



# Report and Recommendation of the President to the Board of Directors

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Project Number: 45301-003  
Loan and Grant Numbers: 3041-LAO and 0363-LAO  
August 2018

## Proposed Grant for Additional Financing Lao People's Democratic Republic: Water Supply and Sanitation Sector Project

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Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 17 July 2018)

Currency unit	–	kip (KN)
KN1.00	=	\$0.0001190
\$1.00	=	KN8,405

## ABBREVIATIONS

ADB	–	Asian Development Bank
DED	–	detailed engineering design
DWS	–	Department of Water Supply
HH	–	household
IEE	–	initial environmental examination
km	–	kilometer
Lao PDR	–	Lao People's Democratic Republic
MPWT	–	Ministry of Public Works and Transport
NRW	–	nonrevenue water
PNP	–	provincial <i>nam papa</i> (provincial water utility)
VEI	–	village environmental improvement
WSS	–	water supply and sanitation

## NOTE

In this report, "\$" refers to United States dollars.

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## PROJECT AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number:</b> 45301-003	
<b>Project Name</b>	Water Supply and Sanitation Sector Project (Additional Financing)	<b>Department /Division</b>	SERD/SEUW
<b>Country Borrower</b>	Lao People's Democratic Republic	<b>Executing Agency</b>	Ministry of Public Works and Transport
<b>2. Sector</b>		<b>ADB Financing (\$ million)</b>	
✓ <b>Water and other urban infrastructure and services</b>	<b>Subsector(s)</b> Urban policy, institutional and capacity development		6.13
	Urban sanitation		1.87
	Urban water supply		22.50
		<b>Total</b>	<b>30.50</b>
<b>3. Strategic Agenda</b>		<b>Subcomponents</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	<b>Climate Change Information</b>	
Environmentally sustainable growth (ESG)	Global and regional transboundary environmental concerns	Adaptation (\$ million)	7.36
	Urban environmental improvement	Climate Change impact on the Project	Medium
<b>4. Drivers of Change</b>		<b>Components</b>	
Governance and capacity development (GCD)	Institutional development	<b>Gender Equity and Mainstreaming</b>	
Partnerships (PAR)	Civil society organizations Implementation	Effective gender mainstreaming (EGM)	✓
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
Geographic Targeting	No	Urban	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG6, SDG9		
<b>6. Risk Categorization:</b>	Low		
<b>7. Safeguard Categorization</b>	Environment: B Involuntary Resettlement: B Indigenous Peoples: C		
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>30.50</b>	
Sovereign Project grant: Asian Development Fund		23.14	
Sovereign Project grant: ADF Disaster Risk Reduction Fund		7.36	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>5.43</b>	
Beneficiaries		0.63	
Government		3.38	
Participating nam papas		1.42	
<b>Total</b>		<b>35.93</b>	





# LAO PEOPLE'S DEMOCRATIC REPUBLIC WATER SUPPLY AND SANITATION SECTOR PROJECT Additional Financing



- Additional Financing
  - Original Project
  - National Capital
  - Provincial Capital
  - City/Town
  - National Road
  - Paved Provincial Road
  - River
  - Provincial Boundary
  - International Boundary
- Boundaries are not necessarily authoritative.

This map was produced by the cartography unit of the Asian Development Bank. The boundaries, colors, denominations, and any other information shown on this map do not imply, on the part of the Asian Development Bank, any judgment on the legal status of any territory, or any endorsement or acceptance of such boundaries, colors, denominations, or information.



## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed grant to the Lao People's Democratic Republic (Lao PDR) for the additional financing of the Water Supply and Sanitation Sector Project.
2. Recognizing the importance of provincial water utilities, or provincial *nam papas* (PNPs), in providing sustainable water supply and sanitation (WSS) services, the Asian Development Bank (ADB), on 9 October 2013, approved a loan amounting to \$35 million from ADB's Special Fund and a grant totaling \$6 million from Phu Bia Mining Limited, to be administered by ADB, for the Water Supply and Sanitation Sector Project (current project) to the Lao PDR.<sup>1</sup>
3. Since its approval in 2013, the current project has helped improve the performance of PNPs and expand access to better WSS services for urban residents in select small towns of the Lao PDR. Given the current project's good performance and achievements, the additional financing will continue to strengthen PNPs and expand access to more efficient, and climate- and disaster-resilient WSS services for urban residents in small towns. It will support the implementation of subprojects in six new towns, in addition to those ongoing in nine towns.
4. With the additional financing, the overall project will (i) expand access to high-quality and reliable piped water supply services for the urban population, (ii) strengthen the PNPs' capacity to manage water supply systems in a resilient manner, and (iii) support government and community efforts to deliver urban WSS. The inclusion of women and poor people will remain a priority. The current project's approach and structure will apply under the additional financing.

## II. THE PROJECT

### A. Rationale

5. **Sector constraints and opportunities.** The population of the Lao PDR in 2017 is estimated at 6.69 million, of whom a third reside in five large urban centers and 150 small towns in 144 districts. The gross domestic product was estimated at \$2,408 per capita in 2016 and \$2,550 in 2017.<sup>2</sup> The poverty rate declined to 23.2% in 2013 and is projected to fall by 1 percentage point per annum.
6. WSS is a basic urban service which contributes to the economic growth of towns. Access to piped water supply is still low in the Lao PDR—only 64% of urban residents had it in 2015. However, access to improved sanitation is high, covering 94% of the population in 2015. Increasing water supply coverage and quantity, improving its quality, and ensuring service continuity will help improve urban residents' health condition and accelerate poverty reduction. Further, the urban WSS systems in the Lao PDR are exposed to disaster and climate change risks that may impact water reservoirs, treatment plant structures, and distribution networks. The urban WSS systems in the Lao PDR require careful designing to incorporate resilient features based on the principles of water safety planning.<sup>3</sup>

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<sup>1</sup> ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Grant to the Lao People's Democratic Republic: Water Supply and Sanitation Sector Project*. Manila.

<sup>2</sup> Country Economic Indicators (accessible from the list of linked documents in Appendix 2).

<sup>3</sup> ADB and World Health Organization. 2017. *Water Safety Planning for Urban Water Utilities: Practical Guide for ADB Staff*. Manila.

7. **The current project.** The current project supports the government's urban sector targets—90% coverage for piped water supply and 100% coverage for sanitation by 2030—and its expected outcome is stronger performance of participating PNPs in delivering sustainable water supply to 155,500 urban residents and sanitation services to 163,000 urban residents in 11 towns in six provinces. The project is being executed by the Department of Water Supply (DWS), which was established in 2015 in the Ministry of Public Works and Transport (MPWT).

8. **Implementation progress.** The current project started slowly due to the implementation assistance consultant late recruitment and subsequent delays in subprojects' design and procurement. It also suffered from grant funds loss as Phu Bia Mining Limited withdrew in December 2016; it did so primarily because of the project's slow start and because its ownership changed and its priorities shifted to dealing with the mining global decline and price erosion.

9. **Achievements to date.** After the change in financing plan and project scope, the current project's implementation significantly accelerated. It is rated *on track*, with cumulative contract awards of \$22.29 million equivalent (69% of the loan amount) and cumulative disbursement of \$7.06 million equivalent (21% of the loan amount). To date, the following results have been achieved:

- (i) Institutional reform successfully yielded a new and dedicated DWS (also covering sanitation), reflecting the growing importance of the sector within the MPWT.<sup>4</sup> In addition, corporate plans were developed for six subprojects by four PNPs, two of which have secured approval.
- (ii) The project (categorized as *effective gender mainstreaming*) greatly contributed to strengthening women's roles by achieving the targets for the number of female staff in local government and project-related committees.
- (iii) Community consultation meetings and workshops were delivered to 7,390 persons, of which 45% are women.
- (iv) Having a dedicated DWS also allowed the staff to focus on project administration and improve project performance.<sup>5</sup>

10. **Rationale for additional financing.** Phu Bia Mining Limited's withdrawal resulted in a \$6 million funding shortfall and reduced project benefits, accordingly. Having overcome the slow start and having strengthened the sector's oversight through the DWS, the government was keen to ramp up its efforts and therefore requested additional financing of \$30.50 million to expand WSS coverage and improve PNPs' performance. Helped by an experienced DWS, project management staff, and consultants, the government is fitted to using funds successfully to achieve its 2030 WSS targets. With the additional financing, the current project will be almost doubled. Based on the DWS performance for the last six months,<sup>6</sup> the government is confident of implementing the overall project successfully.

11. **Strategic alignment.** The current project is *on track*, maintaining both a satisfactory implementation pace and compliance with ADB policies. It has shown compliance with its loan covenants, particularly on project implementation, contract awards, safeguards reporting requirements, updated WSS sector policies, and grievance redress mechanism, and has partially

<sup>4</sup> Water supply and sanitation were previously the responsibility of the Department of Housing and Urban Planning.

<sup>5</sup> Summary of Project Performance (accessible from the list of linked documents in Appendix 2).

<sup>6</sup> The EA's performance has significantly improved in terms of overseeing design and procurement. The average number of days from advertisement to final bid evaluation report was 102 days for the bids invited in July–November 2016 while it was 64 days for the bids invited in October–November 2017.

complied covenants on tariff increases and gender. It has, however, not complied with its covenant on outstanding water bills because the actual institutional setup in the Lao PDR is more complicated than it was considered during project conceptualization and further work is required on supporting the reform process. The project meets the eligibility criteria for additional financing, such as overall development objectives, being consistent and being strategically aligned with ADB's country partnership strategy for Lao PDR, 2017–2020, and is included in ADB's country operations business plan for Lao PDR, 2018–2020.<sup>7</sup> The additional financing modality is appropriate because the current project is performing well and exhibits a high degree of project readiness in design, implementation capacity, and safeguards. It will continue to contribute to the government's efforts to achieve its urban sector targets by 2030.

12. **Development coordination.** Development coordination supports capacity development to achieve policy reforms. The Norwegian Agency for Development Cooperation supported corporate plans for those PNPs included in the Small Towns Water Supply and Sanitation Sector Project. It supported 5 years of capacity development technical assistance to improve PNPs management capabilities, on which the additional financing will build to deliver a comprehensive corporate plan.

13. **Lessons learned.** Lessons learned from the implementation of the current project include PNP's poor capacity on operation and maintenance (O&M) and budget management, poor water conservation practices, and lack of disaster risk awareness. To address these issues, the additional financing will (i) provide training for PNP staff on O&M, budget preparation and execution, accounting, cash planning, and performance measurement; (ii) conduct awareness programs for village communities on water conservation to cope with urbanization and reduced dry season river flows caused by deforestation; (iii) use robust equipment to reduce O&M; and (iv) provide easy access to units within facilities for easy O&M.

14. **ADB's value addition.** ADB's value addition lies in supporting the government through a sector reform process by providing both lending and non-lending support and helping improve the PNPs' performance in the delivery of urban WSS services. Through the overall project and ongoing activities under the Greater Mekong Subregion Corridor Towns Development projects, ADB's support will allow the government to expand its sanitation mandate and help achieve its 2030 WSS targets, and address improved health and hygiene conditions in urban areas.

## B. Impact and Outcome

15. The impact of the overall project remains unchanged: urban access to quality and reliable piped water supply and sanitation services in the Lao PDR improved. The outcome of the overall project also remains unchanged: performance of the participating PNPs in delivering sustainable WSS improved. In terms of beneficiaries, the number of urban residents with access to safe piped water supply will increase from 100,000 to 200,000 while the number of urban residents with access to improved sanitation facilities will increase from 170,000 to 210,000. The overall project is expected to cover eight PNPs and improve WSS in 15 towns.

## C. Outputs

16. **Output 1: Sector coordination and policy implementation improved.** Output 1 will continue the reforms introduced under previous projects and implement additional policy reforms,

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<sup>7</sup> ADB. 2017. *Country Partnership Strategy: Lao People's Democratic Republic, 2017–2020—Fostering Inclusive and Sustainable Economic Growth*. Manila; and ADB. 2017. *Country Operations Business Plan: Lao People's Democratic Republic, 2018–2020*. Manila.

improving the performance in six PNPs under the current project to eight PNPs under the overall project. These activities entail (i) service agreements between PNPs and provincial governments; PNPs training on corporate planning and financial management, tariff adjustments, issuance of district sanitation regulations, use of simplified corporate plans, and integration of disaster preparedness measures in the corporate planning process; (ii) expanded policy implementation, including nationalizing a policy for sanitation regulations and inclusive connection fees, wider coordination of nonrevenue water (NRW) management, asset management, and water safety plans; and (iii) capacity development, including safeguards training and the introduction of O&M service contracts for participating PNPs (e.g., administration support, PNP leak-detection equipment) for two additional PNPs under the additional financing.

17. **Output 2: NRW management and water supply development improved.** Output 2 will integrate a comprehensive program to reduce NRW in the existing system and expand water supply to areas not yet covered, lowering average NRW levels to 20%. The current project covers three towns, and the additional financing will cover three towns thereby covering six towns in total. The overall project will expand water supply distribution pipelines to 250 kilometers (km): 150 km under the current project and 100 km under the additional financing.

18. **Output 3: New water supply systems in small towns developed.** PNPs participating in outputs 1 and 2 will be eligible for financing to build a new water system in a small district town in the same province, acquire related O&M equipment, and offer free metered connections to households (HHs), provided they have sanitation facilities installed. Special attention will be paid to ensure that the infrastructure is in the least-risk area and the proposed structures are built to withstand floods and geophysical hazards. The current project covers six towns, and the additional financing will add three towns. The overall project will construct 150 km of new water distribution systems: 100 km under the current project and 50 km under the additional financing.

19. **Output 4: Community action in water supply and sanitation enhanced.** It will widen the benefits from investing in water supply systems to 15 small towns (nine towns under the current project and six under the additional financing) through sanitation and awareness activities. These involve (i) VEI grants<sup>8</sup>, such as drainage improvements and village access roads for core villages according to agreed eligibility criteria; (ii) HH sanitation grants for the poor<sup>9</sup> without a sanitary private latrine (construct a new or upgrade existing) to improve HH sanitation; (iii) new or rehabilitated public sanitation facilities, for which O&M can be contracted to a business or social entity, and septage disposal facilities where they are unavailable in the subproject area; and (iv) increased project and hygiene awareness through stakeholder consultations and community participation aiming at improved sanitation and hygiene behavior change. Access to sanitation will be expanded in participating towns, whereby beneficiaries finance their own units to become eligible for water supply connections. Output 4 will also strengthen communities capacity to understand the factors contributing to disaster and climate risks through improvements on community-level infrastructure.<sup>10</sup> The community engagement process will allow identifying and

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<sup>8</sup> The project will contribute up to 80% of the cost of improvements (\$10–\$25 per capita), local governments at least 10%, and the village at least 10% in cash. Percentages exclude taxes and duties, which the government will finance.

<sup>9</sup> The poor households will be identified in accordance with the criteria set forth in the Prime Minister's Decree No. 285, dated October 2009, or otherwise agreed to in advance with ADB. Each eligible will receive materials for the construction of durable water seal pit latrine amounting to \$140. Construction materials will be procured through shopping and handed to the poor.

<sup>10</sup> The project will contribute up to 80% of the cost of improvement (from \$10 per capita to \$25 per capita), local government at least 10%, and the village at least 10% in cash. Percentages exclude taxes and duties, which the government will finance.

prioritizing resilient community infrastructures that can be funded through the small-grants provided through the overall project.

20. **Output 5: Capacity for project implementation and O&M strengthened.** Output 5 will be delivered through capacity development programs that include safeguards training; O&M training for the participating PNPs; and financial, auditing, and improved administration support. Regular ADB review missions confirm that established financial, administrative, procurement, and reporting systems are effective and therefore will be continued.

#### D. Investment and Financing Plans

21. The project is estimated to cost \$35.93 million (Table 1).

**Table 1: Project Investment Plan (\$ million)**

Item	Current Amount <sup>a</sup>	Additional Financing <sup>b</sup>	Total
<b>A. Base Cost<sup>c</sup></b>			
1. Output 1: Sector coordination and policy implementation improved	0.20	0.21	0.41
2. Output 2: Nonrevenue water management and water supply development improved	12.85	18.55	31.40
3. Output 3: New water supply systems in small towns developed	6.28	2.65	8.93
4. Output 4: Community action in water supply and sanitation enhanced	2.58	2.41	4.99
5. Output 5: Capacity for project implementation, operation, and maintenance strengthened	12.39	5.92	18.31
<b>Subtotal (A)</b>	<b>34.30</b>	<b>29.74</b>	<b>64.04</b>
<b>B. Contingencies<sup>d</sup></b>	<b>5.16</b>	<b>4.77</b>	<b>9.93</b>
<b>C. Financing Charges During Implementation</b>	<b>1.16</b>	<b>1.42</b>	<b>2.58</b>
<b>Total (A+B+C)</b>	<b>40.62</b>	<b>35.93</b>	<b>76.55</b>

<sup>a</sup> The original project amount was \$46.55 million, including \$6 million from PBM. With the withdrawal of PBM from the original project, the current project amount was reduced to \$40.62 million.

<sup>b</sup> Government will finance taxes and duties of \$3.07 million as exemption. ADB may finance taxes and duties on recurrent costs in case they are not exempted. Such amount does not represent an excessive share of the project cost.

<sup>c</sup> In April 2018 prices.

<sup>d</sup> Under the additional financing, physical contingencies are computed at 10%. Price contingencies computed at 1.5% on foreign exchange costs from 2019 to 2020 and 1.6% in 2021 and thereafter; and 2.5% on local currency costs in 2019 and 3.0% in 2020 and thereafter; includes provision for potential exchange rate fluctuation under the assumption of a purchasing power parity exchange rate. Source: Asian Development Bank.

22. The government has requested a grant not exceeding \$30.50 million from ADB's Special Funds resources (Asian Development Fund) to help finance the project. The financing plan is in Table 2, of which, climate adaptation is estimated at \$7.36 million and will be fully financed by ADB through a grant from the Asian Development Fund 12 Disaster Risk Reduction funding.

**Table 2: Financing Plan**

Source	Current		Additional Financing		Total	
	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)
Asian Development Bank						
Special Funds resources (loan)	35.00	86.2	0.00	0.0	35.00	45.7
Special Funds resources (grant) <sup>a</sup>	0.00	0.0	30.50	84.9	30.50	40.0
Government <sup>b</sup>	4.27	10.5	3.38	9.4	7.65	9.9
Beneficiaries						
Village environmental improvements <sup>c</sup>	0.09	0.2	0.09	0.2	0.18	0.2
Household sanitation <sup>d</sup>	1.26	3.1	0.54	1.5	1.80	2.3
Participating <i>nam papas</i>	0.00	0.0	1.42	4.0	1.42	1.9
<b>Total</b>	<b>40.62</b>	<b>100.0</b>	<b>35.93</b>	<b>100.0</b>	<b>76.55</b>	<b>100.0</b>

<sup>a</sup> Climate adaptation is estimated to cost \$7.36 million, which will be financed by the Asian Development Bank through a grant from the Asian Development Fund 12 Disaster Risk Reduction funding.

<sup>b</sup> The government will provide in-kind contribution with no incremental cost for the project management unit and project implementation units, office space for the consultants, and audit costs.

<sup>c</sup> Beneficiaries will provide a monetary contribution toward the village environmental improvements, such as public toilets in markets, road enhancements, and drainage in critical flooded places.

<sup>d</sup> Beneficiaries will finance their own units, since only households with improved sanitation facilities will receive free upfront payment for water supply connections.

Source: Asian Development Bank.

## E. Implementation Arrangements

23. The implementation arrangements are summarized in Table 3 and described in detail in the Project Administration Manual.<sup>11</sup>

**Table 3: Implementation Arrangements**

Aspects	Arrangements		
Implementation period	January 2019–March 2023 (additional financing physical completion)		
Estimated completion date	31 March 2023 (grant closing date: 30 September 2023)		
<b>Management</b>			
(i) Project steering committee and subcommittee on corporatization	Vice minister, MPWT (chair); representatives from MOF, MPI, MONRE, and DHUP; PCU director and deputy director; Lao Women's Union (members). The subcommittee will include director general, MPWT (chair); deputy director general, MPWT; PCU project director (Secretariat); and representatives from NCBD (PMO) and the Department of State-Owned Enterprise and Financial Management (MOF)		
(ii) Project coordination unit	Project director, deputy project directors, senior engineer, corporate planner, safeguards specialist, procurement specialist, HRD specialist, chief accountant; and support staff		
(iii) Executing agency	MPWT/DWS		
(iv) Provincial project steering committee	Vice provincial governor (chair); district governor (vice chair), representatives from PIUs, DPWT, PNP, DOF, DPI, DONRE, and provincial Lao women's union (members)		
(v) Key implementing agencies	DPWT and PNPs		
(vi) Project implementation unit	The PCU, with 20 staff, will be under DWS and PIUs, under provincial Departments of Public Works and Transport DPWT, with 110 staff.		
(vii) Village development committees	Village development committees will facilitate output 4; members may be assigned to work specifically on water and sanitation aspects.		
Procurement	International competitive bidding	4 contracts	\$17.90 million
	National competitive bidding	10 contracts	\$3.80 million
	Shopping	Various	\$0.45 million
Consulting services	Contract variation to existing PIA consultant contract for project management and capacity building	616 person-months (165 international and 451 national)	\$5.57 million
	Financial project audit (State Audit Office)	4 years	\$0.03 million
	Independent PNP audit (CQS, biodata proposal)	Accounting firm	\$0.61 million
Advance contracting	Advance actions include negotiating with the PIA consultant a contract variation for additional scope to cover works planned under the additional financing.		
Disbursement	The grant proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed upon between the government and ADB.		

ADB = Asian Development Bank, CQS = consultant qualification selection, DHUP = Department of Housing and Urban Planning, DOF = Department of Finance, DONRE = Department of Natural Resources and Environment, DPI = Department of Planning and Investment, DPWT = Department of Public Works and Transport, DWS = Department of Water Supply, HRD = human resource development, MOF = Ministry of Finance, MONRE = Ministry of Natural Resources and Environment, MPI = Ministry of Planning and Investment, MPWT = Ministry of Public Works and Transport, NCBD = National Committee Business Development, PAM = project administration manual, PCU = project coordination unit, PIA = project implementation assistance, PIU = project implementation unit, PMO = Prime Minister's Office, PNP = provincial *nam papa* (provincial water utility).

Sources: Asian Development Bank and Ministry of Public Works and Transport.

<sup>11</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).



24. **Project readiness.** Recruitment of a new project implementation assistance consultant is not required; a contract variation will be prepared to extend the contract of the current consultant. As for the six towns under the additional financing, feasibility studies are available for four of them and DEDs for two. It is expected that contracts amounting to 50% of the additional financing amount will be awarded by end Q1 2019. The market assessment of construction contractors indicates availability of a small pool of firms eligible to undertake WSS works. Consequently, bid evaluations will carefully consider bidders' personnel and financial capacity to undertake more works of similar nature and size before awarding contracts.

### III. DUE DILIGENCE

#### A. Technical

25. Location and design features of water treatment plant facilities will factor in disaster and climate risk considerations and, where relevant to the lifespan of the infrastructure, future changes in the frequency and/or intensity of extreme events as well as long-term changes in average disaster, climate, and geophysical risks. These designs have proven to be robust, durable, technically viable, and disaster risk measures were well received by the PNPs. Subproject selection will be based on criteria such as population density, poverty incidence, and existing WSS coverage. Feasibility studies and DEDs for the sample subprojects in Sopbao and Xam-Nua towns, which are representative of subprojects under the additional financing, have all factored in lessons from the current project.

#### B. Economic and Financial

26. **Economic analysis.** It was conducted for two water-supply sample subprojects, Sopbao and Xam-Nua, following ADB guidelines. Benefits considered are (i) resource cost savings associated with the replacement of non-incremental water consumed and previously obtained from alternative sources; and (ii) consumer surplus, reflected in the incremental water consumed. The estimated economic internal rates of return are 16.03% for Sopbao and 18.63% for Xam-Nua, higher than the economic opportunity cost of capital assumed at 9.00%, indicating significant economic returns. Sensitivity analysis for various scenarios revealed that the proposed components are most sensitive to a project delay and a decrease in subproject benefits but remain above the economic opportunity cost of capital.<sup>12</sup>

27. **Financial analysis.** It was assumed that the government would extend subloans to the Houaphan PNP for implementing the Sopbao and Xam-Nua subprojects (and all those considered for additional financing) on the same terms as for the subprojects under the current project (i.e., of the total subproject cost, 70% will be granted and 30% will be on-lent at 6.40% per annum with a 6-year grace period). The financial internal rate of return is 12.43% for Xam-Nua and 8.63% for Sopbao, exceeding the weighted average cost of capital of 7.18%. The sensitivity analysis indicates that the subprojects are most sensitive to a project delay and a decrease in revenues but remain well above the weighted average cost of capital. The PNPs' sustainability depends heavily on the implementation of tariff revisions, and participating PNPs will conduct a tariff review every 3 years and adjust levels to meet the government's cost-recovery objectives on sustainability as well as ADB's loan and grant covenants.

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<sup>12</sup> Economic Analysis (available from the list of linked documents in Appendix 2).

### C. Governance

28. The pre-mitigation financial management risk is moderate. Project fund utilization is in accordance with the original expenditure category, but funds needed to be reallocated to align the financing plan with actual conditions. Procurement oversight by the government has improved since the establishment of the DWS under the MPWT in 2015. To ensure good governance, conditions precedent for contract award include (i) submission of corporate plans, and (ii) subsidiary loan agreements executed. The institutional capacity of the State Audit Office has improved with support from ADB and other development partners. Financial management solutions such as building the accounting capacity of PNP staff are being considered, and an independent auditing company, complying with international standards, is also being recruited. Additional measures will be taken to enhance financial management, such as (i) updating the PNP's financial reporting systems to comply with international accounting standards, and (ii) PNP's capacity building. No complaints were recorded, nor any incidence of corruption; and compliance with ADB's Anticorruption Policy has been satisfactory. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government. The specific policy requirements and supplementary measures are described in the project administration manual.<sup>13</sup>

### D. Poverty and Social

29. **Poverty reduction and social impacts.** The additional financing will directly benefit about 19,760 HHs in the six towns with access to reliable piped water supply, and 491 of them with access to improved sanitation facilities. It eliminates barriers to access for the urban poor and prioritizes poor districts. Health benefits will be derived through access to improved drinking water; greater water availability for sanitation and personal hygiene; and better access to improved sanitation. The additional financing will provide VEI grants to enhance community involvement in sanitation and environmental improvements, targeted latrine subsidies for poor HHs, and free water connections for poor HHs.

30. **Gender.** The current project is categorized *effective gender mainstreaming*, and the additional financing will align with this. The gender action plan builds on current project implementation experiences. Gender benefits for women will result from greater convenience, less physical strain, and time savings in water collection; stronger family health; more privacy and dignity when tending to sanitation needs; and improved facilities specific to women's health and menstrual hygiene. It supports gender equity in decision-making on, and water and sanitation issues management. Strategic measures include (i) gender-sensitive targets in the PNP's corporate action plans, (ii) targets for female PNP staff members in the asset management task forces, (iii) a target of 20%–30% of village development committee subcommittee members (depending upon VEI size) responsible for planning and managing VEIs being women; and (iv) a minimum of 30% women staff in the project coordination unit and project implementation units.

### E. Safeguards

31. In compliance with ADB's Safeguard Policy Statement (2009), the project's safeguard categories are detailed below.<sup>14</sup> Any subprojects classified as category A will be excluded from the overall project. Public consultations were carried out to inform stakeholders and affected persons about the overall project design and will continue during implementation. A project safeguard grievance redress mechanism will facilitate the resolution of complaints.

<sup>13</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

<sup>14</sup> ADB. Safeguard Categories. <https://www.adb.org/site/safeguards/safeguard-categories>.

32. **Environment (category B).** Two initial environmental examination (IEE) reports and environmental management plans were prepared for representative subprojects, Sopbao and Xam-Nua, in Houaphan province. Environmental management plans include identified impacts mitigation and monitoring measures, enforced by grant covenants, with adequate implementation budget. The updated environmental assessment and review framework provides subprojects guidance on the selection, screening, assessment, and implementation that will be prepared after grant approval. Draft IEEs, environmental assessment and review framework were disclosed on ADB website on 13 April 2018.<sup>15</sup> Final IEEs will be updated once DEDs are completed.

33. The subprojects in Sopbao and Xam-Nua will provide safer, cleaner, and more reliable water supply to beneficiaries in 17 villages within the two towns. Identified subprojects will have localized, short-term impacts during construction. Further studies are proposed during DED preparation in respect of raw water quality and downstream fish conservation zones. Construction and operational environmental impacts can be prevented or minimized to an acceptable level through effective implementation of mitigation and monitoring measures specified in the environmental management plans. The proposed capacity building for O&M will include raw water quality monitoring, treatment process, management and risks associated with sludge disposal.

34. **Resettlement (category B).** Due diligence conducted on four subprojects implemented under the current project indicates that impacts during construction are temporary in nature. Safeguard monitoring reports were submitted regularly and disclosed on the ADB website. It also confirms that HHs were compensated as prescribed in the land acquisition and compensation plan of each subproject and that no voluntary donation mechanisms were utilized to acquire land. Overall, the additional financing will adhere to methods used for the current project, but the land acquisition and compensation framework was revised and updated to remove voluntary donation mechanisms in relation to the water supply component of the project.

35. The two sample subprojects in Sopbao and Xam-Nua will not severely affect any individual or have significant impacts. No land acquisition is required in Sopbao, and only 284 square meters of land will be acquired from two HHs in Xam-Nua, but the impacts are not significant in nature, representing only 2.94% and 1% of these households' total land holdings. Temporary or minor impacts on driveways, fences, and walls, with no loss of income, shall occur; the contractor will restore these to pre-project conditions. A loss of fruit-bearing trees will also occur, but the loss of income—at an average of 2% of HH income—is not significant in nature. Households shall be compensated for their losses at replacement cost. Initial screening was undertaken for four other subprojects already identified but indicated neither land acquisition nor resettlement needs. To mitigate and manage any impacts, two land acquisition and compensation plans were developed in line with the updated land acquisition and compensation framework and disclosed on the ADB website on 26 April 2018.<sup>16</sup> The final plans will be updated and disclosed in English and Lao once DEDs are completed. No physical or economic displacement will occur until full replacement cost compensation and assistance in accordance with the plans has been paid.

36. **Indigenous peoples (category C).** The additional financing is category C for indigenous peoples. The poverty and social assessment confirmed that the project will not affect ethnic groups' traditional sociocultural or belief practices, customary livelihoods, or ancestral domains.

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<sup>15</sup> IEE, Environmental Assessment and Review Framework (available from the list of linked documents in Appendix 2).

<sup>16</sup> Land Acquisition and Compensation Plan, and Land Acquisition and Compensation Framework (available from the list of linked documents in Appendix 2).

## F. Risks and Mitigating Measures

37. The overall risk assessment is low, and the integrated benefits and impacts are expected to outweigh the costs. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.<sup>17</sup>

**Table 4: Summary of Risks and Mitigating Measures**

<b>Risks</b>	<b>Mitigating Measures</b>
Government and service providers do not adopt sector policy reforms.	Adoption of sector reforms form part of the subproject selection criteria and support investment sustainability. Delays should not affect regular tariff adjustments.
Slow disbursement as a result of low readiness and slow procurement	The executing agency has prepared several detailed engineering designs that can proceed to procurement. Procurement support will be provided, so contracts can be awarded shortly after ADB approval of the additional financing.
Weak project financial management system, particularly for accounting, budget preparation and execution, cash planning, and performance measurement	ADB, the World Bank, and other development partners continue to support ongoing efforts to strengthen public financial management arrangements, through technical assistance and lending.
Shortage of PCU and PNP staff skills in financial management, including financial analysis, management accounting, financial reporting, and audit	The existing PCU under the current project, whose staff have been trained in ADB project accounting and reporting requirements, will continue to be used. Support will also be provided through a financial management consultant from among the PIA consultants.
Arrangements for O&M of subproject assets are not implemented successfully. NRW reduction measures are unsustainable.	The project supports the provincial water utilities in updating and improving O&M plans, and in developing new approaches for continuous nonrevenue water reduction and asset management.

ADB = Asian Development Bank, NRW = nonrevenue water, O&M = operation and maintenance, PCU = project coordination unit, PIA = project implementation assistance.

Source: Asian Development Bank.

## IV. ASSURANCES

38. The government and the MPWT have assured ADB that implementation of the project shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the project administration manual and grant documents.

39. The government and the MPWT have agreed with ADB on the covenants for the project, which are set forth in the grant agreement.

## V. RECOMMENDATION

40. I am satisfied that the proposed grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the grant not exceeding \$30,500,000 to the Lao People's Democratic Republic from ADB's Special Funds resources (Asian Development Fund) for the additional financing of the Water Supply and Sanitation Sector Project, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement presented to the Board.

Takehiko Nakao  
President

22 August 2018

<sup>17</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

## REVISED DESIGN AND MONITORING FRAMEWORK

Impact the Project is Aligned with			
<b>Current project</b> Urban access to quality and reliable piped water supply and sanitation services in the Lao PDR improved (Eighth National Socio-Economic Development Plan, 2016–2020). <b>Overall project</b> Unchanged			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<b>Outcome</b>  <b>Current project</b> Performance of participating PNPs in delivering sustainable water supply and sanitation services increased  <b>Overall project</b> Expanded	<b>Current project</b> <b>By 2021:</b> a. About 110,000 urban residents in 9 towns with access to reliable piped water supply meeting appropriate drinking water quality standards (2013 baseline: 50,000 residents) b. About 115,000 urban residents in 9 towns with access to improved sanitation facilities (2013 baseline: 89,000 residents) c. NRW in about three provincial capital water supply systems reduced to 20% or less when pressurized d. All participating PNPs achieved full cost recovery and maintained arrears at less than 90 days (2013 baseline: one of six PNPs) e. At least one of six participating PNPs able to access other external financing as a result of improved creditworthiness  <b>Overall project</b> <b>By 2023:</b> a. About 200,000 urban residents in about 15 towns with access to reliable piped water supply meeting appropriate drinking water quality standards (2013 baseline: 100,000 residents) b. About 210,000 urban residents in about 15 towns with access to improved sanitation facilities (2013 baseline: 170,000 residents) c. NRW in about six provincial capital water supply systems reduced to 20% or less when pressurized d. All participating PNPs achieved full cost recovery and maintained arrears at less than 90 days (2013 baseline: one of six PNPs) e. At least three of eight participating PNPs able to access other external financing as a result of improved creditworthiness.	a–e. Annual reports by MPWT, monitoring reports, ADB loan missions, project completion report	Government and service providers do not adopt sector policy reforms.
<b>Output 1</b>  <b>Current project</b> Sector coordination and policy implementation improved  <b>Overall project</b> Unchanged	<b>By 2021:</b> <b>1a. Current project</b> At least five joint subsector reviews held. At least three hygiene promotion events held about WASH and gender (2013 baseline: 0) <b>Overall project</b> Unchanged  <b>1b. Current project</b>	1a–1e. Project progress and annual PPME reports	PNPs are not yet in a position to develop and prepare corporate plans independently.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<p>The sector's professional women's group participating in at least two job fairs annually (2013 baseline: 0)  <b>Overall project</b>            Unchanged</p> <p><b>1c. Current project</b>            Water safety plans prepared and implemented for each project-support system by participating PNPs. An asset register prepared by participating PNPs (2013 baseline: 0)  <b>Overall project</b>            Unchanged</p> <p><b>1d. Current project</b>            Participating PNPs updating their corporate plans annually and including sex-disaggregated information (2013: one PNP)  <b>Overall project</b>            Unchanged</p> <p><b>1e. Current project</b>            One service contract signed for each new or expanded system (2013 baseline: 0)  <b>Overall project</b>            Unchanged</p>		
<p><b>Output 2</b></p> <p><b>Current project</b>            NRW management and water supply development improved</p> <p><b>Overall project</b>            Expanded</p>	<p><b>By 2021:</b></p> <p><b>2a. Current project</b>            At least three systems expanded in provincial capitals (2013 baseline: 0)  <b>Overall project</b>            At least six systems expanded in provincial capitals (2013 baseline: 0)</p> <p><b>2b. Current project</b>            150 kilometers of water supply distribution pipelines installed (baseline 2013: 0)            NRW programs completed in at least five participating PNPs (2013 baseline: 0)  <b>Overall project</b>            250 kilometers of water supply distribution pipelines installed (2013 baseline: 0)            NRW programs completed in at least six participating PNPs (2013 baseline: 0)</p>	<p>2a–2b.            PNP corporate plans, WSRC annual performance reports, project progress reports, annual PPME reports</p>	<p>Arrangements for O&amp;M of subproject assets are not implemented successfully. NRW reduction measures are unsustainable.</p>

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<p><b>Output 3</b></p> <p><b>Current project</b> New water supply systems in small towns developed</p> <p><b>Overall project</b> Expanded</p>	<p><b>By 2021:</b></p> <p><b>3a. Current project</b> At least six new systems constructed (2013 baseline: 0)</p> <p><b>Overall project</b> At least nine new systems constructed (2013 baseline: 0)</p> <p><b>3b. Current project</b> 100 kilometers of water supply distribution pipelines installed (2013 baseline: 0)</p> <p><b>Overall project</b> 150 kilometers of water supply distribution pipelines installed (2013 baseline: 0)</p>	<p>3a–3b. PNP corporate plans, WSRC annual performance reports, project progress reports, annual PPME reports</p>	<p>Slow disbursement because of low readiness and slow procurement.</p>
<p><b>Output 4</b></p> <p><b>Current project</b> Community action in urban water supply and sanitation enhanced</p> <p><b>Overall project</b> Expanded</p>	<p><b>By 2021:</b></p> <p><b>4a. Current project</b> At least 30% of VDC members assigned to manage VEIs are women</p> <p><b>Overall project</b> Unchanged</p> <p><b>4b. Current project</b> Awareness of health, hygiene, and sanitation increased by at least 30% in about 88 project villages</p> <p><b>Overall project</b> Unchanged</p> <p><b>4c. Current project</b> 100% of improved public toilet facilities conducive to proper menstrual hygiene</p> <p><b>Overall project</b> Unchanged</p> <p><b>4d. Current project</b> At least 2,000 meters of roads with drainage improved in project villages</p> <p><b>Overall project</b> At least 3,000 meters of roads with drainage improved in project villages</p> <p><b>4e. Current project</b> Each participating district town approved a sanitation regulation</p> <p><b>Overall project</b> Each participating district town approved a sanitation regulation and confirms that HHs with improved sanitation systems receive piped water supply connections</p> <p><b>4f. Current project</b> Water conservation programs adopted in project villages</p> <p><b>Overall project</b> Unchanged</p>	<p>4a–4f. Project progress and project completion reports, community participation plans, village proposals and agreements for VEIs, construction records</p>	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<p><b>Output 5</b></p> <p><b>Current project</b> Capacity for project implementation and O&amp;M strengthened</p> <p><b>Overall project</b> Unchanged</p>	<p><b>By 2021:</b></p> <p><b>5a. Current project</b> An O&amp;M plan is prepared for each VEI</p> <p><b>Overall project</b> Unchanged</p> <p><b>5b. Current project</b> At least 30% of project training opportunities, professional exchanges, and peer study tours and study trips for qualified women</p> <p><b>Overall project</b> Unchanged</p> <p><b>5c. Current project</b> 100% of female staff from participating PNPs receiving training in a job-related subject of their choice</p> <p><b>Overall project</b> Unchanged</p> <p><b>5d. Current project</b> At least 30% of staff in project coordination and implementation units are women</p> <p><b>Overall project</b> Unchanged</p>	<p>5a–5d. Project progress and completion reports, community participation plans, village proposals and agreements for VEIs, construction records</p>	<p>Shortage of skills in financial management, including financial analysis, management accounting, financial reporting, and audit.</p>
<p><b>Key Activities with Milestones</b></p> <p><b>1. Sector coordination and policy implementation improved</b></p> <p>1.1 Convene meetings of the technical working group subgroup on urban development, and the subsector working group on water and sanitation twice a year (Q2 and Q3 annually).</p> <p>1.2 Convene WASH sector professional women's group meetings (Q3 2014–onward).</p> <p>1.3 Participating PNPs adopt a free connection policy (Q3 2013–onward).</p> <p>1.4 Include drinking water quality parameters in PNP corporate plans and select indicators to monitor regularly using available resources (Q3 2013–onward).</p> <p>1.5 Implement hygiene promotion events about WASH and gender (2014, 2016, 2018).</p> <p>1.6 PNPs adopt a NRW management approach (Q3 2013–onward).</p> <p>1.7 PNPs adopt assets management approach (Q3 2013–onward).</p> <p><b>2. NRW management and water supply development improved</b> (Phase 1: Q3 2015–Q4 2017; phase 2: Q1 2016–Q3 2019; phase 3: Q4 2017–Q3 2021; and phase 4: Q1 2019–Q1 2022).</p> <p>2.1 Confirm screening criteria before feasibility study preparation and update (Q3 2018).</p> <p>2.2 Update and prepare feasibility study and subproject appraisal report for government and ADB approval (Q3–Q4 2018).</p> <p>2.3 Establish and train NRW units in each PNP, undertake NRW surveys and designs, and prepare contracts (Q3–Q4 2019).</p> <p>2.4 Bid, evaluate, and award NRW contracts (Q2 2019–onward).</p> <p>2.5 Undertake NRW program (Q3 2018–onward).</p> <p>2.6 Survey and design expansion and rehabilitation works (Q4 2014–Q4 2018).</p> <p>2.7 Update and approve corporate plans; adjust tariffs; and sign service contracts, sanitation regulations, and subsidiary loan agreements (Q3 2015–Q3 2019).</p> <p>2.8 Bid, evaluate, and award main construction civil works contracts (Q4 2016–Q4 2019).</p> <p>2.9 Implement land acquisition and resettlement (Q3 2016–Q3 2020).</p> <p>2.10 Construct and commission new systems (Q1 2017–Q1 2022).</p> <p><b>3. New water supply systems in small towns developed</b> (Phase 1: Q3 2015–Q4 2017; phase 2: Q1 2016–Q3 2019; and phase 3: Q4 2017–Q4 2021).</p> <p>3.1 Confirm screening criteria before feasibility study preparation and update (Q1 2018).</p> <p>3.2 Update and prepare feasibility study and subproject appraisal reports for government and ADB approval (Q3 2015–Q4 2019).</p>			



**Key Activities with Milestones**

- 3.3 Survey and design water supply system works (Q4 2015–Q3 2019).
- 3.4 Update and approve corporate plans; adjust tariffs; and sign service contracts, sanitation regulations, and subsidiary loan agreements (Q3 2015–Q3 2019, with activity 2.7).
- 3.5 Bid, evaluate, and award construction civil works contracts (Q4 2016–Q4 2019).
- 3.6 Implement land acquisition and resettlement activities (Q3 2016–Q3 2020).
- 3.7 Construct and commission new water supply systems (Q1 2017–Q1 2022).
- 4. Community action in urban water supply and sanitation enhanced**
- 4.1 Prepare stakeholder consultation and participation plan (Q4 2015–Q1 2019).
- 4.2 Hold community planning and prioritization meetings (Q1 2016–Q2 2020).
- 4.3 District authorities implement sanitation and hygiene activities (Q4 2015–Q1 2021).
- 4.4 Include VEIs and public latrines in respective subproject feasibility studies and subproject appraisal reports (with activities 2.2 and 3.2).
- 4.5 Identify VEIs, poor HHs for latrine grants, and location of public latrines; prepare safeguard and O&M plans (Q4 2019).
- 4.6 Bid, evaluate, and award contracts for VEIs and public latrines (Q3–Q4 2019).
- 4.7 Implement land acquisition and resettlement activities (Q3 2016–Q3 2020).
- 4.8 Implement VEIs and construct public latrines (Q3 2017–Q2 2022).
- 5. Capacity for project implementation and O&M strengthened**
- 5.1 Hold PCU and PIU project orientation meetings (Q2 2016–Q1 2019).
- 5.2 Finalize PPMS, disaggregating indicators by sex, income, and ethnicity (Q3 2015).
- 5.3 Review and update capacity development plan (Q3 2014–onward).
- 5.4 Review and update O&M plans in each corporate plan (with activities 2.7 and 3.4).
- 5.5 Implement water safety plans within corporate plans (with activities 2.6 and 3.4).
- 5.6 Provide continuous project implementation assistance (Q3 2015–onward).
- 5.7 Manage and administer the project (Q3 2013–onward).
- 5.8 Agree and commence on-the-job O&M training for each participating PNP (Q3–Q4 2017, with activities 2.10 and 3.7).

**Inputs**

<b>Asian Development Bank: Loan</b>	\$35,000,000 (current); \$0 (additional); \$35,000,000 (overall)
<b>Grant</b>	\$0 (current); \$30,500,00 (additional); \$30,500,000 (overall)
<b>Government</b>	\$4,270,000 (current); \$3,380,000 (additional); \$7,650,000 (overall)
<b>Beneficiaries of VEIs</b>	\$90,000 (current); \$90,000 (additional); \$180,000 (overall)
<b>Beneficiaries of sanitation</b>	\$1,259,000 (current); \$543,000 (additional); \$1,803,000 (overall)
<b>PNPs</b>	\$0 (current); \$1,420,000 (additional); \$1,420,000 (overall)

**Assumptions for Partner Financing**

Not applicable

Note: Where a baseline is not indicated, the baseline is zero; costing figures may not total due to rounding.

ADB = Asian Development Bank; MPWT = Ministry of Public Works and Transport; NRW = nonrevenue water; O&M = operation and maintenance; PCU = project coordination unit; PIU = project implementation unit; PNP = provincial *nam papa* (provincial water utility); PPME = project performance monitoring and evaluation; PPMS = project performance monitoring system; Q = quarter; VDC = village development committee; VEI = village environmental improvement; WASH = water, sanitation, and hygiene; WSRC = Water Supply Regulatory Committee.

Sources: Asian Development Bank; Ministry of Public Works and Transport; Joint Monitoring Programme for Water and Sanitation. 2013. *Progress on Sanitation and Drinking Water: 2013 Update*. New York: United Nations Children's Fund and World Health Organization.

### **LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=45301-003-2>

1. Grant Agreement
2. Sector Assessment (Summary): Water and Other Urban Infrastructure and Services
3. Project Administration Manual
4. Summary of Project Performance
5. Contribution to the ADB Results Framework
6. Development Coordination
7. Financial Analysis
8. Economic Analysis
9. Country Economic Indicators
10. Summary Poverty Reduction and Social Strategy
11. Gender Action Plan
12. Initial Environmental Examination: Sopbao
13. Initial Environmental Examination: Xam-Nua
14. Environmental Assessment and Review Framework
15. Updated Land Acquisition and Compensation Plan: Sopbao
16. Updated Land Acquisition and Compensation Plan: Xam-Nua
17. Updated Land Acquisition and Compensation Framework
18. Risk Assessment and Risk Management Plan
19. Project Climate and Disaster Risk Assessment

### **Supplementary Documents**

20. Stakeholder Communication Strategy
21. Financial Management Assessment
22. Loan Covenants Compliance Summary for the Current Project
23. Financing Gap by Financier Against Original Scope