

CONFORMED COPY

LOAN NUMBER 4597 CHA

Project Agreement

(Huai River Pollution Control Project)

between

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

and

ANHUI PROVINCE

and

SHANDONG PROVINCE

Dated September 24, 2001

LOAN NUMBER 4597 CHA

PROJECT AGREEMENT

AGREEMENT, dated September 24, 2001, between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and Anhui Province and Shandong Province (collectively, the Project Provinces and, individually, a Project Province).

WHEREAS by the Loan Agreement of even date herewith between the Borrower and the Bank, the Bank has agreed to make available to the Borrower an amount equal to one hundred five million five hundred thousand dollars (\$105,500,000) on the terms and conditions set forth in the Loan Agreement, but only on condition that the Project Provinces agree to undertake such obligations toward the Bank as are set forth in this Agreement; and

WHEREAS the Project Provinces, in consideration of the Bank's entering into the Loan Agreement with the Borrower, has agreed to undertake the obligations set forth in this Agreement;

NOW THEREFORE, the parties hereto hereby agree as follows:

ARTICLE I

Definitions

Section 1.01. Unless the context otherwise requires, the several terms defined in the Loan Agreement, the General Conditions (as so defined in the Loan Agreement) and the preamble to this Agreement have the respective meanings therein set forth.

ARTICLE II

Execution of the Project

Section 2.01. (a) Each Project Province declares its commitment to the objectives of the Project as set forth in Schedule 2 to the Loan Agreement, and, to this end,

- (i) Anhui shall: (A) carry out Parts A.2 and A.3 of the Project; and (B) cause the Respective Project Participants to carry out Parts A.3 and C of the Project and also to carry out Parts A.1 and A.3 of the Project through the concerned Project Company;
- (ii) Shandong shall: (A) carry out Part B.3 of the Project; and (B) cause the Respective Project Participants to carry out Parts B.3 and C of the Project and to carry out Parts B.1, B.2 and B.3 of the Project through the concerned Project Company;

all with due diligence and efficiency and in conformity with appropriate administrative, financial, engineering, and environmental practices, and shall provide, or cause to be provided, 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 Bank and the concerned Project Province shall otherwise agree, each Project Province shall carry out the Project, or cause the Project to be carried out, in accordance with the Implementation Program set forth in Schedule 2 to this Agreement.

Section 2.02. Except as the Bank 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 Loan shall be governed by the provisions of Schedule 1 to this Agreement.

Section 2.03. (a) Each Project Province shall carry out the obligations or cause to be carried out the obligations set forth in Sections 9.04, 9.05, 9.06, 9.07, 9.08 and 9.09 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) in respect of this Agreement.

(b) For the purposes of Section 9.07 of the General Conditions and without limitation thereto, each Project Province shall:

- (i) prepare, on the basis of guidelines acceptable to the Bank, and furnish to the Bank not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Bank and said Project Province, a plan for the future operation of the Project; and
- (ii) afford the Bank a reasonable opportunity to exchange views with said Project Province on said plan.

Section 2.04. (a) Each Project Province shall, at the request of the Bank, exchange views with the Bank with regard to the progress of the Project, the performance of its obligations under this Agreement, and other matters relating to the purposes of the Loan.

(b) Each Project Province shall promptly inform the Bank of any condition which interferes or threatens to interfere with the progress of the Project, the accomplishment of the purposes of the Loan, or the performance by said Project

Province of its obligations under this Agreement.

ARTICLE III

Financial Covenants

Section 3.01. (a) Each Project Province 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 said Project Province, as well as the Project Participants, responsible for carrying out the Project or any part thereof.

(b) Each Project Province shall:

- (i) have the records and accounts referred to in paragraph (a) of this Section for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;
- (ii) furnish to the Bank as soon as available, but in any case not later than six (6) 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 Bank shall have reasonably requested; and
- (iii) furnish to the Bank such other information concerning said records and accounts and the audit thereof, as the Bank shall from time to time reasonably request.

ARTICLE IV

Effective Date; Termination Cancellation and Suspension

Section 4.01. This Agreement shall come into force and effect on the date upon which the Loan Agreement becomes effective.

Section 4.02. This Agreement and all obligations of the Bank and of each Project Province thereunder shall terminate on the date on which the Loan Agreement shall terminate in accordance with its terms, and the Bank shall promptly notify each Province thereof.

Section 4.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

ARTICLE V

Miscellaneous Provisions

Section 5.01. Any notice or request required or permitted to be given or made under this Agreement and any agreement between the parties contemplated by this Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand or by mail, telegram, cable, telex or facsimile to the party to which it is required or permitted to be given or made at such party's address hereinafter specified or at such other addresses as such party shall have designated by notice to the party giving such notice or making such request. Deliveries made by facsimile transmission shall also be confirmed by mail. The addresses so specified are:

For the Bank:

International Bank for
Reconstruction and Development

1818 H Street, NW
Washington, DC 20433
United States of America

Cable address:	Telex:	Facsimile:
INTBAFRAD Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-6391

For Anhui Province:

Anhui Provincial Finance Bureau
238 Funanxi Road
Hefei, Anhui 230061
People's Republic of China

Facsimile:
86-551-5100162

For Shandong Province:

Shandong Project Management Office
46 Jingwu Xiaoweisi Road
Jinan 250001
People's Republic of China

Cable address:	Facsimile:
4102 JINANCHA	86-531-7939754

Section 5.02. Any action required or permitted to be taken, and any documents required or permitted to be executed, under this Agreement on behalf of a Project Province may be taken or executed by the Governor or Vice-Governor of said Project Province, or by such other person or persons as said Governor or Vice-Governor shall designate in writing, and said Project Province shall furnish to the Bank sufficient evidence of the authority and the authenticated specimen signature of each such person.

Section 5.03. This Agreement may be executed in several counterparts, each of which shall be an original, and all collectively but one instrument.

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Beijing, People's Republic of China, as of the day and year first above written.

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

By /s/ Yukon Huang

Authorized Representative

ANHUI PROVINCE

By /s/ Ju Kuilin

Authorized Representative

SHANDONG PROVINCE

By /s/ Ju Kuilin

Authorized Representative

SCHEDULE 1

Procurement

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, September 1997 and January 1999 (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 and works 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 provision shall apply to goods and works to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Part B.

(a) Prequalification

Bidders for contracts for works that include the supply of sewer concrete pipes shall be prequalified in accordance with the provisions of paragraphs 2.9 and 2.10 of the Guidelines.

(b) Grouping of contracts

To the extent practicable: (i) contracts for works shall be grouped in bid packages estimated to cost \$7,000,000 equivalent or more each; and (ii) contracts for goods shall be grouped in bid packages estimated to cost \$200,000 equivalent or more each.

(c) 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 (other than goods manufactured in the Hong Kong Special Administrative Region or the Macau Administrative Region of the Borrower and works carried out by contractors from either of said regions).

Part C: Other Procurement Procedures

1. National Competitive Bidding

Works estimated to cost less than \$7,000,000 equivalent per contract, up to an aggregate amount not to exceed \$138,000,000 equivalent; and (b) goods estimated to cost less than \$200,000 equivalent per contract, up to an aggregate amount not to exceed \$1,150,000 equivalent, 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 \$390,000 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.

Part D: Review by the Bank of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Bank 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 Bank, and with the provisions of said paragraph 1.

2. Prior Review

With respect to each contract for: (i) works estimated to cost the equivalent of \$5,000,000 or more; (ii) goods estimated to cost the equivalent of \$200,000 or more; and (iii) regardless of cost, the first two contracts for goods and the first two contracts for works for each Project Province that is procured in accordance with Part C.1 of Section I of this Schedule, 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 and revised in September 1997 and January 1999 (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.

Part C: Other Procedures for the Selection of Consultants

1. Selection Under a Fixed Budget

Services under Parts A.3 and B.3 of the Project may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.5 of the Consultant Guidelines.

2. Least-cost Selection

Services under Part A.3 of the Project, estimated to cost less than \$200,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

3. Selection Based on Consultants' Qualifications

Services under Parts A.3 and B.3 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.

4. Individual Consultants

Services for tasks that meet the requirements set forth in paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.

Part D: Review by the Bank 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 Bank 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 Bank, 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 (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 Bank 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 2

Implementation Program

For the purposes of Section 2.01(b) of this Agreement, the Implementation Program shall consist of the provisions set forth or referred to below.

Project Management

1. In order to ensure the proper carrying out of the Project, each Project Province shall:

(a) continue to maintain a project management office (the Project Management Office, also referred to as 'PMO'), with functions satisfactory to the Bank, staffed by qualified personnel in adequate numbers, to be responsible for: the overall coordination, management, supervision and quality assurance of Project execution; the

supervision of the procurement of goods and services thereunder; the coordination of training activities; the preparation and furnishing to the Bank of reports and other information thereon; and annual budget preparation for the Project; and

(b) ensure that each of the Respective Project Participants shall continue to maintain a project office with functions satisfactory to the Bank, staffed by qualified personnel in adequate numbers, to be responsible for: the coordination and supervision of the execution of its respective part of the Project and, where applicable, its Project Company's Respective Part of the Project; the supervision of the procurement of goods and services under its respective part of the Project and, where applicable, its Project Company's Respective Part of the Project; and the preparation and furnishing to PMO of reports and other information thereon.

Resettlement Action Plan and Environmental Assessment

2. Each Project Province: (a) shall take, and shall cause the Respective Project Participants and Project Company concerned to take, all measures necessary to ensure that the Project shall be carried out in accordance with the Resettlement Action Plans and the Environmental Assessments; and (b) ensure that any proposed revision of the Resettlement Action Plans or the Environmental Assessments shall be furnished to the Bank for its prior approval.

Financial Arrangements

3. Each Project Province shall allocate to each of the Respective Project Participants an amount of the Loan under arrangements satisfactory to the Bank, which shall include, without limitation, the following principal terms:

(a) The principal amount so made available to each Project Participant shall be the amount in Dollars (on the date, or respective dates, of withdrawal from the Loan Account) of the value of the currency or currencies so withdrawn on account of each Project Participant's respective part of the Project and each Project Company's Respective Part of the Project.

(b) Each Project Province shall recover such principal amount so made available and an amount equal to one percent of such principal amount, over a period of twenty (20) years, inclusive of a grace period of five (5) years, except that the principal amount so made available for purposes of carrying out Part B.2 of the Project shall be recovered over a period of not less than eight (8) years, inclusive of a grace period of three (3) years.

(c) (i) Anhui shall charge interest on such principal amount, withdrawn and outstanding from time to time, at a rate not exceeding the rate of interest applicable from time to time to the Loan pursuant to Section 2.06 of the Loan Agreement; and

(ii) Shandong shall charge interest rate on such principal amount, withdrawn and outstanding from time to time, at a rate not exceeding the rate of interest applicable from time to time to the Loan pursuant to Section 2.06 of the Loan Agreement plus: (A) two tenths of one percent (2/10 of 1%) with respect to the amount of the Loan allocated for the carrying out of Parts B.1 and B.3 of the Project; and (B) five tenths of one percent (5/10 of 1%) with respect to the amount of the Loan allocated for the carrying out of Part B.2 of the Project.

(d) Each Project Province shall charge a commitment charge on such principal amount, not withdrawn from time to time at a rate equal to three fourths of one percent (3/4 of 1%) per annum.

Subsidiary Loan Agreements

4. Each Project Province shall cause each of the Respective Project Participants to relend the portions of the proceeds of the Loan, which was allocated to it pursuant paragraph 3 of this Schedule for the purposes of carrying out its Project Company's Respective Part of the Project, to its Project Company under a subsidiary loan

agreement to be entered into between said Project Participant and each of its Project Company: (a) on the principal terms set forth in Section I of Schedule 3 to this Agreement; and (b) under conditions which shall have been approved by the Bank, and which shall include, without limitation, those set forth in Section II of Schedule 3 to this Agreement.

5. (a) Each Project Province shall ensure that each of the Respective Project Participants causes its Project Company to:

(i) perform, in accordance with the provisions of the Subsidiary Loan Agreement to which said Project Company is a party, all of the obligations of said Project Company therein set forth;

(ii) take or cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable said Project Company to perform such obligations; and

(iii) not take or permit to be taken any action which would prevent or interfere with such performance.

(b) Each Project Province shall exercise, and shall cause each Respective Project Participant to exercise, its rights under each Subsidiary Loan Agreement to which it is a party in such manner as to protect the interests of the Borrower, the Bank, the Project Province concerned and said Project Participant, and to accomplish the purposes of the Loan, and except as the Bank shall otherwise agree, not assign, amend, abrogate or waive any Subsidiary Loan Agreement to which the Project Province or said Project Participant is a party or any provision thereof.

Institutional Development and Training

6. (a) Anhui shall carry out, and shall cause each of the Respective Project Participants and its Project Company to carry out, Part A.3 of the Project in accordance with a time-bound action plan acceptable to the Bank, which said action plan may be modified only with the agreement of the Bank.

(b) Shandong shall carry out, and shall cause each of the Respective Project Participants and its Project Company to carry out, Part B.3 of the Project in accordance with a time-bound action plan acceptable to the Bank, which said action plan may be modified only with the agreement of the Bank.

Maintenance and Quality Control Plan

7. Each Project Province shall cause each of the Respective Project Participants and its Project Company to:

(a) furnish to the Bank by October 31 in each year, beginning on October 31, 2001, an action plan acceptable to the Bank for activities to be carried out the following calendar year to improve the maintenance of drainage and sewerage facilities, to desludge septic tanks, and to improve the quality of industrial wastewater discharges in public sewers; and

(b) begin implementation of said plan by January 1 of the following year, taking into account the Bank's comments thereon.

8. Each Project Province shall furnish to the Bank, as soon as completed, the annual reports on water quality monitoring in the Huai River Basin published by agencies that carry out such monitoring in each Project Province.

Funding by Project Participants

9. Each Project Province shall cause each of the Respective Project Participants to maintain its practice of: (a) carrying out an annual forecast of funds needed to implement its Project Company's Respective Part of the Project; (b) updating such

forecast on a quarterly basis if there is a shortfall in funds needed; and (c) timely allocating and depositing the requisite amount of monies so forecasted and available into a special account for said Project Company.

Monitoring and Reporting

10. Each Project Province 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 Bank, the carrying out of the Project, including the Resettlement Action Plans and the Environmental Assessments, as well as the achievement of the objectives thereof.

(b) Prepare, under terms of reference acceptable to the Bank, and furnish to the Bank semi-annual reports by January 31 and July 31 in each year, beginning on January 31, 2002. Said semi-annual reports shall integrate the results of the monitoring and evaluation activities performed pursuant to subparagraph (a) hereof, cover the physical and financial progress achieved in the carrying out of the Project during the preceding calendar semester and set out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date. The report due on January 31, 2003, shall summarize progress achieved during the period, June 1, 2001, through December 31, 2002.

(c) Prepare, under terms of reference acceptable to the Bank, and furnish to the Bank annual reports by March 31 in each year, beginning on January 31, 2002, on the status of implementation of the Anhui EA and Anhui RAP for Anhui and the status of implementation of the Shandong EA and Shandong RAP for Shandong.

(d) After furnishing each report referred to in subparagraphs (b) and (c) hereof, review said report with the Bank, and promptly take all measures required to ensure the efficient completion of the Project (including, when applicable, the carrying out of the Resettlement Action Plans and the Environmental Assessments) and the achievement of the objectives thereof, based on the conclusions and recommendations of said report and the Bank's views on the matter. The report due on January 31, 2003, that is prepared pursuant to subparagraph (b) hereof shall be reviewed with the Bank by March 31, 2003, or such later date as the Bank shall request.

SCHEDULE 3

Principal Terms and Conditions of the Subsidiary Loan Agreements

For the purposes of paragraph 4 of Schedule 2 to this Agreement, the terms of availability of the Loan proceeds shall be those set forth in Section I of this Schedule 3 and the Subsidiary Loan Agreements shall be entered into on the conditions set forth in Section II of this Schedule 3.

Section I. Terms of Availability

1. The principal amount of each subsidiary loan made by a Project Participant to its Project Company, shall be the amount equivalent in Dollars (on the respective dates of withdrawal from the Loan Account) of the value of the currency or currencies so withdrawn on account of said Project Company's Respective Part of the Project.

2. Each Project Company shall repay such principal amount and an amount equal to one percent of such principal amount over a period of twenty (20) years, inclusive of a grace period of five (5) years, except that Chengwu PM shall repay the principal amount and an amount equal to one percent of such principal amount so made available to it for purposes of carrying out Part B.2 of the Project over a period of not less than eight (8) years, inclusive of a grace period of three (3) years.

3. Each Project Company implementing the Project in Anhui shall pay interest on the principal amount thereof withdrawn and outstanding from time to time at a rate not

less than the rate of interest applicable from time to time to the Loan pursuant to Section 2.06 of the Loan Agreement.

4. Each Project Company implementing the Project in Shandong shall pay interest on the principal amount thereof withdrawn and outstanding from time to time at a rate not exceeding the rate of interest set forth in paragraph 3(c)(ii)(A) of Schedule 2 to this Project Agreement plus two tenths of one percent (2/10 of 1%), except for Chengwu PM which shall pay interest on the principal amount thereof withdrawn and outstanding from time to time at a rate not exceeding the rate of interest set forth in paragraph 3(c)(ii)(B) of Schedule 2 to this Project Agreement plus five tenths of one percent (5/10 of 1%).

5. Each Project Participant shall charge a commitment charge on such principal amount, not withdrawn from time to time at a rate equal to three fourths of one percent (3/4 of 1%) per annum.

Section II. Conditions

The Subsidiary Loan Agreements shall include the following principal conditions.

1. Each Project Company shall undertake to:

(a) carry out the Project Company's Respective Part of the Project with due diligence and efficiency and in accordance with:

(i) appropriate engineering, financial, public utility (except for Chengwu PM) and technical practices; and

(ii) appropriate health, safety and environmental standards acceptable to the Bank, and provide, promptly as needed, the funds, facilities and other resources required for the purpose; and

(b) without limitation on the foregoing take all measures necessary to ensure that the Project Company's Respective Part of the Project shall be implemented in accordance with its Respective RAP and its Respective EA.

2. Each Project Company shall undertake to procure the goods and services to be financed out of the proceeds of the Loan in accordance with the provisions of Schedule 1 to this Agreement, and utilize such goods and services exclusively in the carrying out of its Project Company's Respective Part of the Project.

3. Each Project Company shall undertake to enable the Bank, and the Project Participant concerned to inspect such goods and the sites and works included in its Project Company's Respective Part of the Project, the operation thereof, and any relevant records and documents.

4. Each Project Company shall undertake to take out and maintain with responsible insurers such insurance, against such risks and in such amounts, as shall be consistent with sound business practice, including, without limitation, such insurance to cover hazards incident to the acquisition, transportation and delivery of goods financed out of the proceeds of the Loan to the place of use or installation, any indemnity thereunder to be made payable in a currency freely usable by the Project Company to replace or repair such goods.

5. Each Project Company shall undertake to:

(a) maintain records and accounts adequate to reflect in accordance with consistently maintained sound accounting practices its operations and financial condition;

(b) have its financial statements (balance sheets, statements of income and expenses and related statements) for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors

acceptable to the Bank and the Project Participant concerned;

(c) furnish to the Bank and the Project Province and Project Participant concerned, as soon as available, but in any case not later than six months after the end of each such year:

- (i) certified copies of said financial statements and accounts for such year as so audited; and
- (ii) the report of such audit by said auditors in such scope and detail as the Bank, said Project Province and said Project Participant shall have reasonably requested; and

(d) prepare and furnish to the Bank and the Project Province and the Project Participant concerned all such other information concerning said records, accounts and financial statements, as well as the audit thereof, as the Bank, said Project Province, and said Project Participant shall reasonably request.

6. Each Project Company, except Chengwu PM, shall for each fiscal year, as of 2001, undertake:

(a) to produce total revenues (including, without limitation, the adjustments of the structure or levels of wastewater tariffs), equivalent to not less than the sum of:

- (i) its total operating expenses;
- (ii) the amount by which debt service requirements exceeds the provision for depreciation; and
- (iii) working capital other than minimum cash;

(b) to review, before September 30 in each year and on the basis of forecasts prepared by it and satisfactory to the Bank, whether it would meet the requirements set forth in subparagraph (a) hereof, in respect of such year and the next following fiscal year and furnish to the Bank the results of such review upon its completion; and

(c) if any such review shows that it would not meet the requirements set forth in subparagraph (a) hereof for the fiscal years covered by such review, promptly to prepare an action plan acceptable to the Project Participant concerned and the Bank (including, without limitation, making adjustments to the structure or levels of its tariffs) in order to meet such requirements and promptly take all necessary measures to implement said plan before January 1 of the following calendar year.

7. Each Project Company, except Chengwu PM, shall undertake such measures as shall be necessary to ensure that the accounts receivable resulting from its provision of wastewater services to customers do not exceed an amount equal to the annual average of service fees billed for three (3) months of such services by December 31, 2001, and said amount shall decline progressively thereafter to an amount equal to the annual average of service fees billed for no more than 1.75 months of such service by December 31, 2005.

8. Chengwu PM shall undertake to establish by July 1, 2001, a unit with functions satisfactory to the Bank, staffed by qualified personnel in adequate numbers, to be responsible for: the coordination and supervision of the execution of Part B.2 of the Project; the supervision of the procurement of goods and services thereunder; and the preparation and furnishing to Shandong's PMO of reports and other information thereon.

9. (a) Chengwu PM shall undertake: (i) to maintain a ratio of current assets, determined in accordance with paragraph 11(i) of this Schedule 3, to current liabilities of not less than 2.0; and (ii) to maintain a ratio of current assets, determined in accordance with paragraph 11(j) of this Schedule 3, to current

liabilities of not less than 0.8.

(b) Before October 31 in each of its fiscal years, Chengwu PM shall, on the basis of forecasts prepared by Chengwu PM and satisfactory to the Bank, review whether it would meet the requirements set forth in subparagraph (a) hereof in respect of such year and the next following fiscal year and shall furnish to the Bank the results of such review upon its completion.

(c) If any such review shows that Chengwu PM would not meet the requirements set forth in subparagraph (a) hereof for Chengwu PM's fiscal years covered by such review, Chengwu PM shall promptly take all necessary measures (including, without limitation, adjustments of the structure or levels of its rates) in order to meet such requirements.

10. Chengwu PM shall undertake to maintain a debt service ratio coverage of at least 1.2 times and shall not incur any debt unless a reasonable forecast shows that the debt service ratio coverage in all succeeding years is at least 1.5 times.

11. For purposes of this Schedule:

(a) The term "total revenues" means the terms of total operating revenues and net non-operating income.

(b) The term "total operating revenues" means revenues from all sources related to operations.

(c) The term "total operating expenses" means all expenses related to operations, including administration, adequate maintenance, taxes and payments in lieu of taxes, provision for depreciation, but excluding interest and other charges on debt.

(d) The term "debt service requirements" means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges on, debt.

(e) The term "debt " means any indebtedness of a Project Company maturing by its terms more than one year after the date on which it is originally incurred. Debt shall be deemed to be incurred: (i) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract, agreement or instrument; and (ii) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into.

(f) The term "reasonable forecast" means a forecast prepared by a Project Company not earlier than twelve months prior to the incurrence of the debt in question, which both the Bank and said Project Company accept as reasonable and as to which the Bank has notified said Project Company of its acceptability, provided that no event has occurred since such notification which has, or may reasonably be expected in the future to have, a material adverse effect on the financial condition or future operating results of said Project Company.

(g) The term "working capital other than minimum cash" means the difference between current assets, excluding cash in an amount equivalent to one month's cash operating expenses, and current liabilities at the end of each fiscal year.

(h) The term "net non-operating income" means the difference between: (i) revenues from all sources other than those related to operations; and (ii) expenses, including taxes and payments in lieu of taxes, incurred in the generation of revenues in subparagraph (h)(i) hereof.

(i) With respect to paragraph 9(a)(i) of this Schedule 3, the term "current assets" means cash, all assets which could in the ordinary course of business be converted into cash within twelve months, including account receivable, marketable securities, inventories and pre-paid expenses properly chargeable to operating

expenses within the next fiscal year.

(j) With respect to paragraph 9(a)(ii) of this Schedule 3, the term "current assets" means cash, all assets which could in the ordinary course of business be converted into cash within twelve months, including account receivable, marketable securities and pre-paid expenses properly chargeable to operating expenses within the next fiscal year.

(k) The term "current liabilities" means all liabilities which will become due and payable or could under circumstances then existing be called for payment within twelve months, including accounts payable, customer advances, debt service requirements, taxes and payments in lieu of taxes, and dividends.

12. Whenever, for the purposes of this Schedule, it shall be necessary to value, in terms of the currency of the Borrower, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

13. Each Project Participant shall have the right to suspend or terminate the right of its Project Company to the use of the proceeds of the loan made available under the Subsidiary Loan Agreement with said Project Company upon failure by such Project Company to perform its obligations under the agreement.

