

**FOR
INFORMATION**

FO/DIS/21/29

February 26, 2021

To: Members of the Executive Board

From: The Secretary

Subject: **Islamic Republic of Afghanistan—Technical Assistance Report—
Strengthening Oversight over State-Owned Corporations, PPPs, and Fiscal
Risks**

Board Action: Executive Directors' **information**

Publication: Yes, after Friday, March 5, 2021

Questions: Mr. Charaoui, FAD (ext. 34072)

Islamic Republic of Afghanistan

Strengthening Oversight over State-Owned Corporations, PPPs and Fiscal Risks

Jacques Charaoui, Jonas Frank, Olya Kroytor, and Mathilde Ravanel-Vassy



Technical Report

July 2020

CONTENTS

ABBREVIATIONS AND ACRONYMS	5
PREFACE	6
EXECUTIVE SUMMARY	7
I. LEGAL AND INSTITUTIONAL ARRANGEMENTS FOR FISCAL RISKS	10
A. Overview of Fiscal Risk Management	10
B. Recommendations	15
II. STATED OWNED CORPORATIONS	15
A. SOEs/SOCs and the Oversight Framework	15
B. Fiscal Risks of SOEs/SOCs	19
C. Reporting on Fiscal Risks Related to SOEs/SOCs	23
D. Recommendations	26
III. PUBLIC-PRIVATE PARTNERSHIP	28
A. Overview of PPPs	28
B. Legal and Oversight Framework	29
C. Main Fiscal Risks from PPPs	32
D. Recommendations	36
BOXES	
1. Country Examples of Fiscal Risk Management Provisions in PFM Legal Frameworks (Summaries)	13
2. Status of the SOC Law	16
3. Observations of Audits of Financial Statements	20
4. Entities Involved in Fiscal Risk Monitoring and Oversight of SOEs/SOCs	24
5. Project Cycle Under the PPP Law	31
6. PPP Fiscal Risk Assessment Mode	34
7. Examples of Budget Ceilings for Public Private Partnerships	35
FIGURES	
1. Distribution of SOEs and SOC by Line Ministry	17
2. Share of the Total Income for SOEs and SOC and Total Number of Employees	17
3. Current Liabilities as Share of Total Liabilities	22
4. Share of SOC and SOEs Running a Deficit	22
5. Investment Capital of Public-Private Partnership Projects at Various Stages of the Project Cycle	29

TABLES

1. Key Recommendations	9
2. Main SOEs/ SOCs Financial Data	21

ANNEXES

I. Roles and Responsibilities of the SOE Department at the Ministry of Finance	38
II. List of State-Owned Enterprises	40
III. Template for a PPP Database	42
IV. Disclosure of PPPs in Fiscal Strategy Paper	44
V. Disclosure of PPPs in the Budget Documentation	45

ABBREVIATIONS AND ACRONYMS

CPA	Central Partnership Agency
DABS	Da Afghanistan Breshna Sherkat
DG	Directorate General
ECF	Extended Credit Facility
FAD	Fiscal Affairs Department of the International Monetary Fund
FSP	Fiscal Strategy Paper
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standard
LEG	Legal Department of the International Monetary Fund
MCD	Middle East Central Asian Department of the International Monetary Fund
METAC	Middle East Regional Technical Assistance Center
MFPD	Macro-Fiscal Policy Department
MoF	Ministry of Finance of Afghanistan
PDF	Project Development Fund
PEC	Project Evaluation Committee
PFEM Law	Public Finance and Expenditure Management Law
PFM	Public Financial Management
PIM	Public Investment Management
PNC	Project Concept Note
PPP	Public-Private Partnership
P-FRAM	PPP Fiscal Risk Assessment Model
SOC	State-Owned Corporation
SOE	State Owned Enterprise
VGf	Viability Gap Fund

PREFACE

At the request of the Minister of Finance, a team from the Fiscal Affairs Department (FAD), the Middle East Regional Technical Assistance Center (METAC) and the Legal Department (LEG) of the IMF conducted a remote mission undertaken intermittently from June 22 through July 30, 2020. The team comprised Jacques Charaoui (lead-FAD), Jonas Frank (METAC), Olya Kroytor (LEG), and Mathilde Ravanel-Vassy (FAD Expert). The objective was to provide advice to the authorities on the management of fiscal risks. This work could be followed up in subsequent missions by FAD, METAC, and LEG to support the implementation of the reform agenda laid in this report.

This mission was conducted in parallel with a Middle East and Central Asian Department (MCD) mission, led by Mr. Azim Sadikov, aimed at discussing a new Extended Credit Facility (ECF) arrangement.

In the Ministry of Finance (MoF), the team met with Mr. Sayed Naseer, Director General of Budget; Mr. Rafiullah Nabeel, Director of Legal Board; Mr. Abdul Rahman Rahimi, Director General of Fiscal Policy; Mr. Talha Hidayat, Director General for PPP; Mr. Aboozar Karimi, Senior Finance Specialist State Owned Enterprises & Corporations. The mission wishes to thank all of them for the open discussions.

The team thanks Mr. Rafiullah Nabeel for his huge support in arranging the meetings and briefing the team on many topics; and Azim Sadikov (mission chief), Mariusz Sumlinski, and all of the IMF country team in the Middle East and Central Asia Department (MCD), for their generous support.

EXECUTIVE SUMMARY

This remote mission provided the authorities with advice in fiscal risk management. The mission covered three interrelated topics: (i) the Public Finance and Expenditure Management (PFEM) Law and fiscal risks oversight and management; (ii) the Stated-Owned Corporations (SOC); and (iii) the Public-Private Partnerships (PPP). This report focuses especially on reforms that could be implemented during the life of the next IMF program.

Fiscal risk oversight and management

There is an emerging institutional framework for fiscal risk oversight and management, but it is not yet fully consolidated. The overarching fiscal risk management function is carried out by the Macro-Fiscal Policy Department (MFPD). It has taken initial steps to mention and disclose fiscal risks in the annual Fiscal Strategy Paper (FSP). This provides a very useful base and starting point to further strengthen this critical function for public finance management. However, the legal framework does not envisage a consolidated fiscal risk oversight mandate of the MoF, and SOEs/SOCs are excluded from the scope of the PFEM Law. Future efforts should focus on an initial quantification of contingent liabilities from SOEs/SOCs and PPPs; and widening the scope of fiscal risk by a guarantee framework, and clearly enshrining the fiscal risk oversight mandate of the MoF in the legal framework.

Fiscal Risks of Stated Owned Corporations

Fiscal risks from SOEs/SOCs can materialize and influence negatively public finances from various angles. SOCs and SOEs' total liabilities represent over 6 percent of GDP in 2017, but this amount is likely underestimated, given the significant deficiencies and gaps in reporting and accounting. From the total of 51 SOEs/SOCs, about 23 SOEs and 8 SOCs were not profitable on their core business. Five SOEs or SOCs account for about 80 percent of the total income and about 60 percent of the workforce. One of the five largest SOE, DABS, also displays large long-term liabilities that would justify even closer supervision. The total long-term loans for that entity amounted, in 2017 (latest available data) to AFN 26 billion, almost 2 percent of the 2017 GDP. Overall, this implies that fiscal risk in this sector is quite concentrated. It also implies that it makes sense to continue to focus monitoring in this segment, while gradually expanding oversight to also the 40+ smaller SOEs/SOCs where fiscal risks currently remain undetected.

There are several limitations for improved fiscal risk management of SOEs/SOCs. (i) Financial reporting of SOEs/SOCs is seriously deficient, amidst the backdrop of decades of weak governance, limited oversight and lack of sanctions. Only a fraction of SOEs/SOCs regularly produce financial statements and they are often incomplete; most SOEs/SOCs have not established a balance sheet for over 10 years. The SOC Law provisions on the strengthening of the governance structure of SOCs and reporting by SOCs to the MoF for purposes of fiscal risk monitoring are yet to be fully implemented. (ii) There are blurred lines of accountability between the Department of SOEs/SOCs at the MoF (which acts as secretariat to the SOC Oversight Board)

and the SOC Oversight Board particularly with regards to financial support to SOCs. (iii) The Oversight Board is not yet fully discharging its functions; no annual report on fiscal risks has yet been published.

Fiscal Risks of Public-Private Partnership

Fiscal risks from PPPs appear to be relatively modest, but the government intends to scale up its use of PPPs. While six projects are already under contract with a total investment cost of around 5 percent of GDP, the budget does not quantify contingent liabilities from such projects. In addition, there are 23 projects in the pipeline worth a further 7.2 percent of GDP. Total commitments under PPPs and similar arrangements are not disclosed in any government document. Nor is there a central database within the government consolidating the total noncontingent payments and contingent liabilities of all projects across government. PPPs are regulated by their own Law and the process of developing PPP projects currently runs in parallel to traditional government projects; this bears the risk of a non-efficient choice of modalities for public investment management.

Strengthening Monitoring of Fiscal Risk from SOEs/SOCs and PPPs

Regarding fiscal risk of SOEs/SOCs, authorities should continue with their focus on the largest SOEs/SOCs but being more strategic by moving towards monitoring of balance sheets. This requires improving the quality of financial information in terms of depth and scope; conducting additional external audits of financial statements; deepening the disclosure of fiscal risks at SOEs/SOCs; and creating accountability for financial results. The functions of the secretariat of the SOC Oversight Board (the SOE Department of the MoF) and the SOC Oversight Board need to be further differentiated. A key enhancement is for the SOC Oversight Board to establish a fiscal risk tolerance level based on which approval for financial support can be based upon. It is also important that the Oversight Board soon publishes its first annual report on SOEs/SOCs performance and proposes instructions and guidelines on implementing mitigating measures. Discharging all Oversight Board functions in practice, and reaching more solid levels of transparency of financial accounts will be necessary before a more institutionalized budgetary framework for SOE/SOC can be considered.

Regarding fiscal risk of PPPs, authorities should enforce the “gate-keeping” role of the MoF.

This includes strengthening efficiency considerations through the establishment of an integrated PIM-PPP process, integrating PPPs into the budget process alongside a disclosure of fiscal risks, and disclosure of full costs of PPPs and associated contingent liabilities, and facilitating a more efficient risk sharing between different stakeholders.

Legal enhancements can strengthen the fiscal risk function. The mandate and powers of the MoF with regards to monitoring and managing fiscal risks should be articulated more clearly in the different legal instruments. The risk oversight function embodied in the SOC law which, while in force, is still being considered by Parliament, should be improved; the PFEM Law could envisage a comprehensive fiscal risk mandate of the MoF, while details may be incorporated in regulations.

The choice of the legal instrument will be determined by the nature and timing of the reform priorities.

Table 1 provides a summary of key recommendations covering the three areas discussed above.

Table 1. Afghanistan: Key Recommendations			
Area/Recommendation	Action Step/Activity	Timeframe	Responsibility
Part A: Fiscal risk framework			
1.1. Strengthen the fiscal risk framework	Prepare a concept note determining the scope and objectives of the fiscal risk function in Afghanistan.	December 2020	MFPD
Part B: SOEs/SOCs Oversight and fiscal risks			
2.1. Improving the compliance and quality of financial reporting at the level of individual SOEs/SOCs	Receive and submit to external audit the financial statements (including balance sheets) of the five largest SOEs/SOCs for the last 3 years; define financial targets for 2021-2023; analyze contingent liabilities.	December 2020	SOE/SOC Department of MoF
	Disclose quality of reporting: publish a list of the gaps in reporting from all SOEs/SOCs on a website of MoF and update regularly.	June 2021	SOE/SOC Department of MoF
2.2. Strengthening the SOE/SOC Oversight Board in its regulatory and supervisory tasks	Submit a first annual report covering the financial statements of SOEs/SOCs of 2019 to Oversight Board for analysis and approval.	January 2021	SOE/SOC Department of MoF
	Provide for a clear distinction between (i) the approval of funding / SOCs financial support at the level of MoF and (ii) the role of the SOC Oversight Board to establish risk tolerance levels within which financial support for SOEs/SOCs can be granted.	December 2020	SOE/SOC Department of MoF and SOC Oversight Board, or MoF
	Improve professional capacity of the secretariat of the SOC Oversight Board. In addition, review the staffing profile of the existing 80 staff in light of the responsibilities of the Department and fiscal risk of SOEs/SOCs.	December 2020	SOE/SOC of MoF
2.3. Improving fiscal risk reporting on SOEs/SOCs at the aggregate level	Prepare an initial quantification of contingent liabilities of SOEs/SOCs using the IMF's SOE health check tool. First, as a technical paper and then disclosed in the annual FSP.	Budget 2022	MFPD
	Prepare a concept note for an institutionalized budgetary treatment of SOEs/SOCs.	January 2021	Budget Department, with inputs from MFPD
Part C: PPP Oversight and fiscal risks			
3.1. Strengthening the monitoring and assessment of risks of PPP projects	Use the IMF's PFRAM tool to ensure that fiscal risks associated with PPPs are assessed at the time the contract is entered into, and on an ongoing basis throughout the contract.	On-going	CPA
3.2. Integrate PPPs into the budget framework and improve capacity to assess the budget affordability of PPPs	Disclose information on PPPs in FSP and budget documentation.	Budget 2022	MFPD with input from CPA

I. LEGAL AND INSTITUTIONAL ARRANGEMENTS FOR FISCAL RISKS

A. Overview of Fiscal Risk Management

The Role of the Ministry of Finance in Fiscal Risk Management

- 1. The State-Owned Corporations (SOC) Law mandates the establishment of a fiscal risk unit in the Ministry of Finance, mandated with managing overall fiscal risks.** Such unit — which has to be “organizationally separate and independent from the Secretariat of the SOC Oversight Board”¹ — has not been established to date. The MoF has clarified that the existing MFPD is intended for the role, and in fact it publishes fiscal risk sections in the Fiscal Strategy Papers.
- 2. While there is reference to a fiscal risk unit, and in practice the MFPD discharges these responsibilities, the overall fiscal risk function is not fully articulated in legal instruments.** Fiscal risk monitoring should be comprehensive and cover, in addition to central government, municipalities, SOEs/SOCs, and also state-owned banks. This would require further clarifications to determine what are fiscal risks, what is considered fiscal risk management, and should also include information request and collection powers from all relevant entities, including corresponding requirements for information provision, and sanctions for non-compliance.
- 3. Against this backdrop, the responsibilities within MoF and the different entities should be further clarified.** This chiefly includes the role of the MFPD, the State-Owned Enterprise Department, and the PPP Unit. It is critical to discern between original data collection (best placed in the specialized units) from the analytical task of monitoring fiscal risk in the aggregate and for the overall impact on the budget (best placed in the MFPD).

Type of Fiscal Risks Recognized in the Legal Framework and Mitigation Measures

- 4. The PFEM Law² includes “contingent liabilities.”** Article 33(6) of the PFEM Law states that the assets and liabilities information, to be included in the budget, must incorporate “[d]etails of the estimated amount of contingent liabilities of the State that will rise to actual liabilities during the fiscal year.” Article 58(6) requires that assets and liabilities information included in the budget reporting incorporates an “[d]etails of difference” between the estimated and materialized

¹ Article 12(1)(f) of the SOC Law.

² The PFEM Law was adopted in July 2005 and amended in 2016. Public Finance and Expenditure Management (PFEM) Law regulates the organization and management of the financial affairs of Afghanistan. The mission team reviewed the English translation of the PFEM Law. The existing PFEM Regulation, although shared with the team, has not been reviewed, since it is not available in English.

contingent liabilities. The MoF is also required to maintain records of borrowing or lending by the state, including “guarantees and contingent liabilities.”³

5. The PFEM Law only incorporates a general provision on the MoF issuance of loan guarantees. Following information by MoF to date no guarantees were issued. Article 20 of the PFEM Law clarifies that the MoF may only issue a loan guarantee “where authorized by Law” and in the amount specified in the law, and where a non-expended amount is available within the appropriations. This does not represent as of yet a framework for guarantee management.

6. The PFEM Law envisages a contingency allocation within the budget. It may not exceed 3 percent of “total program expenditures” and is to be included in “the revenue and expenditure plan.”⁴ Its purpose and the process of resorting to it are broadly outlined in Article 46: in case of “urgent and unforeseen requirements” the MoF may propose to the President to “change the purpose of part of a contingent expenditure appropriation of a state administration to a purpose of a program of the requesting state administration.” The MoF is currently working on developing a regulation that would detail the terms and conditions for the use of contingency allocation, which is expected to be adopted by end-December 2020.

Fiscal Risks from SOCs

7. Article 12 of the SOC Law vests the MoF with the responsibility to “monitor, analyze, disclose and mitigate” fiscal risks resulting from SOCs activities. The law refers to the objective of ensuring fiscal sustainability.⁵ Therefore, MoF is entitled to obtain from SOCs and the SOC Oversight Board “all relevant data and information considered necessary to monitor and analyze the potential fiscal risks,” including quarterly reports, annual financial statements and auditor's reports. Based on its analysis, MoF should produce and publish fiscal risk evaluation and mitigation reports related to SOCs.

Information Requirements

8. The PFEM Law incorporates information provision requirements for state administration authorities and municipalities but lacks specifics. State administration authorities are obliged to report on public spending under Article 5. Municipalities are subject to reporting requirements under Article 25 of the PFEM Law. There are, however, no mechanisms to enforce this requirement (inter alia, sanctions), and it is unclear whether the details of such information provision requirement (e.g., type of information, frequency etc.) are specified in a secondary legal instrument (e.g., regulation).

³ Article 17(4) of the PFEM Law.

⁴ Article 32(9) of PFEM Law; it specifies that the details on contingency expenditures are to be included in the revenue and expenditure report (Article 57(8)).

⁵ Article 2(7) of the SOC Law refers to fiscal sustainability.

Fiscal Risk Reporting and Disclosure

9. The MoF has an obligation to publish risk reports. MoF must submit to SOCs, the SOC Oversight Board, other relevant Ministries, the Supreme Audit Office, the President and the National Assembly, all the produced fiscal risk evaluation and risk mitigation reports, as well as publish them on the official website of the MoF.⁶ Article 12(1)(e) states that fiscal risk functions (including production and publication of the reports) are performed “through the unit or department within the Ministry of Finance assigned with the responsibility to control and oversee fiscal risks.

10. The main vehicle for reporting on fiscal risks is the annual Fiscal Strategy Paper. In the past, the MFPPF has published separate quarterly fiscal risk reports, but has discontinued doing so in recent years. Today, fiscal risk reporting is mainly done through the annual Fiscal Strategy Paper (FSP). Should a future, self-standing Fiscal Risk Statement be published, its function and objective must be aligned with the corresponding sections of the FSP. Reporting specifically on SOEs/SOCs and PPPs could be strengthened and the corresponding sections in the FSP further enhanced.

Potential Legal Enhancements

11. A careful analysis of potential legal enhancements and the choice of the legal instrument is necessary. The above issues could be addressed through amending the PFEM Law (which also needs to be aligned with the SOC Law, as appropriate), in particular to:

- Incorporate a comprehensive MoF fiscal risk management function (not only limited to fiscal risks stemming from SOEs/SOCs);
- Determine what constitutes fiscal risks and fiscal risk management;
- Clarify PFEM Law coverage for purposes of managing fiscal risks (specifically including SOCs) thus bringing PFEM Law in compliance with the SOC Law;
- Envisage MoF powers to collect information from respective entities to implement fiscal risk management function and corresponding requirements for relevant entities to provide such information, as well as, potentially, enforcement powers (sanctions – see below);
- Reconfirm that the FSP is used to report on fiscal risks from SOEs/SOCs and PPPs as part of the annual budget process;
- Introduce and/or enhance a sanctions regime for non-compliance with the requirements of the law, in particular information provision requirements (if incorporating those in the PFEM Law is appropriate under the legal tradition in Afghanistan).

⁶ See Article 12(1)(d) of the SOC Law

12. The MoF has also informed the mission that, given the SOC Law is still being discussed with the Parliament, amendments to it are possible.⁷ Based on the necessary improvements to be made at the level of the primary law, amending or developing secondary legislation could also contribute to resolving the issues mentioned in this report.

- In developing the SOC Regulation, the MoF powers on information collection from SOC's could be detailed, for example by specifying the types of information to be provided, for instance the frequency of reporting etc.
- Operationalization of the SOC Law will also need to ensure clarity in the distribution of roles between the MFPD, the SOE/SOC department of the MoF and the SOC Oversight Board.

13. Adopting these legal changes would strengthen the mandate and powers of MoF with regards to monitoring and managing fiscal risks. To this end, it could further draw from different international references and practices (see Box 1).

Box 1. Country Examples of Fiscal Risk Management Provisions in PFM Legal Frameworks (Summaries)

Bahrain Budget Law 2002

Information provision requirement

Article 47 requires Government Organizations subject to this Decree Law to submit to the MoF regular reports on their activities. **Article 55** requires that fully owned Government Companies submit to the MoF, inter alia, proposed budgets, investment plans, as well as other information that may be specified by the MoF. Prior approval of the MoF is required before fully owned Government Companies may obtain a loan "for expansion, modernization or other similar purposes."

Brazil Fiscal Responsibility Law 2000

Obligation to disclose fiscal risks in budget documentation

Article 4 requires that the Budgetary Guidelines Law encloses a Fiscal Risk Appendix, "evaluating contingent liabilities and other risks that may affect public accounts, and detailing the measures to be taken, should such occur."

Ecuador Organic Code for Planning and Public Finances 2010

Information collection powers (including sanctions)

Article 152 requires public sector entities to submit the financial and budget information (specified in the law or regulations) within the designated timeframe. Failure to do so will result in a suspension of the allocation of resources and/or transfers from the general budget.

⁷ While being cautious lest the current framework specified in the SOC Law be weakened, consideration may be given to strengthening the SOC Law by introducing a framework for sanctions for non-compliance with information provision requirements. On the other hand, this may be addressed more comprehensively through amending the PFEM Law, and duplication in this case should be avoided. With regards to the TA recommendation to further differentiate the role of the SOC Oversight Board with regards to state support approval, it seems that no change to the SOC Law will be needed to implement the power of the SOC Oversight Board with regards to defining risk parameters (which will then be used by the MoF to exercise their approval powers), although ultimate deference in this regard is made to the authorities; in any case, this should not undermine the existing approval requirements. The SOC Law as adopted should be implemented in full.

**Box 1. Country Examples of Fiscal Risk Management Provisions in PFM Legal Frameworks
(Summaries) [concluded]**

Ghana Public Financial Management Act 2016

Information collection powers (including sanctions)

Section 5 allows the MoF to request a report or other information from any “covered entity” or “any other person receiving grants, advances, loans, guarantees or indemnities from the Government.”

Section 75 specifies reporting requirements of local government authorities, and **Sections 76** and **77** specify, respectively, borrowing (limits, approval by the MoF) and reporting requirements by public corporations (PCs) and SOEs; **Article 94** specifies the MoF power to issue a “financial directive” to PCs and SOEs, inter alia, to “provide financial information that the Minister may specify,” and includes a corresponding obligation for the PC or SOE to comply with it. **Article 98** specifies individual liability for refusal or failure to produce or submit any information required under the PFM Act, which includes, where no penalty is provided for the offence, a fine or imprisonment or both (in addition to being subject to, other, e.g., disciplinary sanctions).

Montenegro Law on Budget and Responsibility 2014

Information collection powers (including sanctions)

Article 44 requires spending units to submit to the MoF “an accurate and complete report on receipts, expenditures and commitments” (there also are other, more specific, information provision requirements envisaged in this law). **Article 83** envisages a fine for a responsible person in a “spending unit, business organization founded by the Government or a municipality, and legal person with majority state ownership” for submission of “an incorrect and incomplete report on receipts, expenditures, and commitments” (per Article 44); failure to “submit the report on each disbursement of the loan funds” within designated period of time; or failure to submit the quarterly report on stock of overall borrowings; erroneous and incorrect record of receipts, commitments and expenditures; and failure to submit a financial report based on the MoF special order. **Article 84** also envisages a fine for failure by the responsible person of a spending unit to “report for recording in the Treasury General Ledger the State Budget receipts, expenditures, and commitments.”

New Zealand Public Finance Act

Information collection powers

Section 26Z enables the Secretary to request “any department, any departmental agency, or any entity referred to in section 27(3)(a) to (f), or any entity that manages an asset or liability of the Government,” to provide “any information that is necessary to enable the preparation of any fiscal forecasts and projections referred to in sections 26L, 26N, 26NA, 26O, 26Q, 26S, and 26T.”

Obligation to disclose fiscal risks in budget documentation

Section 26Q requires that fiscal forecasts include, among other things, “a statement of specific fiscal risks of the Government as at the day on which the forecast financial statements are finalized,” that, among other things, “discloses the rules used to determine what is and is not a fiscal risk.”

B. Recommendations

14. The following are key elements of a strategy to strengthen the fiscal risk framework:

Recommendation	Within one year – duration of ECF	As of mid-2021
1.1. Strengthen the fiscal risk framework	Prepare a concept determining the scope and objectives of the fiscal risk function in Afghanistan (describing types of fiscal risks; fiscal risk management; information request and collection powers; requirements for information provision; and sanctions for non-compliance), including an analysis of the legal instruments to be used and/or that may need to be amended.	Produce manuals and guidelines, as necessary. Develop and adopt legislative amendments (PFEM Law, PFEM Regulation, other legal instruments as may be appropriate).

II. STATED OWNED CORPORATIONS

A. SOEs/SOCs and the Oversight Framework

Definitions of State-Owned Enterprises

15. **Definition of state-owned enterprises are enshrined in the legal framework.** There is an important distinction between the PFEM Law,⁸ which excludes SOEs, and the SOC Law (Box 2). Article 3(1) of the SOC Law⁹ defines an SOC as “a company that is separate and distinct from its owners and is established under this law, with capital that is specific and divided into shares, and with the responsibility of each shareholder limited to the proportion of his or her shares and where at least 25 percent of the issued shares are owned by organs of the state, including subnational governments, or when organs of the state, including subnational governments, can exercise control over the company, regardless of the proportion of shares they own.” The SOC Law intends to cover all existing state-owned companies and mixed companies¹⁰ as well as “all the other companies that are established in accordance with the present law and become part of the governance structure of the government or whose ownership is transferred to the government

⁸ State owned companies and enterprises are excluded from the scope of the PFEM Law. Article 64 subjects them to the regulation of “their related laws”. At the same time, there is a reference to SOC in Article 9.4 of the PFEM Law states that funds and revenues that become public assets upon receipt include, among others, “[d]ividends or other payments from enterprises owned by the State.” Furthermore, Article 21 of the PFEM Law mentions that the MoF may provide loans to any “administration, tassady or company,” which provision may also cover SOEs and/or SOC.

⁹ The mission reviewed the English translation of the State-Owned Corporations Law published in the Official Gazette (Serial Number 1322 dated 1397/8/15).

¹⁰ A Mixed Company is defined in Article 3(18) of the SOC Law as “any commercial entity not wholly owned by organs of the state, but where the proportion of capital owned by organs of the state is 25 percent or more, or when the organs of the state can exercise control over the company regardless of the proportion of capital they own.”

after the implementation of the present law.”¹¹ In turn, State-owned banks are governed by the Banking Law.

16. State-owned enterprises are being converted into State-owned corporations in a process which is ongoing and expected to be concluded in December 2020. Article 50(3) of the SOC Law requires that all SOEs amend their articles of association in compliance with the SOC Law.¹² The start of this process was the approval of sample articles of association by the Cabinet in June 2020. The process of converting all existing entities that would fall under the SOC Law to SOC is ongoing, however there is no overview available regarding changes at the level of individual SOC/SOEs (see Box 2).

Box 2. Status of the SOC Law

The adoption of the SOC Law in 2018 is aimed at strengthening the oversight function; although the SOC Law has the force of a law from the moment it was ratified by the President (2018), it is yet to be fully implemented. The SOC Law was developed with technical assistance support from the IMF and the World Bank.

The SOC Law, enacted as a legislative decree by the President, is currently being discussed by the Parliament; it is important to ensure that any potential revisions to the law do not weaken the new framework. SOC Law was enacted as a “legislative decree” pursuant to Article 79 of the Constitution, during Parliamentary recess. Under the Constitution, the SOC Law was subsequently submitted to the Parliament within thirty days of convening the first session of the Parliament following Presidential ratification of the law. The Constitution states that a legislative decree becomes void if it is rejected by the National Assembly. To date, the National Assembly has not formally rejected the SOC Law. However, the text of the SOC may be revised by the Parliament in the course of the debate. The timeline for the ongoing legislative process is unknown. No SOC regulation has been developed based on the SOC Law, as explained by the MoF, partly due to the fact that the law may be amended by the Parliament. It should be emphasized that any amendments that may be proposed to the SOC Law as part of this process do not have a negative impact on the quality of the existing (newly adopted) provisions.

Source: IMF staff.

Overview of the SOC and SOEs

17. There are 36 SOEs and 15 SOC¹³ distributed unevenly among different ministries (Figure 1 and Annex II). With 11 SOEs/SOCs the Ministry of Commerce and Industry has the largest number of entities but the SOC and SOEs of the Ministry of Finance (MoF) account for 18 percent of the total 2019 income. The most important SOC in terms of income, that accounts

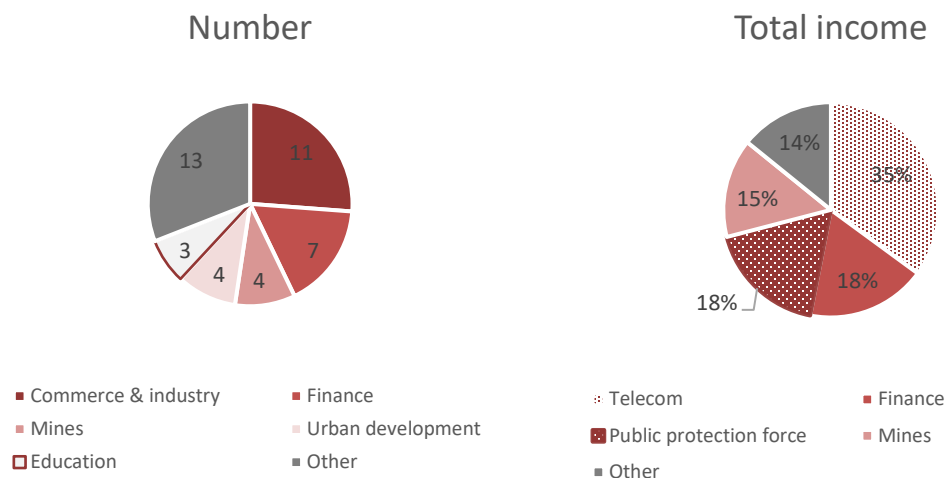
¹¹ Article 4(1) of the SOC Law.

¹² The SOC Law does not appear to incorporate a definition of a “state-owned company.” At the same time, in a few instances, references to state-owned companies seem to be used interchangeably with SOC. The SOC Law also uses the term “state-owned enterprise” in several instances, where it appears that the reference is meant to be to SOC. This may be a translation issue, however. The timeline established in the SOC Law has not been followed. For example, Article 50(6) of the SOC Law states that “all existing government positions in entities that change into SOC in compliance with the present law, are required to accordingly change their articles of association by December 2019.”

¹³ We here refer to SOC for entities that had the SOC status before the adoption of the SOC law.

for 35 percent of the total income of SOEs and SOC, is Afghanistan Telecom, for which the line ministry is the Telecom Communication and Information ministry.

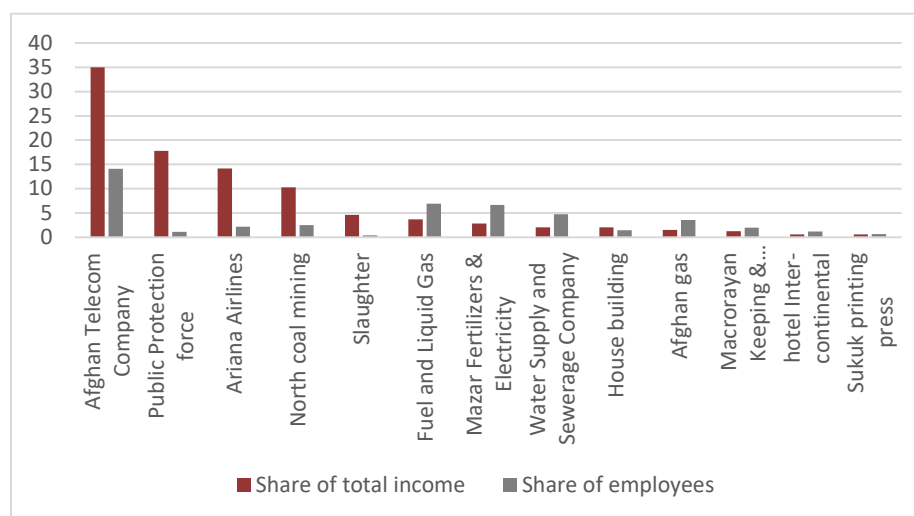
Figure 1. Distribution of SOEs and SOC by Line Ministry (number and total income)



Source: MoF SOE and SOC analysis

18. The total income and workforce are concentrated in a limited number of SOEs and SOC. As shown in Figure 2, five SOEs/SOCs account for about 80 percent of the total income and about 60 percent of the workforce. The other ones are much smaller in size.

Figure 2. Share of the Total Income for SOEs and SOC and Total Number of Employees¹ (percent)



Source: MoF SOE and SOC analysis

1/ Here are only included SOEs and SOC for which the income represents more than 0.5 percent of the total income of SOEs and SOC. DABS is not included for lack of data since 2017.

Oversight Framework

19. There is a centralized oversight model with the option of sector ministries to become shareholders. MoF is the State's registered shareholder in a SOC.¹⁴ Although the letter and spirit of the SOC Law have centralized the exercise of ownership rights with the MoF, the law allows other "ministries and state agencies" to become SOC shareholders based on the Cabinet approval.¹⁵

20. The SOC Oversight Board has been established and held several meetings, however, it has not been discharging all of its functions. Its role is to act as "a central advisory, monitoring and oversight body with respect to SOCs."¹⁶ The SOC Oversight Board is composed of five members appointed by the President and is chaired by the Minister of Finance. The SOC Oversight Board powers include, among others, establishing an ownership policy framework; reviewing the strategy and performance of all SOCs; prescribing corporate governance standards for SOCs; conducting periodic study, examination, evaluation and assessment of the performance of SOCs; review and assess existing salary scales; selection and appointment of the members of the Board of Directors of each SOC from the shortlist of Director candidates prepared by the Civil Service Commission etc. Despite a requirement that (at least some of) the SOC Oversight Board members serve full-time positions,¹⁷ the SOC Oversight Board has not been meeting on a daily basis as prescribed by the SOC Law. It does not publish minutes of its meetings; and the annual reports on the performance of each SOC have neither been prepared nor submitted to the High Economic Council.

21. The MoF State-Owned Enterprises Department is to be transformed into an SOC Department and would act as the secretariat of the SOC Oversight Board.¹⁸ The responsibilities as highlighted by the website of MoF are reported in Annex I. The department has 80 staff and seems to have capacity constraints to perform more strategic fiscal risk analysis of SOEs/SOCs; the mission was not able to do further analysis of staffing profiles and tasks.¹⁹ A

¹⁴ See, e.g., Articles 5 ("The state's registered Shareholder in a SOC will be the Ministry of Finance, and other ministries and state agencies can become shareholders by the approval of the Cabinet of Ministers") and 9 ("The Ministry of Finance is the state Shareholder in every SOC, and in any commercial entity where the state owns a minority interest or less than 25% of the capital").

¹⁵ The MoF has clarified that the latter option may be considered when technical expertise may be needed to manage an SOC.

¹⁶ Article 10 of the SOC Law.

¹⁷ Article 15(1)(d) of the SOC Law, which lists members of the SOC Oversight Board, mentions that "[a]ll the aforementioned positions are full time" (which implies, e.g., the Executive Director, "one member with the rank of deputy prime minister," and "two other full-time members who will not prior to the appointment be government employees." . However, Article 15(3) only mentions that the position of the Executive Director is full-time.

¹⁸ Article 11 of the SOC Law

¹⁹ It is not known to the mission what the ratio of operational versus non-operational staff is.

separate SOE oversight unit for four SOEs supervised by the Ministry of Mines and Petroleum will cease to exist once the transition to SOC is completed.²⁰

B. Fiscal Risks of SOEs/SOCs

Availability and Quality of Financial Information on SOEs/SOCs

22. Reporting from SOEs and SOC on their financial statements is limited in terms of coverage and timeliness. Per article 21(3) of the SOC Law, SOC is required to prepare and approve quarterly and annual financial statements containing at least (i) the balance sheet; (ii) profit and loss account (income statement); and (iii) cash flows, and other information requested by the SOC Oversight Board. The SOC Oversight Board analyzes annual balance sheets and quarterly reports on the SOC activities and reports to the Board of Directors on any "concerns or observations."²¹ All SOC is per SOC Law required to follow the IFRS standards in reporting. However, the availability of financial information for SOEs and SOC is poor:

- 13 of the 15 SOC regularly produce financial statements (quarterly; annual); that is, two SOC do not regularly prepare financial statements either on a quarterly or annual basis. Ten of them include the last year's financial performance in their financial statements; and five do not.
- The financial statements themselves are often incomplete²² and there is limited detailed information regarding income statement or balance sheet, preventing a better understanding the financial relationships with the Government. Most of the time, balance sheet information is altogether missing and income statement information is only based on large aggregates (income, expenses and profit). This information is not available in the budget documents.
- Most SOEs/SOCs have not established a balance sheet for over 10 years; this implies that the MoF does not have information about the size and structure of SOEs/SOCs liabilities. Completing balance sheets is also a sine qua non condition before equity can be transferred to the private sector.
- Many SOC have a backlog in preparing financial statements; this holds for 8 of the 15 SOC, among them are four of the five SOC which have audited statements (Ariana Afghan Airline, Hotel intercontinental, Da Afghanistan Breshna Sherkat (DABS) and Afghan Telecom); some audits were not shared with MoF.

23. External audits are not conducted regularly, however initial applications focusing on the largest SOC point to significant issues in financial transparency. External audits conducted through external firms are not performed regularly. To date and over the range of the

²⁰ <https://momp.gov.af/directorate-state-owned-enterprise>

²¹ Article 10(9)(1) of the SOC Law.

²² The audited statements contain, as an example from DABS: (i) statement of financial position (assets and liabilities); (ii) statement of profit and loss; (iii) statement of comprehensive income; (iv) statement of changes in equity; (v) statement of cash flows.

last years, only five out of the 15 SOCs had their statements audited. Nevertheless, external audits are covering mostly SOCs with high financial volume. Audit findings point to serious deficiencies in financial governance and transparency (Box 3). Audits through the Supreme Audit Office (SAO) are apparently not conducted.

Box 3. Observations of Audits of Financial Statements

Issues that are referred to in the audited financial statements include, inter alia: financial statements that keep changing while the audit is being conducted (Ariana); evidence that SOCs receive grants from the government (DABS); that non-monetary grants have been provided from donors and bilateral agencies that are not recorded properly and in a way that recognizes fair value of economic benefit; revaluations of assets that “overinflate” the balance sheet; valuation of land in a way that prevents fair valuation (DABS); inconsistent applications of exchange rates (Hotel Intercontinental); inconsistent recording of receivables given they are from entities which were later outsourced (Ariana); lack of updated asset inventories (Ariana).

Source: Audit reports; IMF staff

Overview of the Financial Situation of the Main SOEs and SOCs and Fiscal Risks

24. Given the data issues outlined above, the financial analysis below might not be entirely reliable. The mission has compared some of the financial data published online by SOCs and the spreadsheet provided by the MoF and has found some discrepancies.²³ Though not necessarily important in amounts, the following financial analysis should be read carefully, keeping in mind that there are different information sources which do not match up properly in all instances. This underscores the need for consistent audits of financial statements.

25. The SOCs and SOEs’ total liabilities represent over 6 percent of the GDP in 2017, but this amount could be underestimated. This number is likely more important as the mission only used the balance sheet data available (and balance sheet information is mostly missing for the SOEs and SOCs). In total, considering the liabilities of 7 SOEs or SOCs²⁴ representing around 90 percent of the total income of the SOEs and SOCs, the total liabilities amount to 6.4 percent of the GDP in 2017 (Table 2).

²³ For example: Afghan telecom corporation Net earnings for year 2016 is reported AFN 1 193 100 413 in the excel spreadsheet whereas in the income statement, it is reported at AFN 483 506 124. This comes from operational error in the MoF spreadsheet construction but testifies to the lack of verification in the process.

²⁴ DABS, Afghan Telecom company, Public protection force, Ariana airlines, North coal mines, Slaughter, Fuel and liquid gas. Note that for lack of available data, income for DABS used to calculate the 90% share is that of 2017 and is considered to have remained stable since then.

Table 2. Main SOEs/ SOCs Financial Data¹

Name	Status	Total liabilities (in bn)	As share of 2018 GDP (in %)	Latest information on liabilities	Total income (in bn)	As share of 2018 GDP (in %)	Latest information on total income
DABS	SOE	61,6	4%	2017	28,6	2%	2017
Afghan Telecom Company	SOC	10,7	1%	2019	10,2	1%	2019
Fuel and Liquid Gas	SOC	10,6	1%	2017	1,1	0%	2019
Mazar Fertilizers & Electricity	SOE	6,8	0%	2016	0,8	0%	2019
Public Protection force	SOE	4,9	0%	2013	5,2	0%	2019
North coal mining	SOE	2,1	0%	2018	3,0	0%	2019
Ariana Airlines	SOC	1,4	0%	2019	4,1	0%	2019
Slaughter	SOE	0,4	0%	2018	1,3	0%	2019
Water Supply and Sewerage Company	SOE	NA	#VALUE!	NA	0,6	0%	2019

Source: MoF
1/ Data for SOEs rely on information provided by the MOF and not financial statements.

26. The long-term liabilities of DABS could constitute a risk for the Government. The total long-term loans amounted, in 2017 (latest available data) to AFN 26 billion, almost 2 percent of the 2017 GDP. This loan is an Asian development bank loan granted through the Government. The first repayment dates for this loan are between 2017 and 2024. In 2017, the company had been running a deficit on operational income for three consecutive years and it was running a deficit on total income basis for the first year. This situation might prevent DABS from meeting its repayment obligations and the loan might then fall back on the Government.

27. The SOEs and SOCs liabilities are mostly current (short term) liabilities (Figure 3). For SOEs, the data the mission had access to does not display long-term liabilities. For SOCs, apart from the electricity company DABS, the current liabilities represent over 80 percent of the total liabilities. The mission did not have access to detailed financial statements and therefore it is not clear whether SOCs and SOEs keep a trace of the “age” of the short-term liabilities.

28. Most of the largest SOEs and SOCs²⁵ are generally profitable, or in balance, limiting the fiscal risk associated with the losses associated with SOEs and SOCs.²⁶ The total operational profit of the SOEs and SOCs sector amount to AFN 4,062 million for profit including

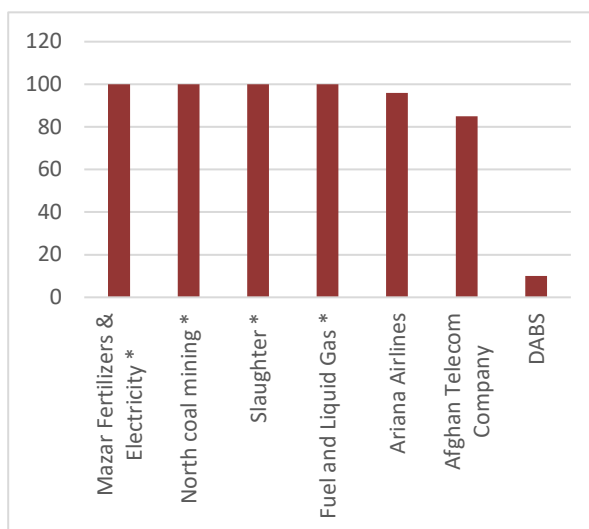
²⁵ Afghan Telecom, North Coal mines, Slaughter, Fuel and liquid gas, Mazars fertilizer, Public protection force, Central Silo, Afghan gas, Pharmacy, Afghan Tour, Hotels, Afghan Poultry, Afghan National insurance company, Afghan textile, Water supply and sewage company, Carving and carpentry.

²⁶ Data for DABS is not available past 2017, where it operated at a deficit.

non-operational income. The total income of the SOEs and SOC that are running a deficit represents around one fifth of the sector total income.²⁷ Ariana airlines is the largest loss maker and accounts for most of that figure. It runs a deficit in 2019 both excluding and including non-operational income in the latest year.

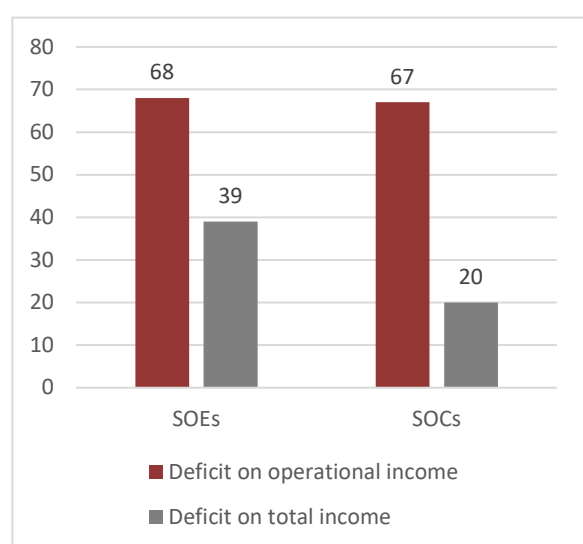
29. Nonetheless, the majority of SOEs and SOC run their operations at a loss in the latest fiscal year and only non-operational income allows them to display a profit. Indeed 23 SOEs and 8 SOC were not profitable on their core business. Including other incomes, 12 SOEs and 3 SOC were still displaying deficits. The mission did not have access to detailed accounts, but these other incomes are mainly the proceeds of the rents of the buildings. This specific point could be seen as a non-financial transfer from the Government to the SOEs and SOC. Indeed, those are gaining most their profit on financial gains made from renting assets. If those assets are not used to produce the products and services of the core mission, it could be said that the Government could reincorporate the assets on its own balance sheet and benefit from the financial gains (Figure 4).

Figure 3. Current Liabilities as Share of Total Liabilities (percent)



Source: MoF data (SOEs marked with a *), published accounts for the SOC

Figure 4. Share of SOC and SOE Running a Deficit (percent)



Source: MoF SOE and SoC analysis

30. The largest SOC, Afghan Telecom, displays a profit in the last five years mainly due to the operation it is running in monopolistic markets. Afghan Telecom has 5 percent of the market share of the mobile telecommunication. However, it is operating monopolistically in land lines, satellite and optic fiber. This monopoly position facilitates the profitability of the firm. Indeed, the balance sheet of Afghan Telecom appears sound despite some commitments not

²⁷ These numbers are calculated on the SOEs and SOC for which profit/ loss data is available for 2019. Therefore 10 SOEs or SOC are excluded.

being reported. In the latest fiscal year, the company displays a commitment of AFN 6bn (0.5% of the 2018 GDP) towards certain telecom vendors (ZTE, Huawei, Tamas telecom, Sunsky, Insta telecom). As reported, the current ratio is almost 11. Adding this extra commitment, the current ratio falls to 2.4, which still displays a sound liquidity position. This position lies on cash balance but also on government grants that account for almost 10 percent of the assets.

31. Out of the five largest SOC/SOEs,²⁸ all except one have seen an improvement in their liquidity positions in the past years. The weakest is the Slaughter company with a current ratio around 1. A current ratio under 1 can be a cause for concern because it means that a company might not have enough liquidity to cover current liabilities. Over the last four years, the current ratio for Ariana Airlines has fallen from 3.5 to 2.0. This ratio still displays a comfortable liquidity position, however, the company has run a deficit for the last two years and this could lead to a worsening of the current ratio and to a threat to its liquidity position.

32. The three public banks of the country are mainly handling deposits with very limited amount of loans.²⁹ The public banks represent 11 percent of the loans of the sector but 96 percent of the deposits. This could potentially imply a less risky position. However, while state-owned banks are governed by the Banking Law, the SOC Law requires the MoF to “cooperate with the government of Afghanistan in exercising supervision over financial risks in the banking sector,(...) assess financial risks, and prepare reports whenever the need arises.”³⁰ It is not entirely clear how such cooperation is done in practice. Also, this drives the income of the banks to be driven by non-interest income which could be more volatile and therefore risky.

C. Reporting on Fiscal Risks Related to SOEs/SOCs

33. A reporting framework is established by the SOC Law. Box 4 gives an overview of the key entities involved in fiscal risk reporting and monitoring. One can identify four different reporting lines that are currently being built up: (i) at the SOC/SOE Department at the Ministry of Finance; (ii) oversight from the SOC Oversight Board vis-à-vis the SOCs; (iii) reporting from the SOC Oversight Board to the High Economic Council; (iv) reporting from the Executive towards the Parliament.

²⁸ Ariana airlines, Afghan telecom, DABS, North coal mining, Slaughter, Fuel and liquid gas

²⁹ In August 2020, the merger of two SOCBs (Bank-e-Millie Afghan (BMA) and New Kabul Bank (NKB)) was announced.

³⁰ Article 4(2) clarifies that state owned banks are subject to the Law on Banking of Afghanistan, published in the Official Gazette 1197 dated November 2015, and are therefore not subject to this law, and that the MoF will “cooperate with the government of Afghanistan in exercising supervision over financial risks in the banking sector, will assess financial risks, and prepare reports whenever the need arises.”

Box 4. Entities Involved in Fiscal Risk Monitoring and Oversight of SOEs/SOCs

The SOC/SOE Department at the Ministry of Finance: roles of the State-Owned Enterprises department are to develop and implement Government SOE policy, strategy and regulations for divestment of approved SOEs, and control financial affairs of SOEs and develop proper procedures for effective and efficient financial management of all Public Enterprises. Per Article 11 of the SOC Law, the SOC/SOE Department is the secretariat of the SOC Oversight Board, supporting it.

SOC Oversight Board: central advisory, monitoring and oversight body with respect to SOC. Its main task is to (i) coordinate and monitor the operations of SOC, ensuring alignment and consistency with the national development policies and programs; (ii) select and appoint the members of the Board of Directors of each SOC from the shortlist of Director candidates prepared by the Civil Service Commission; (iii) carry out analysis of annual balance sheets and the quarterly reports on the SOC's activities and report to the Board of Directors on any concerns or observations.

Macro-Fiscal Policy Department: the MFPD analyzes the financial and economic risks and anticipates their impact. The risk analysis reports, which include risks of exchange rate fluctuations, financial risks and economic risks, are published quarterly. Regarding financial risk analysis, the directorate of macroeconomic and fiscal policy analyzes the financial and economic risks and anticipates their impact. Article 12 of the SOC Law charges the MFPD with the responsibility of SOC fiscal risks monitoring, analysis, disclosure, and mitigation, and vests it with respective powers (e.g., information collection).

High Economic Council: to determine essential financial and economic objectives and policies, short-term, medium-term and long-term development priorities of the government in accordance with national budget structure; to evaluate and make decisions on national economic plans and reforms; to initiate coordination on policies and programs of development and economic sectors; to create a suitable environment for coaxing business people to invest; to issue necessary instructions on following and coordinating nationally prioritized programs, regional economic cooperation programs and national and international economic meetings.

Source: Audit reports; IMF staff

34. The SOE/SOC Department performs basic financial analysis of SOE/SOC budgets (responsibilities in Annex I). The Department conducts the following risk analysis:

- It receives the annual budgets from SOEs/SOCs; it analyzes actual vs. planned budgets. Given there are deviations which seem to be substantial, this type of analysis may hint at broader risks of underperformance of these entities.
- It analyzes the profitability of SOEs/SOCs in two dimensions: (i) operational profitability (profit on the income from operating income); and (ii) total profitability (including other income, mainly renting out properties). SOEs which are not profitable on their operations are considered at risk, but little is known about possible corrective measures or enforcement of sanctions.
- There is no monitoring of balance sheets, in part because of inconsistent information flow from the SOEs/SOCs.

35. There is an imbalance in type of SOEs/SOCs that are being supervised. The monitoring of the largest SOEs seems to be done fairly regularly with the main criteria on

profitability. However, the 40+ smaller SOEs are not paid sufficient attention. Although this segment of SOEs/SOCs has as a whole less financial weight compared to the largest entities, contingent liabilities can also build up in this segment without being detected and thus imply a fiscal cost if such liabilities materialize. Moreover, the smallest SOEs/SOCs, like the biggest ones, benefit from public assets and it could be useful to have a plan to review the usefulness of each smaller SOE/ SOC.

36. Fiscal risk monitoring between MoF and the Oversight Board are blurred in practice implying weak accountability. There is lack of clarity about the authority of conducting supervision tasks on behalf of the SOE/SOC Department at MoF as the secretariat of the Oversight Board.

- The SOC Oversight Board seems to be actively monitoring SOC's, but little is known about the depth of the analysis and enforcement in light of shortcomings. The SOC Oversight Board has access to financial projections/plans of SOC's as reflected in the business plans; it seems to hold meetings with the contact points of SOC's ("SOC's in charges") in order to assess their financial performances.
- Given "performance indicators" have not been set for any SOC and this being a legal requirement, this assessment seems not to be done against any benchmark.
- However, the SOC Oversight Board issues recommendations to SOC's. There are however no minutes of meetings of the Oversight Board. Future plans are to monitor the application of the HR policy on behalf of the oversight board.

37. Reporting to the High Economic Council is not yet been done. Quarterly and annual reports (as demanded by Art. 10 of the SOC Law) with the economic performance of each SOC have not been produced or submitted to the High Economic Council until now. According to the SOC law, the SOC Oversight Board shall produce and publish an annual report and submit it to the High Economic Council.

38. Fiscal risk reporting on SOEs/SOCs through the FSP is merely general in nature, lacking quantification of fiscal risks or an assessment of materialization of contingent liabilities. The latest FSP 1399/2020, published by the MFPD, does not provide an analytical frame which discloses fiscal risks related to SOEs/SOCs and presents mitigating measures. Currently, the FSP contains one paragraph which is fairly general in nature and does not present any quantitative information; it speaks broadly about the fact that SOEs" do not have enough revenues," however it is outspoken of the fact that "the continued functioning of these enterprises without their accurate financial statements could bring serious financial risks to the economy." Since SOEs/SOCs are explicitly excluded from the PFEM Law, the legal framework also does not require that FSP covers SOC's, and there is no requirement on the inclusion of a fiscal risk statement in the FSP in the PFEM Law.³¹

³¹ Although the latter can be included either at the level of primary or secondary law.

D. Recommendations

39. The following are key elements of a strategy to strengthen SOE/SOC oversight while addressing fiscal risk:

- Continue with a risk-based approach by (i) focusing on the largest SOEs/SOCs – however moving to balance sheet analysis; improving and enforcing financial reporting by creating adequate incentives; and (ii) gradually expand risk monitoring to the 40+ smaller SOEs/SOCs.
- Improving governance for SOE/SOC oversight, by further separating the functions of the SOC Oversight Board from the Ministry of Finance in order to address the risk of conflict of interest.
- For disclosure, use the current Fiscal Strategy Paper as main avenue, starting with an initial quantification of fiscal risks and refine over time.
- While many reform steps can be implemented with the existing legal framework, further sharpening of different legal instruments could be considered by authorities.

Recommendation	Within one year – duration of ECF	As of mid-2021
2.1. Improve compliance and quality of financial reporting at the level of individual SOEs/SOCs	<ul style="list-style-type: none"> • For the five largest SOEs/SOCs: (i) audited financial statements of the last 3 years should be available; (ii) an analysis of contingent liabilities will be conducted; (iii) targets for the largest SOEs/SOCs for year 2021 will be formally adopted, with indicative targets for 2022 and 2023. • Disclose quality of reporting: a list of the gaps in reporting from all SOEs/SOCs to be published in a website of MoF and updated regularly. 	<ul style="list-style-type: none"> • For the five largest SOEs/SOCs, (i) expand the set of financial indicators to include, on the balance sheet when data is available: current ratio (current liabilities / current assets), debt ratio (debt / total assets) and, for SOEs/SOCs with large debts – DABS at this point – interest coverage ratio (Earnings before Interest and Taxes/Interest Expense; (ii) new indicators for outbound years (firm for 2021 and indicative for 2022-2023); (iii) non-financial performance indicators as methods of identifying potential risks alongside more standard financial indicators. • For all other SOEs/SOCs, increase the quality and coverage of financial information. Provide capacity development to SOEs/SOCs to improve accounting capacities. • Conduct regular audits of financial statements. • Adopt graduated sanctions for non- or under-reporting on behalf of SOEs/SOCs. To this end,

Recommendation	Within one year – duration of ECF	As of mid-2021
		carefully assess the legal instrument that could be used for this purpose, taking into account the existing legal framework and the legal tradition (to ensure enforceability, sanctions, or the power to impose the same, should be specified in primary law).
2.2. Strengthen SOE/SOC Oversight Board in its regulatory and supervisory tasks	<ul style="list-style-type: none"> • Submit, on behalf of the SOC Oversight Board secretariat, a first annual report covering the financial statements of SOEs/SOCs of 2019 to SOC Oversight Board for analysis and approval. The report should focus on profitability on operational income and non-operational income; and include instructions and guidelines on the implementation of the mitigation measures for fiscal risk, recommended by the MoF. • Provide for a clear distinction between (i) the approval of funding / SOC's financial support at the level of MoF and (ii) the role of the Oversight Board to establish a fiscal risk tolerance level and corresponding consent to financial support. • Improve professional capacity of the SOC Oversight Board secretariat. In addition, review the staffing profile of the existing 80 staff in light of the responsibilities of the Department and fiscal risk of SOEs/SOCs. 	<ul style="list-style-type: none"> • Increase coverage and regularity on reporting on SOEs performance by the SOC Oversight Board secretariat, alongside instructions and guidelines on the mitigation measures. • Determine a plan for each SOE/SOC (privatize, liquidate, merge, restructure...).
2.3. Improve fiscal risk reporting on SOEs/SOCs at the aggregate level	<ul style="list-style-type: none"> • Prepare an initial quantification of contingent liabilities of SOEs/SOCs using the SOE health check tool. First as a technical paper and then disclosed in the annual FSP (published and prepared by the MFPD and submitted for the 2022 Budget). • Prepare a concept for an institutionalized budgetary treatment of SOEs/SOCs, clarifying information requirements, types of assistance, and approval process, and including an analysis of the relevant legal instruments. Given that SOC's are excluded from the application of the PFEM Law, integration of information on SOC's into the budget process will likely require amendments to the PFEM Law (as described above). 	<ul style="list-style-type: none"> • A framework for the issuance of guarantees should be developed and adopted. This might require enhancements of the PFEM Law (Art. 20) and development of additional legal instruments, as may be needed.

III. PUBLIC-PRIVATE PARTNERSHIP

A. Overview of PPPs

40. Previous missions made a number of recommendations to improve Public Investment Management (PIM) institutions.³² While progress in implementation has been slower than expected, preparations are underway supported by the World Bank's Public-Private Partnership and Public Investment Advisory Project (PPIAP) which was launched in June 2018.³³ The PPIAP seeks to create an integrated PIM-PPP framework and has assisted MoF in establishing a project evaluation committee (PEC) to screen project proposals and recommend to the Minister of Finance those that should proceed further for project preparation.³⁴

41. However, the current reach of the PEC is not comprehensive. The main challenge of the current legal situation is that the PEC has no formal role in the public investment process (including with regards to PIM and PPP projects), as the institutional arrangements of the PEC have not been reflected in the national laws. Projects financed by the World Bank are being reviewed by the PEC, but this is not systematically applied to other projects. The PEC role and the PIM pre-investment processes are described in the Terms of Reference of the PEC and are going to be specified in the PIM Regulation³⁵ and could be included in the budget circular process to strengthen the integration of the PIM -PPP framework. Good practices require investment planning to start with a robust project appraisal process that facilitates clear prioritization of different projects based on their economic and social returns. Only after a project is found worth taking (PEC's role), should the question of how to procure it—traditional public procurement or PPP (CPA's role)—be evaluated.

42. A five-year plan for public-private partnerships has been developed, together with a list exceeding one hundred projects. The five-year plan (2017-2021) lists a number of activities and expected outputs and outcomes to enhance the PPP's institutional and legal setup. This list comprises potential projects from various sectors including agriculture, energy and transport. Currently (Figure 5), there are six PPP projects under contract, with a total investment cost of

³² See *Afghanistan. Strengthening Budget Formulation and Fiscal Risk Management*, November 2018; *Taking Stock of Public Financial Management Reforms*, November 2017.

³³ This is a five-year project (2018-2023) aiming at strengthening institutional and technical capacity of relevant local institutions and support development of a Public Investment Management - Public-Private Partnerships framework in Afghanistan.

³⁴ The PEC Terms of Reference have been approved in April 2019. An Integrated Bank of Projects – a software system to form the backbone of the PIM process – is under conception.

³⁵ The authorities have clarified that the choice of the legal instrument to establish PEC (a regulation, as opposed to a law) was motivated by PEC being a “lower level committee,” since it is composed of Director General level officials only. An English translation of the draft PIM Regulation has been shared with the mission team. An updated and final version of the PIM Regulation was sent to the Cabinet for approval in July 2020, however the mission team was not able to review it since it was not available in English.

around USD 960 million (5 percent of GDP).³⁶ In addition, there are 23 projects in the pipeline (with three pending approval of the cabinet) worth around USD 1.4 billion (about 7.2 percent of GDP). Total commitments under PPPs and similar arrangements are not disclosed in any government document. Nor is there a central database within the government consolidating the total noncontingent payments and contingent liabilities of all projects across government.

Figure 5. Investment Capital of Public-Private Partnership Projects at Various Stages of the Project Cycle (Percent of GDP)



Source: MoF

B. Legal and Oversight Framework

43. The PPP Law, adopted in 2018, sets out the institutional framework and procedure for the development and implementation of PPP projects in Afghanistan.³⁷ Similar to the SOC Law, the PPP Law was signed by the President in 2018 as a legislative decree and subsequently submitted to the Parliament pursuant to the Constitution. The Lower House of the Parliament approved the PPP Law without change, and the Upper House of the Parliament is expected to vote on the PPP Law within the next month.³⁸

³⁶ All six PPP projects are Power Purchase Agreements for the following projects: (i) Sheberghan gas power project; (ii) Mazar IPP Payment Security; (iii) Kandahar Zolaristan 15 MW Solar payment security; (iv) Kandahar 77 CC 15 MW Solar payment security; (v) Kajaki Hydro Power Project; and (vi) Badakhshan Electrification.

³⁷ The mission reviewed the English translation of the Public-Private Partnership Law published in the Official Gazette (Serial Number 1322) of 2018. The mission team has also been provided with a draft PPP regulation that details the PPP Law but is yet to be adopted.

³⁸ Submission to the Parliament of amendments to the PPP Law was a structural benchmark under the Fund-supported Extended Credit Facility, which was successfully met (see [Islamic Republic of Afghanistan : Fourth Review Under the Extended Credit Facility Arrangement, Request for Modification of Performance Criteria, and Request for Extension and Rephasing of the Arrangement-Press Release; and Staff Report](#))

44. The PPP Law allocates the central role in the PPP process to the Central Partnership Authority (CPA) within the MoF, and in practice the CPA responsibilities appear to be even broader.³⁹ The CPA is tasked, among other things, with developing PPP project selection criteria and project evaluation indicators, reviewing the Concept,⁴⁰ providing technical recommendations to the High Economic Council, the MoF, the public entity, the private partner and other stakeholders, providing technical support to the public entities after the approval of the project Concept etc.⁴¹ The CPA also assists or prepares the project “if deemed necessary after the approval of the Minister of Finance for effective management and economies of scale.”⁴² In practice, while, for example, the Feasibility Study is to be developed by the relevant public entity (and reviewed by the CPA), it has been the CPA that has prepares the project Feasibility Study.⁴³ The MoF powers include, among others, approving or rejecting the Concept, Prefeasibility, and Feasibility Studies of the PPP project.⁴⁴ The High Economic Council, inter alia, takes decision on the financial and economic support, guarantees, and commitments of the State, provides guidance to the CPA on regulating the overall policy on PPP, and approves, reviews, and rejects the award of the partnership contract.⁴⁵ The Cabinet is charged with approving, amending, rejecting or reviewing the partnership contract that has been attested by the High Economic Council. Box 5 describes PPP project cycle under the Article 30 of the PPP Law.

³⁹ According to good international practice, MoF’s strong role is critical for safeguarding public finances against fiscal costs and risks from PPPs. MoF should have the authority to stop or suspend a PPP project at any stage of the project cycle, including project appraisal, assessment of PPP appropriateness, tendering, contract closure, and renegotiation. This requires continuous assessment and careful management of fiscal risks stemming from PPPs (and any other government actions that would give rise to public contingent liabilities).

⁴⁰ The term “Concept” used in this paragraph refers to the definition in Article 3(5) of the PPP Law “Any proposal developed by an Entity and/or Proponent for execution of Partnership Project through a Public Private Partnership.”

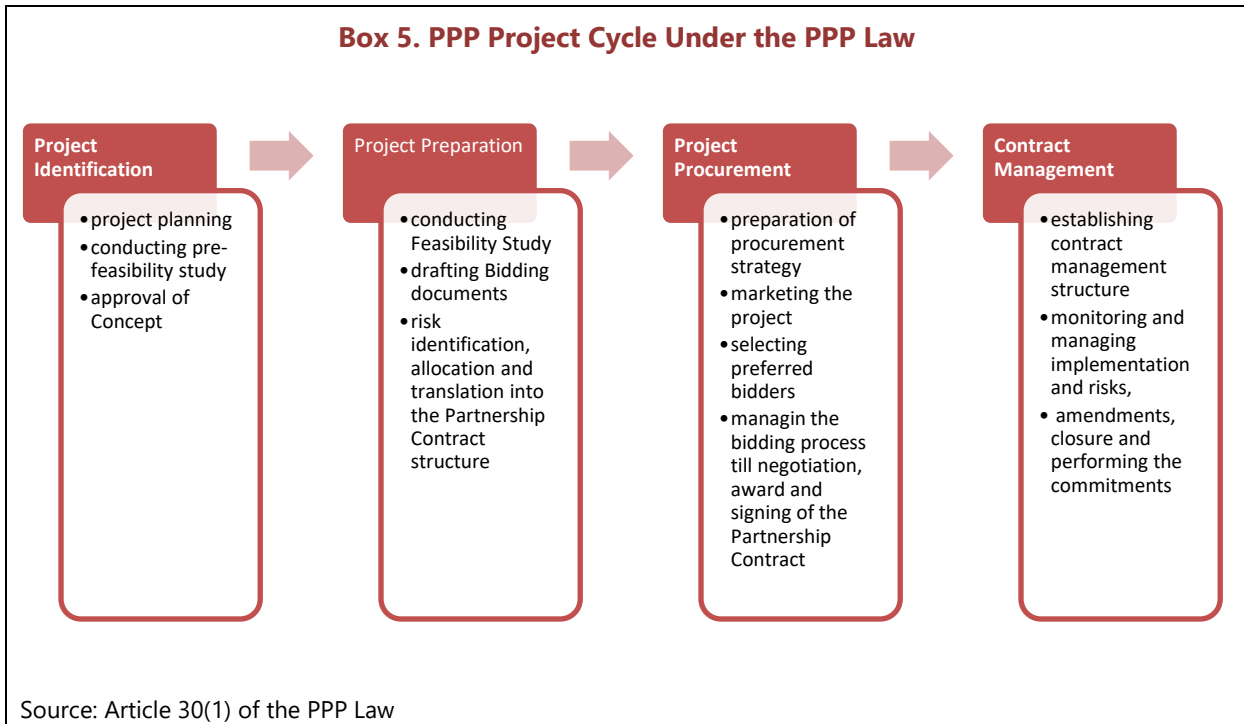
⁴¹ Article 13 of the PPP Law.

⁴² Article 33(2) of the PPP Law.

⁴³ Each public entity has their own development plan, which is used for identification and prioritization of relevant project Concepts (see Article 32(2) of the PPP Law).

⁴⁴ Article 11 of the PPP Law.

⁴⁵ Article 10 of the PPP Law.



45. The PPP Law requires that a risk analysis be performed before a PPP contract is entered into, and monitoring and oversight responsibilities are allocated to the MoF and the CPA, although in practice those appear to be implemented predominantly by the CPA.⁴⁶ The PPP Law requires the MoF to carry out the risk and financial analysis for contingent and non-contingent liabilities before public entities enter into contract with private parties.⁴⁷ The CPA has the power to “assess the fiscal commitments and tangible and non-contingent liabilities of the Partnership Project in the different phases of the project cycle.”⁴⁸ In practice, the CPA collects relevant information from PPPs and produces reports on an annual basis, that are shared with the MoF for the inclusion in the annual budget, as well as with the Debt Management Office.⁴⁹ These reports, along with the Feasibility Studies, are also shared with the MFPD. The MoF also has the power to “control” potential risks from the PPP project being implemented (which includes, an assessment of the risks, liabilities, guarantees that may be undertaken by the government), however currently there is no mechanism to implement this provision.⁵⁰ It is the responsibility of

⁴⁶ Furthermore, Article 18(6) of the draft PPP Regulation states that Feasibility Study, prepared after the project concept has been approved by the MoF, includes “A detailed description of the proposed Project including an assessment of the risks in such a Project, together with clear register identifying risk allocation and mitigation in respect of such risks”

⁴⁷ Article 8(1) of the PPP Law.

⁴⁸ Article 13(6) of the PPP Law.

⁴⁹ Article 14 envisages the establishment of PPP Project Units within each public entity, that interacts with the CPA in the process of the PPP project implementation.

⁵⁰ Article 8(2) of the PPP Law.

the relevant public entity and the CPA to monitor the “ongoing management and performance” of the PPP projects.⁵¹

46. PPP projects may receive government support, however the terms and conditions are not detailed in the PPP Law or the draft PPP regulation. Article 46 states that the MoF may “provide or assist in the provision of economic and financial supports, guarantees and commitments” to a PPP project. Such government support must be indicated in the Feasibility Study and bidding documents and included in the partnership contract, and is granted based on the assessment and recommendation by the MoF and the approval of the High Economic Council.⁵² There are no criteria in the legal framework to provide such support. The PPP Law envisages the creation of the Viability Gap Fund (VGF) and the Project Development Fund (PDF).⁵³ Both funds are to be managed by the CPA. Assistance from the VGF is disbursed to PPPs by the MoF, based on the analysis and approval of the High Economic Council, to the projects that require development and growth from economic and social perspectives but their implementation “may not be viable in the absence of financial support of the government.”⁵⁴ The VGF has not been established, but it is expected to be funded through grant funds. The PDF has been established and is currently funded by the World Bank.⁵⁵

C. Main Fiscal Risks from PPPs

47. PPPs have the potential to improve the efficiency of infrastructure provision, but they can also be a source of fiscal risk. PPPs can create debt-like obligations for the government as the government commits to paying for services over the life of the contract. In addition, PPPs may commit the government to a range of contingent obligations such as guarantees for market risks or changes in government policy, minimum revenue guarantees, and protections against force majeure events. In many countries these contingent obligations are not included in the government’s fiscal aggregates. To benefit from PPPs while safeguarding fiscal sustainability, governments should be able to select good projects, and strengthen their capacity to manage and monitor in a transparent manner all implementation phases of such projects. The latter is the responsibility of the CPA as stipulated in article 12 of the PPP Law.

⁵¹ Article 44 of the PPP Law.

⁵² Article 46 of the PPP Law states that such support is effective further to the economic, financial, and value for money analysis of the project. Article 12 of the draft PPP Regulation details the types of government support that may be provided to a PPP; however, it seems to imply that only the MoF approval is required to grant such support. High Economic Council approval seems to be required only if support other than government is provided to a PPP project.

⁵³ Article 50 of the PPP Law

⁵⁴ Article 50(2) of the PPP Law

⁵⁵ PDF is created by the MoF for conducting the “pre-feasibility and feasibility studies, recruitment of experts, and other financial and economic analysis” of a PPP project (Article 3(15) of the PPP Law).

48. In Afghanistan, fiscal risks from PPPs currently appear to be relatively modest, but the government intends to scale up its use of PPPs. While six projects are already under contract, the budget does not quantify contingent liabilities from such projects. PPPs can impose fiscal costs through the direct and contingent liabilities assumed by the government, including under the contractual terms. The most common types include capital subsidies, such as the VGF; availability payments; volume-based payments for services, such as shadow tolls or subsidies; tax incentives; payments related to the risks assumed by the government, such as revenue, exchange-rate, and interest-rate guarantees; payments related to regulatory risks, early termination, and extraordinary events; and payments arising from debt guarantees. Costs may also arise from renegotiations, disputes, and implicit guarantees—for example, in financially distressed projects. The type of PPP information to be disclosed in the budget documentation is presented in Annex V.

49. Fiscal risks associated with contingent commitments should be assessed in order to test affordability at the point of decision, and risks should be monitored throughout the life of the project. While assessments of total exposure from PPPs are difficult, they can be made by examining the maximum value of exposure. For example, where there are variable service payments linked to volume, the maximum payment can be estimated by assuming the project operates at full capacity or sells as much as the contract permits. The present value of these payments is an estimate of the government's maximum exposure. Similarly, maximum exposure from a minimum-revenue guarantee is the present value of the revenue that is guaranteed over the life of the contract. The PPP Fiscal Risk Assessment Model (P-FRAM) could be used to analyze specific PPP contracts in order to better identify and quantify total rights, obligations, and other exposures under PPPs contracts (see Box 6).⁵⁶

50. There are no overall limits on the government's total exposure on PPPs, and no clear procedures to ensure the affordability of PPP projects in the longer term. To assist in containing fiscal costs and risks of PPP projects, a number of countries have imposed a numerical ceiling on PPP exposures. While not a substitute for medium-term planning, ceilings can help ensure that the government's overall risk exposure and long-term commitments are affordable and sustainable. This is particularly relevant where the institutional framework for managing medium-term commitments is not fully developed, as is the case in Afghanistan. Ceilings can be imposed on the total stock of PPP commitments, the flow of PPP commitments permitted within a given year, or both. In all cases, the basis for measuring the size of the PPP program should be clear and unambiguous. For example, the measure could be based on the capital investment under the contract, present value of known obligations and a simple measure of contingent liabilities (such as maximum values). As more sophisticated valuation techniques are developed, the ceilings could be amended. Box 7 provides some examples of PPP ceilings adopted in other countries.

⁵⁶ METAC delivered two workshops in 2018 and 2019 to help developing capacity for assessing and mitigating fiscal risks related to specific PPPs contracts and using the P-FRAM tool.

Box 6. PPP Fiscal Risk Assessment Model

The IMF has developed a standardized tool PPP Fiscal Risk Assessment Model (P-FRAM) to assess the fiscal risks associated with PPPs. Capacity Development support is available from the IMF to deploy the P-FRAM.⁵⁷ There is a widespread consensus on the need to improve project evaluation techniques for PPPs to ensure that only the right projects are procured. However, better project evaluation techniques cannot, by themselves, ensure the budget affordability of a project. Typically, financing and funding conditions for projects are managed by separate processes. Governments may end up procuring projects that either cannot be funded within the existing budgetary envelope or expose the public finances to excessive fiscal risks. To address these concerns, the PFRAM has been developed as an analytical tool to quantify the macro-fiscal implications of PPP projects. The tool uses a simple, user-friendly, Excel-based platform and follows a four-step decision tree:

- Who initiates the project? The impact of main fiscal indicators (i.e., deficit and debt) varies depending on the public entity ultimately responsible for the project (e.g., central or local governments, state-owned enterprises).
- Who controls the asset? Simple standardized questions assist the user in making an informed decision about the government's ability to control a PPP-related asset—through ownership, beneficial entitlement, or other means. If the government is regarded as controlling the asset, this typically impacts the main fiscal indicators.
- Who ultimately pays for the asset? P-FRAM allows for three funding alternatives: (i) the government pays for the asset using public funds (e.g., periodic payments); (ii) the government allows the private sector to collect fees directly from the asset's users (e.g., tolls); or (iii) a combination of methods (i) and (ii).
- Does the government provide additional support to the private partner? Governments may not only fund PPP projects directly but can also support private partners by providing guarantees (e.g., debt and minimum revenues), equity injections, and tax amnesties, among other methods. Once project-specific and macroeconomic data are introduced, P-FRAM automatically generates standardized outputs: (i) project cash flows over the whole life cycle; (ii) fiscal tables and charts, both on a cash and accrual basis—that is, government's cash statement, income statement, and balance sheet; (iii) debt sustainability analyses with and without the PPP project; and (iv) sensitivity analyses of the main fiscal aggregates to changes in the macroeconomic and project-specific parameters. These outputs can be compared to the country-specific reporting standards of PPP transactions to evaluate how closely they conform to best practices.

Source: IMF

⁵⁷ For access to the Excel-based tool and the user manual, visit:
<http://www.imf.org/external/np/fad/publicinvestment/index.htm>

Box 7. Examples of Budget Ceilings for Public Private Partnerships

A number of countries have adopted ceilings on the size of PPP programs in their PPP or annual budget law as a means of containing commitments or limiting exposure to fiscal risks.

Brazil: The PPP law sets a ceiling on current spending from PPP contracts of 3 percent of net current revenue applicable to all levels of government (Articles 22 and 28). New PPP contracts cannot be signed if: (i) existing commitments already amount to 3 percent of net current revenue; or (ii) the new contract would entail commitments in excess of 3 percent of net revenues at any time during the forthcoming 10 years. The Ministry of Finance is responsible, through an inter-ministerial council, for monitoring compliance with the ceiling, as well as for monitoring fiscal risks from PPPs (Article 14).

Peru: The PPP law sets a ceiling on the present value of the accumulated stock of both contingent and non-contingent liabilities in PPP projects of 7 percent of GDP.

Hungary: The Public Finance Act limits the nominal value of new long-term commitments to 3 percent of total state budget revenues in any given budget year. The ceiling does not apply to commitments of local governments or other general government units not covered by the state budget. Long-term commitments cover expenditures for investment, renovation, operation and maintenance, service purchase, and rents, including those arising from PPP contracts.

El Salvador: Limits the present value of the cumulative amount of quantifiable firm and contingent future payments, net of revenue, assumed under PPPs to 5 percent of GDP.

Source: IMF FAD- How to Control the Fiscal Costs of PPPs – Oct 2018

51. There is no conclusive data that identifies basic financial information regarding their total investment value of signed PPPs in Afghanistan. As a consequence, there is currently insufficient data to allow a full assessment of fiscal risks at a project or portfolio level. Although the government has not provided guarantees to any PPP project, it is implicitly guaranteeing the Power Purchase Agreements (PPAs) supporting the energy sector. A PPA provides a guarantee to an electricity generator that a specified level of power will be bought in future, at a pre-agreed price. Unlike a minimum revenue guarantee, this commitment is a direct obligation akin to an availability payment (though it may also entail a contingent obligation in the event that the purchased power cannot be consumed or sold on). In Afghanistan, PPAs are signed by DABS, the SOC which sells power to consumers at a loss, requiring a subsidy from the government.⁵⁸ It is important to set up a PPP database in the form of a simple Excel file (see Annex III) to keep a record of PPP projects with critical fiscal information. Another alternative would be to include the information listed in this annex as a requirement when designing the Integrated Bank of Projects' software.

52. There is currently limited understanding of the nature and possible consequences of contingent liabilities. Most of the operational PPP projects in the energy sector are structured around Purchase Agreements which require the contracting authority to agree to a minimum purchase of the service provided (such as kwh of power). If demand falls below that level, for

⁵⁸ The price of electricity is 0.049 USD per kWh for households whereas the energy price agreed in one of the PPA contract is 0.059 USD.

whatever reason, the authority has to pay anyway.⁵⁹ These 'take or pay' agreements work well if demand forecasts are accurate (or even conservative). Furthermore, since demand for power is price sensitive, further increases in consumer prices for electricity are likely to reduce demand or to encourage the use of alternatives. This raises the risk of having to pay for power that is not needed.

53. The FAD 2018 report highlighted that as there may be an increasing demand for government guarantees to support PPPs, a more comprehensive reporting framework is necessary. The increasing reliance on a restructured SOC sector and on PPPs to foster economic development may create pressure to issue more government guarantees. However, the existing legal procedures for the issuance of government guarantees (refer to section I of this report - Article 20 of the PFEM Law) do not provide the proper procedural safeguards to ensure that affordability of such guarantees is considered.

54. As discussed in the SOC section, the fiscal risk reporting on PPPs through the FSP lacks analytical elements. The latest FSP 1399/2020 briefly describes PPP projects and related risks. It does not provide a summary of the PPP program, including the policy and management framework, nor a list of PPP projects, and discussion of new contracts; and it does not include the cumulative overall multi-year fiscal commitments of the PPP program and gross exposure from guarantees and other contingent commitments attached to PPP contracts. The FSP could also provide an estimate of what government liabilities would be under current PPP contracts if the government were to report on a basis consistent with IPSAS 32, International Public Sector Accounting Standard on "service-concession arrangements." Annex IV provides a list of data that could be included in the PPP section of the FSP.

D. Recommendations

55. The following are key elements of a strategy to strengthen PPP oversight while addressing fiscal risk:

- Enforce "gate-keeping" and strengthen efficiency considerations through the establishment of an integrated PIM-PPP process.
- Strengthen considerations of affordability by integrating PPPs into the budget process alongside a disclosure of fiscal risks.
- Disclose full costs of PPPs and associated contingent liabilities, and thus facilitate a more efficient risk sharing between different stakeholders.
- Strengthen transparency in implementation of PPPs by publishing tender documents and evaluation reports, PPP contracts, financial statements of private partners, and verification results of construction.

⁵⁹ The mission was informed that during the first quarter of 2020, the Government had to pay the Bayat Power (Gas to Energy) project for electricity produced by the project but not consumed by DABS.

Recommendation	Within one year – duration of ECF	As of mid-2021
3.1. Strengthen monitoring and assessment of risks of PPP projects	<ul style="list-style-type: none"> • Strengthen MoF/CPA monitoring and reporting of PPP projects by: <ul style="list-style-type: none"> - Using the IMF's PFRAM tool to ensure that fiscal risks associated with PPPs are assessed by the MoF at the time the contract is entered into and on an ongoing basis throughout the contract; - Establishing and maintaining a PPP database (see Annex III) or augmenting the Integrated Bank of Projects with information on service payments over the life of the project as well as all guarantees or contingent commitments attached to the project. 	<ul style="list-style-type: none"> • Publish tender documents and evaluation reports, PPP contracts, financial statements of private partners, and verification results of construction.
3.2. Integrate PPP projects into the budget framework and improve capacity to assess the budget affordability of PPPs	<ul style="list-style-type: none"> • Require that new PPPs are assessed within the context of medium-term fiscal objectives and take account of the liabilities of existing projects in assessing affordability (end-2020). • Disclose information on PPPs in the budget documentation (see Annex V): this gives potential contractors foresight on projects that will be tendered and demonstrates the government's commitment to the projects. This can attract more high-quality bidders to participate in the tender process, improving the quality and reducing the cost of projects (Budget 1400/2021). • Add a quantification of contingent liabilities to the PPP section of the FSP (see Annex IV). This demonstrates to financial investors that the government is aware of the risks and is managing these risks. This reduces uncertainty for investors, potentially lowering the risk premium and thus the cost of financing for the government (Budget 1400/2021). 	<ul style="list-style-type: none"> • Develop a framework for assessing the aggregate exposure of the PPP portfolio and consider establishing a ceiling on PPPs (2021).
3.3. Strengthen the integrated PIM-PPP framework	<ul style="list-style-type: none"> • Institutionalize the role of the PEC in the investment (PIM and PPP) process through appropriate legal mechanisms and ensure clarity of PEC interaction with other institutional participants of the PPP process (CPA, MoF etc.) 	

Annex I. Roles and Responsibilities of the SOE Department at the Ministry of Finance¹

The key roles of the State-Owned Enterprises department are to develop and implement Government SOE policy, strategy and regulations for divestment of approved SOEs, and control financial affairs of SOEs and develop proper procedures for effective and efficient financial management of all Public Enterprises.

The core objectives of the SOE Department are to practice good governance and effective financial and operational oversight over SOEs and to restructure, corporatize and privatize State Owned Enterprises and Properties as stipulated in the Law on State Owned Enterprises and the Procedures for the Liquidation and Corporatization of State Owned Enterprises, with the objective of enhancing private enterprise and creating economic growth, sustainable employment and income for the state.

According to the mandate given to the SOE Department, it has two main tasks:

1. Financial and operational oversight of public enterprise. The most significant SOEs will be divested last, thus adding to the requirements for the oversight task.
 1. Improvement of the financial management oversight on those major SOEs that are scheduled to remain state owned for the time being, in particular public utilities and public transport enterprises and SOEs which will be divested during the transitional period
 2. Concurrence of financial plans for SOEs at the beginning of each fiscal year and then gets regular and accurate quarterly reports. Improvement of accountability and transparency
 3. Income and expenditure control of State-Owned Enterprises.
 4. Working closely with the Line Ministries and Office of Audit and Control in the improvement of the above-mentioned tasks

Managing the process of restructuring and privatization of the SOEs;

Implementation of the privatization Policy of the Islamic Republic of Afghanistan

Determination of the priorities of the divestment program of the SOEs

Preparation of comprehensive proposals to the SOE Evaluation Commission and to the Cabinet of Ministers to facilitate the proper decision of the Cabinet of Ministers

¹ Source: <http://old.mof.gov.af/en/page/14369/dm-amin/dg-enerprises>

It should be noted that the SOE Department ceases to have a direct financial management oversight role of State-Owned Enterprises once these are corporatized and thus regulated by the Company Law.

The structure of the State-Owned Enterprise Department accommodates the two key tasks financial oversight and privatization as well as coordination.

The Government of Afghanistan seeks to promote the private sector as the engine of economic growth and the key to Afghanistan's long-term development and poverty reduction. Furthermore, the Government is committed to expanding the private sector through the efficient and rapid transfer of State-Owned assets into private ownership. Such transfers shall take place in an open, fair, and transparent manner with the objectives of maximizing sales revenues balanced against employment preservation and creation and encouragement of investments and technological development.

The Ministry of Finance has assumed the responsibilities for preparing proposal of the economic restructuring and divestiture of State-Owned assets. As part of this process an extensive review of the operations and assets of the State-Owned Enterprises, was completed in December 2004.

Enterprises have been classified into the following two categories:

1. Enterprises currently recommended remaining in State ownership. Enterprises in this group provide important services including public transportation, water distribution, electricity production and distribution, incarceration services, residential services, or Enterprises that must remain in Government ownership by law.
2. Enterprises recommended for divestiture. This group is composed of Enterprises, which would benefit from a transfer of ownership into the private sector, or Enterprises with limited or no economic viability and which will continue to be a drain on State resources. These Enterprises are proposed to be divested by the State.

Various divestiture options will be assessed for the transfer of State-Owned Enterprises into private ownership, including transfer of assets, sale of shares in corporative Enterprises, long-term leases or management contracts. The divestiture option ultimately selected for each Enterprise will depend on the specific characteristic of that Enterprise.

Annex II. List of State-Owned Enterprises

State-owned Companies	Line Ministry	B.o.D	Shareholders - %
Ariana Afghan Airlines	Ministry of Transport & Aviation	MoF	1- Ministry of Finance 57.5% 2- Ministry of Economy 30% 3- Pashtani Bank 6.25% 4- Afghan National Bank
Hotel Inter-Continental	Ministry of Finance	Mof	1- MOF 64.79% 2- Pashtani Bank 6.44% 3- Aryana Airline CO 12.14% 4- Afghan National Insurance 2.91% 5- Ministry of Transportation 6- Spenser Co 1.44%
Afghan National Insurance Company (ANIC) MoF	Ministry of Finance	MoF	1- MOF 60.63% 2- Afghan National Bank 7.66% 3- Pashtani Bank 7.66% 4- Afghan Textile Co 6.97% 5- Aryana Airline CO2.79% 6- Carpet Export Co 2.37% 7- Spenser Co 1.8%, 8- Sugar Co 1.05%, 9- Serves Co 1.05% 10-Textile Carpet 1.05% 11-Qaraqol Export Co 6.97%.
Afghan Telecom	Ministry of Tele-communication	MoTC	Ministry of Communications 100%.
Da Afghanistan Breshna Sherkat (DABS)	Ministry of Energy & Water	MoF	1- MOF 45% 2- Ministry of Water and Energy 35% 3- Ministry of Economy 10% 4- Ministry of Urban 5- Development 10%.
Afghanistan Urban Water Supply & Sewerage Corporation (AUWSSC)	Ministry of Finance	MoF	1- MOF 40% 2- Ministry of Urban Development 35% 3- Ministry of Economy 10% 4- National Environment Protection Agency 10% 5- Municipality 5%.
Helmand Joined Aragonite & Wood Work Factory.	Ministry of Industries & Commerce	Helmand Joined Aragonite & Wood Work Factory	1- Ministry of Commerce 49% 2- Eshaq Firoz Co. 51%.
Afghan Card	Ministry of Industries & Commerce	MoIC	1- Ministry of Commerce Individual 88.5% 2- MOF 3.89%
			3- Pashtani Bank 1.47% 4- LTD & 228 tradesman6.10%.
Afghan Textile	Ministry of Finance	MoF	1- MOF 9.2% 2- National Bank 54.25% 3- Pashtani Bank 0.35% 4- Co& LTD ... 37.35%.

State-owned Companies	Line Ministry	B.o.D	Shareholders - %
Afsotar	Ministry of Industries & Commerce	MoIC	1- Russia Federative 49% 2- CO(STRAS) 10% 3- Torgundi 10% 4- Sherkhan Port services 5% 5- Ministry of Commerce Individual 26%.
Esteras	Ministry of Industries & Commerce	Esteras	1- Russia Federative 40% 2- Afghanistan 60%.
Afghan Poultry Company	Ministry of Industries & Commerce	MoIC	1- 70 % MoF 2- 8% is Mixed.
New Baghlan Sugar	Ministry of Agriculture MAIL	Ministry of Agriculture MAIL	1- Ministry of Agriculture MAIL 60 % 2- MOF 20% 3- Ministry of Commerce Individual 4- Ministry of Economy 10%.
Afghan Wireless Communication Company (AWCC)	Ministry of Telecommunication	PRIVATE	1- TSI CO 80% 2- Afghanistan 20%.

Source: MoF

Annex III. Template for a PPP Database

The following information should be included in a PPP database:

- Project identifier (unique number)
- Project name
- Responsible (supervising) Ministry
- Responsible (implementing) Authority
- Objective of project
- Type of project (greenfield or brownfield, i.e., rehabilitation)
- Contract signature (year)
- Contract duration (number of years)
- Financial closure (year)
- Begin of construction (year)
- First year of operation (year)
- Total project value (investment cost plus cost for maintenance and operation) (planned) (local currency)
- Total project value (investment cost plus cost for maintenance and operation) (actual) (local currency)
- Total investment cost to private partner (local currency)
- Investment cost (year 1, 2, 3, ..., n --- planned)
- Investment cost (year 1, 2, 3, ..., n --- actual)
- Annual maintenance cost to private partner (local currency)
- Maintenance cost (year 1, 2, 3, ..., n --- planned)
- Maintenance cost (year 1, 2, 3, ..., n --- actual)
- Annual operation cost to private partner (local currency)
- Operation cost (year 1, 2, 3, ..., n --- planned)
- Operation cost (year 1, 2, 3, ..., n --- actual)
- Annual revenues to private partner (local currency)
- Revenues (year 1, 2, 3, ..., n --- planned)
- Revenues (year 1, 2, 3, ..., n --- actual)
- NPV of total government payments (local currency)
- Annual government payment (availability/fee for service) (local currency)
- Government payment 1 (year 1, 2, 3, ..., n --- planned) (local currency)
- Government payment 1 (year 1, 2, 3, ..., n --- actual) (local currency)
- Government payment 2 (year 1, 2, 3, ..., n --- planned) (local currency)
- Government payment 2 (year 1, 2, 3, ..., n --- actual) (local currency)
- ...
- Government payment n (year 1, 2, 3, ..., n --- planned) (local currency)
- Government payment n (year 1, 2, 3, ..., n --- actual) (local currency)
- Government equity contribution contracted (local currency)
- Government equity contribution paid in (local currency)
- Government financing 1 contracted (e.g., on-lending) (local currency)
- Government financing 1 drawn (e.g., on-lending) (local currency)
- Government financing 2 contracted (e.g., on-lending) (local currency)
- Government financing 2 drawn (e.g., on-lending) (local currency)
- ...
- Government financing n contracted (e.g., on-lending) (local currency)
- Government financing n drawn (e.g., on-lending) (local currency)

- Government guarantee 1 (type, e.g., debt guarantee or minimum revenue guarantee)
- Government guarantee 1 (maximum amount local currency)
- Government guarantee 1 (outstanding amount local currency)
- Government guarantee 2 (type, e.g., debt guarantee or minimum revenue guarantee)
- Government guarantee 2 (maximum amount local currency)
- Government guarantee 2 (outstanding amount local currency)
- ...
- Government guarantee n (type, e.g., debt guarantee or minimum revenue guarantee)
- Government guarantee n (maximum amount local currency)
- Government guarantee n (outstanding amount local currency)
- Other government contributions (describe)
- Tax exemptions and other benefits (describe)
- Major project risks (describe)

Annex IV. Disclosure of PPPs in Fiscal Strategy Paper

Background information

- PPP policy of the government and its objectives
- Summary of current situation and expected development of PPP portfolio, including a quantification of PPP related assets and liabilities, and of any contingent liabilities, i.e. guarantees (this can be provided by P-FRAM if all ongoing projects are entered into the tool)

PPP portfolio

- Table with information on a project by project basis
- Project name
- Responsible government entity
- Total investment
- Total contract value
- Status of project
- Contract duration (either including construction or construction and service period separately)
- Start of construction
- Start of service
- Funding (government payments, user fees, combination)
- Financing provided by government (loans or equity contribution provided to SPV)
- Firm cash impact on government, i.e., payments from government (e.g., availability payments) and revenues to government (e.g., concession fees or revenue sharing) by year (annual for t through t+5, for 5 years from t+6 through t+10 and t+11 through t+15, and cumulative for the remainder of the contract period)
- Explicit contingent liabilities, e.g., debt or minimum revenue guarantees
- Other contingent liabilities, e.g., pre-conditions in the government's responsibility that may lead to penalty payments or to contract termination
- Recent performance of project company as measured by performance indicators (service delivery and financial)

Risk Analysis

- Sources of major risks from PPPs, including related to performance of specific projects and capacity of responsible government entity to manage contract (this can be derived from the P-FRAM Fiscal Risk Matrix)
- Assessment of risks (revenue, expenditure, debt, contingent liabilities, service provision, etc.)
- Assessment of implications of risks for public finances

Mitigating Measures and Risk Management Approach

- Direct controls, ceilings or caps in place
- Regulatory instruments in place
- Risk transfer, sharing or insurance in place
- Provisioning in budget

Annex V. Disclosure of PPPs in the Budget Documentation

Presentation of new projects as PPPs in the budget			Presentation of ongoing PPP projects in the budget		
Project			Project		
Responsible Ministry			Responsible Ministry		
Objective			Objective		
Total project value			Total project value		
Total investment cost			Total investment cost		
Contract duration			Contract duration		
Project begin			Project begin		
First year of operation			First year of operation		
Annual maintenance cost			Annual maintenance cost		
Annual operation cost			Annual operation cost		
Annual revenues			Revenues collected t-1		
NPV of total government payments			NPV of total government payments		
Annual government payment (availability/fee for service)			Government payments to date		
Government equity contribution			Government spending Year t		
Government guarantee			Government spending Year t+1		
			Government spending Year t+2		
			Total government spending after Year t+2		
			Government equity contribution		
			Government guarantees outstanding		

Presentation of new public investment projects in the budget			Presentation of ongoing public investment projects in the budget		
Project			Project		
Responsible Ministry			Responsible Ministry		
Objective			Objective		
Expected start construction year			Start construction year		
Total investment cost			Start of operation		
Cost Year 1			Duration of operation		
Cost Year 2			Total project cost		
Cost Year 3			Annual operation and maintenance cost		
Annual revenues			Revenues t-1		
Start of operation			Total spending to date (incl. t-1)		
Duration of operation			Spending Year t		
Annual operation and maintenance cost			Spending Year t+1		
			Spending Year t+2		
			Total spending after Year t+2		