

**CONFORMED COPY**

---

---

**GRANT NUMBER H501-AF**

# **Financing Agreement**

**(Strengthening Institutions Development Policy Grant)**

**between**

**ISLAMIC REPUBLIC OF AFGHANISTAN**

**and**

**INTERNATIONAL DEVELOPMENT ASSOCIATION**

**Dated July 7, 2009**

---

---

## **FINANCING AGREEMENT**

AGREEMENT dated July 7, 2009, entered into between ISLAMIC REPUBLIC OF AFGHANISTAN (the “Recipient”) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the “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 1 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 this Agreement have the meanings ascribed to them in the General Conditions.

### **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 twenty three million five hundred thousand Special Drawing Rights (SDR 23,500,000) (the “Grant “ or the “Financing”).
- 2.02. The Recipient may withdraw the proceeds of the Grant 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 February 15 and August 15 in each year.
- 2.05. The Payment Currency is United States Dollar.

### **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 promptly inform the Association of any situation that 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 I of Schedule 1 to this Agreement.

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

- 4.01. The Additional Event of Suspension consists of the following:

A situation has arisen which shall make it improbable that the Program, or a significant part of it, will be carried out.

### **ARTICLE V — EFFECTIVENESS; 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  
Pashtunistan Watt  
Kabul  
Islamic Republic of Afghanistan

Facsimile:

93-20-210-3258

6.03. The Association's Address is:

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

Cable:

Telex:

Facsimile:

INDEVAS

248423 (MCI)

1-202-477-6391

Washington, D.C.

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

ISLAMIC REPUBLIC OF AFGHANISTAN

By

/s/ Mohammed Omar Zakhilwal  
Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By

/s/ Mariam J. Sherman  
Authorized Representative

## SCHEDULE 1

### Program Actions; Availability of Grant Proceeds

#### Section I. Actions under the Program

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

1. The Recipient has: (i) submitted to Parliament a medium-term fiscal framework budget statement for discussion as part of the Solar Year 1388 budget discussion, which includes expenditure estimates based on reasonable approximations of the medium term cost impact of pay and grading reforms; and (ii) established and appointed members to a joint MOF – IARCSC technical working group on pay and grading reform implementation.
2. The Recipient has completed the reorganization of MOF's budget department along the ANDS priority sectors with a view to ensuring that the budget becomes an implementation instrument for the ANDS and is approved by the Recipient's cabinet and Parliament in a timely manner.
3. The Recipient has: (i) issued a Presidential decree approving an amendment to the Procurement Law providing for, *inter alia*, the reinstatement of transparency of the procurement process with respect to low value procurement; and (ii) reissued a circular restoring ARDS' procurement oversight.
4. The Recipient has published in its official gazette a new Civil Servants Law which includes a pay and grading scale.
5. The Recipient has increased the number of direct deposits under its Verified Payroll Plan from 50,801 civil servants at the end of SY1386 to at least 95,000 by the end of SY1387.
6. The Recipient's Ministry of Finance has issued a report on its assessment of the provincial budgeting pilot with a view to developing an institutional position on sub-national financing reform.
7. The Recipient's cabinet has publicly announced the Recipient's commitment to the Extractive Industries Transparency Initiative (EITI).
8. The Recipient's Ministry of Finance has established within its internal audit department: (i) a fraud investigation unit with a qualified auditor and training program for staff; and (ii) an information technology (IT) audit unit.

**Section II. Availability of Grant Proceeds**

- A. General.** The Recipient may withdraw the proceeds of the Grant 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 Grant shall be withdrawn in a single tranche.
- C. Deposits of Financing Amounts.** Except as the Association may otherwise agree:
1. the Recipient shall open, prior to furnishing to the Association the first request for withdrawal from the Financing Account, and thereafter maintain the following two deposit accounts (“Deposit Accounts”) on terms and conditions satisfactory to the Bank:
    - (a) a deposit account in Dollar (“Foreign Currency Deposit Account”); and
    - (b) a deposit account in Afghani (“Local Currency Deposit Account”).
  2. all withdrawals from the Financing Account shall be deposited by the Association into the Foreign Currency Deposit Account. Upon each deposit of an amount of the Financing into the Foreign Currency Deposit Account, the Recipient shall deposit an equivalent amount into the Local Currency Deposit Account for the financing of expenditures in the Recipient’s development budget.
- D. Audit.** Upon the Association’s request, the Recipient shall:
1. have the Deposit Accounts 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 Accounts and their audit as the Association shall reasonably request.
- E. Excluded Expenditures.** The Recipient undertakes that the proceeds of the Grant shall not be used to finance Excluded Expenditures. If the Association determines at any time that an amount of the Grant 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 August 31, 2010.

## APPENDIX

### Section I. Definitions

1. “Afghani” means the currency of the Recipient.
2. “ANDS” means the Afghanistan National Development Strategy adopted by the Recipient as its medium-term development plan in April 2008, which is also its Poverty Reduction Strategy Paper.
3. “ARDS” means the Afghanistan Reconstruction and Development Services, a central procurement facilitation service under the supervision of the Recipient’s Ministry of Economy.
4. “Civil Servants Law” means the Recipient’s Civil Servants Law No. 32 of June 16, 2008.
5. “Deposit Accounts” means both the Foreign Currency Deposit Account and the Local Currency Deposit Account.
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 credit, grant or loan;
  - (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 sub-groups under future revisions to the SITC, as designated by the Association by notice to the Recipient:



<b>Group</b>	<b>Sub-group</b>	<b>Description of Item</b>
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) with respect to which the Association determines that corrupt, fraudulent, collusive or coercive practices were engaged in by representatives of the

Recipient or other recipient of the Grant proceeds, without the Recipient (or other such recipient) having taken timely and appropriate action satisfactory to the Association to address such practices when they occur.

7. “Foreign Currency Deposit Account” means the account referred to in Part C.1(a) of Section II of Schedule 1 to this Agreement.
8. “General Conditions” means the “International Development Association General Conditions for Credits and Grants”, dated July 1, 2005, (as amended through October 15, 2006) with the modifications set forth in Section II of this Appendix.
9. “IARCSC” means the Recipient’s Independent Administrative Reform and Civil Service Commission established and operating under the Civil Service Law, No. 861 dated September 11, 2005.
10. “Local Currency Deposit Account” means the account referred to in Part C.1(b) of Section II of Schedule 1 to this Agreement.
11. “MOF” means the Recipient’s Ministry of Finance or any successor thereto.
12. “Parliament” means the Recipient’s *Wolesi Jirga* and *Meshrano Jirga*.
13. “Procurement Law” means the Recipient’s Law No. 865, dated October 25, 2005, as amended on January 19, 2009.
14. “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 April 16, 2009, 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 during its execution.
15. “Solar Year” means the Recipient’s solar year, commencing on March 21 of each calendar year and ending on March 20 of the following calendar year.
16. “Verified Payroll Plan” means a MOF initiative to provide assurance that payrolls submitted by the budget units are supported by genuine employment contracts, are prepared accurately, and are disbursed to the individual identified in the payroll summary.

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

The modifications to the “International Development Association General Conditions for Credits and Grants”, dated July 1, 2005, (as amended through October 15, 2006) 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. Section 2.05 (renumbered as such pursuant to paragraph 2 above) is modified to read as follows:

“Section 2.05. *Refinancing Preparation Advance*

If the Financing Agreement provides for the repayment out of the proceeds of the Grant of an advance made by the Association or the Bank (“Preparation Advance”), the Association shall, on behalf of the Recipient, withdraw from the Financing Account on or after the Effective Date the amount required to repay the withdrawn and outstanding balance of the advance as at the date of such withdrawal from the Financing Account and to pay all accrued and unpaid charges, if any, on the advance as at such date. The Association shall pay the amount so withdrawn to itself or the Bank, as the case may be, and shall cancel the remaining unwithdrawn amount of the advance.”

4. 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.
5. Paragraph (a) of Section 4.05 (renumbered as such pursuant to paragraph 3 above and relating to *Use of Goods, Works and Services*) is deleted in its entirety.
6. Paragraph (c) of Section 4.06 (renumbered as such 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 Grant until two years after the Closing Date. The Recipient shall enable the Association’s representatives to examine such records.”

7. Section 4.07 (renumbered as such 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 Legal Agreements and the accomplishment of the purposes of the Grant.”

8. 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 Grant 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 Grant is made.” All references to “Project” throughout these General Conditions are deemed to be references to “Program”.

- (d) The term “Program Preparation Advance” (renamed as such pursuant to subparagraph 8(c) above) is modified to read “Preparation Advance” and its definition is modified to read as follows:

“‘Preparation Advance’ means the advance referred to in the Financing Agreement and repayable in accordance with Section 2.05.”