

ANNEX

CREDIT NUMBER 4229-IN

# **Restated and Amended Development Credit Agreement**

**(Karnataka Health System Development and Reform Project)**

**between**

**INDIA**

**and**

**INTERNATIONAL DEVELOPMENT ASSOCIATION**

**Originally Dated October 16, 2006**

**CREDIT NUMBER 4229-IN**

**DEVELOPMENT CREDIT AGREEMENT**

AGREEMENT, dated October 16, 2006, between INDIA, acting by its President (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement (the Project) has requested the Association to assist in the financing of the Project;

(B) the Project will be carried out by the State of Karnataka (Karnataka) with the Borrower's assistance and, as part of such assistance, the Borrower will make the proceeds of the credit provided for in Article II of this Agreement (the Credit) available to Karnataka, as set forth in this Agreement; and

WHEREAS the Association has agreed, on the basis, *inter alia*, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement and in the agreement (the Project Agreement) of even date herewith between the Association and Karnataka;

NOW THEREFORE the parties hereto hereby agree as follows:

**ARTICLE I**

**General Conditions; Definitions**

Section 1.01. The "General Conditions Applicable to Development Credit Agreements" of the Association (the General Conditions), dated January 1, 1985 (as amended through May 1, 2004), with the modifications set forth below, constitute an integral part of this Agreement:

a) Section 5.08 of the General Conditions is amended to read as follows:

“Section 5.08. *Treatment of Taxes*

Except as otherwise provided in the Development Credit Agreement, the proceeds of the Credit may be withdrawn to pay for taxes levied by, or in the territory of, the Borrower on the goods or services to be financed under the Credit, or on their importation, manufacture, procurement or supply. Financing of such taxes is subject to the Association's policy of requiring economy and efficiency in the use of the proceeds of its credits. To that end, if the Association shall at any time determine that the amount of any taxes levied on or in respect of any item to be financed out of the proceeds of the Credit is excessive or otherwise unreasonable, the Association may, by notice to the

Borrower, adjust the percentage for withdrawal set forth or referred to in respect of such item in the Development Credit Agreement as required to be consistent with such policy of the Association.”

(b) Section 6.03(c) of the General Conditions is amended by replacing the words “corrupt or fraudulent” with the words “corrupt, fraudulent, collusive or coercive”.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “Consolidated Report on Audits” means the report covering the audits referred to in paragraph 5(f) of Schedule 2 to the Project Agreement, and as referred to in paragraph 5 (g) of Schedule 2 to the Project Agreement;

(b) “Comptroller and Auditor General of India” or “CAG” means the Comptroller and Auditor General of India appointed in accordance with the Constitution of India, as amended;

(c) “DHO” means District Health Officer;

(d) “District” means an administrative unit within Karnataka, including any successors thereto;

(e) “District Project Management Unit” or “DPMU” means the unit to be established by Karnataka in each District in accordance with the provisions of paragraph 1(d) of Schedule 2 to the Project Agreement;

(f) “DOHFW” means Karnataka’s Department of Health and Family Welfare, which is responsible, *inter alia*, for oversight and implementation of the Project;

(g) “DOHFW Budget” means DOHFW’s annual budget for activities under the Program (as defined hereinafter);

(h) “Eligible Categories” means Categories (1) through (5) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

(i) “Eligible Expenditures” means the expenditures for goods, works, services, operating expenses and medical insurance claims referred to in Section 2.02 of this Agreement;

(j) “EMP” means Karnataka’s Environmental Management Plan dated October 2004, which, *inter-alia*, identifies measures to address environmental impacts resulting from, or likely to result from, the carrying out of the Project and arrangements

to implement such measures; as such plan may be updated from time to time in a manner satisfactory to the Association;

(k) “Financial Management Manual” or “FMM” means Karnataka’s manual dated January 12, 2006 which sets out, *inter alia*, the accounting policies and procedures, funds flow arrangements, internal controls and auditing and reporting arrangements for carrying out of the Project; as such manual may be updated from time to time in a manner satisfactory to the Association;

(l) “Financial Monitoring Report” or “FMR” means each report prepared in accordance with Section 3.02(a) of the Project Agreement;

(m) “Fiscal Year” or “FY” means the Fiscal Year of the Borrower and Karnataka beginning on April 1 of a calendar year and ending on March 31 of the following calendar year;

(n) “Gram Panchayats” or “GPs” means the Gram Panchayats as defined in and established pursuant to the Karnataka Panchayat Raj Act of 1993, as amended;

(o) “Health Sector Procurement Reform Action Plan” or “HSPRAP” means Karnataka’s plan dated July 15, 2006, which sets out, *inter-alia*, the framework to ensure competition, transparency and efficiency in the procurement of goods, works and services under the Program and the measures to be taken by Karnataka for strengthening its procurement capacity for the health sector, as such Plan may be amended from time to time with the agreement of the Association and Karnataka;

(p) “IFB” means an invitation for bid;

(q) “Karnataka Panchayat Raj Act” means the Karnataka Panchayat Raj Act of 1993 and includes the Rules, Regulations, Orders and Notifications issued pursuant to such Act; as such Act, Rules, Regulations, Orders and its Notifications may be amended from time to time;

(r) “KSIHP” means the Karnataka State Integrated Health Policy of 2004;

(s) “KTPP Act” means the Karnataka Transparency in Public Procurement Act, 2000 and includes the Rules, Regulations, Orders and Notifications issued pursuant to such Act; as such Act, Rules, Regulations, Orders and its Notifications may be amended from time to time;

(t) “Management Committee” means the committee to be set up by Karnataka in accordance with paragraph 8(b) of Schedule 2 to the Project Agreement;

(u) “Medium Term Fiscal Plan” means Karnataka’s Medium Term Fiscal Plan of 2004;

(v) "Mid-term Review" means the review carried out in July 2010 in accordance with in paragraph 13 (c) of Schedule 2 to the Project Agreement;

(w) "Operational Manual" means Karnataka's manual dated August 2005, for the operation of PHCF (as defined hereinafter) which sets out, *inter-alia*, the procedures, guidelines, and the criteria for the operation of PHCF; as such manual may be updated from time to time in a manner satisfactory to the Association;

(x) "Program" means the overall health sector program of Karnataka consistent with KSIHP;

(y) "Project Agreement" means the agreement between the Association and Karnataka of even date herewith, as the same may be amended from time to time, and such term includes all schedules and agreements supplemental to the Project Agreement;

(z) "Project Executing Agencies" means any agency of Karnataka responsible for implementation and execution of the Project, and includes DOHFW, SAST (as defined hereinafter), the Districts and PRIs (as defined hereinafter);

(aa) "PGB" means the Project Governing Board to be maintained by Karnataka in accordance with the provisions of paragraph 1(a) of Schedule 2 to the Project Agreement;

(bb) "PHCF Grant" means a grant made or proposed to be made by Karnataka out of the proceeds of the Credit to a PHCF Recipient for carrying out a PHCF Subproject;

(cc) "PHCF Recipient" means any organization meeting the eligibility criteria set forth in the Operational Manual including the criteria set forth in paragraph 9 of Schedule 2 to the Project Agreement for carrying out PHCF Subproject (as defined hereinafter) and to which Karnataka has made or proposes to make PHCF Grant;

(dd) "PHCF Subproject" means a subproject, for carrying out activities under Part B.1(b) of the Project, which subproject meets the eligibility criteria set forth in the Operational Manual including the criteria set forth in paragraph 8(d) of Schedule 2 to the Project Agreement and which is to be carried out by a PHCF Recipient utilizing, *inter alia*, the proceeds of the PHCF Grant;

(ee) "Phase I" means the period beginning with the initiation of activities under Part B.1 (a) of the Project and ending on the date after the expiry of 18 months from the Effective Date;

(ff) "Procurement Audit" means the audit to be carried out in accordance with the provisions of paragraph 5(c) of Schedule 2 to the Project Agreement;

(gg) "Procurement Plan" means Karnataka's procurement plan, dated July 31, 2006 covering the initial 18 month period (or longer) of Project implementation, as shall be updated from time to time in accordance with the provisions of Section 2.02(b) of the Agreement;

(hh) "Procurement Manuals" means the manuals to be prepared by Karnataka in accordance with the Health Sector Procurement Reform Action Plan for procurement of medical equipment, and pharmaceuticals;

(ll) "PRIs" means the Zilla Panchayats, the Taluk Panchayats, and the Gram Panchayats as defined in and established pursuant to the Karnataka Panchayat Raj Act;

(mm) "Project Implementation Plan" or "PIP" means Karnataka's plan dated July 31, 2006 which sets out, *inter alia*, details of all procedures, guidelines, timetables, institutional and implementation arrangements for carrying out of the Project by Karnataka (including specific/detailed arrangement for the carrying out of Part B.2 of the Project), and which includes the Health Sector Procurement Reform Action Plan; as such PIP may be updated from time to time in a manner satisfactory to the Association;

(nn) "PSC" means the Program Steering Committee to be established by Karnataka in accordance with the provisions of paragraph 1(b) of Schedule 2 to the Project Agreement;

(oo) "Public Health Competitive Fund" or "PHCF" means the fund to be established by Karnataka in accordance with the provisions of paragraph 8(a) of Schedule 2 to the Project Agreement;

(pp) "Report-based Disbursements" means the Borrower's option for withdrawal of funds from the Credit Account referred to in Part A.4 of Schedule 1 to this Agreement;

(qq) "Service Improvement Challenge Fund" or "SICF" means the fund to be established by Karnataka in accordance with the provisions of paragraph 6(a) of Schedule 2 to the Project Agreement;

(rr) "SICF Subproject" means a subproject for carrying out activities under Part B.1(a) of the Project, which subproject meets the eligibility criteria set out in paragraph 6(b) of Schedule 2 to the Project Agreement and which is to be carried out by a Project Executing Agency utilizing, *inter alia*, the proceeds of the Credit;

(ss) "Special Account" means the account referred to in Part B of Schedule 1 to this Agreement;

(tt) "SPMU" means the State Project Management Unit referred to in paragraph 1(c) of Schedule 2 to the Project Agreement;

(uu) "SAST" means Karnataka's Suvarna Arogya Suraksha Trust, which is responsible, *inter alia*, for implementation of Part B.2 of the Project.

(vv) "Taluk Panchayats" or "TPs" means Taluk Panchayats as defined in and established pursuant to the Karnataka Panchayat Raj Act of 1993; as amended;

(ww) "Vulnerable Communities Health Plan" means Karnataka's Vulnerable Communities Health Plan dated October 30, 2004, which, *inter alia*, delineates measures for addressing the specific health needs of vulnerable communities; and as such Plan may be updated from time to time in a manner satisfactory to the Association; and

(xx) "Zilla Panchayats" or "ZPs" means the Zilla Panchayats as defined in and established pursuant to the Karnataka Panchayat Raj Act of 1993; as amended.

Section 1.03. Each reference in the General Conditions to the Project implementation entity shall be deemed as a reference to each of the Project Executing Agencies.

## ARTICLE II

### The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, an amount in various currencies equivalent to ninety six million five hundred thousand Special Drawing Rights (SDR 96,500,000).

Section 2.02. The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods, works, services, operating expenses and medical insurance claims required for the Project and to be financed out of the proceeds of the Credit.

Section 2.03. The Closing Date shall be March 31, 2012 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty (60) days after the date of this Agreement (the accrual date) to the respective dates on which

amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent ( $3/4$  of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on February 15 and August 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each February 15 and August 15 commencing February 15, 2017 and ending August 15, 2041. Each installment to and including the installment payable on August 15, 2026 shall be one and one-fourth percent ( $1-1/4\%$ ) of such principal amount, and each installment thereafter shall be two and one half percent ( $2-1/2\%$ ) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

- (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and
- (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six (6) months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided,



however, that there shall be a grace period of a minimum of five (5) years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

### **ARTICLE III**

#### **Execution of the Project**

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, without any limitation or restriction upon any of its other obligations under this Agreement, shall cause Karnataka to perform in accordance with the provisions of the Project Agreement all the obligations of Karnataka therein set forth, 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.

(b) The Borrower shall make available the proceeds of the Credit to Karnataka in accordance with the Borrower's arrangements for developmental assistance to its states.

Section 3.02. Except as the Association shall otherwise agree, procurement of the goods, works and 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 the Project Agreement, as said provisions may be further elaborated in the Procurement Plan.

Section 3.03. The Borrower shall: (i) participate in the exchange of views with the Association and Karnataka on the plan for the future operation of the Project to be

provided by Karnataka pursuant to Section 2.03(b) of the Project Agreement; and (ii) participate with the Association and Karnataka in the Mid-term Review.

Section 3.04. The Borrower and the Association hereby agree that 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 shall be carried out by Karnataka pursuant to Section 2.03 of the Project Agreement.

Section 3.05. (a) The Borrower shall, at the request of the Association, exchange views with the Association with regard to the progress of the Project the performance of obligations under this Agreement, and other matters relating to the purposes of the Credit.

(b) The Borrower 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 the Borrower of its obligations under this Agreement.

#### **ARTICLE IV**

##### **Financial Covenants**

Section 4.01. (a) The Borrower shall establish and maintain a financial management system, including records and accounts, and prepare financial statements, all in accordance with consistently applied accounting standards acceptable to the Association, adequate to reflect its operations, resources and expenditures related to the Project.

(b) The Borrower shall:

- (i) have the financial statements referred to in paragraph (a) of this Section for each fiscal year (or other period agreed to by the Association) and those for the Special Account for each Fiscal Year, audited, in accordance with consistently applied auditing standards acceptable to the Association, 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 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 year (or such other period agreed to by the Association), as so audited; and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Association; and

- (iii) furnish to the Association such other information concerning such records, accounts and the audit of such financial statements, and concerning said auditors, as the Association may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of reports referred to in Part A.4 of Schedule 1 to this Agreement (Report-based Disbursements), the Borrower shall:

- (i) ensure that all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures are retained until at least one year after the Association has received the audit report for, or covering, the fiscal year in which the last withdrawal from the Credit Account was made;
- (ii) enable the Association's representatives to examine such records; and
- (iii) ensure that such reports are included in the audit for each fiscal year referred to in paragraph (b) of this Section.

## **ARTICLE V**

### **Remedies of the Association**

Section 5.01. Pursuant to Section 6.02(1) of the General Conditions, the following additional events are specified:

- (a) a situation shall have arisen which shall make it improbable that the Program, or a significant part thereof, will be carried out;
- (b) Karnataka shall have failed to perform any of its obligations under the Project Agreement;
- (c) the Project Implementation Plan shall have been amended, waived or abrogated so as to adversely affect the implementation of the Project or the achievement of the objectives thereof;
- (d) the Financial Management Manual or the Procurement Manuals shall have been amended, waived or abrogated so as to adversely affect the implementation of the Project or the achievement of the objectives thereof;

(e) the Health Sector Procurement Reform Action Plan shall have been amended, waived or abrogated so as to adversely affect the achievement of the objectives of efficiency, economy and transparency of procurement methods and procedures;

(f) the KTPP Act shall have been amended, waived or abrogated so as to adversely affect the achievement of the objectives of efficiency, economy and transparency of procurement methods and procedures;

(g) the Karnataka Panchayat Raj Act shall have been amended, waived or abrogated so as to adversely affect the achievement of the objectives of the Project or the ability of Karnataka or the PRIs to implement the Project;

(h) the Association shall have determined that a fraudulent or corrupt activity has occurred in the carrying out of the Project; and

(i) as a result of events which have occurred after the date of the Development Credit Agreement, an extraordinary situation shall have arisen which shall make it improbable that Karnataka will be able to perform its obligations under the Project Agreement.

Section 5.02. Pursuant to Section 7.01(h) of the General Conditions, the following additional events are specified:

(a) the events specified in paragraphs (b) to (h) of Section 5.01 of this Agreement shall occur and shall continue for a period of sixty (60) days after notice thereof shall have been given by the Association to the Borrower and Karnataka; and

(b) the event specified in paragraphs (a) and (i) of Section 5.01 of this Agreement shall occur.

## **ARTICLE VI**

### **Effective Date; Termination**

Section 6.01. The following event is specified as an additional matter, within the meaning of Section 12.02(b) of the General Conditions, to be included in the opinion or opinions to be furnished to the Association, namely, that the Project Agreement has been duly authorized or ratified by Karnataka, and is legally binding upon Karnataka in accordance with its terms.

Section 6.02. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

## **ARTICLE VII**

### **Representative of the Borrower; Addresses**

Section 7.01. The Secretary, Additional Secretary, Joint Secretary, Director, Deputy Secretary or Under Secretary of the Department of Economic Affairs in the Ministry of Finance or successor thereto of the Borrower are each designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Secretary to the Government of India  
Department of Economic Affairs  
Ministry of Finance  
New Delhi 110 001  
India

Cable address:

Telex:

Facsimile:

ECOFAIRS  
New Delhi

953-31-66175  
FINE IN

91-11-23092477

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

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.

INDIA

By

/s/ Madhusudan Prasad  
Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By

/s/ Rachid Benmessaoud  
Acting Regional Vice President  
South Asia

**SCHEDULE 1**

**Withdrawal of the Proceeds of the Credit**

A. General

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>Expenditures to be Financed</u>
(1) Goods, works, operating expenses and services under Eligible Subprograms	37,400,000	50 % of Eligible Subprogram Expenditures in each Fiscal Year or any other percentage that the Association may establish from time to time.
(2) Goods, works and services under SICF Subprojects	17,623,898	90%
(a) Phase I	11,806,102	90%
(3) Goods, works and services under PHCF Subprojects	2,850,000	90%
(4) Good, services and operating expenses under Parts A.1 and C of the Project and services and operating expenses under Part B.2 of the Project	20,520,000	90%
(5) Medical insurance claims under Part B.2 of the Project	6,300,000	90% upon verification of the agreed milestones referred to in paragraph A.2 (d) of Schedule 1 to this Agreement

(6) Unallocated

TOTAL 96,500,000

2. For the purposes of this Schedule 1, the following terms have the following meanings:

(a) "Eligible Subprogram" means Karnataka's subprogram for each Fiscal Year, beginning with Fiscal Year 2006-2007 until Fiscal Year 2010-2011, for carrying out the activities under Part A.2 of the Project, falling within the DOHFW Budget, and eligible for financing under the Project provided that for each such Fiscal Year, Karnataka shall have satisfactorily implemented milestones satisfactory to the Association, and excluding the following activities: activities related to medical colleges, tertiary level hospitals including specialty hospitals, or hospitals attached to teaching institutions; activities by the Gram Panchayats until such time that the Association shall have, after due assessment of the institutional, financial and procurement arrangements at the Gram Panchayat level, approved carrying out activities under Part A.2 of the Project by the Gram Panchayats; activities under the Borrower's centrally assisted schemes; and activities under other externally assisted projects;

(b) "Eligible Subprogram Expenditures" means the aggregate of expenditures under Category (1) incurred by Karnataka in each Fiscal Year for the Eligible Subprogram for such Fiscal Year in accordance with the provisions of this Agreement in excess of a threshold level of expenditure in a Fiscal Year (the "Threshold Level of Expenditure") established by the Association and determined in the manner set out in paragraphs 5 and 6(a) below;

Provided, however, that expenditures for pharmaceuticals (including medical supplies) and medical equipment under Category (1) incurred by Karnataka shall not qualify as Eligible Subprogram Expenditures until such time when the Borrower and Karnataka shall have established and implemented arrangements, satisfactory to the Association, for the procurement of pharmaceuticals (including medical supplies) and medical equipment;

(c) "Operating Expenses" means the cost of operation and maintenance of buildings, equipment, furniture and vehicles, office rentals, salaries, travel allowances of all Project staff, expenses for hiring of vehicles, all incurred for the purposes of carrying out the Project; and

(d) "Medical Insurance Claims" means the claims to be submitted by Karnataka for reimbursement under Part B.2 of the Project, and eligible for financing



under the Project, provided that Karnataka shall have satisfactorily implemented the following milestones within the context of said Part of the Project:

(i) SAST develops: (A) staffing plan; (B) information system specifications; (C) information, education and communication (IEC) strategy; and (D) terms of reference for a monitoring/verification system for Medical Insurance Claims;

(ii) (A) Key SAST staff are appointed and a management capacity building plan is developed; and (B) monitoring/verification system for Medical Insurance Claims is functional, including regular verification of a sample of claims;

(iii) (A) Contractor pilot tests IT system; (B) IEC activities started; and (C) analysis of data from monitoring/verification system is done;

(iv) (A) IT system in SAST is installed and in use; (B) management capacity-building activities started; and (C) evaluation of the design and functioning of the health insurance scheme is done.

3. Notwithstanding the provisions of the foregoing paragraphs above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement except that withdrawals under Categories (1) to (5) set out in the Table in paragraph A.1 of this Schedule in an amount not exceeding the equivalent of SDR 10,460,000 may be made on account of payments made for expenditures before that date and incurred after October 1, 2005.

4. The Borrower may request withdrawals from the Credit account to be made on the basis of reports to be submitted to the Association in form and substance satisfactory to the Association, such reports to include Financial Monitoring Report and other information as the Association shall specify by notice to the Borrower (Report-based Disbursements).

5. Except as the Association may otherwise agree, the Threshold Level of Expenditure for Fiscal Year 2006-2007 shall be Rs. 463.69 crores, for Fiscal Year 2007-2008 shall be Rs. 486.88 crores, for Fiscal Year 2008-2009 shall be Rs.511.22 crores, for Fiscal Year 2009-2010 shall be Rs. 536.78 crores, and for Fiscal Year 2010-2011 shall be Rs.563.62 crores. The Threshold Level of Expenditure for a Fiscal Year may be revised by the Association in consultation with Karnataka and communicated to Karnataka.

6. Notwithstanding the provisions of the foregoing paragraphs, and except as the Association may otherwise agree,

(a) withdrawals from the Credit Account under Category 1 shall be made on an annual basis in accordance with the following provisions:

- (I) with respect to Eligible Subprogram Expenditures, the Borrower may request withdrawals from the Credit Account to be made on the basis of reports to be submitted to the Association in form and substance satisfactory to the Association, such reports to include the Financial Monitoring Report and any other information as the Association shall specify by notice to the Borrower (Report-based Disbursements). Except as the Association may otherwise agree, such request in respect of a Fiscal Year shall be made no later than May 31 of the following Fiscal Year;
- II. beginning Fiscal Year 2006-2007 and until Fiscal Year 2008-2009, withdrawals from the proceeds of the Credit for Eligible Subprogram Expenditures for each Fiscal Year shall not exceed \$15,000,000 equivalent;
- III. no withdrawals shall be made from the proceeds of the Credit for a Fiscal Year unless the Association shall have received in respect of the previous Fiscal Year: (i) audit reports required to be furnished by the Borrower in accordance with the provisions of Section 4.01 of this Agreement; (ii) audit reports required to be furnished by Karnataka in accordance with the provisions of Section 3.01 of the Project Agreement; and (iii) the Consolidated Report on Audits required to be furnished by Karnataka in accordance with the provisions of paragraph 5(g) of Schedule 2 to the Project Agreement; and
- IV. any amount disbursed by the Association to the Borrower in accordance with the above provisions shall be adjusted for actual levels of Eligible Subprogram Expenditures confirmed by audit reports and the Consolidated Report on Audits required to be furnished by Karnataka in accordance with the provisions of Section 3.01 of the Project Agreement and paragraph 5(g) of Schedule 2 to the Project Agreement respectively or by other reports or information submitted by Karnataka pursuant to Association's request, such adjustment to be made from the next disbursement under Category (1), provided, however, that the Association may at any time request refunds of amounts not confirmed by such audit reports, other reports and information, and the Consolidated Report on Audits, and upon such request, the Borrower shall immediately refund such amount. Any such refunds made to the Association shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the provisions of this Agreement.

(b) withdrawals from the Credit Account under Categories 2 to 5 shall be made on a quarterly basis in accordance with the following provisions:

- I. the Borrower may request withdrawals from the Credit Account to be made on the basis of reports to be submitted to the Association in form and substance satisfactory to the Association, such reports to include the Financial Monitoring Report and any other information as the Association shall specify by notice to the Borrower (Report-based Disbursements);
- II. no withdrawals from the proceeds of the Credit under Category 5 shall exceed SDR1,600,000 equivalent per withdrawal application, upon satisfactory verification of compliance with the relevant milestone referred to in paragraph A.2(d) of this Schedule (as prescribed in the PIP).

7. The Borrower undertakes that the proceeds of the Credit shall not be used to finance expenditures for goods, works or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association shall have financed or agreed to finance, or which the Association or the Bank shall have financed or agreed to finance under another credit or loan. If the Association determines at any time that an amount of the Credit was used to make a payment for an expenditure so excluded, the Borrower shall, promptly upon notice from the Association, refund an amount equal to the amount of said payment to the Association. Amounts refunded to the Association upon such request shall be cancelled.

B. Special Account

1. The Borrower shall open and maintain in Dollars a special deposit account in the Reserve Bank of India, on terms and conditions satisfactory to the Association.

2. After the Association has received evidence satisfactory to it that the Special Account has been opened, withdrawals from the Credit Account of amounts to be deposited into the Special Account shall be made in accordance with the provisions of the Annex to this Schedule 1.

3. Payments out of the Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for Eligible Expenditures.

4. Notwithstanding the provisions of Part B.2 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

(a) if the Association, at any time, is not satisfied that the reports referred to in Part A.4 of this Schedule 1 adequately provide the information required for Report-based Disbursements;

(b) if the Association determines at any time that all further withdrawals for payment of Eligible Expenditures should be made by the Borrower directly from the Credit Account;

(c) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01(b)(ii) of the Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of: (i) the records and accounts for the Special Account; or (ii) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements; or

(d) if Karnataka shall have failed to furnish to the Association: (i) within the period of time specified in Section 3.01 of the Project Agreement, the audit reports required to be furnished to the Association pursuant to the said Section; or (ii) within the period of time specified in paragraph 5(g) of Schedule 2 to the Project Agreement, the Consolidated Report on Audits required to be furnished to the Association pursuant to the said paragraph.

5. The Association shall not be required to make further deposits into the Special Account in accordance with the provisions of Part B.2 of this Schedule if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to Section 6.02 of the General Conditions. Upon such notification, the Association shall determine, in its sole discretion, whether further deposits into the Special Account may be made and what procedures should be followed for making such deposits, and shall notify the Borrower of its determination.

6. (a) If the Association determines at any time that any payment out of the Special Account was made for an expenditure which is not an Eligible Expenditure, or was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association, provide such additional evidence as the Association may request, or deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association determines at any time that any amount outstanding in the Special Account will not be required to cover payments for Eligible Expenditures during the six-month period following such determination, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Association made pursuant to subparagraph (a), (b) or (c) of this paragraph 6 shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the provisions of the Development Credit Agreement.

**Annex  
to  
SCHEDULE 1**

**Operation of Special Account  
When Withdrawals Are  
Report-based Disbursements**

1. For the purposes of this Annex, the term “Authorized Allocation” means the amount of \$25,000,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 2 of this Annex.

2. Withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for deposit into the Special Account of an amount or amounts which in the aggregate do not exceed the Authorized Allocation. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested.

(b) For withdrawals of the Credit under Category 1, the Borrower shall furnish to the Association requests for deposit into the Special Account at such intervals as the Association shall specify. Prior to or at the time of each such request, the Borrower shall furnish to the Association the reports required pursuant to Part A.6(a)(I) of Schedule 1 to this Agreement for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account an amount equal to the lesser of (a) the amount so requested; and (b) the amount which the Association has determined, based on the reports referred to in Part A.6(a)(I) of Schedule 1 applicable to such withdrawal application and any adjustments carried out pursuant to Part A.6(a)(IV), required to be deposited in order to finance Eligible Subprogram Expenditures during the Fiscal Year prior to the date of such reports.

(c) For withdrawals of the Credit under Categories 2 to 5, the Borrower shall furnish to the Association requests for deposits into the Special Account at such intervals as the Association shall specify. Prior to or at the time of each such request, the Borrower shall furnish to the Association the reports required pursuant to Part A.6(b) (I) of Schedule 1 to this Agreement for the payment or payments in respect of when replenishment is requested. On the basis of each such report, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account an amount equal to the lesser of (a) the amount so requested; and (b) the amount which the Association has determined, based on the reports referred to in Part A.6(b) (I) of Schedule 1 to this Agreement as applicable to such withdrawal application, required to

be deposited in order to finance Eligible Expenditures, other than Eligible Subprogram Expenditures, during the period covered by such reports.

3. The Association shall not be required to make further deposits into the Special Account, once the total unwithdrawn amount of the Credit minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions shall equal the equivalent of twice the amount of the Authorized Allocation. Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for Eligible Expenditures.

## SCHEDULE 2

### Description of the Project

The objective of the Project is to support the Program and to assist Karnataka in improving the utilization of essential curative and public health services, particularly in the underserved areas and amongst vulnerable groups. The Project consists of the following Parts, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objectives:

#### Part A: Strengthening Essential Government Health Programs to Achieve More Effective and Equitable Delivery of Services

##### 1. Organizational Development:

(a) Preparing and implementing a strategy for organizational development of DOHFW for, *inter alia*, building capacity of key officials through conducting training programs, study tours, workshops, conferences and services.

(b) Carrying out institutional reforms within DOHFW through, *inter alia*:

(i) establishing a health planning unit with capacities in each District, which shall be responsible, *inter alia*, for providing policy guidance to relevant decision makers and for providing assistance to the Districts in formulating, executing and monitoring service improvement plans for implementing the Project; and

(ii) strengthening DOHFW's institutional capacity for organization and management of public health services.

##### 2. Improving the Effectiveness of Primary and Secondary Health Care Services

(a) Carrying out activities for delivering essential public health, and primary and secondary care curative services, including:

(i) expanding the coverage and quality of preventive and ambulatory curative care services in areas including maternal and child care; and

(ii) strengthening inpatient curative care services, emergency obstetric care services and services for first treatment of accidents; and



(b) Strengthening the framework of planning, executing and monitoring of activities under DOHFW.

Part B. Innovation in Service Delivery and Health Financing

1. Developing and implementing innovative programs in service delivery.

(a) Expanding coverage and quality of curative care, primary and secondary health services through establishment of a Service Improvement Challenge Fund (SICF) for carrying out activities, including the following, in a phased manner:-

- (i) constructing new Primary Health Centers (PHCs) and subcenters;
- (ii) refurbishing of existing PHCs, Primary Health Units, Community Health Centers (CHCs), sub centers and selected First Referral Units;
- (iii) developing and implementing public private partnerships for enhancing delivery of essential health care services; and
- (iv) developing and implementing strategies, including strategies for extending mobile clinics to remote areas and for training and staffing auxiliary nurses to tribal areas, for expanding outreach of health care services to rural and tribal populations.

(b) Improving health status of communities and promoting community involvement for addressing public health issues through establishment of a Public Health Competitive Fund (PHCF), for carrying out activities including:

- (i) developing and implementing IEC strategies for bringing about behavioral change;
- (ii) programs for improving sanitation and hygiene amongst communities; and
- (iii) enhancing transparency and accessibility of information relating to quality and costs of public health and primary health care services.

2. Innovations in health financing.

Designing, carrying out and evaluating a health insurance pilot for providing financial support to meet health expenditure of populations in Karnataka.

Part C: Project Management, Monitoring and Evaluation

1. Supporting the establishment of Project management unit at the state level (SPMUs) and the District level (DPMUs) and other institutions responsible for carrying out the Project.
2. Strengthening capacity of the SPMUs, DPMUs and other institutions implementing the Project.
3. Supporting the establishment of a new Health Management Information system.
4. Carrying out evaluation activities under the Project.

\* \* \*

The Project is expected to be completed by September 30, 2011.