



# **CROATIA**

## **Joint Portfolio Note**

**March 2006**

## CROATIA: STATUS OF LENDING PORTFOLIO

### I. BACKGROUND AND OBJECTIVES

1. The Portfolio Note outlines a brief assessment of the current status of Bank-financed operations in Croatia with a special focus on unsatisfactory and “at risk” projects and fiduciary and implementation capacity of Croatian project portfolio. The specific objectives of this Note are to: (i) examine the efficiency and effectiveness of the portfolio by looking at project performance both at the individual project level and across portfolio; (ii) identify issues impeding the progress of specific projects; (iii) recommend corrective measures as to improve their implementation performance; (iv) outline cross-cutting issues related to implementation capacity. We refer to problem projects as those with unsatisfactory ratings in terms of either Development Objectives or Implementation Progress; effectiveness delays; risk flags; and possible loan closing extensions.

### II. ACTIVE PORTFOLIO

2. The World Bank lending portfolio as of February 23, 2006 is composed of 14 active projects with total commitment value of \$563 million<sup>1</sup> and an undisbursed balance of \$432 million. Five loans amounting to \$241 million<sup>2</sup> were approved under the new Country Assistance Strategy (CAS). These are:
  - *Social and Economic Recovery Project* (approved on March 29, 2005);
  - *Social Welfare Development Project* (approved on June 14, 2005);
  - *Science and Technology Project* (approved on July 7, 2005);
  - *Education Sector Development Project* (approved on September 15, 2005); and
  - *Agricultural Acquis Cohesion Project* (approved on February 16, 2006).
3. Three projects closed during the past 12 months:
  - *Health System Reform Project* (closed on December 30, 2005);
  - *Railway Modernization and Restructuring Project* (closed on June 30, 2005); and
  - *Trade and Transport Facilitation Project* (closed on March 31, 2005).
4. The influx of new projects and the loan closures resulted in a relatively young portfolio (3.2 years average age) but also caused an explainable drop in the disbursement ratio from 27.3 percent in FY05 to 13.0 in the first half of FY06<sup>3</sup>. The ratio at the end of FY06 is expected to be below 27 percent, but it will still be comparable or higher than the average disbursement ratio in the Bank’s Europe and Central Asia region, provided that implementation remains on track.

Attachment 1 lists all active projects and disbursement figures.

### III. PORTFOLIO PERFORMANCE AND MAIN ISSUES

5. A collaborative and proactive program between the Government and the Bank initiated a year and a half ago reversed a deteriorating portfolio quality trend. The Bank’s FY04

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<sup>1</sup> The lending portfolio numbers do not include three Global Environmental Facility (GEF) Trust Fund projects: *Karst Ecosystem Conservation Project* (\$5.1 million), *Energy Efficiency Project* (\$7 million), and *Renewable Energy Project* (\$5.5 million). The portfolio includes the *Programmatic Adjustment Loan* (\$184.9 million) which has been fully disbursed.

<sup>2</sup> In addition, the GEF funded *Renewable Energy Project* was also approved as part of the new CAS.

<sup>3</sup> Disbursement ratio for FY06 is only at mid-year, as compared to a whole FY05.

Annual Review of Portfolio Performance listed the Croatia portfolio as one of the worst performers in the Bank with 37 percent of the Croatia commitments at risk in June 2004. A project improvement plan was designed for the five unsatisfactory projects in Croatia's portfolio, all of which are now Satisfactory (*Court and Bankruptcy Administration Project, Real Property Registration and Cadastre Project, and Pension System Investment Project*), or have closed with a Satisfactory status (*Health System Project and Railway Modernization and Restructuring Project*).

### **Problem Projects**

6. The current portfolio has two major problem projects, both approved under the new CAS.
  - *Social and Economic Recovery Project* is the only project in the current portfolio that has been rated Unsatisfactory in terms of both Development Objectives and Implementation Performance. The Unsatisfactory status is significant given that the Project became effective only in September 2005.
  - *Science and Technology Project* was granted a one time extension of effectiveness to May 12, 2006 after which the loan and project agreements would lapse should the effectiveness conditions not be fulfilled. The Project has a long history of difficulties, and there are continuing concerns about meeting the conditions for effectiveness.

### **Projects with Risk Flags**

7. In addition to the two abovementioned projects, four projects have one risk flag each but actions have been initiated to address these.
  - *Education Sector Development Project* has one legal covenant to be fulfilled to be declared effective. There has been one extension of effectiveness date, which is currently March 15.
  - *Municipal Environmental Infrastructure Project* has a financial management issue on which actions are being undertaken, mainly to upgrade the accounting and auditing standards, and to undertake the 2005 audit as well as restate the 2003 and 2004 accounts based on these new standards.
  - *Real Property Registration and Cadastre Project* does not have a fully functioning Monitoring and Evaluation System, and a Consultant has been engaged to help rectify the situation by mid-term review in mid-February.
  - *Technical Assistance for Institutional and Regulatory Reform for Private Sector Development Project* has slow disbursement but the implementation of a new procurement plan should improve the situation over the next few months.

### **Projects to Close in Next 12 Months:**

8. Four projects are expected to close within the next 12 months, but adhering to the closing dates remains a challenge for two of the projects. The projects closing in 12 months are:
  - *Technical Assistance for Institutional and Regulatory Reform for Private Sector Development* (closing date: June 30, 2006);
  - *Municipal Environmental Infrastructure Project* (closing date: June 30, 2006);
  - *Pension System Investment Project* (closing date: December 31, 2006); and
  - *Court and Bankruptcy Administration Project* (closing date: January 31, 2007).

9. The Bank project teams do not expect further extensions of the closing dates of the two projects: *Technical Assistance for Institutional and Regulatory Reform for Private Sector Development* and *Court and Bankruptcy Administration Project*. However, the Bank has received an 18-month extension request for the *Municipal Environmental Infrastructure Project*, while the counterparts have indicated that they would request a 12-month extension for the *Pension System Investment Project*. The Bank will review the requests and discuss with the MoF and other relevant government ministries or offices various options, including canceling undisbursed amounts under certain conditions (e.g., remaining amounts are small relative to original loan, other sources of funds are available, etc.).
10. *It should be noted that extensions of implementation periods add to the cost of Bank money, because of increased commitment fee on undisbursed amounts, and implementation resources that crowd out resources for new activities, and delay achievement of outcomes.*

#### IV. AGREED CORRECTIVE MEASURES

11. The Bank and Government teams agreed to the following set of measures<sup>4</sup> to upgrade the implementation performance of the *Social and Economic Recovery Project*. A Supervision Mission in April will evaluate progress in implementing these measures, which are listed below:
- Selection of new Project Director satisfactory to the Bank;
  - Satisfactory performance of PCU and RCUs staff at the end of contract extension;
  - Establishment of a revised Steering Committee;
  - Launching of tender for CSERP information campaign;
  - Basic software of Management Information System and Monitoring and Evaluation System and key performance indicators in place;
  - Official project launch conducted at the national level and three launch workshops planned in the three main project areas with the relevant counties, municipalities, and stakeholder.

***JPR Progress Update:*** *new project director has been selected and his formal appointment is expected beginning of April; the composition of the project Steering Committee has been revised (representative of the Ministry of Finance will be included as well); the expression of interest for the CSERP information campaign tender will be published in the last week of March and on May 2, 2006, the Ministry of Sea, Tourism Transport and Development (MSTTD) will send the letter to the Bank on final staffing list as the staff performance evaluation will be finalized by 30 April, 2006 (the date when contract extensions expire); and official project launch will take place in April, the exact date to be agreed once the project director is officially on board. It was also agreed the MSTTD initiate an internal review (through its internal financial control) to establish whether the provisions of the Croatian Public Procurement Law were followed by 1 July 2006. The Ministry of the Sea, Tourism, Transport, and Development is entrusted with a timely implementation of all activities required for obtaining the «satisfactory» rating for the Social and Economic Recovery Project by IBRD until summer 2006 and with informing about that the Government of the Republic of Croatia and the Ministry of Finance until July 1, 2006.*

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<sup>4</sup> Letter to Minister Kalmeta of January 11, 2006.

12. To declare the Loan and Project Agreements under the *Science and Technology Project* effective, the Bank needs to receive the following:<sup>5</sup>

- Copies of the signed Subsidiary Finance Agreements in English or their certified translations;
- Satisfactory legal opinions from the Borrower and Project Agencies confirming that the Loan Agreement, Project Agreements and Subsidiary Financing Agreements have been duly authorized and ratified by, and executed and delivered on behalf of the Borrower and Project Agencies, respectively;
- Evidence of the completion and approval of the Science and Technology Policy satisfactory to the Bank; and
- Evidence of the signing of an agreement with one of the RDIs.

***JPR Progress Update:*** *Subsidiary Finance Agreements with BI and BICRO are finalized and will be signed by April 5; RBI Subsidiary Finance Agreement to be signed by May 2, otherwise this component will be cancelled; Science and Technology Policy prepared and scheduled for the scientific council discussion/approval in order to be sent for Bank's review by April 7; GoC approval of S&T Policy expected by 30 April; Bank to send a draft Project Agreement with the Rudjer Boskovic Institute (RBI) to the MoF for review in the week of 27 March (done). Other effectiveness conditions to be met by May 12.*

13. Supervision missions for three of the four projects with risk flags were undertaken during the past month. The following are the mission findings and recommendations on the risk flags.

- The February *Municipal Environmental Infrastructure Project* mission concluded that there has been sufficient progress towards implementing a new set of accounting procedures. In addition there is agreement that the 2005 audit will incorporate the restatement of 2003 and 2004 accounts according to revised procedures. The risk flag expected to be eliminated after the Bank review of the 2005 audit.
- The mid-February Mid-term Review of the *Real Property Registration and Cadastre Project* made an assessment of the Monitoring and Evaluation System which the mission concluded to be satisfactory. The System is now producing quarterly reports. The risk flag was eliminated in the Implementation Status Report of March 8, 2006.
- The February *Education Sector Development Project* mission determined that the progress has been made in reaching the remaining effectiveness condition. The Ministry of Science, Education and Sports submitted the Operational Manual in early March and the project became effective on March 13, 2006.

14. With respect to the request for an extension of the closing date of the *Municipal Environment Infrastructure Project*, the Bank has granted an 18-month extension. The Supervision mission in February was informed of additional investments proposed by EKO for the purpose of optimization of the overall system and to extend the sewage collection network to the area of Dugopolje, north on Split. The additional investments are estimated at about Euro 45 million of which about Euro 10 million could be financed by the Bank by increasing the loan amount of the existing project. The Borrower might request additional financing from IBRD at a later stage.

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<sup>5</sup> Letter to Minister Suker of January 16, 2006.

Attachments 2-4 provide a brief background and summary for the *Social and Economic Recovery Project*, *Science and Technology Project*, and *Municipal Environmental Infrastructure Project*.

## **V. AGREED ACTIONS FOR OTHER PROJECTS:**

**Pensions System Investment Project:** the Ministry of Economy, Labor, and Entrepreneurship is entrusted with submitting to the Government of the Republic of Croatia a proposal for appointment of new members of the Coordination Committee for the implementation of the Pensions System Investment Project until April 15, 2006 and in line with that initiate the procedure for the change of the authorized signatories for loan disbursement.

The Coordination Committee for the implementation of the Pension System Investment Project is entrusted with passing a decision, by May 15, 2006, on the following:

- a) Reallocation or cancellation of \$1.8 million of undisbursed funds originally earmarked for the HAGENA component
- b) Restructuring of the component of the Croatian Institute of Pension Insurance (HZMO)
- c) Extension of the Closing Date of the Loan by one year with a view to successful implementation of the HZMO restructuring

The Coordination Committee for the implementation of the Pension System Investment Project is entrusted with informing IBRD and the Ministry of Finance about the decisions.

**Education System Development Project:** the Ministry of Science, Education, and Sports is entrusted with harmonizing the content of the Operational Manual with IBRD until May 1, 2006 and in the shortest possible period to identify the schools in which the investments will be made under the project as to reduce the number of schools operating in multiple shifts.

**Coastal Cities Pollution Control Project:** the Ministry of the Sea, Tourism, Transport, and Development, the Ministry of Agriculture, Forestry, and Water Management, the Ministry of Environmental Protection, Physical Planning, and Construction, and the Ministry of Finance are entrusted with harmonizing, by April 30, 2006, the single draft agreement to be concluded between local self-government units participating in the Coastal Cities Pollution Control Project and the Croatian Waters company Jadranski Projekt d.o.o.

The Ministry of the Sea, Tourism, Transport, and Development and the Croatian Waters company Jadranski Projekt d.o.o. are entrusted with harmonizing, until April 30, 2006, the manner of selection of the local self-government units to be included into the Project, as well as the procedure and requirements for submitting requests for withdrawal of funds secured in the State Budget as counterpart funding in Project financing.

The Ministry of Environmental Protection, Physical Planning, and Construction is entrusted with submitting until April 24, 2006 to IBRD and the Ministry of Finance the procurement plan and the plan of implementation of a part of the Coastal Cities Pollution Control Project in its area of competence.

**Trade and Transport Integration Project:** the Ministry of the Sea, Tourism, Transport, and Development is entrusted with defining, until April 15, 2006, and proposing to the Ministry of Finance the final financial structure of the Trade and Transport Integration Project – Port of Ploče Project, envisaged amounts of IBRD's and EBRD's loans, including projections of the required counterpart funds for the Loan, and the manner of financing of

the railway component and fitting the investment liabilities assumed with the Project into the Croatian Railways investment plan.

**Agriculture Acquis Cohesion Project:** the Ministry of Agriculture, Forestry, and Water Management and the Ministry of Finance are entrusted with organizing, by April 30, 2006, signing of the Loan Agreement and the Grant Agreement on the Dutch grant for the Agriculture Acquis Cohesion Project.

**Energy Efficiency Project:** the Ministry of Economy, Labor, and Entrepreneurship is entrusted with submitting to the Government of the Republic of Croatia, IBRD, and the Ministry of Finance by April 15, 2006 a plan of passage of subordinate legislation aimed at removing impediments in the implementation of the Energy Efficiency Project.

The Ministry of Economy, Labor, and Entrepreneurship is entrusted with submitting to the Ministry of Finance, by May 1, 2006 an incentive and proposal for the legal solution of the treatment of investments into energy efficiency as per ESCO model for budget beneficiaries.

The Ministry of Economy, Labor, and Entrepreneurship, the Croatian Bank for Reconstruction and Development, and the Environmental Protection and Energy Efficiency Fund are entrusted with fulfilling the requirements for disbursement of grant funds by April 30, 2006.

## **VI. PORTFOLIO MANAGEMENT REVIEW**

### **Project Implementation Coordinator**

15. Since the previous JPR, the Ministry of Finance's Directorate for International Financial Institutions, has delegated some of its coordination tasks to line ministries/agencies. As some of them lack the experience in handling administration of documents and procedures necessary for concluding international agreements, it is recommended that the Ministry of Finance, jointly with the Bank's project teams, closely monitor this process especially in the project preparation stage and the first year of project implementation.

### **Role of Project Implementation Units (PIUs)**

16. As reported in the earlier JPRs, the Government has been considering the implementation setting of Bank-funded projects over the past years, with a specific review of PIU status within line ministries and agencies. As a result of this process, the Ministry of Finance has recently proposed that civil servants, rather than externally hired consultants, are in charge of carrying out the implementation of projects. The Ministry has consequently requested the Bank to discontinue the practice of funding the PIU staff from the loan and grant proceeds.

17. The Bank has accepted to apply this principle as its primary policy. This institutional arrangement reinforces the capacity building efforts and ensures the integration of projects within ministries/agencies. This has been successfully practiced in various public authorities, which embraced the project-mode approach early enough. However, such arrangements should be thoroughly monitored in the ministries with no experience

in implementing the Bank-funded projects<sup>6</sup>. The task teams and the IFI's directorate of the Ministry of Finance should jointly carry out this task. Early nomination of state administration employees that would be responsible for administration of projects and their substantial training in Bank procedures for procurement and financial management are vital to achieve project readiness at the start up of implementation. Sound English language skills and experience in project management are prerequisite for qualifying for this task.

18. In addition, there is the issue of limited capacity building, questionable sustainability, and incentive issues associated with salary differentials paid to PIU staff. A mixed project implementation approach, relying on staff from the main implementing agency in policy and oversight positions with a limited number of consultants in key technical roles, is likely to be the most feasible approach during a transition period. The tendency should be to integrate the PIUs activities more closely into the existing ministerial structures. The following recommendations could be considered further:

- Self standing PIUs not to be accepted in any future Bank-supported projects (except in very rare situations with particularly strong justification);
- Where consultants are needed to assist in project implementation, more use should be made of task-oriented fixed term contracts (with a possibility of renewal);
- The Government may wish to establish salary bands for the employment of consultants to reduce disparities across projects; and
- All projects should monitor progress in capacity building and aim to scale back the reliance on PIUs as institutional capacity is developed.

## **Project Management Systems**

### **Procurement**

19. Croatia Portfolio has no particular issues that would seriously affect the implementation of projects. Overall the review has noted several developments over the past 12 months:

- **Relocation of Bank Procurement Staff to Zagreb Office** - The procurement function for the decentralized projects in Croatia portfolio is currently shared between two procurement staff - a Senior Procurement Specialist stationed in Bucharest, and a Procurement Analyst located in the Bank's Office in Zagreb (February 2005). The presence of the Procurement Analyst is invaluable for providing first-hand training to project implementation units, and it also enables the Country office project staff to benefit from an early and timely advice in their daily monitoring of operations. With this relocation, the Croatia Portfolio has progressively started the process towards its full decentralization. In addition to taking over majority of Croatia projects, including new operations, the Procurement Analyst is also performing ex post reviews on non-decentralized projects, extending the advisory assistance to all PIUs in Croatia, as well as assessing the institutional capacities of projects under preparation.
- **Implementation Capacity** – The need of strengthening capacity in procurement management of implementing bodies is being addressed through a five-day procurement seminar, organized for PIUs from Croatia, Bulgaria and Romania in Zagreb end February 2006. A trend to integrate project implementation within

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<sup>6</sup> Most fortunate solution was found under the recently approved Agricultural Acquis Cohesion Project. A person who worked on the completed Farmer Support Services Project will carry out the implementation of the new project.

Government agencies has been beneficial when considering that the capacity built over the project life remains in a relevant agency. This practice however requires closer supervision to ensure the compliance with Bank's procurement guidelines.

- **Increased Threshold** - As a result of an improved borrower capacity, the Bank has increased the allowable levels for National Competitive Bidding (NCB) on goods and works, which are now < \$1 million for goods and < \$5 million for works. The starting point for mandatory prior review levels has been increased as well. While the new thresholds are in effect for all projects negotiated after February 15, 2006, ongoing operations also have the possibility to benefit from newly approved levels, through a standard waiver procedure.

It has been agreed that the Bank will send an official note on the threshold increase to the Ministry of Finance and the PIUs.

- Two recent trends should be addressed: too long evaluation process (more than a month) and advance payments in civil works contracts are not allowed. This is an impediment for a number of infrastructure projects. Approving advance payments is apparently not a local practice, whereas it is needed for mobilization and typically amounts in Bank's projects to 10–20 percent, safeguarded by a bank guarantee.

## **Financial Management**

20. As of July 2005, the financial management function for Croatia Portfolio is being handled from the Bank's office in Bucharest.
21. Overall, the Croatian portfolio has shown a stable development in financial management and financial performance over the last year. However, following the recent fiduciary supervision, two projects have been rated unsatisfactory for their FM arrangement (Court and Bankruptcy Administration and TAL II). Action plans have been agreed with the relevant PIUs to address the identified issues, and a follow up will be ensured by Bank's FM specialist in the coming months.

## **Generic financial management issues:**

22. (i) Budgetary allocations and counterpart contribution:  
One of the financial management issues that affect the portfolio is the ceiling imposed on withdrawals from external financing, through the Budget Law and very strict policy throughout the year concerning the total amount of external financing available, that cannot be changed during the budget rectification process. However, the 2006 allocation was considered to be sufficient for the recently supervised projects and there are no issues related with the late receiving of counterpart contribution. The projects should try to seek adequate funding during the next budgeting process.
23. (ii) Financial Reporting Requirements:  
The Bank's project based financial reporting requirements (financial monitoring reports - FMRs) have simplified. The changes allow more flexible reporting formats that will be customized to reflect country circumstances and the needs of each individual project.
24. Decentralization of EU pre-accession assistance management to Croatian ministries and agencies will require an accelerated strengthening of Croatia's fiduciary system. In this context, the Bank could consider options to align its FM reporting requirements and

make use of country systems to the extent possible, to avoid duplication and help build the capacity. A case-by-case evaluation could be applied, as this approach would be particularly relevant and valuable for projects with good FM performance record.

25. All projects must submit FMRs/ PRMs on timely basis and reconciled with the loan data. Some of the projects submit the reports on time, some submit with delays or unreconciled and some don't submit at all. This issue will be followed up with the project teams and tackled during each FM supervision.

26. All projects use the traditional disbursement method (SOE-based) rather than report-based disbursements, because of the deficiencies mentioned in the FMRs. However, new projects can use both methods as per loan agreements. So if the borrower feels confident, report-based disbursement can be used. Moreover, the Education Sector Development Program will use the report-based disbursement for utilized funds. The standard Croatian budget execution report, on the Croatian economic classifications will be used.

27. (iii) Implementation arrangements

The fiduciary safeguarding and financial management is arranged mostly using stand-alone project implementation units. However, progress has been made in respect of using civil servants in the PIUs, either for position of project directors or FM/accounting. Also, on the new Education Sector Development Program, the implementing entity will be the Ministry itself. The Bank will continue where possible to use the country system. This approach has been used for some of the recent projects: Agriculture Acquis Cohesion and Education Sector Development Program.

28. (iv) SA arrangements

The Loan funds are channeled from the Bank to the Special Account, while the Government co-financing is received in a separate Project Account. All projects open their Special Accounts at safe and sound commercial banks acceptable to the Bank that have submitted comfort letters to the WB. Most of the Projects are keeping their SAs at the three biggest Croatian commercial banks: Privedna Banka, Zagrebacka Banka, Rijeka Banka or foreign banks such as Raiffeisen Bank.

29. (v) Staffing

Project financial management staff comprises individual local staff and consultants. It is moderately difficult to recruit qualified financial management. The financial management persons employed by the PIUs are financed mostly from the World Bank loans and in some cases are financed by the Government. Usually, PIUs have on average 1-2 FM staff (depending on size of the projects). Some projects do not have detailed job descriptions available, or these are incomplete, and/or do not ensure a full segregation of duties. It is recommended that the financial management staffing of all projects takes into account that duties must be allocated in such a way that there are no conflicts of interest that may jeopardize the project's assets.

30. It is also recommended to consider and evaluate the skills gap between standard financial management staff, employed under normal civil servant contracts by line ministries, and the financial management consultants engaged by the PIUs. This would allow for further development of civil servants' capacity to fill in the FM function. In view of the envisaged transition towards increased reliance on the existing institutions and their financial management staff.

***JPR Progress Update:*** *As the need for further development of civil servants capacity filling in the FM function was highlighted at the review, it has been agreed that the*

*Bank will organize FM training for all newly approved projects. This coincides well with the ECSPS note of March 27, announcing the availability of small funding to conduct a joint FM and disbursement training for the PIUs staff in late May and June 2006. One-week regional training is scheduled to take place in Zagreb in the week of May 29, 2006. The TTLs are being asked to send out the invitation to their respective PIU.*

31. (vi) Financial Management Procedures Manual

All projects must develop a financial management, internal controls and accounting procedures manual and update the manual on a regular basis. For the majority of the projects recently supervised, the manual has not been updated since the start of implementing the project. Some projects have not developed a manual at all.

32. (vii) Auditing

All Bank financed projects must be audited by independent auditors and under terms of reference acceptable to the Bank. The audit compliance has enhanced over the past year, with most of the Bank-financed projects submitting acceptable audit reports and management letters by 30 June 2005. Some of the projects have sent the audit reports with a three-month delay. All the audit reports for the Croatian portfolio projects have been received for 2004 FY.

33. The financial management (FM) rating introduced in 2002 by the Bank in its Project Status Report relates to the project FM supervision. Projects with audit reports overdue more than 4 months automatically receive an unsatisfactory FM rating, irrespective of the other aspects.

34. Auditors of Bank-financed projects are generally appointed on an annual basis by each PIU. Currently, there is a list of acceptable auditors to the Bank, based on the audits received for the past projects. This list includes local member firms of the four big international audit networks and some local audit firms (Iris Nova Rijeka, Revidas, Teb Revizija, Zagreb, Audit D.O.O Zagreb, Interexpert–Zagreb, Revizija Zagreb, Inzenjerski Biro - Revizija D.O.O.). Moreover, in the recently negotiated project, the SAO has been considered independent for the audit purposes as it reports to a committee of Parliament and not to the Government. There has been no project audited by SAO so far. The Bank's review of the audit firms is overdue and should be carried out in the future. It is essential that all the projects initiate the selection of auditors early enough to ensure their appointment is finalized preferably before, or immediately after the year's end and that the audit work is carried out in a manner to allow sufficient time for a timely submission of all audit reports. In addition to the timely submission of all reports, it is recommended the key issues mentioned in the audit report and management letter to be followed up by the PIUs.

***JPR Progress Update:*** *It has been agreed that the Bank will send to the MoF and PIUs a revised list of acceptable auditors together with the recommended TORs and instruction on the procedure related to audit selection.*

***35. JPR Progress Update regarding E-disbursement:*** *Karst Ecosystem Conservation (KEC) Project and Real Property Registration and Cadastre Project are the two pilot projects in Croatian portfolio selected for e-disbursement through Client Connection. The Bank will send an official letter to the Ministry of Finance to that effect.*

*ATTACHMENTS:*

1. Projects table
2. Croatia Social and Economic Recovery Project (CSERP)
3. Science and Technology Policy (STP)
4. Municipal Environmental Infrastructure Project (MEIP)

**Attachement 1.**

<b>Project Name</b>	<b>Amount of Loan</b> (millions/USD/EUR)	<b>Undisbursed Balance</b> (millions/USD/EUR)	<b>Board Approval Date</b>	<b>Date of Effectiveness</b>	<b>Original Closing date</b>	<b>Project Age</b> ( months)
1. Agricultural Aquis Cohesion Project	EUR 25,5	EUR 25,5	2/16/2006	Expected effectiveness date: 4/30/2006	10/31/2010	0
2. Programatic Adjustment Loan	EUR 150	0	9/15/2005	12/19/2005	6/30/2006	5
3. Social and Economic Recovery Project	EUR 35	EUR 35	3/29/2005	9/30/2005	6/30/2009	11
4. Real Property Registration and Cadastre Project	EUR 26	EUR 16,4	8/29/2002	2/20/2003	9/30/2008	42
5. Pension System Investment Project	USD 27,3	USD 13,7	7/18/2002	2/20/2003	12/31/2006	43
6. Court and Bankruptcy Administration Project	USD 5	USD 2,6	6/13/2001	1/29/2002	7/31/2005 NCD: 1/3/2007	56
7. Municipal Environmental Infrastructure Project	EUR 33,23	EUR 12,27	6/18/1998	6/28/1999	6/30/2006	92
8. Technical Assistance 2	USD 7,30	USD 0,42	4/20/1999	8/03/1999	6/30/2003 NCD: 6/30/2006	82
9. Energy Efficiency Project	EUR 4,40	EUR 4,06	10/7/2003	4/8/2004	6/30/2010	28
10. Social Welfare Development Program	EUR 31	EUR 31	6/14/2005	1/30/2006	9/30/2009	8
11. Rijeka Gateway Project	USD 156,5	USD 92,5	7/8/2003	10/10/2003	9/30/2009	31
12. Coastal Cities Pollution Control Project	EUR 40	EUR 36,4	6/1/2004	12/17/2004	11/30/2008	20
13. Education Sector Development Project	EUR 67,8	EUR 67,8	9/15/2005	Effectiveness deadline extended to March 15, 2006	3/31/2010	5
14. Science and Technology Project	EUR 31	EUR 31	7/7/2005	Effectiveness deadline extended to May 12, 2006	11/30/2009	7
15. Karst Ecosystem Conservation	USD 5,07	USD 1,99	5/23/2002	9/18/2002	12/31/2007	45
16. Renewable Energy Resources	USD 5,5	not activated	6/23/2005	11/24/2005	3/31/2010	8
17. Energy Efficiency (Grant)	USD 7	USD 5,5	10/7/2003	4/8/2004	6/30/2010	28

As of March, 2006

	Active Projects		Grants
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## ***Attachment 2.***

### **Croatia Social and Economic Recovery Project (CSERP)**

#### **Action Program to address unsatisfactory rating**

##### Nature of the Problem

The Project became effective on September 30<sup>th</sup> 2005, however due to non transparent practices and inadequate leadership in the PCU, the project was first rated unsatisfactory in October 2005. In particular, serious procurement issues deviating from the Loan Agreement were discovered during the first supervision mission in October 2005. A significant amount of procurement activity had been underway on contract packages that were identified in the agreed Procurement Plan to be subject to prior review, but which had not been submitted to the Bank for review as required under the provisions of the Loan Agreement and the Procurement Plan. There were:

- (a) Indications that complaints had been lodged by firms wishing to compete for contract work on the project, and the complaints had not been properly addressed by the implementing agency; and
- (b) Indications that documentation relating to ongoing contract activity was either not available, or not provided to the Bank for its review as required by Appendix 1 of both the Procurement and Consultant Guidelines.

Based on preliminary review of CVs and interviews with consultants selected by the PCU, the Bank team was not confident that all of the PCU current staff was technically suitable to implement the CSERP project effectively. Information was not flowing from the PCU to those who need it, including, the World Bank, other departments within the Ministry of Sea, Tourism, Transport and Development (MSTTD), and other partners, such as the EC Delegation.

##### Actions Agreed to Upgrade to Project to satisfactory rating

Although the project supervision mission again rated the project unsatisfactory in December 2005, the Bank team and Government then agreed on specific measures to be completed by March 31<sup>st</sup> 2006, as a condition for upgrading the project rating. The main measures include:

- selection of a new Project Director satisfactory to the World Bank to ensure adequate leadership, technical capacity and transparency in project implementation;
- Internal review of current PCU staff competencies and performance so that, where needed, such staff can be replaced.
- Revision of the composition of the Steering Committee members in line with the Operations' Manual guidelines;
- Opening of the Special Account;
- Launching of the tender for CSERP information campaign.

Thanks to the commitment of senior representatives of the MSTTD and the support of the Ministry of Finance to a timely resolution of project matters, all the above-indicated measures are in the process of satisfactory completion or have already been resolved. The World Bank CSERP team is especially pleased with the progress made by the MSTTD team under the leadership of the acting project manager Franka Vojnovic, who also led project preparation activities on the Croatian side. A World Bank supervision is scheduled to arrive in Croatia in late March 06 and the project launch is being planned for the first week in April, after which the rating will be reassessed and very likely upgraded. No drastic decisions are therefore envisaged for the near future, however specific options for the future development of the project will be identified, if need be.

### **Attachment 3.**

## **Science and Technology Policy (Ln Nr. 7320-HR)**

### **Pending effectiveness issue**

- Extended effectiveness deadline to May 12, 2006 (from January 16, 2006) due to noncompliance with still pending effectiveness conditions that include the following actions by the MSES/MoF (of which the Bank should receive a copy):
  - (i) Sign the Subsidiary Finance Agreements with BI and BICRO;
  - (ii) Obtain legal opinions from the Borrower and Project Agencies on the Loan Agreement, Project Agreements and Subsidiary Financing Agreements;
  - (iii) Complete and approve the Science and Technology Policy (dated covenant the original deadline of which was **October 31, 2005**); and
  - (iv) Sign an agreement with one of the RBIs (Rudjer Boskovic Institute) (dated covenant the original deadline of which was **December 31, 2005**).
- Progress: With regards to RBI, a lot of progress – although with a delay – has been made since September 2005 when RBI decided not to join STP directly. The Bank in principle accepts RBI's *new* proposal to assist RBI in establishing an RBI-owned agency, Rudjer Innovations, Ltd., for transfer of RBI's intellectual property. The Bank and RBI are finalizing legal agreements to operationalize this arrangement so that they can be submitted to the RBI Board for final approval. Signing of these agreements would fulfill the effectiveness condition.
- Concern: The Bank is greatly concerned about the continuing delays in completing the S&T policy (it has been under works even before Appraisal, September 2004) and the lack of information on its status and contents. According to the Loan Agreement, the Bank also needs to agree to the policy before its final approval. There is concern that the policy will neither be completed nor approved on time or that the Bank will not be provided sufficient time to review and comment it.
- Final extension: The Bank will not agree to another extension if effectiveness conditions are not complied with by May 12, 2006, and the Loan for STP will automatically lapse. The borrower will not be under obligation to pay commitment fees in case of such termination.

### **Implementation issues**

- Components: Until the Bank's mission in the first week of March, MSES had not made progress with launching one of the components; the important initiative of the Unity through Knowledge Fund managed by MSES (not appointed Committees neither selected the program staff, etc.). It appears that MSES is now starting the process of preparing a list of candidates for the committees, but much more needs to be done not to further delay launching of its implementation. BI and BICRO have been working hard in preparing business and procurement plans, as well bid/consultants' packages, together with PMU.
- Project management: Difficulties to access MSES (the Project Coordinator) have hampered the work of the PMU and Project Agencies and STP, in general. Any decisions that need to be coordinated with MSES have been delayed. The Bank team has not succeeded in contacting MSES via video or telephone either. Possible solutions include delegating STP coordination within MSES and/or delegating more authority to the Project Agencies in implementation of their respective components. In this regard, the Bank proposed to the Minister during the mission that the UKF component would be delegated to BICRO and that the project management procedures included in the Operational Manual would be simplified.

#### *Attachment 4.*

### **Municipal Environmental Infrastructure Project**

1. **Project Results and Implementation Status.** Project implementation is advancing satisfactorily. All planned activities under the water supply component and under the Split-Solin wastewater component have been completed, attaining and surpassing all agreed objectives. In these two components only about 10% of contracted works, all of them additional activities remain under way to be completed by the end of March 2006. Activities under the Kastela-Trogir wastewater component continue as planned. Construction of the Ciovo tunnel has reached the 1000 m benchmark and should be completed by the end of June 2006, before the tourist season starts and works have to be stopped. Final designs for the wastewater treatment plant, bay crossing and submarine outfall have been completed and bidding documents will be sent to the Bank shortly for their review with the objective to complete contracting by end of March 2006. Designs for the Kastela, Trogir and Ciovo network contracts are also advancing as planned, with the objective of completing contracting by June 2006.

2. A better idea of the project achievements is given by the scope of the works already carried out. Currently, investments for Euro 99.5 million, before taxes, have been contracted, of which 89.6 million have been disbursed. Additional contracts, for a total of about Euro 136 million (against a total planned at appraisal of about Euro 108 million equivalents – without taxes), are currently under preparation, which would fully commit the Bank's loan. World Bank loan disbursements reached Euro 20 million at the end of 2005 and additional Euro 1.5 million have been certified to be disbursed by the end of February, bringing loan disbursements to about 65%.

3. **Project Closing Date Extension.** The Project will need an extension of its closing date to allow for the completion of all planned infrastructure under the Kastela-Trogir sewerage component. A proposal to extend the loan's closing date to December 2007 was processed by ViK and HBOR and sent to the Bank. The proposed 1.5 years extension is substantially shorter than the accumulated delay (3 years) the implementation of this component initially had before the World Bank agreed to finance it, and would be the first one for this project. A plan for disbursements until the proposed new closing date has been prepared by EKO and HBOR.

4. **Additional Investments.** The last supervision mission was informed of the additional investments proposed by EKO for the purpose of optimization of the overall system and to extend the sewage collection network to the area of Dugopolje, north of Split. The mission reviewed the proposals prepared by EKO and found them justified and satisfactory. With these additional activities, not only the project would reach a larger number of beneficiaries, but also its hydraulic operation would improve. Furthermore, the extension of the network would allow the protection of the main water source, the Jadro River, on which the supply system of the whole region depends.

5. The EKO Board meeting held in December 2005 reviewed the overall additional investment plan and gave instructions to the Agency to initiate work on the preparation of investment details and bidding procedures for a detailed list of additional investments that affect several of the area's municipalities. The overall investment foreseen under this additional program amounts to about Euro 45 million, of which about Euro 10 million could potentially be financed by the Bank. Once endorsement is obtained by the respective municipalities of the proposed investment plan, works could commence shortly, and be completed in an 18-month period, according to estimates prepared by EKO.