This action is funded by the European Union

ANNEX 1

of the Commission Implementing Decision on the Annual Action Programme 2017 part II and 2018 part I in favour of Afghanistan to be financed from the general budget of the Union

**Action Document Afghanistan – Support to Public Finance Management (PFM) Reform**

<table>
<thead>
<tr>
<th>1. Title/basic act/CRIS number</th>
<th>Support to Public Finance Management (PFM) Reform Financed under the Development Cooperation Instrument for the Annual Action Programme 2017 CRIS number: ACA / 2017 / 039-882</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Zone benefiting from the action/location</td>
<td>Afghanistan The action shall be carried out nationwide</td>
</tr>
<tr>
<td>4. Sector of concentration/thematic area</td>
<td>MIP Sector 4: Democratisation and accountability</td>
</tr>
<tr>
<td>5. Amounts concerned</td>
<td>Total amount of EU budget contribution EUR 9 000 000 The contribution is for an amount of EUR 9 000 000 from the general budget of the European Union for the financial year 2017</td>
</tr>
<tr>
<td>6. Aid modality(ies) and implementation modality(ies)</td>
<td>Project Modality Indirect management with the Afghanistan Reconstruction Trust Fund (ARTF) and direct management (services)</td>
</tr>
<tr>
<td>7 a) DAC code(s)</td>
<td>15111 Public Finance Management</td>
</tr>
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<td>b) Main Delivery Channel</td>
<td><em>World Bank – 44001 Service contract for Technical Assistance - 21000</em></td>
</tr>
<tr>
<td>8. Markers (from CRIS DAC form)</td>
<td>General policy objective</td>
</tr>
<tr>
<td></td>
<td>Participation development/good governance</td>
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<td></td>
<td>Aid to environment</td>
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<td>Gender equality (including Women In Development)</td>
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<td>Trade Development</td>
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<td>Reproductive, Maternal, Newborn and child health</td>
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<td></td>
<td>RIO Convention markers</td>
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<td></td>
<td>Biological diversity</td>
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<tr>
<td>9. Global Public Goods and Challenges (GPDC) thematic flagships</td>
<td>N.A.</td>
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<td>---------------------------------------------------------------</td>
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<td>10. SDGs</td>
<td>Main SDG: 17 Finance</td>
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</table>

**SUMMARY**

This proposed action in support of Public Finance Management Reform (PFM) is complementary to the State Building Contract for Afghanistan (SBC 2016-2018). While the SBC provides very much needed resources to the government for the implementation of the new 2017-2021 Afghanistan National Peace and Development Framework (ANPDF)\(^1\) and associated National Priority Programmes (NPPs)\(^2\), there is a recognised need by the Government of the Islamic Republic of Afghanistan (GIRoA) and donors to further strengthen country systems towards sound management of public finances, reduction of fiduciary risks and improved policy-based budgeting. These elements are equally important for the successful implementation of the SBC as for creating the conditions for international aid to be increasingly delivered on-budget to generate greater aid effectiveness and help reduce the acute fiscal gap.

The proposed action aims at providing the government with the means for implementing additional and deep reforms on PFM with a focus on efficient expenditure management and oversight leading to greater fiduciary assurance. Since 2001, Afghanistan has indeed seen significant progress, albeit from a low base, in establishing a functioning PFM system. Renewed serious efforts are now emerging from the government-owned PFM Roadmap II Strategy of 2015 and the Five-year rolling Fiscal Performance Improvement Plan 2016-2020 (FPIP).

In response, and building on previous phases, the World Bank's (WB) forthcoming PFM sequence programme, implemented through the Afghanistan Reconstruction Trust Fund (ARTF) will support the government's FPIP while building upon the achievements of existing WB and donor programmes. The government has identified this approach as the preferred option for coordinated on-budget donor support in line with the recent commitments made at the Brussels Conference on Afghanistan and with development effectiveness principles. It is, therefore, advocated that the EU support to PFM reform shall be delivered through this programme whose intended outcomes are improved PFM performance, including increased domestic revenues, enhanced oversight of the budget, and a strengthened strategic dialogue among donors and the government. Cumulatively, the benefits attained would lead to improved service delivery and greater confidence on the part of the public and donors that the government is operating efficiently and transparently, thus reducing the fiduciary risk for the

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current SBC and potentially setting the conditions for further (sector) budget support operations.

1. CONTEXT

1.1 Sector/Country/Regional context/Thematic area

During the Brussels Conference on Afghanistan (4-5 October 2016) it was recognised that the need persists of promoting a high degree of Afghan ownership through the use of country systems and commitment was confirmed by the international community to explore possibilities for different forms of flexible on-budget assistance. As a first step towards the latter, the EU's State Building Contract (SBC 2016-2018) intends to provide €200 million in direct budget support against robust policy dialogue on reform progress in public development policies, a stable macroeconomic framework, public financial management, as well as on transparency and oversight. However, still in 2017 on-budget assistance hinges on deep reforms of the PFM system and the containment of corruption.

In context, since 2001 the Government of Afghanistan has made significant progress towards establishing a functioning PFM system under the direction of the Ministry of Finance (MoF) with assistance from the international donor community. Despite having reached a reform plateau in 2008, by 2013 global improvements in budget credibility and fiduciary risk reduction were achieved, surpassing average Public Expenditure Financial Accountability (PEFA) results in the region/group of fragile states/average low-income-countries. However, on most other dimensions such as budget comprehensiveness, predictability and control in budget execution or reporting, PEFA scores remained low and policy based budgeting even slightly declined. The development budget was and still is characterised by fragmentation and low execution rates due to large non-discretionary part of donor projects. With donors focussing on fiduciary risk particularly on the expenditure side of the budget, reforms targeting systems that are most prone to manipulation and weak controls – such as non-tax revenue, procurement, banking supervision and taxation - have been the slowest to improve.

The impact of the 2014 fiscal crisis in terms of depleted cash reserves and an accumulation of arrears were addressed with sound reforms efforts. In 2015 the government successfully completed the International Monetary Fund’s (IMF) staff monitored programme (SMP) and in 2016 negotiated an IMF-Extended Credit Facility (ECF). With domestic revenue at 10.2% of Gross Domestic Product (GDP) in 2015, the government has exceeded in 2016 the IMF-ECF domestic revenue target thereby demonstrating its political will and capacity to implement reforms. In contrast budget execution has been disappointing in FY 1395 (2016) with overall execution at 76% (only 54% of development budget) attributed to security issues and limited delegation of procurement award authority, contributing to political instability in the country and between Government and Parliament.

Hence, and despite some progress, there is consensus that further reforms are necessary to properly budget and prioritise interventions within tight budget constraints and donor community's concern with fiduciary risks for on-budget operations, and to increasingly make the budget the central tool for ANPDF and NPPs implementation, as stated by the government.

1.1.1 Public Policy Assessment and EU Policy Framework

Following the confirmation of the donor community at the London Conference in 2010 to increase to 50% the share of development aid delivered through government, and to align

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3 as demonstrated by PEFA assessments of 2005, 2008 and 2013
80% of aid with the NPPs, the government presented its PFM Roadmap I (2010-2013) at the Kabul Conference in 2010 as a credible plan for strengthening PFM reform. Albeit some progress, the PEFA 2013, a SWOT analysis and three expert reviews commissioned by the Office of the President/MoF in 2015\(^4\) revealed significant weaknesses which led the government to launch a new PFM Roadmap II 2016-2020\(^5\).

This roadmap - the key document when designing the SBC roadmap and assessing the eligibility for Budget Support - presented a relevant PFM strategy. Spanning the budgetary cycle it sets five generic strategic objectives: (i) budget in accordance with fiscal constraints and national priorities; (ii) increase of national revenues to enable self-reliance; (iii) credible budgets aligned with national and sub-national strategies; (iv) programme-based planning, procurement and execution; and (v) monitoring, evaluation and audit. It identifies two enabling factors: sustainable human resources, and integrated information systems, with globally defined outputs and high-level priority inputs, but without reform sequencing. The PFM Roadmap II 2016-2020 is operationalised into a five-year rolling Fiscal Performance Improvement Plan 2016-2021 (FPIP)\(^6\) demonstrating ownership and the strong ambition of the government to move to the next level of maturity in reform planning. With a pronounced process-orientation for team-based performance improvement, it sets out detailed theme-based activities per administrative unit, aligned to the strategic priorities with overall outcome and outputs per implementation year, while implementation is monitored formally through bi-annual team-performance assessments supervised by the Office of the President. The President announced mid-2016 his intention to gradually expand reforms to include more agencies and ministries starting with the Central Statistics Organisation, Supreme Audit Organisation, Independent Directorate of Local Governance, Ministry of Agriculture Irrigation and Livestock and Ministry of Interior Affairs. The absorptive capacity of these stakeholders has been positively evaluated by WB albeit recognising the need to strengthen their corporate functions as part of the PFM reform process. In addition the new ANPDF with the NPP on Effective Governance (in preparation) identifies the comprehensive reforms that are needed throughout the budget cycle in view of attaining improved budget planning, consolidation, execution, and capacities. The ANPDF also stresses the commitment of the government to rooting out corruption with a national anti-corruption strategy combining prevention with a strong programme and sound leadership at the Supreme Court and Attorney General’s Office in order to end the culture of impunity. This is essential in building a functioning and delivering state and, thus, increasing the confidence of the people of Afghanistan that quality services can be efficiently provided by the government, which in turn will increase levels of public support.

The Afghan Ministry of Finance (MoF) initiated Gender Responsive Budgeting (GRB) reform in 2010 and put forward a GRB strategy in 2014, since when GRB has been incorporated into basic budget circulars issued by the Ministry. Gender Budget Units have been formed in fourteen line ministries, including the MoF. However, Units in the six pilot ministries have struggled to apply GRB, largely deriving from challenges in the practical application of benchmarks to the budgeting process, as well as core issues of functionality and capability in policy development and data analysis. In 2016 the MoF has charged UNWOMEN to provide support and follow-up on GRB policy and implementation. Direct benefits for women from the successful application of GRB would include expanded ministry budgets for gender-responsive programming.

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\(^4\)“Strategic Overview – Development and Public Financial Management”; “Bottlenecks to budget execution”; and “A Preliminary Fiduciary, Development Risk and Cost-Effectiveness Assessment”


An integral and important part of the EU contribution to the Global Partnership for the implementation of the 2030 Agenda and the follow-up of the Addis Ababa Action Agenda are the actions stemming from the Staff Working Document *Collect More – Spend Better*\(^7\), issued end of 2015. The overall approach covers support to domestic public finance, oversight and efficiency in public procurement in the context of economic governance and budget support programmes, with actions benefitting essentially directly national level. This is reflected in the recent *European Commission's Directorate-General for International Cooperation and Development Strategic Plan 2016-2020* which as one of its specific objectives (No. 6) promotes support to the public sector capacity, public finance management, tax policy and administration, procurement, and fight against corruption in our partner countries. Equally the EU is committed to contributing in a measurable manner to girls’ and women's economic and social empowerment, to their active participation in the economy and to the prevention of economic exploitation as highlighted in the *Gender Action Plan 2016-2020*\(^8\) and its thematic priority on *Economic, Social and Cultural Rights - Economic and Social Empowerment* (objective 15).

The *EU Strategy for Afghanistan*\(^9\) commits to increasing aid effectiveness and restoring fiscal sustainability through progress in public financial management and greater domestic resource mobilisation, in line with government policies. Embedding into the strategy, the *EU-Afghanistan MIP 2014-2020* enshrines EU’s support to the PFM reform as a cross-cutting priority in its fourth sector "Democratisation and accountability" in full alignment with the Self-Reliance through Mutual Accountability Framework (SMAF) and its indicator 17 which relates to the increase of on-budget assistance to progress in PFM reform, and within the legal framework underpinning PFM constituted by (i) the Public Finance and Expenditure Management Law of 2005; (ii) the Public Procurement Law of 2008 with a major revision in 2015; and (iii) the Audit Law of 2013.

### 1.1.2 Stakeholder Analysis

The key stakeholders of the PFM reform project are the government (Office of the President, Ministry of Finance, line ministries and agencies) as well as the oversight institutions such as the Supreme Audit Office, Parliament, and the civil society organisations engaged in public oversight. In terms of International Financial Institutions IFIs the WB is the main stakeholder through its PFM Reform programmes and the IMF.

To date the main support to reforms of the PFM system has been provided through the WB administered ARTF with an on-budget operation of more than ten years of operations in Afghanistan. After a successful initial PFM Reform (PFMR I) programme, the WB/ARTF *PFM Reform successor programme* (PFMR II, 2011–2017; budget: $114 million) modelled to some extent on the government's PFM Roadmap I (2010) focusses after its latest extension in January 2016 and with additional financing of $41 million on five core areas: 1) reform process, 2) procurement, 3) audit, 4) treasury (+Afghanistan Financial Management Information System - AFMIS) and 5) revenue mobilisation. The last evaluation of June 2016 showed satisfactory progress towards the achievement of the overall programme objectives.

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\(^7\) Collect more Spend better. Staff Working Document. European Commission, October 2015.


\(^9\)Afghanistan: European Union Strategy

and on all indicators while the project is expected to meet its objectives by the closing date of June 2017.

In addition, support to PFM reform is provided by other development partners and institutions:

- UK Department of International Development (DFID) as well as Australia and Norway: technical assistance provided through international consultancy firms for the implementation of the Fiscal Improvement Plan (ended in December 2016); DFID also implemented between 2007-2012-2016 the project Strengthening Afghanistan’s Budget that while falling short of meeting its outcome indicator targets led to progress on the MTFF, budget process, budget execution, collection of aid data and performance monitoring.

- US Agency for International Development (USAID): implementing the Afghanistan PFM Project (APFM, 2015-2017, USD 22.1 m) with an international consultancy firm in the areas of budget and revenue.

- UNWomen: implementation of Gender Responsive Budgeting (GRB) policies in particular in budget preparation with six line ministries.

These projects characterised by limited coordination among them and with WB, as well as by a lack of alignment with the Government's agenda have led to significant fragmentation of the PFM reform process. Therefore the UK, Australia and Norway are all considering realigning under and supporting the forthcoming WB / ARTF PFM programme.

Equally, a few international civil society organisations are active in the field advocating for the much needed transparency and oversight such as Integrity Watch Afghanistan (IWA) by establishing the Open Budget Index (OBI) and the annual Corruption Survey; implementing capacity building and awareness raising measures such as Equality for Peace and Democracy (EPD) and Transparency International (TI), a leader in combating corruption and preventing criminal activities arising from corruption.

1.1.3 Priority areas for support/problem analysis

To ensure the successful implementation of the SBC it is judged indispensable to put in place a complementary measure on PFM reform to ensure sound management of public finances, a further reduction of fiduciary risks and improved policy-based budgeting. As an extra measure to promote effective and transparent Afghan institutions, budget support needs to be accompanied by significant capacity and institutional development support for official GoA services and departments being able to design and implement policies and deliver key services to the population, to promote active engagement of Government with civil society and other stakeholders enhancing their voice and legitimacy. In the long term, support to PFM reform is expected to contribute to setting the basis for further EU Budget Support operations and encourage other donors – including EU Member States - to join to move directly on-budget with some operations.

Priority areas for support relate to all three core areas of PFM, notably aggregate fiscal discipline, strategic allocation of resources in compliance with public policy objectives - ANPDF & NPPs- and efficient delivery of public services. With the latest PEFA assessment dating back to 2013 and the next PEFA expected by end 2017, the most recent diagnostic assessment of the Afghan PFM system is the one commissioned by the Office of the President in 201510. It identified a list of interdependent PFM challenges, regrouped into eight priority areas for the government: (i) Insufficient domestic revenues to meet spending needs; (ii) Government fiscal framework does not sufficiently constrain national expenditure; (iii) Government

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10 Three studies, notably “Strategic Overview – Development and Public Financial Management”; “Bottlenecks to budget execution”; and “A Preliminary Fiduciary, Development Risk and Cost-Effectiveness Assessment” and a SWOT analysis.
resource allocation does not adequately reflect national priorities in addition to the lack of properly costed sector strategies; (iv) Budget remains fragmented with no consolidated operational and development budgets and a pre-dominance of projects; (v) Budget execution suffers from process weaknesses; (vi) The development budget is routinely suffering from under-execution; (vii) Corruption inhibits effectiveness and efficiency of government administration and undermines the trust between government and citizens; and (viii) Service delivery is difficult to improve due to weak accountability and monitoring and evaluation.

In addition, PFM reform efforts had been fragmented either issue or theme-based by various donor projects making it more difficult to manage performance and establish a positive performance-oriented culture within MoF and the government linking PFM reforms to international benchmarks (PEFA, OBI) and incentivising reform achievements. These issues have been already taken into consideration for the development of the **five-year rolling Fiscal Performance Improvement Plan (FPIP 2016-2020)**. The methodology has been lauded for many positive aspects such as its realism, the importance attributed to the Tashkeel and Capacity Building for Results (CBR), the layered approach, the matrices to track progress with mid-year and annual reviews as well as annual self-assessment against rolling aspirational targets of PEFA and OBI, and the planned annual revision of the work plan and performance targets. Nevertheless, there have equally been suggestions by the donor community for further improvements (in areas such as sequencing of reforms, simplicity, holistic approach, quality focus, administrative burden, balance of technical assistance and Tashkeel) which are expected to be taken on board for the revised five-year rolling Fiscal Performance Improvement Plan in 2017. The first performance tracking report issued in October 2016 claims a number of achievements in policy (High Economic Council), budget formulation (medium term expenditure framework), procurement (National Procurement Authority, reinforced competition/oversight/monitoring) and increased revenue collection (customs and revenue departments). However, it equally revealed persisting challenges in reporting on fiscal performance & institutional capacity that relates to some lack of concerted leadership across all concerned entities, a limited ownership/buy-in (in particular in the revenue and budget departments), missing clarity and focus of the initial reform plans (lacking foundations and reform sequencing), and most importantly the continuing significant dependency on external support (persistent Tashkeel resources and capacity gaps). GRB policy implementation is at present not explicitly referred to in the FPIP but upon the impetus of the EU DEL discussions on its integration as part of the annual rolling FPIP reviews are ongoing with the key stakeholders (Ministry of Finance, UNWomen, World Bank).

The **baseline** for the development of complementary measures on PFM reform aimed at ensuring the successful implementation of the SBC will thus be based - in the absence of a recent PEFA assessment – on the above mentioned analyses commissioned by the Office of the President in 2015; the mid-term and annual reviews of the government's five-year rolling Fiscal Performance Improvement Plan (October 2016 and February 2017); and the gap analysis carried out by a WB missions throughout end 2016/beginning 2017 to inform the design of the forthcoming WB/ARTF PFM programme;

### 2. RISKS AND ASSUMPTIONS

<table>
<thead>
<tr>
<th>Risks</th>
<th>Level</th>
<th>Mitigating measures</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Political and security</strong></td>
<td>H</td>
<td>Mitigated through a concerted international political and policy dialogue.</td>
</tr>
<tr>
<td>Stability, effectiveness of government is hampered by internal division/external challenges.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Corruption / Fraud</strong></td>
<td>H</td>
<td>Addressed through a combination of continued support for PFM, anti-corruption institutions, civil</td>
</tr>
<tr>
<td>I's corruption perception index 206: 169th out of 176</td>
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</tbody>
</table>

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11 Government's organigram
<table>
<thead>
<tr>
<th><strong>Public Finance Management</strong></th>
<th><strong>Assumptions</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>PFM risks have overall been reduced through significant international support since 2003.</td>
<td>- The government remains committed to pursue its ambitious reform agenda by formulating and implementing credible policies (ANPDF, SMAF, NPPs, PFM Reform);</td>
</tr>
<tr>
<td>Weak institutional capacity in the MoF to direct PFM reforms and for self-evaluation.</td>
<td>- The international community remains engaged in Afghanistan and actively engaged in the PFM reform process.</td>
</tr>
<tr>
<td>Lack of clarity on the link PFM Roadmap II - FPIP, including FPIP implementation</td>
<td><strong>Macroeconomic</strong></td>
</tr>
<tr>
<td>Continuing dependency on Technical Assistance for the execution and supervision of reforms leading to a lack of sustainability.</td>
<td>Strong vulnerabilities due to aid dependency, security and potential external shocks.</td>
</tr>
<tr>
<td>Insufficient engagement of line ministries by the MoF.</td>
<td>Creation of the High Economic Council and Macro Fiscal Department in MoF; EU SBC, IMF ECF and WB Development Policy Grant (DPG) targeting domestic revenue mobilisation; Brussels Conference on Afghanistan pledges;</td>
</tr>
<tr>
<td>Lack of a programmatic approach to PFM with separate functional projects.</td>
<td><strong>Public Finance Management</strong></td>
</tr>
<tr>
<td>Lack of alignment of PFM reform projects between donors.</td>
<td>The five-year FPPIP presents a credible realistic policy with a high degree of government ownership of the reform process.</td>
</tr>
<tr>
<td>MoF led PFM reform extended to SAO could jeopardise independence.</td>
<td>The five-year FPPIP supported by WB/ARTF is committed to institutional capacity building.</td>
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</table>

<table>
<thead>
<tr>
<th><strong>Assumptions</strong></th>
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</thead>
<tbody>
<tr>
<td>- Budget Support in fragile countries require complementary support to PFM reform;</td>
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<tr>
<td>- Government ownership of the reform process, strategic leadership of the reform process at the highest levels but equally buy-in of all concerned stakeholders across ministry directorates as well as line ministries has been identified as key to the success of reform;</td>
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<tr>
<td>- Gradually reducing external, uncoordinated technical assistance and building Tashkeel capacities is of key importance to ensure sustainability;</td>
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<tr>
<td>- It is essential for the reform to provide more attention to revenue mobilisation (without suffocating the nascent private sector and with a focus on customs) and creating extra fiscal space for financing social economic development and reducing poverty;</td>
</tr>
<tr>
<td>- It is critical to ensure better alignment of expenditure with national priorities to improve government’s service delivery;</td>
</tr>
</tbody>
</table>

**3. LESSONS LEARNT, COMPLEMENTARITY AND CROSS-CUTTING ISSUES**

**3.1 Lessons learnt**

The proposed action towards PFM reform incorporates lessons learned from programmes in other areas managed by the EU in Afghanistan, both in direct and indirect management, as well as from various incentive programmes financed by the EU and the donor community in Afghanistan, and external assessments of PFM programmes in Afghanistan; and of course lessons from EU BS operations worldwide.

Out of such past experience and after numerous meetings held between the government and the EU during the design of the SBC and of this complementary measure, the following lessons learnt have been retained:

- Budget Support in fragile countries require complementary support to PFM reform;
- Government ownership of the reform process, strategic leadership of the reform process at the highest levels but equally buy-in of all concerned stakeholders across ministry directorates as well as line ministries has been identified as key to the success of reform;
- Gradually reducing external, uncoordinated technical assistance and building Tashkeel capacities is of key importance to ensure sustainability;
- It is essential for the reform to provide more attention to revenue mobilisation (without suffocating the nascent private sector and with a focus on customs) and creating extra fiscal space for financing social economic development and reducing poverty;
- It is critical to ensure better alignment of expenditure with national priorities to improve government’s service delivery;
Ensuring better availability of financial information for improved management and timely decisions, as well as better accountability at all levels of the management line is key;

While a variety of low- and middle-income countries have used gender-responsive budgeting (GRB) as one way to support gender equality, the fragile context of Afghanistan, the state of PFM and Government capacities requires particular attention and a focus on enabling factors such as sustained political support, sufficient capacities and conducive institutional arrangements, among local and international actors. Moreover, past PFM reform programmes in Afghanistan such as the WB/ARTF one (in which the EU has been involved as a major ARTF donor) aiming at sustainable PFM reform as opposed to bilateral projects, have shown to be successful being fully on-budget and aligned with government strategies and implemented in a concerted and coordinated manner between donors.

### 3.2 Complementarity, synergy and donor coordination

The proposed action is complementary to the SBC for Afghanistan. Supporting PFM reform is an eligibility criterion and has equally been identified as a substantial risk. Complementarity is also guaranteed with the IMF's ECF of 2016 and in particular the pillar on Fiscal reform.

In addition the proposed action is complimentary to the following EU-funded projects:

- **SMAF Incentive Programme**, particularly under Area 3 of the SMAF (Restoring Fiscal Sustainability and Integrity of the Public Finance and Commercial Banking) and its four indicators (15-18) that is providing the platform for policy dialogue with MoF and the Central Bank DAB;

- **Civil Society Organisations and Local Authorities' Thematic Programme**, and its objectives of supporting governance, institutional capacities and Civil Society Organisations oversight in the field of budget planning and execution at provincial and local level;

- **UNDP Institutional and Capacity Support to the Parliament of Afghanistan (ICSPA)**, and the capacity building of Parliamentary budget committees to further enable the Committees' oversight role;

- **ARTF Capacity Building for Results CBR**, with proposed PFM actions focus on the increase of Tashkeel workforce.

Policy dialogue with the Afghan government and the international community is well established in formal and informal settings, with a high degree of institutionalisation and coordination at all levels. The SBC provides a complementary platform and strengthens strategic policy dialogue with the Afghan government on mutually agreed objectives on PFM reform with a significant political leverage.

At the core of the proposed action is a new engagement model whereby the governance of the support to PFM reform is firmly anchored in the leadership structure of the FPPIP at MoF centring both the management and oversight of the program within MoF's leadership team, while maintaining the stringent ARTF control, evaluation and monitoring mechanisms. In parallel the government and WB/ARTF are jointly committed to reinforcing the PFM Shura as central donor consultation mechanism on PFM reform chaired by MoF while the ARTF Gender Working Group is equally consulted. These existing structures and arrangements are providing the context and the complementary measures for the PFM action to be an effective additional instrument in the overall international engagement in Afghanistan.

This proposed action is relevant for the Agenda 2030 as it intends to contribute primarily to the progressive achievement of **SDG 17 (Finance)** and its target 17.1 (Strengthen domestic resource mobilisation, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection). Sustainable development relies on sound macroeconomic and development policies, a supportive climate for private
investment, and good governance with sound PFM being critical to ensuring effective use of public resources. In addition indicators 1.b (sound policy framework based on pro-poor and gender-sensitive development strategies), 10.4 (fiscal policies to achieve greater equality), 16.5 (reduction of corruption), 16.6 (effective, accountable and transparent institutions), 16.7 (responsive, inclusive, participatory and representative decision-making), 16.10 (public access to information) are equally addressed to the extent feasible. However it should be noted, that the nationalisation process of the SDGs by the Government is still on-going to date.

3.3 Cross-cutting issues

Gender is a key priority of the EU and the wider international community in its policy dialogue and engagement with the Afghan government. It is prominently included in the SMAF and the success of the ANDPF will be judged to a large degree on how it mainstreamed gender in government activities in addition to dedicated strategies such as the National Women Economic Empowerment Programme. In addition, the existing policy dialogue mechanisms such as the policy dialogue framework of the SBC and the ARTF Gender Working Group, the PFM Shura will serve as a forum to follow-up on the implementation of the government's Gender Responsive Budgeting Strategic Action Plan (GRB 2014).

In terms of the Right-Based-Approach, the implementation modality of indirect management with the ARTF poses a limitation in terms of the WB globally not having incorporated RBA into its programming. However, the EU Del is committed to pursuing the discussion to ensure that the national budget is increasingly used as the central tool for implementation equitable pro-poor development policies that advance the human rights agenda.

The ANDPF recognises climate change adaptation and mitigation as important in particular for agriculture and energy respectively. Improved governance, in this case improved efficiency and accountability in the use of public funds on basis of implemented PFM reforms, will support the implementation of policies in all sectors, including on climate change.

4. Description of the action

4.1 Objectives/results

The present action aims at providing support to the implementation of the five-year rolling Fiscal Performance Improvement Plan (FPIP), building on past reform achievements.

The overall objective of the programme is the stimulation of sustainable and inclusive economic growth, social development and good governance.

The specific objective is fiscal sustainability on the basis of (i) strengthened PFM institutions and reform implementation; (ii) enhanced PFM and budgeting processes, control and oversight; (iii) strengthened gender equality perspective in PFM; and (iv) augmented fiscal self-reliance through increased domestic revenue mobilisation.

The action is twofold. It contributes to PFM system and operations reform; and it provides technical assistance in selected areas of PFM institutional and operational arrangements related to the oversight by the Supreme Audit Office.

The outputs are expected to be:
1. Line ministries are able to prepare and execute budget as well as deliver services more efficiently;
2. Improved capacity of civil servants (Tashkeel) to operate the PFM systems;
3. Compliant, transparent and accountable management of financial resources;
4. Strengthened internal and external audit function and operation;
5. Higher levels of domestic revenue mobilisation.
6. promote Gender Responsive Budgeting (GRB) as part of PFM reform;

4.2 MAIN ACTIVITIES

Core component - support to PFM reform through the WB ARTF programme

The activities for Result 1 to 5 are expected to be:

- Operationalise FPIP work plans for specific activities across the departments of MoF, line ministries and agencies;
- Trainings for performance monitoring and evaluation under the FPIP work plan;
- Selected trainings related to PFM systems and operation.

Complementary support directly managed by the EU Delegation

The activity for Result 5 is to provide technical assistance to the Supreme Audit Office to strengthen SAO's PFM oversight function and promote reinforced linkage with peer institution(s) in selected MS.

4.3 INTERVENTION LOGIC

This programme will aim at enhancing the effective use of resources and alignment of expenditure with national priorities to improve Government’s service delivery and spur economic growth. This will require strengthening the wider PFM system, through improving (i) institutional capacity to implement reform, (ii) budget comprehensiveness and transparency, (iii) policy-based budgeting, (iv) predictability and control in budget execution, (v) accounting, recording and reporting, (vi) external scrutiny and audit of the budget, and (vii) public accountability.

These objectives should contribute to improved transparency and oversight as well as confidence of the population in the performance of the Government, particularly as regards the budget process.

Considering the high level of Government ownership over the FPIP, this programme is proposed to support core PFM reforms through the newly restructured and consolidated World Bank / ARTF engagement model for FPIP reform that builds on three inter-related and complementary instruments. At the core of the new engagement model with the Government is the governance of the program which is firmly anchored in the leadership structure of the FPIP centring the management and oversight of the program within the MoF leadership team.

Of the three instruments, EU funds shall – within the possibilities of ARTF preferencing - support the Fiscal Performance Improvement Support Program (FSP). This is a flexible Government-executed Investment Financing Project that continues strengthening core financial and fiscal management systems through a mix of activities with a comprehensive reach to beneficiary departments including functional departments of the Ministry of Finance's corporate backbone such as administration and human resources. The FSP is designed so as to introduce greater flexibility in allocating resources where they are needed.

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12 A detailed description of activities shall be added as an Annex to the Administration Agreement with WB.

13 The other two instruments – part of the World Bank ARTF programmatic approach to PFM reform but not directly supported by EU funds - are the FPIP Advisory Facility (World Bank executed technical assistance with the development of work plans for MoF departments, participation in the quality control of the bi-annual FPIP assessment processes, analytical support for reform implementation, and on-demand assistance on emerging issues; training and workshop activities) and the ARTF Incentive Program Plus with quantitative benchmarks that reflect progress in achieving the strategic objectives of the FPIP and measure whole-of-MoF performance.
Activity and procurement plans are updated regularly in close cooperation with the MoF leadership team, reflecting the performance based nature of the FPIP management process. The FSP is focused on project implementation through country systems (existing Government Corporate support areas) and without a designated Project Implementation Unit.

In addition it is foreseen to support the FPIP reform with flexible technical assistance to the Supreme Audit Organisation based on a joint-needs assessment between the Government and Development Partners once the exact scope and depth of the WB ARTF FSP has been determined.

5. IMPLEMENTATION

5.1 Financing agreement

In order to implement this action, it is foreseen to conclude a financing agreement with the partner country, referred to in Article 184(2)(b) of Regulation (EU, Euratom) No 966/2012.

5.2 Indicative implementation period

The indicative operational implementation period of this action, during which the activities described in section 4.2 will be carried out and the corresponding contracts and agreements implemented, is 36 months from the date of entry into force of the financing agreement.

Extensions of the implementation period may be agreed by the Commission's authorising officer responsible by amending this decision and the relevant contracts and agreements, such amendments to this decision constitute technical amendments in the sense of point (i) of Article 2(3)(c) of Regulation (EU) No 236/2014.

5.3 Implementation modalities

It is proposed to implement the present action through a combination of support to the WB ARTF FSP programme in indirect management and the provision of technical assistance to the Ministry of Finance (MoF) and Supreme Audit Organisation (SAO) in direct management. The support provided to PFM reform through these complementary modalities shall assist the Government with the implementation of the five-year rolling Fiscal Performance Improvement Plan (FPIP) building on past reform achievements (indirect management) and at the same time provide flexible additional support to strengthen the oversight capacities of the independent SAO (direct management).

Both in indirect and direct management, the Commission will ensure that the EU appropriate rules and procedures for providing financing to third parties are respected, including review procedures, where appropriate, and compliance of the action with EU restrictive measures affecting the respective countries of operation.

5.3.1 Indirect Management with an International Organization

One component of this action with the specific objective of supporting PFM reform is proposed to be implemented in indirect management with the World Bank in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012. This implementation is justified because the World Bank as ARTF Administrator has long standing experience in implementing development aid in Afghanistan and in particular more than 10 year successful experience with PFM reform in Afghanistan (IDA projects, WB/ARTF PFMR I and II). Moreover it allows for a coordination framework with the government and donors (PFM Shura) not only for the present action but equally for the SBC's eligibility criteria of PFM and transparency/oversight.

The entrusted entity would carry out the following budget implementation tasks: launch calls

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for tenders and for proposals; define eligibility, selection and award criteria; evaluate tenders and proposals; award grants, contracts and financial instruments; act as contracting authority concluding and managing contracts, carrying out payments.

For the budget implementation tasks not yet assessed, the entrusted international organisation is currently undergoing the ex-ante assessment in accordance with Article 61(1) of Regulation (EU, Euratom) No 966/2012. The Commission’s authorising officer responsible deems that, based on the compliance with the ex-ante assessment based on Regulation (EU, Euratom) No 1605/2002 and long-lasting problem-free cooperation, the international organisation can be entrusted with budget-implementation tasks under indirect management.

If negotiations with the above-mentioned entrusted entity fail, that part of this action may be implemented in direct management in accordance with the implementation modalities identified in section 5.3.2.

5.3.2 Procurement (direct management)

The other component of this action with the specific objective of supporting PFM reform is proposed to be implemented in direct management for the provision of technical assistance to the Supreme Audit Organisation through a Service Contract. This component shall be complementary to the component in indirect management providing flexible additional support to these institutions for the benefit of PFM reform.

<table>
<thead>
<tr>
<th>Subject in generic terms, if possible</th>
<th>Type (works, supplies, services)</th>
<th>Indicative number of contracts</th>
<th>Indicative trimester of launch of the procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technical assistance</td>
<td>Services</td>
<td>1</td>
<td>1st trimester 2018</td>
</tr>
</tbody>
</table>

5.4 Scope of geographical eligibility for procurement and grants

The geographical eligibility in terms of place of establishment for participating in procurement and grant award procedures and in terms of origin of supplies purchased as established in the basic act and set out in the relevant contractual documents shall apply.

The Commission's authorising officer responsible may extend the geographical eligibility in accordance with Article 9(2)(b) of Regulation (EU) No 236/2014 on the basis of urgency or of unavailability of products and services in the markets of the countries concerned, or in other duly substantiated cases where the eligibility rules would make the realisation of this action impossible or exceedingly difficult.

5.5 Indicative budget

<table>
<thead>
<tr>
<th>5.3.1 Indirect management with the World Bank</th>
<th>EU contribution (amount in EUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.3.2 Technical assistance</td>
<td>8 000 000</td>
</tr>
<tr>
<td>5.8 Evaluation, 5.9 Audit</td>
<td>700 000</td>
</tr>
<tr>
<td>5.10 Communication and visibility</td>
<td>300 000</td>
</tr>
<tr>
<td>Total</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>9 000 000</td>
</tr>
</tbody>
</table>

5.6 Organisational set-up and responsibilities

Component of the action in indirect management through the WB ARTF

The Afghanistan Reconstruction Trust Fund (ARTF) was originally conceived in 2002 as a
multi-donor trust fund to support immediate stabilisation and reconstruction needs in Afghanistan through a coordinated financing mechanism. The ARTF has since then evolved to become the main vehicle for multi-donor, on-budget support for the government’s national programmes reform agenda, fiscal sustainability and the prioritisation and delivery of the national development strategy. The ARTF is supported by 34 donors and administered by the World Bank. Its three-tier governance framework is composed of a Steering Committee, a Management Committee and the World Bank as an Administrator.

The Steering Committee, co-chaired by the Ministry of Finance and the World Bank, consists of all 33 ARTF donors and sets the ARTF strategy. Steering Committee decisions are made on a consensus basis and are informed by ARTF working groups. The Steering Committee meets once every quarter in Kabul.

The Management Committee is responsible for implementing ARTF’s financing strategy, endorsed by ARTF Steering Committee. In practice, the Management Committee reviews and approves requests for financing based on their technical quality and alignment with the financing strategy. The Management Committee consists of the Ministry of Finance, the Asian Development Bank, the United Nations Development Programme, the Islamic Development Bank and is chaired by the World Bank. The United Nations Assistance Mission in Afghanistan acts as an observer.

The Fiscal Performance Improvement Support Programme (FSP) is focused on project implementation through country systems (existing Government Corporate support areas) and without a designated Project Implementation Unit. At the core of the new engagement model between the Government and WB / ARTF is the governance of the program which is firmly anchored in the leadership structure of the FPIP centring the management and oversight of the program within the MoF leadership team. The MoF leadership team thus manages the implementation of the program through corporate MoF systems and most importantly, the MoF leadership team – not the individual MoF beneficiary – will in the future oversee and guide the implementation of the program.

Component of the action in direct management

Review and monitoring of progress in the implementation of PFM reform shall be entrusted to MoF with regular reporting to all stakeholders through the PFM Shura. The MoF leadership team will liaise as necessary with all stakeholders, including implementing agencies, line ministries, Parliament, SAO, and the civil society to ensure comprehensive and effective monitoring.

In addition to the PFM Shura regular bilateral meetings shall be organised by MoF, SAO and the EU Delegation to monitor progress in overall programme implementation, identify and address bottlenecks as well as the areas for additional support through technical assistance.

5.7 Performance monitoring and reporting

The day-to-day technical and financial monitoring of the implementation of this action will be a continuous process and part of the implementing partner’s responsibilities. To this aim, the implementing partner shall establish a permanent internal, technical and financial monitoring system for the action and elaborate regular progress reports (not less than annual) and final reports. Every report shall provide an accurate account of implementation of the action, difficulties encountered, changes introduced, as well as the degree of achievement of its results (outputs and direct outcomes) as measured by corresponding indicators. The report shall be laid out in such a way as to allow monitoring of the means envisaged and employed and of the budget details for the action. The final report, narrative and financial, will cover the entire period of the action implementation.

The Commission may undertake additional project monitoring visits both through its own
staff and through independent consultants recruited directly by the Commission for independent monitoring reviews (or recruited by the responsible agent contracted by the Commission for implementing such reviews).

5.8 Evaluation

Evaluations and audit arrangements are an integral part of the contractual modalities. An external evaluation (ex-post) may also be conducted by independent consultants recruited directly by the Delegation in accordance with EU rules and procedures on specifically established terms of reference. The budget for this action foresees funds for evaluation and audit that can be complemented by funds from support measures if needed.

5.9 Audit

Without prejudice to the obligations applicable to contracts concluded for the implementation of this action, the Commission may, on the basis of a risk assessment, contract independent audits or expenditure verification assignments for one or several contracts or agreements. Indicatively, one contract for audit services shall be concluded under a framework contract at the end of the implementation period of the action.

5.10 Communication and visibility

Communication and visibility of the EU is a legal obligation for all external actions funded by the EU.

This action shall contain communication and visibility measures which shall be based on a specific Communication and Visibility Plan of the Action, to be elaborated before the start of implementation and supported by the EU’s horizontal communication contract.

The measures shall be implemented by the partner country, contractors (EU’s horizontal communication contract), and entrusted entities. Appropriate contractual obligations shall be included in, respectively, financing agreements, procurement and grant contracts, and delegation agreements.

The Communication and Visibility Manual for European Union External Action shall be used to establish the Communication and Visibility Plan of the Action and the appropriate contractual obligations.
APPENDIX - Indicative Logframe matrix (for project modality)

The activities, the expected outputs and all the indicators, targets and baselines included in the logframe matrix are indicative and may be updated during the implementation of the action, no amendment being required to the financing decision. When it is not possible to determine the outputs of an action at formulation stage, intermediary outcomes should be presented and the outputs defined during inception of the overall programme and its components. The indicative logframe matrix will evolve during the lifetime of the action: new lines will be added for including the activities as well as new columns for intermediary targets (milestones) for the output and outcome indicators whenever it is relevant for monitoring and reporting purposes. Note also that indicators should be disaggregated by sex whenever relevant.

<table>
<thead>
<tr>
<th>Results chain</th>
<th>Indicators</th>
<th>Baselines (incl. reference year)</th>
<th>Targets (incl. reference year)</th>
<th>Sources and means of verification</th>
<th>Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall objective Impact</td>
<td>O. O Stimulation of sustainable and inclusive economic growth, social development and good governance</td>
<td>Fiscal sustainability indicator (revenues over total expenditures) (**EU RF level 1 # 13)</td>
<td>36% (2016)</td>
<td>50% (2020)</td>
<td>IMF ECF / art 4 reports, WB development Outlook reports</td>
</tr>
<tr>
<td>Specific objective Outcome(s)</td>
<td>SO1 Strengthen PFM institutions and reforms implementation; SO2 Enhance PFM and budgeting processes, control and oversight; SO3 Strengthen gender equality perspective in PFM processes; (iv) Augment fiscal self-reliance through increased domestic revenue mobilisation.</td>
<td>• Budget execution rates for the recurrent and development • Eligibility ratio • Budget Oversight ranking (OBI) • Government revenue excluding grants / GDP</td>
<td>• 90% and 54% (2016) • 61.5% (2016) • 50% (OBI 2015) • 10.7% (2016)</td>
<td>• 97% and 75% (2020) • 85% (2020) • 65% (2020) • 12% (2020)</td>
<td>• Budget execution reports, Treasury/ARTF Monitoring Agent reports, IBP/OBI reports, IMF ECF / art 4 reports</td>
</tr>
</tbody>
</table>
| Outputs | O1. Strengthened internal and external audit functions and operation of PFM related institutions;  
|         | O2. Strengthened capacity of relevant institutions and staff (civil servants (Tashkeel), line ministries, etc.) to prepare and execute budget, deliver services more efficiently, operate PFM systems, and manage financial resources;  
|         | O3. Strengthened capacity of the Ministry of Finance to engage in policy dialogue on PFM reform,  
|         | O4. Promote Gender Responsive Budgeting (GRB) as part of PFM reform | 1.1 Overall rating of PEFA PI26 (internal audit) and PI 30 (external audit)  
|         | 1.2 Achievement of the annual performance targets indicated in the FPIP work plans  
|         | 1.3 Government ownership and frequency of PFM Shuras  
|         | 1.4 Gender perspective included in the ARTF FPIP | 1.1 Overall score C for PI-21 (internal audit) and overall score C+ for PI-26 (external audit) – PEFA 2013  
|         | 1.2 Annual FPIP performance assessment 2016: average grade B  
|         | 1.3 PFM Shuras donor organised and infrequent  
|         | 1.4 Gender perspective is not included in the WB ARTF PFMRII | 1.1 Overall Score C+ PI 26 (internal audit) and overall Score B- PI 30 (external audit) – PEFA 2020/21  
|         | 1.2 Annual assessment 2020: improvement in the average grade  
|         | 1.3 Bi-monthly PFM Shuras organised by MoF  
|         | 1.4 Gender perspective included in the WB ARTF FPIP programme and results framework | PEFA assessment  
|         | Annual FPIP Performance Assessment  
|         | PFM Shuras minutes  
|         | WB ARTF FPIP Programme Appraisal Document and Results Framework  
|         | Institutionalisation of the FPIP reform programme  
|         | Appropriate resource allocation (human and capital)  
|         | Institutional reform of SAO |