September 25, 2013

Hon. Don Pomb Polye, MP
Minister for Treasury
Department of Treasury
Vulupindi Haus 4th Floor
P.O. Box 542
Waigani, 131 NCD
Papua New Guinea

Dear Minister,

Papua New Guinea Sustainable Development Program Grant No. TF015507
Rural Service Delivery Local Governance Project

In response to the request for financial assistance made on behalf of the Independent State of Papua New Guinea (the “Recipient”), I am pleased to inform you that the International Bank for Reconstruction and Development and the International Development Association (collectively, the “World Bank”), acting as administrator of grant funds provided by the Papua New Guinea Sustainable Development Program Ltd. (the “Donor”), proposes to extend to the Recipient a grant in an amount not to exceed three million two hundred thousand United States Dollars (U.S.$3,200,000) (the “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 Donor. 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 Donor under the abovementioned trust fund, and the Recipient’s right to withdraw the Grant proceeds is subject to the availability of such funds.

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effective as of the date of the countersignature; provided, however, that the offer of this Agreement shall be deemed withdrawn if the World Bank has not received the countersigned copy of this Agreement within ninety (90) days after the date of signature of this Agreement by the World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 \( \text{Franz R. Drees-Gross} \)
Country Director
Timor-Leste, Papua New Guinea
& Pacific Islands
East Asia and Pacific Region

AGREED:
INDEPENDENT STATE OF PAPUA NEW GUINEA

By \( \text{AUTHORIZED REPRESENTATIVE} \)

Name: \( \text{Bank Buy} \)
Title: \( \text{Treasurer} \)
Date: \( 14/11/13 \)

Enclosures:

(2) Disbursement Letter of the same date as this Agreement, together with World Bank Disbursement Guidelines for Projects, dated May 1, 2006
1.01. **Standard Conditions.** The Standard Conditions for Grants Made by the World Bank out of Various Funds dated February 15, 2012 ("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, and the following additional terms have the following meanings:

1. "Sub-grant Recipient" means each pilot ward within the Participating Provinces that is eligible to participate in the Project, as set out in the Project Operations Manual, and as a result has received, or is entitled to receive, a Sub-grant for the implementation of a Sub-project under Part 1 of the Project.

2. "Department for Provincial and Local Government Affairs" or "DPLGA" means the Recipient’s department that handles provincial and local government affairs or any successor thereto.

3. "ESMF" means the Environmental and Social Management Framework prepared and adopted by the Recipient, dated June 25, 2013, defining the set of mitigation, enhancement, monitoring, and institutional measures to be taken during implementation of the Project to eliminate any adverse environmental and social impacts, offset them, reduce them to acceptable levels, or to enhance positive impacts of the Project activities, including provisions for distinct, vulnerable, social and cultural groups, and for compensation, rehabilitation, and resettlement assistance to displaced persons, as such framework may be amended by the Recipient from time to time, with the prior written agreement of the World Bank.

4. "ESMP" means an environmental and social management plan, in form and substance satisfactory to the World Bank, to be prepared by the Recipient on the basis of the ESMF, and giving details of measures to manage potential environmental risks and mitigate, reduce and/or offset adverse environmental impacts associated with the implementation of the Project, together with adequate institutional, monitoring, and reporting arrangements capable of ensuring proper implementation of, and regular feedback on compliance with, its terms, as any such plan may be amended and/or supplemented from time to time with prior written approval of the World Bank.

5. "Local Level Government" or "LLG" means the lowest administrative division of government in the Recipient's territory, and for the purpose of this Project, the focal point for determining the selection of Sub-grant Recipients and the associated Sub-projects and responsible for monitoring the transfer of Sub-grants to selected Sub-grant Recipients and the implementation of Sub-projects.
6. "Participating Provinces" means Central and Western provinces.

7. "Project Management Unit" means the unit within the DPLGA, consisting of Provincial Project Offices in each Participating Province, responsible for day-to-day management and implementation of the Project, in accordance with Section 2.03 of this Agreement.

8. "Project Operations Manual" means the manual prepared by the Recipient dated August 14, 2013, setting forth the implementation arrangements for the Project, covering, among other things, the process and criteria for identifying Sub-projects and providing Sub-grants, and procedures for procurement, financial management, monitoring and evaluation, and environmental and social safeguards, along with grievance redress mechanism, including all annexes and supplements thereto, as such Project Operations Manual may be updated from time to time with the prior written agreement of the Recipient and the World Bank.

9. "Project Steering Committee" means the steering committee established by the Recipient and chaired by the DPLGA Secretary, with responsibility for overall Project direction and oversight, in accordance with Section 2.03 of this Agreement.

10. "Provincial Project Office" means the office under the Project Management Unit to be established in each of the Participating Provinces and responsible for coordination among provincial, district and LLG and ward administrations for the purposes of implementation of Sub-projects.

11. "Sub-grant" means the proceeds of the Grant to be made available to each eligible Sub-grant Recipient, in accordance with Section 2.05(a) of this Annex, for the purposes of carrying out a Sub-project.

12. "Sub-grant Agreement" means each agreement to be entered into by a Sub-grant Recipient and the Recipient, setting out the terms and conditions, acceptable to the World Bank, on which the Recipient may make a portion of the proceeds of the Grant available to a Sub-grant Recipient for the purposes of carrying out a Sub-project, in each case on terms and conditions consistent with this Agreement, including each of the provisions set out in Section 2.05(b) of this Annex.

13. "Sub-project" means those activities consistent with Part 1 of Section 2.01 of this Annex; (a) meeting the requirements of the Project Operations Manual; (b) which are not listed as ineligible in the Project Operations Manual; and (c) for which a Sub-grant shall be made by the Recipient to a Sub-grant Recipient in accordance with the provisions of Section 2.05 of this Annex.

14. "Ward Development Committees" mean the committees responsible for ward development planning; which, for the purposes of the project, are also responsible for supporting Sub-grant Recipients to prepare Sub-project proposals; implement Sub-projects; and manage Sub-grants.
Article II
Project Execution

2.01. **Project Objectives and Description.** The objective of the Project is to develop a community-driven development model to improve access to, and the quality of, basic services in rural communities in the Recipient's territory, that can be scaled-up. The Project consists of the following parts:

Part 1: **Systems and Financing of Ward Development Grants**

Provision of Sub-grants to finance local social and economic infrastructure Sub-projects, such as construction of latrines, rehabilitation of local roads, or construction or repair of schools.

Part 2: **Capacity Building of National and Sub-national entities**

Carrying out a program of activities designed to strengthen the capacity of the national and sub-national government entities for management and implementation the project and basic service delivery.

Part 3: **Project Management**

Carrying out a program of activities designed to strengthen the Project management team at the national level and Project management teams in the targeted provincial administrations for day-to-day management of the Project.

2.02. **Project Execution Generally.** The Recipient declares its commitment to the objectives of the Project. To this end, the Recipient shall carry out the Project through its Department for Provincial and Local Government Affairs (DPLGA) 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 establish and maintain throughout the Project implementation period: (a) a Project Steering Committee chaired by the Secretary of DPLGA; (b) a Project Management Unit at the national level with responsibility for day-to-day management of the Project; and (c) Project management teams in each Participating Province; each with composition and duties as set out in the Project Operations Manual and with resources satisfactory to the World Bank.

2.04 **Project Implementation.**

(a) The Recipient shall ensure that the Project is implemented in accordance with the Project Operations Manual and shall not waive, amend, or abrogate any provision of the Project Operations Manual without the prior written consent of the World Bank.

(b) The Recipient shall prepare and submit an annual work plan and budget to the World Bank for review and approval by no later than November 30 of each year, commencing
on November 30, 2013, and thereafter carry out the Project in accordance with the annual work plan and budget as shall have been approved by the World Bank.

2.05  **Sub-grants**

(a) The Recipient shall make available the proceeds of the Grant allocated to Category (2) of the table in paragraph 3.01 of this Annex to one or more eligible Sub-grant Recipient, in each case under a Sub-grant Agreement to be entered into between the Sub-grant Recipient and the Recipient, on terms and conditions consistent with this Agreement, and including in all cases the provisions of sub-paragraph (b) of this Section 2.05, for the purposes of carrying out Sub-project activities in accordance with the Project Operations Manual.

(b) The Recipient shall ensure that each Sub-grant Agreement shall provide for rights adequate to protect the interests of the World Bank and the Recipient and shall:

(i) require the Sub-grant Recipient, with the support of the respective LLG, to carry out activities specified in the relevant Sub-grant Agreement in accordance with due diligence and efficiency and in accordance with sound technical, economic, financial, managerial, environmental and social standards and practices satisfactory to the Bank, including in accordance with the ESMF, any ESMP required pursuant to the ESMF, the Project Operations Manual, and the Anti-Corruption Guidelines;

(ii) require that all goods, works, and services necessary for the Sub-project shall be procured by the Sub-grant Recipient in accordance with the provisions of paragraph 2.10 of this Annex;

(iii) require that all goods, works, and services be used exclusively in the carrying out of the Sub-project activities;

(iv) require that the Sub-grant Recipient, with the support of the respective LLG, monitor and evaluate the progress of the Sub-project in accordance with the Project Operations Manual;

(v) require that the Sub-grant Recipient, with the support of the respective LLG, maintain a financial management system in accordance with the Project Operations Manual and prepare financial statements in accordance with consistently applied accounting standards acceptable to the World Bank and the Recipient; both in a manner adequate to reflect the operations, resources, and expenditures related to the Sub-project and, at the World Bank's or the Recipient's request, have such financial statements audited by independent auditors acceptable to the World Bank and the Recipient in accordance with consistently applied auditing standards acceptable to the World Bank, and promptly furnish the statements as so audited to the Recipient and the World Bank;

(vi) enable the Recipient and the World Bank to inspect the Sub-project, its operation, and any relevant records and documents; and prepare and furnish to the Recipient and the World Bank all such information as the Recipient or the World Bank shall reasonably request relating to the foregoing; and
(vii) set out the right of the Recipient to suspend or terminate the right of the Sub-grant Recipient to use the proceeds of the Sub-grant, or obtain a refund of all or any part of the amount of the Sub-grant upon failure of the Sub-grant Recipient to perform any of its obligations under the Sub-grant Agreement.

2.06 **Environmental and Social Safeguards.** The Recipient shall ensure that the Project is carried out in accordance with the ESMF and the ESMP as may be required; except as the World Bank shall otherwise agree, the Recipient shall not assign, amend, abrogate, or waive, or permit to be assigned, amended, abrogated, or waived, the aforementioned, or any provision thereof.

2.07. **Donor Visibility and Visit.**

(a) The Recipient shall take or cause to be taken all such measures as the World Bank may reasonably request to identify publicly the Donor's 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 to visit any part of the Recipient’s territory for purposes related to the Project.

2.08. **Project Monitoring, Reporting and Evaluation.** 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 indicators acceptable to the World Bank. Each Project Report shall cover the period of one (1) calendar semester, and shall be furnished to the World Bank not later than one (1) month after the end of the period covered by such report.

2.09. **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 calendar quarter, covering the quarter, in form and substance satisfactory to the World Bank.

(c) The Recipient shall have the Project’s 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.

2.10. **Procurement**

(a) **General.** All goods, works, non-consulting services, 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
(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, Works, and Non-consulting Services

(i) Except as otherwise provided in sub-paragraph (ii) below, goods, works, and non-consulting services shall be procured under contracts awarded on the basis of International Competitive Bidding; and

(ii) The following methods, other than International Competitive Bidding, may be used for procurement of goods, works, and non-consulting services for those contracts which are specified in the Procurement Plan: (A) Shopping; and (B) Community Participation in Procurement.

(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, other than Quality- and Cost-based Selection, may be used for the procurement of consultants’ services for those assignments which are specified in the Procurement Plan: (A) Selection based on Consultants’ Qualifications; (B) Single Source Selection; (C) Selection of Individual Consultants; and (D) Sole Source Procedures for the Selection of Firms and 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:

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount of the Grant Allocated (expressed in USD)</th>
<th>Percentage of Expenditures to be Financed (inclusive of Taxes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Goods, consultants’ services, Training, and Incremental Operating Costs.</td>
<td>1,800,000</td>
<td>100%</td>
</tr>
<tr>
<td>(2) Sub-grants</td>
<td>1,400,000</td>
<td>100% Sub-grants disbursed</td>
</tr>
<tr>
<td>TOTAL AMOUNT</td>
<td>3,200,000</td>
<td></td>
</tr>
</tbody>
</table>

For the purpose of this paragraph, the terms: (i) “Training” means the reasonable cost of training, seminars, workshops, meetings, and study tours required for the Project, including materials, rental of facilities, reasonable transportation costs, course fees, as well as domestic and international travel and subsistence of trainers and training participants, and other costs directly related to training preparation and implementation; and (ii) “Incremental Operating Costs” means incremental expenses incurred on account of Project implementation, support, and management, and reasonably related thereto, including consumable materials and supplies, communications, utilities, mass media and printing services, vehicle rental, operation and maintenance, insurance charges, charges for the opening and operation of bank accounts required for the Project, and travel, lodging and per diems, but excluding salaries of officials of the Recipient’s civil service, as included in an annual budget approved by the World Bank.

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.

3.03. Withdrawal Period. The Closing Date referred to in Section 3.06 (c) of the Standard Conditions is August 31, 2016.
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 Minister for Treasury and Finance of the Recipient.

4.02. **Recipient’s Address.** The Recipient’s Address referred to in Section 7.01 of the Standard Conditions is:

Department of Treasury
Vulupindi Haus 4th Floor
P.O. Box 542
Waigani, 131 NCD
Papua New Guinea

Facsimile:
(675) 312 8808 or (675) 312 8804

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