

FIGHTING CORRUPTION  
IN  
AFGHANISTAN

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SUMMARIES OF  
VULNERABILITIES TO  
CORRUPTION ASSESSMENTS

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*May 2009*



The World Bank



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# ACKNOWLEDGEMENTS

This report, prepared by the World Bank, summarizes six completed Vulnerabilities to Corruption Assessments (VCAs) for various key sectors, government agencies, and core government functions in Afghanistan. These VCAs were conducted by the Asian Development Bank (ADB), UK Department for International Development (DFID), United Nations Development Programme (UNDP), and the World Bank, in close cooperation with the concerned ministries and agencies of the Government of Afghanistan. The extensive work of these agencies together with the Government provided the basis for this report and is gratefully acknowledged. The guidance and support provided by the Ministry of Finance in particular has been instrumental in enabling the work on VCAs to move forward and to achieve positive results.

Responsibilities of international partner institutions for the different VCAs were as follows:

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This report was prepared by Yoichiro Ishihara and William Byrd of the World Bank based on the respective VCA documents and, in the case of the introductory chapter, other available documents and materials on corruption in Afghanistan. The report was processed and formatted by Marinella Yadao (World Bank). It should be noted that although the report has been prepared by the World Bank (including both the introductory chapter and the summary chapters on the different VCAs), the contents of the summary chapters are based on the work of the organizations that prepared each individual VCA, and do not necessarily reflect the work and activities of other organizations including the World Bank.

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# ACRONYMS

ACL	Anti-Corruption Law
AD	Audit Department
ADB	Asian Development Bank
AFMIS	Afghanistan Financial Management Information System
AGO	Attorney General's Office
ANDS	Afghanistan National Development Strategy
ARDS	Afghanistan Reconstruction and Development Services
ARDS-PU	Afghanistan Reconstruction and Development Scheme Project Unit
ARTF	Afghanistan Reconstruction Trust Fund
B27	Allotment Request Form
CAO	Controller and Auditor General's Audit Office
CMO	Contract Management Office
CPS	Computerized Payroll System
DAB	Da Afghanistan Bank
DABM	State Electricity Company
DFID	UK Department for International Development
ED	Expansion Department
EFT	Electronic Funds Transfer
FPU	Fiscal Policy Unit
FR	Finance Regulations
GDP	Gross Domestic Product
GIAAC	General and Independent Administating of Anti-Corruption and Bribery
HQ	Headquarters
IAB	Independent Appointment Board
IAB	Independent Appointment Board
IARCSC	Independent Administrative Reform and Civil Service Commission
ICE	Inter-ministerial Commission for Energy
ICT	Information and Communications Technology
IDLG	Independent Department for Local Government
IPC	Interim Payment Certificates
IWA	Integrity Watch Afghanistan
KED	Kabul Electricity Department
LEP/MCP	Lateral Entry Program/Management Capacity Program
LTO	Large Taxpayers Office
ITO	Income Tax Office
MoF	Ministry of Finance
MPW	Ministry of Public Works
MRRD	Ministry of Rural Rehabilitation and Development
MTFF	Medium-Term Fiscal Framework
O&M	Operations and Maintenance
OAA	Office of Administrative Affairs
P&G	Pay and grade reform
PAR	Public Administration Reform
PCS	Project Coding Sheet
PEFA	Public Expenditure and Financial Accountability
PFEM	Public Finance and Expenditure Management
PFM	Public Financial Management

PIFC	Public Internal Financial Control
PIUs	Project Implementation Units
PPU	Procurement Policy Unit
PRGF	Poverty Reduction and Growth Facility
PRR	Priority Reform and Restructuring
RRU	Regional Reconstruction Unit
SAIs	Supreme Audit Institutions
SDU	Special Disbursement Unit
SOEs	State-Owned Enterprises
SPC	Special Procurement Commission
TA	Technical Assistance
TIN	Taxpayer Identification Number
UNCAC	United Nations Convention Against Corruption
UNDP	United Nations Development Programme
UNODC	United Nations Office on Drugs and Crime
VCAs	Vulnerabilities to Corruption Assessments
VPP	Verified Payroll Program



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## **1. INTRODUCTION, LESSONS LEARNED, AND WAYS FORWARD**

1.1 Corruption is widely recognized to be an extremely serious problem in Afghanistan. In addition to the direct financial costs as well as distortions and inefficiencies resulting from corrupt practices, perceptions of pervasive and systematic corruption undermine the credibility and perceived legitimacy of the government. Thus corruption, a symptom of poor governance, constitutes a serious threat to Afghanistan's entire state-building and development agenda. Progress in fighting corruption has been limited; on the contrary, available survey and other evidence suggests that corruption has become increasingly widespread, entrenched, and systematic in recent years.

1.2 Recognizing the importance of this threat, and working in close cooperation with the concerned government agencies, especially the Ministry of Finance, the World Bank and other international partners (ADB, DFID, and UNDP) have conducted Vulnerabilities to Corruption Assessments (VCAs) for a number of sectors, agencies, and key government functions. Six VCAs have been completed so far, and this report provides summaries of the following VCAs:

- Public Financial Management and Procurement (Chapter 2), conducted by the World Bank
- Revenue Department of the Ministry of Finance (Chapter 3), conducted by DFID
- Budget Department of the Ministry of Finance (Chapter 4), conducted by UNDP and DFID
- Merit-Based Appointments in the Civil Service (Chapter 5), conducted by the World Bank
- The Road Sector (Chapter 6), conducted by ADB
- The Energy Sector (Chapter 7), conducted by ADB

1.3 This introductory chapter provides background and sets the stage for the summaries of VCAs. The chapter includes: (i) a brief overview of corruption in Afghanistan; (ii) a discussion on the rationale for the VCAs, their current status, and outcomes; (iii) main findings of the VCAs; (iv) recommendations on how to take the anti-corruption agenda forward through the VCAs; and (v) key lessons emerging from the experience with the VCAs. It is hoped that the lessons learned will inform and help further improve subsequent VCAs and other anti-corruption work.

### **A. Overview of Corruption in Afghanistan**

1.4 By all accounts corruption has become widespread, even pervasive in Afghanistan. The country's ranking in Transparency International's Corruption Perception Index dropped from 117<sup>th</sup> out of 159 countries covered in 2005 to 172<sup>nd</sup> of 180 countries in 2007 and subsequently to 176<sup>th</sup> out of 180 countries in 2008 (i.e. fifth-worst in the world). Based on available survey evidence and other information,<sup>1</sup> most Afghans perceive that bribes must be paid in order to obtain services from the government. Much of the public may be willing to tolerate petty corruption on the part of poorly-paid government officials trying to make ends meet, but corruption is commonly perceived to have become organized and entrenched, involving corruption networks with people at all levels involved and those at the top reaping large rewards. Public positions and services are seen by many as being for sale. The police, justice system, municipalities, and customs department are

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<sup>1</sup> Surveys on corruption have been conducted by Integrity Watch Afghanistan (IWA), as well as focus group research by IWA and UNDP. Other surveys not focused solely on corruption (e.g. the Investment Climate Assessment conducted by the World Bank in 2005) also provide some useful information. Since corruption is an illegal activity, data on corruption by their nature are imperfect. However, the information that is available consistently points to the patterns summarized here, and also accords with information from other sources, such as the VCAs which are the subject of this report.

widely seen as the most corrupt institutions. Extortion and other crimes by police and drug-related corruption are major issues.

1.5 Afghanistan's international partners also have become increasingly concerned about perceived corruption, although there are some significant differences in attitudes: Many Afghans consider high pay and overheads for NGOs, contractors, consultants, and advisors to be a form of corruption, irrespective of whether or not the applicable rules were followed in their contracting. For its part, the Afghan government is concerned about waste of aid resources that are channeled outside the national budget (i.e. through the external budget), regardless of whether or not outright corruption is involved (e.g. waste from multiple stages of subcontracting, or large and multiple overheads, especially those accruing to agency headquarters and staff outside Afghanistan).

1.6 Corruption constitutes a serious threat to Afghanistan's state-building and development agenda. Adverse effects include, in addition to direct wastage and loss of funds or public sector assets, *inter alia* the following: distortion of government policies and decisions; ineffectiveness of service delivery and limited results; disproportionate damage to the poor who can least afford to pay bribes and other costs of corruption (and who typically lack political connections to avoid paying); adverse effects on private sector development; loss of government revenue (the "tax gap"); and entrenchment of a criminal culture with "networks of corruption" in government (including buying and selling of government positions). But most important in the Afghanistan context is the erosion of government credibility and loss of perceived state legitimacy resulting from corruption. Perceptions of widespread corruption may also make donors more reluctant to provide funds through government budget channels, despite the findings of earlier and recent assessments of public financial management performance that financial controls and fiduciary standards are adequate and reduce the risk of fraud and other misuse of budgetary funds.

1.7 Despite strong statements against corruption by government leaders, little concrete progress has been achieved in the fight against corruption. A high-level inter-institutional committee set up by President Karzai has completed its report which is now available, but this report is widely considered not to constitute a full-blown anti-corruption strategy. More generally, a number of separate, overlapping, and to some extent competing government anti-corruption documents are in circulation (including the Afghanistan National Development Strategy's anti-corruption document, the anti-corruption roadmap paper, and others), which leads to risk of confusion and lack of broad ownership of a clear anti-corruption agenda.

1.8 Afghanistan's legal framework for fighting corruption has been outdated and unclear, and institutional arrangements for anti-corruption have been facing serious problems. Different institutions have been working in isolation and often at cross-purposes; the anti-corruption agency created in 2004 (the General Independent Administration for Anti-Corruption—GIAAC) has been dysfunctional and poorly led; there has been confusion over or unwillingness to implement existing institutional arrangements; lack of clarity over leadership and coordination has been evident; there are numerous disparate complaints mechanisms but with no systematic follow-up; there are concerns about political interference and lack of political support; corruption in the law enforcement agencies is perceived to be widespread; insecurity and intimidation against anti-corruption efforts have been problems; and limited capacity constitutes a serious constraint hindering anti-corruption efforts.

1.9 Recently some progress has been made on the legal and institutional front. A new law on corruption has been promulgated, under which a new anti-corruption agency reporting directly to the President—the High Office for Monitoring Implementation of the Anti-Corruption Strategy—has been established, and an experienced technocrat with a reputation of strong integrity has been

appointed to head it. With the new law, GIAAC stands abolished, and the new agency is not taking over most of GIAAC's existing staff and management. However, there are some remaining technical issues with the new law, and more generally the extent to which the new legal and institutional arrangements will achieve better results than past efforts, is not yet clear. Parliament has ratified the United Nations Convention Against Corruption (UNCAC), and the Government is working with the United Nations Organization on Drugs and Crime to progressively over time make Afghanistan's laws consistent with UNCAC.

1.10 Considerable progress has been made on the prevention side of the anti-corruption effort as mentioned earlier through public financial management (PFM) reforms and improvements.<sup>2</sup> This progress does not, however, apply to the two-thirds of development assistance that flows outside the budget, where corruption prevention depends on the level of donor oversight, particularly at the lower levels of the subcontracting chain. More generally, there are limitations on the impacts that can be achieved through prevention alone, in the absence of other critical components of anti-corruption strategy such as external accountability and law enforcement.

1.11 In summary, the problem of corruption faced by Afghanistan is dire, and effective actions to improve the situation are urgently needed. The anti-corruption effort has to be a broad-based, multi-faceted, sustained medium-term effort. By itself, just trying to catch and punish corrupt officials will not work or be sustainable. A holistic approach is needed, which incorporates all main elements of anti-corruption strategy (prevention through systems and capacity improvements, law enforcement and administrative measures, consciousness raising, and external accountability). Corruption as a key cross-cutting issue should be mainstreamed, with an anti-corruption "lens" applied to policies and programs. Changing the "culture of corruption" also will be very important. It is unrealistic to expect sudden, major breakthroughs in the short run, but meaningful progress, sustained over time, is essential.

1.12 While further developing, refining, and building consensus with respect to a national anti-corruption strategy, it is important in the meantime to move ahead with concrete actions. In line with the anti-corruption roadmap paper, key priorities include:

- Promulgating and implementing a near-term action plan of feasible yet credible measures against corruption, with some strong, visible up-front actions;
- Further strengthening the institutional arrangements and responsibilities for fighting corruption (building on recent improvements); and
- Strengthening leadership, accountability for results, and fostering popular and political support for the anti-corruption effort.

1.13 The rest of this section fleshes out some key elements of the anti-corruption agenda looking ahead:

1.14 **Leadership is crucial.** This includes strong signals from the top leadership of the nation about its commitment to fight corruption and to follow through in a sustained manner. Moreover, the leadership of key institutions involved in the fight against corruption should meet high ethical and professional standards. Leadership also involves setting a good example in terms of taking meaningful (even if initially modest) actions to address corruption at higher levels. It also involves measuring the success of anti-corruption measures (e.g. through surveys) and ensuring meaningful accountability for decreasing corruption across the government.

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<sup>2</sup> See more details in "Afghanistan: Public Financial Management Performance Assessment" (World Bank and DFID, June 2008)

1.15 **Credibility needs to be established in the fight against corruption.** This can be done in the short run by means of a meaningful yet feasible government action plan, promulgated at the top level, with a strong up-front component and clear benchmarks for implementation. Follow-through in implementing the action plan will be critical in building the government's credibility.

1.16 **Institutional arrangements need to be further strengthened and adequately functional.** It is important in this regard that the new anti-corruption law not only be clear with respect to institutional responsibilities but also be bought into by all the government agencies engaged in the fight against corruption. The agencies involved most directly in anti-corruption efforts need to work together and synergize, rather than working in isolation and/or competing over "turf". To this end, coordination of the overall anti-corruption effort by an inter-institutional high-level body would be very helpful, since corruption is a quintessential cross-cutting issue.

1.17 **Enforcement is a key pillar of anti-corruption strategy.** This includes both law enforcement and enforcement of administrative rules and sanctions against corrupt government officials (thus public administration reform will play a key role here, as well as on the prevention side, discussed below). There is a need to focus on the basics, enhance integrity in the enforcement mechanisms, and avoid their misuse or becoming part of the problem.

1.18 **Process and capacity improvements will help prevent / minimize corruption.** Prevention is an all too often neglected dimension of anti-corruption strategy. Improvements in PFM as noted earlier have reduced risks of corruption directly affecting budgetary funds, and need to be maintained and further strengthened, as well as extended to improving PFM in line ministries and at sub-national levels of government. Since corruption often involves networks that stretch from the political system and private sector into the government, merit-based appointments of civil servants through a revitalized public administration reform would help prevent and retard the growth of these networks. Currently salaries of civil servants are very low, and the ongoing pay and grading reform which will ensure adequate and appropriately de-compressed salaries is very important, although pay increases alone will not be sufficient to make much progress against corruption. The VCAs which form the subject of this report need to be (and in some cases already are being) translated into corruption risk management programs to reduce vulnerabilities to corruption in the government functions, agencies, and sectors concerned.

1.19 **Information and transparency are powerful tools against corruption.** Making information available widely, both within the government and to the public, will greatly help in the fight against corruption. Corruption thrives in secrecy and in back rooms, not in the light of day. Information is a critical component of process improvements, as is transparency; both deter and prevent corruption. Computerization, with appropriate safeguards and checks and balances, can substantially reduce opportunities for corruption. The internet (e-government) can be a powerful tool, in combination with other measures. Modalities of generating and disseminating information and transparency need to be adapted to Afghan conditions; for example, especially in rural areas radio may play a relatively important role. Protection of press freedom and of whistleblowers supports information dissemination and transparency, and thereby helps stimulate public demand for less corruption. Transparency and information sharing are also very important in relation to the aid that flows outside core national budget channels.

1.20 **Much more external accountability is essential.** This is an ultimate check against corruption, which brings beneficiaries, citizens, and businesses into the picture to hold corrupt officials accountable for their actions. External accountability can be strengthened in a variety of ways, ranging from external audit and parliamentary review to community-based monitoring, exit surveys of service "beneficiaries", pro-active media reporting, business advocacy, etc.

## B. Rationale and Process for the VCAs

1.21 As discussed earlier, prevention is a very important dimension of anti-corruption strategy that is too often neglected. The VCAs aim at developing concrete insights regarding forms of corruption, sources, implications, extent, and vulnerabilities to corruption in particular sectors, agencies, and functions in order to develop practical prevention measures. The VCAs have been conducted since 2007 by several international agencies and donors (Asian Development Bank, DFID, and UNDP) and the World Bank through close collaboration with relevant ministries and government agencies. The selection of VCAs was based on strong government interest as well as on the importance of the sector, agency, and/or function. There was heavy concentration in the initial set of VCAs on PFM elements. As of mid-2008, six VCAs were completed covering: (i) the merit-based appointment process for senior civil servants; (ii) the Revenue Department of the Ministry of Finance; (iii) the Budget Department of the Ministry of Finance; (iv) public financial management and procurement; (v) the energy sector; and (vi) the road sector (Table 1.1). In addition to these completed VCAs, work is ongoing or under preparation for VCAs for the Justice Sector, Urban Water Sector, Education, and Customs Department of the Ministry of Finance, and there may be a possibility of conducting other VCAs e.g. for the Ministry of Interior and Police.

1.22 The VCAs use a simple methodology focused on analysis of key government “business processes”. This approach normally involves initial meetings, usually with the most senior members of staff for each area, followed by observations of work places and processes, and then return meetings with wider groups of staff to discuss, review, and revise information on business processes. Efforts were made to understand both the formal (*de jure*) and informal (*de facto*) processes that are in place and operative. Staff at all levels were very cooperative, interested, and able to describe their own roles, their places within structures, and overall processes, and contributed openly to the discussions. The VCAs in general followed these steps.

- Identify key business processes;
- Conduct a review of these business processes including to;
- Identify the underlying laws, regulations, and guidelines for each process;
- Identify key steps (both formal and informal) for each business process, including the key stakeholders/decision-makers/managerial responsibilities and tools to hold them accountable;
- Assess strengths and vulnerabilities to corruption of each step (based on weaknesses in the formal system and weaknesses in the capacity/ incentives to implement the formal system);
- Assess key vulnerabilities to corruption in each sector through interviews and focus groups, notably involving clients of the sector;
- Based on the interviews and focus group meetings and desk review of processes, summarize key vulnerabilities to corruption; and
- Develop options to mitigate these vulnerabilities to corruption.

**Table 1.1: Summary of Completed VCAs as of May 2008**

	Areas	Conducted by	VCAs Prepared
1	Appointment Process of Civil Servants	World Bank	November 2007
2	Revenue Department	DFID	October 2007
3	Budget Department	UNDP, DFID	November 2007
4	Public Financial Management and Procurement	World Bank	March 2008
5	Energy	ADB	July 2007
6	Roads	ADB	April 2008

1.23 Several workshops were organized to share the preliminary findings and recommendations of the VCAs with government officials and donors. Since the VCAs summarized in this volume

were completed in 2007 and 2008, considerable progress has already been made in implementing the recommendations of some of them. Hence the VCAs should be seen as “snapshots” of the situation when they were conducted, and not necessarily fully reflective of the status in 2009.

### **C. Main Findings of the VCAs**

#### **FORMS AND IMPLICATIONS OF CORRUPTION**

1.24 In all six VCAs that have been conducted, various forms of corruption are observed, which have serious adverse implications for state building through leakage and misallocation of public resources, deterioration of public service delivery, and loss of confidence on the part of the public. Petty corruption, bribery, and patronage are commonly observed, in particular wherever there are connections between civil servants and the public, and among different civil servants. In the Revenue Department of the Ministry of Finance, for example, bribe taking is observed in taxpayer identification number registration and in reducing/removing tax liabilities.

1.25 Patronage includes a variety of harmful practices such as reciprocal exchange of favors through parallel appointments, appointment on basis of ethnic or other interest group, and political patronage. Patronage conflicts with the merit-based approach, and represents a clash between traditional values and the requirements of a modern bureaucracy. Pervasive interference in merit-based appointments may reflect development or strengthening of corruption networks. Patronage appears to play a large role in how Afghan energy staff are hired, for example. Many such hires lack the technical capacity required for the positions concerned. Also, in the energy sector the culture of patronage extends to contracting out services and procuring equipment and supplies, especially seen in procurements of liquid fuels where certain ethnic preferences are clearly indicated by managers.

#### **COMMON SOURCES OF VULNERABILITIES TO CORRUPTION**

1.26 The VCAs find several common areas of vulnerability to corruption, although the specific types of vulnerabilities and the extent of problems differ across sectors. Common vulnerable areas include (i) organizational weaknesses; (ii) capacity weaknesses; (iii) procurement; (iv) overly bureaucratic processes; and (v) vulnerabilities at sub-national levels.

##### *(i) Organizational weaknesses*

1.27 Organizational structures remain weak in many sectors from the perspective of preventing corruption. Such weaknesses may result in discretionary powers being given to small groups without proper checks and balances. Moreover, where multiple ministries/institutions are involved in one sector without effective coordination, the risks of corruption may be greater. Introduction/implementation of checks and balances becomes much more difficult under such circumstances, and rights/responsibilities become less clear and transparent, which could provide more opportunities for corruption. For example, nine ministries are members of the Inter-ministerial Commission for Energy (ICE) which, coordinated by the Ministry of Economy, is supposed to have coordinating and policy formulation functions.

1.28 In the road sector, the organizational structure of the Ministry of Public Works (MPW) is such that all departments are linked to advisors rather than to deputy ministers, and key monitoring bodies like the audit office and monitoring function do not report directly to the Minister. These arrangements may hinder or prevent management from obtaining necessary information. In the energy sector, weak governance and accountability leaves managers of ministries and SOEs to



control the development and sequencing of project priorities, often in response to local political and other pressures. Also, key managers do not normally have terms of reference. Legal and regulatory frameworks in the energy sector remain underdeveloped, and there is no transparent licensing of operations in place. Thus governance arrangements are inherently flawed in terms of supporting a market based energy system.

(ii) Capacity weaknesses

1.29 Although weak organizational structures are a source of vulnerabilities to corruption, organizational restructuring alone will not guarantee achievement of better anti-corruption results. Weak capacity is pervasive across sectors due to grossly insufficient numbers of qualified staff and lack of education and relevant training, which prevents systems and organizational structures from properly functioning. Capacity weaknesses combined with organizational weaknesses compound the risks of corruption.

1.30 With respect to the revenue and expenditure functions of the Ministry of Finance, the capacity of the Internal Audit Department has already been strengthened, but additional capacity development could further reduce risks of corruption, as this department has some authority over which activities and transactions to subject to audit. In the Budget Department, the processes of budget submissions and establishing appropriations face corruption risks. Weak budget formulation capacity of line ministries, resulting in poor budget proposals, opens up scope for rent seeking by budget officers. In the road sector, MPW does not have the capacity to effectively supervise construction work, design new projects, or maintain existing roads. Due to this weak capacity, the supervision function of MPW is outsourced to private firms. With respect to the merit-based appointment process, the capacity of the commissioners of the Independent Appointment Board (IAB) for selecting high-level civil servants is questionable.

(iii) Procurement

1.31 Despite the major improvements in the legal and regulatory framework resulting from the enactment of the new Procurement Law in 2005, there remain significant issues related to procurement in all sectors. As noted in the VCA for the energy sector, for example, lack of human capacity to understand the modern procurement system and to implement it have resulted either in very loosely conducted procurement transactions with little to no oversight, or at the other extreme in closely guarded tender processes that have often stalled important work. The manipulation of certain procurements in the energy sector, notably for equipment and supplies, has resulted in procurement of inferior quality products, often at inflated prices. However, there has often been better experience with procurements involving larger contracts with international competition. In the road sector, a procurement officer may provide false (incomplete) information to one bidder in return for the payment of a bribe by a competing bidder. Experience varies across different types of road projects, however, and has been considerably better in some cases. More generally, in the project cycle, procurement, project monitoring, and payments are especially vulnerable to corruption.

1.32 While the road and energy sectors exemplify how weak procurement implementation provides opportunities for corruption, the procurement mechanism itself has room for improvement. The transition from the previous procurement regulations to the new Procurement Law is not yet complete in practice. Many procuring entities still tend to follow the bidding procedure that was prescribed in the old procurement regulations. The previous Anti-Corruption Law did not distinguish between corrupt procurement practices and mistakes or negligence, which was a serious problem. There are also concerns about the ambiguities and the wide ambit of the

new anti-corruption law which has been recently prepared. The award of contracts on single-source basis, often justified on account of the need to rapidly utilize funds and to expedite infrastructure works, also is vulnerable to corruption. The corruption risk associated with single-source procurement lies not only in selection of a preferred contractor but also in negotiation of the terms and conditions of the contract, which may be adversely affected by poor technical capacity of the procuring entity. Finally, there is no advertising system in place for national procurements conducted outside the Afghanistan Reconstruction and Development Services-Project Unit (ARDS-PU).

*(iv) Overly bureaucratic processes*

1.33 With respect to public service delivery, overly bureaucratic processes provide scope and incentives for engaging in corrupt practices to both government officials and beneficiaries. In the road sector, bribery appears to be common in exchange of bid/tender information and release of a payment. In the energy sector, bribery reportedly has become a normal part of operations. In Kabul, as many as 25 signatures are required to officially obtain an electricity connection. Such a complicated process invites consumers and DABM (the state electricity company) to become engaged in bribery in order to bypass complex official processes.

1.34 Process improvements and checks and balances are especially important where there are significant inherent vulnerabilities in the transactions themselves. For example, in the Revenue Department of the Ministry of Finance, some activities related to the Large Taxpayers Office (LTO) are especially prone to corruption since the LTO has strong discretionary powers over the selection of taxpayers for audit investigations and the conduct of corporate audit investigations (e.g. planning, implementation, collection, analysis, and interpretation of financial information).

*(v) Vulnerabilities at sub-national level*

1.35 There are also serious vulnerabilities to corruption at sub-national levels of government outside of Kabul, which the centralized system finds more difficult to reach. In the Revenue Department, areas under the responsibility of Mustofiats (Ministry of Finance provincial offices) are vulnerable, including returns, processing, and reviewing of taxes of smaller taxpayers. Survey evidence indicates that the equivalent of 5-10 percent of tax liability can be paid to officials in Mustofiats as bribes, in return for drastically reducing the tax liability. There has been deliberate distortion of the recruitment process for Mustofiats' personal. For example, highly technical questions and requirement of many years' experience clearly favored incumbents.

## **D. Key Policy Recommendations**

1.36 The essence of the VCAs is their numerous specific recommendations for corruption prevention measures to be implemented in each sector. However, there are some cross-cutting recommendations which are common to most sectors. These include: (i) organizational restructuring and where necessary improving the legal framework; (ii) developing capacity; (iii) strengthening procurement; (iv) addressing vulnerabilities at sub-national level; (v) ICT development; and (vi) enhancing internal audit.

### **ORGANIZATIONAL RESTRUCTURING AND IMPROVING THE LEGAL FRAMEWORK**

1.37 Organizational restructuring is important for preventing corruption by strengthening formal check and balance mechanisms. Restructuring, as well as strengthening external and internal audits, will contribute to counterbalancing discretionary power. However, organizational

restructuring alone cannot guarantee anti-corruption results; on the contrary, an initial stage of organizational restructuring could possibly make a situation worse if government officials do not understand the new structure. Therefore, organizational restructuring should be accompanied by capacity building. In some areas the legal framework will also need to be improved, but this should be selective and targeted at clear priorities for achieving objectives. An example of how these different dimensions need to come together is the corporatization of DABM, which involves organizational restructuring and capacity building as well as changing the legal framework.

## **DEVELOPING CAPACITY TO ADDRESS WEAKNESSES**

1.38 The first step in capacity development is to identify staffing and skill shortages in areas vulnerable to corruption and to develop plans and budgets to alleviate such shortages. Measures to promote high levels of professionalism and integrity include merit-based recruitment policies, adequate remuneration, conflict of interest rules, enforced codes of conduct, and effective staff oversight. Also, it would be important to adapt and deliver current ethics induction training as a wider corruption awareness and staff conduct training program, as a means of introducing planned organizational integrity policies and initiatives.

## **PROCUREMENT**

1.39 In addition to strengthening the capacity of staff, the PFM VCA puts forward six key measures to improve procurement.

- **Transition to the new Procurement Law:** Accommodate the transition from the previously prevailing practices under the old procurement regulations to the enhanced procurement environment of open and transparent procurement practice;
- **Regulatory framework:** The adequacy of the procurement legislation against international standards for anti-corruption should be confirmed;
- **Continue to use ARDS-PU to manage bidding processes for major contracts,** which provides substantial mitigation of corruption risks as an international consulting firm serves as the central procurement facilitating agent—but over time these roles should be transferred to sustainable national capacity, whose development is a priority;
- **Sole-source awards:** The "Rules of Procedure for Public Procurement", which require documentation of the process and justification for sole source selection, should be strictly followed;
- **Advertising:** The Procurement Policy Unit (PPU) should enforce a system to be put in place for monitoring advertising of national procurements conducted without involving ARDS-PU;
- **Timing of procurement:** Enforce procedures to advertise on time and to provide adequate notice to bidders by increasing capacity and improving planning; and
- **Management of procurement:** Adherence to acceptable international practices and guidelines should be strictly insisted upon—also, a comprehensive contracts database in the Ministry of Finance would improve control and management of procurement contracts.

## **VULNERABILITIES AT SUB-NATIONAL LEVEL**

1.40 Human capacity and financial resource constraints in Afghanistan are even more severe at sub-national levels. Also, it is more difficult for reform processes to reach sub-national levels. Hence more attention should be given to sub-national aspects of vulnerabilities to corruption. In the Revenue Department, for example, the reform of seven priority provinces under the Priority Reform and Restructuring (PRR) Program is expected to have a positive impact in preventing corruption.

## **ICT DEVELOPMENT**

1.41 ICT is an important platform for the development of a coherent control environment to support organizational integrity. Introducing a computerized integrated information system is commendable and should be accompanied by extensive staff training. In the Budget Department, introduction of software that facilitates the budget preparation process would be helpful. Computerization would make the budget formulation process more transparent. In the Revenue Department, introduction of a computerized integrated revenue management information system with documented operating procedures and protocol is recommended, including incorporation of business taxpayer data in a computerized integrated revenue information management system.

## **INTERNAL AUDIT**

1.42 In most of the VCAs, the weakness of internal audit is highlighted. In the PFM VCA, key recommendations for improving Internal Audit include to:

- Implement an annual internal audit plan under the Ministry of Finance for the whole of government;
- Proceed to align the roles and responsibilities of MoF, the CAO, and other entities with respect to Internal Audit, in order to ensure that clear organizational lines are drawn and that internal audit activities are coordinated by the Ministry of Finance;
- Place the Department of Internal Audit of the Ministry of Finance directly under the Minister as this would best enable it to fulfill its responsibilities;
- Implement the key internal audit provisions of the law;
- Continue implementation of the PFM Action Plan in particular for internal audit; and
- Develop internal audit activities in the line ministries, which will be under the control of the line ministries but in accordance with standards issued by the Ministry of Finance.

## **E. Lessons from the Experience with VCAs**

1.43 In addition to achieving some initial results, the VCAs through the experience in conducting them, as well as in follow-up, provide useful lessons. The advantages and limitations of the VCAs, as well as some concrete lessons with respect to what works well, need to be kept in mind in taking forward the anti-corruption agenda in the future.

## **UP-FRONT AND CONTINUOUS ENGAGEMENT WITH AGENCY MANAGEMENT IS ESSENTIAL**

1.44 It is critical for the success of the VCAs, and even more for their meaningful impact including through follow-up, that the leadership of the agencies concerned not only is fully briefed at the outset of the work, but also is regularly consulted during the process and is fully engaged particularly in absorbing and acting on the recommendations of the VCAs. In addition, engagement at the senior working level of the agencies for which the VCAs were being conducted played a major role in achieving results. The VCAs where there was strong engagement at both leadership and management levels tended to achieve better results than those where there was less engagement by agency management. This applies especially to government ownership of VCA recommendations and subsequent follow-up (see below).

## **QUALITY AND OVERSIGHT OF THE TEAMS CONDUCTING VCAs IS CRITICAL**

1.45 The VCAs demonstrate that not only are the skills and approaches of the teams conducting the VCAs a major determinant of success, but also the oversight of such teams by staff of the

international partners responsible is very important. In some cases the content of a VCA report veered significantly away from the TORs, possibly due to lack of regular supervision of the work on the part of those who had commissioned it.

#### **FLEXIBILITY IS NECESSARY, WITHIN CLEAR OBJECTIVES AND PARAMETERS**

1.46 The experience with the VCAs shows that there needs to be considerable flexibility in how each sector, agency, and core government function is approached, depending on specific circumstances and entry points etc. However, such flexibility needs to be exercised while maintaining focus on the objectives of the VCAs and within the broad methodological parameters specified, such as the need to concentrate on selected key processes and identify vulnerabilities to corruption on the basis of individual process steps, and to test findings through “reality checks” with the staff and leaders of the agency concerned as well as other knowledgeable persons.

#### **FOLLOWING UP WITH RESPECT TO THE FINDINGS OF VCAS IS CRITICAL**

1.47 The VCA exercises demonstrate that this is a useful process to identify vulnerable areas to corruption in particular sectors, agencies, and functions, and to provide practical recommendations for mitigation measures. However, follow-up will be the key to the VCAs achieving meaningful impacts in reducing vulnerabilities to corruption. In some cases, development of an action plan and a matrix were seen as an integral part of the VCAs, which provides some confidence that there will be follow-up. Prioritization of key actions to be taken under the action program, and careful monitoring of implementation, will be critical. It is also helpful if the international agency or agencies that commissioned the VCA, and/or the persons who conducted it, remain engaged throughout the follow-up process.

#### **NEED FOR CORRUPTION RISK MANAGEMENT / FRAUD-CORRUPTION PREVENTION PLANS**

1.48 An essential element of follow-up to the VCAs is production of corruption risk management / fraud-corruption prevention plans for the sectors, agencies, and functions concerned. At a more general level, it would be desirable to introduce a formal requirement for agencies and departments to prepare such plans that are reported on and reviewed annually. The plans should be realistic, taking the current status and resource constraints into account, as well as differences among agencies in terms of corruption risks and areas of vulnerability.

#### **DIFFERENCES BETWEEN VCAS FOR CORE FUNCTIONS AND IN LINE MINISTRIES**

1.49 The VCAs tended to work reasonably well for core government processes (e.g. revenue, PFM, and merit-based appointment process). However, the VCAs for line ministries (i.e. roads and energy) faced difficulties obtaining support, encouragement, and buy-in as well as follow-up. A possible reason is that multiple ministries/government agencies are involved in these sectors. Moreover, in several other sectors VCAs did not get underway or were long delayed, reflecting in part also difficulties in mobilizing sector staff of the international partners that were commissioning and supporting the concerned VCAs. And finally, the VCA methodology appears to work better in general in the case of VCAs for core government processes, in particular where the predominant focus is on processes within the government. In the case of service delivery, the VCA methodology needs to be adjusted to include a focus on the beneficiaries of the public services concerned. In the light of all these considerations, the methodology of the VCAs needs some further development and adjustments when public service delivery is being assessed, as opposed to primarily internal government processes.

## **EXTERNAL BUDGET AND DONOR SUPPORT**

1.50 The VCAs do not directly address vulnerabilities associated with the external budget (donors' funds that are not channeled through the Government's Core Budget and Treasury System). As the external budget accounts for more than 70 percent of total public expenditures (average during SY1382-86), this means that most of overall public spending is not covered by the VCAs. Thus addressing vulnerabilities to corruption in the external budget would be important, but is beyond the scope of most of the VCAs. A possible way forward is through auditing—one of the critical elements of a corruption prevention system, but in the case of the external budget this is determined solely by each donor's own auditing requirements. At a minimum, the government could be provided regular access to the audit reports for any audits of these activities that may be conducted for or by the donors. Another potentially productive way forward could be assessment of the unit costs of comparable projects and activities carried out through the core budget and through the external budget. While not necessarily able to distinguish clearly between corruption and waste / inefficiency, these kinds of comparative assessments would be useful and could be included, for example, in some of the sectoral VCAs.

## **DONOR COORDINATION**

1.51 Improving donor coordination can also facilitate efforts to prevent corruption, although only in combination with other measures and with strong government leadership. The lack of coordination among donors supporting the energy sector, for example, has resulted in considerable delays in project development and implementation, duplication of efforts (i.e. three donor programs provided diesel operator training but no coordination of who was getting the training), ineffective optimization of donor and government funds, and on several occasions the generation of ill-will among donors and between donor agents and government officials.

## **SCOPE AND LIMITATIONS OF VCAS**

1.52 While the experience with the six VCAs that have been completed demonstrates that this can be a useful instrument to support better prevention of corruption, this experience also indicates the limitations and weaknesses of VCAs. As mentioned earlier, the VCA approach appears to be better-suited to assessment of core government internal processes as opposed to delivery of services to the public. The focus of the more successful VCAs on a single ministry, or in some cases even on a department within a given ministry, suggests that there may be greater difficulties in conducting VCAs when multiple ministries are involved in a sector or process. And finally, the VCA approach seems much better suited to address smaller-scale and petty corruption as opposed to large-scale corruption (especially so-called "grand corruption") and entrenched corruption involving corruption networks embedded in the system.

## **CONCLUDING POINTS AND WAYS FORWARD**

1.53 A first priority is to disseminate and discuss widely the six completed VCAs, a process this report is intended to facilitate. Second, there are several ongoing and planned VCAs, which need to be completed. Third, the methodology of VCAs can be further developed and adjusted based on experience. Fourth, effective review and follow up on the progress in implementing corruption risk management / fraud-corruption prevention plans is needed, which will be essential for the success of the whole endeavor. Finally, it is hoped that even though their objectives are modest and their focus is on individual sectors, agencies, and government functions, the VCAs will contribute to the broader fight against corruption, which must be a multi-faceted effort incorporating a number of elements as discussed in the introductory section of this chapter.

## 2. PUBLIC FINANCIAL MANAGEMENT AND PROCUREMENT<sup>1</sup>

### A. Introduction and Background

2.1 Public Financial Management (PFM) is the foundation for effective government functioning and spending in all countries, but given the state-building process underway in Afghanistan, it is especially critical. The current government is highly reliant upon extensive donor funding and a wide array of external funding sources. The continued willingness of external sources to be forthcoming to assist the Government in a regular and predictable manner will depend upon broadening and deepening transparency and good governance in public financial management. Resistance to corrupt practices is an important part of PFM.

2.2 It is important to recognize that significant progress has been achieved so far in PFM.<sup>2</sup> Over the past six years, significant achievements in PFM have progressively built credibility in the budget system as a policy instrument and as a vehicle for good governance. Afghanistan has laid good foundations for a national budgeting system and to a lesser extent for a modern public administration, with a focus on the legal framework and institutions at the center.

2.3 These considerable achievements by the Government provide an institutional and systems framework for PFM. Much now needs to be done to build capacity in terms of human resources to address implementation weaknesses and firmly establish efficient and effective working PFM processes. The focus of the Government's reform program is shifting toward building capacity to deliver services throughout government. Reforms are being extended from the center (Ministry of Finance) to line ministries and provinces. This will involve a much wider range of staffing, and it will be important to use sound human resource management principles and practices to create incentives for integrity and disciplined performance, and to create disincentives for dishonesty, lack of discipline, and inactivity.

2.4 Corruption can undermine PFM systems, reduce or destroy their benefits, and undermine the credibility of PFM and more broadly that of the government. To provide a sound basis for going forward, vulnerabilities to corruption assessments (VCAs) in the key PFM functional areas are conducted. These focus on (i) payments; (ii) cash transfers; (iii) bank reconciliations, (iv) payroll; (v) asset management; (vi) internal audit; (vii) external audit; and (viii) procurement.

2.5 **VCA Process:** This set of VCAs covering the above areas: (i) assesses compliance with stated procedures; (ii) assesses the nature of irregularities within the current institutional and organizational arrangements; and (iii) proposes a Risk Management Plan containing high level recommendations and implementation steps to link with other broad-based reform programs, and PEFA (Public Expenditure and Financial Accountability) and FM (Financial Management) benchmarks. The VCAs on PFM were conducted through the following processes:

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<sup>1</sup> This summary is based on the Vulnerabilities to Corruption Assessments (VCAs) for Public Financial Management, Procurement and Audit. These were conducted by the World Bank in very close collaboration with the concerned departments of the Ministry of Finance and the Control and Audit Office. The findings are detailed in the report entitled "Assessment of Vulnerabilities to Corruption in Public Financial Management" (2008).

<sup>2</sup> Further details can be found in *Afghanistan: Public Financial Management Performance Assessment* (2008). Also see *Afghanistan: Managing Public Finances for Development* (2006).

- Identify major business processes based on an informed assessment of the processes potentially most vulnerable to corruption;
- Conduct a desk review of key business processes;
  - Identify underlying laws, regulations, guidelines, and standards for each process.
  - Identify key actions within each business process including key stakeholders, managers, and decision makers and the tools used to hold them accountable.
  - Where practicable, assess strengths and vulnerabilities to corruption for each step based on weaknesses in the formal system or weaknesses in the capacity and incentives to implement the formal system. This step can be based on assessments of relevant staff.
  - Summarize key vulnerabilities to corruption and develop options to mitigate these vulnerabilities. Document areas where vulnerabilities have already been mitigated.
- Use questionnaires to be completed by agency management on a checklist of relevant risk assessment and control issues.

## **B. General Considerations and Recommendations**

2.6 In addition to the brief general overview below, the need for a comprehensive integrated fraud control approach is emphasized in this section.

2.7 **Forms and Sources of Corruption and Mitigation Measures:** The VCAs on PFM find several weaknesses which need to be rectified through a Risk Management Plan (Appendix 2.1) if significant corruption is to be avoided, particularly during the expansion of PFM activities to line ministries and Mustofiats (provincial units of the Ministry of Finance). The implementation of this Plan is supported by proposed tracking methods, and progress should be monitored by the Internal Audit Unit of the Ministry of Finance.

2.8 Across the PFM areas, common themes that emerged in terms of implementation weaknesses are:

- Inadequate and poorly followed procedures;
- Capacity limitations and need for training of government staff;
- Manual workarounds of automated processes; and
- Very restricted accounting systems.

2.9 In a broad sense, corruption opportunities in PFM can be divided into high level opportunities, petty corruption and bribery, and financial leakages and embezzlement.

2.10 **High level opportunities.** Opportunities at high level to influence patronage, and to engage in corrupt financial decision-making in the execution of the government budget or the diversion of government revenues, are very substantial unless PFM systems are immunized by adequate system controls that are strongly enforced. This is rarely achievable without a strong system of transparency, supported by legislative and professional protections for officers engaged in the PFM system. If there are weak external accountability mechanisms such as poorly supported audit, legislative review and judicial review functions, there is potential for very substantial exercise of grand corruption.

2.11 **Petty corruption and bribery:** This is the most common and pervasive form of corruption, including “petty theft” of government property, petty fraud (e.g. illicit diversion of government resources), and “petty bribery” to assure the delivery of government services, or other “petty” illicit activities. The fragmented nature of these corrupt activities, the relatively small amounts involved per corrupt act, and their pervasiveness throughout the system, complicate



efforts at effective detection and prosecution of petty corruption in the administration. Responses include sound public expenditure management practices, direct inspection through supervisory activities, and arrangements whereby citizens can report corrupt activities. MoF has introduced a pilot whistleblower scheme, and the Internal Audit Unit of MoF is preparing a paper on the general approach to fraud investigation which could lead to improvements.

**2.12 Financial leakages and embezzlement:** In Afghanistan, the strong centrally managed and computerized payments mechanism has contributed to the soundness of the PFM system. Maintenance of the effectiveness of this system requires continuous monitoring and renewal of system components along with strengthening of the professionalism of public sector accountants. As the government pursues multiple reforms and capacity building initiatives all along the public accountability chain of accounting, reporting, internal audit, external audit, and parliamentary oversight, progress is being made in establishing the foundation for a multi-faceted and mutually reinforcing governance system to help deter and detect corruption. Much work remains to be done, but each of these components provides a piece of the overall picture for strengthening public accountability. As Parliamentary oversight and media attention have been absent until recently, transparency mechanisms have been less effective than desired, which has resulted in weak external accountability. Under various reform programs and investment projects, these building blocks are being put into place, and external accountability is in the early stages of playing a contributing role to help detect and deter fraud and corruption in public administration.

**2.13 Need for a Comprehensive Integrated Fraud Approach:** At a general level, it is essential to introduce a formal requirement for agencies and departments to prepare risk management and fraud prevention plans that are reported on and reviewed annually. Oversight of implementation would be part of the responsibilities of heads of budgetary units for the status of financial management in the unit, as per Chapter 1 of the Finance Regulations (FR) issued under the PFEM (Public Finance and Expenditure Management) Law. Overall policy for this process should be set by MoF in concert with anti-corruption, audit, and investigation agencies. The FR would provide the regulatory vehicle for implementation rules under Chapter 11 on Control and Audit, according to which budgetary units are responsible for establishing good financial control frameworks to prevent losses and illegal actions including those resulting from fraud and error. As part of the development of a whistle blowing and fraud investigation function in MoF, the Internal Audit Unit is using a contractor to develop frameworks, methodologies, and training. The first phase report was completed and presented to MoF in early 2008.

**2.14** The rest of this chapter summarizes specific assessments and recommended mitigation measures for eight functional areas, namely: (i) payments; (ii) cash transfers; (iii) bank reconciliations; (iv) payroll; (v) asset management; (vi) internal audit; (vii) external audit; and (viii) procurement.

### **C. Payments: Need for Improved Documentation and Procedures**

#### **VULNERABILITIES**

**2.15** The VCA for Payments covers cash advance payments, Special Disbursement Unit (SDU) payments, and other payments. There are significant weaknesses which could allow corrupt practices to occur. The strongest concern is the security situation, which prevents physical inspection in a number of provinces. For example, the auditors of World Bank-supported and ARTF projects could only visit four of the 15 major provinces; the ARTF Monitoring Agent was similarly restricted. In these cases, checks are limited to examining those documents that can be

transported for verification, and such methods have inherent deficiencies that could allow corruption to go undetected.

2.16 The lack of a comprehensive archive makes it difficult to track and resolve past payment irregularities. An area of possible concern is that double payments might occur due to an AFMIS limitation whereby temporary and permanent files can be opened simultaneously, although this vulnerability is limited because payments can only be made if accompanied by the relevant voucher, which will not be available for a temporary file. Nevertheless, duplicate checks are sometimes printed (centrally and provincially), although apparently such duplications are quickly detected. According to the CAO audit reports for 2006/07 (SY1385), there are inadequate checks and balances in the operation of AFMIS, especially in entering data, correcting wrongly entered data, and reconciling financial information of the line ministry with the SDU. Audits found that AFMIS economic codes were sometimes not properly interpreted, resulting in incorrect classification of expenditure. Audit has noticed wrong entries for Tax Deductions entered as Security Deposits (which can be repaid – representing a possible fraudulent entry).

2.17 The CAO complained of poor record-keeping practices in line ministries, citing numerous occasions on which records could not or would not be supplied to auditors. The key vulnerability in payments is that incorrect or unauthorized transfers could be processed. In some cases, there is insufficient segregation of duties, with invoices modified and then paid by the same operator or unit. Payment procedures are incomplete and not fully documented in an approved manual, so operators are left to fend for themselves when they encounter an unusual transaction. The current process, supported by weak internal controls, might allow payments and transfers to be made without complete documentation, not properly authorized by the unit or the Director General of the Treasury Department, or not properly filed and archived. Major vulnerabilities also arise through payments for shoddy or incomplete goods or services. Certifications of completion need to be verifiable and reliable. Record keeping requirements need to be enforced. The 2006/07 (SY1385) CAO audit report states that in all the line ministries the condition of accounts and the response to audit was poor, so there is vulnerability that corrupt practices will not be detected because records are incomplete or unavailable.

2.18 In sum, vulnerabilities in general payments and cash advance payments include:

- General Payments
  - Possible double payments due to the presence of a temporary file and a final file;
  - Payments can be processed with incorrect or incomplete details or improper authorization; and
  - Improper payment recording in AFMIS.
- Cash Advance Payments
  - Lack of proper supporting documentation for expenditures; and
  - Need for automated procedures to track payments which could result in untimely settlement of advances.

## **MITIGATION MEASURES**

2.19 **Changed Procedures for Payment Processing:** AFMIS is intended to provide a comprehensive, systematic approach to handle all payments, accompanied by appropriate documentation and approvals. To be fully effective, AFMIS should support a well-documented, speedy payments process that enables the government to quickly verify legitimacy of payment requests, assess quality and completeness of documentation, expedite accurate processing, minimize errors and potential for duplicate payments, and reduce opportunities for fraud.

Generally AFMIS performs these functions, but there are some imperfections, especially in other related operations that link with the central AFMIS system, such as provincial processes and bank processes. AFMIS is installed in two line ministries and one province, but IT operational capacity in Projects, Mustofiat, and Line Ministries is very low, so errors and other vulnerabilities can arise through poor supervision. The lack of an approved manual in line ministries can lead to inconsistent execution of payments, and MoF finds it difficult to enforce proper record keeping practices.

2.20 Sometimes controls such as budget checks in the system are overridden. For example, if error messages are encountered when processing a payment, the operator can ignore the message and process the payment. This is a weakness in the system controls which creates vulnerabilities. To prevent such vulnerabilities, all of the controls available in the FreeBalance software should be utilized to the extent needed to ensure reliability and security of transactions data. Overriding budget constraints is a fundamental violation of general system controls and creates a major vulnerability to corruption. The key advantage of a strong automated system is that discretion and the potential for malign pressure on accounting personnel is removed; overriding these controls to re-introduce discretion opens up possibilities for petty and grand corruption.

2.21 Key recommendations are as follows:

- General payments
  - Develop payment process descriptions and a manual to be used by all staff;
  - Improve filing of supporting documentation;
  - Explore ways in AFMIS to avoid processing temporary files; and
  - Fully automate the reconciliation of AFMIS payments with periodic and monthly bank statements.
- Advance payments
  - Implement consistent procedures with adequate segregation of duties which should accompany the planned upgrade in AFMIS.
- SDU payments
  - Payment requests need to be fully supported, properly authorized, and systematically archived;
  - Transfers must be authorized by DG Treasury.
- Non-development payments
  - Implement consistent procedures with adequate segregation of duties;
  - Maintain full document archives.

## **D. Cash Transfers: Documentation Gaps**

### **VULNERABILITIES**

2.22 The VCA for Cash Transfers assesses cash transfers abroad, cash transfers to provinces, and cash transfers for letters of credit. Several weaknesses are found in cash transfers. Lack of common, official, documented procedures has in the past led to inconsistent execution of cash transfers. Procedures depend on the particular donor or grant agreement, and the variations are difficult for the Cash Management Unit to manage.

2.23 The principal vulnerability in cash transfers abroad is that journal vouchers (instructions to transfer money between bank accounts) are sometimes processed without proper documentation or signature verification. The primary vulnerability in cash transfers to provinces is that incorrect or

unauthorized transfers could be processed, as full and proper signatures on the requests are not always reviewed by Treasury. Vulnerabilities in cash transfers for letters of credit include the following: (i) double cash transfers could occur when expense vouchers and journal vouchers are processed simultaneously, which is not likely but possible, and (ii) adjustments to the amount transferred could be effected.

#### **MITIGATION MEASURES**

**2.24 Improved Documentation Recommended for Cash Transfers Processing:** A comprehensive, systematic approach to handle all cash transfer requests, with appropriate documentation and approvals, is recommended. An effective, well-documented cash transfers process would enable the Government to quickly verify the legitimacy of cash transfer requests, expedite accurate processing, minimize errors, and reduce opportunities for fraud.

**2.25** For cash transfers abroad, the key recommendation is to implement consistent procedures with adequate segregation of duties by ensuring that signatures on the requests are verified. For cash transfers to provinces, the key recommendations are to ensure that: (i) payment requisitions are supported and properly authorized, and (ii) transfers are authorized by the appropriate authority. For letters of credit, the key recommendations are to: (i) use official stamps, (ii) maintain full document archives, and (iii) implement safety features in AFMIS to prevent simultaneous processing of expense and journal vouchers.

### **E. Bank Reconciliation: Delays and Manual Processes**

#### **VULNERABILITIES**

**2.26** This assessment covers 95 bank accounts and includes the Chart of Accounts, selected Da Afghanistan Bank (DAB, the central bank) transactions and records, selected AFMIS transactions, and a complex, inter-related chain of business processes.

**2.27** There are certain weaknesses in bank reconciliation. As a result of delays in preparing bank reconciliations, the current financial position of the government and the depletion of budgets cannot be reported accurately. Also, there has been no automated process for passing closing balances to the new fiscal year, so at the beginning of each year all accounts start at zero until a first transaction is entered, which can create major distortions in financial records. In addition, errors in the account closing process permit transactions to occur with closed accounts.

**2.28** The chart of accounts has listed some bank accounts twice under different names. Another important concern is that transactions and payment processing can occur outside of AFMIS temporarily while the final Afghani equivalent is determined for foreign currency transactions. The Treasury Department advised that one weakness is that DAB does not provide bank reconciliation information on a regular basis.

#### **MITIGATION MEASURES**

**2.29 Recommendations for Automating Processes to Assist Bank Reconciliations:** Extensions of the current AFMIS implementation or other means should be used to handle foreign currency transactions, bank reconciliations, and the annual closing process more automatically, preferably using FreeBalance modules where they are available, for example, for transferring closing balances. It is advised to log all transactions that take place temporarily outside of AFMIS to maintain a full record, and to make every effort to minimize these transactions over time. One

approach is where possible to use Electronic Funds Transfer (EFT) to request DAB payments so as to eliminate the delay in recording.

2.30 Also, assignment and retention of sufficient and qualified staff in both the SDU and the Regional Reconstruction Unit (RRU) is needed to implement these key reforms and to further advance the internal controls work in bank reconciliations. A more timely bank reconciliation process would enable the Government to quickly aggregate its cash reserves balances, assess its overall cash position, more closely align expenditures with actual budgets, and reduce errors in payments as well as in transaction processing and recording.

## **F. Payrolls: Problems with Manual Processes**

### **VULNERABILITIES**

2.31 The scope of this assessment covers salary paid versus authorized source documents, and calculations and processing of salary, overtime, and deductions.

2.32 Errors occur in pension deductions and overtime calculations, mainly because of the manual process used for pension payment calculations and accounting entries. Payroll payments are affected by the security situation which has made physical inspection of records and staffing in multiple provinces by the Monitoring Agent more difficult. The auditors of World Bank supported projects and the ARTF could only visit four of the 34 provinces. In provinces not visited, checks are limited to examining those documents that can be transported for verification, and such methods have inherent deficiencies that could leave corruption undetected. Audits of Afghan budget expenditures, including salaries, by CAO were less restricted in terms of provincial visits.

2.33 One specific vulnerability is that staff can collect salaries in cash at the bank for other staff—a major internal control weakness. DAB processes are not reliable in ensuring proper identification of persons collecting cash for salaries. Nowhere in the government is payroll preparation integrated with personnel files. As of November 2007, payroll for a total of 88,000 of the 340,000 government employees was processed in automated payroll systems with an interface to an identity card database. Payroll for the rest of the civil service and other public employees is calculated mostly manually.

2.34 An overall payroll control weakness arises from lax management controls, in that staff can be paid even when not attending work, and if attending when they may not be actually working. Controls on the payroll authorization process are provided by the Tashkeel (establishment control) mechanism, whereby staffing establishments are proposed by ministries and approved during the budget process. But at best, this only provides an upper bound on payroll – which is still vulnerable to ghost workers and other corrupt practices.

2.35 These higher-level risks, such as ghost workers are substantially mitigated by the activities of the Monitoring Agent in the case of payroll-based and non payroll-based salary expenditures funded through the ARTF for the non-military payroll. The Monitoring Agent reviews eligibility of payments against employee lists. The MoF Headcount database is an Access database developed to record the government headcount and accrual-based payroll information. MoF maintains two separate databases, one for Military employees and one for Non-Military employees. Since the MoF Headcount database is a stand-alone application that is not connected to the government cash-based AFMIS accounting system, a close watch needs to be kept on the reconciliation between the headcount database and AFMIS, and the Monitoring Agent does this.

2.36 According to Monitoring Agent reports, the eligibility ratio for salary payments improved to 93 percent in SY1385. Ineligibility of payroll expenditures can arise from non-compliance with Government of Afghanistan regulations, the ARTF Grant Agreement, and specific additional fiduciary standards mainly concerning headcount caps, payroll submission deadlines, etc. Most of the ineligibility found was caused by these fiduciary standards constraints and is unlikely to relate to improper payments. However, these checks relate only to the particular tests for eligibility for payment, and the possible management lapses mentioned in the previous paragraph are not checked in this process.

## **MITIGATION MEASURES**

2.37 A comprehensive, systematic approach to handle all attendance, work supervision, and payroll processing is recommended to be developed and implemented over time on a priority basis. An effective, well-documented payroll process would enable the Government to quickly verify the legitimacy of payroll requests, expedite accurate payroll processing, minimize errors and potential for duplicate payments, and reduce opportunities for fraud (see the Risk Management Plan in Appendix 2.1). However, the ARTF Monitoring Agent and external auditors must have access to make physical inspections in provinces.

2.38 Key mitigation measures to effect the above include:

- Fully deploy the Computerized Payroll System (CPS);
- Reconcile the attendance records with payroll journal;
- Implement stricter automated controls and reviews for overtime and pension calculations; and
- Implement stricter controls for bank release of salary funds.

2.39 These recommendations will be realized through execution of the verified payroll program (VPP) already underway. Currently 65,000 employees in Kabul and 29,000 employees in provinces are enlisted in the VPP process. The VPP process includes three phases; the first is making salary payments in the presence of officials of DAB, the line ministries, and MoF; most employees enlisted in the VPP process are currently in this phase. The implementation of the second phase, involving Ministry ID cards, has long been hampered by the limited capability of the ID card machines. The third phase is implementing the CPS which contains standing data including ID card number and salaries. The system is capable of generating automated monthly payrolls and payment requests. Payments based on the CPS output are processed through MoF and paid directly to bank accounts held by the individual employees in commercial banks. Approximately 9,000 employees have reached this final phase.

## **G. Asset Management**

### **VULNERABILITIES**

2.40 The scope of the assessment of asset management is related to the procurement process that begins with asset specification and acquisition for a particular use and also includes:

- Technical acceptance of goods based on original specifications;
- Tagging merchandise with a unique identification number;
- Logging key asset information including manufacturer, distributor, serial number, warranty, maintenance schedule, and useful life in a fixed asset register and inventory systems;
- Transferring and tracking goods within and outside the department; and
- Managing asset disposal.

2.41 Difficulties resulting from corrupt practices can arise after procuring new assets, including:

- Goods might fulfill only a portion of the specifications;
- Warranty conditions may be ignored; and
- Incomplete orders may be received.

2.42 In addition, without adequate asset records and stock checks, new and existing merchandise can be moved, removed, exchanged, or damaged without detection, creating obvious opportunities for corruption. Useful lives for individual assets can be under-reported with the intention of diversion. Without a tracking system in place to periodically locate all items, fixed assets are subject to diversion. Maintenance of assets also is an area of vulnerability. Missed repairs while under warranty and missed routine preventive maintenance can cause a drain on government funds to repair or replace assets. A vulnerability to corruption also lies in the risk of an agreement between suppliers and officers to ignore the contractual conditions for a payment.

2.43 External audit reports by the CAO show a general failure to observe requirements for maintaining asset registers or asset checks, and this is a serious vulnerability to corrupt practices. CAO recommends that asset management policies including the maintenance of a fixed assets register be implemented. For many years several line ministries have procured large-scale assets. A time has come to review obsolete assets and come up with a list of unused assets at the end of the year. Physical verification of assets before Annual Closing of Accounts should be insisted upon. In the case of donor projects, the CAO asserts that there is an ethical need to ensure that the assets are returned on completion of project term; if this does not happen, there is an evident gap for corrupt practices to flourish. Measures are needed to develop a comprehensive asset accounting system at ministerial level and at the level of AFMIS.

2.44 These findings emphasize the need for an automated system of asset recording and management. Chapter eight of the PFEM Law, dealing with asset management, requires each Head of a budgetary unit to ensure that information and records of all Public Property are retained in accordance with the procedures stipulated by MoF. It specifies the accounting, stock taking, and asset management processes required. The SY1385 (2006/07) Government of Afghanistan annual accounts provide a schedule of fixed asset acquisitions for the year amounting to Afs.22 billion, and mentions that asset registers are being developed by the government to ensure complete and accurate reporting of fixed assets.

## MITIGATION MEASURES

2.45 **Automated Asset Management System in the PFM System:** A comprehensive Asset Management system should be explored as part of PFM systems development. However, the introduction of the Asset Management module of AFMIS should be preceded by an initial inventory check. The PFEM Law requires this in any case, and early action would enable the government to document what assets the government owns, locate where they are deployed, note the value of the assets, identify assets requiring routine maintenance, identify assets nearing the end of their useful lives, and track moves of assets with the government.

2.46 To help reduce errors in asset specification during the procurement cycle, a technical review can be added to validate the specifications of assets above a pre-stipulated value. Procedures can be instituted which confirm that all goods arrive as specified and that quantities, conditions, packaging, parts, and documentation are complete. To help maintain more effective control and records, pre-numbered inventory tags should be affixed to goods upon receipt, the

serial numbers noted, and all goods logged into an asset inventory. Another key control is to track goods during routine physical inventories and as they are moved to different locations.

## **H. Internal Audit: Incomplete Institutional Arrangements**

### **VULNERABILITIES**

2.47 The assessment of Internal Audit covers:

- Domestic audit controlled by the CAO according to its 1981 Control and Audit Act;
- Departmental internal audit units in 12 line ministries; and
- The recently improved central Internal Audit Unit in MoF.

2.48 Current vulnerabilities of Internal Audit to corruption in terms of conducting the actual audits are assessed on a very limited basis. The types of potential corrupt practices reviewed in this assessment include: bribery, extortion, rent seeking, favoritism, prevention of scrutiny, and cover-up.

2.49 The internal audit function is widely dispersed and not fully coordinated within the government. Until recently there has been little professional training. The CAO provides a degree of scrutiny of the work of the internal audit units in the line ministries, which mitigates the level of risk arising from this dispersion of activities. However, until line ministries establish well-ordered arrangements for their internal audit units based on modern practices, this function will remain vulnerable. The CAO recommends in its SY1385 (2006/07) audit report that the internal audit system needs to be reworked to enforce safeguards, and that Ministry-wise internal audit departments with reporting to the Head of the concerned Ministry should be in place.

2.50 Currently, the overall organizational arrangements for internal audit are not adequate to resist improper influence over internal audit, due to uneven coordination and oversight. Under the 1981 Control and Audit Law, the CAO has been required to oversee internal audit, and the law requires internal auditors to provide reports to the CAO which can recheck the documents and reports. Under the new arrangements, the line ministries will manage their own internal audit units. This is consistent with international standard practice to give line ministries responsibility for their own internal audit, subject to some central scrutiny from the Auditor General and MoF. Arrangements for these central oversight processes are yet to be finalized.

2.51 Internal Audit staff appointments are not made on the basis of independent selection panels that provide recommendations based on open, transparent competition with specified rights of appeal. More general public sector reforms are needed with respect to the internal audit staff appointment processes. As relevant courses increasingly become available, specific qualifications may be mandated in the Finance Regulations. The Finance Regulations appear to call for internal audit units within the line ministries, operating under MoF direction. Support is provided by the current and next phases of strengthening under the Public Financial Management Reform Project.

2.52 An area of weakness is that there is no set of formal reporting arrangements for internal audit with each ministry; this could potentially lead to dilution of audit findings. An organization might evade response to audit findings if reporting is not carefully monitored by an independent body. Report contents are vulnerable to being negotiated down to lesser infractions. Audit Committees have not yet begun operations to enhance confidence in reporting, so ministry audits are overseen by the CAO.



2.53 Internal Audit work programs are not thoroughly planned and carefully executed due to lack of budget, resources, and oversight. There is potential vulnerability that rent-seeking opportunities might present themselves by trading non-inclusion in the internal audit program for favors. These constraints also pose a risk in areas receiving only limited audit coverage where more extensive coverage could be warranted.

#### **MITIGATION MEASURES**

2.54 Key recommendations for Internal Audit are to:

- Implement an annual internal audit plan under MoF for the whole of government;
- Proceed to align the roles and responsibilities of MoF, the CAO, and other entities with respect to Internal Audit, in order to ensure that clear organizational lines are drawn and that internal audit activities are coordinated by MoF;
- Place the Department of Internal Audit of MoF directly under the Minister of Finance as this would best enable the department to fulfill its important responsibilities;
- Implement the key internal audit provisions of the law;
- Continue implementation of the PFM Action Plan in particular as it relates to internal audit; and
- Develop internal audit activities in the line ministries, which will be under the control of the line ministries but in accordance with standards issued by the MoF.

2.55 Using the MoF Audit Committee to oversee Internal Audit arrangements across the Government of Afghanistan, and use of the Institute of Internal Auditors' standards—the International Standards for the Professional Practice of Internal Auditing, are critical. For example, these standards cover authority and responsibility issues under internal audit charters. Usually an Audit Committee with at least one member independent of the body is used to provide confidence about reporting, audit work programs, and audit plans.

2.56 The Finance Regulations should specify qualifications for appointment as an internal audit staff anywhere in the government. Staff appointments should be made on the basis of accounting qualifications as specified in the regulations. Independent staff selection panels should provide recommendations based on open, transparent competition with specified rights of appeal.

2.57 To support proper behavior on the part of internal auditors, a Code of Ethics and Code of Conduct, and employment contracts that specify approved codes of ethics and conduct, should be implemented. And as part of Audit Quality Control as per international standards, there should be a mechanism so that audited units can register complaints regarding audit staff behavior, if warranted.

2.58 International standards specify the use of an adequate internal audit manual and adherence to good practices for maintaining working papers whereby the extent of planning, the work performed, and the findings are presented as audit evidence. In addition, an adequate procedures manual for audit planning, supervision, and required documentation should be in place to help increase the effectiveness of internal audit. This would indicate to the auditor the procedure to follow in setting the quantity and quality of evidence required for each type of audit engagement and how the audit findings would be processed by the Internal Audit Department and discussed and reported externally.

2.59 Internal Audit should also maintain an effective audit follow-up process in accordance with international standards to monitor whether significant audit concerns for which corrective and

punitive actions are recommended have been adequately addressed by management. The process involves assessing the adequacy and effectiveness of actions taken by management and documenting and communicating outstanding follow-up issues to higher levels of management when appropriate actions have not been taken. And, in cases where there are significant irregularities, auditors need to report possible fraud to the Attorney General's Department early in the process.

## **I. External Audit: Inadequate Powers and Skills**

### **VULNERABILITIES**

2.60 This VCA examines the general vulnerabilities within the CAO (including bribery, extortion, rent seeking, favoritism, prevention of scrutiny, and cover-up) rather than the vulnerabilities of contracted international firms providing and supporting external audit services. These firms operate largely using staff on short-term assignments from their home countries, and operate under the quality control systems of their international associate bodies. Their vulnerabilities to corruption are lessened by these multiple managerial, quality management, and contract oversight arrangements.

2.61 There are significant systemic weaknesses in the comprehensiveness of the government audit function. Afghanistan has only rudimentary legislative provisions and very weak institutional capacity for External Audit; the current Legislature was formed in early 2006 after decades of conflict. The External Audit of the CAO has emerged as an important link in the overall PFM accountability framework, with its reports on donor audits, on the annual Government financial statement (the Qatia) and on its regularity audits—especially with the Legislature subjecting the Qatia audit report to Parliamentary enquiry by the Budget and Finance Committee.

2.62 In the future, the CAO and Afghan nationals employed by the contracted audit firm will be required to undertake more responsibility for the overall audit program, and vulnerabilities to corruption could change as the highly-experienced and relatively independent international firms become less involved in the day-to-day work. The CAO has to date relied heavily on support provided by international consultants for its audits of donor funds, and this has mitigated risks of corrupt practices. Donor project certification audits are conducted by international firms using their own standards. The CAO is implementing a comprehensive departmental and staff strengthening program, but substantial progress especially in training and competency development is still required to more closely align the CAO with international practices.

2.63 Supreme Audit Institutions (SAIs) need to maintain full independence regarding the scope of external audits, to enable effective auditing of sensitive and high-risk areas in the government, ministries, and departments. In Afghanistan the CAO lacks independence from the government, which presents opportunities to limit reviews and could provide scope to scale back findings and reduce candor in reporting.

2.64 There are also other major variances with international standards. External Audit staffs are not appointed based on specific accounting qualifications and international standards for auditor competence. Supervisory standards have not yet been shown to be adequate. There is a constraint on the External Audit work program due to lack of budget and resources. There is a potential vulnerability to corruption for audit managers in selecting audits, removing findings, or revising reports based on rent-seeking behavior.

## MITIGATION MEASURES

2.65 **Establishing the Powers of the Audit Institution:** A sound Audit Law and regulations are necessary for External Audit to fulfill its critical role in the PFM accountability chain. The independence of SAIs and clear statutory agreement regarding the scope of auditing are essential for effective auditing of sensitive and high-risk areas in government, ministries, and departments. These include investigating issues such as lack of segregation of duties, and conducting performance audits and other examinations involving the highest levels of public office. Audit independence is critical for effective accountability. The PFEM Law includes provisions that define a satisfactory framework for External Audit, but the law itself does not specifically identify the Auditor General as the independent auditor of the appropriation accounts (although this is probably intended), and nor does it give the Auditor General adequate powers or mandate.

2.66 **Appointment of the Auditor General:** The pool of potential candidates for the office of the Auditor General needs to be formed by identifying individuals who are qualified persons in relevant matters (particularly financial management or public sector management qualifications of a high order), maintain the highest standards of ethics and integrity, and demonstrate the resolve to make the SAI a proper link in the overall PFM accountability chain.

2.67 **Appointing Audit Staff:** Employment contracts and codes of conduct were unanimously approved and issued by INTOSAI at the international congress of SAIs in 1998. The code constitutes a significant step forward in the process of harmonizing ethical concepts within INTOSAI. It addresses the basic postulates of ethical behavior and recognizes the need for their adaptation to the specific cultural, linguistic, legal, and social environment present in a particular country. This code should therefore be seen as a foundation for national codes of ethics to be developed in Afghanistan, and applies directly to appointing qualified audit staff to specific audit engagements. The CAO has adopted a code and has required all staff to sign and follow the code.

2.68 **Supervising Audits:** The CAO needs adequate provisions to guard against misbehavior on the part of audit staff. The CAO Law has various penalties, and to enforce these conditions the CAO should have some investigative resources to monitor staff activities. Close collaboration with other investigation and prosecution organizations is needed where issues are discovered or complaints are made. The Advisors provided to the CAO should be deployed across all types of CAO audit to improve standards and ensure that practices are in place to help prevent corrupt behavior. The Audit Agent is finalizing a manual of audit procedures for the CAO to use. The adequacy of record keeping and internal controls in the audited agencies is important for reducing external audit vulnerabilities.

2.69 **Publishing the Audit Report:** It is strongly recommended that, once the quality of external audits meets adequate standards, external audit reports be submitted and made public promptly. The CAO must be enabled to publish reports annually after submitting them to Parliament. The CAO's main objective should become to provide Parliament with an independent opinion on relevant matters. Timely public release of the audit report (usually on a webpage for convenience of access and low distribution costs) helps to strengthen accountability. The public will increasingly participate in dialogue if the topics are relevant and timely and if there is a positive communications environment. This assists in developing a role for public scrutiny of budget execution. In corruption-related cases, it is important to avoid excessive time lags between conduct of the actual audit and the finalization of SAI reports for presentation to authorities for action. This should take place before publication as part of the final quality checking and editing processes, but should not delay publication of the audit report. Therefore, streamlined measures need to be in place for dealing with identified corruption cases.

2.70 **Submitting the Audit Report to the National Assembly:** Recommendations to submit audit reports on a timely basis have already been in effect. A key element of effective External Audit follow-up mechanisms is the existence of provisions requiring SAIs to report any systemic internal control weaknesses to the National Assembly. In addition, suspected violations of law and any criminal activity uncovered during the performance of the audit should be reported to Parliament and to appropriate law enforcement bodies. These recommendations support the development of a system of scrutiny of audit reports including involvement of a Public Accounts Committee of Parliament, and development of capacity in the Budget and Finance Committee. Routine authorization for publication of audit reports by the Legislature, once they are presented to it, and subsequent placement on a CAO website, would greatly improve transparency and would be cost-effective and efficient.

2.71 **Taking Action on Audit Recommendations:** Another key element of effective follow-up is that audit recommendations are implemented in a timely manner through a formally monitored system. This requires commitment to ensure that each agency audited takes serious action to remedy identified weaknesses; a tracking system used to report on progress publicly would be very effective in this regard. Heads of budget units should be held responsible for action on external audit and Parliamentary committee recommendations, and they can be assisted by their internal audit departments in carrying out these remedial measures. An adequate external audit procedures manual should include enforceable recommendations. This assists to develop a response system to audit reports by concerned ministries.

## **J. Procurement: Application of the New Procurement Law**

### **VULNERABILITIES**

2.72 This assessment on procurement covers the following aspects:

- Transition to the new Procurement Law;
- Regulatory framework;
- Evaluation of bids;
- Sole source awards;
- Advertising;
- Timing of procurement; and
- Choice of procedure.

2.73 **Transition to New Procurement Law:** The transition from the previous procurement regulations to the new Procurement Law in Afghanistan is not yet complete in practice. Many procuring entities still tend to follow the bidding procedure that was prescribed in the old Procurement Regulations. Monitoring Agent reviews of ARTF expenditures found that procurement ineligibilities largely arose from non-compliance with the advertising requirements of the new Law, and also from favoring direct purchase from State Enterprises over more competitive bidders. Most of this is likely to be due to lack of familiarity with the new arrangements rather than corrupt practices, but continuing non-compliance could leave ample scope for corrupt practices to arise.

2.74 It is also reported that in many cases when the procuring entity follows the new procedure, instructions are subsequently issued to carry out a second round of bidding or to award the contract to a lower bidder who did not participate in the bidding process. At times, the enforcement agencies also question why a second round of bidding was not conducted and issue instructions to award a contract to a complainant who offers a lower price but had not participated in the bidding

process. These practices, which reflect the continuing influence of unusual provisions of the old procurement regulations, are problematic and undermine the credibility of the Procurement Law.

**2.75 Regulatory Framework:** The Anti-Corruption Law (ACL) does not distinguish between corrupt procurement practices and mistakes or negligence, which constitutes a serious problem. Any alleged breach of the Procurement Law could therefore be treated as corruption, regardless of whether or not there is any hard evidence, and could be sent to the Attorney General for prosecution. Such an approach would erode confidence in anti-corruption processes. Article 81 (3) of the Procurement Law of Afghanistan provides that “Procurement employees who violate this Law are liable to applicable administrative sanctions and payment of compensation for losses, as well as to prosecution pursuant to Law.” Given the fragile procurement environment in Afghanistan, until the procurement reform and associated capacity building measures result in adequate enhancement of the procurement environment, there could be unintentional instances of violation of procedural aspects of the Law because of improper understanding. Such cases would invite application of Article 81 (3) of the Law related to “applicable administrative sanction,” which could range from censure to more serious administrative penalties depending on the gravity of the lapse.

**2.76** Also, the qualifications of bidders have to be examined with respect to pre-disclosed qualification criteria in a transparent manner. A misunderstanding that the contract is to be awarded only to the lowest bidder often leads to questioning of procurement officers by enforcement agencies when a lower bid is rejected on grounds of the bidder not being qualified or the bid not being responsive. Procurement officers have also faced questioning when the bid prices are corrected for arithmetical errors. An arithmetical error in a bid is an error which has to be corrected to arrive at the actual bid price for price comparison. The actual bid price quoted by the bidder is the corrected price and not the price read out at the bid opening. Assuming that the corrected bid price of a bid is higher than the read out bid price but is still the lowest, the contract is awarded to such bidder at the corrected bid price (lowest evaluated price). Although this is the appropriate procedure, a procurement officer might well find it difficult to explain if a question is raised as to whether this has resulted in a loss to exchequer because the contract is alleged to have been awarded at a price higher than what was read out at bid opening.

**2.77 Sole Source Awards:** Another vulnerable area of public procurement is the award of contracts on single-source basis, often justified as needed for rapid utilization of funds and to expedite infrastructure works. The vulnerability of the single-source process lies not only in selection of a preferred contractor but also in negotiation of the terms and conditions of the contract, which may be adversely affected by weak technical capacity of the procuring entity. Although the law provides for "Single Source Procurement Procedure" and stipulates the conditions under which this procedure be used, in the absence of "Rules of Procedure" requiring documentation of the process and the procedure to be followed, the provision could be vulnerable to misuse. The government has now adopted and prescribed the "Rules of Procedure for Public Procurement" with effect from 1386, which require documentation of the process and justification for selection of a particular method of procurement other than open tendering. Also, the Contract Management Office (CMO) has now been established in MoF, which will serve as the secretariat for the Special Procurement Commission (SPC). The SPC will be the authority to approve award of contracts with a contract value more the prescribed limit for approval by the first grade award authority. The approval process of the SPC would require the procuring entities to submit award recommendations with adequate documentation and evaluation reports.

**2.78 Advertising:** The Afghanistan Reconstruction and Development Services-Project Unit (ARDS-PU) manages procurements for goods valued at over US\$200,000 and consultancies over

US\$100,000. For procurements conducted by ARDS-PU, advertising is not an issue because they have a system of notifying all registered suppliers and contractors in addition to publishing in mass media as per legal requirement. However, there is no advertising system in place for national procurements conducted outside this framework, although it is a priority for the new Procurement Policy Unit (PPU) in MoF. Advertising failures may result from inadequate circulation of currently available newspapers. The absence of such publicity clearly could increase the scope for corrupt practices by allowing procuring entities to deal with favored contractors, with inadequate competition.

**2.79 Timing of Procurement:** Although it might well reflect corrupt practices, failure to advertise in time and to provide adequate notice to bidders could also be due to lack of proper planning. While this could be due to lack of capacity, poor planning can also have serious consequences for competition. It leads to poor and untimely dissemination of information and results in lack of transparency. The added time pressure leaves insufficient time for preparation and submission of adequate bids (except by those who might have been given advance notice). In some cases, poor timeliness may lead to the use of exceptional procurement procedures other than the open procedure, on the pretext that there insufficient time to conduct an open procedure. This is clearly a circular and self-inflicted problem, but one which could allow an unethical officer to exploit the less competitive procedure to his or her advantage. In the context of ARDS procedures, there have been a few examples of ministries sending requirements for publication at the last moment and then seeking to pressure ARDS into using less open methods of procurement due to the time constraint.

**2.80** An example would be annual procurements of ministries tied to use in a specific season. For instance, seeds and fertilizers should be procured well in time and stored at distribution centers for use at the time of sowing. Fuel for heating systems should be procured such that deliveries commence when winter sets in and are spread over the winter season as per the requirement. Fuel for generators of power stations is a regular requirement, and procurement should be completed for the needs of a specified period of time such that deliveries commence on time and adequate stock for requirements of a minimum period of time is maintained. Absence of procurement planning taking into account the procurement cycle of open tendering has sometimes resulted in artificial emergencies, leading to suggestion of award of contract to State Owned Enterprises in some cases on sole-source basis. On the other hand, resort to open tendering with a short bidding period may be inadequate for effective competitive bidding—which requires desired publicity and sufficient time for bidders to prepare a competitive bid.

**2.81** At present, these kinds of problems appear to reflect poor understanding of provisions of the Procurement Law, as well as following the customary practice of direct procurement from State Owned Enterprises. However, the motive of corrupt practice cannot be ruled out. Failure of user departments to take action in time and delays in procurement by procurement officers compound the problem and can lead to choice of less competitive procurement methods. At times, even if an action is taken on time, delays in decision making at various levels render the procurement process vulnerable to corruption. Such vulnerabilities at various levels and associated with various steps of procurement need to be addressed through proper procurement planning and monitoring of the procurement process.

## **MITIGATION MEASURES**

**2.82 Transition to the New Procurement Law:** The challenge is to successfully navigate the transition from the previously prevailing practices under the old Procurement Regulations to the enhanced procurement environment of open and transparent procurement practice prescribed under

the new Law, which should provide equal opportunity to all. Not only is capacity building of procurement officers required, but also awareness and exposure of award authorities and enforcement agencies is needed.

**2.83 Regulatory Framework:** Continuous review of the adequacy of the legislation against international standards for anti-corruption measures needs to occur regularly and must be documented. Due care needs to be taken by enforcement agencies in application of penal provisions of the Anti-Corruption Law, so that the action and resulting punishment is neither excessive nor inadequate. Poor understanding of the procurement process on the part of enforcement agencies may lead to improper categorization of cases of violation and unjustified punitive measures.

**2.84** Use of ARDS-PU to manage bidding processes for contracts provides substantial mitigation of corruption risks. An international consulting firm is in place in the ARDS-PU as the central procurement facilitating agent for the country. The consultant team includes a sufficient number of Procurement Specialists to ensure adequate attention to the procurement cases processed by the team. The ARDS-PU maintains a large database of all suppliers, contractors and consultants who have so far worked in the country or have ever expressed interest in procurement opportunities in the country. ARDS-PU also has a procurement portal ([www.ards.org.af](http://www.ards.org.af)) that provides on-line access for sourcing country procurement information. For procurements conducted by ARDS-PU, advertising of bidding opportunities is not an issue because they have a system for notifying all registered suppliers/contractors in addition to publishing in mass media as per legal requirement and on-line in the procurement portal.

**2.85 Sole Source Awards:** The "Rules of Procedure for Public Procurement", which require documentation of the process and justification for sole source selection, need to be followed. The Special Procurement Commission shall review large contract award recommendations, supported with adequate documentation and evaluation reports.

**2.86 Advertising:** The Procurement Policy Unit (PPU) should put in place a system for monitoring advertising of national procurements not involving ARDS-PU. Ways should be explored to expand advertising in cases where inadequate circulation of available newspapers could enable entities to deal with favored contractors in the face of inadequate competition.

**2.87 Timing of Procurement:** Enforce procedures to advertise on time and to provide adequate notice to bidders by increasing capacity and emphasizing improved planning. A key focus area needs to be the implementation and enforcement of the new procurement regulatory framework. This includes not only improved awareness of the rules but also more guidance and assistance in applying the Law and Regulations. This work has been commenced by the PPU, whose work will also be supported by the efforts of the capacity building consultant which has recently been mobilized.

**2.88 Management of Procurement:** The CAO in its SY1385 audit report recommends that adherence to World Bank Procurement Guidelines should be strictly insisted upon, and also that a comprehensive contracts database in MoF would improve control and management of procurement contracts. Corruption in procurement arises through collusive or under-bidding practices; maintenance of a searchable records base therefore assists in control as well as improving tender management. Project implementation can suffer from sub-standard or slow deliveries or implementation practices if low bids are accepted in preference to technically supported more reasonable bids.

## K. Conclusions

2.89 The VCAs for PFM show that significant progress has been achieved and that there are multiple efforts and initiatives underway to prevent corruption. This progress, however, is fragile, as not all procedures have been agreed upon and documented in operations manuals. This contributes to inefficient and inconsistent business processes and variable execution of some types of transactions. Weaknesses across the PFM areas remain, including inadequate and poorly followed procedures; capacity limitations and need for training of Government staff; manual work-arounds of automated processes; very restricted accounting systems; and specific procurement weaknesses.

2.90 The recommendations of these VCAs are broadly in line with the Government's MoF reform program that is supported by donors. The Cabinet has approved an Action Plan to strengthen Public Financial Management. The Government intends to expand the functionality and coverage of AFMIS. There are reform processes and procedures underway in Mustofiats. Work is ongoing to prepare regulations for expenditure processing and accounting in accordance with the PFEM Law. The Government intends to implement an annual internal audit plan under MoF for the whole of government. There is a program to align external audit with international standards and the regulations contained in the PFEM Law. Work is ongoing to implement the Procurement Law, including adopting procurement regulations and establishing a functioning review system. All in all, the recommendations from the VCAs should provide important guidance for the reform program advancing the overall PFM framework in Afghanistan.

2.91 The achievements in PFM have been accomplished with a high degree of direct donor assistance through the use of costly operations contracts with international firms, including the hiring of qualified Afghans as national contractors. Moreover, the integrity of the system has depended on having PFM operations centralized in MoF, with little direct management assigned to the line ministries, provincial offices, or state-owned enterprises. At this stage, such central control is being exercised on a transaction-by-transaction basis, and with significant levels of ex ante clearances. It is therefore important that the transition from dependence on international experts to perform PFM functions to reliance on national contractors and civil servants be carried out, and that the confidence achieved so far in PFM performance be maintained. This requirement to preserve the high level of PFM performance may constrain the pace at which MoF can effect such a major transition.

2.92 There are limits to the scope for further building the internal capacity of MoF to expand more widely the transaction-based system and remain responsive, accountable, and efficient. Line ministries and agencies with reforms underway will become more heavily involved in PFM, which should increase the predictability and timeliness of their operations, but in parallel their capacity must be developed. This will open up new vulnerabilities to corruption, which then also must be assessed as part of a continuing risk management process.

2.93 The expected devolution of PFM activities, particularly in the context of the roll-out of AFMIS, makes this vulnerability to corruption assessment particularly timely. It is important to strengthen anti-corruption efforts and maintain accountability and transparency while reforms take place. Afghanistan's PFM control environment is seriously undermined by lingering confusion over the legal framework, limited expertise of staff involved in PFM both in line and review positions, and failure to prosecute cases of corruption reported to the authorities. The Treasury Department advised that there is an effective procedure for receiving and investigating allegations of fraud and corruption, but that no complaints have been received so far. There are informal arrangements by which service complaints with possible fraud or corruption implications are



passed on to a designated officer. A few cases of fraud or corruption had been examined in SY1384, but these were not proven. The cases were not very serious. Treasury advised that there are agreed procedures for handling breaches of regulations and for investigating suspected fraud and corruption, but they are not documented or in written form. There are good liaison arrangements with the police, the anti-corruption agency, and other departments and relevant bodies, according to MoF. However, there are no registers kept in which staffs are required to record their interests.

2.94 At a general level, all agencies and departments should be required to prepare risk management and fraud prevention plans that are reported on and reviewed annually. (Appendix 2.1 presents proposed risk management plans for the business processes covered by the VCAs summarized in this chapter.) Oversight of implementation would be part of the responsibility of heads of budgetary units for the status of financial management in the unit as per Chapter 1 of the Finance Regulations (FR) issued under the PFEM Law. Overall policy for this process should be set by MoF in concert with anti-corruption, audit, and investigation agencies. The Finance Regulations would provide the regulatory vehicle for implementation rules under Chapter 11 on Control and Audit, according to which budgetary units are responsible for establishing good financial control frameworks to prevent illegal actions and losses including those resulting from fraud and error.

## Appendix 2.1: Proposed Risk Management Plans by Business Process

This appendix presents a summary of the business processes reviewed in this vulnerability to corruption assessment noting the responsible agency, methods for tracking the business process, areas associated with each business process that are vulnerable to corruption, prescribed mitigation measures, as well as the potential impact to the government of corrupt practices within each business process.

Process	Agencies Responsible for Mitigation Measures	Method for Tracking	Potential Vulnerabilities to Corruption	Mitigation Measures	Potential Impact if not Remedied
<b>RISK MANAGEMENT AND FRAUD CONTROL</b>					
Risk management plans	MoF and Heads of Budgetary Units	Review of Risk Management Plans	<ul style="list-style-type: none"> <li>Incomplete prevention of fraud through inconsistent approaches, and not factoring corruption risks into reform plans</li> </ul>	<ul style="list-style-type: none"> <li>Adopt a fraud management policy framework possibly based on the results of a design being prepared in the Internal Audit Department of the MoF</li> </ul>	H
<b>PAYMENTS</b>					
General payments	MoF and Line Ministries	Review M16, B27, and supporting documentation	<ul style="list-style-type: none"> <li>Possible double payments due to the presence of a temporary file and a final file</li> </ul>	<ul style="list-style-type: none"> <li>Identify ways in AFMIS to avoid processing temporary files</li> </ul>	H
			<ul style="list-style-type: none"> <li>Payments can be processed with incorrect or incomplete documentation or improper authorization – e.g. need to include requirements for proof of physical verifications of deliveries and services including qualities and quantities. Need to ensure that completion certificates are valid and verified</li> </ul>	<ul style="list-style-type: none"> <li>Develop payment process descriptions and a manual to be used by all staff</li> <li>Related PSIB III Reform Program: expand functionalities of AFMIS and roll out to provinces and line ministries; Complete expansion of AFMIS</li> <li>Increase internal audit verifications of key processes</li> </ul>	
			<ul style="list-style-type: none"> <li>Improper payment recording in AFMIS</li> </ul>	<ul style="list-style-type: none"> <li>Ensure that full, proper documentation is presented, reviewed, and archived</li> </ul>	
			<ul style="list-style-type: none"> <li>Lack of segregation of duties</li> </ul>	<ul style="list-style-type: none"> <li>Implement fully automated reconciliations of AFMIS payments with bank statements</li> </ul>	
General payments	MoF and Line Ministries	Procedure manual in use	<ul style="list-style-type: none"> <li>No procedure manual in use, and lack of continuity of knowledge to support consistent and robust operations</li> </ul>	<ul style="list-style-type: none"> <li>Implement a procedures manual to be used by all staff</li> <li>Related PSIB III Reform Program: implement PFM Action Plan</li> </ul>	M
Advance payments	MoF and Line Ministries	Review unit budget, pay Ministry up front	<ul style="list-style-type: none"> <li>By definition, advance payments are made without supporting documentation expenditures</li> </ul>	<ul style="list-style-type: none"> <li>Implement consistent procedures with adequate segregation of duties</li> </ul>	H
		Log in APSF	<ul style="list-style-type: none"> <li>Excel sheet is used to track payments as unit budget deductions for Journal Vouchers</li> </ul>	<ul style="list-style-type: none"> <li>Include automated controls with the upgrade in AFMIS</li> </ul>	
SDU payments	SDU MoF, and Line Ministries	Review payment requests and supporting documentation	<ul style="list-style-type: none"> <li>Incorrect or unauthorized transfers could be processed</li> </ul>	<ul style="list-style-type: none"> <li>Ensure payment request are supported, properly authorized, and archived</li> <li>Ensure transfers are authorized by DG Treasury</li> </ul>	H
Non-development payments	MoF and Line Ministries	Review payment requests and supporting documentation	<ul style="list-style-type: none"> <li>Incorrect or unauthorized transfers could be processed</li> </ul>	<ul style="list-style-type: none"> <li>Implement consistent procedures with adequate segregation of duties</li> </ul>	S
				<ul style="list-style-type: none"> <li>Maintain full document archives</li> </ul>	

Process	Agencies Responsible for Mitigation Measures	Method for Tracking	Potential Vulnerabilities to Corruption	Mitigation Measures	Potential Impact if not Remedied
<b>CASH TRANSFERS</b>					
General cash transfers	MoF	Review payment request supporting documentation	▪ Journal vouchers are sometimes processed without proper documentation or signature verification	▪ Implement a procedures manual to be used by all staff	H
			▪ Lack of segregation of duties	▪ Ensure that full documentation is presented	
				▪ Maintain full document archives	
Cash transfers abroad	MoF	Review payment requests supporting documentation, and currency request form	▪ Incorrect or unauthorized transfers could be processed	▪ Implement consistent procedures with adequate segregation of duties	H
Cash transfers to provinces	MoF	Review expenditure report and transfer request and supporting documentation against the forecast	▪ Incorrect or unauthorized transfers could be processed	▪ Transfers authorized by DG Treasury	H
Cash transfers of letter of credit	MoF	Review supporting documentation,	▪ Incorrect or unauthorized transfers could be processed; incorrect payments could be made	▪ Use official stamps	H
			▪ Adjustments to the amount transferred could be prone to fraud	▪ Maintain full document archives	
			▪ Double cash transfers could occur when expense vouchers and Journal vouchers are processed simultaneously	▪ Implement safety feature in AFMIS to prevent simultaneous processing of EV and JV	
<b>BANK RECONCILIATIONS</b>					
Treasury Single Account reconciliations	SDU/RRU	Matching monthly DAB statements for open accounts with AFMIS with exception reports reviewed by Treasury	▪ Adjusting entries for bank reconciliations are significant and many reconciliations are months overdue so the current cash position cannot be confidently accurately stated	▪ Ensure timely monthly bank reconciliations for each open account. Have them reviewed and signed by DG Treasury	H
				▪ Related PSIB III Reform Program: improve bank account reconciliations	
				▪ Compare suspense accounts and canceled checks in AFMIS monthly	
				▪ Implement an effective closing process	
			▪ Assign more staff to bank reconciliations		

Process	Agencies Responsible for Mitigation Measures	Method for Tracking	Potential Vulnerabilities to Corruption	Mitigation Measures	Potential Impact if not Remedied
Financial year opening and closing	MoF	Tracking closing balances to opening balances at the end of each year	<ul style="list-style-type: none"> <li>At the beginning of each year, all accounts start at zero until a first transaction is entered</li> </ul>	<ul style="list-style-type: none"> <li>Implement FreeBalance module</li> <li>Acquire and train staff ; monitor compliance</li> </ul>	H
Account closing process	MoF	Some closed accounts are still open at DAB		<ul style="list-style-type: none"> <li>Acquire and train staff ; monitor compliance</li> </ul>	H
Updating the Chart of Accounts	MoF	Accounts can reference the wrong bank account number or bank accounts can be listed twice under a different name	<ul style="list-style-type: none"> <li>Transactions can take place on the wrong accounts</li> </ul>	<ul style="list-style-type: none"> <li>DAB to adopt a formal account opening and closing process</li> <li>Conduct an annual review of CoA and GL before any COA updates</li> <li>Periodically compare the CoA and GL Offset sheet</li> <li>Assign more staff to do bank reconciliations</li> </ul>	H
Transaction and payment processing temporarily outside of AFMS	MoF	Log all transactions out side o f AFMS	<ul style="list-style-type: none"> <li>Exact balance of accounts not known leading to inaccurate reporting of cash position</li> </ul>	<ul style="list-style-type: none"> <li>Use EFT to request DAB payments to minimize currency fluctuations</li> </ul>	H
<b>PAYROLL</b>					
Payroll processing	MoF and Line Ministries	Review payroll journals and check requests and supporting documentation	<ul style="list-style-type: none"> <li>Staff can be paid even when not attending, or if attending, not working</li> </ul>	<ul style="list-style-type: none"> <li>Reconcile the attendance module with Computerized Payroll System outputs</li> </ul>	H
			<ul style="list-style-type: none"> <li>Error-prone manual entries and calculations are present on some forms</li> </ul>	<ul style="list-style-type: none"> <li>Implement stricter automated controls and reviews for all overtime and pension calculations</li> </ul>	
			<ul style="list-style-type: none"> <li>Pension deductions can be calculated incorrectly</li> </ul>	<ul style="list-style-type: none"> <li>Implement stricter controls for bank release of salary funds</li> </ul>	
			<ul style="list-style-type: none"> <li>Overtime can be calculated incorrectly</li> </ul>		
		<ul style="list-style-type: none"> <li>Employees can collect salaries at the bank for other employees</li> </ul>			
<b>ASSET MANAGEMENT</b>					
Asset specification	Line department	Pre-bid document tracked by requesting department	<ul style="list-style-type: none"> <li>Specifications can unfairly favor a particular product or vendor</li> </ul>	<ul style="list-style-type: none"> <li>Add a technical review for asset specifications for goods above a threshold value to help ensure impartial selection</li> </ul>	H
			<ul style="list-style-type: none"> <li>Specifications are insufficient/excessive for asset to perform as intended</li> </ul>		

Process	Agencies Responsible for Mitigation Measures	Method for Tracking	Potential Vulnerabilities to Corruption	Mitigation Measures	Potential Impact if not Remedied
Technical acceptance of goods	Line department	Compare product specifications and quantities received against those specified in purchase order and invoice	<ul style="list-style-type: none"> <li>Goods can partially fulfill specs. Goods might not be fit for the intended use</li> </ul>	<ul style="list-style-type: none"> <li>Confirm that all goods arrived as specified; use a technical review if warranted</li> </ul>	M
			<ul style="list-style-type: none"> <li>Incomplete orders might be received</li> </ul>	<ul style="list-style-type: none"> <li>Ensure that quantities, condition, packaging, parts, and documentation are complete</li> </ul>	
Tagging merchandise with unique identification number	Line department	Currently no process in many ministries	<ul style="list-style-type: none"> <li>Merchandise can be moved, removed, exchanged, or damaged without detection</li> </ul>	<ul style="list-style-type: none"> <li>Securely affix pre-numbered inventory tags to goods upon receipt</li> </ul>	M
Logging key assets into a fixed asset register and inventory	Line department	Informal and uneven process in many ministries	<ul style="list-style-type: none"> <li>Goods might be moved, damaged, or diverted without a tracking system in place to identify and periodically locate all fixed assets</li> </ul>	<ul style="list-style-type: none"> <li>Conduct a full asset inventory check as per PFEM Law under MoF guidance and confirmation. Enter serial number of goods into a fixed asset register noting a unique State product identification number</li> </ul>	H
			<ul style="list-style-type: none"> <li>Missed repairs while under warranty</li> </ul>	<ul style="list-style-type: none"> <li>Log asset into inventory notify Finance Officer of asset status</li> </ul>	
			<ul style="list-style-type: none"> <li>Missed preventive maintenance</li> </ul>	<ul style="list-style-type: none"> <li>Undertake a routine physical inventory each year</li> </ul>	
			<ul style="list-style-type: none"> <li>Intentionally under-reporting asset's useful life with expectation of asset diversion</li> </ul>		
Transferring and tracking goods within and outside the department	Line department	Informal and uneven process in many ministries	<ul style="list-style-type: none"> <li>Goods might be moved, damaged, or diverted without a tracking system in place to identify and periodically locate all fixed assets</li> </ul>	<ul style="list-style-type: none"> <li>Use an asset transfer form to record serial number of goods, date of transfer, and destination department</li> </ul>	H
			<ul style="list-style-type: none"> <li>Missed repairs while under warranty</li> </ul>	<ul style="list-style-type: none"> <li>Destination department to sign and return copy of asset transfer form</li> </ul>	
			<ul style="list-style-type: none"> <li>Missed preventive maintenance</li> </ul>	<ul style="list-style-type: none"> <li>Log asset into inventory notify Finance Officer of asset status</li> </ul>	
				<ul style="list-style-type: none"> <li>Undertake a routine physical inventory</li> </ul>	
Asset disposal	Line department, MoF	Informal and uneven process in many ministries	<ul style="list-style-type: none"> <li>High-value assets can be removed from duty prematurely and diverted to other uses or sold for personal gain</li> </ul>	<ul style="list-style-type: none"> <li>Prescribe asset removal and disposal procedures</li> <li>Sign-off by Finance staff</li> <li>Guards to review asset paperwork at exits</li> <li>Reviews by Internal Audit</li> </ul>	H

Process	Agencies Responsible for Mitigation Measures	Method for Tracking	Potential Vulnerabilities to Corruption	Mitigation Measures	Potential Impact if not Remedied
<b>INTERNAL AUDIT</b>					
Establish Internal Audit Institution	CAO, MoF	Progress by MoF in rolling out IA to line departments and by CAO in changing domestic auditor process.	<ul style="list-style-type: none"> <li>Prevention of scrutiny: Organizational arrangements for internal audit are not adequate to resist improper influence over internal audit establishment because of poor coordination and oversight</li> </ul>	<ul style="list-style-type: none"> <li>Coordinate all internal audit activity from the MoF or the CAO. Use the Ministry of Finance Audit Committee to oversight IA arrangements in the Government of Afghanistan, preferably using Institute of Internal Auditors (IIA) standards – the International Standards for the Professional Practice of Internal Auditing. For example these standards cover authority and responsibility issues under internal audit charters.</li> <li>Related PSIB III Reform Program: finalize internal audit law and regulations; Implement annual internal audit plan</li> </ul>	H
Appoint Chief Internal Auditor (CIA)	MoF, Line Ministries	Finance Regulations	<ul style="list-style-type: none"> <li>Favoritism, Bribery, Extortion: CIA appointment might be subject to corrupt pressures through favoritism, bribery, and extortion</li> </ul>	<ul style="list-style-type: none"> <li>The Financial Regulations may specify requirements for qualifications for appointment. Public Service regulations may specify appointment and independent appeal processes</li> </ul>	H
Establish reporting arrangements for CIA in each relevant agency	MoF, Line Ministries	Finance Regulations	<ul style="list-style-type: none"> <li>Prevention of scrutiny and cover-up: The organization may evade responses to the findings of internal audit if reporting is internal and not monitored by some independent body</li> </ul>	<ul style="list-style-type: none"> <li>Usually an Audit Committee with at least one member independent of the body is used to provide confidence about reporting</li> </ul>	S
Appoint audit staff	Public Service Commission and MoF	Audit staff appointment process is assessed against good practice	<ul style="list-style-type: none"> <li>Favoritism, Bribery, Extortion: Appointment subject to corruption pressures through favoritism, bribery, extortion</li> </ul>	<ul style="list-style-type: none"> <li>Staff appointments are made on the basis of independent selection panels that provide recommendations based on open, transparent competitions with rights of appeal</li> </ul>	S
				<ul style="list-style-type: none"> <li>Staff qualifications are specified in regulations. To provide for the independence of the internal auditing department, its personnel should report to the CIA</li> </ul>	
Establish reporting and management arrangement for audit staff	MoF	Employment contracts and codes of conduct are assessed against IIA benchmarks.	<ul style="list-style-type: none"> <li>Bribery, Extortion: Improper behavior of auditors with general impunity from punishment</li> </ul>	<ul style="list-style-type: none"> <li>To support proper behavior, institute Code of Ethics and Code of Conduct Employment contracts that specify approved codes of ethics and conduct</li> </ul>	H
Develop the audit plan	MoF, Line Ministries	Enquiries in Internal Audit Units	<ul style="list-style-type: none"> <li>Constraints on audit programs by lack of budget and resources : CIA selecting audits based on rent-seeking opportunities or trading non-inclusion in the audit program for favors or bribes, or because of special interests or favoritism</li> </ul>	<ul style="list-style-type: none"> <li>Audit plans to be reviewed by the Audit Committee. Audit Quality as per IIA standards - Complaints mechanism available to audited units regarding audit staff behavior</li> </ul>	S
Managing the audit processes	MoF, Line Ministries	Enquiry in Audit Units	<ul style="list-style-type: none"> <li>Rent Seeking: Rent seeking through negotiation of report content with involved parties. Individual staff or groups assigned to pass rents to managers</li> </ul>	<ul style="list-style-type: none"> <li>Audit Quality Control as per IIA standards – Complaints mechanism available to audited units regarding audit staff behavior</li> </ul>	H

Process	Agencies Responsible for Mitigation Measures	Method for Tracking	Potential Vulnerabilities to Corruption	Mitigation Measures	Potential Impact if not Remedied
Conducting the audit	Audit staff and CIA	Enquiry in Audit Units	<ul style="list-style-type: none"> <li>Rent Seeking: Rent seeking through negotiation of report content with involved parties</li> <li>Rent seeking by individual auditors or the team by negotiating limits into audit content or audit testing</li> </ul>	<ul style="list-style-type: none"> <li>IIA standards - Use an adequate audit manual and adhere to established working paper standards</li> </ul>	S
Reporting the audit	MoF, CIA	Reports	<ul style="list-style-type: none"> <li>Rent Seeking: Rent seeking through negotiation of report content with involved parties</li> </ul>	<ul style="list-style-type: none"> <li>Reporting Irregularities - Auditors report possible fraud to the Attorney General's Department at the field audit stage. Apply an adequate audit procedures manual for audit planning, supervision, and work paper management</li> </ul>	H
Audit follow up	MoF, CIA	Reports	<ul style="list-style-type: none"> <li>Bribery, extortion: Members of follow-up teams to clear audit findings expect payments. Other authorities handling fraud do not continue actions</li> </ul>	<ul style="list-style-type: none"> <li>Internal Audit maintains an audit follow-up process in accordance with IIA standards to monitor whether significant audit concerns for which corrective and punitive actions are recommended have been adequately addressed by management. The process involves assessing the adequacy and effectiveness of actions taken by management and documenting and communicating outstanding follow-up issues to higher levels of management when appropriate actions have not yet been taken</li> </ul>	S
Fraud Investigation	MoF, Attorney General	Progress by MoF in establishing the institutional framework for risk management and fraud control in line departments and by Attorney General in establishing fraud prosecution arrangements.	<ul style="list-style-type: none"> <li>Lack of investigative skills and administrative arrangements for dealing with fraud make fraud control difficult</li> </ul>	<ul style="list-style-type: none"> <li>MoF Internal Audit has prepared a proposal for an institutional framework for fraud control in line ministries and begun training of its internal audit staff in fraud investigation. Continuation and expansion of these activities is needed</li> </ul>	H
<b>EXTERNAL AUDIT</b>					
Establishing the Audit Institution	MoF, Ministry of Justice and President's Office	Audit law and regulations are compared against international standards	<ul style="list-style-type: none"> <li>Prevention of scrutiny: Lack of independence from government and clear definition of the scope of government auditing in the laws. Audit function subject to corrupt pressure through limitations on review and public reporting clauses in the audit laws</li> </ul>	<ul style="list-style-type: none"> <li>Auditor Independence - The independence of SAIs and clear statutory agreement regarding the scope of auditing are necessary to enable effective auditing of sensitive or high-risk areas.</li> <li>Related PSIB III Reform Program: approve Audit Law</li> </ul>	H
				<ul style="list-style-type: none"> <li>Legislative provisions are needed in accordance with the independence standard in the INTOSAI International Standards for SAIs. Institutional, personal, and operational independence of the CAO needs to be supported by statute</li> </ul>	H

Process	Agencies Responsible for Mitigation Measures	Method for Tracking	Potential Vulnerabilities to Corruption	Mitigation Measures	Potential Impact if not Remedied
Appointing the Auditor General	GOA Ministry of Finance, Public Service Commission, and President's Office	Audit law and regulations on the AG appointment process are compared for adequacy against international standards for audit law	<ul style="list-style-type: none"> <li>Favoritism, Bribery, Extortion: AG appointment might be subject to corrupt pressures through favoritism, bribery, and extortion.</li> </ul>	<ul style="list-style-type: none"> <li>Auditor Qualifications - A sound Audit Law requires significant financial or public sector management qualifications for the Auditor General. The President appoints the AG on the recommendation of an independent panel based on an open, transparent international competition with rights of appeal</li> </ul>	H
Appointing the Audit Staff	Public Service Commission and Auditor General's Office	Audit staff appointment process is assessed against good practice	<ul style="list-style-type: none"> <li>Favoritism, Bribery, Extortion: Appointment subject to corruption pressures through favoritism, bribery, and extortion</li> </ul>	<ul style="list-style-type: none"> <li>Staff Appointment Process - Audit Law requires specific qualifications for auditors as per international standards for auditor competence.</li> <li>Staff appointments are made on the basis of independent selection panels that provide recommendations based on open, transparent competitions with rights of appeal</li> </ul>	H
Managing Audit Staff	Public Service Commission and Auditor General's Office	Employment contracts and codes of conduct are assessed against peer reviews and INTOSAI Code of Ethics	<ul style="list-style-type: none"> <li>Bribery, Extortion:</li> </ul>	<ul style="list-style-type: none"> <li>Code of Ethics and Code of Conduct Employment contracts that specify approved codes of ethics and conduct are the foundation for national codes</li> </ul>	S
			<ul style="list-style-type: none"> <li>Improper behavior of auditors with general impunity from disciplinary action</li> </ul>	<ul style="list-style-type: none"> <li>Code of Ethics and Code of Conduct Employment contracts that specify approved codes of ethics and conduct are the foundation for national codes</li> </ul>	S
Developing the Audit Program	Auditor General's Office, Ministry of Finance, Parliament	Audit mandate, strategic coverage, and audit programs are assessed against good practice	<ul style="list-style-type: none"> <li>Prevention of scrutiny, Favoritism, Bribery, Extortion: Lack of sufficient mandate, powers, program limitations, and scope for enforcement of findings. Constraints on audit programs by lack of budget and resources</li> </ul>	<ul style="list-style-type: none"> <li>Annual Audit Program – In a proper Audit Law the audit program scope is specified. The Audit Committee is to monitor the annual audit program and provide oversight and scrutiny.</li> <li>Related PSIB III Reform Program: improve quality of external audit and follow-up by Government; Develop capacity of Budget and Finance Committee; Public release of audit annual report and Government's follow-up actions</li> </ul>	S
			<ul style="list-style-type: none"> <li>Audit managers selecting audits based on rent-seeking opportunities or trading non-inclusion in the audit program for favors or bribes</li> </ul>	<ul style="list-style-type: none"> <li>Annual audit program to be made public and tabled in the legislature with comments on any restrictions imposed</li> </ul>	S
			<ul style="list-style-type: none"> <li>Rent Seeking: Individual staff or groups assigned to pass rents to managers or responsible politicians</li> </ul>	<ul style="list-style-type: none"> <li>Proposed Audit Budget to be made public and separately submitted to legislature</li> </ul>	S
				<ul style="list-style-type: none"> <li>Audit client surveys by AG or independent survey group will assist in uncovering irregularities</li> </ul>	M



Process	Agencies Responsible for Mitigation Measures	Method for Tracking	Potential Vulnerabilities to Corruption	Mitigation Measures	Potential Impact if not Remedied
Assigning Staff to the Audit Program	Auditor General's Office	Monitor Quality Assurance through international audit peer review	<ul style="list-style-type: none"> <li>Rent Seeking: Individual staff or groups seek rents</li> </ul>	<ul style="list-style-type: none"> <li>Audit Quality Control – Complaints mechanism available to audited bodies regarding audit staff behavior</li> <li>Oversight body or strong internal audit is needed</li> </ul>	S
Conducting the Audit	Audit staff and managers	QA reviews conducted by Audit Office and reported annually	<ul style="list-style-type: none"> <li>Rent Seeking: Individual staff or groups assigned to pass rents to managers or responsible politicians</li> </ul>	<ul style="list-style-type: none"> <li>Whistle-blower legislation to protect informants is advised. International standards - Use an adequate audit manual and adhere to established working paper standards. Use Advisors to assist with all types of audit and improve practices so that audits are effective and secure from corruption</li> </ul>	H
				<ul style="list-style-type: none"> <li>Apply auditor code of ethics as a condition of employment</li> </ul>	M
				<ul style="list-style-type: none"> <li>Use effective disciplinary procedures based on complaints</li> </ul>	M
<b>PROCUREMENT</b>					
Transition from old procurement law to new procurement law	Line Ministries, ARDS-PU	Track open and transparent procurement practices as prescribed under the new Law	<ul style="list-style-type: none"> <li>Unequal bidding opportunities during the transition to new law due to lack of clarity of final procedures and uneven enforcement</li> </ul>	<ul style="list-style-type: none"> <li>Use ARDS-PU processes until capacities are fully proven. Build capacity in procurement officers. Increase awareness of award authorities and enforcement agencies.</li> <li>Related PSIB III Reform Program: roll out training and decentralization of procurement authority; Roll out monitoring system and disclosure; Adoption of model tender and contract documents; Gradually decentralize procurement function; Gradually implement training strategy</li> </ul>	H
Categorisation of potential violations to Procurement and Anti-corruption laws	Attorney General	Log perceived violations for further review and for potential need for new laws	<ul style="list-style-type: none"> <li>Improper understanding of procurement process on the part of enforcement agencies may lead to improper categorization of cases of violation and unjustified punitive measures</li> </ul>	<ul style="list-style-type: none"> <li>Enforce penal provisions of Law so that punishments are neither excessive nor inadequate</li> </ul>	S
Evaluation of bids	Line Ministries, ARDS-PU	Note review members on each bid and post list of winning and losing bidders for each major purchase	<ul style="list-style-type: none"> <li>Bids have the potential to be evaluated unevenly or unfairly leading to improper selection or miss the vulnerabilities to collusive or non-compliant bidding</li> </ul>	<ul style="list-style-type: none"> <li>Examine qualifications of bidders in a transparent manner according to pre-disclosed qualification criteria verifying as necessary any supporting documentation and using Bank standards for bid evaluation and decisions and for transparency through publication.</li> <li>Related PSIB III Reform Program: develop procurement code of conduct</li> </ul>	H

<b>Process</b>	<b>Agencies Responsible for Mitigation Measures</b>	<b>Method for Tracking</b>	<b>Potential Vulnerabilities to Corruption</b>	<b>Mitigation Measures</b>	<b>Potential Impact if not Remedied</b>
Bid price corrections	ARDS-PU	Record all initial revised bid prices, along with supporting rationale for any changes	<ul style="list-style-type: none"> <li>▪ Bid prices are corrected for arithmetical errors to arrive at the actual bid price for price comparison</li> </ul>	<ul style="list-style-type: none"> <li>▪ A procurement officer will explain the cost revisions and the process when questioned</li> </ul>	S
Sole source contracts	Line Ministries, ARDS-PU	Number and value of bids using this method	<ul style="list-style-type: none"> <li>▪ Selection of a preferred contractor. Negotiation of the terms and conditions. Poor technical capacity of the procuring entity</li> </ul>	<ul style="list-style-type: none"> <li>▪ Document the process and justification of sole source selection and submit to the Special Procurement Commission to approve award of large contracts</li> </ul>	S
Advertising	Line Ministries	Type and timing of media announcements	<ul style="list-style-type: none"> <li>▪ National procurement conducted outside the framework can result in inadequate notice due to limited circulation of newspapers</li> </ul>	<ul style="list-style-type: none"> <li>▪ New PPU will have procedures to combat this threat</li> </ul>	M

### 3. REVENUE DEPARTMENT OF THE MINISTRY OF FINANCE<sup>1</sup>

#### A. Introduction

3.1 Rapid growth of revenues is one of the most important factors for Afghanistan's development. A strong revenue performance contributes to macroeconomic stability through fiscal sustainability (in Afghan context, the operating expenditures covered by domestic revenues). Stable tax system and smooth tax collection processes without corruption are essential for enabling environment for the private sector.

3.2 Afghanistan has achieved a significant improvement in revenue collection since 2001 (Table 3.1). Total revenues increased by more than four times from Afs.5.8 billion in 2002/03 to Afs.28.8 billion in 2006/7. In terms of the share in GDP, it increased from 4.5 percent to 7.5 percent during the same period. Revenue performance between 2004/5 and 2006/07 exceeded the IMF's PRGF targets by 0.2 percent, 8.9 percent and 6.5 percent, respectively. In the past customs revenues (managed by the custom department) were dominant sources in domestic revenues, but its share declined from 56 percent in 2004/05 to about 40 percent in 2006/07. An indicator of fiscal sustainability has improved accordingly. The ratio between domestic revenues and the operating expenditures improved from 47 percent in 2003/04 to 67 percent in 2006/07.

3.3 Nevertheless, revenue performance in 2007/08 was disappointing. Total revenues reached Afs.34.2 billion (preliminary actual), 18 percent higher than the 2006/07 figures. However, the preliminary realization was below the target by 5 percent.

**Table 3.1: Revenue Performance**

	2003/04	2004/05	2005/06	2006/07	2007/08
Afs billions	10.2	12.8	20.0	28.8	34.2
% of GDP	4.5	4.7	6.1	7.5	7.8
Fiscal Sustainability Indicator <sup>1/</sup>	47	48	65	67	67

*1/ the ratio between domestic revenues and the operating expenditures*

*Source: Ministry of Finance, World Bank*

3.4 Revenue powers of the Ministry of Finance are granted under the Income Tax Law (November 2005) imposed under the authority of Article 42 of the Constitution of Afghanistan for the purpose of tax determination and tax payment. The Revenue Department plays a central role in collecting taxes.<sup>2</sup> The Department is structured as follows: (i) Large Taxpayer Office; (ii) Operations (comprising Information Technology, Client Services and Privatization) and (iii) Policy and Strategy.

<sup>1</sup> This summary is based on the Vulnerabilities to Corruption Assessment (VCA) for the Revenue Department of the Ministry of Finance, Government of Afghanistan. This was conducted by the UK's Department for International Development in very close collaboration with the Revenue Department, and the findings are detailed in the report entitled "Vulnerabilities to Corruption Assessment, Revenue Department, Ministry of Finance, Islamic Republic of Afghanistan (2007)".

<sup>2</sup> The Customs Department collects import duties and some other taxes on international trade. In addition, Mustofiat (Provincial Offices of Ministry of Finance) are responsible for revenue collection (sales and fixed taxes and an array of Sukooks (administrative levy) and fees, in total 133 revenue areas), payment processing of revenues, accounting functions and processing of central government expenditure budgets to provincial government ministries (except Kabul). Line ministries are responsible for the collection of some non-tax revenues.

3.5 The current Revenue Reform Program in the Ministry of Finance has correctly approached the problem of corruption on a preventative basis including through legislative reform, systemic and procedural improvements, and organizational capacity building that should reduce opportunities for corruption to occur. The next phase of the Revenue Department's reform process should address corruption explicitly via the development of the following policy and procedural framework: organizational, systems and management development processes, and continuing analysis of the problem of corruption and the efficacy of the Department's preventative and mitigation measures.

3.6 Thus, it is imperative that corruption mitigation initiatives related to tax transaction business processes are supported by the continuing wider organizational development promoted via the revenue reform process. This should serve to design out corruption and use human resource management principles and practices to create incentives for integrity and performance and to create disincentives for dishonesty and inactivity.

## **B. VCA Process**

3.7 The VCA for the Revenue Department was conducted using the following methodology (steps):

- Identify key business processes at Revenue Department Headquarters and in selected Mustofiats;
- Conduct a review of these business processes;
  - The underlying laws, regulations and guidelines for each process
  - Key steps for each business process, including the key stakeholders/decision makers/managerial responsibilities and the tools to hold them accountable.
  - Strengths and vulnerabilities to corruption of each step (based on weaknesses in the formal system or weaknesses in the capacity / incentives to implement the formal system.
- Assess key vulnerabilities to corruption in each sector through focus groups, notably involving clients of the sector; and
- Based on the focus group approach and desk review of processes, summarize key vulnerabilities to corruption, and develop options to mitigate these vulnerabilities.

3.8 More specifically, the assessment of corruption risk (the third bullet point of para.7 above) involves a three-tier approach.

- **Supra organizational level:** the identification and evaluation of the legal and regulatory framework, the overall governance system for tax administration;
- **Revenue Department level:** the existence and robustness of the Department's, and where applicable the government's, policy and procedural framework that guides the activities and performance of revenue administration; and
- **Operational and administrative levels:** identifying the core functions of the organization and evaluating the extent to which its related systems and processes are vulnerable to corruption in its various forms.

## **AREAS ASSOCIATED WITH HIGH VULNERABILITY AND HIGH POTENTIAL LOSS IN REVENUES**

3.9 The VCA has identified five main processes in the Revenue Department along with 17 sub-areas and has assessed corruption risks (see Table 3.2 and details in Appendix 3.1). For each process, four dimensions are analyzed. They are (i) the principal elements of the process; (ii) potential vulnerabilities to corruption (both within the formal system and/or in the

capacity/incentive to implement the formal system); (iii) the current location, the type of risk, the level of risk, and the scale of revenue loss; and (iv) the recommended mitigation measures.

3.10 Among the 17 sub-areas, the VCA identifies five sub-areas which have the combination of high corruption risk and high potential revenue losses (shown in bold in Table 3.2). The assessments for the five critical sub-areas with high corruption risk and high potential revenue loss are discussed at more length below, while a detailed discussion of all 17 sub-areas is included in the full VCA.

### **RETURNS PROCESSING, REVIEW AND ANALYSIS IN MUSTOFIATS**

3.11 **Process:** Except for large taxpayers, Mustofiats retain responsibility for the assessment and collection of a wide range of taxes and sukooks (administrative levies), including Business Receipts Tax of Limited Liability Companies and Corporations, Tax on Income of Importers/Exporters. Financial management and record keeping practices vary between Mustofiats. There is a high degree of discretionary authority during the process of reviewing returns, where taxpayers are required to present different forms of business and financial information.

**Table 3.2: Five Main Processes and 17 Sub-Areas**

	<b>Main Process</b>	<b>Sub-Process</b>
1	Identification and Registration of Taxpayers	<ul style="list-style-type: none"> <li>• Taxpayer services: provision of information, advice and tax forms</li> <li>• Taxpayer Identification Number (TIN) Registration</li> <li>• Taxpayer identification and compliance – LTO</li> </ul>
2	Assessment and Collection of Taxes	<ul style="list-style-type: none"> <li>• Returns processing at Headquarters – LTO/ITO</li> <li>• Returns Review and Analysis LTO/ITO</li> <li>• Returns processing, review, and analysis by Mustofiats</li> <li>• Sale of Road Toll Project decals to vendors</li> <li>• Collection of Airport Departure Fee</li> </ul>
3	Receipt and Monitoring of Revenues	<ul style="list-style-type: none"> <li>• Tax receipts processing in Headquarters/Mustofiats</li> <li>• LTO/ITO /Mustofiats File Management</li> <li>• Revenue analysis and reporting</li> <li>• Issue of tax clearance certificates – Headquarters/Mustofiats</li> <li>• Internal Audit <b>MOF</b></li> </ul>
4	Investigation of Tax Liabilities	<ul style="list-style-type: none"> <li>• Selection of taxpayers for audit investigation</li> <li>• Corporate Audit Investigation</li> </ul>
5	Enforcement of Total Tax Liability including Penalties	<ul style="list-style-type: none"> <li>• Enforcement: Failure to file/provide information/ pay</li> <li>• Issuing Public/Private rulings, handling objections and appeals and the litigation process</li> </ul>

3.12 **Vulnerabilities and Potential Scale of Revenue Loss:** Returns processing, and all other tax assessment and collection process in the Mustofiats are inherently prone to a high degree of corruption risk at petty and major administrative levels both merely to facilitate its administration and to enable taxpayers to avoid their tax obligations. Survey evidence consistently confirms the requirement of “speed money” as the norm at all levels of the Mustofiats and a “bribery tariff” offered to remove or reduce tax liabilities based on payment of 5-10 percent of the actual liability.

3.13 **Mitigation Measures:** The reform of the seven priority provinces<sup>3</sup> supported by 982 appointments under the PRR Program should be of great significance to corruption prevention. Interim mitigation measures, which should also serve to send positive anti corruption signals to the

<sup>3</sup> These seven provinces are Kabul, Kandahar, Nangarhar, Parwan, Balkh, Herat and Kunduz.

priority and remaining Mustofiats include: (i) increasing the level of internal audit; (ii) risk-based MoF audit of selected taxpayers; (iii) staff rotation policy and practices; and (iv) introduction of taxpayer report card, secure post box and telephone hotline supported by complaints investigation procedure and application of disciplinary framework under Article 111 of the Income Tax Law.

#### **INTERNAL AUDIT OF MINISTRY OF FINANCE**

3.14 **Process:** The Ministry's internal audit function holds responsibility for the audit of the government's revenues and expenditures. In addition, the Revenue Department has also incorporated into its proposed new organizational structure an Internal Audit unit separate from the MoF's Internal Audit Department. Currently the function undertakes audits within the MOF's departments and in the Mustofiats, working to annual coverage plan and identified priorities, but without any documented procedures and reliant on the experience and knowledge of existing staff.

3.15 **Vulnerabilities:** The current capacity of the audit function represents a very serious weakness in the Ministry's system of financial controls. The weak capacity increases the Ministry's overall vulnerability to corruption throughout its revenue and expenditure processes by increasing the likelihood of corruption remaining undetected and decreasing the potential for introducing and implementing systemic changes that will prevent future corruption.

3.16 **Level of Risk and Scale of Potential Revenue Loss:** The expansion of the Ministry's Internal Audit function both within the MOF itself and in the line ministries represents a potential control resource against corruption but also a source of corruption risks given the operational methods of internal auditors and the degree of discretionary authority they hold. The principal corruption risk is due to collusion or bribery of auditors for not revealing financial discrepancies or procedural irregularities. Corruption can range from petty to major, with high degree of risk of its occurrence and an equally high level of potential loss of revenue. Indirect corruption risks resulting from fundamental control weaknesses can create widespread opportunities for corruption throughout the revenue administration system and can enable corrupt practices to remain undetected for lengthy periods of time. Thus the current level of audit capacity in the MOF can carry the risk of deeper systemic corruption, encompassing all tax transaction and business processes.

3.17 **Mitigation Measures:** Mitigation requires the expansion of internal capacity complemented by the development of systems and risk-based audit capability directed at detecting and at designing out weaknesses in the financial risk assessment and control framework. The capacity development of the internal audit function, within the MOF and in the line ministries, represents a key component of the revenue reform process. It needs to be planned strategically as a micro-organizational development project to ensure that it creates a key driver of the MOF's financial governance system and does not become a major platform in its corruption infrastructure. Interim mitigation measures include: incorporation of corruption awareness and corruption detection and investigation techniques into current audit training programs, and design and use of anti corruption checklists and worksheets for use by internal auditors.

#### **SELECTION OF TAXPAYERS FOR AUDIT INVESTIGATION**

3.18 **Process:** The MoF is empowered to undertake information collection activities (Article 96 of the Income Tax Law). The LTO has established an Audit Team, initially to support its compliance and enforcement efforts for non-filing companies. Currently, the largest non-filing and other non-compliant companies have been selected for audit on the basis of internal discussions

between case management Team Leaders, the Compliance Technical Adviser, Audit and members of the Audit Team.

3.19 **Vulnerabilities:** The selection of entities for taxpayer audits within the LTO is an area of high vulnerability to corruption. It is a high-risk area susceptible to abuse of office, where improper influence can be used to exclude companies from audit, with improper individual selection decisions potentially enabling companies to avoid their legitimate tax obligations, resulting in long-term loss of large tax revenues.

3.20 **Mitigation Measures:** Tax audit investigation is a new and to date highly effective function in the Revenue Department. Its company selection process needs to be formalized, made transparent, and undertaken by a properly constituted panel based on members with an appropriate level of authority, reflecting a balanced range of “interests” within the Revenue Department. The transparency and accountability of process needs to be underpinned by an agreed and documented policy framework, procedure manual, agreed delegation of authority, and maintained by comprehensive record-keeping of all panel discussions, decisions by the panel and delegated individuals, and all interactions with the audited companies.

## **CORPORATE AUDIT INVESTIGATION**

3.21 **Process:** In the LTO, the function-based structure with its greater segregation of duties and its reduction in continuing relationship between case managers and individual companies greatly reduces corruption risks of collusion and bribery. The creation of a discrete audit investigation team, particularly when more adequately resourced, is an essential component of a revenue assessment, verification, and enforcement regime. The audit team gives the Revenue Department the capacity to undertake detailed examination of company accounts and is achieving major successes with large-scale companies that have been non-filers or chronic under-reporters of business turnover and/or profit.

3.22 **Vulnerabilities:** The tax audit process and methods of operation are inherently prone to risks of corruption, representing an area of the tax assessment process where auditors hold high levels of discretion in the planning and conduct of audits, and in the collection, analysis, and interpretation of financial information. In addition, the audit process includes out-of-office activities and involves direct contact with the taxpayer or their key agents.

3.23 **Level of Risk and Scale of Potential Revenue Loss:** The inherent risks involve collusion between auditor and company to accept fraudulent records, extortion by the auditor, and/or failure to impose reassessments and penalties where due. The degree of discretion afforded to auditors in terms of their unsupervised work on taxpayer premises, exclusive access to financial information, and ultimate responsibility for undertaking assessments and for the presentation of their findings generates a high degree of risk of corruption and a high level of potential revenue loss. Such risks are compounded by the potential tax liabilities of a country’s large taxpayers.

3.24 **Mitigation Measures:** A control framework to minimize areas and levels of discretion given to the auditor is required. The framework includes standard audit procedures, increased level of supervision of auditors, and audit records such as records of meetings and other communication with the taxpayer. MOF’s Audit Team is still in its initial phase of development, but the expansion of the team over time should be supported by agreed policies and procedures covering staff rotation, professional development, record keeping complemented by wider organizational initiatives covering ethics training, staff conduct, registration of gifts, declaration of assets and interests, etc.

## **PUBLIC/PRIVATE RULINGS, HANDLING OBJECTIONS AND APPEALS AND THE LITIGATION PROCESS**

3.25 **Process:** The MoF is empowered under the Income Tax Law (Article 113) to issue an income tax manual and separate public and private rulings as required, “for the better administration of this law”. The MoF has no legal powers under the Income Tax Law to write off or write down tax debts or to allow deferred payments or grant tax exemptions. However, there is an Arrears Law and an Arrears Collection Law which allow Mustofiats to defer tax payments.

3.26 **Vulnerability:** The issuance of public and private rulings thus has a clear legal basis and is subject to the authority of the Minister; however, the scale of potential tax liabilities makes this area inherently prone to corruption risk unless high levels of public oversight are in place. The Mustofiats’ powers under the Arrears Law and the Arrears Collection Law exceed those of the MoF, and are open to potential abuse unless adequate monitoring and supervisory procedures, and the wider controls already considered, operate effectively.

3.27 **Level of Risk and Scale of Potential Revenue Loss:** The risk of corruption via favoritism, patronage, or bribery for offering undue benefits to taxpayers in private rulings exists, but this is constrained by the Income Tax Law and the Revenue Department’s resultant governance system.

3.28 **Mitigation Measures:** The illegitimate waiving of legal procedures and/or the granting of undue benefits to taxpayers can only be curbed by increasing the constraints provided by comprehensive and robust legislation and regulations, clearly defined revenue administration polices and procedures and checks on decision-making authority reinforced by the influence of the wider civil society.

### **C. Key Recommendations**

3.29 Besides specific mitigation measures for especially vulnerable and high potential loss areas (see Appendix 3.1), the Revenue Department could reduce the vulnerability to corruption through organizational development and capacity development; corruption awareness; taxpayer information; and control enhancement.

#### **ORGANIZATIONAL DEVELOPMENT**

- **Legislative and Regulatory Framework Development:** (i) Review the existing laws pertaining to corruption to confirm the powers and sanctions available to the MOF to combat internal and business sector corruption and prepare an implementation plan for the Revenue Department and, if required, recommendations for legislative improvements; and (ii) analyze the Regulation on Civil Service Code of Conduct to ensure its powers and sanctions in relation to the above legislation and draw up a program of action to confirm the organizational structures, procedures and responsibilities required to support its implementation in the Revenue Department.
- **Policy and Procedural Framework Development:** (i) Design and introduce the policies and procedures required to support effective application of the existing legislative and regulatory framework to improve corruption detection, deterrence, and prevention, including performance management system, staff training, and staff rotation; (ii) develop a communication strategy, and related resources plan, covering within-MOF communication and inter-ministry communication on corruption issues, and public awareness communication; (iii) continue, based on the level of corruption vulnerability, the phased development of documented standard



operating procedures for all revenue transaction business processes; (iv) review, clarify, and redraft the MOF “Delegation of Authority” document as a procedure manual; and (v) discuss with the IARCSC the feasibility of introducing legal measures to restrict former Revenue Department staff, dismissed for corrupt practices, from providing professional tax advice services.

- **Infrastructure Development:** Introduce a computerized integrated revenue management information system in tandem with documented operating procedures and protocols, supported by induction and consolidation staff training.
- **Mustofiats Reform:** Implement the Mustofiats Priority Reform Program, review its implementation and outcomes, and extend reforms, as feasible, to all Mustofiats.

## CORRUPTION MITIGATION MEASURES

- Immediate / Short-Term Mitigation Measures
  - **Organizational Capacity:** (i) Implement the recruitment and selection of staff for all currently approved Priority Reform and Restructuring (PRR) posts; (ii) identify staffing and skill shortages in areas of the Revenue Department most vulnerable to corruption and submit plans/ budgets; (iii) select, on the basis of merit and performance, a cadre of supervisory managers, including current LTO Team Leaders, and provide a management development program based on formal and informal training interventions such as managing organizational and individual performance; and (iv) complete the re-organization of the LTO, dividing existing case managers into separate functional units of debt management, audit investigations, and enforcement, to include procedures for scheduled staff rotation.
  - **Corruption Awareness:** (i) Adapt and deliver current ethics induction training as a wider corruption awareness and staff conduct training program in order to introduce planned organizational integrity policies and initiatives; and (ii) introduce and implement the Revenue Department’s communication strategy for within the MOF, inter-Ministry, and public awareness of corruption issues and corruption prevention measures.
  - **Taxpayer Information:** (i) Provide notices and leaflets on the MOF and related websites and local internet access availability; (ii) Distribute the existing MOF taxpayer guide to Mustofiats; (iii) Produce and display dated notices with current exchange rates for the payment of Airport Departure Fees and institute a controlled system for issuing and return of cash floats to airports; and (iv) Liaise with Mustofiats Reform Program on the feasibility of a phased installation of web-linked PCs and printers in priority Mustofiats providing downloads of tax forms and taxpayer guides.
  - **Controls:** (i) Introduce taxpayer meeting and communication records pro forma by all staff with direct taxpayer contact, which should be filed and logged in taxpayer files; (ii) analyze all corruption complaints received, directly and indirectly, by the Revenue Department in the last 12 months, to identify issues to be considered by senior management; (iii) make available (post-paid if possible) report cards for taxpayers and staff to report incidents of attempted corruption in the Mustofiats and Headquarters; (iv) upgrade the functionality of the TIN database to improve its analytical and reporting capability; (v) formulate an audit investigation selection policy, and formalize the selection process and related record-keeping procedures; (vi) prioritize the implementation of increased level of audit of Mustofiats; and (vii) re-organize the storage of decals in the Sukook Store to ensure their future issuance in numbered sequence.
- Medium-Term Mitigation Measures
  - **Organizational Capacity:** (i) Complete the re-organization of the LTO into a functionally based structure; (ii) plan and introduce changes of work patterns in support of corruption

prevention including increasing levels of supervision of staff; (iii) remove all individual case work responsibilities from LTO Team Leaders, including Audit and Enforcement, so as to enable the Team Leaders to concentrate on supervisory responsibilities; and (iv) schedule and begin the development of improved management practices in support of organization and staff development.

- **Controls:** (i) Formulate a complaints handling and review mechanism with designation of responsibilities for: handling all complaints received directly from the public, handling complaints received from investigation agencies, analyzing and reporting to senior management on key issues, and identifying significant patterns and trends; (ii) establish an internal corruption monitoring function to analyze corruption patterns, levels, and trends, and to establish benchmarks; (iii) introduce secure post boxes in the Mustofiat's for deposit of taxpayer and staff report cards, and implement a controlled collection system; (iv) construct a secure store room for road toll decal storage, if the road toll is to continue, and relocate existing stock from the Sukook Store; (v) establish a joint task team with the MOF Internal Audit to plan and implement the phased improvement of internal audit coverage using a risk-based approach; (vi) introduce risk-based taxpayer analysis and audit; and (vii) schedule and begin the phased formulation and documentation of standard operating procedures, based on the Income Tax Manual, for all tax transaction business processes.
- Long-Term Mitigations Measures
  - **Organizational Capacity:** (i) Consolidate all changed work patterns in support of corruption prevention, including maximizing segregation of duties; and (ii) continue the development of improved management practices in support of organization and staff development.
  - **Controls:** Complete the formulation and documentation of standard operating procedures, based on the Income Tax Manual, for all tax transaction business processes, to be used as the basis for:
    - Service standards outlining all tax transactions and direct contact and communication with taxpayers;
    - Operations manuals for all tax transaction business processes;
    - The management of work productivity and performance standards;
    - Supervisory management of staff;
    - Staff training and development;
    - Handling complaints and investigations; and
    - Discipline and grievance procedures.

## **D. Conclusion**

3.30 Strong revenue performance is especially important for Afghanistan where fiscal policy is the central policy tool for development. Reducing the vulnerabilities to corruption in the revenue department would contribute not only to further improving revenue performance but also to creating enabling environment for the private sector development.

3.31 As a country develops more, there are more opportunities for corruption, it is important to take concrete steps to mitigate vulnerabilities to corruption in the earliest manner. The Ministry of Finance is commended to focus especially on five most vulnerable areas, while implementing capacity building of the Revenue Department.

### Appendix 3.1: Potential Vulnerabilities; Current Location(s)/Types/Level of Risk and Revenue Loss and Mitigation Measures

#### 1. Identification and Registration of Taxpayers

Sub-Areas	Potential Vulnerability	Location	Types	Risk Level	Loss	Mitigation Measures
Taxpayer services: information, advice and forms	<ul style="list-style-type: none"> <li>• Illegitimate payment demanded for the provision of free services/ documents</li> </ul>	MS	Petty admin “in rule”	H	L	<ul style="list-style-type: none"> <li>• Signs providing MoF website address and local access points.</li> <li>• Displays stands for forms/guides, signed free information</li> <li>• Staffed web-linked PCs in priority Ms.</li> </ul>
Taxpayer identification number registration	<ul style="list-style-type: none"> <li>• Illegitimate payments demanded for facilitating/ accelerating registration.</li> </ul>	HQ	Petty admin “in rule”	L	L	<ul style="list-style-type: none"> <li>• Supervisory management/ taxpayer report cards/ hotline.</li> </ul>
	<ul style="list-style-type: none"> <li>• Falsifying or accepting false documentation</li> </ul>	HQ	Petty admin “ex-rule”	L	L	<ul style="list-style-type: none"> <li>• Staff report card/hotline</li> </ul>
	<ul style="list-style-type: none"> <li>• Control risks resulting from multiple registration numbers and poor reporting functionality.</li> </ul>	HQ	Major admin “ex-rule”	L	H	<ul style="list-style-type: none"> <li>• Database upgrade/ identification and use of controls achievable from improved functionality</li> </ul>
	<ul style="list-style-type: none"> <li>• Intimidation or bribery for non-identification of companies or deletion from records</li> </ul>	HQ	Petty-Major admin “ex-rule”	L	H	<ul style="list-style-type: none"> <li>• Staff report card/hotline</li> <li>• Taxpayer report cards/hotline</li> <li>• Integrated revenue management information system</li> </ul>
Taxpayer identification and compliance-LTO	Collusion or bribery for companies to defer or avoid compliance with their tax obligations					<ul style="list-style-type: none"> <li>• Risk-based internal audit practices</li> </ul>

## 2. Assessment and Collection of Taxes

Sub-Areas	Potential Vulnerability	Location	Types	Risk Level	Loss	Mitigation Measures
Returns processing HQ - LTO/ITO	<ul style="list-style-type: none"> <li>Provision of taxpayer information to business competitors and/or political opponents</li> <li>Illegitimate payment demanded for facilitating/accelerating service</li> </ul>	HQ&MU	Petty admin “ex-rule”	H	L	<ul style="list-style-type: none"> <li>Application of Income Tax Law, Art.111 and disciplinary action</li> <li>Taxpayer report card/hotline</li> </ul>
- MU	<ul style="list-style-type: none"> <li>Collusion/bribery for acceptance of incorrect tax return information</li> </ul>	HQ&MU MU	Petty admin “in-rule” Petty-Major admin “ex-rule”	H H	L H	<ul style="list-style-type: none"> <li>Risk based audit of selected taxpayers</li> <li>Staff rotation policy and practice</li> <li>Application of Income Tax Law, Art.111 and disciplinary action</li> </ul>
Returns review & analysis- LTO/ITO	<ul style="list-style-type: none"> <li>Bribery for passing on taxpayer information to business competitors and/or political opponents</li> <li>Collusion/bribery for reducing/removing actual tax liability</li> </ul>	HQ HQ	Petty-Major admin “ex-rule” Petty admin “ex-rule”	H H	L L	<ul style="list-style-type: none"> <li>Risk based audit of selected taxpayers.</li> <li>Staff rotation policy and practices</li> </ul>
Returns review & analysis- MU	<ul style="list-style-type: none"> <li>Collusion/bribery for reducing/removing actual tax liability.</li> </ul>	MU	Major admin “ex-rule”	H	H	<ul style="list-style-type: none"> <li>Risk based audit of selected taxpayers</li> <li>Staff rotation policy and practices</li> </ul>
Sale of road toll decals to vendors	<ul style="list-style-type: none"> <li>Theft from stock of re-issuable “expired” decals and private sale</li> </ul>	HQ	Petty-Major admin “ex-rule”	L	L	<ul style="list-style-type: none"> <li>Construction and use of secure store exclusively for road decals.</li> <li>Introduction of system/schedule for re-issue of decals in the same period for the following year.</li> </ul>
Collection of airport departure tax	<ul style="list-style-type: none"> <li>Obtaining personal profit from foreign currency exchange</li> <li>Favoritism/bribery by MoF/police/airport staff for allowing passengers to avoid payment.</li> </ul>	HQ Airports	Petty admin “ex-rule” Petty admin “ex-rule”	H H	L L	<ul style="list-style-type: none"> <li>Notices displaying current exchange rates for selected foreign currencies.</li> <li>Complaints cards/secure “postbox”</li> </ul>

### 3. Receipt /Monitoring of Revenues

Sub-Areas	Potential Vulnerability	Location	Types	Risk Level	Loss	Mitigation Measures
Tax receipts processing HQ/MU	<ul style="list-style-type: none"> <li>Falsifying information</li> </ul>	HQ&MU	Petty and Major admin “ex-rule”	L	L	<ul style="list-style-type: none"> <li>Improved supervision and application of Income Tax Law, Art.111 and disciplinary action</li> </ul>
File management HQ/MU	<ul style="list-style-type: none"> <li>Removal of documents</li> </ul>	MU	Petty and Major admin “ex-rule”	H	L	<ul style="list-style-type: none"> <li>Ditto</li> </ul>
		HQ		L	L	
Revenue analysis and reporting	<ul style="list-style-type: none"> <li>Falsification of data/records</li> </ul>	MU	Petty-Major admin “ex-rule”	H	L	<ul style="list-style-type: none"> <li>Ditto</li> </ul>
		HQ	Petty-Major admin-political “ex-rule”	L	L	
Issue of tax clearance certificates HQ/MU	<ul style="list-style-type: none"> <li>Provision of certificates without clearance of current tax liabilities</li> <li>Illegitimate payments for facilitating/accelerating the process</li> </ul>	HQ	Petty-Major admin “ex-rule”	L	L	<ul style="list-style-type: none"> <li>Risk based audit of selected taxpayers</li> </ul>
			Petty admin “in-rule”	H	L	
Internal Audit of MOF	<ul style="list-style-type: none"> <li>Collusion/bribery for not revealing discrepancies discovered</li> </ul>	HQ&MU	Petty-Major admin “ex-rule”	H	H	<ul style="list-style-type: none"> <li>Capacity building in audit function included audit management and supervision</li> </ul>

### 4. Investigation of actual tax liabilities

Sub-Areas	Potential Vulnerability	Location	Types	Risk Level	Loss	Mitigation Measures
Selection of taxpayers for audit investigation	<ul style="list-style-type: none"> <li>Poor transparency in selection criteria and process.</li> </ul>	HQ	Major admin “ex-rule”	H	H	<ul style="list-style-type: none"> <li>Documented selection policy and procedures.</li> <li>Audit Selection Panel formally constituted.</li> <li>Panel Meetings minute</li> </ul>
Corporate audit investigation	<ul style="list-style-type: none"> <li>Improper use of influence in excluding/removing specific taxpayers from audit investigation</li> <li>Completion of audit without adjustment being made or due penalty imposed.</li> <li>Extortion from taxpayer in lieu of or in addition to assessed tax liabilities</li> </ul>	HQ	Major admin “ex-rule”	H	H	<ul style="list-style-type: none"> <li>Meeting/audit activity pro-forma.</li> <li>Audit Managers to take on exclusive supervisory management responsibility.</li> <li>Taxpayer report cards/hotline</li> </ul>

## 5. Enforcement of total tax liabilities including penalties

Sub-Areas	Potential Vulnerability	Location	Types	Risk Level	Loss	Mitigation Measures
Enforcement: failure to file/provide information pay	• Collusion/bribery to conceal late/non filing	HQ	Major admin “ex-rule”	L	L	<ul style="list-style-type: none"> <li>• Strengthening of ITL2005, standard operating procedures.</li> <li>• Clarification and documented confirmation of authorities and delegations</li> </ul>
	• Collusion/bribery to conceal/postpone failure to provide information	HQ	Ditto			
	• Improper influence on the confirmation and/or implementation of enforcement action	HQ	Major political “ex-rule”	L	L	
	• Writing down/off tax debts without legitimate cause and outside of due process		Ditto	H	H	
	• Conflict of interest	HQ		H	H	
Public/private ruling, objections/appeals & litigation	• Favoritism/patronage/bribery in write down/off correctly assessed taxes due or waiving legal provisions	HQ	Major political “ex-rule”	H	H	

## 4. BUDGET DEPARTMENT OF THE MINISTRY OF FINANCE<sup>1</sup>

### A. Introduction

4.1 In Afghanistan, the national budget is intended to be the main policy tool to achieve development objectives. Since 2004, reporting of Afghanistan's National Budget includes a Core Budget and an External Budget. The Core Budget includes all funds flowing through the treasury system of the government, and included in the budget appropriation approved by the Parliament (or before Parliament came into existence, by the Cabinet followed by a Presidential decree). By contrast, the External Budget includes all external assistance funds not flowing through the treasury system, i.e. external assistance directly disbursed to implementing agencies (e.g. NGOs and private firms). Core budget expenditures are financed by government domestic revenues and external assistance (mostly grants such as the Afghanistan Reconstruction Trust Fund (ARTF) and highly concessional loans). Expenditures are composed of operating expenditures and development expenditures. Operating expenditures are primarily recurrent, and include civil servants' wages and pensions, and goods and services for operations and maintenance (O&M), although O&M also includes some small capital expenditures. Development expenditures include projects that finance capital goods (e.g. road), but also include some recurrent expenditures such as technical assistance, training, basic health services and community grants. When there is a gap between domestic revenues (after grants) and core budget expenditures, concessional external loans as well as drawdown of cash reserves are used for financing. By contrast, the external budget is entirely financed by donors.

4.2 The budget process consists of the following stages: formulation, adoption, execution, and control. Budget formulation takes place at two levels: (i) policy level—major strategic decisions are made based on national priorities, and (ii) technical level—major strategic decisions (i.e. policy objectives) and fiscal constraints are translated into the national budget. After the initial review by the Budget department, budget proposals made by the line ministries and other government agencies are reviewed by the Budget Committee of parliament and the Cabinet, followed by the review and adoption to parliament. Once the Parliament approves the budget (adoption), it is signed into law by the President in the form of a Presidential Decree. During the execution stage the Budget Department plays an important role in reviewing and approving requests from budgetary units of line ministries to expend the funds that have been appropriated (i.e. allotment). Execution involves the Ministry of Finance (MoF), the budgetary units of line ministries, and their sub-national offices. There are several monitoring mechanisms in a public financial management system at various national, sub-national, and line ministry levels. While the Budget Department plays a role in controlling at a macro level, the control of the budget most effectively rests with the internal and external audit departments. The Parliament reviews the audited final budget execution report (Qatia).

4.3 This VCA for the Budget Department was conducted using the following methodology:

- Identify and briefly describe key business processes at the Budget Department.

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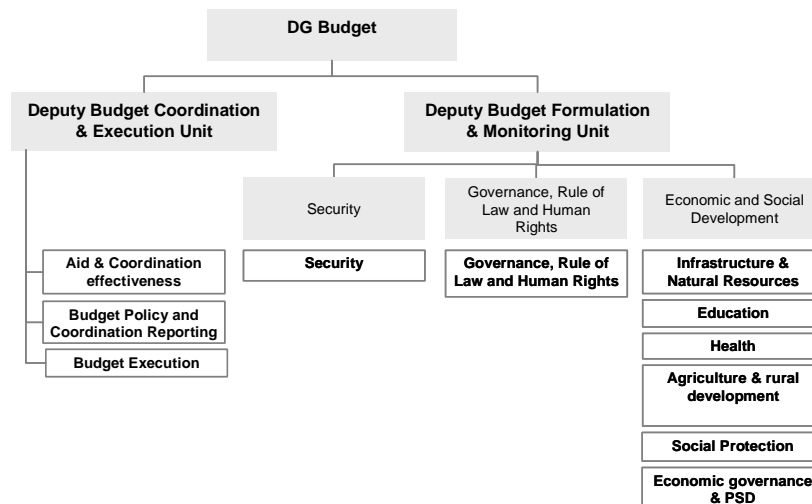
<sup>1</sup> This summary is based on the Vulnerabilities to Corruption Assessment (VCA) for the Budget Department of the Ministry of Finance, Government of Afghanistan. This was conducted by the United Nations Development Programme (UNDP) and UK's Department for International Development (DFID) in very close collaboration with the Budget Department, and the findings are detailed in the report entitled "Vulnerabilities to Corruption Assessment, Budget Department, Ministry of Finance, Islamic Republic of Afghanistan (2007)".

- Review the business processes including:
  - Underlying laws, regulations, and guidelines;
  - Key steps for each business process including the actors involved, responsibilities of the different actors and systems in place for accountability purpose;
  - Strengths and weaknesses of each process in relation to the formal system (and if possible the informal system).
- Assess the key vulnerabilities to corruption.
- Make recommendations to mitigate corruption risk.

## **B. Organizational Structure and Roles of the Budget Department in the Budget Process**

4.4 The Budget Department consists of the budget formulation and monitoring unit and the budget coordination and execution unit (Figure 4.1). The budget formulation and monitoring unit is further divided into three pillars and eight sectors in accordance with the structure of Afghanistan National Development Strategy (ANDS). This unit is primarily responsible for assisting and overseeing budget formulation of line ministries’ budgetary units, and for supervision and monitoring of budget execution (by processing and approving allotments and changes in budgets). Budget officers interact very closely with their designated line ministries. They take an active role in sector strategy discussions, as well as in discussions with donors about support to particular development projects. Budget officers also participate in line ministries’ procurements by sitting in on the bid opening process to ensure that procedures are properly followed. The budget coordination and execution unit consists of four sections. The budget policy coordination and reporting team collects and consolidates information from the different sectors and prepares budget execution reports for the management of the MoF, the government, and parliament. It coordinates the budget preparation timetable, budget circulars, budget, and mid-year budget review. The budget execution team monitors and reports about expenditure, approves allotments (second check after focal point in budget formulation and monitoring unit), and registers appropriations, allotments and changes to budget appropriations in the Afghanistan Management Information System (AFMIS). The aid coordination and effectiveness team manages grant and loan agreements with donors. It facilitates information sharing with donors, tracks aid flow, acts as secretariat for the donor Consultative Group, and compiles the external budget. The program and provincial budgeting team is an addition to and working in parallel to the “standard” budget process.

**Figure 4.1: Organizational Structure of the Budget Department**





4.5 The Budget Department plays an important role in the budget process, as follows:

- Formulation: Policy Level
  - Medium-Term Fiscal Framework (MTFF)<sup>2</sup>, annual fiscal envelope, budget policy outline
  - Preparing the external budget (based on information reported by donors)
- Formulation: Technical Level
  - Budget preparation procedures
  - Processing/analyzing budget submissions
  - Budget Committee hearings and establishing appropriations
- Execution
  - Budget execution preparation
  - Allotment process
  - Amending budget appropriations and allotments
- Monitoring and Control
  - Monitoring expenditure /budget execution reports
  - Aid coordination and effectiveness

### **C. VCA for the Budget Department**

4.6 Limited corruption risks seem to exist in the areas where the roles of the Budget Department are information/coordination and the Budget Department provides important inputs without decision making power. On the contrary, relatively significant corruption risks are observed in the areas where the Budget Department has discretionary/decision making power. The areas include:

#### **PROCESSING BUDGET SUBMISSIONS AND ESTABLISHING APPROPRIATIONS**

4.7 Budgetary units of line ministries have to prepare budget submissions according to a specified template. The budget officers in the budget formulation and monitoring unit in the Budget Department review the received budget submissions. The budget officers assist the line ministries in better defining and prioritizing their needs within the given framework, and evaluate the integrity of the proposals.

The processing of budget submissions and establishing of appropriations face considerable corruption risks. A number of line ministries prepare poor budget proposals both due to poor capacity and also as a result of the weak information base, resulting in proposals based on assumptions rather than on audited/verified data. In such a context, budget officers have considerable discretion to support or challenge weak or incomplete submissions. There is a risk of rent-seeking by budget officers to accept and support inappropriate budget submissions, or collusion with line ministries.

#### **ALLOTMENT APPROVAL PROCESS**

4.8 An allotment is an advice (form) issued by the MoF authorizing budgetary units to make expenditures/commitments (e.g. enter into service contracts, buying goods) of the amount specified in the advice/form. This enables the Budget Department to assure that budget funds are spent

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<sup>2</sup> The MTFF is prepared by the Fiscal Policy Unit (FPU). The FPU is not part of the Budget Department, but the Budget Department and FPU work closely together on the MTFF.

according to the purposes for which they were approved. Once allotments have been issued, budgetary units may request payments from the Treasury. The allotment approval process involves two units within the Budget Department: the focal point in the budget formulation and monitoring unit, and then the budget execution team in the budget coordination and execution unit. “Regular” requests are further approved by the Director General or Deputy Director General according to the rule.

4.9 A budgetary unit submits an allotment request to the MoF using a Project Coding Sheet (PCS) and an Allotment Request Form (B27). Requests are registered by archives. The official timeline requires that each step of the process ((1). processing by the budget officer; (2) processing by the Budget Execution team; (3) approval by the DG/Deputy DG) is completed within a 24-hours for a total of three working days. On occasion, focal points receive incomplete or inaccurate allotment requests. With a view of expediting the process, the focal point often contacts the budget units directly with a request for clarifications, thereby breaching the 24-hour/one business day time limit for processing an allotment request. While form may dictate that incomplete requests be returned to the budget unit through the “official channels” (signed and dated through Budget Department archives, to be received by the budget unit’s archives), this official process would in fact involve a longer time period.

4.10 The allotment approval process is particularly vulnerable to corruption. Allotment requests for development projects—where a large number of additional documents must be presented—are particularly vulnerable. Budget officers could extract payments from budgetary units of line ministries in a variety of cases:

- To expedite requests (place ahead of others, particularly in cases of backlogs);
- Not to delay the process (by placing the file at the bottom of the request list, or “losing” it in a drawer); and/or
- By focusing on (irrelevant) formal mistakes.

4.11 Budget officers could also act in collusion with line ministries in accepting incomplete or unjustified allotment requests. The ability of budget officers to do this depends on the level and efficacy of oversight by their superiors, who may also be complicit. In addition to complaints about delays, some line ministries consulted during this assessment noted that guidelines for completing B27 forms are insufficient or incomplete. It is also suggested that grounds outside the checklist have been used for rejecting allotments (e.g. no stamp on contract). In addition, the preponderance of rules, and changes in rules over the years (procurement guidelines, in particular), which have not yet been fully systematized, create a certain amount of confusion about which regulations to apply in evaluating the quality/validity of a particular allotment request.

#### **AMENDING APPROPRIATIONS AND ALLOTMENTS**

4.12 Amendments of the original budget are proposed to accommodate changing fiscal and other realities (e.g. natural disasters). The Budget Department is involved in budget amendments in the following areas, with decision-making power.

- Transfer of funds among major codes and sub-codes in the operating budget: Budget units may transfer funds within the operating budget from one budget line (main code or sub-code) up to five percent of the budget appropriation (ceiling), with some restrictions. Such transfers are subject to approval by the Deputy Minister of Finance, in consultation with the Budget Committee.

- Transfer of funds between projects in the development budget: Similar procedures apply to the transfer of funds between projects in the development budget. In case of non-discretionary funds, a “no objection” certification must be obtained from the relevant donor, and a formal letter needs to be submitted for approval from the Deputy Minister of Finance before being executed by the Budget Department.
- Changes in overall appropriations: Budgetary Units may request the MoF for an increase in their approved appropriation. During the mid-year review, the Budget Department reports on execution rates of budgetary units, projecting potential over- or under-spending. Based on this assessment, and taking into account requests from line ministries, the Director General of the Budget Department proposes amendments to budget appropriations for Budget Committee consideration. All changes require approval by the Cabinet.

4.13 A number of risks exist at different points in the budget amendment processes. Many of the risks lie in rent-seeking by focal points and other Budget Department staff and corrupt trade-offs with decision-makers in the budget executing agencies who have the discretionary decision-making powers in this process. Some specific risks include the following:

- Changes in provincial allocations, without proper oversight, can be made to redirect resources to provinces with less effective financial control in exchange for payment.
- Decisions on financing of “approved projects” may be vulnerable to line ministries’ trying to (or having to) influence the MoF/Budget Committee in order to have their project higher on the list.
- Unclear criteria for allocation of contingency funds present opportunities for “deal-making” between budgetary units and relevant decision-makers.

4.14 Risks are amplified as major budgetary amendments can be made outside the scope of parliamentary oversight (the parliament has no mandate to approve amendments, unless the overall budget is increased).

## **D. Possible Mitigation Measures and Policy Recommendations**

### **PROCESSING BUDGET SUBMISSIONS AND ESTABLISHING APPROPRIATIONS**

4.15 The discretionary powers of budget officers of the Budget Department appear to be adequately counterbalanced with the Deputy Director General and Director General, and culminating with the Budget Committee whose members make the ultimate decisions regarding the budget submission. This check and balance structure should be maintained. Moreover, it is important that budget officers be of high integrity and work in the interest of the Afghan state rather than that of the individual ministries. Measures to promote high levels of professionalism and integrity include merit-based recruitment policies, adequate remuneration, conflict of interest rules, enforced codes of conduct, and effective staff oversight.

4.16 On a technical level, the introduction of software that facilitates the budget preparation process in the Budget Department would be helpful. Computerization of a part of the budget preparation process makes it possible to register a variety of data on the various development projects, investment proposals, recurrent cost on sub-codes, and eventually links with strategies and policies. As a consequence, the process becomes more transparent and the submission more coherent. This would lead to consolidating data and the processing of aggregated reports that would support further decision-making on setting priorities.

4.17 Indirect measures outside the Budget Department include capacity building in the budgetary units of line ministries, such as project design and project evaluation capacities for core development expenditures, to produce quality budget submissions based on audited/verified information. Higher-quality proposals based on sound information would reduce the budget officers' discretionary power.

#### **ALLOTMENT APPROVAL PROCESS**

4.18 The bureaucracy in the allotment process can be reduced by rationalizing the array of documents which need to be enclosed with allotment requests<sup>3</sup>. Furthermore, the guidelines for submitting allotments, and the criteria for evaluating allotments, can be made clearer and more transparent by circulating to budgetary units along with other budget execution guidelines and posting on the website. It should be noted, however, that every conceivable criterion for assessing the validity of an allotment request can never be completely codified, and some space for judgment must be left to the discretion of the budget analysts. Sufficient accountability mechanisms must therefore be in place to counterbalance this discretion. The actual official timelines for processing allotment requests could be more strictly observed, with the consequence of actually increasing the duration of the approval procedures to clarify the responsibility for the delay in the procedures. In doing so, a careful consultation with the budgetary units is highly recommended in determining whether this is a desirable trade-off, however; it may be, if the budgetary units feel that the discretion of the Budget Department is otherwise abused.

4.19 In the medium term, the MoF can reduce controls and accept/process allotment requests at the level of sub-programs or projects rather than at activity level. This is, in fact, the way forward foreseen by the proposed conversion to the program budgeting model. However, before entering this phase, it is of vital importance that the financial management systems (including the system of Public Internal Financial Control (PIFC) be strongly improved and well established in the budgetary units.

#### **AMENDING APPROPRIATIONS AND ALLOTMENT**

4.20 Mitigation measures consist first and foremost in elaborating clear and unambiguous criteria and procedures for amending the budget in all the instances identified above, to be presented along with other budget execution guidelines in the relevant regulations and the recommended budgeting manual. All amendments to the budget should be explicitly reported and monitored for proper implementation, both at budgetary unit and MoF level. Furthermore, as the capacities of the parliament increase, it may be considered to require parliamentary approval for budgetary amendments over a certain threshold, regardless of whether or not the change represents a net increase of the total budget.

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<sup>3</sup> For example, development budget allotments do not require the full range of tender documents if the approval document from the tender commission is in place).

## 5. MERIT-BASED APPOINTMENTS IN THE CIVIL SERVICE<sup>1</sup>

### A. Introduction

5.1 Merit-based appointment of government employees is a cornerstones of Afghanistan's Public Administration Reform (PAR) program and as such is a key element in building an effective state.<sup>2</sup> The Independent Appointment Board (IAB) is mandated to carry out merit-based recruitment for senior civil service positions and to monitor appointments to other positions in government ministries and agencies. While significant progress has been achieved over the last few years, the merit-based appointment agenda has not been able to command a political consensus or to overcome ingrained resistance. As a consequence the Independent Administrative Reform and Civil Service Commission (IARCSC) and the IAB are widely criticized, irrespective of whether they do a poor or a proper job.

5.2 Culture and politics interact to aggravate the perceived and real weaknesses of the merit-based approach to appointments. Like many ethnically and politically fragmented societies, Afghan society often finds it difficult to accept merit-based appointment as a fair process to select its civil servants. The whole merit-based selection process is therefore subject to considerable suspicion: for many in the bureaucracy, it is in the best of circumstances widely perceived as a "blind" and irresponsible decision making process; in the worst cases it is viewed as just a new device to appoint cronies. As a result, despite the President's official approval, there is not a widespread political consensus to support the new process. While strongly supported and praised by donors, by IARCSC and IAB staff, as well as by a small group of "modernists" in the bureaucracy, the merit-based appointment process is only grudgingly accepted by the administrative apparatus, many of whom still consider merit-based selection and open competition as alien to both local administrative traditions and Afghan culture.

### B. Main Vulnerabilities

5.3 Despite enormous efforts and the acknowledged difficulties surrounding implementation of the merit-based appointment process, criticisms are echoed from the President's office, the Office of Administrative Affairs, key line ministries (e.g. Education, Interior, MRRD, and Finance), and even from IARCSC and IAB staff. Vulnerabilities can be divided into two categories. One is weaknesses in the system of merit-based appointments. The other is organizational and capacity weaknesses in IAB.

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<sup>1</sup> This summary is based on the "Assessment of Progress Made in the Implementation of Merit-Based Appointments in the Afghan Civil Service" (2007); and the "Update on the Implementation of IAB's Action Plan". This work was conducted by the World Bank in very close collaboration with the Independent Administrative Reform and Civil Service Commission (IARCSC) and the Independent Appointment Board (IAB).

<sup>2</sup> For a general overview of civil service reform and PAR issues, see *Afghanistan: Building an Effective State: Priorities for Public Administration Reform* (Report No. 42166-AF, 23 January 2008, The World Bank).

## **WEAKNESSES OF THE MERIT-BASED APPOINTMENT SYSTEM**

### *Inadequate or Poorly Respected Procedures*

5.4 The key issues are:

- Lack of discussion of job selection criteria between line ministries and the IAB, leading to unclear selection criteria;
- Poor quality (or lack) of job descriptions due to inadequate preparation by the ministries, which are unclear about their basic missions and their actual needs. In this case, the IAB has to take a tough stance by holding up inadequate requests and asking ministries to clarify their needs;
- Deliberately distorted selection criteria and requirements, emphasizing for instance administrative experience and knowledge of detailed administrative procedures over judgment in order to favor incumbents and exclude outsiders;
- Systematic omission or underestimation of the basic technical requirements of the positions, and lack of analysis of the candidates' technical expertise;
- Lack of proper advertisement or late advertisement, either for logistical reasons or as a deliberate attempt to limit the number of applicants and favor incumbents, although the IAB has made progress by mobilizing six regional offices;
- Lack of proper reference checks leading to selection of candidates with dubious records and even possibly criminal records;<sup>3</sup> and
- Cases of ministries completely bypassing the civil service law procedures to get direct approval by the President of appointments of senior personnel without any involvement of IARCSC and IAB.

### *Inadequate Experience, Capacity and Training at the IAB*

5.5 There are criticisms from different quarters about both the insufficient professional and managerial experience and the intellectual capacity of some commissioners, as well as improper behavior on their part. Common criticisms include openly supporting one candidate over others by short-listing him and providing him with high scores without justification; publicly commenting negatively or positively about a candidate's answers; suggesting answers; publicly criticizing his/her dress; publicly criticizing a female applicant for wearing make-up; not recognizing the adequacy of a candidate's degrees for the required qualifications; not understanding a candidate's answers due to a language problem; inability to properly score a candidate; lack of balance in judging the appropriateness of the answers provided; yelling at a candidate; answering cell phone calls during interviews; and making final decisions without properly consulting the interview panel. The more acute criticisms are voiced by ministries that have already developed significant HR capacity. In the Ministry of Education, a confidential log book of complaints has even been created to document improper behavior of some commissioners.

5.6 During 2007, a number of changes have taken place. The former head of IAB was replaced by one of the senior commissioners. Out of the 10 commissioners (including the head of IAB) present by early 2007, five left IAB. Two new commissioners, including a female commissioner, joined IAB in early 2007 and have now taken up their jobs. Four additional new commissioners, including another female commissioner, were appointed by the President. It is too early to judge whether these six new commissioners will prove to have the judgment and capacity to hold such demanding positions. While showing impressive personalities and diverse personal credentials,

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<sup>3</sup>The investigation unit of the IAB has strengthened reference checks in a systematic way. There is a specific form signed by the investigation officer in charge of the check.

their management and administrative experience is generally very limited. One gets a sense that the selection process which led to their appointment was most likely determined by political considerations rather than by objective criteria.

#### Narrow Bureaucratic Decision Making

5.7 The appointment process involves short-listing procedures and interviews by appointment panels chaired by a commissioner with a representative of the requesting ministry and an expert from the IAB or IARCSC. Initially the participation of the ministry was not allowed, and there is a general consensus that the recent reform resulting in the presence of a representative of the requesting ministry has resulted in a great improvement in the process. Nevertheless, there is still skepticism regarding the decision making when combined with other common criticisms such as the panel's ignorance of the basic dimensions of some of the positions to be filled; the inadequacy of the job descriptions and superficiality of the selection criteria; the lack of adequate pre-screening of candidates and the lack of checks for records; the superficiality and sometimes informality of the interview process with insufficient recourse to written responses; and finally the lack of interview experience and professionalism of some commissioners. The ongoing selection and appointment by the IAB is a rather mechanistic procedure, hopefully allowing for some ethnic "mixing" in the appointment process (i.e. avoiding the common past pattern of individual agencies tending to be dominated in terms of staffing by particular ethnic groups), but certainly not resulting in fully satisfactory and documented merit-based appointments.

#### Ethnic or Political Bias

5.8 Sometimes concerns are raised about ethnic or political bias in specific selections as well as in IARCSC's own staffing. Basically, IARCSC is perceived as a political institution, politically and ethnically biased to favor Tajiks and representatives of the Northern Alliance. In fact, the ethnic composition of IAB's key personnel does not support this charge. Tajiks are not disproportionately represented among commissioners (out of ten commissioners five are Pashtun—including a commissioner who resigned, two Hazara, two Tajik, and one Uzbek). Regarding the appointment of senior staff in ministries, IAB recognizes that 53 percent of appointments made so far have been Tajiks, but this reflects, in IAB's view, mostly the demographic weight of educated Tajiks in Kabul where the large majority of appointments have taken place. However, one of the more forceful criticisms is that "IARCSC should first apply candidly its merit-based selection rules to the selection of its own staff".

#### Patronage

5.9 Patronage conflicts with the merit-based approach and represents a clash between traditional values and the requirements of a modern bureaucracy. There are constant attempts to interfere with standard merit-based appointment processes by members of the government, the President's office, members of Parliament, individual commanders, and influential political personalities of all origins. Such constant pressures and interference take much time and energy of IAB.

5.10 Interference in the appointment process does not stop at the IAB director level, and once appointments are decided by IAB they are sent to the President's office for final review and approval. According to IAB, refusals by the President's office to confirm its appointment decisions have remained the exception. However, while there is a broad consensus that final clearance is needed by the President's office precisely to reduce risks of patronage, the possibility of patronage-type interference after the IAB has made a decision, during the final approval process

which may take up to a couple of months and involves about six signatures<sup>4</sup> in the President's office, is clearly an area that will need to be monitored. Political interference in the appointment process certainly will not disappear overnight.

### Corruption Networks

5.11 Interference in an appointment process may reflect a strategic move to develop or strengthen a corruption network in a given institution by making sure that all positions of authority—from the decision maker to those who will implement and control the decisions (including the internal auditors)—are filled by close “associates” in what becomes a “corruption pact”. The overall purpose of such pacts may be to fund and strengthen a specific ethnic or political group or simply to enrich a group of corrupt individuals.

### Mustofiats and District Heads

5.12 There has been a case of deliberate distortion of the recruitment process for Mustofiats' personnel (grade 3 and below) in the Ministry of Finance, based on the use of highly technical questions and the requirement of many years of relevant experience in the government, which clearly favored incumbents and which were imposed by IARCSC against the Ministry of Finance's wishes. This may reflect the interest of some incumbent staff in keeping their jobs rather than a desire by an internal network of Mustofiat staff to keep positions under close control, allowing significant opportunities for bribery.

5.13 There has been a significant dispute over the selection of district governors. IAB, which had been conducting at the government's request a regular process to select 132 district governors in the provinces, had already advertised the positions widely and began processing 1,150 applications. However, the Minister of Interior decided to bypass IAB and to get direct appointment decisions out of its own list from the President. IAB and IARCSC were justifiably outraged.

5.14 The IAB perceives this as one example among many attempts by powerful ministers to bypass IAB and the civil service law, and that such cases would unravel the whole merit-based appointment process and greatly undermine IARCSC. The position of the Ministry of Interior (MoI) was that many district governor positions, in areas of high insecurity, are politically too sensitive to be handled by the blind processes of IAB (i.e. the “incompetence of commissioners ready to appoint people no one knows about”). In MoI's view, district governors are politically as sensitive as provincial governors and should therefore be classified among “political appointments”. However, this may also be linked to issues of money and corruption, as district governor positions are considered to be lucrative particularly in areas with substantial opium production and/or trade.

5.15 This issue should be looked at more carefully, but it may well be that due to lack of adequate transparency in the final process, the arguments on all sides may be justifiable: (i) unless a clear political decision is made to decide that the district governor positions are to be filled through a political process, the IAB position is justified; (ii) at the same time, given IAB's mixed

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<sup>4</sup> The signatures requested at the President's office to confirm the senior appointments are those of the head of the human resource department, the head of the Taskeel, the first and the second deputy of the Office of Administrative Affairs (OAA), the minister in charge of parliament and the chairman of the OAA. Simplification of this complex process would be warranted in order at least to reduce the number of required signatures.



performance MoI may be justified in feeling that it must bypass IAB on sensitive appointments; and (iii) any allegations of corruption should be a source of serious concern given the importance of district governors in a post-conflict situation and the associated political and security dimensions. With the subsequent formation of the Independent Department for Local Government (IDLG), the supervision of district governor has been separated out of MoI and is now with IDLG.

#### **ORGANIZATIONAL AND CAPACITY WEAKNESS OF THE IAB**

5.16 IAB is confronted with serious organizational and capacity weaknesses which will require more forceful measures to address than simply amendments to existing procedures.

##### *Is the number and quality of commissioners adequate?*

5.17 As part of the upcoming pay and grade reform (P&G), the IAB commissioners are mandated to appoint the whole management structure and senior positions of the entire Afghan civil service in a few years' time. This will be an exceptionally challenging task. Some of the current commissioners are not adequate for it, as (i) although they are supposed to select managers, some commissioners themselves do not have managerial experience; (ii) they do not have technical background; (iii) the existing processes do not provide for appropriate pre-screening by technical specialists; and (iv) some of the commissioners lack substantial professional experience.

5.18 IAB is thus confronted with a serious capacity problem. The present staffing arrangements (one board director, four permanent commissioners, five temporary, and five additional temporary commissioners soon to be recruited) are insufficient. The understaffing would be more problematic when the Pay and Grading program is implemented, as IAB would be expected to appoint about 7,500 senior staff in a maximum of two years. The number of commissioners is insufficient for this purpose. Moreover, the staffing and logistics of the Appeal Board (whose activity is likely to increase following IAB's growing activity), also are inadequate and would require serious improvements. According to the IAB director, with some improvement in productivity the appointment capacity of 20 commissioners should be 7,500 senior staff in two years time. However, such a rapid and large increase in numbers of appointments would worsen the quality of the process. Moreover, the feasibility of recruiting 20 commissioners with the required qualifications itself is in doubt. Thus it is inadvisable to significantly increase the number of commissioners, whereas other measures may be more appropriate to meet increased demand for appointments.

##### *How should the commissioners' profiles and experience be enhanced?*

5.19 The criteria for commissioners' selection have not been specified. Clearly, before extending the tenure of the temporary commissioners and planning for a doubling in their number, at least a serious screening and performance assessment of the present group should be conducted (suggested selection criteria are found in the section on recommendations). Investigations should be conducted regarding accusations of improper behavior. Better training also should be provided.

##### *Is the Present Organizational Set-Up for Appointment Decisions Satisfactory?*

5.20 The interview panels make short-listing and appointment decisions. The panels are generally composed of three people: an IAB commissioner, a representative of the requesting ministry, and an "expert" (in fact a senior staff from one of the four existing appointment support teams provided by IAB or a staff from IARCSC). The commissioner plays a leading role in the process, and the interview (a 20-40 minute process) is critical. Although there has been some

improvement in pre-screening by IAB, this puts a particularly heavy burden on the IAB selection panel, especially on the commissioners. Despite the huge task, the current staffing of IAB is weak: the investigation unit (four professional staff), the personnel affairs unit (only one senior expert), and the recruitment teams (four teams of only one senior expert each) providing support, when compared to a fairly large number of commissioners (9 to 10).

## **C. Recommendations**

### **COMMISSIONERS' SELECTION**

5.21 The present limit of 10 (to maybe 12) commissioners is unlikely to be exceeded due to lack of adequate candidates, budget and space constraints, as well as the parallel need to develop other bodies such as the Appeal Board, as the IAB's processing capacity increases. A critical issue is to select a new and more experienced body of commissioners over a 12 to 18 month period, without losing institutional memory. Careful attention is needed to avoid hasty selection and improper appointments. The following are some suggested selection criteria for commissioners:

- Demonstrated administrative or managerial experience and skills;
- Adequate educational background (unless he/she already has had an outstanding career and practical managerial experience, commissioners should at a minimum have a master's level degree);
- Clean criminal record and high integrity;
- Courage, ability to stand up to and resist pressures;
- Knowledge of the Afghan administrative system, first-hand experience in an Afghan institution;
- Capacity to listen;
- Ability to express oneself clearly in a structured way, both in writing and orally;
- Vision; and
- The group of commissioners should encompass a diversity of experiences and backgrounds (in terms of education, ethnic origin, gender, and possible political affiliation).

### **IAB'S ORGANIZATIONAL STRUCTURE**

5.22 A ratio in the range of two professional staff per commissioner, located in a reinforced investigation unit and a strong HR unit, would be the minimum requirement to provide adequate technical support to commissioners. In addition, each commissioner should have the support of a full team composed as presently of a senior expert, one or two junior professionals, and a support staff. Strengthening of the investigation unit and an HR unit where foreign TA (Technical Assistance) can help make a difference, and establishment of a support unit for each commissioner, should come before increasing the number of commissioners.

5.23 Clearly, before expanding the number of commissioners, significant strengthening of IAB is needed to increase the commissioners' productivity. This would involve strengthening the investigation unit and the HR unit, increasing the staffing of the support team, and organizing careful monitoring. TA should be provided either on a permanent or semi-permanent basis (with regular missions if it is difficult to attract high-quality TA to be based in Afghanistan) in order to facilitate dissemination of best practices in recruitment processes, coaching of commissioners, training in HR issues, etc.

## **SHOULD RECRUITMENT PROCEDURES BE TIGHTENED TO REDUCE PATRONAGE AND MINIMIZE RISKS OF CORRUPTION?**

5.24 A first set of recommendations includes: (1) systematic monitoring; (2) coaching of commissioners by an experienced foreign consultant on HR issues and selection processes; (3) use of a dedicated hot line for corruption complaints; (4) encouragement to ministries to file log books describing the selection processes and noting proper or improper behavior of participants; (5) systematic investigation of doubtful cases; and (6) eventually random monitoring of commissioners' performance by a consultant specialized in HR.

5.25 A second set of recommendations would require the presence of two (and not one) commissioners at each interview panel as specified in the civil service law. The related reduction in IAB's processing capacity should be addressed through productivity improvements resulting from an increase in the number of support teams, increased staffing in the investigation and HR units, better reference checks, better overall organization, and better logistics (transport etc.).

5.26 A third set of recommendations is to appoint commissioners for an 18-month term renewable once, to avoid sinking into routine and loss of dynamism. Commissioners should be frequently rotated and, contrary to present practice, should never specialize in appointments in a given ministry so as to limit the risk of corruption. Commissioners should be assigned sometimes at the last moment to specific interview panels to disrupt any attempts at pre-arranged corruption. Systematic investigations should be conducted whenever there is suspicion of corruption on the part of a commissioner, and strong administrative or legal actions implemented if corruption cases are proven.

## **HOW SHOULD THE HIGH-LEVEL TECHNICAL EXPERTS BE SELECTED?**

5.27 The lack of technical expertise in the pre-screening process is a serious issue for jobs involving a technical dimension. A key concern is that while this issue is emphasized by the line ministries, it is not recognized by the IAB commissioners. The latter do not appear to understand that senior technical staff need to be screened by technical experts. Since there is no pre-screening of applicants by technical commissions or technical boards, the recruitment process for senior technical positions is definitely inadequate.

5.28 Among possible options are: (1) preparation of a set of technical questions by technical ministries or experts, to be responded to in writing by the candidates at the time of the interview; and (2) the establishment of a roster of local technical experts (about a dozen, covering key fields from civil engineering to accounting and financial management etc.), and associating such specialists as consultants at least for the pre-screening of candidates for jobs with a technical dimension (on the basis of written questions).

## **HOW SHOULD THE PROBLEM OF INCUMBENT STAFF RESISTING USE OF THE MERIT-BASED APPOINTMENT PROCESS BE ADDRESSED?**

5.29 IAB's normal procedures have been deliberately distorted by ministries in various ways to favor incumbents and avoid recruitment of external candidates. However, indiscriminate use of superficially merit-based appointments could lead to a serious and unjustified loss of administrative expertise, while generating considerable anxiety and stress among civil servants.

5.30 Although one of the purposes of merit-based selection has been to attract new staff into the civil service, expectations in this regard sometimes may have been overly ambitious. First, a

massive influx of new staff without prior administrative experience can be disruptive. Second, the poor performance of many senior staff is due to a dysfunctional environment; with the right incentives and organizational set-up they should be able to perform better. Third, a large number of incumbents just need adequate training; thus it would be unfair, contrary to Afghan culture and values, and inefficient to dismiss them, particularly on the basis of a very superficial interview.

5.31 Inadequate job descriptions and poor selection criteria are obvious flaws in the present recruitment process. In a context where most ministries have not done a proper analysis of their basic missions and related human resource needs, the best selection process is powerless. The basic recommendation is that appointments for poorly documented positions should be put on hold until satisfactory and convincing documentation has been provided. This argues for a careful progression in the merit-based appointment process for senior positions and avoidance of hasty across-the-board implementation of the Pay and Grading reform.

#### **HOW SHOULD SYSTEMATIC PERFORMANCE EVALUATION BE DEVELOPED?**

5.32 It is of the utmost importance to complement the merit-based appointment process with a serious performance evaluation mechanism. IARCSC has devoted time and effort in this respect, but more certainly more needs to be done. In this context, IARCSC should focus its efforts on providing adequate support and know-how to HR units of line ministries, which have the primary responsibility for conducting such performance evaluations and for taking remedial action when needed.

5.33 MRRD has, for instance, built up its HR capacity and is conducting systematic performance evaluations; it is also taking remedial actions when needed by dismissing under-performing staff. However, MRRD is an exception. Such performance evaluations require that missions, goals, and objectives have been clearly specified from top to lower levels, which is seldom the case in Afghanistan's ministries. The establishment of performance evaluation systems is all the more important since this is a key element for judging the performance of the incumbent staff, devising appropriate training programs to improve their performance, and avoiding unnecessary wholesale new recruitments, which may put excessive stress on existing institutions and lead to loss of administrative know-how.

#### **SHOULD POLITICAL APPOINTMENTS BE MORE STRICTLY LIMITED?**

5.34 Excessive rigidity and ambitions for merit-based appointments in Afghanistan may undermine the political acceptability of the whole process. For instance, it is clear that the President's office should benefit from some flexibility in its recruitment criteria, since political considerations and loyalty are a primary issue there. Ministers and deputy ministers should also be free to select as they wish their closest assistants without unnecessary IAB involvement (from secretaries to a few senior aides on a short-term contract basis).

5.35 Further discussion is required to assess which positions (such as district governors) should be defined as political appointments and as a result should not be subjected to the IAB appointment processes. In this respect, at least for the time being, it may be better to have a fairly broad understanding (but a clarified one) of which would be politically appointed positions, rather than to try to strictly limit the number of these positions. Designation of such "political" positions also should be accompanied by a minimum degree of transparency in the recruitment of political appointees, most likely based on the principle of appointment from specified short-lists. In this regard, the vetting process for political appointments which has been established (but which apparently is not yet functioning) is important.

## **HOW MUCH EMPHASIS SHOULD BE PUT ON MERIT-BASED APPOINTMENTS AT SUB-NATIONAL LEVELS?**

5.36 Given the resistance still encountered at the central level against implementation of merit-based appointments, IAB's mixed record, and the huge needs in the provinces for better public services, it is advisable to: (1) significantly step up the merit-based appointment process in the provincial governor's offices, at least where there is understanding and support for the process, and (2) also step up the appointments at sub-national level for ministries which have already done a proper job in terms of clarifying their missions, defining adequate organizational structures, and strengthening their HR capacity.

5.37 In this context, more responsibility should be entrusted to decentralized appointment processes, relying on provincial committees whose selection skills and HR knowledge should be enhanced through adequate training. The Ministry of Education, for instance, is decentralizing the appointment of teachers, a process which formerly was completely centralized. IARCSC is presently strengthening its capacity to provide support to decentralized merit-based appointment efforts, and this should be encouraged.

### **D. Conclusions**

5.38 Full establishment of merit-based appointments is a long and difficult process. Criticisms, weaknesses, and problems discussed in this chapter should not be perceived as an overall failure of the merit-based appointment process in Afghanistan. Rather they reflect the difficulties and challenges faced by IARCSC. In terms of institutional and capacity development, and starting from a very low base, Afghanistan's progress has been remarkable. However, more progress is needed to address weaknesses and to firmly establish an efficient, fair, and well-accepted mechanism. Overly ambitious expectations and demands have been put on a system which requires time, regular adjustments, money, and constant political support (all elements which have been somewhat missing in Afghanistan) to establish firmly its credibility and its effectiveness. Since credibility is a critical issue in this area, determined and fast action is recommended to address the identified weaknesses.

5.39 It is necessary to be careful not to overload the existing institutional system with excessively ambitious quantitative targets. The recommendations in this report strive to address weaknesses in the appointment process as well as to limit the risks of corruption. However, the search for quality will also make the existing quantitative processing bottlenecks more severe. In this context, any attempt to quickly process very large numbers of appointments would most likely overload the system and prevent it from making the needed adjustments to drastically improve its quality as required. It makes little sense to try to establish quantitative objectives if the result is likely to be a breakdown in quality. Such an outcome would jeopardize the whole merit-based program and lead to questioning of the justification for a process which would in reality become a mechanical bureaucratic exercise.

5.40 Based on the findings and recommendations of the VCA on merit-based appointments in the civil service and extensive internal consultations subsequently, IAB and IARCSC developed a detailed Action Plan consisting of short-term and longer-term measures to improve the merit-based appointment process. This Action Plan is shown in Appendix 5.1. Based on a subsequent review conducted six months later, the actions already taken in the initial six months also are included, as well as outstanding decisions still to be made at that time.

**Appendix 5.1: Action Plan for Independent Appointments Board: March 2007 – March 2010**

Area for Improvement	Short-term Actions (next 8 months)	Action taken so far	Longer-term Actions (8 months to three years)	Decisions to be Made
<i>Identification of vacant positions</i>	<ul style="list-style-type: none"> <li>• Review template for ToR (including job description, selection criteria and eligibility criteria).</li> <li>• Introduce system to check job description including grading against approved tashkeel with PAR Implementation Dept (CSMD).</li> <li>• If ToR is weak, put application on hold pending discussion with relevant ministry and redrafting of ToR to required standard.</li> </ul>	<ul style="list-style-type: none"> <li>• This has been improved although there are still significant problems with ministry capacity This is now in place</li>   <li>• This is now the usual practice</li> </ul>	<ul style="list-style-type: none"> <li>• Introduce a method of uniquely identifying posts with PAR Implementation Dept (CSMD).</li> <li>• Develop a simple computerized management information system to track progress on each application.</li> <li>• Ensure that the development of a comprehensive HRMIS takes into consideration needs of IAB.</li> <li>• Develop plan to better engage in systematic dialogue with ministries to clarify needs, job descriptions and selection criteria.</li> <li>• Support the establishment of HR units in ministries to process junior appointments.</li> </ul>	
<i>Advertisement of vacant positions</i>	<ul style="list-style-type: none"> <li>• Ensure advertisements are sufficiently detailed, including those for provincial level positions.</li> <li>• Frequently update website with new advertisements.</li> <li>• Develop and implement plan for outreach for advertisements depending on position (center, provincial, district) to ensure geographical reach as well as to different sections of society (e.g. relating to gender, ethnicity).</li> <li>• Explore options for contracting out advertisement of positions.</li> </ul>	<ul style="list-style-type: none"> <li>• Advertisements is first made through a newsletter for the dissemination to the six regional offices, additional advertisement is disseminated through the local media (radio and eventually TV)</li> </ul>		

Area for Improvement	Short-term Actions (next 8 months)	Action taken so far	Longer-term Actions (8 months to three years)	Decisions to be Made
<b>Selection procedures (including pre-screening and short-listing)</b>	<ul style="list-style-type: none"> <li>• Introduce system of initial check by ‘Vetting Section’ to see if information provided on application form meets minimum entry requirements.</li> <li>• Review requirements and improve procedures for pre-screening and short-listing of candidates (including more thorough reference checks including from previous/current employer, verification of educational certificates, health check, preliminary interviews of candidates by senior technical staff of IAB (Experts).</li> </ul>	<ul style="list-style-type: none"> <li>• The investigation committee has been beefed up from 3 to 7 members. This committee checks education backgrounds and reliability of documents. It conducts a reference check with the present employer. It checks that the candidate does not have any criminal engagement.</li> <li>• The committee is preparing the short list but is not involved in the interview.</li> <li>• If the number of candidates is more than 5, a prescreening test will reduce it to a manageable group of three to four candidates for the interview.</li> <li>• A form has been developed to help the short listing process.</li> </ul>	<ul style="list-style-type: none"> <li>• Deconcentrate the selection processes at IARCSC regional offices for provincial level appointments.</li> <li>• Review structure and increase staffing levels of IARCSC regional offices for deconcentration.</li> <li>• Ensure short-list panel includes one Commissioner, one Expert and one Ministry representative or whenever possible two commissioners.</li> <li>• Development and implement short-term capacity development training modules to Commissioners, Experts and Ministry panel members on different aspects of selection procedures including pre-screening and short-listing.</li> </ul>	<ul style="list-style-type: none"> <li>• Identify stages of selection process that should be deconcentrated: <i>Senior IARCSC staff (end-2007)</i></li> </ul>
<b>Interview/final selection</b>	<ul style="list-style-type: none"> <li>• Selection of interview questions from database to be made jointly by all panel members (including ministry representative) just prior to interview. Interview question to be based on selection criteria.</li> <li>• Interview questions criteria based and greater focus on what candidate has done rather than how s/he would complete a task.</li> <li>• Balance between behavior-based and knowledge questions.</li> <li>• Same set of questions for a position to be asked of all candidates.</li> <li>• Design of form with selection criteria which can be distributed to each panel member to allowing ranking of the candidate.</li> </ul>	<ul style="list-style-type: none"> <li>• The ministry representative is present from the short listing to the final selection process.</li> <li>• The questions are selected jointly with the ministry representative one hour before the interview.</li> <li>• The questions are more pragmatic and job related than academic and descriptive.</li> <li>• Out of the standard 10 questions, four are to be answered in writing and six orally. The same set of questions is asked to all the short listed candidates for a specific position.</li> </ul>	<ul style="list-style-type: none"> <li>• Review possibility of regular rotation in assignments of IAB Commissioners including different Commissioners for short-listing and interview stages.</li> <li>• Ensure interview panels include at least one Commissioner, one Expert and one Ministry representative.</li> <li>• Identify and appoint a roster of high-level Afghan technical specialists who can be called upon for advice, pre-screening or highly technical interviews.</li> <li>• Development and implementation of short-term capacity development training modules for Commissioners, Experts and Ministry panel members on different stages of interview/final selection including interview techniques.</li> </ul>	

Area for Improvement	Short-term Actions (next 8 months)	Action taken so far	Longer-term Actions (8 months to three years)	Decisions to be Made
	<ul style="list-style-type: none"> <li>• Scoring of candidates to be done individually by each panel member, not in consultation with other members.</li> <li>• Detailed record of interview process taken, including what interviewers and candidates have said.</li> <li>• Detailed record to be signed by panel members and interviewee.</li> <li>• Development of procedures based on a more detailed review of the evidence for final selection decision in the event of a tie.</li> </ul>	<ul style="list-style-type: none"> <li>• The oral responses are recorded by an expert during the interview and at the end the incumbent reads the answers, signs off and endorses the accuracy of the record of the oral responses.</li> <li>• A scoring sheet has been developed and each interview panel member grades individual candidates. the final result is the arithmetic average of the individual grades.</li> <li>• All members sign off on the final selection and the documents are kept in the applicant's files.</li> </ul>		
<i>Appointment</i>	<ul style="list-style-type: none"> <li>• Develop plan to simplify (including reduction in number of signatories) confirmation process at OAA and the Office of the President.</li> </ul>	<ul style="list-style-type: none"> <li>• Number of signatory has not been reduced but discussion has taken place with the OAA to clarify its role so that it no longer is involved in the selection process.. The situation has improved.</li> </ul>	<ul style="list-style-type: none"> <li>• Simplify (including reduction in number of signatories) the confirmation process at OAA and the Office of the President.</li> </ul>	<ul style="list-style-type: none"> <li>• Adoption of plan to simplify confirmation process: <i>OAA/Office of the President (end-2007)</i></li> </ul>
<i>Monitoring of Junior Appointments</i>	<ul style="list-style-type: none"> <li>• Role of monitor (observer only) should be clarified to all ministries and agencies.</li> </ul>	<ul style="list-style-type: none"> <li>• Monitoring of the junior position has improved drastically. The monitoring department has been boosted from 6 to 20 staff.</li> <li>• The monitors participate in the selection panel of the ministries and now all the recruitment committees follow the process adopted for high level positions by IAB</li> </ul>	<ul style="list-style-type: none"> <li>• Increase staffing levels of IARCSC regional offices for adequate monitoring of provincial level appointments.</li> </ul>	



Area for Improvement	Short-term Actions (next 8 months)	Action taken so far	Longer-term Actions (8 months to three years)	Decisions to be Made
		<ul style="list-style-type: none"> <li>• A form has been developed to give the number recruited daily segregated by sex and education</li> <li>• Regular and periodic reports are prepared and submitted to the ARS</li> </ul>		
<i>M&amp;E</i>	<ul style="list-style-type: none"> <li>• Weekly business reporting outlining status of appointments to commence again.</li> <li>• Quarterly analytical reports to be submitted to ARS and progress presented to PAR Steering Committee.</li> <li>• Annual report to continue to be produced.</li> <li>• Monitor outreach of advertisements.</li> </ul>	<ul style="list-style-type: none"> <li>• The annual M &amp; E report has been prepared and improved in term of statistical data and will soon be published.</li> </ul>	<ul style="list-style-type: none"> <li>• Implement monitoring mechanism to assess in terms of quantity and quality processes and outcomes of merit-based senior appointments.</li> <li>• Development and implementation of a mechanism for monitoring of junior appointments.</li> </ul>	
<i>Communication/Public Awareness</i>	<ul style="list-style-type: none"> <li>• Public statement from the President denouncing political interference in the merit-based appointment process.</li> <li>• Develop and implement a plan to communicate senior merit-based appointments procedures across the civil service, including at sub-national level.</li> <li>• Develop with the support of the ARS, a country-wide communication campaign to explain the stakes and challenges, merit-based appointment being a cornerstone of the state-building agenda and of the modernization process.</li> <li>• Publication and dissemination of Annual Report.</li> </ul>	<ul style="list-style-type: none"> <li>• ESLAHAT biweekly publication is disseminated to inform the civil servants on the PAR and IAB policy and procedures.</li> <li>• Radio spots to introduce IARCSC and IAB are on the air.</li> <li>• Work is completed for the TV spots for the same purpose.</li> <li>• The communication department capacity has been improved through ASGP of UNDP and also the WB CSR project and the lateral entry project.</li> <li>• The communication director post has been advertised twice. A new candidate has been interviewed on 4 Nov-07.</li> </ul>	<ul style="list-style-type: none"> <li>• Implement country-wide communication campaign plan.</li> <li>• Official and public confirmation by the President that all civil service appointments must be in line with the Civil Service Law.</li> </ul>	

Area for Improvement	Short-term Actions (next 8 months)	Action taken so far	Longer-term Actions (8 months to three years)	Decisions to be Made
<b>Capacity Development/ Training</b>	<ul style="list-style-type: none"> <li>Development of initial priority training programs based on recommendations of review (TA to be provided to support this).</li> </ul>	<ul style="list-style-type: none"> <li>The training of the four remaining commissioners is on going through support of MCP project of UNDP. A coach is working with the commissioners to build their capacity.</li> <li>Four newly appointed commissioners are under an introduction training designed by IAB experts.</li> <li>Moreover through WB bridging support an HR specialist work long term to build the IAB capacity for the implementation of Pay and grading challenges.</li> </ul>	<ul style="list-style-type: none"> <li>Develop and implement a comprehensive capacity development program (including delivery of an extensive and ‘continuous learning’ training and skills development program) to increase capacity of Commissioners (including on criteria based appointments); training will also be provided to Ministry representatives and Secretariat staff.</li> <li>Training workshops to be conducted for HR staff working in line ministries on HR policies.</li> <li>Organize study tour for Commissioners and Experts.</li> </ul>	
<b>General</b>	<ul style="list-style-type: none"> <li>Develop a realistic 3-year work-plan following finalization of the P&amp;G Implementation Plan. Focus should be on priorities in merit-based appointments and quality appointments rather than achieving unrealistic quantitative targets.</li> <li>Establish mechanism to record accusations of improper behavior and/or corruption.</li> </ul>	<ul style="list-style-type: none"> <li>Generally the board has developed the required processes and procedures and built the required trust and confidence. IAB is in the learning curve.</li> <li>With the support of the HR specialist they would revise and refine existing plans taking the past experience and current challenges.</li> </ul>	<ul style="list-style-type: none"> <li>Re-clarification by Cabinet as to which positions are political appointments (possible expansion of the scope of political appointments may be required to facilitate political acceptance of merit-based appointment e.g. in OoP and aides to Deputy Ministers and Ministers).</li> <li>Develop process to investigate thoroughly accusations of improper behavior and/or corruption.</li> </ul>	<ul style="list-style-type: none"> <li>Re-clarification of political appointments: <i>President (end-2007)</i></li> </ul>
<b>Staffing</b>	<ul style="list-style-type: none"> <li>Establish clear and robust selection criteria for Commissioners.</li> <li>Appoint new temporary Commissioners (in line with revised selection criteria).</li> <li>Review salary scale for Commissioners based on comparators e.g. election or human rights commissioners and in line with revised, more robust selection criteria and discuss proposed increases with MoF.</li> </ul>	<ul style="list-style-type: none"> <li>Work has not been done on this and needs to focus on the issue. The appointment of commissioners should be under close monitoring. Efforts to build their capacity are prime for the IAB success.</li> </ul>	<ul style="list-style-type: none"> <li>Progressively terminate Commissioners with inadequate profile and experience.</li> <li>Extension of Commissioners’ contracts coming to term for no more than 6 months.</li> </ul>	<ul style="list-style-type: none"> <li>Adoption of selection criteria for Commissioners: <i>(technical panel to develop criteria on the basis of CSC proposals)</i></li> </ul>

Area for Improvement	Short-term Actions (next 8 months)	Action taken so far	Longer-term Actions (8 months to three years)	Decisions to be Made
	<ul style="list-style-type: none"> <li>Increase staffing of Experts and administrative staff of Secretariat to increase capacity for pre-screening, short-listing and general filing and administration through expanded tashkeel, LEP/MCP, etc.</li> </ul>	<ul style="list-style-type: none"> <li>A change in the salary scale has been proposed and has been endorsed by ministry of finances.</li> <li>The board has proposed 15 additional staff for the different committees, and this proposal was approved to be included in the mid year review of Tashkeel. This decision has not materialized yet.</li> <li>The board is thinking of having ten interview committee and additional monitoring and investigation committees to support the interview committees and proposes 7 to 9 national consultants to work with the committees for the improved processes..</li> </ul>		<ul style="list-style-type: none"> <li>Appointment of new temporary Commissioners: <i>President and new specialist panel for political appointments (Oct-2007)</i></li> <li>Adoption of revised salary scale for Commissioners: <i>Chairman IARCSC and Ministry of Finance (Octo-2007)</i></li> </ul>
<b>Budget</b>	<ul style="list-style-type: none"> <li>Develop case for separate budget line for IAB and increased budget to provide support for candidates from provinces (lodging and per diem) for the mid-year budget review.</li> <li>Develop clear procedures (including reimbursable expenditures) for provision of support for candidates from provinces.</li> </ul>	<ul style="list-style-type: none"> <li>The formation of expert committee for the selection of high technical positions and the bringing candidates from the provinces need additional resources if we want to improve the situation of merit based appointments.</li> <li>The process has not started yet.</li> </ul>		<ul style="list-style-type: none"> <li>Separate budget line and increased budget for IAB: <i>IARCSC to present case to MoF (Oct-2007)</i></li> </ul>
<b>Physical</b>	<ul style="list-style-type: none"> <li>Identify additional office space for IAB given significant expansion in staffing.</li> </ul>	<ul style="list-style-type: none"> <li>As the size of the institution is growing we have been under a huge pressure regarding office space.</li> </ul>	<ul style="list-style-type: none"> <li>Put in place additional office space to meet needs.</li> </ul>	



## 6. THE ROAD SECTOR<sup>1</sup>

### A. Introduction

6.1 Afghanistan is a landlocked country, and roads are the principal means for domestic and international transportation. For the government and the international community, the reconstruction/rehabilitation of the road network has been among the country's top development priorities since 2001. An effective, reliable, and modern road network can serve poverty reduction by supporting improved efficiency of agriculture and industries, facilitating cross-border trade, and contributing to economic integration of the region.

6.2 Afghanistan has a total road network of nearly 34,000 km, the vast bulk of which are provincial and rural roads, often of very low quality. Roads have been classified into four types based on their purposes and standards. The functions of each type of road are as follows (see also Table 6.1):

- Regional Highways: to form a complete “ring road” connecting major urban centers in the country as well as principal road links with neighboring countries (Iran, Pakistan, Tajikistan, Turkmenistan and Uzbekistan);
- National Highways: to promote internal trade and economic linkages and extend Regional Highways to provincial capitals;
- Provincial Roads: to improve trade and economic contacts between district headquarters and respective provincial capitals; and
- Rural Roads: to bring the hinterland into commercial contact with markets.

**Table 6.1: Road Network Classification**

Classification	Responsibility	Total Length (km)	Under construction	Remaining Length
			or committed length (km)	(km)
Regional Highway	MPW	3,242	3,134	108
National Highway	MPW	4,884	3,049	1,835
Provincial Road	MPW	9,656	1,000	8,656
Subtotal		17,782	7,173	10,599
Rural Road (Est.)	MRRD	17,000	n.a	n.a
<b>Total</b>		<b>34,782</b>	-	-

Source: JICA (November 2006).

6.3 The administrative structures responsible for the road sector are scattered among different ministries, and there is no high level authority for coordinating and monitoring the sector as a whole (Table 6.2).

6.4 The opportunities for corruption are great in Afghanistan due to the large influx of donor money for road construction/rehabilitation in a situation lacking adequate institutional and human capacity and necessary public oversight and monitoring mechanisms. Spending on road projects has been the second highest after the security sector. The cost of the current major road reconstruction investment program is estimated at more than US\$1.3 billion. Funding of road

<sup>1</sup> This summary is based on the Vulnerabilities to Corruption Assessment (VCA) for the Road Sector. This was conducted by the Asian Development Bank in close collaboration with the Ministry of Public Works and the findings are detailed in the report entitled “Vulnerability to Corruption Assessment (VCA) for the Road Sector of Afghanistan (2008)”.

projects has been mainly provided by donors in the form of grants and loans through both the Core Budget and the External Budget. Donors directly finance, carry out the procurement and implementation arrangements of road projects in the External budget. In SY1385 (2006/07), about 60 percent of road construction and rehabilitation funds were executed outside the Government budget.

**Table 6.2: Ministries Involved in the Road Sector**

<b>Ministries</b>	<b>Responsibilities</b>
Ministry of Public Works	Managing road assets involving planning and budgeting of maintenance, rehabilitation and construction, supervision, monitoring, accounting and auditing of donor financed projects.
Ministry of Rural Rehabilitation and Development (MRRD)	Rural roads providing access to markets and other social services. The lines of authority between MRRD and MPW are unclear.
Ministry of Urban Development and the Municipalities	Construction and maintenance of all city roads except for the roads in Kabul Municipality
Ministry of Finance	Collecting fees from road; involved in approval of awarding of contracts, as part of commission; and responsible for releasing payments to construction firms after their work/services have been completed.
Ministry of Foreign Affairs	Issuing “road passes” for foreign registered commercial vehicles.
Ministry of Commerce and Industries	Issuing and renewing domestic and foreign business licenses, including all commercial licenses for companies, individuals, transit and forwarding passes, and cooperatives.
Ministry of Economy	Procurement Unit of the Afghanistan Reconstruction and Development Services (ARDS) under the Ministry of Economy assists MPW in the selection of Consultants and procurement of Civil Works under externally funded projects.

6.5 These vulnerabilities to corruption assessment (VCA) focuses on the highway network (the first two categories of roads in (Table 6.1) and associated large projects. Risks of corruption are also present in the case of secondary, tertiary, and rural roads (the last two categories) but there are some differences in the vulnerabilities and the mitigation measures called for. These latter types of roads are not included in this VCA.

## **B. Forms of Corruption and Key Vulnerabilities**

### **FORMS OF CORRUPTION**

6.6 Projects in the road sector are vulnerable to corruption because of their size, complexity, and costs. Most large road projects are one-off projects tailored to particular terrain and hence not subject to standardized costing, opening opportunities for corruption and inflating costs. Some forms of corruption in the road sector include:

- Leaking of bid/tender information to contractors for a bribe; contractors submitting false claims which are approved in exchange for bribe; or release of a payment in return for a bribe. Usually a third-person—a “commission-taker”—facilitates the process.
- Awarding of work contracts to construction firms owned by power-holders;
- A procurement officer may use deception by providing false (incomplete) information to one bidder in order to speed up the payment of a bribe for a competing bidder; and
- Preference for a bidder of a certain region or ethnicity regardless of their qualifications and previous employment background by both the donor community and the Government.

## VULNERABILITIES

### Organizational Structure of the Ministry of Public Works

6.7 The current organizational structure of the MPW is not suitable for its current mandate. Lines of authority from all departments are linked to the advisors not the deputy ministers. Key monitoring bodies such as the audit office and monitoring do not report directly to the Minister. In terms of increasing the accountability and transparency of the MPW, the audit office of the ministry and the project management department can play vital roles in ensuring that good quality roads are built based in a cost effective manner. However, these suffer from capacity constraints (like many other departments).

### Public Finance Management

6.8 **Capacity constraints:** The MPW does not have the capacity to effectively supervise construction work, design new projects, or maintain existing roads. Capacity constraints do not directly cause corruption but they can allow corruption not to be detected and thus facilitate corruption to be sustained. The MPW is not responsible for actual construction activities, but for supervisions. Due to the weak capacity the supervision function of the ministry is outsourced to private firms. These are basically international private companies selected through tendering process. However, as there are only limited numbers of companies involved, there are risks of collusion with constructors. Moreover, although there is supervision procedures in the MPW, implementations are weak due to capacity constraints.

6.9 **Weak/non-existent external scrutiny and audit:** External monitoring and evaluation of road projects are not properly carried out. The capacity of the CAO (Controller and Auditor General's Audit Office) is weak and its focus is limited to basic financial audits of annual accounts. The government's main anti-corruption institutions such as GIAAC (General and Independent Administration of Anti-Corruption and Bribery) and the AGO (Attorney General's Office) lack the capacity and formal procedures for investigating allegations. The Ministry of Economy is responsible for monitoring and evaluation of all development projects, but the Ministry has not monitored or evaluated any road projects. The oversight procedures of parliament have not been formally established. Sector-specific oversight committees (economy, infrastructure, anti-corruption) have been established but due to the weak technical sector specific knowledge, the members of these committees may not have the necessary degree of competence.

6.10 **External Budget:** The implementation and procurement of road projects funded by the External Budget are based on donor specific regulations without adequate involvement of the MPW. This leads to great variation in the final quality and unit cost of many roads. Once construction/rehabilitation projects are completed, the MPW becomes responsible for the operation and maintenance of these roads. Weak collaboration between donors and the government on road projects does not necessarily cause corruption but reduces the overall transparency of the whole process.

### Project Cycle: General

6.11 Within the project cycle (shown in Table 6.3), procurement, project monitoring, and payments are especially vulnerable to corruption. The number of bidders is limited and bid prices are often far in excess of the estimated costs. The capacity of the private sector for project implementation is currently limited and thus also affects the procurement process adversely. Furthermore, the procurement process is complex. The extremely weak oversight capacity during

the implementation stages contributes to the construction of bad road with high costs. The quality of contractors and consultants bidding for jobs does not often reach the minimum standard necessary to undertake the work. In addition to an overly bureaucratic procurement process and extremely weak project monitoring capacity in the MPW, the payment process is perhaps unnecessarily complicated. Insecurity is a factor in the procurement process as contractors must include their security costs in their bids. The implication of the new tax law for contractors and consultants is creating problems as some are refusing to pay the taxes which are required, thus leading to an overall reconsideration of the contract award. The existing system suffers from poor financial and records management systems, which also opens up opportunities for corruption.

**Table 6.3: Key Processes of a Road Project Cycle**

<b>Process</b>	<b>Primary Stakeholder(s)/Agencies</b>
1 Identification of Road Rehabilitation/Construction Site	MPW
2 Pre-Feasibility Study	Donors
3 Feasibility Study	Contractor
4 Final Engineering Design	Contractor
5 Procurement	ARDS PU, MPW, MoF
6 Implementation	Contractor, Consultant, MPW
7 Quality Control	Consultant, MPW
8 Payment	MoF, Donors

Procurement

6.12 **Bidders’ Collusion:** The main cause is the limited numbers of construction firms bidding for a given number of road projects. The bidders can collude with each other to share the market (“pooling”), leading to an increase in the price of a project and/or agree with each other on a “losers’ fee” arrangement. For example, each bidder includes in their price a fixed sum representing the estimated aggregate bid costs of all the bidders. The winner then divides this fixed sum equally among the losers. Another arrangement is that bidders make an arrangement where each bidder has an opportunity to be awarded a project.

6.13 **Capacity Constraints** and the lack of a developed institutional structure provide opportunities for a bidder to influence the procurement procedures. A five or six member committee is set up by the Minister (or Deputy Minister) who decides on the evaluation of bidding documents and the award of contracts. The members of the Committee are usually the heads of the various departments of the ministry. The Committee does not operate during the implementation stage of the project. The capacity of the Committee reportedly has been weak, causing delays in the procurement process and opportunities to be influenced by bidders and others.

Bribing for Contract Awarding includes:

6.14 **Front Companies:** Despite strict selection criteria, front companies (both national and international companies with no prior history or ownership records or hidden owners) may be awarded contracts based on connections to influential individuals.

6.15 **Sub-contracting:** Sub-contracting also may disrupt the accountability chain of the project. Several levels of sub-contracting increase the project cost as each contractor takes a percentage of the price of the project as overheads. Furthermore, bribery in multiple layers of sub-contracting may be facilitated and further increase costs.



6.16 **Security Constraints:** Especially in the East and South, lack of security constitutes a major constraint on monitoring projects and allows lack of transparency on certain expenses. The need for a range of temporary security arrangements during a road project generates many contracts, payments, employment requirements, and associated opportunities for corruption.

#### Construction and Quality Control

6.17 The implementation of a road project also generates vulnerabilities due to weak monitoring and oversight of the daily work of contractors and consultants; tolerance on the part of government officials with respect to faulty work; and lack of effective mechanisms for punishing the corruption of contractors and officials. An enormous dependence is placed on supervision consultants who must certify the correctness or quality of work before it is no longer observable. It has been reported that collusion between the contractors/sub-contractors and supervision consultants provides opportunities for bribes. Some examples of corruption during the construction phase of roads projects include:

- Irregular variation of contracts such as costs, specification, and scope of work without the requisite approvals by the responsible authorities;
- Poor quality of work undetected by a weak quality control set-up;
- Involvement of a large number of subcontractors, which makes monitoring more difficult; and
- Use of sub-standard materials, which results in poor quality and durability of roads.

6.18 Completions of road projects require government confirmation and approval. Government officials may accept roads which are not constructed according to the specifications in the agreed contract. Furthermore, adequate punitive measures are not in place to discourage a corrupt contractor from engaging in corruption. For example, despite use of the “black-listing” method for non-performing contractors, it is reported that few large companies are actually black-listed and many of the contractors with bad records were given new contracts for other road projects.

#### Payment Process

6.19 Vulnerabilities to corruption in the payment process stem from two types of interactions; (i) between contractors/sub-contractors, consultants and ministry staff, and (ii) contractors and Government officials. The process of payment and disbursement starts with submission of invoices from the contractor, which is followed by due diligence by the supervising consultant to certify quality and quantity of work. A consultant may accept a bribe or engage in kickbacks from contractors for certifying too much work and/or approving defective and non-existent work (for example, for signing off on falsified timesheets for work that was not completed or attempted).

6.20 There are many steps that a contractor needs to follow in order for his/her payment to be released. Each step of the process may involve negotiation between the contractor and the Government official. Government officials may use false claims or delay the process in order to negotiate a bribe. The process should take one day but it often takes more. The stage of a contractor receiving payment is highly susceptible to financial corruption usually in the form of petty corruption.

### **C. Key Recommendations**

6.21 Considering the very large amounts of financial resources invested in the construction and rehabilitation of roads in Afghanistan, it is very much in the interest of both the government and

donor community to increase efforts to ensure that the road investments are properly managed and executed, while enhancing integrity and reducing vulnerabilities to corruption in the key processes.

## **CAPACITY BUILDING**

6.22 Major capacity development is needed in order for the MPW to effectively and efficiently perform its functions. The required capacity building at the MPW should be much more than just training. Management capability should be enhanced and overall organizational capacity built, with priority given to providing capacity training in the areas of contract management, supervision of contractors and consultants, internal auditing and monitoring of road projects; engineering design, and supervision capacity. Experts/consultants should be placed at the department level working with Afghan officials and making available their work output in local languages; during projects and engineering stages, local staff should work with international consultants on the design of roads, bridges and other structures.

## **ORGANIZATIONAL STRUCTURE OF THE MPW**

6.23 Restructuring of the ministry to make it better able to efficiently and effectively perform its regulatory role; the policy and planning department should be divided into four sections: planning, procurement, contract administration and financial management and funding arrangement; Contract administration requires high-level engineering skills to check Interim Payment Certificates (IPC) of supervision consultants and undertake site visits; There is scope to realign the records management department to make it lean and efficient and transfer resources to other departments.

6.24 Business procedures need to be improved, with areas of focus involving establishing procedures of the selection of the review committee, which is in charge of review and selection of contractors; establishing internal accountability mechanisms, administrative structures and processes; and core functions the procedures.

6.25 The donor community and the Government should examine a feasible way for gradually integrating the PIUs (Project Implementation Units) into the ministry structure in a manner whereby these units are still effectively and efficiently functioning but are also contributing directly to the capacity of the ministry staff. PMUs/PIUs shouldn't be covering only a specific donor's projects but should be handling a variety of different projects and should be integrated in the line ministry. In addition, PIUs should be merged with the policy and planning department, with two major functions—namely contract administration and procurement and financial management;

## **INSTITUTIONALIZE CORRUPTION CONTROL**

6.26 Providing clearly defined purposes and priorities to guide the structures, values, procedures, and conduct of the MPW in support of corruption prevention in road projects is essential. It is imperative to build and retain public trust, and the administrative system should be based on high ethical, behavioral and performance standards. Measures include:

- Establishing contractual anti-corruption commitments between the main project participants to prevent anti-corruption through sub-contracting chain.
- Raising awareness among relevant project staff in which corruption can occur and including about the risks of criminal penalty for involvement in corruption—this can be done through training sessions on anti-corruption rules;
- Developing, enforcement, and monitoring of a code of ethics for ministry staff;

- Strengthening internal compliance auditing and external audit of accounts, with a principal focus on priority corruption risk areas; and
- Effective asset declarations and monitoring for high-level government officials and their family members.

## **PROCUREMENT**

6.27 Although the Procurement Law provides a solid legal framework, the transition from the previous procurement regulations to the new Procurement Law is not yet complete in practice.

- Changing contract designs to performance-based contract design which focuses on the targeted performance required for the business processes and the needs of the users—a step in this direction is for the government to develop project monitoring indicators;
- Developing (harmonization) of design and specification codes and standards;
- Training of government staff in procurement procedures (involvement of the MPW staff in ARDS PU road procurement procedures);
- Mainstreaming of transparency and accountability measures in procurement procedures by involving civil society in the bidding process, publishing of bidding results, black-listing of fraudulent contractors; and developing independent complaints mechanisms to investigate procurement irregularities and to provide the losing bidders an effective way to appeal the decisions made for the bidding.

## **ESTABLISHING TRANSPARENCY MECHANISMS**

6.28 Public scrutiny of road projects is virtually non-existent. Generating demand for accountability in the road sector, with the involvement of the public, civil society, and the media, is crucial. Building the necessary political will against corruption in the road sector may be encouraged by efforts to enhance public awareness and mobilize constituencies of civil society to support anticorruption efforts. Measures include:

- Establishing a process whereby the public can access the performance documents of road projects, audit reports, etc.;
- A reliable system for sharing of reports and audits with the President and the National Assembly should be developed;
- Developing mechanisms to enable civil society to engage in reporting on road projects, procurement and cost status of road projects, etc.; and
- Piloting Construction Transparency Initiative as described below.

## **IMPROVING ACCOUNTABILITY MECHANISMS**

6.29 To ensure accountability of the MPW in regard to the construction of road projects, an explicit governance regime will need to be put in place. The governance regime not only should encompass the new mandate of the ministry, but will also need to put in place mechanisms to prevent, monitor, and deter corruption, as well as the transparency measures mentioned above. Some specific measures include:

- There is a need for an external independent regulatory body linked to the highest level of government as the current system does not work. An independent assessment mechanism should be established whereby an independent third party monitors and reports on the project throughout its life cycle on an on-going basis. Persons of integrity to be appointed to carry out the assessment with direct link to the President or one of the vice-president;

## **D. Conclusion**

6.30 The road sector in Afghanistan is exposed to serious vulnerabilities to corruption given the combination of very large amounts of financial resources for the sector and weak capacity of the Ministry of Public Works. The number of stakeholders involved in the road sector further provides opportunities for corruption.

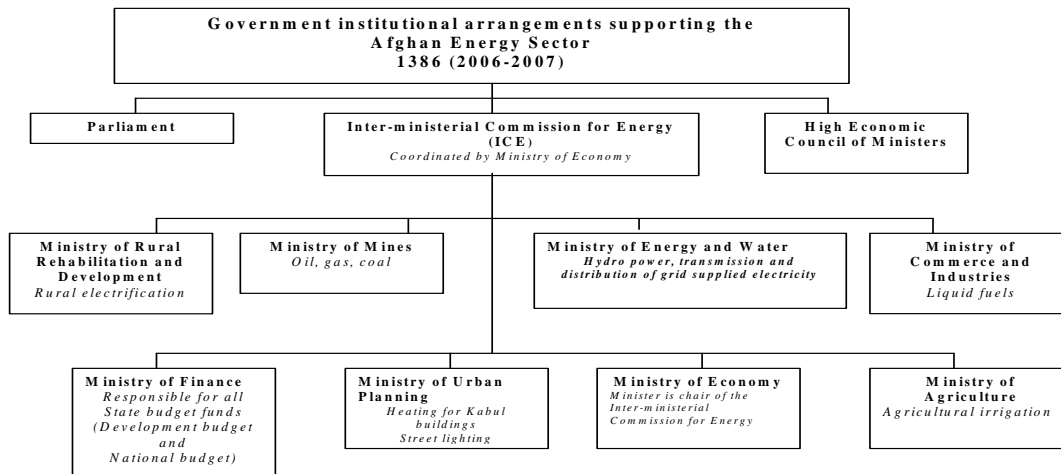
6.31 Possible measures to prevent corruption include, (i) legal framework; (ii) organizational structure; (iii) capacity building; (iv) procurement; (v) corruption control and (vi) transparency mechanism and (vii) accountability mechanism. As donors are heavily involved in the road sector through the external budget, improved cooperation between donors and the government also is essential to implement the corruption prevention measures.

## 7. THE ENERGY SECTOR<sup>1</sup>

### A. Introduction and Background

7.1 Afghanistan's energy sector includes primary resources in the form of natural gas, coal, hydropower, and oil. Electric power in the country is generated by hydel (water) and thermal (diesel, domestic natural gas) means, as well as significant amounts of electricity imported by transmission lines. Nine ministers are members of the Inter-ministerial Commission for Energy (ICE), which is a coordinating and policy formulation body for the energy sector coordinated by the Ministry of Economy (Figure 7.1). In addition, 11 state-owned enterprises (SOEs) exist under different ministries.

**Figure 7.1: Government Framework of Energy Sector**



7.2 Governance arrangements in the energy sector are inherently flawed with respect to supporting an efficient, commercially-oriented energy system. The legacy of Soviet-era central planning in the Afghan energy sector is strong. Government continues to dominate all aspects of sector and policy development, implementation, and management. With regard to the legal framework, the current array of energy sector institutions reflects insufficient policy and functional analysis. As a result, the sector lacks clear operating rules, predictable processes, systematic contracting, procurement, and enforcement, as well as a trained cadre of government officials, enterprise managers, lawyers, accountants, and project finance specialists to implement them.

### B. Forms and Implications of Corruption

7.3 Due to the nascent state of energy sector development and fairly limited and fragmented donor funding that has supported isolated technical rehabilitation works, the energy sector so far has presented less direct opportunities for large-scale corruption. Nevertheless, the scope for such corruption in the energy sector in the future is great, as Afghanistan has significant un-harnessed potential in indigenous energy resources and is geographically well positioned for trade in energy resources with neighboring countries. In the present situation, there are numerous examples of

<sup>1</sup>This summary is based on the Vulnerabilities to Corruption Assessment (VCA) for the energy sector. This was conducted by Asian Development Bank, and the findings are detailed in the report entitled "Transparency and Accountability in Country Partnership Strategy and Program, Afghanistan Energy Sector: Corruption Assessment" (June 2007).

petty bribes and patronage in the energy sector, which are widely perceived to be pervasive and entrenched. There also appears to be corruption on a medium scale where projects and contracts are involved.

7.4 Corruption in the energy sector has significant negative implications, including especially the following: (i) serious adverse effects resulting from institutionalization of corrupt practices; (ii) reduction in public service quality; (iii) leakages and misallocations of public resources; and (iv) aggravating uncertainty for private investors.

#### **SERIOUS ADVERSE EFFECTS FROM INSTITUTIONALIZATION OF CORRUPT PRACTICES**

7.5 In the energy sector, governance arrangements are structurally weak. Decision making occurs on an ad hoc basis. Policy formulation is not transparent or consistent. Donors and private investors are often hindered by dysfunctional institutional dynamics, which results in changed program design, delayed implementation, or stopping of project implementation. The array of institutional and governance arrangements in the energy sector has additional implications for corrupt practices, including the following:

- Priorities for technical improvements are often based on regional managers' relationships with ministries and government personnel responsible for funding;
- Consumer expectations of demands for bribes and tendency to agree to pay bribes for utility services;
- Investor expectations of and tendency to agree to pay bribes, fees, and penalties based on discretionary ministerial and SOE determination;
- Patronage staffing in government ministries and SOEs per each institution's preference;
- Personalization of contracts based on relations with various ministry and SOE managers, grossly undermining tendering processes; and
- Institutions' ability to play donors against each other to secure program funding.

#### **DEDUCTION OF PUBLIC SERVICE QUALITY**

7.6 This is exemplified by electricity distribution and corruption in obtaining electricity connections (see further discussion below). The public perception is that priority for electricity connections is given to politically well-connected households and businesses. Lack of working meters and absence of meter policies results in petty bribes for service and inability to truly track power demand and use. Inflated billing for power supplied can be reduced with minimal bribes; connections can be provided for a price. Optimization of power resources is not possible without a dispatch and systems control center. Incomplete inventories of spare parts, equipment, and supplies result in staff's and others' ability to engage in theft of products, with no prospect for holding them accountable—for example, cable purchased with DABM (the state power company) funds has been found in the local markets for sale.

#### **LEAKAGE AND MISALLOCATION OF PUBLIC RESOURCES**

7.7 The use of sector properties for non-energy sector operations is pervasive. Most obvious is the leasing of energy sector properties for non-sector activities, resulting in collection of rents. Virtually every SOE rents out property. Managers of key energy facilities indicate that without using public properties for non-energy sector related work, they would lack requisite financial resources to pay staff and implement necessary energy projects. Patronage plays a large role in how Afghan energy staffs are hired. Many hires lack the technical capacity required for particular positions. This culture of patronage extends to contracting out services and procuring equipment

and supplies, especially seen in procurement of liquid fuels, where certain preferences in terms of ethnicity are clearly indicated by managers. Jobs and contracts awarded in this way do not ensure technical quality or safeguarding of public resources.

#### **CREATING UNCERTAINTY FOR PRIVATE INVESTORS**

7.8 Corruption is seen by the private sector as one of the top constraints to doing business in Afghanistan. This is supported by considerable anecdotal evidence. As a result of the manner in which energy operations are conducted, there is little opportunity for legitimate competition in the Afghan energy sector. Most interested investors indicate that the only sure way to secure a contract in the energy sector is to meet directly with the Minister or the manager of the concerned SOE. Ad-hoc tenders, even those involving donor funds, put off credible investors and promotes a culture of back-room meetings and trips abroad for “contract signing”. None of the ministries has a web page where tender opportunities are regularly posted.

### **C. Vulnerabilities to Corruption**

#### **INSTITUTIONAL AND GOVERNANCE ARRANGEMENTS**

7.9 The institutional arrangements in the energy sector are too fragmented and unclear and thereby increase vulnerabilities to corruption. Weak governance and accountability leave ministers and SOE managers fully in control of the development and sequencing of project priorities, often in response to political and other pressures, without checks and balances, and not always aligned with sound technical considerations. Virtually no accountability mechanisms are in place, which leaves policy formulation and its application subject to manipulation that can result in personal gain for public officials.

7.10 As institutions and key managers normally do not have terms of reference, project development occurs on a discretionary basis, no systematic strategy is in place, and individual mandates rather than institutional approaches are being pursued. The existing governance arrangements do not provide for any level of stakeholder consultation that would ordinarily perform a watchdog function and could contribute to ensuring a certain acceptable level of utility performance, customer service, and even due diligence in oversight of subcontractors implementing certain government contracts.

7.11 The energy sector is to a considerable extent functioning in a legal and regulatory vacuum. The legal and regulatory framework remains undeveloped, and there is no transparent regulation or licensing of operations in place.

#### **LOW HUMAN CAPACITY**

7.12 Human capacity at both technical and managerial levels is weak. Decades have passed without skills upgrading or exposure to modern technical approaches to energy sector development. Sound sector development is impeded by the state of human capacity, non-incentive based and low salaries, and lack of or weak implementation of procurement, accounting, tenders, and regulatory aspects of energy sector operations. Government officials and sector managers as well as SOE managers are primarily engineers with no market-based institutional understanding of how the sector needs to operate.

7.13 Corruption by all accounts has become widespread and endemic in energy sector operations. Anecdotal evidence of the ways in which low-paid energy sector staff receive additional compensation includes the following examples, which are openly discussed:

- Project funds include 5-30 percent used to pay ministry and enterprise workers “top-up” salary payments;
- For each person for whom a ministry official or enterprise manager obtains work, that new worker may pay up to 20 percent of his/her salary per month to the official or manager;
- All non-ministry or enterprise operations engaged in energy sector work pay a monthly fee to ministry managers (e.g. for coal mining rights, distribution rights); and
- Non-core assets including housing, vehicles, and land are used by enterprise managers and their colleagues for revenue generation outside core sector operations.

7.14 Staffing is based on traditional approaches reflecting patronage and personal relations. There are no incentive-based performance schemes or promotions. This staffing approach results in diminished technical and other skills.

#### **PUBLIC EXPENDITURE MANAGEMENT**

7.15 There is little capacity in the energy sector for strategic planning or public expenditure management. Accounting systems in the line ministries and in energy sector public enterprises are antiquated and based on artificial production and cost information as a remnant of central planning. The energy sector budget process does not sufficiently consider production costs, operations and maintenance, additional staffing needs, emergency supplies, building maintenance, or spare parts. Part of the reason for these problems is lack of baseline data as well as lack of knowledge of current market costs for operating the existing system. There is also a fundamental lack of critical thinking and strategy based on which sector staff could develop budgets to ensure appropriate coverage of project system costs, including emergency costs. While the SOEs submit their budget requests, there has been no internal or external audit conducted of energy assets to provide a baseline for justifying any requests.

#### **PROCUREMENT**

7.16 Each line ministry maintains both domestic and international procurement staff who are responsible for oversight and implementation of procurement processes. While capacity has been developed in some offices, in many cases there remains a critical lack of capacity and inability to implement market-based procurement activities. The domestic procurement offices are primarily responsible for procurement of materials and supplies available on the local market. The international procurement offices are used to support both donor and other procurement transactions where products and services may be from outside the country.

7.17 All energy sector tenders should be subject to the Procurement Law. In the energy sector, however, the public contracting mechanism is arduous, does not promote transparency, is unpredictable, and fails to procure on a timely basis goods and services required for sector operations. Underlying these problems is a general lack of capacity and understanding of market-based procurement. It is almost impossible to cite any public procurement transaction in the Afghan energy sector since 2002 that was conducted without difficulty.

7.18 Ministry and SOE managers facilitate a number of contracts and tender processes with virtually no ministry or government oversight or independent monitoring. It appears that there is no reliable mechanism by which due diligence of contractors is or can be conducted. The bid



evaluation process for procurement may be the step most vulnerable to influence. The manipulation of certain procurements in the energy sector, notably for equipment and supplies, results in the procurement of inferior quality products, often at inflated prices.

7.19 In a great number of cases, donor-supported procurements for energy sector projects occur outside government systems and are not necessarily coordinated with other donors or with the appropriate government counterparts. Due to the isolated procurement process used by many donors, various international experts are somewhat thrust upon counterparts who do not have sufficient information about the experts' terms of reference, resumes, or experience. In some confirmed instances, donor staff have managed to hire friends and former colleagues to conduct advisory work, which in at least two cases included individuals that had been fired from their previous work.

### OVERLY BUREAUCRATIC PROCESSES

7.20 Overly bureaucratic processes create systemic vulnerabilities to corruption as corrupt practices are institutionalized. How electricity connections are obtained provides a good example of bureaucratic processes leading to corruption.

7.21 As many as 25 signatures are required to secure an electricity connection in Kabul in a legal manner through the official procedures (Table 7.1). By contrast, no signatures are required when the connection is obtained through personal connections or bribes. The complicated official electricity connection process practically invites consumers and DABM officials to engage in corrupt practices. Obtaining an unofficial electricity connection requires only one of the followings two procedures:

- Knowing or contacting an individual working at DABM and/or the Kabul Electricity Department (KED) to request a connection for payment or for political or other favors.
- DABM or KED staff members actually knock on doors of potential customers to inquire of their interest to be connected.

**Table 7.1: Official Steps to Obtain Official Electricity Connection in Kabul (2007)**

No.	Process	No.	Process
1	Formal signed customer request	14	ED director requests signature from Junction Group
2	Kabul Electricity Department (KED) signs	15	Signed comments from ED staff members
3	Application assigned to Expansion Department (ED)	16	Signed comments from Junction staff members
4	ED assigns staff member	17	Final signed confirmation form of various [what is this]
5	Director of junction group assigns person case	18	Signed confirmation by neighbors
6	KED director assigns junction group to the case	19	Signed confirmation by neighbors (requires confirmations from two different neighbors)
7	Audit Department (AD) director assigns an auditor	20	Signed confirmation by local attorney
8	KED director requests AD to get involved	21	Signed confirmation by technical staff
9	ED director prepares a form and signs	22	Signed confirmation by technical staff (requires confirmations from two staffs)
10	ED director requests for an invoice and drawing	23	Signed confirmation by technical staff one
11	Formal agreement and account number	24	Signed confirmation by renter (if renter)
12	Comments signed by ED and sent to KED	25	Signed confirmation by municipal district dept.
13	ED director requests signature from technical deputy		

## **LACK OF COMMERCIALIZATION OR DIVESTITURE OF STATE ASSETS**

7.22 Fundamental capacity, accountability conditions and market-based approaches are not in place to support new technical developments (i.e. billing and collection, retail power purchase, market operator, dispatch and systems control). Little progress has occurred in terms of effectively commercializing activities and facilitating private investment, or allowing the private sector to operate energy assets. As a “source” of corruption, the stagnating condition of energy assets in Afghanistan provides considerable opportunities for corrupt practices that range from misuse of public property to misappropriation of resources, over-employment and patronage positions that are not cost effective, and an overall lack of resource management for sustainable outcomes. These shortcomings will have very serious adverse economic and other consequences if left unchecked.

7.23 No meaningful valuation of energy assets has been conducted in Afghanistan. As power assets are refurbished, it is possible that they might attract commercial operators. Some rough estimates for oil, gas, and coal have been posited, but not until investors have direct access to the resources to test for quality and economic recovery of the reserves will true valuation be possible. Commercialization would bring greater financial returns as well as greater transparency for the energy sector. Technical improvements will reduce electricity losses, while installation of meters will surely reduce commercial losses in the power sector.

## **LACK OF HARDWARE TO CONDUCT OPERATIONS**

7.24 Basic spare parts, supplies, and tools are not available for sector operations, which may increase vulnerabilities to corruption as traders may be able to influence local managers and workers to engage in irregular transactions. The result in many cases is that materials supplied from the market, using public resources that are not necessarily accounted for, are not of sound technical quality or are “one-offs” and cannot be replaced. Examples include cable used for distribution that has proven reliable only for a short while and is of such poor quality that it burns out. There has been similar experience with meters, switches, and simple tools.

## **LACK OF ACTUAL DATA ON ENERGY ASSETS**

7.25 Independent audits of energy assets have not been conducted. Inaccurate reporting of energy asset values and resources for operations may result in the generation of funds on an extra-legal basis. In many cases, especially in power, where governance is not in place and billing systems are corrupted, the poor are especially impacted, having to pay more for electricity than they would under a well-regulated and well-governed scheme, and unable to navigate the system through connections or paying bribes.

## **LACK OF INFORMATION OUTREACH, AND REPORTING**

7.26 There is a lack of reliable information exchange at the government, parliamentary, and ministry levels; this adversely affects donors’ understanding of the government’s agenda and results in media sensationalism about how the sector is or is not developing. Staff members in the sector are not aware of their authorities or responsibilities other than those verbally conveyed to them by management. The lack of a published strategy for energy sector development provides opportunities for sector leaders to develop their own rules and to implement approaches as they see fit. Aside from there being no meaningful reporting, mechanisms are not in place for filing grievances, enforcing what should be the appropriate approaches, or even knowing about certain developments—absent word of mouth. These conditions fuel media sensationalizing of energy issues, clouds parliamentary judgment on resource development and allocation matters, and results

in a lack of trust among Afghans as to whether and how the government is safeguarding national resources.

#### **DONOR DRIVEN DEVELOPMENT**

7.27 Any significant improvements in energy sector operations as well as infrastructure rehabilitation and development have been driven by donor funding. Donor driven development has heavily relied on a few English-speaking Afghan counterparts, primarily seated in high levels of government, with limited interaction with government departments and SOE managers. As a result, the sector remains vulnerable to corrupt practices by a few key staff and officials who are privy to the details of how the sector is being developed, attractive investments in line with emerging priorities, and near-term donor priorities where employment opportunities exist.

#### **WEAK PRIVATE SECTOR DEVELOPMENT**

7.28 Firms with no technical expertise but sufficient political ties often gain contracts to conduct sector business, with the expectation that they subcontract out technical work. Through a variety of mechanisms and processes they actively exclude competitors and have positioned themselves to be the major beneficiaries of growth in the energy sector.

### **D. Mitigation Measures and Policy Recommendations**

#### **DEFINING INSTITUTIONAL ROLES**

7.29 There is an urgent need to define institutional roles and responsibilities in the various segments of the energy sector. Structural change is required to facilitate good governance. The government needs to assess how it will progressively withdraw as energy sector operator and take on a regulatory function. Donors need to improve mechanisms for coordination and capacity building and pay more attention to the commercial and institutional aspects of energy sector operations. Required structural changes include:

- Closing of non-viable entities (which will result in reduction of ghost workers and will reduce opportunities for misallocation of public funds);
- Unbundling and structural separation of assets (decentralization of financial decision making where possible), including divestiture of some energy assets;
- Facilitation and promotion of transparent private sector engagement over time;
- Viable regulatory and contracting development and oversight;
- Enforcement of clear budget and project funding rules as well as procurement arrangements;
- Facilitation of non-monopoly behavior: consolidation of ministerial oversight, establishment of a sound regulatory regime, emphasis on safeguarding consumers, development of predictable rate-making / tariffs, and installation of market-based licensing regimes; and
- Clear sector strategies that have some robustness and cannot be completely overhauled in the wake of new political appointments at the ministerial level.

#### **IMPROVED SECTOR GOVERNANCE**

7.30 Improved sector governance is essential to ensure that corrupt practices do not remain firmly entrenched in energy operations. More attention to regional operations and decentralization of sector operations is required. Some of the key indicators for assessing institutional and governance risks in the energy sector, as well as their management / mitigation, include the following:

- Appointment of technically qualified ministry and enterprise management and staff: This includes contractual commitments including fiduciary duties and, optimally, incentives for good performance;
- Fiscal governance: A renewed assessment of sector assets and their values, mechanisms for budgeting, tracking the flow and sequencing of budget funds, monitoring project cost overruns, and providing government support for sector operations;
- Comprehensive sector reform and integration: Complementary ministerial functions need to be integrated as part of a comprehensive approach to restructuring the energy sector. The functional role of ICE as a unifying entity for sector stakeholders can advance some of this integration;
- Establishment of public information and outreach offices: This could enhance government /parliamentary relations, public accountability and feedback, and private sector promotion;
- Building stakeholder participation: This needs to be done at all levels, including installation of consumer protection mechanisms, arbitration procedures that reduce lengthy court actions, and transparent contracting.

#### **VALUATION OF STATE ENERGY ASSETS AND DEVELOPMENT OF DIVESTMENT PLANS**

7.31 As no audit of state energy assets has occurred, independent audits of at least the primary assets should be conducted to provide baseline information so that asset development priorities can be shaped on a sensible basis. The first step toward restructuring the sector will include a serious valuation of energy assets commencing with the key energy assets, DABM, Liquid Fuels, and natural gas. Immediate actions that may be taken to mitigate opportunities for corrupt practices include:

- Putting in place and using international accounting systems at key energy assets and relevant ministry offices;
- Outsourcing energy functions where viable, with clear performance terms in place;
- Formalization of energy operations now functioning outside the legal framework (e.g. private power, fuel sources); and
- More attention to reducing the opportunities for corrupt practices at the regional and local levels.

#### **ESTABLISHMENT OF LEGAL AND REGULATORY PRINCIPLES**

7.32 Without sound legal and regulatory processes in the energy sector, it will be very difficult to address the risks of corruption. There are virtually no checks and balances in the present system, and no system is in place to conduct due diligence for energy projects. Immediate attention is required to assess existing legal instruments and to identify areas for improvements. Following this, drafting of legal and regulatory tools by Afghan experts with international inputs will help to build capacity as well as a practical framework for sector operations. Based on this, legal training including training on basic regulatory work, dispute resolution, contract negotiations, and legal management will help to implement the new, more commercially oriented culture.

7.33 Stronger legal and regulatory parameters are required to support sound power import contracts, possible power transit legal arrangements, and even the transit or import/export of other resources such as coal and natural gas. Liquid fuel legal and regulatory arrangements can be more predictable and operated on a more even playing field for market entrants. Consumer service contracts need to be simplified, and processes for obtaining them regularized in a legal context.

Public information about new legal and regulatory arrangements will be very important to gain credibility with implementers, consumers, and investors.

#### **HARMONIZATION OF DONOR FUNDING AND IMPROVING AID COORDINATION**

7.34 The lack of coordination among donors supporting the energy sector has resulted in considerable delays in project development and implementation, duplication of efforts (e.g. three donor programs provided diesel operator training but with no coordination with respect to who was getting the training), ineffective allocation and deployment of donor and government funds, and on several occasions generation of ill-will among donors and between donor agents and government officials. Donors can help the Afghan government reduce vulnerabilities to corruption in the energy sector by providing more programmatic and multi-year funding for technical and institutional support. Sharply increased funding support for young professional recruitment and training programs can directly implement market-based training, which will be important since these professionals may be managing the sector in years to come.

#### **HUMAN CAPACITY**

7.35 Enhanced education and training facilities should be supported, as well as short and extended internships abroad (along with a requirement to return and work for a stipulated length of time in the sector) where Afghan technicians and managers can see first-hand how operational protocols are put in place, systems synchronized, and profits made in open ways of doing business. Managers need to gain confidence in market systems and to embrace the skills required to promote private investment. Workers need to be informed of new expectations and how their performance will be monitored. Capacity building to implement the requirements of the Law on State owned enterprises, Commercial Code, Law on Procurement, and newly emerging commercial legislation needs to start. International accounting procedures to support donor and government projects, as well as installation of hardware and software to support basic preservation of sector information, are essential. Existing contracts need to be reviewed, and “long-term leasing” remains problematic without remedy both due to lack of enforcement and oversight of the privatization process and gaps or loopholes in existing legal provisions. Developing capacity in all of these respects can have a significant impact in reducing sector vulnerabilities to corrupt practices.

### **E. Conclusions**

7.36 The energy sector in Afghanistan plays a vital role in development. Currently, due to lower levels of energy sector development and donor funding, there are fewer direct opportunities for large-scale corruption. Nevertheless, the potential for corruption in the energy sector is high, as Afghanistan has significant unharnessed potential in indigenous energy resources. Also, petty bribes and patronage are pervasive, as is illustrated strikingly in electricity distribution, in particular bribery for obtaining electricity connections. Corruption leads to (i) serious adverse impacts resulting from the institutionalization of corrupt practices; (ii) worse public service delivery; (iii) leakages and misallocation of public resources; and (iv) generating a climate of uncertainty for private investors.

7.37 Vulnerabilities to corruption in the energy sector are observed in:

- Institutional and governance arrangements;
- Low human capacity;
- Public expenditure management;
- Procurement;

- Overly bureaucratic processes;
- Lack of commercialization and divestiture of state assets;
- Lack of hardware to conduct operations;
- Lack of actual market data on energy assets;
- Lack of information, outreach, and reporting;
- Donor driven development; and
- Weak private sector development.

7.38 In order to prevent corruption, the above vulnerabilities need to be addressed. Key recommendations include:

- Defining institutional roles;
- Improved sector governance;
- Valuation of state energy assets and development of divestment plans;
- Establishment of legal and regulatory principles;
- Harmonization of donor funding and improving aid coordination; and
- Strengthening human capacity.

7.39 However, given weak organizational and human capacities in the energy sector, implementation of these key recommendations will be extremely challenging. Formulation of risk management plans and corruption prevention action plans should not be overly ambitious but needs to be realistic.