

CONFORMED COPY

June 27, 2002

Mr. Karsten Nilaus Pedersen
Head of Asia Department
Ministry of Foreign Affairs
Asiatisk Plads
1448 Copenhagen K,
Kingdom of Denmark

Dear Sir:

AFGHANISTAN**Afghanistan Reconstruction Trust Fund (Ref: TF050576)**

With reference to your government's recent pledge, we are pleased to acknowledge, on behalf of the International Bank for Reconstruction and Development ("IBRD") and the International Development Association (collectively, the "Bank"), the intention of the Government of the Kingdom of Denmark to make available to the Bank the sum of five million United States dollars (US\$5,000,000) as a grant for the purpose of contributing to the Afghanistan Reconstruction Trust Fund (the "Trust Fund"). The standard terms and conditions governing contributions to the Trust Fund are specified in the Annex to this letter (hereinafter referred to as this or the "Letter Agreement") and constitutes an integral part hereof.

Promptly following confirmation of this Letter Agreement by you, the Government of the Kingdom of Denmark will deposit the Grant Funds, i.e., five million United States dollars (US\$5,000,000), into the IBRD Cash Account "T" (Swift Bic Code: MRMDUS33; Account Number: IBRT 000125199; Internal Route Code: MRMDUS) maintained with the HSBC Bank USA, 140 Broadway, New York, NY 10005, United States of America (the "T-Account"). When making such deposit, the Government of the Kingdom of Denmark will notify the HSBC Bank USA to advise the IBRD's Treasury Operations Department as to the amount received, that it is from the Government of the Kingdom of Denmark for the Afghanistan Reconstruction Trust Fund (Project No. TF050576), and the date of the deposit. In addition, the Government of the Kingdom of Denmark will fax to IBRD's Accounting Department, Trust Funds Division (Fax No. 202.477.7163), a copy of its deposit instruction to the HSBC Bank USA.

The offices responsible for coordination of all matters related to the implementation of this arrangement are:

For the Bank:

Afghanistan Country Management Unit
South Asia Region
The World Bank
1818 "H" Street, N.W.
Washington, D.C., 20433

Telephone: (202) 473-3047

Fax: (202) 522-3707

For the Government of the Kingdom of Denmark:

Mr. Karsten Nilaus Pedersen
Head of Asia Department
Ministry of Foreign Affairs
Asiatisk Plads
1448 Copenhagen K,
Kingdom of Denmark

We propose that this Letter Agreement shall, upon confirmation in the manner indicated below, constitute an agreement between the Government of the Kingdom of Denmark and the Bank.

Sincerely yours,

/s/ Alastair J. McKechnie
Alastair J. McKechnie
Country Director
Afghanistan
South Asia Region

Confirmed and Agreed:

Government of the Kingdom of Denmark

By: /s/ Karsten Nilaus Pedersen

Name: Mr. Karsten Nilaus Pedersen

Title: Head of Asia Department
Ministry of Foreign Affairs

Date: July 16, 2002

Annex

Standard Terms and Conditions Governing Contributions to the Afghanistan Reconstruction Trust Fund

1. General.

The following terms and conditions will govern all agreements entered into between the Bank and donor countries or agencies (individually referred to herein as the “Donors”; each a “Donor”) that provide grants to the Bank as contributions to the Trust Fund (the “Grant Funds”).

2. Objective of the Trust Fund

The objective of the Trust Fund is to provide a vehicle for Donors to pool resources and coordinate their support to the programme of the Afghanistan Interim Administration for the reconstruction of Afghanistan.

3. Definitions

Unless the context otherwise requires, the several terms defined in the Letter Agreement and in paragraph 1 above have the respective meanings therein set forth, and the following additional terms and expressions have the following meanings:

(a) “Administration” means, collectively, the Afghanistan Interim Administration and/or any successor thereto;

(b) “Category” means any of the categories of expenditures set forth in the table in paragraph 4 of this Annex.

(c) “Management Committee” means the committee responsible for overseeing the activities of the Trust Fund whose membership will consist of representatives of the Asian Development Bank, the Islamic Development Bank, the United Nations Development Programme and the Bank, and whose responsibilities are described in paragraph 5 (b) of this Annex;

(d) “Donor Committee” means the committee whose responsibilities are described in paragraph 5 (c) of this Annex, and whose membership (to be reviewed on an annual basis) consists of representatives of: (i) the Bank; (ii) each Donor whose contribution to the Trust Fund equals or exceeds five million United States dollars (US\$5,000,000) per annum; and (iii) two (2) members representing Donors whose individual contribution to the Trust Fund does not meet the five million United States dollars (US\$5,000,000) per annum threshold;

(e) “Recurrent Expenditures” means those recurrent expenditures set forth in the Administration’s budget, whose eligibility for financing hereunder will have been determined by the Management Committee, relating to wages, benefits and other payments for civil servants, pension payments, debt service obligations, including the payment of interest, fees and other charges, and operation and maintenance costs, but excluding military and paramilitary expenditures and police-related expenditures, other than the activities contemplated under paragraph 3(h);

(f) “Capital Expenditures” means expenditures on account of goods, including, without limitation, office furniture and equipment, as set forth in the Administration’s budget, the eligibility for financing of which will have been approved by the Management Committee;

(g) “Investment and Program Activity” means activities, the purpose of which will be to meet a recognized development objective and which is part of an investment or sector program of the Administration that will have been approved by the Management Committee. Such activities will include, without limitation, activities in agriculture, infrastructure, micro-finance and the social sectors, as well as reintegration of combatants into society and programs to facilitate the return of private business to Afghanistan, together with pre-feasibility and other studies related thereto. The expression “Investment and Program Activity” includes a Law and Order Project (as this expression is hereinafter defined);

(h) “Law and Order Project” means an Investment Project the purpose of which, in whole or in part, will be the carrying out, in connection with the civil branch of the police force of the Administration, of one or more of the following activities: (i) payment of salaries and benefits; (ii) provision of uniforms; (iii) provision of non-military vehicles; (iv) provision of computer and two way communications equipment; (v) provision of fuel; and (vi) payment of operating and maintenance costs associated with said vehicles and computer and communications equipment;

(i) “Sub-grant” means a grant made or proposed to be made by the Bank, out of the Grant Funds allocated to Category (3), herewith to any public or private entity to carry out an Investment and Program Activity;

(j) “Sub-grant Recipient” means a public or private entity to which the Bank proposes to make, or has made, a Sub-grant;

(k) “Sub-grant Agreement” means an agreement entered into, or proposed to be entered into, between the Bank and a Sub-grant Recipient; and

(l) “Monitoring Agent” means the independent firm to be engaged by the Bank in accordance with the provisions of paragraph 6 (a) of this Annex.

4. Categories of Expenditure

The categories of expenditure that are eligible for financing from the Trust Fund, together with the percentages of expenditures to be financed, are as follows:

	<u>Category</u>	<u>Percentage of Expenditures to be Financed</u>
(1)	Recurrent and Capital Expenditures	100%
(2)	Expert services and training	100%
(3)	Sub-grants for Investment Projects	100%

5. Governance Structure of the Trust Fund

The Trust Fund will have the following three-tier governance structure:

(a) The Bank will be the administrator of the Trust Fund. In this capacity, the Bank will establish and maintain appropriate records and accounts to identify the contributions to the Trust Fund, the commitments to be financed out of the Grant Funds and the receipt and disbursement of Grant Funds. The Bank will also be responsible to supervise the performance of the Monitoring Agent subject to the proviso set forth at the end of paragraph 8 (a) of this Annex.

(b) The Management Committee will be responsible, *inter alia*, for resource allocation decisions with respect to the Grant Funds. In allocating Grant Funds, the Management Committee will be guided by the overall program of expenditures and other relevant guidance to be provided to the Management Committee, on a quarterly basis, by the Administration. The Management Committee will, on a monthly basis, meet in Kabul, Afghanistan, or in such other location as the Management Committee may decide from time to time, or by teleconference and, following such meeting, report in writing to each Donor and to the Minister of Finance of the Administration on operations and activities financed by Grant Funds disbursements made by the Trust Fund and decisions taken by the Management Committee. The Management Committee will, on a quarterly basis, prepare and submit to the Donor Committee a report which will describe in detail the operations of the Trust Fund, including the receipt and use of Grant Funds and the activities financed therefrom, together with minutes of the monthly meetings of the Management Committee. The Management Committee will act collectively and, to the extent practicable, make decisions by consensus.

(c) The Donor Committee will be responsible for overseeing and supervising the performance of the Management Committee. The Donor Committee will, on a quarterly basis, meet in Kabul, Afghanistan, or in such place as the Committee may decide to review progress in the implementation of activities financed under the Trust Fund, and provide guidance to the Management Committee on Grant Fund allocation strategies.

6. Implementation of Activities under the Trust Fund

(a) The Administration will be responsible for implementing the activities to be financed under Categories (1) and (2). Implementation of the activities to be financed under Category (3) is governed by the provisions of paragraph 9 of this Annex. The Bank will engage the Monitoring Agent to monitor expenditures related to the activities financed under Categories (1), (2) and (3). The Monitoring Agent will be selected and retained by the Bank on the basis of terms of reference/scope of work agreed by the Management Committee and the Bank. The responsibilities of the Monitoring Agent will include monitoring the procurement of goods, services and other items, screening and recommending withdrawal applications for the Bank's approval and payment, monitoring all expenditures financed by Grant Funds and pre-screening the financial management capacity of potential Sub-grant Recipients so as to ensure that Grant Funds are disbursed only for the purposes specified in paragraph 4 of this Annex and according to applicable Bank procedures.

(b) The Monitoring Agent will report to the Bank. Subject to the approval of the Management Committee, the Bank will have the authority to change the terms of reference/scope of work of the Monitoring Agent and, where justified, to replace the Monitoring Agent with another firm or agency. The Bank will give advance notice to the Administration, the Management Committee and the Donors of changes to the terms of reference/scope of work of the Monitoring Agent. The Bank will perform ex-post evaluations of the activities undertaken by the Monitoring Agent, and will, upon completion of the activities financed under the Trust Fund, arrange for an independent review of the performance of the Monitoring Agent and report its findings to the Donors.

(c) The Grant Funds may be used by the Bank to: (a) pay the reasonable fees, travel and other reimbursable costs of the Monitoring Agent; and (b) pay the cost of goods, services and other items of expenditure in furtherance of the Trust Fund activities, all in accordance with the provisions of the Letter Agreement and this Annex.

(d) The selection and recruitment of the Monitoring Agent by the Bank, and the procurement and financing of expenditures for goods and services to be carried out by the Administration, in connection with goods and services financed under Categories (1) and (2), and by the Monitoring Agent, will take place on an untied basis, in accordance with the Bank's "Guidelines for Procurement under IBRD Loans and IDA Credits" and the "Guidelines for the Use of Consultants by World Bank Borrowers and by the World Bank as Executing Agency".

7. The Bank's Use of the Grant Funds and Administrative Cost Recovery

(a) The Grant Funds will be accounted for as a single Trust Fund and will be kept separate and apart from other funds of the Bank. Donor contributions may not be earmarked for one or more specific Categories and will instead be allocated among all Categories in accordance with the decisions of the Management Committee. A Donor may state a preference that its contribution be used to finance one or more Categories, or certain activities in a given sector, with the understanding that neither the Management Committee nor the Bank will be in a position to guarantee that total spending with respect to any given Category or sector will match or exceed the level of the contribution in connection with which a preference will have been stated. Undesignated contributions will be allocated among Categories in accordance with the decisions of the Management Committee. No contribution to the Trust Fund will be accepted unless it equals or exceeds two hundred thousand United States dollars (US\$200,000).

(b) The Bank may invest the Grant Funds pending their disbursement in any instrument in which the Bank is authorized to invest its own funds. The investment income earned on the Grant Funds pending their disbursement will be added to the account to be used for purposes of the Trust Fund. In order to assist in the defrayment of its administrative costs, the Bank may, following deposit of the Grant Funds, deduct from the T-Account and transfer to itself an amount equivalent to one and one half percent (1.5%) of the amount of the Grant Funds, such amount to be adjusted, upward or downward, by not later than June 30, 2003. The Bank may also deduct from the T-Account and transfer to itself the actual costs of the Bank's contract with the Monitoring Agent, as well as the cost of the independent review of the Monitoring Agent's performance referred to under paragraph 6(b) of this Annex.

8. Fiduciary Responsibilities of the Bank

(a) The Bank will be responsible only for performing those functions specifically set forth in the Letter Agreement and this Annex, and will not be subject to any other duties or responsibilities to the Donors, including, without limitation, any duties or obligations that might otherwise apply to a fiduciary or trustee under general principles of trust or fiduciary law. Nothing in the Letter Agreement and in this Annex will be considered a waiver of any privileges or immunities of the Bank under its Articles of Agreement or any applicable law, all of which are expressly reserved. The Bank will have no responsibility to the Donors with respect to the performance of the Monitoring Agent and will have no obligation to reimburse the Trust Fund or provide any compensation to any Donor if the Grant Funds are not disbursed for the purposes specified in this Annex as a result of actions of the Monitoring Agent.

(b) The Bank will apply its normal financial management procedures to the Fund. Such procedures applicable to the operation of the Trust Fund will be communicated to the Donors without delay.

9. Terms and Conditions Governing Sub-Grants Under Category (3)

In the event that the Bank deems it necessary to pass on all or part of the Grant Funds to an entity or entities inside or outside Afghanistan for purposes of carrying out an Investment and Program Activity eligible for financing under Category (3), the following provisions will apply:

(a) The Bank will conclude a Sub-grant Agreement with each “Sub-grant Recipient”.

(b) Except as provided in paragraph (c) below, responsibility for the accounting and administration of Grant Funds made available by the Bank to Sub-grant Recipients will be decided upon on a case-by-case basis by the Management Committee, considering, inter alia, the recommendations made by the Monitoring Agent. Accordingly, the Management Committee will review proposals to carry out activities eligible for financing under Category (3) and award Sub-grants in connection with proposals deemed by the Management Committee to be suitable for financing and supportive of the Administration’s overall program of expenditures referred to under paragraph 5 (b) of this Annex. Proposals for financing under Category (3) will be submitted for approval to the Administration which, when approved, will forward them to the Management Committee for consideration. Only proposals vetted by the Administration in the manner described in this sub-paragraph will be considered by the Management Committee. A proposal submitted to the Management Committee, through the Administration, will include an appraisal of the Investment and Program Activity sought to be financed. For those proposals that do not include an appraisal of the Investment Project sought to be financed, the Bank will carry out the appraisal of the Investment Project. The representative of a member organization of the Management Committee will recuse him or herself from deliberations over the suitability of proposal(s) submitted or co-financed by the organization that he or she represents.

(c) Notwithstanding the provisions of sub-paragraph (b) of this paragraph 9, proposals to carry out a Law and Order Project may only be made and carried out by the United Nations Development Programme. The latter will be the sole organization authorized to carry out Law and Order Projects financed hereunder. Sub-grants to finance Law and Order Projects will be made in accordance with terms and conditions acceptable to the Bank including, without limitation, those set forth in sub-paragraphs (a), (d), (e), (f) and (g) of this paragraph 9 whose provisions shall apply, mutatis mutandis, to any Sub-grant made or to be made by the Bank to the United Nations Development Programme for purposes of carrying out a Law and Order Project. UNDP, the Bank and the Management Committee will agree on detailed procedures including procurement, disbursements and audits for processing Law and Order Projects.

(d) Sub-grants will be used to finance expenditures for goods, works and services, as the case may be, in accordance with the Bank's "Guidelines for Procurement under IBRD Loans and IDA Credits" and the "Guidelines for the Use of Consultants by World Bank Borrowers and by the World Bank as Executing Agency", as in effect at the date of the relevant Sub-grant agreement (hereinafter collectively referred to as the "Bank's Guidelines"). Any departure from the Bank's Guidelines will have to be pre-approved by the Bank.

(e) The fiduciary arrangements for an Investment and Program Activity to be financed under Category (3) will be carried out in accordance with the guidelines and procedures specified in para 8(b) including but not limited to an environmental and social screening and assessment framework approved by the Bank. Any departure from the guidelines contained in said framework will have to be pre-approved by the Bank.

(f) As required under regular Bank lending operations, a Sub-grant Agreement will obligate a Sub-Grant Recipient, among other things, to maintain an appropriate and adequate financial management system, including records and accounts, and prepare financial statements adequate to separately reflect the operations, resources and expenditures related to the Investment and Program Activity financed under the Sub-grant. Within ninety (90) days of each June 30 and December 31, the Sub-grant Recipient will prepare unaudited financial statements with respect to such Sub-grant and forward a copy to the Bank. All financial statements appropriate to the size and purpose of the Sub-grant, as indicated in the Sub-grant agreement will be expressed in the currency in which the Grant Funds subject of the Sub-grant are maintained by the Sub-grant Recipient, as indicated in the Sub-grant Agreement, and will show the allocation of such funds among the activities financed by the Sub-grant. In addition, the Sub-grant Recipient will: (i) have the above-mentioned records, accounts and financial statements audited, in accordance with auditing standards acceptable to the Bank, by independent auditors acceptable to the Bank; (ii) furnish to the Bank, as soon as available, but in any case not later than six (6) months after the end of each calendar year: (a) certified copies of the financial statements referred to above for such year as so audited, and (b) an opinion on such statements, records and accounts and report of such audit, by said auditors, of such scope and in such detail as the Bank will have reasonably requested; and (iii) furnish to the Bank such other information concerning said records and accounts, and the audit thereof, as the Bank will from time to time reasonably request. In such cases where the Sub-grant is \leq US\$100,000 the Bank has the discretion to specify in the Sub-grant agreement that attestation from the Monitoring Agent will be sufficient to comply with the audit procedures above.

(g) The Bank will report quarterly to the Donors on the status of the Grant Funds made available to a Sub-grant Recipient under a Sub-grant Agreement.

10. Reporting Responsibilities of the Bank

(a) The Bank will maintain separate records and ledger accounts in respect of the aggregate Grant Funds for the agreed activities and disbursements made therefrom to the Monitoring Agent. Within one hundred eighty (180) days of the completion of the activities financed by the Grant Funds, the Bank will prepare unaudited financial statements in United States dollars with respect to the Grant Funds and forward a copy to each Donor. The Bank will provide the Donors annually with a management assertion together with an attestation from the Bank's external auditors on the satisfactory performance of the procedures and controls used by the Bank in administering the Grant Funds.

(b) The Bank will maintain close consultation and coordination with the Donors. The Bank will provide each Donor with quarterly reports on its quarterly ex-post evaluation of the activities undertaken by the Monitoring Agent including disbursements made out of the Grant Funds. Within (6) six months of the completion of the activities, or of full disbursement of the Grant Funds, whichever comes later, the Bank will provide a final progress report to each Donor, together with a copy of the independent review of the performance of the Monitoring Agent. Upon request by any Donor, the Bank will send to such Donor the draft and final reports received by the Bank from the Monitoring Agent on the activities financed by the Grant Funds.

11. Termination

Unless otherwise agreed by the Donors and the Bank, the Trust Fund arrangement provided for under the Letter Agreement and this Annex will terminate on the earlier of: (i) June 30, 2006; or (ii) or such date as the Grant Funds shall have been fully disbursed. Upon termination, unless otherwise agreed by the Donors and the Bank: (i) any agreement entered into among the Bank, the Monitoring Agent, and/or other third parties will not be affected by the termination, and the Bank will be entitled to continue permitting withdrawals of Grant Funds in respect of such agreements as if this arrangement had not been so terminated; and (ii) any remaining Grant Funds will be returned to the Donors on a pro-rata basis, and the Bank's functions pursuant hereto will be considered terminated. Within six (6) months following such termination, the Bank will furnish to the Donors an unaudited financial statement with respect to the aggregate amount contributed by all Donors.

12. Legal Documentation

For purposes of channeling Grant Funds to their intended beneficiaries in accordance with the terms and conditions of the Letter Agreement and this Annex, the Bank will enter into a grant agreement with the Administration concerning Grant Funds allocated to Categories (1) and (2). Grant Funds allocated to Category (3) will be governed by separate sub-grant agreements to be entered into between the Bank, on the one part, and sub-grant Recipients, on the other part, with each such agreement relating to one or more Investment and Program Activity. Without prejudice to the foregoing, Grant Funds allocated to Category (3) for the specific purpose of financing Law and Order Projects will be governed by one or more grant agreements, as the case may be, to be

entered into between the Bank, on the one part, and the United Nations Development Programme, on the other part.