



## Country Partnership Strategy

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### **Public Financial Management, Procurement and Combating Corruption**

### **Risk Assessment of Country Level Systems in Afghanistan**

August 2007

This document is part of a series of background assessments, diagnostics, and discussion papers commissioned by the Asian Development Bank (ADB) to underpin the development of its new Country Partnership Strategy (CPS) for Afghanistan. The findings, opinions, and recommendations contained in this document may not reflect those of the Asian Development Bank, but are provided to generate stakeholder comment.

Such comment is welcomed by ADB, and can be sent to: [gcurtis@adb.org](mailto:gcurtis@adb.org)

## ABBREVIATIONS

|          |  |
|----------|--|
| AACA     | Afghanistan Assistance Coordination Agency                         |
| ABP      | Afghan Border Police   |
| ACD      | Afghan Customs Department  |
| ADB      | Asian Development Bank   |
| ADTA     | Advisory Technical Assistance                                      |
| AEP      | Afghanistan Expatriate Program                                     |
| AFG      | Afghanistan  |
| AFMS     | Administrative and Financial Management System                     |
| AGE      | Antigovernment elements  |
| AIB      | Afghanistan International Bank                                     |
| AIGF     | Afghanistan Investment Guarantee Facility                          |
| ANA      | Afghan national Army   |
| ANP      | Afghan National Police   |
| ARDS     | Afghanistan Reconstruction and Development Services                |
| CAO      | Control and Audit Office   |
| CARA     | Civil Aviation Regulatory Authority                                |
| CDC      | Community Development Council                                      |
| CEO      | Chief Executive Officer  |
| CG       | Consultative Group   |
| COFOG    | Classification of Functions of Government                          |
| CP       | Customs Police   |
| CPI      | Consumer Price Index   |
| CSM      | Civil Service Management   |
| CSO      | Central Statistical Office   |
| DAB      | Da Afghanistan Bank  |
| DABM     | Da Afghanistan Breshna Moessessa                                   |
| DCA      | Directorate of Civil Aviation                                      |
| DDR      | Disarming, Demobilization and Rehabilitation                       |
| DIAG     | Disbandment of Illegal Armed Groups                                |
| EC       | European Commission  |
| EIRRP    | Emergency Infrastructure Rehabilitation and Reconstruction Project |
| EPAP     | Emergency Public Administration Project                            |
| FCC      | Fiscal Coordination Committee                                      |
| FM       | Financial Management   |
| FMPAR    | Financial Market and Public Administration Reform Program          |
| GACAP II | Second Governance and Anticorruption Action Plan                   |
| GIAAC    | General Independent Administration for Anticorruption              |
| GIS      | Geographic Information System                                      |
| GFS      | government financial statistics                                    |
| IAB      | Independent Appointments Board                                     |
| IAG      | Illegal armed groups   |
| I-ANDS   | Interim Afghanistan National Development Strategy                  |
| IARCSC   | Independent Administrative Reform and Civil Service Commission     |
| IATA     | International Air Transport Association                            |

|       |  |
|-------|--|
| ICB   | International Competitive Bidding                |
| ICT   | Information and communication technology         |
| IDPs  | Internally Displaced Persons                     |
| IMF   | International Monetary Fund                      |
| IPC   | Interim Payment Certificate                      |
| ISAF  | International Security Assistance Force          |
| JCMB  | Joint Coordination and Monitoring Board          |
| LEP   | Lateral Entry Program                            |
| O & M | Operation and Maintenance                        |
| MAAH  | Ministry of Agriculture and Animal Husbandry     |
| MAC   | Ministerial Advisory Committee                   |
| MDG   | Millennium Development Goal                      |
| MEW   | Ministry of Energy and Water                     |
| MIGA  | Multilateral Investment Guarantee Agency         |
| MM    | Ministry of Mines                                |
| MOC   | Ministry of Commerce                             |
| MOE   | Ministry of Education                            |
| MOF   | Ministry of Finance                              |
| MOPH  | Ministry of Public Health                        |
| MOT   | Ministry of Transport                            |
| MOWA  | Ministry of Women's Affairs                      |
| MPW   | Ministry of Public Works                         |
| MTBF  | Medium-term Budgeting Framework                  |
| NATO  | North Atlantic Treaty Organization               |
| LCB   | Local Competitive Bidding                        |
| NCB   | National Competitive Bidding                     |
| NDS   | National Development Strategy                    |
| NEEP  | National Emergency Employment Program            |
| NPP   | National Priority Program                        |
| NSP   | National Solidarity Program                      |
| OEF   | Operation Enduring Freedom                       |
| PAR   | Public Administration Reform                     |
| PFM   | Public Financial Management                      |
| PIP   | Public Investment Program                        |
| PMPL  | Post conflict Multisector Program Loan           |
| PPU   | Procurement Policy Unit                          |
| PRGF  | Poverty Reduction Growth Facility                |
| PRR   | Priority Reform and Restructuring                |
| PRT   | Provincial Reconstruction Team                   |
| RIMU  | Reform Implementation Monitoring Unit            |
| RRR   | Retraining, Reskilling and Redeployment          |
| SEPAP | Second Emergency Public Administration Project   |
| SME   | Small- and medium-sized enterprise               |
| SMP   | Staff Monitored Program                          |
| SOE   | State Owned Enterprise                           |
| TA    | Technical Assistance                             |
| UNAMA | United Nations Assistance Mission to Afghanistan |
| UNCAC | United Nations Convention against Corruption     |
| WB    | World Bank                                       |

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## I. INTRODUCTION

1. In 2005, ADB initiated a combined *Review of the Implementation of Governance and Anticorruption Policies* (the Review). The Review found that ADB has succeeded in raising the profile of governance in the region. At the same time, the Review also concludes that there is still a long way to go toward embedding implementation of governance and anticorruption policies in the mainstream of ADB operations. The Review further identified strengthening country systems in public financial management and procurement, and reducing vulnerability to corruption, as priority areas for improving governance and strengthening development effectiveness.

2. Following the Review, ADB developed the *Second Governance and Anticorruption Action Plan* (GACAP II) to improve ADB's performance in the implementation of the governance and anticorruption policies in the sectors and sub sectors where ADB is active. The July 2006 GACAP II is a results-oriented action plan designed to add value to ADB's policy and operations.

3. ADB's Country Partnership Strategy Guidelines (January 2007) require that "risk assessment[s] and risk management plan[s] including public financial management, procurement, and corruption" are prepared for the new CPS for Afghanistan. This report is a background document to the new CPS. It assesses the status of public financial management, procurement systems, and integrity systems for combating corruption.

4. In addition to informing the context of the CPS, this report also underpins the sector governance and anticorruption risk assessments and mitigation plans for the energy and road transport sectors, which have been prepared separately, as part of the CPS formulation process. The sector level risk assessments are expected to inform the design of projects and programs in the energy and road transport sectors.

5. Section II of the report provides a brief summary of the country context in Afghanistan. Section III summarizes ADB's programming in Afghanistan, past and future. Section IV provides an assessment of public financial management systems. Section V further elaborates on procurement systems. Section VI provides an overview and assessment of national integrity systems to combat corruption. Section VII summarizes key risks and makes recommendations for mitigating risks in ADB operations.

6. In line with harmonization goals and ADB's Second Medium Term Strategy (MTS II), this report draws on diagnostic reviews and assessments undertaken by other multilateral and bilateral development partners, notably: the World Bank report: *Afghanistan: Managing Public Finances for Development (2005)* and the *Reconstruction National Integrity System Survey (2007)* prepared by Integrity Watch Afghanistan. Other secondary sources are referenced through the report.

## II. AFGHANISTAN COUNTRY CONTEXT

5. Afghanistan is emerging from a quarter century of war and civil conflict that left the country's physical, financial and institutional infrastructures in ruins. In late 2001, when coalition forces ousted the Taliban, the state had collapsed for all practical purposes; a functioning government had not been formed and the bureaucracy was in disarray and unable to provide minimum civil service functions, in the absence of skills, leadership, motivation and integrity. The legal framework for good governance was lacking; rule of law was all but non-existent; the market was undeveloped and dominated by the public sector, and private, public and civil society partnership was in its infancy.

6. In 2001, the international community committed itself to the recovery of war-torn

Afghanistan. The priorities were to: remove the Taliban from power; capture key al Qaeda figures; organize elections; build infrastructure; manage the return of refugees, and deliver humanitarian relief. Considerable progress had been made towards these objectives during the first four years of reconstruction.

7. By 2005, however, Afghans faced new challenges. In much of the country, the situation had evolved from war, humanitarian, emergency, and political negotiation to transition, development and institution building. The international community and the government began to pursue a comprehensive development strategy. A centralized model was adopted, with the Afghan government responsible for making progress in all sectors at the same time. Citizens and local communities were relying on leadership from Kabul and international organizations to deliver improvement. However, the country was not yet ready to move to a traditional development partnership, and donors were skeptical of Afghanistan's capacity to manage its own recovery. The needs were great, the state too weak, and the modalities of international aid too static and slow.<sup>1</sup>

8. Since 2005, an election has taken place resulting in a functioning parliament; a state-building agenda has been articulated in the Afghanistan National Development Strategy (ANDS) and endorsed by the international community through the Afghanistan Compact; international military forces came under NATO command. However riots erupted in Kabul; the Taliban has reasserted its power in south and east pockets of the country; and opium production has accelerated. There have been improvements in education, communication, government capacity, and private investment. However, the challenges of warlordism, dependence on the poppy, pervasive corruption, a resurgent Taliban, and scarcity of electricity continue.<sup>2</sup>

### III. ADB ASSISTANCE IN AFGHANISTAN

6. ADB's initial country strategy and program (I-CSP) for 2002-2004 specified four principles for ADB operations in Afghanistan: (i) full involvement of Afghan men and women in the reconstruction process; (ii) an appropriate policy and institutional framework to support the country's reconstruction; (iii) national capacity development to ensure the effectiveness of reconstruction and development efforts; and (iv) promotion of human rights and social inclusion.<sup>3</sup> The I-CSP identified the following areas for ADB assistance: (i) capacity development; (ii) rehabilitation of physical infrastructure; (iii) revitalization of agriculture and rural development; (iv) private sector development; (v) social development; and (vi) gender empowerment.

7. While the priorities identified in the I-CSP corresponded with those in the Government's 2002 Interim Development Strategy, given the large number of development partners and limited institutional capacity, the Government subsequently requested ADB (and other donors) to focus their assistance on a maximum of three sectors. The Government and ADB agreed that ADB's operational focus in Afghanistan would be to (i) build institutional and human resource capacity; (ii) support policy and institutional reform; and (iii) support infrastructure rehabilitation. It was also agreed that ADB assistance would be focused on (i) agriculture and natural resource management; (ii) energy; and (iii) transport and communications sectors, with some additional support to (iv) governance and finance-related activities. It was further agreed that ADB would provide support for Afghanistan's private sector development, including, banking and telecommunications. ADB undertook to

<sup>1</sup> Center for Strategic and International Studies (CSIS). 2007. *Breaking Point: Measuring Progress in Afghanistan*.

<sup>2</sup> Ibid. p. 11-12.

<sup>3</sup> ADB. 2002. *Initial Country Strategy and Program (2002-2004): Afghanistan*. Manila.

mainstream social development and gender empowerment across all of its activities, and to promote regional cooperation through its sector-based investment projects. By the end of 2006, more than 43% of ADB's assistance to Afghanistan was in the transport and communications sector, with nearly equal shares for agriculture (15.8%) and natural resources (15.3%) and a slightly lower share for energy (12.3%).

8. With ADB resuming operations in Afghanistan only in 2002, none of the 13 ADF loan and grant projects/programs had been completed by mid-2007. Key constraints to effective project implementation and portfolio management are (i) lack of government ownership (a function, to some extent, of aid dependence); (ii) frequent changes in senior ministry personnel; and (iii) lack of qualified counterpart staff in executing agencies. Such constraints result in ineffective project design and implementation, and an over-reliance on donors and donor-funded consultants for project management activities.

9. Security risks are increasingly affecting project implementation. Some contractors have had to withdraw because of lack of adequate security. Consultants and have declined positions and supervision contracts. Poor security also results in due diligence not being fully exercised, with project design consultants prevented from conducting full field surveys. Lack of reliable data prevents definitive economic and financial analysis of project activities. Consultation with local authorities, beneficiaries, and other stakeholders – and particularly women – is also deficient. The difficult security environment increases project costs, results in delays, and constrains effective monitoring.

10. Project implementation also suffers from weak ministry capacity and inadequate or cumbersome government systems and procedures. Lengthy procurement has delayed project implementation, with contract awards taking well over a year from release of bid documents to signing of contracts. Under government regulations, contracts larger than \$100,000 must be cleared by the Ministry of Finance, with contracts over \$3.5 million also requiring clearance by the Office of the President prior to signing. In addition, all aspects of any procurement larger than \$200,000, including contract documents, prequalification and tender evaluations, and award recommendations, must be reviewed by the Afghanistan Reconstruction and Development Services, assisted by international procurement experts. Disbursement performance for donor-funded activities remains well below expectations, as does physical progress on most infrastructure projects.

11. In view of the country's institutional and capacity limitations, the Government has reiterated its request that development partners focus their assistance on a limited number of sectors. Given ADB's comparative advantages, staff skills mix, the sectoral priorities identified in ADB's medium-term strategy II, and recent country experience, ADB and the Government have agreed that ADB's new CPS should focus ADB assistance on three sectors:

- (i) agriculture, including irrigation and water resource management, rural development, and commercial agriculture;
- (ii) energy, including power generation, transmission, and distribution and regional cooperation and trade; and
- (iii) road infrastructure, with a focus on rehabilitation and construction of national roads, including links to neighboring countries

12. In addition to infrastructure investments and support for capacity and institutional development, ADB has contributed to improvements in the enabling environment for private-sector-led economic growth and has made strategic private sector investments, which have catalyzed additional private sector investment. This focus for ADB's private sector activities

will probably remain in banking, telecommunications, and energy and mining sectors. Given public and private sector capacity and institutional constraints, public-private partnerships are not expected to be a major feature in the medium term.

#### **IV. PUBLIC FINANCIAL MANAGEMENT (PFM)**

##### **A. Legal Framework**

7. Afghanistan's fiscal framework is governed by four pieces of legislation (i) the Budget Law (1983); (ii) the Accounting Manual (circa 1964); (iii) the Control and Audit Regulation (issued under the Budget Law in 1985), and (iv) the Procurement Regulations (1987).

8. The 1983 Budget Law provides appropriate checks and balances and assigns roles for fiscal management. It requires pre-audit to be conducted by MoF. It also requires the full cost of donor projects to be reflected in the Government budget. It does not cover important issues related to public monies, treasury operations, or accounting. The Law provides for a separation between the "development" and "ordinary" budget, rather than between recurrent and capital budgets. The Law does not reflect the current budget or organizational structure of Afghanistan as spending is allocated to central and rural, development and social welfare budgets, and a confidential budget.

9. The Accounting Manual establishes the "legal requirements, organization, policies, procedures, and rules concerning the accounting system" of the Government of Afghanistan. However, the last full set of financial statements prepared by the accounting department in MoF was over 15 years ago.

10. The Control and Audit Regulation recognizes the General Control and Inspection Presidency of the Council of Ministers as the supreme audit authority for the whole of government, under the auditor general, providing ex-post external audit. The authority audits the Final Account of Revenues and Expenditures of the MoF. The "Final Account" contains the appropriations of the primary budgetary units; allocations issued during the fiscal year; revenues collected, and expenditures made by government entities. The Final Account is prepared by the accounting, treasury, and revenue departments of MoF and is the primary source of information for the preparation of the budget for the following fiscal year. The Regulation also provides for ministries to have their own internal audit departments which must coordinate with the General control and Inspection Presidency.

11. The PFM legal framework also includes the annual budget decree which set ceilings on maximum levels of new debt to be incurred, prohibits overdrafts, and authorizes MoF to issue instructions regarding finance and budget implementation. Presidential Decrees are used to provide specific PFM guidance and prohibitions. During the last five years, MoF has also issued a number of Budget and Treasury Circulars.

12. The multiple PFM laws and regulations are selectively applied and do not assign clear responsibility to the line ministries. The partial application of the Budget Law and regulations has led to the imposition of contravening provisions in the annual budget decree and undermined the demand for compliance with the emerging legal framework supported by the Presidential Decrees.

13. To address these issues, the Government enacted a Public Finance and Expenditure Management (PFEM) Law in June 2005. The Law provides clear rules and roles in public financial management functions, requires adequate levels of reporting, provides for independent review, and holds public officials accountable. It covers the entire general (non-financial) government sector but does not apply to state owned enterprises which operate

under the SOE (Tassady) Act. MoF is responsible for framing financial policy, regulating the use of public money, and applying the PFEM Law. The law has been gazetted and regulations to implement it are being/have been drafted.

## **B. Assessment of PFM**

### **1. Framework for Analysis**

15. A PFM performance rating system has been developed by the Public Expenditure and Financial Accountability (PEFA) multi-agency partnership program. This provides an objective, internationally comparable framework for assessing a country's PFM system. The World Bank study<sup>4</sup> presents a summary of Afghanistan's PFM system against the PEFA indicators.

16. The PFM performance assessment framework includes 31 high-level PFM performance indicators, measuring performance in one of six dimensions: (i) credibility of the budget; (ii) comprehensiveness and transparency; (iii) policy-based budgeting; (iv) predictability and control in budget execution; (iv) accounting, recording, and reporting; (vi) external scrutiny and audit; and (vii) donor practices. The PFM performance indicators also measure how key parts of the budget process are working, cross-cutting features of the budget, and whether the budget is credible (as demonstrated by out-turn).

### **2. Assessment of PEFA Indicators**

17. Table ??? summarizes the ratings for Afghanistan, as of June 2005 on the 31 indicators. The assessment is discussed in detail, rating by rating, in Volume II, Part I of the World Bank study, and is summarized below. The situation in Afghanistan has special features which need to be kept in mind when interpreting the ratings. First, some ratings reflect temporary factors (for instance the absence – at the time of the assessment – of a Parliament). Second, some ratings are based on changes made recently, and it is still uncertain whether they will sustain. Third, the ratings assess the current situation in which significant external support (both advisory and operational) is being provided to the Government. This raises sustainability issues as the external support will decline over time, including in relation to financial management operations.

18. **Credibility of the budget** (Performance Indicators 1-4). Progress has been made toward a credible budget, based on fiscal discipline. However, the credibility of the budget is hampered by over-optimistic projections, attributable to lack of realism at the budget formulation stage, limited capacity to implement the budget, and large deviations between budgeted amounts and out-turns. This is in particular the case for the External Budget (accounting for as much as three-quarters of total public spending), which remains effectively outside the Government's control.

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<sup>4</sup> World Bank. 2005. Afghanistan: Managing Public Finances for Development.

Table ????: Public Finance Management Performance Indicators

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

Note: In the rating system 4 is the top performance rating, 1 the lowest. The ratings measured performance as of June 2005. Broadly speaking, most indicators would have been rated "4" in 2002.

Source: World Bank staff estimates based on PEFA framework (PEFA, 2005, Annex 1, and table on p. 9).

**19. Comprehensiveness and transparency of information** (Performance Indicators 5-10).

The Government is committed to share budgetary information transparently. The annual budget for the national Government is impressive, with coverage of most public spending of the general Government sector, whether implemented by the Government or directly by donors. It is a useful public document relating the expenditures on projects to National Programs. Fiscal, revenue, and expenditure records for the Core Budget are maintained through the budget implementation system based in the Afghanistan Financial Management Information System (AFMIS). Comprehensive reports on budgetary aggregates are produced monthly and are now available on MoF's website. This information is generally reliable but is affected by lags in recording provincial operations. Improvements are needed with respect to external audit reports. There are also uncertainties about the quality of information on the External Budget. Further, fiscal risks which could arise from activities in state-owned enterprises and municipalities are not effectively monitored because the financial information is unverified and too limited for fiscal risk management in these areas.

**20. Policy-based budgeting** (Performance Indicators 11-12). Some progress has been

made toward the Government's objective of making the national budget the central instrument of policy and reform, but there are still constraints. The implications of policy decisions, including for fiscal sustainability, are not taken into account due to lack of capacity in Government to develop policy, agree on trade-offs between investments and recurrent costs, and match resources with policies. Multi-year planning is also constrained by the complexity of aid coordination. Budgeting for recurrent and investment expenditures is carried out separately, exacerbating sustainability risks from recurrent expenditure implications of investment operations. The budget process is orderly and well understood within Government, but needs to be linked more closely with Government strategy; better owned by Cabinet and Parliament; and more reflective of sector issues, with more engagement by sector agencies, provinces, and civil society.

**21. Predictability and control in budget execution** (Performance Indicators 13-21).

Progress has been made in improving the implementation of the budget (notably the allotment process and cash management), but there is a need to enhance the predictability of funding for service delivery units. Line departments at provincial level cannot predict fund availability accurately, because of delays in communication with the Mustoufiats (provincial offices of MoF) and the complexity of the allocation process. This has led to cash rationing at the discretion of the Treasury and the Mustoufiats. Many adjustments are made during the year, in particular through allocation transfers and use of contingencies. No information is available at the local level (e.g. in primary schools) on funds allocated.

**22.** Revenue collection is not effective, with a large gap between potential revenue and actual collection. Despite some progress with taxpayer registration, controls on the revenue side remain weak. Clarification of the legislation and strengthening of financial management (including banking arrangements to ensure a steady flow of revenues to the Treasury Single Account, TSA) have improved revenue performance.

**23.** Progress has been made in implementing the control framework, with a significant increase in the eligibility rate measured by ARTF. There is a division of duties between the line

ministries, which approve expenditure, and MoF, which makes payments. Controls also include effective cash management, allotment control on budget uses, and reconciliation of records of the Treasury and the line ministries. Significant weaknesses remain, however, compounded by the lack of internal audit. Further improvements in the internal control framework are needed both for payroll and non-payroll expenditures, and for revenues. Current arrangements are also fragile since they rely on external operational support in Treasury and the review by the ARTF Monitoring Agent (Box 6.2). The recent approval of a new Public Finance and Expenditure Management (PFEM) Law will help in further strengthening the control framework.

24. Streamlining of the revenue base has been one of the major achievements of Government's fiscal reform effort. In March 2005, the Government gazetted the Revenue Law, which was amended in September 2005. Together with the amendment, the Revenue Law overrides the main tax holidays granted under the Investment Law and includes collection enforcement powers, corporate tax reforms, and a new airport departure fee (introduced in October 2005). Further efforts are under way to consolidate and simplify tax measures. An inventory of existing taxes, *soukes* (licenses), and fees at the provincial level (including fees levied by public enterprises or administered by line ministries) will assist in moving towards a simpler tax code, and transferring responsibility to MOF. All taxes collected at province level are to be transferred to a treasury single account. Municipalities will raise revenue locally to finance provision of basic services like sewerage, sanitation, construction and maintenance of municipal infrastructure.

25. All public revenue and expenditures for operations are managed by Treasury under a treasury single account (TSA). The disbursements unit in the Treasury manages special accounts for donor programs. Revenue and expenditure projections are drawn from targets rather than from historical patterns and procurement plans. Cash shortages or idle funds often result. On the revenue side, there are difficulties in reconciling accounts between the central treasury and line ministries. Development budgets are not well integrated with cash planning which complicates the synchronization of cash flow needs and borrowing. The public debt management system and skills are inadequate. Cash flow imbalances have often forced the government to utilize loan proceeds for meeting current expenditure requirements. The payroll system is not fully developed and implemented, especially at the provincial and district level. At present, payroll release involves 27 steps.

26. **Accounting, recording, and reporting** (Performance Indicators 22-25). Considerable improvements have been made in this area. The recording of expenditures and revenues has been strengthened by implementation of a computerized system (AFMIS) in MoF. Accountability of line ministries and MoF to the Cabinet is supported by frequent reporting on budget implementation, but more reporting and accounting capacity in line ministries is required. Significant progress has been made toward consolidation of bank accounts under the TSA system. However, much remains to be done to improve standards of accounting, frequency of bank reconciliation, and usefulness of reporting for line ministries' management.

27. **External scrutiny and audit** (Performance Indicators 26-28). The Auditor General is working to international auditing standards with support from an audit advisor. However, the final audit of the 2003/04 annual statements has not yet been released. The absence of a Parliament (until recently) has limited the extent of external scrutiny of the budget and its performance.

28. **Donor practices** (Donor Performance Indicators 1-3). Donors have mobilized considerable support for Afghanistan's budget, mainly through the ARTF. Support to the

recurrent budget through ARTF has been large and predictable. However, direct budget support accounts for a small percentage of external assistance, and the proportion of aid managed through national procedures remains low. Financial information provided by donors on donor-executed assistance activities, while reasonably comprehensive, is subject to delays, usually relates to disbursements rather than actual expenditures, and may suffer from inaccuracies and inconsistencies.

29. **Conclusions.** Afghanistan's PFM ratings indicate that financial resources are, by and large, being used for their intended purposes, authorized by a generally transparent budget. The expenditures are reported reliably in an understandable format. There is uncertainty with respect to revenue reporting. The efficiency of spending across programs and the efficiency of operations is not as good, however. Given that performance most likely would have been rated "1" on all dimensions in 2001 or 2002, this assessment indicates significant achievements over the last four years. The ratings are now comparable to other low-income countries. Areas of relative weakness include tax collection (indicators 13-15); legislative oversight (27-28). Payroll control (18) and predictability of budget-support (D1) are areas of relative strength.

### **C. Impact on ADB Operations (INSERT LATER)**

- Questions to be answered in this para – by someone with country experience/historic memory:

- a) Do any projects use national PFM systems?
- b) If ADB has provided budget support (program loans), how was this justified at the time?
- c) What support to PFM-strengthening has ADB provided to date and what is planned?

## **V. PUBLIC PROCUREMENT**

### **A. Legal Framework**

11. Most public procurement in Afghanistan is conducted through donor procurement procedures. Until 2005, procurement provision under government rules included (i) a Law on procurement of 1987; (ii) a Purchase Regulation adopted as a Decree of the Islamic Emirate of Afghanistan in 2001, both of which apply to the procurement of goods (and routine works and maintenance); and (iii) Rules and Regulations for the procurement of works adopted after 1989. The Purchase Regulation effectively replaces the Law on Procurement.

49. In 2005, Parliament passed the Law on Procurement pursuant to the provision of Article 75, section 4 of the Constitution to regulate procurement of goods and services. According to Section 2 of the Law *"The purpose of this law is to establish an open, transparent, competitive procurement system, based on effective budgetary and expenditure controls and reporting requirements designed to achieve efficiency, economy, the prevention of abuses, and a fair opportunity for participation by all potential contractors, including small enterprises and individuals."* The law on Procurement lays down the framework for procurement planning, eligibility and qualification of bidders, procurement proceedings and conditions for implementation, procurement methods, securities, contract administration, transparency and accountability, review, and procurement entities. Maximum levels for award authorities (Procurement Committee, Procurement Unit, Board of Directors or other award authority) have been established for national and international tenders. Though comprehensive, this law is still not operational. Detailed regulations and procedures on the implementation of the law are being

drafted by the Procurement Policy Unit (PPU) of MOF.

50. The Law on Procurement calls for a decentralized procurement system with each ministry/agency handling procurement through its own procurement unit by end-2007. This represents a substantial capacity development challenge at ministry and other levels. ARDS is providing some training to ministry staff but this is not sufficient. It is expected that the ARDS procurement unit will need to continue to provide procurement support to line ministries for at least another three years. At the January 30-31 2007 meeting of the Joint Coordination Monitoring Board, the Government indicated that line ministries need assistance in the areas of financial management, policy and strategy development, and procurement. The Procurement Policy Unit (PPU) of MOF is funded by the World Bank to assist in preparation of legal documents and capacity development. There are five staff members at PPU: the Head, one international consultant, three national officers, and one assistant. This is modest capacity in relation to the tasks entrusted to the PPU.

## **B. Assessment of Public Procurement**

### **1. Framework for Analysis**

31. Under the auspices of the joint World Bank and OECD Development Assistance Committee (DAC) Procurement Round Table initiative, developing countries and bilateral and multilateral donors have developed tools and standards that provide guidance for improvements in procurement systems. The Round Table initiative culminated with the December 2004 adoption of the "Johannesburg Declaration" including a commitment for the adoption of the Baseline Indicators Tool as the agreed international standard for assessment of national procurement systems. The Joint Venture for Procurement was created and has further developed the methodology for the baseline and associated compliance and performance indicators<sup>5</sup>.

32. The OECD/DAC Joint Venture for Procurement methodology for assessment of national procurement systems is intended to provide a common tool which developing countries and donors can use to assess the quality and effectiveness of national procurement systems. The understanding is that the assessment will provide a basis for a capacity development plan to improve procurement. Donors can use the assessment to develop capacity development plans and to mitigate risk in operations. The goal is that countries will improve national procurement systems to meet international standards.

33. The methodology includes numeric scoring against defined criteria. The JV for Procurement agreed that the scoring criterion should also contribute to the primary objective of supporting capacity development by consistently identifying the strengths and weaknesses of national systems and tracking progress of reform initiatives. While scoring has been introduced to this methodology, there has been no definition on aggregation of scores or of weighting. This is considered to be most useful in specific country applications and within donor organizations that may choose to assign weights or priorities to reflect concerns unique to the country or the donor.

### **2. Assessment of Procurement Benchmark Indicators**

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<sup>5</sup> A full explanation of the methodology can be found at [www.oecd.org/dataoecd/1/36/37390076.pdf](http://www.oecd.org/dataoecd/1/36/37390076.pdf)

34. The World Bank assessment against the benchmark indicators are presented in Table ??? below. The assessment was based on two assumptions: first, that the activities of the central procurement agent have not been taken into account because they are not based on the national procurement system, but on the WB and other donors' procurement guidelines; and second, the assessment is based on the national rules and regulations in place at the time of the assessment (June 2005, before the adoption of the new Procurement Law).

**Table ?????: Public Procurement Benchmark Indicators**

| <b>Pillar I – Legislative and Regulatory Framework</b>  | <b>BLI Score</b> |
|---|------------------|
| <b>Indicator 1. Public procurement legislative and regulatory framework achieves the agreed standards and complies with applicable obligations.</b> Includes assessment of the following sub-indicators (a) scope of application and coverage of the legislative and regulatory framework; (b) procurement methods; (c) advertising rules and time limits; (d) rules on participation; (e) tender documentation and technical specifications; (f) tender evaluation and award criteria; (g) submission, receipt and opening of tenders; and (viii) complaints.  | 2 PA             |
| <b>Indicator 2. Existence of Implementing Regulations and Documentation.</b> Includes assessment of the following sub-indicators (a) implementing regulation that provide defined processes and procedures not included in higher-level legislation; (b) model tender documents for goods, works, and services; (c) procedures for pre-qualification; (d) procedures suitable for contracting for services or other requirements in which technical capacity is a key criterion; (e) user's guide or manual for contracting entities; and (f) General Conditions of Contracts (GCC) for public sector contracts covering goods, works and services consistent with national requirements and, when applicable, international requirements.  | 1 NA             |
| <b>Pillar II. Institutional Framework and Management Capacity</b>   |                  |
| <b>Indicator 3. The public procurement system is mainstreamed and well integrated into the public sector governance system.</b> Includes assessment of the following sub-indicators (a) procurement planning and associated expenditures are part of the budget formulation process and contribute to multiyear planning; (b) budget law and financial procedures support timely procurement, contract execution, and payment; (c) no initiation of procurement actions without existing budget appropriations; (d) systematic completion reports are prepared for certification of budget execution and for reconciliation of delivery with budget programming.  | 2 PA             |
| <b>Indicator 4. The country has a functional normative/regulatory body.</b> Includes assessment of the following sub-indicators (a) the status and basis for the normative/regulatory body is covered in the legislative and regulatory framework; (b) the body has a defined set of responsibilities; (c) the body's organization, funding, staffing, and level of independence and authority (formal power) to exercise its duties should be sufficient and consistent with the responsibilities; and (d) the responsibilities should also provide for separation and clarity so as to avoid conflict of interest and direct involvement in the execution of procurement transactions.  | 1 NA             |
| <b>Indicator 5. Existence of institutional development capacity.</b> Includes assessment of the following sub-indicators (a) the country has a system for collecting and disseminating procurement information, including tender invitations, requests for proposals, and contract award information; (b) the country has systems and procedures for collecting and monitoring national procurement statistics; (c) a sustainable strategy and training capacity exists to provide training, advice and assistance to develop the capacity of government and private sector participants to understand the rules and regulations and how they should be implemented; and (d) quality control standards are disseminated and used to evaluate staff performance and address capacity development issues. | 1 NA             |
| <b>Pillar III. Procurement Operations and Market Practices</b>  |                  |
| <b>Indicator 6. The country's procurement operations and practices are efficient.</b> Includes assessment of the following sub-indicators (a) the level of procurement competence among   | 1 NA             |

|   |      |
|---|------|
| government officials within the entity is consistent with their procurement responsibilities; (b) the procurement training and information programs for government officials and for private sector participants are consistent with demand; (c) there are established norms for the safekeeping of records and documents related to transactions and contract management; (d) there are provisions for delegating authority to others who have the capacity to exercise responsibilities.  |      |
| <b>Indicator 7. Functionality of the public procurement market.</b> Includes assessment of the following sub-indicators (a)there are effective mechanisms for partnerships between the public and private sector; (b) private sector institutions are well organized and able to facilitate access to the market; (c) there are no major systemic constraints (e.g. inadequate access to credit, contracting practices, etc.) inhibiting the private sector's capacity to access the procurement market.  | 2 PA |
| <b>Indicator 8. Existence of contract administration and dispute resolution provisions.</b> Includes assessment of the following sub-indicators (a)procedures are clearly defined for undertaking contract administration responsibilities that include inspection and acceptance procedures, quality control procedures, and methods to review and issue contract amendments in a timely manner; (b) contracts include dispute resolution procedures that provide for an efficient and fair process to resolve disputes arising during the performance of the contract; (c) procedures exist to enforce the outcome of the dispute resolution process.   | 2 PA |
| <b>Pillar IV. Integrity and Transparency of the Public Procurement System.</b>  |      |
| <b>Indicator 9. The country has effective control and audit systems.</b> Includes assessment of the following sub-indicators: (a) a legal framework, organization, policy, and procedures for internal and external control and audit of public procurement operations are in place to provide a functioning control framework; (b) enforcement and follow-up on findings and recommendations of the control framework provide an environment that fosters compliance; (c) the internal control system provides timely information on compliance to enable management action; (d) the internal control systems are sufficiently defined to allow performance audits to be conducted; and (e) auditors are sufficiently informed about procurement requirements and control systems to conduct quality audits that contribute to compliance.   | 1 NA |
| <b>Indicator 10. Efficiency of appeals mechanism.</b> Includes assessment of the following sub-indicators (a) decisions are deliberated on the basis of available information, and the final decision can be reviewed and ruled upon by a body (or authority) with enforcement capacity under the law; (b) the complaint review system has the capacity to handle complaints efficiently and a means to enforce the remedy imposed; (c) the system operates in a fair manner, with outcomes of decisions balanced and justified on the basis of available information; (d) decisions are published and made available to all interested parties and to the public; and (e) the system ensures that the complaint review body has full authority and independence for resolution of complaints.  | 1 NA |
| <b>Indicator 11. Degree of access to information.</b> Includes assessment of the following sub-indicator (a) Information is published and distributed through available media with support from information technology when feasible.   | 2 PA |
| <b>Indicator 12. The country has ethics and anticorruption measures in place.</b> Includes assessment of the following sub-indicators (a) the legal and regulatory framework for procurement, including tender and contract documents, includes provisions addressing corruption, fraud, conflict of interest, and unethical behavior and sets out (either directly or by reference to other laws) the actions that can be taken with regard to such behavior; (b) the legal system defines responsibilities, accountabilities, and penalties for individuals and firms found to have engaged in fraudulent or corrupt practices; (c) evidence of enforcement of rulings and penalties exists; (d) special measures exist to prevent and detect fraud and corruption in public procurement; (e) stakeholders (private sector, civil society, and ultimate beneficiaries of procurement/end-users) support the creation of a procurement market known for its integrity and ethical behaviors; and (f) the country should have in place a secure mechanism for reporting fraudulent, corrupt, or unethical behavior; and (g) existence of Codes of Conduct/Codes of Ethics for participants that are involved in aspects of the public financial management systems that also provide for disclosure for those in decision making positions. | 1 NA |

| Baseline Achievement | Score | Assessment Key |
|----------------------|-------|----------------|
|----------------------|-------|----------------|

|                             |   |   |
|-----------------------------|---|---|
| Fully Achieved (FA)         | 4 | Almost all benchmarks met                                       |
| Substantially Achieved (SA) | 3 | Some procedural deficiencies, but most benchmarks met           |
| Partially Achieved (PA)     | 2 | Procedural deficiencies and less than 50% of the benchmarks met |
| Not Achieved (NA)           | 1 | Serious procedural deficiencies and only a few benchmarks met   |

35. **Legislative and Regulatory Framework (Benchmark indicators 1-2):** As at June 2005, Afghanistan had the following legislation governing procurement: (i) a Law on procurement of 1987; (ii) a Purchase Regulation adopted as a Decree of the Islamic Emirate of Afghanistan in 2000, both of which apply to the procurement of goods and routine works and maintenance; and (iii) Rules and Regulations for the procurement of works adopted sometime after 1989 (since this replaces the rules adopted on that date). The Purchase Regulation effectively replaces the Law on Procurement. However, it is more or less a copy of the Law with just a few amendments, mostly religious in nature.

36. Provisions relating to goods need improvement to provide further detail and clarification. The direction of these provisions is acceptable, but confusing, suggesting that the concepts of a good procurement system will not be new. Large value contracts are subject to competition (national and international) based on open tender following proper advertisement and subject to time limits. Smaller value contracts with international procurement are procured via an RQF (Request for Qualification) procedure. The main problems with the provisions are the lack of detail and clarity in the qualification requirements, the setting of specifications, drafting of bidding documents and award criteria, particularly with the current preference for negotiation, and the tendency to re-open bidding to attract lower prices.

37. For works, the Government is applying regulations adopted in 1989. The problem with these regulations is that they are more bid and contract preparation guidelines than a regulatory framework for competitive bidding. They require significant updating. The regulations provide for open competition through advertisement in the newspaper. However, they are inadequate in terms of setting out qualification criteria, requirements for specifications, award criteria, processes, and minimum time limits.

38. Overall, the current legal system offers a reasonable, if confused, framework. The key issues are (i) regulations are not comprehensive or user-friendly and need to be modernized; (ii) price is overemphasized to the detriment of quality and transparency; (iii) opening bids before the end of the tendering process can take place; and (iv) there is no complaint review process.

39. None of the following benchmarks have been achieved: (i) implementing regulation that provides defined processes and procedures not included in higher legislation; (ii) model documents for goods, works, and services; (iii) procedures for evaluation of tenders and award of contracts; (iv) procedures for pre-qualification; (v) procedures for contracting for consultant services is not defined in the legislation; (vi) there is no user's guide or manual for contracting entities; (vii) general conditions of contracts for public sector contract covering goods, works and services consistent with national requirements and international requirements when applicable.

40. **Central Institutional Framework and Capacity (Benchmark indicators 3-5):** As at June 2005, a critical issue for the Government was a lack of a central body to lead the effort on public procurement reform. While ARDS has been assigned the role of managing the

procurement agent contract, it is not designed as a central procurement policy unit. ARDS assists line ministries in the selection of consultants and procurement of civil works under externally-funded projects. However, its functions and location are, to a large extent, incompatible with such a role, and it has insufficient capacity. Under a WB-financed project, the procurement agent has been carrying out activities (training, documentation preparation, drafting of new laws etc) that would normally be the responsibility of a central policy unit.

41. Line ministries and ARDS work together to float tenders which are evaluated by ministry committees, with results transmitted to ARDS, donor agencies, and the MOF for approval. The contracts are entered into by ministries with consultants and contractors. The ARDS Procurement Unit (PU) assists ministries to undertake procurement in accordance with donor requirements. It also provides advice and guidance on procurement matters to the Government as required. The procurement unit has a team comprising foreign procurement specialists, Afghan liaison and procurement officers who work together with ministry staff with a view to transparent and effective procurement of goods, services and works.

42. Procurement is integrated into the public finance management framework. For example, adequate procurement documentation is one of the requirements of financial controls. However, procurement processes are not fully integrated in the PFM system due to weaknesses in both the procurement and PFM systems. Capacity is weak in the following areas: (i) although tender invitations are published in national newspapers, broadcast on national radio, and sent directly to foreign missions in Kabul, there is no central system for collection, publication and dissemination of such information; (ii) there is no systematic plan to train government procurement officials; (iii) there are no systems and procedures for collection and monitoring of national procurement statistics; and (iv) there are no quality control standards to evaluate performance of staff and address capacity development issues.

43. **Procurement Operations and Market Performance (Benchmark indicators 6-8):** The lack of data makes the evaluation of performance difficult. However, there are encouraging signs that regulations and processes could support effective procurement. However, capacity constraints (of people and systems) severely limit efficiency. Most procurement officials are aware of the existing rules and regulations, and are willing to apply them. However, the lack of guidance from the center results in different branches of government providing their own interpretations leading to inconsistency questionable practices. The major problem is the inadequacy of the rules, as well as decisions being taken at a high level, with over-emphasis on price alone.

44. There are a growing number of producers and suppliers in the private sector which should help a public procurement market work. However, their capacity to follow regulations and submit bids is weak. Further, the private sector has limited confidence in the system. There are contract administration provisions, but they need to be made more explicit, with more detailed implementation regulations. There is also a lack of dispute resolution mechanisms. Afghan women entrepreneurs face particular constraints to participation.

45. The lengthy and complex disbursement and payment process discourages some qualified contractors from bidding for jobs. The payment system is susceptible to manipulation and corruption. The process can take as long as four to five months, with technical and non-technical delays. Less time is usually required for payment against Letters of Credit (LC) and direct payment to suppliers.

46. **Integrity and Transparency of the Public Procurement System (Benchmark**

**indicators 9-12):** The framework of control and audit is mainly centered on financial issues, with little on performance of procurement. The lack of publicly-available information on procurement and the absence of an appeal mechanism compound these weaknesses. No procurement-specific audits have been conducted by the Auditor-General's Office (AGO), and capacity within the AGO to perform such audits is weak.

47. There is no formal complaints mechanism in the existing regulations. There is an informal mechanism whereby the procuring entity may set up an investigation committee to hear a complaint, followed by a second-level complaint to the "Government". However, this informal mechanism appears to be hypothetical as there is no evidence of actual complaints being filed or progressed.

### 3. Procurement Outside the Country Procurement Systems

51. Most procurement of goods, services and works is through international competitive bidding (ICB) and national competitive bidding (NCB), as stipulated in donor procurement procedures. This involves advertising; public bid opening; objective bid-evaluation criteria; independent evaluation consistent with the stipulations of the bidding documents; award to the qualified bidder submitting the lowest evaluated bid without negotiations; publication of award results; fair and speedy complaint-handling; disclosure of signed contracts and prices. Donor procurement regulations normally provide losing bidders the opportunity to submit contract award complaints.

#### C. Impact on ADB Operations

##### Box ??? ADB Experience with Procurement Process in Afghanistan

The major ICB steps for ADB-financed projects are: (i) preparation of contract packages, (ii) advanced procurement actions by ministries/agencies if applicable, (iii) advertisement, (iv) accreditation of firms by ARDS, (v) preparation of bidding documents, (vi) issuance of Bidding Documents (for works or goods) or Request for Proposal (for supervision consultants or services), (vii) pre-bid meeting with interested firms to clarify questions, (viii) bid/proposal submission within 42-90 days, (ix) opening of technical bid/proposal, (x) evaluation of technical bid/proposal, (xi) clarification requests sent to bidders/contractors, (xii) clarifications from bidders/contractors, (xiii) final technical evaluation report of bids and technical proposals submitted to ADB, (xiv) ADB approval of final technical evaluation report, (xv) opening of financial bid/proposal, (xvi) final evaluation and ranking, (xvii) final evaluation and ranking submitted to ADB, (xviii) ADB approval of final ranking, (xix) pre-award discussion/negotiation, (xx) request for revised TOR and financial proposal, (xxi) ADB approval of revised TOR and financial proposal, (xxii) endorsement and approval from MOF, (xxiii) authorization from office of the President, (xxiv) issuance of letter of acceptance, (xxv) contract signing, (xxvi) transmittal of signed contract to ADB, and finally (xxvii) mobilization. Significant delays can result from this process. Complications (no bids, few bids, disqualified bids, bid price significantly above contract value estimates) can cause further delays. The security situation and the cost of security affect the number of qualified bidders. According to ADB's quarterly portfolio reviews, lack of capacity is causing delays in contract awards, compounded by requirements that contracts valued above \$ 100,000 must be cleared by MOF, and those above \$3.5 million by the Office of the President, prior to signing. The procurement of the power transmission component under the ADB-financed Emergency Infrastructure Rehabilitation and Reconstruction Project (Loan No. 1997) took nine months; it took 15 months to complete procurement of supervision consultants for the Power Transmission and Distribution Project (Loan No. 2165).

**(INSERT LATER)**

Someone with historic memory to draft a para, summarizing :-

- a) ADB project experience and Lessons learned.
- b) Ideas for more workable Proc't processes (The box strongly suggests that current procedures are not appropriate for the current AFG environment)
- c) Has ADB supported BIS-assessment and/or reform the national procurement systems? What further support is planned?

**VI. COMBATTING CORRUPTION****A. Country Context**

52. A quarter-century of conflict and erosion of state institutions; irregular financing of the conflict; worsening tensions among ethnic and tribal groups; and the growth of informal/illicit economic activity has contributed to the erosion of state institutions in Afghanistan. Since 2001, the escalating drug economy and large inflows of aid have increased opportunities for corruption. The transition from informal to formal economic transactions has opened up new opportunities for corruption as a growing state sector, with regulations and 'red tape', increase the scope for corrupt activities.

53. The drug economy is widely considered to be the most important source of corruption. Drug-financed corruption appears to be undermining the state and political system through both "grand corruption" and "state capture". Research indicates that some government agencies, particularly at the provincial and local level, have been compromised by drug interests. Opium production and trade was essentially legal during most of the Taliban period. Drug-related corruption burgeoned in the post-Taliban period, characterized by state-rebuilding and despite significant counter-narcotics efforts. Drug-related and drug-financed corruption is an important threat to state-building and fuel corruption in the security sector (especially the police) and justice sector. Corruption in counter-narcotics efforts has consolidated the drug industry with fewer, powerful players with strong political connections, severely compromising parts of the Government.

54. Key constraints to anti-corruption efforts include lack of reliable data; unreformed public administration with weak legal and regulatory frameworks; lack of external oversight bodies; limited oversight by the central government of sub-national administration; the opium economy, and continued reliance on aid. Anticorruption initiatives in Afghanistan have been lackluster due to weaknesses of the General Independent Administration for Anticorruption (GIAAC), law and order bodies and the justice sector. GIAAC lacks managerial, technical and financial resources to perform its role effectively.

55. Over 70% of aid is not controlled by the State, mainly due to the weakness of Afghan national integrity systems (NIS). Donors have preferred to create trust funds administered by international organizations. Strong national integrity systems are necessary if Afghanistan is to have better control over aid flows. Ironically, aid was supposed to achieve this, but in practice,

only certain domains of the NIS have been effectively strengthened.

## **B. Assessment of National Integrity Systems for Combating Vulnerability to Corruption**

### **1. Framework for Analysis**

56. The framework for analysis and risk assessment of the national integrity systems for combating vulnerability to corruption comprises four areas (i) the legislative and policy framework for preventing and prosecuting corruption; (ii) the institutional framework and capacities; (iii) implementation and enforcement challenges; and (iv) public perceptions and awareness; civil society and business initiatives to prevent and combat corruption. Strengths and weaknesses in these four areas will be assessed, and key risks identified.

57. The analysis draws on the *Reconstruction National Integrity System Survey (2007)* for Afghanistan prepared by Integrity Watch Afghanistan, in particular, areas concerning understanding of weaknesses of state institutions, causes of corruption, relationships of the Executive to other state institutions, key areas where corruption occurs, institutions with a role to play in promoting reform and dealing with corruption, and integrated approaches to dealing with corruption.

### **2. Legislative and Policy Framework for Preventing and Prohibiting Corruption**

58. The **2001 Bonn Accord** retained most national laws, including the 1976 penal code, which identifies corruption, if in a somewhat narrow manner. The penal code does distinguish between similar terms including embezzlement, stealing and falsifying of documents, and waste of state resources. The **2004 Afghan Constitution** states that one of the duties of government officials is "*Maintenance of public law and order and elimination of all types of administrative corruption*".<sup>6</sup>

59. In 2004 Afghanistan signed the **United Nation Convention Against Corruption (UNCAC)** which contains measures to prevent, investigate and sanction corruption. The convention provides a framework for international support to build capacity to fight corruption and have access to international tools and political backing. It outlines elements to develop a strategy to combat corruption. The **London Compact** specifies a timeframe for the ratification of the convention and its implementation stating that "*The UN Convention against Corruption will be ratified by end-2006, national legislation adapted accordingly by end-2007 and a monitoring mechanism to oversee implementation will be in place by end-2008*".<sup>7</sup> It is currently unclear whether the government will be able to ratify, modify internal laws and put in place a strategy within the agreed timeframe.

60. Article 3 (3) of the **2004 Afghan Law Against Bribery and Official Corruption** defines official corruption by government employees as an illegal act committed through embezzlement and deception; stealing documents; "wastage of official records"; transgressing the legal scope of authorities; using government facilities and official time for personal affairs; refusing to

<sup>6</sup> The Constitution of Afghanistan, 2004.

<sup>7</sup> The London Compact, February 2006, p.9.

perform duties without legal justification; concealing the truth; forging documents; pretending to have power to do or refuse to do an act which is outside the scope of the public servant's official power; receiving gifts to perform jobs "in the related affairs"; negligence in performing delegated duties; misbehavior of public servants toward individuals; bribing, illegally recommending, requesting and lobbying; and involving ethnic, regional, linguistic, partisan, gender and personal consideration in selection and employment. The Law is confusing in many respects. Corruption is defined broadly as "an illegal act committed by government employees and other public servants to attain to personal or group aims"<sup>8</sup> which creates some confusion as to what is corruption and what is not.

61. The **ANDS (Afghan National Development Strategy) Office** is responsible for implementing the London Compact Benchmark. The ANDS interim paper states that "Government's goal is to eliminate corruption in the public and private sector in order to improve the effectiveness, transparency, and accountability of government and to create an environment conducive to investment, both of which are necessary for economic growth and poverty reduction".<sup>9</sup> The ANDS recognizes that corruption undermines the accountability of government; allows illegal power grabbing at all levels' is fuelled by the narcotics trade; discourages investment by increasing transaction costs; misallocates resources and reduces the development impact of aid; creates problems for business licensing and enforcement of property rights and contracts; reduces competition; encourages the illicit economy; and reduces government revenue, especially from customs.<sup>10</sup>

### 3. Institutional Framework and Capacity

62. The **General Independent Administration of Anti-corruption (GIAAC)** was established in 2004 under the Law of Campaign against Bribery and Administrative Corruption. The main power of the GIAAC has been investigative: requesting required documents from offices. The GIAAC has the power to bring bribery suspects to court. It follows and ensures the enforcement of anticorruption decisions. It has the mandate to inspect the financial and economic activities of private and public offices and organizations, including "*investigating into how public goods and properties are kept and maintained in accordance with the provisions of the law*". In this area, there may be overlapping activities with the CAO.

63. The GIAAC has been constrained by incoherence in some aspects of the law, and has limited powers, resources and capacity. To date, GIAAC has not been able to develop a national anti-corruption strategy. Plans exist to extend the GIAAC activity to the provincial level, but limited resources and security risks have influenced GIAAC to concentrate activity in the capital. While the GIAAC is presented as an independent agency, the law enables interference from the Executive, and the duties and functions of the agency are not clearly defined in the law. The head of the Executive can add tasks to its remit. The law does not provide for clear nomination and dismissal procedures for the head of the agency and leaves these to the discretion of the head of the Executive. Budgetary provisions are unclear and during the last fiscal year, a special salary scale and advantages decided by the Office of Administrative Affairs under the head of the Executive were established.

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<sup>8</sup> The Law of Campaign Against Bribery and Administrative Corruption, October 2004.

<sup>9</sup> Afghan National Development Strategy, an interim strategy for security, governance, economic growth and poverty reduction, January 2006, p. 104.

<sup>10</sup> Islamic Republic of Afghanistan, *Afghanistan National Development Strategy, Interim Report*. Pp 103-104.

64. There is **no functional nationwide legal system**, and in many places justice is administered on the basis of a mixture of legal codes by judges with minimal training. Outside influence over the judiciary remains strong, and judges and lawyers are frequently unable to act independently because of threats from local power brokers or armed groups. Salaries for judges are inadequate, and corruption and bribery are widespread. In rural areas, with no police or judicial institutions, unelected and often conservative tribal councils dispense justice. The Supreme Court, composed of religious scholars who have little knowledge of civil jurisprudence, is in need of reform, although the replacement of Fazl Hadi Shinwari as chief justice was a positive step. The administration's plans to rebuild the judiciary have proceeded slowly, although a new criminal procedure code was promulgated in early 2004 and some progress has been made with the construction of courts and correctional facilities. However, in April 2005, the justice minister noted that more than 50 percent of Afghans still did not have access to judicial or legal services.

65. The work initiated by the **Afghan Independent Judicial Reform Commission** encountered many obstacles, including competing ideological camps. More than 60% of the judiciary's personnel come from traditional and Islamic schools, Madrasas, with no links with the law that is taught at the Afghan Universities of Law and Political Science that forms the other half of the judiciary staff. This has led to a **divided judiciary** and tarnished the image of a modern and professional judiciary. As a result, "allegations of widespread corruption in the formal justice system have undermined its legitimacy and improved the relative status of the traditional justice system".<sup>11</sup>

66. The nomination of **judges** has suffered from political opposition between the two groups. The principles of inclusiveness, ethnic balancing and representation that have prevailed during the reconstruction process have not extended to merit-based appointments in the judiciary. Patronage networks and relationships play a major role in the recruitment and dismissal of judges and senior officials in the judicial system. For example: "*appointment of head judges of the primary and provincial courts is often based not on the merit of their legal education and expertise, but rather on their personal, tribal, ethnic, or political affiliations with the district or provincial leadership*".<sup>12</sup> Reform of the justice sector was sidelined by the international community's political agenda to bring peace and involve the warlords. Donors have paid relatively little attention to the re-establishment of the rule of law beyond police training and reform.

67. The Constitution states that the President shall appoint the Attorney General – at the level of a minister – and his deputy. Article 34 of the Constitution defines the role of the **Attorney General** as follows: "*...discovery of crimes is the duty of police and investigation and prosecution are conducted by the Attorney General's office in accordance with the provisions of the law*". The relationship between the Attorney General's Office and the Ministry of Justice became tense after the redefinition of institutional structures following the Bonn Agreement, which withdrew prosecution powers from the Ministry of Justice, as had been the case during the communist regime, and granted the powers exclusively to the Attorney General. In addition to the central office in Kabul, the Attorney-General's Office has offices in the provinces.

68. The Bonn Agreement recognized the need to create a professional **police** force. However, progress has been slow. The Afghan National Police, which numbers approximately 60,000, has been plagued by inadequate training, illiteracy, corruption, involvement in drug

<sup>11</sup> ILDO, Lessons learned on Judicial and Prosecutorial Reform in Post-Conflict Countries, June 2004, p. 6.

<sup>12</sup> Tufts University, Afghanistan's System of Justice: Formal, Traditional and Customary, June 2004, p.15.

trafficking and desertion. The Ministry of Interior has overall responsibility for law enforcement. Policeman's salaries vary between USD 40-100 per month. A new salary scale is currently under consideration but in order for it to be sustainable, it must fit within the fiscal constraints of the Afghan budget. Between 2002 and 2005 the US had provided USD 804 million for training of police. In addition, the provincial reconstruction teams have rebuilt police stations. However, despite these efforts, the training of professional police remains a failure. The extension of a police presence in the provinces has not increased perceptions of personal security. This is evidenced by a general increase in the number of crimes, and the emergence of organized crime, sometimes composed of policemen. Drug transport within the country is believed to be facilitated by powerful and well-organized police networks. Positions in the police force are not always associated with professionalism but linked to patronage networks related to commanders, governors and district administrators.

69. **The reform of the police needs to be linked to a functioning reform of the justice sector.** Currently, there is a significant difference in funding of the two sectors: the police benefits from 28% of the security expenses while just 3% goes to justice.<sup>13</sup> There is still a lack of trust in the police: just 52% of persons surveyed would go to the police or provincial court in the case of theft, and only 58% would go in the case of murder.<sup>14</sup>

70. **Civil society:** Article 35 of the Constitution legislates the right of citizens to form social organizations for the purpose of securing material or spiritual aims in accordance with the law. The law governing the establishment and function of social organizations is separate from the NGO law. NGO's are registered with the Ministry of Economy, and considered by civil servants as for-profit organizations. Afghan Social Organizations (ASO) is registered by the Ministry of Justice and is considered as non-profits. Hundreds of international and Afghan NGO's and aid agencies are able to operate freely, but their effectiveness is impeded by the poor security situation in much of the country. CSO's have provided a convenient structure for donors to channel funds. While donors rationalize their use of CSOs by pointing to their apparent role as citizen representatives, the reality is that CSOs are increasingly assuming the role of project subcontractors rather than organizers of citizen action. The emergence of poorly performing organizations with large budgets has fueled the perception of CSO corruption and failure to distribute aid correctly, resulting in a decrease in CSOs' ability to mobilize the population.

#### 4. Implementation and Enforcement Challenges

71. **Discretionary power vested in authorities:** Opportunities for corruption have been created by the discretionary powers vested in authorities; complex procedures, bureaucratic attitudes and unnecessary controls and administrative regulations. Discretionary powers have been used with impunity due to lack of central control and weak management. The situation is worse in provinces and districts because of their isolation and indifference to transparency and accountability. Opportunities for corruption are multiplied by poor audit systems; weak financial management; poor communication; and lack of data and automation.

72. **Resistance at local level to central authority,** combined with lack of audit and anticorruption controls, has resulted in instability in parts of the county. The political appointments made by the Ministry of Interior to provinces often encounter resistance. Those taking up positions in sensitive areas such as security, customs, or positions of a political

<sup>13</sup> World Bank. Afghanistan: Managing Public Finances for Development, Vol. V, p. ????, December 2005.

<sup>14</sup> ABC News/BBC World Service Poll, Af where things stand, December 2006, p. 22.

nature, have often had to return to Kabul because of local hostility. Some nominations resulted in armed conflict and assassination, including positions of district and provincial governors and heads of police appointed by central government

73. **Short time horizons:** Government servants, senior officials, international community representatives, and non-state actors with public power are typically in power for short durations, which creates incentives for corruption.

74. **Limited capacity in the Government:** Non-functioning institutions and severely limited capacity in the Government, reflecting the legacy of the long period of conflict, are important factors enabling corruption. Weak capacity and reported corruption in the justice sector are a major constraint hindering prosecution and punishment of corruption in other sectors. Fragmentation of society during the conflict resulted in more reliance on traditional and conflict-generated patronage networks, with associated corruption.

75. **Low salary and remuneration:** As in many developing countries, low government salaries can push individuals to petty corruption to meet basic needs.

76. **Vague sanctions for civil servants under the Civil Servant Law:** The sanctions for civil servants under the Civil Service Law for corruption are very vague. It states that “*A civil servant who does not perform his day to day duties in accordance with the relevant legal documents will be disciplined*”.<sup>15</sup> In theory, civil servants are protected against mismanagement, abuse of authority by their managers and are able to issue complaints about their superiors under article 28 of the Civil Servant Law. The only power of sanction against bribery is specified in the 1976 penal code in articles 254 -261 and embezzlement and treachery in articles 268 – 279. High officials are granted flats, houses, cars, and domestic staff, in many cases without a written record. The allocation of building plots, and distribution of land and houses are made in the municipalities, often with no transparency. Loan systems for civil servants are not well developed. There are virtually no checks and balances on the decisions of individual public officials. Corruption often occurs with the complicity of subordinates and managers. The Ombudsman function does not yet exist in Afghanistan.

77. **Politicization of prosecution of corruption offences:** Prior to September 2006, prosecutions were limited. Until recently, only minor petty corruption cases have been referred, such as using petrol from the office for private purposes, selling office computers, and employing public staff for private duties. More significant cases relate to state-owned land grabs by senior civil servants. The GIAAC has accumulated many cases of corruption but has had difficulties in processing them through the courts. In August 2006 a special anticorruption committee was setup by the President’s Office to crack down on corruption, including arrest and prosecution. The committee is comprised of the heads of the main anti-corruption agencies: the CAO, GIAAC, the new Attorney General,<sup>16</sup> the Supreme Court, and senior advisors to the President. The work of the committee will begin at the central level and will eventually extend to provinces. It is too early to say whether this political initiative will impact on the quality and efficiency of GIAAC and the other components of the national integrity system activities.

<sup>15</sup> Civil Servant Law, article 30, Discipline of Civil Servant.

<sup>16</sup> The GIAAC had complained that most of its prosecution requests were blocked at the level of the Attorney General. This has changed since the nomination of a new Attorney General by the President. The influence of warlords and the weakness of the rule of law since the end of the conflict were the major reasons for the inaction of the prosecutor. Since September 2006, the new appointment is making a difference although at the provincial level prosecutors are still not seen as effective.

78. **Unprecedented large inflows of international assistance:** The large inflows accompanied by pressure to spend resources quickly are a source of corruption. This includes development and humanitarian aid, contracts related to international military forces and their activities, as well as international and domestic security firms and aid to Afghan security forces.

## **5. Public Perceptions and Awareness, and Civil Society Initiatives to Prevent and Combat corruption**

79. **Increasing perceptions of corruption:** Available data on perceptions and anecdotal evidence indicate that corruption is seen to be very widespread, and probably increasing in recent years, compared to the Taliban period pre-2001. This may reflect the more limited opportunities for corruption at that time due to small resources flows and the 'de-facto quasi – legal status' of the opium economy. Irrespective of the actual incidence, public perceptions of widespread corruption result in disenchantment with the Government. This applies particularly to corruption faced by people in their daily lives. For example, corruption in gaining access to and paying for water and power services; paying above the mandated fees for licenses and certificates; paying teachers for extra school time or for grade promotions; paying doctors for extra care etc. These perceptions (and the reality underlying them) hinder efforts to strengthen the Government's credibility and legitimacy. Popular discontent about corruption is combining with perceptions that the Government is not delivering services to the people, and that international assistance is being wasted.

80. **GIAAC public awareness role:** Under article 5 of the law, the GIAAC is tasked with a public awareness role including publication of annual reports of its activities, and conducting training courses and seminars to promote the efficiency and professional capacity of the GIAAC in the capital and the provinces. It is also responsible for creating an information centre to register assets of public servants, but this is not operative yet.

81. **Civil society capture by donors:** Most civil society actions are donor and supply-oriented and rarely respond to local needs and demands. During the war, CSO's were less dependent on external support, and more able to build relationships with the communities benefiting from their services. Today, CSOs have increased their dependency on donor funds; the level of local support has declined, and they lack the capacity to use local financial resources. However, religious organizations, which are independent from the state have strong mobilization power in contrast to the emerging CSOs. Civil society activists who focus on human rights or government accountability continue to face threats and harassment.

82. **Monitoring function of civil society still in early stages of development:** CSO representatives are taking part in discussions with government and donors on formulation of a national anticorruption strategy. CSOs rarely use the National Assembly or other government institutions for lobbying purposes. The international community is the main source of corruption monitoring. Independent groups such as ACBAR and IWA monitor the development community. Civil society aims to increase interaction with the National Assembly, but so far no bills or propositions have been made by CSOs. Currently, just two organizations are working on integrity issues: Integrity Watch Afghanistan and the Afghan Civil Society Forum. Integrity Watch Afghanistan is doing research towards a national anticorruption strategy. To date, there have been no anticorruption or awareness-raising campaigns and the media have been the main catalyst for bringing corruption into the debate. Integrity Watch Afghanistan has recently introduced monitoring mechanisms and training of CSOs to address corruption.

**83. Afghan media continues to grow and diversify, but still faces a number of threats:**

In December 2005 a revised press law was passed, guaranteeing the right to freedom of expression and prohibiting censorship, but retaining restrictions such as registration requirements and guidelines on content. It also establishes five commissions to regulate media agencies and investigate complaints. Media diversity and freedom are higher in Kabul, and some warlords display limited tolerance for independent media in the areas under their control. The number of outlets has grown steadily: authorities have granted approximately 300 licenses to independent publications, and dozens of private radio stations and six private television stations are now broadcasting. However, a number of journalists have been threatened or harassed by government ministers, politicians, police, security services, and others in positions of power as a result of their reporting. Reporters have faced difficulties in covering proceedings at the newly established parliament, with several being assaulted and more denied access on various occasions. The use of the internet and mobile phones continues to grow and has broadened the flow of new and other information, particularly for urban Afghans.

**84. Role of religion as an integrity pillar:** Since the fall of the Taliban, in reconstruction, in the drafting of the new constitution and the election, religion has been used to build the legitimacy of the new regime. The establishment of good relations between the State and religious leaders is fundamental for the Afghan State to keep its legitimacy in the eyes of religious and tribal alliances that are reputed for their genuine integrity.

**6. Towards and Integrated National Integrity System for Combating Corruption**

85. For integrity institutions to function effectively, the judiciary must become independent, giving citizens the capacity to appeal court decisions. The budget allocation for the judiciary must increase. The media has considerable autonomy, and could pressure the Executive, as well as its prime role as purveyor of information. Media could be an expression channel for civil society organizations' claims, despite its low level of activism, in order to protect themselves from the risk of being directly targeted by criticized power holders.

**C. Impact on ADB Operations**

**(INSERT LATER)**

Para. by someone with historic memory, covering:

- a) Evidence/experience of corruption in ADB projects
- b) ADB support, current or future, to L&J sector, anti-corruption agencies etc.

**VII. SUMMARY OF RECOMMENDATIONS FOR ADB OPERATIONS**

| Major Risks and Reform Needs Identified   | Recommendations to ADB   |
|---|--|
| <p><b>I. PFM</b></p> <p>(i) Actual budget out-turns do not reflect policy based allocations across sectors, and therefore the budget is not a useful ex ante statement of intent.</p> | <p>1. Recommendation re the support is ADB currently giving/planning to strengthen the public financial management systems....</p> |

|   |   |
|---|---|
| <p>(ii) The budget classification system allows for major administrative and economic classifications, but not functional and program – there is a risk that resources are not properly allocated and spend for priority poverty reduction programs as expenditures cannot be tracked by program/outcomes.</p> <p>(iii) There is no medium term fiscal framework for operating expenditures – there is a risk that operating and maintenance costs for capital projects and development programs are under funded.</p> <p>(iv) Projects financed by donors are largely aligned to general national programs such as education or health – there is a risk that high priority Government projects do not receive financing if their fail to attract donor interest.</p> <p>(v) The operating cost implications of projects in the development budget are often not identified and included in the core recurrent budget – there is a risk that development projects and programs are not sustainable over the long term and that the true costs of maintaining project/programs are not known.</p> <p>(vi) Formulation and execution of the external budget are largely determined and implemented by donors – there is a risk that these investments are not responsive to specific investment proposals identified by line ministries.</p> <p>(vii) While coasted sector strategies exist for several sectors, they have not been reconciled with fiscal forecasts – there is a risk that sector programs will be under funded over the medium to long term.</p> <p>(viii) No verified information on the External Budget is provided by the Government on the extent to which reported disbursements are reaching beneficiaries. There is no record of these expenditures in the Government accounting, and donor reporting on expenditures is not regulated, monitored, or aggregated for management or external reporting – there is a risk that budget resources are not used as intended and do not reach intended beneficiaries.</p> <p>(ix) There is still inadequate capacity within the Control and Audit (CAO) office to conduct financial statement audits without the support of the audit advisor (funded by the World Bank) – there is a risk the fiduciary oversight functions may be compromised if the audit advisor is removed in the future, unless capacity development for staff in the CAO is accelerated.</p> | <p>2. Recommendation re amending; simplifying; replacing etc current ADB financial management procedures.</p>   |
| <p><b>II. National Procurement</b></p> <p>1. The 2005 Law on Procurement marks important progress in reforming the national procurement system. However implementation is at the earliest stage and the generally weak scores against the DAC BIS, assessed in 2005, continue to be valid. Until the provisions of the 2005 Law are better embedded, national systems will remain excessively risky, and unsuitable for donor-financed procurement.</p> <p>2. ICB and NCB, using ADB procedures, are consistently delayed by weak capacity and onerous clearance procedures.</p>  | <p>1. Recommendation re the support is ADB currently giving/planning to strengthen the national procurement system....</p> <p>2. Recommendation re amending; simplifying;</p> |

|  |   |
|--|---|
| <p>These delays and inefficiencies pose a significant risk to the timely achievement of ADB's project investments and the national development effort.</p>   | <p>replacing etc current ADB procurement procedures.</p>  |
| <p><b>III. Anti-Corruption</b><br/> Gross and petty corruption continue to undermine the efficiency of state services and the reputation of government. Despite some progress in establishing anti-corruption institutions and in media independence, the patronage-basis of state functioning continues, fuelled by the growing drug economy. Corruption continues to be a significant and growing risk to the implementation and future operation of donor-financed investments.</p> | <p>Recommendations (i) : On continuing/future ADB support to L&amp;J system, anti-corruption institutions etc.</p> <p>Recommendations (ii) On tackling corruption-risks in ADB project implementation....</p> |
|  |   |

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