

# ‘SUBSTANCE’ OVER ‘Legal Form’

## THE SHIFT FROM ‘PAPER’ BASED INITIATIVES

By: Yuneal Padayachy

‘Substance’ over ‘Legal Form’ is a crucial B-BBEE Verification principle that separates the reality of a transaction and its true intent from its economic impact. While ‘Legal Form’ is central to the faithful representation and reliability of evidence at a B-BBEE Verification, it can fly in the face of real and meaningful transformation. ‘Substance’ may not necessarily meet the paper-driven ‘Legal Form’ requirements at the other end of the spectrum.

The disparity between ‘Substance’ and ‘Legal Form’ reveals itself across all elements of the B-BBEE Scorecard. Sustainable initiatives are critical to a successful B-BBEE Strategy; hence organisations should avoid the once-off initiatives that look good on paper. Essentially, the focus must be on extracting ‘Substance’, away from the ‘paper’ driven ‘Legal Form’, that will benefit ‘Black’ People and yield a tangible return on investment for organisations.

The concept of ‘paper’ driven ‘Legal Form’ refers to a B-BBEE Strategy that crafts, then tracks, initiatives that focus on the results of a B-BBEE Verification. Yet, when the results are analysed, there is no meaningful impact other than the points on a B-BBEE Scorecard.

Let’s investigate how the legislation views ‘Substance’ over ‘Legal Form’ as an essential principle upon which a B-BBEE Rating Agency centres its B-BBEE Verification process.

- > Clause 2.1 under Statement 000 of the Generic Codes of Good Practice (The Codes) refers: The fundamental principle for measuring B-BBEE compliance is that ‘Substance’ takes precedence over ‘Legal Form’.
- > The 2008 Verification Manual, although not currently amended, refers to a B-BBEE Verification as: ... processes and activities conducted by a B-BBEE Rating Agency to assess, verify and validate that the score awarded to an organisation is a result of individual scorecard elements supplied. It includes the evaluation of all transactions to provide an indicative B-BBEE score and certification based on the principles of The Codes.

Organisations should consider the concept of ‘Substance’ over ‘Legal Form’ when developing or evaluating their B-BBEE Strategy as follows:

- > Measuring and reporting results must showcase the economic reality of an initiative rather than the ‘Legal Form’.
- > The ‘Substance’ that takes precedence over the ‘Legal Form’ principle is tiered in its approach to evaluating compliance. Firstly, it measures ‘Legal Form’ against the B-BBEE Act, The Codes, the 2008 Verification Manual and peripheral legislation. Upon meeting the ‘Legal Form’ criteria through the evidence and then checking against ‘Substance’, a B-BBEE Rating Agency will consider an initiative as tested.

If the evidence does not support a claim of ‘Substance’ or ‘Legal Form’, a B-BBEE Rating Agency will not allow the claim, thus will allocate no points. Each element of the B-BBEE Scorecard necessitates evidence that within itself will illustrate the principle of ‘Substance’ over ‘Legal Form’.

### Ownership Priority Element

More often than not, upon examination, there is a disconnect between the ‘Substance’ and ‘Legal Form’ of the Ownership Scorecard. If a ‘Black’ Shareholder does not receive the benefits of Voting Rights, Economic Interest and Net Value, a B-BBEE Rating Agency will not recognise the points. For example, ABC Traders has an individual shareholder with a 30% shareholding, a ‘Black’ Person as defined. ABC Traders presents all the documentary evidence, such as the share certificates, share register and shareholder’s agreement, thus presenting all necessary evidence.

However, during the B-BBEE Verification, the B-BBEE Rating Agency interviews ABC Traders’ ‘Black’ Shareholder. During the interview, it is apparent that the shareholder was not aware of, and has never exercised, any Voting Rights. Furthermore, the Shareholder was unaware of the Economic Interest due.

In this instance, it is clear there was no ‘Substance’ to the transaction; consequently, ABC Traders did not receive Ownership points for Voting Rights or Economic Interest.

Evidence to substantiate ‘Substance’ over ‘Legal Form’ - non-exhaustive.

Share Registers	An inspection of Share Registers to allocate the latest Shareholding of an organisation.
Share Certificates	Inspection of Share Certificates to confirm the latest Shareholding of an organisation.
Shareholders or Members Agreement	Trace the exercisable Voting Rights and Economic Interest in the hands of ‘Black’ People and ‘Black’ Women against the shareholder or member agreement.
Declaration of the outstanding acquisition debt balance.	<ul style="list-style-type: none"><li>&gt; Is ‘Black’ Shareholding structured as a debt? If so, how is the debt funded, for example, through the organisation or via a third party?</li><li>&gt; How long will it take for a ‘Black’ Shareholder to repay any debt obligation?</li></ul>
Interviews	At a B-BBEE Verification, interviews with a sample of ‘Black’ Shareholders will determine whether they: <ul style="list-style-type: none"><li>&gt; Understand what their Voting Rights are;</li><li>&gt; Independently exercised their Voting Rights; and</li><li>&gt; Received their entitlement to Economic Interest.</li></ul>



*Mr Yuneal Padayachy is the Member Support Executive at the BEE Chamber. He previously served as the Accreditation Manager for the B-BBEE Programme at the South African National Accreditation System (SANAS). Before taking up his role at SANAS, he played a critical part in the B-BBEE Policy Unit at the Department of Trade, Industry & Competition. He was responsible for drafting and developing B-BBEE legislation for implementation. Yuneal played a crucial role in establishing the Youth Employment Service, otherwise known as the YES Initiative.*





Management Control

In this element, the disconnect between real ‘Substance’ and ‘Legal Form’ occurs when employees are classified at a particular occupational level on an organogram with an accompanying grading level, on paper only.

ABC Traders has a deficit of ‘Black’ Management and has no capacity to employ more people in this category. To meet their Employment Equity and Management Control targets, they promote a ‘Black’ Employee from a Creditors Clerk to Financial Manager, in title only, reflecting on the organogram. The employee remains on the same salary, does the same work, has the same responsibilities and reports to the same manager as before.

At the time of ABC Traders’ B-BBEE Verification, analysis reveals the shortfall in the ‘Black’ Employee’s salary band, job scope and responsibilities, which vastly differ from his non-‘Black’ counterpart.

The findings were that there was no ‘Substance’ to the position held by the ‘Black’ Employee. Thus, ABC Traders received no points for the transaction under ‘Black’ Management for that employee claim.

Evidence to substantiate ‘Substance’ over ‘Legal Form’ - non-exhaustive.

EEA2 & EEA4 Reports	Agree on the total number of employees and positions as per the payroll.
COR39	Ensure that all Director information on the registration forms corresponds correctly and aligns with the evidence an organisation presents.
Employee list and payroll	Confirm the responsibilities, accountabilities and rewards of ‘Black’ Directors and Managers, including all non-‘Black’ people at the same occupational level.
Minutes of Board Meetings	Ensure the minutes of Board Meetings record and correspond with the people and occupational level of those responsible for strategic decisions.
Interviews	At a B-BBEE Verification, interviews with a sample of ‘Black’ Employees at all occupational levels will determine that information presented is sound.

Skills Development Priority Element

The disconnect between ‘Substance’ and ‘Legal Form’ for Skills Development is about the benefit of the skill vs the skills intervention.

For example, ABC Traders had a unique Skills Development opportunity to provide a ‘Black’ Apprentice with a meaningful 12-month skills intervention with its European counterpart. The skill, due to the training, would positively impact the career of the apprentice and allow ABC Traders to expand its business operation.

At the time of ABC Traders’ B-BBEE Verification, the evidence did not support that the training provider was SAQA registered. The result was that the skills intervention did not qualify as a claim.

In this case, there was a ‘Substance’ that did not meet the ‘Legal Form’; thus, ABC Traders could not claim this skills intervention as a contribution.

Evidence to substantiate ‘Substance’ over ‘Legal Form’ - non-exhaustive.

Categorisation of Training Initiatives	A sample of descriptions of training intervention spend for each category according to the Learning Programme Matrix to confirm the viability of each claim.
Learnership, Internship or Apprenticeship (LIA) Programmes	Samples of LIA Agreements are necessary to evaluate the overall progress.
Proof of Attendance	Samples of attendance registers to confirm attendance of Beneficiaries. The exact process verifies internal and external training interventions.
Proof of cost incurred	A sample of invoices confirming Skills Development spend.
Interviews	At a B-BBEE Verification, interviews with a sample of ‘Black’ Beneficiaries will determine that sufficient claims for ‘Black’ People were prorated against non-‘Black’ Skills Development spend for each intervention for all training.

Enterprise & Supplier Development Priority Element

Vital to the desired Enterprise & Supplier Development outcome of B-BBEE is developing small businesses. However, the approach to Enterprise Development or Supplier Development interventions is such that, more often than not, it leaves the Beneficiaries worse off than before the intervention.

For example, ABC Traders enters into an Enterprise Development contract with Company A. They decide to contribute an interest-free loan. However, following a change of heart, they choose to pay a training provider to upskill the Administration Department at Company A, although the department runs smoothly.

The ‘Legal Form’ allows for ABC Traders to outsource their Enterprise Development contribution. Yet, there is no ‘Substance’ to the assistance as the administration department runs adequately. For example, ‘Substance’ would have been an interest-free loan for the same amount, which would have enabled Company A to invest in equipment to improve their service offering.

Evidence to substantiate ‘Substance’ over ‘Legal Form’ - non-exhaustive.

List of active Suppliers	Obtain a schedule of all B-BBEE suppliers that form part of an organisation’s Preferential Procurement Spend and the total spend with all other suppliers. B-BBEE recognition status and proof thereof is necessary.
Enterprise Development and Supplier Development Agreements	Inspect all Enterprise Development and Supplier Development Agreements to ensure they comply with the criteria stated under Statement 400. Ensure evidence exists that Enterprise Development or Supplier Development contributions have been initiated and implemented within the relevant financial period.
Evidence of contribution	Evidence that the contribution has been made, for example, a proof of payment.

Socio-Economic Development

The desired outcome of Socio-Economic Development is to create income-generating activities for ‘Black’ People. However, an organisation’s approach to ‘Legal Form’ more often than not leaves Beneficiaries worse off following the intervention.

For example, ABC Traders agrees to provide food parcels to a non-profit organisation whereby the benefit of the contribution will reach 100% ‘Black’ People. An initiative such as this would qualify as Corporate Social Investment or Corporate Social Responsibility and does not meet the ‘Substance’ required for Socio-Economic Development which necessitates income-generating activities.

Evidence to substantiate ‘Substance’ over ‘Legal Form’ - non-exhaustive.

Agreement or Acknowledgement of Receipt	> Inspect all of the Socio-Economic Development Agreements; and > Confirm that all activities comply with the criteria stated under Statement 500.
Confirmation of percentage ‘Black’ People as Beneficiaries	Ensure that sufficient and appropriate evidence exists to support that at least 75% of the value of the Socio-Economic Development contributions directly benefit ‘Black’ People.
Proof of Cost incurred	Evidence must indicate that the cost was incurred, for example, in the form of a proof of payment.

Thus, when organisations take their B-BBEE Strategy into 2022 and beyond, each should bear in mind that paper-driven ‘Legal Form’ is, more often than not, more straightforward to administer than ‘Substance’. However, the ‘Substance’ yields meaningful and sustainable transformation, which is precisely what will produce a return on investment for all and have an impact on the livelihood of ‘Black’ People.