

CONFORMED COPY

CREDIT NUMBER 3978-NI

Development Credit Agreement

(Education Project)

between

REPUBLIC OF NICARAGUA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated September 17, 2004

CREDIT NUMBER 3978 -NI

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated September 17, 2004, between the REPUBLIC OF NICARAGUA (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

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

WHEREAS the Borrower has started the elaboration of a Common Work Plan (CWP) with international donors (*Mesa Sectorial de Educación*) to define the principal objectives of the Borrower's education system and the financing requirements for the sector; and whereas such CWP elaboration aims to establish the process whereby the donors' resources and the Borrower's resources would be assigned to progressively reduce the financing gap of the Borrower's education sector, articulating the additional donor resources with the government's budget cycle; 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;

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, dated January 1, 1985 (as amended through May 1, 2004) (the General Conditions), constitute an integral part of this Agreement:

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

(a) "Beneficiary School" means a School, as so defined, which is regulated by the Borrower's Law 413, and is eligible to receive financing under the Project, in accordance with the provisions of the Operational Manual and the School Operational Manual, as applicable;

(b) “Eligible Categories” means Categories (1) through (7) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

(c) “Eligible Expenditures” means the expenditures for goods and consultants’ services referred to in Section 2.02 of this Agreement;

(d) “Financial Monitoring Report” or “FMR” means each report prepared in accordance with Section 4.02 of this Agreement;

(e) “Grant” means a non-reimbursable transfer made by MECD to the Borrower’s Beneficiary Schools on a per-capita basis, intended to provide financing for the incremental effective enrollment of students in a given Beneficiary School, pursuant to the applicable provisions of the Operational Manual and the School Manual;

(f) “IPDP” means the Borrower’s strategy to benefit the indigenous and afro-caribbean populations under the Project;

(g) “Law 413” means *Ley de Participación Educativa y su Reglamento*, the Borrower’s Law of Participative Education and its Regulation, published in the Official Gazette No. 56 of March 21, 2002;

(h) “MECD” means the Borrower’s Ministry of Education, *Ministerio de Educacion, Cultura y Deportes*;

(i) “Operational Manual” means the manual referred to in Section 3.02 (a) of this Agreement;

(j) “Participatory Agreement” means the contractual arrangements between a given Selected Municipality and MECD, for the purposes of supporting the Selected Municipality’s role referred to in Part A.2 of the Project;

(k) “Procurement Plan” means the Borrower’s procurement plan, dated May 21, 2004, covering the initial 18 month period (or longer) of Project implementation, as the same shall be updated from time to time in accordance with the provisions of Section 3.03 to this Agreement, to cover succeeding 18 month periods (or longer) of Project implementation;

(l) “Report-based Disbursements” means the Borrower’s option for withdrawal of funds from the Credit Account referred to in Part A.5 of Schedule 1 to this Agreement;

(m) “School” means a school providing primary and/or secondary education in the Borrower’s territory;

(n) "School Manual" means MECD's manual entitled "*Normas para la Administración de los Bienes y Recursos en los Centros de Participación Educativa*", dated May, 2003;

(o) "Selected Municipality" means a Borrower's municipality, which has been selected to participate in the Project by MECD, in accordance with the provisions of the Operational Manual;

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

(q) "Supplemental Letter" means the letter of even date herewith, from the Borrower to the Association, containing the Project's monitoring indicators and results framework for the carrying out of the Project, referred to in Section 3.05 (a) of this Agreement.

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 the Development Credit Agreement, an amount in various currencies equivalent to ten million four hundred thousand Special Drawing Rights (SDR 10,400,000).

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 and services required for the Project and to be financed out of the proceeds of the Credit.

Section 2.03. The Closing Date shall be June 30, 2008, 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 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, 2015 and ending August 15, 2044. Each installment to, and including the installment payable on, August 15, 2024 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (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 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 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. The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out the Project through MECD, with due diligence and efficiency and in conformity with appropriate administrative, technical, financial, social, environmental and educational practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

Section 3.02 (a) Without limitation upon the provisions of Section 3.01 of this Agreement, and except as the Borrower and the Association may otherwise agree, the Borrower shall carry out the Project in accordance with an operational manual (the Operational Manual), satisfactory to the Association, and to be prepared by MECD, said manual to include specific rules and procedures for Project implementation, including, *inter alia*:

- (i) detailed administrative, financial management and procurement procedures;
- (ii) a description of the types of expenditures Beneficiary Schools are permitted to incur when using the proceeds of Grants or MECD transfers referred to in Section 3.06 of this Agreement;

- (iii) sample model procurement documents to be used for consultants and goods during Project implementation;
- (iv) the IPDP;
- (v) the methodology to calculate the amount of the Grants for each Beneficiary School;
- (vi) environmental impact mitigation procedures to be undertaken by Beneficiary Schools in case they carry out works with any of the Grants or MECD transfers referred to in Section 3.06 of this Agreement;
- (vii) the scope and technical specifications of the reports referred to in Section 3.05 (b) and 3.08; and
- (viii) a detailed work plan for the first year of the implementation of the Project.

(b) The Operational Manual may be amended from time to time, in a manner satisfactory to the Association, to facilitate continued Project implementation. If any provision of the Operational Manual is inconsistent with a provision of this Agreement, the provisions of this Agreement shall prevail.

Section 3.03. (a) Except as the Association shall otherwise agree, procurement of the goods and consultants' services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to this Agreement, as said provisions may be further elaborated in the Procurement Plan.

(b) The Borrower, through MECD, shall update the Procurement Plan in accordance with guidelines acceptable to the Association, and furnish such update to the Association not later than 12 months after the date of the preceding Procurement Plan, for the Association's approval.

Section 3.04. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower, through MECD, shall:

(a) prepare, on the basis of guidelines acceptable to the Association, and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, a plan for the future operation of the Project; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

Section 3.05. Without limitation to the provisions of Section 9.01 of the General Conditions, the Borrower, through MECD, shall:

(a) maintain policies, systems and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the results framework and monitoring indicators set forth in the Supplemental Letter, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association, on or about April 15 of each year during the implementation of the Project, starting in 2005, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out an annual work plan recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date (such plan shall include: (i) the timetable of the Project's activities; (ii) a complete description of all the activities planned under each part of the Project; and (iii) a list of the persons designated to carry out said activities); and

(c) review with the Association, on or about May 1 of each year during the implementation of the Project, starting in 2005, or such later date as the Association shall request, the reports referred to in paragraph (b) of this Section, and, thereafter, carry out the annual work plans referred to in paragraph (b) of this Section and take all other measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said reports and the Association's views on the matter.

Section 3.06. The Borrower, through MECD, shall on an annual basis make available the proceeds of the Credit allocated to finance the Grants under Part C of the Project to each Beneficiary School; said Grants shall only finance (at rates per capita set forth in the Operational Manual) the increment of the effective enrollment of students of the Beneficiary Schools with respect to the prior year. Entirely out of its own non-Credit resources, the Borrower, through MECD, shall also make annual transfers to each Beneficiary School to cover all Beneficiary schools costs not associated with such incremental enrollment, as well as all taxes associated with the Beneficiary Schools expenditures (whether or not such taxes are related to such incremental enrollment).

Section 3.07. The Borrower, through MECD, shall develop, not later than forty five days after the Effective Date, and operate throughout Project implementation, a personnel and consultant management system for the personnel whose salaries and consultants whose fees are financed by the Association under Categories 2 and 6 of the table in Schedule 1 to this Agreement. Said management system shall be satisfactory to the Association, including, *inter alia*, the selection criteria, conflicts of interest,

preventive rules, remuneration policy, performance evaluation rules, and reasons for interruption of the employment or consultancy relationship.

Section 3.08. The Borrower, through MECD, shall prepare and furnish to the Association, not later than October 1 of each year of Project implementation, starting in 2005, a progress report regarding the implementation of the action plan referred to in Part A.1 (b) of the Project

Section 3.09. The Borrower, through MECD, shall prepare and furnish to the Association, not later than each of: (i) February 1, 2006; (ii) October 1, 2006; and (iii) October 1, 2007; an audit report, carried out by external auditors acceptable to the Association, on the implementation of Part C.1 of the Project, in scope and detail satisfactory to the Association.

Section 3.10. The Borrower, through MECD, shall furnish to the Association, not later than forty five days after the Effective Date, the terms of reference referred to in Part A.1 (a) of the Project.

ARTICLE IV

Financial Covenants

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

(b) The Borrower, through MECD, 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), 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 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 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 and 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.5 of Schedule 1 to this Agreement (report-based disbursement) and on the basis of statements of expenditure, the Borrower shall:

- (i) retain, 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, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (ii) enable the Association's representatives to examine such records; and
- (iii) ensure that such reports and statements of expenditure are included in the audit for each fiscal year (or other period agreed to by the Association), referred to in paragraph (b) of this Section.

Section 4.02. (a) Without limitation upon the Borrower's progress reporting obligations set out in Section 3.05 of this Agreement, the Borrower, through MECD, shall prepare and furnish to the Association a financial monitoring report, in form and substance satisfactory to the Association, which:

- (i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Credit, and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation; and
- (iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

(b) The first FMR shall be furnished to the Association not later than 45 days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of

such first calendar quarter; thereafter, each FMR shall be furnished to the Association not later than 45 days after each subsequent calendar quarter, and shall cover such calendar quarter.

ARTICLE V

Effective Date; Termination

Section 5.01. The following event is specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions, namely, that the Operational Manual has been approved by the Association and put into effect.

Section 5.02. The date December 16, 2004 is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Minister of Finance and Public Credit of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Edificio del Ministerio de Hacienda y Crédito Público
Avenida Bolívar, frente a la Asamblea Nacional
Managua, Nicaragua
Apartado Postal 28

Facsimile: (505) 222-3033

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 the District of Columbia, United States of America, as of the day and year first above written.

REPUBLIC OF NICARAGUA

By /s/ Salvador Stadthagen Icaza
Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Jane Armitage
Authorized Representative

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>% of Expenditures to be Financed</u>
(1) Goods		
(a) under Part A of the Project	235,000	100% of foreign expenditures and 87% of local expenditures
(b) other	865,000	100% of foreign expenditures and 87% of local expenditures
(2) Consultants' services		
(a) under Part A of the Project	790,000	100% of foreign expenditures and 91% of local expenditures
(b) other	310,000	100% of foreign expenditures and 91% of local expenditures

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(3) Training		
(a) under Part A of the Project	25,000	100%
(b) other	1,775,000	100%
(4) Grants for Beneficiary Schools	4,100,000	100% of the Grant amount
(5) Incentives (severance payments under Part A.1 of the Project and bonuses under Part D.1 of the Project)	400,000	100%
(6) Incremental Staff Salaries		
(a) under Part A of the Project	620,000	91% until withdrawals have reached an aggregate amount equivalent to 370,000; 70% until withdrawals have reached an aggregate amount equivalent to 525,000; and 50% thereafter
(b) under Part B of the Project	280,000	91% until withdrawals have

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
		reached an aggregate amount equivalent to 165,000; 70% until withdrawals have reached an aggregate amount equivalent to 240,000; and 50% thereafter
(7) Other “non-consultant” services	700,000	91%
(8) Unallocated	300,000	
TOTAL	<u>10,400,000</u>	

2. For the purposes of this Schedule:

(a) the term “foreign expenditures” means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower;

(b) the term “local expenditures” means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;

(c) the term “Training” means reasonable expenditures in respect of organizing, teaching in and/or attending training sessions, workshops and seminars under the Project, including per diem and travel expenses for trainers and participants, rentals for the corresponding facilities and instruction materials, and purchases of the latter when directly related to the aforesaid training sessions, workshops and seminars;

(d) the term “incremental staff salaries” means reasonable expenditures, which would not have been incurred absent the Project, for salaries of MECD’s temporary staff to be converted gradually into MECD’s permanent staff; and

(e) the term “non-consultant services” means the services to carry out the testing of students and teachers under Part B.3 of the Project, the contracts for which may include travel, per diem, and any other logistical arrangements needed for such activities.

3. Notwithstanding the provisions of paragraph 1 above, after October 1 of each year of Project implementation, starting on October 1, 2005, no withdrawals shall be made from the Credit Account in respect of payments for expenditures under Categories 1 (a), 2 (a), 3 (a) and 6 (a) in the table of Part A.1 of this Schedule, unless the Association has approved the report referred to in Section 3.08 of the Agreement;

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures under contracts for: (a) goods costing less than \$150,000 equivalent per contract; (b) services of individual consultants costing less than \$30,000 equivalent per contract; (c) services of consulting firms under contracts costing less than \$100,000 equivalent per contract; and (d) Grants, operational costs, training, and incentives, all under such terms and conditions as the Association shall specify by notice to the Borrower.

5. 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 FMR and any other information as the Association shall specify by notice to the Borrower (Report-based Disbursements). In the case of the first such request submitted to the Association before any withdrawal has been made from the Credit Account, the Borrower shall submit to the Association only a statement with the projected sources and applications of funds for the Project for the six-month period following the date of such request.

B. Special Account

1. The Borrower may open and maintain in Dollars a special deposit account in its Central Bank acceptable to the Association, on terms and conditions satisfactory to the Association, including appropriate protection against set-off, seizure and attachment.

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 as follows:

(a) if the Borrower is not making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) if the Borrower is making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex B 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.5 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; or

(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 this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of: (A) the records and accounts for the Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements or were made on the basis of statements of expenditure, as the case may be.

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 Credit Agreement.

Annex A

to

SCHEDULE 1

**Operation of Special Account
When Withdrawals Are Not
Report-based Disbursements**

1. For the purposes of this Annex, the term “Authorized Allocation” means the amount of \$1,500,000 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 replenishment of the Special Account, 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 documents and other evidence required pursuant to Part B.3 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 such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for Eligible Expenditures. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.
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.

Annex B

to

SCHEDULE 1

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

1. Withdrawals from the Credit Account shall be deposited by the Association into the Special Account in accordance with the provisions of Schedule 1 to this Agreement. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

2. Upon receipt of each application for withdrawal of an amount of the Credit, 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.5 of this Schedule 1 applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.

SCHEDULE 2

Description of the Project

The objectives of the Project are to: (i) increase the enrollment of students for preschool, primary and secondary education in the Borrower's Schools; (ii) improve the quality and relevance of the learning process taking place in said Schools; (iii) improve MECD's systems of governance and accountability and strengthen the community participation in the Borrower's education sector; and (iv) harmonize donor assistance in the Borrower's education sector.

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 MECD Stewardship Capacity

1. Stewardship at the Central Level:

Strengthen MECD's capacity for policy making, planning and budget formulation, through the provision of technical assistance, goods and incentive payments of one time severance pay to the MECD's officials whose jobs are rationalized, including:

(a) the design of the terms of reference, satisfactory to the Association, for a management firm specialized in the management of change;

(b) the execution of a contract between MECD and the firm mentioned in paragraph (a) above, to design an action plan for the modernization of MECD, including: (i) the definition of roles and responsibilities of MECD's units and the Borrower's municipalities; and (ii) the improvement of the process of rationalization of MECD's jobs, including the definition of the rules to hire and promote MECD's officials, and the parameters to downsize MECD as the budget is progressively decentralized; and

(c) the implementation of the action plan referred to in paragraph (b) above.

2. Stewardship at the Municipal Level:

Support the Borrower's policy of decentralization of the administrative and pedagogical supervision of Schools to the Borrower's municipalities, through: (a) the provision of technical assistance to MECD's unit responsible for the design, negotiation and implementation of Participatory Agreements; (b) the carrying out of an impact evaluation study of the municipalization of educational outcomes; and (c) the provision of goods to the Borrower's municipalities for the supervision of Schools.

Part B: Program Monitoring, Evaluation, and Continuous Auditing Systems

Provision of technical assistance, training and goods to strengthen MECD's capacity to disseminate relevant information, including the preparation and publication of an annual audited report on the "State of Education in Nicaragua", with desegregation at the Municipal level, through:

1. The compilation, analysis and dissemination of educational statistics;
2. The strengthening of MECD's unit in charge of educational statistics;
3. The carrying out of a national evaluation strategy that includes the periodic testing of the School's students and teachers in Spanish and mathematics, including the provision of the results of the test to the classroom, the school community and MECD's internet web page; and
4. The carrying out of the audits referred to in Sections 4.01 (b) (i) and 3.09 of this Agreement.

Part C: Implementation of the School Autonomy Program

1. Provision of Grants to the Borrower's Beneficiary Schools to finance the increment in the effective enrollment of students of each Beneficiary School.
2. Provision of financing for the incorporation of 1800 schools into the Borrower's school autonomy regime by 2006.

Part D: Pilot Program for Community Preschools

1. Provision of: (a) incentive payments to community preschool teachers; (b) didactic materials for teachers and students; and (c) training for community preschool teachers; and
2. The design of a strategy for the Borrower's preschools.

* * *

The Project is expected to be completed by December 31, 2007.

SCHEDULE 3

Procurement

Section I. General

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

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

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

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

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

B. Other Procurement Procedures

1. National Competitive Bidding. Goods estimated to cost less than \$150,000 equivalent per contract, may be procured under contracts awarded on the basis of National Competitive Bidding.

2. Shopping. Goods estimated to cost less than \$30,000 equivalent per contract, may be procured under contracts awarded on the basis of Shopping

Section III. Particular Methods of Procurement of Consultants' Services

A. Quality- and Cost-based Selection. Except as otherwise provided in Part B of this Section, consultants' services shall be procured under contracts awarded on the basis of Quality- and Cost-based Selection. For purposes of paragraph 2.7 of the Consultant

Guidelines, the short list of consultants for services estimated to cost less than \$100,000 equivalent per contract may comprise entirely national consultants.

B. Other Procedures

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

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

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

Section IV. Review by the Association of Procurement Decisions

The Procurement Plan shall set forth those contracts which shall be subject to the Association's Prior Review. All other contracts shall be subject to Post Review by the Association.