

Accounting and Accountability of Non Governmental Organization - NGOs in Kosovo

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Abstract:

NGOs in Kosovo are facing a growing tendency of criticism towards their activities.

To improve their public image and credibility in the eyes of the population and to convince the target groups and donor organizations that NGO activities are effective and have a real impact on the development of the country they should raise the responsibility of financial reporting by increasing financial transparency and respecting the requirements from Kosovo regulations and legislations in the field of NGO.

From the incessant calls for NGOs to become more accountable and transparent in the use of funds, to shift to creating accounting procedures and practices of financial information reporting.

NGOs should participate in preventing and raising the awareness about corruption, therefore they will preserve the public's and donor's trust since they are themselves engaging in corruption preventing activities, and they also should testify that they promote the accountability within their organizations.

So far there is no coherent answer that has emerged from within the NGO sector, but NGOs know clearly that the answers to these questions must be addressed.

The study will produce recommendations for NGOs: to show that they are using their resources in an efficient, accountable and transparent way, in order to improve the accountability with donors, target groups and the community in general, especially for them to

fulfil their obligations and requirements arising from legislation, regulations and best accounting practices.

Key words: NGO, Transparency, Accountability, Accounting, Legal Framework

LITERATURE REVIEW

(McGann and Johnstone, 2006: 66), the NGO sector has recently been described as undergoing a "crisis of accountability and transparency" which has damaged the credibility of NGOs.

(Elkington, 2003). The demand for good governance and successful monitoring systems by beneficiaries, donors and governments, is considered a key, to increasing the reliability of informations and reports by NGOs

(Tendler, 2000; Mansuri and Rao, 2004). For example, children whose parents have never been to school may not be able to assess the quality of education their children are receiving.

Other studies have shown that beneficiaries who contribute little or nothing about the goods or services they are receiving, these beneficiaries will make inferior monitoring because they do not have an incentive to review the results of NGO s (Veron, Williams, Corbridge and Srivastava 2006 PLATTEAU and GASPART, 2005).

In addition, recent studies have shown that project managers have knowledge on how to hide information from community members, (Olken 2005) and (Olken, 2006).

Moreover, the case studies show that the members of poor communities sometimes lack self-respect to act boldly (Burger, 2005; Kihato and Kabemba, 2002).

Weak and incomplete legal framework also considers the impact of opportunities to avoid local taxes. The relationship

between opportunities and probability for tax evasion is reviewed by, Slemrod (2007)

Erbash (2004) has analyzed the relationship between transparency and the level of investment that a country can attract. He shows that the return on investment is higher in the most transparent countries and the uncertainty of possible outcomes is greatly reduced. Therefore, these countries attract more capital investment than the less transparent countries.¹

Drabek and Payne, describe transparency as 'reference to the clarity and effectiveness of activities to influence public policy, whereas fiscal transparency as a link of intentions, formulations and implementations of opening policy².

Kopits and Craig have described transparency as: Openness to the general public about the structure and functions of government, fiscal policy intentions, public sector accounts and projections. It includes a direct and reliable, comprehensive, timely, understandable, and internationally comparable access to government activities [...] so that the electorate and financial markets can accurately assess the government's financial position and the true cost and benefits of governmental activities, including the current and future economic and social implications³.

Such a definition given by Craig and Kopits for fiscal transparency corresponds to the IMF Code for Fiscal Transparency (1999, revised 2007). IMF defines fiscal transparency as a public opening for the governments past, present and future fiscal activities, and about the structure and functions of a government that determine fiscal policies and results. Code extends this definition in four fiscal areas: (1) clarity of roles and responsibilities; (2) open budget processes;

¹ S.N. Erbas, 'Ambiguity, Transparency, and Institutional Strength', IMF Working Paper, No. WP/04/115 (2004).

² Z. Drabek, W. Payne, 'The Impact of Transparency on Foreign Direct Investment', Staff Working Paper No. ERAD-99-02 (2001).

³ G. Kopits, J. Craig 'Transparency in Government Operations', 158 IMF Occasional Paper (1998) 1.

(3) the availability of information to the public, and (4) guarantees about the integrity of information, also including the requirement that fiscal information should be examined by the outside.

Whereas Lassen and Alt consider that 'fiscal transparency allows voters, interest groups and competing political parties to observe or conclude better and more accurately the causes and consequences of governmental fiscal policy, either directly or through the media'⁴

In December 2010, the Accounting Standards Board (AcSB) released Part III of the CICA Handbook – Accounting, which consists of accounting standards for not-for-profit organizations. GAAP, Section 1101, in Part III of the Handbook⁵.

The accounting framework for not-for-profit organizations (NFPOs) in Canada is changing. The Public Sector Accounting Board and the Accounting Standards Board separately issued accounting standards for not-for-profit organizations in 2010 and 2011, respectively. The standards for private sector not-for-profit organizations can be found in Part III of the CICA Handbook – Accounting. A not-for-profit organization controlled by a government would, however, refer to the CICA Public Sector Accounting Handbook for applicable standards. In both cases, the standards are effective for annual financial statements for fiscal years beginning on or after January 1, 2012, with earlier application permitted.

Guide to Accounting Standards for Not-for-Profit Organizations in Canada, SEPTEMBER 2012; Published by The Canadian Institute of Chartered Accountants in 2012. It

⁴ E. Alt, D.D. Lassen, 'Fiscal Transparency, Political Parties, and Debt in OECD Countries' 50 *European Economic Review* (2006) 531.

⁵ www.cica.ca/applying-the-standards/index.aspx

has been reissued by Chartered Professional Accountants of Canada⁶.

IFRS does not include separate standards for not-for-profit organizations.

One of the best regulations of this issue is practiced by Croatia - Law on Accounting and financial operations non-profit organizations NGOs in Croatia; Zagreb, July 2014.

INTRODUCTION

The greater need for emergency assistance and reconstruction in Kosovo after devastations brought by the last war, the war conclusion and NATO intervention, as well as the creation of the United Nations Mission in Kosovo (UNMIK) and the Provisional Institutions of Self-Government (PISG) in 1999 have been the turning point for the overall development of civil society in Kosovo. Greater financial and technical support by international donors, coming as a need of channelling international funds for post-war Kosovo resulted in a massive increase in the number of NGOs.

'Easily accessible' funds, combined with dependency on foreign donations, created more donor-driven NGOs, and "passive" NGOs which are active only when funding is available. Of more than 7,452 registered NGOs in 2013, less than 10% are estimated to still be active or partially active. Since the Law on NGOs did not foresee any condition to shutdown passive NGOs, the number of registered NGOs has continually increased since 1999⁷

From 7,452 NGOs registered in December 2013, 6,947 are local and 505 are foreign/international NGOs. From local NGOs, 6,695 are associations while the other 252 are

⁶ *Accounting Standards for Not-for-Profit Organizations CICA Handbook – Accounting, Part III* ; <http://www.psab-ccsp.ca/index.aspx>.

⁷ Civil Society Index - CIVICUS for Kosovo, KCSF 2011

foundations. Out of the total 1,015 PBS organizations only 231 enjoy this status, of which 157 are local and 74 foreign⁸.

Reports on the activities of organizations with public benefit status (PBS) are done in a narrative and financial form, while PBS organizations with an income of more than 100,000 EUR shall also submit the report of the external auditing.

NGO activity until September 2011 was regulated by: REG / UNMIK / / 1999/22 dated November 15, 1999 and 10/2000 AD.

CURRENT SITUATION OF ACCOUNTING AND REPORTING FOR NGOS

Reporting

All NGO activities including accounting and financial reporting is regulated by the Law on NGOs - Law 04 / L-57 on Freedom of Association in Non-Governmental Organization.

Article 11 Legal Status⁹

1. A local NGO has the status of a legal person registered in accordance with this law.
2. Upon registration, foreign countries and international NGOs are authorized to operate as a legal person in Kosovo.
3. Local and international NGOs are subject to all the laws in force in the Republic of Kosovo.

Article 18¹⁰

Obligations for financial and activity reporting for NGOs with public benefit status:

1. The NGO, which has been granted public benefit status, shall submit an annual report for its operations and

⁸ Research conducted by CIVIKOS (KCSF) | III.

⁹ Law 04/L-57 Freedom of Association in Non-Governmental Organization

¹⁰ Law 04/L-57 Freedom of Association in Non-Governmental Organization

activities to the competent authority in Kosovo. Reports must be submitted by the end of March for the reporting year ending on 31st December of the previous year.

6. Financial reports are to be prepared on forms, which are provided by the competent authority, and include, at a minimum:

6.1. a balance-sheet, showing the assets and liabilities of the organization;

6.2. financial report on the source of income, where revenue and expenditure of the NGO is presented separately for the management and administration.

7. The competent body at the request of the NGO can appoint an additional deadline for submitting the annual report, if it had been imposed by emergency situations, but not later than thirty (30) days from the date of recovering from these circumstances.

8. Financial Statements are prepared until the last day of March for the period of one year, on the previous year ending on 31st December.

9. Financial reports prepared and submitted by local NGOs, with annual income or expenditure over one hundred thousand (100,000) Euros, by foreign and international NGOs with annual income or expenditure for their operations and activities within Republic of Kosovo over one hundred thousand (100,000) Euros, shall present a financial statement for the fiscal year as the Republic of Kosovo, including the auditing report for the previous year as well, signed by a licensed auditor in the Republic of Kosovo, so that the material aspect and financial position of the organization for the reporting period to be just.

11th point. Reports submitted in accordance with this article, are made available to the public. The NGO has the possibility to identify information or asset, which it considers confidential in its report and request that the competent authority delete that data before the report is made public.

With no word mentioning accounting, transparency and accountability

Means that NGOs themselves are allowed to choose accounting standards, (even though not specified) in this law.

Reports must be submitted by the end of the March for the period of one year, on the previous year ending on 31st December, and should contain all the information specified in Article 18 of the Law (Appendix 8) (effective from 09.03.2014)

Current form used for financial reporting by NGOs with Public Beneficiary's Status PB status

Part III Financial Reporting: Name of the NGO:_____

Balance Sheet 31.12.20xx¹¹

Assets		Liabilities	
	<i>Type the sum here</i>		<i>Type the sum here</i>
Cash		Accounts Payable	
Receivable Accounts		Obligations to grant	
Trade and other receivables		Unearned income	
Stocks		Mortgages and obligations to securities	
Prepayments of expenditure		Other liabilities	
Investments:		Total Liabilities:	
Securities			
Land, buildings and equipment in preparation		NGO Fun:	
Credit (customers)		Fund transferred to 01.01.20xxx	
Land, buildings, and equipment		Net income of the year, See (P / A)	
other Assets		Total Fund:	
Total Assets:		TOTAL LIABILITIES AND CAPITAL	

¹¹ Ministry of Public Administration, Department of NGOs; Annual report for the registered NGOs in Kosovo ¹¹

Income and Expenditure Statement¹²

Revenue	Type the sum here	Expenditure	Type the sum here
Revenue from contributions, gifts, or grants		Program Expenses	
Income from economic activities		Management and administration costs	
Income from bad debts		Other expenses	
Revenue from interest and dividends		TOTAL Expenditure:	
Income from rent		Operating Income:	
Other entries			
Revenue from sale of assets			
(loss from sale of assets)		Income tax expense	
Other special revenue			
Revenue from sale of goods			
(Cost of goods sold)			
Other revenue			
TOTAL revenues:		Net income of the year:	

PROBLEM IDENTIFYING:

Information and Transparency

Despite the increase in demand and the pressure for more transparency and accountability, it seems that most of the NGOs are only willing to report what is necessary and only when required by law, or when that information might be beneficial for them, thus not taking the need for accountability for granted.

Amid widespread calls for NGOs to be more accountable and transparent, there is a dominance of the discrepancy between what NGOs report and what they do. There is an apparent decline of credibility among the community and NGOs about financial transparency.

It also gives some support to the view that excessive and unrealistic demands of donors can be a barrier to financial transparency. Being called upon the alibi of confidentiality and

¹² Ministry of Public Administration, Department of NGOs; Annual report for the registered NGOs in Kosovo ¹²

wide prevention comes disillusionment with what they may perceive as restrictive, but also ineffective with the requirements for their sector? Or are those simply attempts to hide fraudulent, irresponsible or useless behaviour.

Transparency is recognized as an obligation or desire to publish relevant data to the public and other stakeholders.

Transparency can be seen as a prerequisite for the effective functioning of checks and balances. Without accurate and timely information, interested parties are unable to hold decision makers accountable.

Transparency is a key issue in the NGO sector because of the existence of a significant number of stakeholders such as beneficiaries, donors, the public and the government.

These information/reports of NGOs make relationships with stakeholders full of asymmetrical information, which make it more difficult for donors, government and other beneficiaries to monitor potential problems and keep NGOs accountable.

Geographical distance can prove to be expensive for donors to visit project activities in order to regularly to monitor conditions, outcomes and results.

In such cases, donors will rely on second-hand information, which can often be reported by the NGOs. If the donor is not familiar with the circumstances, legislation and the local culture and does not have a benchmark for cost comparisons, the interpretation of accounts and reports can be a further obstacle for evaluating the performance of NGOs and the utter ineffectiveness or failures.

Accountability

Accountability is one of the principles which is known as a 'hot topic', not only at the political level but also at the non-governmental sector. Therefore, it is important to clarify what we mean by accountability:

Accountability is defined as an obligation or desire to hold accountable, the NGO sector, for their actions towards stakeholders such as beneficiaries, the public, donors and supervisory and TAK institutions.

Furthermore NGO accountability is considered as a “mean by which individuals and organizations report to an authority (or authorities) and are held accountable for their actions”. Therefore, essential to the term ‘accountability’ are trust, verification and feedback¹³.

For example, accountability means more than financial transparency in cases when requested funds have been dedicated to a particular group such as the children with special needs, and in this case it is very important to be accountable to the beneficiaries as well, such as the families of those children, etc¹⁴.

Supervision of these organizations by public authorities is done in the name of protecting the public interest, given that state control over civil society in general can be misused very easily, different countries have developed alternative mechanisms that enable accountability to be forwarded to public in a more direct way rather than through public authorities.

E.g. Hungary is an interesting case where the public benefit organizations are not required to submit reports to any regulative authority, but the same reports should be made available to the public, mainly through websites. Along with their annual report, these organizations need to prepare a "public benefit report", which will be available for access to every citizen¹⁵.

¹³ PLACA, “ Strengthening Accountability in Civil Society Organizations in Uganda, 2011, pg 12

¹⁴ Focus group discussion summary, citation by Iliriana Kaçaniku, KFOS, 25 .10. 2012.

¹⁵ Hungarian Act CLVI i 1997 on public beneficiary organizations, completed by the XIV act and XXXIII Act 1998, Articles 19.1 and 19.4

In Kosovo in recent years, this status has been transfigured due to changes in the basic and tax laws on NGOs. While the obligations to financial and activities report remain and is quite demanding, the benefits that these organizations have once enjoyed no longer exist or are such that do not play a role in the performance and financial sustainability of the organization¹⁶. The Governmental unit that is responsible for implementing this law - at the same time the only central government unit that deals with NGOs - seems to have limited capacity and competence to ensure its full implementation in practice.

With an incomplete legal framework and relevant institutions with limited capacity to implement the relevant legal provisions, the use of normative acts and regulatory institutions to improve the accountability of civil society remains far from attainable.

CONCLUSIONS

While donors - mostly foreign – have the main merit for the rapid development of the civil society sector in post-war Kosovo, they are also in the sting of criticism of those who consider civil society organizations as too dependent on donor agendas. Even globally there is a discussion about the risk that donor support has a contribution to the weakening of internal accountability, because those CSOs often end up giving responsibility to donors and not the people who they claim they represent.

However, before positioning in favour of one extreme or the other, the issue of the impact of donors respectively the accountability of CSOs towards their donors, should be analyzed more thoroughly and put on a broader scale¹⁷.

¹⁶ Civil Society Index - CIVICUS for Kosovo, KCSF 2011

¹⁷ Focus group discussion summary, citation from Iliriana Kaçaniku, KFOS, 25.10.2012.

¹⁸ Research conducted by CIVIKOS

As seen above, one of the main models of accountability is based on accountability between the leader and agents. The leader usually is the donor who sets his own goals, in order to achieve these goals it involves agents, to whom it gives the necessary financial means to achieve the goal. This means that the donor has the full right to decide for their own purposes, while agents are only the donors tools to achieve those goals. In business terms this could well be fully accepted, one pays for a service and the other providing the service with a fixed compensation.

Finally, it must be recalled that it is very unlikely that there is only one forum where CSOs are held accountable. Each Civil Society Organization should have its donor only as one of the addresses where it has to be accountable, while the other addresses should depend on the type of organization and specific areas of activity. In the absence of functionality or engagement of other addresses, donors will remain in the foreground - either being praised for their support, as well as being criticized for excessive impact. The more the other forums are empowered, the lower the role of the donors will be in the sector of civil society in general and further more accountability of civil society will be distributed to different addresses.

Code of Ethics of Non-profit organizations in Estonia 2002, is among the few examples of self-regulatory mechanisms that include all sectors.

Accountability is defined as a responsibility to the founders, members, stakeholders, donors and general public, and promote openness and transparency by requiring that information upon the work of CSOs and their funds to be made available to the general public.

The Estonian Code of Ethics has no specific mechanism that ensures that the principles of the Code are being implemented. Rather, the code serves all individuals and institutions concerned to assess itself whether a CSO is acting in accordance with this Code and therefore whether it should provide support.

Similarly, the Irish code is based on the principle "comply or explain".

In Hungary "Signs of Faith" is a certificate issued after an evaluation process by an evaluation board, whose members can be from CSOs

CSOs in Kosovo propose self-regulation: "Self-regulation is a necessity to increase the accountability of the sector NGO. This form of accountability is preferred among others since it is a voluntarily form of accountability and not mandatory. Accountability of civil society must be regulated independently through a corporate body with a Code of Ethics, which would produce accountability criteria and reports to members, but not to impose penalties, while representation would be with a rotating system. But civil society must be aware before moving to the formalization."¹⁸.

Bernard Kouchner (Special Representative of the Secretary-General) has concluded that: Kosovo does not have sufficient capacity to identify the origin of the funds to numerous non-governmental organizations coming from different countries of the world. This belief is shared by local experts of extremism and terrorism issues. Penetration of money from Arab countries in Kosovo, according to them was done without government control.

This because the Financial Intelligence Unit FIC, which is the main institution that deals with the monitoring of banking transactions was created much later, when this problem had already received a large scale. According to analyst Bashkim Zeqiri, former head of the Financial Investigation Unit in the Directorate of Organized Crime in Kosovo Police, recent years in Kosovo, only from the Middle East countries there has been an infusion of over 50 million Euros.

This figure is based only on the data possessed. Kosovo, according to him, doesn't have sufficient capacities to

¹⁸ Research conducted by CIVIKOS

determine the origin of funds for non-governmental organizations that are deemed suspicious. He said that there is a no good cooperation between the Financial Intelligence Unit of Kosovo and the Kosovo Intelligence Agency as written by 'Tribuna'.

A great number of NGOs do not report at all, hence it is not required by the relevant legislation, so there is no institutional requirement for NGOs that do not have public benefit status to report financial activity, neither NGOs with public beneficiary status which have surpassed a quota of 100,000.00 € of revenue, they do not report anywhere, and do not answer to anybody, TAK is the only institutions that controls this occurrence and only for the reason of tax legislation bindings.

Organizations with Public Benefit Status that have an annual turnover in excess of 100,000 EUR are required to undergo an annual audit by independent certified auditors, whereas even other organizations with larger turnover in most cases voluntarily undergo independent audits, in order to increasing their credibility towards stakeholders.

Another problem is the request of donors that reporting has to be done in cash basis, and monitoring requirements for the office of NGOs that they report in the current accounting basis. Without any law or AI that will regulate accounting for NGOs

NGOs have mixed accounting, they do not neither have the basis of cash nor accrual basis. As requested by their donors, NGOs report their financial statements in cash basis however NGOs that have an obligation to report to Department for Registration and Liaison of non-governmental organizations DRL NGO , should adapt to the requirements of the office for NGO monitoring to report on accrual basis of accounting. There is no law or AI which would regulate the accounting of NGOs. With the current NGO law the basis of accounting have not been determined.

There are no accounting standards that regulate the accounting and financial reporting of NGOs.

NGOs do not report the complete set of financial statements (Cash Flow Statements; Statement of Equity and Disclosure to the financial Statements are not reported)

There is a lack of professional staff in the field of accounting and auditing in the Department for Registration and Liaison of Non-Governmental Organizations DRL NGO. There is also a lack of cooperation between this department and other institutions such as FIC, KIA, SCAAK and Administrative Division of the Kosovo Council for Financial Reporting- KCFR

There are NGOs that do not report at all, such as trade unions, NGO's that have annual income that are not obliged by NGO Law 04 / L-57 to report in DRL NGO

Another observation is that NGOs face many other issues during their activities, such an issue is the VAT reimbursement, an issue faced today in Kosovo by commercial entities as well as NGOs, therefore we recommend to implement recommendations of the IMF and the refund procedure to be as in EU.

RECOMMENDATIONS:

1. Capacity building for DRL NGO- Department for Registration and Liaison with NGOs, especially the unit for admission and analysis of financial reports. Or create an appropriate agency for this issue.
2. Kosovo government to take over the funding of the audit for financial reports of NGOs, for the need of DRL NGO and FIU - Financial Intelligence Unit. This will increase financial transparency, accountability, it would also impact on preventing (or controlling) the phenomenon of terrorism financing and money laundry, TAK may also utilize these reports to assess the risk of tax evasion.

3. NGO legislation to bind NGOs into respecting the principle of fair competition with market prices, NGOs may have lower offers since they are non-profit and the low prices offered by the competition will assist in meeting the targets for the public sector
4. Determining of the fiscal regime for organizations that may also exercise activity mix, which enables them to earn profit but not distribute it and use it for public interest as defined under the statute.
5. Procedures for tax exemption (or the certificate of exemption) from tax liabilities should not be complicated and at the same time should be applicable. Tracking the relevant procedures should be efficient and effective in order to make the benefit of tax exemption accessible and usable in practice.
6. VAT reimbursement by commercial entities as well as NGOs is a major problem being experienced today in Kosovo; therefore we recommend to implement the recommendations of the IMF and the procedure for tax reimbursement to be applicable as in the EU.
7. For non-profit activities NGOs may use a simplified form for financial statements different from the standards of the approved form; Article 18 of Law 04 / L-57 (Appendix 8) (suggested only for NGOs with revenues less than 10,000.00 Euro).
8. Submission of full financial statements under IFRS for SMEs, for all NGOs with revenue higher than 50,000.00 EUR. This area should be regulated by a special law on accounting for NGOs (Model Croatia and Accounting Law of NGOs in Croatia)
9. On the basis of the above references we suggest that it is best to set a legal limit of economic indicators for the auditing of NGOs, and this should be mandatory for all NGOs with funding over € 100,000.00 since so far it is only dictated from donors and legislations of NGOs with

- public benefit status with higher revenues than 100,000.00 Euros.
10. NGOs should lead accounting according to the accrual principle, not to involve reporting to donors with accounting principles (donors seek to be done on cash basis, this should continue for the purpose of projects and reports to donors)
 11. NGOs should keep their accounting according to the accrual principle, reporting towards donors should not be mixed with annual reporting of financial statements and continues bookkeeping (donors request to report on the cash basis, this should be continued only for the purpose of projects and reporting to donors)
 12. Kosovo Financial Reporting Council KFRC should issue a separate standard for accounting of NGO's / Non-Profit Organizations
 13. NGOs must report the full set of financial statements under the requirements of IFRS for SMEs. The same set of financial statements should be submitted to DRL NGO as well, so that NGOs do not need to compile two sets financial reports
 14. To amend the actual law on NGOs so that IFRS for SMEs is legally binding regarding to accounting, financial reporting and transparency; law and standards for NGOs / NPOs as foundations, associations, political parties, religious institutions, trade unions and all another unnamed organization in this research which have the status of a non-profit organization to be obliged to respect these standards and laws.

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