
GRANT NUMBER 0118-NEP(SF)

GRANT AGREEMENT
(Special Operations)

(Governance Support Program Cluster (Subprogram I))

between

FEDERAL DEMOCRATIC REPUBLIC OF NEPAL

and

ASIAN DEVELOPMENT BANK

DATED 15 DECEMBER 2008

LPS:NEP 36172

GRANT AGREEMENT (Special Operations)

GRANT AGREEMENT dated 15 December 2008 between the FEDERAL DEMOCRATIC REPUBLIC OF NEPAL ("the Recipient") and ASIAN DEVELOPMENT BANK ("ADB").

WHEREAS

(A) ADB has received from the Recipient a development policy letter dated 12 September 2008 (hereinafter called the Policy Letter), setting forth certain objectives, policies and actions, described in Schedule 1 to this Grant Agreement, designed to develop the Recipient's governance sector (hereinafter called the GSP), of which this Program (hereinafter called the Program or GSP-I) comprises the first subprogram as described in Schedule 1 to this Grant Agreement;

(B) the Recipient has applied to ADB for a grant from its Special Funds resources for the purposes of the Program; and

(C) ADB has, on the basis inter alia of the foregoing, agreed to provide a grant to the Recipient from ADB's Special Funds resources upon the terms and conditions hereinafter set forth;

NOW THEREFORE the parties agree as follows:

ARTICLE I

Grant Regulations; Definitions

Section 1.01. All the provisions of the Special Operations Grant Regulations of ADB, dated 7 February 2005 (the "Grant Regulations"), are hereby made applicable to this Grant Agreement with the same force and effect as if they were fully set forth herein, subject, however, to the following modifications:

(a) Section 2.01(15) is deleted and the following is substituted therefor:

The term "Program" means the program for which ADB has agreed to make the Grant, as described in the Grant Agreement and as the description thereof may be amended from time to time by agreement between ADB and the Recipient.

(b) The term "Project" wherever it appears in the Grant Regulations shall be substituted by the term "Program".

(c) Section 2.01(17) is deleted and the following is substituted therefor:

The term "Program Executing Agency" means the entity or entities responsible for the carrying out of the Program as specified in the Grant Agreement.

(d) The term "Project Executing Agency" wherever it appears in the Grant Regulations shall be substituted by the term "Program Executing Agency".

(e) Section 5.01(a) is deleted and the following is substituted therefor:

(a) Subject to any conditions or restrictions specified in the Grant Agreement, the Recipient shall be entitled to withdraw from the Grant Account such amounts as shall be required to meet payments for expenditures required for the Program and to be financed under the Grant Agreement.

Section 1.02. The terms defined in the Grant Regulations are incorporated into this Grant Agreement, unless the context requires otherwise. In addition, the following terms have the following meanings:

(a) "ASIP" means annual strategic implementation plan;

(b) "Counterpart Funds" means the Rupees proceeds generated from the proceeds of the Grant and deposited by the Recipient in the Special Account in accordance with paragraph 7 of Schedule 4 to this Grant Agreement;

(c) "Deposit Account" means the account established in accordance with paragraph 4 of Schedule 2 to this Grant Agreement;

(d) "Eligible Items" means the goods imported under the Program (except those specifically excluded pursuant to Attachment 1 to Schedule 2 to this Grant Agreement), the foreign exchange costs of which are eligible for financing out of the proceeds of the Grant;

(e) "First Tranche" means the portion of the proceeds of the Grant not exceeding twenty million dollars (\$20,000,000) to be initially withdrawn and utilized;

(f) "FY" refers to the Recipient's fiscal year which ends on July 15th of every year;

(g) "GE/SI" means gender equality and social inclusion;

(h) "JFA" means Joint Financing Arrangement and refers to the agreement to be signed between the Recipient and developing partners to administer and implement the LGCDP;

(i) "LBs" means local bodies and includes any successor thereto as established in accordance with the Recipient's new Constitution to be promulgated;

(j) "LGCDP" or "national program" refers to the Recipient's national Local Governance and Community Development Program;

(k) "MLD" means the Recipient's Ministry of Local Development and includes any successor thereto;

(l) "MOF" means the Recipient's Ministry of Finance and includes any successor thereto;

(m) "NAC" means National Advisory Committee;

(n) "Policy Letter" means the development policy letter dated 12 September 2008 addressed by the Recipient to ADB and referred to in Preamble (A) of this Grant Agreement;

(o) "Policy Matrix" means the policy matrix agreed between the Recipient and ADB and included in Appendix 5 of the Report and Recommendation of the President to the ADB Board for the Program;

(p) "Program Executing Agency" means, for the purposes of and within the meaning of the Grant Regulations, MLD, and any successor thereto acceptable to ADB, which is responsible for the carrying out of the Program;

(q) "Rupees" refers to the Recipient's currency;

(r) "Second Tranche" means the portion of the proceeds of the Grant not exceeding forty-five million dollars (\$45,000,000) to be withdrawn upon finalization of the JFA pursuant to and subject to the provisions of Attachment 2 to Schedule 2 to this Grant Agreement;

(s) "Social and Environmental Safeguards Framework" refers to the framework on social and environmental safeguards for the national program as agreed between the Recipient and ADB, and set out in Supplementary Appendix G of the Report and Recommendation of the President to the ADB Board for the Program; and

(t) "Third Tranche" means the portion of the proceeds of the Grant not exceeding forty-one million three hundred thousand dollars (\$41,300,000) to be withdrawn pursuant to and subject to the provisions of Attachment 3 to Schedule 2 to this Grant Agreement.

ARTICLE II

The Grant

Section 2.01. ADB agrees to make available to the Recipient from ADB's Special Funds resources on terms and conditions set forth in this Grant Agreement an amount of one hundred and six million three hundred thousand dollars (\$106,300,000).

ARTICLE III

Use of Proceeds of the Grant

Section 3.01. The Recipient shall cause the proceeds of the Grant to be applied to the financing of expenditures on the Program in accordance with the provisions of this Grant Agreement.

Section 3.02. The proceeds of the Grant may be withdrawn from the Grant Account only for the purposes of financing expenditures incurred for Eligible Items under the Program in accordance with the provisions of Schedule 2 to this Grant Agreement, as such Schedule may be amended from time to time by agreement between the Recipient and ADB.

Section 3.03. Except as ADB may otherwise agree, all Eligible Items to be financed out of the proceeds of the Grant shall be procured in accordance with the provisions of Schedule 3 to this Grant Agreement.

Section 3.04. Withdrawals from the Grant Account shall be made only on account of expenditures relating to Eligible Items which:

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

Section 3.05. Except as ADB may otherwise agree, no withdrawals shall be made from the Grant Account in respect of expenditures for Eligible Items incurred more than one hundred eighty days (180) days prior to the Effective Date.

Section 3.06. The Grant Closing Date for the purposes of Section 8.02 of the Grant Regulations shall be 30 June 2013 or such other date as may from time to time be agreed between the Recipient and ADB.

ARTICLE IV

Particular Covenants

Section 4.01. In the carrying out of the Program, the Recipient shall perform, or cause to be performed, all obligations set forth in Schedule 4 to this Grant Agreement.

Section 4.02. (a) The Recipient shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible Items financed out of the proceeds of the Grant and to record the progress of the Program.

(b) The Recipient shall enable ADB's representatives to inspect any relevant records and documents referred to in paragraph (a) of this Section.

Section 4.03. (a) As part of the reports and information referred to in Section 6.04 of the Grant Regulations, the Recipient shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning (i) the Counterpart Funds and the use thereof; and (ii) the implementation of the Program, including the accomplishment of the targets and carrying out of the actions set out in the Policy Letter.

(b) Without limiting the generality of the foregoing or Section 6.04 of the Grant Regulations, the Recipient shall furnish, or cause to be furnished, to ADB four-monthly reports on the carrying out of the Program and on the accomplishment of the targets and carrying out of the actions set out in the Policy Letter.

ARTICLE V

Effectiveness

Section 5.01. A date ninety (90) days after the date of this Grant Agreement is specified for the effectiveness of the Grant Agreement for the purposes of Section 9.04 of the Grant Regulations.

ARTICLE VI

Miscellaneous

Section 6.01. The Secretary of MOF of the Recipient is designated as representative of the Recipient for the purposes of Section 11.02 of the Grant Regulations.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the Grant Regulations:

For the Recipient

Ministry of Finance
Singha Durbar
Kathmandu, Nepal

Facsimile Number

977-1-4211165.

For ADB

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

Facsimile Numbers:

(632) 636-2444
(632) 636-2337.

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

FEDERAL DEMOCRATIC REPUBLIC
OF NEPAL

By 
RAMESHORE PRASAD KHANAL
Authorized Representative

ASIAN DEVELOPMENT BANK

By 
BARRY HITCHCOCK
Country Director
Nepal Resident Mission

SCHEDULE 1

Description of the Program

1. The impact of the GSP is to support the Recipient's medium term reforms in the local governance and community development sector, aimed at the social and economic transformation of Nepal. This will be achieved through supporting: (i) a capable and accountable government at all levels that provides effective and inclusive services; and (ii) empowered communities that engage actively with the Recipient's government to hold it accountable.
2. The Program is the first subprogram of the GSP and will support the Recipient's LGCDP. GSP-I's intended outcomes are: (i) citizens and communities empowered and engaged actively with LBs and hold them accountable; (ii) increased capacity of LBs to manage resources and deliver basic services in an inclusive and equitable manner; and (iii) strengthened policy and national institutional framework for decentralization, devolution and community development. GSP and the Program are described in more detail in the Policy Letter. The Program shall be implemented during the period till December 2012.
3. GSP includes a second subprogram that will support (i) business process reengineering at the center level in support of a federal government structure; (ii) developing the legal framework for local governance; (iii) strengthening the fiscal transfer system and process; and (iv) strengthening community organizations and LBs.
4. In support of the Program:
 - (a) the proceeds of the Grant shall be used to finance the cost of Eligible Items; and
 - (b) the Counterpart Funds shall be used to finance the local currency costs related to the implementation of certain programs and activities consistent with the objectives of the Program, pursuant to the provisions of paragraphs 8 and 9 of Schedule 4 to this Grant Agreement.
5. The proceeds of the Grant are expected to be utilized by 31 December 2012.

SCHEDULE 2**Allocation and Withdrawal of Grant Proceeds**

1. Except as ADB may otherwise agree, the following provisions of this Schedule shall apply to the withdrawal of Grant proceeds from the Grant Account.

2. (a) Withdrawals from the Grant Account shall be made for the financing of the cost of Eligible Items.

(b) No withdrawals from the Grant Account shall be made in respect of any expenditures which have been financed by credits from official international or bilateral aid agencies or any other grants or loans made by ADB.

3. (a) An application for withdrawal from the Grant Account shall be submitted to ADB by the Recipient and shall be in a form satisfactory to ADB.

(b) Such withdrawal applications shall be accompanied by a certificate of the Recipient confirming that with respect to each year during which the proceeds of the Grant are expected to be disbursed, the value of the Eligible Imports is expected to be equal to or greater than the amount of the Grant expected to be disbursed during such year.

(c) For the purposes of this paragraph, the term "Eligible Imports" means the total imports of the Recipient during the relevant period minus the following imports during the same period:

- (i) imports from countries which are not members of ADB;
- (ii) imports for ineligible items specified in Attachment 1 to this Schedule; and
- (iii) imports financed from credits from official international or bilateral aid agencies or any other loans or grants made by ADB.

(d) The Recipient shall allow experts appointed by ADB to verify the value of Eligible Imports during any period in respect of which the Recipient has certified the value of Eligible Imports in its withdrawal application.

4. (a) Prior to submitting the first application to ADB for withdrawal from the Grant Account, the Recipient shall open an account (the Deposit Account) at Nepal Rastra Bank into which the proceeds from the First Tranche shall be deposited. For the Second Tranche and Third Tranche, the pooled Foreign Exchange Account, which shall be established under the LGCDP and shall be held by MLD at the Nepal Rastra Bank, shall function as the Deposit Account. The Deposit Account shall be established, managed and liquidated in accordance with terms and conditions satisfactory to ADB.

(b) Separate accounts and records in respect of the Deposit Account shall be maintained in accordance with consistently maintained sound accounting principles. Upon ADB's request, the Recipient shall have the Deposit Account audited by independent

auditors, whose qualifications, experience and terms of reference are acceptable to ADB, in accordance with appropriate auditing standards. Promptly after their preparation but in any event not later than six (6) months after the date of ADB's request, certified copies of such audited accounts and records shall be furnished to ADB, all in the English language.

(c) Throughout the Program implementation period, the Recipient shall submit trade statistics and any other information as ADB may require from time to time to assess the Recipient's compliance with the formula for determining Eligible Imports.

5. Notwithstanding any other provision of this Grant Agreement and except as ADB may otherwise agree, no withdrawals shall be made from the Second Tranche unless ADB shall be satisfied, after consultation with the Recipient, that (a) sufficient progress has been achieved by the Recipient in the carrying out of the Program; and, in particular, (b) the Recipient has fulfilled the conditions for the release of the Second Tranche specified in Attachment 2 to this Schedule.

6. Notwithstanding any other provision of this Grant Agreement and except as ADB may otherwise agree, no withdrawals shall be made from the Third Tranche unless ADB shall be satisfied, after consultation with the Recipient, that (a) sufficient progress has been achieved by the Recipient in carrying out the Program; and, in particular, (b) the Recipient has fulfilled the conditions for the release of the Third Tranche specified in Attachment 3 to this Schedule.

Attachment 1 to Schedule 2**Negative List**

1. Grant proceeds will finance the foreign currency expenditures for the reasonable cost of imported goods required during the Program.
2. No withdrawals will be made for the following:
 - (i) expenditures for goods included in the following groups or sub-groups of the United Nations Standard International Trade Classification, Revision 3 (SITC, Rev. 3) or any successor groups or sub-groups under future revisions to the SITC, as designated by ADB by notice to the Recipient:

Table A12: Ineligible Items

Chapter	Heading	Description of Items
112		Alcoholic beverages
121		Tobacco, unmanufactured; tobacco refuse
122		Tobacco, manufactured (whether or not containing tobacco substitute)
525		Radioactive and associated materials
667		Pearls, precious and semiprecious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof, fuel elements (cartridges), nonirradiated for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum-group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971		Gold, nonmonetary (excluding gold ore and concentrates)

Source: United Nations.

- (ii) expenditures in the currency of the Recipient or of goods supplied from the territory of the Recipient;
- (iii) expenditures for goods supplied under a contract that any national or international financing institution or agency will have financed or has agreed to finance, including any contract financed under any loan or grant from the ADB;
- (iv) expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;
- (v) expenditures for narcotics;
- (vi) expenditures for environmentally hazardous goods, the manufacture, use or import of which is prohibited under the laws of the Recipient or international agreements to which the Recipient is a party; and

- (vii) expenditures on account of any payment prohibited by the Recipient in compliance with a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations.

Attachment 2 to Schedule 2**Conditions for Release of the Second Tranche**

In addition to maintaining the conditions satisfied under the First Tranche, the following conditions shall be met prior to the release of the Second Tranche:

- (i) The JFA shall have been finalized;
- (ii) The Recipient shall have endorsed the national program;
- (iii) MLD shall have prepared the local governance and community development ASIP for FY2010 in accordance with the objectives and performance targets of the national program, and shall have had it endorsed by all JFA development partners, including ADB;
- (iv) The National Planning Commission and MOF shall have approved the annual workplan and budget for FY2010 for the national program;
- (v) MLD shall have approved a social mobilization strategy, including a detailed action plan with budget allocation, that is relevant to disadvantaged groups;
- (vi) MLD shall have approved a GE/SI strategy, including detailed implementation arrangements with budget allocation;
- (vii) MLD shall have established a local governance and accountability facility aimed at ensuring that LBs are held accountable for service delivery;
- (viii) MLD shall have approved allocation criteria and a roll-out plan for additional block grants;
- (ix) MLD shall have issued guidelines to LBs regarding local own source revenue collection;
- (x) MLD shall have issued guidelines on topping-up grants to LBs;
- (xi) The NAC shall have approved an action plan for improving MLD's capacity to coordinate programs on local governance and community development; and
- (xii) MLD shall have completed a fiduciary risk assessment of inter-governmental fiscal transfers.

Attachment 3 to Schedule 2**Conditions for Release of the Third Tranche**

In addition to maintaining the conditions satisfied under the First and Second Tranche, the following conditions shall be met prior to the release of the Third Tranche:

- (i) MLD shall have prepared the local governance and community development ASIP for FY2011 in accordance with the objectives and performance targets of the national program, and shall have had it endorsed by all JFA development partners, including ADB;
- (ii) MLD shall have achieved, in a manner acceptable to ADB, the performance targets set in the ASIP for FY2010;
- (iii) MLD shall have approved a time-bound action plan with resource allocation on the implementation of the recommendations of the mid-term review of the national program; and
- (iv) MLD shall have prepared an approach paper on how to continue the reform agenda on local governance and community development, including the possibility of using a sector-wide approach.

SCHEDULE 3

Provisions on Procurement and Consulting Services

1. Except as ADB may otherwise agree, the procedures referred to in the following paragraphs of this Schedule shall apply in the procurement of Eligible Items to be financed out of the proceeds of the Grant.

2. (a) Except as provided in subparagraph (b) of this paragraph, each contract for Eligible Items shall be awarded on the basis of either the purchaser's normal commercial procurement practices, in the case of procurement by the private sector, or the Recipient's prescribed procurement procedures, in the case of procurement by the public sector, having due regard for the principles of economy and efficiency.

(b) Each supply contract for Eligible Items which are commonly traded commodities shall be awarded on the basis of procedures appropriate to the trade and acceptable to ADB.

SCHEDULE 4

Program Management, Implementation and Other Matters

A. Program Management, Implementation, Coordination, and Monitoring

1. MLD shall be the Program Executing Agency responsible for the overall and timely implementation of the Program. MLD shall implement, manage, coordinate, audit, monitor, and evaluate the Program in accordance with the goals, responsibilities, funding mechanism, fiduciary requirements, and other Program management and implementation arrangements as set forth in the national program document. MLD shall ensure that the same, or similar, arrangements shall be incorporated in the JFA to be signed between the Recipient and development partners supporting the LGCDP. In the event of discrepancy between the arrangements in the LGCDP document and the JFA, the JFA shall prevail.

2. The NAC, chaired by the Secretary MLD, shall be responsible for: (i) providing support on policy matters related to local governance and community development; (ii) overseeing Program implementation and progress; and (iii) facilitating cooperation and coordination among all relevant agencies including government agencies and development partners.

B. Implementation of the Policy Letter

3. The Recipient shall: (i) ensure that the objectives achieved, policies adopted, and actions taken prior to the date of this Grant Agreement, as set forth in the Policy Letter, shall continue to be in full force and effect for the duration of the Program period and subsequently; (ii) carry out the policies and actions in accordance with the schedule of policy reforms contained in the Policy Matrix and ensure sustainability of the reforms beyond the Program period; (iii) carry out all of its obligations as stipulated under this Schedule and the Grant Agreement, in a timely manner.

C. Policy Dialogue

4. The Recipient shall keep ADB informed of, and the Recipient and ADB shall from time to time exchange views on, sector issues, policy reforms and additional reforms during the Program Period that may be considered necessary or desirable, including the progress made in carrying out the Program.

5. The Recipient shall engage in policy dialogue with ADB, in a timely manner, on problems and constraints encountered during Program implementation and on desirable changes to overcome or mitigate such problems and constraints.

6. The Recipient and ADB shall keep each other mutually informed of policy discussions with other multilateral or bilateral agencies that have implications for implementation of the Program, and shall provide each other with an opportunity to comment on any resulting policy proposals. The Recipient and ADB shall take each other's views into consideration before finalizing and implementing any such proposals.

D. Financial Matters

a. Special Account

7. Immediately after the Effective Date, the Recipient shall establish, in a manner satisfactory to ADB, a Special Account at Nepal Rastra Bank for the specific purpose of depositing and utilizing the Counterpart Funds. Whenever the Recipient withdraws proceeds of the Grant from the Grant Account, the Recipient shall promptly deposit into the Special Account the Rupees amount equivalent to the amount of the proceeds so withdrawn.

b. Counterpart Funds

8. The Recipient shall ensure that the Counterpart Funds shall be used exclusively for the implementation of the Recipient's LGCDP. Except as ADB may otherwise agree, the Counterpart Funds shall be utilized not later than 31 December 2012.

9. MLD shall ensure to provide for the following specific allocations from the Counterpart Funds: (i) four million five hundred thousand dollar equivalent (\$4,500,000) to support the work of the Local Peace Committees; and (ii) one million eight hundred thousand dollar equivalent (\$1,800,000) to support the capacity of MLD and LBs to conduct environmental and social assessments, and manage related safeguard review, monitoring, and reporting activities. These allocations shall be taken in equal amounts from each tranche.

10. Within one month of the Effective Date, MLD shall have established a budget tracking system satisfactory to ADB to track the use of the Counterpart Funds on a four-monthly basis, until such time as the JFA shall have become effective, at which time the provisions of the JFA shall apply.

c. Other Financial Matters

11. MLD shall ensure to provide on a timely basis the allocated financial resources for the Local Governance and Accountability Facility to be established under the LGCDP.

12. MLD shall ensure to review, at the end of the inception phase of the LGCDP, the budget assumptions underlying the national program. Subsequently, MLD shall make all necessary reallocations across budget line items, in accordance with the agreed strategies, action plans, and program approaches.

E. Other Implementation Matters

13. MLD shall ensure that all LBs, as and when they are included under the LGCDP, shall be adequately staffed and provided with the necessary financial, technical, and other resources, including equipment, to perform their functions under the national program.

14. MLD shall ensure to timely and effectively implement the GE/SI action plan agreed between ADB and MLD for the Program, as well as the GE/SI Strategy and Guidelines to be approved for the LGCDP.

15. MLD shall ensure to implement the LGCDP in accordance with the provisions of the Social and Environmental Safeguards Framework.

F. Review

16. In the event the JFA has not become effective by March 2009, ADB and MLD shall jointly conduct a review of the program.

G. Program Performance Monitoring and Evaluation

17. At the latest by the time of the signing of the JFA, MLD as well as the Program implementation unit at the Ministry of Peace and Reconstruction, shall have established a performance monitoring system for the LGCDP and for the activities of the local peace committees respectively.

18. MLD shall ensure to continually update the baseline data for the national program to ensure proper application of results-based management.