

Global Partnership on Output-based Aid
Colombia – Access to Natural Gas Project

Operational Manual

March 30, 2007

1. Detailed description of Project

1.1. The Grant Recipients:

Promigas is currently Colombia's largest private gas transmission and distribution company, accounting for approximately 51% of the total gas transported in the country. Promigas' major shareholders include Prisma Energy (42.9%); Grupo Amalfi (15.9%); Corporacion Financiera del Valle (14%); Corporación Financiera Colombiana (10.3%); Fondo de Pensiones Obligatorias Proteccion (5.4%) and Inversiones Harivalle (5%). Promigas operates 1,000 kilometers of gas pipelines owned by third parties. Through its pipelines, the company distributes gas to more than 1.3 million end users (approximately 7 million people) in 174 towns. Promigas also has an extensive portfolio of natural gas transmission and distribution companies. As of December 31, 2004, the company had unconsolidated total revenues of \$67.5 million and net income of \$42.9 million on total assets of \$484.2 million and shareholders' equity of \$321.7 million. **Fundacion Promigas**, is a foundation established by Promigas, to develop and implement social programs.

The following are the participating distribution utilities active in the distribution and sale of natural gas:

- **Gases del Caribe S.A. E.S.P.**
- **Surtigas S.A. E.S.P.**
- **Gases De La Guajira S.A. E.S.P.**
- **Gases De Occidente S.A. E.S.P**

1.2. Objective of the Project:

The objective of the Project is to connect to the natural gas distribution network an estimate of 35,000 households in the income strata 1 and 2 (as per government classification), permitting their access to natural gas services.

1.3. Institutional arrangements for project implementation:

Based on demand expressed by households, (which may surpass the available funds to subsidize connection fees), the participating distribution utilities, will furnish Fundacion Promigas, with projections, on a quarterly basis, for the scope of subsidized connections across the four distribution areas, with a breakdown of eligible households according to income strata. Fundacion Promigas will coordinate, on the basis of the quarterly forecasts submitted by participating distribution utilities, on the actual allocation of funds across the participating distribution utilities

and will communicate to the participating distribution utilities their “cap” for subsidized connections.

Fundacion Promigas will share with GPOBA, for information and tracking purposes, the connection projections as submitted by company/income strata and a justification for the actual and final allocation for the quarter as well as the final connection projections quarterly.

After receiving, from Fundacion Promigas, their respective quarterly allocation, the participating distribution utilities will then proceed to connect residential users to the network and, for each connected household, collect certificates (“Installation of Connection Certificate”) signed by beneficiary households confirming that households have indeed been connected in accordance with applicable rules and regulations and at a discount to the connection fee in the amount of the GPOBA subsidy payment. The participating distribution utilities (through their respective *Unidad Técnica de Inspección*) will then certify, by means of a “Technical Certificate” that connections have been made as to the technical rules and regulations applicable to the gas sector in Colombia and will get confirmation in writing by local authorities (“Stratification Certificate”) of the fact that the connected households fall within strata 1 and 2 of household income. The certificate master forms have been reviewed by GPOBA and agreed on for use in the project. roject.

After having made the connection to a household, participating distribution utilities will provide services to connected households as per the applicable regulatory provisions. Households will be responsible for paying tariffs for gas consumption and will enjoy customer rights and obligations as per the applicable regulations.

The participating distribution utilities will invoice GPOBA for each subsidized connection made, and will pass the invoices to Fundacion Promigas, jointly with a written confirmation of the collection of the corresponding Installation of Connection Certificates, Technical Certificates, the Stratification Certificates and billing records for three months providing evidence for actual use of the connection. Fundacion Promigas will consolidate invoices and certification as provided by the participating distribution utilities, will review the accuracy and completeness of the documentation, and will forward invoices to GPOBA. GPOBA will subsequently make direct payments to the participating distribution utilities.

To provide for an independent verification of outputs, Fundacion Promigas will be responsible for the contracting of an independent audit firm that would conduct ex post reviews of the completeness, accuracy and authenticity of documentation provided by the participating distribution utilities as well as undertake ex post physical spot checks for a meaningful and random sample of connections. Such technical audits would be conducted every six months.

1.4. Administrative, financial management, disbursement, and procurement

Administrative Arrangements

Fundacion Promigas will oversee compliance with the conditions agreed on with GPOBA. It will process and submit applications for withdrawal of funds, maintain accounting records for ex-post reviews and the manage the external annual audit.

All accounting, auditing, reporting, financial, procurement, contracting and contract execution will be carried out in a decentralized manner by each of the participating distribution utilities, following Colombian laws governing accounting, technical and quality standards, , and in accordance to highest ethical standards and professional integrity.

GPOBA has agreed, based on its satisfactory assessment of the financial and procurement management systems, on implementing the project following each participating distribution utility's operational manuals and internal control procedures. The corresponding sections on accounting, procurement of goods and services, contract management, payments to contractors and suppliers, and document filing and recording, are attached as Annex 3 to this Operational Manual, which is filed on the project preparation records. This Operational Manual must be followed during the project's life. Changes in the internal operational manuals and internal control procedures of the participating distribution utilities must be notified to GPOBA.

Financial Management

The participating distribution utilities will maintain an administrative unit responsible for financial and budget management, reporting and accounting. These units will utilize their respective financial management and reporting systems. The participating distribution utilities will manage their accounts in accordance with their internal procedures. For this purpose the distribution companies and Fundación Promigas have written a document to specify the activities each one of them has to carry out. This document is attached as annex 5.

Annual project financial statements of the participating distribution utilities will be audited by an independent auditor in accordance with International Standards on Auditing issued by the International Federation of Accountants (IFAC). The external auditor must be selected in accordance to terms of reference and procedures subject to a no objection of GPOBA. Fundación Promigas shall prepare and furnish to the World Bank as part of the Project Report not later than forty-five days after the end of each calendar semester, interim un-audited financial reports for the Project covering the semester, in form and substance satisfactory to the World Bank.

Fundacion Promigas will maintain project financial and auditing records for a minimum period of five years after completion of the project.

Disbursement Arrangements

Disbursement will be made as direct payments and/or reimbursement upon application for withdrawal of funds. Direct payments and/or reimbursement to the Recipients will be in Colombian Pesos using the exchange rate in effect at the date disbursements are processed by the Bank. All foreign exchange risks associated with the project will be borne by the participating distribution utilities. The participating distribution utilities will be liable for payments of applicable duties and taxes on all goods and works for the project.

Procurement

Procurement for the acquisition of goods and small works for the installation services of the internal gas pipe work, including shopping and direct contracting, will be carried out in accordance with each participating distribution utility's operational manuals and internal control procedures and standard bidding and contract documents.

The timing and sequencing of procurement and contracting decisions, including procurement thresholds, payment schedules to contractors, and choice of contracts for making the household connections will be the discretion of the participating distribution utilities, and preparation of detailed procurement plans will not be required.

The bidding documents will include specifications for construction works as defined by Colombian legislation and regulations as well as technical description of works (based on the technical specifications provided by the participating distribution utilities). The specifications, among others, will include requirements for the compliance of the installations services with Colombian laws and regulations for the gas sector governing environmental, technical, metrology and quality standards, and in accordance to highest ethical standards and professional integrity.

1.5. Indicative timeline for project implementation

It is anticipated that the implementation of the project would take up to 18 months, from effectiveness of the grant agreement.

Fundacion Promigas, in cooperation with the distribution utilities, has provided to GPOBA a tentative breakdown of connections likely to be made as result of the project. It is expected that participating distribution companies would take one-two months to conduct an extensive marketing/community involvement campaign to sensitize lower income households to the opportunity of receiving subsidized household connections. As a result of this campaign and corresponding to the resulting demand, the actual breakdown of connections per utility and timing may differ from these indicative figures. Therefore, Fundacion Promigas, in coordination with participating distribution utilities, would decide on the final quarterly allocation of funds, only after the marketing campaign, and would determine quarterly allocations thereafter (to reflect the possibility of weaker than anticipated demand among some utilities) until committed GPOBA funds are exhausted.

| Empresa | No. Viviendas a Conectar Proyecto GPOBA/Mes | | | | | | | | | | | | TOTAL |
|---------------------|---|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | |
| GASES DEL CARIBE | 840 | 839 | 837 | 835 | 835 | 835 | 835 | 834 | 832 | 829 | 825 | 824 | 10,000 |
| SURTIGAS | 834 | 834 | 834 | 834 | 834 | 834 | 833 | 833 | 833 | 833 | 832 | 832 | 10,000 |
| GDO | 1,087 | 1,083 | 1,083 | 1,083 | 1,083 | 1,083 | 1,083 | 1,083 | 1,083 | 1,083 | 1,083 | 1,083 | 13,000 |
| GASES DE LA GUAJIRA | 168 | 168 | 168 | 168 | 166 | 166 | 166 | 166 | 166 | 166 | 166 | 166 | 2,000 |
| TOTAL | 2,929 | 2,924 | 2,922 | 2,920 | 2,918 | 2,918 | 2,917 | 2,916 | 2,914 | 2,911 | 2,906 | 2,905 | 35,000 |

It is anticipated, that, on average, 9000 connections would be installed jointly by all participating distribution utilities per quarter, and that therefore, all connections would have been made about 14 months after effectiveness of the grant.

1.6. Disbursement schedule

Disbursements for connections will be deferred for three months to provide evidence of gas consumption and bill payment. The project would therefore be expected to fully disburse by 18 months into the project.

| Month | 1-2 | 5 | 8 | 11 | 14 | 17 | Total |
|--|-----|-------|-----------|-----------|-----------|-----------|-----------|
| Connections made | 0 | 8,775 | 8,756 | 8,747 | 8,722 | 0 | 35,000 |
| Connections eligible for reimbursement (at US\$ 141/ per conn.) | | | 8,775 | 8,756 | 8,747 | 8,722 | |
| Disbursements | | | | | | | |
| Subsidy payments | 0 | 0 | 1,237,275 | 1,234,596 | 1,233,327 | 1,229,802 | 4,935,000 |
| Technical assistance (Audit) | 0 | 0 | 30,000 | 0 | 60,000 | 60,000 | 150,000 |
| Total | 0 | 0 | 1,267,275 | 1,234,596 | 1,293,327 | 1,289,802 | 5,085,000 |

1.7. Civic society involvement and stakeholder consultation

The four participating distribution utilities will be responsible for marketing gas connections (at the subsidized rate) to eligible low income (ie income strata 1 and 2) households; to provide for sufficient civil society involvement and publicity as to the availability of subsidized connections specifically to strata 1 households, the four participating utilities, in cooperation with Fundacion Promigas, will conduct each at least one public stakeholder consultation event, which would be advertised in relevant local media, to which local media would specifically be invited in order to enable broad publicity as to the availability of this program, and in which local representatives of civil society and other relevant stakeholders would be invited to express views, including as to possible ways to improve dissemination to specifically strata 1 households.

2. Environmental management plan

Due diligence by the World Bank has concluded that the proposed project meets the applicable World Bank/IFC environment and social policies and the environmental, health and safety guidelines upon successful implementation of the agreed mitigation measures as laid out in the Corrective Action Plan submitted by Promigas on April 5, 2006. GPOBA will evaluate the project's compliance with the applicable environmental and social requirements during the lifetime of the project by reviewing the annual monitoring reports (AMRs) prepared for the project covering the status of implementation of measures contained in the Corrective Action Plan (CAP) and ongoing performance of project-specific environmental, health and safety and social activities. Periodic site supervision visits will also be conducted. Further information is provided in the documentation attached in Annex 4.

3. Eligibility criteria for the Beneficiary Households;

In Colombia, a geographical targeting instrument (known as the Estratificación Socio-Económica, ESE) has been in operation since 1965. This system classifies neighborhoods and rural areas in six strata, 1 to 6 (from poor to rich) based on the external characteristics of houses and neighborhoods. It is applied by municipalities for urban and rural areas following procedures and guidelines provided by the National Planning Department (DNP). It is based on a questionnaire that is applied in the field by trained people and a weighting system (not known publicly) to get to

the six strata. This system has been used to target water, electricity and other public services, and infrastructure subsidies.

Eligibility to the GPOBA subsidies will be restricted to households in strata 1 and 2 of the ESE rating system. Participating distribution utilities will need to provide evidence of households being classified as either strata 1 or 2 jointly with the submission of invoices to Fundacion Promigas. In making allocations to individual participating distribution utilities, Fundacion Promigas will ensure that no less than 50% of total beneficiaries are ranked as strata 1.

4. Definition of output:

Natural gas connections made by the participating distribution utilities, would qualify for reimbursement of connection fee discounts by GPOBA

Provided:

- i. each eligible household falls under strata 1 or 2;
- ii. the connection is new, and made after the signing of the grant agreement with GPOBA;
- iii. the service has been used at the connection for a period of at least three months prior to the application for payment, as evidenced by consumption and billing records;
- iv. In-house installations are provided sufficient for the operation of a kitchen gas stove and such stove has been provided to the household at no additional cost
- v. the connection is of the approved specification as per the applicable laws and regulations for the gas sector in Colombia;

Furthermore, to qualify for reimbursement by GPOBA, participating utilities would have to provide evidence that connections made are actually usable and used. Sufficient evidence to that extent would be an indication of gas usage/consumption as per billing records for three full months subsequent to the month of connection.

5. Monitoring and supervision of the Project

Fundacion Promigas will have the primary responsibility for monitoring project progress. It is of great importance to GPOBA to monitor and document sustainability and impact of the project even beyond the disbursement period of the project. To this extent, Fundacion Promigas will coordinate with participating distribution companies to gather information, and prepare consolidated annual reports over a period of at least three years, for use by GPOBA, including, but not limited to the following indicators:

- Level of defined "output" achieved, e.g. number of connections made
- Total number of beneficiary households
- Breakdown of beneficiary households by ESE classification
- Breakdown of total households in service area by ESE classification
- Annual reports on service quality (as required under the applicable regulatory regime)
- Average monthly consumption per beneficiary household
- Average expenditure on service by beneficiary households as a percentage of total hh expenditure

- Average household expenditure on alternative fuels (firewood, LPG) prior to connection to gas services
- Average residential tariff for beneficiary households (and specify if different than tariff for other consumers)
- Total project costs as per actual incurred expenditure (please breakdown into components if possible)
- Average project costs per household or connection

Annex 2

Project cost breakdown

Project costs are estimated at about US\$13.1 million, including the indicative GPOBA subsidy payment (US\$ million 4,935,000) plus customer contributions of about US\$ million 8,015,000, and the costs of the audit firm (ongoing costs and periodic evaluations) of US\$ 150,000.

| Expenditure categories | GPOBA contribution (US\$) | Co-financing | | Total Project Cost (US\$) |
|---------------------------------------|---------------------------|------------------|---|---------------------------|
| | | US\$ | Details | |
| Projected subsidy expenditure | 4,935,000 | 8,015,000 | Customer contribution, in part financed by utilities; | 12,950,000 |
| Consulting services (Technical Audit) | 150,000 | | | 150,000 |
| Total Financing/Costs | 5,085,000 | 8,015,000 | | 13,100,000 |

Annex 3

The manuals as relevant to the financial management and procurement for each of the participating utilities are listed as follows:

Gases del Caribe

Manual on accounting
Manual on procurement of goods and services
Manual on contract management
Manual on payments to contractors and suppliers
Manual on document filling and recording

Surtigas

Manual on accounting
Manual on procurement of goods and services
Manual on contract management
Manual on payments to contractors and suppliers
Manual on document filling and recording

Gases de Occidente

Manual on accounting
Manual on procurement of goods and services
Manual on contract management
Manual on payments to contractors and suppliers
Manual on document filling and recording

Gases de La Guajira

Manual on accounting
Manual on procurement of goods and services
Manual on contract management
Manual on payments to contractors and suppliers
Manual on document filling and recording

These manuals were sent to the World Bank's office in Bogotá.