterprise to which the division or business unit belongs is measurable as per Statement 500.*

Exempted Small & Micro Enterprises and Qualifying Small Enterprises that are Related Enterprises

The following applies to exempted small and micro enterprises that are related enterprises:

- They MUST obtain either a consolidated B-BBEE scorecard as if they were a group structure or individual B-BBEE scorecards for each related enterprise if their combined turnover exceeds R5 million per annum
- But if their combined turnover is less than R5 million per annum, they can remain exempted from obtaining a B-BBEE scorecard.

Related Enterprises that are Qualifying Small Enterprises

- If their combined turnover exceeds R35 million per annum, they MUST obtain either a consolidated B-BBEE scorecard as if they were a group structure or individual B-BBEE scorecards for each related enterprise;
- But if their combined turnover is less than R35 million per annum, they can comply only with the requirements of the Qualifying Small Enterprises scorecard in their individual capacity.

Unincorporated Joint Ventures

Unincorporated joint ventures may obtain a consolidated B-BBEE scorecard as if they were a group structure, provided that such a consolidated B-BBEE scorecard is prepared for every separate venture.

Transfer of B-BBEE compliance data on B-BBEE scorecards

- The following types of B-BBEE initiatives attach to the underlying assets of the initiating entity:
 - Historical contributions under Code series 600 and 700; and
 - Historical contributions arising from Statement 102.
- Where a measured entity concludes any good faith transaction transferring ownership of all or part of its underlying assets, the measured entity may transfer benefit of those historical contributions to the new ownership of those assets. A written agreement recording the transaction must record:
 - The details of contributions transferred on a contribution-by-contribution basis;
 - The division between the parties if relevant; and
 - Such transfer can only take place once.

SECTION B: FRONTING

Fronting means a deliberate circumvention or attempted circumvention of the B-BBEE Act and the Codes. Fronting commonly involves reliance on data or claims of compliance based on misrepresentations of facts, whether made by the party claiming compliance or by any other person. Verification agencies, and /or procurement officers and relevant decision-makers may come across fronting indicators through their interactions with measured entities.

FRONTING PRACTICES

Window-dressing: This includes cases in which black people are appointed or introduced to an enterprise on the basis of tokenism and may be:

- Discouraged or inhibited from substantially participating in the core activities of an enterprise; and
- Discouraged or inhibited from substantially participating in the stated areas and/or levels of their participation;

Benefit Diversion: This includes initiatives implemented where the economic benefits received as a result of the B-BBEE Status of an enterprise do not flow to black people in the ratio as specified in the relevant legal documentation.

Opportunistic Intermediaries: This includes enterprises that have concluded agreements with other enterprises with a view to leveraging the opportunistic intermediary's favourable B-BBEE status in circumstances where the agreement involves:

- Significant limitations or restrictions upon the identity of the opportunistic intermediary's suppliers, service providers, clients or customers;
- The maintenance of their business operations in a context reasonably considered improbable having regard to resources; and
- Terms and conditions that are not negotiated at arms-length on a fair and reasonable basis.

Responsibility to Report Fronting

In order to effectively deal with the scourge of Fronting, verification agencies, and/or procurement officers and relevant decision makers are encouraged to obtain a signed declaration from the clients or

entities that they verify or provide business opportunities to, which states that the client or entity understands and accepts that the verification agency, procurement officer or relevant decision maker may report Fronting practices to **the dti**. Intentional misrepresentation by measured entities may constitute fraudulent practices, public officials and verification agencies are to report such cases to **the dti**.

FRONTING INDICATORS

1. The black people identified by an enterprise as its shareholders, executives or management are unaware or uncertain of their role within an enterprise;
2. The black people identified by an enterprise as its shareholders, executives or management have roles of responsibility that differ significantly from those of their non-black peers;
3. The black people who serve in executive or management positions in an enterprise are paid significantly lower than the market norm, unless all executives or management of an enterprise are paid at a similar level;
4. There is no significant indication of active participation by black people identified as top management at strategic decision making level;
5. An enterprise only conducts peripheral functions and does not perform the core functions reasonably expected of other, similar, enterprises;
6. An enterprise relies on a third-party to conduct most core functions normally conducted by enterprises similar to it;
7. An enterprise cannot operate independently without a third-party, because of contractual obligations or the lack of technical or operational competence;
8. The enterprise displays evidence of circumvention or attempted circumvention;

9. An enterprise buys goods or services at a significantly different rate than the market from a related person or shareholder;
10. An enterprise obtains loans, not linked to the good faith share purchases or enterprise development initiatives, from a related person at an excessive rate; and
11. An enterprise shares all premises and infrastructure with a related person, or with a shareholder with no B-BBEE status or a third-party operating in the same industry where the cost of such premises and infrastructure is disproportionate to market-related costs.

Procedure for reporting of Fronting :

The following diagram depicts the procedure for reporting Fronting practices:

