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Report No: 39321-BD

PROJECT PAPER
ON A
PROPOSED ADDITIONAL FINANCING CREDIT
IN THE AMOUNT OF SDR 5.4 MILLION
(US\$8.0 MILLION EQUIVALENT)
TO THE
PEOPLE'S REPUBLIC OF BANGLADESH
FOR A
SOCIAL INVESTMENT PROGRAM PROJECT

April 18, 2007

**Sustainable Development Sector Unit
South Asia Region**

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CURRENCY EQUIVALENTS
(Exchange Rate Effective March 15, 2007)

Currency Unit = BDT
BDT 1.00 = US\$0.01449
US\$1.00 = BDT 69.005

FISCAL YEAR
July 01 -- June 30

ABBREVIATIONS AND ACRONYMS

CAP	Community Action Plan
CAS	Country Assistance Strategy
CDD	Community-Driven Development
COM	Community Operational Manual
DFID	Department for International Development (UK)
DO	Development Objectives
FM	Financial Management
GOB	Government of Bangladesh
IDA	International Development Association
IP	Implementation Progress
MD	Managing Director
MIS	Management Information System
MOF	Ministry of Finance
MTR	Mid-Term Review
OM	Operational Manual
O&M	Operations and Maintenance
PDO	Project Development Objective
PO	Partner Organization
PRSP	Poverty Reduction Strategy Paper
SDF	Social Development Foundation
SIPP	Social Investment Program Project
VDC	Village Development Committee

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BANGLADESH

**SOCIAL INVESTMENT PROGRAM PROJECT
ADDITIONAL FINANCING**

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BANGLADESH

**SOCIAL INVESTMENT PROGRAM PROJECT
ADDITIONAL FINANCING**

PROJECT PAPER

SOUTH ASIA - SASSD

Date: April 18, 2007 Country: Bangladesh Project Name: Social Investment Program Project Project ID: P104483	Team Leader: Meena M. Munshi Sector Director: Constance Bernard Country Director: Xian Zhu Environmental Category: B				
Borrower: People's Republic of Bangladesh					
Responsible agency: Social Development Foundation					
Revised estimated disbursements (Bank FY/US\$m)					
FY	FY07	FY08	FY09		
Annual	0.5	3.0	4.5		
Cumulative	0.5	3.5	8.0		
Current closing date: 06/30/2007					
Revised closing date: 09/30/2009					
Does the restructured or scaled-up project require any exceptions from Bank policies? Have these been approved by Bank management? Is approval for any policy exception sought from the Board?		<input type="radio"/> Yes <input checked="" type="checkbox"/> No <input type="radio"/> Yes <input type="radio"/> No <input type="radio"/> Yes <input checked="" type="checkbox"/> No			
Revised project development objectives/outcomes					
The Project Development Objective would remain the same as the Original Project. The Additional Financing would continue to support the development of effective and efficient financing and institutional arrangements at the local level for improving access to local infrastructure and basic services through the implementation of community-driven small-scale socio-economic infrastructure, social assistance and income generating activities.					
Does the scaled-up or restructured project trigger any new safeguard policies? No					
For Additional Financing					
<input type="checkbox"/> Loan <input checked="" type="checkbox"/> Credit <input type="checkbox"/> Grant For Loans/Credits/Grants: Total Bank financing : SDR 5.4 million (USD 8.0 million equivalent) Proposed terms: Standard Credit					
Financing Plan (US\$m.)					
Source	Local	Foreign	Total		
Borrower	0.70	0.00	0.70		
IDA	7.75	0.25	8.00		
communities	0.75	0.00	0.75		
Total	9.20	0.25	9.45		

I. Introduction

This Project Paper seeks the approval of the Executive Directors to provide an additional Credit in an amount of SDR 5.4 million (US\$8.0 million equivalent) to Bangladesh, for the Social Investment Program Project (Cr.3740-BD).

The proposed additional Credit would help finance the costs associated with the scaling up of activities to enhance the developmental impact of this well-performing project. No major changes are proposed to the Project's Development Objective, design or implementation arrangements of the Original Project.

The proposed Additional Financing would continue to support the development of sustainable and effective institutional arrangements at the local level, through which communities are empowered to address their own basic needs through investments in infrastructure services, social assistance and income generating sub-projects. Activities in villages presently served by the project would be deepened, with a particular focus on strengthening community-driven institutions of the poor, building upon both the existing implementation capacity and field results to date. Project activities would also be extended into a limited number of villages in four additional districts, where some refinements in implementation strategy would be piloted, reflecting lessons learned and agreed post-Mid Term Review (MTR). The strategy maintains a focus on capacity building of the poor via strengthening and direct financing to village level institutions. It enhances the focus on inclusion of youth and the 'hardcore' poor and responds to community demands for increased support for economic activities. Finally, the additional financing will pave the way for a future more significant scaling up of support to the Social Investment Program, consistent with the Country Assistance Strategy (CAS) for Bangladesh.

Partnership Arrangements: The proposed Additional Financing does not envisage specific partnership arrangements with other development partners. However, existing cooperating arrangements with Department for International Development (DFID), under the Bangladesh Country Trust Fund, and partnership with national and local NGOs will continue. In addition, during implementation under the Additional Financing, partnerships with the private sector will be deepened.

II. Background and Rationale for Additional Financing in the Amount of US\$8.0 Million

Original Project Design: Since 2003, the Government of Bangladesh (GOB), with support from IDA through the institutional channel of the Social Development Foundation (SDF), has been implementing the Social Investment Program Project (SIPP). This is a community demand-driven (CDD) operation, which is exploring new ways of delivering critical infrastructure services and social assistance to the rural poor, while at the same time addressing institutional organization and capacity-building needs at village level. Overall, this CDD approach entails a focus on community organization and principles of participation, empowerment and downward accountability. The project has been successful in demonstrating the capacity of rural villagers to prioritize needs, manage resources and implement subprojects, empowering them to play an active role in shaping poverty reduction efforts at the local level.

The original Credit, in the amount of SDR 13.5 million (US\$18.24 million equivalent) was approved on March 18, 2003, and became effective on April 20, 2003. The project was intended as a small-scale pilot, implemented in two of the poorest districts of Bangladesh, to test new financing and institutional arrangements for improving access to local infrastructure and basic services.

As under the Original Project, the Additional Financing would support the following four components:

- (i) **Strengthening of SDF** will support information and communication, capacity building, monitoring and learning, and project management.
- (ii) **Institutional Development at Community-Level** will support awareness raising and information sharing, and institutional development and planning.
- (iii) **Implementation of Community Action Plans (CAP)** will provide matching grants for community subprojects to finance the implementation of small scale socio-economic infrastructure and income generating activities, and provide technical assistance to increase the capacity of the poorest and socially excluded groups to avail themselves of social and economic opportunities and resources.
- (iv) **Pilot Private Financing of Community Utilities** will finance the provision of technical advisory services for testing of new approaches to mobilize private participation in the program.

Reasons for Additional Financing: The original Project Development Objective (PDO) is still valid, and overall project design and scope remain the same. The Additional Financing will be used primarily to consolidate gains and meet already identified community demands in the first three batches of villages where the Original Project is under implementation. It will also scale up the approach with focus on institutional building and livelihoods in a batch of villages in four additional districts. Finally, the additional financing will permit the piloting of some refinements in strategy based on lessons learned to date, prior to subsequent more significant scaling-up of the program. Overall, it is anticipated that building on ongoing activities in project villages and testing a revised strategy for future scale-up will contribute to enhanced development impact.

Supervision ratings for the Original Project have consistently been satisfactory both for Development Objectives (DO) and Implementation Progress (IP). Thus far, the Original Project has demonstrated the benefits of community level planning and has generated positive community responses as a result of their increased participation in planning and implementation of village level activities; enhanced information and empowerment base at the village level; and quality and cost of community implemented infrastructure activities. As of March 15, 2007, the project has reached 950 villages, (roughly 2.0 million people) through 1400 community subprojects.

As SDF has gained experience with the project strategy and methodology, the pace of execution has accelerated steadily (US\$14.1 million have been disbursed and the remainder of the IDA Credit is fully committed) and at this time more than 950 Village Development Committees have requested additional project support for strengthening their institutions and financing critical investments for which they need resources. The Additional Financing instrument is ideally suited for this purpose. With the volume of demand already substantiated, the implementation capacity

of SDF and the government record under this project of timely provision of counterpart financing, no difficulty is anticipated in the full utilization of the Additional Financing within the proposed revised Closing Date.

Implementation arrangements for Additional Financing: Implementation arrangements under the Additional Financing would remain the same as those of the ongoing project, which have been performing well. Overall, the project management would continue to be the responsibility of the existing implementation agency SDF. The project will continue to be implemented according to procedures defined in its project Operational Manual and Community Operational Manual. The implementation of the village activities would continue to be the responsibility of the village organizations. The fiduciary tasks of procurement and financial management also detailed in the Operational Manual, are already satisfactory to IDA and will remain unchanged under the proposed Additional Financing. Audit reports and reviews during supervision missions confirm the effectiveness of these arrangements.

III. Proposed Changes

As mentioned above, the Project Development Objective, its design and institutional arrangements will remain the same as the Original Project. The Closing Date for the Original Project would be extended; and revised Closing Date for the Original Project and the Additional Financing would be September 30, 2009.

Allocation of Credit Proceeds: The same expenditure categories would be maintained as under the Original Project. IDA would fund 100% of allocation for all categories except incremental and operating costs (which will be maintained as in the Original Project) as approved under current Country Financing Parameters. The bulk of IDA funds would be transferred to the communities directly as sub-grants for subprojects under expenditure Category 1 for which there is no tax element, and that there is insignificant tax element in Categories 2 to 4 under consultancies and goods. Therefore, the higher financing percentages in these Categories under IDA funds would be justified, and is within the approved Country Financing parameters. Schedule 1 of Development Credit Agreement has been revised to reflect re-allocation of “unallocated category” of the Original Credit among other expenditure categories. Expenditure categories and revised allocations of the Original Credit and Additional Financing are shown below:

Category	Amount of the Revised Allocation under the Original Credit SDR Million (US million equivalent)	Amount of the Additional Credit allocated SDR Million (US\$ million equivalent)	% of Expenditures to be Financed
Sub-grants for subprojects under Part C	8.960 (12.100)	4.400 (6.600)	100%
TA for partnerships with private sector under Part D	0.420 (0.567)	0.100 (0.150)	100%
Goods, including vehicles and equipment	0.220 (0.297)	0.180 (0.250)	100%
Services, including POs, audit, training	3.250 (4.387)	0.360 (0.500)	100%
Incremental staff salaries and operating costs	0.650 (0.889)	0.360 (0.500)	80% in FY03 and FY04 and 60% thereafter
Unallocated	Nil	Nil	
Total	13.500 (18.240)	5.400 (8.000)	

IV. Consistency With Country Assistance Strategy (CAS)

The recent Bangladesh CAS (2006-10) aligns IDA assistance with the Government of Bangladesh's national strategy as articulated in Poverty Reduction Strategy Paper (PRSP), through two pillars which emphasize empowering the poor and improving the climate for growth, supported by a cross-cutting focus on good governance. Expanding poor people's ability to make choices and participate in constructive actions to improve their situation is at the heart of empowerment and poverty reduction. One way of doing this is through a CDD approach that engages the poor directly in priority setting and increases both their control over and accountability for resources and decision-making. These are the central principles on which Social Investment Program Project operates, with the aim of reducing poverty amongst the rural population, especially the "poorest of the poor and most vulnerable", currently outside the reach of most official development interventions.

The Additional Financing would support the deepening of the original operation's development impacts and is therefore fully consistent with the CAS and the PRSP.

V. Appraisal of Scaled-Up Project Activities

A. Economic and Financial Analyses.

Important aspects of project design under the Original Project, to be maintained under the additional financing, help ensure that community subproject investments represent the most cost-

effective alternative. The demand driven nature of the community subproject selection helps ensure that scarce resources flow where they are most needed and that selected subprojects and institutional strengthening activities are the best alternatives for the communities. The direct involvement of the communities in decision making and implementation have proven to generate very significant cost savings when compared to similar works executed by public sector agencies. Cost-benefit ratios of such investments are high and analysis suggests that investments are generally financially sustainable. Although Village Development Committees receive a one-time matching grant, the communities contribute towards investment costs and take full responsibility for the cost of operation and maintenance of assets. The strong sense of ownership by recipients, because they have played such an active role in decision making at all stages of subproject selection and implementation, not only produces the kind of cost savings mentioned above (as communities carefully monitor the use of very scarce resources), but also improves quality (as compared with similar works done by others), and is a major factor explaining the strong prospects for sustainability of investments.

Technical Analysis

Technical viability of small scale infrastructure works under the Original Project has been demonstrated over the first 3 years of implementation. At the time of the MTR, both quality and cost indicators surpass those of comparable works undertaken by the Local Government Engineering Division. Technical standards have been regularly reviewed by the IDA task team, looking at engineering designs, financial and economic feasibility, environmental impacts and Operation and Maintenance (O&M) arrangements. Indicative rates of return are high, and SDF is currently undertaking a comprehensive assessment to systematically document these. Villages which will participate under the Additional Financing will have an open menu and may use their budget envelope for socio-economic infrastructure needs, social and institutional assistance or income generating subprojects. As under the original project, only technically feasible, simple, labor intensive and economically viable sub-projects which can be easily maintained and operated and sustained by the communities would be eligible. All sub-projects will be screened by qualified staff in subproject appraisal teams and SDF, and communities can contract technical assistance to assist in design and implementation of sub-projects, and in strengthening of their community based organizations.

B. Fiduciary Analysis

The same financial management and procurement arrangements used in the Original Project will be used under the proposed Additional Financing. During implementation to date, SDF's finance and procurement team has acquired significant experience in IDA guidelines and requirements, and community financial management and procurement. Adequate fiduciary controls are in place at the national level, with appropriate controls and accountability measures at community level. Regular field level supervision by SDF staff and IDA supervision missions will be continued. A detailed Fiduciary Risk Assessment is included in attached Annex.

SDF has prepared a revised Procurement Plan for the Original Project as well as the Additional Financing. Given the demand driven nature of subprojects, the community level procurement cannot be planned up-front. However, the key rules, procedures and process steps for community level procurement have been agreed and are incorporated in the procurement chapter of Operational Manual. The Procurement Plan would be updated annually or as required to reflect actual project implementation pace and needs.

Environmental and Social Aspects

Environmental: The Original Project has an Environmental Category B classification, with community subprojects subject to screening and impact assessment criteria as detailed in the approved Operational Manual. Under the project to date, no adverse environmental impacts have been experienced. The Additional Financing would fund community subprojects similar in scale and scope to those implemented under the Original Project. No subprojects are approved or funds transferred until the environmental viability of the investments is determined, and subproject agreement between SDF and the community organizations contain environmental compliance clauses as detailed in the Operational Manual.

Social: While the tribal population is insignificant in the project districts, a Tribal Development Plan was developed under the Original Project. This will be applicable to the additional financing as well, and the guidelines are detailed in the Operational Manual.

Other social impacts are expected to be positive, with project activities gradually leading to improved quality of life of the poor and vulnerable groups through enhancing their access to social and economic opportunities. In the villages already participating under the ongoing project, achievements to date will be capitalized on by further enhancing functioning and sustainability of community groups, and broadening their inclusion to ensure participation of young people and the poorest of the poor. In the new villages, initial social mobilization activities will also seek to identify and include the poorest, youth and women, introducing the principles and benefits of collective action for both social and economic empowerment.

VI. Expected Outcomes

The existing project monitoring and evaluation system is comprehensive. The implementing agency has a robust Management Information System (MIS) system in place, from which they generate quarterly reports tracking physical/financial progress and key Results Framework indicators. In addition, they are making use of an independent agency to provide process monitoring reports on a monthly and quarterly basis, in order to bring field level operational issues to management attention. The Original Project baseline is complete and an impact assessment was carried out in preparation for MTR. With Additional Financing in place, expected outcomes will remain largely unchanged with outcome indicators similar to those of the Original Project, tracking (i) the numbers of poor benefited; (ii) numbers of viable community organizations formed and functioning; and (iii) savings mobilized and non-project funds/financing leveraged by community organizations.

VII. Benefits And Risks

The proposed Additional Financing will benefit 2.0 million rural poor in the two districts of Jamalpur and Gaibandha, served under the Original Project, through further strengthening of their community-based organizations and additional support to productive economic activities and investments. In addition, in the four districts to which the project will be extended under the Additional Financing, a further 150,000 people will benefit. The key risk may be that uncertainty about future elections and loss of political commitment to address the needs of the poorest may present a challenge to implementation. However, this has not been an issue so far, and the Care

Taker Government has shown strong commitment to the interest of the poor. Maintaining a highly participatory nature of the program at local level and engaging the poor directly in the implementation of the program would mitigate this risk. The second risk could be SDF's institutional structure and capacity to ensure compliance to the project rules in the ground. However, the institutional set up of SDF has worked effectively in the past, with an independent Governing Body, a competent Managing Director and supporting staff to ensure professionalism and compliance to the project rules. This risk would be further addressed through strengthening SDF's field presence to enable it to monitor compliance to the project rules, and respond quickly to the demands of the communities. In addition, the institutional set-up created at the community level under the ongoing project, which includes the participation of all members of the community in the selection, preparation, implementation and management of resources, have proven to be a strong mechanism to limit outside interference and address this type of risk.

Otherwise, the activities scaled up under Additional Financing should pose no additional risks, other than those identified in the Original Project, for which effective mitigation measures are already in place.

VIII. Financial Terms And Conditions For The Additional Financing

Bangladesh is eligible for IDA financing. Accordingly, the Additional Financing will take the form of an IDA Credit, with standard terms of 10 years grace and 40 year maturity.

Annex **Fiduciary Risk Assessment**

A. Summary of Project Description

1. The proposed additional financing would support the scaling up of the Social Investment Program project (SIPP) to develop effective and efficient financing and institutional arrangements for improving access to local infrastructure and basic services through the implementation of community-driven small-scale socio-economic infrastructure, social assistance and income generating activities.
2. The project is implemented by the Social Development Foundation (SDF), an autonomous body established by a notification of the Government of Bangladesh in 2000 and registered in 2001 under the Bangladesh Companies Act of 1994. Day to day management of SDF is vested in a management team heading by the Managing Director, appointed by the SDF Government Body. The Governing Body of nine persons is responsible for determining the direction and scope of SDF's activities, the management and administration of the Foundation. Policy direction and oversight is provided by a 20-member General Body.

B. Financial Management Capacity Assessment:

3. The financial management (FM) system developed under the Original Project is adequate to account for, monitor and report the project resources and expenditures. Under Additional Financing, the priority for SDF is to maintain a sound community Financial Management system in a sustainable manner, to continue ensuring appropriate downward accountability mechanisms that maintain integrity of accounts at the local level. A summary of key strengths and identified weaknesses is given below. Agreed actions are included in the Financial Management Improvement Action Plan in Paragraph 20 below.

Overall Strengths and Weaknesses

4. **Staffing:** SDF has a Finance and Administrative Division, with eight staff headed by a General Manager, who have been maintaining a sound Financial Management system, capable of producing timely financial information and maintaining checks and balance in the financial transactions. Existing staff will be able to manage the additional financing for the project.

- **Suggested Improvement:** The Financial Management staff need to diversify their focus from entity-based (SDF) financial management arrangements to the community level Financial Management system, to be able to support strong community-based systems, downward accountability mechanisms and provide constant field-based training and monitoring. In order to optimize overall Financial Management arrangements, it would be useful for SDF to clearly identify focal staff to work on community level accountability and distinguish their TOR/job descriptions from those who focus on SDF level Financial Management issues. To support these staff, the revised Community Operational Manual and Guidelines need to be widely disseminated, applied and monitored.

5. **Computerized Financial Management System:** Overall, SDF's financial management system is a combination of manual-based control functions and a computerized accounting

package for posting of transactions. The key function of the accounting package is to consolidate financial information from the field as well as from central level and produce a set of financial monitoring reports. The use of a computerized system was a good start from the perspective of traditional automation of financial information. This has helped SDF to consistently meet the financial covenant to send quarterly Financial Management Reports (FMRs) within forty-five days of the end of the quarter to the Bank, including preparation of annual financial Statements.

- Suggested Improvement: A computerized financial management system having control functions built into the system for the sub-project as well as other revenue and capital expenditure at the central level should be considered. This would help avoid time consuming pre-audit functions for numerous transactions and use of automated system at the transaction level rather than posting transactions after they occur. This would also help application of control functions across the various types of transactions with minimal human error.

6. **Internal Control and Audit:** SDF is responsible for carrying out periodic internal audit functions and submitting such reports to the MD. Supervision missions have shown that SDF has been conducting these internal audits regularly and that they have been a good source of information to monitor the robustness of its Financial Management system. The internal audit reports should always include a clear record of management response for prior internal audit observations. The Governing Body have already demonstrated their commitment to this internal audit practice and should continue to monitor and review the prompt action by management, where necessary.

- Suggested Improvement: Overall, internal audit could be further strengthened under Additional Financing by taking the following steps: (i) introducing an annual internal audit plan; (ii) show management responses in the internal audits; and, (iii) a table showing current status of previous observations in the same district/ thana/ villages.

Disbursement Arrangements:

7. For utilization of IDA's share of expenditures, SDF makes use of the Special Account, which, under the Original Project, has been working well. The authorized allocation of the Special Account is equivalent to 3-4 months of estimated expenditures and this would be maintained under Additional Financing.

8. Current IDA disbursements – as of March 15, 2007 – are US\$14.1 million or little above 70% of the total Credit amount of SDR 13.5 million (equivalent to US\$18.24 million). This includes only the amount advanced to the project Special Account, not those expenditures under processing.

9. Commitments: Total commitments and estimated expenditure as of March 15, 2007, is US\$5.8m (Approx).

Allocations under Additional Financing:

10. The same expenditure categories will be maintained, as under the Original Project. The allocation between categories and the percentage of expenditures to be financed are shown below in Table 1. The current approved Country Financing Parameters, 100% financing has been selected for all categories (except incremental costs), owing to enhanced practicality of such arrangements. The bulk of IDA funds would be transferred to the communities directly as sub-

grants for subprojects under expenditure Category 1 for which there is no tax element, and that there is insignificant tax element in Categories 2 to 4 under consultancies and goods. Therefore, the higher financing percentages in these Categories under IDA funds would be justified, and is within the approved Country Financing parameters.

Table 1: Category-wise Allocations

Category	Amount of the Revised Allocation under the Original Credit SDR Million (US million equivalent) (US\$ million)	Amount of the Credit allocated SDR Million (US million equivalent))	% of Expenditures to be Financed
Sub-grants for subprojects under Part C	8.960 (12.100)	4.400 (6.600)	100%
TA for partnerships with private sector under Part D	0.420 (0.567)	0.100 (0.150)	100%
Goods, including vehicles and equipment	0.220 (0.297)	0.180 (0.250)	100%
Services, including POs, audit, training	3.250 (4.387)	0.360 (0.500)	100%
Incremental staff salaries and operating costs	0.650 (0.889)	0.360 (0.500)	80% in FY03 and FY04 and 60% thereafter
Unallocated	Nil	Nil	
Total	13.500 (18.240)	5.400 (8.000)	

Project Planning and Budgeting

11. *National level:* The national budget includes sector wise allocations, and is approved by the Parliament. The project planning process for each financial year would follow the GOB budgeting cycle and would be completed when the project estimates are included in the Annual Development Plan and approved by Ministry of Finance (MOF) for its execution by the line ministries/departments. Under the Original Project, the entire amount of counterpart funding for SIPP was received from the MOF in two tranches. However, for the additional financing, it is recommended that counterpart funding is received annually.

12. *Community level:* As under the ongoing project, the planning process for community level sub-grants would follow a ‘bottom-up’ approach. Grants for sub-projects are disbursed based upon a signed Financing Agreement, specifying the mode and triggers for tranche release, submitted by the community organizations and approved by SDF. Communities’ budgetary procedure will follow the sub-grants, based on the total resource envelope allocated to them, by planning and prioritizing village priorities in a participatory transparent manner and reflecting these in a Community Action Plan (CAP).

Funds Flow Arrangements

13. *From IDA and Government to SDF:* Under a Subsidiary Grant Agreement between the Government and SDF, the Ministry of Finance would provide the IDA Credit and any Government contribution to SDF. The original Subsidiary Grant Agreement would be amended to reflect the requirement under Additional Financing. IDA funds would continue to be channeled to the Special Account operated by SDF for SIPP, under terms and conditions acceptable to IDA. The Managing Director of SDF would remain the authorized person to withdraw IDA credit proceeds and the Government contribution, as under the current arrangements. GOB counterpart will follow the same procedures SIPP.

14. *From SDF to participating communities:* Upon approval of a Community Action Plan and sub-projects proposals, SDF will directly transfer funds to the relevant Community Account. The transfer will be conditional to the communities complying with the project rules.

Reconciliation of Accounts

15. SDF will carry out periodic reconciliation of funds with community accounts so that any request for project funding or tranche payment can be based on balance remaining at the community account, as well as funds to be disbursed.

Financial Management Reports (FMRs)

16. FMRs have been received consistently under the on-going project and are of acceptable quality. It would assist SDF if one set of FMRs is prepared that meets both SDF and World Bank's requirement and is used by all parties to monitor financial performance of the project. This would be increasingly important with the Additional Financing also to be monitored and reported.

External Audit

17. Since SDF is governed by the Companies Act, it is mandatory for their accounts to be audited by a private audit firm. The external audit report, conducted under terms of reference satisfactory to IDA, should be submitted to IDA within six months of the end of each fiscal year. Under the on-going project, IDA has been receiving external audit reports in a timely manner. The next audit report is due on December 31, 2007.

18. Overall, future external audits could be strengthened by covering the Bank's requirement for an audit opinion on both the SOE and Special account. It has also been recommended that SDF's Audit committee discusses both internal and external audit report and documents the decisions. The following audit reports are monitored in the Audit Report Compliance system (ARCS):

Implementing Agency	Audit	Auditors	Audit Due Date
SDF	Entity Financial Statements with additional opinion on SOE (whether SOE can be relied to disburse IDA funds) and SA	Private Audit firm	6 months after the end of each fiscal year (December 31)

Adequacy of Financial Management Arrangements

19. The Financial Management arrangements under the on-going project will be adequate for the proposed additional finances. From the fiduciary perspective, the FM risk rating is: modest. Attachment 1 provides the FM Risk Rating Summary and mitigation measures.

Financial Management Action Plan

20. In the context of scaling up, SDF has committed to completing following activities in a time-bound action plan, summarized in Table 2 below. Most of the activities are extensions of past activities and many of the enhancements are already under progress.

Table 2: FM Improvement Action Plan

Issues	Responsibility	Completion date
A computerized financial management system having control functions built into the system for the sub-project as well as other revenue and capital expenditure at the central level should be considered.	SDF- Finance team	July 31 2007
Recruit staff with adequate skills and competence to develop and monitor downward accountability framework with TOR acceptable to the Bank.	SDF and World Bank	June 30, 2007
Further strengthen Internal Audit functions covering Additional Financing by taking the following steps: (i) introducing an annual internal audit plan; (ii) show management responses in the internal audits; and, (iii) a table showing current status of previous observations in the same district/ thana/ villages.	SDF -Management Team	June 30, 2007
Revise and update the Operational Manual and the Financial Management Manual, taking into consideration the lessons learned to date and feedback from MTR. Prepare the draft ready for submission to IDA for approval/clearance.	SDF -Management Team	May 30, 2007

Supervision/Implementation Support

21. In the early stages of Additional Financing Financial Management supervision activities will focus on the adequacy of implementation of the action plan items. As project implementation moves forward, desk reviews of internal, external, and social audit reports will be conducted. To help ensure transparency, the SDF website will be reviewed for timely and correct postings of sub-project details *vis-à-vis* information contained in the project FMRs. Site and field visits will be planned as needed to review internal control procedures and community level practices.

C. Procurement Capacity Assessment

22. SDF has been carrying out procurement responsibilities under the original project since it's inception in 2003. Existing procurement arrangements are adequate, and the established SDF system is sufficient to handle procurement activities arising out of the Additional Financing.

23. As under the Original Project, procurement for the Additional Financing would be carried out in accordance with IDA's "Guidelines: Procurement Under IBRD Loans and IDA Credits" dated May 2004 and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, as well as the Public Procurement Regulations, 2003 promulgated by the Government of Bangladesh and the provisions stipulated in the revised Legal Agreement. Threshold limits for the applicable Guidelines and/or Regulations and review category and methods of procurement are indicated in the Procurement Plan for the additional financing. These procurement responsibilities are carried out at the national level by SDF itself, while procurement of community infrastructure works is carried out at the village level by the community committee members who have been imparted training on procurement by SDF through its partner organizations.

24. Given that the nature of the project is essentially community driven, the procurement through community participation cannot be planned upfront. However, SDF have prepared a Procurement Plan for the first eighteen months for the other components to be covered by the financing. The Procurement Plan will be updated at least annually or as required to reflect the actual project implementation pace and needs.

25. A summary of SDF's key strengths and identified weaknesses in procurement is given below. Agreed actions for future improvement are included in the Procurement Improvement Action Plan in paragraph 30.

Overall strengths and weaknesses

26. **Staffing:** SDF has a Finance and Administrative Division, with eight staff headed by a General Manager, who have been maintaining a sound Financial Management and Procurement system. A designated Procurement Manager is responsible for all procurement activities under the project, including oversight of procurement at community level.

- **Suggested improvement:** While the Procurement Manager has proven to be very capable in her job and is more than adequate as the specialist in charge at national level, SDF could optimize staffing arrangements in order to further enhance their capacity to oversee community-based procurement. This would include personnel designated to carry out regular quality control of training activities carried out by partner organizations in the field, and monitoring of community level procurement transactions.

27. **National level procurement:** The volume of procurement by SDF at the national level is relatively small, to the tune of \$1.4m only, while, as noted, the majority of activities take place as community sub-project procurement. However, given the country context, irrespective of the volume of procurement, procurement activities in Bank-financed projects have typically faced risk probabilities in two areas: (i) qualitative, arising out of lack of transparency and poor fiduciary controls, and (ii) quantitative, as seen in non-achievement of planned targets in the procurement plan and/or related project documents. Under the Original Project and as monitored during regular IDA implementation support missions, SDF has not faced major issues in these areas. Nevertheless, it is important to maintain close and regular review on the part of IDA and for SDF to continue to utilize risk mitigation measures, including enhancement of staff procurement capacity.

28. **Community level procurement:** Under Additional Financing, the quality of community procurement would continue to assume great priority and detailed reviews would be regularly

undertaken in the field by IDA supervision teams. In past reviews, procurement training at the field level has emerged as an important aspect for capacity building and considerable demand has been seen at community level for refreshment and updating of skills.

- Suggested improvement: SDF therefore needs to orient the SDF staff, field teams and partner organizations to respond adequately to such demands, so that they may regularly monitor the quality of procurement done by communities, in terms of transparency, accountability and adherence to procedures, as well as reviewing technical quality of resulting works, and checking adequacy of training offered to communities by field-based partner organizations (POs). SDF should have the capacity to guide POs, assisting with design and delivery of training, and routinely monitoring quality and impact of such training.

29. Procedures for community-level procurement shall continue to follow the project's Community Operational Manual (COM), including the recently revised and updated chapter on Community Procurement detailing procurement rules, arrangements and methods for procuring works, goods and services, thresholds, roles and responsibilities of community organizations, and various accountability controls at the local level. Most activities undertaken in the Community Action Plan component will continue to use community participation to mobilize and pay labor, with a small number of works procured through small works.

- Suggested improvement: Under Additional Financing, SDF should ensure that all participating communities are aware of and following the applicable updated procurement rules and procedures. POs should be well-oriented to ensure that their training is also following the latest revisions. SDF should ensure that regular field-based reviews are undertaken of any procurement practices at community level.

30. **Procurement Action Plan:** The table below briefly describes the identified procurement constraints and suggested mitigating measures to further improve procurement related activities under the proposed Additional Financing:

Table 3: Procurement Improvement Action Plan

Issues	Action	Responsibility	Date
Enhancing SDF's procurement training capability in community level procurement	SDF to expand its capacity with appropriate experts to prepare procurement training modules and deliver the training for trainers (POs) along with adequate assurance to receive and/or measure the level of feedback from the communities on the training imparted	SDF – Management and Procurement team	The training modules to be finalized by May 31, 2007; and training to start immediately after May 31, 2007 and on a continuous basis.
Enhancing SDF's capability in overseeing community level procurement	SDF is to diversify its procurement capacity to strengthen its oversight at community level by identifying a dedicated specialist(s) position at the field level and strengthening the national procurement team	SDF – Management and Procurement team	The required field-based staff to be in place by June 30, 2007

Issues	Action	Responsibility	Date
	with regular field-based supervision capabilities.		
Lessons learned assessment of the fiduciary and qualitative aspects of community procurement that was carried out during the last three years of SIPP (2003-2006). Specifically, looking at: (i) assessing the quality of procurement done by the communities in terms of transparency and adherence to procedures in which they were trained, and (ii) determining the technical quality of the infrastructures constructed by the communities as compared to similar infrastructural works done by other entities like GOB, UPs, UZs, Zila Parishads, etc.	SDF to engage appropriate, qualified technical assistance to undertake the review (possible to be undertaken in conjunction with wider cost-benefit analysis of community infrastructure works under SIPP). Findings and lessons learned would be used to improve the community procurement activities and training offered under the Additional Financing. Dissemination of positive findings amongst the community members will boost self-confidence among the community members in terms of being capable of undertaking procurement and implementing infrastructural works and will provide lessons to new communities.	SDF – Management and Procurement team	Consultant to be hired by June 30, 2007; and Study to be completed by August 31, 2007

D. Social Accountability and Transparency

31. The special focus of the Original Project on principles of downward accountability, transparency, participation and equity would be maintained and further strengthened under the Additional Financing. Transparent financial management and procurement practices at the local level are of a high priority to the project, given that the bulk of funds are disbursed at this level. Accountability of office bearers, committee members and service providers (including SDF staff and partner organizations) to the communities whom they are serving and in their handling of

funds is paramount, and community-based mechanisms to institutionalize and monitor this should continue to be a priority.

32. Clear operational procedures for Financial Management, procurement and the functioning of village level institutions, which are founded on principles of downward accountability, participation and transparency, are key means to embed the overall ‘social accountability’ framework. Such a framework allows for community members to directly demand accountability from their leaders and service providers, and to participate in monitoring their performance, thereby introducing increased understanding and application of principles of ‘good governance’ at the local level. Simple mechanisms are already routinely in use under the project, such as regular village-wide information-sharing and decision-taking meetings, or public display of funds received, expenditures incurred, procurement information, etc. SDF has also tested a ‘report card’ mechanism, by which performance of VDCs has been evaluated by their communities.

33. This social accountability framework and tools would be further strengthened through building capacity of the communities to regular displays and information sharing forums, village level general assembly meetings to take key decisions and share information; formation and strengthening of ‘Social Audit Committees to monitor office bearers’ performance, and institutionalizing report cards for the office bearers and service providers and project teams. A wide range of practical tools are available that could be more systematically employed in monitoring accountability and performance in a participatory, community-driven manner. SDF has already planned a series of practical, field-based trainings in these ‘social accountability’ tools, in partnership with World Bank Institute (WBI). The first workshop is planned during second quarter of 2007.

FM Risk Rating Summary

	<i>Risk Mitigating Measures</i>	<i>Residual Risk</i>
INHERENT RISKS		
Entity level	SDF will designate focal full-time staff, with clear job descriptions, to work specifically on strengthening community level FM and accountability system. Their jobs descriptions and roles and responsibilities would be separated from those who focus on SDF level FM issues. To support these staff, the latest Community FM Guidelines need to be widely disseminated, applied and monitored.	M
OVERALL INHERENT RISK	Implementation of Action Plan	M
CONTROL RISKS		
Budget	X	L
Accounting	X	L
Internal Controls	X	M
Funds flow	X	L
Financial Reporting	X	L
Auditing	X	M
OVERALL CONTROL RISK		M
RESIDUAL RISK RATING		MODEST

H – High

S – Substantial

M – Modest

L – Low