SOUTH AFRICA CORPORATE SOCIAL RESPONSIBILITY: A REGULATORY REVIEW

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ACRONYMS

B-BBEE	Broad-Based Black Economic Empowerment
BEE	Black Economic Empowerment
CRISA	Code on Responsible Investment for Institutional Investors in South Africa
CSI	Corporate Social Investment
CSR	Corporate Social Responsibility
dti	Department of Trade and Industry
EME	Exempt Microenterprises
JSE	Johannesburg Stock Exchange
NGO	Nongovernmental Organization
NPO	Nonprofit Organization
PBO	Public Benefit Organization
PEPFAR	President’s Emergency Plan for AIDS Relief
QSE	Qualifying Small Enterprises
SAG	Government of South Africa
SANAS	South African National Accreditation System
SANS	South Africa National Standards
SHOPS	Strengthening Health Outcomes through the Private Sector
SRI	Socially Responsible Investing
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

This regulatory brief examines legal and regulatory policies in South Africa relevant to corporate social responsibility (CSR). Its objective is to understand how CSR policies might impact or benefit PEPFAR partners transitioning from direct USAID funding in South Africa. PEPFAR partners are exploring a range of sustainability strategies including corporate partnerships and contracts with the Government of South Africa. In addition to examining the CSR regulatory landscape, the brief also looks at laws affecting PEPFAR partner provision of commercial services.

There are four major policies affecting CSR in South Africa, although there are additional policies (e.g., the Occupational Health and Safety Act) that specify health, safety, and wellness requirements for corporate employees. The King Reports I (1994), II (2002), and III (2009) set the broad framework, establishing a code of ethical corporate conduct including encouraging investments in broader social and environment welfare. The Company Act of 2008 (amended in 2011) creates a CSR monitoring function through required Social and Ethics Committees. The Johannesburg Stock Exchange (JSE) Social Responsibility Index rewards social responsibility with “best performer” rankings. The Broad-Based Black Economic Empowerment (B-BBEE) Act of 2003 provides concrete targets across a broad checklist of activities which includes socio-economic development activities. Collectively, the CSR policies act as a catalyst for companies to act as responsible corporate citizens, invest in their communities, support South Africa’s racial transformation agenda, and care for the health of their employees. These policies do not have the force of law, but do provide business incentives to comply.

Policy	Key Relevant Compliance Metrics
KING Reports	Public reporting on strategies for promoting employee health and risk mitigation
B-BBEE Act	Scores based on contributions to black empowerment, especially enterprise development, skill building and ownership/management role
Company Act	Existence of a Social and Ethics Committee to monitor and report on CSR
JSE Social Responsibility Index	Evidence of employee prevention, education and awareness programs; access to voluntary HIV counseling and testing; and sponsorship of/support for community-based prevention, education and awareness programs

The B-BBEE Act has the most “teeth” among the CSR policies in that business licenses in many sectors require applicants to have an active B-BBEE Certificate. A key focus of B-BBEE scoring is on developing and building skills of new local enterprises. PEPFAR partners who can position themselves as qualified B-BBEE suppliers stand to gain preferred status for business contracts and access to corporate funds and training assistance. Corporations benefit from supporting B-BBEE compliant organizations by increasing their B-BBEE scores.

Corporate incentives to support PEPFAR partners are also heavily weighted in the B-BBEE score elements related to enterprise and supplier development. Where possible, PEPFAR partners should obtain B-BBEE Certificates to enhance their attractiveness to corporations as suppliers. PEPFAR partners who qualify as exempt microenterprises (with annual turnover < R10 million) can obtain automatic BEE certification just by verifying their annual turnover.

Access to corporate contracts will be further enhanced by documenting/expanding black ownership, control, and employment. Corporations gain maximum points by contracting with new BEE suppliers. Finally, the B-BBEE Certificate is required for any contract with a public agency including the Department of Health.

LEGAL IMPLICATIONS FOR PEPFAR PARTNER PROVISION OF COMMERCIAL ACTIVITIES

PEPFAR partners can engage in the sale of services and remain tax exempt, as long as any profits are reinvested in the organization's social welfare mission as stated in its founding documents, and are not disbursed to individuals, owners, or entities. If revenue-generating activities are deemed to be unrelated to the principal mission of the organization and are intended for profit, not cost-recovery, they will be taxed at a flat rate of 28 percent of profits.

1. BACKGROUND AND OBJECTIVES

USAID/Southern Africa commissioned this analysis through the Strengthening Health Outcomes through the Private Sector (SHOPS) project to better understand the legal and regulatory environment affecting PEPFAR partner options for transitioning away from direct PEPFAR support. Given South Africa's developed economy and sophisticated corporate social responsibility (CSR) landscape, PEPFAR partners are pursuing numerous opportunities with commercial funders. This brief determines how South Africa's legal and regulatory environment may incentivize or support increased funding opportunities for PEPFAR partners through corporate social investment (CSI) opportunities. This brief is designed as a companion piece to a forthcoming, broader South Africa SHOPS private sector assessment report on private sector opportunities and alternative revenue sources for PEPFAR-funded nongovernmental organization (NGO) partners.

The questions addressed in this brief are focused on two perspectives, including:

1. **Understanding the CSR regulatory landscape**: What are South Africa's legal and regulatory requirements, if any, governing CSR in general and support for HIV and AIDS prevention, treatment and care in particular?
2. **Understanding regulatory requirements related to income generation for PEPFAR partners**: What are the legal, tax, and regulatory rules applicable to NGO provision of revenue-generating activities?

2. METHODOLOGY

Analysis for this legal review was grounded in desk research conducted between May - July 2014. Key sources included Government of South Africa (SAG) websites posting gazetted regulations and codes, analyses provided by the International Center for Non-profit Law, South Africa Revenue Service guidance, Institute of Directors of South Africa surveys and Practice Notes, global philanthropic institutions, and peer reviewed journals as well as gray literature.

3. CORPORATE SOCIAL RESPONSIBILITY POLICY IN SOUTH AFRICA

3.1 WHAT IS CSR?

CSR and the companion term CSI is premised upon the imperative that corporate business decisions and actions should consider the needs of a broad set of stakeholders other than just company owners and investors. Those stakeholders include employees, suppliers, regulators, customers, partners, communities, and the environment. Good corporate governance includes both sound fiduciary management as well as empowering those with a stake in the company's performance.

> **CSR Definition**
>
> "The responsibility of an organization for the impacts of its decisions and activities on society and the environment, through transparent and ethical behavior that contributes to sustainable development, health and the welfare of society; takes into account the expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behavior; and is integrated throughout the organization and practiced in its relationships" – ISO, 2010

Globally, there is a trend toward linking philanthropy with business objectives to optimize sustainable investments that benefit both the business and the beneficiary. CSI can create opportunities for businesses to improve their reputation with customers, attract and retain employees, develop new markets, and meet regulatory requirements.

The CSR category is a broad one and many areas covered by the term are not relevant to or addressed in this brief, including issues related to corporate transparency and reporting; use of formal dispute resolution; use of internal audits for regulatory compliance; process of board deliberations, decision-making and membership; transparency of accounting; risk management policies; budgeting for good governance processes; information technology governance; and environmental compliance. Rather, this legal review will focus on those elements of CSR relevant to the services offered by PEPFAR partners with a strong focus on health.

> **Corporate Social Responsibility** is the most widely used term for corporate support of social welfare concerns such as health. CSR will be used as the primary term throughout this report.
>
> **Corporate Social Investment** is an element of CSR, but CSR is a more expansive term including ethical business practices.
>
> **Impact Investing** refers to an investment strategy that actively places capital in businesses and funds that generate social and/or environmental good and at least return nominal principal to the investor.
>
> **Socially Responsible Investing** refers to an investment strategy that seeks to consider both financial returns and social good, and focuses primarily on avoiding investments in "harmful" companies or encouraging improved corporate practices related to the environment, social performance, or governance.
>
> **Socio-Economic Development** is the term used in the B-BBEE Act to measure CSI. These activities are part of the broader term CSR.

3.2 OVERVIEW OF POLICIES PROMOTING CSR IN SOUTH AFRICA

The policies governing CSR are voluntary in nature, not mandated by corporate law or enforced with penalties. There is a set of “soft laws,” described below, that set forth guidance and benchmarks to steer corporations toward ethical and commercially prudent practices, including caring for the communities in which they do business. Collectively, the policies set the tone for good corporate citizenship as one that contributes to community development. While there is no explicit duty of corporate directors to take into account the interests of its stakeholders, various policies are in reality mandatory because companies cannot receive licenses to do business, be listed on the Johannesburg Stock Exchange or access SAG contracts absent compliance with certain CSR policies.

South Africa has been a global leader in CSR, starting with the publication of the **King Reports** beginning in 1994 (Institute of Directors, 2011). This ground-breaking initiative established a framework for achieving a triple corporate bottom line: financial, social and environmental. Through a set of voluntary aspirational requirements, it set a benchmark for good corporate citizenship. It was designed to promote a mindset of ethical behavior, and establish a code of corporate conduct.

The **Broad-Based Black Economic Empowerment Act of 2003** (B-BBEE) was established as a framework for the promotion of black economic empowerment, to authorize the issuance of codes of good practice and to publish transformation charters (Republic of South Africa, 2004). B-BBEE seeks to redress racial inequalities brought about by apartheid which disadvantaged black (defined as African, Colored and Indian) South Africans, and to promote social investment and the empowerment of communities. The B-BBEE framework is a uniquely South African CSR initiative, with a scorecard approach that imposes hard targets on companies who must comply or risk losing business contracts, investors, and customers.

The **Company Act of 2008**, as amended in 2011, is a comprehensive set of laws regulating the formation and liquidation of companies and regulates the conduct of corporate activities (Republic of South Africa, 2009). There is no legal obligation for companies to act in a socially responsible manner but governance provisions include the creation of a Social and Ethics Committee to monitor and report infractions.

The **Johannesburg Stock Exchange (JSE) Socially Responsible Investment Index** (SRI) was adopted in 2004 as a set of criteria against which companies can be ranked on their social investment performance (Johannesburg Stock Exchange, 2014a). Among other requirements, the JSE committee has made compliance with King Report documentation mandatory in order to be listed on the exchange.

TABLE 1: SUMMARY OF KEY CSR REGULATORY REQUIREMENTS

Policy	Key Relevant Compliance Metrics
KING Reports	Public reporting on strategies for promoting employee health and risk mitigation
B-BBEE Act	Scores based on contributions to black empowerment, especially enterprise development, skill building and ownership/management role
Company Act	Existence of a Social and Ethics Committee to monitor and report on CSR
JSE Social Responsibility Index	Evidence of employee prevention, education and awareness programs; access to voluntary HIV counseling and testing; and sponsorship of/support for community-based prevention, education and awareness programs

3.3 KING REPORTS I, II, III

In 1994, the SAG published the first King Report, a set of aspirational measures companies can take to ensure ethical corporate conduct. This ground-breaking document, unique in the world, provides a framework for companies to achieve a “triple bottom line” reflecting growth in profits, investment in people, and protection of environmental resources. The King Codes have been updated twice (in 2002 and 2009) and continue to serve as a benchmark for good governance (Flores-Araoz, 2011).

These codes are overseen by the Institute of Directors of Southern Africa and enforced through a set of voluntary “comply or explain” provisions, with companies expected to justify why they have not adopted King Report guidelines. Company directors are insulated from interference in decisions that they deem to be in the best interest of their company, and thus may favor shareowner interests over that of other stakeholders. However, companies can use their compliance with King Codes to demonstrate to investors, employees, suppliers, regulators, customers, partners and communities socially responsible practices.

Of greatest relevance to PEPFAR partners seeking to engage corporations are provisions recommending that organizations measure and report on employee health, taking into account significant health threats such as HIV and AIDS. Boards of Directors are expected to understand and have a strategy in place to mitigate health risks to their workforce and produce annual reports that include not just financial results but practices related to social and environmental programs. Workforce health and safety are a key focus, thus encouraging, but not mandating, HIV and AIDS programs for employees.

3.4 BROAD-BASED BLACK ECONOMIC EMPOWERMENT

The B-BBEE Act of 2003 seeks to redress racial inequalities brought about by apartheid disadvantaging black (defined as African, Colored and Indian) South Africans, and to promote social investment and the empowerment of communities. It seeks to ensure broader and meaningful participation in the economy by black people to achieve sustainable development and prosperity and requires companies to contribute to the economic transformation of the country. B-BBEE is a framework that verifies CSR activities, measuring to what extent companies give resources and carry out initiatives to improve the situation of and to promote access to the economy for historically disadvantaged South Africans. The B-BBEE Act is supported by Section 9(2) of the South Africa Constitution which specifically allows for legislative and other measures designed to protect or advance categories of persons disadvantaged by unfair discrimination.

Public companies must have a B-BBEE score but acquiring a B-BBEE score for private companies is not mandatory. There are no legal consequences for not complying (Flores-Araoz, 2011). However, there are economic consequences such as inability to access licenses in some industries, to bid on public tenders, or to buy state-owned assets (Practical Law, 2014; BEE Navigator, 2014). Different industrial sectors have different B-BBEE requirements. For example, the South African mining industry charter requires all mining companies to renew their licenses contingent upon their compliance with the B-BBEE scorecard (African Rainbow Minerals, 2014; BEE Certificate SA, 2014). The Act is structured to promote a “knock-on” effect throughout the business supply chain, in which businesses as buyers gain points for doing business with B-BBEE compliant suppliers and other stakeholders (Esser and Dekker, 2008). Although there are no direct financial penalties that could be applied to non-compliant black economic empowerment (BEE) businesses, the system ensures that managers will favor businesses that are compliant since that decision enhances their own BEE Scorecard under the Preferential Procurement element provisions.

3.4.1 HOW THE B-BBEE CODE WORKS

The B-BBEE Act provides for the creation of BEE Codes of Good Practice which operationalize the policies in the Act and contain the detailed regulations. A B-BBEE Certificate is regarded as evidence of a company's B-BBEE credentials. The process involves an audit in order to determine the BEE level of compliance of the company. Through the audit, the company will be assessed and validated in terms of the BEE Codes of Good Practice. The South African National Accreditation System (SANAS) is the recognized accreditation body on behalf of the Department of Trade and Industry (dti) and is responsible for overseeing the development and maintenance of the rating standards.

The dti oversees enforcement. To comply with B-BBEE policy, companies must submit documentation to dti-accredited verification agencies. Auditors visit companies to check the score on different aspects. Corporate boards are encouraged to establish a BEE policy and set BEE targets as part of their broader performance goals.

The B-BBEE Codes were revised in October 2013 in part to address perceived implementation weaknesses, including a "tick box" approach to the scorecard as opposed to substantive broad-based application (Republic of South Africa, 2013; Ismail and Luckett, 2013). Target areas were reorganized with a goal to better promote a South African business culture supportive of entrepreneurship and diversification of value chains.

3.4.2 B-BBEE SCORECARD

The Act developed a scorecard used to measure quantifiable responsibilities of institutions. The scorecard is an objective set of indicators for measuring implementation, used for self-assessment and awarding of contracts. B-BBEE scores are based along five dimensions: ownership, management control, skills development, enterprise and supplier development and socio-economic development activities. The intent is to transform the South African economy to become more inclusive and increase the participation of black people in skilled, strategic and operational leadership.

Companies are scored and ranked according to their BEE levels, from Level 1 (best) to Level 8 (worst), with a further category for non-compliant. A high "recognition level" increases chances for public contracts and enhances reputation with other stakeholders. Level 4 is considered fully compliant. The points awarded per element are shown below in Table 2. Bonus points are awarded for such indicators as hiring black people on apprenticeships as full employees, or exceeding targets for black managers.

TABLE 2: B-BBEE SCORECARD CALCULATIONS, EFFECTIVE OCTOBER 2014

Element	Weighting	Compliance Targets/ Minimum Requirements	Notes
Ownership	25 points	26% shares are black owned	Calculations include points for new black shareholders, and voting rights.
Management Control	15 points (plus 4 bonus)	40% positions filled by black/previously disadvantaged groups	This element was combined with previously separate “employment equity.”
Skills Development	20 points (plus 5 bonus)	6% of payroll must be devoted to training and development	Points are awarded for bringing in unskilled apprentices and absorbing them in the workforce, as well as for providing professional development to black employees.
Enterprise and Supplier Development	40 points (plus 4 bonus)	Spend minimum 3% net profit after tax	For maximum points, companies are expected to spend 2% of their net profit after tax on supplier development and 1% on enterprise development. Enterprise Supplier Development beneficiaries are defined as Exempt Microenterprises or Qualifying Small Enterprises which are at least 51% black-owned or at least 51% black woman-owned.
Economic and Social Development	5 points	Spend minimum 1% net profit after tax	For a company to claim the full value (5 points) of their contributions to social-economic development, at least 75% of the value of the contribution must flow directly to black beneficiaries.

The new B-BBEE Codes of Practice revised the previous Scorecard adopted in 2007 in three ways. It shifted emphasis from black employment and ownership toward developing downstream suppliers and economically viable black-owned enterprises. Specifically, the revised codes:

- Collapsed Employment Equity and Management Control into a single element
- Collapsed Preferential Procurement and Enterprise Development into a single element
- Adjusted the weightings of the various score elements as demonstrated in Table 3

TABLE 3: COMPARISON OF 2007 AND 2013 BEE CODES

Criteria	2007 BEE Codes		2013 BEE Codes	
	Weighting	Bonus	Weighting	Bonus
Ownership	20	3	25	0
Management Control	10	1	15	4
Employment Equity	15	3	-	-
Skills Development	15	0	20	5
Preferential Procurement	20	0	-	-
Enterprise and Supplier Development	15	0	40	4
Socio-economic Development	5	0	5	0
TOTAL	**100**	**7**	**100**	**13**

Compliance criteria depend upon the size of the company (BEE.co.za, 2014). Most companies in South Africa are small or medium enterprises and are exempt, or subject to relaxed compliance. According to one estimate, only 2 percent (11,871) of all economically active companies in South Africa are expected to comply with the B-BBEE requirements (Department of Trade and Industries, 2013).

The primary target of B-BBEE is large companies (revenue over R50 million annually), which are measured against all five of the elements. These large companies must also meet three of the following criteria as Empowering Suppliers to receive a B-BBEE Certificate:

- At least 25 percent of costs of sales, excluding labor costs and depreciation, must be procured from local producers or suppliers in South Africa (for the service industry, labor costs are included but capped to 15 percent).
- At least 50 percent of jobs created are for black people provided that the number of black employees since the immediate prior verified B-BBEE measurement is maintained.
- At least 25 percent transformation of raw material/beneficiation, which includes local manufacturing, production and/or assembly, and/or packaging, is achieved.
- At least 12 days per annum of productivity is deployed in assisting black exempted microenterprises (EMEs) and qualifying small enterprises (QSEs) beneficiaries to increase their operation or financial capacity.

EMEs with revenue of less than R10 million per year are exempt from compliance with the reporting and audit requirements. A large number of PEPFAR partners are likely to fit in this category. An EME is automatically granted a Level 4 (compliant) B-BBEE status. EMEs with 100 percent black ownership are granted a Level 1 B-BBEE status. The Codes set a target for businesses to buy 15 percent of their total procurement spend from EMEs each year, in an effort to support the growth of small businesses in South Africa.

Enterprises earning between R10 million and R50 million per annum are classified as QSEs and need to comply with all five elements of the scorecard, but only one of the Empowering Supplier criteria listed above. QSEs that are 100 percent black-owned automatically qualify as a Level 1 BEE Supplier and QSEs that are 51 percent black-owned automatically qualify as a Level 2 BEE Supplier.

3.4.3 B-BBEE CODES APPLY TO PEPFAR PARTNERS AS WELL AS CORPORATIONS

The B-BBEE Code applies to both for-profit and non-profit entities, as both the commercial sector and civil society have an important role to play in the transformation of South Africa. NGOs are required to have BEE Certificates to contract with the SAG, and they may be more likely to attract corporate CSR with a demonstration of B-BBEE compliance. However, SHOPS corporate interviews to date suggest that key criteria for CSR decision-making includes organizational beneficiaries that are at least 75 percent black, as well as corporate tax benefits through funding a NGO registered as a public benefit organization (PBO) with a Section 18(a) certificate. Because NGOs do not have shareholders, they cannot be scored on the ownership measure, but they can demonstrate their contribution to transforming South Africa by documenting their levels of black employment, black beneficiaries, black board members, and community development. For the many NGOs with revenue under R10 million, all that is needed is a sworn affidavit on an annual basis confirming that their total annual turnover is R10 million or less. Once documents are submitted, the BEE Certificate is generally provided within a week. New certificates must be obtained every year.

Under the 2000 Preferential Procurement Policy Framework Act, public agencies are required to score organizations in awarding contracts according to both general factors (such as price and quality) as well as BEE factors. The number of points achieved under the BEE factors are calculated in accordance with the BEE Status Level of the supplier, determined by their BEE scorecard, and will change depending upon the size of the contract. For the SAG, smaller contracts put more weight on BEE factors than large contracts (see Table 4).

TABLE 4: SAG SCORING CRITERIA UNDER PUBLIC PROCUREMENT LAW

B-BBEE Status	Tender value below R1 million (20 Points allocated for BEE Factors)	Tender value above R1 million (10 Points allocated for BEE Factors)
Level 1 Contributor	20	10
Level 2 Contributor	18	9
Level 3 Contributor	16	8
Level 4 Contributor	12	5
Level 5 Contributor	8	4
Level 6 Contributor	6	3
Level 7 Contributor	4	2
Level 8 Contributor	2	1
Non-Compliant Contributor	0	0

3.4.4 SECTOR SPECIFIC BEE CODES ("SECTOR CHARTERS")

The B-BBEE Act allows for the development of a Transformation Charter for a particular sector of the economy by the major stakeholders in that sector. Many industries have their own charters and BEE targets including transport, financial services, construction, tourism, information and communications technology, accountancy, mining and agriculture. Companies falling within a sector will be measured by their sector-specific codes. These codes reflect specific aspects of black empowerment which an industry segment is likely to influence including land use and entrepreneurship, and are tied to transformational goals for sectors for development through social and labor plans. The industry-specific codes are not materially different than the generic B-BBEE Code of Conduct but do impose different targets and priorities that may impact partnership opportunities with PEPFAR partners. BEE codes for two sectors are described below for illustrative purposes.

3.4.4.1 FINANCIAL SECTOR CHARTER CODE

The Financial Sector Charter was adopted in 2004 as a voluntary agreement designed to remove inequalities and create a robust financial services sector that reflects the demographics of South Africa (The Banking Association South Africa, 2014). Adherents commit to provide accessible financial services to black people, and direct investment into targeted sectors of the economy. The Charter was transformed into a Code in 2012. The financial sector includes banks, insurance companies, securities firms, and investment firms. In addition to achieving employment, ownership and control equity, financial services firms are expected to promote preferential procurement practices; develop and finance black-owned enterprises, low-income housing, infrastructure and agriculture; and provide effective access to financial services. The focus of the Financial Sector Code targets are to contribute to transformation by increasing access to credit to those who would not qualify under traditional banking processes and by providing financial services to those who are "unbanked."

The key difference between the generic B-BBEE Code and the Financial Sector Code are two additional elements for the Financial Sector Code – one for access to financial services (14 points) and one for empowerment financing (15 points). Points needed in the other five elements are reduced to reflect the priorities of external financial support.

3.4.4.2 MINING SECTOR CHARTER

As reflected in Table 5 below, the Mining Sector Charter adds four elements to the scorecard, reflecting the specific targets of the mining sector in transforming the South African economy (Mining Charter, 2013). These elements include:

- Explicit reporting requirements
- Measures to improve the standard of living conditions for mineworkers
- Sustainable development targets focused on environmental plans, employee health and safety, and research and development
- Local beneficiation targets for mineral commodities to enhance South Africa's industrialization

The socioeconomic development element is focused on enterprise and community development in line with required Social and Labor Plans for community investments.

TABLE 5: COMPARISON OF MINING CHARTER AND GENERIC B-BBEE CODE

Mining Charter		dti B-BBEE
Application	Applies to all holders of mining licenses	Applies to all SAG entities and therefore to all companies that do business with these entities
Relevance	Mining industry only	Generic
Scorecard categories	1. Reporting	N/A
	2. Ownership	Ownership
	3. Housing and living conditions	N/A
	4. Procurement and enterprise development	Enterprise and supplier development (incorporating Preferential Procurement)
	5. Employment equity	Management control (incorporating employment equity)
	6. Human resource development	Skills development
	7. Mine community development	Socio-economic development
	8. Sustainable development and growth	N/A
	9. Beneficiation	N/A

3.4.5 OTHER B-BBEE COMPLIANCE IMPLICATIONS

Companies investing in community organizations to comply with B-BBEE targets may receive tax deductions as allowed business expenses, or as a philanthropic deduction (South African Institute of Chartered Accountants, 2012). From a corporate governance perspective, B-BBEE compliance is designed to strengthen accountability and care for the broader environment in which a company operates. The B-BBEE Act aims not only to correct racial imbalances in post-apartheid South Africa but to promote social investment and the empowerment of communities.

3.5 COMPANIES ACT NO. 71 OF 2008, AS AMENDED IN 2011

The Companies Act is a comprehensive set of laws governing corporate activities including fiduciary responsibilities, governance, and fiscal management (South Africa Institute of Chartered Accountants, 2008). The Companies Act regulates the formation, conduct of affairs, and liquidation of all companies and it makes no distinction between locally-owned or foreign-owned companies. Companies may be either private or public.

Comprehensive reform of company law undertaken in 2011 did not introduce mandatory integration of CSR into governance structures and decision-making. The new law does not reference the King Reports or Guidance on Social Responsibility, which could have elevated their force of law. As a result, companies are not legally obliged to act in a socially responsible manner.

What the revised law did do was to require that at a minimum, companies of a certain size must establish a Social and Ethics Committee to oversee CSR. Section 72(4)(a) authorized the Minister of Trade and Industry to prescribe regulation which were released in April 2011. The Companies Act Regulations sets forth the requirements for the Social and Ethics Committees (Department of Trade and Industry, 2013). The essence of these requirements includes:

- The purpose of the Committee is to embed CSR in corporate governance.
- At least one member of the Committee must not be involved in day-to-day management of the company, to enhance transparency and promote adequate attention to and responsibility for CSR activities.
- The Committee's primary function is to monitor the company's activities, give attention to prevailing codes of best practice (including the B-BBEE Act), and promote good corporate citizenship.
- The Committeee is required to report on the company's record of sponsorship, donations and charitable giving.

The practical effect of the Committees is to increase accountability of CSR activities within a company, and to increase scrutiny on social investment budgets to ensure they are effective. Although companies have no duty under the law to contribute to local communities, they are required to report on their contributions. The Social and Ethics Committee provides a central point of contact, and helps to formalize criteria for investing and measuring impact.

3.6 JOHANNESBURG STOCK EXCHANGE SOCIALLY RESPONSIBLE INVESTMENT INDEX

Similar to the UK's stock exchange FTSE4Good Index, South Africa adopted its Socially Responsible Investment (SRI) index in 2004. The Johannesburg Stock Exchange (JSE) was the first emerging economy to balance financial returns with positive social impact (Johannesburg Stock Exchange, 2014a). Compliance with King Report documentation is mandatory in order to be listed on the exchange, heightening the level of public reporting and disclosure. Reports must be filed annually, and companies who meet the criteria ("aspirational benchmarks of best practice") are identified. Companies with favorable JSE SRI scores are more likely to distinguish themselves from their competitors.

The JSE SRI Index was revised in 2010 following the release of the Code on Responsible Investment for Institutional Investors in South Africa (CRISA). The CRISA code emphasized the importance of environmental, social and governance issues as a measure of a company's sustainability. Oversight of the SRI Index is conducted by a JSE committee. Companies are scrutinized by an independent research company which considers policy, performance and reporting. In 2012, 108 companies applied, and 76 qualified for inclusion in the Index. "Best performance" status is awarded to companies who exceed criteria. Areas of measurement include environment, ethics, climate change, governance, sustainability and society. Under society, areas of measurement include HIV and AIDS, black empowerment, health and safety, and community relations. The JSE uses its own criteria as well as compliance with King III and CRISA, with indicators divided into "core" and "desirable."

Core indicators of the SRI Index related to HIV and AIDS include providing evidence of prevention, education and awareness programs; access to voluntary HIV counseling and testing; and sponsorship of/support for community-based prevention, education and awareness programs. "Desirable" indicators include provision of treatment, care and support benefits for employees (directly or indirectly through providing access or facilitating government programs, sponsorship or support for community-based prevention and education programs and treatment). Sector specific criteria are also in place. These HIV and AIDS specific indicators are complemented by related indicators requiring quantitative data on employee training and development and the monetary value of charitable giving.

In a 2013 report comparing company responses from the previous year, companies received lower scores on HIV and AIDS programs compared to 2012 (JSE, 2013). This decline in HIV and AIDS scores was likely due to new rules limiting evidence of criteria to publicly disclosed activities. Previously, companies could report on internal activities aligned to the various indicators but the new rules impose more rigorous proof of investment.

3.7 IMPLICATIONS OF CSR POLICIES FOR PEPFAR PARTNERS

This legal and regulatory analysis suggests a number of important implications for PEPFAR partners in South Africa. Key implications include:

There is a low priority on HIV and AIDS and other health activities. Corporations gain just 5 points out of 100 for their B-BBEE score for socio-economic investments. Even if a company's CSI were fully dedicated to HIV and AIDS prevention and care, it is likely to be an insignificant contribution compared to investments required to meet other B-BBEE requirements to strengthen local enterprises or expand training activities.

All PEPFAR partners should obtain B-BBEE Certificates. The B-BBEE scorecards provide strong and specific incentives for corporations to invest in community organizations that both enhance social welfare and can provide B-BBEE points to companies. Where possible, PEPFAR partners should obtain B-BBEE certificates to enhance their attractiveness to corporations as suppliers. Especially for those who qualify as EMEs (annual turnover less than R10 million), certification is automatic for applicants. Access to corporate contracts will be enhanced by documenting/expanding black ownership, control, and employment. Corporations gain maximum points by contracting with new BEE suppliers.

BEE Certificates are required to do business with the SAG. Under the Preferential Procurement Policy Framework Act and the B-BBEE Act, agencies must apply the Codes when making procurement decisions or entering into public-private partnerships. No distinction is made between for-profit and not-for-profit organizations in these provisions. PEPFAR partners who qualify as EMEs are automatically granted Level 4 status, thus positioning them favorably for SAG contracts.

B-BBEE provides incentives for corporations to offer organizational development to eligible enterprises. The heaviest emphasis in B-BBEE scoring is on enterprise and supplier development. Large corporations are required to provide assistance (to the value of 3 percent of the corporation's net profit after tax) to black-owned micro and small enterprises to increase their operational or financial capacity. PEPFAR partners with black ownership may qualify as recepients for these assistance funds. Other PEPFAR partners may position themselves as training partners.

Liaising between companies and community enterprises is valuable. PEPFAR partners with extensive connections to other community organizations could become a valuable resource to companies required to continually identify and nurture new black suppliers and beneficiaries.

Monitoring and evaluation skills may be useful to corporations. The focus of Social and Ethics Committees on measurement may provide opportunities for PEPFAR partners with strong research capabilities to offer these skills to corporations.

4. OVERALL IMPLICATIONS FOR NGO PROVISION OF COMMERCIAL SERVICES: A LEGAL AND REGULATORY OVERVIEW

This section of the brief provides background on the overall regulation of NGOs in South Africa and implications for PEPFAR partners engaged in the provision of services for a fee. Under statutory law, described below, nonprofit organizations (NPOs) are legally recognized entities with rights and responsibilities. The right to association is guaranteed by the Constitution, which sets the foundation for an active civil society in South Africa. NPOs unite individuals committed to specific social missions, and may raise resources from individual, corporate or foundation donations, voluntary member dues, SAG subsidies, grants, contracts, and/or self-generated income. The question addressed below is whether PEPFAR partners may contract with SAG or corporate clients for the delivery of fee-based health-related services without losing their tax-exempt status as NPOs.

4.1 NPO ACT OF 1997

The regulation of NPOs in South Africa is governed by the NPO act of 1997 and the Companies Act of 2008 Schedule 1 (Republic of South Africa, 1997). The key characteristics of a NPO are (1) establishment for a public benefit purpose and (2) income and property are not distributable to its members or owners. These qualifiers mean that a NPO can make a profit but cannot distribute those profits to those that establish, control or finance it. NPOs may engage in both market and non-market production, but they cannot be primarily guided by commercial goals and considerations. Their resources may come from sales of goods and services, property income, and donations, as long as any surplus is plowed back into the enterprise.

There are three categories of NPOs: a voluntary association of persons, a company or a trust.

- **Voluntary associations** can be formed through verbal agreement, and need only be able to hold property distinct from its members and make clear that no member has rights to the property. Registration is not compulsory, but lends credibility to the organization by increasing its accountability and is required for tax benefits. The vast majority (estimated 95 percent) of civil society organizations in South Africa are non-registered voluntary associations.
- Registration as a **nonprofit company** under the Companies Act requires registration with the Directorate for Nonprofit Organizations, and the filing of narrative and financial reports. Other formalities include the appointment of auditors, a register of directors and members, and the holding of an annual general meeting.

- The creation of a nonprofit as a **trust** occurs through the registration of trust documents with the Master of the Supreme Court. A written trust deed serves as the agreement between the initial founders and trustees, who must sign their acceptance of the trusteeship.

4.2 INCOME TAX ACT

In order for an organization to receive tax exemption, it must register as a PBO. Preferential tax treatment for PBOs are covered under Section 10(1)(*c*N) of the Income Tax Act 58 of 1962, as amended (South Africa Revenue Service, 2014). Approved PBOs can issue certificates to donors making them eligible for tax exemptions up to 10 percent of their taxable income. The penalty for an organization that does not adhere to the restrictions is its loss of PBO status.

> To **retain PBO status**, commercial activities must be used as the source of funding for approved public benefit activities and cannot become the principal activity of the organization. The level of commercial activity must not overtake the primary public interest mission of the PBO.

PBOs enjoy exemption from income tax for all "public benefit activities" listed in their founding documents to support health, education, community development and other social welfare objectives. **All PEPFAR partners should register as PBOs**. In addition to income tax exemption, PBOs enjoy exemption from stamp duties, capital gains taxes, value added tax (VAT), and transfer duties subject to detailed rules.

PBOs are entitled to conduct trading and commercial activities outside of the public benefit activities for which they are granted PBO status. PBOs do not lose their status for conducting such activities but commercial activities will be subject to tax according to specific rules (Wyngaard, 2010).

4.2.1 TAX EXEMPT ACTIVITIES

There is no limit to the amount of tax exempt revenue PBOs may generate, as long as the activities meet all the tests for tax exemption. In determining whether a business undertaking or trading activity is a tax exempt public benefit activity or a taxable commercial activity, the law applies the following tests:

Is the business undertaking or trading activity integral and directly related to the PBO's principal mission?

The principal mission is defined in a PBO's founding documents. For example, an organization dedicated to increasing HIV and AIDS testing and counseling could charge a fee for its services as this business activity is directly related to its principal mission. If the PBO were to rent unused space in its building, this effort would be an unrelated (and taxable) business undertaking.

Is the activity conducted on a cost-recovery basis?

The goods or service must not be sold to maximize profits but rather with the intention of recovering direct and reasonable indirect costs. "Substantially the whole" of the business undertaking or trading activity (85 percent) must be conducted on a cost-recovery basis, not with the intention of maximizing profits. This provision recognizes that perfect cost recovery is not always possible and that some cost estimates may result in revenues that slightly exceed costs.

Will the trading activity result in unfair competition with other taxable entities?

The PBO should not have an unfair advantage over a taxable entity conducting the same business undertaking or trading activity. This provision is designed to prevent economic distortion caused by the tax exemption. Factors will include how the commercial activity is advertised, whether it is designed to maximize profits or generally related to the primary activity of the organization.

Is the activity an occasional fund-raising activity staffed mainly by volunteer labor?

The law exempts from tax the revenue from non-routine bake sales or street fairs where non-paid labor is relied upon to assist. A PBO that claims an exemption under this subparagraph must demonstrate and provide support for the view that the two above conditions are met.

4.2.2 TAXABLE ACTIVITIES:

If a business activity does not meet all three of the above criteria, then profits from the trading activity will be taxed. Income from unrelated trading activity is not to exceed 15 percent of gross receipts (Charity Law, 2014). The tax rules include the following:

- Allowed unrelated trading activity will be taxed at a flat rate of 28 percent, and this applies regardless of PBO classification as a trust, NPO or voluntary association. There is a provision that exempts the greater of R200000 or 5 percent of total receipts from tax. This exemption clause provides that PBOs may conduct commercial activities tax free up to R200000 (or more if total receipts exceed R4million.) PBOs tally the profits from commercial activity and then subtract the R200000 (or 5 percent of gross receipts of all commercial activity) before calculating the remainder to be taxed.
- Grants or other resources contributed to PBOs made to support their public benefit activities may not be used to support the commercial activities. Use of tax deductible donations to support commercial activities would undermine the intent of the tax deductions to enhance the public welfare and constitute unfair competition.
- The provision of taxable commercial activities by PBOs must be approved by the South Africa Revenue Service. Applications should demonstrate how the commercial activity by the PBO relates to its social mission and does not compromise its public benefit activities, and why it will not result in unfair competition.

4.3 IMPLICATIONS OF NGO REGULATION OF COMMERCIAL ACTIVITIES FOR PEPFAR PARTNERS

As traditional NGOs with a social mission explore options for commercial services, planning is needed to determine how to best structure dual social and commercial activities. Options include keeping the two sets of activities separate by setting up a separate subsidiary for commercial activities, complying with NPO Act rules ensuring profits are used for the primary mission of the organizations and do not constitue more than 5 percent of organizational revenues.

Combining commercial and noncommerical activities can create a host of complex problems including risks of conflicts of interest, need for upgraded accounting and tax assistance, and need for governance oversight. These risks can be managed but constitute a cost of engaging in for-profit activities. Key concerns include not using non-profit resources in for-profit activities. The lowest risk option may be to create separate for-profit subsidiaries for commerical trading activities. To date, in SHOPS interviews with PEPFAR partners, more examples of a dual structure have emerged than models which combine both commercial and non-commercial activities. Failure to comply with the filing and tax requirements of Section 30 of the Act may result in PBOs losing their PBO approval.

5. CONCLUSION

The CSR environment in South Africa is unique in the world, intrinsically tied to the transformation agenda of the B-BBEE Act of 2003. For large companies in South Africa, compliance with the B-BBEE codes is a fact of doing business. Corporate incentives for supporting health programs such as HIV and AIDS prevention and treatment will be much stronger if companies can link that support to other priority areas of social responsibility. These priority areas include skills-building and organizational development for enterprises run by or benefitting black South Africans. NGOs seeking corporate contracts or donations will enhance their status as preferred suppliers or partners by obtaining BEE Certificates to demonstrate their compliance. Corporations then receive increases in their own BEE scores for engaging in CSR activities to support compliant organizations. The B-BBEE policies are reinforced by a broader set of laws designed to promote corporate contributions to disenfranchised populations as an element of good governance.

South African policies recognize the financial pressures under which NPOs operate and permit trading activities needed to sustain such organizations. PEPFAR partners may engage in approved profit-making ventures as long as their principal focus is to serve their primary altruistic mission and any profits earned are used to support the organization. Approval by the South African Revenue Service will depend upon a test to ensure that the service will not unfairly compete with others in the market, among other criteria. The for-profit activities may or may not be taxed depending upon the proportion of revenue the activity represents for the organization. In short, PEPFAR partners are free to pursue corporate or SAG fee-bearing contracts. However, these partners cannot rely on South African law or regulation to compel corporations to invest in HIV and AIDS services.

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