GRANT AGREEMENT
(Special Operations)
(Strengthening Public Management Program)

between

NEPAL

and

ASIAN DEVELOPMENT BANK

DATED 27 DECEMBER 2012
GRANT AGREEMENT
(Special Operations)

GRANT AGREEMENT dated 27 December 2012 between NEPAL (“Recipient”) and ASIAN DEVELOPMENT BANK (“ADB”).

WHEREAS

(A) ADB has received from the Recipient a development policy letter dated 30 July 2012 (“Policy Letter”), setting forth certain objectives, policies and actions, described in Schedule 1 to this Grant Agreement, designed to strengthened the Recipient’s public management program (“Program”);

(B) the Recipient has applied to ADB for a grant for the purposes of the Program;

(C) ADB has also agreed to provide a capacity development technical assistance grant of $500,000 equivalent (“TA”) from ADB’s Technical Assistance Special Fund (TASF-IV) to support the Recipient in implementing the Program;

(D) the Recipient has also applied to the Government of the of the United Kingdom, through the Department for International Development of the United Kingdom, for grants in the amount equivalent to four million Dollars ($4,000,000) to support the Program and in the amount equivalent to two million five hundred thousand Dollars ($2,500,000) to support a technical assistance on the Support for Strengthening Public Management Program; and

(E) ADB has agreed to provide a grant to the Recipient from ADB’s Special Funds resources upon the terms and conditions set forth herein;

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 (“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:

24. 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:

26. 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”.

Section 1.02. Wherever used in this Grant Agreement the several terms defined in the Grant Regulations have the respective meanings therein set forth unless modified herein or the context otherwise requires. Additional terms used in the Grant Agreement have the following meanings:

(a) “CC” means the Recipient’s Constitutional Council;

(b) “CIAA” means the Recipient’s Commission for the Investigation of Abuse of Authority;

(c) “Counterpart Funds” means the Rupees proceeds accruing to the Recipient and generated from the Grant proceeds under the Program and referred to in paragraphs 4 of Schedule 4 to this Grant Agreement;

(d) “DDC” means District Development Committee, and any successor thereto;

(e) “Deposit Account” means the account means the Foreign Currency Account, as referred to in Section 1.02 (m) of and in paragraph 4 of Schedule 2 to this Grant Agreement;

(f) “DFID” means the Department for International Development of the United Kingdom;

(g) “DFID Grant” means the grant in the amount equivalent to $4,000,000 to be provided by DFID to support the Program;

(h) “DFID TA Grant” means the grant amount equivalent to $2,500,000 to be provided by DFID to support the TA;

(i) “e-GP” means e-Government Procurement System;

(j) “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 of ineligible items specified in the Attachment 1 to Schedule 2 to this Grant Agreement; and

(iii) imports financed by official international or bilateral aid agencies or any other loans or grants made by ADB;

(k) “Eligible Items” means the Eligible Imports and services in connection with the delivery and installation of such imports;

(l) “FCGO” means the Recipient’s Financial Comptroller General Office, and any successor thereto;

(m) “First Tranche” means the portion of the proceeds of the Grant in an amount not exceeding $11,000,000 to be withdrawn pursuant to and subject to the conditions set out in Attachment 2 to Schedule 2 to this Grant Agreement and the portion of the proceeds of the DFID Grant in an amount not exceeding $900,000;

(n) “Foreign Currency Account” means the existing foreign currency account that was established under the LGCDP at the Nepal Rastra Bank and managed by MOFALD;

(o) “Implementing Agencies” or “IAs” means the MOFALD, PPMO and NVC as described in paragraph 1 (d) of Schedule 4 of this Grant Agreement;

(p) “LGCDP” means the Recipient’s Local Governance and Community Development Program;

(q) “Loan Disbursement Handbook” means ADB’s Loan Disbursement Handbook (2007, as amended from time to time);

(r) “MARS” means Municipal Administration and Revenue System;

(s) “MOF” means the Recipient’s Ministry of Finance, and any successor thereto;

(t) “MOFALD” means the Recipient’s Ministry of Federal Affairs and Local Development, and any successor thereto;

(u) “NVC” means the Recipient’s National Vigilance Center, and any successor thereto;

(v) “PCU” means program coordination unit as described in paragraph 1 (d) of Schedule 4 to the Grant Agreement;

(w) “PEFA” means public expenditure and financial accountability;

(x) “PETS” means public expenditure tracking survey;

(y) “PFM” means public financial management;
(z) “PFMRP” means the Recipient’s public financial management reform program;

(aa) “Policy Letter” means the development policy letter referred to in Recital (A) of this Grant Agreement;

(bb) “Policy Matrix” means the policy matrix attached to the Policy Letter as agreed between the Recipient and ADB;

(cc) “PMU” means program management unit as described in paragraph 1 (b) of Schedule 4 to the Grant Agreement;

(dd) “PPMO” means the Recipient’s Public Procurement Monitoring Office, and any successor thereto;

(ee) “Program Executing Agency” for the purposes of, and within the meaning of, the Grant Regulations means the MOF or any successor thereto acceptable to ADB, which is responsible for the carrying out of the Program;

(ff) “Rupees” means the currency of the Recipient;

(gg) “Second Tranche” means the balance of the proceeds of the Grant remaining in the Grant Account in the amount of $10,000,000, to be withdrawn pursuant to and subject to the conditions set out in Attachment 3 to Schedule 2 to this Grant Agreement and the balance of the proceeds of the DFID Grant in the amount of $3,100,000; and

(hh) “VDC” means Village Development Committee, and any successor thereto.

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 twenty one million Dollars ($21,000,000).

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 shall be withdrawn 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, the Recipient shall procure, or cause to be procured, the Eligible Items to be financed out of the proceeds of the Grant 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 withdrawal shall be made from the Grant Account in respect of expenditures for Eligible Items incurred more than 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 31 October 2015 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 quarterly 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. The following is specified as an additional condition to the effectiveness of this Grant Agreement for the purposes of Section 9.01(e) of the Grant Regulations: the Recipient shall have satisfied all conditions for the release of the First Tranche, as set out in Attachment 2 to Schedule 2 to this Grant Agreement.

Section 5.02. 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 the 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) 4211164.
For ADB

Asian Development Bank
6 ADB Avenue
Mandaluyong City
1550 Metro 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 as of the day and year first above written and to be delivered at the principal office of ADB.

NEPAL

By

MADHU MARASINI
Authorized Representative

ASIAN DEVELOPMENT BANK

By

KENICHI YOKoyama
Country Director
Nepal Resident Mission
SCHEDULE 1

Description of the Program

1. The principal objective of the Program is to enhance efficiency, transparency, and integrity of the public expenditures at the national and sub-national level and the scope includes (i) local budget and fiscal management; (ii) sub-national fiduciary risk management; (iii) public procurement reform; and (iv) oversight and accountability capacity-building. The Program is described in more detail in the Policy Letter.

2. In support of the Program:

   (a) the proceeds of the Grant shall be used to finance the foreign currency expenditures incurred for the Eligible Items; and

   (b) the Counterpart Funds shall be used to finance the local currency expenditures relating to the implementation of certain programs and other activities consistent with the objectives of the Program. The Recipient shall ensure that the Counterpart Funds shall be used, first, to support the adjustment cost for policies adopted and actions taken under the Program, and second, to finance the expenditures for the general development purposes of the Recipient.

3. The Program is expected to be completed by 31 October 2015.
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. Withdrawals from the Grant Account shall be made for financing foreign currency expenditures incurred for Eligible Items under the Program.

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) 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 nominate the Foreign Currency Account at Nepal Rastra Bank as the Deposit Account into which all withdrawals from the Grant Account shall be deposited. 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 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 provisions of this Grant Agreement and except as ADB may otherwise agree, no withdrawals shall be made from the Grant Account for the Second Tranche unless ADB is satisfied, after consultation with the Recipient, that (a) sufficient progress has been achieved by the Recipient in the carrying out of the Program; (b) the conditions that were met for the release of the First Tranche continue to be complied with by the Recipient; and (c) the Recipient has met the conditions for the release of the Second Tranche specified in Attachment 3 to this Schedule.
Negative List

No withdrawals shall 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:

(ii) expenditures in the currency of the Recipient or for 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 shall have financed or has agreed to finance, including any contract financed under any Grantor 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


Table A12: Ineligible Items

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

Conditions for Release of the First Tranche

I. **Budget and Fiscal Management**

1. MOFALD shall have developed, approved and issued guidelines and a time-bound action plan for timely and streamlined disbursement of block grants from central government to local bodies;

2. MOFALD shall have approved and issued guidelines for allocation and disbursement of small community level grants. The guidelines shall include requirements that the allocation and disbursement shall be prepared based on participatory planning and procurement by ward citizens forums (WCFs) and citizen awareness centers (CACs) to ensure downward accountability in public service delivery at the community level;

3. MOFALD shall have prepared and approved amendments to the local bodies resource mobilization guidelines that shall incorporate measures to enhance existing own-sources of revenues of local bodies.

II. **Sub-national Fiduciary Risk Management**

1. MOFALD shall have completed and approved a strategy and an integrated action plan to strengthen PFM and address fiduciary risks in local bodies;

2. MOFALD shall have developed and introduced results-based reporting system in DDCs for monitoring capital expenditures;

3. MOFALD shall have developed and approved guidelines for external audits of municipalities and VDCs.

III. **Public Procurement Reforms**

1. The PPMO shall have conducted a joint technical review with ADB and the World Bank of public procurement in Nepal;

2. PPMO shall have prepared an implementation roadmap on the development and installation of e-GP in line with its e-Submission operations.

IV. **Oversight and Accountability Capacity Building**

1. The Recipient shall have completed a roster of shortlisted candidates for the posts of Chief Commissioner and Commissioners of the CIAA;

2. The NVC shall have submitted a proposal to cabinet to elevate its status to an independent body to give it greater authority in its conduct of technical audits and its advocacy for corruption prevention.
Conditions for Release of the Second Tranche

I. Budget and Fiscal Management

1. MOF shall have developed and approved a Medium-Term Budget Framework (MTBF) for MOFALD, which shall be presented as part of the national budget for 2013-2014 and thereafter;

2. MOFALD shall have enforced the provisions of earmarked funding for gender empowerment and social inclusion (GESI) activities as per the guidelines for block grants to local bodies (15% for disadvantaged groups, 10% for women, and 10% for children) and provide expenditure tracking record;

3. MOFALD shall have identified and oriented 25 VDCs for the piloting of the revised manual with performance measures in FY 2013/14;

4. MOFALD shall have piloted the MARS in one municipality;

5. MOFALD shall have approved introduction of integrated property tax in 45 municipalities;

II. Sub-national Fiduciary Risk Management

1. MOF shall have completed a PEFA assessment at the sub-national level on a sample basis to establish benchmarks on the key fiscal indicators at sub-national level;

2. MOFALD shall have rolled out the uniform accounting software to at least 1,000 VDCs;

3. MOFALD shall have developed guidelines, criteria and tools for the conduct of risk-based internal audits for DDCs, VDCs and municipalities.

III. Public Procurement Reforms

1. PPMO shall have completed the development of the e-GP software;

2. PPMO shall have completed the development of e-GP training module;

3. PPMO shall have conducted public procurement training for relevant procurement officials of at least 8 ministries and 35 districts.
IV. **Oversight and Accountability Capacity Building**

1. The NVC, through the Office of the Prime Minister and Council of Ministers, shall have submitted to cabinet amendments to the Prevention of Corruption Act of 2002 and subordinate regulations to ensure compliance with the United Nations Convention against Corruption that Nepal ratified in February 2011;

2. The Recipient shall have provided basic and advanced level training for relevant staff of concerned agencies on fraud audit and investigation competencies.
SCHEDULE 3

Procurement

1. Except as ADB may otherwise agree, the procedures referred to in the following paragraph 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 2(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.
SCHEDULE 4

Program Implementation and Other Matters

Implementation Arrangements

1. (a) The Recipient shall be responsible for the coordination and execution of the Program with the various concerned departments and agencies of the Recipient.

(b) The PEFA steering committee, chaired by the Secretary of MOF, shall be the steering committee for and shall provide policy guidance to the Program (PSC). The PSC shall meet, as and when necessary, but at least once every quarter to discuss the progress of the Program and review macroeconomic conditions to ensure continued stability.

(c) The MOF shall be the Program Executing Agency and shall be responsible for the overall implementation of the Program, including compliance with all policy actions, facility administration, disbursements and maintenance of records. The MOF shall receive support from the PEFA Secretariat at the FCGO, which shall serve as the PMU, and provide: (i) technical guidance to the Implementing Agencies, (ii) periodically review the progress of program implementation, and (iii) ensure coordination of the Program with other reform initiatives.

(d) The MOFALD, PPMO and NVC shall be the Implementing Agencies. MOFALD shall implement components 1 and 2 of the Program, PPMO shall implement component 3 of the Program and NVC shall implement component 4 of the Program. PPMO and NVC, respectively, shall establish a PCU to implement their respective components. The existing program coordination unit for LGCDP in MOFALD shall serve as the PCU for MOFALD. Each PCU shall have a manager and shall: (i) supervise implementation of activities under their respective component, (ii) prepare and submit progress reports to the Program Executing Agency and PMU, and (iii) liaise with the PEFA Secretariat in the implementation of the Program. The PCUs shall be supported by consultants to be engaged by MOFALD in consultation with ADB following the existing LGCDP process.

(e) The Recipient shall (i) use its best endeavor to ensure that critical Program staff shall remain in their position on a full-time basis for a reasonable duration to ensure continuity in the implementation of the Program; and (ii) ensure that all Implementing Agencies shall be adequately staffed and provided with the necessary financial, technical, and other resources to perform their functions under the Program.

Policy Actions and Dialogue

2. The Recipient shall ensure that all policies adopted and actions taken under the Program, as set forth in the Policy Letter and the Policy Matrix, continue to be in effect for the duration of the Program.

3. The Recipient shall keep ADB informed of policy discussions with other multilateral and bilateral aid agencies that may have implications for the implementation of the Program and shall provide ADB with an opportunity to comment on any resulting policy proposals. The Recipient shall take into account ADB’s views before finalizing and implementing any such proposal.
Counterpart Funds

4. The Recipient shall ensure that the Counterpart Funds are used to finance the local currency cost relating to the implementation of the Program and other activities consistent with the objectives of the Program and shall provide the necessary budget appropriation to finance costs relating to the implementation of reforms under the Program.

Governance and Anticorruption

5. The Recipient, the Program Executing Agency, and the Implementing Agencies shall: (a) comply with ADB’s Anticorruption Policy (1998, as amended to date) and acknowledge that ADB reserves the right to investigate directly, or through its agents, any alleged corrupt, fraudulent, collusive or coercive practice relating to the Program; and (b) cooperate with any such investigation and extend all necessary assistance for satisfactory completion of such investigation.

6. The Recipient shall ensure that immediately upon the reconstitution of the Parliament, the Recipient shall commence the process for and, subject to the recommendation of the CC, shall appoint the Chief Commissioner and Commissioners of the CIAA. In the event the Recipient’s Parliament has not been reconstituted by the time of the Program midterm review, this condition will be reassessed.

Program Review

7. The Recipient shall undertake periodic reviews during Program implementation to evaluate the scope, implementation arrangements, progress and achievement of the objectives of the Program. In addition to the periodic reviews, a Program review shall take place prior to the Second Tranche release. The Recipient shall ensure that ADB shall have the opportunity to participate in these reviews.

Program Performance Monitoring and Evaluation

8. The Recipient shall monitor the implementation and outcomes of the Program using a set of indicators and targets that has been agreed between the Recipient and ADB to assess progress towards meeting the objectives of the Program. For each of the agreed indicators, progress shall be measured against a baseline in FY2012. The responsible Implementing Agencies shall review the agreed frameworks every quarter to determine progress and identify constraints.

Program Reporting

9. The Recipient shall prepare a quarterly consolidated progress report on policy and institutional reforms implementation and shall forward the same to ADB. The reports shall describe progress made in the Program and any changes to the implementation schedule, and shall also identify any problems encountered and remedial actions taken. The Recipient shall submit a Program completion report not later than 3 months after Program completion.