

# Evaluation of the Non-Profit Regulatory System



planning, monitoring  
& evaluation

Department:  
Planning, Monitoring & Evaluation  
**REPUBLIC OF SOUTH AFRICA**





## Policy summary

South Africa has a large non-profit sector, made up of diverse entities. These entities range from small non-profit organisations (NPOs) operating in a single community to large and well-established organisations with a national footprint. NPOs play a major role in the development of the country by providing much-needed services to the poor and vulnerable in society. In order to deliver these services, NPOs receive funding from the government, donors, corporate funders and the public. The focus of this evaluation is on the regulatory system that guides and steers NPOs in delivering health, education, and social welfare services. Regulation is needed to safeguard the health and safety of beneficiaries and enhance accountability for the use of funds. In relation to the non-profit sector, regulation can improve governance, transparency and service quality. The regulatory system consists of a complex set of legislation, regulations, norms, and standards.

**Five** types of regulation have emerged to guide the development and organisation of the non-profit sector. The **first** type of regulation governs the establishment of legal form, and enables NPOs to establish themselves as legal entities in terms of a statute or common law. The **second** type formalises NPOs by allowing them to register in terms of the Non-Profit Organisations Act (1997), which signals an NPO's commitment to the principles of good governance, transparency, and accountability. The **third** type of regulation provides public support to the non-profit sector through a system of tax exemptions and concessions. The **fourth** type of regulation is service regulation, which seeks to protect the health and safety of beneficiaries while ensuring the delivery of quality social welfare, health and education services. Service regulation is administered mainly by provincial Departments of Social Department, Health, and Education. Finally, NPOs become subject to the **fifth** type of regulation when they apply for funding from the government.

This evaluation examines the effectiveness of the regulatory system, and has made the following key findings:

- The regulatory system has evolved in a piecemeal manner. As a result, registration and compliance processes across the different types of regulation are not aligned.
- A misalignment problem is particularly evident in service regulation. Legislation such as the Children's Act (2005), Older Persons Act (2006), and Prevention of and Treatment of Substance Abuse Act (2008) have created separate and sometimes unconnected regulatory processes. NPOs are therefore required to register multiple times with the same provincial department to deliver certain legislated services. These multiple registration processes impose substantial compliance costs on NPOs and a high administrative burden on the regulators which administer them.
- Considerable progress has been made in formalising organisations through registration in terms of the Non-Profit Organisations Act (1997). However, NPOs and some government officials remain unsure about the purpose and benefit of NPO registration. In particular, many of the NPOs surveyed did not recognise that one of the primary objectives of the Act was to improve the governance of the sector.
- The focus on registration processes within service regulation, particularly within provincial Departments of Social Development, diverts resources away from monitoring the quality of services delivered by NPOs.
- With regard to the Non-Profit Organisations Act (1997), less emphasis is placed on compliance monitoring, mainly due to a lack of capacity and resources. Inadequate monitoring is one of the factors contributing to low rates of compliance with the NPO Act.

- The cost of registration and compliance is high for NPOs in the social welfare and education sectors, because they have to register multiple times and comply with different reporting requirements. These costs are disproportionately high for smaller NPOs, and reduce the amount of resources they have at their disposal to deliver services. Even in sectors such as health, where NPOs do not have a registration requirement legislated in law, government processes are cumbersome, lengthy and costly to comply with.

The main recommendations are as follows:

- The national and provincial Departments of Social Development, Education and Health, should improve the efficiency of the regulatory system for which they are responsible, and cut any unnecessary red tape.
- The national and provincial Departments of Social Development, Education and Health, SARS and the Companies and Intellectual Property Commission (CIPC) should co-ordinate their regulatory processes and provide support to NPOs in complying with regulation.
- The National Department of Social Development should strengthen and streamline the legislative and regulatory framework that guides the development and organisation of the non-profit sector.





# Executive summary

## 1. Introduction

### 1.1 Background to the intervention

The non-profit sector provides vital services to the poor and vulnerable in society, and plays a major role in the development of South Africa. The focus of this evaluation is on the regulatory system that guides and steers NPOs in delivering health, education, and social welfare services. Regulation is needed to safeguard the safety and quality of services received by beneficiaries from NPOs, and enhance accountability for the use of funds by NPOs. Regulation can improve the governance and transparency of the non-profit sector.

**Five** types of regulation have emerged to guide the development and organisation of the non-profit sector. The **first** type of regulation relates to legal or juristic personality, and confers upon NPOs a set of legal rights that enables them to enter into contracts and agreements. Several different routes can be taken to establish an NPO. Registration in terms of the Companies Act (No. 71 of 2008) confers juristic personality on NPOs. The formation of a non-profit trust in terms of the Trusts Property Control Act (No. 57 of 1988) does not confer legal personality, but creates a legal entity under common law. Trustees remain liable in their private capacity for any damages. An NPO may also choose to establish itself as a voluntary association in terms of common law, and provide for legal personality through its founding documents.

The **second** type of regulation is in terms of the Non-Profit Organisations Act (No. 71 of 1997). Registration under the Non-Profit Organisations Act formalises the entity by entering its name on a register, and signals to the state and public that an NPO has complied with a set of governance standards.

The **third** type of regulation establishes tax exemptions and concessions for the non-profit sector. In particular, the Income Tax Act (No. 58 of 1962) exempts entities registered as public benefit organisations (PBOs) from certain types of taxation, and provides for the tax-deductibility of donations to registered PBOs. In the

**fourth** type of regulation, government regulates NPOs in respect of the types of service they offer. This form of service regulation is not unique to NPOs – other organisations wanting to provide similar services must also comply with certain governance, quality, health, safety, and organisational norms and standards. If the NPO applies for state funding, it becomes subject to the **fifth** type of regulation. The transfer of state funds to NPOs is regulated mainly by the Public Finance Management Act (No. 1 of 1999), the National Development Agency Act (No. 108 of 1998), and the National Lotteries Act (No 57 of 1997).

### 1.2 Background to the evaluation

NPOs have to comply with a complex regulatory system consisting of multiple pieces of legislation, regulations, norms and standards. Some of this legislation is designed specifically for NPOs (e.g. the Non-Profit Organisations Act, 1997), whereas other statutes impact on these organisations because of the types of service that they deliver (e.g. the Children's Act, 2005). Over the past two decades, increasing numbers of NPOs have become involved in service delivery. However, while the number of NPOs has grown, so too has the complexity of the regulatory system and the costs associated with compliance. This evaluation was commissioned to examine regulatory obligations placed on NPOs, and to assess the efficiency and effectiveness of regulation in achieving the policy objective of creating “an enabling environment” for NPOs.

## 2. Methodology

This evaluation of the regulatory system governing NPOs combines two methods of evaluation – an implementation evaluation, and a regulatory impact assessment. In this context, the implementation evaluation assesses the extent to which regulation is being implemented as planned. In contrast, a regulatory impact assessment (RIA) explores the influence of laws and regulation on the actions, behaviours and decisions of regulated entities (Jacobs and Associates, 2008). Eight main evaluation questions were contained in the Terms of Reference, and a mix of quantitative and qualitative methods was used to research these issues. These methods included semi-structured interviews with the national and provincial Departments of Social Development, Health and Education; government

agencies; and key role-players within the non-profit sector. A survey using structured, face-to-face interviews was also administered to 647 NPOs.

## 2.1 Literature review

**The democratic era brought significant changes to the legislative framework regulating NPOs. Many of these changes were designed to remove and repeal the restrictive laws imposed by the apartheid government.** The first step in reforming the legislative framework was to develop laws consistent with the Constitution (1996), which entrenched the rights to freedom of religion, belief, opinion, expression, assembly, demonstration, and association – all of which are prerequisites for a vibrant and healthy non-profit sector.

The Non-Profit Organisations Act was promulgated in 1997 after extensive deliberation, and was the first piece of legislation to deal specifically with NPOs. In the first iteration of the NPO Bill (1995), the legislation conferred wide-ranging regulatory powers on the Non-Profit Organisations Commission, a statutory body proposed to regulate NPOs. The Bill made registration compulsory, and the non-profit sector interpreted it as an attempt by the government to permit, authorise, or legitimise a particular non-profit activity (Helen Suzman Foundation, 1999). The legislation that was ultimately promulgated represents a compromise between the state and the non-profit sector. The NPO Act seeks to create an enabling environment in which NPOs can flourish, and allows for voluntary registration with minimal regulatory powers conferred on the NPO Directorate. However, the legislation goes beyond the scope of traditional regulation. Chapter 2 of the Act requires the government to “promote, support and enhance the capacity of non-profit organisations to perform their functions”. By including this obligation in legislation, the government made a deliberate attempt to recognise the capacity constraints faced by NPOs and find mechanisms to address these.

Since the inception of the Non-Profit Organisations Act (1997), a suite of legislation has been developed that affects NPOs. One of the main findings from the documentary review is that there are nuanced differences in definitions across various pieces of

legislation. For example, the definition of an NPO in the Non-Profit Organisations Act (1997) is different from that in the Income Tax Act (1962). Therefore, a research organisation registered under the Non-Profit Organisations Act (1997) may not qualify as a PBO under the Income Tax Act (1962). In practice, these differences make it difficult to align processes and systems across different regulators.

An international review of NPO regulation was conducted, covering Japan, India, Indonesia, Kenya, England and Wales. The international review reveals that some countries have created specific legal forms to meet the needs of the non-profit sector. In England and Wales, registration as a Charitable Incorporated Organisation (CIO) confers legal personality on NPOs, reduces the compliance burden on these organisations, and offers easy access to a range of tax and funding benefits. Most countries have also adopted forms of tiered or differentiated regulation. Differentiated regulation is meant to reduce the compliance obligations of NPOs by ensuring that the regulation is appropriate to their size, service offerings and risk. In three of the five countries, an independent regulatory body for the non-profit sector was established. An arm's-length relationship between the regulator, government and NPOs is generally seen as a way of maintaining a fair, impartial and objective regulatory system.

## Findings

### The size and scope of the non-profit sector

According to the NPO register, as at 5 February 2016 there were 150 456 NPOs registered across 11 sectors and 33 objectives in South Africa. Nearly 40% of all registered NPOs operated in the social services sector, followed by the development and housing sectors. Whereas the NPO register is the single most comprehensive source of data on NPOs, its figures might understate the total number of NPOs operating in the country. Many NPOs are informal organisations deeply rooted in their communities and not registered with government.

## **The performance of the regulatory system**

### ***Legal form***

The regulatory framework provides for three types of legal form: voluntary associations (VAs), non-profit companies (NPCs) and non-profit trusts (NPTs). Of these three forms, NPCs are legal persons in their own right, NPTs are legal entities and VAs are established in common law. The vast majority (94%) of NPOs on the NPO database are VAs. NPCs account for 4% and NPTs make up the remaining 2% of all registered NPOs, although these organisations are probably under-represented on the NPO database, as not all of them register with the NPO Directorate. Many NPCs and NPTs are not likely to register, unless they see the benefits of NPO registration or are required to register to access funding. The popularity of VAs may be ascribed both to the ease with which they can be formed and to their low compliance requirements. Another reason for the popularity of VAs is that the process of establishing a voluntary association and registering it under the Non-Profit Organisations Act (1997) is often carried out at the same time. As the distinction between legal personality and NPO registration is not explained to NPOs in the legislation, a widespread misconception has developed that registration in terms of the NPO Act confers legal personality on an organisation.

### ***Non-Profit Organisations Act (1997)***

Organisations choose voluntarily to enter the regulatory system because they want to reap the benefits of registration in terms of the Non-Profit Organisations Act (1997). When asked about the benefits of NPO registration, 33% of survey respondents thought that the primary advantage of the NPO Act was that it gave them legal personality, which (as mentioned above) is not correct. Only 6% of respondents thought that the legislation's main benefit was helping NPOs with governance, despite the fact that one of the primary objectives of the Act is to "encourage non-profit organisations to maintain adequate standards of governance, transparency and accountability".

The regulatory objectives of the Non-Profit Organisations Act (1997), and the powers and functions conferred on the NPO Directorate in terms of section 5 of the Act, are wide-ranging. According to the Act, the NPO

Directorate is the policymaker, programme designer, regulator and co-ordinator of the NPO sector. Many of these multiple (and sometimes conflicting) roles are not elaborated further in the Act. For example, there is no further mention in the Act of the NPO Directorate's role as a policymaker and designer of programmes, which are functions that fall within the purview of the national Department of Social Development (DSD). Regulatory functions explicitly conferred on the NPO Directorate are limited to registration, deregistration, compliance monitoring, issuing governance models, and publishing information on NPOs.

The mismatch between the regulatory objectives and the scope of regulation is possibly the result of compromises made during the drafting of the NPO Act. The literature review and interviews reveal that policymakers envisaged a more central role for the Act in the regulatory framework. It was thought that NPO registration would become the entry point into the regulatory system, so that once an NPO registered under the Act, it would gain access to funding and tax exemptions. However, this integration never happened as planned, and separate regulatory processes have developed.

While NPO registration is free and straightforward, the survey found that over 60% of the respondents in our sample opted to use consultants to register their organisation as an NPO. Nevertheless, the increased support provided by provincial Departments of Social Development during the registration process, and the roadshows held by the NPO Directorate have made registration more accessible and most probably reduced the use of consultants for registration. A key success has been improvements in the efficiency of NPO registration. Of the NPOs surveyed, just over half of those which registered in 2005 said it took more than two months to receive a registration certificate; in contrast, 80% of those which registered in 2015 had their application adjudicated within a two-month period. Once registered, all NPOs have within nine months of the end of their financial year to submit their narrative report and annual financial statements. As the number of NPOs registered has increased from 103 in 1998 to 131 618 in 2014, rates of compliance have declined. In 2014, only 14.6% of NPOs that should have submitted

their annual return actually did.<sup>1</sup> Compliance rates also tend to vary by sector. In the social welfare sector, compliance rates are higher as NPOs are monitored more closely by provincial Departments of Social Development, which also help NPOs to complete their annual returns. As officials within provincial DSDs explained, many NPO office-bearers lack basic literacy skills, let alone the necessary accounting, record-keeping and management systems and expertise to complete their financial statements and narrative reports. Therefore, it appears that compliance requirements such as producing annual financial statements might be overly complicated for smaller NPOs.

### **Taxation**

Government's system of public support for NPOs includes a series of tax exemptions and concessions. In 2001, amendments to the Income Tax Act (1962) introduced major changes that increased tax exemptions and concessions available to NPOs across a wide range of sectors. While the original intent was to link NPO registration with approval of PBOs, there was a fear that delays in the NPO registration process could curtail PBO registration. Thus the amendments to the Income Tax Act (1962) were designed to allow for open access: in other words, any institution, whether a voluntary association, non-profit company (NPC) or non-profit trust (NPT), could register as a PBO without needing NPO registration.

Based on the survey of NPOs and interviews with focus groups, the following conclusions can be drawn about the efficacy of the taxation system:

- PBO registration requires an extensive set of documentation, and it is difficult to complete the application without some form of assistance. Many of the respondents in the NPO survey left it to their accountants or bookkeepers to complete the registration process.
- A large proportion (about 75%) of the NPOs in the survey are registered as PBOs. About 16% of survey respondents choose not to apply for PBO approval, and 9% of respondents reported that

they did not know they could register as a PBO. It is unclear whether NPOs which have not applied for PBO approval have registered as taxpayers.

### **Service Acts**

Service legislation influences how NPOs deliver social welfare, health, and education services. This evaluation is not an exhaustive assessment of all laws in the welfare, health, and social sectors; more research is needed on this complex legislative landscape. For this evaluation, we have divided the services into **registered** and **non-registered** categories, where registered services are subject to a distinct and separate "service-related" registration requirement in contrast to non-registered services.

With regard to registered services, this evaluation focuses on the Children's Act (No. 38 of 2005), Older Persons Act (No. 1 of 2006) and the Prevention of and Treatment of Substance Abuse Act (No. 70 of 2008). Service Acts are complicated pieces of legislation which aim to create a safe, healthy, and enabling environment for beneficiaries of these services. It is important to mention that all providers of legislated services are subject to these statutes, whether they are public, private, or non-profit organisations. There are some practical challenges with the regulatory system within the social welfare sector administered by national and provincial DSDs:

- There are multiple registration processes under the same service Acts, which impose unnecessary compliance costs on NPOs (e.g. rehabilitation centres must register twice to provide in-patient and outpatient services).
- Similar registration processes exist for different Acts. NPOs must furnish the same or comparable documents and information to various regulators, creating additional administrative work for these organisations (e.g. a constitution is provided during NPO registration, service registration, and in applications for funding).
- Registration is valid for a limited period, and NPOs must go through the entire process again every three to five years, depending on the type of registration for which they apply.

<sup>1</sup> The NPO Directorate uses a broad definition of "compliance". It deems all newly-registered NPOs to be compliant. As a result, the compliance rate for 2014 was 45.5%. However, depending on when an NPO is registered it has between 9 and 12 months until it is required to comply. Therefore, if all new NPOs which are not yet required to submit their annual return are excluded from the calculation of compliance rates, the rate falls to 14.6% for 2014.

- In the five provinces sampled, registration is a paper-based process, which places an enormous administrative burden on NPOs and provincial departments.
- Getting clearance certificates from national and local government is a frequent cause of delay in service registration in respect of services provided to children, older persons and users of controlled substances.
- The large amount of resources spent on registration processes diverts efforts away from compliance monitoring.

The cost of service registration in the social welfare sector is prohibitive. By our estimates, an NPO registering as a provider of early childhood development (ECD) services would incur an expenditure of about R24 693 to obtain all the necessary clearances and paperwork, even before starting operations. Registration costs are significant for about 46% of NPOs that submitted an annual return to the NPO Directorate indicating an annual income of less than R200 000 in 2014.

In the education sector, NPOs running independent schools have to register with the provincial education departments (PEDs) and obtain accreditation from Umalusi. These organisations report that the major compliance costs arise from the requirement to train and retrain staff to comply with accreditation standards. Another source of compliance costs in the education sector is rezoning requirements imposed by local government. In contrast, there is no legislated registration requirement in the health sector. NPOs report that their major source of compliance costs lies in meeting the demands of the “procurement process”, particularly in relation to obtaining tax clearance certificates and Broad-Based Black Economic Empowerment (BBBEE) certificates.

### **Funding regulation**

Finally, NPOs become subject to the **fifth** type of regulation when they apply for funding from the government. The *Policy on Financial Awards to Service Providers* has become a powerful regulatory tool within the regulatory system. Umbrella bodies interviewed during this evaluation indicate that its implementation has forced emerging and micro-enterprises to register as

NPOs to access state funding. They report that owners of these enterprises stand to lose their personal assets if the NPO is dissolved, as the Non-Profit Organisations Act (1997) requires that any assets remaining after an NPO has been wound up must be transferred to another organisation with similar objectives.

### **Regulatory capacity**

The ability of regulators varies considerably across the regulatory system. SARS seems to have sufficient capacity to process most applications for PBO status within 36 working days. It also has an extensive network of regional offices where NPOs can access the information they need to register as taxpayers and apply for PBO approval. On the other hand, the Companies and Intellectual Properties Commission (CIPC) has experienced challenges in recruiting staff to the section that processes applications for NPC registration.

According to the CIPC’s annual report, this section had a vacancy rate of 21% in 2014 as a result of a moratorium on the filling of positions. This freeze on staff hiring, combined with ICT challenges and union disruptions, led to a slowdown in the registration of companies and NPCs in 2014 (CIPC, 2015). Thus, only 71% of applications for company registration filed manually, and 55% of electronic applications, were processed within 25 days.

Significant resources have been spent in building the capacity of the NPO Directorate. The Directorate’s expenditure increased at an average annual rate of 24% from R12.5 million in 2010/11 to R29 million in 2014/15, while its staff complement expanded from 37 in 2011/12 to 67 in 2013/14. The average cost of processing an application within two months increased from R833 in 2010/11 to R999 in 2014/15, an average annual increase of only 5%. In real terms, this means that the NPO Directorate has become more efficient at processing applications, driven by the implementation of a new information technology system.

However, registration processes consume the lion’s share of the NPO Directorate’s resources, and limited resources are spent on improving compliance rates and providing support to NPOs in complying with the Act. If the NPO Directorate is to achieve the objectives intended



by the Act and implement the recommendations in this report, additional legal, regulatory, information technology and analytical capacity will be needed.

Provincial DSDs and PEDs spend considerable time, effort and resources on registering NPOs and monitoring funding. Provincial interviewees report that there is little capacity left to monitor compliance with quality standards once they complete the registration and the funding process.

## Conclusions

The regulatory system is designed to address many of the regulatory problems identified by government and the non-profit sector during the early years of democracy. However, the regulatory system has developed in an unco-ordinated and fragmented manner that is inefficient and costly to NPOs. The legislation is not well aligned within the regulatory scheme. In practice, this means that different regulators ask for similar information from NPOs, or require NPOs to register for each type of service they wish to provide. NPOs incur additional costs for each registration and compliance requirement. In particular, compliance costs are disproportionately high for smaller NPOs, which are left with fewer resources to deliver their services.

Within government, registration processes require significant resources and capacity within the NPO Directorate, provincial DSDs and PEDs. In respect of the NPO Directorate and provincial DSDs, registration activities tend to detract from crucial monitoring activities. Without adequate monitoring, these regulators do not collect sufficient information to evaluate whether regulation is achieving its intended objectives and providing the right type of support needed by NPOs. Moreover, inadequate monitoring makes compliance enforcement difficult.

## Recommendations

The main recommendations are as follows:

- The national and provincial Departments of Social Development, Education and Health should **improve the efficiency of the regulatory system for which they are responsible, and cut any unnecessary red tape.**
  - The national and provincial Departments of Social Development, Education and Health, SARS and the CIPC should **co-ordinate their regulatory processes and provide support to NPOs in complying with regulation.**
  - The National Department of Social Development should **strengthen and streamline the legislative and regulatory framework** that guides the development and organisation of the non-profit sector.
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Department of Planning Monitoring & Evaluations  
330 Grosvenor Street, Hatfield,  
Pretoria  
0028  
South Africa

Tel: 012 312 0000

[www.dpme.gov.za](http://www.dpme.gov.za)