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Report No. 80996-AF

Afghanistan

Public Financial Management and Accountability Assessment

August 2013

The World Bank Group

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FISCAL YEAR
December 21 – December 20

CURRENCY EQUIVALENTS
Currency Unit = Afs
US$1 = Afs 55.25 as at August 26, 2013

Acronyms and Abbreviations

ACBR	Afghanistan Central Business Registry
ACD	Afghanistan Customs Department
ADB	Asian Development Bank
AFMIS	Afghanistan Financial Management Information System
AGA	Autonomous Government Agencies
AISA	Afghanistan Investment Support Agency
AMD	Aid Management Directorate
ANDS	Afghanistan National Development Strategy
ARD	Afghanistan Revenue Department
ARDS	Afghanistan Reconstruction and Development Services
ARTF	Afghanistan Reconstruction Trust Fund
ASYCUDA	Automated System for Customs Data
ATRA	Afghan Telecommunications Regulatory Authority
BC	Budget Circular
BN	Billion
BPHS	Basic Package of Health Services
BRT	Business Receipts Tax
CBS	Core Banking System
COFOG	Classification of the Functions of Government
CSDRMS	Commonwealth Secretariat Debt Recording and Management System
CSO	Civil Society Organization
CSC	Compliance Strategy Committee
CSTC-A	Combined Security Transition Command-Afghanistan
DAB	Da Afghanistan Bank
DABS	Da Afghanistan Breshna Sherkat
DAD	Donor Assistance Database / Development Assistance Database
DFID	Department for International Development
DFR	Donor Financial Review
DI	Donor Indicator
DSA	Debt Sustainability Analysis
ECF	Extended Credit Facility
EITI	Extractive Industries Transparency Initiative
EQUIP	Education Quality Improvement Project
EU	European Union
FPD	Fiscal Policy Department

FLGE	Fuel & Liquid Gas Enterprise
FOB	Free On Board
GCMU	Grant & Contract Management Unit
GDP	Gross Domestic Product
GFS	Government Fiscal Statistics
GoA	Government of Afghanistan
HIPC	Heavily Indebted Poor Countries
IA	Internal Audit
IAD	Internal Audit Department
IARCSC	Independent Administrative Reform and Civil Service Commission
IAU	Internal Audit Unit
IDLG	Independent Directorate of Local Governance
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standard
ISPPIA	International Standards for the Professional Practice in Internal Audit
LIC	Lower Income Country
LOTFA	Law and Order Trust Fund Afghanistan
LTO	Large Taxpayer Office
MDA	Ministry, Department and Agency
MAF	Mutual Accountability Framework
MAIL	Ministry of Agriculture, Irrigation and Livestock
MIC	Middle Income Country
MISFA	Microfinance Investment Support Facility for Afghanistan
MoC	Ministry of Culture
MoCI	Ministry of Commerce and Industry
MoCIT	Ministry of Communications & Information Technology
MoD	Ministry of Defense
MoE	Ministry of Education
MoEc	Ministry of Economy
MoEW	Ministry of Energy & Water
MoF	Ministry of Finance
MoI	Ministry of Interior
MoJ	Ministry of Justice
MoLSAMD	Ministry of Labor, Social Affairs, Martyrs & Disabled
MoMP	Ministry of Mines and Petroleum
MoPH	Ministry of Public Health
MoTCA	Ministry of Transport & Civil Aviation
MoUD	Ministry of Urban Development
MRRD	Ministry of Rural Rehabilitation & Development
MTBF	Medium-Term Budgeting Framework
MTFF	Medium-Term Fiscal Framework
MTO	Medium Taxpayer Office
NA	Not Applicable
NGO	Non-Government Organization

NPI	Non-Profit Institution
NPP	National Priority Program
NR	Not Rated
NRAP	National Rural Access Program
OAA	Office of Administrative Affairs
ODA	Official Development Assistance
O&M	Operation and Maintenance
P&G	Pay and Grading
PAC	Public Accounts Committee
PCBO	Procurement Capacity Building Officer
PDP	Provincial Development Plan
PE	Public Enterprise
PEFA	Public Expenditure and Financial Accountability
PETS	Public Expenditure Tracking Survey
PFEM	Public Finance and Expenditure Management
PFM	Public Financial Management
PFMPA	Public Financial Management Performance Assessment
PFMRII	Second PFM Reform Project
PI	Performance Indicator
PIFC	Public Internal Financial Control
PMIS	Procurement Management Information System
PPU	Public Procurement Unit
PREM	Poverty Reduction and Economic Management
PRGF	Poverty Reduction and Growth Facility
PRT	Provincial Reconstruction Team
RTAS	Revenue Tracking Analysis System
SARFM	South Asia Region Financial Management
SAO	Supreme Audit Office
SBD	Standard Bidding Document
SBPS	State Budget Preparation System
SEHAT	Health Project
SIGTAS	Standard Integrated Government Tax Administration System
SN	Sub-National
SPC	Special Procurement Committee
SOE	State-Owned Enterprise
STO	Small Taxpayers Office
SY	Solar Year
TIN	Tax Identification Number
TDF	Telecommunications Development Fund
TSA	Treasury Single Account
UNDP	United Nations Development Program
USAID	United States Agency for International Development
VAT	Value-Added Tax
VPP	Verified Payroll Plan

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Summary Assessment

This report provides a performance assessment of the Public Financial Management (PFM) system of the Government of Afghanistan (GoA) based on the Public Expenditure and Financial Accountability (PEFA) approach. The scope of the assessment is the on-budget activities of the national-level budget entities since, as a unitary state, Afghanistan has no provincial governments (while municipalities have very limited service provision responsibilities and resources). For the purposes of this report, on-budget refers to all operations, including donor-financed programs and project financing, and their intended use, which are under the full control of the government and are reported in the budget documentation. In Afghanistan's case all on-budget funds are channeled into the main revenue funds (or accounts) of the GoA and then managed through its regular systems of disbursement and financial control. The assessment covers the last three fiscal years – SY1389[1] (2010/11), SY1390 (2011/12), and SY1391 (2012).

Public finance has played and will continue to play a critical role in contributing to economic stability, state-building, growth, and poverty reduction, and in particular enabling the GoA to perform effectively and deliver public services to the Afghan people.

Afghanistan has accomplished, in a difficult post-conflict situation, remarkable progress on the fiscal front. Despite pressures, fiscal discipline has been strictly enforced and maintained, and there is significant fiscal transparency.[2] Both of these have been effected through the use of the budget as the primary policy instrument. Domestic revenues, for example, have increased in the period from fiscal year SY1382 (2003/04) to SY1390 (2011/12) at an average annual rate of 33 percent per year, rising from 4.5 percent of GDP to 11.3 percent.

This 2013 PEFA assessment portrays a public sector in which financial resources of the general government sector are, by and large, tracked and reported within a budget which is processed with transparency and has contributed to aggregate fiscal discipline. The expenditures and financial position of the GoA are reported regularly in an understandable format and Parliament reviews the fiscal reports of the executive. The GoA's commitments to financial transparency and accountability have engendered confidence from donors resulting in mobilization of high levels of external support for both the recurrent and development budgets (on-budget aid is budgeted at US$4 billion, or 60 percent of total funding, for fiscal year 2013). However, performance is still largely dependent on donor-funded technical assistance for policy advice and operational support. This will continue to be required to support the ambitious and crucial public finance reforms during the withdrawal of the security forces in 2014 and the rise in on-budget aid which is expected to follow the transition to national forces.

[1] SY refers to solar year (March 21 to March 20) which was also the fiscal year until 2012, when Dec 21 to Dec 20 was adopted as the fiscal year.
[2] The 2012 Open Budget Index reached 59 from 21 in 2010, which placed it in 26th position compared to 73rd in 2010. The score significantly surpassed the target of 40 agreed in the Tokyo Mutual Accountability Framework (MAF).

The table below compares the overall trajectory of the indicators from 2008 to the current assessment. Overall, there was a decline in five performance indicators (PIs), 10 indicators showed positive progress over the period between assessments and 11 are unchanged, while two indicators (PI-7, PI-15) were not rated in 2013 because there was insufficient information available to score one dimension under each indicator. Out of the total 74 dimensions included in the PFM indicators, two dimensions were not rated (NR) – PI-7 (i) and PI-15 (i); two dimensions were considered not applicable (NA) – PI-8 (I and ii);[3] and, three indicators are affected by changes in methodology (PIs 2, 3 and 19) introduced since 2008.

Table 1.0: Trajectory of Change since 2008

Indicator Group	(Number of indicators)		
	Lower	Equivalent	Higher
Credibility of the budget	1	-	3
Comprehensiveness and transparency	1	3	1
Policy-based budgeting	2	-	-
Predictability and control in budget execution	-	4	4
Accounting, recording and reporting	1	2	1
External scrutiny and audit	-	2	1
Total PFM	**5**	**11**	**10**
Donor practices	-	2	1

1. Integrated Assessment of PFM Performance

a. PFM out-turns: Credibility of the Budget (PI 1-4)

Credibility of the budget is maintained when deviations from the originally approved budget are kept to a minimum, as measured by PI 1-4 in the PEFA assessment. Performance in this core objective has improved since 2008 when it received the lowest ratings of the six core areas.

The predictability of the aggregate expenditure over three years has shown improvement, the score moving from D to C, as the deviation from budget was under 15 percent in all three years considered in the scoring. This deviation arises principally from low execution in the Development Budget.

The composition of expenditure out-turn compared to original budget, on the other hand, exceeded 15 percent in two of the last three years, arising principally from the use of contingency funds in the budget. The rating for composition of expenditure (PI-2) out-turn nevertheless improved as there are no direct charges to contingency funds; this is a new dimension for PI-2 that was added to the PEFA methodology since 2008.

The score for predictability of the GoA's revenue deteriorated, however, because PEFA criteria now considers both revenue overruns from budget as well as revenue shortfalls; Afghanistan's revenue exceeded budget in two of the three years considered in the calculations.

b. Comprehensiveness and Transparency (PI 5-10)

The GoA's budget transparency and comprehensiveness remains strong although PI-7 was not rated because in this assessment dimension (i) on the level of extra-budgetary expenditure could not be scored since expenditure data was not available for the operations of the Telecommunications Development Fund (TDF) and is not reflected in fiscal reports. Nevertheless, the dimension relating to reporting income and expenditure data on donor-funded operations

[3] When a dimension is NA, the dimension is excluded from further consideration; i.e., it is as if the dimension does not exist. When a dimension is NR, the overall PI score is NR because a NR in one dimension leads to NR on the entire indicator.

is rated A. Similarly, PI-8 improved to A because dimension (i) on transparency of horizontal allocations was not rated, as Afghanistan does not have an inter-governmental fiscal transfer system, and dimension (ii) on the extent of consolidation of fiscal data was rated A because the requisite revenue and expenditure information on the major municipalities is collected.

The classification used for recording of the execution of the budget supports administrative, economic and functional (COFOG) reporting. In budget formulation, however, only the Afghanistan National Development Strategy (ANDS) sectors are used, which do not coincide with COFOG.

The comprehensiveness of information included in budget documents in the most recent fiscal year reviewed SY1391 (2012) was rated C down from B in 2008 because it fulfilled only four of the nine information benchmarks.

Oversight of aggregate fiscal risk remains limited, despite effective control over sub-national indebtedness, because of the poor reporting by and auditing of state-owned enterprises (SOEs) and, especially, state corporations.

Accessibility of information for the public remains a positive feature of Afghanistan's budget process. The annual budget document, in-year budget execution reports, year-end financial statements, and the *Qatia* audit report prepared by the Supreme Audit Office (SAO) are all made public. Improvement, however, could be made in access to contract awards and on the amount of budget resources made available to frontline service delivery units.

c. Policy-Based Budgeting (PI 11-12)

The orderliness and participation in the annual budget process in Afghanistan remains good; there is a clear and comprehensive annual budget calendar and ministries are given reasonable time to complete their detailed estimates. However, Parliament still does not approve the budget on a timely basis, and in the most recent budget preparation exercise, the budget circular did not include precise budget ceilings, which caused a slight deterioration from 2008 in the overall rating of PI-11.

The multi-year perspective in fiscal planning, expenditure policy and budgeting is supported by an annual debt sustainability analysis as well as the preparation of multi-year fiscal forecasts and functional allocations for at least two years on a rolling annual basis although the linkage to annual budgets is unclear. However, properly costed sector strategies were prepared for only a relatively small share of the National Priorities Programs (NPPs); moreover, this costing was not in line with the fiscal forecasts since it considered both secured and non-secured funding.

It is noted, however, that the Ministry of Finance (MoF) since 2011 has prepared a Pre-Budget Statement, which is a well-presented document, and that the implementation of this Medium-Term Budgeting Framework (MTBF) is perhaps one of the MoF's major achievements in the budget formulation and preparation process in recent years. Also, the MoF for the SY1392 (2013) budget calculated operating and maintenance (O&M) costs for two line ministries, and more ministries are to be covered in similar exercises in 2013.

d. Predictability and Control in Budget Execution (PI 13-21)

Many improvements have been made in the areas of predictability and control in budget execution. The overall state of this area remains strong with performance on eight of the nine indicators rated C or better in this assessment.

<u>Tax Administration</u>. The MoF has paid considerable attention to tax and customs reforms since 2008 and mobilized technical assistance which has contributed to an improvement in the ratings for tax transparency and effectiveness from C to C+ in both cases. There is now clarity in the laws on taxpayers' liabilities, but great discretion remains with tax authorities over the issuance of tax certificates which is a source of complaint by the private sector. Nevertheless, the public has good access to tax and customs liabilities and administrative procedures. Similarly, appeals mechanisms have been established for tax and customs although there is relatively little use made of these processes. While non-compliance, in terms of timing filing, remains high and effective application of tax audit is limited to large taxpayers, effectiveness in tax assessment has advanced as a result of the extensive coverage of tax registration. Effectiveness in collection of tax payments was not rated because of the limited information on gross tax arrears; there is, however, timely transfer of revenue to the Treasury Department.

Cash and Debt Management. Frequent updates of detailed cash forecasts, good tracking of commitments by the ministries, agencies, and departments (MDAs) and the transparent adjustments in the budget all contribute to good predictability in the availability of funds. Similarly, the MoF has high-quality debt records and controls the contracting debt; it also exercises effective cash control through the consolidation of all funds under its responsibility.

Payroll Controls. A series of complimentary centralized oversight arrangements feed into the control of payroll management, which is largely decentralized along with personnel management, allowing for timing payroll preparation and the integration and reconciliation of payroll and personnel records, although done largely on a manual basis.

Procurement. The assessment methodology for PI-19 was revised in 2011, and as such the scores for 2008 and 2013 are not fully comparable. Nevertheless, on the dimensions used for 2008, the overall rating was B and – on the dimensions required for this 2013 update – the overall rating is B+, so a positive trend is set.

Internal Control. Afghanistan continues to perform well in control because of the good (but manual) commitment controls in the line ministries and improvements in the documentation of procedures. However, although non-compliance with rules for processing is closely monitored, it continues to be excessive.

Internal Audit. Internal audit overall has not advanced since 2008 although good capacity and institutional arrangements are in place for this function in the MoF. The low capacity for internal audit in the line ministries, and the GoA's recent decision to limit the purview of the MoF Internal Audit Department (IAD) to its own ministry is delaying the modernization of government-wide internal audit.

e. Accounting, Recording and Reporting (PI 22-25)

The accounting, recording and reporting practices remain strong. The reliability of the GoA's accounting records is established by the timely reconciliation of its records to bank records. Of most interest to executing agencies and donors, however, is the improvement of availability of information on resources received by service delivery units. For example, information is available on the resources used per unit for most health care facilities.

In-year budget execution reports continue to be reliable, timely and generated in the budget structure albeit only on expenditures as commitment reporting is not available for the recurrent budget. Similarly, external financial reporting is exceptional in its completeness and timeliness. Moreover, the accounting basis is consistently disclosed. However, reporting is not in full compliance with the International Public Sector Accounting Standards (IPSAS) since these require consolidation of all entities under the control of the reporting entity (central government in this case), which is not done.

f. External Scrutiny and Audit (PI 26-28)

The indicators for external scrutiny of Afghanistan's PFM rank high in international comparisons; however, the new Audit Law approved by Parliament, that represents a great step forward, is still subject deviations from the audit principles on independence. These are reasonable to expect from a developing legislature such as that of Afghanistan. SAO applies the ISSAI Level 3 principles, but not the Level 4 standards that translate the principles into more specific, detailed and operational guidelines that could be used in the day-to-day conduct of auditing tasks.

g. Donor Practices (DI 1-3)

Donors are providing timely forecasts for their direct budget support, outside of project financing, and actual support came within 7 percent of forecast in all of the last three fiscal years. While all donors provide timely forecasts for project financing, the reporting on disbursements under these is made for less than 50 percent. Lastly, there remains extensive official development assistance (ODA) outside the budget and outside of the GoA's control.

2. Assessment of the impact of PFM weaknesses

The extent to which the performance of Afghanistan's PFM system supports or does not support the overall achievement of budgetary outcomes should be analyzed from the perspective of how these arrangements contribute to the attainment of aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. The strengths and weaknesses of Afghanistan's PFM system found in the assessment have an impact on these three measures of budget effectiveness, as explained below.

a. Aggregate fiscal discipline

Transparency in the GoA's budget preparation, the comprehensiveness of the budget, and the preparation of multi-year fiscal forecasts all contribute to the attainment of aggregate fiscal discipline. However, credibility of the budget is the one area in which Afghanistan scores lower than an average of LICs. While fiscal discipline can be salvaged by strict cash allotments to keep commitments within the limits of cash availability, the variance to budget both in the aggregate revenue and expenditures is not conducive to fiscal discipline. Similarly, the inconsistent approach followed in monitoring arrears must change if fiscal discipline is to be attained under circumstances of scarcer discretionary sources of funds, which is expected to prevail over the transition period (2013-2017, during which responsibility for national security is taken over by national forces). Robust information on the impact on O&M cost from the massive off-budget spending on infrastructure that will come under the responsibility of the GoA over the transition period, is also critical for fiscal discipline.[4] Lastly, financial compliance is fundamental to the use of the budget as the primary policy instrument and to effecting fiscal discipline; the current rate of non-compliance with rules undermines the capacity of officials to direct operations to agreed targets.

b. Strategic allocation of resources

The preparation of the budget on a three-year rolling basis under the Medium-Term Fiscal Framework (MTFF) supports the introduction of hard constraints as the effect of current policies on future years are costed and considered. However, it is unclear how these estimates have led to the determination of the annual ceilings, i.e., the hard budget constraints.

The strategic policy and sectoral objectives set out in the GoA's NPPs contribute greatly to the prioritization of investment. However, the related detailed costing is only done for a fraction of the programs.

c. Efficient service delivery

Pushing decision-making closer to frontline decision-makers requires transparency and accountability. Information is critical to transparency, but in Afghanistan information on resources available to frontline service delivery units is not provided for the education sector. Moreover, management oversight of service delivery units is limited by the current weak state of internal audit, so a more centralized control persists which adds steps to processing and dilutes accountability. Similarly, the lack of the application of standards by the SAO and the lack of publication of results of compliance reviews weakens accountability arrangements of the Executive.

[4] The IMF in 2012 noted "In particular, the military transition, from now until 2014, and the subsequent transformation decade will pose significant fiscal challenges for Afghanistan as a larger share of security spending will come on budget, and operations and maintenance (O&M) legacy costs associated with donor-funded capital assets (in both the security and nonsecurity sectors) will need to be absorbed. In addition to the increase in overall spending pressures, the government will face difficult allocative choices. Higher spending on security may have to come at the cost of lower spending on development, with resulting implications for service delivery priorities. Given these challenges, the MTFF must play an increasingly important role as a tool to identify short- and medium-term policy trade-offs and financing constraints" (emphasis added) [IMF (2012a): "Advancing Public Financial Management Reforms", April, p. 7].

3. Prospects for reform planning and implementation

The GoA continues to be committed to fiscal discipline and fiscal transparency. To meet these commitments it has charged and empowered the MoF to agree a plan of reforms with donors, negotiate technical assistance agreements and lead the implementation of the reforms. At the Kabul Conference in July 2010, the GoA presented the PFM Roadmap which set out its intentions to strengthen PFM based on a three-year framework that was agreed with donors. The PFM Roadmap became a NPP and the GoA is pursuing funding to implement the program estimated at US$117 million.

The strengths and weaknesses of the institutional factors supporting PFM reform include:

Government Leadership and Ownership. While the PFM Roadmap was developed following a GoA-donor agreement on the need for a credible plan for PFM strengthening, the concrete process of developing the PFM Roadmap was led and owned by the GoA as was the task of creating an enabling environment to support the process.

Coordination across the GoA. While the organizational structure outlined for implementation of the PFM Roadmap – a Steering Committee (group of deputy ministers) to lead the strategic level and a Secretariat (placed at the Office of the Deputy Minister Finance) to undertake program management – was never established, coordination of progress reporting was effected through the Office of the Deputy Minister Finance.

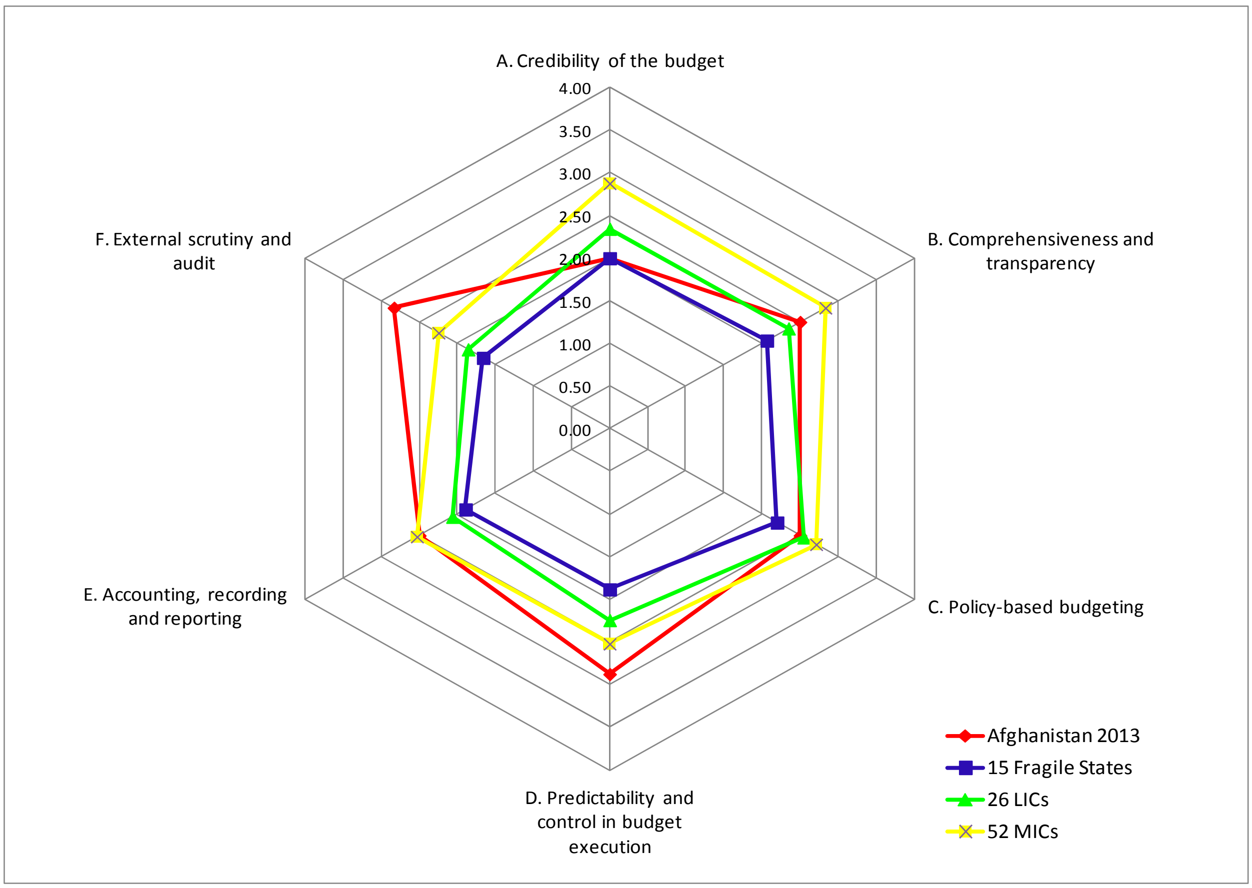
Sustainable Reform Process. While there is progress in implementing the PFM Roadmap, a number of challenges have also been observed. Poor co-ordination and communication among stakeholders coupled with changing goals has meant that the reform process has been difficult. Also, a review of the PFM Roadmap implementation process carried out in May 2012 found that communication efforts had reduced after the first six months. Focus had over time moved from driving progress of activities to collection of progress information, and the monitoring focus had moved from high-level goals to the activity-level. Also, the plan was not updated, and attempts to secure donor financing did not met expectations. Most importantly, with the withdrawal of security forces in 2014, more resources will be put on-budget, increasing the staffing and capacity pressures, which may lead to even greater reliance on technical assistance in PFM from donors, which is not yet fully agreed or in place.

Donors. While donors still use off-budget channels for most aid to Afghanistan, on-budget funding is very significant, at US$2.03 billion (54 percent of total receipts), for the nine months to December 20, 2012 (SY1391). The related operations are implemented through government-wide systems, which have been developed to a great extent with donor-funded technical assistance.

4. International Comparison of the PEFA Scores

Comparison with other countries shows that the PFM system of Afghanistan perform relatively strongly. The graph below shows that Afghanistan's PEFA scores are better than the average of 15 fragile states (except for the Credibility of the Budget, where it is on par). Also, Afghanistan outperforms 27 LICs on four dimensions (except for the Credibility of the Budget, and Policy-based Budgeting, where it is on par). And, compared to the average of 51 MICs, Afghanistan's PFM system scores better on two dimensions, is on par for one dimension, and scores lower on three dimensions. More details are provided in Annex F.

Graph 1: International Comparison of PEFA Scores



PEFA Assessment Management Organization

Oversight Team – The assessment was reviewed as part of the analytical and advisory assistance products of the World Bank (SARFM). As such, the planning (this concept note) and draft assessment reports were submitted for review by a Quality Assurance Team member in SARFM, for review by by peer reviewers and eventually signed off by the Sector Manager and Country Director.

Role	Name	Organization
Chair and Assessment Manager	Fily Sissoko	Manager, South Asia Financial Management – World Bank
Assessment Team Leader	Paul Sisk	Lead Financial Management Specialist, South Asia Financial Management – World Bank
Team Members	Asha Narayan	Senior Financial Management Specialist, Afghanistan – World Bank
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	Suzanne Flynn and Sailendra Pattanayak	Public Expenditure Specialists, International Monetary Fund
	Kevin Lao	Economic Advisor, Department for International Development
	Helena Ramos	PEFA Secretariat
	Paul Banerjee	Advisor, Ministry of Finance
	Arun Kumar Kolsur	Senior Procurement Specialist, South Asia, India, World Bank

Disclosure of Quality Assurance Mechanism (Paul Sisk, TTL, Afghanistan, PEFA 2013 Update)

The following quality assurance arrangements have been established in the planning and preparation of the PEFA assessment report for AFGHANISTAN, final report dated August 2013.

1. Review of Concept Note. The Concept Note was circulated on December 5, 2012 to the peer reviewers and written comments were received from all by the end of December as follows: Claudia Nassif (Sr. Economist, SASEP, World Bank); Suzanne Flynn and Sailendra Pattanayak (Public Expenditure Specialists, International Monetary Fund); Kevin Lao (Economic Advisor, DFID); Rama Krishnan (Sr. Financial Management Specialist, SARFM, World Bank); Helena Maria Grandao Ramos (Sr. Public Finance Specialist, PEFA Secretariat); Paul Banerjee, Ministry of Finance; and Arun Kolsur (Senior Procurement Specialist, World Bank).

The Afghanistan Country Director of the World Bank approved the Concept Note in a Decision Meeting on February 7, 2013. The Decision Meeting Note with the revised Concept Note and a separate file with all peer review comments and the team response was distributed to the team and all reviewers.

2. Review of Draft Report. The draft report was sent to peer reviewers on May 29, 2013 and comments were received from all by the end of June 14, 2013 as follows: Claudia Nassif (Sr. Economist, SASEP, World Bank); Suzanne Flynn and Sailendra Pattanayak (Public Expenditure Specialists, International Monetary Fund); Kevin Lao (Economic Advisor, DFID) Rama Krishnan (Sr. Financial Management Specialist, SARFM, World Bank); Helena Maria Grandao Ramos (Sr. Public Finance Specialist, PEFA Secretariat); Paul Banerjee, Ministry of Finance; and Arun Kolsur (Procurement Specialist, World Bank). PEFA Secretariat peer reviewer comments were received on June 8, 2013.

3. Review of the final draft. A revised final draft assessment was forwarded to reviewers on August 26, 2013, along with a table showing the responses to all comments raised by all reviewers. The Afghanistan Country Director of the World Bank approved the revised final draft in a Decision Meeting on September 2, 2013. The Decision Meeting Note with the revised final draft and a separate file with all peer review comments and the team response was distributed to the team and all reviewers.

PEFA assessment report Afghanistan, August 2013

The quality assurance process followed in the production of this report satisfies all the requirements of the PEFA Secretariat and hence receives the 'PEFA CHECK'.

PEFA Secretariat, August 28, 2013.

Chapter 1: Introduction

1.1. This document reports on a Public Financial Management Performance Assessment (PFMPA) for the government of Afghanistan (GoA). The assessment was conducted with the particular objective of updating the PFMPA published in June 2008 (Report No. 44622-AF) to provide the GoA with an objective, indicator-led assessment of the Public Financial Management (PFM) system in a concise and standardized manner, to form an updated understanding of the overall fiduciary environment of the PFM system, and to assist in identifying those areas in need of further reform and development. The assessment provides a common information pool with establishment of new baselines against which further progress in PFM development can be assessed. The scope of the assessment is the on-budget activities of the national-level budget entities. For the purposes of this report, on-budget refers to all operations, including donor-financed programs and project financing, and their intended use, which are under the full control of the GoA and are reported in the budget documentation. In Afghanistan's case, all on-budget funds are channelled into the main revenue funds (accounts) of the GoA and then managed through its regular systems of disbursement and financial control. This is comprehensive of most of Afghanistan's general government sector financial operations since most general government sector revenue and expenditure is on-budget and, as a unitary state, there are no provincial governments, while municipalities have very limited service provision responsibilities and resource. The assessment does not encompass operations implemented directly by donors (formally referred to as the External Budget). The last three fiscal years – SY1389 (2010/11), SY1390 (2011/12) and SY1391 (2012) – were considered in various indicators according to the PEFA guidance.

1.2. The GoA recognizes the importance of sound PFM and is therefore taking actions to enhance the accountability and effectiveness of public expenditures. Strengthening of the PFM systems currently mainly relies on the implementation of donor-funded projects, including:

- World Bank-financed Second PFM Reform (PFMRII) project with the objective of strengthening PFM through effective procurement, treasury and audit structures and the Second Customs Reform and Trade Facilitation Project.
- DFID-financed Strengthening Afghanistan's Budget at National and Provincial Levels (SAB) project with the goal of supporting the achievement of fiscal discipline, strategic resource allocation and efficient service delivery, and the Tax Administration Reform Project to strengthen and develop the tax administration of the Revenue Department.
- USAID-financed Economic Growth and Governance Initiative (EGGI) project which finances training support on program budgeting, budget preparation process, and technical assistance on revenue and customs administration.
- UNDP implemented Making Budgets and Aid Work (MBAW) project for operational support in the Budget Department of the MoF.
- AusAid funded Development Assistance Facility for Afghanistan (DAFAIII) project for support to line ministries in budget matters.

1.3. The assessment was carried out by the World Bank. The GoA collaborated with and supported the process through the MoF, which coordinated interaction through the Budget Department and from the Office of the Deputy Minister Finance.

1.4. The assessment was conducted as per the PEFA Fieldguide of May 3, 2012.[5] The scope of the current assessment was comprehensive with due consideration of the PEFA Secretariat guidance for repeat assessments. The PFMPA was conducted against 31 PFM Performance Indicators (PIs) – 28 for government performance and three for donor practices – which are grouped into the following critical dimensions of performance of an open and orderly PFM system:

a) **Credibility of the Budget** – Realism and its implementation as intended;
b) **Comprehensiveness and Transparency** – Comprehensiveness of the budget and fiscal risk oversight, and accessibility of the fiscal and budget information to the public;
c) **Policy-based Budgeting** – Preparation of the budget with due regard to government policy;
d) **Predictability and Control in Budget Execution** – Implementation of the budget in an orderly and predictable manner, and arrangements for the exercise of control and stewardship in the use of public funds;
e) **Accounting, Recording and Reporting** – Maintenance of adequate records and information, and their dissemination and use for reporting and management decisions; and
f) **External Scrutiny and Audit** – Arrangements for scrutiny of public finances and follow-up by the Executive.

1.5. In addition, the dimension of donor practices was captured to the extent to which these practices and the management of donor funds affect the PFM systems in the country.

1.6. PFM performance was assessed against each of the indicators by assigning ratings of A to D as per criteria stated in the PEFA Framework, which may broadly be interpreted as follows:

Table 1..1: Interpreting PEFA Scores

A	Represents performance that meets good international practice – the criteria for the indicator are met in a complete, orderly, accurate, timely, and coordinated way.
B	Typically represents a level of performance ranging from good to medium by international standards.
C	Represents a level of performance ranging from medium to poor.
D	Indicates either that a process or procedure does not exist at all, or that it is not functioning effectively.

1.7. The PEFA Framework focuses on operational performance of the key elements of the PFM system based on evidence rather than on the inputs that enable the PFM system to reach a certain level of performance. The PFMPA assesses the extent to which the PFM system is an enabling factor for achieving budgetary outcomes at the three levels of aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery. The information provided by the PFMPA would therefore contribute to the reform process of the GoA by determining the extent to which past reforms have yielded improved performance and by increasing the ability to identify and learn from reform success.

1.8. The task team from the World Bank comprised Paul E. Sisk, Team Leader, (Lead Financial Management Specialist), Asha Narayan (Sr. Financial Management Specialist), Asif Ali (Sr. Procurement Specialist), and Peter Jensen (International Consultant). Nabila Gerowal (Financial Management Program Assistant) provided administrative and logistics support.

[5] The Public Expenditure and Financial Accountability (PEFA) program was established in December 2001 as a multi-donor partnership between the World Bank, the European Commission, DFID, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, and the IMF. The PEFA PFM Performance Measurement Framework was issued in June 2005 and was updated in 2011.

1.9. Peer review was conducted by Rama Krishnan Venkateswaran (Sr. Financial Management Specialist, SARFM, World Bank), Claudia Nassif (Sr. Economist, PREM, World Bank), Arun Kumar Kolsur (Sr. Procurement Specialist, World Bank), Suzanne Flynn (Public Expenditure Specialist, IMF) and Sailendra Pattanayak (Public Expenditure Specialist, IMF), Helena Ramos (PEFA Secretariat), Kevin Lau (Economist, DFID), and Paul Banerjee (Advisor to Deputy Minister Finance, MoF).

1.10. A launch workshop, co-chaired by the MoF and the World Bank and attended by representatives of stakeholders was held on February 5, 2013. Thereafter the team listed above started the assessment activities in collaboration with the MoF. The Director General of the Budget Department served as focal person. The assessment was carried out through a combination of field study and interviews, review of existing studies and related reports, and extensive discussion and dialogue with concerned stakeholders in the GoA. The team acknowledges and appreciates the excellent cooperation extended by the GoA counterparts who facilitated the entire process and enabled a timely completion of the assessment. A final draft was shared with all counterparts in GoA which expressed acceptance and agreement on August 16, 2013. A dissemination workshop is planned for September, 2013 with participation by GoA officials, development partners and civil society representatives.

1.11. The resources consumed included approximately 18 staff weeks and 54 days for the international consultant provided by the World Bank.

1.12. The main body of the assessment report is structured as follows:

- **Chapter 2** provides country background and contextual information with regard to the economic situation as well as the legal and institutional framework supporting PFM;
- **Chapter 3** provides the detailed analysis of the 28 GoA-related and three donor-related performance indicators. A summary assessment of this information is provided in the preceding chapter; and
- **Chapter 4** provides a brief description of the GoA's PFM reform process in recent years and the current PFM reform agenda.

1.13. An overall summary of the results of the PEFA performance indicator scores for 2008 and 2013 is provided in Annex A. A list of references is provided in Annex B, and a list of persons consulted in Annex C. An overview of the administrative structure of the GoA is provided in Annex D, Annex E includes the data applied for PIs 1 and 2, and information about the international PEFA scores is included in Annex F.

Chapter 2: Background Information

2.1. This chapter provides an overview of the broader country economic context and a description of recent budgetary outcomes so as to put the PEFA assessment into perspective.

2.1. Description of the country economic situation

2.1.1. **Afghanistan's development progress over the past 10 years has been mixed**. The economy has grown by an average 9.2 percent between 2003 and 2012, and per capita income has increased from around US$160 to nearly US$600 over the same period. The country has also made significant progress in social and development indicators. Access to education and basic health services has expanded dramatically, life expectancy and maternal mortality have improved, and there is greater participation of women in the economy. In spite of the efforts made, Afghanistan remains one of the least developed countries in the world, with 36 percent of the population living below the poverty line in 2008,[6] and more than half of the population considered vulnerable.[7] In other respects, particularly related to governance, institution-building and security, Afghanistan has also faced significant challenges and currently sees deteriorating trends.

2.1.2. **Growth in Afghanistan has been high, but remained volatile mainly because of its heavy reliance on agriculture.** Agriculture is, after services, the most important economic sector in Afghanistan. During the period SY1382-SY1390 (2003/04-2011/12) real agricultural growth ranged from 22 percent to 45 percent and accounted for nearly one-third of GDP. In the twelve months to March 21, 2013, the country experienced an exceptional harvest, thanks to favorable weather and timely rainfall, resulting in growth of 11.8 percent. Inflation dropped from 10.2 percent to 6.4 percent in 2012, partly because of a decline in food prices.

2.1.3. **Afghanistan is highly aid-dependent.** ODA and military assistance to Afghanistan has been on the rise since 2002 and has grown from US$404 million in SY1381 (2002/03) to more than US$15.7 billion in SY1389 (2010/11). While the bulk of this is security spending, civilian aid was estimated at over US$6 billion a year or nearly 40 percent of GDP in SY1389 (2010/2011). Such aid dependence is almost uniquely high globally. Since much of this aid was provided to support the operations of the international troops, the planned withdrawal ("transition process") is associated with a decline in aid. This is expected to have significant ramifications for Afghanistan's development process.

2.1.4. **Substantial risks lie in Afghanistan's rising financing needs during and after the transition process.** The recovery of the economy and reforms in the public financial management system over the past decade allowed the budget to grow from US$645 million in SY1383 (2003/04) to US$4.2 billion in SY1390 (2011/12). Domestic revenues increased by 33 percent nominally per year over the same period, and grew from a low base of 4.5 percent of GDP in SY1382 (2003/04) to 11.3 percent in SY1390 (2011/12), thanks to reforms in tax and customs administration. Despite this significant increase in revenue mobilization, domestic revenues finance only 65 percent of the operating budget or only 50 percent of the overall core budget, while the rest is being financed by foreign grants. Moreover,

[6] World Bank-Ministry of Economy (2010): "Poverty Status in Afghanistan – A Profile based on the National Risk and Vulnerability Assessment (NRVA) 2007/08", July, p. 10.
[7] Ibid, p. 24.

expenditures are expected to grow with rising security spending for both operations and maintenance (O&M) and wages for the army and police. But it will also be driven by non-security spending, which will increase due to additional O&M liabilities associated with the handover of donor-built assets and with a rising government payroll. These developments could lead to a financing gap of 21 percent in 2025, and could be even higher in the intervening years.

2.1.5. **In order to mitigate fiscal risks, donors have committed to cover the financing gap.** The July 2012 donor meeting in Tokyo pledged US$16 billion in development aid to Afghanistan over the next four years. Together with earlier pledges on the security side, annual aid would amount to about US$8 billion – divided roughly equally between civil and security aid. Donors at the London Conference in January 2010 had already committed to channel 50 percent of the civilian aid (and seemingly much of the security aid) through the national budget. This increases pressures on the PFM system and the absorption capacity of line ministries. Mineral production in Afghanistan is now limited to small coal operations, limestone, construction materials, and gemstones and dimensional stone, but this is expected to change dramatically over the mid-term. In the short run, two deposits – the copper deposit at Aynak and the ore deposit at Hajigak, in Bamyan province – have the potential to generate substantial economic returns (US$322 million a year in 2011-2015, and over US$900 million per year on average until 2031). Opening 11 further mines has the potential to increase revenue to around US$1 billion per year on average from now through 2031. Mining could eventually contribute 2.0-2.5 percent of GDP to domestic revenue (which stood at 11.3 percent of GDP in 2010/11) and annually add 2-3 percentage points of GDP growth.

Table 2.1: Economic Indicators[8]

(percent, unless otherwise indicated)

	1386	1387	1388	1389	1390	1391
	2007/08	2008/9	2009/10	2010/11	2011/12	2012/13
Real Sector						
Nominal GDP (excl. opium; Afs billion)	490	519	615	730	864	1,023
Nominal GDP (excl. opium; US$ billion)	9.8	10.2	12.5	15.9	18.0	19.8
Real GDP growth (%)	13.7	3.6	21	8.4	7.0	11.8
GDP per capita (US$)	338	342	408	507	557	595
Money and Prices						
CPI inflation (period average, %)	12.9	26.8	-12.2	7.7	10.2	6.6
Core inflation (excl. fuel and cereals, %)	4.3	10.6	1.7	9.8	14.6	6.6
Broad money (M2)	24.4	31.3	36.8	38.2	36.8	33.1
Government finance*						
Domestic Revenue	6.8	8.0	10.3	11.0	11.3	8.0
o/w: tax revenue	5.1	5.5	8.4	9.1	8.7	5.9
Donor grants	10.9	10.1	10.2	11.0	10.8	12.2
Total Core Budget expenditure	19.5	22.8	22.1	21.1	23.0	18.5
Operating	10.3	13.9	14.5	15.2	17.4	13.3
Development	9.2	8.9	7.6	5.9	5.7	5.2
Operating balance	1.2	0.3	1.2	3.3	0.9	3.8
Overall Core balance (incl. grants)	-1.8	-4.3	-1.6	0.9	-0.9	1.6
Security spending	5.1	6.0	7.3	8.8	10.0	8.0
Fiscal sustainability ratio	66.1	57.3	71.3	72.7	65.0	60.2
External Sector						
Exports FOB (US$ billion) /1	1.85	2.46	2.52	2.64	2.75	2.61
Imports FOB (US$ billion) /1	7.39	8.95	9.47	9.95	10.62	11.17
Trade balance	-56.3	-63.6	-55.7	-45.9	-43.6	-43.1
Current account balance (incl. grants)	5.2	5.3	1.6	2.8	2.2	3.9
Current account balance (excl. grants)	-60.6	-66.0	-58.6	-48.5	-45.9	-44.9
Gross reserves (US$ million)	3,007	3,565	4,312	5,560	6,193	7,162*
Gross reserves (months of imports)	4.9	4.8	5.5	6.7	7.0	7.7
Total External debt						
Total debt stock (Afs billion) /2	96.6	107.1	106.2	100.8	114.3	112.2*
Debt-to-GDP Ratio (%)	19.7	20.6	17.3	13.8	13.2	11.0*
Memorandum items						
Nominal GDP (incl. opium; Afs billion)	519	541	633	747	904	1,106
Population (millions)	29.1	29.8	30.6	31.4	32.4	33.4
Exchange rate, average (Afs/US$)	49.8	50.9	49.3	45.8	47.9	51.6
Exchange rate, end-year (Afs/US$)	49.5	51.9	48.0	45.3	49.5	52.5

Notes: * indicates values as of December 2012. /1: Includes both official trade and unofficial trade (smuggling) estimates. /2: Official statistics by the MoF. Underlined numbers indicate forecasts or projections.

[8] World Bank (2013): "Afghanistan Economic Update", April.

2.2. Description of budgetary outcomes

2.2.1. The overall budgetary outcomes for the GoA during the past three fiscal years are shown below. It is noted that SY1391 (2012) is a nine-month fiscal year. This change was made so that the fiscal year would begin before the beginning of the construction period (spring) and would allow procurement of works contracts to be in place by the time construction can begin.

Table 2.2: GoA Budgetary Outcomes, SY1389-SY1391 (2010/11-2012)

	SY1389		SY1390		SY1391[9]	
	2010/11		2011/12		2012	
	Afs Million	% of GDP	Afs Million	% of GDP	Afs Million	% of GDP
Total Revenue and Grants	**160,537**	**22.0**	**192,964**	**22.4**	**181,586**	**23.5**
Domestic Revenue	80,492	11.0	99,420	11.5	82,185	10.7
Grants	80,045	11.0	93,544	10.9	99,401	12.9
Total Expenditure	**154,016**	**21.1**	**198,247**	**23.0**	**189,201**	**24.5**
Operating Budget	110,453	15.1	149,301	17.3	135,792	17.6
Wages and salaries	86,474	11.8	111,717	13.0	98,405	12.8
Goods and services	17,158	2.4	25,865	3.0	25,159	3.3
Grants & Pensions	5,152	0.7	8,936	1.0	8,321	1.1
Acquisition of assets	1,589	0.2	2,692	0.3	3,816	0.5
Interest	79	0.0	92	0.0	90	0.0
Development Budget	43,563	6.0	48,946	5.7	53,408	6.9
Wages and salaries	0	0.0	0	0.0	0	0.0
Goods and services	15,773	2.2	20,846	2.4	21,665	2.8
Grants & Pensions	416	0.1	0	0.0	0	0.0
Acquisition of assets	27,373	3.8	28,100	3.3	31,743	4.1
Interest	0	0.0	0	0.0	0	0.0
Aggregate Surplus/Deficit	**6,521**	**0.9**	**-5,283**	**-0.6**	**-7,615**	**-1.0**
Net Financing		**0.0**		**0.0**		**0.0**
Foreign financing (loans)	2,802	0.4	2,207	0.3	2,171	0.3
Domestic financing		0.0		0.0		0.0
GDP (Afs Million)		729,905		861,947		771,083

Sources: Expenditure data – Annual Financial Statements for SY1389-SY1391 from the Treasury Department, MoF. GDP data – MoF (2012): "SY1392 National Budget", p. 21.

2.2.2. Table 2.2 shows that the GoA for SY1389 (2010/11) had a budgetary surplus, which turned into a deficit for SY1390 (2011/12) and SY1391 (2012). This was due to total expenditure increasing relatively more than total revenue and grants. It is noted that in SY1390 (2011/12) especially wages and salaries increased sharply (mainly due to increased staffing numbers under the MoI and MoD). As a share of GDP it is seen that while all expenditure items have grown from SY1389 (2010/11) to SY1391 (2012), as has grants, the size of domestic revenues has fallen (from 11.0 percent to 10.7 percent). Domestic revenues are thus decreasing in absolute terms, due not only to the change in fiscal year (covering only nine calendar months in SY1391), but also in relative terms due to collection under-performance.

[9] SY1391 was only nine months (March 21, 2012 to December 20, 2012) due to the change in fiscal year.

2.2.3. The absolute allocation of resources between sectors is shown below.

Table 2.3: Absolute GoA Expenditure by COFOG Classification, SY1389-SY1391 (2010/11-2012)

Afs Million	SY1389	SY1390	SY1391[10]
	2010/11	2011/12	2012
General public services	16,959	19,651	19,153
Defense	32,330	45,930	43,671
Public order and safety	28,545	41,785	38,925
Economic affairs	32,957	42,075	44,266
Environmental protection	374	517	432
Housing and community amenities	4,918	538	626
Health	6,367	7,147	6,423
Recreation, culture and religion	1,927	1,999	1,673
Education	25,761	30,681	26,736
Social protection	3,878	7,925	7,295
Total Expenditure by COFOG	**154,016**	**198,247**	**189,201**

Sources: Annual Financial Statements SY1389-SY1391 from the Treasury Department, MoF.

2.2.4. Table 2.3 shows that total expenditure increased significantly from SY1389 (2010/11) to SY1390 (2011/12), by about 29 percent, while total expenditure for SY1391 (2012) was only slightly lower than the year before despite the fiscal year only covering nine months. It is also seen that the expenditure increase from SY1389 (2010/11) to SY1390 (2011/12) applied to all sectors except housing/community amenities. The expenditure levels changed for most sectors from SY1390 (2011/12) to SY1391 (2012).

2.2.5. The relative allocation of resources between sectors in shown in the next table.

Table 2.4: Relative GoA Expenditure by COFOG Classification, SY1389-SY1391 (2010/11-2012)

%	SY1389	SY1390	SY1391
	2010/11	2011/12	2012
General public services	11.0	9.9	10.1
Defense	21.0	23.2	23.1
Public order and safety	18.5	21.1	20.6
Economic affairs	21.4	21.2	23.4
Environmental protection	0.2	0.3	0.2
Housing and community amenities	3.2	0.3	0.3
Health	4.1	3.6	3.4
Recreation, culture and religion	1.3	1.0	0.9
Education	16.7	15.5	14.1
Social protection	2.5	4.0	3.9
Total Expenditure by COFOG	**100.0**	**100.0**	**100.0**

Source: Annual Financial Statements SY1389-SY1391 from the Treasury Department, MoF.

[10] SY1391 was only nine months (March 21, 2012 to December 20, 2012) due to the change in fiscal year.

2.2.6. Table 2.4 shows that there were changes in the relative sectoral resource allocations from SY1389 (2010/11) to SY1390 (2011/12), whereas the changes from SY1390 (2011/12) to SY1391 (2012) were quite limited. In SY1390 (2011/12), the share of funding allocated to defense (military), public order/safety (police services), and social protection (pension) increased quite significantly, while those for housing/community amenities (especially water supply) and education decreased noticeably. In SY1391 (2012), the share of funding allocated to economic affairs increased, while that for education decreased.

2.3. The legal and institutional framework for PFM

2.3.1. The 2004 Constitution provides for a directly elected President who appoints the GoA ministers, and a Parliament consisting of a Lower House (directly elected) and Upper House (appointed by provincial councils, district councils and the President). The system of government is unitary and has two tiers, with the administration based on central government units (ministries/agencies) that extend to local administrative units (provinces),[11] and municipalities set up to administer city affairs. The two government levels are thus the central government (including its provincial line departments) and municipalities. With regard to PFM, the Constitution outlines the overall responsibilities of the GoA to prepare the annual budget (Article 75) and for Parliament to approve the budget (Article 90), as well as the procedure to be followed in case of the budget approval process being delayed and temporary appropriations required (Article 98).

2.3.2. The government sector consists of 56 primary budgetary entities,[12] which include 26 ministries and 13 agencies, the President's Office, Parliament's Lower House and Upper House, Supreme Court, Attorney General, SAO, Office of Administrative Affairs & Council of Ministers' Secretariat, and some further entities. There are within these a number of secondary budgetary entities and tertiary spending units, and many ministries/agencies also have provincial line departments. The local government sector consists of about 153 municipalities, but these have only very limited tasks and funds.

2.3.3. The Ministry of Finance (MoF) has four main policy areas, which are each overseen by a Deputy Minister and consist of one or more departments: finance (budget and treasury), customs and revenues, policy, and administration (human resources, properties, insurance and SOEs). The Internal Audit Department (IAD) reports directly to the Minister, the Public Procurement Unit (PPU) reports to the Deputy Minister Policy, while the Fiscal Policy Department (FPD) reports to the Deputy Minister Finance. The Treasury Department has offices (*Mustoufiats*) in all 34 provinces, while the Revenue and Customs Departments have a number of regional offices.

2.3.4. The legal basis for public finances is provided with the 2005 Public Finance and Expenditure Management (PFEM) Law, which outlines the PFM-related obligations of ministries/agencies and, specifically, Treasury responsibilities, as well as a number of aspects related to the protection of public assets, borrowing and lending, budget preparation and approval, budget execution, amendments of appropriations and allotments, as well as regarding accounting and control. The PFEM Law specifically states a requirement for the annual budget to be based on a multi-year framework. The Financial Regulations No. 873 (July 27, 2006) provides specific guidance on budget preparation, budget execution, banking arrangements and cash management, borrowing and lending, asset management, accounting and reporting, municipal finance, and control and audit.

2.3.5. Public procurement is governed by the Procurement Law (2008, amended 2009), the Rules of Procedure for Public Procurement (2007, amended 2009). Also, the PPU – established in 2006 as a monitoring, legal and regulatory body within the MoF – has issued a number of circulars to provide additional guidelines and implementing procedures. The legal framework is applicable to all procurement of goods, works and services (including consultancy services) undertaken by entities, municipalities and other units using public funds. The Afghanistan Reconstruction and Development Services (ARDS), under the Ministry of Economy (MoEc), is mandated to facilitate and oversee compliance of procurement above US$200,000 for goods/services and US$500,000 for works unless ministries/agencies are accredited by the PPU as qualified to do so independently. To date, of the 45 budget entities

[11] This is also illustrated with Figure 1 in Annex D.
[12] The Public Finance and Expenditure Management (PFEM) Law refers to "state administrations", which are defined as all administrations established within the framework of the executive, legislative and judiciary in accordance with law (Article 2).

that carry out procurement, and of the nine entities that were reviewed by the PPU, six have been accredited to carry out their own procurement and are no longer required to go through ARDS The Special Procurement Commission (SPC) approves high-value contracts for all ministries. This commission comprises the Ministers for Economy, Finance and Justice.

2.3.6. Public enterprises are functioning under two different laws: state-owned enterprises (SOEs) work according to the 2005 SOE Law (*Tassady* Law), while state corporations, on the other hand, operate under the 1955 Commercial Code. SOEs are owned by the MoF, where the SOE Department is charged with financial and operational oversight. State corporations are owned by the shareholding ministry, which therefore also has the oversight responsibility. Fiscal risk management of state corporations remains decentralized.

2.3.7. As regards revenues, the MoF Revenue Department is responsible for the collection of income, sales tax (Business Receipts Tax (BRT)) and fixed taxes, while the Customs Department collects customs duties. The legislative and regulatory basis for revenues are the Income Tax Law (2005, amended 2009) and the Customs Law (2005). The Revenue Department has also issued an Income Tax Manual (2010) and a number of Guidance Notes.

2.3.8. Until recently there was a conflict between the PFEM Law and the External Audit Law on oversight of internal audit; the PFEM Law's Article 61 gave the MoF a GoA-wide purview to carry out internal audit across government, while the 1995 Control and Audit Law placed internal audit under the direct control of the respective ministers and charged the Supreme Audit Office (SAO) with evaluating the performance of internal auditors. The GoA on several occasions indicated its intention to resolve the legislative contradiction by removing internal audit responsibility and oversight from SAO, and this eventually happened when the new Audit Law was passed by Parliament in February 2013. However, Parliament had in the meantime (in November 2012) revised Article 61 of the PFEM Law by removing the MoF's GoA-wide internal audit purview and limiting it to a capacity development role in other ministries. While there thus now is no organizational overlap, there also is no responsibility assigned to any entity for setting internal audit standards and ensuring application of a uniform internal audit approach across the GoA.

2.3.9. External audit is carried out by the SAO and is now based on a new Audit Law, passed by Parliament in March 2013. The new law moved the SAO towards greater independence and is – compared to the 1995 Control and Audit Law – a significant improvement in several areas: the SAO is no longer responsible for control of GoA operations nor does it have oversight of internal audit; it can work on any area of its determination; audit must be in line with recognized audit standards (INTOSAI); it can establish provincial units; its own operations are to be audited by an independent body; and, it is to publish audit reports. Shortcomings of the new law, however, include: the selection of the Auditor General rests entirely with the President; there is no effective protection from removal of the Auditor General by the Executive.

Chapter 3: Assessment of the PFM Systems, Processes, and Institutions

3.1. This chapter assesses the current status of all relevant PFM systems, processes, and institutions in the GoA against all performance indicators (PIs) prescribed in the PEFA Framework. Each PI is assigned a rating calculated from the score achieved in each dimension and the minimum requirements for that score as defined in the PEFA Framework. Data used for the assessment has been provided with the full cooperation of the GoA, and the assessments have been discussed in detail with the concerned officials. Summary assessments showing compliance with the relevant minimum requirements for each PI are given in a table in each section and an overall summary of all PI scores is given in Annex 1. All indicators are scored under either Methodology 1 or 2 (M1, M2).[13]

3.2. This PEFA assessment aims to establish an objective baseline set of ratings that will help identify areas of strength and weakness and facilitate monitoring of future progress. Ratings take account of all relevant factors in each dimension, in keeping with the PEFA methodology and related guidance, to identify all areas that may be important for a PFM reform program. It should be noted, however, that in a few cases, issues that are relevant to PFM performance can fall outside the PEFA rating methodology, but may be considered important for future progress. These aspects have been noted below as areas that could be considered in the reform strategy and monitoring program to be developed.

A – Credibility of the Budget

PI-1 Aggregate expenditure out-turn compared to original approved budget

3.3. The indicator measures actual total expenditure compared to originally-budgeted total expenditure, which helps to describe a government's ability through the budget to deliver public services as expressed in policy statements and commitments.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-1 Aggregate expenditure out-turn compared to original approved budget. The difference between actual primary expenditure and the originally budgeted primary expenditure.	D	C	In no more than one of the last three years has actual expenditure deviated from budgeted expenditure by more than the amount equivalent to 15 percent of budgeted expenditure (actual expenditure deviated from budgeted expenditure by more than 10 percent for two of the last three years).

The core budget of the GoA consists of:

[13] The PEFA Scoring Methodology M1 and M2: Most of the indicators have a number of dimensions linked to the subject of the indicator. Each of these dimensions must be assessed separately. The overall score for an indicator is then based on the assessments for the individual dimensions of the indicator. PEFA guidelines set the manner for combining the scores for dimensions into the overall score for the indicator which is either Scoring Method 1 (M1) or Scoring Method 2 (M2). M1 is used for all single dimensional indicators and for multi-dimensional indicators where poor performance on one dimension of the indicator is likely to undermine the impact of good performance on other dimensions of the same indicator. The overall score is set at the lowest-ranked dimension while a "+" is added if there is another dimension score higher than this. M2 is based on averaging the scores for individual dimensions of an indicator. PEFA provides guidance on determining the average of the alphabetic results of two or more dimensions.

- **Operating budget –** Presented based on appropriations currently to 59 primary budgetary units (ministries, agencies, and other entities) for the major economic codes.[14] It consists mainly of wages and salaries, and goods and services. There are also a number of contingency items that made up between 10 percent and 32 percent of the total operating budget in the last three years.
- **Development budget – P**resented and appropriated based on projects (with financing from carry-forward of funds and as new projects) for each primary budgetary unit. It consists mainly of acquisition of assets as well as goods and services. The budget includes discretionary projects (funded by the GoA from its own revenues) and non-discretionary projects (funded by donors), and smaller amounts of contingency items.

3.4. In SY1391 (2012), donor funding covered about half of operating budget expenditures and two-thirds of development budget expenditures.

3.5. The analysis for PI-1 covers the operating budget and the discretionary development budget. The non-discretionary development budget is not included since the GoA has limited influence on when funding becomes available from donors.

3.6. The table below shows the expenditure out-turn compared to the original appropriations for the past three fiscal years.

Table 3.1: Result Matrix for PI-1

Afs Million	SY1389	SY1390	SY1391[15]
	2010/11	2011/12	2012
1. Operating Expenditure (excl. debt service payments)			
Budget	115,966	150,376	133,138
Actual	110,340	149,125	135,680
Deviation (%)	-4.9	-0.8	1.9
2. Discretionary Development Expenditure			
Budget	23,078	18,504	35,048
Actual	10,127	13,059	14,837
Deviation (%)	-56.1	-29.4	-57.7
3. Total Core Discretionary Budget Expenditure (items 1+2)			
Budget	139,044	168,880	168,186
Actual	120,468	162,185	150,516
Deviation (%)	**-13.4**	**-4.0**	**-10.5**

Sources: SY1389-SY1391 budget documents and data from the MoF Treasury Department.
Note: The calculations exclude debt service payments.

3.7. Table 3.1 shows that there were relatively high deviations between planned and actual total core budget expenditure in SY1389 (2010/11) and SY1391 (2012). This resulted almost exclusively from significant under-spending of the discretionary development budget.

3.8. As seen from the next table, the budget execution rates for the total development budget during SY1389-SY1391 are quite similar to those of the discretionary development budget.

[14] Code 21 (Wages and salaries), Code 22 (Services and goods), and Code 25 (Acquisition of assets). Funding under Code 23 (Interest and Repayment of Loans) and Code 24 (Subsidies, Grants and Social Benefits) is appropriated as contingency items in the budget, and funding becomes available when re-allocation is requested by the budgetary units during the fiscal year.
[15] SY1391 was only nine months (March 21, 2012 to December 20, 2012) due to the change in fiscal year.

Table 3.2: Core Development Budget and Expenditure

Afs Million	SY1389	SY1390	SY1391
	2010/11	2011/12	2012
Core Development Expenditure			
Budget	99,230	74,055	111,054
Actual	43,382	48,946	53,408
Deviation (PI-1) %	**-56.3**	**-33.9**	**-51.9**

Sources: SY1389-SY1391 budget documents and data from the MoF Treasury Department.

3.9. Table 3.2 shows very high deviations between planned and actual total development budget expenditure in SY1389 (2010/11) and SY1391 (2012) due to considerable under-spending.

Comparison of Ratings: 2008 and 2013

3.10. The rating improved from D to C because actual expenditure deviated less from budgeted expenditure in 2013 (13.4 percent, 4.0 percent, and 10.5 percent) compared to the 2008 assessment (20.3 percent, 15.1 percent, and 9.7 percent). This would seem to indicate improved budget management on the part of the MoF and line ministries.

Reform developments during 2012

3.11. The MoF in recent years has undertaken a number of activities to improve budgeting processes and budget execution, which are likely to have contributed to a more realistic budget and higher spending in accordance with plans. For 2012 this focused on improving overall fiscal and revenue projections, and specific efforts to improve execution through capacity building in line ministries, developing financial plans, assessing key business processes, and better procurement processes. Also, the ministers of Finance and Economy continued to meet with the top 20 spending ministries through the Budget Execution Committee on a quarterly basis to follow up on spending and implementation related to major projects.

PI-2 Composition of expenditure out-turn compared to original approved budget

3.12. The indicator (table below) measures actual expenditure out-turn against the original budget at the level of administrative budget heads (primary budgetary units), and hence how in-year re-allocations between ministries/agencies have contributed to variance in the expenditure composition (dimension i). This helps to assess the usefulness of the budget as a policy statement. The indicator also measures the extent to which expenditure funded from contingency items is charged to (accounted for under) contingency codes (dimension ii).

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-2 Composition of expenditure out-turn compared to original approved budget.	**D**	**D+**	Overall rating based on M1 methodology.
(i) Extent of the variance in expenditure composition during the last three years, excluding contingency items	D	D	The variance in expenditure composition exceeded 15 percent in two of the last three fiscal years
(ii) The average amount of expenditure actually charged to the contingency vote over the last three years.	-	A	No expenditure was charged to the contingency vote during any of the last three years.

Note: The methodology for PI-2 was revised in 2011 and a new dimension (ii) added. The scores for 2008 and 2013 are therefore not fully comparable.

Dimension (i) Extent of the variance in expenditure composition during the last three years, excluding contingency items

3.13. The analysis is based on the actual expenditure at the administrative level for the 20 primary budgetary units with the highest budget for each of the three years (i.e., the specific units included differ slightly between the years, cf. below), while the remainders are aggregated into a "Sum of Rest" group.

The calculated expenditure composition variances are shown below.

Table 3.3: Variance in Expenditure Composition (PI-2)

	Composition Variance (%)
SY1389 (2010/11)	28.0
SY1390 (2011/12)	9.1
SY1391 (2012)	16.8

Sources: SY1389-SY1391 budget documents and data from the MoF Treasury Department.
Note: The calculations exclude debt service payments as government has limited control over these during the fiscal year. Budgeted contingency items are also excluded.

3.14. Table 3.3 shows that the expenditure composition variances were very high in all three years, especially SY1389 (2010/11) and SY1391 (2012). This reflects significant deviations between budgeted and actual expenditures for most budgetary units, but also resulting from re-allocations of contingency funding during budget execution.

3.15. A detailed overview of the data sets is provided in the following table. It is noted that the budget figures applied, cf. the PEFA methodology, are adjusted so that for each budgetary unit they make up their share of the original budget, but in total these sum up to the actual total expenditure, i.e., the PI-2 calculation is based on relative rather than absolute figures. Also, two major contingency items (Pensions for Martyrs and Disabled, and Pensions for Civilian and Military Staff) that during the fiscal years are re-allocated directly to the Ministry of Labor, Social Affairs, Martyrs & Disabled (MoLSAMD) have for the calculations been moved to the budget of MoLSAMD (i.e., these amounts – accounting for 14 percent, 41 percent, and 37 percent of operating budget contingency funds during the past three years – thus do not contribute to composition variances).

Table 3.4: Original Budgets and Actual Expenditure for Primary Budgetary Units

Afs Million	SY1389		SY1390		SY1391[16]	
	2010/11		2011/12		2012	
	Adjusted Budgets	Actual Exp.	Adjusted Budgets	Actual Exp.	Adjusted Budgets	Actual Exp.
Ministry of Interior	24,702	28,254	37,067	37,391	32,462	36,307
Ministry of Education	20,629	19,364	23,280	23,371	20,436	20,508
Ministry of Defense	15,915	27,672	44,353	40,186	35,510	37,503
Ministry of Energy & Water	7,108	2,391	2,683	3,451	5,579	2,011
Ministry of Public Works	4,239	2,637	4,303	4,319	7,307	4,049
Ministry of Public Health	3,734	2,852	3,671	3,100	3,759	2,790
General Directorate of National Security	3,130	2,958	4,252	4,493	5,140	5,125
Ministry of Higher Education	2,953	2,111	2,866	2,423	3,296	2,991
Ministry of Foreign Affairs	2,896	2,135	2,629	2,892	1,953	2,453
Ministry of Finance	2,556	3,670	2,455	6,455	1,497	6,405
Independent Directorate of Local Governance	2,411	2,106	2,047	1,933	1,754	1,861
Ministry of Communication & Information Technology	2,017	1,812	1,576	1,529	1,248	1,171
Ministry of Agriculture, Irrigation & Livestock	2,005	1,227	1,679	2,321	2,007	2,147
President's Office	1,764	1,372	1,825	1,677	1,293	1,532
Ministry Rural Rehabilitation & Development	1,500	667	1,240	783		
Ministry of Justice	1,437	1,755	2,246	1,649		
Minister of Labor, Social Affairs, Martyrs & Disabled	7,125	5,077	7,466	8,480	6,818	7,539
Ministry of Urban Development	1,174	716				
Ministry Mines & Industries	1,125	671			1,328	1,041
Supreme Court	1,001	1,116	1,338	1,345	958	1,063
Ministry of Commerce			2,040	1,797		
Ministry of Culture & Information			1,149			
Ministry of Transport & Aviation					1,865	1,194
Ministry of Counter Narcotics					1,789	136
Afghanistan Investment Support Agency (AISA)					1,302	0
Sum of Rest	11,046	9,905	12,019	11,854	13,215	12,692
Allocated expenditure	**120,468**	**120,468**	**162,185**	**162,185**	**150,516**	**150,516**

Sources: SY1389-SY1391 budget documents and data from the MoF Treasury Department.
Note: Actual debt service payments, accounted for under the MoF, are excluded.

[16] SY1391 was only nine months (March 21, 2012 to December 20, 2012) due to the change in fiscal year.

3.16. Table 3.4 shows that the adjusted budgets and actual expenditures differ significantly for most of the ministries and agencies. Between three and seven ministries, depending on the year, have had absolute deviations of more than Afs 1 billion, and between eight and 14 ministries have had relative deviations of more than 15 percent.

Dimension (ii) The average amount of expenditure actually charged to the contingency vote over the last three years
3.17. The PFEM Law, Article 32, states that the appropriation for contingencies should not exceed 3 percent of total planned expenditures. The contingency items included in the budgets for SY1389 (2010/11), SY1390 (2011/12), and SY1391 (2012) accounted for 27 percent, 10 percent, and 11 percent of total budgeted operating and discretionary development expenditure.

3.18. The Financial Regulations No. 873 includes rules regarding contingencies and policy reserves (Sections 3.2 and 3.3). These state that for the MoF to issue an allotment advice related to these resources the following, *inter alia,* is required:

- **Contingency reserve** – A state of emergency has been declared for the country or an affected area.
- **Policy reserve** – The expenditure is urgent and could not be predicted before the budget was adopted by Parliament.

3.19. The contingencies included in the GoA's annual budgets are generally not used for emergencies or required for the reasons of urgency and unpredictability. Instead, their uses are defined but not set out in the budget as appropriations to budgetary units because the MoF seeks to avoid the funds being spent for discretionary rather than intended purposes.

3.20. In order to be executed, all contingency funds are to be transferred to the appropriations of specific organization codes, based on requests from the line ministries, and approved by the MoF. The execution of such funds is therefore not charged to specific contingency codes. The Chart of Accounts does include project codes for contingency funds,[17] but these are used for the purpose of managing and controlling the (remaining) balance per contingency item.

3.21. It would seem that some contingency funds could be accounted for vis-à-vis specific contingency codes since they actually are reserve funds (e.g., policy-related funds and funds for implementing Pay & Grading reform), but the MoF does not currently do so.

Comparison of Ratings: 2008 and 2013
3.22. The rating improved from D in 2008 to D+ because of the introduction of a new methodology for PI-2, which excludes contingency items (on the budget side), and measures separately the extent to which actual expenditure is charged directly against contingency items.

3.23. The changed methodology means that the 2013 result cannot be compared directly with that of 2008. However, if applying the old methodology to the 2013 data, the resulting expenditure composition variances would differ from those presented above.[18]

3.24. Also, the calculation in 2008 was based only on the operating budget since a specific fund code in the Chart of Accounts to identify expenditure related to discretionary development budget-funded projects was only introduced in SY1387 (2008/09). However, the 2013 calculations also include the discretionary part of the development budget.

Reform developments during 2012
3.25. As noted under PI-1 above, the MoF has in recent years undertaken a number of activities to improve budgeting processes and budget execution. Efforts likely to have improved budget formulation of ministries/agencies include central monitoring of the 50 development projects with the highest budgets and capacity-building in provinces on program budgeting.

[17] In the SY1391 Chart of Accounts for the operating budget project codes 900001-900030, and for the development budget project codes 910001-910035.
[18] Applying the old methodology results in the following variances: SY1389 – 33.4 percent, SY1390 – 12.9 percent, and SY1391 – 11.9 percent, and hence a "C" score.

PI-3 Aggregate revenue out-turn compared to original approved budget

3.26. A comparison of budgeted and actual revenue provides an overall indicator of the quality of revenue forecasting, which is a key input to the preparation of a credible budget. As it is recognized that revenue out-turn can deviate from the originally approved budget for reasons unrelated to the underlying quality of the forecast (e.g., a major macro-economic shock), the calibration allows for one "outlier" year to be excluded.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-3 Aggregate revenue out-turn compared to original approved budget. Actual domestic revenue compared to domestic revenue in the originally approved budget.	A	C	Actual domestic revenue was between 93 percent and 113 percent of budgeted domestic revenue during the last three years.[19]

3.27. Overall multi-year fiscal forecasting is the responsibility of the MoF Fiscal Policy Department (FPD), which applies a MTFF to make projections of aggregate revenues and expenditures for the primary budgetary units. The FPD earlier relied mainly on the IMF's estimates for economic assumptions and revenues, but it has over time developed its capacity and capability to prepare these more independently. However, according to the IMF, the FPD has an asymmetrical focus on expenditure issues and lacks the analytical component of revenues. The FPD needs to develop especially its capacity to evaluate, review, and analyze revenue projections within a macro framework and consider implications within the overall fiscal policy and strategy.[20] It is noted, though, that the FPD since 2009 has been applying a revenue model quite similar to the one used by the IMF, which provides revenue forecasts used by the Budget Department. Also, the FPD has recently started developing a simple mining revenue model in collaboration with the Ministry of Mines and Petroleum (MoMP). Revenue projections undertaken by the Revenue Department now mainly serve the purpose of settings revenue targets for the different collection entities, but some inputs are provided on a request-basis to the FPD using the detailed seven-year revenue data available in the Revenue Tracking Analysis System (RTAS).

The total domestic revenue attributed to the GoA budget covers the following sources:

- Tax Revenues (Code 11)
- Custom Duties and Fees (Code 12)
- Non-Tax Revenues (Code 13)
- Miscellaneous Revenues (14)
- Sale of Land and Buildings (Code 15)
- Social Contribution (Code 17)

3.28. Table 3.5 shows the aggregate domestic revenue out-turn compared to the original budget for the past three fiscal years, and the actual out-turn as a share of the original budget.

[19] Had the old PEFA methodology been applied, the rating of PI-3 would have been "A" (i.e., similar to that in 2008).
[20] IMF (2012a): op. cit., p. 18.

Table 3.5: Budgeted and Actual Domestic Revenues

Afs Million	SY1389			SY1390			SY1391[21]		
	2010/11			2011/12			2012		
	Budget	Actual	Comp.%	Budget	Actual	Comp. %	Budget	Actual (prel.)	Comp. %
Fixed taxes	5,913	9,087	154	12,315	10,081	82	10,072	8,223	82
Income taxes	7,184	10,288	143	11,878	12,599	106	11,041	13,531	123
Property taxes	96	245	255	330	390	118	263	215	82
Sales taxes	17,181	16,291	95	18,996	18,630	98	17,055	14,895	87
Other taxes	1,657	2,152	130	1,962	2,709	138	2,308	1,457	63
Fines and penalties	-162	623	-384	714	574	80	668	317	48
Tax revenues	**31,869**	**38,687**	**121**	**46,194**	**44,983**	**97**	**41,407**	**38,638**	**93**
Custom duties & fees	**25,105**	**27,705**	**110**	**32,543**	**30,546**	**94**	**30,798**	**21,402**	**69**
Capital/property income	535	281	53	2,862	2,776	97	248	2,927	1178
Sales of goods/services	3,380	4,508	133	4,150	7,374	178	4,983	7,954	160
Administrative fees	7,738	6,282	81	7,227	8,951	124	7,374	6,574	89
Royalties	112	40	36	123	280	226	36	199	558
Fines and penalties	258	339	132	273	671	246	300	407	136
Extractive industry			-		167	-	200	141	71
Non-tax revenues	**12,023**	**11,451**	**95**	**14,635**	**20,218**	**138**	**13,142**	**18,203**	**139**
Misc. revenues	**837**	**719**	**86**	**1,169**	**604**	**52**	**729**	**734**	**101**
Sale of land/buildings		**108**	**-**		**59**	**-**		**178**	**-**
Social contribution	**1,286**	**1,808**	**141**	**1,613**	**2,985**	**185**	**1,834**	**2,616**	**143**
Total	**71,120**	**80,477**	**113**	**96,155**	**99,396**	**103**	**87,910**	**81,771**	**93**

Source: The MoF Revenue Department.

3.29. Table 3.5 shows that the most significant domestic revenue source is tax revenue (especially sales tax and income tax), followed by customs duties/fees and non-tax revenues. Non-tax revenues make up an increasing share of total domestic revenues (22 percent in SY1391, compared to 14 percent in SY1389), while the share of customs duties/fees is decreasing (34 percent, compared to 26 percent).

3.30. It is furthermore seen that while collection for most revenue sources in SY1389 (2010/11) over-performed, collection for both tax revenues and customs duties/fees in SY1390 (2011/12) was slightly below target. This was a result of a slowdown in GDP growth (about 6 percent in 2011 compared with over 8 percent in 2010). However, despite higher than expected growth in 2012 (estimated at about 12 percent), the collection of tax revenue and, especially, customs duties/fees were below target in SY1391 (2012), which was only partly compensated by higher than budgeted non-tax revenues.

3.31. The aggregate budget and actual domestic revenue figures are shown below.

Table 3.6: Budgeted and Actual Domestic Revenues (PI-3)

Afs '000	SY1389	SY1390	SY1391[22]
	2010/11	2011/12	2012
Budget	71,120,000	96,154,847	87,910,000
Actual	80,477,019	99,396,358	81,771,324
Deviation – Absolute	*9,357,019*	*3,241,511*	*-6,138,676*
Deviation (%)	*13.2*	*3.4*	*-7.0*
Actual as share of the Original Budget (%)	**113.2**	**103.4**	**93.0**

Source: Data from the MoF Revenue Department.

[21] SY1391 was only nine months (March 21, 2012 to December 20, 2012) due to the change in fiscal year.
[22] SY1391 was only nine months (March 21, 2012 to December 20, 2012) due to the change in fiscal year.

3.32. Table 3.6 shows that while revenue collection over-performed in SY1389 (2010/11) and was more or less on target for SY1390 (2011/12), it was much below the budgeted revenue figure for SY1391 (2012).

3.33. The domestic revenue data shown above differs from the revenue targets set by the IMF as part of its economic support programs and the corresponding actual revenue figures. This is because the IMF does not include one-off payments such as spectrum licenses, mining fees and royalties, and income from the sale of land and buildings. However, the variation between the IMF revenue target and actual revenues, while less pronounced, has a similar pattern to that presented in Table 3.6 (104.5 percent, 101.4 percent, and 96.1 percent).

Comparison of Ratings: 2008 and 2013

3.34. The rating declined from A in 2008 to C because a new methodology was introduced for PI-3, which changed the scoring approach from a minimum threshold to that of applying a range. This has been done to ensure that not only under-performance in revenue collection, but also over-performance is assessed. That should be done since pessimistic forecasts can result in the proceeds of over-realization being used for spending that has not been subjected to the scrutiny of the budget process.

3.35. It is noted that had the old methodology been applied, the rating of PI-3 would have been A (i.e., similar to that of 2008).

Reform developments during 2012

3.36. The MoF FPD in 2012 further improved its revenue forecasting procedures by including better sensitivity analyses in the MTFF and starting work on a simple mining revenue model in collaboration with the MoMP. Also, Medium Taxpayer Offices (MTOs) and Large Taxpayer Offices (LTOs) were established in four provinces, and a Policy & Investment Promotion Directorate was set up in the MoMP to improve transparency in licensing, contracting, and collection of taxes, royalties, and fees from the extractive industry sector.

PI-4 Stock and monitoring of expenditure payment arrears

3.37. The indicator measures whether there is a stock of arrears, and the extent to which data is available to monitor these. A high level of arrears can indicate financial management problems (for example, inadequate commitment controls, inadequate budgeting for contracts, under-budgeting of specific items, or lack of information).

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-4 Stock and monitoring of expenditure payment arrears.	**D+**	**C+**	Overall rating based on M1 methodology.
(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.	C	A	The stock of arrears is very low (by end-SY1391 0.08 percent of total expenditure).
(ii) Availability of data for monitoring the stock of expenditure payment arrears.	D	C	The MoF has for the past two fiscal years collected data on expenditure payment arrears based on ministry-level surveys that covered the operating budget of all primary budgetary units.

Dimension (i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock

3.38. Financial Regulations No. 873 states that budgetary units must ensure timely and accurate payment settlement and that, unless determined otherwise, all payments due to creditors must be settled within 30 days from the date of statement (Section 4.15). A payment obligation that has not been settled within 30 days is thus considered an expenditure payment arrear, which is in line with international best practice.

3.39. The stock of expenditure payment arrears as of end-SY1390 (March 2012) and end-SY1391 (December 2012) registered by the MoF Treasury Department is shown below. This covers the operating budget, major codes 21 (Wages and Salaries Expenditure) and 22 (Use of Goods and Services).[23]

Table 3.7: Arrears as of end-SY1390 and end-SY1391

Afs '000	End-SY1390		End-SY1391[24]	
	March 2012		December 2012	
	Amount	%	Amount	%
Ministry of Interior	541,090	61		
Ministry of Defense	93,741	11		
Ministry of Education	93,701	11	32,417	30.5
Ministry of Justice	62,576	7		
Ministry of Higher Education	20,440	2		
Attorney General	17,962	2		
Wolesi Jirga (National Assembly)	10,896	1		
Ministry of Urban Development	10,810	1		
Ministry of Refugees & Repatriates	7,621	1		
Ministry of Information & Culture	5,961	1		
Meshanro Jirga (National Assembly)	5,518	1		
Ministry of Energy & Water	4,870	1		
High Office of Oversight & Anti-Corruption	2,315	0		
Ministry of Foreign Affairs	2,207	0		
Ministry of Women Affairs	1,265	0		
IARCSC	1,006	0		
Ministry of Rural Rehabilitation & Development	156	0	4,914	4.6
Ministry of Agriculture, Irrigation & Livestock	93	0	17,761	16.7
Ministry of Public Health	65	0	51,065	48.0
Ministry of Counter Narcotics	-	-	202	0.2
Total	**882,294**	**100**	**106,359**	**100**
Total Operating Budget Expenditure	149,125,000		135,680,000	
Arrears as a Share of Operating Expenditure (%)	*0.59*		*0.08*	

Source: Data provided by the MoF Treasury Department.

[23] Given the assurance of funding under the non-discretionary development budget (donor-funded), project arrears are rare and were not surveyed. Similarly, discretionary development budget expenditures were amply funded in SY1391 (2012) with budget carry forwards from prior years, so no arrears built up.

[24] SY1391 was only nine months (March 21, 2012 to December 20, 2012) due to the change in fiscal year.

3.40. Table 3.7 shows that almost two-thirds of operating budget arrears at end-SY1390 (March 2012) related to the MoI (mainly unpaid food bills for police personnel – object code 21127). For other ministries/agencies the arrears were spread more evenly across wages and salaries, goods and services, and acquisition of assets. As a share of operating expenditure, the arrears at end-SY1390 amounted to 0.6 percent. As for the arrears at end-SY1391 (December 2012), the total approved by the MoF was 0.08 percent.[25]

3.41. It is noted that the GoA's cash balance has improved continuously over the past few years due to un-executed budgets. By end-SY1391 (December 2012), the cash balance was Afs 75.5 billion. To the extent that arrears thus exist, they would not have been caused by cash shortages. Procedural issues, such as timing and accumulation of expenditure pressures, could also be possible reasons.

Dimension (ii) Availability of data for monitoring the stock of expenditure payment arrears

3.42. The MoF Budget Department and Treasury Department have during the past two years – i.e., for SY1390 (2011/12) and SY1391 (2012) – collected data on operating budget arrears from line ministries by sending requests for information. The feedback received has been consolidated by the Treasury Department. It is noted that the data collection exercise for SY1391 (2012) had to be undertaken twice, as the data received from some ministries and agencies following the first request letter lacked specific and detailed data.

3.43. Expenditure commitment management and overall expenditure control is based on the strong centralized nature of allotment and payment controls (see PI-16 and PI-20) to prevent the build-up of arrears. However, despite budgetary units being required to record all commitments – cf. Section 4.13 of Financial Regulations No. 871 – "hidden" arrears (i.e., payments due not presented to the Treasury Department) are not necessarily avoided nor would they be curtailed with the introduction of a commitment management system. However, no evidence has been noted that would suggest the existence of "hidden" arrears.

3.44. AFMIS uses a commitment functionality that facilitates committing budgetary allotments, as sought by budgetary entities, against specific contracts with actual transaction level codes to which budget spending should be charged. It thus acts as an additional layer of control over budget execution and budget monitoring by setting aside the available allotment to the extent it is committed, thereby not allowing the usage of the allotment for any other spending which could pertain to the same budgetary codes. It is noted, however, that this does not as such address the issue of arrears as it could be possible that no invoice is submitted against the committed allotment.

Comparison of Ratings: 2008 and 2013

3.45. The rating improved from D+ in 2008 to C+ because dimension (i) improved from C to A, based on the stock of arrears being established as low, and dimension (ii) improved from D to C because for the past two years the MoF has been collecting data on operating budget expenditure payment arrears for all primary budgetary units.

Reform developments during 2012

3.46. While expenditure payment arrears have not been considered a major issue by the MoF in recent years, the coordinated approach by the Budget Department and the Treasury Department of requesting detailed information about arrears from ministries/agencies was established in 2011.

B – Comprehensiveness and Transparency

PI-5 Classification of the budget

3.47. The indicator describes the classification system used for formulation, execution, and reporting of the budget by reference to international standards. The budget should be presented in a format based on the most important classifications, and reflected in the Chart of Accounts to ensure that transactions can be reported in accordance with the applied classifications.

[25] The MoF rejected payments claimed by line ministries to be arrears if, for example, it was deemed pertaining to SY1392. It is unclear whether the MoD and MoI had payment arrears for SY1391.

Indicator / Dimension	Score 2008	Score 2013	Brief Explanation
PI-5 Classification of the budget. The classification system used for formulation, execution and reporting of the central government's budget.	C	C	Budget *formulation* and *presentation* use administrative, economic and program classifications, while functional classification shows ANDS sectors only, not COFOG. Budget *execution* (accounting) is based on, or can produce using bridge tables, all classifications. *Reporting* is done with administrative, economic and functional (COFOG) classifications. The classifications applied for formulation, presentation, execution and reporting thus differ between the different processes.

3.48. According to Article 53 of the PFEM Law, the MoF establishes classification systems for budget and accounting records based on organization, function, and economic categories. Financial Regulations No. 873 states that the MoF issues a Chart of Accounts containing classifications of budget and accounting records, taking into account the requirements of accounting controls as well as reporting budget and financial information (Section 9.3).

3.49. Budget **formulation** undertaken by the ministries/agencies has been based on integrated forms for traditional (line item) and program budgeting since the SY1390 (2010/11) budget process. The applied forms include major economic codes per program activity for both operating and development budgets, and economic object codes (five-digit level) per program. There are separate forms for revenues (minor group, i.e., three-digit level) and for provincial allocations (major economic code for operating and development budgets).

3.50. The budget **presentation** in the annual budget documents – National Budget (Executive's budget proposal) and Budget Statement (enacted budget) – for SY1391 (2012) and for SY1392 (2013) was done using administrative classification as well as major economic codes for the operating budget per administrative unit (ministries/agencies). Development budget funding sources and projects per administrative unit are also presented. Furthermore, ANDS sectoral/functional classification is shown (with contingency funds included as a separate item/sector) as are revenues in a highly summarized format (and not in line with the economic revenue classification). The MoF Budget Department also annually prepares an overview regarding the provincial allocations of the projects in the development budget (and the external budget), though this is not a publically available document.

3.51. Budget **execution** (accounting) is based on the Chart of Accounts, which for SY1391 (2012) had the following structure and content:

- **Organization** – This follows the administrative structure of the GoA in terms of the entities receiving funding from the budget. It covers 59 ministries/agencies and other entities,[26] 99 sub-organizations, and 179 units.
- **Project** – Codes for 682 specific projects as well as codes for 30 operating budget and 33 development budget contingency items.
- **Program** – Codes for programs, sub-programs, and activities as per the categorizations developed by the ministries/agencies for the purpose of program budgeting. The program and activity segments are used as the basis for conversion into functional classifications, cf. below.
- **Fund** – There are four fund types (general, discretionary development, development budget grants, and development budget loans), 15 fund codes for specific funding sources and donors, and a large number of sub-fund and fund component codes (268 and 436, respectively) that provide further detail regarding purpose and donors.
- **Location** – Covers the 34 provinces as well as one code for central ministries and one code for offshore payments, and codes for the 368 districts, and 34 provincial capitals.
- **Object, Expenditure** – The economic expenditure classification consists of five major codes, six sub-major codes, 28 minor groups, and 188 object codes. This is broadly consistent with the IMF's GFS 2001 Manual,

[26] Other entities include, for example, Kabul Municipality, Afghanistan Investment Support Agency (AISA), Micro Finance Investment Support Facility for Afghanistan (MISFA), Water Supply and Canalization Corporation, Da Afghanistan Brishna Shirkat (DABS), Independent Board of New Kabul, Independent Commission for Overseeing the Implementation of the Constitution, and Afghanistan Independent Human Rights Commission.

and a conversion table is applied to prepare economic expenditure classification fully consistent with the GFS.

- **Object, Revenue** – The economic revenue classification consists of eight major codes, eight sub-major codes, 21 minor groups, and 192 object codes. It is based on the legislation and regulation that determines the specific revenue sources. A conversion table is applied to prepare economic revenue classification consistent with the GFS.

3.52. The Chart of Accounts does not have a dedicated functional classification, which is instead prepared using conversion tables. The ANDS sector categorization is prepared according to the three-digit program codes, while COFOG classification is prepared from the five-digit program activity codes. The latter is used by the Treasury Department for preparing the monthly financial statements (that include the COFOG division and group levels) and for reporting to the IMF.

3.53. **Reporting** is undertaken monthly by the Treasury Department with financial statements that include economic expenditure classification at major code level, administrative classification (revenue in a summarized format and expenditure per major code), and COFOG functional classification at group and division levels. The Budget Department prepares reports based on data from the Treasury Department. The monthly budget execution reports show operating and development allotments and expenditures against budgets per the administrative classification, and also contingency fund execution for the operating budget. The quarterly fiscal bulletins cover revenues at minor group (three-digit) level and by province as well as object code-level for selected revenues. Expenditures are reported per the administrative classification, at minor group (three-digit) level, for COFOG functional divisions, and – for the operating budget – for the eight ANDS sectoral/functional classification.

Comparison of Ratings: 2008 and 2013

3.54. The rating remains unchanged at C because the MoF still does not use functional classification based on COFOG for budget formulation and presentation.

Reform developments during 2012

3.55. No specific developments noted.

PI-6 Comprehensiveness of information included in budget documentation

3.56. The indicator assesses the completeness of information included in the annual budget documentation as submitted to Parliament for scrutiny and approval.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-6 Comprehensiveness of information included in budget documentation. Share of nine core pieces of information in the budget documentation most recently issued by the government.	B	C	The SY1392 (2013) budget documentation fulfils four of nine information benchmarks (macro-economic assumptions, fiscal deficit, debt stock, and explanation of budget implications of new policy initiatives).

3.57. The PFEM Law, Article 30, states that the annual budget prepared by the MoF must include budget overview information, a revenue and expenditure plan, assets and expenditure commitments information, and draft annual budget procedures.[27] This is further detailed in Articles 31-33 to include information about the economic environment, budget deficit, deficit financing, and debt (loans, guarantees and contingent liabilities).

3.58. The latest available annual budget documents are the National Budget (Executive's budget proposal) and Budget Statement (enacted budget) for SY1392 (2013).[28] The annual budget covers all GoA ministries/agencies, including

[27] The same is stated in Section 2.6 of the Financial Regulations No. 873.

[28] The budget preparation and appropriation processes are described under PI-11 and PI-27.

their provincial line departments since these are deconcentrated rather than decentralized units, and other entities receiving financial support from the budget. Some information and data on municipal finances as well as on debt is for informational purposes included in the budget document.

3.59. The comprehensiveness of the information included in the two SY1392 (2013) budget documents vis-à-vis the elements outlined for PI-6 is shown below.

Table 3.8: Summary of Budget Information provided SY1392 (2013)

Elements of Annual Budget Documentation	Included	Comments
1. Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate.	Yes	Budget Statement: Section 2.3 in “Macro-Economic Indicators: Recent Trends and Outlook” outlines assumptions for economic growth, inflation, exchange rate and balance of payments.
2. Fiscal deficit, defined according to GFS or other internationally recognized standard.[29]	Yes	National Budget: The “Development Budget Deficit before Debt Financing” presented in Table 3, p. 32, corresponds to the fiscal deficit.
3. Deficit financing, describing anticipated composition.	No	Information about the expected composition of the deficit (debt) financing is not included in either document. Some sources of debt financing are mentioned in the National Budget, Table 4, p. 34, but is incomplete as it would not cover the full deficit.
4. Debt stock, including details at least for the beginning of the current year**.**	Yes	National Budget: An “Annual Debt Report” overview and summarized information is provided, pp. 22-24.
5. Financial assets, including details at least for the beginning of the current year.	No	Information on financial assets is not provided in either document.[30]
6. Prior year’s budget out-turn, presented in the same format as the budget proposal.	No	The budget out-turn for the previous year (SY1390) is not presented in either document.
7. Current year’s budget (either the revised budget or the estimated out-turn), presented in the same format as the budget proposal.	No	The current year’s budget (SY1391), as revised budget or year-to-date/estimated budget, is not presented in either document.
8. Summarized budget data for both revenue and expenditure according to the main heads of the classification used (ref. PI-5), including data for current and previous year.	No	Summarized budget data on the basis of administrative and program classifications is not included in either document. The National Budget, p. 21, does include a MTFF table showing overall revenues (domestic and grants), three of five major expenditure codes, and ANDS sector/functional classifications for prior years (SY1389-SY1390), current year (SY1391, supplementary budget) and budget year (SY1392), but this data is not the required “main heads of the classification used”.
9. Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.	Yes	Budget Statement: Budgetary impacts for revenues is outlined, including with a sensitivity analysis (Chapter 3), while expenditure performance and outlook is focusing mainly on security sector growth and P&G reform.

3.60. Table 3.8 shows that the budget documents for SY1392 fulfill four of nine information benchmarks – namely macro-economic assumptions, fiscal deficit, debt stock, and explanation of budget implications of new policy initiatives.

[29] The fiscal deficit is understood as the primary deficit (difference between current government spending on goods and services and total current revenue) plus debt service payments.
[30] In the context of Afghanistan, financial assets include funds held by the GoA in the Treasury Single Account (TSA), Other Discretionary Bank Accounts, Donor Bank Accounts, Deposits – Letter of Credits, and Receivables.

Comparison of Ratings: 2008 and 2013

3.61. The rating declined from B in 2008 to C because the last budget presented to Parliament (SY1392 (2013)) in terms of documentation only fulfilled four of nine information benchmarks, as compared with five for the 2008 PEFA assessment (which covered the SY1386 (2007/08 budget)). It is noted that while two elements were not included in the latest budget that were in earlier (*deficit financing,* and *current year's budget*), one new element was included (*explanation of budget implications of new policy initiatives*).

Reform developments during 2012

3.62. No specific developments noted.

PI-7 Extent of unreported government operations

3.63. The annual budget, budget execution reports and year-end financial statements should provide a complete overview of the government's revenues and expenditures. The indicator assesses (i) the level of extra-budgetary expenditure, i.e., government activities not included in the annual budget and/or fiscal reports, and (ii) donor-funded project activities included in the budget, but managed and reported outside the government's PFM system.[31]

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-7 Extent of unreported government operations.	**B+**	**NR**	According to PEFA methodology, when a dimension is NR, the overall score is NR.
(i) The level of extra-budgetary expenditure (other than donor-funded projects) which is unreported, i.e., not included in fiscal reports.	B	NR	The dimension cannot be rated because expenditure data related to the Telecommunications Development Fund (TDF) is not (publically) available.
(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports.	A	A	All funds channeled through the core budget are on-budget and managed using the GoA's PFM system, including for budgeting, accounting and reporting.

Dimension (i) The level of extra-budgetary expenditure (other than donor-funded projects) which is unreported, i.e., not included in fiscal reports

3.64. Extra-budgetary expenditure may be the result of appropriated expenditure being spent, but not included in fiscal reports. This refers thus to the core budget of the GoA. However, this is not known to exist for the GoA since all appropriations are registered in AFMIS, no allotment or payment requests can be processed outside of AFMIS, and all reporting is based on AFMIS transaction records.

3.65. In Afghanistan, therefore, extra-budgetary spending can only occur to the extent that it is based on revenues collected, but not included, in the revenue account of the GoA ("unrecorded revenues"). The PFEM Law states, inter alia, that revenues are public money if they are taxes or fees imposed in accordance with the provisions of law, or proceeds received from leasing or selling any rights controlled by state administrations, including spectrum rights (Article 9).

3.66. The Telecommunications Development Fund (TDF) has been identified as an extra-budgetary fund. It was set up in 2003 and is administered, overseen, and controlled by the Afghan Telecommunications Regulatory Authority (ATRA) under the Ministry of Communications & Information Technology (MoCIT). Based on Article 48 of the Telecommunications Law, 2005, operators and service providers of telecommunication services are obliged to contribute to the TDF (currently set by ATRA at 2.5 percent of net revenues). According to the law, the funds are collected to provide universal access to telecommunication services in rural areas and areas not (yet) covered by

[31] Donors' assistance to the government in providing full financial information on project support (including inputs in-kind) is assessed with indicator D-2.

telecommunication services. It is understood that the scope of the TDF was later expanded to include support for initiatives that develop access and use of telecommunications broadly (e.g., provision of broadband and network to schools, hospitals and colleges/universities). The law states that ATRA opens a separate account at a domestic bank to maintain the funds. It is understood that the TDF bank account is also used by ATRA/MoCIT for depositing payments by service providers for the award of spectrum licenses (though it is unclear why these licenses are not deposited directly into an account under the control of the Treasury Department).

3.67. Some project activities are funded directly from the TDF, but specific information about the functioning of the TDF is not publically available, including how and where resources are used or about contract awards. There is funding transferred from the TDF into the Treasury Single Account (TSA),[32] but the MoF has no documentation to establish how the transfers relate to total deposits or which balance remains in the TDF.[33] The TDF being off-budget appears to be in conflict with the PFEM Law since the fund receives what appears to be 'public money' and therefore should be part of the GoA's budgeting and appropriation procedures, and hence subject to legislative scrutiny.

3.68. It is clear that the TDF has unreported expenditure that is not included in the fiscal reports of the GoA, but the level of extra-budgetary expenditure is uncertain due to the lack of transparency in the finances of the TDF. It is therefore not possible to rate the dimension.

3.69. Extra-budgetary operations may in principle involve all central government entities, which – apart from ministries/agencies – also includes non-market non-profit institutions (NPIs), but excludes sub-national governments and public enterprises.[34] Two entities in Afghanistan generally considered to be autonomous government agencies (AGAs) are the:

- **Microfinance Investment Support Facility for Afghanistan (MISFA)** – MISFA is set up under the Commercial Code, 1955, as an independent, non-distributive, and limited liability company, which has the MoF as its sole shareholder. It is governed by a board which includes representatives from the MRRD, MoF, NGOs, and donors. MISFA is included in the GoA's annual budget as it receives donor grants through the non-discretionary part of the development budget, but it does not receive financial support from the GoA. MISFA funds its administration with an activity-based fee and interest income.
- **Afghanistan Investment Support Agency (AISA)** – AISA was set up in 2003 based on a GoA directive/decree. In 2004 AISA prepared a charter (*Assasnama*) to outline and govern its affairs (mandate, activities, and organizational structure) in which it defined itself as a "public institution".[35] AISA had its specifications publicized in the Official Gazette of the Ministry of Justice,[36] but this would not have provided any legal or formal status to AISA. The Law on Private Investment, 2005, established the High Commission on Investment, comprising seven ministers, as the GoA's premier authority to develop investment policies. The law assigned AISA to carry out the administrative duties of the Commission,[37] and it was mentioned that it could establish AISA as a limited liability company though it does not appear that this was done. The legal and administrative status of AISA is thus unclear, and – functioning outside the GoA system – its finances are off-budget.[38] AISA is included in the annual budget as it receives donor funding for investment projects (e.g., for setting up industrial parks) through the non-discretionary part of the development budget, but the GoA is not funding AISA.

3.70. Although neither MISFA nor AISA fulfill the criteria for non-market NPIs (MISFA is not financed by the GoA, while AISA is not legally a non-government entity), they are considered part of the GoA since they are controlled by it and

[32] The total receipts in revenue account no. 13213 (Mobile Telephone & Services) were Afs 1.6 billion (US$32.3 million), Afs 3.9 billion (US$83.0 million) and Afs 3,9 billion (US$78.0 million) for SY1389, SY1390 and SY1391, respectively.
[33] MoCIT's website notes: "The TDF fund has grown to 74 million USD so far" [http://mcit.gov.af/en/page/6005], but the statement is un-dated.
[34] This follows the IMF GFS definition for central government. Non-market NPIs are controlled and mainly financed by the government and, while legally non-government entities, are considered to be carrying out government policies and effectively are part of the government.
[35] The charter in very general terms outlines AISA's objective (to facilitate investment in Afghanistan) and its structure (Article 5) as well as the duties of some officers. It also states that AISA was established with a initial capital of US$3 million. Furthermore, that income should be deposited in a bank account and can be used for expenses (Article 15).
[36] This is part of the ordinary process undertaken to register a new company and obtain a Tax Identification Number (TIN). Specifications of all new businesses and investments are collected by the MoCI's Afghanistan Central Business Registry (ACBR) and sent to the Ministry of Justice for publication in the Official Gazette.
[37] However, AISA on its website describes the High Commission on Investment as its "Board of Directors".
[38] AISA's income consists of user fees charged for company registration and licensing.

are carrying out its policies. In the context of unreported government operations, MISFA is not relevant since it is not a state administration, given its registered status as a limited liability company, and hence its expenditures cannot be considered extra-budgetary.

3.71. However, the nature of AISA's tasks (government regulation through business registrations and issuance of permits within the GoA's jurisdiction) combined with its funding (user fees), suggests that it in fact has the characteristics of a government agency.[39] AISA's expenditures thus should be considered extra-budgetary. The MoF receives information from AISA about its finances though the financial statements are not made public.

Dimension (ii) Income/expenditure information on donor-funded projects which is included in fiscal reports

3.72. Donor funding for the GoA's core budget was 54 percent of total expenditure in SY1391 (2012), similar to the share in SY1389 (2010/11).[40] All donor funds (both grants and loans) channeled through the core budget are per definition on-budget, and managed through the GoA's budget and accounting systems. Funding received from donors and expenditure following from this is thus automatically and fully included in the GoA's fiscal reports.

3.73. The size of the external budget continues to be very significant. According to MoF's 2012 Development Cooperation Report, the donors in 2011 disbursed a total of US$12.9 billion of which 18 percent was provided on-budget (directly or through trust funds) and hence 82 percent was off-budget.[41] For SY1386 (2007/08), it was estimated that at least 80 percent of the external budget was captured in the Donor Assistance Database (DAD)[42] – which was set up in 2002 by the Aid Management Directorate (AMD) with UNDP support to collect data on aid flows (both for the core budget and the external budget) and thereby facilitate the budgeting processes as well as to improve aid effectiveness – and thus included in fiscal reports.[43] However, it appears that the DAD in the past year or two has become non-functional due to lack of maintenance. External-budget donor funding is currently not captured in fiscal reports.

Comparison of Ratings: 2008 and 2013

3.74. The rating changed from B+ in 2008 to Not Rated (NR) because dimension (i) has not been rated. This is due to expenditure data for the TDF not being available, and the level of unreported extra-budgetary expenditure hence not possible to calculate. This should have been the rating in 2008.

Reform developments during 2012

3.75. It is understood that a GoA committee was formed in late 2012, based on a Cabinet directive, which assessed AISA's legal status (concluding that it was not properly defined) and proposed AISA to approach the Ministry of Justice to resolve the issue. However, the status of this is unclear.

PI-8 Transparency of inter-governmental fiscal relations

3.76. Sub-national governments in many countries have wide-ranging expenditure responsibilities, which require financing that often involves transfers from the central government. Such fiscal relationships should be transparent and rules-based so as to ensure equitable and efficient provision of decentralized public services across sub-national governments. In addition, the ability to generate and track budget and spending data is important for monitoring the system. This indicator measures these different aspects of inter-governmental fiscal relations.

[39] It is acknowledged though that AISA for historical and practical reasons functions in a semi-autonomous manner. Also, AISA does have tasks, e.g., investment promotion and industrial parks development, that in some countries are carried out outside government.
[40] Calculated on the basis of the annual financial statements.
[41] MoF (2012): "Development Cooperation Report", Aid Management Directorate, Table 12, p. 53.
[42] Sometimes also referred to as the Development Assistance Database (DAD).
[43] World Bank-DFID (2008): "Afghanistan, Public Financial Management Performance Assessment", Report No. 44622-AF, June, p. 6.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-8 Transparency of Inter-Governmental Fiscal Relations.	**D**	**A**	Overall rating based on M2 methodology.
(i) Transparency and objectivity in the horizontal allocation among sub-national (SN) governments.	D	NA	Afghanistan does not have an inter-governmental fiscal transfer system.
(ii) Timeliness of reliable information to SN governments on their allocations.	D	NA	Afghanistan does not have an inter-governmental fiscal transfer system
(iii) Extent of consolidation of fiscal data for general government according to sectoral categories.	D	A	The MoF Treasury Department every year collects fiscal data – budgeted and actual revenues and expenditures – from all major municipalities (estimated more than 90 percent in terms of value). The data is consolidated and included in the annual IMF GFS statistical report and for a chapter on municipal finance in the annual Budget Statement (enacted budget).

3.77. As illustrated in Annex D, Figure 1, there are only two government levels in Afghanistan: Central government (which covers the ministries/agencies in Kabul and their provincial and district administrations) and municipalities. It is a common misunderstanding that provincial line departments in Afghanistan constitute a separate level of government, which is not the case.

3.78. It was mentioned in the 2008 PEFA-based PFM Performance Assessment report that Afghanistan – due to its administrative set-up, allocation of expenditure responsibilities, and current fiscal situation – did not have an inter-governmental fiscal transfer system in the traditional sense.[44] It was furthermore noted that municipalities received funding mainly for infrastructure projects, that the distribution between municipalities (horizontal allocation) was not rules-based, and that transfers were not made directly to municipal administrations but rather to line ministries whose provincial line departments collaborated with the municipalities (the exception being Kabul Municipality as a separate primary budgetary unit of the GoA).

3.79. It is now clear that Afghanistan does in fact does not currently have an inter-governmental fiscal transfer system as there is no funding made available to municipalities for capital projects or service delivery. Sector ministries and other national budget entities do carry out infrastructure projects and service delivery throughout the nation, including in municipalities, in line with their nation-wide mandates, but these activities are entirely executed under their direct responsibility.[45] While the Municipalities Act, 2000, assigns specific functions to municipalities, they are fiscally self-sustaining entities that fund the provision of urban services with local revenue collections (e.g., the new City Charges Act, 2011, lists 79 types of property taxes, local service charges, and retail licenses). The PFEM Law allows for state assistance to municipalities if a justifiable need exists (Article 23), but no such transfers have been provided so far.

3.80. It follows from the above that the first two dimensions of PI-8 – (i) Transparency and objectivity in the horizontal allocation among (sub-national (SN) governments, and (ii) Timeliness of reliable information to SN governments on their allocations – at this stage are not relevant for the context of Afghanistan, and hence cannot be meaningfully applied in the PEFA assessment. The two dimensions are therefore "Not Applicable (NA)".

[44] Ibid, p. 7.

[45] It is noted that PI-8 specifically concerns areas where sub-national government have expenditure responsibilities. Municipalities in Afghanistan do not, neither formally nor effectively, have such responsibility regarding the spending of sector ministries, and the spending thus is not a transfer.

Box 3.1: Defining Municipalities in Afghanistan

Municipalities in Afghanistan are administratively divided into provincial and rural municipalities. The 34 provinces each have a provincial municipality, while there are about 119 rural municipalities with a population of 5,000 or more. Kabul Municipality has a special legal status as it ranks as a ministry and the mayor is directly appointed by the President, which serves as a Cabinet-level position. The exact number of municipalities is unclear; it was in 2007 estimated at 217,[46] but the Independent Directorate of Local Governance (IDLG) in 2010 listed a total of 153 municipalities.[47] As of September 2012, the municipalities had 7,563 employees (2,446 civil servants and 5,117 contracted staff), which is an increase of 22 percent from the year before.[48]

For the purpose of government finance statistics, the IMF views municipalities (local governments) as institutional units if they are entitled to own assets, raise funds and can incur liabilities by borrowing on their own account, have some discretion over how funds are spent, and are able to appoint their own officers independently of external administrative control.[49] In its guidelines for sub-national PEFA assessments, the PEFA Secretariat adopted the same criteria (with the exception of the borrowing aspect).[50] However, a more recent PEFA Secretariat working paper applies a broader definition of sub-national governments,[51] which requires that sub-national government entities are:

- Corporate bodies (i.e., having a legal status which can sue and be sued);
- Perform public functions within their territorial jurisdictions;
- Have their own (often elected) political leadership; and,
- Prepare and approve their own budgets.

The framework within which municipalities in Afghanistan currently function differs slightly from the IMF criteria of local governments and also from the new, broader PEFA Secretariat definition of sub-national governments, cf. below.

IMF: According to the Constitution (Article 141), municipalities are set up to administer urban affairs. They can own assets,[52] are assigned own revenue sources (City Charges Act), and are permitted to borrow with authorization from the MoF (Financial Regulations No. 873, Section 10.5). Also, they have some discretion over how funds are spent as they prepare their own budgets and implement them directly (though in some provinces it appears that the provincial municipality supervises/controls the activities and finances of rural municipalities). It is not entirely clear to what extent municipalities are free to appoint their own staff, but formally they report to the IDLG, which appoints mayors and approves staff establishments (*Tashkeel*), and thus determines the organizational structure.[53]

PEFA Secretariat: Municipalities in Afghanistan are corporate bodies,[54] perform public functions within their areas (Municipalities Act, 2000), and have their own political leadership (municipal mayoral and council elections are stated in the Constitution, but until elections are held the IDLG appoints mayors). Municipalities prepare their own budgets, which – according to the Municipalities Act, Article 10 – are approved annually by the MoF.

As the above shows, municipalities in Afghanistan fulfill most, but not all, aspects that would define them as sub-national (local) governments following the IMF criteria (it is not clear that municipalities can appoint their own officers independently) and the new PEFA Secretariat definition (municipalities require MoF approval of their annual budgets). However, for the purpose of this PEFA assessment it would seem pragmatic to consider municipalities in Afghanistan as fulfilling the fundamental elements of sub-national governments.

[46] Asia Foundation (2007): "An Assessment of Sub-National Governance in Afghanistan", April, p. 27.
[47] IDLG (2010): "Sub-National Governance Policy", Annexure III, List of Municipalities, pp. 406-409.
[48] MoF (2013): "SY1392 Budget Statement", p. 67 [Dari version].
[49] IMF (2001): "Government Finance Statistics Manual 2001", p. 14.
[50] PEFA Secretariat (2013): "Supplementary Guidelines for the application of the PEFA Framework to Sub-National Governments", January, p. 5.
[51] Jamie Boex (2013): "PEFA Performance Measurement Framework at Sub-National Government Level – Definitions and Typology", PEFA Secretariat Working Paper, February 12.
[52] This follows implicitly from Section 10.1 of the Financial Regulations No. 873 in that municipalities can sell their fixed assets.
[53] Section 10.8 of the Financial Regulations No. 873 prescribes that municipalities must appoint an accounting officer and cashier as well as establish an audit committee (unless – due to their limited financial operations – they request the provincial *Mustoufiat* to provide these services).
[54] IDLG (2010): op.cit., p. 187.

Dimension (iii) Extent of consolidation of fiscal data for general government according to sectoral categories

3.81. Municipalities must, according to Article 25 of the PFEM Law, provide budget execution reports at least every six months to the MoF through the *Mustoufiat*. The same is mentioned in the Financial Regulations No. 873, Section 10.10.

3.82. The Treasury Department of the MoF annually requests municipalities to send a budget execution report, which covers budgeted and actual revenues and expenditures (but not liabilities). The request is usually sent out about two months after the end of the fiscal year to allow municipalities sufficient time to reconcile their records and prepare the reporting. Based on the data received, the Treasury Department prepares a consolidated overview that is used as an input to the statistical tables in the annual IMF GFS questionnaire. The consolidated data is also used by the Budget Department to prepare a chapter in the annual Budget Statement (enacted budget) on municipal finance, which includes aggregates and data on the municipalities with the highest revenues and expenditure (the 10 largest municipalities account for about 70-75 percent of the totals).

3.83. Municipalities submit their annual budgets to the MoF based on a requirement in the Municipalities Act (Article 10). The Budget Department on the basis of the approved municipal budgets prepares a consolidated overview of the planned municipal expenditures (but not of planned municipal revenues).

3.84. For SY1390 (2011/12), the Treasury Department received budget execution reports with fiscal data from 142 municipalities within eight months of the end of the fiscal year, and a consolidated report was prepared by January 2013 (i.e., within 10 months). This would cover 93 percent of the 153 municipalities listed by IDLG. It is generally believed that the coverage in terms of value is above 90 percent (since all provincial municipalities provide budget execution reports). The MoF Budget Department processed SY1391 (2012) budget approval requests from 150 municipalities, i.e., 98 percent of the total listed by IDLG. This compares with 83 percent (127 municipalities) for SY1386 (2007/08). It is unclear if the MoF has processed and approved the municipal budgets for SY1392 (2013).

3.85. For SY1391 (2012), the Treasury Department had by mid-June 2013 received budget execution reports with fiscal data from 68 municipalities.

Comparison of Ratings: 2008 and 2013

3.86. The rating improved from D in 2008 to A because dimensions (i) and (ii), unlike in 2008, now are deemed not applicable and hence not scored. With hindsight this finding should also have been made in 2008. The overall rating of PI-8 is therefore based only on dimension (iii) that, however, has seen a significantly improved rating (from D to A) since the Treasury Department after 2008 has started collecting budget and expenditure data from the vast majority of municipalities, and consolidated and reported this fiscal data annually.

Reform developments during 2012

3.87. No specific developments noted.

PI-9 Oversight of aggregate fiscal risk from other public sector entities

3.88. The indicator measures the extent to which the government monitors the fiscal risks arising from its activities related to Autonomous Government Agencies (AGAs) and Public Enterprises (PEs). Monitoring is furthermore relevant where sub-national governments can generate fiscal liabilities for the central government.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-9 Oversight of aggregate fiscal risk from other public sector entities.	**D+**	**D+**	Overall rating based on M1 methodology.
(i) Extent of central government monitoring of AGAs and PEs.	D	D	The GoA's monitoring of public enterprises is significantly incomplete. SOEs submit annual balance sheets to the MoF SOE Department, but audits are only done irregularly and audited accounts are not available with the MoF. No reporting on SOE fiscal risks is undertaken. The SOE Department receives no information from and has no interaction with state corporations, and no central GoA entity monitors these in terms of fiscal risks.
(ii) Extent of central government monitoring of sub-national (SN) governments' fiscal position.	A	A	Municipalities cannot generate fiscal liabilities for the GoA.

Dimension (i) Extent of central government monitoring of AGAs and PEs

3.89. As noted above under PI-7, there are two entities which are generally considered to be AGAs, namely MISFA and AISA. However, MISFA is registered as a limited liability company and can therefore not generate fiscal responsibilities or risks for the GoA. The uncertainty about AISA's legal status means that it is unclear whether and to which extent it potentially could generate fiscal risks for the GoA.

3.90. The GoA is involved in two types of public enterprises: State-owned enterprises (SOEs) and state corporations.

3.91. State-owned enterprises: The SOE Law (*Tassady* Law), 2005, defines SOEs as legal entities with independent balances operating with 100 percent capital owned by the GoA. As of February 2013, there were 30 active SOEs operating in various areas (e.g., fuel import, coal mining, transport, construction, hotel, printing, grain storage, fertilizer production and cotton spinning). The SOEs are owned by the MoF, which has a representative on the SOEs' Supreme Council (Board), but the SOEs are formally controlled by their respective line ministries. According to the SOE Law, the minimum profit levels are to be determined in agreement with the MoF, but it is unclear to which extent this takes place. About half of the SOEs have remitted dividends of profit to the MoF during 2012/13, but more than 80 percent was remitted by just one SOE (North Coal).

3.92. The table below provides an overview regarding the active SOEs, including their controlling ministry, staffing number (*Tashkeel*) and profits for the past three financial years.[55]

[55] The MoF SOE Department also mentions the Afghan Public Protection Force (APPF) as a new SOE, but no further information or data are available.

Table 3.9: State-Owned Enterprises (SOEs)

Sr. No.	SOEs	Ministry	Tashkeel SY1390	Profit (Afs Million) *		
				SY1389	SY1390	SY1391[56]
				2010/11	2011/12	2012
1	Macroryan Maintenance	Kabul Municipality	468	8.61	14.25	19.34
2	Kabul Silo	MAIL	408	0.23	1.99	1.93
3	Improved Seed	MAIL	251	0.98	4.35	6.39
4	Pule-e-Khumri Silo	MAIL	50	0.05	-0.09	0.12
5	Balkh Silo	MAIL	40	0.67	0.87	0.61
6	Azadi Printing	MoC	371	5.21	8.18	5.34
7	Afghan Tour	MoC	92	23.56	12.73	6.20
8	Hotels	MoC	116	38.05	38.35	27.60
9	Balkh Gin & Press	MoCI	47	1.48	4.75	3.12
10	Helmand Bust	MoCI	235	11.14	4.78	5.37
11	Balkh Textile	MoCI	30	-1.67	7.25	0.03
12	Fuel & Liquid Gas Enterprise (FLGE)	MoCIT	1,452	387.02	574.46	563.27
13	Slaughterhouse	MoD	105	25.56	23.66	15.19
14	Construction Material Production	MoD	90	3.43	2.74	1.46
15	Education Printing	MoE	145	2.64	4.49	3.32
16	Helmand Construction	MoEW	232	6.01	7.91	8.35
17	Metal Component Production	MoEW	84	2.13	3.55	1.56
18	Security (Sukuk) Printing	MoF	140	20.70	29.02	53.34
19	Prison Industry	MoJ	26	0.90	7.08	n/a
20	North Coal	MoM	450	957.67	707.93	1,316.76
21	Kunduz Spinzar	MoM	230	4.01	5.90	3.62
22	Afghan Gas	MoM	1,041	89.20	110.38	81.61
23	Mazar Fertilizer	MoM	2,246	-67.87	91.73	161.61
24	Jabul Saraj Cement**	MoM	250	-3.60	-2.91	-0.99
25	Pharmacy	MoPH	202	10.06	4.91	4.84
26	Millie Bus	MoTCA	1,686	-7.66	-21.89	8.10
27	Central Transportation	MoTCA	327	4.92	8.01	17.24
28	Banayi Construction	MoUD	267	8.59	23.94	14.15
29	Afghan Construction	MoUD	254	1.82	1.51	1.98
30	Housing Construction	MoUD	227	3.88	1.82	12.26
	Total		**11,562**	**1,537.70**	**1,681.66**	**2,343.72**

Source: SOE Department, MoF. n/a: Not available.
* The profit for SY1391 (2012) is based on actual profit for 19 SOEs, expected profit for 10 SOEs (balance sheets not available to SOE Department as of March 1, 2013) and one SOE without information (Prison Industry).
** Jabal Saraj Cement has been inactive for several years, but a recently proposed loan (Afs 190 million from North Coal) is expected to re-establish the SOE, hence divestment is not planned.

[56] SY1391 was only nine months (March 21, 2012 to December 20, 2012) due to the change in fiscal year.

3.93. Table 3.9 shows that 14 ministries own SOEs, which in SY1390 (2011/12) had 11,562 staff, though more than half were employed by just four SOEs. The reported profits of SOEs have increased during the past three years, but just two SOEs – Fuel & Liquid Gas Enterprise (FLGE) and North Coal– accounted for more than 80 percent of total profits.

3.94. The MoF in late 2007 listed 65 SOEs with almost 27,000 staff, but since then some were corporatized, including the national power utility Da Afghanistan Breshna Moassassa (DABS) and the Central Authority for Water Supply and Sewage (CAWSS). Other SOEs have been divested (i.e., privatized) or are awaiting parliamentary approval in this regard (e.g., Food Stuff), some were integrated into their parent ministry (e.g., Bagrami Textile), a few have leased their assets on a long-term basis to private companies,[57] and the remaining appear to be "inactive" (though the exact implication of this latter status is unclear).

3.95. It was originally expected that the GoA would retain only eight SOEs, but the divestment process has been slow. According to Presidential Decree No. 103, 2005, the MoF has sole responsibility for assessing the economic viability of SOEs. However, in 2008 the Parliament apparently had a requirement established that restructuring or liquidation of public enterprises could not be undertaken without its approval,[58] but it is not clear exactly how the condition was ascertained or whether it still applies.[59]

3.96. The SOE Law (Article 79) outlines financial and operational oversight tasks for the MoF, which are the responsibility of its SOE Department.[60] This includes reviewing the financial operations of the SOEs on the basis of quarterly work progress reports and annual balance sheets. However, it appears that the reporting is lacking in quality and compliance, and also that the SOE Department lacks analytical capacity and capability to monitor fiscal risks. The GoA in November 2011 stated that it would strengthen the SOE Department's capacity so as to make the MoF's control of SOEs more effective,[61] but in mid-2012 it agreed with the IMF that insufficient progress had been made in terms of draft amendments to the SOE Law.[62]

3.97. External audit of the SOEs must, according to the SOE Law (Article 80), be carried out annually. The new Audit Law (Article 5) authorizes the SAO to audit SOEs. According to the SOE Department, about one-third of SOEs were audited by the SAO during the past five years. However, it is not clear if this information is fully accurate and up-to-date.

3.98. State corporations: The GoA also has commercial activities organized in 14 state corporations, which are registered and operate under the Commercial Code, 1955. The state corporations, controlling ministry and the GoA shares are shown below.[63]

[57] This includes Ghori Cement and Baghlan Sugar (though for the latter the lease has ended).
[58] IMF (2009): "Afghanistan, Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility", Country Report No. 09/135, April, p. 8, 10, 14 and 32.
[59] The SOE Department has not been able to provide information in this regard.
[60] According to IMF's 2011 Article IV report, MoF had in April 2010, based on structural benchmark, transferred the SOE Department from the Administration Department to the Finance Department or the Office of the Minister [IMF (2011): "Afghanistan, 2011 Article IV Consultation and Request for a Three-Year Arrangement Under the Extended Credit Facility", Country Report No. 11/330, November, p. 59], but from the MoF it is understood that the SOE Department henceforth refers to the Administration Department.
[61] Ibid, p. 58.
[62] IMF (2012b): "Afghanistan, First Review Under the Extended Credit Facility Arrangement, Country Report No. 12/245, August, pp. 9-10.
[63] The annual budget lists five state corporations as "inactive" – Afghan Nechi (51 percent), Afghan Turk (51 percent), Afghan Teur (98 percent), Aftanto Inactive (N/A), and Handicraft Industry (40 percent).

Table 3.10: State Corporations

Sr. No	State Corporations	Ministry	GoA Ownership (%)
1	Ariana Afghan Airlines	MoTA	100
2	Hotel Inter-Continental	MoC	100
3	Afghan National Insurance Company (ANIC)	MoF	100
4	Afghan Telecom	MoCIT	100
5	Da Afghanistan Breshna Sherkat (DABS)	MoEW	100
6	Afghanistan Urban Water Supply & Sewerage Corporation (AUWSSC)	MoUD	100
7	Central Authority for Water Supply & Sewerage (CAWSS)	MoUD	100
8	Afghan Card	MoCI	92
9	Afghan Textile	MoF	90
10	Afsotar	MoCI	51
11	Esteras	MoCI	51
12	New Afghanistan Project for Cotton & Oil Development (NAPCOD)	MoM	42
13	New Baghlan Sugar	MoCI	33
14	Afghan Wireless Communication Company (AWCC)	MoCIT	20

Source: MoF (2013): "Budget Statement SY1392", p. 78.
Note: Some of the state corporations in which the GoA owns less than 100 percent are, according to the MoF, inactive (with the exception of AWCC).

3.99. Table 3.10 shows that the shares vary between 20 percent and 100 percent, but that only in three corporations does the GoA not have at least a majority stake.

3.100. The GoA has no coordination or centralized fiscal risk monitoring mechanism in place for state corporations. The MoF SOE Department has no role or responsibility vis-à-vis the state corporations, which report only to their respective ministries (the extent or quality of this is not publically known). The IMF in 2012 noted that the GoA, due to the lack of a sound oversight function, has insufficient information on the fiscal implication (both present and future) of the operations particularly regarding state corporations.[64]

3.101. The fiscal relations between state corporations and the GoA have been and remain unclear in terms of subsidies, payment arrears and non-payment of taxes, and attempts by the IMF to support and further reforms have been relatively unsuccessful.[65] The IMF in August 2012 noted that state corporations pose large fiscal risks which require urgent action. A structural benchmark of the Extended Credit Facility (ECF) arrangement regarding the submission to the Ministry of Justice of draft legislation to bring state corporations under effective monitoring and oversight of the MoF was met by the GoA as per the deadline (end-2012).

Dimension (ii) Extent of central government monitoring of SN governments' fiscal position

3.102. The Financial Regulations No. 873, Section 10.5, states that the MoF may authorize borrowing of municipalities upon their request, i.e., municipalities require permission to borrow and hence cannot incur liabilities by borrowing on their own account. Also, if municipalities borrow, the Treasury Department must serve as financial agent, and municipalities are prohibited from using other agents for entering into borrowing agreements.

3.103. Other possibilities for sub-national governments to generate fiscal risks for a central government are, for example, by creating payment arrears (by running budget deficits) or through the issuance of guarantees to public enterprises. However, as noted above under PI-8, dimension (iii), municipal budgets require approval from the MoF,

[64] IMF (2012a): op.cit., p. 42 .
[65] From March 2007 to March 2008, the IMF's Poverty Reduction and Growth Facility (PRGF) arrangement included a structural benchmark aiming at the adoption of a comprehensive restructuring/divestment plan by the GoA, but it was not implemented. A new benchmark for the MoF to review the fiscal relations between the GoA and three state corporations (Ariana Afghan Airlines, Afghan Telecom and DABS/DABM) and one SOE (FLGE) was thereafter set for end-2008, but later extended and met formally only in October 2010. However, it appears that the reviews have had limited practical use.

which means that municipalities ex ante must have a balanced budget. Also, municipal expenditures are related to salaries which are covered through their revenue collections, and municipal budgets are in most cases small. While it may in principle be possible for revenue under-performance to lead to a build-up of payment arrears in municipalities, no such instances have comer to the MoF's attention. As regards issuance of guarantees to public enterprises, only the MoF is permitted to issue loan guarantees (PFEM Law, Article 20). Furthermore, since sovereign guarantees are not yet tenable for Afghanistan, it would seem very unlikely that any entities would guarantee issuance by municipalities.

3.104. From the limitations on municipalities to incur liabilities by borrowing on their own account, generate payment arrears that become the fiscal responsibility of the GoA, and issue guarantees, it follows that they cannot generate fiscal liabilities for the GoA.[66]

Comparison of Ratings: 2008 and 2013

3.105. The rating remains unchanged at D+ because the GoA's monitoring of public enterprises, especially state corporations, continues to be significantly incomplete (poor in terms of quality and coverage for SOEs, non-existent for state corporations) and, as already noted, municipalities cannot generate fiscal liabilities for the GoA.

Reform developments during 2012

3.106. Discussions have been on-going between the GoA and the IMF about legislation to make the MoF's control of SOEs more effective and bring state corporations under effective MoF monitoring and oversight.

PI-10 Public access to key fiscal information

3.107. Transparency in government depends on whether information on plans, budgets and performance is easily accessible by the public. This indicator measures the public availability of key fiscal information.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-10 Public access to key fiscal information.	B	B	The GoA makes available to the public four of the six listed types of information.

3.108. The legislative and regulatory basis for public access to the different budgetary and fiscal documents is as follows:

- **Annual budget documentation** – The MoF must publish the annual budget upon approval (PFEM Law, Article 52).
- **In-year budget execution reports** – The MoF must submit quarterly progress reports to the GoA and the President, and publish these (PFEM Law, Article 54).
- **Year-end financial statements** – The MoF must submit a final budget reconciliation report and a set of financial statements to the GoA and the President within six month of year-end, and publish these (PFEM Law, Article 55).
- **External audit reports** – The SAO must prepare an annual audit report within six months of year-end and submit it to the GoA, which submits it to Parliament whereupon it is to be made publicly available (PFEM Law, Article 59).
- **Contract awards** – Procuring entities must publish a contract award notice in the mass media and on the Internet (Procurement Law, Article 63). Procuring entities must publish a contract award notice for all contracts (Rules of Procedure for Public Procurement, Rule 130). A contract award notice must be published on the procuring entity's notice board and in the mass media (radio/television), and for contracts above Afs 5 million (US$100,000) the contract award must be published on the website of the PPU (Circular PPU/C012/1386).

[66] It is noted that the PEFA scoring criteria for PI-9, dimension (ii), focuses on whether sub-national governments can generate fiscal liabilities for central government *or* whether the net fiscal position is monitored at least annually and central government consolidates overall fiscal risk into annual (or more frequent) reports. There is thus no requirement that both aspects must be addressed/fulfilled, which logically follows from the latter not being relevant if the former is not a concern.

3.109. It is seen that the publication requirement for procurement lack full consistency between the law, rules and circular. There is no legislative or regulatory requirement for the publication of data/information regarding resources available to primary service units.

3.110. The table below discusses the elements determining public access to key fiscal information.

Table 3.11: Public Access to Key Fiscal Information

Elements of information	Publically available	Availability and Means
(i) Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature.	Yes	Budget documents are published on the website of the Budget Department after submission to Parliament (www.budgetmof.gov.af), usually within a few days.
(ii) In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.	Yes	Monthly financial statements are published on the website of the Treasury Department (www.treasury.gov.af). Monthly budget execution reports and quarterly fiscal bulletins are published on the Budget Department's website (www.budgetmof.gov.af). Both types of reports are published within one month of their completion.
(iii) Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit.	Yes	The *Qatias* (Statements of Budget Execution) for the Operating Budget and the Development Budget are published on the Treasury Department's website (www.treasury.gov.af) after their submission to Parliament, which is done on time.
(iv) External audit reports: All reports on National Government consolidated operations are made available to the public through appropriate means within six months of completed audit.	Yes	SAO's audit report on the *Qatia* (annual budget statement) is made public of the latest fiscal year and within the time prescribed by law (six months), although the compliance audit reports and other audit reports are not.
(v) Contract awards: Award of all contracts with value above approximately US$100,000 equivalent are published at least quarterly by appropriate means.	No	All contract awards with a value of more than US$100,000 must be published on the PPU's website (www.ppu.gov.af), but the PPU found compliance to be only 55 percent for SY1391 (2012).[67] Procurement of a value above US$200,000 must be done by the ARDS unless the ministry/agency has a capacity certification from the PPU.[68] ARDS publishes all award notifications on its website (www.ards.gov.af).
(vi) Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics).	No	Data on resources used by/available to health clinics is systemically collected by MoPH's GCMU, but is not published (see PI-23). Data on resources available to schools is not systemically collected or published.

3.111. Table 3.11 shows that there is public access to four of the six elements included in the list.

[67] According to the PPU, overall compliance for SY1391 (2012) for all procuring entities and all contract awards was 32 percent. This includes contracts uploaded on the websites of the PPU and the ARDS.
[68] Currently five line ministries – MoE, MAIL, MoEW, MoUD, and MoLSAMD – are fully certified by the PPU, and two line ministries partly certified – MoPH (for consultancy services only) and MRRD (National Rural Access Program only).

3.112. The classification systems used for budget formulation, presentation, execution and reporting are covered with PI-5, while the comprehensiveness of information in the budget documentation is assessed with PI-6. PI-11 covers the budget process, while PIs 24 and 25 assess in-year and year-end financial reporting.

Comparison of Ratings: 2008 and 2013
3.113. The rating remains unchanged at B because four of six listed types of key fiscal information is available to the public. It is noted though that, while year-end financial statements have become publically available since 2008, contract award notification are no longer considered publically available in all cases (since some line ministries no longer publish these despite a legislative and regulatory requirement to do so).

Reform developments during 2012
3.114. No specific developments took place during 2012 regarding the aspects covered by this indicator. However, it is noted that the Budget Department through workshops has continued its communication with CSOs about the budget formulation and execution processes. Additionally, the website of the Budget Department was redesigned to improve access to information.

C – Policy-Based Budgeting

PI-11 Orderliness and participation in the annual budget process

3.115. A well-planned, well-executed budgeting process is vital for ensuring that the budget – as a policy statement that applies relative spending levels for a variety of programs and activities – reflects the intended fiscal and sectoral policies of the government. This indicator therefore measures planning and timing aspects of the budgeting process (implementation of a budget calendar), the comprehensiveness of political involvement and guidance (through indicative budget ceilings), and the timely approval of the budget by the legislature.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-11 Orderliness and participation in the annual budget process.	**B**	**C+**	Overall rating based on M2 methodology.
(i) Existence of and adherence to a fixed budget calendar.	B	B	A clear annual budget calendar exists, but some delays are experienced in its implementation. The calendar allows ministries reasonable time (four weeks) to complete their detailed estimates on time.
(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent).	B	C	Clear and comprehensive Budget Circulars (BCs) were issued to ministries for the SY1392 (2013) budget process. However, BC2 did not include budget ceilings, which were formally approved by the Cabinet only six weeks after the ministries had submitted their budgets to the MoF.
(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years).	C	C	Parliament has in the last three years approved the budget within two months of the start of the fiscal year.

3.116. The division of responsibilities for budget formulation (Government) and budget approval (Parliament) is stated in the Constitution (Articles 75 and 90). The budget formulation process is outlined in the PFEM Law (Chapter 6), and further detailed in the Financial Regulations No. 873 (Chapter 2).

Dimension (i) Existence of and adherence to a fixed budget calendar
3.117. The budget process for SY1392 (2013) started when the MoF Budget Department issued Budget Circular (BC) 1 to ministries/agencies on March 3, 2012. It included a budget calendar (timetable), which *inter alia* outlined the following tasks and deadlines (the planner for the year under preparation can be assessed at www.budgetmof.gov.af/images/stories/DGB/BPRD/Plannner):[69]

[69] According to the Financial Regulations No. 873, Section 2.1, the MoF must consult with the Budget Committee prior to issuing the budget calendar.

Table 3.12: Selected Tasks and Deadlines for SY1392 (2013) Budget Process

Tasks	Deadline	Actual Date
Budget Committee approves new priority spending proposals.	April 8	July 14
Budget Department submits MTBF (with SY1392-SY1394 budget ceilings) to Cabinet for approval	June 5	September 25
Cabinet approves MTBF containing budget ceilings and new initiatives	June 11	October 8
Budget Department issues BC2 containing budget ceilings, costing instructions and project development templates	June 18	BC2: July 22 Ceilings: October 8
Deadline for BUs for BC2 budget submissions to the Budget Department	August 1	August 23
Budget Hearings – Start	August 25	September 10
Budget Hearings – End	September 16	October 1
Budget Department submits Annual Budget Document to Budget Committee	September 29	October 7
Submission of Annual Budget Document to Cabinet	October 15	October 17
Budget Department finalizes SY1392 Budget Document (in case of changes made by Cabinet)	October 31	October 31
Submission of SY1392 National Budget Document (Executive's budget proposal) to Parliament	November 6	October 31
Submission of SY1392 Budget Statement (enacted budget) to Parliament	November 20	May 10 (2013)

3.118. While a clear and comprehensive budget calendar was prepared for the SY1392 (2013) budgeting process, which took good account of the nine-month fiscal year, Table 3.12 shows that delays were encountered during its implementation, especially in respect to the Pre-Budget Document/Medium-Term Budget Framework (MTBF) and BC2. While the deadline for submitting the budget document to Parliament was met ahead of time, the submission of the Budget Statement was significantly delayed. The lack of adherence to the budget calendar would appear to indicate that the budget formulation and preparation process, despite having received significant levels of technical assistance since 2004, is yet to be fully and properly institutionalized within the Budget Department.

3.119. As regards the time allowed for ministries/agencies to prepare their budget submissions, the budget calendar had originally scheduled six weeks (June 18 to August 1), but the time actually available was four weeks (July 22 to August 23).

Dimension (ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent)

3.120. The Cabinet is – according to the Financial Regulations No. 873, Section 2.5 – required to approve the final budget ceilings, while the MoF must inform each primary budgetary unit separately about the breakdown of the approved ceilings as well as on the preparation of the detailed budget requests within the limits of the budget ceilings.

3.121. BC1 and BC2 issued by the Budget Department on March 3, 2012 and July 22, 2012, respectively, to ministries/agencies were comprehensive and clear in terms of their procedural requirements as well as timing for the tasks to be completed. In particular, the Budget Department emphasized that it – due to the change in the fiscal year, and hence a three-month shorter period available for the SY1392 budget preparation process – would undertake the assessment of existing activity levels (baseline). The ministries/agencies, therefore, in the initial period were to focus on undertaking a policy review, determining key outputs for the medium term, and preparing prioritization and costing of new activities. For the later period covered by BC2, the ministries/agencies were to prepare their detailed and integrated budgets as per the templates issued by the Budget Department, including for provincial allocations.

3.122. It was planned in the budget calendar that BC2 would be issued to ministries/agencies together with the Cabinet-approved MTBF budget ceilings, i.e., including for SY1392 (2013). The full Pre-Budget Statement/MTBF, including proposed budget ceilings, had been prepared on time by the Budget Department (June 5, 2012), but it was not presented by the MoF to the Budget Committee until July 14 and eventually to Cabinet on September 25. The Budget Department, therefore, had to issue BC2 to ministries/agencies without budget ceilings. The Cabinet's formal approval of the budget ceilings took place on October 8, more than six weeks after the BC2 submission deadline.

Dimension (iii) Timely budget approval by the legislature or similarly mandated body (within the last three years)
3.123. There is no formal requirement for when the budget should be submitted by the MoF to Parliament, or when Parliament must approve it. However, given that Article 97 of the Constitution states that the Wolesi Jirga (House of People) should consider the draft budget for no more than one month, and the Meshanro Jirga (House of the Elders) thereafter for no more than fifteen days, it follows that the budget should be submitted to Parliament no later than six weeks before the start of the fiscal year.

The actual budget approval dates for the past three years are shown in the following table:

Table 3.13: Budget Approval Dates, SY1390-SY1392 (2011/12-2013)

Fiscal Year	Start of Fiscal Year	Budget Approval Date	Deviation
SY1390 (2011/12)	March 21, 2011	May 2, 2011	+ 41 days
SY1391 (2012)	March 21, 2012	April 21, 2012	+ 30 days
SY1392 (2013)	December 20, 2012	January 20, 2013	+ 28 days

3.124. Table 3.13 shows that the budget was approved between four weeks and six weeks after the start of the fiscal year for each for the last three budgets.

3.125. The PFEM Law, Article 41, states that temporary appropriations will come into force if the budget is not approved before fiscal year start. This is based on monthly appropriations not exceeding 1/12 of the appropriation for the previous fiscal year. The temporary appropriations lapse after the approval of the annual budget, and expenditures from the temporary appropriation are thereafter charged to the appropriations of the new budget.

Comparison of Ratings: 2008 and 2013
3.126. The rating declined from B in 2008 to C because dimension (ii) was adversely affected by budget ceilings being approved by the Cabinet only six weeks after the ministries had submitted their budgets to the MoF. The ratings of dimensions (i) and (iii) remain unchanged.

Reform developments during 2012
3.127. GoA is working on a broad front to raise sub-national participation in budget formulation. The initial area of focus was the development budget where provincial administrations of line ministries would develop investment proposals under key programs for which donors have already committed funds. This is underway for the EQUIP project under the Ministry of Education (MoE) and in SEHAT under the Ministry of Public Health (MoPH). Norm-based budgeting for operations and maintenance (O&M) costs is the second area of focus. Since Cabinet approved the Sub-National Governance Policy in March 2010, the IDLG has been working with the MoF to introduce a system of provincial budgeting and execution in line with the objectives of policy. The goal is that by end-2014 the budgets of all of the major spending agencies will incorporate activities planned in provinces within dedicated budget envelopes allotted using transparent, equitable, and norm-based allocation systems. Norms have already been developed for the MoE and MoPH. Related to this, the MoF has agreed with the World Bank to develop a mechanism to enhance O&M flows through the Incentive Program of the ARTF Recurrent Window whereby sectors agree to adopt sound O&M policies, asset management, and budgeting processes to participate in the facility. Provinces will be the primary beneficiaries of these arrangements through increased O&M flows.

3.128. Furthermore, the detailed PFM and Public Internal Financial Control (PIFC) assessments of 14 key spending ministries during 2011-2012 (funded by the World Bank and undertaken by a private contractor) has provided insights into specific budget preparation and budget execution methods.

PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting

3.129. Expenditure policy decisions have multi-year implications, and therefore must take into account the availability of resources in the medium-term perspective. A medium-term outlook in the budget process that includes both revenue forecasts and aggregates for mandatory expenditure is thus crucial to ensuring the longer-term sustainability of fiscal and sectoral policies. This indicator assesses the link between budgeting and policy priorities within a medium-term perspective and the extent to which the implications of policy initiatives are costed and integrated into the budget formulation process.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting.	B	C+	Overall rating based on M2 methodology.
(i) Preparation of multi-year fiscal forecasts and functional allocations.	C	C	Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis. But the link to subsequent settings of the annual budgets is unclear.
(ii) Scope and frequency of debt sustainability analysis	A	A	DSA for external debt is undertaken annually.
(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure.	B	C	Costed sector (cluster) strategies exist only for a limited set of NPPs – 17 percent based on SY1391 (2012) actual expenditure – and lack consistency vis-à-vis aggregate fiscal forecasts.
(iv) Linkages between investment budgets and forward expenditure estimates.	C	D	Budgeting for investment and recurrent expenditures are separate processes with no recurrent cost estimates being calculated from investment projects.

Dimension (i) Preparation of multi-year fiscal forecasts and functional allocations

3.130. The PFEM Law states that the preparation of the annual budget must be based on a multi-year framework for at least the coming two years (Article 27), and that the revenue and expenditure plan must cover at least three years (Article 32).

3.131. The MoF Fiscal Policy Department (FPD) in 2005 developed the first Medium-Term Fiscal Framework (MTFF), which was approved by Cabinet. The MTFF is a well-developed, well-functioning tool. It can be further improved to provide better assessment of fiscal pressures by covering identification of O&M cost of assets generated through donor investment, a detailed analysis of labor market pressures on the future wage bill, and more realistic development expenditure forecasts consistent with implementation capacity.[70]

3.132. The MTFF is regularly updated and used in preparing the annual Pre-Budget Statement/MTBF (earlier termed the Fiscal Strategy and Budget Framework Report). The document provides a preliminary draft budget that assesses the GoA's existing budget policies and new funding priorities for the next fiscal year and the medium-term taking into account strategic policy documents such as the ANDS and NPPs. Based on the MTFF's macro-economic forecasts, aggregate fiscal forecasts and analyses presenting the overall fiscal outlook for the medium term as well as projections on fiscal sustainability. The document furthermore includes revenue and expenditure analyses that provide the basis for sector expenditure reviews and, within these, calculation of budget ceilings for the primary budgetary units.

[70] IMF (2012a): op.cit., p. 7.

3.133. While the Pre-Budget Statement/MTBF for SY1391-SY1393 (2012-2014) was a well-prepared, well-presented document (although it did not provide information on programs, including how budget ceilings would apply across these), the Pre-Budget Statement/MTBF for SY1392-SY1394 (2013-2015) appears in large part to be updates of the earlier forecasts and analyses, without detailed budget ceiling calculations. However, both documents are distinctive in establishing the baseline cost estimate (to maintain the existing level of activities and services) separately from new spending priorities (so as to clarify the budgetary impact of new actions). The implementation of this approach is perhaps one of the MoF's more recent and major achievements in the budget formulation and preparation process.

3.134. It is unclear how the multi-year estimates have led to, or have been used in, the subsequent setting of annual budget ceilings. It is understood that the SY1391 (2012) budget ceilings in the Pre-Budget Statement/MTBF for SY1391-SY1393 (2012-2014) were those provided to the ministries/agencies in BC2. However, no information is provided in the budget documents or elsewhere on how the actual budget appropriations were determined. Comparison of forecast budget ceilings and actual budget appropriations for SY1391 (2012) as well as SY1392 (2013) shows significant deviations across almost all units.[71]

Dimension (ii) Scope and frequency of debt sustainability analysis

3.135. The Treasury Department's Debt Management Unit is carrying out debt management in accordance with the PFEM Law (Article 7) and the Financial Regulations No. 873 (Section 7.3).

3.136. Only external debt is assessed since the GoA has no domestic debt except a promissory note with the central bank for the amount of the increase in capitalization required to meet its solvency ratios following its loans and losses to the Kabul Bank. Debt Sustainability Analyses (DSAs) for external debt has been conducted annually during the last three years by the IMF/World Bank.[72] The GoA concurs with the findings and recommendations. In early 2013, after some delays due to lack of technical assistance, the MoF FPD started developing its capacity to prepare DSAs. The Debt Management Performance Assessment (DEMPA) prepared by the World Bank in September 2011, concludes that debts records of the central government are complete and that a quarterly debt report is published.

3.137. The Debt Management Unit has significantly strengthened its capacity during the past few years. Its tasks are mainly monitoring and reporting of the external debt stock, disbursements, and initiating debt service payments. The unit has since 2009 used the Commonwealth Secretariat Debt Recording & Management System (CSDRMS), which was implemented based on a HIPC Floating Completion Point Trigger. This, together with additional staffing to alleviate human resource constraints, has helped to improve debt management processes, and the unit now publishes a quarterly debt report and annual report (included in the annual National Budget Document and Budget Statement). However, capacity to undertake analysis and risk management is considered still to be relatively weak.

3.138. In accordance with Section 7.4 of the Financial Regulations No. 873, the Debt Management Unit in 2005 prepared a Debt Strategy that was approved by Cabinet. A Debt Policy – that outlines the requirements for managing the GoA's legal and contractual obligations regard debt, provides guidance on the handling of debt-related matters, and determines conditions for incurring debt – has been drafted and is expected to be finalized after internal MoF consultations before end-2013.

3.139. In order to develop financial markets and improve cash management, it is a structural benchmark in the current IMF economic program that the MoF submits to the Ministry of Justice (*Taqnin*) legislation for the introduction of marketable debt instruments (*sukuk* securities). The original deadline for this was end-September 2012 to allow for a draft law to be submitted to Parliament by end-March 2013. However, the GoA decided to delay submission in order to ensure that it is consistent with Afghan legal tradition and allow for wider consultations with all stakeholders. It is currently expected that first issuance may take place in early 2014.

[71] It is noted that the IMF in its 2012 assessment report stated that the budget process and resource allocation approach could be further strengthened by aligning the MTBF forward year projections to current year budget ceilings, and conducting an analysis to explain discrepancies across years [IMF (2012a): op.cit., p. 8].

[72] IMF (2010): "Afghanistan, HIPC Initiative Paper", Country Report No. 10/40, February, pp. 19-29; IMF (2011): op.cit. pp. 112-127; IMF (2012b): op.cit., pp. 85-97.

Dimension (iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure

3.140. Sector strategies were earlier developed based on the ANDS, but have not been updated or applied directly for planning or costing purposes since 2009-2010. Since 2010 the National Priority Programs (NPPs) have been the main framework for overall and program-level planning. While the ANDS consists of nine sectors, the NPPs are focused on six clusters,[73] each of which is chaired by a minister. A total of 20 NPPs have been prepared so far, some of which were developed from existing initiatives, while others contain new programs and project activities. Although the NPP/cluster approach may not strictly correspond fully with sector strategies, it would seem reasonable to consider these as such for the purpose of the PEFA assessment.

3.141. The costing undertaken for the NPPs has not followed a prescribed format, having evolved from a very broad and tentative approach in 2010 to a more detailed and unit cost-based approach for the latest approved NPPs. This, however, means that only the NPPs prepared for the human resources development cluster in 2011-2012 can be considered costed in the sense that they include main economic categories (staff, O&M, and assets), by year, and state the necessary parameters and assumptions. The share of expenditure for the human resources development cluster/sector of actual total GoA expenditure in SY1391 (2012) was 17.5 percent.

3.142. The NPP costing exercises do not correspond with aggregate fiscal forecasts since they include both secured and non-secured funding requirements.

Dimension (iv) Linkages between investment budgets and forward expenditure estimates

3.143. The MoF's efforts to integrate the operating budget and development budget was in the late 2000s driven mainly by a desire to ensure that operating cost implications of capital investments were identified, calculated, and included in forward expenditure estimates. Later, efforts were made to integrate the operating budget and development budget formats used in the annual budget process, which was done across all ministries/agencies starting with the SY1390 (2010/11) process.

3.144. While approaches to link investments and operating cost implications were made as part of the ANDS process, they were not fully operationalized since not all ANDS sector strategies had been costed. After the adoption of the NPP approach, there does not appear to have been any emphasis on creating or ensuring linkages between investment planning and forward expenditure estimates. There are likewise no formal requirements expressed in the annual budget process to require linkages between investments and their operating cost implications. Instead, budgeting of development projects is a separate process, and forward expenditure estimates are rarely included in the costing. The projects and respective strategic plans are selected by the MoEc, while resources in most cases are allocated by the Budget Committee during the annual budget hearings.[74] The IMF in its 2012 assessment report noted that the SY1390 budget process showed little consideration of future impacts on O&M expenditure, and it recommended that the process be strengthened to include in budget submissions a summary of O&M implications for all core budget development projects.[75]

3.145. It noted, however, that donors and the GoA consider operating cost implications to be important. It pointed out that the O&M of assets created over the last decade has resulted in a significant expenditure burden for the GoA, which is likely to continue during the transition period. Maintaining activities and services will require difficult prioritization decisions regarding which assets could/should be maintained, and which not. An ARTF-financed O&M facility was established starting with the SY1392 (2013) budget as part of the Incentive Program of the Recurrent Cost Window to provide additional funding. It provides funding for all incremental O&M spending under major code 22 (goods and services) and provides an incentive for proper O&M management through a matching grant of 50 percent of the total incremental spending.

[73] The six clusters are Governance, Infrastructure Development, Agriculture and Rural Development, Human Resource Development, Security, and Private Sector Development.

[74] According to the MoF, the projects in most cases are allocated by the Budget Committee based on the following criteria: (i) Large infrastructure projects; (ii) Ongoing projects; (iii) Projects with results; (iv) Better execution rates; (v) Taking account of external budget flows; and (vi) Other policies (e.g., poorest of the poor provinces and higher education scholarships).

[75] IMF (2012a): op.cit., p. 21.

Comparison of Ratings: 2008 and 2013

3.146. The rating declined from B in 2008 to C because practices worsened since 2008: (i) Costed sector (cluster) strategies now exist for only a limited set of NPPs – 17 percent, based on SY1391 (2012) actual expenditure, compared to 26 percent in SY1387 (2008/09) – and lack consistency vis-à-vis aggregate fiscal forecasts, and (ii) Budgeting for investment and recurrent expenditure continued to be separate processes with no recurrent cost estimates being shared (although efforts were begun in 2008 to address this).

Reform developments during 2012

3.147. The MTFF has been strengthened with sensitivity analyses of domestic revenue projections as well as improved security sector projections. In addition, O&M costs for the MoE and MoPH were calculated and included in the SY1392 (2013) budgets, and a draft mining revenue model was developed by the FPD and shared with the IMF for comment. Furthermore, the Debt Management Unit has prepared a draft Debt Policy, which is currently under discussion within the MoF.

D – Predictability and Control in Budget Execution

PI-13 Transparency of taxpayer obligations and liabilities

3.148. Effective assessment of tax liability is subject to the overall control environment that exists in the revenue administration system but is also very dependent on the direct involvement and co-operation of taxpayers from the individual and the corporate private sector. Contribution to the overall level of compliance is encouraged and facilitated by a high degree of transparency of tax liabilities, including clarity of legislation and administrative procedures, access to information in this regard and the ability to contest administrative rulings on tax liability.

Dimension	Score		Brief explanation of status
	2008	2013	
PI-13 Transparency of Taxpayer Obligations and Liabilities	**C**	**C+**	Overall rating based on M2 methodology
(i) Clarity and comprehensiveness of tax liabilities.	C	C	Legislation and procedures for major taxes are comprehensive and clear. However, there is no uniformity in the applied rules on the issuance of tax clearance certificates required for the annual business licenses hence there is too much discretion by officials over the taxpayers at this stage.
(ii) Taxpayer access to information on tax liabilities and administrative procedures.	C	B	Significant efforts and investment have been made to improve taxpayers' access to information on tax liabilities through both mass media campaigns and more directly-targeted campaigns in Kabul and provinces, as well as through new special information desks. Taxpayers also have easy access to information through brochures and the ARD and ACD websites.
(iii) Existence and functioning of a tax appeals mechanism.	C	C	The mechanism for appeals which is provided for in the Income Tax Law and the Customs Act has been set up and the process is transparent. However, it is not effective, as the limited recourse to this mechanism suggests that taxpayers are unaware of it or do not consider it a worthwhile recourse.

Dimension (i) Clarity and comprehensiveness of tax liabilities

3.149. The major taxes in Afghanistan comprise income, sales tax (Business Receipt Tax, or BRT), and fixed taxes, in addition to customs duties. The law for all these taxes is presented in a single act, the Income Tax Law, which was introduced with a major revenue reform of 2005 and amended in 2009 to eliminate consumption and stamp taxes. Customs operates under its own legislation, the Customs Act of 2005. The Afghanistan Revenue Department (ARD) is responsible for the administration of the Income Tax Law and the Afghanistan Customs Department (ACD) is responsible for the implementation of the Customs Act, although the ACD collects BRT and fixed tax on imports based on Income Tax Law. Both operate under the MoF.

3.150. Following the amendment of the Income Tax Law, an Income Tax Manual was issued in 2010 in which the procedures were presented to assist in comprehension and compliance with all aspects of the law. In addition to this manual, the ARD has issued 15 guidelines on aspects of the tax system.

3.151. The basis for calculation of the tax liabilities is clear, as are the causes and amounts for penalties. The detail in the Income Tax Law and manuals minimize administrative discretion. However, all firms must obtain a tax clearance certificate for the required annual renewal of trading and business licenses. The legal basis for the link between license renewal and tax certification is based on Article 109 of the Income Tax Law which stipulates that licenses can be issued or renewed only if a person or company has fulfilled their “obligations” under the law. The current view of the GoA is that a “tax clearance” is required before the renewal application is processed. There are no precise, uniform rules on the pre-requisites for this tax clearance, thus allowing too much discretion to tax officials. Also, the decisions of objections rest entirely with the staff of one unit of the ARD.

3.152. Since 2003, the legal framework for customs has been modernized and processes simplified through the adoption of the single customs declaration form and the implementation of ASYCUDA with the computerization of transit procedures. Moreover, to support the implementation of the Customs Act, the ACD was established and a harmonized system for classification of goods adopted. Nevertheless, the ACD does not have a clear mandate to manage the Afghan Border (Afghan Customs Territory). Customs are in essence both an administrative and a law enforcement agency, but these functions are divided across ministries, and the ACD cannot effectively manage the borders. Outside of the Customs Act, rules, regulations and requirements, and key policies for import, export, and transit of goods are complex and opaque to traders, and are inconsistently applied across the Customs territory. There is no consistent policy as to where goods are to be cleared (i.e., at the point of entry or close to the point of final delivery, which implies a radically different control model, and affects the needs for infrastructure and equipment). Traders find it extremely difficult, time consuming, and costly to deal with a number of agencies with overlapping, contradictory, and competing requirements.

Dimension (ii) Taxpayer access to information on tax liabilities and administrative procedures

3.153. All legislation, procedures, guidance as well as samples forms for income and sales taxes are available on the ARD website. Hardcopies and CD-ROM copies are similarly available at the tax offices in the two official languages (Pashto and Dari) and English; forms are also issued at ARD offices.

3.154. Mass media tax education campaigns were conducted following the amendment to the Income Tax Law of 2009. Since then the approach has been more targeted, involving seminars for taxpayers specifically in the provinces, distribution of guidance material at ARD offices, and the use of client service offices/special information desks to give first-hand assistance with compliance both at the ARD offices and at offices which issue business licenses (AISA and MoCI).

Dimension (iii) Existence and functioning of a tax appeals mechanism

3.155. With the introduction of the Income Tax Law in 2005, the appeals process was clarified both in the law and in the accompanying procedures. Taxpayers may file a request for amendment of the assessment anytime in the 5 years following an assessment. Once the taxpayer files such request, ARD has 60 days to reply; if the requested amendment is not accepted or if no reply is received, then the taxpayer can object to an Objections Review Panel which comprises officials of the ARD and whose decisions are final. Objections Review Panel decisions are signed by the Director of the Appeals Division; the only recourse, after this is appeal to the courts.

3.156. In the last fiscal year, SY1391 (2012), only 28 objections were made, from approximately 120,000 taxpayers and 10 of them were decided in favor of the taxpayer whereas in the other 18 cases the objection was partially or fully rejected. The cause of the low incidence of appeals may be that the amended assessments arise from audits and the auditors are not sufficiently trained for the more sophisticated cases of telecommunications, banking and mining sectors. Only in two cases has the taxpayer resorted to the courts in the last two years. The extremely low rate of appeal may indicate that the mechanism is either not known or not considered a worthwhile alternative. In the taxpayer’s survey in 2012, 43 percent of respondents indicated they had ‘appealed’ at some time. This is likely to include a large proportion of ‘informal’ appeals to staff in the ARD; objections, etc., and suggests a preference for informal review. Customs appeals are similarly low; there were just 70 appeals for the over 300,000 declarations in SY1391 (2012), i.e., three for every 10,000 declarations.

Comparison of Ratings: 2008 and 2013

3.157. The ratings improved from C in 2008 to C+ because dimension (ii) improved from C to B. There has been fuller dissemination of information on the tax law in particular, as information on the Income Tax Law, Income Tax Manual and tariff codes have all been made available on the MoF website, and ARD has conducted public campaign, including seminars, in Kabul and provinces.

Reform developments during 2012

3.158. The GoA has committed under the Tokyo Mutual Accountability Framework (TMAF) to raise the ratio of revenue collection to GDP from 11 percent to 15 percent by 2016, and to 19 percent by 2025. A major tax policy reform to reach this goal is the commitment to introduce a Value Added Tax (VAT) by March 2014; this is to be introduced along with a new Tax Administration Law.

3.159. On customs, under the ARTF Incentive Program, the GoA has prepared a draft Customs Action Plan, and agreed to make satisfactory progress on its implementation in SY1392 (2013) and SY1393 (2014). The Action Plan aims to empower ACD as the lead agency for managing all cross border, transit, and clearance activities with detective and enforcement powers.

PI-14 Effectiveness of measures for taxpayer registration and tax assessment

3.160. Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of tax liability for those taxpayers. Ensuring that taxpayers comply with their procedural obligations of registration and declaration is usually encouraged by penalties that vary with the seriousness of the offence.

Dimension	Score		Brief explanation of status
	2008	2013	
PI-14 Effectiveness of measures for taxpayer registration and tax assessment	**C**	**C+**	Overall rating based on M2 methodology.
(i) Controls in the Taxpayer Registration system.	C	B	The coverage of registered taxpayers continues to increase and since 2008 this has been reinforced by linkages with other systems. Such linkages ensure that there are not many businesses or individuals who are liable for tax that can operate without tax numbers, with the exception of fixed taxpayers who have been allowed to make tax payments without a tax number.
(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations.	C	C	The Income Tax Law is clear on penalties. Failure to register with the tax authorities, however, carries only a modest penalty and there is poor compliance as many small business which pay fixed taxes do not register. Tax penalties came to 1.1 percent of income taxes in SY1391 (2012). Nevertheless, compliance continues to be an issue with 16 percent non-compliance with medium sized firms and an undetermined proportion of small firms and individuals not filing on time.
(iii) Planning and monitoring of tax audit and fraud investigation programs.	C	C	There is a continuous program of audits for income taxes based on clear risk assessment criteria, but only for LTO and MTO. The ARD is inadequately resourced to apply the risk-based approach effectively to the rest of the income taxpayer base.

Dimension (i) Controls in the taxpayer registration system

3.161. Article 86 of the Income Tax Law of 2009 requires that all persons, organizations and firms which are required under the Income Tax Law or the Customs Act to pay taxes or duties, or withhold taxes, and anyone wishing to open a bank account, obtain a Taxpayer Identification Number (TIN). To obtain a TIN, the individual or firm must register and will appear in one of the distributed databases of the TINs. Procedures and forms to obtain a TIN are available on the ARD website. For Kabul and two zonal offices, the TINs are generated and stored through the identification module of SIGTAS[76] for all three taxpayer categories, i.e., Large Taxpayers Office (LTO), Medium Taxpayers Office (MTO), and Small Taxpayers Office (STO). With the record of the TIN, the ARD records the basic taxpayer information. The TINs for the balance of provinces are issued manually and kept in distributed databases.

3.162. SIGTAS is an automated tax information system with modules for all phases and aspects of tax administration and can be applied to income and sales tax. A VAT module is planned for the introduction of VAT. To date the taxpayer identification module has been implemented for Kabul and two zonal offices. The documents module has been also been implemented for the LTO and MTOs in Kabul, while the collections module is under implementation.

3.163. The full implementation of core system modules (e.g., returns processing, audit, and collections) have yet to be implemented. This is greatly limiting the capacity of the tax administration offices to significantly improve the time- and cost-efficiency of tax administration oversight activities, as well as the ability of the tax authorities to develop a strategically focused audit and enforcement strategy. It is also limiting the ARD's ability to effectively minimize direct contact between taxpayers and tax administration officials, a core element of the tax enforcement strategy.

Table 3.14: Registered Tax Payers (Kabul and two Zones), February 2013

	Firms	Individuals	Total
Large Tax Payers	368	6	374
Medium Tax Payers	17,399	21,442	38,841
Small Tax Payers	18,765	45,712	64,477
Total	36,532	67,160	103,692

3.164. Registration is reinforced by the ACD, which requires a TIN in order to process any import or export, by the MoCI and AISA, which require a TIN before processing business and trading licenses, and the banks which require a TIN in order to open a bank account for an individual or firm.

3.165. All filings with tax and customs authorities are required to quote this reference number which is critical for the attribution of the payment received at the DAB to the individual taxpayer. The registration is supported by a paper-based file in all cases with the related filings and tax receipts information.

3.166. There is good compliance with the registration and use of the TIN with the exception of the numerous fixed taxpayers who are allowed to submit tax and obtain the related certificates even if they are not assigned a TIN. Since these taxes are not creditable to other liabilities there is no overwhelming reason to track the historic payments by taxpayer and applying the TIN requirement would delay collections and produce arrears.

Dimension (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations

3.167. The Income Tax Law and regulations are clear on penalties for failure to register and for late filing or payment. Failure to register with ARD, however, carries a modest penalty and there is poor compliance as many small businesses which pay fix taxes do not register. Late taxes are charged 3 percent a month which should encourage

[76] Standard Integrated Government Tax Administration System.

timely filing and payment and income tax penalties came to 1.1 percent of income taxes collected in the last fiscal year. Nevertheless, compliance continues to be an issue; with 16 percent non-compliance with medium sized firms and an undetermined proportion of small firms and individuals failing to file annual tax returns. Given the largely manual records and processes in place, estimates of noncompliance are not reliable; this will be addressed by the planned automation.

Dimension (iii) Planning and monitoring of tax audit and fraud investigation programs

3.168. The income and sales tax systems rely on self-assessment, however the audit function in place provides limited support for this approach. The LTO has formulated a formal tax audit process which operates on the basis of a Compliance Strategy Committee (CSC) where all tax returns are reviewed against red flag/risk criteria to arrive at a risk score to prioritize cases recommended for audit. Coverage in SY1390 (2011/12) and SY1391 (2012) was 17.5 percent and 13.6 percent,[77] respectively, out of the 374 LTO taxpayers. The current goal for LTO is a 20 percent coverage while a holistic risk identification process for future case selections based on risk management principles is under development. The MTO similarly applies a risk scoring system based on 10 un-weighted risk indicators. However, with limited resources, only 70 case managers and 45 auditors for 38,841 taxpayers less than 1 percent were subject to audit in SY1391 (2012). In the STO, during SY1391 (2012), there were 3,752 audits, which is 100 percent coverage of tax returns filed during the nine-month fiscal year; obviously not a risk-based plan. Customs similarly effects inspection on 100 percent of cases and is not risk-based.

Comparison of Ratings: 2008 and 2013

3.169. The rating improved from C in 2008 to C+ because dimension (i) “controls in taxpayers registered system” improved as the issuance of the unique tax number, TINs, which was not linked with other government agencies now has good linkages.

Reform developments during 2012

3.170. To support the implementation of the Income Tax Law and improve tax administration in general, the implementation of SIGTAS is underway. ARD, with technical assistance from DFID and USAID, is working toward better tax compliance, building management and technical capacity, and establishing the institutions for the implementation of a VAT. Additional SIGTAS modules to include assessment and collections are being implemented and seven zonal centers are being established to support assessment and audit functions in the provinces. A risk-based compliance program is also being developed and support is in place to support taxpayer awareness and education and improve taxpayer services. Most significantly, support for the legislative process of the VAT is planned along with stakeholder coordination. Preparations are underway for the organizational changes and systems to support VAT introduction. On customs, under the ARTF Incentive Program the GoA has prepared a Customs Action Plan, mentioned under PI-13, and agreed to make satisfactory progress on its implementation in SY1392 (2013) and SY1393 (2014). The action plan aims to empower ACD as the lead agency for managing all cross border, transit, and clearance activities with detective and enforcement powers.

PI-15 Effectiveness in collection of tax payments

3.171. Accumulation of tax arrears can be a critical factor undermining high budget out-turns, while the ability to collect tax debt lends credibility to the tax assessment process and reflects equal treatment of all taxpayers, whether they pay voluntarily or need close follow-up. Aggregate reporting on tax assessment, collection, arrears and transfer to Treasury should take place regularly in order to ensure that tax collection system works as intended, that tax arrears are monitored and the revenue float is minimized.

[77] SY1391 (2012) was only nine months, so there was less time for audits; annualized this would be 18.2 percent.

Dimension	Score		Brief explanation of status
	2008	2013	
PI-15 Effectiveness in the collection of tax payments	**D+**	**NR**	According to PEFA methodology, when a dimension is NR, the overall score is NR.[78]
(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years).	D	NR	There is insufficient information to calculate the ratio of collection to gross arrears for the aggregate.
(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.	B	A	Taxes and customs duties are paid by taxpayers and importers directly into designated revenue accounts (separately for income taxes and customs) at the DAB branches located in Kabul, in provincial capitals and at border crossings.
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records, and receipts by the Treasury.	D	D	While there is a good reconciliation of collections to receipts in the Treasury Department there is no reconciliation between assessments less collections to give arrears in aggregate.

<u>Dimension (i) Collection ratio for gross tax arrears,[79] being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years)</u>

3.172. Arrears are the balance of due (assessed) and unpaid taxes. There are few statements on arrears in the Income Tax Law and in practice ARD cannot precisely identify in aggregate tax due, although this is done in provincial offices and STOs, or the collections made against these. The introduction of the Collections Module in SIGTAS and its application to all taxpayers would be required to make this distinction.

3.173. Since it is therefore not possible to determine the average debt collection ratio overall, i.e., payments in a year against the amount of arrears at the beginning of the year, this dimension is not rated.

<u>Dimension (ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration</u>

3.174. Taxes and customs duties are paid by taxpayers and importers directly into designated revenue accounts (separately for income taxes and customs) at the DAB branches located in Kabul, in provincial capitals and at the border crossings. The account number of the related bank account appears on the standard forms issued by the GoA for the tax submission or import processing. All tax revenue and custom duties are deposited into DAB accounts under the control of the Treasury Department. These accounts are periodically swept into consolidated bank accounts in the Kabul branch. For those branches operating under the Core Banking System (CBS) these sweeps should occur daily; these represent 85 percent of total receipts. Of the balance of the accounts (six provinces), four should be swept weekly and two monthly. Since deposits are made to accounts under the control of the Treasury Department, there is no delay in the transfer, but there may be delays in the consolidation and in due accreditation because of classification errors/omissions

<u>Dimension (iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records, and receipts by the Treasury.</u>

3.175. Although there is good reconciliation of collections in ARD records and receipts in the Treasury Department, there is no comparison of assessments with collections to show the aggregate arrears. The self-assessments are presented to the ARD offices (LTO, MTO, STOs, or the zonal offices and *Mustoufiats*) accompanied by evidence of a deposit to the related designated account in the DAB. There are deposits for which the tax type is not identified, but these are posted to suspense accounts. These revenue ledgers are reconciled to receipts in the Treasury Department,

[78] PEFA Fieldguide, page 16, indicates: NR on one dimension would lead to NR on the indicator (irrespective of M1 or M2) . However, there is an exception in the case of an M1 indicator with 3 or 4 dimensions and one is rated "D", one is rated NR and the other(s) rated "C" or above: here the overall rating could be "D+", but for consistency NR may be preferable.

[79] Arrears for the purposes of this indicator does not refer to the tax gap, which in Afghanistan should be extremely large and is now subject to a dedicated study in ARD, but rather to the balance of due and unpaid taxes which are assessed.

booked on the basis of bank movement, monthly with 30 days of month-end. As such, collections are reconciled to transfers to the Treasury Department's consolidated accounts, the amounts posted to suspense accounts are considered in this reconciliation.

3.176. However, the record of assessments based on either the self-assessments or amendments to these amounts, via ARD decision and communications, and related collections by taxpayers is kept in paper files and spreadsheets for STO/MTOs filers and in an electronic media for LTOs. However, this information is not aggregated, or at least not beyond individual tax offices, with the result that there is no reconciliation of assessments of collections and arrears.

Comparison of Ratings: 2008 and 2013

3.177. The rating changed from D+ in 2008 to Not Rated (NR) because dimension (i) has not been rated in this assessment since the data required to calculate the ratio of collections to gross arrears is not available. The rating in 2008 also should have been NR. Dimension (ii), on the other hand, showed improvement as all receipts were deposited in Treasury Department accounts.

Reform developments during 2012

3.178. Additional SIGTAS modules to include assessment and collections are being implemented in Kabul LTO, MTO and seven zonal centers to support assessment and collections functions. With this rollout, both the calculation of arrears from the aggregation of assessments and accurate tracking of collections against these should be possible. This will also enable the reconciliation of ending arrears in assessments and collections.

PI-16 Predictability in availability of funds for commitment of expenditures

3.179. Effective execution of the budget, in accordance with the work plans, requires that the spending ministries, departments, and agencies (MDAs) receive reliable information on availability of funds within which they can commit expenditure for recurrent/operating and capital/development inputs. Predictability is facilitated by effective cash-flow planning, monitoring, and management by the Treasury. This should be based on regular and reliable forecasts of cash inflows and of major, atypical outflows which are linked to the budget implementation and commitment plans for individual MDAs, and incorporates the planned in-year borrowing to ensure adequate liquidity at any time. This indicator assesses the extent to which the MoF provides reliable information on the availability of funds to MDAs.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-16 Predictability in the availability of funds for commitment of expenditures	**B+**	**B+**	Overall rating based on methodology M1.
(i) Extent to which cash flows are forecast and monitored.	A	A	Cash flows are prepared at the beginning of each fiscal year and are updated at least fortnightly on the basis of actual cash movement.
(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment.	B	B	Budget units of MDAs are able to plan and commit expenditures at least quarterly in advance in line with the budgeted appropriations.
(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.	B	B	Significant in-year budget adjustments to budget allocations took place only once or twice during SY1391 (2012), and in a transparent manner.

Dimension (i) Extent to which cash flows are forecast and monitored

3.180. At the beginning of each fiscal year, the Treasury Department produces a forecast of cash flows, in line with budget appropriations and revenue estimates, and by using information available in the financial plans submitted by line ministries. The line ministries prepare the financial plans based on expected realisation of procurements plans and operating costs. The cash flow statement is updated at least fortnightly by the Cash Management Unit (CMU), using data on actual inflows/outflows and revisions to ministry financial plans. The statement of cash flows includes expenditure estimates for all discretionary budget as well as donor-funded projects (non-discretionary). Expenditures forecast for the development budget is updated based on allotments and commitments issued against specific contracts, and posted in AFMIS.[80]

3.181. Revenue information is initially taken from the GoA's fiscal targets, and distributed over the year based on information from the ARD and trends of prior year revenue collections. The Treasury Department prepares a daily report on the total year-to-date expenditures and revenues, available cash resources and shortfalls in realization from discretionary sources. This report is used for making decisions, in line with overall cash position. The monthly cash forecast reports are shared in the monthly meetings of the Cash Management Committee,[81] where the cash forecasts are deliberated and issues impairing cash collections and cash management are addressed and resolved. The CMU's cash flow forecasts are also passed on to the DAB, in line with good practice which aid DAB's own liquidity projections.

3.182. Forecast for donor contributions to the operating budget and other budget support are determined based on donor commitments and expected incurrence and reimbursement of eligible expenditures, in consultation with the Aid Management Directorate (AMD). Donor contributions to the development budget are assumed to be equal to the expenditures planned against these non-discretionary loans and grants due to binding arrangements with the donors for the funding.

Dimension (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment

3.183. For the operating budget, annual budget ceilings for the MDAs are set by the budget appropriations by administrative unit and major expenditure codes. On the development budget, the appropriations provided also set for organizations, specific funding sources, projects and major expenditure codes. Both of these budgets are, for information purposes, distributed by the MDAs on a province by province basis.

3.184. For the operating budget, the budgetary units propose a quarterly distribution to the provinces for each major expenditure code which is reviewed by the Budget Department following consultation with the Treasury Department on the availability of funds. Total allotments are set after the Treasury Department forecasts cash levels at different times in the quarter. On this basis, the Budget Department approves allotment requests for the provinces and central ministries which are uploaded to AFMIS after which the budget entities request disbursements as the funding is assumed to be guaranteed for the respective quarter. The improvements in cash forecasting and a decision to limit allotments to within estimates set by the Treasury Department, along with the decision to use AFMIS as the single reference for determining spending authority, have contributed to a highly reliable basis for expenditure commitments. Where commitments taken under the quarterly allotments are not settled in the same quarter, savings vis-à-vis the quarterly allotment occur which are then available to the ministries in subsequent quarter.

3.185. The Treasury Department meets the disbursements for these allotments on the operating budget from the central Treasury Single Account (TSA) for making payments related to central ministries and Kabul province. For provincial budget execution, the Treasury Department transfers sufficient funds to *Mustoufiats* against allotments issued for specific provinces under each line ministry. Transfers to the provinces are made monthly or at more regular intervals based on estimated expenditures reflected in approved allotments for the provinces.

3.186. Core development budget appropriations, on the other hand, have funds already committed by the donors and are thus available at any given point of time. Allotments are sought by the MDAs based on contracts and approved procurement plans against the relevant funding source. Allotments are issued by the Budget Department and posted in AFMIS. As such, funds are effectively blocked and guaranteed for specific commitments. The MDAs have access to

[80] AFMIS is administered by the MoF Treasury Department and supports Budget Controls, General Ledger, Accounting, Cash Sales, Payments and Financial Reporting through the FreeBalance Financial Accountability Suite (version 6.2/6.5).

[81] The Cash Management Committee was established in SY1386 (2007/08) as a meeting forum by the MoF and DAB.

AFMIS to review allotment information and balance of appropriations. Further, the status of the allotments and execution for the year reported in the monthly AFMIS reports are reconciled and confirmed by the MDAs. Where disbursements are to be made in the provinces, funds are first required to be committed against specific provinces (and entered in AFMIS) and the funding source. Thereafter, equivalent funds are transferred to the *Mustoufiats* upon request from the MDAs. Payments from these funds are made based on payment requests submitted to the *Mustoufiats* by the provincial line departments, and are charged and monitored against the relevant commitment.

Dimension (iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs

3.187. Adjustments to appropriations, within the authority of the MDAs can be made during the year including the assignment of contingency funds to budgetary units. Contingency funds are available in the appropriations to deal with unforeseen demands, but these must be re-appropriated to specific budgetary units prior to issuing allotments against the contingency funds. Annexes to the Budget Decree[82] specify the permitted uses, including the authority to use such funds. The MoF undertakes a mid-year review of the budget that seeks to reallocate budgets, although for SY1391 (2012) there was no mid-year review process. The MoF may, after consultation with the Budget Committee, authorize the transfer of amounts between appropriations for a ministry provided the transferred amount does not exceed 5 percent (Article 47 of the PFEM Law). Where the Executive's authority is surpassed, i.e., ceiling of budget is raised or reassignment among line ministries exceeds 5 percent, the revised budget must be sent to the Parliament for approval. There are frequent adjustments done within the authority of the budgetary units; however, changes above the authority of the budgetary units are only done at the mid-year review (outside of the use of contingency funds). A year-end budget adjustment via Presidential Decree is used to adjust appropriations to actual in the limited cases of overruns.

Comparison of Rating: 2008 and 2013

3.188. No change.

Reform Developments during 2012

3.189. The expansion of online access to AFMIS for all provinces has enhanced the predictability of funding since the integrity of extant allotment information is guaranteed with only one, central source being used and because the state of expenditure and commitments, on the development budget at least, is now more current and reliable given that all transactions are vetted via automated AFMIS controls before expenditure/commitment is incurred.

3.190. Current plans to develop ancillary applications for purchases and asset management will contribute further to the accuracy of forecast of cash availability by recording sooner and in an aggregated manner commitments and control these against allotments.

PI-17 Recording and management of cash balances, debt and guarantees

3.191. Debt management in contracting, servicing and repayment, and the provision of government guarantees is often a major element of overall fiscal management. The maintenance of such a debt data system and regular reporting on main features of the debt portfolio and its development are critical for ensuring data integrity. An important requirement for avoiding unnecessary borrowing and interest costs is that cash balances in all government bank accounts are identified and consolidated.

[82] "Miscellaneous Codes" in the tables of the annual National Budget document.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-17 Recording and management of cash balances, debt and guarantees	**B+**	**B+**	Scoring based on M2 methodology.
(i) Quality of debt data recording and reporting	B	A	Debt records are maintained in a computerized system and are complete, updated, reconciled on a monthly basis, and data is of high integrity. Comprehensive management and statistical reports are produced quarterly and are published on the website of the Treasury Department.
(ii) Extent of consolidation of the government's cash balances	B	B	Daily cash balances are calculated and consolidated by the Treasury Department, and are available to the management. However, some extra-budgetary funds and the Special Fund ledger sub-accounts remain outside of the arrangement
(iii) Systems for contracting loans and issuance of guarantees	A	B	Contracting of loans and guarantees is within the authority given to the MoF, but set by limits established in the budget documents.

Dimension (i) Quality of debt data recording and reporting

3.192. The Debt Management Unit (DMU) within the MoF Treasury Department is responsible for maintaining records of all debts contracted by the GoA, within established ceilings. This unit carried out a debt reconciliation in 2007 as part of the Heavily Indebted Poor Country (HIPC) process and on this solid foundation has kept record of debt movement, initially in spreadsheets but now via a debt register using the CS-DRMS that was implemented in 2009. The CS-DRMS is used to maintain records of debt terms, movements on principal and debt service, and the running balance payable maintained in the currency of the debt. Additional debt management functionalities available in the system include debt servicing schedules, loans and disbursements forecast and scenario analysis. There is only one domestic debt instrument which is controlled separated.

3.193. The DMU also receives a copy of all loan-executed agreements which form the basis for establishing a new entry in the debt system. The system is updated with new disbursements based on advices received from creditors and from consulting the web sites of the creditors where all disbursements on specific loans can be viewed. The information is also confirmed with the DAB, in case the disbursement is received in a special account pertaining to the loan. Loans are currently financed by institutions such as the World Bank and the German Development Bank, but in the form of grants to the GoA. The issuance of Treasury Bills is in the planning stage.

3.194. The Treasury Department initiates debt transactions pertaining to the core budget by processing loan disbursement requests from implementing line ministries. Transactions are recorded in AFMIS at the time of processing the requests, while the DMU recognizes the debt on the date of actual disbursement. The DMU seeks budget allotment and prepares a request for debt service payments using the reports from the CS-DRMS and repayment advice from lending agencies. Payments for servicing debts are made through AFMIS.

3.195. The debt management system implemented in the Treasury Department provides data of high integrity and is reconciled on a monthly basis with the debt disbursement statements received from lending agencies. The DMU prepares a quarterly debt report that is published on the website of the Treasury Department ((http://www.treasury.gov.af/), which includes loan disbursements, repayments, service charge capitalization and debt stock at the end of the reporting period.

Dimension (ii) Extent of consolidation of the government's cash balances

3.196. Management of public funds and cash resources is the responsibility of the Treasury Department, although much of the collection of GoA revenues and execution of the budget takes place in the provinces through the *Mustoufiats*. The primary tools for cash management are the TSA mechanism and AFMIS, which are managed by the Treasury Department. Public funds are maintained in accounts under the control of the Treasury Department, which include the TSA (Afs), TSA (US$), special accounts for donor funds, revenue collection accounts, and expenditure accounts (provinces). These operate under a policy of no overdrafts (deficit financing by DAB) and the use of budget support concessionary terms loans from multilateral financial institutions to finance the shortfall between planned operating expenditure and domestic revenue.

3.197. In line with the Financial Regulations, all public revenues for the GoA are consolidated in the TSA maintained with the DAB. These include collections by MDAs in the centre and provinces, deposits made directly to the DAB relating to revenue collections and deposits from donors.

3.198. The CMU in the Treasury Department prepares a daily report on available cash balance (Available Cash Balance Report), which provides information on the consolidated discretionary funds in the custody of the Treasury Department. Discretionary funds are those not tied by contract with donors to specific inputs, and as such can be assigned to any budget need, except for a negative list attached to the funding agreement. The report provides the opening bank balance, receipts, payments and ending available balance.

3.199. There are some funds/accounts that are outside of the consolidation process. These include extra-budgetary funds and the Special Fund ledger sub-accounts.[83]

<u>Dimension (iii) Systems for contracting loans and issuance of guarantees</u>

3.200. Authorization and negotiation of debt is the responsibility of the MoF, with new debt specifically authorized through provisions in the annual budget. For new debt negotiated after the budget approval, the Cabinet and the Parliament need to provide specific authorization as there is no provision in the budget to incur debt beyond the operations specified. Article 31 of the PFEM Law specifies that the annual budget documentation should include how the annual appropriations will be financed and Article 33 indicates that information in the budget should include limits on borrowing and guarantees that can be made. DMU is also the repository for the debt legal agreements. The National Budget document presents a comprehensive list of loans with terms, committed amount, disbursed amount and balance. Transparent criteria are used to contract loans as seen from the GoA having a debt strategy and loans being included in the budget document.

3.201. Afghanistan reached the HIPC completion point in 2010 and thus received debt relief under the (HIPC Initiative and the Multilateral Debt Relief Initiative (MDRI)). The debt relief brought down the public external debt significantly after Paris Club creditors agreed to provide 100 percent debt relief beyond HIPC. The GoA has incurred very little new debt since 2008.

<u>Comparison of Rating: 2008 and 2013</u>

3.202. No change in the overall rating. However, there was an improvement in dimension (i) which is rated A, compared to B in 2008 because debt records of the DMU now are reconciled monthly to the Treasury Department's accounting records in AFMIS as opposed to quarterly in 2008. Dimension (iii), on the other hand, is rated B because the contracting of debt can only be made to limits set in the budget documents. In 2008, the dimension was rated A, because the "no borrowing policy" in place was considered transparent criteria and a fiscal target.

<u>Reform Developments during 2012</u>

3.203. The key reforms in debt management have taken place with the establishment of current, accurate records on debt and the implementation of the debt register on the basis of the CS-DRMS. The Treasury Department is seeking to establish some interface between AFMIS and this system under the technical assistance consultant contract of the PFMRII.

PI-18 Effectiveness of payroll controls

3.204. The payroll is underpinned by a personnel database which provides a list of all staff, who should be paid every month and which can be verified against the approved establishment list and the individual personnel records (or staff files). The link between the personnel database and the payroll is a key control. This indicator is concerned with the payroll for public servants only and does not encompass procedures for contract staff.

[83] Special Fund (waja khas) ledger sub-accounts established for donor-funded Development Budget projects as per Article 16 of the PFEM Law.

3.205. For the GoA, wages are the most significant cost element in the operating budget, representing more than 72 percent of the recurrent costs incurred in SY1391 (2012).

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-18 Effectiveness of payroll controls	**C+**	**B**	Overall rating based on methodology M1.
(i) Degree of integration and reconciliation between payroll and personnel.	B	B	Personnel data and payroll data are not directly linked, but the payroll is supported by full documentation for all changes made to personnel records.
(ii) Timeliness of changes to personnel and payroll.	B	B	Required changes to personnel records and payroll are updated, but this may take up to 3 months although affecting only a minority of changes.
(iii) Internal controls of changes to personnel records and payroll.	B	B	Authority and basis for changes to personnel records and payroll are clear.
(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.	C	B	Payrolls audits, in stages, have been effected on all central government entities at once in the last three years.

Dimension (i) Degree of integration and reconciliation between payroll and personnel

3.206. The Independent Administrative Reform and Civil Service Commission (IARCSC) is responsible for oversight of appointments and promotions (for positions at grade 2 and above), civil service management, and administrative reform. Under the Civil Servants Law (May 2008) every public employee has a personnel grade and civil servant wage rates and pay policy are established centrally for all public employees (based on a pay scale annexed to the Civil Servants Law). Implementation of pay and grading system started in September 2008, which has been rolled out to 90 percent of non-uniformed public service employees. Under this system, there are 8 grades each containing five steps. Additionally, some special programs such as Super Scale, Capacity Building for Results (which replaced the Management Capacity Program), are extended to a very limited number of staff and allow higher pay rates, based on a clear vision of core responsibilities, structural reorganization, and merit-based appointments.

3.207. Payroll is prepared from the personnel and attendance records maintained by the individual payroll processing units, which may be the Head Office Administrative Department, Provincial Line Department of a Ministry, or even individual service delivery units – although *Mustoufiats* or provincial line departments may prepare payroll for many of the provincial offices or service delivery units. The related payroll journals support check requisitions which are processed by the *Mustoufiats* and recorded in AFMIS. The disbursement takes place either as bank instructions for direct deposit to bank accounts of the staff or a transfer to a bonded agent who effects the individual payments. Furthermore, a small number of staff receive their salaries through M-Paisa, a payment facility developed and operated by a private mobile phone service provider. This decentralization of personnel management and payroll preparation supports timely updating of personnel records and facilitates the related updating of payrolls.

3.208. Nowhere in the government is payroll preparation properly integrated with personnel files. However, for all payrolls prepared under the Verified Payroll Program (VPP), which by the end of 2012 covered 75 percent of the public sector employees,[84] payrolls are processed in automated payroll systems with some interface to an identity card database of verified and vetted personnel. The link limits additions to the payroll system to staff who have been duly vetted and entered in the personnel data base which is centralized in the MoF or under the control of the head offices of the MoE, MoI and the MoD. Payroll for the balance of the civil and other services in the public services are calculated manually. Furthermore, changes to payroll are generally supported by and checked to the changes in personnel records.

[84] VPP includes 504,000 staff with active bank accounts, out of a total civil and uniformed service of 666,000.

Dimension (ii) Timeliness of changes to personnel records and the payroll

3.209. Given the decentralized nature of personnel management and payroll processing the required changes to personnel records and payroll can be expedited at least within three months. Some delay may occur as the requirements for the VPP must be met, which includes the intervention of centralized authorities in which case retroactive adjustments are applied.

Dimension (iii) Internal controls of changes to personnel records and payroll

3.210. Controls over payroll are based first on the staffing establishments (*Tashkeels*) which are proposed by the ministries and approved by the Office of Administrative Affairs (OAA) during the annual budget process. The *Tashkeel* provides the organizational chart for the ministry, detailing staffing positions and levels. In the absence of a centralized nominal roll, actual total headcount is determined through a database kept in MoF by the ARTF Monitoring Agent on the basis of summary reports of monthly payrolls in the provinces and detailed reports provided by the central ministries in Kabul, which accompany the payroll payment requests.

3.211. All payroll payments and accounting are concentrated under the Treasury Department. It establishes that payroll payment requests are supported by quarterly budget allotments for specific MDAs, that the payroll request is properly supported by a payroll journal, and that this is duly approved by the responsible budgetary unit authorities.

3.212. In the payroll processing units, the payroll journal is usually prepared by the accounting unit from the attendance report which is prepared in the HR Departments and is supported by the personnel records also kept in the HR Department. Changes from one period to another in attendance records, and changes in pay rates, are verified against the due authorization by the budgetary unit head for staffing increases and employment contract.

3.213. The Finance Controllers placed in line ministries, who are employees of the Treasury Department, or the provincial *Mustoufiats*, review in detail the payment request for documentary support, accuracy and authorizations. This review examines the sufficiency of the attendance records, changes to the personnel records and the payroll calculation, including applicable deductions before authorizing any payroll payment.

3.214. Although there is no automated reconciliation by the Treasury Department or the budgetary units of the changes in payroll, in staffing or pay levels, manual checks ensure that changes in payroll are linked to authorized changes in the personnel records.

3.215. Information from independent examinations by the ARTF Monitoring Agent of compliance in SY1391 (2012) with authorizations and approvals indicate that rate of exceptions is low, although there is a high incidence of ineligibility because, in many cases, documents were not made available for review.

Dimension (iv) Existence of payroll audits

3.216. Because controls are manual and personnel and payroll processing is decentralized, there is a critical need for centralized controls on the application of controls. The GoA established three independent reviews of payroll costs for this purpose, in addition to internal and external audit.

3.217. The first is the VPP which the MoF applies in three stages of oversight: Stage 1: witnessing by independent staff the payroll distribution; Stage 2: verification of employment and registration of employees in a centralized identity system with payment at the DAB; and, Stage 3: direct deposit to employee bank accounts.

3.218. The VPP, including the version implemented by the Ministries of Education, Interior and Defense, now covers 75 percent of public sector employees, including uniformed and non-uniformed government personnel. The other two reviews are after the fact and carried out by the ARTF Monitoring Agent on all civilian salaries, and by the Law and Order Trust Fund (LOTFA) carried out by its Monitoring Agent on police salaries. ARTF and LOTFA monitoring agents conduct site visits throughout the year to the budgetary units and, on a sample basis, verify payroll journal entries to the attendance records, personnel files and meets the relates staff member. The combination of these three reviews covers all payrolls except Ministry of Defense and General Directorate of National Security. Internal audit is now operational in most ministries and include payroll audits. Similarly, the SAO also carries out reviews across government, including payroll audits.

Comparison of Rating: 2008 and 2013

3.219. The overall rating improved from C+ to B as dimension (iii) improved from C to B as internal audit is now operational in most line ministries and since LOTFA has since 2008 employed an independent Monitoring Agent.

Reform Developments during 2012

3.220. The MoF is supporting the expansion of the VPP across the GoA so that all public servants receive their salary through a direct transfer to individual bank accounts under tight payroll controls integrated to human resources procedures. The aim is to improve the GoA's payroll systems and procedures including the integration of payroll to overall workforce planning and approval (*Tashkeel*) and day-to-day human resource procedures (e.g., recruitment, termination, promotion, etc.). In particular, MoF will diversify banking services available for payroll distribution.

PI-19 Transparency, competition and complaints mechanisms in procurement

3.221. Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively for achieving efficiency in acquiring inputs for, and value for money in, delivery of programs and services by the government. The principles of a well-functioning system need to be stated in a well-defined and transparent legal framework that clearly establishes appropriate policy, procedures, accountability and controls. One of the key principles established by the legal framework is the use of transparency and competition as a means to obtain fair and reasonable prices and overall value for money.

3.222. Public dissemination of information through appropriate means (e.g., government- or agency-level websites, procurement journals, national or regional newspapers, on demand from procurement bodies) on procurement processes and its outcomes are key elements of transparency. In order to generate timely and reliable data, a good information system will capture data on procurement transactions and be secure.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-19 Transparency, competition and complaints mechanisms in procurement	**B**	**B+**	Overall rating based on M2 methodology.
(i) Transparency, comprehensiveness, and competition in the legal and regulatory framework.	-	A	Afghanistan has a well-structured procurement law, supported by implementing regulations and standard bidding documents.
(ii) Use of competitive procurement methods	-	B	Open Competition is the default method of procurement under the procurement law, with justification being required in all cases where direct contracting or single source selection are used.
(iii) Public access to complete, reliable, and timely procurement information	-	A	All procurement opportunities are advertised widely.
(iv) Existence of an independent administrative procurement complaints system.	-	B	There is an independent procurement system under the procurement law

i) Transparency, comprehensiveness, and competition in the legal and regulatory framework.

3.223. Public procurement in Afghanistan is currently governed by the Procurement Law of 2008 (replacing the law of 2005) and since amended in 2009. The law is supplemented by "Rules of Procedures for Public Procurement in Afghanistan", originally from 2007 and now updated to reflect the provisions of the law of 2008, as amended in 2009. These are enacted under Article 95 of the law. In addition, the Procurement Policy Unit (PPU) has issued a series of circulars providing supplementary guidelines and implementing procedures under its functions set out in the law. The precedence therefore is clearly defined and the structure of regulatory framework is adequate. The legal framework is applicable to all procurement of goods, works and services (including consultancy services) undertaken by entities, municipalities and other units using public funds. The law, rules and circulars are all published at the PPU's website (www.ppu.gov.af) and are easily accessible to public at no cost.

3.224. The law clearly defines the permissible procurement methods and the circumstances under which each method is appropriate. The permissible procurement methods for procurement of goods, works, and non-consultancy services are Open Tendering, Restricted Tendering, Request for Quotations, and Single-Source Procurement. The latter may only be used in limited circumstances with the approval of the Award Authority (a higher official within the procuring entity itself). The law makes open, competitive tendering the default method of procurement.

3.225. In terms of international tendering, the 2008 law has removed the value threshold triggering international tendering proceedings which appeared in the 2005 law, so that it now applies only where goods, works or services are not available in Afghanistan or where national tendering has not secured an acceptable bidder. This is no longer consistent with international standards. In other respects, the standards of international competitive tendering are specified in the law and are acceptable.

3.226 Consultancy services and the procedure for their procurement are defined in the law but the detailed provisions are contained only in Chapter V of the rules. There is also a manual dealing specifically with consultancy services.

3.227. The law prohibits fractioning of contracts to limit competition (Article 16). Information related to procurement and procurement opportunities is published on a central PPU website. The information is easily accessible and covers the whole range of procurement activities of relevance to interested parties.

3.228. Article 62 on transparency commits the GoA to make publically available procurement plans, bidding documents, calls for bids and results of procurement processes. In accordance with the provisions of Article 72, the PPU has established a review mechanism and has adopted a Manual of Procedure for Procurement Appeal & Review. The manual requires that the decisions are deliberated on the basis of available evidence submitted by the parties to the Review Board, which has the authority to issue final decision that is binding on the parties on confirmation by the PPU.

(ii) Use of competitive procurement methods

3.229. The law makes open competitive tendering the default method of procurement (Article 23). The law provides for single-source procurement (Article 28) under conditions defined in the law.

3.230 A written justification shall be placed in the record of the procurement proceedings stating the reasons for employing any procurement method other than open tendering. It defines the situations in which other less competitive methods can be used and clearly specifies in Annex-A the approval levels for initiating as well as approving the procurement for each method. Hence, the discretion of individual entities and procurement officials is reasonably controlled to minimize the use of methods that limit competition. For SY1390 (2011/12) and SY1391 (2012), 88 percent of procurements were carried out using competitive methods and 12 percent using single-source selection or direct contracting with appropriate justification.

(iii) Public access to complete, reliable, and timely procurement information.

3.231. As mentioned, the PPU has created a website which is presently functioning (www.ppu.gov.af). The "static" component of the website providing for the dissemination of procurement related information is complete and includes full documentation related to the law, rules, circulars, standard bidding documents (SBDs) and review procedures. Information related to procurement and procurement opportunities is published and the information is easily accessible and covers the whole range of procurement activities of relevance to interested parties.

3.232. The "dynamic" component, relating to bidding opportunities, although provided for, is dependent on the inputs provided by procuring entities. All bidding opportunities are either advertised on the PPU, ARDS or procuring entities websites, as well as being advertised in newspapers of wide circulation, providing access to the public to all bidding opportunities. All contract awards with a value of more than US$100,000 must be published on the PPU's website (www.ppu.gov.af), but the PPU found compliance to be only 55 percent for SY1391 (2012). Procurement of a value above US$200,000 must be done by the ARDS unless the ministry/agency has a capacity certification from the PPU.[85] ARDS publishes all award notifications on its website (www.ards.gov.af). It is estimated that the gap between US$100,000 and US$200,000 represents less than 10 percent of operations by value.

(iv) Existence of an independent administrative procurement complaints system.

3.233. The law (Chapter IX) provides for a review mechanism. It establishes (a) the right to review; (b) the matters that are subject to review; (c) the timeframe for such reviews; and (d) the different steps in the review process. It provides for a time-bound response for a request to review at the level of procuring entity level before conclusion of the procurement process and award of contract. It also makes a provision for appeal against the response or the failure to respond by the procuring entity to an independent Administrative Review Committee. After award of the contract, an application for review may be filed with the Review Committee which has the authority to grant a remedy. The review committee is chaired by the Director General Budget of the MoF, and comprises three members from the PPU, a sector specialist, and two members from the Chambers of Commerce.

3.234 An application for review must be submitted within 10 working days after the applicant knew about the alleged violation. No fee is charged for the application. A decision on the application for review shall be issued by the head of the procuring entity within one week after its submission. The decision of, or the failure to decide within the required time by, the head of the procuring entity may be appealed to the Administrative Review Committee in PPU within 10 working days after either the decision or the expiry of the time for issuing the decision. The Chairman of the Administrative Review committee shall appoint a Review Board which shall decide one week after its receipt an appeal, or application for review. During the hearing of the appeal, and pending a decision, the procurement process remains suspended.

3.235. No precise methods of enforcement of decisions are indicated but it appears that all decisions have so far been implemented correctly.

3.236. In accordance with the provisions of Article 72 of the law, the PPU has established a review mechanism and has adopted a Manual of Procedure for Procurement Appeal & Review. The manual requires that the decisions are deliberated on the basis of available evidence submitted by the parties to the Review Board, which has the authority to issue final decision that is binding on the parties on confirmation by the PPU. So far, all decisions have been correctly implemented.

3.237. The PPU serves as the appellate authority because it not only has to confirm the order, but also it has the power to reopen a review where, in its opinion, it is necessary for the proper conduct of the case.

3.238. The time limits for submission and review of complaints and issuing of decisions are prescribed in the law such that it does not unduly delay the procurement process. To date, 24 cases of appeal have been received by the Review Board, of which 22 have been decided and two are under process. The decisions are available on the PPU website.

Reform Developments during 2012

3.239. In line with provisions of the Procurement Law that was promulgated in October 2005, and the responsibilities of the PPU that was established 2006 as a monitoring, legal and regulatory body. The “Rules of procedures for Public Procurement in Afghanistan” were issued on April 12, 2007 (in Dari and English) and the Special Procurement Commission (SPC) set up to approve the projects valued above the thresholds of the Award Authorities established, In 2012 an Appeal and Review Mechanism: Administrative Review Committee was established to handle complains of bidders for alleged breaches of the provision of the law. To facilitate adherence to the law, STDs continue to be developed and updated along with Procedural Circulars in English and Dari.

3.240. Capacity building comprising training in basics and advanced procurement has reached than 5,000 staff to be sustained by the appointment 30 Procurement Capacity Building Officers (PCBOs), all civil servants, to key ministries.

[85] Currently five line ministries – MoE, MAIL, MoEW, MoUD and MoLSAMD – are fully certified by the PPU, and two line ministries partly certified – MoPH (for consultancy services only) and MRRD (National Rural Access Program only).

3.241. Institutional development has been undertaken in 22 ministries and six provinces, and a management information system under PPU is under development.

Comparison of 2008 and 2013

3.242. As noted the methodology for PI-19 was revised in 2011 and as such, the scores for 2008 and 2013 are not fully comparable. Nevertheless, on the dimensions used for 2008 the overall rating was B and on the dimensions required for this 2013 update, the overall rating is B+ so a positive trend is set.

PI-20 Effectiveness of internal controls for non-salary expenditure

3.243. An effective internal control system is one that (a) is relevant (i.e., based on an assessment of risks and the controls required to manage the risks), (b) incorporates a comprehensive and cost effective set of controls (which address compliance with rules in procurement and other expenditure processes, prevention and detection of mistakes and fraud, safeguard of information and assets, and quality and timeliness of accounting and reporting), (c) is widely understood and complied with, and (d) is circumvented only for genuine emergency reasons.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-20 Effectiveness of internal controls for non-salary expenditure.	**C+**	**C+**	Overall rating based on M1 methodology.
(i) Effectiveness of expenditure commitment controls.	B	A	Comprehensive commitment controls are in place, between the budget unit and the centralized systems, to limit commitments to cash availability and appropriations.
(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures.	C	B	Internal control rules and procedures for non-salary expenditure incorporate a comprehensive set of controls, which are widely understood, but may in some areas be excessive (e.g., through duplication in approvals) and lead to inefficiency in staff use and unnecessary delays
(iii) Degree of compliance with rules for processing and recording transactions.	C	C	Rules are complied with in a significant majority of transactions, but exceptions are still a concern.

Dimension (i) Effectiveness of expenditure commitment controls

3.244. Article 6 of the PFEM law, along with the Financial Regulations, assigns each budgetary unit the responsibility for controls in their operations, including expenditure commitment control. As defined in the Financial Regulations, a commitment is “any order placed, contract awarded, service received or similar transaction that will require payment as a settlement” (Section 1.2). In practice, commitments set aside funds within an allotment for contracts signed, purchase orders places or any other encumbrances.

3.245. The MoF contracted a private firm in 2012 to carry out an assessment of PFM and internal controls of 14 line ministries (comprising expenditures of over 70 percent of the budget). These reports document the presence and reliability of the manual commitment controls in these ministries as commitments that result from purchase orders, advances and travel orders are controlled by line ministries using the Allotment Control Ledger. This ledger records the quarterly allotment granted to the respective budget unit as a credit and reduces the balance by the commitments taken on. This effectively provides a control of commitments against cash availability, which is set by the Treasury Department through the authorized allotments and appropriations since allotments are controlled to stay within the appropriation totals by the automated controls AFMIS. The commitment is reduced by payments or cancellations in the same ledger.

3.246. For contracts that arise under the development budget, the ministries need to record commitments in the AFMIS Commitment Module. The recording of these in AFMIS ensures that these funds are set-aside and cannot be used for any other purchases or expenditures. The commitments for the Development Budget are automatically reduced in AFMIS when the payment is effected against the same coding block as the commitment. Where these contracts are for longer than one fiscal year, the commitment is set only for the amount anticipated to be spent in the given year.

3.247. As such, commitment controls for the operating budget rely on the controls in each budget unit, the Allotments Ledger, while AFMIS provides additional controls and reporting for the commitments under the development budget only.

Dimension (ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures.

3.248. The PFEM law and the Financial Regulations along with circulars from the Treasury Department provide a comprehensive framework for internal control as roles and authorities are made clear and the procedures for transaction processing are provided. This framework is supported by an Accounting Manual, issued in 2012, and the arrangements under which accounting and payments are centralized in the Treasury Department and processed through AFMIS. The manual steps leading up to the transactions are processed throughout the GoA using the same forms, which have been in place for over 10 years, so processes are well understood.

3.249. Similarly, the GoA has a well-structured Procurement Law, supported by implementing regulations and SBDs. The control framework also has the support of a centralized procurement facilitating unit (ARDS) for civilian procurement and support of the PPU and its Procurement Controllers, who are deployed to most agencies for the purposes of monitoring the implementation of the annual procurement plans.

Dimension (iii) Degree of compliance with rules for processing and recording transactions.

3.250. Internal audits done to an acceptable standard are only conducted on operations under the MoF. Therefore, the degree of compliance with rules for processing and recording transactions should be drawn from the results of the monitoring of eligibility of the civilian recurrent costs by the ARTF Monitoring Agent. The Monitoring Agent conducts an independent review of compliance with a wide array of eligibility criteria, including compliance with national law and procedures.

3.251. The Monitoring Agent's report on the eligibility for the transactions in the first six months of SY1391 (2012), i.e., six of the nine months of that fiscal year were available for review. Eligibility is reported separately for four categories, one of which is non-salary expenditures. Non-compliance from a representative sample of transactions of non-salary expenditure, presented by type of exception below, indicates that the rate of non-compliance is significant.

Table 3.15: Rate of Compliance with Internal Control

Type of Non-Compliance	% of sample of transactions found to be non-compliant
Procurement rules / processes not followed	23
Files not available / missing documents	18
Error in budget coding	1

Comparison of Rating: 2008 and 2013

No change in rating.

Reform Developments during 2012

3.252. The Treasury Department has introduced the role of an assurance function for its department whereby a Management Assurance Officer will be recruited reporting directly to the Director General of Treasury to provide comprehensive periodic reports on the identified control points for measuring treasury performance, identify potential weaknesses in the internal control framework and provide recommendations for risk mitigation.

PI-21 Effectiveness of internal audit

3.253. Regular and adequate feedback to management is required on the performance of the internal control systems through an internal audit function (or equivalent systems monitoring function). Such a function should meet international standards such as the International Standards for the Professional Practice in Internal Audit (ISPPIA), issued by the Institute of Internal Auditors. The function should focus on reporting on significant systemic issues in relation to: reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; and compliance with laws, regulations and contracts.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-21 Effectiveness of Internal Audit	**C**	**C**	Overall rating based on methodology M1.
(i) Coverage and quality of internal audit function	C	C	The IA function within MoF is operational, undertakes some systemic reviews and meets recognized professional standards. It carried out system reviews in 10 line ministries in the last two fiscal years. While the function is operational in some key central government entities, there is little or no systemic review and the work does not meet recognized professional standards
(ii) Frequency and distribution of reports	C	C	Reports are issued regularly for all audited entities/departments, but not necessarily submitted to the MoF and SAO
(iii) Extent of management responses to IA findings	C	C	A reasonable degree of corrective action is taken by many managers on major issues, but often with delay

Dimension (i) Coverage and quality of internal audit function

3.254. **Legal and Institutional Framework** – Article 61 to the PFEM Law 2005 gave the MoF IAD the responsibility and authority for the internal audit function across government. But, in November 2012 this article was amended to limit the MoF IAD's purview to the MoF's operations; so it now covers only the budgetary units of MoF at the center, the work of the Financial Controllers,[86] the *Mustoufiats*, and the ACD offices in the provinces. It did however carry out system reviews in 10 line ministries in the last two fiscal years. The unit operates under a Director General and reports to the minister. Most line ministries have their own internal audit unit which is responsible for the internal audit activities within that ministry. These internal audit units are organized along similar lines to the MoF IAD.

3.255. **Audit Activities** – Internal audit in the MoF continues to advance significantly and show progress, and is working to a recognized acceptable standard. The audits are planned using a risk-based approach focusing on systemic issues, and internal controls are reviewed during the audit. The MoF IAD has a Code of Ethics, Standards, Internal Audit Committee Charter, and an Internal Audit Activity Charter, which collectively form "Mandatory Guidance". There is an Internal Audit Operations Manual that provides technical guidance to carry out the audit using a risk-based approach, based on the Institute of Internal Auditors' (IIA) standards. As the MoF IAD is required to plan audits focusing on systemic issues, considerable amount of staff time (between 20 percent and 50 percent) is spent on such issues. As regards the internal audit units in line ministries, the function is operational but the work does not follow a risk-based approach, is not to a recognized standard and there is little systemic review. In the last two fiscal years, however, miscellaneous revenue audits were conducted in eight key line ministries (systems reviews) with technical assistance of the MoF IAD. Annual audit plans were submitted to the SAO, but this will no longer be the case under the new Audit Law (February 2013). The focus is on identification of irregularities and investigation of potential corruption and fraud. Review of internal control processes is not carried out and, as a result, the external auditors do not place reliance on the work done by the internal auditors.

3.256. **Audit Capacity** – The capacity of the MoF IAD has significantly improved over the years through technical assistance to improve internal processes and develop manuals, class room training, and on-the-job training under a series of World Bank-funded PFM projects. Audit experts were recruited to help IAD staff with on-the-job training.

[86] Financial Controllers are the delegates of Treasury department in the line ministries.

Under the ongoing PFMRII,[87] the internal audit capacity will be further developed through a program of training of trainers and staff of line ministries.

3.257. The capacity of the IADs in the line ministries is remarkably weak, although a few key line ministries have marginally better capacity than most. Many staff have little formal education or professional training in the area of internal audit. There have been limited training opportunities and the ability of the staff to absorb the technicalities of a modern internal audit approach is also limited. Furthermore, they lack IT knowledge and skills, so the use of computer-aided audit techniques is practically nil. With the amendment of Article 61 of the PFEM Law limiting the MoF IAD's purview, a plan has been devised to redirect resources under PFMRII to support the internal audit units of the five key line ministries to bring them to acceptable standards.

3.258. Another capacity-building initiative for the line ministries also has been through the investment projects. In recent years, an element of capacity building has been introduced as and when new projects are prepared, where feasible for internal audit (in addition to financial management) through hiring of internal audit consultants. The internal audit consultants have dual responsibilities of performing internal audits, building the capacity of the internal audit staff by engaging them in the audits, and training. Many key ministries[88] are part of this initiative; however, visible positive results of such capacity building efforts are yet to materialize.

<u>Dimension (ii) Frequency and distribution of reports</u>

3.259. The MoF IAD carries out quarterly audits as per the annual audit plan and reports are issued with the same frequency. The reports are not submitted to SAO, but they are made available to the external auditors undertaking field level audit. As regards the internal audit units in the line ministries, the frequency of audits varies from quarterly to bi-annual. The reports are issued with the same frequency mostly, although sometimes with delays. However, these reports are not submitted to the MoF but were distributed to the SAO; under the new Audit Law this practice may change.

<u>Dimension (iii) Extent of management response to internal audit findings</u>

3.260. As regards the MoF, the audited units respond by spelling out their action plans to implement audit recommendations. Some managers take action on major issues, but most often there is delay in implementing remedies. In SY1390 (2011/12), a total of 651 recommendations were made, of which only 203 were implemented within 12 months (31 percent compliance). In the line ministries, actions are taken on major issues, but most often with delays.

<u>Comparison of Ratings: 2008 and 2013</u>

3.261. No change in ratings.

<u>Reform developments during 2012</u>

3.262. Under both the Afghanistan PFM Roadmap and the ARTF Incentive Program, the GoA committed to build the capacity of internal audit founded on the mandate of the MoF IAD to conduct audits and coordinate internal audits across government. Technical assistance has been in place since 2006 to build this capacity. Specifically, an incentive was paid to GoA in SY1390 (2011/12) under the ARTF Incentive Program for clarifying and endorsing this mandate.

3.263. Unfortunately, in 2012 Parliament amended the PFEM Law's Article 61 to limit the MoF IAD purview, thus setting back internal audit capacity within the GoA and sub-optimizing the capacity of the MoF, which had made progress in this regard under technical assistance agreements with the World Bank and the US Treasury.

3.264. In an effort to continue pursuing efforts to strengthen management oversight through internal audits, the technical assistance activities are being re-directed to provide assistance to five key line ministries to build capacity to conduct internal audit to acceptable standards and to train auditors in all line ministries.

[87] Public Financial Management Reform Project II
[88] For example, Ministry of Education and Ministry of Energy and Water.

E – Accounting, Recording and Reporting

PI-22 Timeliness and regularity of accounts reconciliation

3.265. Reliable reporting of financial information requires constant checking and verification of the recording practices of transactions. Timely and frequent reconciliation of data from different sources is fundamental for data integrity and reliability. This includes two critical activities: (i) reconciliation of accounting data, held in the government's books, with government bank account data held by central and commercial banks; and (ii) clearing and reconciliation of suspense accounts and advances.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-22 Timeliness and regularity of accounts reconciliation	**B**	**B**	Overall rating based on M2 methodology.
(i) Regularity of bank reconciliations	B	B	Bank reconciliation for all treasury bank accounts take place at least monthly, usually within four weeks from the end of the month.
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	B	B	Reconciliation and clearance of advances takes place at least annually within two months of end of period, with some un-cleared balances brought forward

3.266. In Afghanistan, line ministries maintain records of their revenue collections, which are deposited with the TSA, and for all expenditure payments authorized by check requisitions. The accounting and payments, however, are performed by the Treasury Department (for Kabul operations) and at the *Mustoufiats* (for provincial operations). The accounting of these operations is done in AFMIS that covers all budget operations, including those at provincial level. All line ministries have online access to AFMIS account balances, and they perform a monthly reconciliations, or confirm miscellaneous income and expenditure figures.

Dimension (i) Regularity of bank reconciliations

3.267. All bank accounts supporting the execution of the core budget are under the control of the Treasury Department; these comprise the TSA for the ordinary budget, the accounts for the GoA's discretionary development budget, and the designated accounts used for donor-funded development projects. All these accounts are reconciled at least monthly, with some transactions being reconciled more frequently. There is a bank account in the central government that is not related to budget operations, i.e., the account for the Telecommunications Development Fund (TDF) of ATRA.[89] The review could not establish the status of the TDF's bank reconciliation.

Dimension (ii) Regularity of reconciliation and clearance of suspense accounts and advances

3.268. **Advances:** All advances are recorded in assigned codes for advances in AFMIS and these are tracked on a daily basis. The advance unit prepares a daily report for the management, which includes all un-liquidated advances that are outstanding in excess of 60 days. Line ministries are required to acquit the outstanding advances prior to the release of any fresh advance, which happens systematically to a large extent on the operating budget. The un-liquidated advances are reconciled each month with the budgetary units. The advances are tracked separately for the operating budget and the development budget, and also by line ministries. Some accounts have outstanding balances brought forward. There are no suspense accounts.

[89] Telecommunications Development Fund (TDF) was established in 2003 and is administered, overseen and controlled by the Afghan Telecommunications Regulatory Authority (ATRA) under the Ministry of Communications & Information Technology (MoCIT). Based on Article 48 of the Telecommunications Law, operators and service providers of telecommunication services are obliged to contribute to the TDF (currently set by ATRA at 2.5 percent of net revenues).

3.269. For the operating budget, Afs 3.4 billion was given in advances in SY1391 (2012) of which Afs 885.5 million were outstanding at year-end. For the development budget, Afs 10.2 billion were given in advances in SY1391 (2012) of which Afs 5.5 billion were outstanding at year-end.

Comparison of Rating: 2008 and 2013

3.270. No change in rating.

Reform developments during 2012

3.271. Since 2008, great advances have been made in the coverage of access to AFMIS, as the *Mustoufiats* now process all their operations online. This eliminates the time lag that caused discord between accounting records and bank balances.

PI-23 Availability of information on resources received by service delivery units

3.272. The indicator measures the availability of information on the provision of resources to frontline service delivery units – schools and health clinics – which were intended for their use. Information on the receipt of resources by service units is critical to ensure that funding becomes available as required and in a timely manner.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-23 Availability of information on resources received by service delivery units. Collection and processing of information to demonstrate the resources that were actually received by primary schools and primary health clinics.	D	C	The MoPH (GCMU) collects data regularly on operating expenditures (salaries, O&M, capital projects) from health care facilities in most provinces (31 of 34), but the information is not compiled into reports. The MoE does not budget at the level of schools, and school-level resource data is not collected or calculated by the MoE.

3.273. The annual budget is appropriated by Parliament at the level of primary budgetary units (economic classification for the operating budget, and projects for the development budget). The budget documents thus include information on resources at the level of ministries/agencies, while a provincial breakdown is presented in a separate document.

3.274. The budget is authorized through the issuance of allotments by the Budget Execution Directorate (within the MoF Budget Department). This is done to provide expenditure control in the budget execution process, and involves reviewing and approving requests from the primary budgetary units to expend their funds as appropriated. The lowest level to which allotments can be made is for provinces.

3.275. The location codes in the Chart of Accounts can be used to register transactions down to the level of districts, but they do not include service-delivery units. Any data at this level would thus have to be separately collected through systems other than AFMIS. However, no Public Expenditure Tracking Surveys (PETS) have been carried out in Afghanistan in recent years (in fact, the only PETS was for the education sector, undertaken by the World Bank as part of the 2005 PEFA assessment).[90]

3.276. The MoE does not provide information to **primary schools** about the resources that is allocated to them, except that teachers employed at the schools are aware that their salaries are included in the MoE's overall operating budget. The MoE likewise does not collect information about the resources that were expended per primary school during the fiscal year. The lowest level of expenditure registration is for districts.

3.277. The provision of services at local **health clinics** is supported by three donors (EU, USAID, and the World Bank) based on the Basic Package of Health Services (BPHS), implemented by NGOs. Although the donors have adopted

[90] World Bank (2005): "Afghanistan, Managing Public Finances for Development, Vol. I"; Report No. 34582-AF, p. 54.

different management approaches in their implementation support,[91] they all require regular reporting of detailed accounting data on actual spending (i.e., resources received) at the level of health facilities. The MoPH Grant & Contract Management Unit (GCMU) therefore every quarter collects and reports to the donors on operating expenditures (salaries, O&M, capital projects) of health care facilities in all provinces. Also, in-kind resources are captured through information on contributions (EU) or detailed asset registers (USAID and World Bank). However, the collected data is not being compiled into reports.

3.278. The annual and multi-year budget formulation processes have generally not been (directly) based on detailed calculation of the resource requirements of service delivery units (e.g., on a per-unit cost basis). However, an O&M costing exercise was carried out in 2012 for the MoE and MoPH (central hospitals), the results of which were included in the budget for SY1393 (2013). The MoF plans to conduct similar exercises for other ministries during 2013.

<u>Comparison of Ratings: 2008 and 2013</u>

3.279. The rating improved from D in 2008 to C because routine (quarterly) data collection is now undertaken by the MoPH (GCMU). This produces reliable information on resources received in the form of operating expenditures (salaries, O&M, capital projects) at the level of health clinics across most of the country (31 of 34 provinces).

<u>Reform developments during 2012</u>

3.280. No specific developments noted.

PI-24 Quality and timeliness of in-year budget reports

3.281. To "bring in" the budget requires timely and regular information on actual budget performance to be available to the MoF (and the Cabinet), to enable it monitor performance and if necessary take action to get the budget back on track, and to the MDAs to enable them to manage the affairs for which they are accountable. The indicator focuses on the ability to produce comprehensive reports from the accounting systems on all aspects of the budget; flash reports on the release of funds to MDAs are not sufficient.

Indicator / Dimension	Score		Brief explanation of status
	2008	2013	
PI-24 Quality and timeliness of in-year budget reports	**C+**	**C+**	Overall rating based on M1 methodology.
(i) Scope of reports in terms of coverage and compatibility with budget estimates.	C	C	The GoA's in-year budget execution reports are generated from AFMIS every month in the same structure as the budget, giving high quality information at all levels of the budget. Non-recording of expenditure at commitment level by MDAs remains a major deficiency to improve score.
(ii) Timeliness of the issue of reports.	A	A	Reports are produced every month from AFMIS within four weeks. Information is available to all financial managers of primary budgetary units on-line as transactions occur.
(iii) Quality of information.	A	A	The GoA's in-year budget reports are generated from AFMIS every month, giving detailed information of budget and actual spending. Data is considered credible and accurate and is confirmed by periodic reconciliation by line ministries.

[91] The EU covers 10 provinces and awards competitive contracts to NGOs that are reimbursed according to their spending on inputs. USAID covers 13 provinces through an implementing agency that contracts NGOs and provides payment for budgeted line items. The World Bank covers 11 provinces using performance-based agreements that provide a lump sum for NGOs to deliver the BPHS and with the NGOs making most spending decisions. The MoPH contracts staff on terms broadly similar to those of NGOs the remaining three provinces.

Dimension (i) Scope of reports in terms of coverage and compatibility with budget estimates

3.282. The PFEM Law stipulates that the MoF must submit quarterly progress reports on the budget to the GoA and the President (Article 54). Through the centralization of accounting and payments in the Treasury Department as well as the use of AFMIS, the MoF is able to produce comprehensive, timely and reliable statements on the budget execution and on the GoA's financial position. All tax and customs receipts, as well as miscellaneous income in the line ministries, are recognized on actual cash deposit into the revenue collection accounts maintained by the Treasury Department. Expenditure of funds are recorded in AFMIS at the payment stage for the entire budget and at the commitment stage for the investments (development budget), which is less than 50 percent of expenditure. The entire development budget is controlled and executed based on commitments entered into AFMIS out of allotments issued against the budget appropriation of each fiscal year. These commitments correspond to disbursements that are expected to be made in the year against the contract for which the budget is appropriated. However, although the budgetary units maintain largely manual controls over commitments for the operating budget in allotment ledgers, there is no recording or reporting on commitment for the operating budget.

3.283. All primary budgetary units now have on-line access to the AFMIS, so the budget execution reports are available to them in real-time. Moreover, the MoF prepares monthly reports on budget execution against appropriations and allotments (warrants) by organizational units and major cost classification determined on a cash basis. Confirmation of the charges in the monthly reports are provided by the budgetary units within 30 days of month-end after which these are locked and the reports published on the website of the Treasury Department (http://www.treasury.gov.af/).

Dimension (ii) Timeliness of the issue of reports

3.284. All transactions are processed online in AFMIS and the monthly in-year budget execution reports are prepared from these records and posted on the website of the Treasury Department by the 28th of the following month based on a reconciliation of the charges by the budgetary units. Revenue collections are similarly reflected in these reports and comprise both central and provincial collections.

Dimension (iii) Quality of information

3.285. The centralization of payments and accounting in the Treasury Department has contributed greatly to the reliability of records. The Treasury Department has the means to review the proposed charges for any payment and process these in AFMIS, which validates against appropriations, allotments and vetted vendors. Furthermore, the AFMIS records are reconciled by the line ministries monthly to their authorizations of changes to appropriations, allotments and expenditures. Reconciliation between AFMIS and Budget Department records of appropriations occurs only at year-end. Revenue classification to final accounts is also mostly done by month-end, but this contains a significant share of unclassified receipts.

Comparison of Ratings: 2008 and 2013

3.286. The rating remains unchanged.

Reform developments during 2012

3.287. Many financial management applications are in use outside FreeBalance and there is no automated integration of data between AFMIS and related non-core systems, or data warehousing to support integrated reporting capability. Technical assistance provided by the ARTF-funded PFMRII is in place to achieve seamless integration with other GoA IT systems, specifically with DAB and Banking Systems, Debt Management System, State Budget Preparation System (SBPS), DAD, where practical and economical.

3.288. As AFMIS functionality is developed, Treasury procedures are also being reformed to achieve the full benefit of the enhanced AFMIS to support more efficient delivery of Treasury functions alongside strengthened internal controls and improved reliability and relevance of government financial information. Under PFMRII, functional expansion of AFMIS is supported to implement non-core applications for Procurement/Purchasing, payroll, and Fixed Asset/Inventory Management and Accounting in the line ministries to improve budget management.

3.289. Treasury has also attained the capacity to process payments in multiple currencies within AFMIS, thus eliminate the dependence on a separate customized application which was formerly used to generate payment instructions in foreign currencies.

PI-25 Quality and timeliness of annual financial statements

3.290. Consolidated year-end financial statements are critical for transparency. To be complete, they must be based on details of all ministries, independent departments and de-concentrated units. The ability to prepare year-end financial statements in a timely fashion is a key indicator of how well the accounting system is operating and the quality of records maintained.

Indicator / Dimension	Score		Brief explanation of status
	2008	2013	
PI-25 Quality and timeliness of annual financial statements	**B+**	**C+**	Overall rating based on M1 methodology.
(i) Completeness of financial statements.	B	A	The annual financial statements are comprehensive of all revenue and expenditures under the budget and information on financial assets and liabilities is provided.
(ii) Timeliness of submission of the financial statements.	B	A	The year-end financial statements are published on the website of the Treasury Department within six months of year-end. Separately, the budget reconciliation statement is submitted for audit and sent to Parliament within six months of year-end.
(iii) Accounting standards used.	A	C	The annual financial statements are presented in a consistent format over time and basis of accounting is disclosed.

Dimension (i) Completeness of the financial statements

3.291. Monthly financial reports, published on the website of the Treasury Department, are drawn from AFMIS, which is used to control the budget. The report comprises a Statement of Receipts and Payments, a concentrated balance sheet and notes to the statements including a note on the accounting policies. The reporting entity covered by the statements is the GoA and all funds entrusted to it and controlled by the annual national core budget. The statements are thus comprehensive of all budget operations which cover practically all revenue and expenditure in the central government. The last month of the fiscal year's statement of expenditure and revenue, confirmed by the respective budgetary units, is considered the annual financial statements. This Statement of Receipts and Payments is prepared with line items, headings and sub-totals in line with the administrative structure of the GoA, and in line with revenue and expenses classifications that reflect the nature of the transactions. The schedules also include a statement of classified expenses based on COFOG. The Treasury Department publishes separately a monthly statement on debt.

3.292. The basis of the annual audit and the statement sent to Parliament is the budget reconciliation, or Statement of Budget Execution (*Qatia*), which is a very detailed version of the Statement of Receipts and Payments.

Dimension (ii) Timeliness of submission of the financial statements

3.293. For SY1389 (2010/11) and SY1390 (2011/12), the annual financial statements were published on the website of the Treasury Department within six months of the year-end and the *Qatia*, which is the basis for the annual external audit, was submitted for audit and sent to Parliament within six months of year-end.

Dimension (iii) Accounting standards used

3.294. Article 55 of the PFEM Law commits the MoF to publish both a set of financial statements which comply with international accounting principles, and the *Qatia,* or budget reconciliation statement. There are no national standards for public financial reporting. The International Public Sector Accounting Standards (IPSAS) require, in the case of cash basis accounting, a statement of cash receipts and payments, and the presentation of accounting policies and explanatory notes. The standards also require that all entities controlled by the reporting entity be consolidated and reflected in the statements and that third party transactions be disclosed separately. The annual financial statements comply with some of the IPSAS standards, but they do not comprise the results and cash position of controlled entities and third party payments, which for the GoA represent approximately 10 percent of budget expenditures. These are not disclosed separately. The statements, however, are presented in consistent format over time with good disclosure of the accounting standards with the authorization date and the authority under which these are issued is disclosed.

Comparison of Ratings: 2008 and 2013

3.295. The overall rating deteriorated, with the lowest dimension now C. The rating of dimension (i) improved from B in 2008 to A as the annual financial statements comply with the current detailed guidance on the coverage that the statements should have. The rating of dimension (ii) improved from B to A since the annual statements and the *Qatia* were produced within six months of year-end. In 2008, the annual financial statements were issued nine months after year-end. Dimension (iii) was rated A in 2008 because of the annual statement for SY1385 (2006/07) were prepared specifically to comply with IPSAS, although not on a consolidated basis. For the last three fiscal years, however, the annual statements were not prepared on this basis.

Reform developments during 2012

3.296. The MoF is committed to improving the timeliness and quality of annual audited financial statements submitted to the legislature and donors, and technical assistance for this is in place under the ARTF-funded PFMRII. Under the predecessor project, PFMR, the MoF had committed to prepare financial statements compliant with international standards (IPSAS), as required in the PFEM Law. However, technical difficulties around compliance with cash basis IPSAS are now widely recognized, as there is limited guidance for the implementation of the cash basis IPSAS, which was first issued in January 2003. In fact, no government anywhere in the world has been able to adopt this standard. Consequently, the MoF is not committed under the current technical assistance to prepare IPSAS-compliant annual financial statements.

F – External Scrutiny and Audit

PI-26 Scope, nature and follow-up of external audit

3.297. For the government to fulfill its fiduciary responsibility, external audit has to be carried out using acceptable standards.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-26 Scope, nature and follow up of external audit	**C**	**C+**	Overall rating based on M1 methodology.
(i) Scope/nature of audit performed	C	C	All GoA entities, including provincial budgetary agencies and Kabul municipality, are covered by the financial audit. SAO's audit coverage is at least 75 percent,[92] and covers revenue and expenditures. SAO applies the ISSAI Level 3 principles, but not the Level 4 standards that translate the principles into more specific, detailed and operational guidelines that could be used in the day-to-day conduct of auditing tasks. While compliance audits are done, performance audit is still at a nascent stage and no performance audits were conducted in SY1390 (2011/12) and SY1391 (2012).

92 This percentage refers to the amount of expenditures and revenues of the entities covered by the annual audit activities. It does not refer to the sample of transactions selected by the auditors for examination within those entities.

(ii) Timeliness of submission of audit reports to legislature	C	B	The financial audit report is submitted to the legislature within six months from the end of the audit period.[93]
(iii) Evidence of follow up on audit recommendations	C	C	Although the number of entities that respond timeously and effectively to audit observations have significantly improved over the years, there are still some entities that do not respond on time and/or do not implement all recommendations. This results in some issues recurring in the following year's audit. It is also noted that on compliance audit, not all recommendations are implemented by the management.

Note: Dimensions (i) and (ii) refer to the audit report on budget execution.

Dimension (i) Scope/nature of audit performed

3.298. Article 98 of the 2004 Constitution mandates the Executive to present to the Parliament accounts of the previous fiscal year. The PFEM Law requires the SAO to prepare and submit an independent report on the previous fiscal year's financial statements within six months from the end of the year. For this purpose, in February 2013 Parliament approved a new Audit Law that represents a great step forward subject to minor caveats that the re-audit (Article 20) and auditor violation (Article 22) clauses could operate to frustrate the independence principles. Reporting publicly seems to be generally unfettered except for reasonable restrictions on specified audit types. The more generous independent resourcing arrangements in some SAIs is not included, nor is the involvement of the Parliament in the selection or dismissal of the Auditor General. While these omissions are deviations from the principles, they are reasonable to expect from a developing legislature such as that of Afghanistan.

3.299. The SAO carries out financial, compliance and performance audits; performance audits are in very nascent stage and were limited by the prior legal framework. For SY1390 (2011/12), the financial audit covered both expenditures and revenue for all central and provincial budgetary entities and Kabul municipality. The compliance audit covered all central and provincial agencies, SOEs, municipalities, tax and revenue agencies. No performance audit was conducted in the last two fiscal years.

3.300. Significant capacity-building and training measures have been put in place through technical assistance under donor-funded projects. The capacity and technical competence level of civil service at the SAO is improving, but is not yet sufficient to conduct audits on its own to satisfy international standards. The SAO applies the ISSAI Level 3 principles, but not the Level 4 standards that translate the principles into more specific, detailed, and operational guidelines that can be used on a daily basis in the conduct of auditing tasks. The audit report on the *Qatia* of SY1390 (2011/12) was recently published, but compliance audit reports are not published.

Dimension (ii) Timeliness of submission of audit reports to Legislature

3.301. The SAO completed the audit of the GoA financial statements of SY1390 (2011/12) and submitted the report to Parliament within the prescribed timeline of six months from the end of the year.

Dimension (iii) Evidence of follow up on audit recommendations

3.302. There is a process of follow-up on audit recommendations of the project audits, but this is not very streamlined or systematic. Although the number of entities that respond timeously and effectively to audit observations have significantly improved over the years, there are still entities that do not respond on time or do not implement recommendations, resulting in some of the issues being repeated in the following year's audit. The MoF plays an active role in following up with ministries to respond to SAO audit reports. On compliance audit, the SAO forwards Inspection Reports to the respective entity and normally three months' time is recommended for implementation of the recommendations. Thereafter, follow-up is done by the SAO on the status of recommended actions. However, while not all recommendations are implemented by the management, the SAO includes the status of those in the following reports.

93 Under existing practice, there is no specific mandate for submission of compliance audit report to the legislature. However, the newly approved Audit Law stipulates submission of the compliance audit report to the legislature by the end of the year, following the previous year covered under the audit.

Comparison of Ratings: 2008 and 2013

3.303. The overall rating for external audit improved from 2008 because for the 2013 update the timeliness of presentation to Parliament (within six months) of the audit of the *Qatia* only was considered. In 2008, the donor grant audits were also considered, but recent PEFA guidance on PI-26 makes it clear that only the budget execution should be considered. Effectively performance on external audit is the same as 2008 although there is now a clearer, modern legal framework in place to support this function.

Reform developments during 2012

3.304. The SAO has technical assistance in place, under the ARTF-funded PFMRII, to support capacity building and the implementation of the new audit methodology for regulatory audits and carry-out the mandate of the proposed audit legislation. Human capacity is being developed by training in general audit and management skills and in the application of international auditing standards. The primary focus of extant and planned technical assistance, however, is on in-source capacity so that donor grant audits are done to an acceptable standard. Funding is also available to extend this approach to include regularity audits of key line ministries.

3.305. A new audit was approved by Parliament in March 30, 2013, which supports the establishment of the SAO as a modern external audit entity.

PI-27 Legislative scrutiny of the annual budget law

3.306. The power to give the government authority to spend rests with the legislature, and is exercised through the passing of the annual budget law. Assessing the legislative scrutiny and debate of the annual budget law will be informed by consideration of several factors, including the scope of the scrutiny, the internal procedures for scrutiny and debate and the time allowed for the process.

3.307. In-year budget amendments constitute a common feature of annual budget processes. In order not to undermine the significance of the original budget, the authorization of amendments that can be done by the Executive must be clearly defined, including limits on extent to which expenditures budgets may be expanded and re-allocated and time limits for the Executive's presentation of amendments for retro-active approval by the legislature.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-27 Legislative Scrutiny of Annual Budget Law	**B+**	**B+**	Overall rating based on M1 methodology.
(i) Scope of the legislature's scrutiny	A	B	The legislature's review covers details of expenditures and revenue and the fiscal policies. Although the MTFF is included in the budget document submitted to the Parliament, this is not discussed. The discussion predominantly focuses on the year in question.
(ii) Extent to which legislature's procedures are well established and respected	B	A	Procedures exist for the legislature's budget review and are respected. The procedures are comprehensive and are mandated in the internal ToR of the Parliament. Specialized committees and joint committees also exist for review.
(iii) Adequacy of time for review by legislature	B	B	As per the Constitution and the PFEM Law, 45 days are provided to the legislature for review.
(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature	A	B	Clear rules exist for the in-year budget amendments by the Executive and are usually respected, but they allow extensive administrative reallocations.

Dimension (i) Scope of the legislature's scrutiny

3.308. The 2004 Constitution provides the legal authority for budget formulation, approval and execution. Responsibilities are clearly established between the government (for formulation) and the bicameral legislature (for approval). As per Article 27 of PFEM Law, the Executive is required to prepare the budget based on multi-year national development and security programs, and economic framework for following two years in addition to the year in question. The budget is submitted through the Upper House (Meshrano Jirga) with an advisory comment for consideration in the Lower House (Wolesi Jirga) where the final approval rests. The SY1391 (2012) budget discussions also focused on the DAB recapitalization which covered an eight-year timeframe, well beyond the mid-term, but the MTFF specifically was not covered. One schedule on the MTFF is part of the budget document submitted to the Parliament for SY1391 (2012), however in the last four years the pre-budget statement/MTBF was not submitted to Parliament, so neither the Budget Committee nor other committees discussed the MTFF. It is to be noted, though, that submission of pre-budget statement/MTBF to the Parliament is not required by law. This is one of the reform areas in the PFM report.

Dimension (ii) Extent to which the legislature's procedures are well established and respected

3.309. In the Lower House, the Budget and Finance Committee carries out the analysis of the budget proposal. The legislative review procedures are comprehensive and are mandated in the Terms of Reference of the Parliament. There are 18 specialized committees, as also joint committees of the 18 committees. Their review concentrates on the detailed final proposals for revenue and expenditure. There is also a parliamentarian group which provides insight on the development issues and long-term growth aspects. The role and mandate of the legislature is clear, and the procedures are respected.

Dimension (iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed for all stages combined)

3.310. Article 98 of the Constitution and Article 39 of the PFEM Law calls on the Executive to send the annual budget document to Parliament at least 45 days in advance of the beginning of the fiscal year.[94] For the last completed fiscal year (SY1391), the draft budget was first submitted to the Parliament on 12/11/1390 (little over 45 days in advance of the new fiscal year), and the Parliament took about the same time allowed as per the law to review it. The Parliament rejected the budget on 28/12/1390 based on the first review. The budget was submitted a second time on 29/12/1390 and again rejected on 21/01/1391. The third submission was made on 21/01/1391 and the budget was finally approved on 02/02/1391.

Dimension (iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature

3.311. The PFEM Law[95] provides guidance for in-year budget amendments. More specific guidance is provided as part of the approved Budget document every year.[96] The MoF may authorize the transfer of amounts between appropriations for a ministry provided the transferred amount does not exceed 5 percent. Even though the PFEM Law allows for over 5 percent adjustments/transfers, such transfers are normally limited in practice due to the strict controls in place. Additionally, the government limits transfer of funds between the major expenditure codes (21, 22 and 25). However, additional appropriations that may be required, transfers of appropriations within a budgetary unit which exceed five percent of appropriation and transfers of appropriations between budget units must all be approved by Parliament. Further, in the event of urgent or unforeseen circumstances, appropriations out of contingencies to a purpose of a program are possible and may be proposed by MoF to the President. To this extent, extensive administrative reallocations are possible.

Comparison of ratings: 2008 and 2013

3.312. No change.

Reform Developments during 2012

3.313. In order to improve the functioning of the Parliamentary budgetary institutions such as the Budget and Economic Committees and the Budget Office, and enhance the budget review and oversight processes through

[94] There are plans to increase the number of days to 60 in the coming year, providing 15 days to the Upper House and 45 days to the Lower House.
[95] Refer Articles 42, 43, 46 and 47 of PFEM Law.
[96] Budget execution guidelines which are part of the approval Budget Law for SY1391 (2012).

effective coordination with the MoF and the SAO, several study trips have been conducted in the past few years for Members of Parliament, the Auditor General and SAO staff, and top officials of the MoF. These included study trips to the US, South Korea, India, France, and Australia, funded by the World Bank and USAID.[97]

3.314. The advances in budget transparency, reported in the Open Budget Index report of 2012, can be further consolidated through more structured and predictable budget review and oversight by Parliament, improved coordination and communication between the MoF and Parliament and a more independent SAO and forging a better working relationship with Parliament on audit and oversight functions.

3.315. During the study trips, the delegations had a chance to see and learn about effective budgetary institutions and processes in the countries visited. The following are the some of the results oriented institutions and practices that are implemented in the countries visited.

PI-28 Legislative scrutiny of external audit reports

3.316. The legislature has a key role in exercising scrutiny over the execution of the budget that it approved. A common way in which this is done is through legislative committee(s) or commission(s) that examines the external audit reports and questions responsible parties about the findings of the reports. The operation of the committee(s) will depend on adequate financial and technical resources, and on adequate time being allocated to keep up-to-date on reviewing audit reports. Two types of audit reports are send to Parliament: the annual *Qatia* and the compliance audit reports.

Indicator / Dimension	Score		Brief Explanation
	2008	2013	
PI-28 Scope, nature and follow up of external audit	**C+**	**C+**	Overall rating based on M1 methodology.
(i) Timeliness of examination of audit reports by the legislature	B	C	The legislature usually takes about four months to review. However, for SY1390 (2011/12), the legislature took more than six months to review the audit reports.[98]
(ii) Extent of hearings on key findings undertaken by the legislature	C	C	There is in-depth review and the extent of hearings has been exhaustive for SY1390 (2011/12). The members of the Executive have been asked to respond to key findings.
(iii) Issuance of recommended actions by the legislature and implementation by the Executive	B	B	The audit report on the budget execution statement (*Qatia*) will not be accepted by the legislature unless recommendations for correction to the accounts are acted upon. However, not all recommended actions in this audit report are implemented in a consistent manner.

Dimension (i) Timeliness of examination of audit reports by the Legislature.
3.317. Only the *Qatia* audit reports are discussed by the legislature, the compliance reports are not. The legislature usually took about four months to review the audit reports, however for SY1390 (2011/12), the legislature continued to examine the *Qatia* audit report for longer than six months.

Dimension (ii) Extent of hearings on key findings undertaken by the legislature.
3.318. The *Qatia* reports are subject to in depth review by the legislature. The observations and recommendations are first examined by the Budget and Finance Committee, and thereafter by the full legislature. During these discussions, hearings with responsible officers from concerned entities are included. The extent of hearings has been exhaustive for SY1390 (2011/12).

[97] See annexes for the list of participants and programs.
[98] Only Qatia audit reports are discussed and examined by the legislature. Compliance audit reports are not at present discussed by the legislature.

Dimension (iii) Issuance of recommended actions by the legislature and implementation by the Executive.
3.319. Where the legislature finds any deviation in the preparation or presentation of the *Qatia* accounts, the recommendation for any corrections/modifications to be made are implemented by the Executive. Without such correction, the *Qatia* accounts are not accepted by the legislature. There are other recommendations issued on the *Qatia* report as well as project audits, however not all recommendations are consistently acted upon.

Comparison of Ratings: 2008 and 2013
3.320. No change in the overall rating. Dimension (i), however, on timeliness was rated as C in this assessment, down from B in 2008, as the review of the audit report for the most recent report was not carried out within six months.

Reform developments during 2012
3.321. In order to improve the functioning of the parliamentary budgetary institutions such as the Budget and Economic Committees and the Budget Office and enhance the budget review and oversight processes through effective coordination with the MoF and the SAO, several study trips have been conducted in the past few years for members of Parliament, the SAO, and officials of the MoF. These included study trips to the US, South Korea, India, France, and Australia, funded by the World Bank and USAID.

G – Donor Practices

D-1 Predictability of direct budget support

3.322. Direct budget support constitutes an important source of revenue for the government. Poor predictability of inflows of budget support affects the government's fiscal management in much the same way that external shocks impact on domestic revenue collection.

Dimension	Score		Brief explanation of status
	2008	2013	
D-1 Predictability of Direct Budget Support	B+	B+	Overall rating based on M1 methodology.
(i) Annual deviation of actual budget support from the forecast provided by donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature.	B	B	Donors provide estimates of budgetary support at least six weeks before budget approval budget. Support fell between 90 percent and 95 percent of the forecast in two of the last three fiscal years
(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)	A	A	Quarterly/monthly disbursement estimates are agreed with donors, which are substantially complied with.

Dimension (i) Annual deviation of actual budget support from the forecast provided by donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature.
3.323. Direct budget support for the purposes of this analysis is considered to be all on-budget donor assistance outside of the project financing; this comprises recurrent cost funding under ARTF, LOTFA and US Department of Defense support (Combined Security Transition Command-Afghanistan (CSTC-A)). Forecast of this support is expressed in the annual budget and the discretionary development budget support.

3.324. The comparison of actual donors receipts to the forecasts provided to the Treasury Department of the last three fiscal years indicate that total receipts from the related sources came to came to 94.7 percent in SY1388 (2009/10), 93.6 percent in SY1389 (2010/11), and exceeded forecast in SY1390 (2011/12).

Dimension (ii) In-year Timeliness of Donor Disbursements.
3.325. Donor Grant Agreements for the ARTF Recurrent Cost Trust Fund and LOTFA hold the donors to advance funds and replenish the advance when the related expenditures are presented in line with funding availability. The annual

cash plan reflects this. The practice in the last three years has been for funds to be disbursed in line with the agreements and budget execution. CSTC-A provides an annual forecast.

3.326. The rating is A because quarterly disbursement estimates for direct budget support have been agreed with donors at the beginning of the year and actual disbursement delays from these targets have not exceeded 25 percent in two of the last three years.

Comparison of Ratings: 2008 and 2013
3.327. No change in rating.

Reform developments during 2012
3.328. No developments were observed.

D-2 Information from donors for budgeting and reporting on project/program aid

3.329. Predictability of disbursement of donor support for projects and programs affects the implementation of specific line items in the budget. Project support can be delivered in a wide range of manners with varying degrees of government involvement in planning and management of resources.

Dimension	Score		Brief explanation of status
	2008	2013	
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	**D**	**D+**	Overall rating based on M1 methodology.
(i) Completeness and timeliness of budget estimates by the donor for project support	D	A	Donors provide significant information to the MoF on development assistance through ad hoc discussions but also in the annual donor consultation meetings as part of budget preparations whereby individual donors meet in person with the AMD of the MoF on their plans for the coming year. Following analysis and agreements, this information is stored in an ad hoc data base and used as reference against the individual line ministry submissions. Effectively, all on-budget project funding is dealt with and reflected in the data base and rolled up in the annual budget.
(ii) Frequency and coverage of aid flow by donors	D	D	While there are periodic donor financial reviews and there are agreements with three donors to provide information quarterly, the reporting on disbursements within two months of each quarter-end is made for less that 50 percent of the estimates so the rating on this dimension is D.

Dimension (i) Completeness and timeliness of budget estimates by donors for project support.
3.330. Donors provide significant information to the MoF on development assistance through ad hoc discussions but also in the annual donor consultation meetings as part of budget preparations whereby individual donors meet in person with the AMD of the MoF on their plans for the coming year. Following analysis and agreements, this information is stored in ad hoc temporary data base[99] and used as reference against the individual line ministry submissions of the development budget portion of the budget, which includes US$700 million in security assistance. Effectively, all on-budget project funding is dealt with and reflected in the database and rolled up in the annual budget.

99 The Donor Assistance Database which operated on a customized software application by the Aid Management Directorate and contained all the detail of both core budget and external budget projects was being overhauled and was not available during the last two fiscal years but will operate for the current fiscal year. An ad hoc temporary data base was established to record donor plans.

(ii) Frequency and Coverage of Reporting by Donors on Actual Flows for Project Support.
3.331. While there are periodic donor financial reviews and agreements with three donors to provide information quarterly, the reporting on disbursements within two months of each quarter-end is made for less that 50 percent of the estimates so the rating on this dimension is D.

Comparison of Ratings: 2008 and 2013
3.332. The rating improved from D to D+ because dimension (ii) improved from D to A. Donors now provide significant information to the MoF on development assistance through ad hoc discussions and also in the annual donor consultation, which is an improvement over 2008. Effectively, all on-budget project funding is dealt with and reflected in the database and rolled up in the annual budget.

Reform developments during 2012
3.333. No developments were observed.

D-3 Proportion of aid that is managed by use of national procedures

3.334. National systems for management of funds are those established in the general legislation (and related regulations) of the country and implemented by the mainstream line management functions of the government. The requirement that national authorities use different (donor-specific) procedures for the management of aid funds diverts capacity away from managing the national systems. This is compounded when different donors have different requirements. Conversely, the use of national systems by donors can help to focus efforts on strengthening and complying with the national procedures also for domestically-funded operations.

Dimension	Score		Brief explanation of status
	2008	2013	
D-3 Proportion of aid that is managed by use of national procedures	D	D	Total on-budget aid receipts in the nine months to December 20, 2012 (truncated year or SY1391) came to US$2.03 billion which is less that 50 percent of estimated total assistance.

Dimension (i) Overall portion of aid funds to central government that are managed through national procedures.
3.335. Total on-budget aid receipts in the nine months to December 20, 2012 (truncated year or SY1391) came to US$2.03 billion. Off-budget ODA is estimated to be US$2.7 billion, which would be much greater if security assistance were added. On-budget assistance is set out in the budget approved by Parliament and the funds are entrusted to the Treasury Department, while the operations are implemented by the sector ministries and managed through national systems. This implies that these funds are subject to national procurement procedures, which recognize donor guidelines where applicable, payments are processed entirely through the Treasury Department's accounting procedures and are reported as part of national budget operations. The receipt, use and reporting of these funds are subject to review by the national audit authorities. The GoA's oversight of operations under donor responsibility is limited. Thus, as regards budget implementation, some recurrent spending and most public investment occurs outside national budgetary channels and procedures. The GoA's control over planning of total public spending, implementation of public spending, and reporting on its execution is rendered more difficult by the large portion occurring outside of GoA control. Donors are not required through their donor agreements to plan, report, and operate in line with GoA procedures. The rating for this indicator is D because less than 50 percent of aid funds to the central government are managed through national procedures.

Comparison of Ratings: 2008 and 2013
3.336. No change in rating.

Reform developments during 2012
3.337. No developments were observed.

Chapter 4: Government Reform Process

4.1. This chapter describes the overall reform efforts made by the GoA in improving PFM performance, and provides some forward-looking perspective on the factors that are likely to affect future PFM reform planning, implementation, and monitoring.

4.2. It is noted that the report – as per PEFA guidance – does not make recommendations for the GoA's PFM reform program and does not include a judgment as to whether the reform program addresses the right PFM weaknesses or if the proposed reform measures are adequate.

4.1. Description of recent and ongoing reforms

4.1.1. At the Kabul Conference in July 2010, the GoA presented the PFM Roadmap that set out its intentions to strengthen PFM based on a three-year framework with four components:

A. Strengthening the budget in driving effective delivery of key priority outcomes – An improved MTFF to better forecast, plan, and prioritize expenditures and domestic revenues;
B. Improving budget execution – Increased by 10-20 percent annually over the medium term, compared to SY1388 (2010/11);
C. Increasing accountability and transparency – Improved Open Budget Index rating to 30 percent for SY1390 (2011/12); and
D. Increasing the capacity of line-ministries to implement programs effectively and efficiently.

4.1.2. The background for developing the PFM Roadmap was the London Conference in January 2010 where donors committed to increase the share of development aid delivered through the GoA to 50 percent over two years. This was based on the GoA agreeing to present a credible plan at the Kabul Conference for further PFM strengthening. However, it was also recognized from the outset that PFM reform would be needed for delivering broader benefits critical for transition in 2014 as well as the subsequent transformation decade.

4.1.3. The PFM Roadmap document outlined reform objectives and time bound actions for each sub-component, while an action plan further detailed activities and sub-activities. Implementation across the GoA was to be overseen at the strategic level by a Steering Committee (group of deputy ministers) and program management led by a Secretariat (placed at the Office of the Deputy Minister Finance). This planned delivery structure was not established, but progress reports were to be coordinated by the Office of the Deputy Minister for Finance (on a somewhat irregular basis). The process was administered by the Governance Cluster.

4.1.4. With the development of the GoA's cluster/NPP approach, the PFM Roadmap became a NPP under the Governance Cluster. The funding required to implement the three-year PFM Roadmap – covering all MoF departments, the MoM and the SAO – was in December 2010 estimated at US$117 million. The GoA's operating budget was to cover US$33.1 million (28 percent) and existing donor activities US$17.7 million (15 percent), while US$66.2 million (57 percent) was unsecured funding. An update in August 2011 estimated the funding need at US$125.13 million.

4.1.5. As noted above, the PFM Roadmap covers four components and a number of sub-components and activities. A brief overview of the initiatives planned and results achieved since August 2010 is provided below. More detailed information is provided in Chapter 3 as and where relevant for the various PEFA Performance Indicators (PIs).

4.1.6. Within the area of aid management, most activities planned with the PFM Roadmap were eventually implemented, though some experienced significant delays. This includes the development of an aid-effectiveness monitoring framework which, as part of the new aid management policy, was presented at the Tokyo Conference in July 2012. Improvements to the DAD were delayed due to drawn-out negotiations between the UNDP and an IT contractor, so training materials were only prepared by mid-2012. Aid coordination, however, was strengthened through a more consultative and reformed Donor Financial Review (DFR) process, and an assessment of PFM capacity in budgetary units was conducted by a private contractor with funding from the World Bank.

4.1.7. The PFM Roadmap included a number of activities related to the revenue and customs administrations, which have experienced some implementation delays. Despite the delays, the MoF approved Value-Added Tax (VAT) legislation in late 2011, a tax administration law was prepared in early 2012, and amendments to the Income Tax Law were prepared and forwarded to the MoJ for review in mid-2012. Also, the staffing of MTOs and LTOs was strengthened. However, agreement between the MoF, MoI and MoCI to improve revenue collection at the borders is yet to be achieved. The introduction of VAT by March 2014, for which a new Tax Administration Law is being prepared, will be a major tax policy reform aimed at raising the revenue-to-GDP ratio.

4.1.8. Specifically for the mining sector, the PFM Roadmap included initiatives to set up an Extractive Industries Transparency Initiative (EITI) secretariat, which took place in late 2010, and the publication of executive summaries of major natural resources contracts awarded. The first EITI revenue report was prepared in mid-2011. Further initiatives undertaken in 2011 included a review of the consistency of the Income Tax Law and the Minerals & Hydrocarbons Laws, establishment of the Policy and Investment Promotion Directorate in the MoM (to increase transparency in the mechanism of licensing, contracting, and collection revenues), and the preparation of a concept paper for the establishment of a separate TSA account for mining revenues.

4.1.9. The MoF's reform of the medium-term fiscal strategy has been successful, and included improvements to the MTFF (inclusion of fiscal pressures such as security and P&G costs), sensitivity analyses of domestic revenue projections, establishment of a FPD-MoM working group to assess mining revenues and a simple mining revenue model developed, and incorporation of future year O&M costs for two ministries (MoE and MoPH) in the MTFF. Moreover, the MTFF results are now included in both the Pre-Budget Statement/MTBF and the annual Budget Statement (enacted budget). Further on-going initiatives include strengthening fiscal sustainability analysis to clearly distinguish between recurrent and capital spending, establishing a formal process to prioritize individual projects developed as part of the NPPs; strengthening planning and management of the capital investment program to take account of the multi-year commitments of capital projects in the MTFF and issuing capital investment ceilings to ministries, and establishing an inventory on on-going capital projects.

4.1.10. Program budgeting by SY1390 (2012) was included with budget submissions in a single format and performance measurement targets aligned to the ANDS. Also, guidelines were developed to support Cabinet's Budget Committee in assessing program budget submissions (end-2010), and an improved communication strategy to further support program budgeting vis-à-vis key stakeholders was implemented (end-2011). Implementation of program budgeting capacity building measures in line ministries was adversely affected, however, by the decision of USAID in early 2011 to significantly reduce funding. However, since then some progress has taken place, for example by simplifying the program budgeting process through a clearer focus on establishing basic expenditure goals and related performance targets tied to core developmental objectives. The MoF is also seeking to ensure better implementation across ministries (where progress has been uneven) by various initiatives, including continued capacity building of managers. Appropriation by program is not being pursued at present.

4.1.11. Budget execution in terms of transparency, time-effectiveness, and accountability has improved noticeably in recent years with the expansion of AFMIS coverage, that facilitates orderly processing and tracking of budgetary allocation, allotment, and payments processes at the national and sub-national levels. All budget operations, from changes in appropriations and granting of allotments, to payments and accounting for receipts and budget uses are processed online via AFMIS, for both the central ministries and provincial operations. These operations are vetted against the approved budget classification and data base of registered vendors. Given the comprehensive nature of the GoA budget, AFMIS provides reliable information on the GoA, which is made public in a timely fashion. The MoF furthermore plans to improve coordination between the Budget and Treasury Departments in issuance of in-year allotments, empower line ministries to process allotments on-line via AFMIS, further training across all ministries (in public procurement, contract management and financial management) and streamlining approval processes within the MoF for all line ministry budget and payment requests.

4.1.12. A number of provincial budgeting reform measures were planned to further improve budget execution, but only some – including facilitation of communication between line ministries, provincial line department and donors to better understand provincial needs, as well as capacity building in 14 provinces – were implemented. Other activities have been delayed – e.g., assistance to selected Provincial Development Councils (PDCs) to enhance their Provincial Development Plans (PDPs), and assessing the impact of the new sub-national governance policy on the PFM framework – while some have not been implemented (consultation and coordination with Provincial Reconstruction Teams (PRTs) to reinforce GoA PFM standards, and the piloting of a norms-based budget allocation process for the MoE (due to a lack of technical assistance). Pilot programs involving five line ministries (MAIL, MRRD, MoE, MoPH and IDLG) are underway to engage provincial and community councils in planning for development expenditure consistent with established NPP priorities. Further initiatives such as making recurrent budget allocations more rules-based are also being pursued.

4.1.13. Improving budget execution also focused on procurement reform, which has covered a number of activities including undertaking of certification of seven line ministries by the PPU which allows them to effect independent procurement, that is without the prior clearance of ARDS, setting up of a joint advisory committee to oversee line ministry procurement, Procurement Management Information System (PMIS) piloting in line ministries, training of 600 officials, and recruitment and training of specialists for the Appeals Review Committee. However, delegation of procurement authority to the provincial level is pending the enactment of a new procurement law which supports this delegation. Also, an assessment of options for establishing an integrated purchasing and asset registration information system is only now underway under the PFMRII in the Treasury Department.

4.1.14. Performance monitoring has focused on improving budget execution by requiring the 19 largest ministries to submit detailed financial plans that incorporate cash flows from procurement plans, and monitoring financial and output performance against program budget submissions. This has improved predictability and consistency of budget allotment planning and facilitated better cash management processes. The quality of submitted reports was addressed though guidance and training by the MoF. Also, the Budget Department has since mid-2011 monitored budget execution of the top 50 development projects and organizing meetings with the top spending ministries to discuss budget execution.

4.1.15. Other PFM reform activities to improve budget execution include payroll (e.g., documenting procedures for updating the payroll system, and working with the Civil Service Commission to ensure alignment of human resources system and payroll data structures), Verified Payroll Program (e.g., completing registration of provincial staff, and expanding salary payments to individual bank accounts), cash management (e.g., Cash Management Committee endorsement of Medium-Term Cash Management Improvement Plan, and improving variance analyses), and debt management (e.g., review of MoF requirements to commence market instruments, and revising the external debt policy). However, some planned activities – e.g., assessment of payroll systems and procedures in the MoE and the MoI, and the drafting of a Public Debt Law – did not take place due to lack of technical assistance, while the development of DSAs is awaiting training of the Debt Management Unit staff (it is noted though that the FPD at present is undertaking DSA training).

4.1.16. The Roadmap plan for internal audit did not anticipate the amendment to the PFEM Law's Article 61, which now limits the purview of the Internal Audit of MoF to its own ministry. While the MoF IAD did conduct risk-based internal audits of four ministries by March 2011 and of the seven largest line ministries by September 2011 as planned, the capacity to provide this management oversight is now limited until the capacity of each line ministry is developed which is expected to take three years or so. This effort required a redesign of technical assistance agreed with the World Bank in the PFMRII.

4.1.17. The PFM Roadmap included a number of external audit reform activities including enactment of a new Audit Law which was approved by Parliament in February 2013 (planned for 2010/11) although the law is yet to be implemented. While Parliament is yet to establish a Public Accounts Committee (PAC) to exercise oversight and review audit reports, this activity is effectively being managed by the Budget and Finance Committee. Also, the SAO has established two of five zone branches (initially planned for 2011/12). Related to reforms on internal and external audit, the GoA undertook commitments under the ARTF Incentive Program with benchmarks for SY1391, SY1392, and SY1393 (fiscal years ending Dec 20, 2012, 2013, and 2014) specifically for the conduct of internal audits and external audits to acceptable standards of targeted percentage of total expenditure. While the internal audit benchmark for FY 2012 was met, work towards the target for both FY 2013 and 2014 have been hindered by the amendment to the PFEM Law's Article 61 in the case of internal audit and in the late mobilization of technical assistance for compliance audits in the case of external audit.

4.1.18. Public enterprises reform activities include meeting key DABS revenue targets as per ARTF Incentive Program benchmarks for SY1390 (2011/12), extending the SOE Department's financial oversight and legal authority to cover state corporations (as per draft legislation submitted to the MoJ for review), and preparing restructuring and business plans of four entities (FLGE, Afghan Telecom, Ariana Afghan Airlines, and DABS). However, carrying out a financial viability analysis and preparing plans to corporatize, privatize or liquidate SOEs (including FLGE, Afghan Gas, North Coal, Mazar Fertilizer and Azadi Printing to be considered for corporatization) did not take place. Additionally, capacity building of SOE Department staff has not been undertaken as planned.

4.2. Institutional factors supporting reform planning and implementation

4.2.1. Institutional factors deemed important in supporting PFM reform planning and implementation processes for an effective PFM reform process in Afghanistan are briefly discussed below.

Government Leadership and Ownership

4.2.2. While the PFM Roadmap was developed following a GoA-donor agreement about the need for a credible plan for PFM strengthening, the concrete process of developing the PFM Roadmap was led and owned by the GoA as was the task of creating an enabling environment to support the process. The MoF applied a change management approach based on a diagnosis of existing PFM strengths and weaknesses, following from which tangible reform objectives and activities were identified. Emphasis was placed on the need for improving transparency by increasing the quantity and quality of information, keeping strategies and plans simple, and ensuring transfer of responsibilities from donors to line ministries so as to support sustainable change. The outcome was a PFM Roadmap and implementation plan that in terms of key reform themes and priority areas was very relevant.

4.2.3. The costing undertaken for the PFM Roadmap – US$117 million, later increased to US$125.13 million, of which about 60 percent was unsecured funding, did not match expected donor funding, in particular, since funding needs were identified in aggregate rather than for specific and prioritized activities. However, implementation planning was not amended, and it is unclear which effect the potential lack of funding overall has had.

Coordination across the GoA

4.2.4. The PFM Roadmap document highlighted that PFM reform implementation in earlier years had been adversely affected by a lack of coordination, and stressed that the consolidated PFM roadmap in itself was a step toward improved coordination. However, there have been some shortcomings regarding coordination; for example, the Customs and Revenue Departments in June 2011 (one year after the launch of the PFM Roadmap) were still not fully engaged in the process although it is noted that efforts were made to ensure improved and effective coordination, including through a dedicated communications strategy.

4.2.5. The organizational structure outlined for implementation of the PFM Roadmap – a Steering Committee (group of deputy ministers) to lead the strategic level and a Secretariat (placed at the Office of the Deputy Minister Finance) to undertake program management – was not established. Coordination of progress reporting was in effect through the Office of the Deputy Minister Finance, but otherwise the structural support for the process was limited, especially after the first year of implementation (i.e., after mid-2011). Overall, progress monitoring has become somewhat weak and irregular, and the PFM Roadmap implementation status as of May 2013 is not clear. It was understood that the MoF currently is taking stock of the Roadmap and would review it after the Senior Officials Meeting and possibly against the 2013 PEFA assessment.

<u>Sustainable Reform Process</u>

4.2.6. While there is progress implementing the PFM Roadmap (cf. section 4.1 above), a number of challenges have also been observed. At a working session in June 2011 it was noted that poor co-ordination and communication among stakeholders, coupled with changing goals has meant that the reform process can be difficult. Also, a review of the PFM Roadmap implementation process carried out in May 2012 found that:

- Communications efforts in general had declined after the first six months.
- Focus had moved from driving progress of activities to collection of progress information.
- Monitoring focus had moved from high-level goals to the activity-level.
- Heads of implementing units often did not prioritize progress meetings and instead assigned their staffs to attend on their behalf.
- Some activities ware out of date, e.g., reforms that had since become routine activities, while in other areas new activities should be added to reflect new policy initiatives.
- Attempts to secure donor financing had not been successful.

4.2.7. It is noted that many organizational entities within the MoF – notably the Budget Department and the FPD – remain heavily dependent on technical assistance and donor funding for staff salaries. There continues to be a lack of focus on ensuring capacity building and retention of civil servants (*Tashkeel*), which implies low sustainability.

4.2.8. The MoF has indicated that it intends to review and update the PFM Roadmap and implementation plan in mid-2013, taking into account the results of this PEFA assessment.

Annex A: Summary of PEFA Performance Indicators

Performance Indicators		Scoring Method	2008					2013				
			Dimension Ratings				Overall Rating	Dimension Ratings				Overall Rating
			i	ii	iii	iv		i	ii	iii	iv	
A – Credibility of the Budget												
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	D				D	C				C
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	D				D	D	A			D+
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	A				A	C				C
PI-4	Stock and monitoring of expenditure payment arrears	M1	C	D			D+	A	C			C+
B – Comprehensiveness and Transparency												
PI-5	Classification of the budget	M1	C				C	C				C
PI-6	Comprehensiveness of information included in budget documentation	M1	B				B	C				C
PI-7	Extent of unreported government operations	M1	B	A			B+	NR	A			NR
PI-8	Transparency of inter-governmental fiscal relations	M2	D	D	D		D	NA	NA	A		A
PI-9	Oversight of aggregate fiscal risk from other public sector entities	M1	D	A			D+	D	A			D+
PI-10	Public access to key fiscal information	M1	B				B	B				B
C – Policy Based Budgeting												
PI-11	Orderliness and participation in the annual budget process	M2	B	B	C		B	B	C	C		C+
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	C	A	B	C	B	C	A	C	D	C+
D – Predictability and Control in Budget Execution												
PI-13	Transparency of taxpayer obligations and liabilities	M2	C	C	C		C	C	B	C		C+
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	C	C	C		C	B	C	C		C+
PI-15	Effectiveness in collection of tax payments	M1	D	B	D		D+	NR	A	D		NR
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	A	B	B		B+	A	B	B		B+
PI-17	Recording and management of cash balances, debt and guarantees	M2	B	B	A		B+	A	B	B		B+
PI-18	Effectiveness of payroll controls	M1	B	B	B	C	C+	B	B	B	B	B
PI-19	Transparency, competition and complaints mechanism in procurement	M2	B	B	B		B	A	B	A	B	B+
PI-20	Effectiveness of internal controls for non-salary Expenditure	M1	B	C	C		C+	A	B	C		C+
PI-21	Effectiveness of internal audit	M1	C	C	C		C	C	C	C		C
E – Accounting, Recording and Reporting												
PI-22	Timeliness and regularity of accounts reconciliation	M2	B	B			B	B	B			B
PI-23	Availability of information on resources received by service delivery unit	M1	D				D	C				C
PI-24	Quality and timeliness of in-year budget reports	M1	C	A	A		C+	C	A	A		C+
PI-25	Quality and timeliness of annual financial statements	M1	B	B	A		B+	A	A	C		C+

Performance Indicators		Scoring Method	2008					2013				
			Dimension Ratings				Overall Rating	Dimension Ratings				Overall Rating
			i	ii	iii	iv		i	ii	iii	iv	
F – External Scrutiny and Audit												
PI-26	Scope, nature and follow-up of external audit	**M1**	**C**	**C**	**C**		**C**	**C**	**B**	**C**		**C+**
PI-27	Legislative scrutiny of the annual budget law	**M1**	**A**	**B**	**B**	**A**	**B+**	**B**	**A**	**B**	**B**	**B+**
PI-28	Legislative scrutiny of external audit reports	**M1**	**B**	**C**	**B**		**C+**	**C**	**C**	**B**		**C+**
G – Donor Practices												
D-1	Predictability of direct budget support	**M1**	**B**	**A**			**B+**	**B**	**A**			**B+**
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	**M1**	**D**	**D**			**D**	**A**	**D**			**D+**
D-3	Proportion of aid that is managed by use of national procedures	**M1**	**D**				**D**	**D**				**D**

Annex B: List of References

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- Supreme Audit Office – http://sao.gov.af/en
- The Kabul Process – http://www.thekabulprocess.gov.af/

Annex C: List of Persons Consulted

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- Mr Hoveyda Abbas – Advisor.
- Mr M. Mehdi Hussaini – Deputy Auditor General.

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- Mr Darian Clark – AusAid.
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- Mr Robbin Burkhardt – USAID.
- Mr Leslie Schafer – USAID.
- Mr Roy Fenn – USAID.
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Others

- Mr Jamie Boex – Senior Research Associate, Urban Institute Center on International Development and Governance.

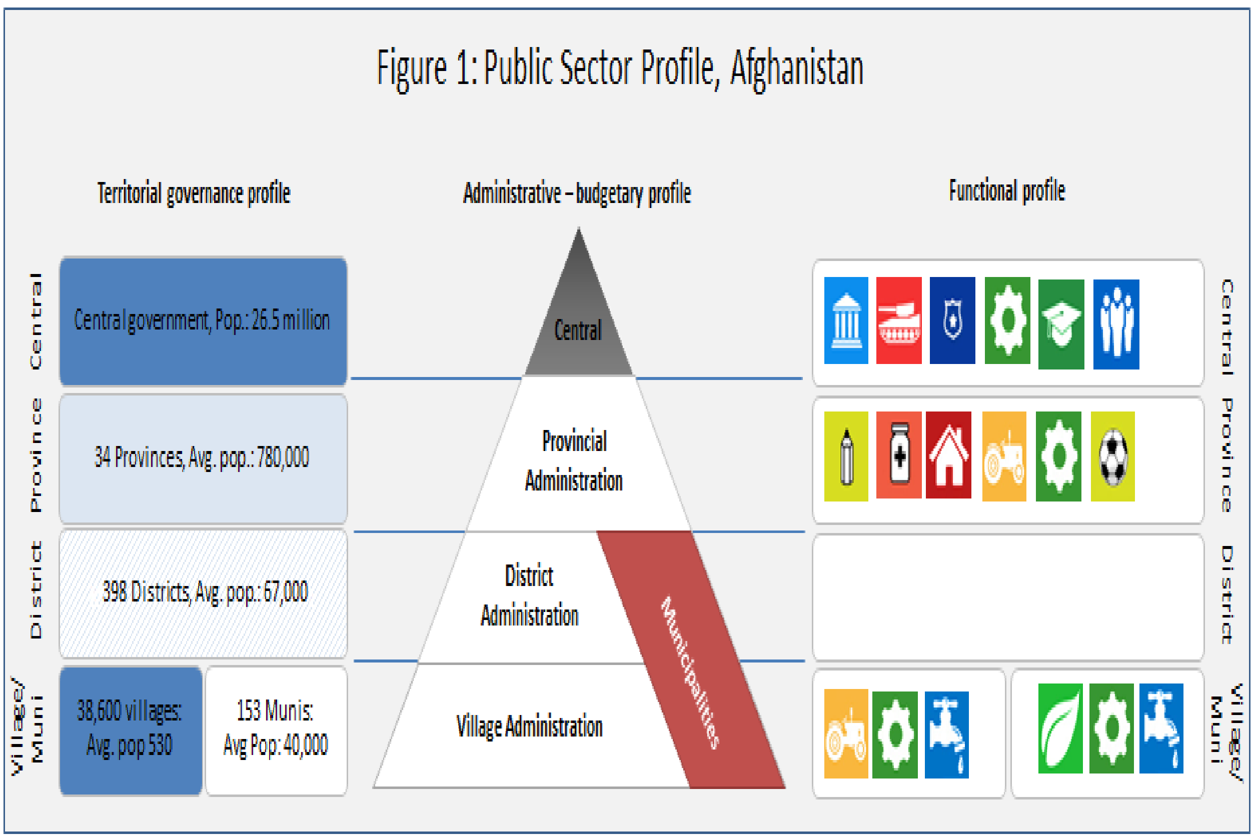
Annex D: Administrative Structure of the Government of Afghanistan

According to Chapter 8 of the Constitution, the public sector in Afghanistan is generally organized in a unitary and centralized manner. The administration is based on central and local administrative units. The central administration is divided into administrative units, each headed by a minister. The Constitution provides the primary legal foundation for the public sector's sub-national administrative structure.

With respect to the assignment of responsibilities to the different levels, the Constitution states that "the government, while preserving the principle of centralism, shall delegate certain authorities to local administration units for the purpose of expediting and promoting economic, social, and cultural affairs, and increasing the participation of people in the development of the nation" (Chapter 8, Article 2).

Provincial councils are elected and should perform their duties in cooperation with the provincial administration. Effectively, however, most service delivery throughout the country occurs under the provincial line departments of the ministries, while municipalities deal with city services and property taxes.

Figure D.1: Public Sector Profile, Afghanistan[100]



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Annex E: Data for PI-1 and PI-2

Table E.1: Data for Year	SY1389 (2010/11) Afs '000					
Administrative or Functional Head	**Original Budgets**	**Actual Exp.**	**Adjusted Budget**	**Deviation**	**Absolute Deviation**	**Percent**
Ministry of Interior	21,925,430	28,254,104	24,702,212	3,551,892	3,551,892	14.4
Ministry of Education	18,310,256	19,363,610	20,629,189	-1,265,579	1,265,579	6.1
Ministry of Defence	14,125,975	27,671,898	15,914,982	11,756,916	11,756,916	73.9
Ministry of Energy and Water	6,308,982	2,391,111	7,107,993	-4,716,882	4,716,882	66.4
Ministry of Public Works	3,762,481	2,637,219	4,238,987	-1,601,768	1,601,768	37.8
Ministry of Public Health	3,313,885	2,851,896	3,733,577	-881,681	881,681	23.6
General Direct of National Sec	2,778,534	2,958,420	3,130,426	-172,006	172,006	5.5
Ministry of Higher Education	2,620,981	2,111,089	2,952,919	-841,830	841,830	28.5
Ministry of Foreign Affairs	2,570,775	2,134,664	2,896,355	-761,691	761,691	26.3
Ministry of Finance	2,268,403	3,669,654	2,555,689	1,113,965	1,113,965	43.6
Indep Direct of Local Gov	2,140,130	2,105,973	2,411,170	-305,197	305,197	12.7
Ministry of Communication	1,789,866	1,812,011	2,016,546	-204,535	204,535	10.1
Ministry of Agriculture	1,779,257	1,227,251	2,004,593	-777,342	777,342	38.8
President's Office	1,565,971	1,372,177	1,764,295	-392,118	392,118	22.2
Ministry Rural Rehab and Dev	1,331,814	666,782	1,500,483	-833,701	833,701	62.6
Ministry of Justice	1,275,285	1,754,669	1,436,796	317,873	317,873	24.9
Min Mrtyrs,Dsabld Scial Aff	6,324,196	5,077,126	7,125,134	-2,048,008	2,048,008	32.4
Ministry of Urban Development	1,042,147	715,827	1,174,131	-458,304	458,304	44.0
Ministry Mines and Industries	998,589	670,668	1,125,056	-454,388	454,388	45.5
Supreme Court	888,196	1,116,026	1,000,683	115,343	115,343	13.0
21 (= sum of rest)	9,804,587	9,905,348	11,046,305	-1,140,958	1,140,958	11.6
Allocated expenditure	106,925,734	120,467,523	120,467,523	0	33,711,978	
Contingency	32,118,568	0				
Total expenditure	139,044,302	120,467,523				
Overall (PI-1) variance (%)						13.4
Composition (PI-2) variance (%)						28.0
Contingency share of budget (%)						0.0

Table E.2: Data for Year	SY1390 (2011/12) Afs '000					
Administrative or Functional Head	Original Budgets	Actual Exp.	Adjusted Budget	Deviation	Absolute Deviation	Percent
Ministry of Defence	43,272,888	40,185,743	44,352,957	-4,167,214	4,167,214	9.4
Ministry of Interior	36,164,665	37,391,410	37,067,316	324,094	324,094	0.9
Ministry of Education	22,713,375	23,371,480	23,280,289	91,191	91,191	0.4
Ministry of Public Works	4,198,097	4,319,125	4,302,879	16,246	16,246	0.4
General Direct of National Sec	4,148,499	4,493,261	4,252,044	241,217	241,217	5.7
Ministry of Public Health	3,581,660	3,100,372	3,671,056	-570,684	570,684	15.5
Ministry of Higher Education	2,796,233	2,423,322	2,866,025	-442,703	442,703	15.4
Ministry of Energy and Water	2,617,204	3,450,930	2,682,528	768,402	768,402	28.6
Ministry of Foreign Affairs	2,565,188	2,891,706	2,629,214	262,492	262,492	10.0
Ministry of Finance	2,395,523	6,454,827	2,455,314	3,999,513	3,999,513	162.9
Ministry of Justice	2,191,063	1,649,006	2,245,750	-596,744	596,744	26.6
Indep Direct of Local Gov	1,997,434	1,933,179	2,047,289	-114,110	114,110	5.6
Ministry of Commerce	1,990,451	1,797,316	2,040,132	-242,816	242,816	11.9
President's Office	1,780,848	1,676,941	1,825,297	-148,356	148,356	8.1
Ministry of Agriculture	1,637,716	2,321,448	1,678,593	642,855	642,855	39.3
Ministry of Communication	1,537,626	1,528,695	1,576,004	-47,309	47,309	3.1
Supreme Court	1,305,047	1,344,667	1,337,620	7,047	7,047	0.5
Ministry Rural Rehab and Dev	1,209,402	782,614	1,239,588	-456,974	456,974	37.8
Min Mrtyrs,Dsabld Scial Aff	7,284,395	8,480,172	7,466,210	1,013,962	1,013,962	13.9
Ministry of Info and Culture	1,121,376	734,816	1,149,365	-414,549	414,549	37.0
21 (= sum of rest)	11,726,414	11,853,539	12,019,099	-165,560	165,560	1.4
Allocated expenditure	158,235,104	162,184,568	162,184,568	0	14,734,039	
Contingency	10,644,568	0				
Total expenditure	168,879,672	162,184,568				
Overall (PI-1) variance (%)						4.0
Composition (PI-2) variance (%)						9.1
Contingency share of budget (%)						0.0

Table E.3: Data for Year	SY1391 (2012) Afs '000					
Administrative or Functional Head	Original Budgets	Actual Exp.	Adjusted Budget	Deviation	Absolute Deviation	Percent
Ministry of Defence	36,598,747	37,502,680	35,510,499	1,992,181	1,992,181	5.6
Ministry of Interior	33,457,238	36,307,020	32,462,402	3,844,618	3,844,618	11.8
Ministry of Education	21,061,873	20,508,410	20,435,607	72,803	72,803	0.4
Ministry of Public Works	7,530,713	4,049,248	7,306,791	-3,257,543	3,257,543	44.6
Ministry of Energy and Water	5,750,140	2,011,160	5,579,162	-3,568,002	3,568,002	64.0
General Direct of National Sec	5,297,971	5,125,329	5,140,438	-15,109	15,109	0.3
Ministry of Public Health	3,874,340	2,789,625	3,759,138	-969,513	969,513	25.8
Ministry of Higher Education	3,396,782	2,990,884	3,295,780	-304,896	304,896	9.3
Ministry of Agriculture	2,068,443	2,147,174	2,006,939	140,235	140,235	7.0
Ministry of Foreign Affairs	2,013,147	2,453,216	1,953,287	499,929	499,929	25.6
Ministry Transport Aviation	1,921,800	1,193,559	1,864,656	-671,097	671,097	36.0
Ministry of Counter Narcotics	1,843,729	135,597	1,788,907	-1,653,310	1,653,310	92.4
Indep Direct of Local Gov	1,807,792	1,860,643	1,754,038	106,605	106,605	6.1
Ministry of Finance	1,542,775	6,404,515	1,496,901	4,907,614	4,907,614	327.9
Ministry Mines and Industries	1,368,440	1,040,516	1,327,750	-287,234	287,234	21.0
AISA	1,342,385	0	1,302,470	-1,302,470	1,302,470	97.0
President's Office	1,332,411	1,532,251	1,292,792	239,459	239,459	18.0
Ministry of Communication	1,286,534	1,171,344	1,248,279	-76,935	76,935	6.0
Min Mrtyrs,Dsabld Scial Aff	7,026,548	7,539,168	6,817,617	721,551	721,551	10.3
Supreme Court	987,773	1,062,518	958,402	104,116	104,116	10.5
21 (= sum of rest)	13,619,546	12,691,573	13,214,575	-523,002	523,002	3.8
Allocated expenditure	155,129,127	150,516,430	150,516,430	0	25,258,222	
Contingency	13,056,750	0				
Total expenditure	168,185,877	150,516,430				
Overall (PI-1) variance (%)						10.5
Composition (PI-2) variance (%)						16.8
Contingency share of budget (%)						0.0

Debt service payments are excluded for all three years, as are budgeted pensions under Contingency Items.

Annex F: International PEFA Scores

The data used for the international comparison in the Executive Summary are based on public assessments available from the PEFA Secretariat. This data set consists of 119 assessments carried out between December 2005 and July 2012 for 85 countries. This covers four countries with three assessments each, 25 countries with two assessments each, and 56 countries with one assessment each.

Table F.1: Public PEFA Assessments

	LICs	Lower MICs	Upper MICs	HICs	Total	Countries
Africa region	35	12	7	0	54	34
East Asia and the Pacific	1	10	2	0	13	11
Eastern Europe and Central Asia	3	9	7	0	19	12
Latin America and the Caribbean	2	6	9	1	18	15
Middle East and North Africa	0	3	3	0	6	5
South Asia Region	4	3	1	0	8	7
Western Europe	0	0	0	1	1	1
Total	**45**	**43**	**29**	**2**	**119**	**85**
Countries	26	34	23	2	85	-

Note: Economies are divided into income groups according to 2009 Gross National Income (GNI) per capita, calculated using the World Bank Atlas method.[101] The groups are: Low Income, US$995 or less; Lower Middle Income, US$996-US$3,945; Upper Middle Income, US$3,946-US$12,195; and High Income, US$12,196 or more.

Table F.1 shows that PEFA assessments are available mostly for Middle Income Countries (MICs), with a total of 57 assessments – 34 for Lower MICs and 23 for Upper MICs. There are 26 assessment from Lower Income Countries (LICs), and just two from Higher Income Countries (HICs).

For the purpose of the international comparison in this report, the countries were divided into three groups: Fragile States, LICs, and MICS. For countries where more than one assessment is available, only the newest assessment was applied.[102]

The Fragile States were identified according to the World Bank's "Harmonized List of Fragile Situations FY13".[103] These countries, for which PEFA assessments have been carried out, are Burundi, Central African Republic, Democratic Republic of Congo, Guinea Bissau, Liberia, Sierra Leone, Togo, Republic of Congo, Cote d'Ivoire, Sudan, Timor-Leste, Haiti, West Bank and Gaza, Yemen, and Nepal.[104]

The country assessment data sets used for the international comparison with 2013 Afghanistan PEFA assessment are shown in the next table.

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101 The Atlas Method is explained at: http://data.worldbank.org/about/country-classifications/world-bank-atlas-method.

102 There were two exceptions: For Togo (a LIC and Fragile State), the PEFA assessors, as part of the quality control procedure, had raised issues of comparability about the latest assessment, from March 2009; as a result, the assessment from June 2006 was used instead. Similar issues were raised about the January 2010 PEFA for Sao Tome & Principe (a Lower MIC), with the result that the assessment from June 2007 was used instead. The reasons for the comparability issues are not stated in the documentation.

103 See: http://siteresources.worldbank.org/EXTLICUS/Resources/511777-1269623894864/FCSHarmonizedListFY13.pdf.

104 Two countries for which PEFA assessments exist – Kosovo and Solomon Islands – were not included for comparison with Afghanistan.

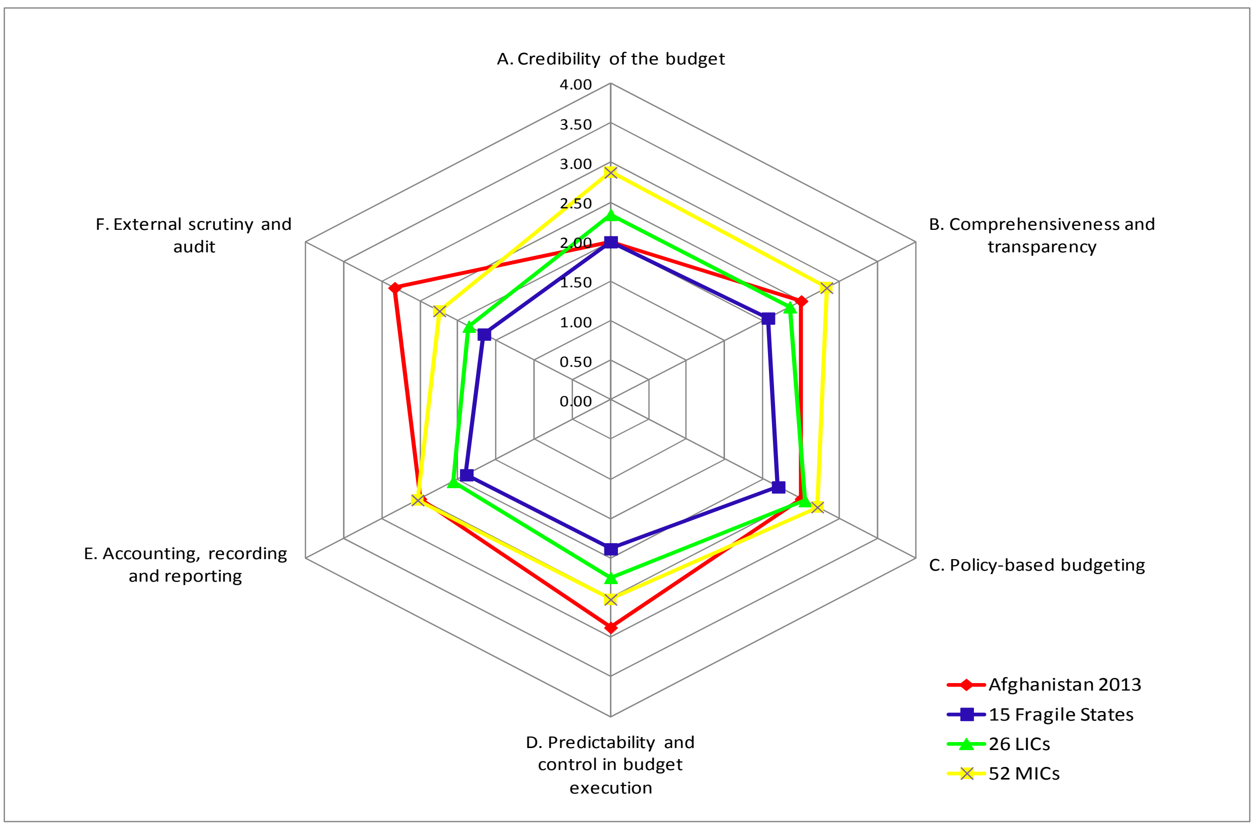
Table F.2: Applied Public Country PEFA Assessments

	Fragile States			LICs	MICs
	LICs	Lower MICs	Total		
Africa region	7	3	10	20	15
East Asia and the Pacific	1	0	1	1	9
Eastern Europe and Central Asia	0	0	0	2	10
Latin America and the Caribbean	0	1	1	1	9
Middle East and North Africa	0	2	2	0	5
South Asia Region	1	0	1	2	4
Western Europe	0	0	0	0	0
Total	**9**	**6**	**15**	**26**	**52**

Table F.2 shows that 15 country assessments were used for the Fragile States group, 26 for the LIC group, and 52 for the MIC group.

The results of the comparisons arising from the applied data sets are depicted in Graph F.1 below.[105]

Graph F.1: Dimension-Level Scores vis-à-vis Fragile States, LICs, and MICs



The results are discussed in the Summary Assessment.

[105] The assessment data were quantified using the following conversion for each Performance Indicator (PI): A = 4, B+ = 3.5, B = 3, C+ = 2.5 C = 2, D+ = 1.5 and D = 1. This is based on first calculating the dimension-level average for each country, and thereafter the average for each dimension for each country group.

The World Bank Group