

## Tool 8: WSI Financing and Audit Protocols

WSIs can engage the private sector to support, also financially, the development or implementation of water policies and services out of their own business interest. This requires high transparency standards and separation of roles in terms of financing and auditing vis-à-vis the governance and decision-making structure of a WSI. Otherwise, WSIs may run risks of capture, misleading expectations, or bad perceptions. Funding standards provide for a thorough due diligence investigation of funders, including an assessment of possible conflicts between public and private interests.<sup>1</sup> Financial management and audit protocols then ensure the follow-through and implementation of agreed arrangements.

Tool	A summary of key aspects of funding arrangements and processes that your WSI's financing and audit protocols should address.
Related Key Activity	Establish equitable decision-making structures, communication, and finance.
Question Addressed	There are private companies willing to invest in the WSI. How can we receive their funding while maintaining our independence and credibility?
Purpose	Ensure compliance with moral and legal duties related to funding arrangements:  ✓ Reduce capture and other integrity risks.
Possible Users	WSI initiators and participants.
Level of Effort	Staff time and possibly resources for external expertise during negotiation of financial agreements; efforts for administering agreements depend on complexity.
WSI Phase	1: Incubation and Initial Analysis, 2: Formalization.

### Guidance for implementation

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*Y pays X funds and it's not clear to the partners — it's not transparent — the finances are hidden. [Civil Society]*

*Does the corporation get to make all the decisions if they are the major [financial] contributor? [Public sector]*

*(From Field Testimony)*

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<sup>1</sup> Government authorities are, for example, usually responsible for ensuring water resources allocation. Although financial contributions may be provided to support the government in doing its job, the responsibility for the development of related regulations and the actual allocation of water should not be shifted to the funder, who may have **vested interests**.

Step 1: Conduct Due Diligence on Potential Private Funders

- Through a due diligence of potential funders, WSI initiators can better understand their motivations and identify potential integrity risks. Due diligence investigations should consider real interests as well as perceptions, since the latter can have very damaging impacts on the credibility of a WSI.
- In addition to the guidance on due diligence, the following aspects should receive particular attention during the **investigation of potential private funders**:
  - How transparent has the potential funder been about their particular interests, expansion plans, and the possible impacts of WSI outcomes on such plans? What are these possible impacts?
  - In terms of provision of WASH services, water use, and discharge, are the current and future (planned) operations of funders in line with local and national policies and regulations, and with international good practices of **sustainable water management**? What are the links between the funder's operational compliance with water regulations and the objectives of the WSI?
  - Could the funding arrangement have (or be perceived to have) an impact on pending licensing, concessional, or legal processes concerning the funder?
  - Which conflicts of interests exist between the potential funder and other water users, and how can these influence the WSI or its perception?

Step 2: Determine Credibility and Integrity of Potential Funders

- Based on the due diligence findings, WSI initiators and participants assess whether they are able to receive funds from the potential funder while maintaining the WSI's integrity. As this discussion goes beyond a yes/no decision into designing possible integrity risk management mechanisms for engaging with this funder, the due diligence shall provide a nuanced, dynamic understanding of the entity. Determining the credibility of funders should be done in collaboration with all **WSI participants** as well as relevant **affected stakeholders** who may be affected by the WSI or who may have special insight into the funder's operations and intentions.

Step 3: Establish Integrity Risk Management Measures with Funders

- Before entering into a funding relationship, the **WSI participants** and the potential funder should establish several preventive measures to manage sensitive areas that have been identified (see box on Recommendations for WSIs).

Step 4: Establish Contracts

- Negotiated agreements and safeguards are formalized into contracts.
- Contractual provisions can be used to prevent and disarm any undue interference by funders during the implementation of the WSI. They also demonstrate to **affected stakeholders** that the **WSI participants** are committed to upholding integrity.
- When feasible, publicly disclosing this contract can further demonstrate the integrity of the WSI.

Step 5: Manage and Report WSI Expenditures

- Even if funding is diverse, a WSI should have a unified set of rules to manage expenditures, to report to those overseeing the WSI, as well as for auditing. These rules should be agreed on by all **WSI participants** as an addendum to the MoU or statutes of the governance body (as part of the description of the body's functions).
- For general financial management and auditing, these will usually be the rules of the organization that manages the secretariat of the WSI (or similar structure). The financial management capacities and possible risks need to be assessed in the process of formalizing the role of the secretariat. If necessary, additional controls such as co-signature or no objections for large expenditures and procurement should be put in place. For guidance on financial management systems, see Instrument 2 of the Integrity Management Toolbox (Hermann-Friede et al., 2014).

Step 6: Continuously Audit Adherence to Contracts

- Throughout the life of the WSI, participants should hire an independent party to intermittently revisit contracts with private funders and assess their adherence to its agreements and safeguards. This allows participants to continuously assess possible integrity risks.
- The scope and frequency of audits are designed to control the compliance of all parties with the agreed funding arrangements. The process for an impartial recruitment of the external auditor has to be agreed with funders (usually included in the financing agreement) and possibly with other **WSI participants**. Audit reports have to be available to all **WSI participants** and should be published if possible. For guidance on the recruitment, see Instrument 21 of the Integrity Management Toolbox (Hermann-Friede et al., 2014).

Recommendations for WSIs that receive private sector funding	
minimum requirements	1. <u>Declaration of intentions and interests of WSI funder(s)</u> : These should go beyond the objective of the WSI and clearly state the individual benefits that a funder expects from investing in the WSI.
	2. <u>Financing agreement that separates the funding structure and the WSI operations</u> : The results framework of the agreement needs to be aligned with the general objectives and outcomes of the WSI. The release of funds must not be bound to specific outcomes that benefit the funder. The funder shall not have any special rights (e.g., veto rights) in the WSI governance structure. The implementing partners shall have to justify only how money has been spent and how decisions on the use of funds have been taken, but not the content of decisions (which may not always be in line with the funder's interests).
	3. <u>Basic disclosure of information</u> : Basic information on the overall budget of the WSI, the funders, and the amounts each provides should be made available to the public.
highly recommended	1. <u>Comprehensive disclosure agreements</u> : The financing agreement and related (audit) reports should be published and distributed to the utmost possible extent. If full public disclosure is not possible, other options are to disclose documents only to <b>WSI participants</b> and/or to disclose key information only to the public or <b>WSI participants</b> . Disclosing financial information is even more crucial in complex funding structures.
	2. <u>Independent oversight</u> : Engaging a social witness in the negotiations of sensitive financing agreements and due diligence investigation of the funder can increase credibility. The social witness could be a community organization or a national or international NGO. (For more info, see <a href="#">Tool 11: Independent Oversight</a> .)
	3. <u>Who is paying what</u> : In a WSI that receives a mix of public and private funding, it is advisable to use public funds for sensitive WSI activities (e.g., development of master plans with direct impact on company operations; assessments that serve as basis for prioritizing measures and intervention areas; travel of public officials, community representatives and NGO partners with oversight function) and earmark private funds for activities that are less sensitive to capture (e.g., the implementation of already agreed measures).
	4. <u>Funding diversity</u> : To mitigate power imbalances and negative perceptions, equal possibilities to provide funding should be assessed for all WSI participants, including those who engage at a later stage. Especially if there are conflicts between different (corporate) water users, options to engage with all parties should be explored and decisions documented.

Further readings and materials:

- An integrity risk assessment checklist for implementing partners and **WSI participants** that receive funding can be obtained upon request from GIZ, the Pacific Institute, or WIN.
- Janek Hermann-Friede, Michael Kropac, Sarah Achermann, Johannes Heeb, and Lotte Feuerstein. 2014. *Integrity Management Toolbox for Water Service Providers — Description of WSP Integrity Instruments* (Berlin: cewas, WIN, and GIZ).  
<http://www.waterintegritynetwork.net/publications/>.