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Enabling poor rural people
to overcome poverty

President's memorandum

Revision to the supplementary financing to the Federal Democratic Republic of Nepal for the

Poverty Alleviation Fund Project – Phase II

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 Debt Sustainability Framework (DSF) grant to the Federal Democratic Republic of Nepal for the Poverty Alleviation Fund Project – Phase II, as contained in paragraph 22.

President’s memorandum

Revision to the supplementary financing to the Federal Democratic Republic of Nepal for the Poverty Alleviation Fund Project – Phase II

I. Background

1. 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), which IFAD has been cofinancing in Nepal together with the World Bank. The approved supplementary financing comprised a loan on highly concessional terms in the amount of three million two hundred and fifty thousand special drawing rights (SDR 3.25 million or approximately US\$5 million) and a grant, also in the amount of three million two hundred and fifty thousand special drawing rights (SDR 3.25 million or approximately US\$5 million).
2. By letter of 12 June 2013, the Ministry of Finance of Nepal informed IFAD that the Government of Nepal was only willing to accept grants for the financing of PAF. This decision was taken by the Council of Ministers of Nepal, which strongly believes that since 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, that is, 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.
3. The Poverty Alleviation Fund was launched as a community-driven development instrument for addressing the interrelated problems of rural poverty and social exclusion. In April 2004, the International Development Association (IDA) provided a grant of US\$15 million to finance the Poverty Alleviation Fund Project (PAF) – Phase I. PAF I was designed as a pilot, operating in districts chosen on the basis of their Human Development Index and geographical location and of whether they were conflict-affected areas. After this phase, the implementation pace accelerated rapidly in response to greater than anticipated – and constantly growing – demands from rural communities.
4. Following the peace process and the agreements reached among political parties, there was a new commitment to address inequality and poverty in the country. PAF II (2008-2014) was designed and funded in 2008 in the amount of US\$100 million by the World Bank. It uses the same targeting mechanisms and beneficiary profiles as PAF I, and is extending its scope nationally in phases, increasing by 15 districts each year.
5. PAF II’s project development objective is to improve living conditions, livelihoods and empowerment among the rural poor, with particular attention to groups that have traditionally been excluded by reason of gender, ethnicity, caste or location. It supports improvements in infrastructure, income-generating activities and citizen

participation in community decision-making. Employment is being generated through income-generating activities and community infrastructure. IFAD joined PAF II in 2007. The project had been approved by the Executive Board on 13 December 2007 with financing of SDR 2.5 million in the form of a grant.

6. PAF II is a highly performing project, covering all districts of the country and a great number of beneficiaries, and bringing a significant amount of cofinancing. The Government of Nepal and the World Bank welcomed IFAD into this operation in 2007 and requested increased financial commitment for the ongoing and coming phases. In 2012, the Government decided to expand PAF II, which will benefit from a US\$80 million contribution from IDA and US\$2.5 million from Japan. By extending its support through this supplementary financing, IFAD will continue its commitment to livelihood improvement.
7. The initial request from the Government and the World Bank was that IFAD increase its participation in PAF cofinancing. An IFAD review mission was fielded in June 2012, which documented good use of the existing IFAD grant, good overall performance of PAF and added value for IFAD in strengthening its support to PAF and developing synergies with other IFAD-funded projects in the country. The main reason for supplementary financing and IFAD value addition, according to the last review mission, was the need to strengthen ongoing activities: knowledge management, targeting, rural finance and project management.
8. This additional support will build on: (i) improving knowledge management (building on the existing PAF management information and web systems); (ii) refining the targeting strategy (outreach to the poor and ensuring that they do not fall back into poverty, and targeting of marginal groups); and (iii) strengthening the rural finance system in PAF and the overall IFAD country programme (as they face the same issues in linking self-help groups to the institutional banking system).
9. By supporting PAF, IFAD contributes to the development of better livelihoods in this crisis country. Its support also provides guidance for a successful programme, and is in line with IFAD's corporate effort to leverage cofinancing (in this case, US\$80 million from the World Bank) in order to reach IFAD's cofinancing target.

II. Justification and rationale

10. In December 2012, the Executive Board of IFAD approved supplementary financing for PAF II, cofinanced with the World Bank. That financing was composed of a loan on highly concessional terms in the amount of three million two hundred and fifty thousand special drawing rights (SDR 3.25 million) and a grant in the same amount.
11. In 2013 the Ministry of Finance of Nepal informed IFAD that the Government would accept only grants for the financing of PAF. This was a decision of the Council of Ministers on the basis that PAF supports social activities and should not be funded on a loan basis (in order to reserve loans for hardware or economic projects with a high economic rate of return). The Government is therefore requesting that the grant be allocated to PAF and the loan to another project of IFAD's portfolio in Nepal.

III. Financial management, procurement and governance

12. Project performance relative to financial management is mostly satisfactory. As of today, total disbursement for the IFAD grant is in the amount of approximately SDR 2.4 million (94 per cent) against a total approved grant of SDR 2.5 million. IFAD's financial management assessment rated the fiduciary risk as medium. However, the project has quite extensive experience in managing externally financed projects, including those financed by IFAD, with generally good outcomes and accountability frameworks. The trained and competent staff dealing with the

financial management of previous projects supported by the Fund will assume responsibility for this project as well, thus minimizing the risk of inappropriate use of funds.

13. The project 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 project will maintain an automated accounting system, and will also maintain a separate ledger and register to record project expenditures by category, project component, subcomponent and activity.
14. **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.
15. **Internal control and external audit.** Internal control systems shall be established. IFAD requires that the consolidated project 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 project must ensure compliance with legal covenants on timeliness in submitting audit reports to IFAD.

IV. Project costs and financing

16. The supplementary financing will be allocated to the following expense categories: (i) technical assistance; (ii) funds; (iii) training and workshops; (iv) capacity-building; (v) equipment; (vi) salaries and allowance; and (vii) operating costs (see following tables).
17. Total project costs will increase from US\$113 million to approximately US\$118.6 million. Sources of financing include: (i) IFAD, with an original grant of approximately US\$4 million and a supplementary grant of approximately US\$5 million; (ii) IDA, US\$100 million; (iii) the Government, US\$1.6 million; and (iv) beneficiaries, US\$8 million.

Nepal
PAF
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 PAF Indicative Disbursement Accounts by Financiers (US\$)								
	The Government		IFAD DSF Grant		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

V. Proposed modifications to the project grant agreement

18. Upon approval by the Executive Board, the existing project grant agreement will be amended to reflect the requested supplementary financing and other necessary changes. The amendments include an extension of the project completion date to 30 June 2017, and of the financing closing date to 31 December 2017. This supplementary financing does not imply any modification of the project description; it will be used to finance the grant activities originally planned, although the activities will be reduced.

VI. Legal instruments and authority

19. An amendment to the current project grant agreement between the Federal Democratic Republic of Nepal and IFAD will constitute the legal instrument for extending the proposed supplementary financing to the recipient.
20. Nepal is empowered under its laws to receive financing from IFAD.
21. I am satisfied that the proposed supplementary financing will comply with the Agreement Establishing IFAD.

VII. Recommendation

22. I recommend that the Executive Board approve a revision to the 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 supplementary financing to Nepal in the form of a DSF grant 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