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**AFGHANISTAN RECONSTRUCTION TRUST FUND****ARTF INCENTIVE PROGRAM SY1389 (2010/11)****ADMINISTRATOR'S TECHNICAL REVIEW: STRUCTURAL BENCHMARKS**DECEMBER 23, 2009

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**Preamble**

1. In December, 2008, ARTF Donors agreed with the Government of Afghanistan to establish the ARTF Incentive Program within the Recurrent Cost (RC) Window of the ARTF. The objective of the Incentive Program is to support the Government's reform agenda, in particular progress toward fiscal sustainability. The Incentive Program offers incentive funds to top-up the ARTF RC Window baseline financing for SY1389 in the amount of US\$60 million. The funding will be allocated through two schemes: a structural reform scheme (accounting for three quarters of the available incentive funds) and the revenue matching grant scheme (accounting for one quarter of the available incentive funds).
2. Following a series of Working Group discussions with donors, the Ministry of Finance and the World Bank, as Administrator, signed the Memorandum of Understanding (MoU) on August 1, 2009. The MoU included the SY1389 benchmarks and the review protocol. It stipulated that all supporting evidence for the fulfillment of the structural reform benchmarks would be delivered to the World Bank not later than November 30, 2009. The Technical Review would be delivered to the ARTF donors of the Working Group<sup>1</sup> before being presented to the Government of Afghanistan within 15 business days after the submission of all supporting evidence for all benchmarks or no later than mid-December 2009.
3. This Technical Review has been undertaken by the World Bank as Administrator, with collaboration of sector experts from ARTF donors. Part I of this Technical Review describes in detail the assessment for the SY1389 structural reform program based on the evidence provided. Part II of this Technical Review summarizes the recommendation to the ARTF Management Committee with regard to the amount of the top-up of the SY1389 ARTF RC window ceiling.

**Part I: Performance Assessment against SY1389 Benchmarks**

4. This Technical Review provides the performance assessment against the SY1389 structural benchmarks of the ARTF Incentive Program only. Structural reforms for the SY1389 Incentive Program tracked government commitments under three reform areas (with three respective benchmarks under each theme): A. Enhancing Domestic Revenue Generation, B. Improving Public Sector Governance and C. Enabling Private Sector Development.
5. All verification material to demonstrate the fulfillment of structural benchmarks was submitted by the Government, as per the agreed schedule. The delivered evidence was then assessed by experts of the ARTF donors and the World Bank and in some cases went through several rounds of clarification and adjustment. The benchmarks were negotiated with close involvement of the relevant line

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<sup>1</sup> EC, US, UK, Italy, & Germany.

ministries/agencies and the Working Group of donors. Line agencies involved included the Ministry of Finance, the Ministry of Transport and Civil Aviation, the Ministry of Commerce and Industries, the Ministry of Mines, the Independent Administrative Reform and Civil Service Commission, the High Office of Oversight and Anti-Corruption (HOO) and the Board of the Da Afghanistan Breshna Sherkat (DABS).

6. The Administrator's Technical Review assesses that, based on the evidence received; the Government of Afghanistan met all SY1389 ARTF structural benchmarks, as described in Table 1 below. However, one benchmark: progress on the DABS corporatization and governance, was assessed as **met, conditional on further adjustments to the plan to reduce commercial and technical losses**, including a timetable and action plan for the establishment of commercial activities and better customer services (see Annex II), expected **by end-March 2010**. This is on consideration of the Government's efforts shown so far in moving ahead with the fulfillment of this important benchmark, following the unexpected delay in the DABS corporatization process after the signing of the MOU in August 2009.

## **Part II: Recommendation on Incentive Fund Allocation for SY1389**

7. The Administrator's Technical Review recommends at this point to the ARTF Management Committee to increase the SY1389 ARTF recurrent cost window ceiling from the baseline of US\$225 million to US\$255 million, reflecting the US\$30 million additional incentive funds for the Incentive Program structural benchmarks (for Theme A and B) as agreed in the MoU. Upon transmittal and assessment of all outstanding evidence in support of the DABS corporatization and governance benchmark by end-March 2010, it is recommended to increase the SY1389 ARTF recurrent cost window ceiling to US\$270 million, reflecting the US\$15 million additional incentive funds for the structural benchmarks under Theme C.

8. The assessment and recommendations based on the calibrated schedule of the Revenue Matching Grant Scheme will take place once actual revenue numbers are confirmed by the Treasury - i.e., after the solar year end (around March 20). This means the Revenue Matching Grant will be calculated and confirmed only after the SY1389 budget is passed by Parliament.

**Table 1: SY1389 Structural Reform Matrix with Evidence Assessment**

<b>Theme A: Enhancing Domestic Revenue Generation <sup>a</sup></b>				
	<b>Benchmarks</b>	<b>Monitoring and Evaluation</b>	<b>Evidence Status</b>	<b>Assessment</b>
A1.	<b>Customs reforms:</b> (i) The customs department at MOF reports quarterly on an agreed set of key output indicators, which will allow better assessment of general progress made within customs administration <sup>b</sup> , and (ii) ASYCUDA roll-out to Sher Kahn Bandar.	<ul style="list-style-type: none"> <li>• The Afghan Customs Department (ACD) will provide the World Bank team with the quarterly reports of the defined output indicators and together with the World Bank Customs Experts will calculate the customs performance indicators. These indicators will be posted on the ACD web-page.</li> <li>• The MOF/ACD will track the ASYCUDA roll-out to Sher Kahn Bandar. It will provide the World Bank with a progress report on the roll-out.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Evidence received.</b> ACD provided the World Bank with the quarterly reporting on key output indicators to calculate customs performance indicators. The World Bank assesses the data as satisfactory. The indicators were posted on the ACD web-page and a link to the web-page was provided.</li> <li>• <b>Evidence received.</b> The official letter from DM Revenue and Customs informing us that the ASYCUDA system is fully operational and implemented as of November 19, 2009 at the Sher Khan Customs station (with the first electronic processed customs declaration attached).</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Met.</b></li> </ul>
A2.	<b>Tax and Non-tax revenue transparency:</b> (i) A MOU on revenue collection is signed between MOF and Ministry of Transport and Civil Aviation (MOTCA); (ii) Publication and posting on the MOF/ACD webpage of all fees and processing charges at the Revenue and Customs Offices; (iii) Monthly posting of detailed customs collection data (by customs station <sup>c</sup> ) on the MOF/ACD web-page.	<ul style="list-style-type: none"> <li>• The MOF will provide the World Bank with a copy of the signed MOU between MOF and MOTCA.</li> <li>• The World Bank will verify the posting of fees and processing charges and the monthly detailed customs collection data on the MOF/ACD web-page.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Evidence received.</b> Copy of the MOU received in English and Dari.</li> <li>• <b>Evidence received.</b> Web-site links were provided for fees and processing charges and for monthly detailed customs collection data. The World Bank assessed the data as satisfactory.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Met.</b></li> </ul>
A3.	<b>Improving tax compliance:</b> The number of companies that are non-compliant with the Business Receipt Tax (BRT) or Income Tax at the start of SY1388 is reduced by 10 percent by the	<ul style="list-style-type: none"> <li>• The MOF/Afghan Revenue Department (ARD) will provide the World Bank with a list of compliant companies (with blacked out names) for the beginning of 1388 and for Q3 1388 to allow for verification of</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Evidence received.</b> Lists which identify newly compliant companies from LTO and MTO, amounting to 106 newly compliant companies (out of 634) or a 17 percent increase in the number of compliant</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Met.</b></li> </ul>

	third quarter of SY1388. <sup>d</sup>	increase in compliant companies.	companies.	
<b>Theme B: Improving Public Sector Governance</b>				
	<b>Benchmarks</b>	<b>Monitoring and Evaluation</b>		
B1.	<b>Asset declaration:</b> (i) Asset declaration roll-out (with no less than 60 percent of the current Cabinet Ministers submitting their asset declarations), and (ii) A draft implementation strategy for asset declarations (including verification procedures) is developed for Cabinet approval and shared with donors.	<ul style="list-style-type: none"> <li>• The HOO confirms in a formal signed statement to the World Bank team how many Cabinet members provided an asset declaration by November 30, 2009, if possible it lists the respective Cabinet members.</li> <li>• The HOO will circulate to ARTF donors and World Bank Experts a draft implementation strategy for asset declarations (including verification procedures). The World Bank Experts will stand ready for assistance in developing and refining the strategy.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Evidence received.</b> World Bank received Dari copies of 18 asset declarations from Cabinet ministers, accompanied by a cover letter from HOO in Dari and English, detailing that those reflect complete asset declarations from 72 percent of all Cabinet members.</li> <li>• <b>Evidence received.</b> A revised draft strategy on asset declaration implementation was transmitted and went through several comment rounds from DFID and World Bank. Although some suggestions of the DFID and World Bank were incorporated in the current version of the implementation strategy, other suggestions, like on public disclosure, remain to be included. Also, it is expected that some recommendations, particularly in regard to sanctions, will be addressed in future versions, through changes in the Anti-corruption Law and in the context of clarifying the overall role of the HOO (Annex I).</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Met.</b></li> </ul>
B2.	<b>Strengthening GOA's Internal Audit function:</b> Reinstatement of Article 61 of the Public Expenditure and Financial Management (PEFM) Law regarding MOF's government-wide purview over Internal Audit through a Presidential Decree.	<ul style="list-style-type: none"> <li>• The MOF will provide the World Bank with a copy of the Presidential Decree on the reinstatement of Article 61 of the PEFM Law.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Evidence received.</b> A letter from the MOJ in Dari (with English translation) was received confirming the validity of Article 61 of the PEFM Law.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Met.</b></li> </ul>

B3.	<p><b>Progress in P&amp;G implementation:</b> A progress report of P&amp;G implementation is prepared covering MOF, Ministry of Rural Rehabilitation and Development (MRRD), Ministry of Education (MoE) (including teachers), Ministry of Justice (MoJ) and Ministry of Agriculture, Irrigation and Livestock (MAIL), featuring: (a) progress of P&amp;G by line ministry as of October 31, 2009, including analysis on re-grading; (b) comparison with the timetable for that ministry set earlier; and (c) action plan for each ministry implementing P&amp;G for the remainder of the year 1388.</p>	<ul style="list-style-type: none"> <li>The Independent Administrative Reform and Civil Service Commission (IARCSC) will deliver the P&amp;G implementation progress report to the World Bank and will work closely with the World Bank Public Administration Reform Team during the preparation of the report.</li> </ul>	<ul style="list-style-type: none"> <li><b>Evidence received.</b> A full report detailing all requirements, i.e. a description of progress on P&amp;G implementation in the five ministries, an explanation of experienced challenges and delays, a section on overall lessons learned and with action plans for finalizing P&amp;G implementation at the ministries during the remainder of 1388. Evidence was commented on and reviewed by the World Bank team and deemed satisfactory.</li> </ul>	<ul style="list-style-type: none"> <li><b>Met.</b></li> </ul>
<p><b>Theme C: Enabling Private Sector Development</b></p>				
	<p><b>Benchmarks</b></p>	<p><b>Monitoring and Evaluation</b></p>		
C1.	<p><b>Progress in DABS corporatization and governance reforms:</b> The DABS Board approves a plan to reduce commercial and technical losses within the next two years; including a timetable and action plan for the establishment of commercial activities and better customer services, including the Kabul region, previously known as the Kabul Electricity Directorate, KED.</p>	<ul style="list-style-type: none"> <li>The DABS Board will provide to the World Bank the approved plan and the minutes of the Board Meeting during which the plan was approved – alternatively a signed cover letter with the approved plans attached is acceptable. The World Bank Power specialist will review the plans and, upon request, assist DABS during the drafting period.</li> </ul>	<ul style="list-style-type: none"> <li><b>Evidence received.</b> Copies of a revised first summary plan for DABS to reduce technical and commercial losses and of the DABS Board Resolution (from the DABS Board meeting of November 23, 2009) endorsing the plan were transmitted. It incorporates most of the suggestions from the World Bank who reviewed the plan and provided inputs to the DABS team for improving the plan. Agreement was reached with DABS that the basic principles of a business plan and forecast are in the plan, but that further improvements are needed within the next months (mainly by making sure better reporting data will become available and will be incorporated; a spread-sheet based monitoring system will be prepared) (see Annex II). It was agreed that the revised plan</li> </ul>	<ul style="list-style-type: none"> <li><b>Met, conditional on further adjustments by end-March 2010.</b></li> </ul>

			will be adopted by the DABS Board within that timeframe.	
C2.	<b>Roll-out of the Central Business Registry to provinces:</b> A pilot Central Business Registry will be launched in Jalalabad.	<ul style="list-style-type: none"> <li>The Ministry of Commerce and Industry will confirm in a formal letter the opening of the Central Business Registry in Jalalabad.</li> </ul>	<ul style="list-style-type: none"> <li><b>Evidence received.</b> A letter from the Minister of Commerce confirms the establishment of the CBR in Jalalabad. USAID confirmed CPR establishment.</li> </ul>	<ul style="list-style-type: none"> <li><b>Met.</b></li> </ul>
C3.	<b>Improvement of the regulatory framework and transparency in the mining sector:</b> (i) The Minerals Law and the revised Hydrocarbon Law (Petroleum Law) are enacted through gazetting; and (ii) A fully-costed and timed action plan for EITI implementation is endorsed by a multi-stakeholder working group and submitted to the EITI secretariat.	<ul style="list-style-type: none"> <li>The government will provide the World Bank with the Gazettes of the Minerals Law and the revised Hydrocarbon Law.</li> <li>The government will provide the World Bank with a copy of the submission letter to the EITI secretariat, including the endorsed action plan of the multi-stakeholder working group. The World Bank Mining Team will work closely with the government and provide advice as needed.</li> </ul>	<ul style="list-style-type: none"> <li><b>Evidence received.</b> Gazettes are transmitted in hard-copy to the World Bank (plus scanned cover-page of Gazette).</li> <li><b>Evidence received.</b> A copy of the official application letter of Afghanistan for becoming an EITI candidacy country sent to the EITI secretariat in Oslo with all candidacy requirements / evidence attached (action plan and budget adopted by the informal multi-stakeholder group, including minutes of the meeting on November 17, 2009). <i>Feedback from the EITI Secretariat is expected.</i></li> </ul>	<ul style="list-style-type: none"> <li><b>Met.</b></li> </ul>

- a. Theme A is complemented by the automatic quantitative revenue scheme in SY1388. The quantitative scheme is based on SY1388 revenue performance, according to the previously agreed schedule.
- b. This will lead to a regularly monitored set of performance indicators used as: (1) a management tool, (2) a basis for comparisons, and (3) a way of measuring productivity gains, which will also provide a better basis for customs resource discussions and decisions.
- c. The report will be listed by customs station, for some locations there is combined reporting.
- d. The number of non-compliant companies (those who have not filed a required return) in both MTO and LTO reached 680 at the beginning of 1388. The Government will work with all companies, but expects to achieve the largest increase with restaurants, airlines and wedding halls.

## Annex I

### *Recommendations to strengthen the asset declaration implementation strategy*

The revised draft asset declaration implementation strategy has been received and commented on, but the World Bank notes that the strategy still remains relatively weak in the area of **public disclosure**. In particular, there is concern about possible delays in the public disclosure of assets.

Compared to earlier versions the draft strategy has been changed and says now that after declarations are received and *examined* by the HOO then it will disclose the information. It is suggested that the strategy will be further clarified to include:

- (i) A description of the examination process conducted by HOO; and
- (ii) The timeframe for the examination process, starting from the time of receipt of the asset declaration (e.g. the HOO will publicly disclose the information within 1 month of receiving a declaration).

Looking ahead, the strategy should include a clear vision and commitment to make the HOO independent and able to enforce the asset declaration scheme. This requires also greater clarity on the assignment of sanction power to the HOO (including, sanctions applying to the failure to submit a required asset registration form and the submission of a false or misleading declaration). It was understood that this could not be addressed yet, given that the strategy is based on the current legal framework, which would need to be adapted. The HOO role and status as an independent agency with more implementation power will be addressed during the revision of the Anti-corruption Law, currently under discussion.

## Annex II

### *Further expectation for the revision of the plan on reducing losses at DABS*

The plan prepared by the DABS team for reduction of commercial and technical losses is well drafted and sets out the basic framework for implementation on the ground. However, it does not meet yet all benchmark requirements and it is suggested that DABS considers the following comments **for a revised plan – to be prepared until end-March 2010**. It is expected that this revised action plan will be approved by the DABS Board and **re-submitted to the ARTF Administrator**.

The following new components are expected to be part of the plan:

- a) The timetable and action plan for the establishment of commercial activities and better customer service is still in draft and will need to be finalized and become part of the to be revised plan.
- b) The plan would need to be backed by an Excel based spread sheet, providing recent information and a forecast for the next 5 years. As part of its technical support, the World Bank had provided and helped DABS staff become familiar with an excel based 'Decision Support Tool' to understand the impacts of power procurement deals. This model should help DABS prepare the Excel sheet required for this benchmark. It is recognized that the initial spreadsheet would be based on non-verified data (from erstwhile DABM planning department) and based on information for some of the provinces. However, this would be useful for monitoring the actions planned by DABS and focus on the high impact actions first. This can be updated in the next six months or before, by when better quality information would be available. The DABS team has agreed with the World Bank to provide the spreadsheet model.
- c) It is also suggested that the plan may include the following measures, which would require small scale investments, but would help meet the objectives of this benchmark:
  - i) Formulation and implementation of a plan to increase absorption of NEPS power in the Kabul system, with clear defined quarterly targets.
  - ii) Formulation and implementation of a plan to maximize use of hydro resources and minimize use of diesel plants. This would require a well prepared model for forecast of water inflows under different scenarios and the optimization of water use and available storage capacity at Naghlu vis a vis expansive diesel plant operation.
  - iii) Identify over-loaded feeders (substation and Junction stations) in Kabul and Mazar and implement measures for load balancing, with quarterly targets.
- d) The loss reduction forecast need to be revised by using energy (MWh) as a basis rather than demand (MW).
- e) It is suggested that DABS identifies a team to implement the plan with clear responsibilities for specific tasks and also create a monitoring system to review and report on progress. The World Bank team stands ready to review the template for monitoring of the intermediate and final outcome indicators.