AFGHANISTAN RECONSTRUCTION TRUST FUND

ARTF INCENTIVE PROGRAM FY1391-93 (2012-2014)

ADMINISTRATOR'S 5TH TECHNICAL REVIEW

DECEMBER 15, 2014

Preamble

1. The Incentive Program (IP) 1391-1393, part of the Recurrent Cost Window (RCW) of the ARTF, is a three-year operation supporting a series of economic policy reforms deemed critical to achieving Afghanistan's development objectives. The IP supports reforms in the areas of public financial management, investment climate and trade facilitation, governance, and revenue mobilization. The reform program aims to improve Afghanistan's fiscal sustainability by strengthening domestic revenue mobilization and expenditure management and bolstering growth prospects.
2. Financing for the IP is allocated across three complementary facilities: (i) the structural reform facility; (ii) the revenue matching grant facility; and (iii) the operations and maintenance (O&M) facility. Detailed information on each of these facilities, description of the structural benchmarks, and timetables are contained in the Memorandum of Understanding (MoU), along with its annexes 1- 4, originally signed July 12, 2012 and subsequently amended December 9, 2012 and June 1, 2014.

Table 1: Indicative Allocations and Disbursements for the ARTF Incentive Program (US$ million)

	Indicative Allocations			Disbursements to Nov. 2014		
	2012 FY1391	**2013 FY1392**	**2014 FY1393**	**2012 FY1391**	**2013 FY1392**	**2014 FY1393**
Structural Benchmarks	$38	$112	$130	$29	$67	$0
Revenue Matching Grant	$13	$38	$45	$0	$19	$0
O&M Facility		$32	$100		$32	$13
Total - ARTF Incentive Program	**$50**	**$182**	**$275**	**$29**	**$118**	**$13**
Baseline RC Support	$175	$150	$125	$175	$150	$125

Note: Disbursements are listed against the year for which they are disbursed, rather than the year in which they are disbursed

3. The timeline for implementation of the incentive program is July 2012 - end 2014 (i.e., FY1391-1393), although substantive assessments of progress are expected to continue through at least mid-2015. Table 1 shows the indicative allocations for the IP for each year, along with

disbursements through November 2014. It is expected that a new incentive program covering reforms for the period 2015-2017 would be discussed starting in the spring of 2015.

4. The basis for this technical review is the MoU signed on July 12, 2012 (amended on December 9, 2012 and June 1, 2014) by the Ministry of Finance (MoF) and the World Bank (as Administrator). The MoU and its annexes include all the benchmarks and the review protocol. It stipulates that technical reviews of the IP will be held every four months. Each review will report on progress and development of the program, and assess the achievement of actions under the structural reform scheme against the agreed deadlines. To this end, Afghanistan is required to submit all documents evidencing the completion, fulfillment, or achievement of any such actions, goals, or targets at least 10 days prior to the commencement of each scheduled review meeting.

5. This technical review has been undertaken by the World Bank as Administrator, with collaboration of sector experts from ARTF donors. Part I of this review describes progress on revenue mobilization and collection. Part II provides an assessment of progress on the ten FY1393 structural reform benchmarks based on the evidence provided and also reports on the four pending FY1392 benchmarks. Part III assesses progress on the O&M facility. Part IV discusses other disbursement conditions, including the adequacy of the macroeconomic framework. Part V concludes with the recommendation to the ARTF management committee regarding disbursement of the IP.

Part I: Progress on Revenue Mobilization and Collection

6. The Revenue Matching Grant Scheme under the IP provides an incentive for improved performance in revenue mobilization and collection. It is anchored in the annual revenue targets agreed in advance between the Ministry of Finance and the International Monetary Fund (IMF). The amount of the incentive grant payable is determined according to a calibrated scale depending on the percentage of the revenue target agreed with the IMF that is met. If Afghanistan achieves 99% or more of the revenue target, the full amount of the incentive grant is payable. On the other hand, if 90% or less of the target is achieved, no incentive is payable.

7. **Progress toward the FY1393 (2014) revenue target:** The FY1393 domestic revenue target agreed as part of the IMF's ECF program discussions was Afs 128 billion (compared to actual revenues of Afs 109 billion in FY1392). However, due to a greater than anticipated economic slowdown, as well as weaknesses in tax and customs administration, revenues have continued a trend of underperformance in FY1393. In the first 10 months of FY1393, revenues amounted to Afs 79.4 billion, compared to Afs 85.2 billion during the first 10 months of FY1392. Based on this trend, since August, the authorities have anticipated revenues of only Afs 105 billion for FY1393, although this was not agreed with the IMF as a revised target. Based on current trends, actual revenues for FY1393 are likely to be even lower than Afs 105 billion, although the exact number will not be known before the end of the fiscal year. Even if actual revenues amount to Afs 105 billion, this would be only 82 percent of the revenue target agreed earlier with the IMF. Moreover, on the whole, the assessment is that weaknesses in tax and customs administration have been a large enough part of the explanation for revenue underperformance in FY1393 that no incentive payment

from the revenue matching grant would be warranted. However, a final definitive determination on this can only be made after the exact figure on actual revenues for the year is known after the end of the fiscal year.

Part II: Performance Assessment of FY1391-1393 Benchmarks

8. This part focuses on the performance assessment for all ten FY1393 structural benchmarks and the four pending FY1392 structural benchmarks. The Fourth Technical Review completed on June 1, 2014 assessed that two additional FY1392 structural benchmarks (External Audit and Business Licensing) had been achieved, with four pending (Internal Audit, Civil Service, AML/CFT, and Customs). The Fourth Technical Review also determined that while implementation of several FY1393 benchmarks was underway, none had been completed by June 1, 2014. Since then, the administrator has engaged on an ongoing basis to facilitate progress. MoF and other government counterparts have also furnished verification material to demonstrate the fulfillment of structural benchmarks for FY1393 and FY1392. This evidence has been reviewed and assessed by the administrator.

9. **Performance assessment of FY1393 benchmarks:** *The matrix in Annex 1 provides a detailed assessment of all ten FY1393 structural benchmarks*. Based on the evidence received up to December 15, 2014, the administrator's technical review assesses that ***five structural benchmarks for FY1393 have been achieved***. These include the following:

   - **External Audit (#1):** The SAO conducted compliance audits of four ministries (MRRD, MoD, MoI, and MoEd) representing 60% of total FY1392 expenditures. The audit reports for MRRD, MoD, and MoI were provided to the Administrator between Nov 12 and Nov18. An expert consultant has completed a review of the three audit reports and found these comprehensive and satisfactory. The review of the underlying working papers took place Dec 13-15 and was satisfactory, thus leading to the overall assessment that the audits are of an acceptable level of compliance with INTOSAI ISSAIs. For MoEd, given media reports in November of ghost workers, the scope of the audit was expanded to include detailed payroll testing in five provinces, which is underway. However, the 3 ministries (MRRD, MoD, MoI) account for 48.2% of FY1392 expenditures, far surpassing the benchmark requirement of 25%. While the benchmark is achieved, it will nevertheless be important to follow-up on the MoEd audit. (This is associated with an incentive payment of **$13 million**.)
   - **Internal Audit (#2):** The Ministry of Finance Internal Audit department (IAD) provided the WB (in the week of Dec 8th) English versions of the reports and the underlying working paper files for the internal audits of the following five (new, additional) line ministries: Mines and Petroleum, Information and Culture, Border and Tribal Affairs, Agriculture, and Hajj and Pilgrimage. The review of the plans, risk analyses, and reports indicated that the work was done to an acceptable standard. However, the review of the underlying working papers is pending and will need to be completed before the benchmark can be declared

achieved. The review of the underlying working papers also supported the assessment that the internal audits substantially meet professional standards and that the benchmark is achieved. (This is associated with an incentive payment of **$13 million**.)

- **Procurement (#3):** An additional three line ministries (MoD, MAIL, and Office of State Minister for Parliamentary Affairs) implemented institutional arrangements and develop capacity sufficient to meet the stand alone procurement criteria set by PPU, resulting in a total of 9 line ministries over the course of the IP. The stand-alone procurement certificates were reviewed: the methodology was found to be adequate and the certificates were found to be supported by assessments in line with the stated methodology. (This is associated with an incentive payment of **$13 million**.)
- **Budget Transparency (#4):** MoF implemented at least four recommendations from the 2012 Open Budget assessment for Afghanistan by the International Budget Partnership (IBP) initiative. This includes: (i) MoF published the 1394 budget planner on its website; (ii) MoF prepared and published a 1393 Citizen Budget on its website; (iii) MoF published a pre-budget statement for the 1394 budget on its website; and (iv) MoF organized a consultation workshops on July 23, 2014 with CSOs on the 1393 budget and published the proceedings on its website. (This is associated with an incentive payment of **$13 million**.)
- **Norms-based budget allocation (#10):** The Ministry of Finance has developed norms for the allocation of the 1394 operating budget for five new ministries (one additional to what is required by the benchmark). These include Ministry of Agriculture, Irrigation and Livestock (MAIL), Ministry of Energy and Water (MoEW), Ministry of Higher Education (MoHE), Ministry of Rural Rehabilitation and Development (MRRD), and Ministry of Communications and Information Technology (MCIT). Furthermore, MoF has also refined the norms for the Civil Aviation Authority (CAA), which had initially been developed as part of the 1392 benchmark but were assessed during the 3rd Technical Review in Nov. 2013 to be not well defined. The revised norms for CAA are now better defined. Depending on the availability of administrative data, the new norms for MoEW, MRRD, MCIT, and particularly MAIL, are comprehensive and well defined. However, the norms for MoHE need to be improved further. The Administrator recommends that, going forward, the norms for the MoHE be refined for the 1395 budget. (This is associated with an incentive payment of **$13 million**.)

10. ***The remaining five benchmarks for 1393 have not yet been achieved.*** The benchmarks on Civil Service Reform (#5), Business Licensing (#7), and Trading Across Borders (#8) are flagged as being associated with a risk of delay. The benchmarks on AML/CFT (#6) and Customs (#9) are flagged as being on track in light of recent developments, but will require active follow through over the next few weeks and months to ensure implementation. The matrix in annex 1 provides additional details regarding the assessment of these benchmarks. The authorities are encouraged to pro-actively follow up on implementation of these remaining five benchmarks to ensure that the associated disbursements are received with the minimum possible penalty of delay.

11. **Progress on pending FY1392 benchmarks:** *The matrix in Annex 2 provides a detailed assessment of the four pending FY1392 structural benchmarks*.

- **The 1392 benchmark on AML/CFT (#6) was achieved with a 4 month delay:** The AML and CFT laws were approved by the Cabinet of Ministers on May 5, 2014. The Minutes of the Cabinet meeting indicate that the version submitted in May 2014 was approved without any changes and that Cabinet requested the MoJ to submit the laws to Parliament through the Office of Parliamentary Affairs. The October 2014 FATF plenary meeting confirmed that the enacted AML and CFT laws, with the approved CFT regulations, are considered acceptable, but noted the need to address deficiencies in 6 areas through regulatory improvements (part of the 1393 IP benchmark). Based on the FATF October 2014 review, the 1392 benchmark is achieved as of May 2014, which amounts to a four month delay. The allocation of $11.2 million against this benchmark is thus reduced by 33.2 percent for an incentive payment of **$7.5 million**.
- **The remaining 3 pending 1392 benchmarks (Internal Audit, Civil Service Reform, and Customs) will likely not be achieved by end-2014.** As such, the allocations against each of these benchmarks will likely be fully discounted to zero. The detailed assessment for each of these benchmarks is provided in the matrix in Annex 2.

Part III: Operations & Maintenance (O&M) Facility

12. The O&M facility is intended to incentivize higher civilian O&M spending. The facility is also intended to promote improved O&M systems in select "participating" line ministries. The indicative allocation for the O&M facility is $100 million for 1393. The basic principle underlying the facility is as follows. For each quarter, a baseline is defined using the average of O&M spending (civilian operating budget code 22) for the last two years. The baseline is defined for both aggregate civilian O&M spending and for the sum of the participating ministries. For each dollar spent above the baseline, the facility intends to provide an incentive payment of 1.5 dollars up to a maximum of the indicative allocation for that year. The participating ministries for 1393 are Ministry of Education (MoE), Ministry of Public Health (MoPH), Ministry of Public Works (MoPW), and the Civil Aviation Authority (CAA). Once the actual O&M spending for each quarter is known, the incentive amount is calculated at both the aggregate level and at the level of the participating ministries, but only the greater of the two incentive amounts is payable. This provides an ex ante incentive at both levels without any ex post double counting.

13. Table 2 below presents the quarterly baselines for 1393 for both aggregate civilian O&M and for the sum of the participating ministries. The table also presents actual O&M spending at each level for the first three quarters, as well as the calculated incentive amount at each level. The incentive payment for the first quarter was already paid at the time of the Fourth Technical Review. For the second quarter, the baseline was exceeded at both the aggregate and at the level of the participating ministries. However, the incentive amount for the aggregate ($14.6 million) is higher.

For the third quarter, the baseline was exceeded only at the level of the participating ministries, leading to an incentive payment of $6.4 million. **Thus, the total incentive payment for the second and third quarters is $21 million**.

Table 2. Quarterly O&M baselines for 1393 and actual expenditures

	1391 Actual Prorated	1392 Actual	Baseline 1393	Actual 1393	Incentive
	Millions Afs	Millions Afs	Millions Afs	Millions Afs	Million US$
Civilian O&M					
Q1	1,486	1,756	1,621	2,152	14.2
Q2	3,130	3,591	3,361	3,906	14.6
Q3	4,716	6,041	5,378	4,142	
Q4	6,388	6,631	6,509		
Participating (MoE+MoPH+MoPW+CAA)					
Q1	388	452	420	619	5.3
Q2	818	1,012	915	1,333	11.2
Q3	1,232	1,361	1,297	1,536	6.4
Q4	1,669	2,610	2,140		

Part IV: Other Disbursement Conditions

14. The MoU of the IP contains the following language to ensure that the macroeconomic framework is acceptable for the purposes of IP disbursements:

“Adequacy of the Macroeconomic Framework and Linkage with IMF Program

The ARTF Donors and Afghanistan have agreed that it is a precondition for the Incentive Program that an adequate macroeconomic and fiscal framework be in place, as assessed by the World Bank in coordination with the IMF. One of the factors that would be taken into account in the assessment of the macroeconomic framework is whether or not an IMF supported program is in place and whether engagement under the IMF program is ongoing.

The Incentive Program disbursements would be withheld by the Administrator if at any point in time it assesses that an adequate macroeconomic framework for the purposes of IP disbursements is not in place. Afghanistan may continue to furnish evidence for completed actions to the Administrator during any such withholdings, so that subsequent disbursements can be immediately resumed once the macroeconomic framework is assessed as adequate.”

15. The implication of this language (as discussed by the IP Working Group at the time of the Fourth Technical Review completed in June 2014) is that if an IMF program is not in place, the

Administrator would ascertain, in coordination with the IMF, whether there exist prohibitive concerns about the adequacy of the macroeconomic framework or whether the circumstances are such that IP disbursements would support macroeconomic stability. Furthermore, it is relevant to note that the design of the IP is different from that of all-or-nothing budget support operations: by selectively disbursing against benchmarks achieved and withholding disbursements for benchmarks not achieved, the IP incentivizes progress.

16. The IMF's three-year ECF program expired in November 2014. The first review of the ECF program was completed in June 2012. Although subsequent reviews were delayed because of increased economic uncertainty and delays in structural reform, the IMF has continued its active engagement on macroeconomic and structural policies during 2013-14. The IMF team met with the authorities during November 10-21, 2014 to discuss a possible nine-month Staff-Monitored Program (SMP). Good progress has been made in the SMP discussions, with understandings reached on several key reform areas to address the difficult macroeconomic challenges facing Afghanistan. Further discussions are needed on other important reform issues as well as the 2015 macroeconomic policy framework Meanwhile, IMF staff notes that disbursement of ARTF incentive funds would support macroeconomic stability.

17. **Afghanistan faces serious macroeconomic and fiscal challenges.** Uncertainty since 2013 over the political and security transition has been compounded by the protracted elections impasse in 2014. Economic growth has fallen sharply to 1.5 percent (estimated) in 2014 from 3.7 percent in 2013 and an average of 9.4 percent per year during 2003-12. A fiscal crisis is underway, with declining revenues leading to an unfinanced fiscal gap, depleted cash reserves, and arrears in 2014. The authorities anticipate revenues of 8.7 percent of GDP (Afs 105 billion) in 2014, down from 11.6 percent in 2011. While the deteriorating economic slowdown is part of the explanation, increasing weaknesses in tax and customs compliance are a large part of the problem. In the first 10 months of 1393, even after urgent donor financing and certain expenditure restraints, the unfinanced fiscal gap was $385 million, leading to depleted cash balances and accumulating arrears[1].

18. **The new government has articulated an ambitious reform program and has begun to take initial steps toward restoring macroeconomic and fiscal stability.** Notably, as part of its paper "Realizing Self Reliance: Commitments to Reform and Renewed Partnership" for the London Conference on December 3-4, 2014, the government has committed to reforms to (i) improve revenue mobilization; and (ii) bolster private sector confidence and economic growth. Reforms to improve revenue mobilization include strengthening enforcement and fighting corruption in customs, pursuing new sources of tax income including a new Value Added Tax (VAT) with an appropriate rate, conducting effective risk-based audits to improve taxpayer compliance, and in the medium term, making progress in developing extractive industries. Reforms to bolster private sector

[1] The unfinanced fiscal gap is recurrent plus discretionary development spending not financed from revenues or discretionary grants. It only includes expenditures that have been paid, so that if arrears are also included, the magnitude of the gap would be even greater.

confidence and economic growth include strengthening the financial sector, improving the investment climate, improving land governance, and promoting growth in key economic sectors including extractive industries and agriculture.

19. **The Afghan authorities face difficult choices on the draft 2015 budget to ensure that it is fully financed, incorporates credible revenue projections, and avoids stifling economic recovery and compromising development progress.** Adequate financing and fiscal space will need to be identified to repay arrears and rebuild cash reserves. At the same time, it is important to ensure that revenue projections are credible and backed by measures that will be successfully implemented during the course of the year. This leaves little room for critical civilian operating and development spending, particularly in light of higher security and social benefit expenditure obligations. The authorities will need to ensure that expenditure austerity is prioritized to avoid stifling economic recovery and compromising development outcomes. The authorities have identified a number of measures to generate expenditure savings, including budgetary guidance for the size of the civil service, consolidating the number of development projects, curtailing social benefit allocations, and improving procurement procedures. Even with improved revenue mobilization and expenditure prioritization, Afghanistan is likely to require additional on-budget assistance. **One part of the solution to the difficult choices on the 2015 budget is to accelerate reforms to earn more incentive-linked funds. As such, disbursement of ARTF incentive funds against the reforms achieved are a part of the solution and would support Afghanistan's efforts to restore macroeconomic and fiscal stability.** Withholding IP disbursements would make the choices on the 2015 budget and the efforts to restore macro-fiscal stability even more difficult. **Based on these unique considerations, the Administrator is recommending disbursement.**

20. **While disbursement of IP funds would support efforts to restore macroeconomic stability, the risks are high.** First, the security situation could deteriorate and undermine economic recovery and efforts to improve revenues. Second, actual implementation of the new government's ambitious reform program could be slow, which would result in continued weak economic growth, revenue underperformance, and low incentive-linked grants. Third, the authorities may be unable to sufficiently prioritize expenditures in light of constrained resources, which would lead to larger accumulating arrears. Some of these risks would be mitigated by accelerating reform implementation and by making further progress in discussion with the IMF to put in place a Staff-Monitored Program (SMP). As such, the disbursement recommendation is accompanied by a strong recommendation to urge the authorities to continue their close engagement with the IMF, with a view to putting in place a Staff Monitored Program (SMP) at the earliest feasible opportunity.

Part V: Recommendation on Incentive Fund Disbursement

21. The administrator's Fifth Technical Review recommends to the ARTF management committee to disburse **US$ 93.5 million** in incentive funds out of the ARTF Incentive Program allocations for 1392 and 1393. This recommendation is based on the following:

    - US$ 65.0 million for five 1393 benchmarks assessed as achieved (with no delay) through December 15, 2014.
    - US$ 7.5 million for one pending 1392 benchmark assessed as achieved with a four month delay.
    - US$ 21.0 million for the O&M facility for 1393.

22. The administrator's Fifth Technical Review strongly encourages the authorities to continue their close engagement with the IMF, with a view to putting in place a Staff Monitored Program (SMP) at the earliest feasible opportunity.

Annex 1: Progress Report on FY1393 Benchmarks –Status as of December 15

A. Public Financial Management		
1393 Benchmarks	**1393 Evidence (from MoU)**	**Progress**
(1) External Audit Performance: CAO carried out in the year and publishes external audits done to acceptable standard of central government entities that represent at least 25 % of total expenditures (Audits covering 50% of the average annual total expenditures in the life of the IP)..	**(1)** Evidence of the coverage would be the semi-annual audit reports provided to Parliament which include the specific reports. The audits must be comprehensive of the entities' operations and not limited to one or two processes or units within the entities. Acceptable standards are provided, both by the INTOSAI and ISSAI.	**Achieved.** For 1393, SAO (with technical assistance of M/s Cowater International Inc.) conducted the compliance audit of four ministries (M/o Rural Rehabilitation and Development, M/o Education, M/o Defense, and M/o Interior) representing 60% of total FY1392 expenditures. The scope of compliance audit includes assessment of internal control and internal audit functions, evaluation of compliance with applicable statutes and regulations, reviewing compliance with laws and regulations; whether the statutes, laws and regulations are being followed, whether they are having the desired results, and, if not, what revisions are necessary which is as reflected in the plan document. The field work in the Central Budgetary Units and provinces of three of the ministries (MRRD, MoD, and MoI) has been completed and observations (Estellam) issued. The audit reports of these three ministries were signed by the Auditor General and a summary of the findings of each of the reports were posted on the SAO web site. The audit reports for MRRD, MoD, and MoI were provided to the Administrator between Nov 12 and Nov18. An expert consultant has completed a review of the three audit reports and found these comprehensive and satisfactory. The review of the underlying working papers took place Dec 13-15 and was satisfactory, thus leading to the overall assessment that the audits are of an acceptable level of compliance with INTOSAI ISSAIs. For MoEd, given media reports in November of ghost workers in MoEd, the scope of the audit was expanded to include detailed payroll testing in five provinces, which is underway. However, the 3 ministries (MRRD, MoD, MoI) for which reports have been submitted account for 48.2% of FY1392 expenditures, far surpassing the benchmark requirement of 25% of expenditures. While the benchmark is achieved, it will nevertheless be important to follow-up on the MoEd audit.

(2) Internal Audit: Additional five (5) ministries undertake internal audits which substantially meet professional standards set by MoF IA based on IIA Standards (15 audits of different Ministries in the life of the IP and after the date of signing the IP).	**(2)** Report describing the work, attesting to compliance with standards and reporting the action taken by management to be prepared by the IA Dept of MoF and the audit reports themselves.	**Achieved.** The Ministry of Finance Internal Audit department (IAD) provided the WB (in the week of Dec 8th) English versions of the reports and the underlying working paper files for the internal audits of the following five (new, additional) line ministries, which were initiated in June 2014: 1) M.o. Mines and Petroleum 2) M.o. Information & Culture 3) M.o. Border & Tribal Affairs 4) M.o. Agriculture 5) M of Hajj and Piligramage The review of the plans, risk analyses, and the reports indicated that the work was done to an acceptable standard. The review of the underlying working papers also supported the assessment that the internal audits substantially meet professional standards and that the benchmark is achieved.
A. Public Financial Management		
1393 Benchmarks	**1393 Evidence (from MoU)**	**Progress**
(3) Procurement Performance: An additional three (3) Line Ministries will implement institutional arrangements and develop capacity sufficient to meet the stand alone procurement criteria set by PPU (at least 9 over the life of the IP).	**(3)** Certification reports by the PPU	**Achieved**. The PPU reports that nine line ministries have been certified. Furthermore, the PPU submitted the Line Ministry Stand Alone Procurement Certificates for MoD, MAIL, and Office of State Minister for Parliamentary Affairs as evidence of achievement of this benchmark for 1393. The evidence was reviewed by WB staff on Sept 23, 24 at PPU in the MoF. WB staff concluded that the methodology was adequate and that the certificates for MOD, MAIL and the Office of State Minister for Parliamentary Affairs were supported by assessments in line with the stated methodology and support the related certificates.

(4) Budget Transparency: MoF implements at least 4 (four) recommendations from the 2012 Open Budget assessment for Afghanistan by the International Budget Partnership (IBP) initiative. This could include: - MoF publishes the 1394 budget planner on MoF website - MoF prepares and publishes a 1393 Citizen Budget on the MoF website - MoF publishes a pre-budget statement for the 1394 budget on the MoF website - MoF organizes consultation workshops with CSO's and media on 1393 budget and publishes proceedings on the MoF website	**(4)** Administrator verifies publications	**Achieved.** Based on the recommendations from the 2012 Open Budget Assessment for Afghanistan, the Ministry of Finance: - Published the 1394 budget planner on its website; - Published a Citizen Budget for the 1393 budget in its website; - Published the pre-budget statement for 1394, under the Medium-Term Budget Framework, in its website; - Organized a consultation workshop on July 23, 2014 with the Civil Society Organizations (CSOs) on 1393 budget, and published the proceedings in the website; The Administrator has reviewed the evidence, and assesses the benchmark as achieved.
B. Governance		
1393 Benchmarks	**1393 Evidence (from MoU)**	**Progress**
(5) Civil Service Reform: The authorities issue relevant regulatory instruments which enable the recruitment of professional staff.	**(5)** Administrator will review and verify issuance of the regulatory instruments.	**Risk of Delay.** The relevant regulations are pending until the Civil Service Law is approved by Parliament. The law will provide the legal basis for the issuance of regulatory instruments. The Civil Service Law is currently under review at the Ministry of Justice to be re-sent to the Council of Ministers for review. It is not clear whether the law would be reviewed by the Cabinet before the end of the year.
(6) AML/CFT: DAB amends the following regulation to address deficiencies identified in the AML/CFT Assessment of Afghanistan (2011), taking into account the suggested amendments of the AML/CFT laws as above and the revised FATF standards (February 2012): - Responsibilities of Financial Institutions in the Fight Against Money Laundering and Terrorist Financing issued by DAB in March 2006;	**(6)** Administrator will review and verify issuance of the regulatory instrument.	**On track.** The AML and CFT laws were enacted in (respectively) June and July 2014. The President further approved the CFT regulations in October 2014. The October 2014 FATF review meeting concluded that the AML and CFT laws, with the accompanying CFT regulations, are considered satisfactory. However, the relevant regulations on the responsibilities of financial institutions, money service providers, and foreign exchange dealers – as required under the 1393 benchmark – have not yet been amended. The October 2014 FATF statement noted 6 deficiencies which Afghanistan

- Money Service Providers issued by DAB in March 2008; and - Foreign Exchange Dealers issued by DAB in July 2008.		should address as part of its action plan to effectively implement the new AML/CFT laws. FINTRACA has noted that it is working on amendments to the 3 regulations noted in this benchmark, as well as other regulations, to effectively implement the new AML / CFT laws. The benchmark is not achieved as of December 2014 but can be declared as achieved when the amendments to the priority regulations are completed.
C. Investment Climate and Trade Facilitation		
1393 Benchmarks	**1393 Evidence (from MoU)**	**Progress**
(7) Business Licensing: The Council of Ministers issues a road map which includes a description of all required institutional and regulatory changes for the establishment of a unified business registration system within 18 months which provides the right to invest, trade and conduct usual business activities.	**(7)** MoCI provides the Administrator with a copy of the Roadmap and Minutes of the cabinet meeting.	**Risk of Delay.** High level ownership within MoCI and the government is critical for progress in this area. This appears now to be taking shape. The new government, through its paper "Realizing Self-Reliance: Commitments to Reforms and Renewed Partnership" for the London Conference on December 3-4, 2014 has committed to improving the investment climate by significantly reforming licensing and registration procedures and establishing a unified business registration system. However, a formal roadmap for this purpose will need to be prepared. Furthermore, Cabinet approval of the roadmap will be needed to deem the benchmark as met. A consultant was mobilized in 2013 to develop a strategy paper for the unification of business licensing and registration processes, including an implementation roadmap for the transfer of AISA's licensing services to MOCI's Afghanistan Central Business Registry. The report was prepared in November 2013 and was shared with the Ministry of Commerce and Industries. The report can inform the government's roadmap toward establishing a unified licensing system. The report remains to be discussed in a workshop with all stakeholders including the MoCI, AISA, and MoF. The Administrator and MoCI have discussed that such a workshop would be most productive pending high level ownership within both MoCI and the government for a unified business registration system. This appears now to be taking shape.

(8) Trading across borders: MoCI in collaboration with MoF reduces the number of required documents for trading across borders and align process with international good practice, including the elimination of product specific export permits other than negative list.	**(8)** MoCI provides the Administrator with a copy of the relevant directives.	**Risk of Delay.** The MoCI is awaiting the approval of the Afghanistan National Trade Policy 2013-2017 which is expected to provide guidance on reducing the number of required documents for trading across borders. Further, the policy is expected to endorse the elimination of all unnecessary export authorization requirements in both the public and the private sector, including certifications from the MoCI, other ministries and various industry associations. The MoCI has submitted the Afghanistan National Trade Policy and an Implementation Roadmap to the Cabinet, following meetings with the Ministry of Economy, ACCI and MoF. It is currently being reviewed by the High Commission on Economy, prior to be reviewed at the Cabinet for approval.
(9) Customs: Government of Afghanistan makes satisfactory progress in the implementation of the customs action plan in 1393 (as agreed at first technical review in 1392)	**(9)** to be determined once action plan is received	**On track.** The new government has declared strengthening enforcement and fighting corruption in customs one of its critical priorities. The Customs Action Plan was agreed and signed by all concerned ministries in October 2014, thus removing a key bottleneck to its effective implementation, and providing high-level government ownership for customs reforms. This sets the stage for the authorities to meet the customs benchmark for 1393 at a future point in time based on successful implementation of a set of substantive reform actions. The Administrator and the ACD have discussed a number of priority customs reform actions identified for implementation by the government to make a substantive impact in improving customs revenue mobilization. These include strengthening enforcement powers of customs by placing the Customs Police under the supervision and direction of ACD; enhancing customs controls by reassigning customs officials based on traffic patterns, introducing additional randomized post-inspections, and mobilizing post clearance audit in major customs houses; revision in procedure for clearance of Miscellaneous (bilti) cargo; decreeing mandatory certification of new as well sitting customs officials by the customs academy; and roll-out of new Valuation Module to all customs houses that are equipped with ASYCUDA World.
D. Sub-national Finance		

1393 Benchmarks	1393 Evidence (from MoU)	Progress
(10) Norm-based budget allocation: MoF applies the norm-based formula for the operating budget to further 4 key ministries. Identity of the ministries to be announced by last quarter 2013	**(10)** MoF submits a report to the Administrator with a summary of the provincial budget distribution and copies of the provincial transfer sheets. The Administrator will review the report for compliance with the benchmark.	**Achieved.** The Ministry of Finance has developed norms for the allocation of the 1394 operating budget for five new ministries (one additional to what is required by the benchmark). These include Ministry of Agriculture, Irrigation and Livestock (MAIL), Ministry of Energy and Water (MoEW), Ministry of Higher Education (MoHE), Ministry of Rural Rehabilitation and Development (MRRD), and Ministry of Communications and Information Technology (MCIT). Furthermore, MoF has also refined the norms for the Civil Aviation Authority (CAA), which had initially been developed as part of the 1392 benchmark but were assessed during the 3rd Technical Review in November 2013 to be not well defined. The revised norms for CAA are now better defined. Depending on the availability of administrative data, the new norms for MoEW, MRRD, MCIT, and particularly MAIL, are comprehensive and well defined. However, the norms for MoHE need to be improved further. The Administrator recommends that, going forward, the norms for the MoHE be refined for the 1395 budget. The MoF has submitted to the Administrator the copies of the issued guidelines for the norms-based allocation of the O&M budget, and the summary of the provincial budget distribution. The Administrator reviewed the evidence and – based on the norms of four new ministries as required by the benchmark – recommends the benchmark as achieved.

Annex 2: Progress Report on Pending FY1392 Benchmarks—Status as of December 15, 2014

A. Public Financial Management		
1392 Benchmarks	**1392 Evidence (from MoU)**	**Progress**
(2) Internal Audit: Five (5) ministries undertake internal audits which substantially meet professional standards set by the Internal Audit (IA) Dept. of the Ministry of Finance (MoF) based on IIA Standards.	**(2)** Report describing the work, attesting to compliance with standards and reporting the action taken by management to be prepared by the IA Dept of MoF and the audit reports themselves.	**Unlikely to be achieved by end-2014.** Internal audits of miscellaneous revenue processes were carried out at the following ministries: Ministry of Women's Affairs; Ministry of Foreign Affairs; Ministry of Economy; Ministry of Haj and Endowment; and Ministry of Border and Tribal Affairs. The selection of miscellaneous revenue arose as a result of negotiation between IAD MoF and Ministry IADs. MOF IAD was precluded from selecting other areas which might have been more appropriate due to, for example, a higher level of risk. The US Treasury Technical Advisor to MoF IAD concluded that "…the completion of these five audits is in line with benchmarks requirements" and cites internal audit performance standards (including independence of the MoF IAD) in support of this opinion. It is true that the IAD is an independent entity in MoF and the audits of miscellaneous revenue were conducted in an objective manner. However, in this instance, the ability of IAD MoF to select areas for audit and indeed even the type of internal audit to be conducted was restricted by the line ministries. Therefore, the benchmark has not been met since the application of professional standards does not "substantially meet" IIA standards given the significant limitation of scope imposed by the line ministries in selecting both the type of internal audit and the areas to be audited. The amendment to Article 61 of the audit law is a key stumbling block and needs to be reversed. The benchmark was agreed to before Art 61 was modified. Further discussions between the SAO, WB, and MoF could also help provide a way forward. MoF had indicated that it would follow up with the line ministries so that the audits would be carried out by the IA Units of the line ministries.

		There is concern that without MOF IAU involvement the audits would not meet the requisite standards. With technical assistance under the PFMRII project, MoF could assist the line ministries in producing the requisite audits for 1392 and 1393, but it is much more difficult to achieve than MOF doing this work directly.
B. Governance		
1392 Benchmarks	**1392 Evidence (from MoU)**	**Progress**
(5) Civil Service Reform: The Council of Ministers approves amendments to the civil servants law.	**(5)** The Authorities will provide the Administrator with the cabinet approved civil service law as well as the cabinet minutes, confirming the approval. The Administrator will review the law for compliance with minimum standards (see annex 3 of MoU).	**Unlikely to be achieved by end-2014.** The Ministry of Justice and the Civil Service Commission together prepared the final draft of the Civil Service Law. MOJ submitted the draft law to the Cabinet's Legislative Review Committee at the Office of Administrative Affairs. The Committee reviewed the draft Law and sent it back to the Ministry of Justice with additional comments. The Civil Service Commission believes that the changes to the Law will be finalized by MOJ within two weeks and sent back to the Cabinet for approval. The Administrator has seen previous drafts but has not received the final draft which has been submitted to the Office of Administrative Affairs for cabinet approval. The Administrator would need to review the final draft of the Law to see that it complies with minimum standards, and the cabinet approved version for compliance with the benchmark standards. The benchmark has not been met and there is strong possibility that the delay may continue.
(6) AML/CFT: The Council of Ministers approve the amendment of the law No. 840 of October 2004 on "Anti-Money Laundering and Proceeds of Crime" and the law No. 830 of October 2004 on "Combating the Financing of Terrorism" to align with international standards (FATF Recommendations on AML/CFT) and submit to parliament.	**(6)** Administrator will review the law and verify the minutes of the cabinet meeting. At the minimum, the requirements on customer due diligence, record keeping, and suspicious transaction reporting should meet the international standards.	**Achieved (May 2014).** The AML and CFT laws were approved by the Cabinet of Ministers on May 5, 2014. The Minutes of the Cabinet meeting indicate that the version submitted in May 2014 was approved without any changes and that Cabinet requested the MoJ to submit the laws to Parliament through the Office of Parliamentary Affairs. The Administrator has received the Dari and English versions of the enacted laws. The June and October 2014 FATF plenary meetings confirmed that the

		enacted AML and CFT laws, with the approved CFT regulations, are acceptable. At the same time, the October 2014 FATF plenary noted deficiencies in 6 areas, which the authorities are addressing by working on the amendments to the regulatory framework (part of the 1393 IP benchmark). Based on the FATF October 2014 review, the Administrator recommends the 1392 benchmark as achieved.
C. Investment Climate and Trade Facilitation		
1392 Benchmarks	**1392 Evidence (from MoU)**	**Progress**
(9) Customs: Government of Afghanistan makes satisfactory progress in the implementation of the customs action plan in 1392 (as agreed at first technical review in 1391)	**(9)** to be determined once action plan is received	**Unlikely to be achieved by end-2014**: ACD had indicated that it would implement select reforms from the action plan as part of satisfying this benchmark for 1392. A number of steps were taken, including in the areas of strategic planning (defining core customs responsibilities and output indicators), performance management (quarterly reporting against key performance indicators at each level), preparing a plan for drafting of Standard Operating Procedures (SOPs), and rolling out risk management. However, the lack of agreement on the customs action plan between key ministries and the lack of high level government ownership compromised the effectiveness of the steps taken, resulting in serious underperformance of customs revenue mobilization. As such, the customs benchmark for 1392 is assessed as not having been met. The Customs Action Plan was agreed and signed by all concerned ministries in October 2014, thus removing a key bottleneck to its effective implementation, and providing high-level government ownership for customs reforms. This sets the stage for the authorities to meet the customs benchmark for 1393 at a future point in time based on successful implementation of a set of substantive reform actions.