

Details of Successful Appeal to a Verification Agency Relating to Shorter Repayment of Invoices

1. The Codes of Good Practice, published on 9th February 2007 refers.
2. This appeal refers to the interpretation and allocation for points for enterprise development.
3. Statement 600, Annexure 600 A refers: The Qualifying Contribution Type is “Shorter payment periods”, the contribution amount is “percentage of invoiced amount” and the benefit factor is “Percentage being 15 days less the number of days from invoice to payment”.
 - a. Mathematically this does not make sense. Take an example where a company pays COD. The formula states:
15 days – 0 days = 15 days. This is not a percentage. A day cannot be converted to a percentage
 - b. Due to this mathematical inconsistency, we at EconoBEE submitted an official request via email to the dti, Xolisile Zondo, sent by our colleague Nhlanhla Damoyi. The response was

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*From: Xolisile Zondo [mailto: XZondo@thedti.gov.za]
Sent: 10 September 2007 12:48
To: Nhlanhla Damoyi
Subject: Re: BBBEE Enquiries*

*Hi Nhlanhla
Apologies for the late response but since I spoke I have been to the office only twice because I had to go to KZN and last week we were in PE.*

*Your first query:
What is the formula to reach a percentage of recognised*

contribution in the shorter payment contribution. For example: What if a Measured Entity pays a supplier within 7 days of R1 m invoice, what should be the % of the recognition contribution? What is the formula to get the correct number?

Here is the shorter-payment rule:

Maximum days for an entity to pay suppliers is 15 Days, but for Govt departments may go up to 30 days.

Lets say a measured entity receives an Invoice dated 05/09/07 from Supplier A with an amount of R2000.00. The measured entity pays by the 10/09/07.

Therefore: 15 days -(less) 5 days = 10 days.

Then you will say: $10/15 \times R2000.00$

= R1333.34. (This is the contribution towards ED shorter payment terms)

Lets say the 3%NPAT of the measured entity is ten million that is contributing to ED. From the ten million you take away the R1333.34 amount.

At the time our own comment, in response to a query from another consultant who believed that the matrix as quite generous was:

The exact wording of the codes supports this view:

"Percentage being 15 days less the number of days from invoice to payment"

If they had said:

"Percentage being 15 less the number of days from invoice to

payment" i.e. left out the word "days" then there would be a stronger case for your interpretation.

However I agree with you that this is a really huge dispensation - as I have said in my previous newsletter. This is about 50 times cheaper than for example providing a grant for enterprise development.

This information was published on the <http://www.bee-expert-group.co.za> web site in September 2007

4. Shorter payments periods is referred to in paragraph 3.2.8.3 “Settlement of accounts with beneficiary entities over a shorter period of time in relation to the measured entity’s normal payment period, provided the shorter period is no longer than 10 days:”
5. The chief director of the dti has written a letter explaining exactly how she sees this interpretation – see attached letter. This interpretation is clearly in agreement with the original email received.
6. It is our opinion that interpretations expressed by the dti should be followed unless a verification agency can prove that the dti was derelict in their duty. In this regard we believe that the verification agency disputing our position should be obliged to give its viewpoint as to why the dti’s opinion should be disregarded rather than us having to justify the dti and our position.
 - a. The verification manual states:
 - i. Any verification agency who issues a verification certificate without applying the guidelines set out in the verification manual shall be guilty of unprofessional conduct and the “dti” may recommend that he lose his accreditation with SANAS.
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 - ii. Documentation shall include a record of the verification agency’s reasoning on all significant matters that require the

exercise of judgment, and related conclusions. The existence of difficult questions of principle or judgment requires the documentation to include the relevant facts that were known by the verification agency at the time the conclusion was reached. (Page 28, Paragraph 16.2)

- b. It can be argued that an agency that does not convince the chief director of the dti that she is incorrect in her interpretation and chooses to use another interpretation is guilty of unprofessional conduct as outlined in (a) above.
 - c. If the chief director, or any officer of the dti has issued two contradictory opinions, we would expect a verification agency to point this out to the dti, to SANAS and ourselves without the need to have issued this appeal.
7. Paragraph 5 of statement 600 is also relevant: It states: *“The minister may from time to time, by notice in the gazette, revise or substitute the benefit factor matrix. Any changes will be applicable only to compliance reports prepared for a measured entity in respect of the first 12-month period following the gazetting of a revision or substitution.”*
- a. This implies that if the minister chooses to change the benefit matrix, the old interpretation will apply for the subsequent 12 months. In many cases the director general, the chief director, or other directors of the dti have issued letters and comments which has been taken as an interpretation, as has occurred in this case. Paragraph 5 suggests that even if the dti, or its officers do change their interpretation, it can only be applied for the subsequent 12 months. Therefore, notwithstanding any additional letter the chief director may have issued, which has not been disclosed to us, the original letter dated October 2008 remains valid for a period of one year.

8. Paragraph 2.2 of statement 000 – key principles states: *“In interpreting the provisions of the codes, any reasonable interpretation consistent with the objectives of the act and the broad-based black economic empowerment strategy must take precedence.”*
 - a. Our opinion is that the interpretation of the dti is consistent with the objectives of the act.
9. Other verification agencies have in the past used the dti’s interpretation for their calculation. This includes Empowerdex, EMEX and Verify Solutions. When the independent person rules on this issue we request that he take into account the damage that will occur whichever way he rules. Some companies have spent hundreds of millions of Rands using the early repayment method and have budgeted to receive their full 15 points in the future due to their cumulative overspend. Their decisions were based on the documents provided by the dti and the interpretations of their relevant verification agencies. This issue can potentially have a 14 point differential on an entity’s scorecard – the difference between non-compliance and level 7, of the difference between level 5 and level 3.
 - a. As a result we see this as a test case for verification. We request the independent person to submit his report to SANAS and the dti recommending disciplinary action against those who misinterpreted the codes at the cost of 2 levels or millions of rands. This would potentially include the dti, SANAS and the verification agencies.
10. While we do not believe that it is necessary to justify our position, because it is based on the dti’s decisions, we will do so for clarity and to help set a precedent in this instance:
 - a. We have seen it said that the concept of shorter payment periods is “too easy” or “too cheap”. Nowhere does the act or the Codes of Good Practice state that implementing B-BBEE should be hard, difficult or expensive. We coined the phrase “BEE should make business senses and Business should make BEE sense, and many

commentators and government officials have taken that up as a mantra.

- b. Enterprise development is aimed at assisting businesses to grow, and become sustainable. Studies show that 53% of the reason why small businesses fail is due to lack of financial control, lack of managing accounts and cashflow. Many large corporations and government itself have very rigid payment policies, effectively denying small black businesses the opportunity of tendering for that business. It can happen where a small business is bankrupted by lack of cashflow even though they may be making a profit.
- c. One of our enterprise development beneficiaries, Mabuya Glass Merchants has a recurring concern – that he will get too much business and not be able to pay for the glass he purchases from PG Glass. His biggest opportunity and nightmare is that he will be awarded a contract by one of the large property management companies and not be able to pay for the glass he needs to buy.
- d. Many companies for whom we have consulted has stated that they would be prepared to change their systems, but admit that it would be at great cost. The companies that have implemented an early repayment system have had to implement a special system to manage their corporate governance issues.
- e. Other companies have stated that they do not have sufficient black owned suppliers so cannot implement the shorter payment period. By encouraging a business to pay ED suppliers COD implies that if they have no black owned suppliers they should search for them and support them. Our approach is to help the company find suitable suppliers that can become ED beneficiaries and then benefit from shorter payment periods.
- f. The codes specifically award enhanced benefits to companies who appoint their suppliers as ED beneficiaries (enhanced recognition of 120% on procurement). Many aspects of the codes are aimed at

growing businesses, which is why the shorter payment period is part of the benefit matrix. The only issue is how the benefit is calculated. While it is true that shorter payment period sounds cheaper than a grant, if the extra admin and corporate governance is taken into account, the cost benefits are not as substantial. The interest costs of shorter payment periods are not the only costs that should be taken into account. The opportunity costs of decreasing available cash flow or overdraft facilities should be acknowledged.

- g. The codes would more want the business to become sustainable than simply receive a grant. The link between ED and supporting the beneficiary via purchases of his services or products is more likely to result in a successful, viable and sustainable business than a grant.
- h. If the interpretation of shorter payment period was limited to 15% of invoice value, many companies would find this too expensive and not implement the system. It would result in less use being made of ED beneficiaries as suppliers, largely defeating the aim of ED.
- i. In any event other contributions on the benefit matrix are also “cheap”.
 - i. A minority investment in a black owned business could almost instantly result in that business becoming profitable. There would be no spend, only an investment with potentially substantial returns.
 - ii. The cost of a loan is only an opportunity cost of interest, yet an interest bearing loan still earns 70% of the value of the loan.
 - iii. Even professional service providers rendering services at no cost is “cheap”. The actual cost to company is the employee salary but the ED claim is taken at 80% of commercial rates

11. We submit that we have given sufficient documentation and reason for the calculation of the enterprise development points to be calculated in the manner supplied by two different people from the dti.
12. We submit that it is reasonable to take into account the chief director's letter. Paragraph 10.3.2 of the Verification Manual states the criteria to be used for verification engagement, which includes guidelines issued by the dti. We submit this overrides any determination made by an individual verification agency or industry association.
13. We submit that the philosophical concept behind the chief director's letter is reasonable.