

CA Benefit Corporations: Directors' Reports

10.12.16 | Linda J. Rosenthal, JD



Socially conscious entrepreneurs in the Golden State now have two hybrid corporate models available to achieve the goal of “business-with-a-conscience.”

In “[Social Enterprises: A Revolution Under the Radar](#),” we introduced the California “benefit corporation” and the California “social purpose” corporation (formerly called a “flexible purpose” corporation).

In “[California Benefit Corporations: An Introduction](#),” we highlighted the special features of the “benefit corporation” option. It’s authorized by the California Business Corporation Law as a for-profit entity, but there are key distinctions from the traditional business format. Most particularly, directors and officers of a California benefit corporation must focus not only on the bottom-line profit, but also on achieving a “general public benefit,” as well as optional “specific public benefits.”

How Are These Multiple Purposes Achieved?

How, exactly, the corporate directors and officers juggle these multiple purposes is a bit up in the air because this special format has only been around since 2011. The benefit corporation board must make business decisions with an eye on much more than just the financial bottom line. It’s *required* to take into account the “[triple bottom line](#)” of “profits, people and planet.”

What’s not in doubt, though, is that benefit corporation directors are required once a year to: (1) measure the entity’s success and failures against a third-party standard of accountability; and (2) disclose this assessment in a formal report.

Benefit Corporation: Transparency

There are some variations among the many U.S. states that have recently authorized a hybrid, benefit corporation

The cornerstone of the California model is a mandatory annual report disclosing five categories of

information. The key element is a report of the required comprehensive, consistent assessment of successes and failures based not on subjective analysis, but measured against an objective third-party standard. This assessment description must explain how the corporation pursued its multiple purposes (including the general public benefit and any identified specific public benefits), how well these purposes were achieved, and if – and how – these goals were *not* achieved.

Disclosure: When and Where

“The benefit report shall be sent annually to each shareholder ...” (“Shall” indicates a mandatory duty.) The due date is “within 120 days following the end of the fiscal year of the benefit corporation or at the same time that the benefit corporation delivers any other annual report to its shareholders.” In addition to delivering the report to shareholders, a “benefit corporation shall post all of its benefit reports on the public portion of its Internet Web site, if any.” If there’s no web site, then the corporation must provide the report, “without charge, to any person that requests a copy.” Good news, though: The corporation doesn’t have to post or provide information about its directors’ compensation, or any “financial or proprietary” material.

Annual Report: Required Elements

There are five sections of required explanation and information: (1) a narrative description; (2) an assessment; (3) certain identifying information; (4) a statement describing failures, if any; and (5) a statement of connection, if any, with the creators of the third-party assessment-standard that is used.

Narrative Description

The first element of the annual report is a “narrative description” : a detailed summary of all of the following:

- “The process and rationale for selecting the third-party standard used to prepare the benefit report;”
- “The ways in which the benefit corporation pursued a general public benefit during the applicable year and to the extent to which that general public benefit was created;”
- “The ways in which the benefit corporation pursued any specific public benefit that the articles state it is the purpose of the benefit corporation to create and the extent to which that specific public benefit was created;”
- “Any circumstances that have hindered the creation by the benefit corporation of a general or specific public benefit;” and
- “A statement of any connection between the entity that established the third-party standard, or its directors, officers, or material owners, and the benefit corporation, or its directors, officers, and material owners, including any financial or governance relationship that might materially affect the credibility of the objective assessment of the third-party standard.”

Assessment

The second element is a report on the mandatory yearly assessment “of the overall social and environmental performance of the benefit corporation, prepared in accordance with a third-party standard applied consistently with any application of that standard in prior benefit reports or accompanied by an explanation of the reasons for any inconsistent application.”

There’s no requirement that the benefit corporation be audited or certified by any third party – only that it self-assess, based a standard developed by an independent, third party. The standard must be consistent from year to year. We’ll have more about the third-party standard in later posts.

Identifying Information

The third element is disclosure of the “name of each person that owns 5 percent or more of the outstanding shares of the benefit corporation, either beneficially, to the extent known to the benefit corporation without independent investigation, or of record.”

Statement About Failures

The fourth element is a statement “indicating whether, in the opinion of the board of directors, the benefit corporation failed to pursue its general, and any specific, public benefit purpose in all material respects during the period covered by the report.” If, “in the opinion of the board of directors, the benefit corporation failed to pursue its general, and any specific, public benefit purpose, the statement ...shall include a description of the ways in which the benefit corporation failed to pursue its general, and any specific, public benefit purpose.

Statement of Connection

The fifth, and final, required element of the annual report is a disclosure of any connections between the benefit corporation and the company that developed the third-party standard chosen to use as the basis of the annual assessment. (There are several corporations that develop and issue these independent assessment standard protocols.)

Conclusion

The hybrid corporate format comes with huge benefits to socially conscious entrepreneurs and to the general public, but this is balanced by fairly stringent assessment and disclosure requirements.