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Countering NGO corruption

Rethinking the conventional approaches

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1 Introduction

Donor agencies are increasingly vigilant for signs of corruption or other abuses in the projects and programmes they fund, no matter what aid modality is in question or who the implementer or recipient of the funds may be. This includes non-governmental organisations (NGOs), which are often seen as preferred implementation partners because of their closer ties to communities, particularly in contexts where state infrastructure is lacking, or due to the perception that they are less corrupt than the governments of beneficiary countries. But NGOs are not immune to fraud and corruption.

Among the spectacular scandals is the United Way in the US, where the chief executives of the umbrella organisation and its Washington DC chapter were convicted for theft and misappropriation of hundreds of thousands of dollars in 1995 and 2004 respectively.[1] More recently, at the end of 2007, the International Helsinki Federation for Human Rights was forced to close due to insolvency resulting from its former finance manager embezzling some EUR 1.2 million (Fischer 2007). There is also no shortage of less dramatic examples: NGOs involved in inappropriate activities are included in the World Bank's institutional integrity unit reports and debarment lists,[2]and the European Commission Anti-Fraud Office (OLAF) case studies of irregularities in external aid.[3]

All donor agencies have likely heard anecdotal evidence of NGO corruption. The most common forms appear to include the following practices:

- inflated, duplicate, or fictional invoices for goods and services procured for a project;
- 'ghost' employees, participants or beneficiaries that inflate the costs of project activities;
- kickback arrangements in procurement of goods or services or in hiring of project staff;
- 'double-dipping', or seeking or accepting funds from more than one donor for (parts of) the same project
- fictitious NGOs, or politically connected organisations set up to win public contracts.

Donors have a number of mechanisms in place to prevent and detect corruption in development aid, including in funds disbursed to and through NGO counterparts. The measures are typically applied at the key stages of the programme/project cycle: in the selection process of aid recipients/partners, during programme/project implementation, and at project or programme end.

But how effective are these mechanisms? Are they designed to address specific NGO needs and challenges? Does their application create any unintended negative consequences? While a lack of empirical evidence prevents reaching conclusive answers to these questions, this issue draws on practitioner experience gathered through informal interviews and an extensive civil society accountability discourse to lay out the key issues that should be considered by donors in reviewing their NGO accountability regimes.

[1] See, for instance Wilhelm (2004) and Strom (2006).

[2] See http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/ORGUNITS/EXTDOII/0,,menuPK:588927~pagePK:64168427~piPK:64168435~theSitePK:588921,00.html.

[3] See http://ec.europa.eu/anti_fraud/cases/aid_en.html.

2 How are NGOs distinct and what systems are required?

In assessing what is needed to limit corruption vulnerabilities of NGOs, the first set of considerations relate to the specificities of NGOs in comparison to other partners. NGOs are one of the three categories of development assistance implementers – along with state institutions and private companies (i.e., consultancy firms). Some differences, such as the perceived voluntary nature of the NGO's formation (as opposed to state bodies) and a lack of a profit motive (as opposed to private firms) do not necessarily impact on corruption prevention considerations. The one significant difference that does bear on the question is the fact that, as private entities, NGOs are not subject to potentially rigorous integrity regimes that apply to a national civil service and state institutions, including relevant internal and external oversight bodies. As a result, NGOs need to develop effective internal standards to ensure that they operate with the highest levels of integrity.

2.1 NGO accountability structures

The first consideration for donors in selecting potential grantees or partners, then, is the existence and efficacy of NGO internal accountability mechanisms, institutionalised through their internal governance structure. The main set of standards that indicate an effective governance structure has been defined by civil society organisations themselves, many of whom have recognised their obligation and interest not only to help identify and restrict the opportunities of less than reputable organisations, but also to assist new and less well resourced ones in establishing and maintaining high integrity standards. These standards have been codified through various self-regulatory mechanisms such as codes of conduct or certification systems,[4] and can be summarised as follows.

Essential NGO internal governance indicators

Clear governance structure, particularly role of the principal governing body (the Board).	▪ name of body ▪ description of relationship to other organizational entities (Board functions must be separate from management; if CEO member of board, non-voting only) ▪ list of current Board members with occupations and cities/towns of residence ▪ (where appropriate, the controller/beneficial owner of NGO should also be identified)
Governing body description to include:	▪ basic responsibilities and powers ▪ duties of individual board members ▪ minimum number of board members ▪ membership rules (including eligibility, suspension, and expulsion) and terms of office (length of terms, limits on re-election) ▪ clear election procedure ▪ minimum number of board meetings and method of convening meetings (who initiates, how to set dates, who decides agenda, etc.) ▪ decision-making procedures (number needed for quorum, how to vote and record decisions) with explicit indications that decisions are to be taken collectively ▪ record of Board meeting minutes ▪ conflict-of-interest provisions (for the Board and organisation overall) ▪ Board member remuneration (Board Members should not receive compensation beyond reimbursement of expenses)

[4] See, for instance, the Philippine Council for NGO Certification (PCNC) *Guidebook on the Basics of NGO Governance* available at http://www.pcnc.com.ph.

Board competencies to include:	▪ annual review of CEO performance ▪ review of financial (management) performance/ annual financial statements ▪ responsibility to recruit CEO ▪ responsibility to engage auditor

Reviewing the soundness of NGO governance structures, particularly their adherence to the above indicators, can help separate bona fide organisations from "NGO businesses" established to employ or contract to friends and associates, or possibly worse.

The second concern for donors is the existence of a sound financial management system. Here too, civil society organisations have defined a minimum set of requirements, summarised as follows:

Essential financial management indicators

Existence of basic accounting tools:	▪ books of accounts (general ledger, general journal, etc.) ▪ cash receipts book ▪ cash disbursements book ▪ bank account records
Basic accounting practices:	▪ written policies and procedures that follow accepted principles of accounting and control ▪ division of functions: the approving officer for fund releases (e.g. CEO) is different from the bookkeeper and the cash custodian.
Financial reporting and record-keeping	▪ annual financial statements of income and expenditures, on file for a certain number of years (suggested minimum two fiscal years)
Auditing practices	▪ annual audits commissioned by Board (auditor must not have a relationship to anyone in the organisation)
Fraud prevention and anti-money laundering practices	▪ existence of full and accurate audit trails of funds transferred outside NGO jurisdiction/ country ▪ use of registered bank accounts for money flows in case of every transaction (small amounts of cash for daily expenditure excepted) ▪ procedures to verify the identity, credentials and good faith of their beneficiaries, donors and associate NGOs ▪ secure and confidential maintenance of the list of the bank account numbers under the name of the NGO and any document on identifying information of persons
Advanced systems (for more developed organisations)	▪ sound investment policies ▪ resource generation plan

Donor agencies reviewing the above indicators are likely to recognise them as part of their own partner/grantee selection criteria. The existence of a governance structure with clear lines of accountability, internal conflict of interest rules, specified operational policies, as well a financial management system that follows good practice indicates that, with the appropriate human resources, the organisation has the appropriate framework to operate with integrity. But ascertaining whether or not the internal rules are in fact respected requires further investigation.

2.2 Partner selection procedures

Donors' pre-selection due diligence procedures beyond formal checks of the above conditions will differ – primarily depending on the amount of funding involved or the urgency with which a programme needs to be initiated. For instance, the cost of an in-depth financial review (e.g. of an organisation's audited financial statements) may run into thousands of Euros and therefore may represent an investment out of proportion to the amount of funding being disbursed. Similarly, in emergency humanitarian relief situations, the immediate threat of loss of human life limits the opportunity to thoroughly assess the institutional capacity and past performance of a potential partner before initiating cooperation.[5] In ordinary circumstances, however, donors do, and should, carry out minimal background checks of prospective grantees, including reviewing past performance on project financed by other agencies. Such assessments can help to identify disreputable organisations, or attempts at 'double dipping'. They can also be undertaken relatively easily, particularly by the local agency staff in the country where the aid is being disbursed. Such exchanges are further facilitated through regular donor information exchange and coordination efforts.[6]

3 Neglected questions and unintended consequences

Are there down sides to these corruption-prevention mechanisms? The question of unintended negative consequences is too often overlooked in corruption prevention efforts. Once again, civil society organisations themselves have pointed out a number of issues that deserve serious attention.

Both effective internal governance structures and strong financial management processes require a level of institutional capacity that may not be present in recently-established or more grassroots-based community organisations. Thus, many promising and potentially very effective partners would be automatically excluded from consideration if these standards are applied mechanically. Such an approach would de facto restrict the development of authentic civil society in favour of larger, more well-established and 'professional' NGOs. In fact, such practices would function contrary to the very rationale by which NGOs are supported or engaged as local counterparts in programme delivery.

The problem is not restricted only to the integrity capacity of particular organisations. Where past performance is a consideration for selection, newer organisations will fall short due to a shorter, rather than unsatisfactory, track record. And even if they are selected as partners or grantees, less developed organisations will likely encounter the challenge in slightly different form again during the project implementation phase, when they find financial and activity reporting requirements stretching their modest capacities.

Many donors have recognised these limitations – particularly the problem of excluding less developed organisations – and have responded with (at least) two funding mechanisms for NGOs: one for more well-established organisations that can demonstrate institutional and governance capacity, and one for lower-capacity NGOs that cannot. The latter types of programmes typically involve significantly smaller amounts of funds, i.e. less financial risk. However, these measures do not address the fundamental capacity deficiencies that are the source of the dilemma.

It is not that donors lack programmes to support the development of NGO institutional capacities. The problem is that these tend to be separate from and unrelated to grants for specific substantive projects. In other words, they tend not to be integrated into the everyday operations of an NGO while it goes

[5] The latter situation is a particular challenge for humanitarian agencies and donors alike, and some research has been undertaken to assist in developing mechanisms to address corruption risks in challenging contexts. See for instance, Ewins et al. (2007) or Transparency International (2010).

[6] Recognizing the value of such information exchanges, the European Commission has supported the development of TR-AID – an information gathering system developed to support information-sharing across major international donors with the aim to use aid funds most effectively.

about undertaking activities in support of their mission. Even more unhelpfully, upgrading operational or financial management practices as part of project implementation would likely be viewed as an administrative endeavour, hence an administrative expense, and as such – in view of ever increasing pressure to reduce administrative costs – discouraged.

One cannot but be reminded of the precisely opposite tendency when it comes to working with partner governments in pursuing Paris Declaration principles through budget support. In these cases, donors address any identified shortcomings or risks in national systems (particularly financial management systems) precisely in combination with service delivery programmes. There is a compelling argument to be made that the same approach should also be applied with NGOs. Considering that all donors recognise the value of civil society organisations in the countries in which they work – and sometimes even have explicit civil society development funds – the challenge is rather to shift the modality of that support toward capacity development concurrently with actual project implementation.

Motivations for financial malfeasance

The unintended consequences of donor practices may be even more grim than the marginalisation of authentic civil society described above. Some funding practices, particularly efforts to reduce administrative costs, may, in fact, encourage NGO corruption. Anecdotal evidence shows that some NGOs engage in diversion of programme funds not for personal enrichment of individuals, but for the very survival of the organisation. In contexts of low institutional capacities and pressure to operate with minimal administrative costs, some organisations may find themselves unable to maintain operations unless additional administrative funds are obtained by “skimming” from projects (Holloway 2004).

As in other examples discussed in this brief, the situation is especially problematic for smaller, newer, less developed NGOs that may not have as steady a flow of support and struggle to cover basic institutional costs such as rent, utilities, and staff salaries during the periods between projects. In addition, particularly in difficult national contexts, project implementation often has to be extended beyond the initially-planned period due to unforeseen circumstances. Even in these situations, there are few instances where grant arrangements allow for additional funds to cover administrative costs during the extension period.

This explanation does not aim to excuse such practices. It will always be difficult to establish with certainty the true motivations for malfeasance, and NGOs who engage in financial manipulation find themselves on a “slippery slope” with potentially devastating consequences for their reputation and future. The intention here is to underline the problem of unintended negative consequences of donor practices, which need to be fundamentally reconsidered if there is a wish to seriously tackle NGO corruption without decimating civil society is the process.

4 Effectiveness of existing measures

The previous section noted a range of pre-selection measures that can and do assist donors in identifying and excluding disreputable or bogus organisations, even if they also sometimes disqualify undeveloped but otherwise deserving actors. Unintended negative consequences aside, pre-selection measures serve to ensure that the pre-conditions for operating with integrity are in place, but are no guarantors that future programme activities will be carried out in such a manner. For that purpose, donors typically have a number of implementation-period mechanisms not only to detect any potential corruption and fraud, but also to ensure that the programme is carried out as planned. These activity-level monitoring systems typically consist of (a) regular activity and financial reporting by the recipient organisations, and (b) field monitoring of select activities or outputs.

4.1 Activity and financial reporting

While documented evidence is scarce, many practitioners share the impression that the corruption-detection potential of activity and financial reporting is limited. Unless they are independently verified, it is unlikely that a report would reveal that activities did not take place as stated, or that the reported amount of goods or services was not delivered. With financial reporting too, even if accompanied by receipts, it is difficult to ascertain through a desk review and without specialised personnel, who are tasked specifically to seek out fraud, whether, for instance, the receipts are not duplicates or that some other manipulation of the invoices has not taken place.[7] To fully assess the veracity of the reports, independent monitoring of activities during the implementation stage, or post-implementation forensic audit, are needed. With increased pressure to reduce administrative costs, however, many donor agencies have also reduced the numbers of local agency staff, which translates into fewer persons who could carry out such activity monitoring or scrutinise the reports effectively.

4.2 Field visits and corruption reporting

In contrast to reporting, field visits (inspections) are widely recognised as a more effective corruption prevention and detection mechanism – whether a programme is administered by an NGO, a government counterpart or any other service provider. However, the process is time consuming and expensive, while at the same time, as noted above, the staff resources required to undertake such monitoring effectively are increasingly being cut.

As alternatives reflecting the available resources are clearly needed, many donors have turned their attention to developing and promoting corruption reporting and whistle blowing mechanisms: essentially external monitoring approaches that function as an add-on to the limited internal system. The rationale is to extend the range of 'eyes watching,' and thus engage the stakeholders and programme beneficiaries in ensuring that the funds are being used as intended and that programme outputs are delivered as expected. Once again, empirical evidence is scarce, but there appears to be a widely held perception that such mechanisms are filling an important gap and may provide donors with a better value for money than investing in ever more detailed reporting requirements.

This is a development worth noting, as it coincides with increasing interest in downward accountability mechanisms that have been gaining attention from civil society organisations themselves.

5 Downward accountability

The notion of accountability is broader than corruption prevention, as it implies assuming responsibility for consequences of actions, not only for the (presumably unimpeachable) way they are implemented. In the development context, accountability considerations then extend to responsibility for outcomes of interventions. The civil society accountability discourse is in fact concerned primarily with development outcomes and with NGO legitimacy in claiming to represent particular communities. Integrity and corruption prevention measures are considered in service of those broader objectives.

The debate identifies as a key problem the phenomenon that NGOs historically have been more accountable to donors (upward accountability) than their beneficiaries (downward accountability).[8] In such circumstances, questions arise as to whether NGOs can truly identify and serve the needs of their constituencies. The answer is seen in developing better and more extensive consultative and participatory mechanisms with stakeholders, especially with beneficiaries, at all phases of a project: definition, implementation, and evaluation. The objective is to promote their engagement with the initiative and provide them with the opportunity to contribute to its success – particularly as it concerns meeting their needs. From a corruption prevention perspective, the rationale is similar to that in reporting and whistleblowing mechanisms: essentially, the approach involves enlarging the

[7] On the challenges of detecting corruption and fraud see, for instance, Kramer (2007).

[8] For a good introduction to the downward accountability debate, see Ebrahim 2003.

range of persons who have an interest in a programme being carried out as intended and providing them with the means to react if they detect a problem.

Approaches to promote beneficiary engagement are many and diverse, and range from informally seeking out beneficiary views for needs assessments, to far more formal participation in project reviews. Some downward accountability approaches are already frequently used by NGOs. A recent survey over more than 400 representatives of NGOs and donor agencies in 20 countries in Europe, Asia, Africa and North and Latin America (Keystone 2006) found, for instance, that NGOs regularly seek the views and feedback of beneficiaries when conducting needs assessments (84%); reviewing strategies and activity plans (68%); evaluating programmes (65%); and defining and measuring impact (54%).[9] The mechanisms for soliciting feedback are largely ad hoc and informal, however. Surveyed NGOs reported obtaining beneficiaries' views primarily through the ordinary course of staff field work (85%) and from partners in the field (70%), although a significant proportion of organisations also collected comments in more structured ways: through formal data collection operations led by staff (65%) and through formal participatory reviews of their work (61%).

Many other methods exist, of course, such as open house policies for all beneficiaries to attend any meeting of the organisation; community town hall meetings/public hearings where the beneficiaries can comment on the project. More complex approaches such as social audits are also increasingly being used. The data above suggests that the NGO community has made a promising start in the direction of greater downward accountability, but much more can be done to foster proactive engagement, and to strengthen, systematise and further integrate into core operations these and other participatory approaches.

Of course, transforming organisational policies and becoming competent to apply new methodologies is neither quick nor simple.[10] Nevertheless, the investment in adopting more effective participatory approaches does appear to be a promising way forward in addressing both corruption prevention concerns and considerations of wider accountability for development outcomes.

A word of caution, however. Here, too, organisations with less capacity are at risk of being marginalised. And while it is difficult for development agencies themselves to counteract the larger political decisions regarding development aid, it is essential that they begin to understand the significance of NGO capacity deficits in order to reframe the debate. Developing the capacities required to implement promising downward accountability mechanisms is not 'wasteful bureaucracy' but rather an essential integrity investment to prevent waste and ensure that development aid achieves maximum impact.

Downward accountability through financial reporting

The UK organisation Mango, which assists humanitarian and development NGOs and their partners to strengthen financial management and accountability, advocates providing regular activity and financial reports to beneficiaries, not only trustees and donors.

Financial reporting to beneficiaries may appear particularly daunting, as finance staff do not typically interact with beneficiaries, and field staff typically do not feel well-versed to discuss finances. A number of tips and suggestions for overcoming this challenge and developing ways to communicate financial information effectively to beneficiaries can be found on www.mango.org.uk/Guide/HowReportToBeneficiaries as part of the Mango *Guide to Financial Management for NGOs*.

[9] Less so for considering the organization's governance practices (34%) or examining financial accounts (20%). The latter, in particular, may be a particularly effective way to engage beneficiaries as fraud and corruption watchdogs.

[10] For challenges in implementing social auditing mechanisms in practices, see for instance Potter and Emmens (2004).

6 Conclusions and recommendations

- While the evidence is mostly anecdotal, there are indications of important deficiencies in donors' existing accountability systems.
- Among these deficiencies is the unintended negative consequences of complex pre-qualification and reporting requirements for the development of smaller, more grass-roots organisations.
- There are no 'one size fits all' solutions for accountability measures: the size and level of capacity of an NGO matters greatly. Requirements should be adjusted to the institutional and administrative capacities of more well-established vs. newer and smaller NGOs.
- There is a rich set of ideas and proposals on corruption prevention and detection embedded in the broader NGO accountability discourse. Investments should be made in the development and expansion of downward accountability measures in dialogue with NGO partners not only to reduce risks of corruption, but to optimise development outcomes.
- Investments in accountability systems, and in NGOs' capacities to implement them, should be regarded as essential and integral programme activities rather than administrative expenses.

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Abstract

Donor agencies are increasingly vigilant for signs of corruption or other abuses in the projects and programmes they fund, no matter what aid modality is in question or who the implementer or recipient of the funds may be. Mechanisms can be put into place to prevent and detect corruption in development aid, including in funds disbursed to and through NGO counterparts, and these measures are typically applied at the key stages of the programme/project cycle. But how effective are these mechanisms? Are they designed to address specific NGO needs and challenges? Does their application create any unintended negative consequences? While a lack of empirical evidence prevents reaching conclusive answers to these questions, this issue draws on practitioner experience gathered through informal interviews and an extensive civil society accountability discourse to lay out the key issues that should be considered by donors in reviewing their NGO accountability regimes.

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