
AFGHANISTAN RECONSTRUCTION TRUST FUND

ARTF INCENTIVE PROGRAM SY1390 (2011/12)

ADMINISTRATOR'S TECHNICAL REVIEW: STRUCTURAL BENCHMARKS AND PRE-CONDITIONS

JUNE 16, 2011

Preamble

1. In December, 2008, ARTF Donors agreed with the Government of Afghanistan (GoIRA) to establish the ARTF Incentive Program (IP) 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. Throughout this document, the SY1390 ARTF Incentive Program relates to a program of reforms that are carried out during SY1389 but for which ARTF incentives are available in the SY1390 budget.
2. The Incentive program offers incentive funds to top-up the ARTF RC Window baseline financing for SY1390 in the amount of US\$70 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).
3. Following a series of working group discussions with donors, the Ministry of Finance and the World Bank, as Administrator on behalf of the Donors, signed the Memorandum of Understanding (MoU) on June 12, 2010. The MoU included the SY1390 benchmarks and the review protocol.
4. The supporting evidence for the fulfillment of the structural reform benchmarks were, as stipulated by the MoU, delivered to the World Bank by November 30, 2010. First technical review meetings were held on December 6 and 15, 2010. Due to shortcomings in meeting the requirements of all benchmarks, in particular benchmark B1 (i.) related to the audit law and the precondition related to the cooperation with the IMF, the final technical review was postponed to March 15, 2011.
5. The technical review has been undertaken by the World Bank as Administrator, with collaboration of sector experts from the ARTF IP donor working group. Part I of this Technical Review describes in detail the assessment for the SY1390 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 disbursement of Incentive Fund allocation for SY1390.

I. Performance Assessment against SY1390 Benchmarks and Preconditions

6. This review provides the performance assessment against the SY1390 structural benchmarks and pre-conditions of the ARTF Incentive Program only. Structural reforms for the SY1390 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.

7. All verification material to demonstrate the fulfillment of structural benchmarks was submitted by the Government, as per revised 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. Consultations were held with relevant line ministries/agencies and the Working Group of donors. Line agencies involved included the Ministry of Finance, 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).

8. **Theme A – Enhancing Domestic Revenue:** The Administrator’s Technical Review assesses that, based on the evidence received; the Government of Afghanistan met all SY1390 ARTF structural benchmarks related to *customs reform* as well as *improvements in the revenue administration* (see table 1 below). Reforms in both areas have since continued to show good progress.

9. **Theme B – Improved Public Sector Governance:** Reforms related to *corruption control mechanisms* (asset verification) and *civil service administration* (pay & grading reform) have also been achieved as agreed by the benchmarks. In both areas, quantitative targets were over-achieved. Reforms can be expected to proceed further without large risk of backsliding. However, technical capacity constraints, especially within the HoO, might limit the depth of further progress. The next step for HoO would be to move from administrative to more substantive asset declaration verification. CSC continues to be responsive in addressing issues with regard to transparency in the recruitment process.

10. Progress can also be noted in improving *public and financial management standards*. The authorities have initiated internal audits in four line Ministries and have, meanwhile, continued with their implementation.

11. The second element in this area [B1(i)] relates to the cabinet approval of an audit law that meets international standards. This benchmark was formulated in a way that required Afghanistan to meet all eight principles of the INTOSAI Mexico Declaration. INTOSAI, however, acknowledges in the preamble to the Mexico declaration that in no country do “supreme audit institutions currently meet all of the application provisions”. It is therefore recognized that there is a large variation in audit legislation and practices across countries with respect to the application of the eight principles.

12. In this light, the Administrator and members of the ARTF IP working group asked a number of outside experts to examine the Afghan audit law for compliance with the INTSOAI standards (see annex 1). The views of the experts were not unanimous and the judgment is not a clear-cut one. The audit law is responsive to international standards, but does not demonstrate full compliance with all of the eight principles. At the same time, the draft law represents a tremendous improvement in (a) the existing legal framework for external audits which dates back to 1995 and (b) moving towards greater independence of the supreme audit institution. In particular, in comparison to the existing legislation, the draft audit law marks significant progress in the following areas:

- The law no longer requires the CAO to run its operations according to Sharia Law
- The law provides a requirement that independent audit reports are published
- The CAO is no longer responsible for control of government operations.

- The law establishes the CAO as an independent body to work on any area of its determination and from a position which is protected from removal by the executive.
- The law removes from the CAO's duties the control of manufactures' processes under the public sector and the implementation of quality improvement plans.
- There is a commitment for the CAO to carry out its work in line with a recognized set of audit standards (INTOSAI).
- The law gives the CAO the right to establish regional units in the provinces.
- The law removes contradicting provisions with the Public Finance and Expenditure Management Law respecting internal audit.
- The responsibility for and oversight of the internal audit function has been removed from the CAO's responsibilities and duties.
- The law requires the CAO's own operations be audited by an independent body.

13. The audit law, approved by cabinet on March 7, 2011, also includes two critical recommendations by the Administrator to a previous draft on the independence of the national audit office:

- The tenure of the Auditor General is increased from 3 to 6 years thereby introducing a period with exceeds that of the presidential period.
- Reports by the Auditor General will go directly to the Lower House of Parliament, in addition to the President.

14. The technical review found, in the areas where application of the eight principles of the INTOSAI Mexico Declaration fell short, that Government should work to improve the following going forward:

- Principle 1 – The position of the Auditor General and/or the audit institution is not fully protected in the Afghan Constitution. Any future amendment of the Constitution could consider including constitutional independence for the Auditor General.
- Principle 2 – The appointment process for the Auditor General should have greater independence from the Executive. This could, for instance, be ensured through use by the President of an independent advisory committee to screen candidates or an approval process in the legislature. Term of Auditor General for six years could be lengthened, particularly as there is no possibility of a second term.
- Principle 6 – The freedom of the SAI to publish and disseminate its audit reports has the condition that it should be after the President's office evaluates them and the lower house discusses them rather than when the report is delivered or tabled. The procedures by which these actions occur could, in practice, lead to unreasonable delays in publication and the rules under Article 9 (4) would need to prevent this.
- Principle 7 - More explicit provision for follow-up mechanisms would enhance the SAI capacity to obtain feedback and action of their recommendations.
- Principle 8 – Under the draft law the SAI prepares its own budget which is submitted to the Council of Ministers 'through the national budget'. This could open the SAI to possible interference in fulfillment of its mandate through undue constraint on its resources. However, the Auditor General is free to use the annual national audit report required under Article 9 of

the law to report to the legislature any inadequacies in the budget provision which provides recourse, in practice, beyond the executive.

15. The next Incentive Program also offers the possibility to improve on some of the weaknesses in the law in its application to the audit function. The Government has committed to continue working with the Administrator and the ARTF IP working group to overcome the weaknesses pertaining to external and internal auditing functions and institutions. This should include: (i) the publication of all CAO reports within a minimum time after submission to parliament and (ii) audit reports should contain details on the follow-up by the audited organizations.

16. **Theme C – Private Sector Development:** All benchmarks under this theme (functioning and efficient management of the corporatized power utility DABS) have been met. A DAB over-achieved the targets set out by the benchmark and continues to effectively pursue corporate objectives related to loss reduction and revenue generation. It continues improving customer care. Challenges in fully assuming corporate roles and functions continue to lie in the division of responsibilities between the Ministry of Energy and DABS.

17. The Ministry of Mines showed strong commitment to increasing transparency in the mining industry. Summaries of all mining contracts were published on the website. In a press release the Ministry of mines also committed to ensuring transparency in the mining industry in the future.

18. **Revenue Matching Grant Scheme:** Based on the calibrated schedule, the Revenue Matching Grant scheme provides incentive funds upon meeting the IMF revenue target for SY1389. The full value of the allocation for the Revenue Matching grant scheme is only available if the Government achieves 99% or more of the revenue target. In SY1389, the Ministry of Finance collected a total of Afs 77.5 billion and exceeded the target (Afs 75.3 billion) at a target rate of 103%.

19. **Pre-conditions:** the MoU specifies eligibility for the ARTF Incentive Program with

- maintained commitment by Government to quality standards of public expenditure auditing, and
- maintained commitment by Government to the agreed macro-fiscal framework, evidenced by staying on track with the overall IMF Poverty Reduction and Growth Facility – PRGF (now: Extended Credit Facility – ECF)

While the first pre-condition has been met, the PRGF/ECF was considered formally off-track at the time of the technical review.

II. Recommendations for Disbursement

20. The Administrator's Technical Review concludes that:

- based on the evidence received, the Government of Afghanistan met all SY1390 ARTF structural benchmarks with the exception of sub-benchmark B1(i) as set out above;

- The precondition related to an active engagement in an IMF-supported adjustment facility was not fulfilled by the time of the technical review.
21. In a meeting on March 15, ARTF donors agreed that the time of the technical review would be postponed to June 11, one year from the signing of the MoU, in order to give GoIRA more time to agree on a new IMF-supported ECF. This would be evidenced by the signing of a Memorandum of Economic and Financial Policies (MEFP) between the GoIRA and the IMF. However, this deadline passed without conclusion of an agreement on an MEFP.
 22. The Administrator's Technical Review, therefore, will make no recommendations regarding the disbursement of funds under the Incentive Program to the ARTF Management Committee on grounds of non-observance of the program's precondition.

SY1390 Structural Reform Matrix with Progress Assessment

Theme A: Enhancing Domestic Revenue Generation ^a				
	Benchmarks	Monitoring and Evaluation	Evidence Status	Assessment
A1.	<p>Customs reforms: (i) implementation of a pilot ASYCUDA valuation module for 200 revenue earning commodities, and (ii.) establishing automation of the Exemption Process in the Afghan Customs Department (ACD) Head Quarters.</p>	<ul style="list-style-type: none"> The MoF/ACD will track the implementation of the pilot ASYCUDA valuation module. It will provide the Administrator with a progress report on the implementation and confirm the list of 200 items for which it becomes operational The MOF/ACD will track progress on the automation of the Exemption Process and inform the Administrator of it. The ACD will confirm to the Administrator the finalization of the automation of the Exemption Process in the ACD HQ. 	<ul style="list-style-type: none"> Evidence received: ACD submitted (i.) a list of 200 items which will be included into the pilot, (ii.) the user manual for the new valuation module, (iii.) a screen shot of the valuation control window in the ASYCUDA system, (iv.) a screen shots for the loaded HS codes (TARRIC) with full commercial description of goods (incl. values), v) as well as a screen shot of a customs declaration which confirm the validity check. In lieu of a progress report, the ACD team gave a presentation at the technical review meeting on December 6. Evidence received: ACD demonstrated the ACYUDA exemption module, which was loaded at the computers at ACD HQ, to the World Bank team. ACD also submitted an example of an exemption certificate issued by the system as well as a screen shot from the online exemption form. However, it was decided that the system will not be used until the automation process has at least linked the applicants to the web-based system as the procedure would otherwise require scanning and loading of all documents at ACD HQ. Considering the volume of new applications each day, this would greatly hinder the efficiency of ACD. ACD provided a signed copy of the purchase order for user licenses to demonstrate further progress on the automation process. 	Met
A2.	<p>Improving governance in revenue administration: (i) establishing a functional Post Audit Unit in the Afghan Revenue Department (ARD) legal office to improve</p>	<ul style="list-style-type: none"> The MOF/ARD will certify the establishment of a functional Post Audit Unit by providing evidence to the Administrator on staffing, resource / funding allocations, and evidence of 	<ul style="list-style-type: none"> Evidence received: ARD submitted (i.) a proposal for the establishment of the post-audit unit including information staffing and funding allocation (unit manual) , (ii.) a letter by the CSC which approves to extend the function of the 	Met

	quality control of audit processes, and (ii) establishing and implementation of the direct and exclusive reporting of Medium Taxpayer Offices in the Provinces of Herat and Balkh to ARD HQ.	<p>functioning business. A list of first audits to be undertaken will be provided, as selected by the selection committee.</p> <ul style="list-style-type: none"> The MOF will provide the Administrator with a decree/ordinance/circular which establishes the new reporting regime. It will also provide evidence for publication of this instrument (e.g. on the MOF web-page). The MOF will provide the Administrator with samples of initial reports. If electronically done, it reserves the right for physical inspection to get first-hand confirmation of the reporting system. 	<p>existing Compliance Inspection Unit according to the proposal, as well as (iii) a list of the activity schedule for the post audit unit including a list of companies selected for post audit on the basis of the agreed procedures and criteria for the unit. The administrator verifies that the unit is functioning in relation to these selected companies and this activity schedule.</p> <ul style="list-style-type: none"> Evidence received: ARD submitted (i.) a letter by CSC which confirms the appointment of the MTO Director in Kabul and confirmed the postholder's responsibilities, and (ii.) a report including monthly revenue reporting from Herat and Balkh broken down by revenue types 	
Theme B: Improved Public Sector Governance				
	Benchmarks	Monitoring and Evaluation		
B1.	<p>Improving Public Financial Management and Fiduciary Standards: (i) Cabinet approval of an Audit Law in line with international auditing standards (and consistent with Article 61 of the PFEM Law that gives MoF purview over Internal Audit) clarifying the role of CAO as an independent external audit agency both in mandate and reporting, and (ii) start implementing the Internal Audit Action plan by providing inception reports for an audit in 4 line ministries, on the basis of a risk analysis across</p>	<ul style="list-style-type: none"> The Authorities will provide the Administrator with the Audit Law as approved by Cabinet and the Cabinet minutes, confirming the approval. The World Bank will review the Law and determine if it fulfills international standards, i.e. if it is in accordance with the Declaration of 8 principles for Supreme Audit Institutions by INTOSAI. The Authorities will provide the four inception reports for the audits in the Ministry of Public Health, Ministry of Transport and Civil Aviation, Ministry of Rural Development, Ministry of Energy and Water. The World Bank 	<ul style="list-style-type: none"> Evidence received: The authorities submitted the draft audit law as well as minutes of the cabinet meeting which confirm the approval of the draft. A detailed review of compliance with this benchmark is provided in annex1. Evidence received: All four inception reports were received in English and positively reviewed for compliance. 	<p>See assessment in paragraphs 10-16 above and annex 1</p>

	Government.	team will work closely with the Authorities on the initiation of the implementation of the Internal Audit Action plan.		
B2.	Progress in asset declaration implementation: (i) roll-out of asset declarations with at least 20 (out of the total 34) provincial governors submitting their asset declarations to the HOO; and (ii) the implementation of the first phase of the verification process, i.e. the administrative review (also referred to as the preliminary verification ^b of in-country assets) of the asset declaration of 5 Cabinet ministers and 12 senior officials.	<ul style="list-style-type: none"> The HOO confirms in a formal signed statement to the Administrator the number of provincial governors who provided an asset declaration by November 30, 2010, and it will also provide list of the respective provincial governors to the Administrator. The HOO will provide the Administrator with evidence of all steps in the preliminary verification process (as defined in the footnote) and will notify the Administrator of all cases of misinformation/false information. 	<ul style="list-style-type: none"> Evidence received: HOO submitted a formal letter HOO with a list of 20 provincial governors who have provided an asset declaration to the HOO by 30 November, 2010 as well as a brief summary of preliminary review. Evidence received: HOO provided the Administrator with a tabulated preliminary verification report of the administrative verification of 5 Cabinet ministers and 12 senior officials. The Administrator conducted a site visit to confirm existence of case files on 5 Cabinet ministers and 12 senior officials. 3 cabinet Minister and 2 senior official case files were selected for more in depth review. The review process clearly established that a) files were in order b) contained completed declaration forms and correspondence between HOO and individuals concerned seeking clarification on various issues raised in preliminary verification of the forms, and c) that preliminary income/ wealth analysis based on submitted forms had been carried out. The declarations have been completed and were published in government newspaper. 	Met
B3.	Implementing the P&G reform and improving merit-based appointments: (i) completion of the re-grading phase in 5 ministries/agencies: Ministry of Labor, Social Affairs, Martyrs and Disabled; Ministry of Parliamentary Affairs; IDLG,	<ul style="list-style-type: none"> The Independent Administrative Reform and Civil Service Commission (IARCSC) will deliver to the Administrator an implementation report on the progress of re-grading in the 5 ministries. The IARCSC will work closely with the World Bank Public 	<ul style="list-style-type: none"> Evidence received: CSC submitted a report on the progress of the re-grading (in Dari with English summary). Progress made until Nov 30: <ul style="list-style-type: none"> MoPAs: 133 positions re-graded. President approval obtained. MoTCA: 2092 positions re-graded. President 	Met

	<p>Ministry of Higher Education; Ministry of Transport and Civil Aviation, (ii) develop and approve simplified procedure for the recruitment of senior civil servants (i.e. grades 1 and 2) that increase transparency, fairness and openness in the appointment process (including vetting, short-listing, interviewing and selection procedures), and (iii) develop and pilot a mechanism to observe and provide external scrutiny to senior appointment panels by having an independent resource person from universities and civil society sit on a sample of 20 senior appointments during the reporting period and a final approval of the mechanism by the Chairman of the Commission.</p>	<p>Administration Reform Team during the preparation of the report. The IARCSC will confirm the completion of the re-grading process in the 5 ministries to the Administrator.</p> <ul style="list-style-type: none"> • The IARCSC will provide the Administrator with a copy of the simplified procedures and the approval letter by the Chairman of the Commission. • The IARCSC will provide the Administrator with a report on the pilot, plus the new annex describing the mechanism added to the recruitment procedure as approved by the Chairman of the Commission. 	<p>approval obtained.</p> <ul style="list-style-type: none"> – IDLG: 6802 positions plus 13439 provincial & district municipality positions re-graded. President approval obtained. – MoLSAMD: 7235 positions re-graded. President approval obtained. – MoHE: 240 positions re-graded. President approval obtained. <ul style="list-style-type: none"> • Evidence received: (i.) CSC submitted a copy of the simplified procedure for the recruitment of senior civil servants (in Dari), (ii.) an accompanying approval letter by the Chairman of CSC , as well as (iii.) a summary of the changes to the recruitment procedure which substantiates that the new process is simplified, more transparent, fair and open. • Evidence received: CSC submitted a report (in English) on the pilot of the new recruitment mechanism. The annex to this report clearly describes the new procedure which allows the participation of independent resource persons from the Civil Society. <p>The new procedure was applied in the recruitment of district governor positions in August, 2010. Four external resource persons observed the recruitment of 33 governors (written tests and interview panels).</p>	
Theme C. Enabling Private Sector Development				
	<p>Benchmarks</p> <p>Progress towards establishing DABS as a functioning and efficient power utility: (i)</p>	<p>Monitoring and Evaluation</p> <ul style="list-style-type: none"> • The DABS management will confirm to the Administrator the 	<ul style="list-style-type: none"> • Evidence received: DABS confirmed the construction of 3 Customer Care Center’s in Deh 	<p>Met</p>

	<p>improving customer care by (a) establishing 3 fully functional Customer Care Centers (CCCs) (from baseline 1), and (b) shifting 180,000 Kabul Electricity Directorate (KED) customers from manual to a computerized billing system (from baseline 41,500 at end of billing cycle 4 in 1388), and (ii) improving key indicators for measuring loss reduction and revenue generation: (a) revenue from billed energy in Afs (from baseline of a cumulative total of Afs 1.504 billion for the first six months of the year 1388 to target 1.15 *baseline for the first 6 months of year 1389), and (b) cash realized per kWh energy supplied (i.e., cash collected/total energy input to the system) (from a baseline 2.557Afs/kWh using cumulative data for the first six months of the year 1388 to target: 1.10*baseline using cumulative data for the first six months of the year 1389.</p>	<p>establishment of the 3 CCCs and will provide evidence of functioning business. The DABS Board will provide and confirm evidence for a computerized billing system functioning for 180,000 KED customers. The Administrator will review submitted evidence with input from the World Bank Power Team.</p> <ul style="list-style-type: none"> The DABS management will confirm and publish key indicators for measuring loss performance (as stated in the benchmark). The Administrator will review submitted evidence with input from the World Bank Power Team. 	<p>Mazang, Taimany and Chimtala and the administrator verified the functioning of two CCCs (Mazang and Taimany). Information on the functioning of the CCC Chimtala has been provided. The CCCs are catering to the needs of about 200, 150 and 100 customers daily. The CCC at Khairkhana is partially functional in make-shift arrangements (due to the non completion of civil works, but the building is now almost complete and the CCC will is expected to be formally inaugurated around mid-December). DABS confirmed that over 215,000 customers have been shifted from manual to computerized billing. administrator visited the bill computerization section at DABS headquarters and seen the bill computerization work in progress.</p> <ul style="list-style-type: none"> Evidence received: DABS submitted a detailed table with key indicators which show that the quantitative targets for loss reduction and revenue generation were met. The administrator confirmed the achievement of the targets: The revenue billed has reached Afs 1.744 billion (from a baseline of a cumulative total of Afs 1.504 billion for the first six months of the year 1388), which is 1.16 times the baseline number (against the target of 1.15 times of the baseline number), hence, the target has been exceeded. 	
C2.	<p>Increasing transparency in the mining industry: (i) publishing the executive summary of the Aynak contract and the public announcement to commit to publish at least the executive</p>	<ul style="list-style-type: none"> The Administrator will verify the publication and posting of the executive summary of the Aynak contract on the Ministry of Mines (MOM) web-page. The Authorities will provide the Administrator with a 	<ul style="list-style-type: none"> Evidence received: the Administrator confirms that a summary of the signed Aynak contract is published at the MoM webpage. In lieu of the summary of the Hanyak contract which has not been finalized by Nov 30, 2010, the MoM published a news release which indicates a 	Met

	<p>summary for the forthcoming Hajigak contract, and (ii) publishing the results of the review of 8 existing small-to-medium scale mining contracts.</p>	<p>copy of the announcement of the commitment to publish at least the executive summary for the forthcoming Hajigak contract. The Administrator will verify the publication of that announcement on the MoM web-page and will be provided with a copy of the press release.</p> <ul style="list-style-type: none"> The results of the review of 8 mining contracts by the government will be posted on the MOM web-page. The Administrator will verify the posting. 	<p>continued commitment to transparency through the publication of mining contracts.</p> <ul style="list-style-type: none"> Evidence received: the results of the review of 8 mining contracts by the government were posted on the website. The Administrator confirms the publication. 	
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- 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. Definition of administrative/preliminary verification:
 - Upon submission, the asset form is reviewed by a unit within the Asset Declaration Department at HOO. The review includes the following: - examining the form (checking for signatures, initials, family members list, blank areas, contact info, etc),
 - cross-checking the information on each column (assets, references, document/licenses numbers, sources of assets),
 - corrections and clarifications (this will include having the public official go through the form for corrections/mistakes and re-submit,
 - analysis of the declared wealth e.g. comparison of income against wealth,

In case of identification of mis-information/false information after the review and delays in responses by the public official, the public official will be formally notified e.g. by an official letter from HOO

ANNEX 1: REVIEW OF AUDIT LAW (BENCHMARK B1)

Introduction

This is a technical review of the ARTF Incentive Program benchmark B1 (i.) “Improving Public Financial Management and Fiduciary Standards” which requires an Afghanistan Supreme Audit Institution Law approved by Cabinet. The benchmark demands that this law is consistent with Art 61 of the PFEM law and clarifies the role of CAO as an independent external audit agency in mandate and reporting assessed against the principles of independence contained in the “Mexico Declaration on SAI Independence” given in the International Standard of Supreme Audit Institutions (ISSAI) No 10. In ISSAI 10 eight core principles are recognized, which derive from the Lima Declaration of Guidelines on Auditing Precepts and decisions made at the XVIIth Congress of INTOSAI (in Seoul, Korea), as essential requirements of proper public sector auditing. ISSAI 11 “INTOSAI Guidelines and Good Practices Related to SAI Independence” provides a source of examples of good practices for implementation of the principles.

Evaluation

A draft audit law was approved by Cabinet on March 7, 2011 and submitted to the World Bank in relation to the benchmark. The table below presents the review by two external advisors against ISSAI 10, principle by principle. This technical review indicates that the new law represents an enormous improvement for the legal framework of the external review process in that: i) it clarifies the role of the CAO as an independent review function with no oversight or responsibility for internal audit which thus resolves the overlap with the Ministry of Finance internal audit’s duties and opens the way for the application of Article 61 of the Public Finance and Expenditure Management Law and ii) the law establishes independence both in mandate and reporting for the CAO.

However, the assessment concludes that the draft falls short of meeting all principles set out in ISSAI 10; residual issues on the application of the principles include:

- Principle 1 – The position of the Auditor General and/or the audit institution is not fully protected in the Afghan Constitution. Any future amendment of the Constitution could consider including constitutional independence for the Auditor General.
- Principle 2 – The appointment process for the Auditor General should have greater independence from the Executive. This could, for instance, be ensured through use by the President of an independent advisory committee to screen candidates or an approval process in the legislature. Term of Auditor General for six years could be lengthened, particularly as there is no possibility of a second term.
- Principle 6 – The freedom of the SAI to publish and disseminate its audit reports has the condition that it should be after the President’s office evaluates them and the lower house discusses them rather than when the report is delivered or tabled. The procedures by which these actions occur could, in practice, lead to unreasonable delays in publication and the rules under Article 9 (4) would need to prevent this.
- Principle 7 - More explicit provision for follow-up mechanisms would enhance the SAI capacity to obtain feedback and action of their recommendations.
- Principle 8 – Under the draft law the SAI prepares its own budget which is submitted to the Council of Ministers ‘through the national budget’. This could open the SAI to possible interference in fulfillment of its mandate through undue constraint on its resources. However, the Auditor General is free to use the annual national audit report required under Article 9 of

the law to report to the legislature any inadequacies in the budget provision which provides recourse, in practice, beyond the executive.

Table 1: Original Text of Benchmark in ARTF IP 1390 MoU

Benchmark	<ul style="list-style-type: none"> Monitoring and Evaluation
<p>Improving Public Financial Management and Fiduciary Standards: (i) Cabinet approval of an Audit Law in line with international auditing standards (and consistent with Article 61 of the PFEM Law that gives MoF purview over Internal Audit) clarifying the role of CAO as an independent external audit agency both in mandate and reporting</p>	<ul style="list-style-type: none"> The Authorities will provide the Administrator with the Audit Law as approved by Cabinet and the Cabinet minutes, confirming the approval. The World Bank will review the Law and determine if it fulfills international standards, i.e. if it is in accordance with the Declaration of 8 principles for Supreme Audit Institutions by INTOSAI.

Detailed Assessment by Principle			
	CV of Assessor	CV of Assessor	
	<p>Michael J. Jacobs Fellow, CPA Australia Bachelor of Science (Mathematics and Physics)University of Southampton, UK; Master of Science (Operations Research) London School of Economics; Graduate Diploma Economics) Australian National University; Graduate Diploma (Administration) University of Canberra Deputy Auditor General, Australian National Audit Office Auditor General, Fiji</p>	<p>Phil Duncombe Diploma in Auditing and Accounting – City of London Polytechnic, London, UK Bachelor of Arts – University of Essex PKF - Associate, Sigma, OECD; Audit Expert. National Audit Office , UK; Audit Director</p>	
ISSAI Principle	Assessment By Jacobs	Assessment by Duncombe	Notes
<p>Principle 1 The existence of an appropriate and effective constitutional/statutory/legal framework and of de facto application provisions of this framework. Legislation that spells out, in detail, the extent of SAI independence is</p>	<p>Section 5 of the Lima Declaration on which this principle is based states that the establishment of Supreme Audit Institutions and the necessary degree of their independence shall be laid down in the Constitution; and</p>	<p>The Constitution and the adoption of this Law will comply with Principle 1. The reference in the Constitution is not ideal, but it will provide a sufficient basis for the NAO until such time as the</p>	<p>Draft law supports good practices of Principle 1.</p>

<p>required.</p>	<p>details may be set out in legislation. Three pieces of Afghan legislation are relevant – the Constitution, the Public Finance and Expenditure Management Law, and the SAI Law.</p> <p>The Constitution of Afghanistan Year 1382 (2003) does not contain any reference to the SAI and a future amendment should be made to remedy this. In the interim the other laws provide for independence.</p> <ol style="list-style-type: none"> 1. Article 59 of the Public Finance and Expenditure Management Law provides some requirements for independent audit reporting on the Government’s annual financial statements but does not specify the Auditor General although in practice the CAO has done the work to date. Article 12 of the Afghanistan Supreme Audit Institution Law clarifies this through requiring the Auditor General to provide this reporting. The PFEM Law provisions will then directly apply to the Auditor General. 2. The draft Afghanistan Supreme Audit Institution Law establishes the SAI as the highest authority to inspect financial and accounting activities of agencies specified in Article (5) of the law (this article covers all 	<p>Constitution is amended so that a proper reference to the AG or the NAO can be included.</p>	
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	<p>entities using public funds) and requires that the SAI shall act in an independent, responsible and impartial manner.</p> <p>3. The legislation will comply with Principle 1 apart from any deficiencies set out below for the other principles.</p>		
<p>Principle 2</p> <p>'The independence of SAI heads and members (of collegial institutions), including security of tenure and legal immunity in the normal discharge of their duties. The applicable legislation specifies the conditions for appointments, re-appointments, employment, removal and retirement of the head of SAI and members of collegial institutions, who are:</p> <ul style="list-style-type: none"> • appointed, re-appointed, or removed by a process that ensures their independence from the Executive (see ISSAI-11 Guidelines and Good Practices Related to SAI Independence); • given appointments with sufficiently long and fixed terms, to allow them to carry out their mandates without fear of retaliation; and • immune to any prosecution for any act, past or present, that results from the normal discharge of their duties as the case may be.' 	<p>Under Article. 7, the Auditor General is appointed by the President subject to meeting specified personal characteristics To ensure an independent appointment process ISSAI 11 recommends good practices as approval by the legislature or use of an advisory committee to screen candidates.</p> <p>Security of tenure and immunity are covered by Articles 7, 8 and 22 of the law - tenure is for six years, dismissal conditions are specified, and the reasons for which auditors may be prosecuted are specified.</p>	<p>Under Article 7, the AG is appointed solely by the President, therefore the process is not independent of the Executive; the involvement of the Parliament (the Legislature) is normally considered the most appropriate appointment process.</p> <p>Tenure of AG is for six years (Article7), which is only just acceptable. A longer period would be preferable – nine years. There is no requirement regarding a second term. If a six-year term is adopted, without a possibility of a second term, this would unnecessarily limit the experience of an AG in post.</p>	<p>Section 6 of the Lima Declaration, which the basis for the Principles, states that independence of the SAI is inseparably linked to the independence of its members.</p> <p>The appointment of the Head of the SAI in the draft law is by President so his appointment is not independent of the executive. However, since procedures for his removal from office are embodied in the law and since his tenure is 6 years and the Presidential period is 4 then over the mid-term there will</p>

			be a head of the SAI who is not appointed by the President.
<p>Principle 3</p> <p>‘A sufficiently broad mandate and full discretion, in the discharge of SAI functions. SAIs should be empowered to audit the:</p> <ul style="list-style-type: none"> • use of public monies, resources, or assets, by a recipient or beneficiary regardless of its legal nature; • collection of revenues owed to the government or public entities; • legality and regularity of government or public entities accounts; • quality of financial management and reporting; and • economy, efficiency, and effectiveness of government or public entities operations. 	<p>Articles. 2, 9 and 11 cover the objectives of the SAI law and the duties and authorities of the SAI and its audit staff in detail. These provisions are wide enough to provide the mandate and discretions required by this principle including economy efficiency and effectiveness</p>	<p>Articles 2, 4 and 5 are not now sufficiently broad to meet Principle 3. The six ‘Objectives’ in the previous draft law (October 2010) were sufficient to meet the requirements of the Standards, but this draft does not include ‘the protection of public assets’ and ‘recognising illegal activities etc’). I regard these three deletions as significantly detracting from the scope of responsibilities of the Audit Office and they need to be re-instated if the requirements of the Standards, as set out above, are to be achieved. The power to undertake ‘performance audits’ (‘economy, efficiency and effectiveness’) is particularly important.</p>	<p>Powers to review for compliance with PFM laws and inspect procurement, utilization of goods and assets to ensure effective utilization in Art 11 certainly support principle 3.</p>
<p>Except when specifically required to do so by legislation, SAIs do not audit government or public entities policy but restrict themselves to the audit of policy implementation. While respecting the laws enacted by the Legislature that apply to them, SAIs are free from direction or interference from the Legislature or the Executive in the:</p> <ul style="list-style-type: none"> • selection of audit issues; • planning, programming, conduct, reporting, and follow-up of their audits; • organization and management of their office; 	<p>Articles 9, 10 and 11 gives the SAI these powers and there are no provisions for the Auditor General to be given direction.</p>		

<p>and</p> <ul style="list-style-type: none"> enforcement of their decisions where the application of sanctions is part of their mandate 			
<p>SAIs should not be involved or be seen to be involved, in any manner, whatsoever, in the management of the organizations that they audit. SAIs should ensure that their personnel do not develop too close a relationship with the entities they audit, so they remain objective and appear objective.</p> <p>SAI should have full discretion in the discharge of their responsibilities, they should cooperate with governments or public entities that strive to improve the use and management of public funds. SAI should use appropriate work and audit standards, and a code of ethics, based on official documents of INTOSAI, International Federation of Accountants, or other recognized standard-setting bodies.</p> <p>SAIs should submit an annual activity report to the Legislature and to other state bodies— as required by the constitution, statutes, or legislation—which they should make available to the public’.</p>	<p>These matters are covered in the law. Article 11 requires auditors to be impartial and responsible in their work. Article 14 prohibits the involvement of auditors in audits where they may have close relationships. Article 10 gives the Auditor General leadership and control of the SAI and its audit staff. Article 9 provides that the SAI follow INTOSAI standards and develop rules for implementation of the SAI Law. Article 1 provides for reporting to the President and the lower house of the Assembly on SAI activities and Article 18 provides for independent audit of the SAI itself in accordance with INTOSAI standards.</p>	<p>Article 14 prohibits AG and NAO staff from having any relationship with entities that they audit. Although not specifically covered by an Article, the AG it is implicit that the AG has ‘discretion in the discharge of his responsibilities’. Also NAO are required ‘to comply with the audit executive standards approved by INTOSAI, considering the provisions of this law’ (Art 9.4). I consider this to be acceptable. Article 11 requires auditors to be ‘impartial and responsible’ which implies that a Code of Ethics might be appropriate for NAO and the staff. This is acceptable.</p>	
<p>Principle 4 ‘Unrestricted access to information. SAIs should have adequate powers to obtain timely, unfettered, direct, and free access to all the necessary documents and information, for the proper discharge of their statutory responsibilities’</p>	<p>Articles 15 and 21 provide for these powers and their enforcement.</p>	<p>Satisfactorily covered in Article 11, subject to the comments set out regarding Art 14 above.</p>	<p>Draft law supports good practices of Principle 4.</p>

<p>Principle 5 'The right and obligation to report on their work. SAIs should not be restricted from reporting the results of their audit work. They should be required by law to report at least once a year on the results of their audit work.'</p>	<p>These rights and obligations are covered in Articles 9, 10 and 12 which provide for the SAI to produce an annual National Audit Report to be published on the SAI's website, and for the Auditor General to present reports to the President and the lower house of the National Assembly, on the audit of the financial statements of the previous fiscal year and the annual audit of government agencies' revenue and budget expenses.</p>	<p>This requirement is covered in Article 12, although the involvement of the President as described is not desirable. However, Article 12.2 does require the AG to report also to the 'Wolesi Jirga'.</p>	<p>Draft law supports good practices of Principle 5.</p>
<p>Principle 6 The freedom to decide the content and timing of audit reports and to publish and disseminate them. SAIs are free to decide the content of their audit reports. SAIs are free to make observations and recommendations in their audit reports, taking into consideration, as appropriate, the views of the audited entity. Legislation specifies minimum audit reporting requirements of SAIs and, where appropriate, specific matters that should be subject to a formal audit opinion or certificate. SAIs are free to decide on the timing of their audit reports except where specific reporting requirements are prescribed by law. SAIs may accommodate specific requests for investigations or audits by the Legislature, as a whole, or one of its commissions, or the government. <u>SAIs are free to publish and disseminate their reports, once they have been</u></p>	<p>Articles 10, 11, 12 and 19 confer these powers and responsibilities including preparing reports, providing opinions and recommendations to the auditee, identifying financial and accounting violations and those involved, presenting special audit reports upon request, and after evaluation by the president's office and the lower house's discussion, publishing the results of reports in the mass media. This publication arrangement is a more restrictive condition than the Principle uses - once the report has been formally tabled or delivered to the appropriate authority.</p>	<p>Timing of reporting is defined in the law (Article 12). In itself this is acceptable (it is related to the timing of the financial statements), but AG ought to have the power to present reports at times of his own choosing. Also, delay by Ministry of Finance in presenting financial statements for audit, will impact adversely on the ability of the AG to carry out effective audit.</p> <p>This Law is too restrictive at present and, given the close involvement of the President, I am not confident that it complies fully with the spirit of this Principle.</p>	<p>The draft law provides clear freedom to the SAI to decide on content and to some extent timing although publication occurs only after the evaluation by the President and discussion in Parliament per Art 19.</p> <p>Article 59 of the PFEM Law, however, indicates that the audit reports will be submitted to the parliament at the first meeting of this body following due date i.e. 6 months after fiscal year end and that these would be publically</p>

<p>formally tabled or delivered to the appropriate authority—as required by law.</p>			<p>available upon submission to parliament.</p> <p>On the basis of these provisions the CAO is free to publish its reports after these dates. This supports the provisions of principle 6.</p>
<p>Principle 7</p> <p>The existence of effective follow-up mechanisms on SAI recommendations. SAIs submit their reports to the Legislature, one of its commissions, or an auditee’s governing board, as appropriate, for review and follow-up on specific recommendations for corrective action. SAIs have their own internal follow-up system to ensure that the audited entities properly address their observations and recommendations as well as those made by the Legislature, one of its commissions, or the auditee’s governing board, as appropriate. SAIs submit their follow-up reports to the Legislature, one of its commissions, or the auditee’s governing board, as appropriate, for consideration and action, even when SAIs have their own statutory power for follow-up and sanctions.</p>	<p>Various follow-up mechanisms are contained within the law or allowed for through the requirement on the SAI to adopt INTOSAI audit standards. Article 19 deals with evaluation of audit reports by the President’s Office and the Lower House of the Assembly. INTOSAI standards require the SAI to follow up – ‘Reporting Standards’ ISSAI 400, 4.0.26, ‘Compliance Audit Guidelines’ ISSAI 4000 Section 9.2 – and Article 9 requires the SAI to follow these standards. Article 15 requires agencies to assure the SAI about the implementation of audit results within a specified time, and Articles 11, 16 and 17 deal with involving the Attorney General in criminal cases.</p>	<p>There are no provisions for follow-up mechanisms in the Law. There is no requirement for the President and Wolesi Jirga to review and act upon the AG’s Reports. There should be provision for AG to publish independently if no action within a specified time. It will also be important for AG to have legal immunity in such a situation (see Principle 2 above).</p>	<p>While the CAO is not empowered by the law to effect any pressure on auditees to respond to findings there is a commitment to applying INTOSAI (4000 section 9.2) standards which cover follow-up. Similarly, the SAI is free to include a report on action taken in subsequent reports so effectively information on action taken or not taken is published.</p>
<p>Principle 8</p> <p>Financial and managerial/administrative autonomy and the availability of appropriate human,</p>	<p>The law provides for the normal civil service arrangements for budget and staffing. Article 26 requires</p>	<p>Article 26 requires the NAO budget to be submitted to the Council of Ministers ‘through the national</p>	<p>Draft law supports good practices of Principle 8.</p>

<p>material, and monetary resources. SAs should have available necessary and reasonable human, material, and monetary resources—the Executive should not control or direct the access to these resources. SAs manage their own budget and allocate it appropriately. The Legislature or one of its commissions is responsible for ensuring that SAs has the proper resources to fulfil their mandate. SAs have the right of direct appeal to the Legislature if the resources provided are insufficient to allow them to fulfil their mandate</p>	<p>the SAI to prepare its budget and to present it to the Council of Ministers through the national budget for further processing. Article 23 provides for grading of a professional cadre for the SAI and their benefits to be governed by the relevant regulations. This is not inconsistent with the Principle and the distinct professional cadre provides the potential for a high quality service. Under Article 10 the Auditor General leads the Supreme Audit Institution of Afghanistan and designates auditors and authorized persons to conduct financial and accounting inspection of agencies and institutions provided for in the SAI law. The Auditor General is free to use the annual National Audit Report required under Article 9 to report to the legislature any inadequacies in the budget provision.</p>	<p>budget’. Freedom of interference from the Executive is an important principle. It is often difficult to arrange such financial independence for an SAI but, in this case, NAO is only required ‘to prepare its budget independently’ and others in the process may well be able to interfere. This is not acceptable. The involvement of the Legislature ‘to approve the budget of NAO’ would provide some safeguard.</p> <p>Similarly, Article 23 provides ‘professional benefits’ for the AG and staff of NAO. But they ‘shall be governed by the relevant regulations’. These regulations are not defined but this implies that the AG and staff of NAO will remain ‘Civil Servants’ subject to those regulations. It is preferable for AG and NAO to have more flexibility in pay and conditions of service.</p>	
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ANNEX 2: RECOMMENDATIONS TO DABS REGARDING LOSS REDUCTION (BENCHMARK C1)

As outlined in the technical review, DABS has exceeded the revenue targets outlined in the MoU. However, actual cash collected for the same period is 1.464 billion (against Afs 1.744 billed revenue). According to DABS, the difference between the revenue billed and cash collected is due to delays in bill deliveries (earlier the meter readers were preparing bills on the spot at customers' premises, but now bills are prepared in the billing department and delivered to customers, which being a new system for DABS has its delays) and customer payment management (with bills being paid at 70 branches of 4 banks, there are delays in payment reports from the banks to DABS). Hence, the difference between revenue billed and cash collected is due to transition delays to the new billing system.

In addition, disconnection and reconnection procedures are also being developed and DABS is making a concerted effort to collect outstanding dues. DABS also has plans are to procure a more sophisticated billing system (with USAID funding and expected to be in place by June 2011) which will help DABS compile timely reports of customer information and manage billing and collection more effectively.

While the rate of collected revenue does not affect the benchmark, it is recommended that DABS continues its efforts to speed up the recovery of bills and lessen the time between issuance of bills and collection of cash.