NPO Legal Issues

Keeping an eye on non-profit laws

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THE COMPANIES ACT OF 2008

By Ricardo Wyngaard

Article Two: Directors of the new non-profit company

This article focuses on the provisions of the Companies Act of 2008 (the Act) dealing with directors of non-profit companies. In the King Code of Governance Principles (King III), the chairman of the King Committee, Prof. Mervyn E. King, states that: "*...perhaps the most important change is incorporation of the common law duties of directors in the (Companies Act of 2008). This is an international trend*." The Act predictably raises the standard of governance.

Defining 'directors'

The Act draws a distinction between '*appointed* and '*elected* directors. *Appointed* directors include:

- A director appointed in terms of the Memorandum of Incorporation (MoI),
- An ex officio director,
- An alternate director,
- A temporary director, and
- An incorporator of a company (automatically serving as first director until the required minimum of three directors have been appointed).

Non-profit companies with voting members must, in terms of section 68, *elect* directors who do not fall within any of the above categories.

Duties of directors

Section 66 (1) of the Act states that the business and affairs of a company must *be managed by or under the direction of its board*. Section 76 of the Act sets out the required standard of conduct for directors. The main duties of directors are as follows:

The **fiduciary duty** prohibits directors from using their position or any information obtained whilst being directors to gain an advantage for him/herself or another person or to cause harm to the company. This duty is not new as it has been recognised by the South African courts for many years.

The **duty to communicate** requires directors to communicate to the board any information that comes to their attention, unless they reasonably believe that such information is immaterial to the company or publicly available or cannot be disclosed for reasons of confidentiality.

The **duty to exercise good faith, care, skill and diligence** requires directors to govern the company in good faith, for a proper purpose and in the best interests of the company. A director must further act with the degree of care, skill and diligence reasonably expected of a person carrying out similar functions and having the general knowledge, skill and experience of that director.

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About NPO Legal Issues:

This is an electronic newsletter published by: **Ricardo Wyngaard Attorneys** which is aimed at updating the non-profit sector on relevant legal issues.

In this edition:

Ricardo Wyngaard Attorneys is a law practice that specialises in rendering advice and assistance on non-profit law and governance.

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FROM THE COURTS:

Cuninghame v First Ready Development 249 [2009] ZASCA 120

On 28 September 2009 the Supreme Court of Appeal (the SCA) delivered a judgment in which it found that a section 21 company was conducting business unlawfully.

The main object of the section 21 company was, in essence, to manage a furnished hotel on behalf and for the benefit of the owners of the hotel.

The SCA found that even though section 21 companies can be established with the main object of *promoting communal or group interests* – such phrase is not without limitation.

The SCA found that Companies Act of 1973 does not provide for the incorporation of a section 21 company aimed at promoting a commercial object for its members. The court further found: "*If the expression 'group interest' in section 21 (1) (b) is to be construed without any limitation, the preceding references in the section to religion, arts, sciences and so forth could hardly have any meaning*." The court further stated that such references refer to: "*associations pursuing charitable, benevolent, cultural or social activities, as opposed to commercial enterprises*."

ON THE TAX FRONT:

The discretion of the Commissioner of the South African Revenue Service to grant PBO approval retrospectively has been extended.

The Commissioner may do so if satisfied that the organisation complied with the requirements of a PBO prior to its application. Donations made to an unapproved PBO would not, in my view, be deductible even though PBO status is granted with retrospective effect. This is because the discretion is only granted for purposes of section 30 not for section 18A.

Change introduced in terms section 41 (1) (b) of the Taxation Laws Amendment, No. 17 of 2009 and is deemed to have come into operation on 1 January 2009.

Directors of the new non-profit company/…

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The Act essentially retains the **duty to declare conflicting interests** provided for under the current Act. Directors having a personal financial interest in matters considered at a board meeting must; disclose such interest and any material information relating thereto, leave the meeting immediately after such disclosure and not take part in the consideration of such matter.

Directors may rely on the performance, information, opinions, recommendations, reports or statements of reliable and competent employees and experts.

Liability of directors

Directors may be held liable if they breach any provision of the Act (including their duties) and any provision of the company's MoI. **NB:** *This liability extends to members of a committee appointed by the board – irrespective whether that person is a member of the company or not.*
Directors will also be held liable for loss, damages or costs sustained by the company in situations where the director, amongst other:

- Acted beyond the scope of his/her authority,
- Participated in reckless, grossly negligent or fraudulent trading,
- Participated in trading under insolvent circumstances, and
- Knowingly signed, consented or authorised the publication of materially false or misleading financial statements.

Implications for non-profit companies:

As the chairman of the King Committee pointed out - incorporating common law duties of directors has become an international trend. It remains to be seen how this will impact on South African non-profit companies. Research in countries like the USA, UK and Australia have revealed that increased legal regulation has impacted on the ability of NPOs to recruit directors.

It is apparent that the Companies Act and King III, raise the standard of governance significantly. It seems that non-profit companies should start to incorporate **board development** and **indemnity insurance** as standard budget line items.

Code Name: B-BBEE – Episode 1

By Ricardo Wyngaard

This is the first of a two-part article aimed at explaining the relationship between NPOs and the Broad-Based Black Economic Empowerment Codes of Conduct (the Codes). The first article focuses on the compliance aspect and the second article will focus on how NPOs can position themselves to gain from the application of the Codes.

Brief Introduction

The Codes have been published under section 9 (1) of the Broad-Based Black Economic Empowerment Act, 53 of 2003 (the Act). The main objective of the Act is to promote black economic empowerment. The Codes introduced a generic scorecard with seven elements to calculate and measure BEE. The first four elements deal mainly with the internal affairs of the enterprise and the last three elements focus on matters outside of, but related to, the enterprise. The seven elements are:

1. Ownership
2. Management Control
3. Employment Equity
4. Skills Development
5. Preferential Procurement
6. Enterprise Development
7. Socio-Economic Development Initiatives

All organs of state and public entities must apply the Codes when procuring services, issuing licenses and concessions, entering into public and private partnerships and selling state-owned entities. The direct result is that all enterprises (including NPOs) that want to interact with the state in one of those areas must apply the Codes. The indirect result is that enterprises interacting with the state should, in turn, procure services from other BEE compliant private enterprises. The Codes also make provision for other scorecards to calculate and measure compliance for different kinds of enterprises - including NPOs.

A BEE verification agency will allocate a score out of 100 to an enterprise in terms of the relevant scorecard. The *BEE status* of that enterprise will be determined in accordance with that score. There are nine BEE status levels ranging from Non-compliant to Level One. Level one being the highest BEE status level. Each BEE status level has a *BEE Procurement Recognition Level* assigned to it (ranging from 0% to 135%) – see table below. A high BEE Procurement Recognition Level means a higher likelihood to be engaged with by the state or other private enterprises.

BEE Status Level	Score	BEE Procurement Recognition Level
One	100	135%
Two	85 – 99	125%
Three	75 – 84	110%
Four	65 – 74	100%
Five	55 – 64	80%
Six	45 – 54	60%
Seven	40 – 44	50%
Eight	30 – 39	10%
Non-Compliant	Less than 30	0%

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Where do NPOs fit in?

NPOs obtain a BEE score in different ways. Below are the three options:

1. Exempt Micro-Enterprises

NPOs with an annual turnover of less than R5 million would qualify as Exempt Micro-Enterprises (EMEs). EMEs are deemed to have a B-BBEE status of Level Four. EMEs can be promoted to a higher B-BBEE status only if it is more than 50% owned by black people of black women. NPOs do not have ownership and cannot, as EMEs, be promoted to a higher B-BBEE status. An audit report or certificate issued by an accounting officer is sufficient proof to demonstrate that an NPO meets the EME criteria. A certificate from a verification agency is not required for this purpose.

Research has already shown that most NPOs in South Africa have a turnover of less than R5m. The majority of South African NPOs would accordingly qualify as EMEs.

Adjusted Scorecards:

The Codes make provision for an Adjusted Generic Scorecard and an Adjusted Qualifying Small Enterprises Scorecard to accommodate entities that don't have ownership – including NPOs.

2. Specialised Qualifying Small Enterprises

NPOs with an annual turnover between R5 – R35 million are eligible as Qualifying Small Enterprises (QSEs) in terms of the Adjusted Qualifying Small Enterprises Scorecard (Adjusted QSE scorecard). This Adjusted QSE scorecard does not have the 'ownership' element.

Qualifying NPOs can choose to be measured for compliance in terms of any four of the six elements that are on the Adjusted QSE scorecard. The four chosen elements on the Adjusted QSE scorecard have equal weighting points. Only a verification agency can measure compliance in terms of this scorecard.

Please note: EMEs can choose to be measured in terms of the Adjusted QSE Scorecard to increase their BEE status.

3. Specialised Enterprises

NPOs with an annual turnover above R35 million can be measured in terms of the Adjusted Generic Scorecard. The ownership element is also absent from this scorecard. All six remaining elements on this scorecard will be used to measure these NPOs – not only four. Not all the weighting points on this Adjusted Scorecard are equal – skills development and preferential procurement weigh more than the other four on this scorecard.

Implications for NPOs:

NPOs with an annual turnover of less than R5 million automatically qualify for BEE status level four by simply producing an auditor's certificate as proof of their annual turnover. Some of those NPOs may want to pursue a higher BEE status level to exhibit their commitment to the BEE process. This would mean being measured in terms of the Adjusted Qualifying Small Enterprises Scorecard. This would have cost implications, but may hold longer-term benefits for such NPOs. The Department of Social Development has stated, for example, in its Policy on Financial Awards to Service-Providers, that: "*Some of [civil society] organisations have made strides in realigning their services with government policies and priorities. However, this has regrettably not been the general trend and the pace of transformation must be accelerated.*" NPOs, deemed as EMEs, that want to engage the state as agents of service-delivery should consider being measured in terms of the Adjusted Qualifying Small Enterprises Scorecard.