

CONFORMED COPY

CREDIT NUMBER 3058 CE

Development Credit Agreement

(Mahaweli Restructuring and Rehabilitation Project)

between

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated April 30, 1998

CREDIT NUMBER 3058 CE

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated April 30, 1998, between DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement, has requested the Association to assist in the financing of the Project; and

WHEREAS the Association has agreed, on the basis, inter alia, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Development Credit Agreements" of the Association, dated January 1, 1985, with the modifications set forth below (the General Conditions) constitute an integral part of this Agreement:

- (a) The last sentence of Section 3.02 is deleted.
- (b) The second sentence of Section 5.01 is modified to read:

"Except as the Association and the Borrower shall otherwise agree, no withdrawals shall be made: (a) on account of expenditures in the territories of any country which is not a member of the Bank or for goods produced in, or services supplied from, such territories; or (b) for the purpose of any payment to persons or entities, or for any import of goods, if such payment or import, to the knowledge of the Association, is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations."

(c) Section 6.03 is modified to read:

"Section 6.03. Cancellation by the Association. If (a) the right of the Borrower to make withdrawals from the Credit Account shall have been suspended with respect to any amount of the Credit for a continuous period of thirty days, or (b) at any time, the Association determines, after consultation with the Borrower, that an amount of the Credit will not be required to finance the Project's costs to be financed out of the proceeds of the Credit, or (c) at any time, the Association determines, with respect to any contract to be financed out of the proceeds of the Credit, that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Credit during the procurement or the execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Association to remedy the situation, and establishes the amount of expenditures in respect of such contract which would otherwise have been eligible for financing out of the proceeds of the Credit, or (d) at any time, the Association determines that the procurement of any contract to be financed out of the proceeds of the Credit is inconsistent with the procedures set forth or referred to in the Development Credit Agreement and establishes the amount of expenditures in respect of such contract which would otherwise have been eligible for financing out of the proceeds of the Credit, or (e) after the Closing Date, an amount of the Credit shall remain unwithdrawn from the Credit Account, the Association may, by notice to the Borrower, terminate the right of the Borrower to make withdrawals with respect to such amount. Upon the giving of such notice, such amount of the Credit shall be cancelled."

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions have the respective meanings therein set forth and the following additional terms have the following meanings:

- (a) "Act" means the Mahaweli Authority of Sri Lanka Act No. 23 of 1979;
- (b) "DCFOs" means Distributory Canal Farmer Organizations established under the relevant laws of the Borrower for the purposes, inter alia, of managing and operating the distributory and field canals in the Mahaweli Area;
- (c) "Fiscal Year" or "FY" means the fiscal year of the Borrower and MASL beginning on January 1 and ending on December 31;
- (d) "Implementing Agency" means MASL or any other entity, acceptable to the Association, that may be established as a result of the transformation of MASL pursuant to the provisions of paragraph 8 of Schedule 4 to this Agreement;
- (e) "LDD" means the Livestock Development Division within MASL;
- (f) "Mahaweli Area" means the area within the jurisdiction of MASL;
- (g) "Mahaweli Master Plan" means the plan as recorded in the Mahaweli Ganga Irrigation and Hydropower Survey Ceylon, FAO/SF: 55/CEY 7, Rome, 1969;
- (h) "MASL" means the Mahaweli Authority of Sri Lanka as established under the Act;
- (i) "MECA" means the Mahaweli Engineering and Construction Agency within the Mahaweli Authority;
- (j) "MMD" means the Ministry of Mahaweli Development of the Borrower;

(k) "International Panel of Experts" means the panel of experts appointed by the Borrower in accordance within the provisions of paragraph 9 of Schedule 4 to this Agreement;

(l) "PIU" means the Project Implementation Unit established by MASL in a manner satisfactory to the Association;

(m) "PSC" means the Project Steering Committee established by the Borrower in a manner satisfactory to the Association;

(n) "Project Preparation Advance" means the project preparation advance granted by the Association to the Borrower pursuant to an exchange of letters dated August 2, 1996 and August 12, 1996 between the Borrower and the Association;

(o) "Special Account" means the account referred to in Section 2.02 (b) of this Agreement;

(p) "Special Area" means a special area as defined in the Act;

(q) "System H" means the area defined as System H under the Mahaweli Master Plan and designated as a Special Area by the Order No. 2 of 1979 published in the Gazette of the Borrower dated June 25, 1979; and

(r) "VESP" means the Voluntary Early Separation Package formulated by MASL and offered to its staff employed in those categories deemed to be overstaffed pursuant to the findings of the Workforce Analysis Study and Staffing Plan for the MASL.

## ARTICLE II

### The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to forty-one million seven hundred thousand Special Drawing Rights (SDR 41,700,000).

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods and services required for the Project described in Schedule 2 to this Agreement and to be financed out of the proceeds of the Credit.

(b) The Borrower may, for the purposes of the Project, open and maintain in dollars a special deposit account in its Central Bank on terms and conditions satisfactory to the Association. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 5 to this Agreement.

(c) Promptly after the Effective Date, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and pay to itself the amount required to repay the principal amount of the Project Preparation Advance withdrawn and outstanding as of such date and to pay all unpaid charges thereon. The unwithdrawn balance of the authorized amount of the Project Preparation Advance shall thereupon be canceled.

Section 2.03. The Closing Date shall be December 31, 2003 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at

the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent ( $3/4$  of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semi-annually on March 1 and September 1 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semi-annual installments payable on each March 1 and September 1 commencing September 1, 2008, and ending March 1, 2038. Each installment to and including the installment payable on March 1, 2018 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by: (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semi-annual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

### ARTICLE III

#### Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out the Project through the Implementing Agency with due diligence and efficiency and in conformity with appropriate administrative, financial, agricultural and engineering

practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Borrower and the Association shall otherwise agree, the Borrower shall carry out the Project in accordance with the Implementation Program set forth in Schedule 4 to this Agreement.

Section 3.02. Except as the Association shall otherwise agree, procurement of the goods, works and consultants' services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to this Agreement.

Section 3.03. For the purposes of Section 9.07 of the General Conditions and without limitation thereto, the Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Association, and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, a plan for the future operation of the Project; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

#### ARTICLE IV

##### Financial Covenants

Section 4.01. (a) The Borrower shall maintain or cause to be maintained records and accounts adequate to reflect in accordance with sound accounting practices the operations, resources and expenditures in respect of the Project of the departments or agencies of the Borrower responsible for carrying out the Project or any part thereof.

(b) The Borrower shall:

(i) have the records and accounts referred to in paragraph (a) of this Section including those for the Special Account for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association;

(ii) furnish to the Association, as soon as available, but in any case not later than six months after the end of each such year, the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested; and

(iii) furnish to the Association such other information concerning said records and accounts and the audit thereof as the Association shall from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of statements of expenditure, the Borrower shall:

(a) of this (i) maintain or cause to be maintained, in accordance with paragraph Section, records and accounts reflecting such expenditures;

(ii) retain, until at least one year after the Association has received the audit report for the fiscal year in which the last withdrawal from the Credit Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;

(iii) enable the Association's representatives to examine such records; and

(iv) ensure that such records and accounts are included in the annual audit referred to in paragraph (b) of this Section and that the

report of such audit as to whether the statements of year, together with the procedures their preparation, can be relied upon to withdrawals. contains a separate opinion by said auditors expenditure submitted during such fiscal and internal controls involved in support the related

#### ARTICLE V

##### Remedies of the Association

Section 5.01. Pursuant to Section 6.02 (h) of the General Conditions, the following additional event is specified, namely, that the Act and any other legislation or regulation of the Borrower governing the establishment, organization and powers of the Implementing Agency shall have been amended, suspended, abrogated, repealed, waived, or shall cease to be enforced, so as to materially and adversely affect the ability of the Implementing Agency to carry out the Project, provided, however, that this provision shall not apply to any changes to the Act that are made for the purpose of restructuring MASL to the extent that the ability of MASL or another entity resulting from such restructuring to carry out the Project is not materially and adversely affected thereby.

Section 5.02. Pursuant to Section 7.01(d) of the General Conditions, the following additional event is specified, namely, that the event specified in Section 5.01 of this Agreement shall occur.

#### ARTICLE VI

##### Effective Date; Termination

Section 6.01. The following event is specified as an additional condition to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions, namely, that the Borrower has selected auditors for the Project satisfactory to the Association, pursuant to Section 4.01 hereof.

Section 6.02. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

#### ARTICLE VII

##### Representative of the Borrower; Addresses

Section 7.01. The Secretary, or the Director General, External Resources Department, Ministry of Finance and Planning of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance and Planning  
Democratic Socialist Republic of Sri Lanka  
Colombo, Sri Lanka

Cable address:

SECMINFIN  
Colombo

Telex:

FINMIN 21409  
FORAID 21232

For the Association:

International Development Association  
1818 H Street, N.W.  
Washington, D.C. 20433  
United States of America

Cable address:

INDEVAS  
Washington, D.C.

Telex:

248423 (MCI) or  
64145 (MCI)

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

By /s/ Warnasena Rasaputram

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Mieko Nishimizu

Regional Vice President  
South Asia

#### SCHEDULE 1

##### Withdrawal of the Proceeds of the Credit

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

Category	Amount of the Credit Allocated (Expressed in SDR Equivalent)	% of Expenditures to be Financed
(1) Civil works	20,500,000	80%
(2) Equipment and vehicles	1,830,000	100% of foreign expenditures, 100% of local expenditures (ex-factory cost) and 70% of local expenditures for other items procured locally
(3) Consultants' services and training	2,200,000	100%
(4) Severance payments	13,880,000	80%
(5) Incremental O&M costs	370,000	80%
(6) Refunding of Project Preparation Advance	400,000	Amount due pursuant to Section 2.02 (c) of this Agreement
(7) Unallocated	<u>2,520,000</u>	

TOTAL 41,700,000

2. For the purposes of this Schedule:

(a) the term "foreign expenditures" means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower;

(b) the term "local expenditures" means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;

(c) the term "severance payments" means payments to MASL staff who receive a voluntary early separation package under the VESP; and

(d) the term "incremental O&M costs" means the expenditures incurred by the Implementing Agency under the Project for the operation and maintenance of vehicles and equipment.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding the equivalent of SDR 4,170,000, may be made in respect of Category 4 on account of payments made for expenditures before that date but after November 1, 1997.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures: (a) for goods and works under contracts not exceeding \$100,000 equivalent; (b) for consulting firms under contracts not exceeding \$100,000 equivalent; (c) for individual consultants under contracts not exceeding \$50,000 equivalent; and (d) under Categories 4 and 5, all under such terms and conditions as the Association shall specify by notice to the Borrower.

## SCHEDULE 2

### Description of the Project

The objectives of the Project are: (a) to shift the focus of MASL from project implementation to river basin management; and (b) to improve agricultural productivity in System H.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objectives:

#### Part A: Institutional Restructuring of MASL

1. Reducing MASL staff to an appropriate level through provision of a voluntary early separation program for selected categories thereof, and retraining and redeployment of remaining staff.

2. Promoting farmer sustainability by strengthening approximately 757 DCFOs through provision of technical assistance, training, vehicles and equipment to take over operation and maintenance of the distributory and field canals serving about 91,000 ha of irrigated land.

3. Provision of technical assistance and training to prepare MECA, LDD and other MASL business units for commercialization/privatization.

4. Handing over MASL constructed roads and buildings to national and local line agencies.

5. Strengthening MASL's natural resource management capacity through provision of technical assistance and training.

#### Part B: Irrigation Rehabilitation and Improvement

Carrying out essential repair and rehabilitation works and improvements where



required on facilities serving about 31,500 ha of irrigated land in System H, including irrigation tanks, main canals, branch canals, distributory canals, field canals, drains and canal bund roads, through provision of civil works, electro-mechanical works, vehicles and equipment.

\* \* \*

The Project is expected to be completed by June 30, 2003.

### SCHEDULE 3

#### Procurement and Consultants' Services

##### Section I. Procurement of Goods and Works

###### Part A: General

Goods and works shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in January 1995 and revised in January and August 1996 (the Guidelines) and the following provisions of Section I of this Schedule.

###### Part B: International Competitive Bidding

1. Except as otherwise provided in Part C of this Section, goods shall be procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.

2. The following provisions shall apply to goods to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Part B. Preference for domestically manufactured goods The provisions of paragraphs 2.54 and 2.55 of the Guidelines and Appendix 2 thereto shall apply to goods manufactured in the territory of the Borrower.

###### Part C: Other Procurement Procedures

###### 1. National Competitive Bidding

Goods estimated to cost less than \$100,000 equivalent per contract, up to an aggregate amount not to exceed \$1,600,000 equivalent, and civil works may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

2. National Shopping Goods estimated to cost less than \$50,000 equivalent per contract, up to an aggregate amount not to exceed \$200,000 equivalent, may be procured under contracts awarded on the basis of national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

###### 3. Direct Contracting

Small field works estimated to cost less than \$10,000 each and which may be carried out by DCFOs and costing \$2,200,000 equivalent or less in the aggregate, may, with the Association's prior agreement, be procured in accordance with the provisions of paragraph 3.7 of the Guidelines.

###### Part D: Review by the Association of Procurement Decisions

###### 1. Procurement Planning

Prior to the issuance of any invitations to prequalify for bidding or to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Association for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Guidelines. Procurement of all goods and works shall be undertaken in accordance with such procurement plan as shall have been approved by the Association, and with the provisions of said paragraph 1.

###### 2. Prior Review

With respect to each contract for goods and civil works estimated to cost the equivalent of \$100,000 or more, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Guidelines shall apply.

Section II. Employment of Consultants

Part A: General

Consultants' services shall be procured in accordance with the provisions of the Introduction and Section IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" published by the Bank in January 1997 (the Consultant Guidelines) and the following provisions of Section II of this Schedule.

Part B: Quality- and Cost-based Selection

1. Except as otherwise provided in Part C of this Section, consultants' services shall be procured under contracts awarded in accordance with the provisions of Section II of the Consultant Guidelines, paragraph 3 of Appendix 1 thereto, Appendix 2 thereto, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

2. The following provisions shall apply to consultants' services to be procured under contracts awarded in accordance with the provisions of the preceding paragraph. The short list of consultants for services under Parts A.2, A.3 and A.5 of the Project, estimated to cost less than \$100,000 equivalent per contract, may comprise entirely national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Part C: Other Procedures for the Selection of Consultants

1. Selection Based on Consultants' Qualifications

Services under Parts A.2, A.3 and A.5 of the Project estimated to cost less than \$100,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.7 of the Consultant Guidelines.

2. Individual Consultants

Services under Parts A.2, A.3 and A.5 of the Project that meet the requirements set forth in paragraph 5.1 of the Consultant Guidelines shall be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines.

Part D: Review by the Association of the Selection of Consultants

1. Selection Planning

Prior to the issuance to consultants of any requests for proposals, the proposed plan for the selection of consultants under the Project shall be furnished to the Association for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Consultant Guidelines. Selection of all consultants' services shall be undertaken in accordance with such selection plan as shall have been approved by the Association, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to each contract for the employment of consulting firms estimated to cost the equivalent of \$100,000 or more, the procedures set forth in paragraphs 1, 2 and (other than the third subparagraph of paragraph 2(a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of \$50,000 or more, the qualifications, experience, terms of reference and terms of employment of the consultants shall be furnished to the Association for its prior review and approval. The contract shall be awarded only after the said approval shall have been given.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

SCHEDULE 4

Implementation Program

1. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators satisfactory to the Association, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association, on or about November 30, 1999 and November 30, 2001, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of each said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following each such date; and

(c) review with the Association, by December 30, 1999 and December 30, 2001, or such later date as the Association shall request, the respective report referred to in paragraph (b) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of each said report and the Association's views on the matter.

2. The Borrower shall cause the Implementing Agency to:

(a) ensure that the separation of staff receiving the VESP is completed no later than August 31, 1998; and

(b) refrain from new recruitment of staff in those categories specified in the VESP and take all budgetary and other measures, satisfactory to the Association, to prevent the recurrence of overstaffing.

3. The Borrower shall cause the Implementing Agency to:

(a) conduct consultations with DCFOs for carrying out irrigation rehabilitation and improvement works under Part B of the Project, and take all steps as may be necessary or required for encouraging joint management of distribution and field canals in the Mahaweli Area with the objective of ultimately transferring these canals to DCFOs under arrangements and in accordance with a time schedule satisfactory to the Association, which shall include a requirement for DCFOs to contribute at least 10% of the capital cost of irrigation rehabilitation and improvement works in respect of these canals; and

(b) ensure that the principles and processes developed for encouraging the participation of DCFOs and the arrangements for transferring the distribution and field canals to DCFOs, all as set out in paragraph 3 (a) hereof are uniformly applied throughout the Mahaweli Area.

4. The Borrower shall cause the Implementing Agency to:

(a) maintain the PIU with adequate staff, powers, functions and resources,

satisfactory to the Association;

(b) ensure that the PIU prepares annual action plans for the implementation of the Project, satisfactory to the Association, and implements the Project in accordance with such plans; and

(c) ensure that the PIU prepares and submits to the Association quarterly reports on the progress of the Project.

5. The Borrower shall cause the Implementing Agency to:

(a) promptly divide MECA into two separate units covering architectural and consultancy functions respectively and operate the LDD and such other units of MASL that the Association may approve as independent business units;

(b) establish for each such business unit a gradually increasing target for revenue generation as a share, satisfactory to the Association, of its costs for the next three years;

(c) furnish to the Association annual accounts of each such business unit for each year referred to in subparagraph (b) of this paragraph audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association within three months after the end of each such year; and

(d) liquidate any business unit which does not meet the revenue generation target established pursuant to subparagraph (b) above as demonstrated by the annual audited accounts to be furnished pursuant to subparagraph (c) of this paragraph within three months of the receipt of the audited accounts for the third year of operation.

6. The Borrower shall:

(a) by December 15, 1998 submit to the Association through MMD a list of all infrastructure constructed by MASL to be transferred to line agencies and the amount of funds required to repair and rehabilitate them and to operate and maintain them;

(b) make adequate provisions in its annual budgets from FY 1999 to FY 2003 to carry out repair and rehabilitation of aforesaid infrastructure in accordance with the list referred to in subparagraph (a) of this paragraph; and

(c) ensure that the infrastructure included in the list referred to in subparagraph (a) of this paragraph are transferred to line agencies in accordance with arrangements and time schedule satisfactory to the Association.

7. The Borrower shall allocate sufficient funds, in amounts satisfactory to the Association, in its annual budget for each Fiscal Year during the implementation of the Project for operation and maintenance of the main and branch canals in the Mahaweli Area.

8. The Borrower shall:

(a) by June 30, 2000, submit to the Association a proposal for refocusing MASL on river basin management in accordance with terms of reference satisfactory to the Association;

(b) by December 31, 2000, discuss with the Association the aforesaid proposal; and

(c) by June 30, 2001, complete the refocusing of MASL taking into account any comments made by the Association and any recommendation made by the International Panel of Experts.

9. For purposes of assisting the Borrower in the carrying out of Part A of the Project, the Borrower shall, by September 30, 1998, establish and thereafter maintain an International Panel of Experts with composition, functions and terms of reference satisfactory to the Association.

10. The Borrower shall maintain the PSC with adequate members, powers, functions and

resources, satisfactory to the Association, for purposes, inter alia, of coordinating and monitoring the implementation of the Project.

#### SCHEDULE 5

##### Special Account

1. For the purposes of this Schedule:

(a) the term "eligible Categories" means Categories 1 through 5 set forth in the table in paragraph 1 of Schedule 1 to this Agreement;

(b) the term "eligible expenditures" means expenditures in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Credit allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and

(c) the term "Authorized Allocation" means an amount equivalent to \$7,000,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 3(a) of this Schedule, provided, however, that unless the Association shall otherwise agree, the Authorized Allocation shall be reduced to an amount equivalent to \$1,000,000 when the proceeds of the Credit initially allocated to Category 4 have been fully disbursed for the purposes specified thereunder, or have been reallocated to another category.

2. Payments out of the Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.

3. After the Association has received evidence satisfactory to it that the Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for deposit into the Special Account of an amount or amounts which do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount or amounts as the Borrower shall have requested.

(b) (i) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposits into the Special Account at such intervals as the Association shall specify.

(ii) Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to paragraph 4 of this Schedule for the payment or replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for eligible expenditures. All such deposits shall be withdrawn by the Association from the Credit Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

(a) if, at any time, the Association shall have determined that all further withdrawals should be made by the Borrower directly from the Credit Account in accordance with the provisions of Article V of the General Conditions and paragraph

(a) of Section 2.02 of this Agreement;

(b) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01 (b)(ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of the records and accounts for the Special Account;

(c) if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to the provisions of Section 6.02 of the General Conditions; or

(d) once the total unwithdrawn amount of the Credit allocated to the eligible Categories, minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions with respect to the Project, shall equal the equivalent of twice the amount of the Authorized Allocation. Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit allocated to the eligible Categories shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If the Association shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association: (A) provide such additional evidence as the Association may request; or (B) deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Association made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.

