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Enabling poor rural people
to overcome poverty

President's memorandum

Proposed supplementary financing to the Federal Democratic Republic of Nepal

Kisankalagi Unnat Biu-Bijan Karyakram (Improved Seeds for Farmers Programme)

Note to Executive Board representatives

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For: Approval

Recommendation for approval

The Executive Board is invited to repeal its decision in EB 2012/LOT/P.13 in order to approve the recommendation for proposed supplementary financing in the form of a loan on highly concessional terms to the Federal Democratic Republic of Nepal for the Kisankalagi Unnat Biu-Bijan Karyakram (Improved Seeds for Farmers Programme), as contained in paragraph 30.

President's memorandum

Proposed supplementary financing to the Federal Democratic Republic of Nepal for Kisankalagi Unnat Biu-Bijan Karyakram (Improved Seeds for Farmers Programme)

I. Background

1. In September 2012, the Executive Board of IFAD approved Kisankalagi Unnat Biu-Bijan Karyakram (Improved Seeds for Farmers Programme – ISFP). The financing agreement was signed in December 2012 and operations started in March 2013.
2. In December 2012, the Executive Board of IFAD approved a proposal to provide supplementary financing for the Poverty Alleviation Fund Project – Phase II (PAF II) in Nepal, which IFAD has been cofinancing with the World Bank. The proposed supplementary financing comprised a loan on highly concessional terms in the amount of SDR 3.25 million (approximately US\$5 million) and a grant, also in the amount of SDR 3.25 million (approximately US\$5 million).
3. By letter of 12 June 2013, IFAD was notified by the Ministry of Finance of Nepal that the Government of Nepal was only willing to accept grants for the financing of the Poverty Alleviation Fund Project (PAF). This decision was taken by the Council of Ministers of Nepal, which strongly believes that as PAF supports social activities, it should not be financed on a loan basis. Accordingly, the Government is requesting that only the grant component of the proposed supplementary financing be allocated to PAF II, in the amount of approximately US\$5 million, and that the loan component, also in the amount of approximately US\$5 million, be allocated to another project of IFAD's portfolio in Nepal.
4. It was therefore agreed with the Government of Nepal to transfer the rural finance activities from PAF II to ISFP. The approval of the Executive Board is sought for a revised proposal to allocate the available resources. It is proposed to provide a supplementary grant for PAF II in the amount of approximately US\$5 million and a supplementary loan for ISFP also in the amount of approximately US\$5 million. This will allow Nepal to fully utilize the allocated US\$10 million.

II. Justification and rationale

5. The approach of ISFP takes into account: (i) the need for collaboration and harmonization with other government and internationally funded efforts to benefit from their experience and complementary activities; (ii) the national Agricultural Development Strategy (ADS) 2015-2035, expected to take effect in 2015, which will make seed a national priority; and (iii) the existence of significant risks, including possible political instability, and the degree to which collaboration with other development initiatives is likely.

6. The supplementary financing responds to the above trends and has been designed within the framework of IFAD's results-based country strategic opportunities programme and the forthcoming ADS. It advocates an approach that specifically targets private initiatives in order to achieve sustainable productivity increases. Social inclusion is built into programme design at all levels through a variety of measures and mechanisms. Productivity gains are based on the identification of areas with clear competitive advantages for farmers in different farming systems and poverty contexts.
7. The supplementary financing for the country programme in Nepal intends to develop a stronger, more efficient rural finance sector. Indeed each IFAD-funded project in the country is implementing a rural finance component. As noted during the recent country programme evaluation, there are consistent failures of these components, especially when trying to scale up successful self-help groups into cooperatives and link them to the banking sector.
8. Moreover, the goal of supplementary financing for the financial sector is to promote an environment conducive to overall economic growth. Its development objective is to create competitive, sustainable and inclusive microfinance and rural finance institutions in the target area. Beneficiaries of IFAD-funded projects will have access to financial resources, thus enabling them to develop cottage businesses and improve their livelihoods.
9. The supplementary financing will implement a microfinance/rural finance unit (MRFU) that will eventually benefit all IFAD projects by: (i) coordinating approaches towards microfinance and rural finance; (ii) providing technical assistance for strengthening rural finance and microfinance institutions and their linkages with the financial sector to increase outreach and ensure sustainability; (iii) adopting an advocacy role in policy discussion with the Government of Nepal, the Central Bank of Nepal and other relevant stakeholders of the financial sector; and (iv) promoting and piloting new financial services for rural microenterprises such as remittance services.
10. The activities envisaged in the supplementary financing will focus on securing sustainable access by IFAD target groups to adequate financial services, in order to support the development of economic activities by linking self-help groups to financial institutions. They build on the approach of the IFAD-financed ISFP, as well as the Small Farmers Cooperative Limited (SFCL) movement, and will be scaled up to the IFAD country programme. There are six subcomponents, to be implemented in close collaboration with ISFP: (i) strategy development; (ii) capacity-building; (iii) small-scale farmers' cooperatives; (iv) linkages to development banks; (v) scaling up; and (vi) start-up capital for cooperatives.

III. Programme implementation

11. **Approach.** MRFU will be established at the level of the ISFP in Kathmandu and staffed with two highly qualified financial specialists and one assistant financial specialist. The two specialists and the assistant will be competitively recruited from the private sector and their contracts will be performance-based. Contract renewal will be dependent on meeting predetermined performance indicators (as yet to be finalized). Staff will have a probationary period in keeping with the labour laws of Nepal.
12. One financial specialist will be responsible for financial investments in cooperatives and for policy dialogue, while the other will be responsible for promotion/development of new products, especially regarding remittances.
13. The specialist dealing with cooperatives will review investment proposals and submit eligible ones to an MRFU Investment Committee. This committee will be composed of the financial specialist for cooperatives and representatives of the selected commercial bank through which the investment will be carried out.

14. A due diligence exercise will be undertaken at programme inception to select the commercial bank. It will be carried out by a reputable audit firm acceptable to IFAD, selected on the basis of a national bidding process.
15. A memorandum of understanding will be signed by the selected commercial bank and the programme that specifies the role and responsibilities of all partners: the commercial bank and its investment entity, the programme and the MRFU.
16. **Monitoring and evaluation (M&E) and management information systems** will be developed at the beginning of the programme and will be central to all activities. Selected indicators from IFAD's Results and Impact Management System (RIMS), together with other indicators included in the programme's logical framework, will provide underlying guidance for programme planning and monitoring for each year. As part of annual local consultations, an annual workplan and budget will be prepared in a participatory process for each target district. These plans will then be integrated into the overall programme workplan and budget.
17. The programme M&E system will also oversee each equity position of MRFU. Indicators to be monitored include: (i) sustainability perspective and results from each investment; (ii) number of members in each cooperative; (iii) volume of activity in each cooperative (disaggregated by gender and activity); (iv) PAR rating and repayment rate in each cooperative; and (v) risk associated with each investment.

IV. Financial management

18. IFAD's financial management assessment of the country rated the fiduciary risk as medium. Mitigation measures comprise extensive supervision and support missions, including staff training and the obligatory use of accounting software. The financial-management performance of projects in Nepal is mostly satisfactory. Since the programme became effective in December 2012 and operations started in March 2013, total disbursement for the project has been approximately SDR 1.657 million (6.45 per cent) against the total of the approved loan and grant of SDR 25.7 million. The programme will maintain accounts and records in accordance with the practice of other IFAD-funded projects in Nepal (i.e. use of double-entry bookkeeping and compliance with International Financial Reporting Standards and IFAD guidelines). The programme will maintain an accounting system and a separate ledger and register to record programme expenditures by category, programme component, subcomponent and activity.
19. **Flow of funds.** A new designated account will be opened, in a bank acceptable to IFAD, through which the supplementary financing will be channelled. The designated account will be administered following imprest fund arrangements. Government funds will flow to a separate account.
20. **Internal control and external audits.** Internal control systems will be established. IFAD requires that the consolidated programme accounts be audited in accordance with auditing standards acceptable to the Fund and its Guidelines on Project Audits, and by independent auditors acceptable to the Fund. The programme must ensure compliance with legal covenants on timeliness in submitting audit reports to IFAD.

V. Programme costs and financing

21. With the supplementary financing, IFAD's contribution to the programme will increase approximately from US\$59.7 million to US\$65.4 million.
22. Total investment and incremental recurrent supplementary financing costs, including physical and price contingencies, are estimated at about US\$5.65 million. Investment costs represent 91 per cent (US\$5.17 million), while recurrent costs represent 5 per cent (US\$284,000).

23. The IFAD supplementary financing will amount to approximately US\$5 million while the Government contribution will amount to approximately US\$0.63 million in duties and taxes (indicative cost summary tables below).

Nepal
ISFP/KUBK
Components Project Cost Summary

	(NPR)			(US\$)			% Foreign Exchange	% Total Base Costs
	Local	Foreign	Total	Local	Foreign	Total		
1. Capacity Building	474 315 735.0	-	474 315 735.0	5 451 905.0	-	5 451 905.0	-	100
Total BASELINE COSTS	474 315 735.0	-	474 315 735.0	5 451 905.0	-	5 451 905.0	-	100
Physical Contingencies	17 299 536.8	-	17 299 536.8	198 845.3	-	198 845.3	-	4
Price Contingencies	-	-	-	-	-	-	-	-
Total PROJECT COSTS	491 615 271.8	-	491 615 271.8	5 650 750.3	-	5 650 750.3	-	104

Nepal
ISFP/KUBK
Indicative Disbursement Accounts by Financiers
(US\$)

	The Government		IFAD Loan		Total		For. Exch.	Local (Excl. Taxes)	Duties & Taxes
	Amount	%	Amount	%	Amount	%			
Consultancies	-	-	161 175.0	100.0	161 175.0	2.9	-	161 175.0	-
Grants & Subsidies	130 000.0	13.0	870 000.0	87.0	1 000 000.0	17.7	-	870 000.0	130 000.0
Training	461 408.2	13.0	3 087 885.8	87.0	3 549 294.0	62.8	-	3 087 885.8	461 408.2
Equipment & Material	21 734.2	13.0	145 452.0	87.0	167 186.3	3.0	-	145 452.0	21 734.2
Operating Costs	18 768.75	6.3	279 326.25	93.7	298 095.00	5.3	0.00	279 326.25	18 768.75
Unallocated	-	-	475 000.0	-	475 000.0	8.4	-	475 000.0	-
Total PROJECT COSTS	631 911.2	11.2	5 018 839.1	88.8	5 650 750.3	100.0	-	5 018 839.1	631 911.2

VI. Proposed modifications to the programme loan and grant agreement

24. Upon approval by the Executive Board, the original programme loan and grant agreement will be amended to reflect this revised supplementary financing and other required changes. The supplementary financing does not imply any modification of the programme objectives, target area, strategy, approach or target groups, which will remain as described in the design completion report and in the financing agreement.
25. The fiduciary arrangements defined in the related design completion report, financing agreement and programme implementation manual (i.e. flow of funds, procurement and contracting modalities, audit and reporting requirements) will remain valid and applicable for the supplementary financing.
26. This supplementary financing does not imply any modification of the overall programme description and it will be used to finance and expand/scale up the activities originally planned

VII. Legal instruments and authority

27. An amendment to the current programme loan and grant agreement between the Federal Democratic Republic of Nepal and IFAD will constitute the legal instrument for extending the proposed supplementary financing to the borrower.
28. Nepal is empowered under its laws to receive financing from IFAD.
29. I am satisfied that the proposed supplementary financing will comply with the Agreement Establishing IFAD.

VIII. Recommendation

30. I recommend that the Executive Board approve the proposed supplementary financing in terms of the following resolution:

RESOLVED: that the supplementary financing approved by the Executive Board on 10 December 2012 to the Federal Democratic Republic of Nepal under the lapse-of-time procedure (EB 2012/LOT/P.13) shall be repealed to allow a supplementary financing to Nepal in the form of a loan on highly concessional terms in an amount equivalent to three million two hundred and seventy thousand special drawing rights (SDR 3,270,000) only, and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Kanayo F. Nwanze
President