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**GRANT NUMBER H194 -AF**

# **Financing Agreement**

**(Second Programmatic Support for Institution Building)**

**between**

**ISLAMIC REPUBLIC OF AFGHANISTAN**

**and**

**INTERNATIONAL DEVELOPMENT ASSOCIATION**

**Dated December 15, 2005**

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**FINANCING AGREEMENT**

Agreement dated December 15, 2005, entered into between ISLAMIC REPUBLIC OF AFGHANISTAN (“Recipient”) and INTERNATIONAL DEVELOPMENT ASSOCIATION (“Association”) for the purpose of providing financing in support of the Program (as defined in the Appendix to this Agreement). The Association has decided to provide this financing on the basis, *inter alia*, of: (a) the actions which the Recipient has already taken under the Program and which are described in Section I of Schedule I to this Agreement; and (b) the Recipient’s maintenance of an appropriate macro-economic policy framework. The Recipient and the Association therefore hereby agree as follows:

**ARTICLE I—GENERAL CONDITIONS; DEFINITIONS**

- 1.01. The General Conditions (as defined in the Appendix to this Agreement) constitute an integral part of this Agreement.
- 1.02. Unless the context requires otherwise, the capitalized terms used in the Financing Agreement have the meanings ascribed to them in the General Conditions or in the Appendix to this Agreement.

**ARTICLE II—FINANCING**

- 2.01. The Association agrees to extend to the Recipient, on the terms and conditions set forth or referred to in this Agreement, a grant in an amount equivalent to fifty five million three hundred thousand Special Drawing Rights (SDR 55,300,000) (“Grant”) to assist in financing the Program.
- 2.02. The Recipient may withdraw the proceeds of the Financing in support of the Program in accordance with Section II of Schedule 1 to this Agreement.
- 2.03. The Maximum Commitment Charge Rate payable by the Recipient on the Unwithdrawn Financing Balance shall be one-half of one percent (1/2 of 1%) per annum.
- 2.04. The Payment Dates are June 15 and December 15 in each year.

**ARTICLE III—PROGRAM**

- 3.01 The Recipient declares its commitment to the Program and its implementation. To this end:
  - (a) the Recipient and the Association shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program;
  - (b) prior to each such exchange of views, the Recipient shall furnish to the Association for its review and comment a report on the progress achieved in

carrying out the Program, in such detail as the Association shall reasonably request; and

- (c) without limitation upon the provisions of paragraphs (a) and (b) of this Section, the Recipient shall exchange views with the Association on any proposed action to be taken after the disbursement of the Financing which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program including any action specified in Section 1 of Schedule 1 to this Agreement.

#### **ARTICLE IV—REMEDIES OF THE ASSOCIATION**

4.01. The Additional Event of Suspension is that a situation has arisen which shall make it improbable that the Program, or a significant part of the Program, will be carried out.

4.02. The Additional Events of Acceleration is that the event specified in Section 4.01 of this Agreement occurs and is continuing for a period of sixty (60) days after notice of the event has been given by the Association to the Recipient.

#### **ARTICLE V—TERMINATION**

5.01. The Effectiveness Deadline is the date ninety (90) days after the date of this Agreement.

#### **ARTICLE VI — REPRESENTATIVE; ADDRESSES**

6.01. The Recipient's Representative is the Minister of Finance.

6.02. The Recipient's Address is:

Ministry of Finance  
Kabul  
Islamic Republic of Afghanistan

6.03. The Association's Address is:

International Development Association  
1818 H Street, N.W.  
Washington, D.C. 20433  
United States of America

Cable address:	Telex:	Facsimile:
INTBAFRAD Washington, D.C.	248423(MCI) or 64145(MCI)	1-202-477-6391

AGREED at Kabul, Islamic Republic of Afghanistan, as of the day and year first above written.

ISLAMIC REPUBLIC OF AFGHANISTAN

By

/s/ Anwar-ul-Haq Ahady  
Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By

/s/ Jean Mazurelle  
Authorized Representative

## SCHEDULE 1

### Program Actions; Availability of Financing Proceeds

#### Section I. Actions Taken Under the Program

The actions taken by the Recipient under the Program include the following:

1. The Recipient's cabinet has adopted a supplemental budget for its Fiscal Year 1384, which includes an adequate financing and fiscal framework reflecting the sources for financing the Recipient's budget deficit.
2. The Recipient's cabinet has adopted a medium-term fiscal framework which includes: (i) four-year projections of revenues, expenditures, fiscal deficit and sources for financing the said deficit; and (ii) specific fiscal policy actions sustaining the four-year projections referred to in sub-paragraph (i) of this paragraph.
3. The Recipient has, as part of its public administrative reforms: (i) published in its official gazette a new Civil Service Law; (ii) maintained the increase in the number of un-uniformed central government employees except teachers at a number below 10,000; (iii) made individualized salary payments to 15,000 government employees; (iv) placed 15,000 government staff positions under an elevated pay-scale in accordance with the PRR Program; and (v) processed more than 600 recruitments for senior positions following a merit-based process.
4. The Recipient has, as part of its public financial management reforms: (i) taken adequate steps to bring operations and maintenance expenditures ineligible for ARTF financing, to a ratio (as a percentage of expenditures monitored by the ARTF Monitoring Agent) below 35%; (ii) maintained wage expenditures ineligible for ARTF financing at a ratio (as a percentage of expenditures monitored by the ARTF Monitoring Agent) below 10%; and (iii) published in its official gazette the Public Finance and Expenditure Management Law and the Procurement Law.
5. The Recipient has, in the context of its financial sector reforms: (i) issued fourteen (14) commercial banking prudential regulations; (ii) published in the Da Afghanistan Bank financial statements for its Fiscal Year 1382; and (iii) licensed twelve (12) banking organizations.
6. The Recipient has, in the context of its program to strengthen the monitoring and evaluation of health delivery, completed a baseline evaluation of health service delivery performance.
7. The Recipient has completed a census of teachers.
8. The Recipient's MOF has prepared a list of SOEs categorized in accordance with its SOE Reform Strategy.

#### Section II. Availability of Financing Proceeds

- A. **General.** The Recipient may withdraw the proceeds of the Financing in accordance with the provisions of this Section and such additional instructions as the Association may specify by notice to the Recipient.

- B. Allocation of Grant Amounts.** The Financing shall be withdrawn in a single tranche.
- C. Deposits of Financing Proceeds**
1. The Recipient shall open, prior to furnishing to the Association the first request for withdrawal from the Financing Account, and thereafter maintain a deposit account (“Deposit Account”) on terms and conditions satisfactory to the Association.
  2. The Recipient shall ensure that upon each deposit of an amount of the Financing into the Deposit Account, an equivalent amount is accounted for in the Recipient’s budget management system, in a manner acceptable to the Association.
- D. Audit.** Upon the Association’s request, the Recipient shall:
1. have the Deposit Account audited by independent auditors acceptable to the Association, in accordance with consistently applied auditing standards acceptable to the Association;
  2. furnish to the Association as soon as available, but in any case not later than six (6) months after the date of the Association’s request for such audit, a certified copy of the report of such audit, of such scope and in such detail as the Association shall reasonably request; and
  3. furnish to the Association such other information concerning the Deposit Account and its audit as the Association shall reasonably request.
- E. Excluded Expenditures.** The Recipient undertakes that the proceeds of the Financing shall not be used to finance Excluded Expenditures. If the Association determines at any time that an amount of the Financing was used to make a payment for an Excluded Expenditure, the Recipient shall, promptly upon notice from the Association, refund an amount equal to the amount of such payment to the Association. Amounts refunded to the Association upon such request shall be cancelled.
- F. Closing Date.** The Closing Date is September 30, 2006.

## APPENDIX

### Section I. Definitions

1. “ARTF” means the Afghanistan Reconstruction Trust Fund established in March 2002 to support the recurrent and capital costs of the Recipient and to finance priority reconstruction projects and programs, which is administered by the Association and jointly managed by the Association, the United Nations Development Programme, the Asian Development Bank and the Islamic Development Bank.
2. “ARTF Monitoring Agent” means the independent firm contracted by the Association as administrator of ARTF, to monitor the procurement of goods and services, review and recommend approval of withdrawal applications and monitor all expenditures financed by ARTF grant funds.
3. “Civil Service Law” means the Recipient’s Law No. 861 dated September 11, 2005, as the same may be amended from time to time, which introduces the principle of merit-based recruitment, and provides for, among other things, the establishment of IARCSC, an appointments board and an appeals board.
4. “Da Afghanistan Bank” means the Recipient’s central bank.
5. “Deposit Account” means the account referred to in Part C. 1 of Section II of Schedule 1 to this Agreement.
6. “Excluded Expenditure” means any expenditure:
  - (a) for goods or services supplied under a contract which any national or international financing institution or agency other than the Association or the Bank has financed or agreed to finance, or which the Association or the Bank has financed or agreed to finance under another loan, credit, or grant;
  - (b) for goods included in the following groups or sub-groups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Association by notice to the Recipient:

Group	Sub-group	Description of Item
112		Alcoholic beverages
121		Tobacco, un-manufactured, tobacco refuse
122		Tobacco, manufactured (whether or not containing tobacco substitutes)
525		Radioactive and associated materials
667		Pearls, precious and semiprecious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971		Gold, non-monetary (excluding gold ores and concentrates)

- (c) for goods intended for a military or paramilitary purpose or for luxury consumption;
  - (d) for environmentally hazardous goods, the manufacture, use or import of which is prohibited under the laws of the Recipient or international agreements to which the Recipient is a party;
  - (e) on account of any payment prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and
  - (f) under a contract with respect to which the Association determines that corrupt, fraudulent, collusive or coercive practices were engaged in by representatives of the Recipient or of recipient of the Financing proceeds during the procurement or execution of such contract, without the Recipient (or other such recipient) having taken timely and appropriate action satisfactory to the Association to remedy the situation.
7. "Fiscal Year" means the Recipient's fiscal year, commencing on March 21 of each calendar year and ending on March 20 of the following calendar year.



8. “General Conditions” means the “International Development Association General Conditions for Credits and Grants”, dated July 1, 2005 with the modifications set forth in Section II of this Appendix.
9. “IARCSC” means the Independent Administrative Reform and Civil Service Commission established and operating under the Civil Service Law.
10. “MOF” or “Ministry of Finance” means the Recipient’s Ministry of Finance or any successor thereto.
11. “Procurement Law” means the Recipient’s Law No. 865, dated October 25, 2005, as the same may be amended from time to time, which, among other things, sets out procedures for transparent and competitive procurement and specifies clear accountabilities in procurement.
12. “Program” means the program of actions, objectives and policies designed to promote growth and achieve sustainable reductions in poverty and set forth or referred to in the letter dated October 25, 2005 from the Recipient to the Association declaring the Recipient’s commitment to the execution of the Program, and requesting assistance from the Association in support of the Program, such Program to exclude all aspects related to the promotion of security and rule of law.
13. “PRR Program” means the Recipient’s Priority Reform and Restructuring Program.
14. “Public Finance and Expenditure Management Law” means the Recipient’s Law No. 856, dated June 27, 2005, as the same may be amended from time to time, which, among other things, specifies clear accountabilities in financial management and sets accounting standards in line with international best practice.
15. “SOE” means State Owned Enterprise.
16. “SOE Reform Strategy” means the strategy adopted by MOF for the reform of State Owned Enterprises, under which SOEs shall either remain under the Recipient’s ownership or be divested by the Recipient.
17. “Treasury Single Account” means an account or set of linked accounts opened and maintained by MOF in the Recipient’s central bank, through which the government’s collection of revenues and payment transactions are made.

## **Section II. Modifications to the General Conditions**

The modifications to the “International Development Association General Conditions for Credits and Grants”, dated July 1, 2005 are as follows:

1. The last sentence of paragraph (a) of Section 2.03 (relating to Applications for Withdrawal) is deleted in its entirety.
2. Sections 2.04 (*Designated Accounts*) and 2.05 (*Eligible Expenditures*) are deleted in their entirety, and the remaining Sections in Article II are renumbered accordingly.

3. Sections 4.01 (*Project Execution Generally*), and 4.09 (*Financial Management; Financial Statements; Audits*) are deleted in their entirety, and the remaining Sections in Article IV are renumbered accordingly.
4. Paragraph (a) of Section 4.06 (relating to Use of Goods, Works and Services) is deleted in its entirety.
5. Paragraph (c) of Section 4.06 (renumbered pursuant to paragraph 3 above) is modified to read as follows:

“Section 4.06. *Plans; Documents; Records*

... (c) The Recipient shall retain all records (contracts, orders, invoices, bills, receipts and other documents) evidencing expenditures under the Financing until two years after the Closing Date. The Recipient shall enable the Association’s representatives to examine such records.”

6. Section 4.07 (renumbered pursuant to paragraph 3 above) is modified to read as follows:

Section 4.07. *Program Monitoring and Evaluation*

... (c) The Recipient shall prepare, or cause to be prepared, and furnish to the Association not later than six (6) months after the Closing Date, a report of such scope and in such detail as the Association shall reasonably request, on the execution of the Program, the performance by the Recipient and the Association of their respective obligations under the Financing Agreement and the accomplishment of the purposes of the Financing.

7. The following terms and definitions set forth in the Appendix are modified or deleted as follows, and the following new terms and definitions are added in alphabetical order to the Appendix as follows, with the terms being renumbered accordingly:

- (a) The definition of the term “Eligible Expenditure” is modified to read as follows:

““Eligible Expenditure” means any use to which the Financing is put in support of the Program, other than to finance expenditures excluded pursuant to the Financing Agreement.”

- (b) The term “Financial Statements” and its definition as set forth in the Appendix are deleted in their entirety.

- (c) The term “Project” is modified to read “Program” and its definition is modified to read as follows:

““Program” means the program referred to in the Financing Agreement in support of which the Financing is made.” All references to “Project” throughout these General Conditions are deemed to be references to “Program”.