

Public Disclosure Authorized

CONFIRMED COPY

GRANT NUMBER TF054011
RELATED CREDIT NUMBER 4081-TON

Co-financing Grant Agreement

(Co-financing of Tonga Education Support Project)

between

KINGDOM OF TONGA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated July 5, 2005

Public Disclosure Authorized



**GRANT NUMBER TF054011
RELATED CREDIT NUMBER 4081-TON**

CO-FINANCING GRANT AGREEMENT

AGREEMENT, dated July 5, 2005, between KINGDOM OF TONGA (the Recipient) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association) acting as Administrator (the Administrator) of grant funds (the NZAID Grant) provided by the New Zealand Agency for International Development (NZAID).

WHEREAS (A) the Recipient, having satisfied itself as to the feasibility and priority of the project described in Schedule 2 to this Agreement (the Project), has requested assistance from the NZAID Grant for financing Parts A.3(a) and B of the Project;

(B) the Recipient has also requested the Association to provide additional assistance towards the financing of Part A (except for Part A.3(a)) of the Project, and by an agreement of even date herewith between the Recipient and the Association (the Credit Agreement), the Association is agreeing to provide such assistance in an amount equal to six hundred sixty two thousand Special Drawing Rights (SDR 662,000) (the Credit); and

WHEREAS, the Association, as Administrator of the NZAID Grant provided by NZAID has agreed, on the basis of the foregoing, to extend the NZAID Grant to the Recipient upon the terms and conditions set forth in this Agreement; and

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

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

- (i) Article I;
- (ii) Sections 2.01 except (11), 2.02 and 2.03;
- (iii) Section 3.01;
- (iv) Sections 4.01 and 4.05;

- (v) Article V;
 - (vi) Sections 6.01, 6.02, 6.03, 6.04 and 6.06;
 - (vii) Section 8.01(b);
 - (viii) Sections 9.01, 9.03, 9.04, 9.05, 9.06, 9.07, and 9.08;
 - (ix) Article X;
 - (x) Article XI; and
 - (xi) Sections 12.01(b), 12.03 and 12.04.
- (b) The General Conditions shall be modified as follows:
- (i) the term “Association” wherever used in the General Conditions, other than in Sections 2.01(6) and 6.02(e) thereof, and the last use of such term in Section 5.01 thereof, means the Association acting as Administrator of the NZAID Grant, except that in Section 6.02, the term “Association” shall also include the Association acting in its own capacity;
 - (ii) the term “Borrower” wherever used in the General Conditions, means the Recipient;
 - (iii) the term “Development Credit Agreement,” wherever used in the General Conditions, means this Agreement;
 - (iv) the term “Credit,” wherever used in the General Conditions, means the NZAID Grant;
 - (v) the term “Credit Account,” wherever used in the General Conditions, means the NZAID Grant Account, an account opened by the Administrator on its books in the name of the Recipient to which the amount of the NZAID Grant is credited; and
 - (vi) Section 4.01 shall be modified to read:

“Withdrawals from the NZAID Grant Account shall be made in Dollars; provided, however, that if the expenditures to be financed out of the proceeds of the NZAID Grant have been paid or are payable in another currency, the Administrator shall, at the request of the Recipient, purchase such currency with the proceeds of such withdrawal.”

Section 1.02. Wherever used in this Agreement, unless the context otherwise requires, the several terms defined in the General Conditions, in the Recitals to this Agreement, and in the Credit Agreement have the respective meanings therein set forth, and the following additional terms have the following meanings:

(a) “Credit Agreement” means the agreement of even date herewith between the Recipient and the Association for the Project, as such agreement may be amended from time to time; and such term includes all schedules and agreements supplemental to the Credit Agreement.

(b) “Eligible Categories” means Categories (1), (2), and (3) set forth in the table in Part A.1 of Schedule 1 to this Agreement.

(c) “Eligible Expenditures” means the expenditures 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) “Special Account” means the account referred to in Part B of Schedule 1 to this Agreement.

ARTICLE II

The NZAID Grant

Section 2.01. The Association agrees to make available to the Recipient, on the terms and conditions set forth or referred to in this Agreement, the NZAID Grant in an amount not exceeding three million eight hundred eighteen thousand Dollars (\$3,818,000) (the NZAID Grant)

Section 2.02. The amount of the NZAID Grant may be withdrawn from the NZAID Grant Account in accordance with the provisions of Schedule 1 to this Agreement for: (i) expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of services required for Part B. 1 of the Project and to be financed out of the proceeds of the NZAID Grant; and (ii) School Grants under Parts A.3(a) and B.2 of the Project to meet the reasonable costs of goods, works, and services required for an eligible School-Grant Sub-project and in respect of which the withdrawal from the NZAID Grant Account is requested.

Section 2.03. The Closing Date shall be June 30, 2010, or such later date as the Bank shall establish. The Bank shall promptly notify the Recipient of such later date.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Recipient 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 carry out the Project through its Ministry of Education; with due diligence and efficiency and in conformity with appropriate administrative, management, financial, engineering and education practices, and sound social and environment standards acceptable to the Association; and shall provide, and shall cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Recipient and the Association shall otherwise agree, the Recipient shall carry out the Project in accordance with the Implementation Program set forth in Schedule 4 to the Credit Agreement.

Section 3.02. Except as the Bank shall otherwise agree, procurement of the goods, works, or services required for Parts A.3(a) and B of the Project and to be financed out of the proceeds of the NZAID Grant shall be governed by the provisions of Schedule 3 to the Credit Agreement, as said provisions may be further elaborated in the Procurement Plan.

Section 3.03. For the purposes of Section 9.08 of the General Conditions and without limitation thereto, the Recipient 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 Recipient and the Association, a plan for the continued achievement of the Project's objectives; and

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

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Recipient 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 Recipient 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 (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 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 NZAID Grant Account were made on the basis of reports referred to in Part A.4 of Schedule 1 to this Agreement (Report-based Disbursements), the Recipient shall:

- (i) retain, until at least one (1) year after the Association has received the audit report for, or covering, the fiscal year in which the last withdrawal from the NZAID Grant 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 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 Recipient's progress reporting obligations set out in paragraph 14 of Schedule 4 to the Credit Agreement, the Recipient 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 NZAID Grant, and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in implementation of the Project, 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 financial monitoring report shall be furnished to the Association not later than forty-five (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 financial monitoring report shall be furnished to the Association not later than forty-five (45) days after each subsequent calendar quarter, and shall cover such calendar quarter.

ARTICLE V

Remedies of the Association

Section 5.01. Pursuant to Section 6.02(p) of the General Conditions, the following additional event is specified:

- (a) (i) Subject to sub-paragraph (ii) of this paragraph (a):
 - (A) the right of the Recipient to withdraw the proceeds of the Credit shall have been suspended, canceled or terminated in whole or in part, pursuant to the terms of the Credit agreement; or
 - (B) the Credit shall have become due and payable prior to the agreed maturity thereof.
- (ii) Sub-paragraph (i) of this paragraph (a) shall not apply if the Recipient establishes to the satisfaction of the Association that:
 - (A) such suspension, cancellation, termination or prematuring is not caused by the failure of the Recipient to perform any of its obligations under the Credit Agreement; and
 - (B) adequate funds for the Project are available to the Recipient from other sources on terms and conditions consistent with the obligations of the Recipient under this Agreement.

ARTICLE VI

Effectiveness, Termination

Section 6.01. This Agreement shall become effective upon its execution by the parties hereto or the Effective Date of the Credit Agreement, whichever is later.

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.

Section 6.03. This Agreement shall continue in effect until the NAZID Grant has been fully disbursed and the parties to this Agreement have fulfilled all their obligations hereunder, provided, however, that if the Credit Agreement terminates prior to the termination of this Agreement, this Agreement shall terminate automatically and shall cease to have any further force or effect.

ARTICLE VII

Representative of the Recipient; Addresses

Section 7.01. The Minister of Finance of the Recipient is designated as representative of the Recipient 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 Recipient:

Ministry of Finance
Vuna Road, Nuku 'alofa
Kingdom of Tonga

Facsimile: 676-26-011

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)

(1-202) 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.

KINGDOM OF TONGA

By /s/ Siosiua T. T. 'Utokamanu

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Jemal-ud-din Kassum

Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the NZAID Grant

A. General

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

	<u>Category</u>	Amount of the NZAID Grant Allocated (Expressed <u>in Dollars</u>)	% of Expenditures <u>to be Financed</u>
(1)	School Grants under Parts A.3(a) and B.2 of the Project	2,820,000	100% of School Grants amount disbursed
(2)	Consultants Services under Part B.1 of the Project	862,000	90% for individual consultants and 100% for consulting firms
(3)	Incremental operating cost	136,000	100%
	TOTAL	<u>3,818,000</u>	

2. For the purposes of this Schedule, the term “Incremental operating costs” means reasonable expenditures directly related to the Project, incurred by the Recipient (which expenditures would not have been incurred absent the Project), for: (i) bank charges relating to the Special Account; and (ii) costs for communication, technology support, office supplies, travel and travel per diem of Project staff incurred under Part B.1 of the Project, but excluding salaries and allowances.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of a School Grant under Category (1) of the table in paragraph 1 of this Schedule, unless and until the School Grant Operations Manual, satisfactory to the Association, has been duly adopted by the Recipient pursuant to paragraph 3 of Schedule 4 to the Credit Agreement.

4. The Recipient may request withdrawals from the NZAID Grant 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 Recipient (Report-based Disbursements). In the case of the first such request submitted to the Association before any withdrawal has been made from the NZAID Grant Account, the Recipient shall submit to the Association only a statement with the projected sources and applications of funds for Parts A.3(a) and B of the Project for the six-month period following the date of such request.

B. Special Account

1. The Recipient may open and maintain in Dollars a special deposit account in the National Reserve Bank of Tonga, 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 NZAID Grant Account of amounts to be deposited into the Special Account shall be made in accordance with the provisions of Annex A to this Schedule 1.

3. Payments out of the Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Recipient out of the Special Account, the Recipient 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 Recipient directly from the NZAID Grant Account; or

(c) if the Recipient 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.

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 Recipient of its intention to suspend in whole or in

part the right of the Recipient to make withdrawals from the NZAID Grant 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 Recipient 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 Recipient 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 Recipient 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 Recipient shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Recipient 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 sub-paragraph (a), (b) or (c) of this paragraph 6 shall be credited to the NZAID Grant Account for subsequent withdrawal or for cancellation in accordance with the provisions of this Agreement.

**Annex A
to
SCHEDULE 1**

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

1. Withdrawals from the NZAID Grant 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 NZAID Grant Account under one or more of the Eligible Categories.
2. Upon receipt of each application for withdrawal of an amount of the NZAID Grant, the Association shall, on behalf of the Recipient, withdraw from the NZAID Grant 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.4 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 objective of the Project is to assist the Recipient in establishing a consistent and equitable mechanism that will empower schools and communities to improve the quality of schooling at primary and secondary schools levels, and to produce an upward trend in educational outcomes.

The Project consists of the following parts, subject to such modifications thereof as the Recipient and the Association may agree upon from time to time to achieve such objectives:

Part A: Institutional Strengthening and Capacity Building

1. Strengthening the capacity of MOE, specifically with respect to the School Grants Program, to: (a) develop, analyze and review education policies; (b) establish investment priorities; (c) develop specific rolling plans based on the sector priorities; (d) efficiently allocate resources; and (e) conduct consultative policy dialogues with relevant stakeholders.
2. Strengthening the capacity of MOE to: (a) develop and annually review three (3) year rolling plans detailing the Project investments and the performance indicators at both the national and school levels; and (b) monitor the Project implementation and collect baseline information for the Project.
3. Strengthening the capacity of the schools participating in the Project, including: (a) provision of School Grants for managing their resources and planning their three (3) years rolling development plans; and (b) provision of training to head teachers, teachers and community members.

Part B: School Grants Program

1. Designing, managing, and monitoring the School Grants Program, including:
 - (a) providing technical assistance to design and manage the School Grants Program, and to develop the operations guidelines for said Program;
 - (b) conducting public awareness campaigns for the School Grants Program;
 - (c) providing training to schools participating in the School Grants Program on the processes and procedures of the School Grants Program, and
 - (d) supporting the annual review of the performance of the participating schools in the School Grants Program.

2. Providing School Grants to selected primary or secondary schools to finance the schools' overall development needs detailed in their three (3) year rolling plans.

* * *

The Project is expected to be completed by December 31, 2009.