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CONFORMED COPY

CREDIT NUMBER 4211-IN

Project Agreement

(Karnataka Panchayats Strengthening Project)

between

INTERNATIONAL DEVELOPMENT ASSOCIATION

and

STATE OF KARNATAKA

Dated July 24, 2006

CREDIT NUMBER 4211-IN

PROJECT AGREEMENT

AGREEMENT, dated July 24, 2006, between INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association) and STATE OF KARNATAKA (Karnataka).

WHEREAS by the Development Credit Agreement of even date herewith between India, acting by its President (the Borrower) and the Association, the Association has agreed to make available to the Borrower an amount in various currencies equivalent to eighty two million two hundred thousand Special Drawing Rights (SDR 82,200,000), on the terms and conditions set forth in the Development Credit Agreement, but only on condition that Karnataka agrees to undertake such obligations toward the Association as are set forth in this Agreement; and

WHEREAS Karnataka, in consideration of the Association's entering into the Development Credit Agreement with the Borrower, has agreed to undertake the obligations set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

Definitions

Section 1.01. Unless the context otherwise requires, the several terms defined in the Development Credit Agreement, the Preamble to this Agreement and in the General Conditions (as so defined) have the respective meanings therein set forth.

ARTICLE II

Execution of the Project

Section 2.01. (a) Karnataka declares its commitment to the objectives of the Project as set forth in Schedule 2 to the Development Credit Agreement, and, to this end, shall carry out the Project with due diligence and efficiency and in conformity with appropriate administrative, financial, and technical practices with due regard to social and environmental considerations, and shall provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Association shall otherwise agree, Karnataka shall carry out the Project in accordance with the Implementation Program set forth in Schedule 2 to this Agreement.

(c) Except as the Association may otherwise agree, Karnataka shall, in accordance with arrangements and procedures satisfactory to the Association, make available to the DF, the RDPR and the PRIs, proceeds of the Credit made available to Karnataka by the Borrower, as well as additional funds from Karnataka's own resources required for effective and timely implementation of the Project.

(d) Without limitation or restriction upon any of its other obligations under the Project Agreement, in order to achieve the objectives of the Project, Karnataka shall, and shall cause each GP to, carry out Part A of the Project in accordance with the provisions of the Panchayat Raj Act of 1993 (as amended) and with its accompanying orders and mapping activities (dated August 12, 2003 and October 16, 2004, respectively).

Section 2.02. (a) Except as the Association shall otherwise agree, procurement of the goods, works and consultants' services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 1 to this Agreement.

(b) Karnataka shall update the Procurement Plan dated May 2006 in accordance with guidelines acceptable to the Association not later than 12 (twelve) months after the date of the preceding Procurement Plan, for the Association's approval.

Section 2.03. (a) Karnataka shall carry out the obligations set forth in Sections 9.03, 9.04, 9.05, 9.06, 9.07 and 9.08 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) in respect of the Project Agreement.

(b) For the purposes of Section 9.06 of the General Conditions and without limitation thereto, Karnataka shall:

- (i) prepare, on the basis of guidelines acceptable to the Association and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Association and Karnataka, a plan for the future operation of the Project; and
- (ii) afford the Association a reasonable opportunity to exchange views with Karnataka on the said plan.

Section 2.04. (a) Karnataka shall, at the request of the Association, exchange views with the Association with regard to the progress of the Project, the performance of its obligations under this Agreement, and other matters relating to the purposes of the Credit.

(b) Karnataka shall promptly inform the Association of any condition which interferes or threatens to interfere with the progress of the Project, the accomplishment of the purposes of the Credit, or the performance by Karnataka of its obligations under this Agreement.

ARTICLE III

Financial Covenants

Section 3.01. (a) Karnataka shall maintain a financial management system, including records and accounts and prepare financial statements in a format acceptable to the Association, adequate to reflect in accordance with sound accounting practices the operations, resources and expenditures related to the Project of the department or agencies of Karnataka responsible for the carrying out of the Project or any part thereof.

- (b) Karnataka shall, and shall cause its PRIs to:
- (i) have the records, accounts and the financial statements referred to in paragraph (a) of this Section for each Fiscal Year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association;
 - (ii) furnish to the Association as soon as available, but in any case not later than six (6) months after the end of each such Fiscal Year (or such other period agreed to by the Association): (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such Fiscal Year (or such other period agreed to by the Association), as so audited; and (B) an opinion on such financial statements, records and accounts and report of such audit, by the said auditors, of such scope and in such detail as the Association shall have reasonably requested; and
 - (iii) furnish to the Association such other information as the Association may reasonably request from time to time concerning such records, accounts and financial statements as well as the audit thereof.

Section 3.02. (a) Karnataka shall prepare and furnish to the Association a Financial Monitoring Report, in form and substance satisfactory to the Association which:

- (i) sets forth sources and applications of funds for the Project, both cumulatively and for the period covered by said report, showing separately the funds provided under the Credit and explains the

variances between the actual and planned sources and uses of such funds and Projected sources and applications of funds for the Project for the six-month period following the period covered by said report;

- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by the said report; and explains variances between the actual and previously forecast implementation targets; and
- (iii) sets forth the status of procurement under the Project and expenditures under contracts financed out of the proceeds of the Credit, as at the end of the period covered by the said report.

(b) The first Financial Monitoring Report shall be furnished to the Association not later than May 1, 2007, thirty (30) days after the end of the first six monthly period after the Effective Date and shall cover the period from the incurrence of the first expenditure under the Project through the end of such first six month period; thereafter each Financial Monitoring Report shall be furnished to the Association not later than thirty (30) days after each subsequent six month period and shall cover the period not covered by the previous Financial Monitoring Report until the end of such six month period.

ARTICLE IV

Effective Date; Termination; Cancellation and Suspension

Section 4.01. This Agreement shall come into force and effect on the date upon which the Development Credit Agreement becomes effective.

Section 4.02. (a) This Agreement and all obligations of the Association and of Karnataka thereunder shall terminate on the earlier of the following two dates:

- (i) the date on which the Development Credit Agreement shall terminate in accordance with its terms; or
- (ii) the date twenty (20) years after the date of this Agreement.

(b) If the Development Credit Agreement terminates in accordance with its terms before the date specified in paragraph (a)(ii) of this Section, the Association shall promptly notify Karnataka of this event.

Section 4.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

ARTICLE V

Miscellaneous Provisions

Section 5.01. Any notice or request required or permitted to be given or made under this Agreement and any agreement between the parties contemplated by this Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand or by mail, telex or facsimile to the party to which it is required or permitted to be given or made at such party's address hereinafter specified or at such other address as such party shall have designated by notice to the party giving such notice or making such request. Deliveries made by facsimile transmission shall also be confirmed by mail. The addresses so specified are:

For the Association:

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

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

For Karnataka

The Chief Secretary to the Government
The Government of Karnataka
Karnataka

Facsimile
(080) 22258913

Section 5.02. Any action required or permitted to be taken, and any document required or permitted to be executed, under this Agreement on behalf of Karnataka may be taken or executed by its Chief Secretary or by such other person or persons as Karnataka shall designate in writing, and Karnataka shall furnish to the Association sufficient evidence of the authority and the authenticated specimen signature of each such person.

Section 5.03. This Agreement may be executed in several counterparts, each of which shall be an original, and all collectively but one instrument.

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in New Delhi, India, as of the day and year first above written.

INTERNATIONAL DEVELOPMENT ASSOCIATION

By

/s/ Michael F. Carter
Country Director, India

STATE OF KARNATAKA

By

/s/ V.P. Baligar
Authorized Representative

SCHEDULE 1

Procurement and Consultants' Services

Section I. General

A. All goods, works and services (other than consultants' services) shall be procured in accordance with the provisions of Section I of the "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004 (the Procurement Guidelines), and with the provisions of this Schedule.

B. All consultants' services shall be procured in accordance with Sections I and IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004 (the Consultant Guidelines), and with the provisions of this Schedule.

C. The capitalized terms used below in this Schedule to describe particular procurement methods or methods of review by the Association of particular contracts, have the meanings ascribed to them in the Procurement Guidelines, or Consultant Guidelines, as the case may be.

Section II. Particular Methods of Procurement of Goods, Works and Services (other than Consultants' Services)

A. International Competitive Bidding. Except as otherwise provided in Part B of this Section, contracts shall be awarded on the basis of International Competitive Bidding. The provisions of paragraphs 2.55 and 2.56 of the Procurement Guidelines, providing for domestic preference in the evaluation of bids, shall apply to goods manufactured in the territory of the Borrower.

B. Other Procurement Procedures

1. National Competitive Bidding. For the purposes of National Competitive Bidding (NCB), the procedures under the Karnataka Transparency in Public Procurement Act of 1999 (as amended) will be followed. For GPs using block grant monies, goods estimated to cost more than \$2,100 equivalent per contract, and works estimated to cost more than \$4,200 equivalent per contract, may be procured under contracts awarded on the basis of NCB using the procedures under the Karnataka Transparency in Public Procurement Act of 1999 (as amended) and the additional provisions agreed between the Borrower and the Association in writing from time to time. Otherwise, goods and work estimated to cost more than \$30,000 equivalent may be procured under contracts awarded on the basis of NCB. However, goods estimated to cost more than \$2 million shall be procured under contracts awarded on the basis of ICB.

2. Shopping. For GPs using block grant monies, goods and work estimated to cost respectively less than \$2,100 and \$4,200 equivalent may be procured under contracts

awarded on the basis of Shopping. Otherwise, goods and work estimated to cost less than \$30,000 equivalent may be procured under contracts awarded on the basis of Shopping.

3. Direct Contracting. Goods and works which the Association agrees meet the requirements for Direct Contracting may be procured in accordance with the provisions of said procurement method. Contracts above \$15,000 equivalent will require prior clearance from the Association.

4. Community Participation in Procurement. Goods and works required for Subprojects shall be procured in accordance with procedures acceptable to the Association, and specified in the Operations Manual.

5. Force Account. Works which the Association agrees meet the requirements for Force Account may be carried out in accordance with the provisions of said procurement method.

Section III. Particular Methods of Procurement of Consultants' Services

A. Quality and Cost-based Selection. Except as otherwise provided in Part B of this Section, consultants' services shall be procured under contracts awarded on the basis of Quality and Cost-based Selection. For purposes of paragraph 2.7 of the Consultant Guidelines, the short list of consultants for services estimated to cost less than \$500,000 equivalent per contract may comprise entirely national consultants.

B. Other Procedures

1. Quality-based Selection. Services for assignments which the Association agrees meet the requirements set forth in paragraph 3.2 of the Consultant Guidelines may be procured under contracts awarded on the basis of Quality-based Selection in accordance with the provisions of paragraphs 3.1 through 3.4 of the Consultant Guidelines.

2. Selection Under a Fixed Budget. Services for assignments which the Association agrees meet the requirements of paragraph 3.5 of the Consultant Guidelines may be procured under contracts awarded on the basis of a Fixed Budget in accordance with the provisions of paragraphs 3.1 and 3.5 of the Consultant Guidelines.

3. Least-cost Selection. Services for assignments which the Association agrees meet the requirements of paragraph 3.6 of the Consultant Guidelines may be procured under contracts awarded on the basis of Least-cost Selection in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

4. Selection Based on Consultants' Qualifications. Services estimated to cost less than \$100,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1, 3.7 and 3.8 of the Consultant Guidelines.

5. Single Source Selection. Services for tasks in circumstances which meet the requirements of paragraph 3.10 of the Consultant Guidelines for Single Source Selection, may, with the Association's prior agreement, be procured in accordance with the provisions of paragraphs 3.9 through 3.13 of the Consultant Guidelines.

6. Service Delivery Contractors. Services to be provided by data entry operators, social workers, staff nurses and laboratory technicians may be procured in accordance with the provisions of paragraph 3.21 of the Consultant Guidelines on the basis of procedures acceptable to the Association.

7. Individual Consultants. Services for assignments that meet the requirements set forth in the first sentence of paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines. Under the circumstances described in paragraph 5.4 of the Consultant Guidelines, such contracts may be awarded to individual consultants on a sole-source basis subject to prior approval by the Association.

Section IV. Review by the Association of Procurement Decisions

Contracts for works, goods and consultancies (with firms) estimated to cost \$200,000 or more per contract are subject to prior review. Contracts for individual consultants estimated to cost \$50,000 or more per contract are likewise subject to prior review. All other contracts shall be subject to Post Review by the Association.

SCHEDULE 2

Implementation Program

1. Karnataka shall not take any action which in the opinion of the Association may materially and adversely affect the carrying out of the Project or the achievement of the objectives thereof.
2. Karnataka shall carry out Parts B, C & D of the Project and shall take and cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable Karnataka to perform such obligations, and shall not take or permit to be taken any action which would prevent or interfere with such performance.
3. Karnataka shall carry out the Project in accordance with the provisions of the Decentralization Program Operational Manual and, except as the Association shall otherwise agree, Karnataka shall not amend or waive any provision of said Manual if, in the opinion of the Association, such amendment or waiver may materially and adversely affect the carrying out of the Project or the achievement of the objectives thereof.
4. For the purpose of managing the implementation of the Project, Karnataka shall:
 - (a) establish, not later than November 15, 2006, and thereafter maintain to the satisfaction of the Association, the DAC within DF with staff with requisite qualification and experience; and
 - (b) establish, not later than November 15, 2006, and thereafter maintain to the satisfaction of the Association, the FC within the RDPR with staff with requisite qualification and experience.
5. Karnataka shall cause GPs to carry out Sub-projects in accordance with the objectives, policies, procedures, time schedules and other provisions set forth in the Environmental Framework and shall not amend or waive any provisions of such Framework without the prior approval of the Association. In addition, Karnataka shall provide an Environmental Officer at the state level to provide technical and managerial support to the GPs in a manner satisfactory to the Association and in accordance with the Framework.
6. Karnataka shall monitor Gram Sabhas and shall increase the amount of Block Grants to those GPs whose strategic objective setting and decision-making process are deemed by Karnataka to be of superior quality.
7. Karnataka shall, and shall cause the GPs to adhere to the FMAS, in a manner satisfactory to the Association.

8. Throughout the duration of the Project, Karnataka shall: (i) make adequate budgetary allocation for timely release of funds to GPs, (ii) ensure that funds released under Block Grants are transferred to GPs within forty five (45) days of the start of each calendar year quarter; and (iii) cause GPs to maintain policies and procedures adequate to monitor and evaluate on an ongoing basis, in accordance with indicators satisfactory to the Association, the use of Block Grant funds, the carrying out of the Sub-projects and the achievement of the objectives thereof.
9. Karnataka shall, and shall cause the GPs to follow the Planning Guidelines for GPs and shall provide periodic evidence to the Association of progress achieved in the implementation of the Project in accordance with indicators agreed with the Association (to be set out in a supplemental letter).
10. Karnataka shall ensure that no civil works shall be carried out that will require the acquisition of land or that may result in the involuntary resettlement of local population.
11. Karnataka shall: (a) carry out the Project in accordance with the time-frame set forth in the Decentralization Program Operational Manual; (b) not later than five (5) months after the end of each Fiscal Year, shall review with the Association the implementation of Sub-projects in the preceding Fiscal Year; and (c) shall furnish to the Association a plan outlining Sub-projects to be undertaken in the following Fiscal Year.
12. Karnataka shall:

maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators satisfactory to the Association, the carrying out of the Project and the achievement of the objectives thereof including the monitoring of inclusion of tribal populations.

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association no later than August 31, 2009 a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in carrying out of the Project during the period preceding the date of the said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objective thereof during the period following such date; and

(c) review with the Association by December 30, 2009, or such later date as the Association shall request, the report referred to in paragraph (b) of this Section, and thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objective thereof, based on the conclusions and recommendations of the said reports and the Association's views on the matter.

