



Recent developments in legislation and voluntary codes have important implications for the NPO sector. Coupled with this, donors are increasingly asking for evidence of more robust governance as they strive to ensure effective use of their funds. NPOs need to align themselves with best practice in governance, or face losing support. In this article, **Triologue** provides an overview of the most relevant changes arising from the Companies Act and King III Code of Governance for both NPOs and CSI practitioners, as well as a brief introduction to the Global Reporting Initiative (GRI) supplement for the NPO sector.

## NPO governance: What NPOs and grantmakers need to know

“ NPOs are accountable to donors, beneficiaries and the broader public, as they often receive public donations. NPOs have a duty to use their assets effectively in serving the cause for which they were established. ”

**DEPARTMENT OF SOCIAL DEVELOPMENT, *Governance Practices of National Non-profit Bodies and National Networking Organisations in South Africa, 2010***

The introduction of the Companies Act 71 of 2008 in May 2011 has had significant implications for NPOs, as well as grantmaking bodies within corporate structures. In terms of the new Act, the two main categories of entities are profit and non-profit companies. The non-profit company (NPC) is public benefit, facilitating cultural activities or to represent communal interests. The NPC replaces the ‘association not for gain’ previously incorporated in terms of Section 21 of the earlier Companies Act.

### Registering an NPC

All new companies are required to be registered in terms of the new Act and existing Section 21 companies have a period of two years in which to implement the new provisions, with some key sections coming into force with immediate effect.

A new NPC can be incorporated by submitting a copy of its completed and signed memorandum of incorporation (MOI) in the prescribed form and filing a notice of incorporation with the prescribed fee and supporting documentation with the Companies and Intellectual Property Commission (CIPC). The CIPC was recently established through the amalgamation of the Office of Companies and Intellectual Property Enforcement (OCIPE) and the Companies and Intellectual Property Registration Office (CIPRO).

Any existing company has two years in which to file an amendment to its MOI and change its name, without charge, to ensure compliance with the new Act and to ensure that governance rules issued by the company are consistent with the new Act.

### Key changes for NPCs

NPOs that choose to register as NPCs will need to take note of how requirements have changed from Section 21 stipulations. The most notable sections of the new Companies Act regarding NPCs include:

### **Incorporation**

The MOI replaces the memorandum and articles of association. In terms of the Act, the MOI must be written in language intelligible to an ordinary person without having to struggle to understand its terms. Furthermore, the MOI contains both alterable and unalterable provisions that should be reviewed specific to each NPC.

### **Directors and members**

Under the new Act, a minimum of three directors must be appointed (in place of the previous minimum of two directors). The duties, obligations and performance standards in terms of the conduct and potential liability of directors – previously left to common law – are clearly outlined by the new Act, with immediate effect. This includes the provision that directors may incur personal liability if they approve or allow transactions to take place which conflict with the newly introduced solvency and liquidity tests. Directors may be held liable if they breach any provision of the Act (including their duties) and any provision of the company's MOI. This liability extends to members of a committee appointed by the board, irrespective of whether that person is a member of the company or not. This provision is likely to make co-opting of high-level volunteers more difficult than it already is for NPOs, and will also affect the consulting sector.

Appointment of members for NPCs is optional (replacing the obligatory minimum of seven members for Section 21 companies) and where there are members, they have rights of access to detailed company information. Remuneration and other benefits for directors must be approved by special resolution of the members in a general meeting. Circumstances under which directors or other officers of the company may be given loans or other financial assistance is highly regulated by the new Act. The new Act provides detailed provisions regarding the meetings of shareholders and directors including voting procedures, proxies, quorums and directions on the conduct of meetings and required notices.

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### **Financial statements, the public interest score and audits**

All companies must prepare annual financial statements within six months after the end of each financial year. NPCs will be subject to the calculation of a public interest score (PIS) which will determine the degree to which NPCs must adhere to higher reporting standards and the manner in which financial statements are audited and presented (similar to that applicable to BEE scores). Due to the way it is calculated, the majority of NPOs are unlikely to be affected by the requirements of higher public interest scores.

Companies will have to decide whether the finances of the company will be audited, independently reviewed or neither. The only non-profit companies where auditing is mandatory are those incorporated by the State, an organ of State, a State-owned company, an international entity, a foreign State entity or company, or those incorporated primarily to perform a statutory or regulatory function.

### **Reviewing documentation**

While a number of specimen forms are provided by the Act, it is strongly recommended that NPCs adapt these forms to their particular circumstances before simply adopting the standard forms without reviewing them and thereby risking full compliance with the Act. Reviewing existing documents may result in reworking present governance arrangements.

### **Implications for tax exemption**

Incorporation as an NPC does not result in automatic tax exemption, or any particular classification for tax purposes. NPCs therefore need to be aware of the interplay and possible conflict areas between the Companies Act and specific legislation applicable to public benefit organisations (PBO) under the Income Tax Act 58 of 1962.

### **Going forward**

While there may certainly be several benefits to the new legislation, which improves the manner in which companies are incorporated and regulated, most organisations have felt overwhelmed as they attempt to come to terms with the requirements of the new Act. Both directors and members should familiarise themselves with the responsibilities and potential liabilities attached to their roles.

With the introduction of the public interest score, NPCs will be required to adhere to varying levels of reporting and auditing standards with which donors will need to familiarise themselves. They will need to communicate directly with NPCs on their reporting and auditing expectations.

### King III and a reporting code for NPOs

The King III Code of Governance, released in September 2009, was developed for directors of corporates with a strong bias towards commercial entities, but it also applies to all entities regardless of the manner and form of incorporation or establishment. While the code is recognised internationally for its progressive governance principles, the application to non-profit entities is less clear and there are a number of concerns that are raised in the translation of the code to the NPO sector.

The fundamental difference between profit and non-profit companies lies in their core objectives of profit for shareholders vs. the creation of public benefit or social value. The King III principles are based on the premise that shareholders (directors) have vested private interests in entities, while NPO office bearers are generally more risk averse with no potential for personal financial reward. The King III principles rely on the marketplace as a regulator – an approach which is not transferable to the NPO sector, being based on philanthropic and beneficiary support. Furthermore, the call for comprehensive audits (even if not required in terms of the Companies Act) could have impacts on donor support for NPO activities. It's possible that NPOs could receive qualified audits, where these will not accurately reflect the actual efficacy or governance capacity of the organisation since it is being measured against inappropriate corporate benchmarks.

At a meeting – initiated by Shelagh Gastrow of Inyathelo – with the representatives of the King Committee in

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August 2010, concerns about the inapplicability of the code to the NPO sector were raised, with special reference to the potential impacts on donor funding. A sub-committee of the King Committee was formed to address the lack of representation and consultation with the NPO sector in the writing of King III, and to develop a set of practice notes. However, inadequate consultation with the NPO sector resulted in Gastrow's Consultative Forum seeking broader stakeholder representation.

A new governance code tailored for the NPO sector is being proposed by the Consultative Forum. This moves beyond a response to King III to address the need for a comprehensive governance code tailored specifically for the NPO sector. The proposed code is not without contention, and another NPO group is currently working with the Institute of Directors to develop a King III Addendum for the NPO sector. These developments highlight the interest and need for addressing these issues, but there still appear to be more questions than clear answers at this time. ■

### NGO REPORTING WITH G3

The G3 Guidelines are part of the Global Reporting Initiative (GRI). This set of guidelines helps organisations report to their stakeholders on the impacts of their activities and how they are dealing with these impacts in order to preserve relationships and resources for the future sustainability of the organisation. All aspects of economic behaviour are covered, including governance, social, environmental and economic equity.

The publication of the GRI NGO Supplement is a version of the GRI's G3 Guidelines, specifically tailored for NGOs, that aims to help them ensure that their accountability and/or sustainability reports effectively cover all key issues. The GRI NGO Supplement is an essential guide on reporting for large NGOs, but smaller NGOs can also benefit from this reporting tool, as it has been created to assist in the preparation of basic GRI sustainability reports.

The GRI NGO Supplement, examples of reports, further information and support can be obtained from: [www.globalreporting.org/ReportingFramework/SectorSupplements/NGO/](http://www.globalreporting.org/ReportingFramework/SectorSupplements/NGO/)