Afghanistan

Public Financial Management Performance Assessment

June 2008

DFID Department for International Development

Table of Contents

Acronyms and Abbreviations

ACU	Aid Coordination Unit
AFMIS	Afghanistan Financial Management Information System
AISA	Afghanistan Investment Support Agency
ANDS	Afghanistan National Development Strategy
ARDS	Afghanistan Reconstruction and Development Service
ARTF	Afghanistan Reconstruction Trust Fund
BRT	Business Receipt Tax
CAO	Control and Audit Office
COFOG	Classification of Functions of Government
CPIs	Compliance Performance Indicators
CSTC-A	Combined Security Transition Command-Afghanistan
DAB	Central Bank of Afghanistan
DAD	Donor Assistance Database
DFID	UK Department for International Development
FY	Fiscal Year
GDP	Gross Domestic Product
GFS	Government Finance Statistics
HR	Human Resource
HPIC	Heavily Indebted Poor Countries
IDLG	Independent Directorate of Local Governance
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
LOTFA	Law and Order Trust Fund
LTO	Large Taxpayer Office
MDAs	Ministries, Departments and Agencies
MoF	Ministry of Finance
MTFF	Medium-Term Fiscal Framework
MTO	Medium Taxpayer Office
Mustofiats	Provincial branches of the MoF
OAA	Office of Administrative Affairs
PBU	Primary Budget Unit
PEFA	Public Expenditure and Financial Accountability
PFEM	Public Finance and Expenditure Management Law
PFM	Public Financial Management
PIPs	Public Investment Programs
PRR	Priority Reform and Restructuring
PRT	Provincial Reconstruction Team
PPU	Procurement Policy Unit
PRGF	Poverty Reduction and Growth Facility
Qatia	Statement of budget execution
SOE	State Owned Enterprises
Tashkeel	Manpower ceiling
TIN	Taxpayer Identification Number
TSA	Treasury Single Account
UNDP	United Nations Development Programme

Acknowledgements

This is the second PFM Performance Assessment, based on the information as of December 2007, two and half years after the first assessment as of June 2005. This second assessment aims to measure reform progress during this period and to identify outstanding issues. Comparison between the first and second assessment shows significant improvements within the area of PFM. The process of carrying out the Performance Assessment involved extensive interactions with the Ministry of Finance (Budget Department, Treasury Department, Revenue Department, Fiscal Policy Unit and SOE Department) and other government agencies, whose valuable cooperation and support was indispensable for completing this Performance Assessment and also greatly benefited this report.

This PFM Performance Assessment was prepared by the following team: Yoichiro Ishihara (World Bank, SASPF, Task Team Leader), Paul Sisk (World Bank, SARFM, Co-task Team Leader), Deepal Fernando (World Bank, SARPS) and Peter Jensen (Consultant, DFID). Peer reviewer is Justin Tyson (IMF).

Overall guidance was provided by William Byrd (World Bank, SASPF) and Freddy Bob-Jones (DFID). Valuable comments and inputs were provided by Mohammad Aqa (Director of Treasury, Ministry of Finance), Stuart Coffey (Adam Smith International), Theodora B. Dell (USAID), Raju Kalidindi (DG Budget, Ministry of Finance), Masood Herhamand (Provincial Budgeting and Reporting Officer, Budget Integration Reform Unit of Ministry of Finance), Lejla Catic Hurtic (Program Budgeting Advisor, Budget Integration Reform Unit of Ministry of Finance, UNDP), Vishal Gandi (Accounting Advisor), Alastair McKechnie (Country director for Afghanistan, World Bank), Mustafa Mastoor (Director General of Budget Department Ministry of Finance), Sher Mohammad (National Officer, Security Sector, Budget Department, Ministry of Finance), Ahmad Farid Nabi (Manager, Fiscal Policy Unit, Ministry of Finance), Marie C. Patrick (Costing Advisor to Ministry of Finance), Khalid Payenda (Research Analyst, World Bank), Janis Platais (Treasury Advisor to Ministry of Finance, International Monetary Fund), Richard Rundle (Advisor to the Auditor General, Control and Audit Office), Gul Sabit (Director of Internal Audit, Ministry of Finance), Sherif Sherifi (President of Control Audit Office), Mozammil Shinwari (National Officer, Budget Policy Unit, Ministry of Finance) and the PEFA secretariat.

Executive Summary

Key Findings

Overall: Afghanistan's public financial management (PFM) system achieved significant improvements between June 2005 and December 2007. Among 28 performance indicators, 18 indicators improved, two indicators deteriorated (however, the 2005 ratings for these two indicators were based on limited information), and eight indicators remained unchanged. Among three indicators of donor practices, two deteriorated and one remained unchanged.

International comparison: In relation to other countries for which PEFA assessments have been conducted, Afghanistan's ratings are better than the average for other low-income countries and in some areas better than the average for middle-income countries.

Legal framework: The Public Finance and Expenditure Management (PFEM) Law of July 2005, the Income Tax Law of November 2005, and the Procurement Law of October 2005 and their supporting regulations have provided solid legal foundations for PFM.

Technical expertise: The technical expertise of the Ministry of Finance has been significantly improved in several areas, although additional emphasis on sustainable staff development through targeted recruitment and training will be needed.

Credibility: The operating budget is credible as funding from domestic revenues and donors (e.g. ARTF and LOFTA) has been stable. However, the gap between the budget and realization remains significant in the development budget expenditures.

Comprehensiveness: The comprehensiveness of the budget is generally good, although reporting and especially transparency should be improved. However, fiscal risk oversight of state-owned enterprises and municipalities is practically non-existent and thus problematic.

Process: The budget process is based on multi-year fiscal planning and comparatively detailed budgeting at the level of ministries and agencies, but so far has lacked the necessary strategic prioritisations of resources by the Cabinet early in the process.

Long-term fiscal planning: Long-term fiscal planning remains uncertain since there are few well-prioritized and costed sector strategies (though this is being addressed) and a continuing lack of proper linkages between investments and future recurrent expenditures.

Effectiveness: Payroll processing is highly decentralized which contributes to timely updates of payroll and reconciliation of personnel and payroll records. However, centralized oversight of payroll is weak, and the extension of the verified payroll program to the provinces has not progressed in line with plans. Access to a number of provinces by the external auditor and the ARTF Monitoring Agent is hampered by security concerns.

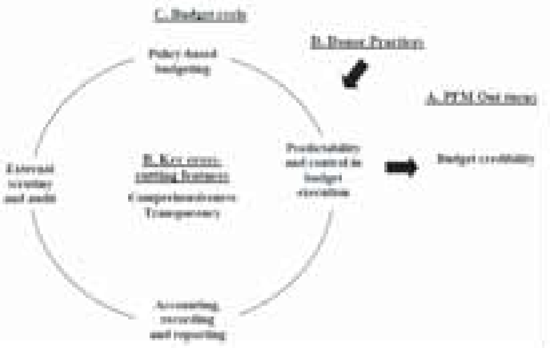
Audit: External audit of donor funding is conducted to acceptable standards, but the quality of review of the annual budget statement and of regulatory audits needs to be improved. Arrangements are in place for effective internal audit of treasury and revenue operations of government, but capacity for internal audit in the line ministries is still very weak.

Donors: Donors have good practices for budget support, as this support is well communicated and disbursements are in line with forecasts. Other donor practices continue to undermine effective budgeting, as limited and unreliable information is provided on forecast and most assistance is handled outside of government's procedures and budget.

Public Financial Management (PFM) Performance Assessment Framework

Fiscal policy and the budget comprise a central tool for achieving Afghanistan's development objectives. The quality of the PFM systems and procedures has an important impact on development performance. First, fiscal discipline and transparency contribute to macroeconomic stability and sustained external assistance. Second, inadequate prioritization and lack of information would make it difficult to allocate resources across/within sectors appropriately. Third, weaknesses in procurement and insufficient financial data would constrain the effectiveness and efficiency of public expenditures.

Figure 1: The Structure and Coverage of PEFA System



Source: "Public Financial Management: Performance Measurement Framework, 2005, p.4"

This paper presents an assessment of the performance of Afghanistan's PFM systems, based on a performance measurement framework developed by the Public Expenditure and Financial Accountability (PEFA) partnership program (see http://www.pefa.org/index2.htm for more information) which identifies a set of critical objectives of a PFM system and a standard set of high-level PFM indicators to assess performance against the objectives (Figure 1). The 28 PEFA indicators of PFM performance are structured in three categories namely: (A) PFM out-turns; (B): Key cross-cutting features; and (C) Budget cycle. In addition, three indicators relate to donor practices (D). This methodology provides a consistent framework for analysis and a monitoring tool for the Government to manage reform and demonstrate progress to domestic and international stakeholders.

This assessment builds on and updates an earlier PEFA assessment of Afghanistan's PFM performance as of June 2005. Changes in the ratings for the various PEFA indicators between June 2005 and December 2007 thus can provide insights into changes in the performance of Afghanistan's PFM systems during this period of time. Comparisons between Afghanistan and other countries for which PEFA assessments have been conducted also are possible.

The limitations of the PEFA framework need to be kept in mind when reviewing the results. First, the ratings reflect very substantial external technical support (advisory and to some extent operational) to PFM in Afghanistan. Although the results accurately depict what is happening now, the challenge for the future will be to progressively replace this external capacity with sustainable core domestic capacity over time. Supporting this transition is a very important element of current external assistance to PFM functions.

Second, the PEFA ratings apply to the government's PFM systems which are used in formulating and implementing the core national budget, whereas most aid to Afghanistan is executed by donors and their contractors or implementing agencies outside the national budget and PFM systems. This assessment therefore does not provide any insights into or confidence about the performance of systems for off-budget aid which constitutes most of the total assistance to Afghanistan.

Third, the PEFA framework does not evaluate whether expenditures have the desired effect in promoting national objectives like reducing poverty, or whether there is value for money achieved in service delivery. The PEFA assessment rates PFM performance per se, which is very important in its own right but is not a sufficient condition for achieving development outcomes. An open and orderly PFM system is one of the critical enabling elements for aggregate fiscal discipline, strategic allocation of resources, and effective and efficient service delivery.

Fourth, and more specifically with respect to the sub-national level, Afghanistan is a unitary state with a centralized government structure. Therefore, except for municipalities (which have separate budgets of their own), sub-national fiscal operations occur as part of a single legal entity which is the national government of Afghanistan. The PEFA indicators thus relate to PFM processes for the government as a whole (including sub-national levels). However, as indicated above, PEFA cannot measure the effectiveness of service delivery or outcomes achieved at sub-national level or national level.

Fifth, the four-level PEFA scale of ratings and the nature of most of the performance indicators being rated mean that changes in PFM performance generally would become evident in terms of changes in PEFA ratings only over multi-year periods. It is for this reason that PEFA assessments for Afghanistan are being conducted approximately every two years. More frequent monitoring of PEFA indicators would not provide much in the way of useful additional information.

Finally, the PEFA indicators do not assess government revenue mobilization in relation to the level of potential revenues, only in relation to the budget target for revenues. This is a very important issue for Afghanistan, since the country's revenue-to-GDP ratio is quite low by international standards.

Key Results

Out of total 28 PFM performance indicators, 18 indicators improved and two indicators deteriorated, while eight indicators remained unchanged. This signifies a major improvement in PFM performance overall. Moreover, it should also be noted that some of the 2005 assessment were based on limited information, so some indicators are not really comparable between the first and second assessments (including notably the first two indicators, which declines between 2005 and 2007). Second, while the ratings are based on the information as of December 2007, some progress since then is explained in narrative parts of each indicator.

PFM in Afghanistan as depicted by the PFM Performance Indicators is summarized below under the six critical attributes of a PFM system. The ratings against each of the 28 individual PFM Performance Indicators and for the three indicators of donor performance are shown in a table at the end of this Executive Summary.

Credibility of the Budget (Performance Indicators 1-4)

These indicators measure whether the budget is realistic and is implemented as intended.

Strong revenue performance in the past few years and donor support to operating expenditures through the Afghanistan Reconstruction Trust Fund (ARTF) and Law and Order Trust Fund (LOTFA) have enabled the government to maintain budgeted operational expenditures (about 60 percent of which is salaries and wages). The centralized nature of payment controls prevents a build-up of arrears, although Afghanistan has not yet established an arrears monitoring mechanism. By contrast, the credibility of the budget is hampered by the existence of a significant volume of reserve funds in the budget, which affects outcomes in terms of expenditure composition as compared to the budget targets. More importantly, the sizable gap between the budgeted and actual core development expenditures is of significant concern. The gap mainly attributes to a lack of realism at the budget formulation stage and limited capacity to implement the budget.

Comprehensiveness and Transparency (Performance Indicators 5-10)

These indicators measure whether the budget and fiscal risk oversight are comprehensive and whether fiscal and budget information is accessible to public.

Significant progress has been made in improving transparency and comprehensiveness, although some weaknesses remain. The government has developed a robust classification system which to some extent facilitates the tracking of expenditures on organizational, economic and functional, and program basis. However, the Chart of Accounts needs to be further developed and amended to support and facilitate program budgeting. The government is committed to share budgetary information transparently, and the annual budget documentation has been improved in terms of quality and comprehensiveness. The extent of unreported government operations in terms of extra-budgetary funds appears to be very low, and all donor funding to the Core Budget is included in fiscal reports. Municipalities, which are fiscally autonomous from the national government, report on their fiscal and financial status on an annual basis, although information is currently not being fully consolidated or reported. Fiscal risk oversight of the commercial activities of the government, including state-owned enterprises (SOEs) and state corporations, is lacking due to low reporting compliance and quality, requiring urgent action. Public access to fiscal information has improved but needs further attention to ensure full transparency for the public, especially with regard to audit reports.

Policy Based Budgeting (Performance Indicators 11-12)

These indicators measure whether the budget is prepared with due regard to government policy.

Progress has been made in planning and organizing the annual budget process with a longer and more realistic budget formulation schedule as well as political guidance needed to ensure strategic prioritization in the resource allocation process. The Cabinet approved a rough inter-sectoral prioritization of the ANDS, which is planned to be integrated in the budget process beginning in 2009/10 (SY1388). Further initiatives are needed to ensure the successful implementation of program budgeting in additional ministries during the coming years. The budget approval process of the National Assembly has been greatly improved, and the 2008/09 (SY1387) budget was approved by parliament before the start of the fiscal year.

The multi-year perspective of the budget process has been enhanced since 2005 with the linking of budget and national strategy and regular updating of the Medium-Term Fiscal Framework (MTFF), which is gradually emerging as a multi-year budgeting framework through the estimation of budget ceilings. Debt sustainability analyses have been undertaken annually by the IMF and the World Bank for the past three years, but the Ministry of Finance needs to develop its capacity in this area. Three sector strategies are being costed, and additional sectors are planned to be costed in 2008/09 (SY1387). However, linkages between investment budgets and forward expenditure estimates generally remain very weak and need to be strengthened in the interest of future fiscal sustainability.

Predictability and Control in Budget Execution (Indicators 13-21)

These indicators measure whether the budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.

Budget predictability has been greatly improved both for revenues and expenditures, while budget control has room for further improvement. On the revenue side, the Income Tax Law (November 2005) provides clarity on tax liabilities and procedures, although enforcement remains a concern. The establishment of the Large Taxpayer Office (LTO) in 2004 and its operationalization are important steps to improve enforcement. On the expenditure side, predictability of funds availability has improved through better cash flow forecasts where there has been improved information on actual cash balances and commitments.

However, and despite the improvements in most indicators, there has been no progress on internal audit, except in the Ministry of Finance. Internal audit is operational for most national government entities but, except in the Ministry of Finance, this work is not done to any recognized professional standard, and there is little follow-up of audit recommendations.

Accountability, Recording and Reporting (Indicators 22-25)

These indicators measure whether adequate records and information are produced, maintained, and disseminated for purposes of decision-making, control, management, and reporting on operations.

Progress has been made in improving these indicators since 2005. Reconciliation of bank and advance accounts is regularly conducted at least on a quarterly basis, within four weeks after the end of the month. The Treasury Department has established and implemented a procedure by which advances and suspense accounts are cleared at least annually. The computerized Afghanistan Financial Management Information System (AFMIS) enables the Ministry of Finance to produce monthly reports (which are put on their website) within a month. A consolidated government statement is prepared annually with a complete set of information. This is sent to the President's office within six months of the fiscal year end. Despite good information on Core Budget execution, data are not specifically collected on resources utilized for service delivery. Also, AFMIS does not record/report commitments.

External Scrutiny and Audit (Indicators 26-28)

These indicators assess the arrangements for scrutiny of public finances and follow up by the executive.

With the enactment of the PFEM Law in July 2005 and the subsequent formation of the National Assembly, the legislature started its involvement in budget scrutiny. The PFEM Law provides clear rules such as for budget amendments within the financial year. Nevertheless, the legislature's procedures for scrutiny are rather weak and need to be documented and formalized. Also, legislative scrutiny of audit reports needs to extend beyond the review of only the audit of the traditional accounts (Qatia). Currently, over 50 percent of expenditures are audited annually and reports are issued within 12 months of year-end with significant issues being identified. However, there has been no significant improvement on the quality of review from the 2005 Assessment.

Donor Practices (Donor Practices Indicators 1-3)

Afghanistan's great reliance on donor financing requires that donor practices are very important for PFM and development performance. Actual budget support reached at least 90 percent of budgeted figures in two of the last three years, and quarterly disbursements do not deviate from the original disbursements schedule. The Aid Coordination Unit (ACU) of the Ministry of Finance now plays a bigger role in collecting financial information from donors. The ACU initiated a "donor financial review" in late 2007, which will enable the Ministry of Finance to acquire forward looking information for the next five years.

However, the continuing pattern whereby most aid funds do not go through the national budget and PFM procedures hampers fiscal policy as the government has limited control of the related expenditure. Furthermore, donor practices need be improved to support properly and correspond to a reasonable extent with the budget process of the national government, especially with regard to the Development Budget which in past years has been finalized very late in the process due among other reasons to a lack of timely communication from some donors with regard to their spending priorities.

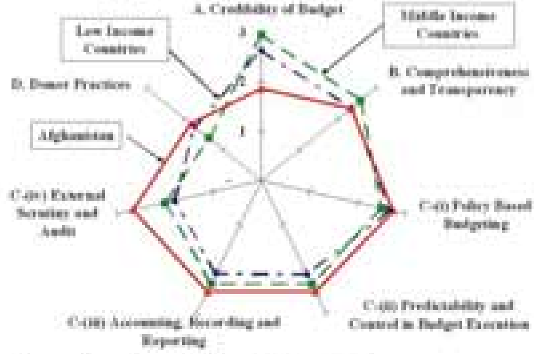
International Comparison

Comparison with other countries[1] shows that PFM performance in Afghanistan as of December 2007 is better than that of many other comparable countries in most categories (Figure 2). Indicators on budget cycle (C-(i)-(iv)) outperform even average for those middle income countries for which PEFA assessments are available, which suggests that there have been major improvements in this area.

[1] Data on 23 countries (12 low income countries and 11 middle income countries) are available on the PEFA website: www.pefa.org.

However, the credibility of budget (A) is lower than the average for other low income countries for which PEFA assessments have been conducted, while comprehensiveness and transparency (B) is equivalent to the average of these low income countries.

Figure 2: International Comparison
(Afghanistan and other PEFA countries)



Source: PEFA wensite, World Bank staff

Conclusion: Improving the PFM System in Afghanistan

This report depicts significant positive developments in Afghanistan's PFM system since the 2005 PEFA-based PFM review. The comparison with other countries also shows that the PFM system in Afghanistan performs relatively well. Nevertheless, a number of weaknesses exist which must be addressed, including areas where progress in improving the PFM system and processes has been slow. Additional improvements in the following areas would contribute to further improving future PEFA ratings:

- **Credibility of the Budget:** The gap between budget and realization remains substantial especially for core development expenditures, although there has been an improvement in recent years. Measures for further improvement would include, first, further strengthening the link between the annual budget and the MTFF. This includes, for example, systematically estimating future recurrent costs implications of investments. Second, there needs to be a proper link between the ANDS and fiscal policy.

- **PFM capacity outside the Ministry of Finance:** Capacity development in line ministries, as executing agencies of expenditures, is critical. Compared with the progress in the Ministry of Finance, developments in most line ministries lag behind. For example, cash management and payment scheduling procedures in line ministries have not improved. Capacity of internal audit in line ministries should be developed. Also, capacity building on public procurement (now underway) should be accelerated so that line ministries can progressively take greater responsibility for procurement activities.

- **Comprehensiveness, transparency, accounting and reporting:** The centralized nature of Afghanistan's fiscal system has helped to prevent exposure to significant contingent liabilities. However, in order to mitigate future fiscal risks, accounting and reporting of the State Owned Enterprises (SOEs) and municipalities should be strengthened through developing their capacities. Related to this, the monitoring of the stock of expenditure payment arrears should be improved.

- **Internal and external audit:** PEFA ratings related to audits remain low. Although internal audit is operating in most of the government entities, the work does not yet meet recognized professional standards, especially in line ministries. In addition to in-house training in the ministries, formal academic/professional training in auditing should be made available for staff in internal audit departments. Also, most internal audit manuals are very outdated and need to be revised based on modern internal audit practices that also take into account the current context in Afghanistan. Likewise, capacity for external audit needs to be further developed along with a revised legal foundation based on international standards. However, the Audit Law is not yet in effect. Acceleration of the accounting and auditing certification process for all professional staff is commendable.

Table 1: Summary of PFM Performance Assessment Indicators

		Jun 05	Dec 07	1	2	3	4
	A. PFM-OUT-TURNS: *Credibility of the budget*						
PI-1	Aggregate expenditure out-turn compared to original approved budget	2	1				
PI-2	Composition of expenditure out-turn compared to original approved budget	2	1				
PI-3	Aggregate revenue out-turn compared to original approved budget	4	4				
PI-4	Stock and monitoring of expenditure payment arrears	1+	1+				
	B. KEY CROSS-CUTTING ISSUES: *Comprehensiveness and Transparency*						
PI-5	Classification of the budget	2	2				
PI-6	Comprehensiveness of information included in budget documentation	2	3				
PI-7	Extent of unreported government operations	3	3+				
PI-8	Transparency of inter-governmental fiscal relations	1	1				
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	1	1+				
PI-10	Public access to key fiscal information	2	3				
	C. BUDGET CYCLE						
	C(i) Policy-Based Budgeting						
PI-11	Orderliness and participation in the annual budget process	2	3				
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	1+	3				
	C(ii) Predictability and Control in Budget Execution						
PI-13	Transparency of taxpayer obligations and liabilities	1+	2				
PI-14	Effectiveness of measures for taxpayer registration andtax assessment	1+	2				
PI-15	Effectiveness in collection of tax payments	1+	1+				
PI-16	Predictability in the availability of funds for commitment of expenditures	1+	3+				
PI-17	Recording and management of cash balances, debt and guarantees	2+	3+				
PI-18	Effectiveness of payroll controls	2	2+				
PI-19	Competition, value for money and controls in procurement	2/3	3				
PI-20	Effectiveness of internal controls for non-salary expenditure	2	2+				
PI-21	Effectiveness of internal audit	2	2				
	C(iii) Accounting, Recording and Reporting						
PI-22	Timeliness and regularity of accounts reconciliation	2+	3				
PI-23	Availability of information on resources received by service delivery units	1	1				
PI-24	Quality and timeliness of in-year budget reports	2	2+				
PI-25	Quality and timeliness of annual financial statements	2	3+				
	C(iv) External Scrutiny and Audit						
PI-26	Scope, nature and follow-up of external audit	2	2				
PI-27	Legislative scrutiny of the annual budget law	1	3+				
PI-28	Legislative scrutiny of external audit reports	1	2+				
	D. DONOR PRACTICES						
D-1	Predictability of Direct Budget Support	4	3+				
D-2	Financial inform ation provided by donors for budgeting and reporting on project and program aid	1+	1				
D-3	Proportion of aid that is managed by use of national procedures	1	1				

Overall Performance of PFM System

A. PFM-OUT-Turns: Credibility of the Budget

PI-1: Aggregate Expenditure Out-Turn Compared to Original Approved Budget

Rating 1 (deteriorated from 2 in the 2005 PEFA)[2] : This indicator describes the government ability to deliver the public services as expressed in the budget. As in 2005/06 (SY1384) and 2006/07 (Sy1385), actual expenditures (operating expenditures excluding debt services plus a part of core development expenditures discretionary financed) deviate from the budget expenditures by more than 15 percent in 2004/5 (SY1383) and 2005/06, (SY1384)the rating is 1.

Table 2: Result Matrix for PI-1

Millions Afs	SY1383 (2004/05)	SY1384 (2005/06)	SY1385 (2006/07)
1. Core Development Expenditures (Discretionary)			
Budget	5,760	9,796	8,977
Actual 1/	1,785	4,310	4,848
2. Operating Expenditures (excluding debt repayment)			
Budget	30,054	32,479	43,767
Actual	26,756	31,597	42,782
3. Total Expenditures (1+2)			
Budget	35,814	42,275	52,744
Actual	28,542	35,907	47,630
Deviation	**20.3%**	**15.1%**	**9.7%**

1/ Actual figures are estimated based on disbursement ratios of total core development expenditures
Source: Ministry of Finance, World Bank Staff

The core budget expenditures comprises of the operating budget expenditures and development budget expenditures. The operating budget expenditures include wage and salaries, operation and maintenance and investment funded by the operational budget expenditures. In 2006/07 (SY1385), domestic revenues contribute to 67 percent of the operating budget expenditures. The remainder is financed by donors through ARTF (Afghanistan Reconstruction Trusty Fund), LOTFA (Law and Order Trust Fund for Afghanistan) and CSTC-A (Combined Security Transition Command-Afghanistan). The core development budget expenditures include investment operations (as well as recurrent costs) implemented by the government, which are also mostly funded by donors. In addition, external budget expenditures, which do not go through the Treasury system, include technical assistance and most capital expenditures.

The deviation of the budget expenditures[3] between the realization and budget shrank from 20.3 percent in 2004/2005 (SY1383) to less than 10 percent in 2006/07 (SY1385) mainly due to (i) strong revenue performance (see PI-3 on revenues), (ii) stable donor supports on operational budget expenditures and (iii) increase in disbursement ratio of core development expenditures.

[2] This indicator is not really comparable to the 2005 PEFA as the 2005 PEFA is based on limited information.
[3] The sum of core operating expenditures (excluding debt service) plus core development expenditures from discretionary sources (operating budget surplus and donor budget supports).

Nevertheless, the deviation is significant for development budget expenditures (Table 3). The actual development budget expenditures were less than 40 percent of the budgeted ones in 2004/05 (SY1383) and 2005/2006(SY1384). There were significant improvements in 2006/07 (SY1385) in terms of absolute amounts and the comparison with the budget. However, the realization was still 55 percent of budget. The low disbursement ratios are mainly due to the overestimates of absorption capacity of the governments and of disbursement projection of donors.

Table 3: Core Development Budget Expenditures

Afs million	2004/05 (SY1383)	2005/06 (SY1384)	2006/07 (SY1385)
Budget	53,558	58,534	62,898
Actual	19,282	22,243	35,180
Deviation	-64.0%	-62.0%	-44.1%

Source: Ministry of Finance, World Bank

PI-2: Composition of Expenditure Out-Turn Compared to Original Approved Budget

Rating 1 (deteriorated from 2 in the 2005 PEFA)[4]: If the composition of expenditures varies considerably from the budget, it is not a useful policy statement. This indicator measures the composition at a sub-aggregate level. Variance in the operating budge expenditure (excluding debt service payments) composition exceeded overall deviation by more than 10 percent in the past three years[5]. Therefore, the rating is "1".

The existence of unallocated reserve funds[6] in the budget greatly contributed to the deviation. In 2004/05 (SY1383) the contingency fund (e.g. extraordinary item reserve and civil service reform fund) accounted for nine percent of total budget. In 2005/06 (SY1384) and 2006/07 (SY1385), the share of reserve funds fell to five and four percent, respectively.

The quality of budget implementation measured by changes in expenditure composition is still weak. Total expenditure variance exceeded 10 percent in 2004/05 (SY1383) and 2005/06 (SY1384), before it went down to eight percent in 2006/07[7] (SY1385).

[4] This indicator is not really comparable to the 2005 PEFA as the 2005 PEFA is based on limited information.
[5] Ministry level desegregation exists for both core operating and development expenditures, but is available only for the core operating expenditures when conducting the PEFA. Accordingly, PI-1 and PI2 use different data set.
[6] Unallocated reserve funds are defined as reserve funds which are not earmarked to any ministries.
[7] The variance in excess of total deviation was 13.5 percent, 10.6 percent and 7.5 percent in 2004/05, 2005/06 and 2006/07, respectively.

PI-3: Aggregate Revenue Out-Turn Compared to Original Approved Budget

Rating 4 (same as the 2005 PEFA): A comparison of budget and actual revenues provides an overall indicator of the quality of revenue forecasting. Actual domestic revenue collection was higher than the budget in 2005/06 (SY1384) and 2006/07 (SY1385) (Table 4). Therefore, the overall rating is "4".

Strong revenue collection is critical for Afghanistan to achieve its development objectives and macroeconomic stability (through fiscal sustainability). Domestic revenues to GDP ratio improved from 4.7 percent in 2004/05 (SY1383) to 7.5 percent in 2006/07 (SY1385). Despite strong performance until 2006/07 (SY1385), the revenue performance in 2006/07 (SY1385) is disappointing. Preliminary results show that revenues in 2007/08 (SY1386) were below the target.

Table 4: Domestic Revenues

Afs million	2004/05 (SY1383)	2005/06 (SY1384)	2006/07 (SY1385)
Budget	15,380	16,150	25,220
Actual	12,812	20,652	29,050
Deviation	-16.7%	27.9%	15.2%

Source: Ministry of Finance, World Bank

PI-4: Stock and Monitoring of Expenditure Payment Arrears

Rating 1+ (same as the 2005 PEFA[8]): A high level of arrears can indicate a number of different problems such as inadequate commitment controls. The rating on the first dimension is "2", as there may be a stock of expenditure arrears below 10 percent of total expenditures. The rating on the second dimension is "1" as there is no data monitoring mechanism. Therefore, the overall rating is "1+".

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

Although there is no monitoring mechanism for arrears, the strong centralized nature of payment controls prevents substantial build-up of arrears. The arrears are considered to be insignificant for non-payroll payments. Many suppliers require pre-payments of goods and services from the government and/or open a letter of credit through a bank before they provide goods and services to the government. Although seasonality of payroll indicates that salaries are paid with substantial delays (up to several months) in some locations, the delays do not affect much on the accumulation of arrears. The Ministry of Finance conducted two end-year surveys of payroll payable with a few ministries and Mustufiats.

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

Data for monitoring the stock of expenditure payment arrears is not available. The government has not yet adopted accounting practices allowing tracking arrears. The government plans to implement a module of FreeBalance to allow for commitment controls in the next fiscal year (2008/09).

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[8] The 2005 PEFA rating was "2" for PI-4, however the rating is now changed to "1+" based on PEFA guidance.

B: Key Cross-Cutting Issues: Comprehensiveness and Transparency

PI-5: Classification of the Budget

Rating 2 (same as the 2005 PEFA)[4]: This indicator describes the classification system used for formulation, execution and reporting of the government budget with reference to international standards. The budget should be presented in a format that reflects the most important classifications, which should be embedded in the Chart of Accounts to ensure that transactions can be reported in accordance with the applied classifications. The rating is "2" because the Ministry of Finance does not fully apply functional and economic classifications in the budget formulation process.

The National Budget document includes the Core Budget which consists of the Operating Budget and the Development Budget. The Operating Budget is formulated by the Afghanistan National Development Strategy (ANDS) grouping that to some extent resembles a functional classification and the expenditure classification in the budget appropriations is formulated by major economic code for each budget entity. However, the details of the Development Budget are not shown using either the GFS or the COFOG structure, and the economic and functional distribution of the public expenditures is therefore not made properly available.

In expenditure recording for the Core Budget, the classification for both operating and development expenditures are made at the level of the organizational unit, source of funding and specific contract, expenditure type (GFS economic classification), and location (province). Bridging tables from program classification to functional (COFOG) classification are being used. The reclassification of some items based on the organizational classification is required to allocate to appropriate COFOG functions programs implemented by some ministries responsible for several government functions simultaneously. Poverty reduction expenditures can be tracked using the functional classification.

The Chart of Accounts introduced by the Ministry of Finance in 2005/06 (SY1384) conforms to the structure of the GFS economic classification system and also enables consolidated reporting on the Operating and Development Budgets. However, the Chart of Accounts applied for 2007/08 (SY1386) - while facilitating the need of the Ministry of Finance to track budget transactions - is problematic in some areas:

- It does not adequately support the tracking of program expenditures for management purposes since the ad hoc changes introduced in 2006/07 (SY1385) reduced the program hierarchy levels from four to two. The three pilot line ministries that adopted a program structure for 2007/08 (SY1386) (Ministry of Education, Public Health and, Rural Rehabilitation and Development) also declined to use the program segment of the Chart of Accounts for tracking Program expenditures due to budget control arrangements;
- In line ministries and provincial Mustofiats with AFMIS roll-out, where responsibility centers for transaction processing are not distinguished, e.g. secondary and tertiary budgetary units, it is difficult to obtain good management information;
- Integration of the Operating and Development Budgets is not well supported since the Development Budget economic classification is not disaggregated during the budget formulation and classification structures in the fund segment do not provide an appropriate reporting and management framework.

[4] In the 2005 report, the rating for PI-5 was given as "2+" which was incorrect since the scoring methodology for this PI is M1 where a "+" is only possible for indicators with two or more dimensions.

PI-6: Comprehensiveness of Information Included in the Budget Documentation

Rating 3 (improved from 2 in the 2005 PEFA): This indicator assesses the completeness of information included in the annual budget documentation as submitted to the National Assembly for scrutiny and approval. The rating is "3" since the budget documentation covers five of the nine recommended aspects. It provides an overview of the basis for the annual budget, but is not fully comprehensive as some aspects - information on financial assets, prior year's budget out-turn, summarized budget data and explanation of the implications of new policies - are missing.

The required content of the budget is set out in the PFEM Law, and includes detailed overview information, revenue and expenditure plans as well as information on assets and liabilities. The content of the 2007/08 (SY1386) National Budget document is outlined in Table 5.

Table 5: Summary of budget information provided for SY1386 (2007/08)

Elements of annual budget documentation	Included	Comments
1. Macro-economic assumptions, incl. at least estimates of aggregate growth, inflation and exchange rate	Yes	Section 2.1 includes expected GDP growth and inflation rates, while the exchange rate estimate is mentioned in annex table 1 (Core Budget by ANDS)
2. Fiscal deficit, defined according to GFS or other internationally recognised standard	Yes	The annex Financing Table states the deficit
3. Deficit financing, describing anticipated composition	Yes	The expected deficit financing is outlined in the annex Financing Table
4. Debt stock, incl. details at least for the beginning of the current year	Yes	Grant and loan information is outlined in Annex 1
5. Financial assets, incl. details at least for the beginning of the current year	No	No information on assets is provided
6. Prior years budget out-turn, presented in the same format as the budget proposal	No	Past budget performance in section 1.2 has information from SY1382-1384, but not SY1385 nor are they in the same format or level of detail as SY1386 budget data
7. Current years budget (either the revised budget or the estimated out-turn), presented in the same format as the budget proposal	Yes	The SY1385 budget is shown together with SY1386 in annex table 1 (Core Budget by ANDS)
8. Summarised budget data for both revenue and expenditure according to the main heads of the classification used (ref. PI-5), incl. data for current and previous year	No	Comparable figures for prior year (SY1384), current year (SY1385) and budget year (SY1386) are not presented at an aggregated level for the major lines in the budget classifications (administrative, economic or ANDS classifications)
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	No	Although new policy initiatives are outlined for both revenues and expenditures, only some very general budget implications are mentioned for expenditures while no budgetary details are presented with regard to revenues

PI-7: Extent of Unreported Government Operations

Rating 3+ (improved from 3 in the 2005 PEFA): One element that affects the efficient allocation of resources is the extent to which government operations may go unreported as extra-budgetary revenues and expenditures. The annual budget, budget execution reports and year-end financial statements should provide a complete overview of National Government revenues and expenditures. The rating for the first dimension (Unreported extra-budgetary expenditures) is "3" because the extent appears to be insignificant, although exact figures are not available. The rating for the second dimension (Income and expenditure information on donor-financed projects included in fiscal reports) is "4" as all donor-funded activities included in the Core Budget are managed using government systems and therefore are included in fiscal reports. The overall rating is therefore "3+".

(i) The Level of Extra-Budgetary Expenditure

The current level of unreported extra-budgetary expenditures (other than donor-funds) appears to be very low and limited to situations where minor revenues have been collected and spent without appropriation. This seems to occur among some local administrations (provinces and districts) as well as autonomous/statutory government entities. However, it is not entirely clear to which extent the latter are to be considered part of the government in the budgetary sense. For example, the Afghanistan Investment Support Agency (AISA) appears to have extra-budgetary revenues though government support to AISA is in fact part of the budget and included in fiscal reports. Other areas of unreported extra-budgetary expenditures have not been identified.

(ii) Income/Expenditure Information on Donor-Funded Projects

With regard to donor-financed activities, all funds channeled through the Core Budget are managed through the government's budget and accounting systems. The size of the external budget is still very significant, for 2007/08 (SY1386) approximately half the total budget (and almost 2/3 for the 2008/09 (SY1387) budget), although it is estimated that at least 80 percent is now captured in the Donor Financial Review and thus included in external fiscal reports. The recent availability of Provincial Reconstruction Team (PRT) data is expected to increase this figure somewhat as is the introduction of harmonized reporting formats and on-line reporting access to the Donor Financial Review. Also, part of the remaining 20 percent is inputs provided in-kind (e.g. humanitarian assistance, equipment and vehicles) although precise figures are not available. However, some expenditures related to the security sector are not included in the external budget and remains unreported though parts of this was reported in January 2008 which led to a re-estimation of the ANDS funding requirement.

PI-8: Transparency of Inter-Governmental Fiscal Relations

Rating 1 (same as in the 2005 PEFA): Inter-governmental fiscal relations between different levels of government should be transparent and rule-based so as to ensure equitable and efficient provision of decentralized public services across Sub-National Governments. Since Afghanistan - due to its administrative set-up, allocation of expenditure responsibilities and current fiscal situation- does not have an inter-governmental fiscal transfer system in a traditional sense, the ratings of first two dimensions of this performance indicator "Transparency and objectivity in the horizontal allocation" and "Timeliness of reliable information" are "1". The rating of the third dimension (Extent of consolidation of fiscal data for general government according to sectoral categories) is "1" since municipal revenue and expenditure data, although collected, is not consolidated into annual reports. The overall rating is therefore "1".

Afghanistan is a highly centralized state with provinces being de-concentrated units of the National Government. Provinces are, according to the 2004 Constitution, local administrative units with elected councils that have an advisory role, and are subdivided into districts and villages. Expenditures of provinces are part of the ministerial budgets and all revenues go to the Treasury of the Ministry of Finance. Provincial staffs are appointed by and are employees of the National Government and refer to their respective ministries (although regional and local leaders in practice have significant influence).

Municipalities are distinctively different entities. According to the Constitution, municipalities are set up in order to administer city affairs and are to have elected mayors and councils (elections are planned for 2010/11 (SY1389) with current office holders being appointed). They are by and large self-sustaining entities with specific service delivery tasks (e.g. water, sewage, garbage collection and recreation) which must be financed by local charges and fees. Based on staffing levels approved by the Tashkeel (Manpower Ceiling) Office and the Ministry of Interior (in future the newly established Independent Directorate of Local Governance (IDLG), municipalities prepare their own budgets, which are approved by the MoF. It appears that the budgets are often forwarded for approval to the ministries only after the beginning of the fiscal year, and the approval process of the MoF continues up to the second quarter. The number of municipalities is currently estimated at 217, with provincial municipalities in each of the provincial capitals and at least 180 rural municipalities.

<u>Transfers:</u> The fiscal relationship between the National Government and municipalities is not stated in the Constitution. According to the PFEM Law municipalities can receive assistance (transfers) from the national budget if a justifiable need exists and proposals are submitted to the MoF during the annual budget process. The Chart of Accounts is coded accordingly for this purpose. However, transfers from the National Government to municipalities are very limited and appear to take place only for capital outlays (infrastructure developments), mainly in Kabul Municipality which faces particular and growing urban challenges. Transfers for service provision do not exist which reflects the division of tasks between the two levels of government with most expenditure responsibilities, incl. for primary services such as education and health, assigned to the central level.

The funds budgeted for Kabul Municipality in 2007/08 (SY1386) for infrastructure projects are about US$39 million, while projects in the other cities combined receive less than half that amount. The overall level of assistance (vertical allocation) depends on a budget policy decision of the National Government. The distribution between municipalities (horizontal allocation) is not based on explicit criteria or rule-based formulas, but instead appears to be the result of political negotiations and lobbying. Although the Ministry of Finance afterwards reviews and assesses each specific municipal project proposal, this in effect means that the allocation process is not transparent and that the availability of funds is not predictable in the medium term. However, an important difference is that for all municipalities other than Kabul, transfers are made directly to line ministries whose provincial departments collaborate with and support the municipalities, rather than transferring the funds to the municipal administrations. Afghanistan does therefore not have an inter-governmental fiscal transfer system in a traditional sense[10].

Reporting: Reporting from municipalities to the National Government should be based on the PFEM Law which states that municipalities must provide budget execution reports at least on a six-monthly basis to the Ministry of Finance through the Mustufiats (Ministry of Finance's provincial branches). However, specific reporting formats and procedures for this purpose have not been established. The MoF instead receives budget execution data only once a year and as part of the annual municipal budget approval procedure, cf. above, in that the municipal budget proposals include last year's budget execution figures. For the fiscal year 2007/08 (SY1386), the MoF received budget proposals from 127 municipalities (i.e. 59 percent of all municipalities) which, according to the Budget Department, includes all major municipalities with an approved Tashkeel. The budget data is combined into a table and actual revenue data used for ad hoc analyses. However, consolidated ex-ante and ex-post fiscal and financial data from the municipalities is currently not available or reported.

[10] However, it should be mentioned that a recent report by the World Bank ("Service Delivery and Governance at the Sub-National Level in Afghanistan", July 2007, p. 21) states that Kabul Municipality relies on transfers for over 40 percent of its total income though it is not clear whether this refers to operating or development expenditures.

PI-9: Oversight of Aggregate Fiscal Risk from Other Public Sector Entities

Rating 1+ (improved from 1 in the 2005 PEFA): The government should monitor and manage all significant fiscal risks arising from its activities, including SOEs, state corporations and other commercial activities. The rating for the first dimension (Extent of National Government monitoring of public enterprises) is "1" because the extent of monitoring is significantly incomplete as it only includes SOEs, and even then is very limited in scope and quality. For the second dimension (Extent of National Government monitoring of municipalities' fiscal position), the rating is "4" as these cannot currently generate fiscal liabilities with national implications. The overall rating is therefore "1+".

The national budget comprises the legislature, the judiciary, all executive entities including deconcentrated operations in provinces and districts, and budget support to autonomous agencies. However, it does not include Public Enterprises or Sub-National Governments.

(i) Extent of Central Government Monitoring of Autonomous Government Agencies and Public Enterprises

Public Enterprises may take the form of State-Owned Enterprises (SOEs) which, according to the revised SOEs Law (Thassady Law) of November 2005, and are defined as legal entities with independent balances operating with 100 percent capital owned by the state. As of December 2007, the Ministry of Finance lists 65 SOEs as registered under the SOEs Law which include utilities and public transportation companies as well as regular businesses (e.g. hotels, mines and construction companies)[11]. SOEs are controlled by their respective line ministries though the shares are owned by the Ministry of Finance. Some commercial activities - e.g. Ariana Afghan Airlines, ANIC insurance, telecommunications and import/export businesses - are organized in some of 13 state corporations, authorised and operated under the 1955 Commercial Code, where the state shares from 20-100 percent. Furthermore, some ministries are involved in real estate activities, for example leasing of ministry-controlled property or land. Finally, some ministries are involved in other types of commercial activities, either directly or through quasi-autonomous, in such varied areas as agricultural production, garment manufacturing, cement and coal production, media (TV, newspapers) and sports facilities. The number of SOEs and non-SOE commercial activities is shown in the table below together with employment figures where available.

[11] However, the exact number of SOEs is not currently known.

Table 6: Overview over Commercial Activities of Ministries

	Ministry	State Owned Enterprises (SOEs)	State Corporations	Real Estate Activity	Non-Real Estate Commercial Activities	
					Ministry / Department	Independent Entity
1	Agriculture	8		1	2	1
2	Commerce	6	7			
3	Communication		2	1		
4	Culture & Information	4		3	2	1
5	Defense	2		1		1
6	Education	1		2		
7	Energy and Water	6				
8	Finance	1	2			
9	Higher Education			3		
10	Justice	1				
11	Labor & Social Affairs			1		
12	Mines & Industry	20		1*	3	
13	Public Health	1		1		
14	Rural Rehabilitation			1		
15	Transport & Aviation	10	2			
16	Urban Development	5				
-	**Sum**	**65**	**13**	**15**	**7**	**3**
No. of employees / No. of entities providing data		*26,820 / 65*	*1,613 / 9*	*Not Applicable*	*329 / 3*	*43 / 1*

Sources: USAID (2006): "Phase 1 Report on Non-SOE Commercial Activities at Government Ministries"; Afghanistan Research and Evaluation Unit (2006): "Privatization and Economic Reform in Afghanistan". Employment figures for SOEs were provided by MoF's SOE Department. Note: The Ministry of Mines & Industry has a total of 47 contracts with private companies.

The Law on Control and Audit Law charges the Control and Audit Office (CAO) with auditing SOEs. CAO's audit plan for 2007/08 (SY1386) includes about 20 SOEs where transaction checks on spending as well as audit of the annual accounts is carried out. However, only a few SOEs produce annual income and expenditure accounts as well as balance sheet accounts for audit.[12]

In accordance with the SOE Law, the SOE Department of the Ministry of Finance has an important oversight role vis-à-vis SOEs in evaluating and assessing their financial and economic operations. However, the reporting is of poor quality and with low compliance. Together with low analytical capacity in the SOE Department, the Ministry of Finance is not able to monitor the fiscal risks of SOEs in a systematic manner and it therefore cannot consolidate these for the National Government as a whole. However, the SOE Department indicates that future improvements are anticipated through new reporting formats, merit-based appointments and skills upgrading of staff (applying to both SOEs and the SOE Department).

[12] World Bank (2007): "Afghanistan, Public Sector Accounting and Audit". Report No. 41041-AF, p. 7.

The ongoing process of privatizing SOEs, where 15 are currently approved for liquidation is expected to gradually ease the oversight task and at the same time reduce the remaining fiscal risks. However, there exist a large number of public enterprises in the provinces, which includes utilities, transport companies as well as ordinary commercial activities.[13] To the extent that these entities are owned by the local administrations (and not municipalities), they present a potential, if probably limited, fiscal risk for the National Government.

With regard to state corporations and other commercial activities, there is currently no overall monitoring of fiscal risks taking place nor is it known if and how these report to their respective ministries. The Ministry of Finance does not have any oversight role, formal or informal, and the relationship between state corporations and the national budget is unclear in terms of subsidies, payment arrears and non-payment of taxes. Some state corporations - e.g. Ariana Afghan Airlines - represent very significant and on-going fiscal risks to the government due to operational losses and significant liabilities. This has been recognized by the IMF and the National Government, and a monitoring benchmark covering non-SOE commercial activities established,[14] but its implementation has so far been delayed from March 2007 till March 2008.[15] The World Bank is providing technical support in the preparation of a restructuring/divestment plan. It is the expectation of the Ministry of Finance's SOE Department that it in 2008/09 (SY1387) will be charged with the monitoring of state corporations.

(ii) Extent of Central Government Monitoring of Sub-National Governments' Fiscal Position

The Financial Regulations (No. 873 of 27 July 2006) developed pursuant to the PFEM Law state that borrowing by municipalities is subject to authorization by the Ministry of Finance and that only the Treasury can serve as an agent in this regard. The Ministry of Finance has so far not given its authorization to any municipal borrowing and in this area there is therefore not currently a need for the National Government to monitor risks. Furthermore, it is estimated that only few municipalities own and operate public enterprises (utilities) and fiscal risks stemming from these is therefore believed to be limited.

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[13] The Audit Plan 1386 of CAO's Enterprise Department lists 15 provinces (Kandahar, Balkh, Herat, Nangarhar, Helmand, Badghis, Hairatan, Baghlan, Kunduz, Paktia, Parwan, Badakhshan, Takhar, Laghman and Jawzjan) with a total of 50 public enterprises.

[14] IMF (2006): "Islamic Republic of Afghanistan: Seventh Review under the Staff-Monitored Program and Request for a Three-Year Arrangement under the Poverty Reduction and Growth Facility." IMF Country Report No. 06/251.

[15] IMF (2007): "Islamic Republic of Afghanistan: Second Review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility." IMF Country Report No. 07/252. According to information from the IMF, the new target date is subject to an IMF Board decision which is expected in mid-February 2008.

PI-10: Public access to key fiscal information

Rating 3 (improved from 2 in the 2005 PEFA): Transparency in government depends on whether information on plans, budgets and performance is available and how, as well as if it is readily understandable. The rating is "3" because annual budget documents, in-year budget execution reports (financial statements) and contract awards are made publicly available. However, year-end audited financial statements and external audit reports are - despite the provisions in the PFEM Law- not currently made public, while specific information on resources for primary service units is not being prepared.

The legislative basis for public access to various budgetary and fiscal documents is the PFEM Law which stipulates that the Ministry of Finance must publish the annual budget upon approval, quarterly progress reports upon submission to the Government and the President as well as a final budget reconciliation report and a set of financial statements. Also, the PEFM Law states that the Government must make publicly available the annual audit report (prepared within six months from the end of the fiscal year) when it is submitted to the National Assembly. The Procurement Law (October 2005) stipulates that the procuring entities must promptly publish notice of all procurement contract awards on a central and dedicated web site. The actual public availability of these documents as well as resource information is described in Table 7.

Table 7: Public Access to Key Fiscal Information

Elements of information	Publicly 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	The annual budget documents are made available at the Budget Web Site which is linked to www.mof.gov.af .
(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	Comprehensive budget execution reports are being prepared by the Budget Department on a regular basis, but are not made public; However, the Treasury Department prepares monthly financial statements which are routinely placed on the MoF web site
(iii) Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit	No	Year-end financial statements are currently not made public.
(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	No	External audit reports are currently not made public.
(v) Contract awards: Award of all contracts with value above approx. US$ 100,000 equiv. are published at least quarterly through appropriate means	Yes	Information on awarded contracts is made available at www.ards.org.af .
(vi) Resources available to primary service units: Information is publicised 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	Specific information on resources for primary service units is not being used or prepared by the line ministries.

C. Budget Cycle C
(i) Policy-Based Budgeting

PI-11: Orderliness and Participation in the Annual Budget Process

Rating 3 (improved from 2 in 2005)[16]: A well-planned and executed budgeting process is essential for ensuring that the final budget reflects the intended fiscal and sectoral policies of the Government since it, through the relative spending levels for different programs and activities, is an implicit policy statement. This requires not only a clear timetable but also comprehensive guidance, including political involvement and guidance through indicative budget ceilings announced early in the budget process, as well as timely approval of the budget by the legislature. The rating for the first dimension (Existence of and adherence to a fixed budget calendar) is "3" since delays have been experienced in the implementation of the budget calendar. The rating for the second dimension (Comprehensiveness and political involvement in the guidance for preparing the budget submissions) is "3" since the Budget Circular was comprehensive and included indicative budget ceilings though these were not approved by the Cabinet prior to circular's distribution. The rating for the third dimension (Timely budget approval by the legislature) is "2" since the National Assembly has not approved the budgets before the start of the fiscal years. The overall rating for this indicator is therefore "3".

The overall division of responsibilities between the annual budget formulation (the Government) and budget approval (the National Assembly) is stated in the Constitution, while the specific procedures are outlined in the PFEM Law and detailed in the Financial Regulations.[17] The main steps in the budget process are:

- The MoF informs the primary budgetary units with the Budget Circular about procedures and the timetable;
- The MoF in consultation with the Budget Committee of the Cabinet drafts a Fiscal Strategy Report which includes indicate budget ceilings;
- The primary budgetary units prepare their budget requests;
- Budget deliberations and hearings based on which the Budget Committee makes recommendations to the Government
- The Cabinet approves the final budget ceilings;
- The MoF prepares the consolidated draft budget document; and
- The Cabinet in consultation with the Budget Committee approves the final budget for submission to the National Assembly (which is to take place no less than 45 days prior to the new fiscal year, i.e. no later than 5 February).

[16] The ratings are, in accordance with the PEFA framework, based on the last fully completed budget process, i.e. On the SY1386 process. However, in the assessment, improvements and changes in the budget process for SY1387 have been observed.
[17] Article 29 in the PFEM Law and Chapter 2 in the Financial Regulations

(i) Existence of and Adherence to a Fixed Budget Calendar

For the 2007/08 (SY1386) budget, the Ministry of Finance issued the Budget Circular on 1 November 2006. It included a timetable that allowed the budgetary units approximately six weeks to prepare the budget requests (which should be considered a best practice-minimum). The budget calendar was not fully adhered to and although the time to prepare the budget requests was generally sufficient, delays occurred during the budget hearing process and with regard to the Cabinet's approval of the final ceilings. The budget was submitted on time to the National Assembly.

For the 2008/09 (SY1387) budget, the Ministry of Finance issued the ordinary Budget Circular (No.2) on 3 November 2007 with a timetable that allowed the budgetary units approximately four weeks to prepare their budget requests. The budget calendar was not fully adhered to, among other reasons due to the lack of indicative budget ceilings, cf. below, resulting in delayed budget hearings and Cabinet approval of the final budget ceilings. The budget was submitted to the National Assembly ahead of plan on 2 February 2008. The 2008/09 (SY1387) budget was approved on March 15, about a week before the beginning of the fiscal year.

(ii) Clarity/Comprehensiveness of and Political Involvement in the Guidance on the Preparation of Budget Submission

For the 2007/08 (SY1386) budget, the Ministry of Finance developed a "Fiscal Strategy and Budget Framework Report" in accordance with the Financial Regulations, but it was not approved by the Cabinet as the indicative budget ceilings included in the report were not agreed upon. The report was therefore not submitted to the National Assembly. The Circular included background information, details about the process, a timetable, a medium-term fiscal policy and budget framework, and instructions for the three line ministries piloting program budgeting. The Budget Circular also included the indicative budget ceilings, although the ceilings were only fixed more than two months later, which left little time for the ministries to undertake proper prioritizations and consultations.

For the 2008/09 (SY1387) budget, the Ministry of Finance issued a budget circular in July 2007 to request information on ministerial and sectoral strategies with the aim of aligning budgetary resources with the ANDS/Afghanistan Compact priorities. The ordinary budget circular was issued on November 3 2007 and included background information, process details, a timetable, a medium-term fiscal policy and budget framework as well as budget forms and specific information on program and provincial budgeting for the pilot ministries (now increased to seven). However, budget ceilings for the budgetary units were not included as these had not been decided upon by the Cabinet. The lack of even indicative budget ceilings (as had been provided for 2007/08 (SY1386)) meant that the budget hearing process generally was used to discuss the ceilings for the Operating Budgets, while the ceilings for the Development Budgets were fixed by the Cabinet only a few days before the budget was submitted to the National Assembly. The allocations were for several ministries significantly below their budget requests, but the reformulation of the budgets within the final ceilings took place in just one day, which was insufficient for meaningful prioritizations and consultations.

The lack of clear budget ceilings set by the Cabinet for 2008/09 (SY1387) meant that line ministries were encouraged to prepare their budget requests based on perceived needs rather than established availability of scarce resources. This made it difficult for line ministries to properly translate their strategies into decisions about the allocation of resources that would be realistic at the programmatic and operational levels once the final ceilings were set by the Cabinet, which undermined the credibility of the process. However, the ceilings adopted by the Cabinet for the period of 2008/09-2012/13 (SY1387-1391) should facilitate the budget preparation processes of the ministries in the coming years. Furthermore, it should be stressed that the delay in setting ceilings for the Development Budget often has been the result of a lack of timely communication from the side of some donors with regard to their spending priorities.

With regard to the program and provincial budgeting, three line ministries piloted the program budgeting for 2007/08 (SY1386) and seven ministries (including the Ministry of Finance) for 2008/09 (SY1387). Provincial budgeting intends to ensure that resources are spent more equitably across provinces, while program budgeting aims at ensuring that resource allocation is in line with stated policy objectives and priorities such as ANDS and at the same time introducing a process of measuring service levels and quality. The starting point was to integrate the Operating and Development Budgets into one budget structure, and - in order to ensure ownership and link the budgeting process directly to the ministerial strategies - this was coupled with program and provincial budgeting. The ministries have generally been positive towards and participated actively in the initiative, though some ministries lacked the necessary capacity since it requires both specialized skills (often being provided by international consultants) and substantial personnel time (also since the pilot ministries have had to prepare both the conventional line-item based budget and the new program budget). It appears that there, at least with regard to some line ministries, has been a lack of consultation, preparation and staff training. Furthermore, although program budgeting can offer improvements over traditional line-item budgets in terms of results-orientation, the question is whether the timing has been right. Apart from thorough prior planning and capacity building, the introduction of program budgeting requires a relatively advanced state of performance management being in place - since the development of good performance measures, including output and outcome indicators, is a necessary precondition for program budgeting - but that does not currently exist in all ministries, which potentially weakens quality and potential benefits. Moreover, introducing program budgeting before the foundations for ordinary budgeting, accounting, reporting and monitoring are fully in place risks undermining the overall development of the budgetary and financial management of the administrations. Program budgeting is planed for roll-out in a further ten line ministries for 2009/10 (SY1388). The Ministry of Finance is planning to hold a conference for members of the National Assembly to inform about the link between policy development and budgeting, the national budget process as well as program budgeting.

(iii) Timely Budget Approval by Legislature

The parliament has only been involved in deliberating and approving the national budgets for 2006/07 (SY1385) and 2007/08 (SY1386). The deliberations on the budget for 2006/07 were extensive, to some extent reflecting that the process itself was recently established and new to the participants, and the budget approved in mid-June almost three months into the fiscal year. The 2007/08 (SY1386) budget was approved about four weeks into the fiscal year, on April 16 2007, which was a noteworthy improvement. However, since the budget execution process cannot commence until the budget is approved, delays should be avoided as they lower actual spending, especially of the Development Budget.

PI-12: Multi-Year Perspective in Fiscal Planning, Expenditure Policy and Budgeting

Rating 3 (improved from 1+ in the 2005 PEFA): A medium-term outlook in the budget process is necessary to ensure the longer-term sustainability of fiscal policies. This indicator therefore 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. The rating for the first dimension (Multi-year forecasts) is "2" because fiscal forecasts are prepared for at least two years on a rolling basis though the link with the subsequent setting of annual ceilings is not clear. The rating for the second dimension (Debt sustainability analysis) is "4" since analyses have been prepared for the external debt annually for the past three years (as mentioned, analyses of domestic debt are not currently relevant). The rating for the third dimension (Costed sector strategies) is "3" since costed strategies only exist for some sectors and for 2008/09 (SY1387) cover just around 26 percent of the Core Budget. The rating for the fourth dimension (Linkages between investments and operating budgets) is "2" because - although linkages have been created for those areas where costed strategies exist (education, health and roads) - they are generally weak. The overall rating for this indicator is therefore "3".

(i) Multi-Year Fiscal Forecasts and Functional Allocations

The PFEM Law states that the preparation of the annual budget must be based on a multi-year framework and that the revenue and expenditure plans must cover at least three years. The Ministry of Finance developed the first Cabinet-approved Medium Term Fiscal Framework (MTFF) in October 2005, which was used in preparing the "Fiscal Strategy and Budget Framework Report" for the 2007/08 (SY1386) budget. The MTFF is now being updated twice a year.

The MTFF in November 2007 covers 2008/09-2012/13 (SY1387-1391). Revenue projections are from the Revenue Department and IMF together with grants estimates by the Budget Department. On expenditures, the Operating Budget was projected for each primary budgetary entity based on existing expenditures on salaries (with additional recruitments for specific sectors), goods and services as well as capital. This resulted in specific budget forecasts for each budgetary entity for the period 2008/09-2012/13 (SY1387-1391) (comparisons were not made to costed sectoral or ministerial strategies). The applied macroeconomic assumptions used in projections, e.g. inflation and nominal GDP growth, were aligned with the aims of the IMF-supported PRGF program.[18] The Development Budget is based on the commitments made by donors for the upcoming year though these figures may not in all cases be fully reliable.

(ii) Scope and Frequency of Debt Sustainability Analysis

Assessments of debt sustainability are important to provide guidance to borrowers and lenders, and are vital in the budgeting process of the National Government to forecast future deficits and financing requirements. In the case of Afghanistan it is currently only relevant to assess the external debt since domestic debt is basically non-existent.

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[18] IMF (2007) "Islamic Republic of Afghanistan: Enhanced Heavily Indebted Poor Countries Initiative-Decision Point Document and Debt Sustainability Analysis" IMF Country Report No. 07/253

Debt sustainability analyses of Afghanistan's external debt have been carried out annually for the past three years. In 2005 and 2006 by the IMF,[19] and in 2007 jointly by the World Bank and IMF as part of the so-called Enhanced Heavily Indebted Poor Countries (HIPC) Initiative.[20]

Debt management is, in accordance with the PFEM Law, carried out by the Treasury Department. However, analytical capacities to undertake effective debt management are currently insufficient to undertake it independently and a modern debt database and reporting system is yet to be acquired (though the Paris Club scheduling agreement and the Enhanced HIPC Initiative have facilitated efforts to rebuild creditor records). Capacities must thus be developed significantly to ensure that the debt is managed in a sustainable manner and that coordination within the Ministry of Finance between debt management and macroeconomic policy is improved and with gradually less dependence on support from the IMF and the World Bank.

(iii) Existence of Costed Sector Strategies

The first assessment of recovery and reconstruction needs in Afghanistan on a sector-by-sector basis was undertaken in January 2002,[21] while the first tentative costed sector strategies were prepared as part of the so-called SAF report.[22] However, only recently and as part of the 2008/09 (SY1387) budget process have actual costed sector strategies been developed. They have a five-year perspective and include both operating and development expenditures, and cover the areas of education (sector), health (sector) and roads (sub-sector of transport). Bottom-up and top-down approaches are used for the estimations. The three costed strategies include operating and development expenditures, estimated to cover approx. 26 percent of the 2008/09 (SY1387) Core Budget, but differ quite significantly from the MTFF fiscal forecasts of the entities that the sectors cover. The government plans to implement costing of the Security, Infrastructure and Natural Resources, and Social Protection sectors by June and others by November 2008.

(iv) Linkage between Investment Budgets and Forward Expenditure Estimates

The ongoing integration of the operating and development budgets has been largely driven by the need to ensure that the operating cost implications of capital investments are identified, calculated and included in forward budget estimates. Strategies have been developed for all sectors as part of the ANDS process but are not fully operationalized so as to be used as a basis for selecting investments, partly since the strategies are not all costed, cf. above. It will thus take some time before all investments can be meaningfully selected on the basis of specific sector strategies.

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[19] IMF (2005): "Islamic Republic of Afghanistan: Selected Issues and Statistical Appendix." IMF Country Report No. 05/34; IMF (2006): "Islamic Republic of Afghanistan: 2005 Article IV Consultation and Sixth Review under the Staff Monitored Program." IMF Country Report No. 06/113.

[20] IMF (2007): "Islamic Republic of Afghanistan: Enhanced Heavily Indebted Poor Countries Initiative-Decision Point Document and Debt Sustainability Analysis." IMF Country Report No. 07/253.

[21] ADB-UNDP-WB (2002): "Preliminary Needs Assessment for Recovery and Reconstruction".

[22] GoA et al (2004): "Securing Afghanistan's Future - Accomplishments and the Strategic Path Forward." Chapters 2 and 3.

Linkage between investments and their operating cost implications remain weak. In many cases budgeting of development projects remains a separate process and forward budget estimates are rarely included in the costing, though some ministries are further in this process than others. However, there exists no full overview with regard to the operating expenditures required for all existing and planned capital projects, also since consolidated information is lacking with regard to the External Budget.

The preference of many donors to fund development projects rather than operating expenditures through budget support, coupled with the general lack of calculating recurrent cost implications, significantly decreases the possibility for future fiscal sustainability on the national budget level, and it thereby risks undermining the actual value of some current donor-financed investments. Comprehensive Public Investment Programs (PIPs) as frameworks for investment programming and specific project selections are therefore needed so as to take the future annual capital and recurrent expenditures into account when making investment decisions.

C (ii) Predictability and Control in Budget Execution

PI-13: Transparency of Tax Payer Obligations and Liabilities

Overall Rating 2 (Improved from 1+ from the 2005 PEFA): On the first dimension "clarity and comprehensiveness of tax liabilities", the rating is "2" since the existence of Income Tax Law and custom codes make the legislative framework relatively comprehensive and clear. However, as observed by recent changes in tariff policies, the government still has substantial discretionary powers. On the second dimension "taxpayer access to information on tax liabilities and administrative procedures", the rating is "2". Taxpayers have access to some information through, for example, Ministry of Finance website. However, taxpayers' coverage is still limited. On the third dimension "existence and functioning of a tax appeals mechanism", the rating is "2" since the revised Income Tax Law stipulates the appealing mechanism. The overall rating for this indicator is therefore "2".

(i) Clarity and Comprehensiveness of Tax Liabilities

The Income Tax Law[23] was published and gazetted in November 2005 after being revised twice. Afterwards, income tax manual was released in March 2006 based on an article in Income Tax Law. The Income tax manual aims at clarifying the application of the Income Tax Law. While the new law and the manual provide more clarity on tax liabilities, the application of fixed tax remains unclear. The new customs code (March 2005) provides the enabling legislation for implementing the revised tariff structure. In 2002, the customs tariff structure was complicated with 25 bands. Although the number of tariff band was reduced to six in 2004, it increased to 10 bands in August 2006. More importantly, in 2007, the government introduced ad-hoc changes in tariff rates, for example, on soft drinks and bottled water (from 20 to 40 percent) and selected raw/intermediate materials (from 2.5 percent to 1 percent). Decision making process as well as applicability of new tariff is of concern.

(ii) Taxpayer Access to Information on Tax Liabilities and Administrative Procedures

Information on the Income Tax Law, income tax manual and tariff codes are all available on the official Ministry of Finance website. In addition, Ministry of Finance has conducted public campaign including seminars and copies of all guides, tax law and tax manual have been distributed to all Mustufiats. However, lack of financial resources has prevented Ministry of Finance from fully disseminating information on tax.

(iii) Existence and Functioning of a Tax Appeals Mechanism

Article 94 of the Income Tax Law stipulates tax appeal mechanism and based on the article a relevant department was established in Ministry of Finance in September 2006. When the appeals unit was set up a press release was issued which was released to the print and electronic media. Also, Guide 11 was produced and forwarded to all Mustufiats and placed on the website. However, as there are no specific advertisements on the appealing mechanism, the usage of the system is very limited.

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[23] Amendment of the income tax law was submitted to parliament in March 2007. However, parliament has not yet approved the amendment.

PI-14: Effectiveness of Measures for Taxpayer Registration and Tax Assessment

Rating 2 (Improved from 1+ from the 2005 PEFA): On the first dimension "controls in the taxpayer registration system", the rating is "2". The number of registered taxpayers increased more than three times in three years. However, linkages with other government agencies remain very weak. On the second dimension "effectiveness of penalties for non-compliance with registration and tax declaration", the rating is "2" since Income Tax Law clearly stipulate it and LTO (Large Taxpayer Office) started to apply penalties. On the third dimension "planning and monitoring of tax audit programs", the rating is "2", since LTO has established and implemented regular audit. The overall rating is therefore "2".

(i) Controls in the Taxpayer Registration System

Article 91 of the Income Tax Law requires that "all individual persons, companies, and organizations which are required to pay taxes or customs duties, including social, non-profit, and welfare organizations that are withholding taxes from the salaries of employees or from rental payments are required to have a Taxpayer Identification Number (TIN). As of late 2007, around 70,000 TINs had been issued for six TIN offices throughout the country (improvement from 19,000 as of March 2005). All self-assessment tax payments made at the DAB have a TIN and in the Ministry of Finance the payment is recorded against that TIN in a spreadsheet). LTO and MTO (Medium Taxpayer Office) have 140 and 4,000 TINs, respectively. LTO established the identification unit in June 2007.

However, TINs are not linked with actual tax and are not linked with other government agencies. There is a plan to collaborate with AISA (Afghanistan Investment Support Agency) and the Ministry of Commerce which both deal with business registration and licensing. In terms of recording system, as there is no tax administration software actual recording is still on a paper basis (except for LTO where self assessment payments are recorded in a spreadsheet).

(ii) Effectiveness of Penalties for Non-compliance with Registration and Declaration Obligations

Chapter 16 of the Income Tax Law stipulates additional tax and tax penalties. However, except for LTO and MTO, enforcement of it for compliance is weak.

(iii) Planning and Monitoring of Tax Audit and Fraud Investigation Programs

The new revenue systems have been shifting to rely on self-assessment by taxpayers from collections through Mustofiats. In recent years, BRT (Business Receipt Tax) (2005) and income dividend (2006) had adopted the self-assessment system. Also self-assessment for wage withholding tax, rent withholding tax and income tax for legal entities in the LTO and MTO.

LTO has formulated a formal tax audit process. LTO has a committee, review regularly and conduct case management and risk criteria based on a point system. Furthermore, LTO began preparing an audit manual in November 2007 and this should be completed by the end of March 2008. In 2007, LTO completed 12 audits. MTO, which was operationalized in October 2007, will adopt the same audit process.

Risk criteria point system is based on 5 criteria with scales of 1-3 or 1-5 as shown in the examples below (Table 8):

Table 8: Risk Criteria Point System

Turnover	Future growth	Complexity	Industry business type	Compliance history	total	Example of taxpayer
3	0	5	5	5	**18**	A: high turnover, little future growth, high complexity, industry category as high risk, poor compliance history
3	0	0	5	0	**8**	B: high turnover, high risk industry type, yet good compliance history
1	3	2	4	5	**15**	C: moderate turnover, moderate future growth, medium risk business poor compliance history

Source: Ministry of Finance

PI-15: Effectiveness in collection of tax payments

Rating 1+ (Same as in the 2005 PEFA): On the first dimension "Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during the fiscal year (average of the last two fiscal years)", the rating is "1" since there is little data on tax arrears and effective enforcement mechanism. On the second dimension "effectiveness of transfer of tax collections to the Treasury by the revenue administration", the rating is "3", since revenue collections are transferred to TSA at least weekly. On the third dimension "frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury", the rating is "1" due to the fact there is no integrated computer system to reconcile tax assessments, collections, arrears and transfers to Treasury. The overall rating for this indicator is therefore "1+".

(i) Collection Ratio for Gross Tax Arrears, being the Percentage of Tax Arrears at the Beginning of a Fiscal Year, which was Collected during the Fiscal Year

In Afghanistan, the tax gap should be extremely large- broadly this is the difference between the current tax level, around 7.5 percent of GDP in 2006/07 (SY1386), and the potential is assumed to be closer to 11 percent of GDP[24]. There are few statements on arrears in the Income Tax Law and is little effective enforcement mechanism to collect tax arrears. In other words, except for LTO which handles 140 accounts, the Ministry of Finance cannot precisely identify tax payments. This must have resulted in significant accumulation of tax arrears, although precise figures are unknown.

(ii) Effectiveness of Transfer of Tax Collections to the Treasury by the Revenue Administration

The Treasury Single Account (TSA) was established in 2004. The TSA helps to integrate Government accounts into an account or set of linked accounts through which the Government collects revenues and transacts all its payments. Revenue transfer to the TSA is on a daily or weekly basis depending on the distances from provinces. Currently, around 85 percent of revenues is transferred to the TSA on a daily basis.

(iii) Frequency of Complete Accounts Reconciliation between Tax Assessments, Collections, Arrears Records and Receipts by the Treasury

Reporting on tax collection is done monthly by the revenue department and Treasury. The revenue authority and the Treasury generally report on revenue collections and reconcile the cash balance with collection reports. Tax assessments are done only by LTO but not Mustufiats nor MTO.

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[24] World Bank (2005) Afghanistan: Managing Public Finances for Development Volume III, Chapter 1, p.10

PI-16: Predictability in the Availability of Funds for Commitment of Expenditures

Rating 3+ (improved from 1+ in the 2005 PEFA): Predictability in the availability of funds is critical for line management to operate effectively. On the first dimension (forecast and monitoring of cash flows), the rating is "4" because cash flows are prepared for the fiscal year and updated monthly on the basis of actual cash movement. On the second dimension (reliability and horizon of periodic in-year information), the rating is "3", since the Budget Units of MDAs (ministries, departments and agencies) are able to plan and commit expenditure at least quarterly in advance in line with the budgeted appropriations. On the third dimension (frequency and transparency of adjustment), the rating is "3", as significant in-year budget adjustments to appropriations above the Budget Units take place only once or twice a year. The overall rating therefore is "3+".

The PFEM Law and the annual budget decree establish the budget's role as the single authority for expenditures, through appropriations for expenditures and ceilings to public employment. This legislation is also clear that the Ministry of Finance has the sole authority, through the granting of allotments, to authorize the budget units to commit to expenditure against the annual budget. The objective of these mechanisms is to support budget execution within cash resources of the government and to provide a predictable flow of cash to executing units. The PFEM Law also provides the Treasury Department with full control over public banking and cash and calls for all receipts to be turned over to the Treasury. The Treasury and provincial Mustofiats are the sole authority to control the flow of core budget expenditure payments from official Government accounts. Hence the authority for keeping expenditure commitments in line with resources is in place[25].

(i) Extent to which Cash Flows are Forecast and Monitored

Since the end of 2004, forecasts of all cash inflows and outflows under the operating budget are set out for each fiscal year and updated monthly. On the operating expenditures, forecasts do not arise from procurement plans but rather from prior year's pattern by month. The difficulty in establishing the pattern of expenditures from a prior year is now resolved because since 2005/06 (SY1384) recording by month is no longer affected by delays in submission of provincial expenditures. Expenditure forecast for the development budget is determined from the allotments since these relate to specific contracts.

Revenue information is initially taken from the Government's fiscal targets and distributed over the year based on previous year's experience. In the monthly updates, the forecast for the remaining months is kept so any shortfall from the initial forecast is reflected in a shortfall in the year's total and considered by management in evaluating the overall cash position.

Donor contributions to the operating budget and other budget support contributions are determined based on the remaining undisbursed balance of the agreed total financing for the current year where it seems likely that conditions will be met. Donor contributions to the development budget are assumed to be equal to the expenditures planned against these non-discretionary loans and grants as there are binding arrangements with the donors for this financing.

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[25] The execution of the External Budget, the part of the budget that is not implemented by the government, is more difficult to assess because reporting on these activities is limited to disbursements, and is not considered herein.

The opening cash position for the forecast is determined timely and reliably as the Treasury uses the information available in AFMIS which is updated daily and consolidates all the Government's cash balances.

(ii) Reliability and Horizon of Periodic In-Year Information to MDAs on Ceiling for Expenditure Commitment

For the Operating Budget, annual ceilings for budget are given in the annual budget to specific organizations (Budget Units) and specific major expenditure codes and for the Development Budge, to specific organizations, specific funding sources and programs and specific major expenditure codes.

For the Operating Budget, the Budget Units propose a quarterly distribution to the sub-budget units for each major expenditure code which are reviewed by the Budget Department of the Ministry of Finance following consultation with the Treasury Department on the availability of funds. Allotments, however, may not reflect the quarterly pattern of expenditures as they are usually set at 25 percent of the annual appropriation regardless of expenditure patterns. Allotments can therefore constrain expenditures where the expenditure pattern does not follow the 25 percent per quarter distribution allowed by allotments; but in this case amendments are made within the quarter.

Before each quarter, total allotments are set after the Treasury determines their Monthly Cash Meeting the level of cash available. On this basis the Budget Department authorizes Budget Unit allotment requests. Once approved by the Ministry of Finance the allotments are entered in AFMIS and funding is guaranteed. The 2005/06 (SY1384) Budget Decree has established AFMIS as the sole source of allotment information to address this issue.

Treasury meets the disbursements for these allotments from the central Treasury Single Account (TSA) or transfers sufficient funds to Mustufiats for the allotments made to the specific province by the line ministries. Transfers to the province are made on the basis of estimated expenditure needs derived from the approved allotments for the provincial offices of the line ministries for the quarter. All approved allotments appear in the monthly AFMIS reports which are distributed to both the line ministries and the Provincials Mustofiats. Earlier problems of conflicting allotment figures at the provincial level have been effectively eliminated by making the allotment figures entered in AFMIS the sole and final authority for expenditure commitment.

Core Development Budget expenditures, on the other hand, have funds allotted for the entire amount of the current's year disbursement of a related contract. These allotments are granted once the funding is ascertained by confirmation with the donor, if applicable, and once a contract is ready. After this point, the funds, both for projects with Special Accounts and those financed out of the discretionary pool of funds, are effectively blocked and guaranteed for the specific contract. All core development budget disbursements are processed centrally through the Special Disbursements Unit of the Treasury. The respective Project Units are responsible for requesting timely advances or replenishments to the Special Accounts. Similarly, the status of the execution and allotments for the year appear in the monthly AFMIS reports and, as such, the Project Units have sufficient and timely information to ensure adequate cash flow.

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

Appropriations expressed in the budget law are made to primary budgetary units (the ministries). Many adjustments, within the authority of the Budget Units, are 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 and provided allotments before use. Annexes to the Budget Decree specify the uses permitted and who has the authority over each fund; the contingency funds must be transferred to organizational units to be spent. Since mid-FY 2003/04, the Government has prepared a major mid-year review which seeks to reallocate budgets when appropriate. Where the executive's authority is surpassed, i.e. ceiling of budget is raised or reassignment among ministries exceeds five percent, the revised budget is sent to Parliament[26]. Otherwise there are no revisions to the appropriations.

These adjustments to the appropriations as well as the modifications to allotments are done once a month and are input to AFMIS so all units have a single comprehensive reference for the allotment amounts. These frequent adjustments are within the authority of the Budget Units; changes above the Budget Unit are only done at the mid year review (outside of the use of contingency funds).

It was noted that the use of a year-end decree to regularize expenditures over appropriations, used in prior years and which indicates that there are uncontrolled within-year deviations from allotments, was not necessary for the most recently closed fiscal year (2006/2007).

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[26] This was necessary for the 2006/07 (SY1385) mid year but not 2007/08 (Sy1386).

PI-17: Recording and Management of Cash Balances, Debt and Guarantees

Rating 3+ (improved from 2+ in the 2005 PEFA): Good cash balance, debt, and guarantee management are required to make most effective use of public financial resources, avoid unnecessary costs, and guarantee predictability and sustainability. The rating is "3" on the first dimension, "quality of debt data and reporting" as domestic and foreign debt records are up to date and reconciled monthly. The rating is "3" on the second dimension, "extent of consolidation of the Government's cash balances", because, there is daily calculation and consolidation of government cash balances although a number of provincial accounts are reconciled and consolidated only monthly. The rating is "4" on the third dimension, "systems of contracting loans and issuance of guarantees", since the system for loans is transparent and effective (with authority given to the Ministry of Finance and policies set in the Budget Decree). Overall, the rating is therefore "3+".

(i) Quality of Debt Data Recording and Reporting

The debt register is an Excel spreadsheet application used to record loan terms, movement on principal and debt service, and the running balance payable maintained in the currency of the liability. Through the debt reconciliation work under the HIPC process of early 2007, the Debt Management Unit (DMU) established the current debt position. While the DMU does not participate in the negotiation of all new lending, the DMU tests all new debt terms to ensure compliance with the financing policy which stipulates a minimum of 60 percent grant element. The DMU also receives a copy of all loan executed agreements which are the basis for establishing a new entry in the debt register. The register is updated for new disbursements from the advices received from creditors and from consulting the web sites of the creditors where all disbursements on specific loans can be viewed. This is complemented by confirmation with the Da Afghanistan Bank (DAB) on receipt of the disbursement where applicable.

Recording in the accounting of the Treasury department, however, is not initiated by the DMU and may or may not coincide with the movement reported in the DMU but these are reconciled quarterly, albeit on a cash basis. Debt service payments are initiated in the DMU; these are prepared manually outside the register and are not recorded in the register until DAB and the creditor confirms payment. Again, these are recorded separately in Treasury accounting and not integrated with the debt register. There is no automation under the debt register for budgeting of debt service for existing loans, forecasting for new loans and disbursements, analysis under different scenarios, or query reporting and costing. Similarly, the system does not offer the requisite data integrity or audit trails to support integration with AFMIS or reliance on its reports without manual verification. Under the HIPC initiative the Ministry of Finance has agreed to implement to establish a database system on external public and publicly guaranteed debt.

In October, 2005 a debt strategy was completed. The Ministry of Finance has never conducted a debt sustainability analysis itself, but such analysis has been conducted by the IMF (which suggests that the level of debt will remain sustainable if there is strong economic growth, complete forgiveness of all old debt and claims, robust increases in revenues, and external assistance overwhelmingly in the form of grants).

(ii) Extent of Consolidation of the Government's Cash Balances

Cash management is the responsibility of the Treasury, although much of its execution depends upon Mustofiats. The main tools for cash management are the Treasury Single Account (TSA) in the DAB and the integrated financial management system (Afghanistan Financial Management Information System- AFMIS) under the Treasury. These operate under a policy of no overdrafts (deficit financing by the Central Bank) and the use of budget support concessionary terms loans from multilateral financial institutions to finance the shortfall between planned operating expenditure and domestic revenue.

In line with the Financial Regulations, all public revenues, for the general government sector, are transferred to the TSA including cash collected by the Treasury and by agencies, and deposits made to the DAB relating to tax collection.

The Cash Management Unit in the Treasury prepares daily reports on available cash balance (Available Cash Balance Report) which present the daily movement of all discretionary funds. Discretionary funds are those which are not tied by contract with donors to specific inputs and as such can be assigned to any budget need; the report provides the opening bank balance, receipts, payments and ending available balance. Unfortunately, the report does not include the state of advances to budget units which comprise another source of cash and need be considered.

(iii) System for Contracting Loans and Issuances of Guarantees

Authorization and negotiation of debt is the responsibility of the Ministry of Finance, with new debt specifically authorized through provisions in the annual budget law. For new debt 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. The PFEM Law specifies that the annual budget documentation should include how the annual appropriations will be financed and designate a maximum amount of borrowing and guarantees that can be made. DMU is also the repository for the debt legal agreements. The 2007/2008 (SY1387) budget document presents a comprehensive list of loans with terms, committed amount, disbursed amount and balance. As the Government has a debt strategy and loans are included in the budget documents then transparent criteria is obviously used in regard to contracting of loans.

Following the work in preparation for the HIPC submission to the World Bank Board, most debt is fully reconciled with creditors; at least one creditor, however, with a balance under US$100 million is still to be reconciled. The Government is not granting any loan guarantees; the poor state of financial control over SOEs does not allow any conclusions to be drawn on the existence or amounts of guarantees issued on loans taken by these.

PI-18: Effectiveness of Payroll Controls [27]

Rating 2+ (improved from 2 in the 2005 PEFA): Wages and salaries is the largest cost element in the operating budget, representing more than 60 percent of the operating budget. On the first dimension (degree of integration and reconciliation), the rating is "3", as the payroll is supported by full documentation for all changes made to personnel record. On the second dimension (timeliness of changes to personnel and payroll), the rating is "3", as changes are updated monthly. On the third dimension (internal controls of changes), the rating is "3", since authority for changes are clear and oversight compliance is applied. On the fourth dimension (existence of payroll audit), the rating is "2" as no comprehensive audits were undertaken within the last three years. The overall rating is therefore "2+".

Controls exist over payroll expense in aggregate through Tashkeel and the allotments. Personnel and payroll processing are decentralized; this facilitates timely changes to personnel records although reconciliations between personnel records and the payrolls are done manually. The implementation of the verified payroll program has provided good assurance that payroll goes to bona fide employees but this program has not expanded in coverage to provide sufficient assurance. Similarly, the ARTF Monitoring provides some oversight but only on the non-uniformed payroll costs. Lastly, no effective partial payroll audits have been during the last three years and in light of the decentralization of payroll processing regular comprehensive audits should be carried-out.

(i) Degree of Integration and Reconciliation between Payroll and Personnel

The Independent Administrative Reform and Civil Service Commission is responsible for oversight of appointments and promotions (for positions at grade two and above), civil service management, and administrative reform. Every public employee has a personnel grade. Civil servant wage rates and pay policy are established centrally for all public employees in Afghanistan. Two base pay scales - one for contract staff and another for permanent staff - apply equally everywhere in Afghanistan. There are separate pay scales, however, for teachers, the army, and police. In addition, several new programs allow higher pay rates, based on a clear vision of core responsibilities, structural reorganization, and merit-based appointments. The Government has begun introducing a new pay and grading program which addresses the excessive concentration of the current scales and to improve compensation.

(ii) Timeliness of Changes to Personnel and Payroll

Historically, the line ministries held personnel files for all staff, but since these are no longer maintained and since the ministries do not have information on the position and grade for all hiring, the payroll is prepared from the personnel and attendance records maintained by the individual budgetary units. Some Mustofiats prepare payroll for many of the Provincial Budget Units. All payroll payments and accounting are processed by the Treasury (Head Office or Provincial Offices) and recorded in AFMIS. This decentralization of personnel management and payroll preparation supports timely updating of personnel records and facilitates the timely related updating of payrolls.

[27] "Fiduciary Oversight of ARTF Funded Recurrent Costs" (World Bank, 2008) further explains a payroll issue.

Nowhere in the government is payroll preparation integrated with personnel files. As of November, 2007 payroll for a total of 88,000 employees was processed in automated payroll systems with an interface to an identity card database. Payroll for the balance of the civil and other services in the public services are calculated manually.

(iii) Internal Controls of Changes to Personnel Records and Payroll

Controls over payroll are based first on Tashkeel 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 only determined through a database kept in the Ministry of Finance by the ARTF Monitoring Agent on the basis of summary reports of monthly payrolls in the provinces and detail reports provided by the Kabul ministries which accompany the payroll payment requests.

All payroll payments and accounting are concentrated under the Treasury. The Treasury establishes that payroll payment requests are supported by quarterly budget allotments for specific Budget Units, that the payroll request is properly supported by a payroll journal and this is duly approved by the responsible Budget Unit authorities. The Finance Controllers, who are employees of the Treasury or provincial Mustofiats, review in detail the payment request for payroll and support for 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.

In the Budget 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 Budget Unit Head for staffing increases and employment contract. Although there is no automated reconciliation by Treasury or the Budget Units of changes in payroll and changes in staffing or pay levels, manual checks ensure that changes in payroll are linked to authorized changes in the personnel records.

(iv) Existence of Payroll Audits

Since the controls are manual and, personnel and payroll processing is decentralized, there is a critical need for centralized controls on the application of controls. The Government established two independent reviews of payroll costs for this purpose. The first is the verified payroll program which the Ministry of Finance 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 Central Bank; and
- Stage 3: direct deposit to employee bank accounts. This program covers at present only 88,000, including uniformed and non-uniform government personnel, of the current year's average staffing level of 341,000 staff, that is only one in four employees.

The other review is ex-post and is carried out by the ARTF Monitoring Agent who conducts site visits throughout the year to the Budget Units and, on a sample basis, verifies payroll journal entries to the attendance records, personnel files and witnesses. This review is limited to the non-uniformed personnel who comprise 67 percent of staff in 2007/08 (SY1386) but verification of additions in many provinces is hampered by security concerns.

Internal audit is not conducted to any known standard in the line ministries and just got underway in late 2007 in the Ministry of Finance. External audit is performed by the CAO however most payroll in incurred under the recurrent budget where the audit, outside of the expenditures funded by the ARTF and LOTFA, is not yet done to an acceptable standard.

PI-19: Competition, Value for Money and Controls in Procurement [28]

Rating 3 (improved from 2/3 in the 2005 PEFA): As significant public spending takes place through the public procurement system, a well-functioning procurement system ensures that money is used effectively and efficiently. On the first dimension (Use of open competition) the rating is "3". Although the absence of relevant data is of concern, more than 90 percent of contract through ARDS-PU (Afghanistan Reconstruction Development Service) follow open tendering. On the second dimension (Justification for use of less competitive procurement methods) the rating is "3" because the discretion of individual entities and procurement officials is reasonably controlled to minimize the use of methods that limit competition by the Procurement Law. On the third dimension (Procurement complaint mechanism), the rating is "3" since a procurement complaint mechanism is operative. The overall rating is therefore "3".

(i) Use of Open Competition for Award of Contracts that Exceed Nationally Established Monetary Threshold for Small Purchases

The Procurement 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 (Article 23), Restricted Tendering (Article 24) and Request for Quotations (Article 27). The permissible procurement method for procurement of consultancy services is Request for Proposal (Article 26).

The Procurement Law makes open competitive tendering the default method of procurement (Article 23). The assessment of Compliance Performance Indicators (CPIs) in Afghanistan faced the challenge of absence of relevant data. The sample data available from ARDS-PU was not considered representative because it presents the most ideal situation of procurement being conducted with facilitation and support of an international consulting firm. The sample data attempted from other procuring entities lacked coherence and assimilation of the purpose of the assessment.

The available data indicates that 94 percent of contracts procured by ARDS-PU followed open tendering. The threshold prescribed for request for quotations is very low (US$ 5,000 for goods US$ 10,000 for works) in Afghanistan. The contracts of procuring entities also mostly follow open tendering method. However there is a feeling that this is resulting in delays in procurement of small contracts and there is a need to revise the threshold upwards for open tendering.

[28] Report on Assessment of National Procurement Systems produced by Procurement Policy Unit of Ministry of Finance (September 2007) is also available.

(ii) Justification for Use of Less Competitive Procurement Methods

The Procurement Law prohibits fractioning of contracts to limit competition (Article 18). The standards of international competitive tendering are specified in the Law and are consistent with international standards. 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.

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 in the Law 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.

(iii) Existence and Operation of a Procurement Complaint Mechanism

The Procurement 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 mechanism has been put in place only from April 2007. In case of complaints received earlier, responses were issued in time. Formal process prescribed now has seen only one case for which a response was issued. A need for wider dissemination of the review opportunity is felt.

PI-20: Effectiveness of Internal Controls for Non-Salary Expenditure

Rating 2+ (improved from 2 in the 2005 PEFA): On the first dimension (effectiveness of expenditure commitment controls), the rating is "3", as expenditure commitment controls are in place in particular in the treasury department. On the second dimension (comprehensiveness of other internal control rules), the rating is "2", since other internal controls and procedures consist of a basis set of rules for processing and recording transactions. On the third dimension (degree of compliance), the rating is "2", because rules are complied with in a majority of transactions but exceptions arise principally around procurement. The overall rating therefore is "2+".

(i) Effectiveness of Expenditure Commitment Controls

The PFEM Law, along with its regulations, assigns the Budget Unit responsibility for controls in their operations, including expenditure commitment control. The Treasury Department is given the responsibility for centralization of government accounts, cash management and expenditure control.

AFMIS has been operating in the Treasury Department since 2002. AFMIS using FreeBalance software, supporting cash based accounting, was initially configured to accept expenditure information and to produce checks but now handles all data entry and check runs for the Ministry of Finance and line ministries in Kabul. It records, in summary, the operations of the Mustofiats based on their monthly reports on expenditures and revenues. The structure of AFMIS enables recording of the Approved Budget, Primary Budget Unit (PBU) allotments, and location allotments. The system provides facilities to ensure the control for making within the approved budget and expenditures within allotments.

Expenditure commitment controls for the operating budget depend on the controls of each Budget Unit and differ for the operating and development budgets. Problems have arisen here where discretionary expenditures are incurred and utilities invoices go unpaid. For the development budget, the Budget Department authorizes an allotment for each contract for the estimated disbursements or letter of credit to be issued in the budget year. AFMIS's automated controls ensure that commitments do not exceed allotments, which relate to cash availability, and that the total commitment (contract value) is not exceeded with disbursements against it. For both operating and development budget expenditures, the Ministry of Finance delegates in line ministries, the Financial Controllers, review and approve check requests before they are sent to Payments in Treasury of the Provincial Offices of the Ministry of Finance. The review is affected against the AFMIS report of allotments issued by Treasury monthly, and reconciled by the line ministries to their allotment authorizations sent to the Ministry of Finance. This has advanced greatly from 2005 when stand- alone individual allotment authorizations of the line ministries were used.

(ii) Comprehensiveness, Relevance and Understanding of Internal Control Rules and Procedures.

The PFEM law and regulations along with circulars from the Treasury provide a comprehensive framework for internal control as roles and authorities are made clear and the procedures for transaction processing are provided. Also, transactions are processed using the same forms which have been in use for years and as such the procedures are well know. Serious misunderstanding arises, however, in the case of procurement where a new legal framework was introduced in 2005 but the civil service training in the new law just got underway in 2007.

(iii) Degree of Compliance with Rules for Processing and Recording Transactions

As regular internal audits done to an acceptable standard only got underway in 2007, and just for the Ministry of Finance, there is not a full record from which to judge compliance. This independent review of compliance is provided, however, by the ARTF Monitoring Agent whose representatives review the processes following for non-security expenditures. Their review helps to verify compliance with procedures and witnesses evidence of services or goods received. The ineligibility rate on goods and services in 2006/2007 (SY1385) came to 35.4 percent. Their sample, however, is biased to focus on the high risk units and high value transactions. The main cause (60 percent of ineligibility) was failure to follow the current procurement rules.

The degree of compliance with finance procedures can be inferred from the results of the Ministry of Finance review of payment requests, form M-16 (Table 9). The error rate incurred by ministries and agencies in Kabul on the submissions of M-16 (payment requests) to the Treasury has been improving over time and in the current year is down to 6.7 percent.

Table 9: Error Rate on Submissions to Ministry of Finance

Solar Year	2006/2007	2007/2008
Check Request	21.7	6.7
ARTF M.A.	35.4	Not yet determined

PI-21: Effectiveness of Internal Audit

Rating 2 (same as the 2005 PEFA): Regular and adequate feedback to management is required on the performance of the internal control systems through an internal audit function. On the first dimension (coverage and quality of the internal audit function), the rating is "2", as internal audit is operational for most of central government entities and a systems review was conducted for the Treasury in 2007. However, other than the Treasury review and internal audit in the Ministry of Finance, the work does not meet recognized professional standards. On the second dimension (frequency and distribution of reports), the rating is "2", as audit reports are distributed to the corresponding line ministry with summaries provided to the CAO but no copies provided to Ministry of Finance. On the third dimension (extent of management response to internal audit findings), the rating is "2", as major findings are acted upon but generally there is little formal follow-up of audit recommendations. The overall rating is therefore "2".

Monitoring of the internal control system is in place in the Ministry of Finance and through the extraordinary arrangements relying on the Financial Management Advisor in the Treasury Department and Procurement Advisor to ARDS. The Internal Audit Department of the Ministry of Finance reviews the internal control systems in place and reports on any control weaknesses. The ARTF Monitoring Agent also monitors compliance with control via transaction reviews but in 2007 it evaluated the internal control system in the Treasury Department where all accounting and payments are concentrated.

(i) Coverage and Quality of Internal Audit Function

Internal audit in the Ministry of Finance has advanced considerably since 2005 and is working at an acceptable standard although this has not impacted the rating since this unit does not represent 50 percent of internal audit staff time.

Legal and Institutional Framework: The Control and Audit Regulation provides for the internal audit function as part of the line ministries' organization and calls for coordination with the external auditors. On the other hand, the PFEM Law calls for the Ministry of Finance to establish an internal audit function and appoint internal auditors in the budget units. The regulation to the law outlines the tasks and authorities of the internal audit units as well as reporting and follow-up procedures. However, a recent commission under the Ministry of Justice has determined that the audit units in these units will not report to the Ministry of Finance but rather operate in line with the CAO Law. In view of this decision by the Ministry of Justice, the Internal Audit Department of the Ministry of Finance audits only the Budget Units of the Ministry of Finance and only the work of the Financial Controllers, who are delegates of the Treasury Department in the line ministries. There are Internal Audit Departments in most ministries. Each Internal Audit Department is organized along similar lines and is under the control of an Audit Director, with separate audit units for: Relations - to co-ordinate and supervise audit work; Planning - to plan audit work; Analyses - to carry out analysis of the work done by the audit groups; Audit Groups - to carry out the financial and accounting audits.

Audit Activity: Audits are carried out on all entities on an annual basis. Audit plans are submitted to the CAO to coordinate efforts across departments and prevent duplication of work. A Director in the CAO is tasked with coordinating work with the Internal Audit Departments. Internal audit work is focused on the identification of irregularities and the investigation of potential corruption and fraud. However, until now in none of the ministries except the Ministry of Finance, there are audit plans based on risk-related factors. Reviews of internal control processes are not carried out by the internal audit units, with the exception of the Ministry of Finance, so the external audits carried out by the CAO place no reliance on the work done by the Internal Audit Departments.

In the Ministry of Finance, on the other hand, the Internal Audit Department carries out audits under risk based audit plans and during the audit, reviews of internal control processes are carried out. The Internal Audit Department was reorganized in 2005 under the PRR and expanded from a staff of 18 to 127 today. The expansion comprised new merit based recruits who have all been trained in basic accounting and auditing. In 2007/08 (SY1386) a first round of risk based reviews took place employing new audit practice tools developed by audit specialists hired under a World Bank technical assistance project (PACB). These audits are using modern risk-based approaches included in the internal audit manual which is based on Institute of Internal Auditors standards. The work is being carried out under the supervision of qualified auditors and is done to acceptable audit standards. This approach of in-house training and on-the-job training will be expanded to cover the major line ministries.

In addition to the work of the Internal Audit Units, the ARTF's Monitoring Agent provides reports to the Ministry of Finance with data on performance of line ministries with regard to compliance with fiduciary standards. Even though the mechanism should be seen as temporary, this work provides feedback to management on performance and progress in meeting these fiduciary standards. Additionally, in 2007 the ARTF Monitoring Agent was requested to conduct a review of internal control in the Treasury Department which has been largely completed and shared with management for follow-up.

Audit Capacity: With the exception of the Ministry of Finance, all Internal Audit Departments recruit staff from within their own Ministries. It is common for Internal Audit staff to have in excess of 20 years experience within the ministry concerned. Ministries carry out training themselves mainly through seminars to discuss problems and resolve issues. No formal academic or professional training in internal auditing is available in Afghanistan. Internal auditing manuals exist, but these are 30 years old and only refer to work methods and not to modern internal audit practices. The level of information technology knowledge and experience is this area is very low or non-existent, and there is no attempt to carry out internal audits using computed aided audit techniques.

The Ministry of Finance, on the other hand, recruited new staff under the PRR and they are being provided four months of certifiable class room training by an Afghan training institute. Thereafter the new auditors are placed under audit experts for On-the-Job training lasting four to five months. Internal Audit Manual for Ministry of Finance following IIA Guidelines has been prepared, and this contains modern work methods. This Department is in the process of hiring an IT Audit expert to develop computer aided audit techniques and to train specialist staff in those techniques

Therefore, the Internal Audit Departments in general cannot be regarded as independent they report to Deputy Ministers who are also responsible for the ministry's administration. They do not carry out work that would be considered to comply with recognized international internal auditing standards.

(ii) Frequency and Distribution of Reports

Reports of the reviews are provided to ministry management upon completion of each audit with summaries of audit results submitted to the CAO for information.

(iii) Extent of Management responses to IA findings

No formal follow-up or response procedure is followed however where a potential crime is identified, cases are passed to the Attorney General for legal action. Currently, however, every audit report from the Ministry of Finance Internal Audit Department contains audit observations and recommendations and a request to the auditee to implement the recommendations and confirm in writing action taken. Around 50 percent of the auditees reply but there is no formal system for follow-up. In subsequent audits of the same area the status of recommendations is reported. The Internal Audit Manual provides an adequate procedure for follow-up of audits although this is yet to be implemented. There is also good Government response and follow-up on the observations of the ARTF Monitoring Agent to address specific uses of budget funds which were disallowed, and also on the trends in quality of submissions which are tracked by unit.

C (iii) Accounting, Recording and Reporting

PI-22: Timeliness and Regularity of Accounts Reconciliation

Rating 3 (Improved from 2+ in the 2005 PEFA): Timely and frequent reconciliation of data from different sources is fundamental for data reliability. On the first dimension (regularity of bank reconciliations), the rating is "3" because bank reconciliation takes place at least quarterly, usually within four weeks after the end of each month. On the second dimension (regularity of reconciliation and clearance of suspense accounts and advances), the rating is "3" as the Treasury has established and implemented new procedures by which these accounts are cleared at least annually. The overall rating is therefore "3".

In Afghanistan, line ministries keep records of both their direct revenues, which is deposited into the TSA, and expenditure payments authorized via check requisitions. The accounting and payments, however, are concentrated in the Treasury for Kabul operations and with the Mustofiats for provincial operations. The accounting of these operations comprises the AFMIS records and the corresponding ledgers in the Mustofiats. The treasury circulates a report of revenues and expenditures from AFMIS to all line ministries monthly which is reconciled or confirmed by the units.

(i) Regularity of Bank Reconciliations

All bank accounts supporting the execution of the national core budget are under the control of the Treasury Department. These comprise the single treasury accounts for the ordinary budget and the accounts used for donor funded development projects. The single treasury accounts are reconciled daily and they are up to date with the provincial accounts reconciled monthly. Similarly, the special accounts for the development budget operations are reconciled monthly and are up to date as of December 2007. The reconciliation matches the AFMIS records and the bank statement information. There is a group of 10 accounts with limited activity which have some outstanding items. The treasury is corresponding with the DAB on the reasons for the differences. [29]

Advances: All advances are settled or written off at the end of each fiscal year. For the current year Afs.1,392 million were given in advances of which Afs.524 million were outstanding as of December 22, 2007, Afs.239 million is over 30 days.

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[29] There are 77 development budget bank accounts, these of 57, that have had activity in 2007/08 (SY1386), are reconciled monthly, the others are reconciled only at year end. Reconciliations are done using an Access data base to store the AFMIS (general ledger) bank records which are matched against a data dump of the DAB records per account. Adjusting entries have all been identified and most are booked within the month. The four TSA accounts at HQ are reconciled daily and are up to date. The 120 other accounts including the Mustofiats TSA and the tameenat (accounts for guarantees) are all, except for 10, reconciled up to the end of month 6.

Reconciliation to the Revenue Department and Line Ministry and Provincial Mustofiats Records: Revenues collected through the Mustofiats or line ministries are deposited directly to DAB and are recorded in revenue accounts, called Unclassified Revenue, in AFMIS as soon as these appear in the TSA revenue account. When the corresponding accounting by exact revenue code is received from the Mustofiats by report Form No.M29 or from line ministry by revenue voucher M27, a journal entry is affected to record the revenue in the exact revenue code. Revenue detail accounts are entered monthly as received from provincial Mustofiats together with the bank reconciliation statement. M27 revenue vouchers are reconciled with the receipts to the Treasury Single Account from line ministry revenue sub-accounts in DAB. Revenue Dept's has access to AFMIS and requests the Treasury to make book entries in case, if reconciliation brings up any differences.

Reconciliation of Central records with budget units' and provincial records: All budget units keep records of the expenditure allotments which they authorize and the checks they request for payment. The Treasury department issues AFMIS statement monthly for all allotments, ordinary and development budget payments for all budget units in the centre and requires confirmation or documentary proof for correcting entry in AFMIS. Every provincial Mustofiats prepares a M-23 or summary posting for all expenditure payments along with the (T8) expenditure bank account reconciliation statement and submits to the Treasury for entry into AFMIS. The Payment Unit and Accounting Unit in every provincial Mustofiats reconcile payment ledgers (M21) with expenditure ledgers (M20). Both are basis for reporting to the Ministry of Finance and line ministries on expenditures.

PI-23: Availability of Information on Resources Received by Service Delivery Units

Rating 1 (same as the 2005 PEFA): This indicator describes information on the provision of goods and services to front-line service delivery units which were intended for their use. Information on the receipt of resources by service units is critical. Overall, despite good information on Core Budget execution, the rating is "1" because there is no data collection on resources to service delivery units specifically.

All public spending under the control of the government is subject to the rules of the annual budget, which is expressed in appropriations and authorized through the allotment process under the responsibility of the Ministry of Finance. For the Core Budget, there is good information on what resources are received and incurred by level of administration, by central versus provincial departments and by type of budget unit within a ministry. However, service delivery units are not necessarily budget units, so the expenditure by these is not isolated in the chart of accounts although historical cost is available for any analysis with this vantage point.

Information from the Chart of Accounts does not specifically identify and classify expenditure by front line services units. AFMIS can produce budget execution reports on a COFOG basis, if the transaction vouchers are segregated accordingly. COFOG at the level of coding by class may provide a separation of actual expenditure data between administrative units and service delivery units. However, for the budget formulation and administration purposes, the government units are not segregated into groups of administrative and service delivery units. No COFOG level analysis is made during the budget formulation process.

With the introduction of program budgeting and the call for provincial level budgeting reporting changes are planned for the Chart of Accounts which may separate service delivery units. At present AFMIS reports by budget structure and by point of disbursement but not by area benefited.

Information on the receipt of resources by service units (at the facility or district level) is often lacking. Front line service units (e.g. primary schools) have little or no information on resources allocated to them (beyond employees) because the allotments are made only to the provincial level. Expenditure tracking by service delivery unit is being piloted along with program budgeting but over the last threes no expenditure tracking of front line expenditure by health units or by schools has been completed.

On the external budget, no verified information is provided by the Government on the extent to which reported disbursements are reaching the beneficiaries. There is no record of these expenditures in the Government accounting, and donor reporting on expenditures is limited to the Harmonized not regulated, monitored, or aggregated for management or external reporting.

PI-24: Quality and Timeliness of In-Year Budget Reporting

Rating 2+ (improved from 2 in the 2005 PEFA): Effective budget implementation requires timely and regular information on actual budget performance in the hands of implementing units. This information should be comprehensive of all activities and should cover commitment and payment stages and most of all be accurate. On the first dimension (scope of reports), the rating is "2", as classification of data allows direct comparison to the original budget. Information includes all items of budget estimates, however commitments, the value of contracts already signed with suppliers, are not reported. On the second dimension (timeliness of the issue of reports), the rating is "4", since reports are prepared quarterly or more frequently and distributed within four weeks from the end of period. On the third dimension (quality of information), the rating is "4", because there are no material concerns regarding accuracy. The overall rating is therefore "2+".

(i) Scope of Reports in terms of Coverage and Compatibility with Budget Estimates

The PFEM Law stipulates that the Ministry of Finance submits quarterly progress reports on the budget to the government and the President. Through the centralization of accounting and payments in the Treasury and the use of the integrated financial management system, AFMIS, the Ministry of Finance is able to produce comprehensive, timely and reliable statements on the budget execution and on the government's financial position. The in-year reporting to the government on budget execution comprises presentation of reports with expenditure by organizational unit determined on a cash basis presented year to date against the allotments granted and year's appropriations. This is done monthly for all budget units via hard copy distribution. The units are responding within 30 days to confirm their agreement with the reports. The reporting of the aggregates is met by the monthly posting on the Ministry of Finance Website of the government-wide high level fiscal report which comprised both budget execution and financial position. The system does not, however, record or report commitments although this are addressed in the Development Budget by assigning separate allotments for each commitment. The Ministry of Finance is adding a purchasing module to AFMIS to provide commitment registration and reporting.

(ii) Timeliness of the Issues of Reports

For the transactions made centrally, the information is immediately recorded in AFMIS and available for consultation on-line in Kabul. Three line ministries have on-line access to AFMIS. Two provincial Mustofiats process their transactions directly in AFMIS. The rest of provincial Mustofiats report aggregated information for entry into AFMIS in the Treasury HQ. The monthly reports are posted on the Ministry of Finance website by the 28th on the following month. Revenue from the provinces is recorded in the cash position and to a revenue holding account on a weekly basis. Funds are swept from the revenue accounts but specific accounts are only assigned after summary reports from the Mustofiats are received (see above). Revenue classification to final accounts is mostly done by month end.

(iii) Quality of Information.

The centralization of payments and accounting has contributed greatly to the reliability of records. The Treasury Department has the means to review the proposed charges for any payment and process all these in an integrated financial management systems which validates against allotments and appropriations. Furthermore, the AFMIS records are reconciled by the line ministries monthly to their authorizations.

PI-25: Quality and Timeliness of Annual Financial Statements

Rating 3+ (Improved from 2 in the 2005 PEFA): The consolidated year-end financial statements are a critical element of transparency in the system. In addition, 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 of the quality of the records maintained. On the first dimension (completeness of the financial statements), the rating is "3", since a consolidated government statement is prepared annually and includes full information on revenue, expenditure, and cash balances and stock of debt. On the second dimension (timeliness of submission), the rating is "3", as the consolidated government statements is submitted within 10 months of the end of the fiscal year. On the third dimension (accounting standard used), the rating is "4", since International Public Sector Accounting Standards are applied. The overall rating therefore is "3+".

The PFEM Law, Article 55 calls for the Ministry of Finance to publish and send to the President and the Government a final reconciliation report on the budget (Qatia) and a set of financial statements complied in accordance with international accounting standards within six months of year-end.

(i) Completeness of the Financial Statements

At year-end, statements of expenditure and revenue by ministries are generated through AFMIS which are confirmed by the respective spending units and the consolidated budget execution report (Qatia) is prepared. Additionally, the Treasury Department prepared and issued by January 23, 2008 a IPSAS compliant set of financial statements for the 2006/07 (SY1385) budget. These statements are cash based and comprise the main statement required under IPSAS Statement No.1. The reporting entity covered by the statements is the national government and all funds entrusted to it and controlled by the annual national core budget. The external budget, are not covered.

(ii) Timeliness of Submission of the Financial Statements

The Statement of Budget Execution (Qatia) of the last two fiscal years was sent to the President's Office within six months of the fiscal year end. The set of financial statements compliant with international statements was only published by January 23, 2008. The Ministry of Finance delivers to the Auditor a set of financials before this date and the external auditor delivers his report on the Qatia to the President with the Financials by Sept 20.

(iii) Accounting Standards Used

The state budget report is prepared from the accounts in AFMIS on a cash basis. Similarly, the set of financial statements which incorporate the budget statement, are prepared on a cash basis and presented in line with international public sector accounting standards. These statements do not reflect donor contributions under direct implementation which, under the standard for cash accounting, are payments by third parties on behalf of the central government. However, in the accounting policies to the financial statements the entity is defined and limited to the Core Budget.

C (iv) External Scrutiny and Audit

PI-26: Scope, Nature and Follow-Up of External Audit

Rating 2 (same as the 2005 PEFA): For the Government to fulfill its fiduciary responsibility, external audit has to be carried using acceptable standards. On the first dimension (scope/nature), the rating is "2", as 50 percent of government expenditures are audited annually and significant issues are identified. On the second dimension (timeliness of submission), the rating is "2", as audit reports are issued within 12 months of year-end. The Budget Execution Financial Statement for the State Budget (Qatia) is done within six months but audits on the donor funded projects come in after nine months. On the third dimension (evidence of follow up on audit recommendations), the rating is "2", while the response by the Ministry of Finance on the observations on internal control made in the annual audit on financial statements is thorough and supported by an action plan,, responses on the project audits and on compliance audits are practically non-existent. The overall rating therefore is "2".

(i) Scope/Nature of Audit Performed

Mandate and Independence: Under the 2004 Constitution, the Executive must present to the National Assembly a final account of the prior year's budget transactions, but there is no provision for an external review of this rendering. However, the PFEM Law grants the CAO the right to acquire all information and explanations deemed necessary and calls on the CAO to issue an audit report within six months of year-end on the financial statements of the prior year. The Auditor conducts an audit of all revenues and expenditures annually and provides a certification on the budget uses and recommendations for sanctions under the PFEM Law. It was noted that by decision of the President, in 2007, the CAO does not audit provincial administrations, Governors' Offices, while governance arrangements are being re-considered so the plans to establish regional offices of the CAO will not proceed for now. These expenditures represent less than one percent of budget uses.

Capacity and Performance: The training provided under the Audit Operations Advisor Contract and under the Internal Audit in-house training for CAO is insufficient to bring the CAO staff to the level of competence to conduct audits to international standards on their own. Audits of the state budget statement (Qatia) for 2005/06 (SY1384) and 2006/07 (SY1385), on the other hand, were not implemented through international auditing standards. In 2005/2006 (SY1384) no concrete assurance by way of an audit opinion certificate was provided but the audit of the 2006/2007 (SY1385) statement for the first time included an audit certificate.

(ii) Timeliness of Submission of Audit Reports to Legislature

For the last two fiscal years (2005/2006 and 2006/2007) the CAO completed the audit of the budget statement and submitted this report to the President Office for remittance to Parliament within the legal requirements of six months following year-end.

(iii) Evidence of Follow-Up on Audit Recommendations

Follow-up of State Budget Financial Statement Audit Report: The 2005/06 (SY1384) state budget statement audit has been responded by the Ministry of Finance although the 2006/07 (SY1385) audit report noted that audit guidance issues presented in previous years had not been attended to by the Ministry of Finance. The 1385 state budget audit has not been responded to yet, however a response is being prepared

Follow-up on Project Financial Statement and Regulatory Review audit findings: The Ministry of Finance has been closely involved in responding to CAO audit reports. Other ministries, despite some improvements, are less responsive and there are still some ministries that do not reply to audit reports. The CAO is seeking remedies with the Ministry of Finance to impose sanctions on some those which fail to follow up on findings. The Auditor General prepares reports on department and special reviews which are presented to the Cabinet semi-annually. These reports are not public, and no response or action is offered by the reviewed administrative units.

PI-27: Legislative Scrutiny of the Annual Budget Law

Rating 3+ (improved from 1 in the 2005 PEFA): The power to give the government spending authority definitely rests with the legislature which is assisted by the Budget and Finance Committee. On the first dimension (scope of the legislative's scrutiny), the rating is "4", because the legislature's review covers fiscal policies, medium term fiscal framework and policy framework as well as the revenue and expenditure detail for both the Core and External Budget. On the second dimension (legislature's procedures), the rating is "3" as simple rules are in place and respected. On the third dimension (adequacy of time), the rating is "3", as the legislature is given the budget proposal 45 days before the new fiscal year. On the fourth dimension (rules for in-year amendments), the rating is "4", as Clear rules exist for in-year budget amendments by the executive. The overall rating is therefore "3+".

(i) Scope of the Legislature's Scrutiny

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). Parliament began sitting in 2005 so the annual budget laws of the last three fiscal years (2005/06-2008/09) were reviewed and passed by Parliament. The budget is submitted through the upper house (Meshrano Jirga) with an advisory comment for consideration in the lower house (Wolesi Jirga) where final approval rests.

(ii) Extent to Which the Legislature's Procedures are Well-Established and Respected

In the lower house, the Budget and Finance Committee carries-out the analysis of the budget proposal. This committee comprises 18 members and meets with the Budget Committee of the executive on a regular basis. Their review concentrates on the detailed final proposals for revenue and expenditure. The role and mandate of the Budget and Committee is clear and simple procedures for the legislature's review exist and are respected.

(Iii) Adequacy of Time for Legislature

The PFEM Law calls on the executive to send the annual budget bill to Parliament 45 days in advance of the beginning of fiscal year. This has been done for the first two years of Parliament. Parliament has taken over two months to respond for each of the last two years given that these were their first budget reviews and the Parliamentarians were all new. The Constitution limits the Lower House debate on the budget to one month.

(iv) Rules for In-Year Amendments to the Budget without Ex-Ante Approval by the Legislature

The PFEM Law provides clear and specific guidance for in-year budget amendments: additional appropriations required under new laws must be approved by Parliament; transfers of appropriations within a Budget Unit which are exceed five percent of the appropriation and transfers of appropriation between Budget Units also must be approved by Parliament. These rules are consistently applied.

PI-28: Legislative Scrutiny of External Audit Reports

Rating 2+ (Improved from 1 in the 2005 PEFA): The legislature plays a key role in exercising scrutiny over the execution of the budget that it approves. On the first dimension (timeliness), the rating is "3", as main audit report reviewed within six months. On the second dimension (extent of hearing on key findings undertaken by the legislature), the rating is "2", as in-depth discussion of key findings is conducted occasionally. On the third dimension (issuance of recommended actions), the rating is "3", because the Ministry of Finance took appropriate and prompt action to satisfactorily address the Commission's concerns on the 2005/2006 State Budget Execution Financial Statement (Qatia) audit report. The overall rating is therefore "2+".

Under the 2004 Constitution, the Executive must present to the National Assembly a final account of the prior year's budget transactions, but there is no provision for an external review of this rendering. The PFEM Law, however, grants the CAO the right to acquire all information and explanations deemed necessary and calls on the CAO to issue an audit report within six months of year-end on the financial statements of the prior year. The report should provide a certification on the budget uses and recommendations for sanctions under the PFEM Law.

(i) Timeliness of Examination of Audit Reports by the Legislature

The audit reports on 2005/2006 (SY1384) and 2006/2007 (SY1385) state budget have been sent to Parliament. A Budget and Finance Committee has been formed and has responsibilities that include those of a Public Accounts Committee. A Public Accounts Committee has been formed but is just becoming operative. The Committee did review the audit report on the 2005/2006 Qatia within 12 months of the fiscal year end and within six months of receiving the report.

(ii) Extent of hearing on key findings undertaken by the legislature / Issuance of recommended actions by the legislature and implementation by the executive / (iii) Issuance of Recommended Actions by the Legislature and Implementation by the Executives

The Parliamentary Finance and Budget Commission called on the Treasurer to respond to the issues raised in the 2005/2006 (SY1384) audit report which indicates that there is in-depth review of some findings. At this time the legislature is not exercising any review through the use of the other reports or work of the Auditor General. The Auditor General has met with the chair of the Public Accounts Committee and offered to brief them on the 2006/2007 (SY1385) audit's management letter issues when it is operating. Representatives of the Committee have been invited to the PAC training in February, 2008.

(iii) Issuance of recommended actions by the legislature and implementation by the executive.

Follow-up discussions with the Audit actions are recommended but seldom acted upon.

D. Donor Practices

D-1: Predictability of Direct Budget Support (Table 10)

Rating 3+ (deteriorated from 4 in the 2005 PEFA): Poor predictability of inflows of budget support affects the government's fiscal management in much the same way as the impact of external shocks on domestic revenue collection. On the first dimension (annual deviation of actual budget support), the rating is "3", because budget support reached at 91 percent in 2005/2006 (SY1384) and 90 percent in 2006/2007 (SY1385) of budgeted amounts. On the second dimension (in-year timeliness of donor disbursements), the rating is "4", since quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual delays have not exceeded 20 percent (19 percent in 2005/2006 (SY1384) and nine percent in 2006/2007 SY1385). The overall rating is therefore "3+".

(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.

Direct budget support in Afghanistan in the last three fiscals years (2005/2006, 2006/2007 and 2007/2008) comprised two multi-donor trust funds (ARTF and LOTFA) as well as budget support operations from the Asian Development Bank, the World Bank and a number of smaller operations.

Actual disbursements against the forecast of budget support reached at least 90 percent in two of the last three years so the rating is 3 on this dimension i.e. support fell short by no more than 10 percent in no more than one of the last three years.

(ii) In-year Timeliness of Donor Disbursements

Agreements with donors on the timing are for ARTF and LOTFA are to pay requests for reimbursement as quickly as these arise and the forecast reflects this. These funds were disbursed in line with the agreements and in line with budget execution. As these two funds represent over 80 percent of total budget support, the rating is determined based on their performance.

Table 10: Budget Supports

Dimension	2004/2005	2005/2006	2006/2007
(1) Budget Support as % of Budget	84%	91%	90%
(2) ARTF and LOTFA as % of Budget Support	72%	81%	91%

D-2: Financial Information Provided by Donors for Budgeting and Reporting on Project and Program Aid

Rating 1 (deteriorated from 1+ in the 2005 PEFA): Predictability of disbursement of donor support for projects and programs affect the implementation of specific line items in the budget. On the first dimension (completeness and timeliness of budget estimates), the rating is "1", since budget estimates for disbursements are less than 50 percent of total assistance. On the second dimension (frequency and coverage of reporting), the rating is "1", as donor reports account for less than 50 percent of total assistance. The overall rating is therefore "1".

(i) Completeness and Timeliness of Budget Estimates by Donors for Project Support

Donors provide significant information to the Ministry of Finance on development assistance. This information is stored in the Donor Assistance Database which operates on a commercial software platform and contains all the detail of both Core Budget and External Budget projects which are required for the Harmonized Reporting Format. Specifically, in addition to project identification, both funding and disbursements amounts in total for the projects by year are recorded. In the fiscal year of 2007/2008 (SY1386) a financial review was carried out for which all major donors provided information on funding and disbursements for the current year. This report comprised donor financing estimates of over 80 percent of the non-security assistance for next fiscal year. Considering, however, that security related expenditures exceed the non-security assistance, the financial information provided by donors represents less than 50 percent of total assistance.

(ii) Frequency and Coverage of Reporting by Donors on Actual Flows for Project Support

The donor financial review is done twice a year: before the fiscal year begins and at mid-year. Although there are agreements with three donors to provide information quarterly, their assistance comes to less than 44 percent of total project assistance before the security related assistance is even considered.

D-3: Proportion of Aid that is Managed by Use of National Procedures

Rating 1 (same as the 2005 PEFA): The use of national systems by donors can help to focus effort on strengthening national procedures. The rating is "1" because less than 50 percent of aid funds to central government are managed through national procedures.

Total official development assistance in the 2007/2008 (SY1386) budget is estimated at US$4.3 billion. Of this US$1.9 billion, 44 percent is included in the Government Core Budget which is implemented through national procedures. These resources flow through the budget approved by Parliament, the funds are entrusted to the Treasury, the accounts are kept by the Ministry of Finance and the operations are implemented by the sector ministries. On the other hand, US$2.4 billion of the total assistance is implemented by the donors outside of Government's control.

The oversight by the Government of the operations implemented under donor responsibility is limited. As such, from the perspective of budget implementation, some recurrent spending and most public investment occurs outside national budgetary channels and procedures. The Government'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 which occurs outside of Government control. Donors are not subject, through their donor agreements, to plan, report, and operate in line with Government procedures.

Nevertheless, under the initiatives led by the Ministry of Finance under the Aid Effectiveness Committee steps are in place to improve coordination and reporting on these external funds.

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Appendix 1: Updates on Policy Roadmap of the 2005 PEFA

A: Revenue Mobilization

A-1: Sound and Fair Revenue Policies; Revenue Projection

Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
3, 13, 14,15	MoF/ Revenue & customs	A1. Implement agreed policy decisions on income tax A2. Consolidate / simplify tax measures (reducing small nuisance taxes)	The government has submitted revision of income tax laws (including abolishment of nuisance taxes) in March 2007. However, parliament has not yet approved the amendment.
	MoF/ Revenue and Budget	A3. Develop revenue projections and publish underlying assumptions as part of budget documentation (see B1)	Revenue projections and the assumptions are prepared and regularly updated. They are incorporated into budgetary processes.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
3, 13, 14,15	MoF/ Revenue & Customs	A4. Develop policy proposals for modern tax policy (e.g. consider excise taxes, convert business receipts tax into a simple broad-based consumption tax)	See A1 and A2.
		A5. Enact modernized tax laws	See A1 and A2
	MoF/ Municip.	A6. Review and modernize tax policy for municipalities	Progressively moving towards municipalities collecting property taxes and the central government collecting income tax and consumption tax

A-2: Effective Revenue Administration

Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
3, 13, 14,15	MoF/ Revenue & Customs	A7. Improve focus of Large Taxpayer Office and its performance monitoring	Performance of LTO has been significantly improved. The LTO now collects 35 percent of domestic tax revenues. Roll-out to MTO is essential.
		A8. Develop enforcement powers of customs and revenue administration	Basic enforcement powers for Revenue Department/ Mustufiats staff were introduced in the 2005 Income Tax Law.
	Ditto with Treasury	A9. Strengthen accounting mechanisms of revenue collection	Continuous reconciliation takes place between the Treasury, Revenue and Customs Departments on checking the recording of revenue collections.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
3, 13, 14,15	MoF/ Revenue	A1. Implement 5-year tax plan (and revise as needed)	The five year tax plan was amended in 2006 to adjust implementation date. A steering committee was established to monitor the progress in January 2007.
	MOF/ Customs	A2. Implement 5-year customs plan (and revise as needed)	Updated in 2008
	MOF/ Municip.	A3. Prepare and implement plan to modernize revenue collection by municipalities	No progress.

B: Budget Formulation

B-1: Strategic, realistic, predictable multi-year framework

Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
12	MOF/ Budget, IARCSC	B1. Strengthen medium term fiscal projections (in particular wage bill, revenues, donor contributions) in light of the ANDS	The MTFF is updated twice yearly. The framework is for the Operating Budget gradually being developed into a Budget Framework (MTBF) with expenditure estimates for the primary budgetary units. To strengthen the link with ANDS, three sectors currently being costed (education, health and roads) and others will be fully costed in 2008.
	MOF/ Budget	B2. Use clear standard budget definitions in new budget (e.g. cash budget vs. commitments)	The budget is formulated and executed using cash budgeting in accordance with IMFs GFS standard budget definitions.
		B3. Define clear criteria for investment program prioritization and establish link to the ANDS and Budget	ANDS is currently working to develop Public Investment Programs (PIPs) for three sectors (education, health and roads) as frameworks for investment programming and project selection procedures.
		B4. Set budget ceilings for all major sectors based on policy orientation and allocative efficiency (as informed by mid-year review)	Budget ceilings with five year perspective, based on ANDS priorities, were approved by the Cabinet as part of the SY1387 budget process. These will need to be adjusted based on further costing of sector strategies

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
12	MOF/ Budget, line ministries	B5. Deepen link between National Development Strategy and Budget	See B1.
		B6. Develop sector strategies and MTEF in selected sectors	See B1
	MOF/ Budget, MOE, CSO	B7. Roll-out preparation of sector strategies and MTEF	See B1
		B8. Develop monitoring and evaluation system	A monitoring and evaluation system is under preparation to ensure the outputs and outcomes of the ANDS Compact benchmarks are currently being monitored through JCMB.
		B9. Move gradually towards an output-based budget system and, over the longer-term, a results-oriented system	A budget system based on expected outputs and results is being piloted with program budgeting approach, which for SY1387 includes seven ministries. The expansion to all ministries is currently under review and consideration.

B-2: Comprehensive, Fully Integrated Budget
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
9,11	MOF/ Budget, line ministries	B10. Enforce requirement to estimate recurrent costs implications of proposed investments for largest investments	Initiatives have been implemented but specific requirements to estimate recurrent costs of investment are yet to be operationalized in terms of process and selection of projects.
	MOF Treasury	B11. Further integration of offbudget activities	a) Assessment of remaining entities that may have extra-budgetary funds should be undertaken. b) A long-term plan for bringing all donor funds, incl. those related to security, into the Core Budget should be prepared and implemented.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
9,11	MOF/ Budget and Treasury	B12. Clarify definitions of ordinary and development budget and present core budget under a fund structure and fully unify classifications	A unified classification system is to be finalised and introduced to integrate the budgets through program budgeting.
	MOF/ Budget, donors	B13. Further develop linkages between investments and recurrent costs (starting with key sectors such as education, health and road development)	See B10
		B14. Further integrate external assistance in budget (see below)	See B11
5		B15. Develop the budget along policy goals and objectives (program budget) supported by the budget classification	See B12
9	MOF, MOI, Municip., line ministries	B16. Identify poverty-reduction related expenditure in the budget based on functional classification	See B12
	MOF/ MOLSA	B17. Include data on municipalities in budget documentation	The approval procedure for municipal budgets must be analysed and streamlined as well as developed in terms of comprehensiveness (increase from 59% to include 100%) and timeliness.
		B18. Include data on State-Owned Enterprises in budget documentation (requires program to strengthen SOE PFM capacity, see D11)	The SOE Department is currently preparing new monitoring formats and procedures, and plans to initiate training for own staff and SOE accountants.
		B19. Include data on pensions in budget documentation	Limited data on planned expenditures is reported in the budget but information on number of pensioners and possible liabilities is not currently included.

B-3: Orderly, Open, Participative Budget Process and Revisions
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
11, 12	MOF/ Budget (and donors), cabinet secretariat	B20. Introduce new budget calendar (starting early in the year with the budget envelop, e.g. with a Budget Policy Statement, and sending budget circular in advance)	A new budget calendar was introduced for the SY1386 budget process but implementing a timely process is outstanding.
		B21. Introduce notion of sector ceilings (see B40)	The budget ceilings approved by the Cabinet for SY1387 have a five-year perspective.
11		B22. Review provincial expenditures by Cabinet and publish the report	a) Provincial-level revenue and expenditure data is now published monthly by the Treasury Department as part of the Financial Statements.
2,6		B23. Solicit input from provinces on 2006/07 budget and review their role on budget formulation	b) Pilot provincial budgeting is ongoing c) The role of provinces in budget formulation is being strengthened through the preparation of Provincial Development Plans
		B24. Reduce frequency of transfers across budgets and reliance on contingencies	Transfers have been reduced significantly as capacity in budget formulation and execution improves across the Government. Criteria for accessing contingency funds were also strengthened in the Financial Regulations.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
11,12	MOF/ Budget	B25. Develop capacity in line ministry to articulate budget proposals (see C26)	Improving with each budget cycle though continued support and development is needed for the medium-term.
		B26. Continue and strengthen practice of mid-year review	Mid-year reviews have been carried out annually since SY1384 but the results are yet to be applied fully as an input in the budget process for the coming fiscal year.
11		B27. Formalize role of provinces in budget formulation process (encouraging higher participation, including on investment programs)	See B22 and B23

B-4: Adequate Legislative Scrutiny of the Annual Budget Law
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
27	MOF/ Budget	B28. Prepare 2006/07 Budget for parliamentary approval, with a focus on enhancing transparency in provincial allotments for both the operating and development budgets	Finance and Budget Commission now has budget analysts and members of the Commission are participating in WB training.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
27	MOF/ Budget Committee	B29. Develop support for the Parliament to carry-out informed review of the budget	Finance and Budget Commission now has budget analysts and members of the Commission are participating in WB training.

C: Budget Execution
C-1: Effective Cash Management
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
17	MOF/ Treasury	C1. Develop monthly forecast for TSA flows and provincial flows	Cash Management Unit now doing annual cash plan updated monthly.
17,19		C2. Create Cash Flow Management Committee (Treasury / Budget/ Revenue/ DAB/ MoE)	Cash Committee is now working.
		C3. Further consolidate banking arrangements toward TSA	Now consolidated all discretionary funds flow through the system of TSA

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
17,19	MOF/ Treasury	C4. Refine monthly cash flow forecasts	See C1
		C5. Introduce cash management and payment scheduling procedures for line ministries and Mustufiats	No progress on line ministries or Mustufiats cash planning
		C6. Fully consolidate TSA	Now consolidated all discretionary funds flow through the system of TSA.

C-2: Effective Debt and Guarantees Management
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
17	MOF/ Treasury	C7. Conclude review of existing debt	Debt review finished and fully reconciled.
		C8. Develop external debt strategy.	In October 2005, a debt strategy was completed

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
17	MOF/ Treasury; DAB	C9. Develop requirements for debt management system consistent with AFMIS architecture	Detail specifications not yet elaborated.
		C10. Implement debt management system	Ditto.
		C11. Review internal debt policy (no overdraft) and link with cash management.	Now considered under Cash Planning.
		C12. Develop domestic debt instruments as appropriate.	No progress as there has been no need for domestic debt.
		C13. Develop and implement policy on guarantees	Ditto.

C-3: Smooth, Predictable Budget Implementation
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
16	MOF/ Treasury (with budget)	C14. Capture and report expenditure by province under all appropriations (including development budget)	Development budget expenditures still reported from point of disbursements.
4		C15. Repeat simple survey of arrears at year-end	No progress
9		C16. Develop an asset registry to be established under each budgetary unit and develop related procedures for incorporating assets received through operations implemented outside the government systems	No progress. Asset module of AFMIS may be purchased in 2008.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
16	MOF/ Treasury (with budget)	C17. Improve allotment system to ensure transparent assignment of scare resources	Allotments are now based on AFMIS. There is no longer any confusion with the hard copy B22 which are sent to the secondary budgetary units.
		C18. Develop a strategy for enhancing financial management information systems and implement outcome of system study	Systems Study done and results incorporated into new TA project from WB for roll out of AFMIS and expansion of functionality.
		C19. Initiate roll-out of AFMIS to line ministries and Mustofiats (see D4 and D5)	Contract for this in place; targeted 12 line ministries and 12 Mustufiats
16,4	MOF	C20. Develop commitment control (processes; regulations; systems) which will form basis for monitoring arrears.	This will be part of the AFMIS function expansion.
23		C21. Develop expenditure tracking surveys	No progress
9		C22. Roll-out the asset registry to the budgetary units.	No progress. Planned as option in AFMIS roll-out.

C-4: Internal Controls
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
20	MOF, MOF/ Treasury	C23. Align MOF control staff with PFEM Law (Financial Controllers to stop pre-approval of expenditure and to be integrated in budgetary units or MoF Internal Audit)	Awaiting capacity building of Internal Controllers in line ministries
	MOF, Office of the president	C24. Review and streamline internal controls for contracts to speed up implementation while strengthening accountability.	No significant change here but by and large there are no serious delays.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
20	MOF/ Treasury & Admin; CAO	C25. Develop standards of internal control and adopt related PFEM regulations.	Financial Regulations call for internal control in line ministries and identify responsibilities.
		C26. Carry-out the PRR of the Administrative units of line ministries and implement the PFEM provisions for Chief Financial Officers.	No progress
		C27. Roll-out AFMIS for on-line recording and editing to the budget units and Mustofiats (see D4 and D5)	On line capacity already in place in two provinces.
		C28. Develop control framework for municipalities.	No progress

C-5: Internal Audit

Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
21	MOF/ Treasury	C29. Use Monitoring Agent to provide feedback to MOF and line ministries on compliance with fiduciary standards.	Underway
		C30. Implement PRR in MOFs internal audit department.	Completed
	MOF/ IA	C31. Carry out training and certification of internal audit staff	Completed for 200 staff and underway for another 200
		C32. Develop internal regulation, audit manual, and audit programs for key typical reviews	Completed

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
21	MOF/ IA	C33. Roll-out implementation of MOFs internal audit department reform and annual internal plan.	The Internal Audit Department of MOF has produced audit guidelines and operates at acceptable standards. Line ministries now responsible for their own internal audit.
		C34. Develop internal audit activities in line ministries.	Ministry of Defense following in-house audit training.
		C35. Coordinate all internal audit activity from the MoF	Presidential decree reassigned responsibility to CAO for this coordination.
		C36. Develop internal audit for municipalities.	No progress

C-6: Payroll

Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
18	MOF/ Treasury	C37. Expand coverage of Individualized Salary Payments (including pay from the list and payment by bank transfer).	Underway, from 23,000 in 2005 to 88,000 in 2007.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
18	MOF/ Treasury	C38. Develop a human resources management system for the budgetary units and means to consolidate information centrally for personnel, pension and other needs (see C18)	IARCSC is addressing this.
		C39. Extend verified payroll program to whole of national government.	Included in plans but there are practical limitations for the provinces.

C-7: Procurement

Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
19	MOF/ MOE	C40. Adopt regulations to implement the new Procurement Law (and clarify rules regarding projects in development budget)	"Rules of Procedures for Public Procurement" has been issued as circular PPU/C005/1386 in April 2007
		C41. Establish a procurement policy unit (PPU)	PPU was established in August 2006

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
19	MOF/ MOE	C42. Line ministries progressively take responsibility for procurement transactions	Little progress due to capacity constraint. A consultant has been in place since April 2007 to carry-out an intensive and extensive capacity building program on public procurement.
		C43. Train private sector in tendering procedures	Projected in 2008
		C44. Prepare a needs analysis in respect of product standardizaion, building codes	No progress
		C45. Establish an independent review mechanism and an appeal mechanism	Manual of Procedures for "Procurement Appeal and Review " has been issued by MOF circular number PPU/N001/1385 in March 2007
		C46. Develop and implement standards of transparency	No progress

D: Accounting and Reporting
D-1: Accounting, In-Year Reporting
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
22,25	MOF/ Treasury; DAB	D1. Automate reconciliation of government accounting records with banking data, particularly the Treasury Single Account (TSA).	Semi-automated reconciliation now in place and performing satisfactorily.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
22,25	MOF/ Treasury; MOF/ Budget	D2. Develop public accounting standards and clarify role of line ministries (regulations to implement PFEM Law)	In progress
		D3. Enforce use of modern budget classification and increase capacity to issue timely monthly reports.	Completed
		D4. Complete roll-out of AFMIS to line ministries for complete and timely in-year reporting.	Planned
		D5. Undertake roll-out of AFMIS to Mustufiats.	Two finished 12 more are planned
		D6. Develop accounting capacity of municipalities.	No Progress
6,7,8,9	MOF/ Treasury, SOE dpt	D7. Develop accounting capacity of SOEs	No Progress
		D8. Move towards modernized accounting standards over time.	Called for in the PFEM Law and regulations

D-2: Transparent and Accessible External Financial Reporting
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
25	MOF/ Budget with Treasury	D9. Develop the means to capture and report accurately expenditures of donor implemented projects.	Progress made through the Harmonized reporting and the financial reviews by Aid Coordination Unit of MOF.
	MOF/ Treasury	D10. MoF to commit to preparing formal accounting period cut-offs at least quarterly.	No progress

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
9,25	IARCSC MOF/ Line ministries CAO MOF/ Budget	D11. Disclose state enterprises annual financial results and financial position, company objectives, ownership, governance structure and information on employees. All information should be audited. All SOEs (regardless of form of public ownership) should be covered. D12. Establish the procedures and requirements for the line ministries for collection, review and follow-up of the external audits of donor implemented projects	No progress. No progress.

E: External Accountability, Audit and Scrutiny
E-1: External Audit
Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
26	CAO; MOF/IA	E1. Carry-out accounting and auditing certification process for all professional staff. E2. Develop audit work of whole-of-Government annual accounts.	Limited progress, only 12 out of 50 planned for certification at in house audit training completed the course. Work on Qatia is improving and will benefit from more advisor oversight in coming years.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
26,28	CAO	E3. Finalize draft and gazette new Audit Law. E4. Develop external audit regulation, implement Audit Law. E5. Develop external audit of procurement. E6. Create Public Accounts Committee and its processes. E7. Develop the system for scrutiny and response to audit reports including responses by involved ministries and scrutiny by a Public Accounts Committee of Parliament E8. Develop role of media and civil society in the scrutiny of the budget (formulation and execution)	Law still being drafted. See E3 Some training of audits in new procurement law has been carried out. Committee has been formed and its key duties have been preformed by Finance and Budget Committee. No Progress No Progress

F: Donor Practices

Short-Term (Next 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
1, D1, D2	MOF	F1. Develop MTEF to which donor financial support can respond (see B1).	See B1
	Donors	F2. Donors to provide timely information on actual expenditures following Governments definitions (see D9)	See D9
		F3. Donors to provide information on planned disbursements early in fiscal year.	Now done through the Harmonized reporting and the financial reviews by Aid Coordination Unit of MoF.

Medium-Term (Beyond 6 to 12 Months)

Ind.	Resp.	Actions in 2005 PEFA	Progress
D3	MOF	F4. Government to regularly publish internal and external assessment of PFM performance.	Done by dissemination of PEFA Reports.
	Donors	F5. Support enhanced alignment of donor funding for priorities established under the ANDS.	Ongoing through JCMB process
		F6. Donors to further move toward support through Treasury and budget support.	Some progress as ARTF and LOTFA increase in size.

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