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February 23, 2012

Mr. Krishna Hari Baskota
Secretary
Ministry of Finance
Government of Nepal
Singha Durbar
Kathmandu, Nepal

**Re: Nepal Public Financial Management Multi-donor Trust Fund
Strengthening the Office of the Auditor General Project
PFM Grant No. TF010455**

Dear Sir:

In response to the request for financial assistance made on behalf of Nepal ("Recipient"), I am pleased to inform you that the International Bank for Reconstruction and Development/International Development Association ("World Bank"), acting as administrator of grant funds provided under the Nepal Public Financial Management ("PFM") Multi-donor Trust Fund proposes to extend to the Recipient, a grant in an amount not to exceed two million three hundred thousand United States Dollars (US\$2,300,000) ("Grant") on the terms and conditions set forth or referred to in this letter agreement ("Agreement"), which includes the attached Annex, to assist in the financing of the project described in the Annex ("Project").

This Grant is funded out of the abovementioned trust fund for which the World Bank receives periodic contributions from the Donors. In accordance with Section 3.02 of the Standard Conditions (as defined in the Annex to this Agreement), the World Bank's payment obligations in connection with this Agreement are limited to the amount of funds made available to it by the Donors under the abovementioned trust fund, and the Recipient's right to withdraw the Grant proceeds is subject to the availability of such funds. Accordingly, in the event that any Donor cancels or fails to pay any contributions under the trust fund to the World Bank for any reason, or that as a result of currency exchange variations the amount of funds available in the trust fund is insufficient for the purposes of the Grant, the Recipient shall bear the risk of such funding shortfall and the World Bank shall not have any liability whatsoever to the Recipient or to any third parties in respect of any expenditures or liabilities incurred by the Recipient or any third parties in connection with this Agreement which exceed the amount of funds made available to the World Bank by the Donors for the purposes of the Grant.

The Recipient represents, by confirming its agreement below, that it is authorized to enter into this Agreement and to carry out the Project in accordance with the terms and conditions set forth or referred to in this Agreement.

Please confirm the Recipient's agreement to the foregoing by having an authorized official of the Recipient sign and date the enclosed copy of this Agreement, and returning it to the World Bank. Upon receipt by the World Bank of this countersigned copy, this Agreement shall become effective as of the date of the countersignature; provided, however, that the offer of this Agreement shall be deemed withdrawn if the World Bank has not received the countersigned copy of this Agreement within ninety (90) days after the date of signature of this Agreement by the World Bank, unless the World Bank shall have established a later date for such purpose.

Very truly yours,

**INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION**

By K. Kimes
Authorized Representative
South Asia Region

**AGREED
NEPAL**

By K. Kimes
Authorized Representative
Name L. S. Kishor
Title Joint Secretary
Date: 23 Feb 2012

Enclosures:

- (1) Standard Conditions for Grants Made by the World Bank out of Various Funds, dated July 31, 2010.
- (2) Disbursement Letter of the same date as this Agreement, together with World Bank Disbursement Guidelines for Projects, dated May 1, 2006.

Article I
Standard Conditions; Definitions

1.01. *Standard Conditions.*

The Standard Conditions for Grants Made by the World Bank out of Various Funds dated July 31, 2010 (“Standard Conditions”) constitute an integral part of this Agreement.

1.02. *Definitions.*

Unless the context requires otherwise, the capitalized terms used in this Agreement have the meanings ascribed to them in the Standard Conditions or in this Agreement as follows:

- (a) “OAG” means Office of the Auditor General, a Supreme Audit Institution (“SAI”), and a member of the International Organization of Supreme Audit Institutions (“INTOSAI”), established in 1959 with an aim to enhance good governance by promoting public accountability and transparency through the provision of independent professional audit services to Nepal.
- (b) “SAI” means Supreme Audit Institution which is the national level audit institution established by a country’s Constitution or legislation to audit the public financial operations of that country.
- (c) “INTOSAI” means International Organization of Supreme Audit Institutions, which is the umbrella organization of the external government audit community, comprising the national audit institutions of over 185 countries of the world.
- (d) “ISSAI” means International Standards of Supreme Audit Institutions, which states the basic prerequisites for the proper functioning and professional conduct of SAIs and the fundamental principles in auditing of public entities.
- (e) “Project Management Team” means the Team comprising key staff responsible for the implementation of the Project in their respective expertise as described in Section 2.03(a) of the Annex to this Agreement.
- (f) “PAC” means Public Accounts Committee which is the standing committee of Legislative Parliament responsible for scrutinizing any matters concerning the Public Accounts, including but not limited to matters raised in the Auditor General’s Report.
- (g) “INTOSAI Mexico Declaration on SAI Independence” means the document adopted by the XIX Congress of the INTOSAI which met in Mexico on the eight core principles of SAI independence.

- (h) “GAAP” means the Governance and Accountability Action Plan developed to address operational concerns related to the management of the Project, to ensure good governance and cost-effectiveness in the management of the Project activities.

Article II Project Execution

2.01. *Project Objectives and Description.*

The objective of the Project is to enhance the quality and impact of public sector audit in Nepal. The Project consists of the following parts:

Part A: Enhancing the Quality of Financial Statement Audits

- (1) Provide technical advice to OAG in preparing its annual audit plans and program.
- (2) Conduct pilot financial statement audits to support the development of a financial audit manual, including (a) gather case study materials to be used to design practical and relevant training courses in financial audit; (b) field test and identify the needs for refining the financial audit manual; (c) provide opportunity for on-the-job training for the pilot audit teams; and (d) supply the materials and the trainers for a comprehensive training course to be designed and delivered to all auditors.
- (3) Update existing operational guidelines and finalize the draft financial audit manual based on ISSAI and risk based audit approach.
- (4) Support the quality assurance arrangements in OAG, including support to the quality assurance team in selecting, conducting and assessing the results of its quality assurance reviews and in designing and implementing appropriate actions to address identified deficiencies.
- (5) Arrange for a peer review of OAG by an agreed SAI, and compare the results with the earlier SAI conducted peer review.
- (6) Provide advisory services to the Auditor General, including consultation by the OAG management on policy and topical issues and special areas of audit selected by the Auditor General.
- (7) Pilot the use of computer audit technologies to determine the practicality and feasibility of introducing electronic working papers and computer assisted audit techniques, including exchange visits to learn from practices in other SAIs in the region.

Part B: Upgrading the Capacity of OAG to Conduct Performance Audits

- (1) Provide on-the-job training to OAG performance audit teams in planning, conducting and reporting the results of actual performance audits, including support in revising the performance audit manual based on pilot performance audit experiences.
- (2) Support strategic planning by the performance audit division of OAG, including support the process of selecting performance audits to be conducted.
- (3) Support the performance audit division to incorporate management selected high profile topics, including support to develop the audit objectives, audit criteria and audit procedures.

Part C: Enhancing the Impact of Audit

- (1) Provide technical support to the PAC secretariat: (a) to conduct a research study to compare the Nepal audit legislation to the INTOSAI Mexico Declaration on SAI Independence, and to recommend ways of strengthening the SAI of Nepal; (b) to draft PAC reports to the Parliament and provide such reports to the PAC as necessary; and (c) to provide other technical assistance to enhance the capacity of the PAC secretariat.
- (2) Summarize key recommendations from audit reports, including (a) review of audit observations raised in recent years' audit reports, to identify major recommendations dealing with systemic issues that have the potential for significantly enhancing country systems of governance and accountability; and (b) support OAG in preparing the Auditor General's annual report to Parliament in order to emphasize recommendations on improving public financial management, including reporting on the status of the Government's executive branch implementation of prior years' recommendations.
- (3) Design and implement a communications strategy, including consultations with major stakeholder groups such as the PAC, the Government's executive branch, civil society and the media, as well as developing a communications policy for more effective interaction with various stakeholders and measures to improve the means of communicating audit results.
- (4) Redesign and computerize the databank of audit and PAC recommendations, including supporting the monitoring of the status of implementation of audit and PAC recommendations by the Government's executive branch and reviewing and upgrading of the system of archiving older audit and PAC reports, as well as design of interactive web linkages to facilitate the right to information access.

Part D: Project management

Support Project management activities including procurement, preparation of annual work plans, and preparation of inception, mid-term and final reports and monitoring and evaluation of all aspects of the Project.

2.02. *Project Execution.*

The Recipient declares its commitment to the objectives of the Project. To this end, the Recipient shall carry out the Project through the Office of the Auditor General in accordance with the provisions of: (a) Article II of the Standard Conditions; (b) the “Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants”, dated October 15, 2006 and revised in January 2011 (“Anti-Corruption Guidelines”); and (c) this Article II.

2.03. *Institutional and Other Arrangements.*

The Recipient shall, through the OAG:

- (a) (i) ensure that OAG maintains throughout the Project period the following key staff as the Project Management Team: Project Coordinator, Audit Director, Audit Officer, Finance Officer, Monitoring and Evaluation Officer, lead financial audit counterpart, and lead performance audit counterpart; the Project Coordinator shall be the OAG Assistant Auditor General, and the Monitoring and Evaluation Officer shall be the OAG Head of the Monitoring and Evaluation Unit; and (ii) ensure that these key staff, assuming satisfactory performance, are not transferred internally during the Project period (and in the case of the Finance officer, until six (6) months following the Closing Date or until submission of the final audited Financial Statements, whichever occurs later), except with prior notice to and consultation with the World Bank and as required by the applicable laws of the Recipient.
- (b) form a steering committee no later than one (1) month after the date of countersignature of this Agreement by the Recipient, and thereafter maintain throughout the Project, such a committee chaired by a Deputy Auditor General, comprising representatives from the Ministry of Finance (Joint Secretary of the Foreign Aid Cooperation Division), FCGO (Joint Financial Comptroller General), the Public Accounts Committee of the Parliament (PAC Secretary), and the private sector auditors (Chairman of the Auditing Standards Board) and the Assistant Auditor General who functions as the Coordinator of the program; and such committee shall meet at least twice annually to: (i) review and approve the annual work plan; (ii) monitor progress in relation to the approved work plan; (iii) monitor achievements in relation to the agreed results indicators; and (iv) provide strategic direction.

- (c) maintain a management committee chaired by a program coordinator comprising one other Assistant Auditor General, two Audit Directors, and one Audit Officer; and such committee shall monitor the progress of the Project against the results indicators.
- (d) adopt and implement the GAAP prepared for the Project to address key governance issues, including coordination with PAC, other Government stakeholders and civil society, and transparency of Project activities and capacity building of OAG and PAC, and monitor implementation of the GAAP throughout the Project implementation period.

2.04. ***Donor Visibility and Visits.***

- (a) The Recipient shall take or cause to be taken all such measures as the World Bank may reasonably request to identify publicly the Donors' support for the Project.
- (b) For the purposes of Section 2.09 of the Standard Conditions, the Recipient shall, upon the World Bank's request, enable the representatives of the Donor(s) to visit any part of the Recipient's territory for purposes related to the Project.

2.05. ***Project Monitoring, Reporting and Evaluation.***

- (a) The Recipient shall monitor and evaluate the progress of the Project and prepare Project Reports in accordance with the provisions of Section 2.06 of the Standard Conditions and on the basis of the indicators set forth below in paragraph (b) of this Section. Each Project Report shall cover the period of one (1) fiscal year trimester, and shall be furnished to the World Bank not later than forty-five (45) days after the end of the period covered by such report.
- (b) The performance indicators referred to above in paragraph (a) consist of the following:
 - (i) Audits meeting OAG financial statement auditing standards;
 - (ii) In-depth performance audit reports submitted to Parliament in year;
 - (iii) Current year audit observations implemented by the Government's executive branch within one (1) year;
 - (iv) Office-wide audit plan implements risk-based concepts;
 - (v) Numbers of financial audit teams included in pilot audits;
 - (vi) Peer review recommendations by an SAI;
 - (vii) Strategic plan for performance audit division prepared and updated;

- (viii) Lessons learned from current year pilots documented and reflected in revised audit guides and training materials;
 - (ix) Current year audit observations accepted by the Government's executive branch within thirty-five (35) days;
 - (x) Installation and implementation of Electronic Working Paper (EWP) on a pilot basis;
 - (xi) Strategy document prepared with actions for improving relations with the Government's executive branch, PAC, media and other stakeholders;
 - (xii) Computerized databank of audit observations produces monthly status reports;
 - (xiii) Annual work plan approved by Steering Committee;
 - (xiv) Inception report approved by Steering Committee;
 - (xv) Mid Term Report approved by Steering Committee; and
 - (xvi) Final Report approved by Steering Committee.
- (c) Notwithstanding the provisions of paragraphs (a) and (b) above, the Recipient shall, no later than June 30, 2013, carry out jointly with the World Bank, OAG and Norway SAI (Norway SAI having supported a strategic plan and a capacity building initiative of OAG), a mid-term review to assess the status of Project implementation, as measured against the performance indicators referred to in Section 2.05(b) above.
- (d) Notwithstanding the provisions of paragraphs (a), (b) and (c) above, the Recipient shall, through OAG, prepare, no later than March 30, 2015, an overall Project review documenting the final Project achievements.
- (e) The Recipient shall prepare the Completion Report in accordance with the provisions of Section 2.06 of the Standard Conditions. The Completion Report shall be furnished to the World Bank not later than six (6) months after the Closing Date.

2.06. *Financial Management.*

- (a) The Recipient shall ensure that a financial management system is maintained in accordance with the provisions of Section 2.07 of the Standard Conditions.
- (b) The Recipient shall ensure that interim unaudited financial reports for the Project are prepared and furnished to the World Bank not later than forty-five (45) days after the end of each fiscal year trimester covering the trimester, in form and substance satisfactory to the World Bank.

- (c) The Recipient shall have its Financial Statements audited in accordance with the provisions of Section 2.07 (b) of the Standard Conditions. Each such audit of the Financial Statements shall cover the period of one (1) fiscal year of the Recipient. The audited Financial Statements for each such period shall be furnished to the World Bank not later than six (6) months after the end of such period. .

2.07. **Procurement**

- (a) General. All goods and consultants' services required for the Project and to be financed out of the proceeds of the Grant shall be procured in accordance with the requirements set forth or referred to in:
- (i) Section I of the "Guidelines: Procurement of Goods, Works and Non-consulting Services under IBRD Loans and IDA Credits and Grants by World Bank Borrowers" dated January 2011 ("Procurement Guidelines"), in the case of goods;
 - (ii) Sections I and IV of the "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits and Grants by World Bank Borrowers" dated January 2011 ("Consultant Guidelines") in the case of consultants' services; and
 - (iii) the provisions of this Section, as the same shall be elaborated in the procurement plan prepared and updated from time to time by the Recipient for the Project in accordance with paragraph 1.18 of the Procurement Guidelines and paragraph 1.25 of the Consultant Guidelines ("Procurement Plan").
- (b) Definitions. The capitalized terms used in the following paragraphs of this Section to describe particular procurement methods or methods of review by the World Bank of particular contracts, refer to the corresponding method described in Sections II and III of the Procurement Guidelines, or Sections II, III, IV and V of the Consultant Guidelines, as the case may be.
- (c) Particular Methods of Procurement of Goods
- (i) Except as otherwise provided in sub-paragraph (ii) below, goods shall be procured under contracts awarded on the basis of National Competitive Bidding in accordance with the Public Procurement Act (and regulations made thereunder), subject to the following additional provisions:
 - (a) bid documents shall be made available, by mail or in person, to all who are willing to pay the required fee;
 - (b) foreign bidders shall not be precluded from bidding and no preference of any kind shall be given to national bidders;

- (c) bids shall be opened in public in one place, immediately after the deadline for submission of bids;
 - (d) qualification criteria (in case pre-qualifications were not carried out) shall be stated in the bidding documents, and if a registration process is required, a foreign firm declared as the lowest evaluated bidder shall be given a reasonable opportunity of registering, without let or hindrance;
 - (e) evaluation of bids shall be made in strict adherence to the criteria disclosed in the bidding documents, in a format and specified period agreed with the Association and contracts shall be awarded to the lowest evaluated bidders;
 - (f) rebidding shall not be carried out without the prior concurrence of the Association;
 - (g) extension of bid validity shall not be allowed without the prior concurrence of the Association (A) for the first request for extension if it is longer than four (4) weeks and (B) for all subsequent requests for extension irrespective of the period; and
 - (h) there shall not be any restrictions on the means of delivery of the bids.
- (ii) The following methods, other than National Competitive Bidding, may be used for procurement of goods for those contracts specified in the Procurement Plan: (A) Shopping; and (B) Direct Contracting.
- (d) Particular Methods of Procurement of Consultants' Services
- (i) Except as otherwise provided in item (ii) below, consultants' services shall be procured under contracts awarded on the basis of Quality- and Cost-based Selection.
 - (ii) The following methods may be used for the procurement of consultants' services for those assignments which are specified in the Procurement Plan: (A) Quality-based Selection; (B) Selection under a Fixed Budget; (C) Least Cost Selection; (D) Selection based on Consultants' Qualifications; (E) Single-source Selection; (F) Selection of Individual Consultants; and (G) Sole Source Procedures for the Selection of Individual Consultants.
- (e) Review by the World Bank of Procurement Decisions.

The Procurement Plan shall set forth those contracts which shall be subject to the World Bank's Prior Review. All other contracts shall be subject to Post Review by the World Bank.

Article III
Withdrawal of Grant Proceeds

3.01. *Eligible Expenditures.*

The Recipient may withdraw the proceeds of the Grant in accordance with the provisions of: (a) the Standard Conditions; (b) this Section; and (c) such additional instructions as the World Bank may specify by notice to the Recipient (including the “World Bank Disbursement Guidelines for Projects” dated May 2006, as revised from time to time by the World Bank and as made applicable to this Agreement pursuant to such instructions), to finance Eligible Expenditures as set forth in the following table. The table specifies the categories of Eligible Expenditures that may be financed out of the proceeds of the Grant (“Category”), the allocations of the amounts of the Grant to each Category, and the percentage of expenditures to be financed for Eligible Expenditures in each Category:

| Category | Amount of the Grant Allocated (expressed in USD) | Percentage of Expenditures to be Financed (inclusive of Taxes) |
|--|---|---|
| (1) Goods, consultants’ services and Training, including study tours | 2,240,000 | 100% |
| (2) Incremental Operating Costs | 60,000 | 85% |
| TOTAL AMOUNT | 2,300,000 | |

For the purpose of this paragraph the terms:

- (i) “Training” means the cost of training financed under the Project, attributable to seminars, workshops, and study tours, along with the cost of domestic and international travel and subsistence for training participants, services of trainers, rental of training facilities, preparation and reproduction of training materials, and other activities directly related to course preparation and implementation; and
- (ii) “Operating Costs” means the reasonable costs of incremental expenditures under the Project, incurred by OAG for purposes of Project management, implementation, and monitoring and evaluation, on account of utilities and supplies, bank charges, communications, vehicle operation, maintenance, and insurance, office space rental, building and equipment maintenance, public awareness-related publicity and media expenses, domestic travel and subsistence, and salaries of contractual and temporary staff, but excluding salaries, bonuses, fees, or honoraria of members of the Recipient’s civil service.

3.02. ***Withdrawal Conditions.***

Notwithstanding the provisions of Section 3.01 of this Agreement, no withdrawal shall be made for payments made prior to the date of countersignature of this Agreement by the Recipient, except that withdrawals up to an aggregate amount not to exceed twenty thousand United States Dollars (US\$20,000) equivalent may be made for payments made prior to this date but on or after November 1, 2011, for Eligible Expenditures under Category (2).

3.03. ***Withdrawal Period.***

The Closing Date referred to in Section 3.06 (c) of the Standard Conditions is June 30, 2015.

Article IV
Recipient's Representative; Addresses

4.01. ***Recipient's Representative.***

The Recipient's Representative referred to in Section 7.02 of the Standard Conditions is the Joint Secretary, Ministry of Finance.

4.02. ***Recipient's Address.***

The Recipient's Address referred to in Section 7.01 of the Standard Conditions is:

Ministry of Finance
Government of Nepal
Singha Durbar
Kathmandu, Nepal

Facsimile:
(977-1) 4211-164

4.03. ***World Bank's Address.***

The World Bank's Address referred to in Section 7.01 of the Standard Conditions is:

International Bank for Reconstruction and Development
International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

| | | |
|------------------|-----------------|----------------|
| Cable: | Telex: | Facsimile: |
| INTBAFRAD | | |
| INDEVAS | 248423 (MCI) or | 1-202-477-6391 |
| Washington, D.C. | 64145 (MCI) | |