



ANNUAL PROJECT REPORT 2006

**United Nations Development Programme
Afghanistan
Making Budgets Work (MBW)
01-01-2006 – 31-12-2007**

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Component (MYFF)	2.7. Public Administration Reform
Total Budget	USD 5,785,776
Unfunded Budget	USD 0
Implementing Partners	UNDP in collaboration with Ministry of Finance

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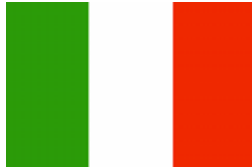
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MBW donors



German Technical Cooperation



Italy



USAID



Agence canadienne de
développement international

Canadian International
Development Agency

Canada/CIDA



UNDP

Acronyms

ANDS	Afghanistan National Development Strategy
ADB	Asian Development Bank
ACU	Aid Coordination Unit
ADF	Afghanistan Development Forum
ANDS	Afghanistan National Development Strategy
ARTF	Afghanistan Reconstruction Trust Fund
CIDA	Canadian International Development Agency
CG	Consultative Group
DAD	Donor Assistance Database
DBER	Development Budget & External Relations
DFID	Department for International Development (UK)
JCMB	Joint Coordination Monitoring Board
MoF	Ministry of Finance
MTEF	Medium Term Expenditure Framework
NDB	National Development Budget
UNDP	United Nations Development Programme
WB	World Bank
WG	Working Group

EXECUTIVE SUMMARY

The *Making Budgets Work* (MBW) project, established in March 2004 as the successor of the Aid Coordination project, has been instrumental in supporting the government in strengthening its budgetary process, aid coordination mechanism, and tracking resources and organisational restructuring to support its vision and mission. Considerable progress has been made during 2006, the third year of the project.

Some new initiatives were taken this year to improve the quality of budget formulation and ensure alignment of the budget with I-ANDS priorities and sector strategies. The project supported the preparation of the first-ever standard budget calendar for the Government of Afghanistan in June 2006. Additionally, in order to strengthen the links between policy, planning and budgeting, a Fiscal Policy and Budget Framework was prepared. Wider consultations under the CG mechanism have also become part of the budget formulation process. Most working groups under the CG mechanism have incorporated the I-ANDS benchmarks, sector strategies, and budgetary priorities into the process. The sector focal points from the Budget Department led some of the discussions to ensure strengthened links between policy, planning and budgeting.

MoF continued to track the performance of donors against their pledges, commitments, disbursements and expenditures made in Tokyo, Berlin and London. In order to improve the quality and effectiveness of aid coming to Afghanistan, the Aid Co-ordination Unit (ACU) successfully conducted the 2006 Survey on the Paris Declaration on Aid Effectiveness. The ACU mandate has been strengthened through monitoring of the Paris Declaration indicators.

The capacity of the grant and loan management unit was emphasized in 2006 to ensure that it can successfully monitor the implementation of the Government's portfolio of grants and loans. The unit monitored the major loan programmes, the IMF Staff-Monitored Programme, the conduct of public expenditure reviews, donor portfolios, and liaised with the three Afghanistan Trust Funds administrators (ARTF, LOTFA and CNTF). In doing so, they strengthened the quality, auditing and scrutiny functions within the Ministry of Finance, contributing to the ministry's effort to ensure the utilization of funds is maximized for the benefit of the Afghan people.

Underpinning all of the above activities is a functional national public finance and expenditure management team. Significant progress has been made to date in propelling the project towards the achievement of this objective. Great foundations have been built within the Budget Department, but it requires significant further work to ensure further capacity needs are deepened and built within the whole government.

1. CONTEXT

Achievement of the Government's vision of a 'stable, prosperous and secure Afghanistan' depends in large measure on building central institutions of the State capable of performing a variety of core Government functions. Afghanistan has sought US\$27.6 billion in external assistance over a seven-year period to help rebuild the nation and achieve self-sufficiency. The donor community pledged US\$ 4.5 billion to Afghanistan during the Tokyo conference in January 2002, a further US\$8.2 billion at Berlin in April 2004 in reconstruction assistance over three years, and over \$10 billion at the London conference in Jan/Feb 2006 for the five-year Compact period. In view of the immense scale of aid flows to Afghanistan, the Ministry of Finance plays a critical role within the Afghan government in regards to co-ordination, policy, and decision-making processes.

The project 'Making Budgets Work (MBW)' contributes to the process of institution building and governance by strengthening the Ministry of Finance, supporting in particular the National Budget process as the central co-ordination mechanism for Government decision-making and allocation of funds to the ANDS sectors and programmes. In this context, the MBW project supports the Ministry of Finance to play its full part as Afghanistan's foremost agent of change.

A further aim of 'Making Budgets Work' is to establish confidence in the national budget to reduce the tendency of international development partners to create and finance parallel systems to the Government. In practical terms, the project is assisting the Ministry of Finance to merge its 'development' budget with its 'operating' budget, where the former is financed through aid flows into Afghanistan remaining largely outside of the Treasury control, and the latter constitutes that portion of aid that flows through Government via Trust Funds, grants and loans, and other project financing channeled directly through the Government's single treasury account.

In this context, the MBW project aims to deliver the following key outputs:

- 1) **A unified national budget** which serves as an instrument of co-operation, founded on principles of accountability, transparency that, consultation, consensus, decision-making, contributing to the development of the nation state.
- 2) **Co-ordination of all Aid Flows to Afghanistan.** A Government-owned and led aid co-ordination system used by all international, national and provincial partners in the reconstruction process.
- 3) **An Effective Grants & Loans Management/ Portfolio Management Unit.** A nationally-run grants and loans management and portfolio monitoring team that provides professional leadership and support to the Government, its partners and stakeholders, in all matters pertaining to the administration and performance of all grants and loans entered into by the Government of Afghanistan.
- 4) **A Robust National Development Framework.** Provision of an enabling service that assists the maintenance of the National Development Framework (later changed to Interim Afghanistan National Development Strategy) and the Consultative Architecture of Government for the purposes of promoting the rational organization of Government Programmes and for their development and implementation through a consultative process, supported by all partners.
- 5) **Capacity Development of a National Public Finance and Expenditure Management Team¹.**

The project's donors—CIDA, USA, Italy, GTZ, and UNDP—have committed a total of USD 5,785,776 to the Making Budgets Work project (April 2004 – March 2007).

¹ This project output was added in order to reflect the government's policy framework

2. PERFORMANCE REVIEW

2.1 PROGRESS REVIEW

Overall progress towards the ANDS benchmark and the UNDAF/CPAP outcome and outputs

The MBW supports the "Economic Governance" pillar in the interim Afghan National Development Strategy (ANDS). These outputs are also in line with the UNDP Multi-Year Funding Framework (MYFF) goal of 'Public administration reform and anti-corruption', and the UNDP Country Programme Output of 'Public sector capacity strengthened through the development of civil service at the central and sub-national levels, the establishment of accountability mechanisms and the enhancement of information management for better service delivery'. These are measured by output indicators such as "80% of aid flow and disbursement tracked through DAD by 2008;" "an integrated, transparent and participatory national budget strategy and mechanism developed;" and "allocation of funds decided on a needs basis to replace historical allocation."

During 2006, the *Making Budgets Work* project contributed to achieving a unified national budget by implementing a restructure of the Budget Department that brought together the operating and development budget staff under the eight sectors of the ANDS policy structure. Further integration of the operating and development budgets was achieved through piloting program budgeting in the Ministry of Education; Ministry of Rural Rehabilitation and Development, and the Ministry of Education (led by DFID/Maxwell Stamp international advisers with UNDP-employed local counterparts). The 1386 (2007 March – 2008 March) budget preparation process followed the approved timetable, meeting with international standards. As part of the production and execution of a Unified National Budget, the following key deliverables were achieved:

- (a) Fiscal Strategy and Budget Framework Report for 1386 (2007 – 2008).
- (b) Budget Execution Reports by Ministries and projects on a weekly, monthly and quarterly basis.
- (c) National Budget Performance Report of 1384 (2005-2006)
- (d) Program and Provincial Budgeting pilot initiated
- (e) MoF Program (Integration) Budget Brief

Capacity Development

The development of the national team has been the main focus of the project. Most staff participated in the various training opportunities available to the project and donors.

Apart from several regular internal trainings and workshops conducted by the international advisors for the staff of the Ministry of Finance and line ministries, a weekly staff meeting is organized with a results oriented focus which has enhanced the team work within the Budget Department (both the government officials and the project staff work together). Pillar Managers in particular have played a more active role in the 1385 National Budget review and the 1386 National Budget preparation process.

Overseas and regional seminars and trainings

During the year, overseas training opportunities were provided to staff members of the Budget Department. The MBW Project supported the Director-General of Budget and the Aid Coordination Manager to attend a workshop in Bangkok in June, on "From Paris to Practice, Tools for better Aid Coordination and Management." Other staff also benefited from various trainings provided by the World Bank, ADB and other bilateral donor countries.

General Management

To achieve development outcomes, Budget Department staff must be trained to become effective leaders and managers of the budget formulation process for the Government. In 2006 the project delivered training to its national staff, which are those staff that are employed by the Government of Afghanistan in the Budget Department, based on the results of the training needs assessment which demonstrated a general need for basic skills development. In regards to

training for project staff in the Budget Department, last year after a Training Needs Assessment, the project contracted a one-year training program with BRAC-Afghanistan for capacity building in different office development skills. The last session course on General Management was conducted during 3 – 13 June 2006 at the BRAC training centre in Kabul.

A further round of training on Office Skills Development was conducted from 25-30 March 2006. The training was on Personal Skills Development (with a focus on Information Management). Twenty four staff members (including 6 females) benefited from the training.

Recruitment of New Staff

To ensure there is sufficient staff in the Budget Department to facilitate and contribute to development outcomes, the following vacant positions were filled: Deputy Director General Budget, Director General Custom, Deputy Director General Treasury, Office Manager, two Sector Managers, nine Budget Officers, six Aid Coordination Officers, four Budget Policy, Coordination and Reporting Officers, three Budget execution Officers, Database Officer, Admin Assistant, Office Assistant, Personal Assistant to DM, Personal Assistant to DG, Receptionist, three Project Drivers, Office Cleaner.

The overall capacity of project planning, design, implementation and monitoring remains an issue to be addressed comprehensively. The budget department has proposed the creation of an institutional mechanism for capacity building by setting up a Training Institute for Public Financial Management in Kabul. This will provide the vital training, consultancy services in public finance management to the government and a 'think tank' forum to the Ministry of Finance, Line Ministries, and provincial and municipal Administration.

It will be necessary to learn to institutionalise the capacity built by the project team in a sustainable manner as well as to build capacity of line ministry staff in the basic budgetary preparation and execution process as well as aid coordination and management.

2.2 IMPLEMENTATION STRATEGY REVIEW

National Ownership, Participatory/consultative process

The success of the project depends on strong partnerships with key internal and external partners. This includes close working relations between the Budget Department and other relevant departments within the Ministry of Finance and across Government ministries. An ongoing strategic partnership will also be required with the international community. Both are essential for maintaining the confidence of line ministries and donors in the ability of MoF to conduct key coordination functions in an effective and efficient manner. MoF has taken the lead in discussions regarding aid effectiveness and public expenditure management with various donors, and also incorporated many recommendations from the IMF and World Bank technical missions in the budget formulation and execution process, and they were supported by the project team. The project provided strategic and logistical support to the MoF in setting up the CG mechanism and coordinating the Working Group mechanism in line with the ANDS. The project has contributed to the objective to promote national ownership of the budgetary process and aid coordination.

Quality of Partnerships

The project is implemented by UNDP under the direct execution modality (DEX). The project is coordinated by the steering committee, chaired by the Deputy Finance Minister with representation from UNDP, CIDA, GTZ and other partners. The project team works closely with the international TA team supported by DFID and ADB. The MoF regularly organizes donor meetings on the budgetary process to facilitate the sharing of information. This coordination mechanism is expected to be further strengthened in the next phase of the project.

Sustainability

Currently the MBW project provides support to 76 staff, who form part of the Budget Department and produce the national budget for the government. The Department also has approximately 30 government-employed civil servants who work along with the project team. Almost all the project

staff hold substantive and functional roles within the Ministry. Although these inputs have been instrumental in promoting various required reforms in line with the project objective, it may be at odds with local ownership ideals and sustainability of outputs. To address this, the MoF/project team has developed an exit strategy in consultation with donors, and an evaluation mission conducted in December 2006 also provided some recommendations to distinguish the roles and responsibilities that could be given by the project in order to ensure sustainable integration of the staff within the government. A new phase with a clear sustainable mechanism will be developed in the first quarter of 2007.

2.3 MANAGEMENT EFFECTIVENESS REVIEW

Quality of monitoring

UNDP has close contacts with the project team and participates in the weekly staff meetings of the Budget Department. One issue that has been raised is that there seems to be less available time by the government for the project management. The Director-General of Budget is so overloaded with the task of ensuring delivery the project outputs that he has little time left for project management. There may be a need for a dedicated person to fill this role.

Timely delivery of outputs

Most project outputs can be considered to have been delivered in a timely manner in comparison with a few years back where a budgetary process was not in place and the project was supported more by international TA. A draft budget was presented on schedule, having gone through various consultation processes. The 1386 budget is expected to be approved at the beginning of the fiscal year, unlike with the previous year, where there was three months delay, consequently affecting the ability of line ministries to spend. While the budgetary preparation process is in place, the current challenges faced are the quality of proposals from line ministries and consequent core development budget execution rate due to the level of capacity in line ministries. In this regard, the need for further support from the MoF to line ministries to improve their budget preparation and execution process will be pursued in coming months.

Resource allocation and cost-effectiveness of inputs

Resource allocation was efficiently managed, moving from the use of international TA to build up a national team. Training was also organized in country and region. The next step is to see more absorption of staffing costs by the government. The ratio of management/running costs vs. development activities are 30:70.

3. PROJECT RESULTS SUMMARY

OUTPUT 1: UNIFIED NATIONAL BUDGET

Progress has been made towards realization of a unified budget with the operating and development budget processes, systems and forms being integrated to produce one set of budget documentation rather than two. Further progress was made with the pilot of program budgeting during the 1386 budget preparation process.

Budget Department Integration

The physical integration of the budget department which was planned during the first quarter of 2006 was delayed due to the finalization and approval of the 1385 National Budget and was implemented and completed in the second quarter of the year. All the newly established units and sector offices were furnished and staff allocated to each unit accordingly.

Workshop on 1385 National Budget Preparation and Execution

In the second week of May 2006, a joint three-day workshop on budget preparation and execution was organised by the Budget and Treasury Departments of the Ministry of Finance for 45 budgetary units and 32 mustofiats. The workshop provided sessions on different stages of the development projects during budget preparation and execution in the Budget and Treasury Departments. For the preparation of the 1386 Budget, which should be in line with the ANDS and incorporate the MDGs, detailed presentations on both I-ANDS and the MDGs were made by the ANDS colleagues.

The following deliverables were achieved towards the preparation of the National Budget:

- Explanatory sessions for the 1385 (21 March 2006 to 20 March 2007) budget process were held with all government ministries/independent directorates. Through these sessions, the Budget Department supported the submission of draft 1385 operating and development budgets in an integrated form.
- The project team supported all ministries and independent directorates in preparing their 1384 performance reports to Budget Committee prior to Budget Hearing Meetings.
- The report of 1385 proposals of all ministries/independent directorates was prepared by the budget team for Budget Committee review before the Budget Hearing Meetings in January 2006.
- The Budget Hearing Meetings took place early January 2006, chaired by Deputy Minister of Finance. The budget team prepared the meeting reports and updated the Donor Assistance Database based on the decisions agreed upon during these meetings.
- After the Budget Hearing Meetings, the UNDP project team along with the civil servants employed by the Government in the Budget Department finalized the draft of 1385 National Budget in mid March and submitted the draft to the Cabinet and then the newly elected Parliament for review and comments.
- The National Budget and its decree were translated in both national languages for the first time for presentation to the Parliament.
- Two female members of the Budget Team made a presentation on the process of Budget preparation and different aspects of National Budget to the Parliament's Finance Commission on 25th March 2006.
- A workshop on the 1385 National Budget (budget guidelines, budget execution procedures) was delivered to the budgetary units of the line ministries.

1385 National Budget approval

The draft 1385 National Budget was presented to the Parliament in early March, but due to a vote of confidence on the proposed cabinet ministers, the review of the budget by the Parliament was delayed.

The Parliament requested the increase of salaries of civil servants, martyrs and the disabled to which the MoF responded that the government's revenues were inadequate to cover higher

salaries. The issue was raised with the IMF, which finally agreed to increase the salaries of martyrs and the disabled by AFS 100 per month from the start of 1385 and AFS 300 per month from the seventh month of 1385. This agreement took several days due to the necessary consultations with the IMF, donors and Parliament.

A second concern of the Parliament was the lack of geographical equity in development projects. To this end, the Parliament proposed including a few more new projects in areas of scarcity and excluding projects in areas where resources are already being spent. The feasibility of the proposal was duly considered by the MoF.

Mid Year Review of the 1385 National Budget

The Mid Year Review system aims to enable the parliament to review the expenditure and resource trends during the course of the implementation of the annual budget cycle. The review was conducted in November 2006. The Mid Year Review followed a process of budget hearings, presided over by the Budget Committee, and chaired by the Minister of Finance. The Mid Year Review Report was also issued to the Consultative Group Standing Committee (CGSC).

The budget hearings provided an important opportunity for the Government to be able to take stock of the progress and performance of its 2006-07(1385) budget, and bring ministries and donor agencies to account for usage of funds during the accounting period. The Ministry of Finance was able to bring substantive revisions to the national budget and to approve them through the passage of a Presidential Decree in December 2006.

1384 National Budget Final Report

The final report on the National Budget was prepared as per the requirements of the budget law. This budget report was fully consistent with the Budget Law and the Finance Regulations Act and based on international standards practiced in most countries.

Preparation of the 1386 National Budget

It was decided to introduce program budgeting and provincial budgeting from the 1386 budget cycle, on a pilot basis. The pilot ministries are the Ministries of Public Health; Education; Rural Rehabilitation and Development; and Agriculture. The provinces where provincial budgeting is being piloted include Balkh, Panjshir, and Kandahar.

1386 National Budget Timetable

In the previous years, the budget preparation schedule provided very little preparation time to the line ministries and the government. For the first time, the budget timetable was prepared such that the budget formulation process began about 9 months before the budget year, a practice used in other countries where the budget formulation process is well developed. Such a schedule provides sufficient time to review the government policies and priorities and link them with the annual budget process and has the impact of facilitating better quality budget submissions. The following provides an overview of the budget time table.

Budget Time Table

May/June, 2006	Finalize the 1386 budget calendar, publish and inform budgetary units
July/August	Review government policies and priorities (including I-ANDS) in the medium term through CG Working Group mechanism
September/ October	Prepare/update Medium Term fiscal Strategy and Budget Framework. Prepare preliminary ceilings for operating and development budget.
1 November 5-6 November 30 Nov- 5 Dec	Issue Budget Circular to line Ministries Budget workshops Working Group Meetings to discuss budget proposals by line ministries
12 December 15 December early January	Budget submissions by budgetary units Budget Hearings

20 January 2007	Submission of draft budget to Cabinet
3 February	Submission of draft budget to Parliament
March	Budget Approval

Outline of Key Outputs Required from CGs for Input into 1386 Budget Preparation Process

The members of the CG and WG in each sector are meeting regularly to coordinate sectoral policies and programs. The CG mechanism and WG meetings are expected to guide the budget formulation process. Since the Aid Coordination Unit (ACU) organizes and coordinates the CG meetings together with I-ANDS team, it coordinated with the budget team in budget preparation and in setting up initial budget ceilings for discussions. The ACU team supported the external and core budget formulation for 1386 and facilitated information sharing on the external budget, thus promoting an increase of donor funding going through the core budget. As a result, more comprehensive information on the external budget was provided to Parliament.

Preparation of Plan for Introduction of a Program Approach to Budgeting

Recently, a mission from the IMF visited Afghanistan to help the Budget Department to introduce a program approach to budgeting in a few key ministries. During the mission, four ministries (MoE, MoH, MRRD and MoF) were selected to introduce program budgeting this year, which signals an important step towards integrating the operating and development budgets. With the assistance of DFID funded Maxwell Stamp advisers, the Budget Department provided guidance and capacity building that led to the pilot ministries presented their budgets in a program format to Parliament for the 1386 budget. A plan has been prepared to extend the pilot during the 1387 budget preparation process.

Budget Ceilings

For each line ministry, indicative budget ceilings for the coming three years were prescribed. The ceilings were worked out on the basis of:

- ANDS priorities and benchmarks
- Implementation capacity (execution rate)
- Donors' multi-year commitments
- External budget priorities
- Resource availability projections

Key Issues

The following issues were identified during the course of 2006 as key areas to improve budget formulation and execution:

- Improve project prioritization
- Eliminate fragmentation of projects
- Align budget priorities with sector and ANDS priorities and benchmarks
- Improve medium term approach and link budgetary priorities with outcomes and outputs
- Improve provincial distribution
- Improve gender equality
- Improve financial management and procurement processes
- Program and Provincial Budgeting as Pilot Implementation in four ministries
- Separate system for Approved Budget and Projects Carried Forward; and those awaiting Approval/implementation (in the pipe line)

OUTPUT 2: CO-ORDINATION OF ALL AID FLOWS TO AFGHANISTAN.

Coordination of aid flows has been improved in Afghanistan through the formation of a dedicated unit, preparation of donor profiles, regular meetings, and taking a relationship management approach to key donors. Aid effectiveness has also been enhanced through more regular information sharing and the introduction of a harmonized reporting format. To achieve the Afghanistan Compact and the Paris Declaration benchmarks on aid effectiveness, the Aid Coordination Unit prioritized six benchmarks, related to ownership, alignment, managing for

results, and mutual accountability. An aid effectiveness paper, outlining these benchmarks as well as a concrete action plan, will be presented in the upcoming ADF for consideration and approval. The main goal is to increase the local impact of aid, agree on a harmonized reporting format, enhance the public financial management system by encouraging donors to channel more funds through the core budget, coordinate and enhance capacity building efforts, and align donors' resources and priorities with national priorities.

In April 2006, the Aid Coordination Unit (ACU) was established with the Directorate General of Budget. ACU is mainly responsible for management and tracking of Aid in Afghanistan. The ACU was established to ensure national ownership by the government in the Afghan development process through effective coordination and management of aid, and in particular to ensure that aid is aligned with the national policies and priorities identified in the Afghanistan National Development Strategy (ANDS). The ACU has been staffed with 7 aid coordination officers, one manager and one technical advisor. Key functions of the ACU are to provide a forum for dialogue on aid policies and strategies between the Government and Donors, manage and disseminate information on donors' assistance to Afghanistan, and coordinate and manage aid at a national level to ensure harmonisation of aid with the national budget cycle. Other responsibilities of the ACU are to provide support to the implementation of ANDS through effective coordination of aid coming to Afghanistan, providing support to the Consultative Groups (CGs) in collaboration with ANDS Implementation Support Unit, enhance partnership and policy level dialogue with donors and UN agencies, track and monitor the indicators of the Paris Declaration and the Afghanistan Compact for aid effectiveness, assist the budget team in formulation and execution of National Development Budget (Core and External) through coordination of donors' funding to the national development budget, assist the Database Unit in improvement and effective management of Donors' Assistance Database (DAD), develop and maintain an effective Information Management System for Grants & Loan and Aid portfolio, facilitate donors' coordination sub-committee meetings on a bi-monthly basis, and conduct donors' financial and portfolio review on a bi-annual basis.

2006 Baseline Survey on the Paris Declaration on Aid Effectiveness

For the most part, the ACU worked on the survey report during the 3rd quarter. In addition to the 12 indicators of the Paris Declaration, the MoF incorporated 6 additional indicators from the Annex II of the Afghanistan Compact to measure the local impact of aid. The ACU was supported by the MBW project in performing the following related tasks:

- holding a workshop for donors to explain the process ;
- one-on-one meetings with each donor to go over each indicator and provide explanation;
- updating donors' profile;
- collecting data from the donors;
- filling out the Government Questionnaire;
- comparing data provided by the donors with data captured in DAD;
- analyzing each indicator in details;
- writing and submitting a detailed report to OECD; and
- sharing the results of the survey with all the donors in Aid Effectiveness Working Group.

It is noteworthy that Afghanistan was the first country to submit the report to OECD in 2006. The results of the survey will be shared at the upcoming JCMB meeting.

Collected Data from Donors:

ACU collected data from donors to update the DAD and submitted the data to sector officers; worked with different donors on counterpart funds, financial agreements, disbursement protocols and made fund codes requests.

Updated Donor Country Profiles:

Each of the donor focal points regularly updated the donor country profiles on getting data from DAD and donors.

Aid Effectiveness Working Group and Executive Sub-Working Group:

- The Aid Effectiveness Working Group and **Executive Sub-Working Group** were established, the ToRs were prepared and shared with the donors, and meetings were held.
- Presented the results of the Survey to the donor community in the Aid Effectiveness Working Group, as well as to the UN Country Team and the JCMB members.

Establishment of a CG Mechanism

On May 25, 2006, the Consultative Groups Mechanism was officially launched. The Minister for Finance, H.E. Ahady; Chief Economic Advisor to the President, Professor Naderi; H.E. Hanif Atmar, the Minister for Education; and representatives from line ministries, donors and UN agencies participated in the launching ceremony. Eight CGs and eight Working Groups (WG) have been established. The ToRs and meeting schedule for the CGs and WGs have been prepared and meetings convened.

Prioritization of AC and PD Benchmarks:

ACU, in consultation with the donor community, prioritized six benchmarks from the Afghanistan Compact and the Paris Declaration. These benchmarks are considered to be the most appropriate elements of the Government's aid effectiveness agenda.

Afghanistan Compact Procurement Study:

To measure the current impact of aid as it relates to local procurement of goods and services, the Government requested the Peace Dividend Trust (PDT) to begin the Afghanistan Compact Procurement Monitoring Project, an analysis of the current status of local procurement. Working closely with the Aid Coordination Unit (ACU), the PDT team collected data from donors, carried out the analysis, and made recommendations. ACU will follow up on the report's recommendations to increase the local impact of aid.

OUTPUT 3: AN EFFECTIVE GRANTS & LOANS MANAGEMENT/ PORTFOLIO MANAGEMENT UNIT

ACU has put together a loans and grants management portfolio. ACU monitors World Bank and ADB loans and grants regularly. DAD will be restructured to reflect loans and grants portfolio, which will be monitored and updated regularly.

ADB Agriculture Loan:

To meet conditions for the release of the second tranche of the loan, meetings were held with a number of ministries, a steering committee was established and meetings were held, and the required documents were collected from a number of government institutions and forwarded to ADB.

Loans and Grants Profile:

Prepared profiles for all loans and grants.

4. IMPLEMENTATION ISSUES

ADDRESSING DEVELOPMENT BUDGET EXECUTION IMPEDIMENTS

The Government's execution rate for the 1385 development budget was significantly improved (to an end result of 56% of the budget being executed compared to 44% in 1384). This result was achieved because of a proactive role of the Budget Department supported and strengthened by the project support (e.g. introducing close monitoring and reporting of progress of execution of top 50 projects; increased assistance to line ministries to address impediments). The MBW project assisted the MoF Budget Department in assessing the reasons for historically low execution rates and developed and implemented strategies to address any impediments. The following are the reasons for low execution rates and actions taken by the Budget Department with the strategic and operational support from the MBW project team.

Reasons for the low execution rates have been attributed to:

Low implementation capacity of line ministry budgetary units leading to:

- poor prioritization of projects;
- poor internal and external coordination;
- unrealistic time, cost and expenditure projections;
- delayed procurement processes;
- considerable delays in project implementation;
- poor financial management; and
- poor monitoring and reporting;
- the development budget being set unrealistically high compared to the absorptive capacity of budgetary units;
- gaps and overlaps within the tasks and responsibilities of Government institutions;
- Security and other domestic conditions hampering project implementation particularly in some of the provinces;
- Unexpected unavailability of discretionary funds from the ARTF;
- Differences in donor versus MoF requirements; and
- Capacity and resource shortages in MoF.

Actions taken by the Budget Department to improve execution rates

- a longer budget preparation process has been introduced for the 1386 budget (9 months as opposed to the current 3 months);
- the 1386 budget was further aligned with the ANDS (once finalized) to improve prioritization and quality of proposed development projects; and
- projects submitted without comprehensive and complete project documents were automatically rejected from consideration for inclusion in the budget.
- Close monitoring of Top 50 Projects: Top 50 projects have been identified and process was established for regular monitoring and follow up with line ministries.
- Improved Coordination between the Budget Department and line ministries: Reorganisation of the Budget Department along the ANDS structure and recruitment of additional 20 budget officers has significantly improved coordination between the MoF and line ministries. Now there is a focal point for each budgetary unit and line ministry.
- Reallocation of discretionary funds: Reallocation of discretionary funds to better performing projects is expected to improve budget execution process will be done in consultation with the Treasury Department.
- Regular Working Group Meetings: WG meetings have become a good coordination mechanism among donors, line ministries, and the MoF. MBW project-hired sector managers play key roles in these meetings.
- Budget Execution Unit: A separate budget execution unit has been established in the Budget Department, which has accelerated the budget execution process.
- Budget Formulation: Budget formulation has improved significantly this year for the 1386 budget. A longer budget preparation process is being introduced for the 1386 budget. Budget ceilings have been introduced and budget circular has been issued much earlier than

previous years. 1386 budget is expected to go to the Parliament by February 4th, 2007 and get the approval by March 20th, 2007. These initiatives are expected to improve project preparation and prioritization and budget execution.

- Options of providing increased technical assistance to budgetary units will be explored in the context of the proposed skills gap analysis to be undertaken by IMF.
- The Aid Coordination Unit is developing an 'Invest in Government of Afghanistan' booklet to provide information to donors on how to channel funds through Government accounts.

The MBW project also facilitated the linkage and collaboration between the Budget Department, the Procurement Policy Unit and Treasury to ensure addressing any execution impediments.

GAP BETWEEN EXPENDITURES AND BUDGET

The gap is expected to be much narrower by the end of 1386 compared to those of the previous years. The MoF is committed to prepare a realistic budget for 1387. The Budget Department developed a mechanism for the 1386 budget with the support from the MBW project, where the 'approved budget' has only those projects that were already started in 1385 and new projects that have completed their procurement process and ready for implementation. All other projects will be categorized under 'approved projects', which will be moved to the 'approved budget when the necessary procurement process is complete and ready for implementation. This mechanism aims to eliminate wish lists from the line ministries and to have more realistic budgets.

SUSTAINABILITY OF THE PROJECT OUTPUTS AND INSTITUTIONAL STRENGTHENING

Currently the MBW project provides support to 76 staff. Almost all project staff hold substantive and functional roles within the Ministry. Although these inputs have been instrumental in promoting various required reforms in line with the project objective, it may be at odds with local ownership ideals that the Paris Declaration and the Afghan Compact promote. The project evaluation mission was organized in December 2006 to review the project achievements and short-comings and the proposed exit strategy for future sustainability. Based on the risk analysis and recommendations made by the external consultant, UNDP and the MoF will revise the project strategy for the next phase.

5. LESSONS LEARNT AND NEXT STEPS

The key lessons learnt from the project are:

- Reform processes take time and need to be well managed and sequenced. They involve cultural change and as such processes, systems and people need capacity to ensure the reforms are a success. The project will use this lesson to facilitate increased technical assistance provision in line ministries and better coordination and management of existing technical assistance. In addition the expansion of the pilots for program and provincial budgeting will be sequenced with program budgeting being introduced first in light of these lessons.
- To encourage donors to invest more in the core budget and provide more comprehensive information, it is necessary for donors to understand the government budget formulation process and public expenditure management principles, and nurture their trust in the government's fiduciary framework. Regular meetings with donors have been established with the support from the MBW project, and future work include developing a booklet outlining all systems, processes and frameworks involved in investing through government system.
- Budgeting requires a medium term focus and framework to ensure objectives of fiscal sustainability and effective public expenditure management. The introduction and development of Fiscal Strategy and Budget Framework is a landmark in this regard, and it will also provide a medium term focus for further development of Medium Term Budget/Expenditure Framework in line with ANDS. Fiscal Strategy and Budget Framework Report for 1386 lays out the fiscal and budget policies and priorities, guided the allocation of resources (Budget) among different sectors of economy and Ministries for upcoming 3 years. It aims to inform Cabinet, Line ministries, Donors and general public about budget policies and initial budget ceiling for each budgetary unit. The Report is divided into four parts:
 - Global, regional and Afghan macroeconomic developments;
 - MTEF and key assumptions, which drive the operating budget (operating budget ceilings);
 - Framework to link government priorities and budgetary priorities and projects (development budget ceilings);
 - Planned improvements: program budgeting and provincial budgeting.
- The above road-map is ambitious but achievable given the recent experience of a good start for the 1386 budget formulation process and improved capacity in the Budget Department. To complete the above reforms and consolidate their gains it is recommended that the project continue for a further five years but with a clear exit strategy.
- One of the key tasks that will confront the Budget Department in the year ahead is the maintenance of accurate information on the Donor Assistance Database (DAD). This requires adherence to a stricter discipline and order to data management, collection, verification and input. A significant investment of time will be required to ensure that the DAD remains valid to the Cabinet, Ministries, donors and the public in general. A stronger and more reliable service orientation will need to be developed and promulgated in 2007. In addition, the DAD will need to be modified according to the new Harmonised Reporting Format (HRF). The ACU presented a new reporting format to the donor community in the January Aid Effectiveness Working Group meeting. This format needs to be further discussed by the working group, finalized and approved. This format is intended to improve the quality of data collection and reporting.
- The current project phase is expected to end in March. With its utmost importance to the core function of the MoF and its achievement, it is suggested to extend the project for further 5 year period with a clear exit strategy for the future sustainability and more institutionalized

capacity building. The new phase is under preparation based on the proposed exit strategy and recommendations from the evaluation mission conducted in the last quarter of 2006.

The future work plan will focus on the following:

- Give more focus to capacity development of the Government in aid management, coordination and dissemination of information;
- Consultative Groups (CGs) and WGs will be further empowered and their roles strengthened within the line ministries, aid agencies and donors.
- Planning for preparation of National Budget 1386 (2007 - 2008)
- Making a more realistic Budget and improved budget execution for 1386
- Approval of National Budget 1386 by cabinet and parliament by end of March 2007
- Fiscal Strategy and budget framework for 1386 budget
- Programme Budgeting
- Provincial budgeting and capacity building of provincial administration
- More effective coordination of core and external budget

6. FINANCIAL STATUS AND UTILIZATION

Note: All annual expenditures are subject to later adjustments by the project.

FINANCIAL STATUS

Table 1: Contribution Overview April 2004 – December 2006

DONOR NAME	CONTRIBUTIONS		CONTRIBUTION BALANCE
	Committed	Received	
Canada	2,575,892	2,058,651	517,241
Germany (GTZ)	1,211,538	641,026	570,513
USA	1,760,401	1,760,401	-
Italy	143,111	143,111	-
UNDP	94,834	94,834	-
TOTAL	5,785,776	4,698,023	1,087,754

Note: USA, Italy money are carried over from the previous Aid Coordination project

Table 2: Funding Status as of 31 December 2006

Donor	Received	Expenditures			Project Balance	Available Funding (as of 1 Jan 2007)	Remarks
		Period Prior to the Reporting Year	Reporting Year Only	Total			
Canada (CIDA)	2,058,651	514,637	1,560,446	2,075,083	(16,432)	(16,432)	The last installment is expected to receive early January 2007
Germany (GTZ)	641,026	-	37,153	37,153	603,873	603,873	
USA	1,760,401	1,760,401	-	1,760,401	-		
Italy	143,111	143,111	-	143,111	-		
UNDP	94,834	74,834	23,003	97,837	(3,003)		
Total	4,698,023	2,492,983	1,620,602	4,113,585	584,438	587,441	

FINANCIAL UTILIZATION

Table 3: Annual Expenditure by Activity [1 January – 31 December 2006]

Activity	Budget - 2006	Expenditures - 2006	Balance	Delivery Rate (%)
Activity 1 (Human capital and social protection)	83,115	118,202	-35,087	142
Activity 2 (Physical infrastructure)	90,446	118,369	-27,923	131
Activity 3 (Environment for Development)	93,900	120,430	-26,530	128
Activity 4 (Grants and Loan Portfolio monitoring)	200,069	345,849	-145,780	173
Activity 5 (Budget coordination and reporting)	228,801	258,084	-29,283	113
Activity 6 (DAD and IT)	84,918	77,758	7,160	92
Activity 7 (Admin support and management)	686,827	477,094	209,733	69
Activity 8 (Support to ADF)	20,000	22,685	-2,685	113
Activity 9 (Provincial budgeting)	53,000	34,911	18,089	66
GMS	76,060	47,220	28,840	62
Total	1,617,136	1,620,602	-3,466	100

Table 4: Annual Expenditure by Donor [1 January – 31 December 2006]

Donors	Activity	2006 Budget	2006 Expenditure	Balance	Delivery Rate
CIDA	Activity 1 (Human capital and social protection)	83,115	117,402	-34,287	141
	Activity 2 (Physical infrastructure)	90,446	118,369	-27,923	131
	Activity 3 (Environment for Development)	93,900	120,430	-26,530	128
	Activity 4 (Grants and Loan portfolio monitoring)	200,069	345,849	-145,780	173
	Activity 5 (Budget coordination and reporting)	228,801	258,084	-29,283	113
	Activity 6 (DAD and IT)	84,918	77,758	7,160	92
	Activity 7 (Admin support and management)	686,827	477,094	209,733	69
	GMS	73,410	45,460	27,950	
	Sub Total (CIDA)	1,541,486	1,560,446	-18,960	101
GTZ	Activity 8 (Support to ADF)	-	482	-482	
	Activity 9 (Provincial budgeting)	53,000	34,911	18,089	
	GMS	2,650	1,760	890	
	Sub Total (GTZ)	55,650	37,153	18,497	66.76
UNDP	Activity 1 (Human capital and social protection)	-	800	-800	
	Activity 8 (Support to ADF)	20,000	22,203	-2,203	
	Sub Total (UNDP)	20,000	23,003	-3,003	115.01
	Total	1,617,136	1,620,602	-3,466	100

CONTACT INFORMATION

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