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## Promoting transparency in the NGO sector: Examining the availability and reliability of self-reported data

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# **Promoting transparency in the NGO sector: Examining the availability and reliability of self- reported data**

by

**Ronelle Burger and Trudy Owens**

## **Abstract**

Amid widespread calls for NGOs to become more accountable and transparent, this work examines the prevalence of discrepancies between what NGOs say and what they do. It does so using a unique dataset of 300 NGOs in Uganda with corresponding beneficiary assessments. Investigating NGO dishonesty with regards to financial transparency and community participation, the study finds a high incidence of misrepresentation among NGOs. Results from a Heckman probit model suggest that the determinants of misrepresentation differ according to the subject matter: the threat of being caught reduces the likelihood of dishonesty about financial transparency, while a desire to ‘save face’ to maintain a good reputation appears to be the main motivator of a misrepresentation of community consultation. The analysis provides tentative indications that NGOs with antagonistic relations with the government may be more likely to hide information and be dishonest. It also lends some support to the view that excessive and unrealistic donor demands may be an obstacle to openness and transparency. The findings of this work caution against an overly naïve and simplistic view of NGOs, and specifically, an overreliance on reported information when regulating, monitoring or surveying NGOs.



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## 1. INTRODUCTION

The NGO sector has recently been described as undergoing a ‘crisis of accountability and transparency’ (McGann and Johnstone, 2006: 66), which has damaged its credibility. Despite rising pressure for more openness and transparency, it appears that most NGOs remain reluctant to share information, and many refuse to recognise the need for accountability (Elkington, 2003)<sup>1</sup>. This is concerning as transparency is generally regarded as a key requirement for good governance and successful feedback systems. Similar to corporations and governments, NGOs are not infallible, and the timely availability of reliable information is essential for the effective regulation and monitoring of NGOs by beneficiaries, donors and governments.

While the lack of transparency in the sector has often been mentioned in passing, there have been few previous attempts to undertake an in-depth empirical study of the phenomenon. Using a 2002 representative survey of approximately 300 Ugandan NGOs, we examine the availability and reliability of self-reported information in this sector.

The data suggests that while most NGOs claim to be transparent, it appears that few NGOs are prepared to face the risks and sacrifices associated with being transparent. According to the survey, 85% of NGOs that produced annual reports claimed that they provided these reports to the public upon request, and 73% of NGOs with balance sheets said that they shared their accounts with the public. But many organizations that claimed to be transparent either failed to provide information, or provided inaccurate information.

One quarter of the NGOs that said they compiled accounts that were publicly available did not provide information when requested to do so. There were also instances of unreliable or inaccurate information provided. In 39% of cases, where NGOs reported that they asked the community about their needs before initiating a project, community members maintained that the NGO in question did not. Similarly, in 38% of cases, where NGOs claimed to have solicited feedback from communities, the community representatives said that they received

no requests for feedback. Misrepresentation of these two dimensions of community involvement overlapped in 69% of cases.

Why are these NGOs opting to withhold information or provide incorrect information? This paper examines the discrepancy between what NGOs say they do and what they actually do, in an attempt to understand why NGOs may be prompted to opt against transparency.

Many NGOs feel compelled to withhold the truth from the public eye in order to keep afloat in a competitive funding market dictated by unrealistic donor expectations and pressures. Could it be that the confidentiality alibi and the prevalence of dishonesty are simply symptoms of a sector-wide disillusionment with what they may perceive as restrictive, but ineffective rules and requirements for their sector? Are NGOs choosing to not answer questions openly and truthfully to protect themselves from an antagonistic government? Or are these merely efforts to hide behaviour that is fraudulent, inappropriate or inefficient?

The paper proceeds as follows: Section 2 describes the information asymmetry problem in the NGO sector. Section 3 outlines the Ugandan data set used to test the hypotheses. Section 4 presents a number of descriptive statistics exploring reported and actual transparency in the data. Section 5 presents the basic contours of a framework of hypotheses for understanding the aforementioned observed lack of transparency. Section 6 translates the framework into an empirical model, while section 7 reports the results of the econometric analysis. Section 8 concludes the study.

## **2. BACKGROUND: INFORMATION ASYMMETRY IN THE NGO SECTOR**

Stiglitz (1999: 23) noted, “To pretend that any institution is infallible, or that there is perfect confidence in the actions being undertaken, is to fly in the face of reality.” Stiglitz proceeds to argue that the case for transparency is largely based on an acknowledgement and recognition of human fallibility. Society has checks and balances so that the blunders, oversights and missteps of individuals and organizations can be identified and rectified. Transparency can be viewed as a precondition for the effective functioning of such checks and balances. Without timely and accurate information, stakeholders are unable to hold decision makers accountable.

Transparency is a key issue in the NGO sector due to the existence of a considerable degree of private information and hidden actions in the NGO-beneficiary-donor nexus. NGOs' relationships with their stakeholders are fraught with information asymmetries, which make it more difficult for donors, government and beneficiaries to observe potential problems and to hold NGOs accountable. For instance, when donors are based in North America or Europe with no local presence, they are physically removed from the site of NGO activities, and the distances involved may make it prohibitively expensive for the donors to visit project sites regularly to observe conditions, outputs and outcomes. In such cases, donors may be heavily reliant on second-hand information, which may often be reported by the NGO itself. If the donor is not familiar with local circumstance and culture and has no benchmark for cost comparisons, the interpretation of accounts and reports may be a further obstacle to assessing the performance of the NGO and detecting ineffectiveness or fraud.

Beneficiary oversight has been proposed as a remedy for the deficiencies in donor information. It is argued that it may be more difficult for NGOs to keep information and actions hidden from beneficiaries due to their close physical and cultural proximity and direct involvement in development projects. However, beneficiaries cannot always observe all the relevant dimensions of a good or a service produced by an NGO (Tendler, 2000; Mansuri and Rao, 2004). For instance, children whose parents have never been to school may not be able to assess the quality of teaching their children are receiving. Other studies have indicated that beneficiaries who contribute little or nothing towards the goods or services they are receiving may make inferior monitors because they do not have an incentive to scrutinise NGO outcomes (Véron, Williams, Corbridge and Srivastava, 2006; Platteau and Gaspart, 2005). If beneficiaries contribute little, they may often be easy to please because they are likely to compare the goods or services supplied by the NGO to receiving no goods or services at all, instead of comparing them to alternative goods and services that the project budget can buy.<sup>2</sup> Additionally, recent studies have shown that community monitoring may be vulnerable to free-riding problems (Olken, 2005) and that project managers know how to hide information from community members (Olken, 2006). Furthermore, case studies show that the members of poor communities sometimes lack the self-esteem to act assertively (Burger, 2005; Kihato and Kabemba, 2002 ).

The arguments outlined above provide an analytical foundation for concerns about opportunities for deception in the NGO sector. However, some theorists have attempted to circumvent these concerns with theory models that aim to show that the decision makers in nonprofit organizations have little incentive to abuse the aforementioned information asymmetries. According to the contract failure theory (Hansmann, 1980; Thompson, 1980; Fama and Jensen, 1983), NGOs are expected to behave more honestly than for-profit firms in cases where there are opportunities for deception. It is argued that, while there are incentives for for-profit organizations to lower their costs by reducing the quality of their goods or services, there are no such incentives for NGOs because they are subject to the nondistribution constraint and are thus not motivated to maximise profit. According to this perspective, the nondistribution constraint prevents the distribution of residual earnings to those who exercise control over the nonprofit organization, and therefore organizations with a profit motive will not choose this organizational form. The theory is contentious because it is heavily reliant on the nondistribution constraint; however, in practice it is unclear how effective this is in averting profit-seeking or self-enrichment by members of these organizations. As the classification of a surplus as profit is largely a matter of accounting, private gains can easily be concealed as inflated salaries, unrealistic bonuses, or undeserved benefits.<sup>3</sup> The presumption that the nonprofit sector will attract more honest and altruistic employees is far from watertight. Due to the sector's notorious lack of transparency (Callamard, 2006; Edwards and Hulme, 1996), its poor track record relating to effective monitoring and regulation (Desai and Yetman, 1995; Callamard, 2006)<sup>4</sup>, the lure of tax exemption, and the often intangible and subjective nature of the services and goods provided in this sector (Hansman, 1987), there is a case to argue that the opposite may be true.

There are at least two alternative arguments worth noting with regard to the altruism assumption. The first one deals with the motivations of nonprofit donors. Atkinson (1989: 73) notes that while "... we cannot ... be sure what their subjective motives are, much less whether they are wholly selfless", it is clear that "they are not going to receive a market return on their investment, which [at least] manifests weak altruism." However, even if one finds this argument convincing, there is little basis for extending this assumed altruism to include a nonprofit organization's manager and staff. The donor subcontracts the responsibility to

deliver the services or produce the goods to a nonprofit organization's employees and, without more information about the details of the contract and the incentives offered, it would be imprudent to make any assumptions about their personalities or their motivation. In fact, Rose-Ackerman (1996) argues that managerial shirking may be more prevalent in nonprofit organizations because there is no take-over threat in this sector.

The second argument pertains to attempts in the literature to argue that nonprofit organizations may successfully attract workers who are systematically more altruistic because they often undercompensate their workers – also known as the donative labour theory. The view is that only individuals who derive utility from helping others will accept jobs in a sector that pays below-market rates (e.g. Rowat and Seabright, 2006). Such a model, however, requires strong assumptions about the labour market, which has little empirical basis.<sup>5</sup>

In Weisbrod's (1998) overview of the empirical research on motivations in this sector, the conclusion is drawn that there is little evidence to justify the bold assumption that NGOs are motivated by altruism and non-monetary preferences. If the assumption of good intentions and pro-social motivation is discarded, it becomes clear that the allure of abusing an information advantage may be just as tempting and feasible for nonprofit organizations as for for-profit organizations. In fact, due to the particular difficulties relating to observing and verifying NGO behaviour described above, it is analytically conceivable that the problem could be worse for nonprofit organizations.

Additionally, the nonprofit sector has traditionally been subjected to less stringent government regulation than either the for-profit or the public realm – this despite the deficit in sectoral disciplining mechanisms, due to the comparatively weak, informal and arbitrary nature of the sanctioning power of consumers and beneficiaries in this sector. In the for-profit sector, consumer choice helps to provide feedback. In cases where the quality of services and products is observable, companies less effective or efficient than their competitors are expected to struggle to retain customers and may eventually have to close their doors. In the public realm, a politician's poor judgment and ineffective management can be punished by voting for one of his opponents. Anticipating such behaviour can help keep politicians in



check. In the nonprofit sector, there are no analogous mechanisms to motivate NGOs to care about the plight of their consumers and beneficiaries. NGO beneficiaries can neither vote against exploitative or corrupt NGOs, nor punish unreliable or misbehaving organizations by ceasing to do business with them.

These information problems are frequently exacerbated in developing countries for a number of reasons. The increased physical distance between the funder (usually from a developed country) and the beneficiary (usually from a developing country) raises the cost of sending and gathering information. Due to the high rate of unemployment, and frequently a dearth of other lucrative entrepreneurial activities with low set-up costs, it may be imprudent to assume that employees and entrepreneurs in this sector are attracted by altruistic motivations – as some developed country theory models would predict. Additionally, the institutions in developing countries are often not as mature or robust, which weakens the impact of any legal deterrence.

### **3. DATA: UGANDAN NGO SURVEY, 2002**

The study uses a 2002 representative survey of the Ugandan NGO sector, which incorporates two modules: (i) an NGO questionnaire to collect information on the organization's structure, finances and activities; and (ii) an interview with a community focus group to explore how the organizations are perceived by community members. By capturing both the community's perceptions and the organization's characteristics, the survey enables researchers to postulate links between community perceptions, such as what value has been added by the organization, and self-reported organizational features such as size and numbers of skilled workers.

The sampling frame for the first survey module (NGO questionnaire) was constructed via a mini-census of the NGO population of 14 districts. The survey sample (298 observations) was drawn from this sampling frame. With 255 questions, the questionnaire is extensive and includes information on funding, ownership, expenditure, assets and governance.

The second survey module comprised 268 community focus group interviews. These interviews aimed to extract information on how beneficiaries perceived the NGOs surveyed in the first module. A NGO survey question in this first module asked respondents to list a

number of parishes in which the NGO worked. This question was used to identify communities that we could ask to assess the behaviour and effectiveness of the NGO. In each community visited, six to ten focus group participants were recruited via a community leader. In addition to gathering detailed information on the beneficiaries' impression of the performance, motivation and staff attitudes of the NGO in question, the community focus group sessions also collected information on group members' perceptions regarding poverty in their community and community needs.

The first module of the survey (NGO questionnaire) can be matched to 205 of the 268 observations from the second module (community focus groups).<sup>6</sup> There were also cases where some NGOs were linked to more than one community. To avoid problems with error terms, 19 duplicates were eliminated randomly, reducing the sample to 186 observations.<sup>7</sup> Barr, Fafchamps and Owens (2005) and Barr and Fafchamps (2004) provide more information regarding the survey questionnaires and focus group interviews respectively.

#### **4. HOW TRANSPARENT ARE UGANDAN NGOS?**

There appears to be little momentum towards greater transparency in the sector. Zadek and Gatward (1996) contend that the reluctance to be transparent is clear from the lack of resources devoted to such activities. According to Stiglitz (1999), this reluctance was not unexpected, as there were many incentives to conceal information. If organizations can choose when to disclose and when to conceal information, they can be praised for their accomplishments without being criticized for their failures, mistakes and shortcomings. Secrecy can also help to hide corruption and ineffectiveness and enable employees to avoid the burden of public scrutiny. Significantly, Stiglitz points out that it is not difficult for an organization to mimic compliance with transparency requirements by using codes, creeds and commitments, without the organization undergoing any real transformation towards becoming more open and transparent.

According to the 2002 survey, reported levels of transparency and accountability were reasonably high. Figure 1 shows that 85% of NGOs that produced annual reports asserted that these reports were available to the public upon request. Given that annual reports are often

used as marketing tools, it may be more interesting to consider the percentage of organizations that were willing to share their accounts with the public. According to Figure 2, 73% of the NGOs that kept accounts said that they would share these accounts with a member of the public, should any member of the public request it.

However, as the evidence in the next two sections highlights, these claims regarding transparency may be exaggerated. A considerable proportion of NGOs report high levels of transparency, but were unwilling to provide information when asked, or chose to dispense inaccurate information. This suggests that while most NGOs are aware that they are expected to be transparent, many may merely pay lip service to the idea.

#### **4.1 INACCURATE INFORMATION**

Analysis of the survey shows that organizations claiming to be transparent may frequently provide inaccurate information, presumably, in most cases, to project a more favourable view of their organization. For instance, it is clear that NGO descriptions of their efforts to involve the community in projects are frequently not aligned with the accounts of the communities.

In 91% of cases, NGOs report that they asked the communities about their needs, and 96% reported that they asked the communities for feedback during or after a project. This contrasted strongly with the much lower prevalence of community involvement cited by the community members' focus groups. Just 54% of the communities said that the particular NGO concerned asked community members about their needs, while only 59% reported that they were requested to give feedback.

In 39% of cases (i.e. for 73 of the 186 matched NGOs in the sample with data available for such a comparison),<sup>8</sup> NGOs reported that they asked the community about their needs before initiating projects, while the community maintained that the NGO did not. Similarly, we found that 38% of NGOs (71 of 186 NGOs) claimed to have solicited feedback from communities while the community representatives said they received no requests for feedback. There is a remarkable extent of overlap between the cases of misrepresentation with regards to community needs assessments and soliciting community feedback: 69% of the NGOs that

claimed that they asked communities about their needs before initiating development projects and appeared not to have done so, *also* reported that they asked the community for feedback, but ostensibly did not. According to Pearson's chi-squared test, the hypothesis that the two indicators are independent cannot be accepted ( $Pr = 0.000$ ).

Given the high degree of overlap between misrepresentation in the two dimensions of community involvement and the plausible motive for misrepresentation, the discrepancies between what the NGOs claimed and what the communities reported are interpreted as evidence that a large share of these NGOs misrepresented their actions.<sup>9</sup> The community focus group's answers with regards to community participation are treated as reliable because we could find little analytical reason to suspect an incentive for misrepresentation among community members, and because misrepresentation among members of a group has a higher cost because it requires coordination and cooperation. Conversely, NGOs may have an incentive to pay lip service to community involvement. They may be ashamed of not having consulted the community, given that community participation is widely viewed as being 'good, by definition' (Botchway, 2001: 135) and is often depicted as the 'magical missing ingredient' (Botchway, 2001: 149) in development projects. This interpretation is further strengthened by the observed asymmetry in the discrepancies – we find only a negligible number of cases where the community reported participation and the NGO did not, while NGOs often claimed to have involved the community when the focus group reported that they had not.<sup>10</sup>

There are also other cases of apparent misrepresentation. In their analysis of the same data set, Barr, Fafchamps and Owens (2005) conclude that the actual prevalence of external auditing may have been considerably lower than the high levels reported in the survey. Many of the allegedly externally audited accounts contained numbers that were either implausible or did not tally with other figures given. 104 NGOs in this matched sample indicated that their reports were audited. However, for 50 NGOs (or 48% of the 104 organizations that claim to have been audited), the accounts contained several careless mistakes or obvious inconsistencies, which one would expect to have been identified and resolved during an audit.

Furthermore, 62% of the NGOs that were unable or unwilling to provide estimates of their assets, told enumerators that they compiled balance sheets on a regular basis and that these were available to the public. Almost half of the NGOs (47%) that refused to give data when the enumerators requested cash flow information had reported elsewhere in the questionnaire that such accounts were kept and available to the public upon request.

Additionally, during the community focus group sessions it was observed that in 11% of cases communities did not know or recognise NGOs that claimed to work in their parish. While it is conceivable that an NGO can be legitimate and effective without being widely known in the parish, it is not feasible that these cases account for the full 11% discrepancy observed – especially given that parishes are quite small and that each of the parishes were identified by the NGO itself as a community where they worked. It must be borne in mind that this 11% is additional to a large percentage – varying between 70% to 85%, depending on the district – of registered NGOs that were eliminated from the sample group because they could not be located. Based on the low share of registered NGOs that could be located as well as anecdotal evidence, Barr, Fafchamps and Owens (2003) assert that a considerable proportion of Ugandan NGOs appear to be briefcase NGOs that have a shadowy existence when they are not receiving grant income.

#### **4.2 UNWILLINGNESS TO PROVIDE INFORMATION**

The survey also shows that there may be a large discrepancy between organizations' reported and actual willingness to provide information. Although 75% of organizations reported that their accounts and annual reports were available to the public, the survey enumerators found that NGOs were often reluctant or unwilling to provide them when asked. For instance, 25% of organizations claiming to have accounts and reporting that these were available to the public upon request, failed to provide enumerators with basic expenditure and revenue information for either 2000 or 2001. Similarly, 9% of the NGOs that claimed to have compiled balance sheets and maintained that these were available to the public upon request, failed to provide enumerators with the estimated value of the NGO's stocks of cars, equipment or inventory.

In cases where information is not provided, it may often be difficult to distinguish between an unwillingness and an inability to provide information. Also, it may often be imprudent to take explanations in this regard at face value, given that an organization may plausibly be motivated to save face by claiming that it is unwilling to provide information when, in fact, they are unable to do so. Similarly, it is conceivable that an organization may try to avoid further queries, visits and calls by claiming to not have the necessary skills to generate the information requested, when they are, in fact, simply unwilling to provide the information.

## **5. HYPOTHESES ON THE ECONOMICS OF MISREPRESENTATION**

To explore why NGOs would provide inaccurate information, we propose a framework reflecting decision making at two consecutive decision nodes. Due to the lack of theoretical and empirical research on transparency in the NGO sector, the framework draws on the tax evasion literature. Deciding whether or not to evade tax has a number of parallels with deciding how accurately to reflect the NGO's community involvement or its level of financial transparency. In both cases, agents need to decide whether or not to deceive in return for a risky benefit, which will be dependent on the likelihood of the deceit being detected. It involves a trade-off of possible positive consequences for the individual or the organization, with negative individual 'psychic costs' associated with the deceit, e.g. guilt or anxiety. Additionally, both decisions have private as well as public dimensions, which add to the complexity.

This work builds on the insights of the tax evasion literature by acknowledging that the decision about whether or not to be honest and transparent is not merely a lottery of anticipated consequences, but that moral nuances as well social and peer effects may be important influences on behaviour. It is therefore vital to consider how social norms may affect certain behavioural choices, and also to investigate the individual values, attitudes and perceptions that may be linked to these norms.

The framework also considers the impact of opportunities to evade, in line with the work of researchers such as Slemrod. Slemrod (2007) repeatedly emphasises the strong empirical relationship between opportunities for evasion and the likelihood of tax evasion.<sup>11</sup>

Based on these ideas from the tax evasion literature as well as on findings from the NGO sector, the following framework is proposed: In the first stage, the NGO chooses whether to adhere to NGO sector norms such as transparency and community involvement. It is suggested that adherence to such norms will be a function of the usual individual worker inputs such as effort and ability, as well as the alignment between the NGO's values and these norms. The individual worker inputs are included because it is assumed that complying with norms usually requires additional effort and work. It is further suggested that effort is a function of inherent and external motivation. Decision making in this first stage can thus be depicted as:

$$y = f(p, e, a) \quad (1)$$

$$e = g(i, x) \quad (2)$$

With  $y = [0,1]$  and  $0 < p, e, a, i, m < 1$ ,  $f_p(\cdot) \geq 0$ ,  $f_e(\cdot) \geq 0$ ,  $f_a(\cdot) \geq 0$ ,  $g_i(\cdot) \geq 0$ ,  $g_x(\cdot) \geq 0$  where  $f_i(\cdot) = \frac{\Delta f(\cdot)}{\Delta i}$ <sup>12</sup> and where  $y$  represents the binary decision outcome,  $p$  represents the extent of alignment of the NGO's own preferences to the sector norm,  $e$  is effort,  $a$  ability,  $i$  internal motivation, and  $x$  external motivation.

In the second stage, NGOs decide how truthfully to respond when asked about the choice they made in the first stage. It is presumed that NGOs will only be dishonest if they have something to hide, which in this context amounts to having chosen against the norm in the first stage. Thus, we look only at the group of organizations that chose against the norm, and ask under what circumstances these NGOs are likely to be honest about their choice?

Along the lines of Spicer's (1986) distinction between the influences of financial gains and psychic costs in motivating tax evasion, the second stage decision about dishonesty is presumed to be motivated by both teleological and deontological considerations. The framework includes deontological considerations by suggesting that the likelihood of truth-telling will be a function of the agent's preference for honesty, here equated with the individual agent's commitment to honesty – regardless of the specific context or strategic concerns. However, we also allow for teleological considerations because the anticipated consequences of telling the truth are also expected to play a role. It is assumed that the main

motivation for dishonesty in this context is a potential loss of reputation associated with revealing the truth. Revenue losses will be mediated via a loss of reputation.

To protect their reputations, NGOs may opt to cover up their deviation from an established sector norm, but this then introduces a new risk, namely, the risk of reputation loss associated with the exposure of this misrepresentation. The net effect of reputation can be negative or positive. The net impact of these two risks is shaped by the likelihood of the misrepresentation being detected. NGOs that are closely monitored or tightly regulated should have less opportunity to misrepresent themselves. Regulation and monitoring are expected to improve outcomes by reducing the lure of diverting funds or staff time, via better observation of inputs and outputs and improved information.

The decision about whether or not to misrepresent can be depicted as:

$$d = U(\alpha, r_L, r_T, \ell) \quad (3)$$

With  $d \in [0,1]$ ,  $U_\alpha(\cdot) \leq 0$ ,  $U_r(\cdot) \geq 0$ ,  $U_\ell(\cdot) \geq 0$ ,  $0 < \alpha < 1$ ,  $r_L < 0$ ,  $r_T < 0$ ,  $\ell < 0$  and where  $d$  is decision to misrepresent or not,  $\alpha$  is the likelihood that the deceit is detected,  $r_L$  is the reputation loss associated with being caught lying,  $r_T$  is the reputation loss associated with the NGO ‘coming clean’ about its digression from sector norms, and  $\ell$  represents the agent’s aversion to lying.

An increase in reputation raises the stakes of truth-telling and lying, and the net effect of such an increase can thus not be determined *ex ante*. Reputable organizations may have more to lose from being exposed as liars than lesser known organizations, or organizations of disrepute, but similarly, reputation is also expected to increase the likelihood of lying to ‘save face’.

In line with what has been proposed in game theory models such as those of Hörner (2002) and Sobel (1985) and concluded in experimental investigations such as those of Camerer and Weigelt (1988) and Bohnet and Huck (2004), it is here presumed that an organization’s reputation is based on the repeated interactions between the organization and its clients. The organization’s reputation can thus be thought of as the cumulative experiences of its clients;



thus, it is regarded as a function of perceived competence, accumulated over years of existence:

$$r = h(c, n) \quad (4)$$

With  $h_c(.) > 0$ ,  $h_n(.) > 0$ ,  $h_{nn}(.) < 0$  and where  $c$  represents the perceived competence, and  $n$  the number of years of existence of the NGO.

Figure 3 represents the two-stage framework as a decision tree, with the decision algorithms in reduced form. The framework suggests that the four main determinants of dishonesty are having something to hide (here appearing as a precondition for inclusion in the second stage sample), a motive for hiding the truth (reputation loss), the ability or opportunity to hide the truth (represented by the extent of imperfect information and the lack of oversight), and the individual preference for concealing the truth.

## 5.1 SUPPLEMENTARY HYPOTHESES

The paper also examines a second set of hypotheses pertaining to dishonesty. In contrast with the hypotheses included in the main framework, these hypotheses lack strong empirical evidence and have been discussed only tentatively in the literature. Due to the speculative nature of these hypotheses, they were not included in the framework, but are tested separately.

The first of these pertains to donor demands and funding pressure. Alexander (1998) highlights the complex and conflicting demands NGOs often face trying to juggle their own missions and commitments, the requirements of donors, the needs of beneficiaries, and the concerns of the wider community. One of the responses to complexity that Alexander has observed in her case studies is *deflecting*, where the NGO ‘limits the amount of external complexity that enters the organization’ (1998: 277). Misrepresentation can be conceived as a useful deflection strategy in situations where NGOs may disagree with some of the demands of donors, because meeting these demands may, for instance, put excessive strain on the organization or conflict with the NGO’s core mission. In a competitive funding environment, NGOs that want to resist unreasonable or intrusive donor demands may choose to misrepresent their activities instead of openly defying the donor’s requirements. This theory is

in line with the observations of Ebrahim,<sup>13</sup> who indicates that grass roots organizations in India are skilled at devising strategies to subtly resist donor demands, while complying sufficiently to ensure that they continue to receive funds.

The same donor pressures may also intensify the inherent trade-off between using information to enhance transparency or to build reputation (Michaelowa and Borrmann, 2006). NGOs may feel under pressure to represent their activities in a more positive light and to gloss over their shortcomings and failures. It is thus not surprising that a survey on NGOs' annual reports found the reports "overwhelmingly positive in tone", with most of the text devoted to describing the organizations' achievements (Bolton, 2003). Chambers (1996) argues that competitive pressure for grant funding may tempt NGOs to misrepresent themselves. This would be in line with the findings of Rice (1992)<sup>14</sup> with regard to tax evasion. He concludes that corporations under strain due to below-average profits appear to be more likely to engage in such dishonest activities.

The second set of supplementary hypotheses explores the impact of an antagonistic government. Many political science theories of civil society emphasise the role of NGOs as a government watchdogs and advocates of improved policies. In this envisaged role, conflicts may often arise between NGOs and government; thus, it is often assumed that there will be a hostile relationship between the sector and the government. Under such circumstances it is plausible that NGOs may choose not to be transparent, but also attempt to not defy sector norms and donor demands publicly. As Florini (1999) notes, transparency does not necessarily protect the weak, it can expose the weak as well. She argues that "secrecy can be the refuge of the weak against the strong, as in the case of human rights organizations working in repressive countries".

The final set of speculative hypotheses investigates whether organizations that have more to hide may be more likely to be evasive and misrepresent themselves. The link between corruption and a lack of transparency is well established in governments (Bac, 2001; Rose-Ackerman, 1999, Stiglitz, 1999; Florini, 1999; Rose-Ackerman, 1978), and here we intend to examine whether such a relationship also holds for the NGO sector. In this paper, we look not

only at corruption; instead, we define ‘having something to hide’ very broadly, so as to include any behaviour that is not in line with the best interests of the beneficiaries, ranging from premeditated cases of fraud to general organizational ineffectiveness.

## **6. CONSTRUCTING AN EMPIRICAL MODEL OF MISREPRESENTATION**

The objective of this paper is to understand why NGOs resist transparency and misrepresent themselves. The framework defined in section 5 is used to guide the empirics.

Financial transparency is represented as the willingness and ability of an NGO to provide information regarding their assets, income and expenditure.<sup>15</sup> An NGO is viewed as misrepresenting their financial transparency if they did not provide asset value estimates yet claimed they compiled accounts which were available to the public upon request, or if they did not provide expenditure or income data yet told enumerators that this data was captured and available to the public.<sup>16</sup> Pertaining to the financial transparency variable, the NGO decides, in the first stage, whether or not to adhere to sector norms regarding transparency. In the second stage, we consider only the subsample of NGOs that were not transparent, and we examine which of these opted to admit that they were not transparent and which of these claimed to be transparent.

To measure accountability, we consider whether the organization asked the community about their needs prior to commencing a project and requested feedback from the community after a project. To ensure that we erred on the side of caution in our attempts to identify possible cases of misrepresentation, we classified an observation as misrepresentation only if the NGO reported that it both asked the community about its needs and solicited feedback while the community focus group said it did neither.<sup>17</sup> For the community accountability variable, the first-stage decision is whether or not an NGO involved the community in a project as sector norms dictated. In the second stage, we look only at those NGOs that neither asked the community about their needs beforehand, nor requested feedback afterwards. For this group of NGOs that failed to involve the community, we study how truthfully they answer questions regarding the NGO’s community participation initiatives.

Given the proposed two-stage structure of the framework, we begin with a Heckman selection model. This model is required because, according to the framework, misrepresenting information is only a temptation for a subsample of observations, namely those that deviated from accepted guidelines on transparency and community involvement. Having decided not to provide financial information and/or not to involve the community, the NGO faces a decision regarding whether or not to misrepresent the organization's actions. The Heckman selection model tests the hypothesis that the error term from the first-stage norm conformation decision affects the likelihood of dishonesty, after controlling for the independent variables in the model of the second stage deceit decision. Due to the binary structure of the variables discussed above, we opt for a Heckman probit selection model.

For this first decision process, the assumption is that there could be variation between the two dimensions being examined and that different factors could determine whether NGOs pursue community involvement and financial transparency. In contrast, the initial presumption for the misrepresentation decision is that determinants about honest and accurate reporting of activities in both these dimensions will be similar.

In the translation of this theoretical structure to an empirically estimable form, we need to make a number of additional assumptions about the functional form of these relationships, and also empirical approximations of these concepts. In terms of the functional form, it is assumed that the impact of the variables on the likelihood function is linear in its parameters.

According to the framework, the first-stage decision, namely whether or not to adhere to sector norms,  $y$ , is determined by the following function:

$$y = f[p, g(i, x), a] \tag{5}$$

The extent of alignment of the NGO's own preferences to the sector norm,  $p$ , may vary according to the norm in question: for financial transparency, we follow the literature in arguing that it may not be meaningfully interpreted by all stakeholders. It is presumed that donors are the most likely users of this information and thus alignment with this norm is represented by an indicator variable on whether or not the NGO had a grant. Following a

similar line of argument, the incentives for community involvement will be stronger among those NGOs obtaining a larger proportion of their funding from the community, and we therefore include the proportion of funds from local donations and fees to capture alignment for this norm.

The ability or capacity variable,  $a$ , is captured by the total number of staff members and the age of the NGO manager. Additionally, to test the hypothesis that quality of staff may be more important than quantity for high skill jobs such as accounting, we also include the share of professionally qualified workers and whether or not the shortage of skilled staff was cited as a constraint by the NGO.

To capture internal motivation, a perceived altruism variable is added. This variable is constructed using the community focus group question regarding the perceived selfishness of the NGO. The variable is coded on a Likert scale, which is coded 1 if there is strong agreement with the statement that the NGO exists to serve the purposes of its own staff rather than to help the community, 2 if there is somewhat of an agreement with the statement, 3 if there is neither agreement nor disagreement, 4 if there is some disagreement, and 5 if there is strong disagreement with the statement. External motivation is represented by independent monitoring. To ensure that the variable that measures monitoring includes direct observation by a third party only, it is limited to cases where the community reports that another NGO or organization asked them for feedback about the NGO in question.

A measure of reporting fatigue is also added to this model, namely the number of accounts the NGO was required to submit per year. We investigate the theory that NGOs may have a reason to not be transparent if they have difficult or hostile relationships with the government by including an indicator variable capturing whether or not the NGO considered its relationship with government to be antagonistic. It is for instance plausible that an advocacy organization that has an adversarial relationship with the government may need to keep their funding information and their planned interventions hidden from the government to protect itself.

The second stage decision is expressed as:<sup>18</sup>

$$d = U[\alpha, h(c, n), \ell] \quad (6)$$

The likelihood that the lie is detected,  $\alpha$ , represents the independent monitoring variable. Perceived competence,  $c$ , is captured by a question that asked the community focus group whether they thought the NGO staff were good at what they did. The answer is coded on a Likert scale.<sup>19</sup> The number of years of existence of the NGO is included in the empirical model, along with a squared term, as is the convention with age effects.

The preference for honesty,  $\ell$ , is proxied<sup>20</sup> by the perceived altruism variable and an indicator variable measuring whether or not the NGO had a religious affiliation. Religious affiliation is added as a proxy because it is here conjectured that such ethical pragmatism will be less prevalent among religious organizations due to the latter's traditional endorsement of rule-based ethics. Many may view misrepresentation to be a white lie under these circumstances because they may believe that there are no tangible, direct, large, negative consequences for others. This is in line with the work of Yankelovich, Skelly and White, Inc., (1984)<sup>21</sup>, which reports that tax evasion was associated with a flexible definition of honesty. Based on the findings of Perrin (2000), Te Voert, Felling and Peters (1994) and Cochran and Akers (1989), markers of religiosity, such as religious affiliation, are expected to be correlated to rule-based ethics.

We add the perceived altruism variable as a proxy to investigate the impact of such values on the preference for truth-telling. Given the emphasis on altruism in this sector, it is natural to ask whether altruism has a significant impact on misrepresentation. Wolfe's (1998) review of altruism in the nonprofit sector distinguishes between behavioural and motivational altruism. Evocative of the classical dichotomy of means versus ends, behavioural altruism considers the actual behaviour of an organization or individual, while motivational altruism focuses on the goal or the intention. In a similar vein, it seems credible to conjecture that higher perceived altruism may not necessarily translate to a higher aversion for dishonesty – especially in the context of this situation where it is conceivable that some may view this type of misrepresentation as a white lie or 'noble lie', required as a means to a laudable end. The

laudable end could, in this context, be retaining the NGO's good reputation, which may be seen to be critical for its survival. Experiments carried out by Gneezy (2005) show that many participants are pragmatic and able to consider the consequences of their lies. In evaluating the fairness of a lie, individuals take account of the size of the loss incurred by others as a result of their fibs.

### **6.1 EMPIRICAL ESTIMATES FOR SUPPLEMENTARY HYPOTHESES**

The influence of disillusionment with donor rules is measured by accounts and report submission fatigue. We test whether the number of reports or accounts required annually by the NGO places a burden on them, affecting misrepresentation. To capture the effect of exposure to competition for donor funding, a binary variable indicating whether or not the organization had a grant at the time is included, as well as a continuous variable showing the proportion of income derived from grant and donor sources.<sup>22</sup>

Four indicator variables are proposed to capture the influence of government antagonism towards the NGO, namely, whether the NGO was involved in advocacy activities, whether it viewed the government as a hindrance, whether the respondent felt that government staff was resentful towards the NGO, and whether the NGO believed that government dictates were one of its main constraints.

It is a challenge to capture whether NGOs 'have something to hide'. Ineffectiveness and corruption are difficult to identify, partly because NGOs would be inclined to conceal such markers. Additionally, many of the most corrupt or ineffective NGOs may be the ones referred to earlier as leading a shadowy existence – present on the files of donors and the NGO register, but not to be found at the address or in the communities where they claim to work. Given that physical traceability was a precondition for inclusion in this survey, it is likely that some of the worst offenders are excluded from our sample. Given that the NGOs themselves are unlikely to reveal such markers of ineffectiveness and deceit, we examine a series of questions asked to the beneficiary focus groups regarding the perceived impact and value of the NGOs. These variables should identify severe cases of ineffectiveness and corruption.<sup>23</sup>

## **7. RESULTS: WHY ARE SOME NGOS DISHONEST?**

Table 1 reports the findings from the Heckman selection models. We present the two dependent variables, namely, whether the NGO misrepresents itself with respect to community involvement and whether the NGO misrepresents its financial transparency. The first set of variables, reported in the top half of the table, are the determinants of misrepresentation. Based on the conceptual framework, it is expected that the same set of variables will determine each dependent variable. The second set of variables is assumed to determine whether the dependent variable is observed. Analytically, the exclusion restrictions are less problematic than in traditional Heckman applications, because it is expected that a different set of factors will be associated with the likelihood of involving the community in projects vs dishonesty regarding community involvement. Likewise, while there may be some overlap in the correlates, the likelihood of making the organization's financial data available when asked to, is not expected to be determined by the same factors that are associated with an honest response about financial transparency.

Because the focus is on misrepresentation, the second set of variables presented in the bottom half of the table are discussed first. The regressions show that community participation is associated with selfishness, number of staff, and independent monitoring. The significance of the total number of staff suggests that the ability or capacity to comply with these norms may be important. Selfishness, as reported by the community, is associated with a lower likelihood of involving the community, providing some credence for the hypothesis that internal motivation matters. As the framework suggested, external motivation – here represented by monitoring – increases the likelihood of community participation.

A number of variables are shown to have a significant association with financial transparency: the number of staff, the age of the manager, the number of annual accounts the NGO is required to submit, whether the NGO has a grant, the share of workers that are professionally qualified, and whether the NGO believed that the government was resentful towards it.

NGOs with grants are more likely to be transparent. In line with the framework this is interpreted as evidence that incentives that align NGOs' preferences with sector norms may be



important. It has been argued that donors are the stakeholders most likely to require financial reports or, at least, some form of financial oversight or feedback. In this way, organizations that have grants may have more incentives to keep careful financial records and make these available to the public upon request.

The results provide confirmation that capacity and ability may be important for determining how financially transparent an organization is. The age of the manager and the share of workers that are professionally qualified are both significant in the regression. The regressions also suggest that NGOs that have fewer annual accounting reports to submit are more likely to provide data on the organizations' financial positions, possibly indicative of the impact of demands on these scarce, qualified human resources. Finally, NGOs that perceive their relationship with government to be antagonistic are less likely to provide access to this data.

Moving to the top half of Table 1, the determinants of misrepresentation are discussed next. Based on the framework we presume that the same factors are associated with both dimensions of misrepresentation. The results, however, suggest that there is no overlap in the factors that are significantly associated across these two dimensions of misrepresentation. NGOs that did not involve the community were more likely to claim that they did so if they had existed for longer, as they would presumably have more of a reputation to risk by admitting that they did not. Religious affiliation, the proxy for the organizations' preferences for honesty, is also significant.

In terms of financial transparency, the results imply that the main factor that matters is the likelihood of being caught – NGOs that are monitored independently are less prone to say that they are financially transparent when in fact they are not.

The next three tables test the additional hypotheses outlined in the previous section, starting with exposure to unreasonable donor demands and funding competition. Four variables are introduced separately to approximate these influences, namely, having a grant, the proportion of revenue from the grant, the number of reports the NGO is required to submit annually, and the number of annual accounts it is required to submit. In line with expectations, NGOs that

are reliant on grants (with a substantial proportion of revenue from grant income) are significantly more likely to misrepresent their financial transparency. However, on the other hand, NGOs that have a grant or are more reliant on their grants are more likely to be truthful about their involvement in the communities. Similar to the effect of reputation, it is conceivable that having a grant, or being dependent on grants, may increase the stakes for NGOs. The discrepancy observed here may thus relate to how observable and detectable the lie is. It may generally be easier to discover and prove negligence through involving the community than through a lack of financial transparency. The only evidence of report-submission fatigue is the significant and positive coefficient on the number of accounts that has to be submitted per year in the model for community participation misrepresentation.

Table 3 explores the relationship between misrepresentation and corruption. The variables used are beneficiary assessments of the impact and value of the NGO, including questions on how important the NGO is in the community, how satisfied the beneficiaries were with the NGO's performance, whether they would notice if the NGO disappeared, and the estimated value added by the NGO. These variables are meant to capture serious cases of corruption or inefficiency that would be observable to beneficiaries. None of the aforesaid four variables are significant in any of the regressions. This may be because the most serious cases of corruption have already been eliminated from this sample. Many briefcase NGOs without an office or permanent staff often had to be dropped from the sample because they were difficult to pin down and may have ceased to exist in all observable ways for long periods between grants. Furthermore, all NGOs that were not known in the parishes where they said they worked had to be removed because there were no community focus group observations that could be matched to these organizations.

Finally, Table 4 considers if hostile government relationships can shape truth-telling and openness. This influence is assessed using four variables, namely, the NGO's engagement in advocacy, the NGO's description of the government as a hindrance, the NGO asserting that it felt that government staff was resentful, and the NGO citing government dictates as one of its main constraints. Advocacy activities appear to have a positive and significant effect on lying regarding community involvement, while viewing government dictates as one of the main

constraints has a positive and significant impact on the likelihood of misrepresenting financial transparency.

## **8. CONCLUSIONS**

The findings of this work caution against an overly naïve view of NGOs and also, specifically, an over-reliance on reported information when regulating, monitoring or surveying NGOs. They also emphasise the value of independent monitoring and regulation in a sector where the effectiveness and appropriateness of monitoring and regulation are often disputed, at least partly because of the conventional association of this sector with pro-social values and altruism. Even if these traditional notions with regard to the sector were not contested, these claims would hardly provide an alibi for secrecy and concealment. Good intentions do not provide insurance against human fallibility. Individuals and organizations should be transparent and accountable because such checks and balances can help identify and rectify blunders, missteps and ineffectiveness.

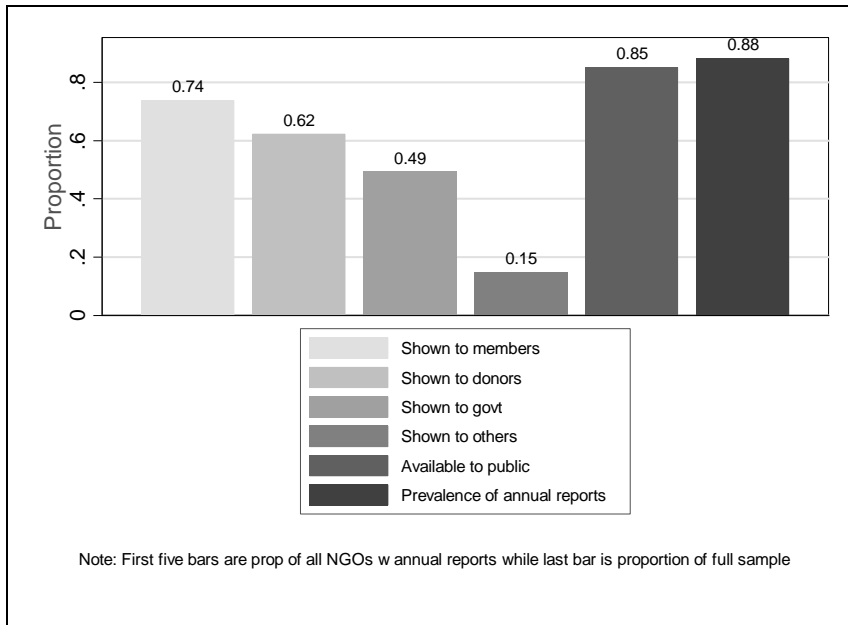
According to this analysis, there is no evidence that perceived altruism has a significant relationship with misrepresentation. The insignificance of altruism may suggest that many selfless NGO employees may often be pragmatic in their approach to ethics. The main focus of these altruistic NGOs may be on their mission, with less emphasis on the means used to reach that mission. Given that there is support from the literature that would lend credence to an interpretation that some NGOs may construe the cases of misrepresentation studied here to be white lies, the most prudent interpretation of the findings may be that altruistic NGOs might have some tolerance for minor digressions in service of the greater good.

The analysis also suggests that the motive for lying may not be homogenous across dimensions, but may depend on the subject matter. With regard to financial transparency, the analysis indicates that motives for lying are less robust correlations of the likelihood of lying than the opportunity for dishonesty, i.e. monitoring. For community involvement, NGO misrepresentation is associated with the organization's desire to 'save face', and a proclivity for rule-based ethics.

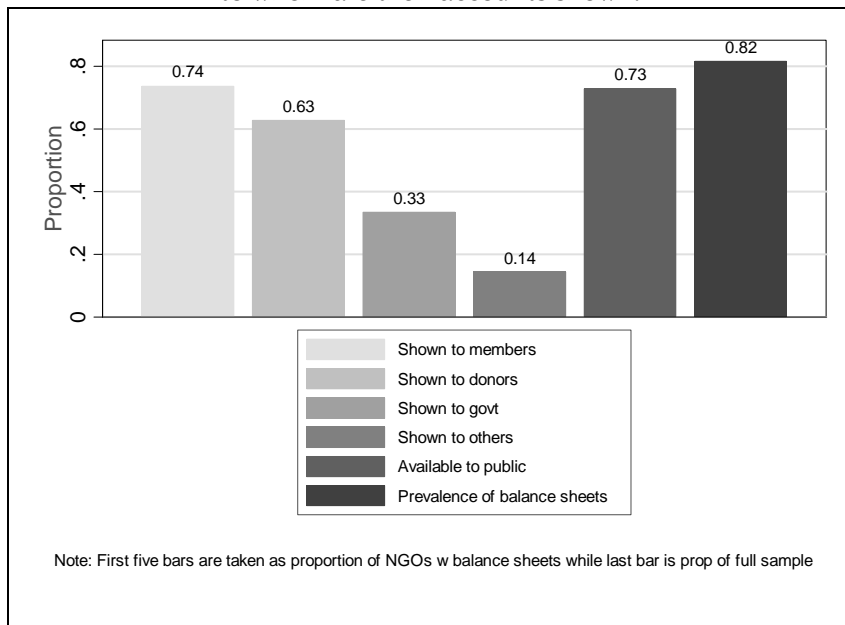
Results are mixed for the supplementary set of hypotheses, but these tentative results may still be valuable, given that this area of research is characterised by a lack of empirical evidence. The results indicate that perceived government antagonism may encourage dishonesty. There is partial and tentative support for a view that NGO misrepresentation can be attributed to excessive and unrealistic donor demands. There is no evidence of a relationship between dishonesty and the set of corruption and ineffectiveness indicators. This may be partially due to the difficulties relating to surveying briefcase and corrupt NGOs that appear to exist only or mainly on paper.

Given the centrality of transparency for good governance of the sector, it is vital to know more about the prevalence of transparency and to better understand why some organizations may be reluctant to become more transparent and accountable. Given the difficulty of generating robust results from a heterogeneous, cross-sectoral NGO data set with a relatively small number of observations, these results are viewed as exploratory and the authors want to encourage other researchers to investigate and test these findings using other data sources.

**Figure 1: How many NGOs produce an annual report and to whom are these reports shown?**



**Figure 2: How many NGOs produce a balance sheet and to whom are their accounts shown?**



**Figure 3: Two-stage framework for examining the economics of misrepresentation**

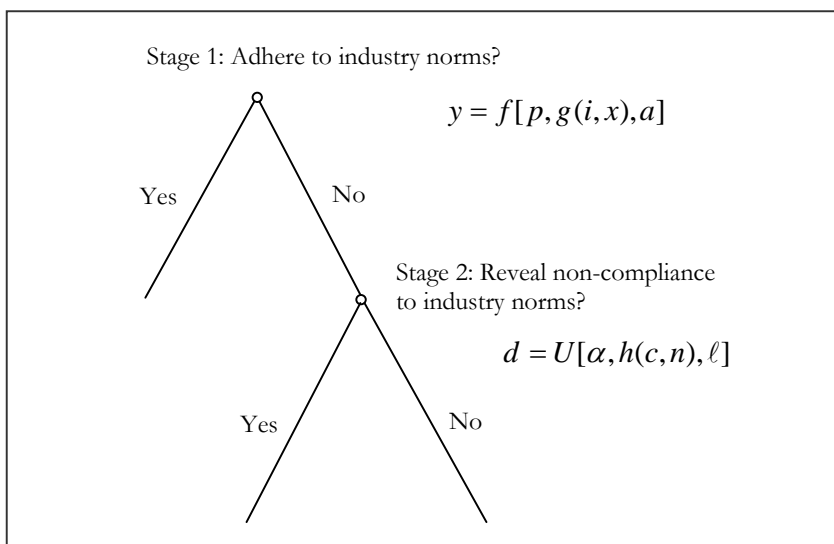


Table 1: Heckman probit for community participation and financial transparency

	Community participation		Financial Transparency	
<b>Core regression: misrepresentation</b>	<b>Coefficient</b>	<b>P-value</b>	<b>Coefficient</b>	<b>P-value</b>
Religious affiliation	-0.84*	0.04	0.06	0.87
Selfishness	-0.09	0.70	0.03	0.88
Competence	0.15	0.46	0.02	0.92
Years of existence	0.14*	0.05	0.05	0.55
Years of existence squared	-0.005*	0.03	-0.001	0.50
Independent monitoring	0.24	0.76	-1.26*	0.02
Constant	0.29	0.87	-0.38	0.73
<b>Selection</b>				
Proportion of funds from local donations and fees	0.28	0.69		
Selfishness	0.19*	0.02	-1.601	0.21
Total number of staff	-0.0005*	0.02	0.0004	0.90
Age of NGO manager	-0.02	0.20	-0.02*	0.07
Independent monitoring	-2.00*	0.00	-0.31	0.31
Number of annual accounts required to be submitted			0.10*	0.06
Does the NGO have a grant?			-1.55*	0.00
Share of professionally qualified workers			-0.77*	0.03
Shortage of skilled staff cited as constraint			0.06	0.83
Antagonistic relationship with government			0.60*	0.03
Constant	0.51	0.41	1.14*	0.02
<b>Diagnostics</b>				
Athrho	0.23	0.89	0.34	0.69
LR test of independent equations ( $\rho = 0$ ) Prob > chi2	0.02	0.89	0.16	0.69
<b>Observations</b>				
Total number of observations	164		163	
Censored observations	80		103	
Uncensored observations	84		60	

\* Coefficient significant at the 10% level of significance.

**Table 2: Examining the potential influence of exposure to unreasonable donor demands and funding competition**

	Community participation				Financial transparency			
Religious affiliation	-0.76*	-0.87*	-0.84*	-0.72*	-0.16	-0.16	-0.13	-0.10
Selfishness	-0.04	-0.12	-0.13	-0.15	-0.03	0.05	0.02	0.07
Competence	0.14	0.13	0.17	0.14	0.1	0.21	0.09	0.18
Years of existence	0.28*	0.21*	0.14*	0.10*	0.05	0.05	0.08	0.05
Years of existence squared	-0.01*	-0.008*	-0.005*	-0.005*	-0.001	-0.001	-0.002	-0.001
Independent monitoring	0.66	0.61	0.32	0.30	-1.17*	-0.06	-1.23*	-1.52*
Does the NGO currently have a grant?	-1.58*				0.9			
Proportion of revenue from grant		-1.21*				2.37*		
Number of annual reports required to be submitted			-0.06				0.003	
Number of annual accounts required to be submitted				0.28*				0.12
Constant	0.53	0.62	0.61	0.48	-0.55	-1.22	-1.11	-0.36
Observations	89	89	89	86	66	66	66	63
Prob [Wald] >chi2	0.01	0.01	0.00	0.03	0.07	0.09	0.03	0.19
Pseudo R-sq	0.28	0.21	0.18	0.17	0.13	0.11	0.14	0.11

\*Coefficient significant at the 10% level of significance.

**Table 3: Examining the potential influence of ineffectiveness or fraud**

	Community participation				Financial transparency			
Religious affiliation	-0.83*	-0.77*	-0.73*	-0.78*	-0.12	-0.23	-0.13	-0.24
Selfishness	-0.10	-0.07	-0.18	-0.12	0.06	-0.01	0.02	-0.03
Competence	0.18	0.14	0.3	0.2	0.01	0.21	0.13	0.25
Years of existence	0.12*	0.12*	0.13*	0.13*	0.08	0.10*	0.08	0.12*
Years of existence squared	0.00*	0.00*	0.00*	0.00*	0	0	0	0.00*
Independent monitoring	0.38	0.32	0.35	0.37	-1.28*	-1.13*	-1.22*	-1.10*
Beneficiary community satisfied with NGO performance?	0.04				0.13			
NGO could disappear without being noticed?		-0.15				0.2		
NGO important part of life?			-0.22				-0.08	
Perceived value added				-0.16				-0.86
Constant	0.20	0.86	0.82	0.36	-0.91	-1.63	-0.48	-0.86
Observations	89	89	89	87	66	66	66	63
Prob [Wald] >chi2	0.0431	0.04	0.03	0.06	0.1948	0.07	0.26	0.29
Pseudo R-sq	0.14	0.16	0.15	0.13	0.11	0.14	0.11	0.14

\* Coefficient significant at the 10% level of significance.



**Table 4: Examining the potential influence of an antagonistic relationship with government**

	Community participation				Financial transparency			
Religious affiliation	-0.67*	-0.88*	-0.82*	-0.60*	0	-0.08	-0.11	-0.36
Selfishness	-0.19	-0.1	-0.12	-0.06	-0.03	-0.01	0.03	-0.02
Competence	0.21	0.14	0.19	0.15	0.08	0.14	0.07	0.10
Years of existence	0.08	0.12*	0.12*	0.11*	0.06	0.07	0.08	0.06
Years of existence squared	-0.004*	-0.004*	-0.005*	-0.004*	-0.001	-0.002	-0.002	-0.001
Independent monitoring	-0.05	0.43	0.37	0.39	-1.36*	-1.34*	-1.34*	-1.54*
Does the NGO engage in advocacy activities?	1.05*				0.4			
Does the NGO describe government as a hindrance?		0.4				-0.46		
Does the NGO feel that government staff is resentful towards it?			-0.02				-0.29	
Does the NGO cite government dictates as one of its main constraints?				-0.06				0.67*
Constant	0.35	0.24	0.33	0.32	-0.72	-0.58	-0.47	-0.80
Observations	89	84	89	78	66	61	66	59
Prob [Wald] >chi2	0.00	0.08	0.04	0.48	0.17	0.25	0.21	0.18
Pseudo R-sq	0.21	0.14	0.14	0.07	0.12	0.15	0.11	0.13

\* Coefficient significant at the 10% level of significance.

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<sup>1</sup> Quoted in *The Economist* (Living with the enemy), 7<sup>th</sup> August 2003.

<sup>2</sup> Véron, Williams, Corbridge and Srivastava (2006) find that 20% of beneficiaries interviewed in their investigations of corruption did not view the corruption in a negative light. They have accepted that bribes were necessary for securing service delivery. Platteau and Gaspard (2005) relate a similar story in their paper. Community members did not view siphoning of funds by a community leader as corrupt or illegitimate, as they argued that they have benefited from the leader's efforts, and without his intervention their situation would not have improved.

<sup>3</sup> Desai and Yetman (1995) emphasise the substantial discretion that most nonprofit organizations retain over the use of their funds. They note that nonprofit organizations can decide how much they want to spend on charitable activities vis-à-vis, for instance, administrative activities, fundraising expenses, and staff compensation.

<sup>4</sup> See Gibelman and Gelman (2004) for a survey of cases of nonprofit sector wrongdoing reported by the media. They suggest that there may be an association between cases of misallocation (or fraud) and a lack of oversight. They report that board members often attributed their ignorance of such activities to their NGO's philosophy of trust.

<sup>5</sup> For instance, Mocan and Tekin (2000)'s study of wages for child care workers finds that there is a nonprofit wage and compensation premium. However, others such as Ruhm and Borkoski (2000) find that the nonprofit sector does pay less. Ruhm and Borkoski (2000) report a slight negative pay differential (2 - 4%) and add that it is only observed in certain subsectors.

<sup>6</sup> To gather information on beneficiary evaluations, we asked NGOs to identify communities where they worked and then visited one of these communities. However, there were cases where the communities did not know the NGO. In these cases, the focus group assessed an alternative NGO, which was often not part of the sample for the first module and was subsequently dropped from the analysis.

<sup>7</sup> In an appendix, available on request, bias introduced by the loss of observations due to the matching is investigated. Based on a number of key observables, there is little evidence of such bias. This does not, however, exclude the possibility that there may be bias based on unobservable factors.

<sup>8</sup> The matched sample refers to the sample resulting from merging the NGO questionnaire sample with the community focus group interview sample.

<sup>9</sup> It is, however, important to note that the authors do not think that the entire discrepancy is attributable to misrepresentation. There are also other explanations for these discrepancies. For instance, it may be because of geographical variation: the NGOs' answers may outline standard or typical practices across the locations where the organizations work, whereas the community focus group answers were based on the impressions of a number of representatives from a specific parish. Some of the differences may also be due to misunderstanding the questions. However, these two explanations cannot account for the size and asymmetry of this difference.

<sup>10</sup> There are four such cases for community needs assessments, and three for feedback.

<sup>11</sup> The evidence he cites includes the positive relationship between the rate of compliance and enforcement mechanisms (e.g. information reports and employer withholding), the correspondence of noncompliance rates to proxies for the traceability, deniability and ambiguity of items (Klepper and Nagin, 1989) and the higher deficiency rates in private companies cf. public companies (Hanlon, Mills, and Slemrod, 2007).

<sup>12</sup> The notational definition is altered to accommodate the binary dependent variables.

<sup>13</sup> Cited by Christensen (2004).

<sup>14</sup> As cited in Slemrod (2007).

<sup>15</sup> If the NGO failed to provide an estimate for the total value of their cars, equipment or inventory – after confirming that they did own such assets, or did not give an estimate of their total expenditure (neither 2000 nor 2001), or did not provide an estimate of total income (neither 2000 nor 2001), the organization was classified as not being transparent with regard to their finances. As detailed in the previous paragraph, in the second stage, the focus was on those organizations that were not transparent. The transparent organizations were coded as missing.

<sup>16</sup> For more detail on the construction of this variable, consult Appendix B.

<sup>17</sup> Appendix B has more information on how the variable was constructed.

<sup>18</sup> Although the decision-making process was implicitly modelled using a utility framework, the observable equivalent, namely the decision itself, will be binary. This is in line with Spicer (1986). He emphasised the binary nature of the tax evasion decision – citing findings from Friedland, Maital and Rutenberg (1978) and Spicer and Thomas (1982). He argues that the decision to evade tax or not appears to precede the choice about what proportion of tax to evade.

<sup>19</sup> The variable was coded on a Likert scale, which is coded 1 if there is strong agreement with the statement that the NGO representatives are good at what they do, 2 if there is somewhat of an agreement with the statement, 3 if there is neither agreement nor disagreement, 4 if there is some disagreement, and 5 if there is strong disagreement with the statement.

<sup>20</sup> In formal notation, if the 'true' model is

$$\delta = a\nu + b\rho + c\mu \quad (1)$$

it is assumed that the only influence that is problematic to capture with the available data is  $\rho$  and the candidate proxy for this variable is  $\vartheta$ . There are two conditions a suitable proxy must meet. Firstly, the variable needs to be redundant in the structural or 'true' model. In formal notation, this can be represented as

$$E(\delta|\nu, \rho, \mu) = E(\delta|\nu, \rho, \mu, \vartheta) \quad (2)$$

If a candidate proxy variable did not meet this criteria and it was significant when added to the 'true' model, it would mean that the variable has an impact and interpretation over and above that of a proxy for the omitted variable, which of course implies that it is not an appropriate proxy. A second condition, which is imposed frequently, but not

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always, requires that after the inclusion of the proxy variable, the other regressors should not be partially correlated with the unobservable variable for which it intends to serve as a proxy. The coefficients will not be consistent without the second condition. However, even if the second condition does not hold, there may still be an argument for using the proxy variable if its inclusion may reduce the bias of the estimates. According to Wooldridge, “This can usually be argued if [the proxy variable] is a reasonable proxy” (2002: 64). Also see Wickens (1972) in this regard.

<sup>21</sup> As cited in Spicer (1986).

<sup>22</sup> Where values were missing for this variable, we replaced such values with subgroup averages, with two identified subgroups: NGOs with, and without grants.

<sup>23</sup> Financial variables are avoided due to the potential high correlation between data availability, and corruption and ineffectiveness.