
LOAN NUMBER 2276-SRI(SF)
(Supplementary to Loan No. 1993-SRI)

LOAN AGREEMENT
(Special Operations)

(Secondary Towns and Rural Community-Based Water Supply and Sanitation Project -
Supplementary)

between

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

and

ASIAN DEVELOPMENT BANK

DATED 14 December 2006

LAS:SRI 31501

**LOAN AGREEMENT
(Special Operations)**

LOAN AGREEMENT dated 14 December 2006 between DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA (hereinafter called the Borrower) and ASIAN DEVELOPMENT BANK (hereinafter called ADB).

WHEREAS

(A) by a Loan Agreement (Loan No. 1993-SRI: Secondary Towns and Rural Community-Based Water Supply and Sanitation Project) dated 18 August 2003 between the Borrower and ADB (hereinafter called the Initial Loan Agreement) ADB had made a loan (hereinafter called the Initial Loan) to the Borrower from ADB's Special Funds resources in the amount of forty five million six hundred eighty-nine thousand Special Drawing Rights (SDR 45,689,000) for the purposes of the project described in Schedule 1 to the Initial Loan Agreement (hereinafter called the Initial Project);

(B) the Borrower has applied to ADB for two supplementary loans, one from ADB's Special Funds resources and one from ADB's ordinary capital resources, both for the purposes of financing cost overruns under the Initial Project, as amended and described in Schedule 1 to this Loan Agreement (hereinafter called the Project);

(C) by an Agreement to be entered between the Borrower and ADB (hereinafter called the Ordinary Operations Loan Agreement), ADB has agreed to make a supplementary loan to the Borrower from ADB's ordinary capital resources for an amount of thirteen million five hundred thousand Dollars (\$13,500,000) for the purposes of the Project upon the terms and conditions set forth in the Ordinary Operations Loan Agreement;

(D) the Project will be carried out by the National Water Supply and Drainage Board (hereinafter called NWSDB), and for this purpose the Borrower will make available to NWSDB the proceeds of the Loan provided for herein upon terms and conditions satisfactory to ADB; and

(E) ADB has agreed to make a supplementary loan to the Borrower from ADB's Special Funds resources upon the terms and conditions set forth herein and in the Project Agreement of even date herewith between ADB and NWSDB;

NOW THEREFORE the parties agree as follows:

ARTICLE I

Loan Regulations; Definitions

Section 1.01. All the provisions of the Special Operations Loan Regulations of ADB, dated 1 January 2006 (the "Loan Regulations"), are hereby made applicable to this Loan Agreement with the same force and effect as if they were fully set forth herein.

Section 1.02. The definitions set forth in the Loan Regulations are applicable to this Loan Agreement, unless the context requires otherwise. In addition, the following terms have the following meanings:

- (a) "CBO(s)" means community-based organization(s);
- (b) "CEA" means the Central Environmental Authority of the Borrower;
- (c) "Component" means any one of the Urban Component, the Rural Component or the Institutional Strengthening Component;
- (d) "Consulting Guidelines" means ADB's "Guidelines on the Use of Consultants by Asian Development Bank and its Borrowers" dated April 2006, as amended from time to time;
- (e) "Goods" means equipment and materials to be financed out of the proceeds of the Loan; including related services such as transportation, insurance, installation, commissioning, training, and initial maintenance, but excluding consulting services;
- (f) "NGO(s)" means non-government organization(s);
- (g) "NWSDB" means the National Water Supply and Drainage Board, established under NWSDB Act, and includes any successor thereto acceptable to ADB;
- (h) "NWSDB Act" means the National Water Supply and Drainage Board Law No. 2, 1974, of the Borrower as may be amended from time to time;
- (i) "Ordinary Operations Loan Agreement" has the meaning given in Recital C of this Loan Agreement;
- (j) "Ordinary Operations Loan Regulations" means the Loan Regulations referred to in Section 1.01 of the Ordinary Operations Loan Agreement;
- (k) "O&M" means operation and maintenance;
- (l) "PMU" means the Project Management Unit;
- (m) "Pradeshiya Sabha(s)" means a local government authority or body of the Borrower created under the Pradeshiya Sabha Act of the Borrower;

(n) "Procurement Guidelines" means ADB's "Procurement Guidelines" dated April 2006, as amended from time to time;

(o) "Procurement Plan" means the procurement plan for the Project dated 12 October 2006 and agreed between the Borrower and ADB, as updated from time to time in accordance with Procurement Guidelines, Consulting Guidelines, and other arrangements agreed with ADB;

(p) "Project Executing Agency" for the purposes of, and within the meaning of, the Loan Regulations and Ordinary Operations Loan Regulations (as defined herein) means NWSDB which is responsible for the carrying out of the Project;

(q) "Project facilities" means the equipment, materials and supplies as well as facilities provided or to be provided under the Project, including such items for Subprojects;

(r) "Provincial Councils" means the councils established for each of the Borrower's provinces under the Thirteenth Amendment to the Constitution of the Borrower, 1987;

(s) "PSIU" means each Pradeshiya Sabha Implementation Unit;

(t) "subproject" means a subproject of the Rural Component meeting the criteria set out in paragraph 13 of Schedule 6 to the Initial Loan Agreement;

(u) "Subsidiary Financing Agreement" means each of the agreements between the Borrower and NWSDB referred to in Section 3.01 of this Loan Agreement and the Ordinary Operations Loan Agreement, respectively; and

(v) "Works" means construction or civil works to be financed out of the proceeds of the Loan, including services such as drilling or mapping, and project related services that are provided as part of a single responsibility or turnkey contract, but excluding consulting services.

ARTICLE II

The Loan

Section 2.01. ADB agrees to lend to the Borrower from ADB's Special Funds resources an amount in various currencies equivalent to thirty one million four hundred eighty-one thousand Special Drawing Rights (SDR 31,481,000).

Section 2.02. (a) The Borrower shall pay to ADB an interest charge at the rate of one percent (1%) per annum during the grace period, and one and one-half percent (1.5%) per annum thereafter, on the amount of the Loan withdrawn from the Loan Account and outstanding from time to time.

(b) The term "grace period" as used in paragraph (a) of this Section means the period prior to payment of the first principal amount of the Loan on the payment date in accordance with the amortization schedule set forth in Schedule 2 to this Loan Agreement.

Section 2.03. The interest charge and any other charge on the Loan shall be payable semiannually on 15 May and 15 November in each year.

Section 2.04. The Borrower shall repay the principal amount of the Loan withdrawn from the Loan Account in accordance with the amortization schedule set forth in Schedule 2 to this Loan Agreement.

Section 2.05. The currency of repayment of the principal of the Loan and the currency of payment of the interest charge for the purposes of Sections 4.03(a) and 4.04 of the Loan Regulations shall be Dollar.

ARTICLE III

Use of Proceeds of the Loan

Section 3.01. (a) The Borrower shall make available the proceeds of the Loan to NWSDB as a loan and a grant under a Subsidiary Financing Agreement upon terms and conditions satisfactory to ADB. Except as ADB may otherwise agree, the Borrower shall make available the proceeds of the Loan to NWSDB as follows:

- (i) eighty-five percent (85%) of funding for water supply schemes in Pradeshiya Sabhas as a grant and fifteen percent (15%) as a loan;
- (ii) for urban councils and municipal councils, fifty percent (50%) of funding as a grant and fifty percent (50%) as a loan; and
- (iii) for rural water supply and sanitation systems implemented by communities, one hundred percent (100%) of funding as a grant.

(b) Except as ADB may otherwise agree, the terms for loan from the Borrower to NWSDB under the Subsidiary Financing Agreement shall include interest at the rate of ten percent (10%) per annum (inclusive of foreign exchange risk) and a repayment period of twenty-four (24) years including a grace period of five (5) years.

(c) The Borrower shall cause NWSDB to apply the proceeds of the Loan to the financing of expenditures on the Project in accordance with the provisions of this Loan Agreement and the Project Agreement.

Section 3.02. The Goods, Works and consulting services and other items of expenditure to be financed out of the proceeds of the Loan and the allocation of amounts of the Loan among different categories of such Goods, Works and consulting

services and other items of expenditure shall be in accordance with the provisions of Schedule 3 to this Loan Agreement, as such Schedule may be amended from time to time by agreement between the Borrower and ADB.

Section 3.03. Withdrawals from the Loan Account in respect of Goods, Works and consulting services shall be made only on account of expenditures relating to

- (a) Goods which are produced in and supplied from and services which are supplied from such member countries of ADB as shall have been specified by ADB from time to time as eligible sources for procurement, and
- (b) Goods, Works and consulting services which meet such other eligibility requirements as shall have been specified by ADB from time to time.

Section 3.04. Except as ADB may otherwise agree, all Goods, Works and consulting services to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 4 to this Loan Agreement.

Section 3.05. The Loan Closing Date for the purposes of Section 8.02 of the Loan Regulations shall be 30 June 2010 or such other date as may from time to time be agreed between the Borrower and ADB.

ARTICLE IV

Particular Covenants and Incorporation of Amendments and Provisions of the Initial Loan Agreement

Section 4.01. (a) In the carrying out of the Project and operation of the Project facilities, the Borrower and NWSDB shall perform, or cause to be performed, all of their respective obligations set forth in Schedule 5 to this Loan Agreement and Schedule 6 to the Initial Loan Agreement. Subject to the provisions of this Loan Agreement, all of the provisions of Schedule 6 to the Initial Loan Agreement are hereby incorporated in this Loan Agreement and shall have the same force and effect as if they were fully set forth herein.

(b) Section 1.02(v) of the Initial Loan Agreement is hereby replaced with the following:

“Project area” means the districts of Anuradhapura, Batticaloa and Polonnaruwa Districts for the Rural Component and towns of Batticaloa, Hambantota, Muttur and Polonnaruwa for the Urban Component;

(c) Paragraph 2(a) and (b) of Schedule 1 to the Initial Loan Agreement is hereby replaced with paragraph 2(a) and (b), respectively, of Schedule 1 to this Loan Agreement.

Section 4.02. The Borrower shall enable ADB's representatives to inspect the Project, the Goods and Works financed out of the proceeds of the Loan, all other plants, sites, properties and equipment of the Borrower, and any relevant records and documents.

Section 4.03. The Borrower shall take all action which shall be necessary on its part of enable NWSDB to perform its obligations under the Project Agreement, including the revision in the tariffs as stipulated in paragraph 9 of Schedule 5 to this Loan Agreement, and shall not take or permit any action which would interfere with the performance of such obligations.

Section 4.04. (a) The Borrower shall exercise its rights under the Subsidiary Financing Agreement in such a manner as to protect the interests of the Borrower and ADB and to accomplish the purposes of the Loan.

(b) No rights or obligations under the Subsidiary Financing Agreement shall be assigned, amended, or waived without the prior concurrence of ADB.

ARTICLE V

Suspension; Cancellation; Acceleration of Maturity

Section 5.01. The following are specified as additional events for suspension of the right of the Borrower to make withdrawals from the Loan Account for the purposes of Section 8.01(m) of the Loan Regulations:

(a) the Borrower shall have failed to perform any of its obligations under the Ordinary Operations Loan Agreement or the Initial Loan Agreement; and

(b) the Borrower or NWSDB shall have failed to perform any of their obligations under the Subsidiary Financing Agreement.

Section 5.02. The following is specified as an additional event for acceleration of maturity for the purposes of Section 8.07(d) of the Loan Regulations: any of the events specified in Section 5.01 of this Loan Agreement shall have occurred.

ARTICLE VI

Effectiveness

Section 6.01. The following is specified as an additional condition to the effectiveness of this Loan Agreement for the purposes of Section 9.01(f) of the Loan Regulations: the Subsidiary Financing Agreement, in a form and substance acceptable to

ADB, shall have been duly authorized or ratified, executed and delivered on behalf of, the Borrower and NWSDB, and is legally binding upon them in accordance with its terms.

Section 6.02. The following is specified as an additional matter, for the purposes of Section 9.02(d) of the Loan Regulations, to be included in the opinion or opinions to be furnished to ADB: that the Subsidiary Financing Agreement has been duly authorized or ratified by, and executed and delivered on behalf of, the Borrower and NWSDB, and is legally binding upon them in accordance with its terms.

Section 6.03. A date ninety (90) days after the date of this Loan Agreement is specified for the effectiveness of the Loan Agreement for the purposes of Section 9.04 of the Loan Regulations.

ARTICLE VII

Delegation of Authority

Section 7.01. The Borrower hereby designates NWSDB its agent for the purposes of taking any action or entering into any agreement required or permitted under Sections 3.02 and 3.05 of this Loan Agreement and under Sections 5.01, 5.02, 5.03 and 5.04 of the Loan Regulations.

Section 7.02. Any action taken or any agreement entered into by NWSDB pursuant to the authority conferred under Section 7.01 of this Loan Agreement shall be fully binding on the Borrower and shall have the same force and effect as if taken by the Borrower.

Section 7.03. The authority conferred on NWSDB under Section 7.01 of this Loan Agreement may be revoked or modified by agreement between the Borrower and ADB.

ARTICLE VIII

Miscellaneous

Section 8.01. The Secretary, Ministry of Finance and Planning of the Borrower is designated as representative of the Borrower for the purposes of Section 11.02 of the Loan Regulations.

Section 8.02. The following addresses are specified for the purposes of Section 11.01 of the Loan Regulations:

For the Borrower

The Secretary
Ministry of Finance and Planning
Secretariat
Colombo 1, Sri Lanka

Copy: Deputy Secretary to the Treasury
Director General, External Resources Department

Cable Address:

SECMINFIN
COLOMBO

Telex Number:

21232 FORAID COLOMBO
21409 FINMIN COLOMBO

Facsimile Number:

(9411) 244-9823
(9411) 244-7633.

For ADB

Asian Development Bank
P.O. Box 789
0980 Manila, Philippines

Cable Address:

ASIANBANK
MANILA

Telex Numbers:

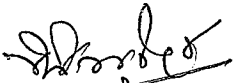
29066 ADB PH (RCA)
42205 ADB PM (ITT)
63587 ADB PN (ETPI)

Facsimile Numbers:


(632) 636-2444
(632) 636-2293.

IN WITNESS WHEREOF the parties hereto, acting through their representatives thereunto duly authorized, have caused this Loan Agreement to be signed in their respective names and to be delivered at the principal office of ADB, as of the day and year first above written.

DEMOCRATIC SOCIALIST REPUBLIC
OF SRI LANKA

By 
PUNCHIBANDARA JAYASUNDERA
Secretary
Ministry of Finance and Planning

ASIAN DEVELOPMENT BANK

By 
RICHARD W. A. VOKES
Country Director
Sri Lanka Resident Mission

SCHEDULE 1

Description of the Project

1. The objectives of the Initial Project are to (i) deliver safe water to approximately 969,000 people; (ii) provide sanitation to approximately 171,500 people; and (iii) increase the financial and institutional sustainability of NWSDB and the institutional capacity of the Provincial Councils, Pradeshiya Sabhas and CBOs participating in the Project. The Project will help in accomplishing these objectives by financing cost overruns incurred under the Initial Project, as amended in this Schedule. The Project shall benefit people living in the rural areas of Anuradhapura, Polonnaruwa and Batticaloa Districts in the North Central and North-East Province and in the towns of Batticaloa, Hambantota, Muttur, and Polonnaruwa.

2. The Project consists of the following Parts:

(a) Part A: Urban Component

The Urban Component shall assist the Borrower to (i) provide new piped water supply systems and improvement of drainage in the towns of Batticaloa and Muttur; (ii) expand the existing water supply systems in the towns of Polonnaruwa and Hambantota; (iii) provide wastewater collection and treatment for Batticaloa Hospital; and (iv) improve drainage in the most densely populated areas of Batticaloa and Muttur.

(b) Part B: Rural Component

The Rural Component shall assist the Borrower to (i) finance a demand driven and community-based rural program to provide water and sanitation in 14 selected Pradeshiya Sabhas of Polonnaruwa and Anuradhapura Districts in North Central Province, and Batticaloa District in the North-East Province; (ii) provide an estimated 322,000 people with safe water and 138,000 people with latrines through subprojects selected during project implementation in consultation with CBOs, NGOs, Pradeshiya Sabha technical officers and beneficiaries; and (iii) provide institutional support for the North Central Provincial Council and for participating Pradeshiya Sabhas and CBOs to develop their capacity to implement, operate and maintain water supply schemes and sanitation facilities and assure the sustainability of water supply after Project completion.

3. The Project is expected to be completed by 31 December 2009.

SCHEDULE 2**Amortization Schedule****(Secondary Towns and Rural Community-Based Water Supply and Sanitation Project -
Supplementary)**

<u>Date Payment Due</u>	<u>Payment of Principal</u> (expressed in Special Drawing Rights)*
15-May-2015	655,854.00
15-Nov-2015	655,854.00
15-May-2016	655,854.00
15-Nov-2016	655,854.00
15-May-2017	655,854.00
15-Nov-2017	655,854.00
15-May-2018	655,854.00
15-Nov-2018	655,854.00
15-May-2019	655,854.00
15-Nov-2019	655,854.00
15-May-2020	655,854.00
15-Nov-2020	655,854.00
15-May-2021	655,854.00
15-Nov-2021	655,854.00
15-May-2022	655,854.00
15-Nov-2022	655,854.00
15-May-2023	655,854.00
15-Nov-2023	655,854.00
15-May-2024	655,854.00
15-Nov-2024	655,854.00
15-May-2025	655,854.00
15-Nov-2025	655,854.00
15-May-2026	655,854.00
15-Nov-2026	655,854.00
15-May-2027	655,854.00
15-Nov-2027	655,854.00
15-May-2028	655,854.00
15-Nov-2028	655,854.00
15-May-2029	655,854.00
15-Nov-2029	655,854.00
15-May-2030	655,854.00
15-Nov-2030	655,854.00
15-May-2031	655,854.00
15-Nov-2031	655,854.00
15-May-2032	655,854.00
15-Nov-2032	655,854.00
15-May-2033	655,854.00

<u>Date Payment Due</u>	<u>Payment of Principal</u> (expressed in Special Drawing Rights)*
15-Nov-2033	655,854.00
15-May-2034	655,854.00
15-Nov-2034	655,854.00
15-May-2035	655,854.00
15-Nov-2035	655,854.00
15-May-2036	655,854.00
15-Nov-2036	655,854.00
15-May-2037	655,854.00
15-Nov-2037	655,854.00
15-May-2038	655,854.00
15-Nov-2038	655,862.00
TOTAL	31,481,000.00

* The figures in this column represent SDR equivalents determined as of the respective dates of withdrawal. The arrangements for payment of each maturity are subject to the provisions of Sections 3.04 and 4.03 of the Loan Regulations.

SCHEDULE 3

Allocation and Withdrawal of Loan Proceeds

General

1. The table attached to this Schedule sets forth the Categories of Goods, Works, services and other items to be financed out of the proceeds of the Loan and the allocation of amounts of the Loan to each such Category (hereinafter called the Table). (Reference to "Category" or "Categories" in this Schedule is to a Category or Categories of the Table.)

Percentages of ADB Financing

2. Except as ADB may otherwise agree, the items of the Categories listed in the Table shall be financed out of the proceeds of the Loan on the basis of the percentages set forth in the Table.

Interest Charge

3. The amount allocated to Category 3 is for financing the interest charge on the Loan during the implementation period of the Project.

Reallocation

4. Notwithstanding the allocation of Loan proceeds and the withdrawal percentages set forth in the Table,

(a) if the amount of the Loan allocated to any Category appears to be insufficient to finance all agreed expenditures in that Category, ADB may, by notice to the Borrower, (i) reallocate to such Category, to the extent required to meet the estimated shortfall, amounts of the Loan which have been allocated to another Category but, in the opinion of ADB, are not needed to meet other expenditures, and (ii) if such reallocation cannot fully meet the estimated shortfall, reduce the withdrawal percentage applicable to such expenditures in order that further withdrawals under such Category may continue until all expenditures thereunder shall have been made; and

(b) if the amount of the Loan then allocated to any Category appears to exceed all agreed expenditures in that Category, ADB may, by notice to the Borrower, reallocate such excess amount to any other Category.

Disbursement Procedures

5. Except as ADB may otherwise agree, all Goods, Works and consulting services and other items to be financed out of the Loan proceeds shall be disbursed in accordance with ADB's "Loan Disbursement Handbook" dated January 2001 (ADB's Loan Disbursement Handbook), as amended from time to time.

Imprest Account: Statement of Expenditures

6. (a) Except as ADB may otherwise agree, the Borrower shall establish immediately after the Effective Date, an imprest account at the Central Bank of Sri Lanka. The imprest account shall be established, managed, replenished and liquidated in accordance with ADB's Loan Disbursement Handbook and detailed arrangements agreed upon between the Borrower and ADB. The currency of the imprest account shall be Dollar. The initial amount to be deposited into the imprest account shall not exceed the lower of (i) the estimated expenditure for the first six months of Project implementation, or (ii) the equivalent of ten (10) percent of the Loan amount.

(b) The statement of expenditures (SOE) procedure may be used for reimbursement of eligible expenditures for the Project and to liquidate advances provided into the imprest accounts, in accordance with ADB's Loan Disbursement Handbook and detailed arrangements agreed upon between the Borrower and ADB. Any individual payment to be reimbursed or liquidated under the SOE procedure shall not exceed the equivalent of \$100,000.

TABLE

ALLOCATION AND WITHDRAWAL OF LOAN PROCEEDS (Secondary Towns and Rural Community - Based Water Supply and Sanitation Project - Supplementary)			
CATEGORY			ADB FINANCING
Number	Item	Amount Allocated SDR Category	Percentage and Basis for Withdrawal from the Loan Account
1	Works	17,270,000	67 percent of total expenditure
2	Equipment and Materials	8,977,000	76 percent of total expenditure*
3	Interest Charge	896,000	100 percent of amount due
4	Unallocated	4,338,000	
	Total	31,481,000	

* Exclusive of duties and taxes.

SCHEDULE 4

Procurement of Goods and Works, and Consulting Services

A. General

1. All Goods and Works, and consulting services, to be financed out of the proceeds of the Loan shall be subject to and governed by the Procurement Guidelines, and the Consulting Guidelines, respectively.

2. All terms used and not otherwise defined in this Loan Agreement have the meanings provided in the Procurement Guidelines and/or the Consulting Guidelines, as applicable.

B. Procurement for Goods and Works

3. Except as ADB may otherwise agree, Goods and Works shall only be procured on the basis of the methods of procurement set forth below:

International Competitive Bidding
National Competitive Bidding

The methods of procurement are subject to, among other things, the detailed arrangements and threshold values set forth in the Procurement Plan. The Borrower may only modify the methods of procurement or threshold values with the prior agreement of ADB, and modifications must be set out in updates to the Procurement Plan.

4. Domestic Preference. The Borrower may grant a margin of preference in the evaluation of bids under international competitive bidding in accordance with paragraphs 2.55(a) and 2.56 of the Procurement Guidelines for domestically manufactured Goods and paragraphs 2.55(b) and 2.56 of the Procurement Guidelines for domestic Works.

5. National Competitive Bidding. No procurement activity may be undertaken under national competitive bidding until ADB and the Borrower have agreed in writing on any necessary modifications or clarifications to Borrower's *Procurement Guidelines (Goods & Works)*, 2006, for purposes of this Project to ensure consistency with ADB's Procurement Guidelines. Any such modifications or clarifications shall be subsequently reflected in the Procurement Plan and are hereby incorporated by reference to this Loan Agreement.

6. Community Participation in Procurement. The Borrower may use community participation in procurement for Works contracts for the Rural Component in accordance with the agreed procedures set out in the Procurement Plan.

C. Selection of Consulting Services

7. Quality- and Cost-Based Selection. Except as ADB may otherwise agree, and except as set forth in the paragraph below, the Borrower shall apply quality- and cost-based selection for selecting and engaging consulting services.

8. The Borrower shall apply the following method for selecting and engaging the specified consulting services, in accordance with, among other things, the procedures set forth in the Procurement Plan:

Single Source Selection for package B

D. Industrial or Intellectual Property Rights

9. (a) The Borrower shall ensure that all Goods and Works procured (including without limitation all computer hardware, software and systems, whether separately procured or incorporated within other goods and services procured) do not violate or infringe any industrial property or intellectual property right or claim of any third party.

(b) The Borrower shall ensure that all contracts for the procurement of Goods and Works contain appropriate representations, warranties and, if appropriate, indemnities from the contractor or supplier with respect to the matters referred to in subparagraph (a) of this paragraph.

10. The Borrower shall ensure that all ADB-financed contracts with consultants contain appropriate representations, warranties and, if appropriate, indemnities from the consultants to ensure that the consulting services provided do not violate or infringe any industrial property or intellectual property right or claim of any third party.

E. ADB's Review of Procurement Decisions

11. All contracts procured under international competitive bidding procedures and contracts for consulting services shall be subject to prior review by ADB, unless otherwise agreed between the Borrower and ADB and set forth in the Procurement Plan.

SCHEDULE 5

Execution of Project and Operation of Project Facilities

Implementation Arrangements

1. NWSDB shall be the Project Executing Agency. The Borrower and NWSDB shall ensure that the Project is implemented in accordance with Schedule 6 to the Initial Loan Agreement and provisions of this Schedule.

Counterpart Funds

2. The Borrower shall ensure that during each year of the Project implementation, adequate budgetary allocations of required counterpart funds are made and released by the relevant authorities on a timely and regular basis by 31 December.

Land Acquisition and Resettlement

3. The Borrower and NWSDB shall ensure (and NWSDB shall obtain assurance from the Land Acquisition Section) that all land, land rights, rights-of way, and other land-related rights, and all water and water-related rights for the Project are acquired and the payment of replacement costs for land acquired is made in accordance with (a) the Borrower's *National Involuntary Resettlement Policy, 2001*; (b) ADB's *Policy on Involuntary Resettlement, 1995*; (c) the short resettlement plans for the Project; and (d) the agreed compensation plan for the Project. The Borrower shall ensure that compliance with this paragraph is covered in the quarterly progress reports to be submitted by the Borrower to ADB.

Environment

4. The Borrower and NWSDB shall ensure that (a) the Project is continued to be carried out in accordance with the existing environmental laws and regulations of Sri Lanka and ADB's *Environment Policy, 2002*; (b) all monitoring and mitigation measures indicated in the initial environmental examination and the CEA environmental approval documents, and provided for under the environmental management plan are undertaken for the Project; and (c) Project implementation shall include consultation with local communities on environmental issues.

Subproject Selection

5. The Borrower and NWSDB shall ensure that rural PSIUs select subprojects that meet selection criteria satisfactory to ADB, including the entry by CBOs and Pradeshiya Sabhas into agreements relating to management, regulation, and distribution of water.

Tariffs; Operation Plan

6. The Borrower shall ensure that water tariffs are set by NWSDB for the schemes maintained by NWSDB or as determined by any amendments to NWSDB Act.

Schedule 5

7. The Borrower and local governments shall prepare by 31 December of each year an operation plan of the next fiscal year and within 2 months thereafter submit a copy to ADB.

8. The Borrower shall ensure that NWSDB submits to ADB before 28 February of each year (a) end of year income statement for the previous year (inclusive of O&M, service debt and depreciation) and (b) annual projections (inclusive of O&M, service debt and depreciation) for the year of concern. In the event that (b) were a negative value, the Borrower shall ensure that NWSDB implements, within 6 months of the above date, the necessary water and sewerage tariff revisions required to secure a positive net income in each of these sectors, respectively.

9. The Borrower shall ensure that NWSDB (a) has introduced a sewerage charge and revised it to accommodate O&M cost recovery for the year of concern, and (b) has revised water tariffs in accordance with paragraph 8 of this Schedule and to ensure coverage of O&M of the schemes developed under the Project within the design period.

10. The Borrower shall ensure that NWSDB implements the financial and operational performance indicators set forth in its corporate strategy, 2002, as improved from time to time.

Anticorruption, Good Governance and Transparency

11. The Borrower and NWSDB acknowledge that consistent with its commitment to good governance, accountability and transparency, ADB reserves the right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive, or coercive practices relating to the Project. The Borrower and NWSDB shall ensure that (a) relevant provisions of ADB's *Anticorruption Policy*, are included in the bidding documents for the Project; (b) all contracts financed by ADB in connection with the Project include provisions specifying the right of ADB to audit and examine the records and accounts of NWSDB and all contractors, suppliers, consultants, and other service providers as they relate to the Project.

12. The Borrower and NWSDB shall ensure that additional specific measures to enhance governance and prevent corruption are introduced and implemented under the Project. The measures include, but are not limited to: (i) continued consultant support to PMU staff on procurement, training and financial management; (ii) continued use of information technology to increase transparency, accountability and efficiency; (iii) development of relevant standard operating procedures to ensure that all representation letters are shared with ADB and attended to within 3 weeks of receipt. The Borrower and NWSDB shall ensure that audit systems shall be strengthened (internally through the audit committee and externally through the Auditor General of the Borrower), and (ii) the management and employees adherence to codes of conduct.

Schedule 5

13. The Borrower and NWSDB shall ensure that specific measures are adopted and implemented to enhance transparency under the Project. The measures include, but are not limited to: (i) random and independent spot checks by ADB review missions on procurement and accounts of the Project; (ii) public disclosure through NWSDB's or the Project's website of information on (a) bidding procedures, bidders and contract awards for the Project, and (b) use of the funds disbursed under the Project; (iii) involvement of beneficiaries in monitoring and evaluation of Project implementation; (iv) transparent process of selection and approval of rural Pradeshia Sabhas allowing the communities on site to access such information. The measures to enhance managerial and procurement capacity include, but are not limited to the following: (i) in the case of prequalification of contractors, the PMU shall undertake a process of verification to meet the specified qualification criteria, making the results available on the website, (ii) tender capacity shall be mandatory criteria for award of contracts, and (iii) implementation and evaluation of the Institutional Strengthening Component under the Initial Project shall be strictly reviewed to determine the level of operational performance and financial management improvement within NWSDB.