AFGHANISTAN RECONSTRUCTION TRUST FUND

INCENTIVE PROGRAM FY1394-96 (2015-2017)

ADMINISTRATOR'S 1ST TECHNICAL REVIEW

NOV 2015

Preamble

1. The Incentive Program (IP) 2015-2017, part of the Recurrent Cost Window (RCW) of the ARTF, is a three-year, rolling budget support operation program based on an underlying series of economic policy reforms deemed critical to achieving greater fiscal self-reliance. The IP incentivizes achievements of results and timely implementation of reforms to improve domestic revenue mobilization, expenditure management and growth prospects.
2. Financing for the IP is allocated across three complementary components: (i) the structural reform scheme; (ii) the revenue matching grant scheme; and (iii) the operations and maintenance (O&M) facility. Detailed information on each of these facilities, description of the structural benchmarks, and timetables are provided in the Memorandum of Understanding (MoU) from September 6, 2015.

Table 1: Indicative Allocation through the Recurrent Cost Window and the IP (US$ Million)

	Allocation		
	2015	**2016**	**2017**
Baseline ARTF RC support	**$125**	**$100**	**$75**
ARTF IP	**$275**	**$300**	**$325**
Structural Benchmarks	$200	$225	$250
Revenue Matching Grant	$75	$75	$75
O&M Facility	Float/balance	Float/balance	Float/balance
Total ARTF RCW	**$400**	**$400**	**$400**

3. The MoU stipulates technical reviews as verification protocol for the achievement of results. Each review will report on progress of the program as well as 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.
4. 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 discusses the Afghanistan's macroeconomic and fiscal environment to contextualize the reforms and the budget support under the IP. Part II describes progress on revenue mobilization and collection. Parts III and IV provide an assessment of

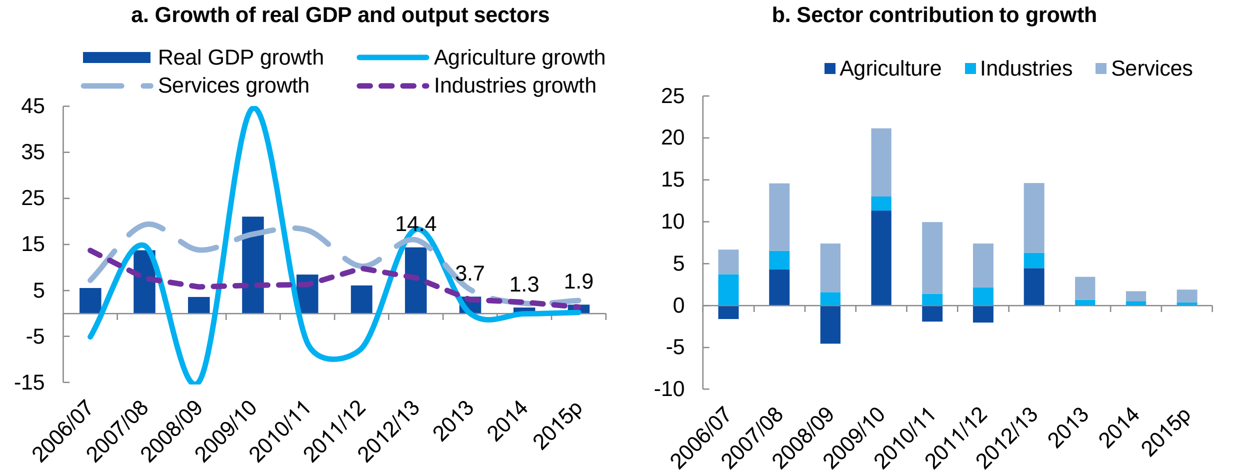
progress on the ten FY1394 structural reform benchmarks based on the evidence provided and also reports on pending FY1393 benchmarks under the previous round of IP (2012-2014). Part V assesses progress on the O&M facility. Part VI concludes with the recommendation to the ARTF management committee regarding disbursement of the IP.

Part I: Assessment of Macro-Fiscal Policy Framework

5. Economic growth fell sharply to 1.3 percent in 2014 from an average of 9 percent during 2003-12. This is a result of: (i) uncertainty from the protracted elections process, compounded by the subsequent difficulties to quickly form a full-fledged government; (ii) flat growth in agriculture; and (iii) medium term headwinds from the drawdown in aid. The economy has so far not shown any credible sign of recovery and will likely remain sluggish in light of a further deterioration in security over the first three quarters in 2015. Private investment activities significantly slowed down, evidenced by a drop of nearly 50 percent in new firm registrations since 2012. Current projections indicate real GDP growth at 1.9 percent in 2015.

Figure 1: GDP growth and sector contributions

(percent)



Sources: Central Statistics Organization (CSO) and Bank staff projections

6. With declining global food and fuel prices and weakening domestic demand, inflation is projected at −1.7 percent (period average) for 2015. The depreciation of the Afghani—around 8 percent vis-à-vis the U.S. dollar in the first eight months of the year—has partially offset deflationary pressures stemming from the decline in food and nonfood prices. Imports amount to around 40 percent of GDP and tend to have a large impact on domestic prices through imported inflation.

7. Fiscal developments in Afghanistan point to some headway on revenue mobilization in 2015. Domestic revenue increased over the first 8 months of 2015 as a result of improvements in the customs and tax administration. New revenue measures, implemented in September 2015, will likely lead to an acceleration of revenue collection in the remainder of the year. The most recent projections

indicate that domestic revenues will reach Afs 114.2 billion (equivalent to 9.8 percent of GDP) by end 2015.

8. However, recurrent expenditures are also projected to increase in 2015, due to growing security costs. Substantial, additional discretionary donor grants this year—agreed under the New Development Partnership Agreement with the United States and the Afghanistan Reconstruction Trust Fund (ARTF) Incentive Program—will likely help to balance the budget this year. Nevertheless, the budget may run a deficit if the Government fails to meet the agreed commitments that trigger fund disbursements under these programs. Moreover, the weak cash reserve position at the beginning of the year exposes the budget to larger fiscal risks.

9. The Government recognizes that restoring fiscal stability requires accelerating revenue enhancing reforms which have considerably slowed down over the past two years. To this end, the authorities agreed on an IMF Staff-Monitored Program (SMP) in May 2015 which includes a set of macroeconomic policies and structural reform measures to be implemented over the course of 9 months. Reforms on the fiscal front include measures to mobilize domestic revenues to finance projected expenditures and rebuild the treasury's cash balance. Financial sector reforms will deal with the implementation of the new banking law, amendment of the central bank law, strengthening banking supervision, and addressing weaknesses in state banks. The first review of the SMP (September 2015) indicated satisfactory performance of the program and the government appears to be on track to meeting the targets set for December 2015.

10. Risks to macroeconomic stability remain high. First, the security situation could further deteriorate and undermine economic recovery and efforts to improve revenues. Second, actual implementation of the new government's ambitious reform program could slow down, 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 under the SMP as well as the ARTF IP. As such, the disbursement recommendation is accompanied by a strong recommendation to urge the authorities to continue their close engagement with donors on reforms.

11. Disbursement of IP funds will support on-going efforts to restore macroeconomic stability. For one, the government needs adequate financing to balance its budget and create fiscal space for critical public services delivery. If the financing needs of Afghanistan are not adequately met, the government may need to further tighten public spending, which, in turn could slow economic recovery, particularly in an environment where private investment is limited. But more importantly, the ARTF IP rewards the accelerated implementation of reforms that are specifically geared towards restoring macroeconomic and fiscal stability. **Based on these considerations the Administrator has no concerns to disburse incentive funds at the time of this review**.

Part II: Progress on Revenue Mobilization and Collection

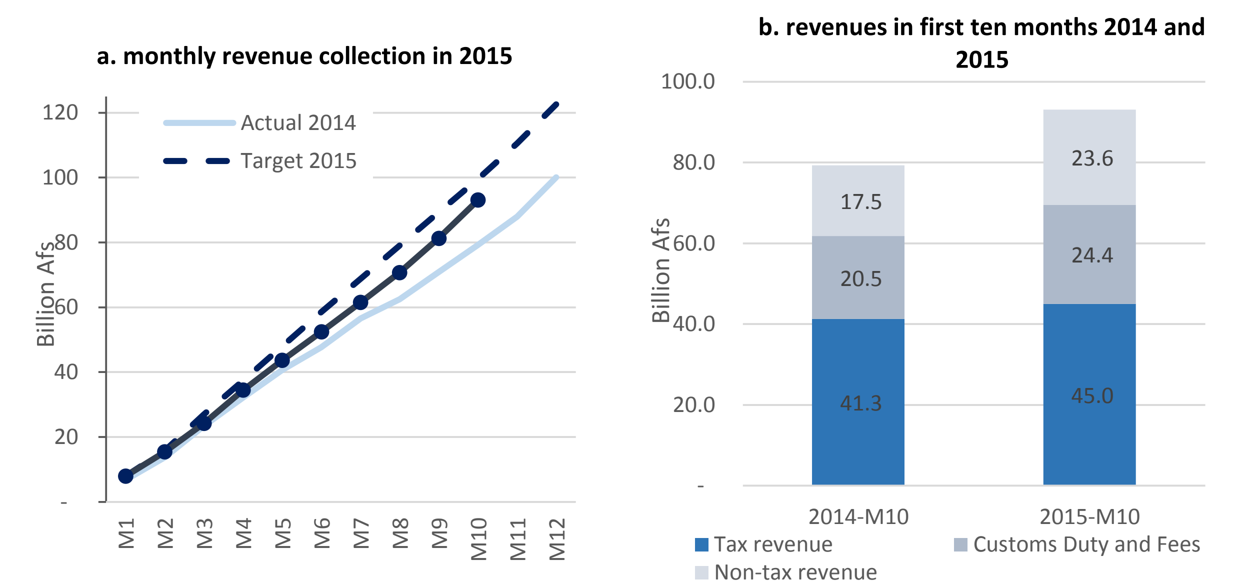
12. The Revenue Matching Grant (RMG) Scheme under the IP provides an incentive for improved performance in revenue mobilization and collection. It is anchored in the annual revenue targets agreed in advance between the Ministry of Finance and the International Monetary Fund (IMF). Revenue growth over the previous program year triggers incentive funds. Disbursements increase proportionally to revenue growth towards the revenue target, i.e. if actual revenues amount to X percent of revenue growth required to reach the target, the same percentage of the allocated RMG funds will be disbursed. The full value of the incentive fund in this scheme would only be made available if the Government of Afghanistan achieves 100 percent or more of the revenue target.

13. **Progress toward the FY1394 (2015) revenue target:** The revenue target for FY 1394 has been revised from Afs 120 billion to Afs 114.2 billion. Incentive funds from the revenue matching grant are triggered if revenue collection shows marginal improvements over past year’s revenue collection - which was Afs 100 billion. Meeting 100 percent of the target would trigger disbursement of $75 million.

14. Revenues amounted to Afs 98.5 billion as of November 15, 2015, which is indicative of good progress towards the revenue target. The positive trend in revenue collection is the result of improved customs performance and the implementation of a series tax measures, which were implemented in the second and third quarters of 2015. These include an increase in the business receipts tax rate from 2 percent to 4 percent, the introduction of a 10-percent telecommunications tax on mobile phone top-ups, increase of fuel fee from Af 1 per liter to Af 2 per liter, and an increase in the overflight fees for Afghanistan’s airspace. Based on current trends, it is anticipated that the government will be able to meet its revised revenue target by end of December

Figure 2: Trends in Revenue Collection

(percent)



Sources: Ministry of Finance and Bank staff projections

15. Since the threshold was not superseded at the time of this technical review, no funds are triggered as of November 15, 2015. However, the design of the RMG principally allows for disbursements as soon as the threshold is reached proportionally increasing with revenue growth towards the target. Since the next technical review will not be conducted before January, the Ministry of Finance requested partial disbursement of RMG incentive funds towards the end of the calendar year in order to ensure a smooth cash-flow. This would be in line with the objectives of the RCW/IP. Partial disbursement of the RMG incentive funds – as long as based on actual revenue collected as reported by AFMIS/SIGTAS - only carry minimal risks of “over-disbursement” and could be easily corrected once fiscal accounts are closed and the final disbursement amount for the RMG will be determined. **The Administrator therefore proposes to release a portion of the RMG incentive funds subsequent to this technical review but in advance of the second technical review of the program**. The disbursement amount would be based on the most up-to-date revenue report submitted by the Ministry of Finance and would not be exceeding the amount determined by the RMG disbursement formula for actual revenues collected. A short note with the disbursement recommendation will be submitted for non-objection to the ARTF IP Working Group prior to disbursement.

Part III: Performance Assessment of Pending FY1393 Benchmarks

16. Five benchmarks for 1393 are still pending completion. The 1393 actions on Civil Service Reform (#5), Business Licensing (#7), and Trading across Borders (#8), AML/CFT (#6) and Customs (#9) have not been implemented as of November 17, 2015. Due to their importance to achieving the objectives of the Incentive Program, and upon request of the Government, business licensing and customs reforms have been rolled over to the FY1394-1396 Incentive Program. Current progress on the three remaining triggers remains slow (Annex 2) and it is not expected that reforms will be completed within calendar year 2015. **As of November 15, 2015 the incentive funds for the three pending triggers will be discounted by 83 %.**

Part IV: Performance Assessment of FY1394 -1396 Benchmarks

17. The Ministry of Finance furnished evidence to demonstrate the fulfillment of structural benchmarks for FY1394. This evidence has been reviewed and assessed by the administrator. Based on the evidence received up to November 15, 2015, **the administrator’s technical review assesses that three structural benchmarks for FY1394 have been achieved**.

18. **Customs HR Reform (#1):** MoF presented the HR reform plan to cabinet on September 2, 2015 and received authorization to proceed with drafting and issuing regulations to implement the planned reforms. Moreover the cabinet resolution mandates that the regulations need to be issued within the next three months. MoF shared and subsequently discussed the HR reform plan with the World Bank at a workshop in Dubai in September 2015. The World Bank assessed that the draft reform plan adequately meets the objectives of the IP benchmark and, if forcefully implemented, should lead to significantly improved HR management and better control of corruption. A few shortcomings were noted with regard to entry mechanism, duration of training, lateralization, retraining of existing staff,

and the curriculum design of the customs academy which need to be addressed in order to meet the 2016 and 2017 benchmarks. It was agreed that the Bank team's recommendations will be considered in the final draft and during the implementation of the reforms. Vigorous follow-up and support will be required for ACD to meet the 2016 targets.

19. **Customs Enforcement (#2):** All evidence as stipulated in the MoU was submitted. The cabinet approved the enforcement reforms, jointly with the HR reforms, on September 2, 2015. The cabinet resolution mandates that (i.) the customs police transitions to from MoI to MoF, and that (ii.) resources be made available for the establishment of the new prevention and enforcement wing. While the ACD roadmap for the new enforcement wing is not mentioned in the cabinet resolution, MoF assured that powers of search, investigation and arrest is implied. The transition plan is currently in preparation and will soon be shared with the World Bank. Moving forward one important aspect to be carefully considered is the placement and reporting lines of the enforcement wing which – in line with good practice – should be under ACD.

20. **Fiscal Deconcentration and Provincial Budgeting (# 9):** MoF furnished all required evidence for the achievement of the provincial budgeting benchmark. The provincial budgeting policy – under discussion and consultation for several years now – has been approved by the cabinet on June 24, 2015. However, the cabinet requested final comments and endorsement from the Ministry of Economy and IDLG. The provincial budgeting policy was subsequently issued on October 5, 2015 by the Council of Ministers. The Provincial Budgeting Policy is intended to set the scene for the gradual introduction of more decentralization in Afghanistan, through an administrative process of fiscal deconcentration. The objective is modest and focuses mostly on establishing a participatory process in budget planning between the central and provincial levels of government as well as on the process for allocation and disbursement of discretionary fiscal resources. A working group was established to oversee the implementation of the budget policy. ToR for the working group as well as the minutes of its first meeting was shared with the Administrator. Budget circulars for provincial directorates were issued.

21. The Bank's assessment is that the policy provides a good starting point for the deconcentration process, carefully and adequately recognizes capacity constraints at provincial level and fiduciary risks and that it provides flexibility for adjustments during the implementation. Recommendations to be considered in the implementation include:

- More clarification on incremental steps to increase autonomy for of provincial directorates could be provided, specifically with regard to how systems and human capacity will be developed over the next years
- Line Ministries could show larger resistance to divest their planning powers and financing to lower levels of government. A stronger monitoring and results framework could help with monitoring the process and hold Line Ministries more accountable.
- There is laudable mention of transparency in the policy but ways to achieve transparency are yet to be made concrete. Some initiatives could include: publication of expenditure norms

and outcomes for each sector, stand-alone budget paper for provinces as well as defining local transparency initiatives as eligibility criteria for resource allocation

- More clarification on how procurement authority will be devolved.

22. The Matrix in Annex 1 provides a detailed assessment of all ten FY1394 structural benchmarks.

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

23. The O&M facility aims at improving the operation and maintenance of public assets in key areas such as education, health, and rural/urban infrastructure and, thus, enhancing their sustainability. To this end, the O&M facility will offer resources for O&M and incentivize their management.

24. The facility funds incremental O&M civilian spending above a baseline (which is sensitive to revenue growth) by a factor of $1.5 for every $1 in order to encourage aggregate spending on O&M and safeguard basic service delivery assets. No specific funds are set aside for the O&M facility. Instead any funds unearned under the other two facilities will become available for the O&M facility. The final assessment of O&M spending to determine disbursement will be done at the beginning of each year.

25. The baseline for 2015, as agreed in the MOU, is Afs 14.9 billion. O&M spending in the first 10 months amounted Afs 12.37 billion. Current projections, however, expect O&M spending to accelerate in November and December due to the release of contingency funds and reach around Afs 16 billion, which in turn would trigger incentive funds if there is sufficient cash flow in the IP (created by e.g. unreleased funds from the RMG or additional financing).

26. Good progress has been achieved on the management of O&M: O&M policy norms as well as O&M streamlining processes have been finalized and sent to the Cabinet for approval. In addition O&M reform activities were carried out in all pilot Ministries and 19 budgetary units including development of O&M guidelines, establishment of O&M committees, workshops and meetings. For next fiscal year, MOF plans to rollout O&M to remaining line ministries. Work is in progress to finalize costing for next year's allocation and to train ministries on implementation guidelines and the establishment of an inter-ministerial O&M working group. Overall, MoF reports that the O&M facility remains helpful in convening stakeholders around O&M issues, maintaining pressures on O&M spending and supporting intra-government coordination.

Part VI: Recommendation on Incentive Fund Disbursement

27. **The Administrator recommends to the ARTF Management Committee to disburse US$ 60.6 million** in incentive funds out of the ARTF Incentive Program allocations for 1394. This recommendation is based on the following:

    - 35.6 US$ million for achieving 1394 benchmarks #1 (customs: HR reform) and #9 (provincial budgeting) without delay by November 15, 2015
    - 25 US$ million for achieving 1394 benchmark #2 (customs: enforcement - super trigger) without delay by November 15, 2015

28. **Upon request of the Ministry of Finance and submission of the latest AFMIS/SIGATS revenue reports, the Administrator recommends partial disbursement of the Revenue Matching Grant in advance of the next technical review**. The Administrator will determine the disbursement amount on basis of the most up-to-date revenue report and provide prior notice to the ARTF IP Working Group.

Annex 1: Scorecard and Progress Report on FY1394 Benchmarks –Status as of November 15, 2015

Goal 1: Increasing fiscal revenue by enhancing tax potential, improving compliance and reducing leakages		
1394 Benchmarks	**1394 Evidence**	**Progress**
(1) Customs HR Reforms: The Cabinet approves a comprehensive a HR reform policy for ACD. The policy will allow ACD to develop a roadmap for the establishment of a new HR platform and will provide authority to ACD to conduct an HR review, take HR actions on existing customs staff, introduce a transparent and competitive recruitment process, determine hiring and commissioning requirements as well as to deploy performance management and related remuneration packages.	**(1)** Copy of cabinet approved HR policy, copy of minutes reflecting the relevant cabinet decision, and copy of the HR reform plan.	**Achieved.** The draft HR reform was shared with the Administrator and subsequently presented to cabinet on September 2, 2015 and received authorization to proceed with drafting and issuing regulations to implement the planned reforms. A few shortcoming were noted with regard to entry mechanism, duration of training, lateralization, retraining of existing staff, and the curriculum design of the customs academy which need to be addressed in order to meet the 2016 and 2017 benchmarks. It was agreed that these the Bank team's recommendations will be considered in the final draft and during the implementation of the reforms. Vigorous follow-up and support will be required for ACD to meet the 2016 targets.
(2) Customs Enforcement: The Cabinet approves the establishment of a Preventive and Enforcement wing within ACD with powers of search, investigation and arrest throughout Customs territory.	**(2)** Copy of minutes reflecting the relevant cabinet decision.	**Achieved.** All evidence as stipulated in the MoU was submitted. The plan to reform customs enforcement was presented jointly with the HR reform plan to the cabinet on September 2, 2015. The cabinet resolution mandates that (i.) the customs police transitions to from MoI to MoF, and that (ii.) resources be made available for the establishment of the new prevention and enforcement wing. While the ACD roadmap for the new enforcement wing is not mentioned in the cabinet resolution, MoF assured that powers of search, investigation and arrest is implied. The transition plan is currently in preparation and will soon be shared with the World Bank team. One important aspect to be carefully considered is the placement and reporting lines of the enforcement wing which – in line with good practice – should be under ACD
(3) Tax Administration: Re-Organization and Modernization: (i.) ARD fully rolls-out SIGTAS to the five most populated province, and introduces risk-based compliance audits in all tax payer's offices in Kabul. (ii.) The Cabinet approves a plan for the re-organization and re-structuring of ARD, including the proposal, policy	**(3)** (i.) Copies of provincial SIGTAS reports; reports of the audit committee indicating details on the selection and results of the audits. (ii.) Copy of the cabinet-approved restructuring plan and copy of	**Risk of delay.** ARD reports that the first part of the benchmark has been completed. However, evidence has not yet been submitted to the Administrator. The draft reorganization and restructuring plan is not yet finalized.

procedures and a new organization structure. The re-organization aims at providing the ARD with more autonomy in decision making, reducing the fragmentation of ARD functions across ARD HQ and provincial tax offices, and at strengthening relevant reporting lines.	relevant minutes recording the decision.	
(4) Tax Policy: (i.) As part of the revenue measures agreed with the IMF under the SMP, MoF decrees the introduction of a mobile telecommunication top-up fee, an increase in the Business Receipt Tax and an increase in the fuel and toll fees. (ii.) MoF establishes and the cabinet authorizes an inter-Ministerial and inter-departmental committee for tax policy. The main function of the committee, which may have a flexible structure, should review, discuss and advise on all major tax policy proposals in a time-bound manner prior to approval by cabinet and ensure that all relevant stakeholders are consulted.	(i.) Copies of the gazetted decrees and satisfactory review by IMF staff, (ii.) copy of cabinet approved procedure and committee's ToR and minutes of cabinet decision	**On track.** The decree was issued, gazette and all revenue measures have been implemented. Parliament raised concerns over the observance of the legislative process and attempted to overturn the decree. However, the revenue measures have been previously approved by parliament as part of the amended budget law. MoF is in the process of clarifying this issue with parliament while it keeps the revenue measures in place. The ToR for the new tax policy committee is in preparation. MoF expect to present the committee for authorization by early December.
Goal 2: Mobilizing revenue by improving conditions for private-sector-led growth		
1394 Benchmarks	**1394 Evidence**	**Progress**
(5) Land Administration and Management The Cabinet approves the new land management law. The new law will include provisions that moves land titling from a court-based to an administrative system, improves security of tenure for various land users (incl. communities, women and private investors), as well as strengthens rights and mechanisms for the restitution of public and private land.	Copy of cabinet approved Land Management Law and copy of minutes reflecting the relevant cabinet decision.	**On track**. The land management law has been finalized and presented for discussion to the legal sub-committee of the cabinet. The draft law is in the pipeline for presentation to cabinet.
(6) **Doing Business Reforms:** The Cabinet approves a road map which includes a description of all required institutional and regulatory changes for the establishment of a unified business registration system which provides the right to invest, trade and conduct usual business activities to the license holders as well delineates the roles, ownership and management	Copy of the roadmap and Minutes of the Cabinet meeting / Presidential decree for establishment of the unified business registration system.	**Risk of delay.** Discussions on the road map are still on-going and there does not yet seem to be a divergence of opinions on the future of the business and licensing system. A high-level decision on this matter would be required at this point and is pending.

responsibilities of MOCI and AISA in relation to business registration and licensing.		
Goal 3: improving the efficiency, accountability and transparency of public spending		
1394 Benchmarks	**1394 Evidence**	**Progress**
(7) Sustainability of Pension and Social Benefits: i) MoF and MoLSAMD conduct a review of the pension and social benefits system which lays out the fiscal implications of the current pension schemes (Civil Servants, Security, Martyrs & Disabled) with recommendations on how to ensure that pensions and social transfers remain fiscally sustainable in the future. The findings of the review will be presented to the President, the Council of Ministers as well as the Cabinet. ii) MOLSAMD has introduced biometric verification / proof of life for the public pension beneficiaries registered in the PMIS.	**(7)** (i) Minutes of meeting of the Cabinet, Council of Ministers and President. (ii) WB field visit report certifying the integration of the biometric verification module with the Pension MIS and banks verification systems.	**Risk of delay.** MoF shared a draft report that reviews the fiscal implications of the current pension schemes for civil servants and security personnel in September 2015. The report also developed policy recommendations. The financial projections in the report show consistent magnitudes with that of earlier projections by the World Bank. Also, the degree of fiscal position improvement appears to be in line with the realities of how much decrease in generosity of the pension system could be pursued in the near future given the political economy of pension reform. Recommendations on harmonizing pension rules for the civil service and security personnel as means of establishing a uniform platform for pension provision and separating the financial flows of the pension system in distinct government pension fund are also supported by the World Bank team. The Administrator shared a number of comments related to accrual rate of the defined benefit pension scheme and the voluntary lump sum payments which MoF agreed to consider in the next draft. However, the proposal thus far is a MoF proposal and the recommendations are not yet shared by MOLSAMD. MoF and MoLSAMD are due to address their disagreements at senior leadership level during the week of November 21; if the difference cannot be resolved, the Administrator advised to acknowledge their differences of opinion in the final report rather than further delaying the submission of the report for presentation to the President, the Cabinet and the Council of Ministers. ii) The procurement of IT services introducing the biometric verification was severely delayed. The procurement process is now progressing, although issues surrounding the eligibility of firms that expresses interest caused further delays. The related contract is now expected to be in place in December 2015. Meeting the trigger condition appears to be feasible within weeks from that point. However, the risk of the benchmark not to be met by December 31, 2015 is substantial in any case.
(8) Electronic Payment Systems: DAB issues a clear and transparent regulatory framework for payment system providers and payment system operators and issues an appropriate license to the Afghanistan Payments System (APS)	**(8)** Copy of the regulation issued by DAB for payment system providers and payment system operators; (ii) Copy of the license issued to Afghanistan Payments System (APS).	**On track.** DAB hired a consultancy to draft the PSO and PSP regulations and deliverables are due before end of 2015. The assessment report has already been submitted to DAB Legal Office and FSD for their comments and review.

(9) Fiscal Deconcentration and Provincial Budgeting: (i.) The Cabinet approves the Provincial Budgeting Policy, allowing budget allocation of discretionary resources to provinces, based on clearly defined norms (developed by central line ministries) and in consideration of the capacity of the receiving Ministries as well as overall fiscal space. (ii.) MoF establishes a Fiscal Deconcentration Working Group that oversees the implementation of the provincial budgeting policy.	**(9)**(i) Minutes of the Cabinet meeting that approves the Provincial Budgeting Policy; (ii) Letter issued by MoF establishing the Fiscal Deconcentration Working Group.	**Achieved.** The cabinet approved the budgeting policy on June 24, 2015 subject to final endorsement by the Council of Ministers which was subsequently issued on October 5. The Bank's assessment is that the policy provides a good starting point for the deconcentration process, carefully and adequately recognizes capacity constraints at provincial level and fiduciary risks and that it provides flexibility for adjustments during the implementation. Recommendations to be considered in the implementation include: • More clarification on incremental steps to increase autonomy for of provincial directorates could be provided, specifically with regard to how systems and human capacity will be developed over the next years. • Line Ministries could show larger resistance to divest their planning powers and financing to lower levels of government. A stronger monitoring and results framework could help with monitoring the process and hold Line Ministries more accountable. • There is laudable mention of transparency in the policy but ways to achieve transparency are yet to be made concrete. Some initiatives could include: publication of expenditure norms and outcomes for each sector, stand-alone budget paper for provinces as well as defining local transparency initiatives as eligibility criteria for resource allocation • More clarification on how procurement authority will be devolved.
(10) External Audit: (i) The Supreme Audit Office (SAO) develops and agrees on a framework and methodology for Performance Audits in line with INTOSAI Auditing Standards. (ii.) SAO prepares and presents a report to Parliament and President on the status of outstanding audit observations and compliance with the audit recommendations of the least three years by each line ministry and government department. With assistance of the Ministry of Finance, SAO notifies an audit follow-up mechanism requiring the line ministries to implement the agreed audit recommendations.	**(10) (** i.) Copy of the framework/guidelines issued for Performance Audits. (ii.) Copies of audit report and notification letter from SAO to Line Ministries.	**Risk of delay**. SAO has developed the performance audit manual based on INTOSAI Auditing Standards with the consultant support. The manual has been presented to the Auditor General for approval. SAO confirmed that approved copy of the manual will be shared with the Bank by first week of December. SAO is compiling the information about status of outstanding audit observations for the last three years that at present is maintained manually in separate files for each audit. SAO communicated to the Bank that they would be able to prepare the detailed report on outstanding audit observations by December 15, 2015. The report will be subsequently presented to the President and Parliament. There has been no progress on the audit follow-up mechanism. During the meeting on November 10, 2015 SAO informed the Bank that MOF did not communicate the ARTF IP triggers to them and they will coordinate with MOF to prepare and notify the audit follow-up mechanism. The Administrator urges SAO and MOF needs to work more closely together to achieve this trigger by December 31, 2015.

Annex 2: Progress Report on Pending FY1393 Benchmarks—Status as of November 15, 2015

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.**
(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.**
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.**

(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.**
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.	**Delayed.** 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.
(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; - Money Service Providers issued by DAB in March 2008; and	**(6)** Administrator will review and verify issuance of the regulatory instrument.	**Delayed.** 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.

- Foreign Exchange Dealers issued by DAB in July 2008.		
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.	**Rolled over into FY 1394 program.** High level ownership within MoCI and the government is critical for progress in this area. 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.
(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.	**Delayed.** 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	**Rolled over.** 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; HR management reforms, 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.**