

FINAL REPORT ON
VALIDATION
OF THE IMPLEMENTATION OF THE
EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
IN AFGHANISTAN



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FINAL REPORT
TO THE MULTI-STAKEHOLDER GROUP

Prepared by HART RESOURCES LTD

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LIST OF ABBREVIATIONS AND ACRONYMS

ACCI	Afghanistan Chamber of Commerce and Industry
AEITI	Afghanistan Extractive Industries Transparency Initiative
AFMIS	Afghanistan Financial Management Information System
Afs	Afghanis – the national currency of Afghanistan
ASI	Adam Smith International
BRT	Business Receipts Tax
CAO	Control and Audit Office
COFOG	United Nations Statistics Division Classifications of the Functions of Government
CSO	Civil Society Organisation
Eoi	Expression of Interest
EPSC	Exploration and Production Sharing Contract
GFS	Government Financial Statistics (as issued by IMF)
IMF	International Monetary Fund
MDTF	Multi Donor Trust Fund (donor funding administered by World Bank)
MJAM	Consortium formed by Metallurgical Group Corporation of China (MCC) with Jiangxi Copper Company Ltd and Aynak Minerals Company
MoF	Ministry of Finance
MoM	Ministry of Mines
MoU	Memorandum of Understanding
MSG	Multi Stakeholder Group
PFMEL	Public Financial Management and Expenditure Law 2005
QEIT	Qualifying Extractive Industries Taxpayer
SDNRP	Sustainable Development and Natural Resources Program
SIGAR	Special Inspector General for Afghanistan Reconstruction

SIGTAS	Standard Integrated Government Tax Administration System
SME	Small and Medium scale Enterprises
ToR	Terms of Reference
USGS	United States Geological Survey
VAT	Value Added Tax

1 INTRODUCTION

1.1 FOREWORD

This report presents the findings of our mission for the validation of the process of implementation of the Extractive Industry Transparency Initiative (EITI) in Afghanistan, conducted between 9th and 18th December 2012. The EITI Validation has been undertaken by Hart Group in association with Talal Abu-Ghazaleh International (TAGI).

The Validator would like to thank the National Coordinator and AEITI Secretariat and the members of the Multi Stakeholder Group who have been extremely helpful to the course of this work. We acknowledge the support during the Validation visit by Government agencies, CSOs and private sector participants, which was extremely helpful in carrying out the assignment.

The structure of the report is as follows:

- Section 1 Introduction: introduces the report, followed by a summary of the EITI Validation process, the methodology and approach adopted in the present exercise, key facts on the extractive industries in Afghanistan and a summary of progress against the Afghanistan EITI Work Plan
- Section 2 Report on progress against the EITI Requirements: presents the Validators' assessment of progress and the status of compliance with each of the EITI Requirements specified in the EITI Rules (2011 Edition)
- Section 3 Table summarising the evaluation: this presents an overall assessment of the implementation in terms of the requirements which are met or unmet
- Section 4 Scope of the AEITI Process: this summarises the scope and progress of the AEITI programme, with respect to engagement by CSOs, engagement by extractive industry companies, the impact of EITI at country level, the sustainability of the process and actions and innovations undertaken by the MSG
- Section 5 Conclusions: this summarises the conclusions with reference to a general evaluation of the implementation of the EITI, lessons learnt from the implementation of EITI and recommendations for strengthening the EITI process
- Section 6 Appendices: these comprise-
 - Appendix 1- Copies of Work Plans 2009 – 2012, as amended September 2011 and as amended May 2012
 - Appendix 2- Time line record of key AEITI actions and events 2009 – 2012
 - Appendix 3 – Collated company self-assessment forms
 - Appendix 4- List of respondents and interviewees

1.2 THE EITI VALIDATION PROCESS

The EITI Validation is the process adopted by the EITI Board to determine the status of a country - Candidate or Compliant. The steps in this process are:

- choosing a Validator;
- preparation of a validation evaluation visit to the country;
- Validation visit in the country, which leads to production of a Report;
- study and approval by the Multi Stakeholder Group (MSG) of the Validation Report;
- presentation of the Report to the International Secretariat, following which the EITI Board decides status of the country.

The main objective of the visit to the country is to provide an independent assessment, based on the collection of evidence, of the progress made by the country in the framework of the implementation of EITI, and to provide recommendations to improve or ensure the sustainability of the implementation of EITI in the future.

The final decision on the country's compliance is the sole responsibility of the EITI Board.

1.3 THE VALIDATION APPROACH AND ACTIVITIES

The Validation team consisted of JOHN KNIGHT, MUNIR HERZALLAH and FATHI ABU FARAH.

The approach and methodology for validation are set out in the Validation Guide published by EITI (version of the 1st November 2011) and are based upon

- a review of documentation
- interviews with members of the MSG and other stakeholder representatives;
- self-assessment forms prepared by companies engaged in extractive activities in Afghanistan.

Meetings were held with members of the MSG representing Government, extractive industry companies and Civil Society Organisations (CSOs). Meetings were also held with representatives of other CSOs and operating companies that are not directly represented in the MSG and also with representatives of international and national donor agencies which have observer status or other direct interest in the MSG.

A list of the various people contacted during this exercise is provided in Appendix 4 of this Report.

We visited Kabul between 9th and 18th December 2012.

1.4 KEY FACTS OF THE EXTRACTIVE INDUSTRIES IN AFGHANISTAN

It is widely accepted that the territory of Afghanistan hosts an exceptionally wide range of mineral deposits of considerable economic value, reflecting the presence over a wide area of the country of one of the major orogenic belts of the world. However, definitive accounts documenting the extent and potential value of these deposits are still incomplete or largely speculative.

Mining extraction of certain materials in Afghanistan probably commenced in prehistoric times and has continued to the present. The earliest phase of regional geological studies dates from the period of British intervention in Afghanistan in 1885, and sporadic periods of investigation continued subsequently, the 1970s being noteworthy for hydrocarbon exploration by European majors. However, more comprehensive formal geological investigation of mineral occurrences across the national territory can be considered to have commenced during the period of Soviet occupation. Subsequently a major effort (approximately 2004 – 2010) for geological mapping has been carried out by the US Geological Survey (USGS), working in close association with the Geological Survey of Afghanistan and British Geological Survey. USGS has published a number of reports identifying the economic significance of the main mineral deposits, but particularly in the case of hydrocarbon fields, the estimates of potential size, and therefore potential value, are based on statistical projections and have not been based on physical exploration. USGS reports on the geological programme and resource evaluation for selected minerals are in the public domain and have been consulted on: <http://afghanistan.cr.usgs.gov/minerals>

The most up-to-date reference documentation of mineral deposits is provided in the USGS Open-File Report 2011-1204: Summaries of Important Areas for Mineral Investment and Production Opportunities of Nonfuel Minerals in Afghanistan (Peters, King, Mack & Cormack, editors)¹.

Information on hydrocarbon potential has been consulted in the USGS Fact Sheet 2006-3031: Assessment of Undiscovered Petroleum Resources of Northern Afghanistan, 2006²

An initiative of the Afghanistan EITI has been to engage a Baseline Study Report³ on Afghanistan's Mineral Wealth as a step to define the scope of the EITI process. This study reported in October 2011 on the results of investigation in 10 provinces, for which it was limited to these areas due to the limitations imposed by access and security. Within these areas, mine sites were visited and interviews were conducted with mineral developers, local authorities and with MoM personnel of the local administrative offices.

In addition a report prepared by the CSO Integrity Watch Afghanistan, entitled- Hajigak The Jewel of Afghan Mines⁴, a Working Paper issued in July 2011, has been consulted as it presents the perspective of the Civil Society sector on the range and development of mineral resources in Afghanistan.

The MoM directorates in Kabul have provided details of recent tender and contract documentation and current tender processes are summarised on the Ministry web-site.

From the above sources, key facts on the mineral sector and hydrocarbon sector are presented below.

1.4.1 MINING SECTOR

There are numerous mining operations currently active throughout the national territory, ranging in scale from artisanal working to medium-scale mines. It is likely that not all of these have been documented⁴, reflecting access and security constraints for MoM staff, reticence of remote communities to recognise Government jurisdiction and the often seasonal nature of operations in areas of harsh climate. Records of mining operations are those recognised by contracts (in effect licences) issued by the MoM or activities logged by the MoM regional offices.

As at October 2012 there were 82 mining contracts recorded as active on the MoM database. Review of the database, to include those that are in the process of contract extension, or where otherwise not classified the expiry date is still valid, suggests mining activity in some 145 contracts; the composition of these may be summarised as follows:

Mineral Commodity	Number of contracts	Locations of contracts by province
Marble	4	Wardak (3), Samangan (1), Herat (1)
Sand & Gravel	40	Kabul (30), Parwan (4), Baghlan (2), Nangarhar (2), Herat (1), Kandahar (1)
Construction stone	61	Kabul (43), Parwan (6), Kandahar (5), Kapisa (3), Baghlan (1), Jawzjan (1), Nangarhar (1), Takhar (1)
Rukham Stone (Alabaster)	2	Bamyan (1), Kandahar (1)
Gypsum	15	Faryab (7), Balkh (3), Baghlan (1), Ghazni (1), Samangan (1), Takhar (1), Wardak (1)
Salt	4	Takhar (2), Balkh (1), Herat (1)
Bentonite	1	Logar (1)
Talc	6	Nangarhar (6)
Chromite	1	Samangan (1)
Copper	1	Logar (1)
Gold	2	Balkh (1), Takhar (1)
Coal	6	Herat (3), Samangan (2), Baghlan (1)
Cement materials (incl. lease of cement plant)	2	Herat (1), Kabul (1)

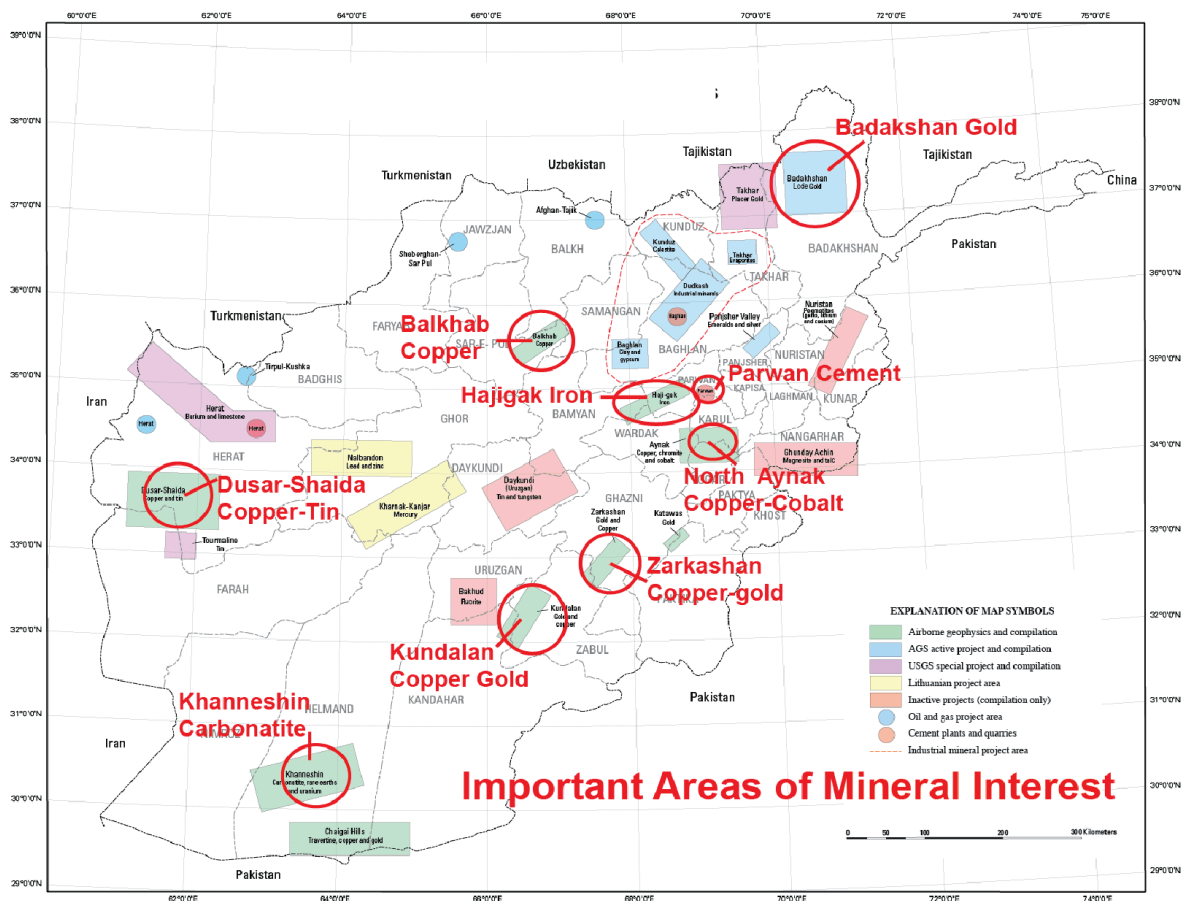
The probably active and recorded mining activities are located in 16 provinces of the total of the 34 provinces of the country and are concentrated in the north-east of the national area; there are no records covering the south-eastern provinces.

A total of some 303 contracts have been published on the MoM website. The majority of these contracts are for smaller operations and are published only in Dari. A small number of contracts are also published in English. The website also publishes a summary of the contract signed with the Chinese consortium Metallurgical Group Corporation with Jiangxi Copper Co Ltd (MCC-JCL) signed 08-04-2008 for development of the Aynak Copper project, which makes specific mention of the need for compliance with EITI principles. No mention of EITI is apparent in the other contract documents.

It is to be noted that the Baseline Study Report³, prepared for AEITI, reported on visits to operations in the provinces of Panjshir and Badakhshan, in the extreme north-east of the country, where mining

is undertaken for gemstones (emeralds in Panjshir; lapis lazuli in Badakhshan). There appear to be no formal licences or contracts for these operations and these provinces and mineral products are not recorded on the MoM contract database. The local Directorate of Mines monitors what is a largely informal exploitation of emeralds in Panjshir but gathers a fee on material traded in the local market. In Badakhshan there is no accurate record of the production of lapis lazuli, although a significant amount of the production passes to the Afghan Emerald Company in Kabul. This entity undertakes sorting and pricing of precious stones and lapis lazuli and collects tax payment to the Government based on a 15% royalty on the value of the material. The Afghan Emerald Company has not been identified as a contributor, either for non-tax or tax revenues, to Government.

The investigation of mineral resources carried out by USGS (2004-2011), in conjunction with the Geological Survey of Afghanistan and British Geological Survey, concentrated on identifying areas of primary interest which were deemed likely to support the development of mineral production in the near-term. Inevitably this approach has identified significant mineral deposits which may attract international investment. A summary of Important Areas of Mineral Interest is presented in the following map published by USGS¹.



The overall programme of resource investigation led by USGS has identified an extensive list of mineral occurrences, including aggregates and construction materials which can be expected to be exploited on small to medium scale by Afghan companies, a large number of minerals for industrial application (including barite, fluorite, magnesite, potash) which are not currently in production and may be exploitable by artisanal, small or medium scale operations depending on market demand,

and also large complex deposits for which efficient exploitation will require the technology, experience and investment capacity of major international mining groups. The results of these studies have been the foundation for a programme of major international tenders for development of resource blocks in the Important Areas of Mineral Interest.

As at December 2012, the status of tenders and awards for large mineral development projects let to international tender can be summarised as follows:

	Name of Project	Principal commodity/product	Status of Contract
1.	Aynak Copper-Cobalt (Logar Province)	Copper (planned smelter to produce Cu anodes)	Contract award to MJAM consortium of China (MCC-JCL Aynak Minerals Co); awaiting archaeological clearance and resolution of security issues; earliest production of ore in 2014 but may be delayed. Issues of resettlement and community funding.
2.	Hajigak Iron ore (Bamyan Province)	Iron ore	Resource base of approx 1,800 Mt @62% Fe; divided into 4 blocks. Contract negotiation underway with Steel Authority of India Ltd for development of 3 blocks (resource base: 1,290 Mt); contract negotiation underway with Kilo Gold Ltd of Canada for development of 1 block (resource base: 483 Mt)
3.	Balkhab Copper (Sar-I-Pul & Balkh provinces)	Copper (downstream process route not yet defined)	Preferred Bidder: Afghan Gold & Minerals Co. <i>(source: MoM website; Mining Journal 07 Dec. 2012)</i>
4.	Shaida Copper (Herat Province)	Copper (downstream process route not yet defined)	Preferred Bidder: Afghan Minerals Group <i>(source: MoM website; Mining Journal 07 Dec. 2012)</i>
5.	Badakhshan Gold (Badakhshan Province)	Gold	Preferred Bidder: Turkish-Afghan Mining Co. <i>(source: MoM website; Mining Journal 07 Dec. 2012)</i>
6.	Zarkhashan Gold-Copper (Ghazni)	Gold, copper concentrate?	Preferred Bidder: Sterling Mining & Belhasa International Co LLC <i>(source: Mining Journal 11 Jan 2013)</i>

It is apparent that a different tendering process, contract negotiation and format, and contract monitoring and reporting applies for large internationally tendered projects as compared to the simple contract format for small and medium scale projects let to Afghan companies. In principle, current legislation requires mineral contract holders to have an Afghan partner. The draft amendment (2012) to the Minerals Law recognises different categories for mineral exploitation licences as large-medium scale operations, small-scale mining operations and artisanal mining; the latter is available only to Afghan citizens.

None of the large internationally tendered projects have yet attained production. The earliest production from these projects is likely to be from the MJAM Aynak Copper Project. Assuming successful development of this and other projects, the character of the mining sector will undergo

profound change in terms of the contribution to national revenues and the scale, technology and number of employees of these new major projects.

1.4.2 HYDROCARBON SECTOR

Much of the petroleum resource potential of Afghanistan and all of the known crude oil and natural gas reserves are in northern Afghanistan, located in parts of two petroliferous geological basins—the Amu Darya Basin to the west and the Afghan-Tajik Basin to the east. The two basins encompass approximately 515,000 km² (200,000 square miles) in those portions that lie within Afghanistan. Although considerable exploration has previously occurred, both the Amu Darya and Afghan-Tajik Basins of northern Afghanistan are considered to have potential for additional crude oil and natural gas discoveries².

Between the 1960s and mid 1980s, more than 15 oil and gas fields in northern Afghanistan were identified by Soviet geological programmes. Only three gas fields- Khwaja Gogerdak, Djarquduk, and Yatimtaq were at that time developed in the area surrounding Sheberghan, which is located about 120 km west of Mazar-i-Sharif. Afghan natural gas production reached 275 million cubic feet per day in the mid-1970s. In the 1970s Soviet geologists had estimated Afghanistan's proven and probable natural gas reserves at up to 5 trillion cubic feet; 144 gas wells were drilled in 7 gas fields, some of which were exploration and others as exploitation wells.

Afghan Gas Enterprise has developed Shakarakh Gas field in the recent past and is now producing about 576,000 m³/day of gas from 35 producing wells in 4 fields – Gerqudaq, Yatimtaq, Khwaja Gogerdak and Shakarak. From these about 456,000 m³ gas is supplied to the Northern Fertilizer (Urea) Plant at Mazar, and the balance is supplied to domestic consumers in Sheberghan, Aqcha and Khoja Dokoh districts. A pilot CNG project with conversion facilities has started operation at Sheberghan. Some 87 vehicles have already been converted to CNG and a single CNG refueling station is in operation, with total sales to date of over 20,000 kg of gas.

Two projects are under implementation at Sheberghan for further development of these fields, with a view to improve the gas supply for existing users and to supply gas to a proposed 200MW gas-fired power plant at Sheberghan.

Development of oil resources in the two major basins, the Amu Darya Basin and the Afghan-Tajik Basin, has been initiated by the award in 2011 of an Exploration and Production Sharing Contract (EPSC) for the Amu Darya Basin and the selection in December 2012 of a preferred bidder consortium for negotiation of EPSCs for oil and gas blocks in the Afghan-Tajik Basin.

The EPSC for the Amu Darya Basin was signed on 28 December 2011 between MoM and a consortium comprising China National Petroleum Corporation International and Watan Oil and Gas Afghanistan Ltd (CNPCIW). The Contract covers three blocks in Sar-I-Pul and Faryab provinces: the Kashkari Block, the Bazarkhami Block and the Zamarudsay Block, together encompassing five designated fields. Development will comprise an Exploration Phase, comprising an Initial Exploration Period of 4.5 years with the option of extension up to two consecutive periods each of two years. Contract award defines a Minimum Exploration Programme and requires a Financial Guaranteed of US\$ 15 million. The Development and Production Phase for each field begins with a declared Commercial Discovery and lasts up to 25 years from the date of

discovery, with potential extension of a further 10 years. The CNPCIW consortium has announced in December 2012 a tender process for sale of crude oil condensate to be produced in the Kashkari block contract area in 2013.

For the Afghan-Tajik Basin, bids were invited in late 2012 under a competitive tender process envisaging selection criteria to include the highest royalty offer. Technical and economic analyses of the tenders were performed by a multi-Ministry Contracts Evaluation Team with review by the Inter-Ministerial Commission. In the event only one compliant tender was received. In December 2012 negotiations have been undertaken with the international consortium consisting of Dragon Oil, Ghazanfar, Kuwait Energy and TPAO for signature of corresponding EPSCs.

With the exception of Afghan Gas Enterprise, there is no other hydrocarbon production, as at December 2012, on which production revenues will be generated. At 01 April 2011, comment from the Adam Smith Institute advisory team at the Ministry of Mines, confirmed that Afghan Gas was barely operational.

1.4.3 LEGAL FRAMEWORK

The general legal framework in Afghanistan is to a large extent still in development, reflecting the relatively recent signing of the current constitution in January 2004. The main body of legislation has been promulgated since that time, but many laws have been the subject of revision and amendment, reflecting the need to resolve inconsistencies or gaps revealed by practical application of the laws.

For the purposes of the AEITI process the relevant laws and regulatory documents are:

- Minerals Law (2009)
 - Minerals Regulations (Official Gazette dated 31 December 2009)
- Oil and Gas (Hydrocarbons) Law (2009)
 - Oil and Gas (Hydrocarbons) Regulations (Official Gazette date 01 November 2009)
- Income Tax Law (2009)
 - Income Tax Manual
- Customs Code (2005)
- Control & Audit Law (1978)
- Law on Corporations and Limited Liability Companies (2007)

As part of the planned effort to achieve compliance with the EITI Requirements, a report was commissioned jointly for the Ministry of Finance and the Ministry of Mines titled “A Review of the Consistency between Afghanistan’s Tax and Mining Laws”⁵, prepared by Adam Smith International

(ASI) and issued in November 2011. The conclusions and recommendations of this report are quoted below with respect to the relevant legislation.

Minerals Law (2009)

The ASI Report summarises as follows:

“The Minerals Law 2009 states that the payment of taxes is subject to the provisions of the Minerals Law 2009 and ‘relevant applicable laws’. Further, balance sheets are to be prepared in accordance with the Income Tax Law and International Accounting Standards. The Ministry of Finance is recognised as the sole public authority with jurisdiction to collect taxes and customs duties in accordance with the relevant laws i.e. the Income Tax law and the Customs Code. These principles are consistent with the understanding that the Income Tax law and the Customs Code take precedence in matters of taxes and customs duties.”

“The Minerals Law 2009 provides certain powers to the Ministry of Finance. The relevant provision states that ‘for the purpose of promoting private investment in the Minerals sector and taking the special circumstances of the holder of the Mineral Rights into account, the Ministry of Finance may propose to Government to adopt one or more of the following forms of relief in relation to taxes and customs duties applicable to holders of Mineral Rights and Mineral Activities:

1. Deferral of tax payment, to be carried forward over subsequent fiscal (tax) years
2. Deferral of deductions for depreciation of assets, to be carried forward over subsequent fiscal (tax) years
3. Deferral of deduction of accelerated depreciation of fixed assets, to be carried forward over subsequent fiscal (tax) years
4. Deferral of payment of Mineral Rights, Exploration and Exploitation depreciation expenditures
5. To lessen the taxes of additional value or similar taxes and customs duties on equipment, machinery and other goods used in the Exploration of Mineral Substances or specific categories thereof
6. To deduct all or a portion of Mineral Royalties payable, and the deferral of such deductions over subsequent fiscal years
7. To maintain the stability of taxes and customs duties and charges in accordance with Article 82 of this law
8. To lessen the taxes and customs duties that are inconsistent with those contained in a Mining Contract
9. Partial or complete exemption from business tax payable on Mineral Substances.”

The development of the Minerals Law, enacted in its first version in 2005 and subsequently amended in 2009, continues to include a number of inconsistencies or exceptional features; these

have been commented on in the Baseline Study Report³ contracted by the AEITI-MSG and also in the ASI review document. Relevant features are summarised as follows:

- The Mineral Law 2009 requires application for exploration and exploitation licenses to be made separately. Licenses are meant to be issued strictly on a bidding process but there is no provision that a company that has invested in exploration obtains any preferential consideration in the bidding for exploitation of the same area. In consequence exploration is a high risk strategy which may generate no return even if target resources are identified, and in consequence exploration is discouraged. A proposed amendment to the Minerals Law submitted to Parliament in 2012 aims to address this.
- The Minerals Law 2009 implies mandatory bidding even for extraction of small amounts of quarry materials. A proposed amendment to the Minerals Law submitted to Parliament in 2012 aims to eliminate the need for bidding for quarry minerals.
- The Minerals Law 2009 does not set out any fixed royalty rates regime for specific mineral products. The law allows the MoM to specify royalty rates for deposits based on calculations on the quality (grade) of the deposit, the infrastructure around it and other indicators which may be subject to change in time. This has given rise to cases where apparently comparable mining operations for the same mineral product may be paying widely different royalty rates; the Baseline Report also claims that the bidding process has induced tendering companies with little experience to offer royalty rates which are punitive and uneconomic, leading to early closure of operations.
- The ASI review notes that the term “mineral activities” is used regularly throughout the Minerals Law but there is no definition of this term, and it is similarly the case in the Mining Regulations. It is apparent the term has broad meaning but arguably the widest interpretation might cover those who do not have a license but are contracted to those who do; i.e. subcontractors may argue they are involved in mineral activities
- The provisions for tax stability under the Income Tax Law apply only to companies that are a “Qualifying Extractive Industries Taxpayer” (QEIT). The ASI review identifies that the stability provisions of the Income Tax Law and the Minerals Law are generally consistent. However, the stability provision proposed by the Minerals Law extends beyond income tax (and business receipts tax) imposed by the Income Tax Law to include stability of customs duties and royalties. The Customs Code contains no provisions which allow for stability of customs duties nor does the Minerals Law allow for the stability of royalties.

The Ministry of Mines has proposed to amend the Minerals Law 2009, with amendments that were submitted to the Ministry of Justice in early 2012. According to the ASI Review none of the amendments were intended to change the current policy regarding the payment of taxes, customs duties and other charges. However, ASI offered the following recommendation with regards to improvement in the Minerals Law:

“The tax and customs provisions in the Minerals Law (should) either more accurately paraphrase the provisions of Chapter 12 of the Income Tax Law 2009, (or) refer directly to the Income Tax Law generally or Chapter 12 of the Income Tax Law specifically, or make no reference to tax and customs treatment at all.”

The Minerals Law contains a confidentiality provision that applicants for Mineral Rights and holders thereof may request the confidential treatment of technical, geological and mining information submitted to the MoM. However, this does not preclude the release of other information such as financial information and does not legally prevent the MoM providing financial information to the MoF for the purposes of the Income Tax law.

The proposed amendment of January 2012 to the Minerals Law encountered opposition in Parliament and awaits re-submission. The amended draft Minerals Law makes specific reference to the commitment of the MoM to apply the principles of the EITI process.

Oil and Gas (Hydrocarbons) Law 2009

The status of legislation in this context is not clear. The Validators have been informed that the Oil and Gas (Hydrocarbons) Law of 2009 has been replaced by the Petroleum Law 2012, which embodies most of the previous legislation but introduces a number of amendments, none of which were intended to change the existing policy regarding payment of taxes, customs duties and other charges. It is not clear that the 2012 amended law has been enacted.

A Ministerial presentation of May 2012 states that the new law clarifies key areas including:

- Application of the Law
- Roles of organizations that govern the sector
- Nature of Legal Instruments: Contracts, Approvals and Licence
- Environmental Protection requirements
- Dispute Resolution process.

The new law is also claimed to fill legislative gaps including:

- Best Practices in Environment Protection, Safety and Conservation
- Promotion of Transparency and Compliance with EITI Requirements
- Comprehensive Regulation Making Powers

However, the hydrocarbons legislation posted on the MoM website (January 2013) comprises only an unofficial translation into English of the Hydrocarbons Law but without any date reference; this legal document makes no reference to transparency in any activity nor reference to the EITI process. The recent tender for the Afghan-Tajik Basin Phase 1 Tender, issued on 19 October 2012, makes reference to the same unofficial translation of the Hydrocarbons Law.

The largest and most recent contract for oilfield development, for the Amu Darya Basin, was finalised in December 2011 under the provisions of the Hydrocarbons Law 2009 of Afghanistan. This is underlined by the letter instruction (18 October 2012) to the CNPCIW Consortium, the contractor for the Amu Darya Basin development, from the Minister of Mines requiring the consortium to

submit an EITI reporting template under the provisions of the Hydrocarbons Regulations; this reporting period will correspond to the 3rd reconciliation exercise.

The unofficial English translation of the currently applicable Hydrocarbons Law (undated) on the MoM website defines that hydrocarbon contracts shall be concluded as one of four types:

1. Exploration and Production Sharing Contracts
2. Service and Production Sharing Contracts
3. Contracts for Geological/Geophysical/Geochemical Services
4. Contracts for Pipeline Operations.

These contracts coincide with those discussed in the ASI Review of the Hydrocarbons Law (2009). ASI concludes that only first and second types of contract (exploration contract; service contract) are consistent with the terms in the Income Tax Law to meet the definition of a QEIT. Geological/Geophysical/Geochemical Services contractors and Pipeline Operations contractors would not be considered QEITs for income tax purposes and therefore would not be entitled to the tax stability provisions provided by the Income Tax Law.

ASI concludes that “It is apparent from the use of the term ‘contractor’ in the relevant provisions of the Income Tax Law and the Hydrocarbons Law that sub-contractors do not qualify as QEITs under the Income Tax Law and are not entitled to be considered by the MoM for ‘assurances on the stability of taxes, levies and charges’ under the Hydrocarbons Law.”

ASI offered the following recommendation with regards to improvement in the Hydrocarbons Law:

“The tax stability provision of the Hydrocarbons Law (should) either more accurately paraphrase the provisions of Chapter 12 of the Income Tax Law 2009 (or) refer directly to the Income Tax law generally or Chapter 12 of the Income Tax Law specifically or make no reference to tax (and customs) treatment at all.”

There are no confidentiality provisions in the Hydrocarbons Law.

Income Tax Law (2009)

As commented in the ASI Review, the Income Tax Law 2009 includes a provision asserting the primacy of this law over other laws. Neither the Minerals Law nor the Hydrocarbons Law expresses primacy over other laws except to the extent the Minerals Law defers to specific laws concerning standards, the environment and social conditions.

The Income Tax Law 2009 includes a chapter (Chapter 12) directed to extractive industries, which overrides other, more general, provisions of the Income Tax Law. The intention is that the provisions of this chapter provide both favourable tax benefits and certainty in the application of tax law to sector-specific issues. Relevant provisions, as identified and commented in the ASI Review, may be summarised:

- Qualifying Taxpayers- only a “qualifying extractive industries taxpayer” (QEIT) will be entitled to use these provisions. A QEIT is defined to mean a person holding a mining license, mining

authorisation or is a person who is a party to a hydrocarbons contract in accordance with the relevant regulatory laws.

- Ring fencing- the Income Tax Law provides that the separate mining licenses, mining authorisations or hydrocarbons contracts of a QEIT are ring fenced, so that each is to be treated and accounted for on the same basis as a separate person; this also precludes the offsetting of expenditure or losses from unproductive sites against profitable sites.
- Exemption from Business Receipts Tax (BRT) - QEITs are exempt from the business receipts tax; the justification for exemption is that QEITs will typically be required to pay royalties to the State.
- Losses carried forward and accelerated depreciation- losses may be carried forward and deducted against the income of future years until fully recouped consistent with the treatment provided to other enterprises. Accelerated depreciation for QEITs is, however, given different treatment to that of other enterprises. Assets of a QEIT which have a life greater than twelve months and are constructed or acquired for use directly in the business subject to the mining license, mining authorisation or hydrocarbons contract, will receive separate depreciation treatment depending upon whether the assets are building or other capital assets.
- Pre-production costs- these are any expenditure incurred by a QEIT prior to commencing commercial production, but does not include the cost of acquiring an asset which qualifies for accelerated depreciation or the cost of constructing a road. Pre-production costs may be deducted on a straight-line basis over the lesser of 15 years or the number of years remaining in the mining license, mining authorisation or hydrocarbons contract after commercial production commences.
- Road construction expenses- these may be deducted by a QEIT over 15 years commencing from when the road was completed; the road must be used to carry on a business that is subject to a mining license, mining authorisation or hydrocarbons contract.
- Environmental and social obligations- a QEIT may deduct any amount that is required to be paid in respect of environmental and social obligations in accordance with the regulatory laws for the extractive industries, such as mine closure and rehabilitation costs. Such costs may be met from a fund which is contributed to over the course of production; contributions will be allowed as deductions provided the amounts are paid to an entity that has no connection to the person claiming the deduction and the person provides a bank guarantee to the MoF for payment of the deductible amount in the event that the entity holding the funds does not apply the funds as required.
- Income tax stability- a QEIT may opt for income tax stability rather than pay tax at prevailing rates; for a period of 5 years for a mining authorisation, 8 years for a mining license or in the case of a hydrocarbons contract, for the duration of the contract, the MoF will apply the Income Tax Law as it stands at the time the QEIT acquired or entered into the authorisation, license or contract. However, this arrangement will incur a fixed corporate income tax rate

of 30% for the duration of the stability agreement as opposed to the currently prevailing corporate income tax rate of 20%.

The ASI review records that the Income Tax Law 2009 provides for an advance income tax and advance BRT payable on imports at the time of import. This applies to all persons who import goods, including extractive industries companies importing capital equipment. Importers with a business license are subject to a 2% fixed income tax on total cost, including customs duties, of the good imported. The tax paid is allowable as a credit (i.e. payment in advance) in the calculation of annual income tax on net profit. The importer is also subject to a 2% BRT on the cost of imported goods including customs duties, which will be treated as a credit (i.e. payment in advance) for BRT payable.

The long-term start-up nature of the extractive industries means that there is an initial period prior to production which will see capital intensive investment and the import of equipment some years before there is any income from sales of mineral product. Furthermore, sales of minerals are exempt from BRT. For this reason the extractive industries are relatively penalised by the payment of advance income tax and BRT as compared to other industrial sectors.

ASI offered the following recommendation with regards to improvement in the Income Tax Law:

“QEITs (should) be exempted from advance business receipts tax payable on imports of capital equipment. For consistency, this could mirror the exemption from value Added Tax for capital equipment used in the extractive industries in the proposed VAT Law”.

ASI note that the Income Tax law provides for confidentiality of information and that such information acquired regarding an income tax return and financial and trade information of a taxpayer or others is confidential and shall not be disclosed by the MoF unless authorised by law. This places a limitation on the disclosure of taxpayers' information to MoM for the purposes of administration of the Minerals Law and the Hydrocarbons Law.

The Customs Code (2005)

As commented in the ASI Review the Customs Code 2005 contains a provision which is intended to provide primacy of the Customs Code over other laws. The Customs Code 2005 imposes import duties and export duties at the rates prescribed by the Customs Tariff Schedule. The import of machinery is subject to a 2.5% import duty.

The Customs Code allows for a range of “favourable tariffs”, which should be requested by the importer and which may be granted based on a separate procedure which may determine any quantitative or value-based limits on imported goods or benefits based on their origin, nature or end-use. A Presidential Decree of 1385 (18 October 2006) exempts manufacturing (production) equipment not more than 5 years old from import duties. The Customs Code provides a range of conditions for approval of goods for temporary importation; the Council of Ministers on recommendation of the MoF may prescribe a period of up to 6 years for goods to remain as temporary imports.

With respect to export duties, domestically manufactured goods and products are exempt but this does not apply to minerals. There is apparently confusion in the interpretation of the minutes of the

Council of Ministers as to whether the export of hydrocarbons is exempt from mineral duty or subject to export duty similar to the treatment of mineral exports.

ASI offered the following recommendation with regards to improvement in the Customs Code:

“That the MoM (should) develop a policy for import and export duties for approval by the MoF and have the import and export duties charges accordingly. In particular the MoM should advocate:

- a. An increase to the 5 year age limit of capital equipment qualifying for exemption from import duties; and
- b. An increase to the 6 year maximum period for temporary imports.

Import (customs) duties and export duties are imposed at rates provided in the Customs Tariff Schedule and may be changed with the recommendation of the Minister of Finance and the approval of the Council of Ministers. As a change to the law is not necessary, there is no need for parliamentary approval.”

ASI notes that the Customs Department is covered by an obligation of confidentiality and will not disclose specific information without the permission of the person concerned and with the legal authority to grant such permission. This limitation would prevent the disclosure of customs information to the MoM for the purposes of administration of the Minerals Law and the Hydrocarbons Law.

Control and Audit Law 1981

The Validators requested to inspect a copy of this law in order to understand the context of the audit process which is obligatory for Government agencies. Available copy of the law is only in Dari or Pashto language. Accordingly reference has been made to the paper prepared by the Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR): “Afghanistan’s Control and Audit Office requires operational and budgetary independence, enhanced authority and focused international assistance to effectively prevent and detect corruption” dated 09 April 2010⁶.

The SIGAR paper provides the organisational chart for the CAO.

It is relevant to note the conclusions of the SIGAR audit reported in this paper, as presented in its executive summary:

“The CAO’s current legislative framework is weak, does not provide the CAO with sufficient independence or authority to serve effectively as Afghanistan’s Supreme Audit Institution, and results in conflicting responsibilities, particularly with Afghanistan’s Ministry of Finance. The CAO’s legislative framework does not provide the CAO with budgetary or operational independence from the executive branch, and this lack of independence interferes with the CAO’s planning, reviewing and reporting processes. In addition, the CAO’s enabling legislation does not provide the CAO with the authority to require audited entities to report on actions taken in response to CAO recommendations, or demand access to necessary documents, officials and premises. Further, current legislation does not require the CAO to report to the National Assembly or to publicly release its audit reports.”

Law on Corporations and Limited Liability Companies (2007)

The Validators requested to inspect a copy of this law in order to verify the requirements of corporate governance and financial reporting for public corporations and companies. The translation into English of this law identifies the relevant section as Article 54 Preparation and Delivery of Financial Statements:

1. Not less than 15 days prior to the Regular/Annual Meeting of the Shareholders, the Corporation shall deliver to all of the Shareholders entitled to attend such Meeting Financial Statements dated as of the last day of the fiscal year of the Corporation, which shall include the balance sheet dated as of the last day of the fiscal year and the profit and loss statement of the Corporation for the fiscal year. All Financial Statements shall include all operations of the company and shall comply in all material respects, with the applicable accounting standards set forth by the International Accounting Standards Board.
2. The Financial Statements, as well as the Corporation's books and records, shall be made available to all Shareholders for investigation at the Corporation's main office not less than 15 days prior to the Regular/Annual Meeting of the Shareholders.

1.5 PROGRESS AGAINST THE WORK PLAN

The Work Plan published and available on the AEITI website at the time of the Validation visit was the version indicated as "updated May 2012" and published on 12 May 2012. This latest work plan indicates that the activity "Appoint an Independent Validator" was originally scheduled for hire of the Validator in January 2012, which was then indicated as delayed to May/June 2012. This is the latest referenced date for completion of an activity on this version of the Work Plan.

After completion of the Validation visit, the AEITI Secretariat has made available a version of the Work Plan amended as at 25 December 2012. This plan identifies that activity beyond the completion of the Validation Report is pending. However, as at 03 February 2013, the version of the Work Plan posted on the AEITI website as the "Amended Work Plan" continues to be that of 12 May 2012, and therefore comments below refer to the latter as the latest Work Plan version.

As commented further under Section 2.5 of this report, the Validators observe that the delays in hire of a Reconciler, and more particularly of a Validator, willing to deploy in Afghanistan, has generated an important loss of momentum in the planning and implementation of the EITI process, and effectively a paralysis in the planning of the work programme, at least as reflected in a Work Plan, since May 2012.

Despite the delayed and poorly documented progress in the latter part of 2012, progress against the work plan first developed in late 2009 and formally adopted in February 2010 (MSG meeting of 09 February 2010), has been achieved successfully through to publication of the First and Second Reconciliation Reports, respectively in July and October 2012. A time-line summary of all significant EITI activity, based on documented information, is attached to this report as Appendix 2.

The Work Plan of February 2010 was updated as of June 2011 (MSG meeting of 05 June 2011), reflecting in particular the efforts to agree reporting templates. Continuing efforts, through meetings of Working Groups and the MSG, are documented for selection of reporting companies

and establishment of materiality thresholds through June – September 2011. The Work Plan was again amended and updated as at 28 September 2011, consolidating a projected time-line based on the now achieved completion of the tasks for preparation of reporting templates, decision on materiality threshold and selection of reporting companies. With respect to activities which define the critical path for completion of the Validation Report, the Work Plan of September 2011 projected the planned engagement of the Reconciler from an original deadline of August 2011 to an amended date of October 2011, publication of the First Reconciliation Report to January 2012, publication of the Second Reconciliation Report to June 2012, engagement of the Validator to May 2012. These amendments were scheduled to meet the submission deadline for the Validation Report in August 2012. The amended Work Plan of September 2011 represented an overall delay against previous plans of maximum 5 months for completion of the Validation Report, which would meet the August 2012 submission deadline.

For an overall summary of progress against the Work Plan, comparison is made in the following section with the amended deadlines in the Work Plan of September 2011:

- The initial Country Work Plan was adjusted to reflect the award of Candidate status on 09 February 2010, requiring submission of the Validation Report at latest 09 August 2012; during 2012 a request for extension of this deadline has been submitted and granted.
- 14 MSG meetings have been held in the period between November 2009 and September 2012
- A number of training and capacity-building courses have been undertaken, including a number of overseas visits (Mongolia, UK, Dubai) and courses directed to members of the MSG, for members of Government agencies, private sector companies and CSOs
- Reporting templates for extractive industry companies and Government agencies have been prepared and were approved in the MSG meeting of 05 June 2011 and final approved adjustments were accepted in August 2011. This incurred a delay against the schedule of the Work Plan (as amended in September 2011) which posted a deadline of May 2011 for final approval of templates and recognised a delay of 2-3 months
- The award of contract to the Reconciler has been achieved through the following process: approval of ToR for the Reconciler, the issue of a request for Expressions of Interest, issue of a Request for Proposal and evaluation of the received proposal leading to signature of the contract on 02 February 2012. These steps all incurred delays against the deadlines and Work Plan (as amended September 2011), as follows:

- | | <u>Amended
Deadline</u> | <u>Achieved</u> | <u>Delay</u> |
|--|-----------------------------|-----------------|--------------|
| ○ Approval of ToR for Reconciler | May 2011 | August 2011 | 2-3 months |
| ○ Issue of request for Expressions of Interest | June 2011 | September 2011 | 2-3 months |
| ○ Contract award to Reconciler | October 2011 | February 2012 | 4-5 months |
- The reconciliation exercise for three financial reporting periods (1387, 1388, 1389) has been completed, requiring implementation of the following activities: issue of the reporting templates, workshops with the reporting companies, meeting with Reconciler to identify discrepancies, approval of draft First Reconciliation Report, publication of First Reconciliation Report (1387, 1388), approval of draft Second Reconciliation Report, publication of Second Reconciliation Report (1389). These steps all incurred delays against the deadlines and Work Plan (as amended September 2011), as follows:

- | | <u>Amended
Deadline</u> | <u>Achieved</u> | <u>Delay</u> |
|---|-----------------------------|-----------------|--------------|
| ○ Explain discrepancies and review First Reconciliation Report | January 2012 | June 2012 | 5 months |
| ○ Publish and disseminate First Reconciliation Report | (not specified) | August 2012 | 5 months |
| ○ Explain discrepancies and review Second Reconciliation Report | May 2012 | September 2011 | 5 months |
| ○ Publish and disseminate Second Reconciliation Report | June 2012 | October 2012 | 5 months |
- The selection and engagement of the Validator has been achieved, but considerable delays were incurred because there were no responses to the initial request for Expressions of Interest, requiring approaches to individual groups accredited as Validators. In response to signature of the contract with Hart Group it is understood that extension for completion of the Validation Report has been granted to 09 February 2013. The steps to achieve completion of the Validation Report incurred delays against the deadlines and Work Plan (as amended September 2011), as follows:

	<u>Deadline</u>	<u>Achieved</u>	<u>Delay</u>
○ Preparation of ToR and approval by MSG and EITI International Secretariat (required agreement of funding and contribution from Government)	November 2011	March 2012	4-5 months
○ Request Expressions of Interest	November 2011	April 2012	4-5 months
○ Engagement of Validator	May 2012		
○ Completion of Validation Report (after grant of extension)	09 Aug 2012	Target 09 Feb 2013	6 months

- Commitment to “Develop Work Plan for 3rd AEITI Report”, is the last activity recorded in any of the later versions of the Country Work Plan, scheduled for April 2012 in both the versions of the Work Plan amended as at 28 September 2011 and updated at 12 May 2012. Apparently no progress has been made with respect to this task.

From the above summary, it is concluded that the principal causes of delay to the schedule set out in the Work Plan updated in September 2011, have been due to the processes of engagement of the Reconciler and the Validator. In the first instance delay was experienced in the approval of ToR for the Reconciler, but further delay was caused by consultation as to the correctness of progressing on the basis of one response to the call for Expressions of Interest.

Delay in the engagement and completion of the Validation process reflects delay in the approval of ToR and, importantly, confirmation of funding in which the Government covered the major part. Once expressions of interest were invited in April 2012, further delay was encountered due to the absence of any response from accredited Validators. This, together with the cumulative delay in the issue of the request for expressions of interest, rendered the deadline for completion of the Validation Report by 09 August 2012 almost impossible to achieve, and an extension to the submission period was requested and granted. Agreement was negotiated with Hart Group with whom a contract was signed on 21 November 2012. The Validators’ Visit was agreed for the period 09 December – 17 December 2012, with the objective of submission of an agreed Validation Report before 09 February 2013.

Notwithstanding the delays experienced in the completion of the core deliverables in the EITI process, it has been widely commented both by members of the MSG, independent extractive industry companies, other CSOs and by independent international observers, that the EITI process has proved, and continues to prove to be a high profile example of the process and benefits of transparency in a country which presents unique challenges to effective and good governance. Against this background, the activities performed and achieved within the Work Plan are assessed by stakeholders as major national benefits, amongst which key elements can be summarised as:

- Participation of CSOs and private sector companies in a transparent collaboration with Government agencies
- Organisation of a functional entity representing stakeholders, the MSG, which is able to take initiatives to progress the EITI principles and standards
- Training and capacity building of the members of the MSG and other relevant stakeholders to generate better informed and capable and active participants in AEITI
- Public and widespread dissemination and promotion of the principles and standards of EITI
- Management of a reconciliation process, generally accepted as transparent, with publication and dissemination to a wide national audience
- Commitment by the key ministries covering the extractive industry sector, to support EITI leading to a commitment to good and transparent practice (e.g. publication of extractive industry contracts).

A number of independent observers have strongly expressed the view that, given the short period since the re-establishment of open parliamentary government in Afghanistan, in 2004, the progress achieved nationally and in the context of EITI represents an exceptional effort to achieve good levels of governance.

2 REPORT ON PROGRESS AGAINST THE EITI REQUIREMENTS

2.1 EITI REQUIREMENT 1

The Government is required to issue an unequivocal public statement of its intention to implement the EITI.

Progress

On 16 March 2009, Dr Omar Zakhilwal, Minister of Finance wrote to the Chair of the EITI Board, and to the President of the World Bank and the Managing Director of IMF, confirming the Cabinet decision that Afghanistan should join the EITI process, with commitment to comply with the requirements for full implementation. In this communication Dr Zakhilwal also confirmed that he had been formally nominated by the Government as the focal point, or Champion, for implementation of EITI.

The first informal meeting of stakeholders to undertake implementation of EITI was held on 11 November 2009 under the chairmanship of Dr Zakhilwal. The national and international media were invited to this meeting and over 10 television and radio channels were represented plus over 10 print media. The address to the meeting stated the commitment of the Government to EITI and the scope of the meeting covered an explanation of the EITI process, the presentation of an initial work plan and corresponding budget. Substantial press coverage on the subsequent day, 12 November 2009, included front page spreads in the leading English language (Afghanistan Times) and local language (The Daily Afghanistan) newspapers.

Of particular significance is the Communiqué of the Kabul International Conference on Afghanistan of 20 July 2010. This communiqué reported the major Conference within the “Kabul Process” which reaffirmed the commitment of the Afghan Government to the Afghan people and of the International Community to Afghanistan. Within the communiqué (paragraph 12) the Government of Afghanistan states its commitment to:

“- setting out detailed plans to rehabilitate and expand regional transport and energy networks to realise the benefits of, amongst other things, its growing extractive industries sectors. This should be supported by relevant policy, fiscal and institutional reforms across these sectors, including implementation of mining regulations and establishing the Extractive Industries Transparency Initiative Secretariat;”

Further widely publicised public statements of Government commitment were made in relation to the 2nd formal MSG meeting for discussion of the reporting template for industries in the extractive industries, which was attended by both Dr Omar Zakhilwal, Minister of Finance and Mr Shahrani, Minister of Mines and also Mr Jonas Moburg, Head of EITI Secretariat. This meeting and the Government statement of commitment were widely published in local language press of 06 December 2010, including in the Hewad Daily.

The continuing Government commitment is emphasised on the website of the Ministry of Mines (<http://mom.gov.af>), which also hosts the link to the website of AEITI (<http://www.aeiti.af>).

Opinions of Stakeholders

All stakeholders agree that the Government has publicly and unequivocally stated its intention to implement the EITI.

Validator's evaluation

Afghanistan is in compliance with this requirement.

2.2 EITI REQUIREMENT 2

The Government is required to commit to work with civil society and companies on the implementation of the EITI.

Progress

In the period prior to formal application to the EITI International Secretariat for acceptance as a Candidate Country, the Government created a Working Group which functioned as a provisional MSG, in which representatives of Civil Society and private sector extractive industry companies were invited to participate. The Civil Society representatives comprised seven attendees from six well-recognised NGOs specialising in governance and transparency. The private sector representatives comprised seven attendees, of which six were from two significant companies plus a representative of the Afghanistan Chamber of Commerce and Industry (ACCI), which includes a number of other extractive industry companies.

Subsequently, since the formal constitution of the MSG, CSO and private sector representatives have been consistently present and active contributors in the meetings of the MSG, as evidenced by minutes and by interview statements. CSO and private sector representatives have also been active participants in the informal working groups which have from time to time been established to generate material on reporting templates and materiality thresholds, to review TOR and selection of the Reconciler and Validator and also to investigate discrepancies in the reconciliation exercise; reports and meeting attendance lists of these working groups have been reviewed.

The Validators note that a model MoU has been signed in October 2012 between the Government, represented by the Ministries of Finance and Mines, and representatives of extractive industry companies and that this will serve as the model agreement with each company to commit to support the EITI process. This will be an important step as each new company entrant to the national extractive sector signs up.

Opinions of Stakeholders

The interview process of the Validation visit has covered representatives of the three constituencies: civil society, private sector and Government agencies. All interviewees expressed agreement that the Government is committed to work with civil society and companies in the extractive industries to achieve implementation of EITI. While many interviewees asserted that members of the MSG can speak freely and communicate without constraint on issues of transparency and natural resource governance issues, nevertheless specific comments have been received that some CSO representatives have felt constrained in their participation in the MSG and also that these parties consider that on some occasions the Government has attempted to sideline or circumvent the CSO participation.

Validator's evaluation

No legislative or regulatory obstacles to the participation of CSOs or private sector companies in the MSG, or otherwise in the EITI process, have been identified. Nevertheless, a number of administrative issues and structures have been identified which from time to time may have impacted on the representativeness and commitment of CSO and private sector membership of the MSG. These administrative issues are identified as relating to internal governance of each of the CSO and private sector group constituencies, and therefore not relating directly to the Government commitment to the collaborative process, although effective resolution of these issues will benefit from Government direction. The issues of governance and representation on the MSG are addressed with respect to Requirement 4.

The representative structure developed this far in the MSG is able to include, both for the CSOs and for the private sector, a broadly representative member with the capacity to communicate across the constituency. In the case of the CSOs, this is the Civil Society Coalition, and for the private sector this is ACCI. Both organisations, by the inclusion in their membership of a wider range of member than those immediately involved in the MSG, have demonstrated their interest and capability to communicate across their respective constituencies and beyond to other organisations not directly engaged in the EITI process. It is recommended that this role should be recognised in each case by MoUs covering the respective constituencies and the obligations to disseminate and communicate information beyond the immediate membership.

Afghanistan is in compliance with this requirement.

2.3 EITI REQUIREMENT 3

The Government is required to appoint a senior individual to lead on the implementation of the EITI.

Progress

The Cabinet of the Government of Afghanistan reached an agreed decision to apply to join the EITI Process in March 2009, and at that time Dr Omar Zakhilwal, Minister of Finance, was formally nominated by the Government as the focal point, or Champion, for implementation of EITI. This was confirmed in a letter of 16 March 2009, addressed to the Chair of the EITI Board, and to the President of the World Bank and the Managing Director of IMF.

Since the commencement of the EITI process in Afghanistan, through to the present, Dr Zakhilwal has continued in post as Minister of Finance and has also sustained an active role as public champion of EITI in the country and as an active participant and driving force in the MSG. Since November 2009, Minister Zakhilwal has personally chaired seven meetings of the MSG and has been the conference host and presided over the Reconciliation Report Dissemination Conference of 01 August 2012.

By a formal MoU between the Ministry of Finance and the Ministry of Mines, of 31 January 2011, close collaboration between the two ministries was formalised with the particular objective of good practice and compliant performance with EITI principles. Following from this close collaboration, the Minister of Mines, Mr Wahidullah Shahrani, is identified as a joint lead on implementation of EITI and is designated a co-Chairman of the AEITI MSG. On those occasions when Dr Zakhilwal is unable to attend and participate in the MSG and related EITI implementation activities, his role is undertaken by Mr Shahrani, ensuring a senior presence in virtually all MSG meetings.

Opinions of Stakeholders

Stakeholders representing all interests and constituencies have expressed agreement that the Government has appointed a senior official to lead the EITI process. No lack of confidence or qualifications on the leadership of the EITI process were expressed by stakeholders, and correspondingly satisfaction with the Government leadership has been widely expressed.

Validator's evaluation

Afghanistan is in compliance with this requirement.

2.4 EITI REQUIREMENT 4

The Government is required to establish a multi-stakeholder group to oversee the implementation of the EITI.

Progress

At the time of the initial decision by Government to commit to participation in the EITI process, an informal group of stakeholders was invited to participate in initial meetings to consult on the steps to set up the formal structures to implement EITI. The participation in the first meeting of 11 November 2009 comprised six Civil Society Organisations (CSOs) which were considered to have specific interests in the extractive industries sector, representatives of the Private Sector comprising two mining companies and the Afghanistan Chamber of Commerce and Industry (ACCI) and Government representatives from the Ministry of Finance, Ministry of Mines, Ministry of Foreign Affairs, Ministry of Commerce and Industry, Ministry of Economy and the Environmental Protection Agency. In a letter to EITI Oslo of 22 November 2009, Dr Zakhilwal confirmed that a National Coordinator for EITI had been appointed in July 2009.

At a second informal meeting of stakeholders, on 17 February 2010 an outline costed work plan was discussed and endorsed. In a joint order of 15 June 2010, the two Ministers, the Minister of Finance and the Minister of Mines, issued an instruction to the Afghanistan Extractive Industries Transparency Initiative (AEITI) Secretariat that a formal Multi-Stakeholder Group (MSG) should be established to consist of stakeholders of CSOs, Private Sector companies and Government institutions; it was specified that the MSG should draft and approve its own ToR.

Records of a formal Memorandum of Understanding and ToR following the June 2010 Ministerial Order have not been located. However, in the period between June 2010 and June 2011, three full MSG meetings were held, chaired by either the Minister of Finance or the Minister of Finance. There is a substantial record of minutes and e-mail interchanges demonstrating very active discussion by CSOs in a separate Civil Society Coalition during this period and the submission of their comments to the AEITI Secretariat for further discussion in the full MSG meeting of 05 June 2011; these comments specifically addressed the reporting templates and the degree of disaggregation in reporting. Minutes also record the participation of the private sector and in particular the ACCI in discussions in this period.

The minutes of the 6th formal meeting of the MSG of 05 June 2011 reflect that concerns had earlier developed regarding the constitution and effectiveness of the MSG. A new MoU and associated ToR for the MSG were signed on the preceding day, 04 June 2011, and were ratified in the subsequent full MSG meeting. Salient aspects of the framework for the MSG function from these documents and minutes are as follows:

- The ToR, signed by members of each of the three constituencies, determine that the MSG would comprise 22 members representing the following constituencies:

AEITI Secretariat	3 seats
Government Agencies/Ministries	6 seats
Civil Society (to include one representative from academia)	6 seats
Extractive Sector Companies	6 seats
Parliament (one representative from Lower House and one from Upper House)	2 seats

It is to be noted that the above distribution represents 23 seats.

- The ToR imply each seat has voting rights, by stipulating that alternates must have authority to voice opinions and vote; the objective for decision-making is specified as to reach consensus and only where this is not possible will decisions be made by vote. The tenure of each member will be for 3 years.
- Neither the ToR or MoU establish the basis of selection of the representatives of the Civil Society or Extractive Industry constituencies
- Concerns were raised in the full MSG meeting of 05 June 2011 that the AEITI Secretariat should have three voting seats; the National Coordinator confirmed the neutrality of the Secretariat with the implication that this would not be a voting constituent.
- It was suggested that CSO participation should be managed through the Civil Society Coalition; however, there is no documentation of a formal relationship between MSG and the Civil Society Coalition
- Concerns were raised regarding the need to include a representative of the media; it was asserted that the Civil Society Coalition was enlarging and that it would ensure the participation of a media representative
- Independent observers commented on the lack of a significant presence of the private sector; the MoU and ToR were signed by representatives of ACCI and one private sector production company, who also attended the MSG meeting.
- Discussion addressed the participation of Parliamentarians; the Ministerial response identified that this should be left to the discretion of Parliament.

A document of 11 September 2011, apparently signed by participants in the MSG, declares the membership to comprise the two Ministers, three representatives each of the Ministry of Finance and Ministry of Mines, the National Coordinator, only, representing the AEITI Secretariat, ten members of CSOs and six representatives of private sector companies.

The composition and scope of the MSG was again discussed in the 8th MSG Meeting of 28 September 2011; it was agreed that the ToR of June 2011 should be reviewed given the revised membership of the MSG. Discussion of the selection of MSG members determined that each constituency should have a set of governance procedures. Civil Society Group proposed it should have 10 members of which 6 will attend at any one time and 2 representatives will rotate for each meeting. Representation of the private sector will be coordinated by ACCI. The Secretariat requested that all members should provide a name of an alternate, who could attend and vote in their place.

The Civil Society Coalition has made available to the AEITI Secretariat a copy of the Charter signed on 08 December 2011 covering internal governance for representation on the MSG. In this the Civil Society Coalition confirms that it will be represented by six seats, to be occupied for each MSG meeting. Members nominated to MSG will be rotated, to ensure wide representation across the range of member organisations, such that for each meeting two new members will occupy the seats of rotated members. The Charter proposes to sanction organisations which do not attend successive meetings by revoking membership. All signatories commit to disseminate information on the EITI process as widely as possible.

Subsequent to this date, no discussions or agreements on MSG composition have been located. However, by review of meetings attendance lists, observation of meetings during the Validator's visit and further comment from Stakeholders, discussed at more length below, the following observations on current performance of the MSG are considered relevant:

- There is no constitution which defines a voting structure or definition as to how decisions should be reached; most minutes indicate a general level of consensus but no record of dissenting views
- The representation of CSOs in MSG meetings shows considerable change from those who participated in initial meetings;
- A number of members of the CSO group who offered forceful opinions in the early meetings no longer participate as individuals and their organisations are not represented
- An essentially permanent representation of the CSOs on the MSG is through Integrity Watch Afghanistan (IWA), which appears to attend regularly with up to three representatives; the National Coordinator asserts that his understanding is that IWA is the coordinating member for the Civil Society constituency if information is provided to IWA, they undertake to distribute such information to all other interested CSOs
- In a number of stakeholder interviews, and in one general meeting, there was dissatisfaction with the dissemination of information to CSOs
- There is no representation of the media among CSO membership of MSG
- There is no representation of academia among CSO membership of MSG
- The provisions of the Civil Society Coalition Charter appear no longer to be met. Some CSO stakeholders indicate that a revised membership of a coalition or forum of CSOs is imminent. The EITI Secretariat indicates that it would be considered inappropriate for this entity to exert any influence on the composition of the CSO constituency in the MSG. In effect the composition of the CSO constituency in the MSG is not managed or reviewed by the MSG but by an external organisation, the Civil Society Coalition, with which the MSG has no formal agreement
- A request was made for a definitive list of members of the MSG at the time of the Validator's Visit, with alternate members as appropriate. This was not available at the time of the visit. A document showing permanent membership of the MSG was sent to the

Validators on 22 January 2013, but no documentation of MSG agreement or discussion accompanies this. There are a number of changes from previous documents, including the fact that the AEITI Secretariat and the National Coordinator are not members of the MSG; it is noted that the National Coordinator has chaired a number of meetings of the MSG, most recently on 13 October 2012.

- Major tendering exercises are currently in progress for the hydrocarbon sector, but at the present time it appears that the representation by both the private sector and the Government (MoM) does not include any individual with specialist knowledge of the hydrocarbon sector
- There has been consistent more or less regular attendance by a number of nominees from the Government agencies and by the two Ministers who may co-chair or separately chair the meetings
- The private sector have maintained a consistent active participation, particularly through ACCI, but also with the frequent presence of those private sector companies originally designated as members of MSG.

Notwithstanding the comments and observations offered on recent performance of the MSG as a functional unit, it was very clear that the MSG continues to be central to all decisions and progress of the EITI process. Meetings have been held regularly through 2011 and 2012 and the majority of those individuals who have identified themselves as members of the MSG in interview are positively committed and demonstrate their participation and clear understanding of the key elements of the programme, including:

- Discussion and establishment of materiality for reporting
- Design and approval of templates
- Selection of the Reconciler
- Critical review and analysis of the two EITI reports
- A nation-wide Communications Strategy
- Participation in capacity-building workshops
- Selection of the Validator.

After completion of the Validation visit, a revised structure of the MSG, with nominated representatives, has been made available to the Validators on 22 January 2013. No supporting documentation of discussion by the MSG of this structure or of approval by the MSG has been made available.

Opinions of Stakeholders

A number of stakeholders, particularly a number from the CSOs and from the Government agencies, expressed the opinion that the establishment and function of the MSG was satisfactory.

In contrast, the view was expressed by some stakeholders (among some CSOs, including some active in the MSG and others who have left the MSG, and also by a MSG representative of a Government agency, and also by some representatives of the Private Sector), that the MSG at the time of interview was either not functioning effectively or that its functionality could be significantly improved, if there was a consistent, regular attendance by informed representatives of the CSOs.

Some CSOs with specific interest in the extractive sector indicate that they have not been invited and do not know the means to participate in the MSG, although they have signed up to an apparently enlarged Civil Society Coalition.

Some CSOs considered that dissemination of information on the activities of the MSG was inadequate, with particular reference to the short notice of meetings and the short notice of the issue of agenda (the National Coordinator recognised there may have been problems for distribution of information within the CSO group).

It was noted in one of the meetings of the MSG during the Validator's Visit that one of the CSOs publicly claimed not to have received a copy of the Communications Strategy. In the meeting this was attributed to failure of dissemination within the CSO constituency.

None of the stakeholder constituency groups suggested that representation on the MSG was inadequate.

Comment was made that apparently on one occasion only a Parliamentarian attended a MSG meeting, although there is no record of this in attendance lists. It was suggested that this constituency was superfluous. However, discussion with stakeholders highlighted concerns that information on forthcoming meetings and topics was inadequately, or failed to be, passed to an appropriate Parliamentary organisation (either the Natural Resources Committee in each of the Upper and Lower House, or through the Office of the Speaker).

Some CSOs expressed the view that the capacity-building programme to date for members of the MSG had been incomplete or inadequate, particularly with respect to capability to understand the financial reporting in the reconciliation process.

Concern was expressed by a number of CSOs, both active and past members of the MSG, that the agenda, priorities and programme planning for the MSG was no longer adequately reflecting the decisions of MSG members but was being driven by the EITI Secretariat.

Validator's evaluation

The MSG has been demonstrably functional and has been instrumental in many key aspects of the EITI process achieved to date. However, a number of administrative issues and structures have been identified which from time to time may have impacted on the representativeness and commitment of CSO and private sector membership of the MSG, giving rise to inconsistencies with regards to the ToR of 04 June 2011.

In particular it is noted that:

- The criteria for inviting stakeholders to participate in the MSG have not been specified in the ToR or MoU of 04 June 2011, and have not been subsequently formalised. While those stakeholders who claimed to have participated in the early stages of the AEITI process have generally expressed satisfaction that there was an open invitation, the process for selection of participants is not documented. Since formalising the ToR and MoU of the MSG, there have been documented discussions on the mechanism for establishing representative membership of the MSG but conclusions have not been documented. It is clear that there is widespread acknowledgement that the CSO representation is organised through the Civil Society coalition, and that of the Extractive Industry Companies through ACCI, but this has not been formalised.
- At the time of the Validation visit it was apparent that there was a lack of clarity as to whether individuals were members of the MSG or a range of organisations, and in consequence there was no appreciation of the term of tenure or of when or how representatives might be re-elected; in the case of the CSOs the view was that they would be chosen under the terms of the Civil Society Coalition and that there was no specific structure for change within the MSG constitution.

The representation of Civil Society in the MSG has been organised through the Civil Society Coalition. This grouping, generally coordinated by Integrity Watch Afghanistan (IWA), has demonstrably maintained a close and effective focus on the EITI process and the meetings of the MSG; this is supported by copies of minutes of a limited number of Civil Society Coalition meetings (July 2011 – June 2012) and comments in interviews with CSOs. Nevertheless, there is no formal MoU or agreement in place between the MSG and Civil Society Coalition. In consequence a number of concerns arise as a result of this:

- In the MSG the range of interest groups, and the geographical areas from which they come, are necessarily limited to those CSOs which have been invited or have chosen to participate in the Civil Society Coalition; apparently the MSG has not sought to extend its collaboration beyond those CSOs which may be linked to the Civil Society Coalition. It is not clear how many CSOs in total belong to the coalition; no reply has been received to the Validator's request for information. Minutes of recent coalition meetings indicate that representatives of up to 6 individual CSOs may attend. Minutes also indicate that the coalition is seeking to extend its membership.
- The nomination of CSO members to the MSG and the apparent concept of rotation of their attendance is outside the control of the MSG; this has given rise to a situation where it is not clear precisely who are the CSO members of the MSG, and attendance of individuals may be very intermittent, and in consequence there are occasions where individuals have claimed to be ignorant of recent developments. In discussion with the Secretariat, it was suggested by the Secretariat that any interference by Government on this pattern might be seen to be coercion.
- Information dissemination from the MSG and specifically from the Secretariat has become channelled down a route of communication primarily with IWA, seen as the coordinating group

for the Civil Society Coalition. The effectiveness of such information dissemination is therefore outside the control of the MSG.

Many of the interviewed CSO members of the MSG stated that they did not participate in the early stages of setting up of the MSG. There have undoubtedly been numerous changes of individuals as apparent *bona fide* members of MSG, but of those interviewed there was no appreciation of specific terms of tenure related to their individual membership. The Validators recommend below, that the relationship of the Civil Society Coalition with the MSG is formalised by a MoU in which members elected to sit in the MSG are clearly nominated, with a specific term of tenure and with clearly defined responsibilities in terms of communicating information not only to other members of the Coalition but also to CSOs which have not become members of the Coalition. The Charter of the Civil Society Coalition would be a component of the MoU.

In general the CSOs who have participated in the MSG and are part of the Civil Society Coalition are almost without exception donor funded or funded by an international parent organisation, and in consequence it appears that many of these CSOs, although not all, are not under-resourced in terms of access to national and international communications, office facilities and their capacity to disseminate information.

With respect to the private sector companies, similar concerns relate to the mechanism for representation on the MSG. According to the AEITI Secretariat, it is accepted that ACCI is the principal coordinating organisation for the sector, and other MSG members are primarily those companies that were included in the recent reconciliation exercise. However, in future, as new and potentially larger extractive industry companies become active in the sector, there will be a need to ensure a balance between large companies operating under new contracts with MoM and also the potentially numerically large sector of medium-scale and smaller companies.

With respect to representation of the private sector on the MSG, it is recommended that the principles of representation are formalised in a MoU between the MSG and representatives of the sector. The MoU would define the length of tenure of each representative and their obligation to disseminate information to all other operators in their sector. Because of the nature of the extractive industries, it can be anticipated that it will be necessary at some point in the future to identify a number of different sectors, each of which should be represented by one or more members (e.g. hydrocarbons/oil, large mining companies under new-form contracts, cement makers and large construction materials groups, medium-sized companies probably represented by ACCI).

There appears to have been an inconsistency in the concept of the role of the Secretariat and its relation with the MSG. The Secretariat operates to a Statute approved by a Ministerial Order of 2011 of the Ministry of Finance; we received a copy and note that the number and date of this order was not recorded on the order. This statute makes clear that the Secretariat role is to provide support and technical assistance to the MSG and also that staff of the Secretariat shall be recruited and appointed or dismissed by the decree of the Chairman of the MSG. However, the MSG in its meeting of 4 June 2011 approved an MoU and ToR which allocated MSG seats to the Secretariat, although subsequent discussion endeavoured to clarify that these were “neutral” and non-voting. On a number of occasions the National Coordinator, apparently not a member of MSG, has chaired full MSG meetings, and most recently on 13 October 2012. In terms of the effective performance of the MSG, it is noted that the MSG set up a Working Group which was the vehicle to advise the

content of reporting templates and materiality thresholds and also the MSG undertook detailed review of Communications Strategy and other aspects of compliant EITI performance. A number of Capacity Building and Training programmes for MSG members have taken place. The MSG has, through to end 2011, been an effective driver to maintain the momentum of the EITI process.

It is apparent that the delays on the progress of the process imposed by the difficulties in engaging a Reconciler and a Validator willing to perform their tasks in Afghanistan has contributed to a loss of momentum.

In the same interval significant changes in the structure of the AEITI Secretariat have been experienced. The Ministerial Order (MoF) covering the setting up of the AEITI Secretariat specifies that the Secretariat will comprise the National Coordinator, Communications Officer, Procurement Specialist, Financial Management Specialist and an Administrative Assistant. From a position in 2011 in which there were three officers (National Coordinator, Deputy National Coordinator, Communications Specialist) working with an Administrative Manager and team, this has been reduced at the end of 2012 to a position in which the National Coordinator is the single officer. The process to select a replacement Deputy National Coordinator has been beset by difficulties, some of which may reflect political issues.

At the time of this validation stage, the Validator expresses concern as to the current functionality of the MSG and in consequence the sustainability of this process. In this respect the following recommendations are proposed to restore functional capability of the MSG:

- Revised MoU and ToR for the MSG are recommended, to ensure a clear compositional basis and internal governance.
- Membership of the MSG should be clearly defined in terms of the individuals who should attend and their alternates, with the objective to ensure that members are clearly aware of their personal commitment; meetings and working groups will be more productive by ensuring contributions from those informed members who should be there, and comment from non-members or observers will be by Chairman's invitation only.
- The MSG should formalise its relationship with the Civil Society Coalition, through an MoU or equivalent document which is published and which clearly defines the representation of individual CSOs, the selection of relevant CSOs and the tenure of each CSO representative on MSG; it is essential that all interested CSOs should have a voice in the selection of representatives on the MSG, irrespective of membership or not of the Coalition. If the Coalition is strongly committed to the principle of rotation, they should be requested to implement this on the basis of not less than at six –monthly intervals, but preferably on a one-year basis, to ensure continuity of knowledge and experience
- Where the MSG establishes Working Groups, the composition, objectives and scope of each Working Group should be clearly defined and documented.
- The MSG should ratify the Statute of the Secretariat, so that there is clear recognition of MSG responsibilities for staffing and resources and also that there is clear understanding of the relationship of the Secretariat to the MSG

- The Secretariat must disseminate all information on MSG meetings equally on the same timetable to all nominated members of the MSG without reliance on intermediaries to distribute information to members of MSG; each member of MSG will have an equal obligation to disseminate information beyond the membership of the MSG
- A review of the knowledge gaps identified by members of the MSG should be performed and a capacity-building programme should be proposed and developed to cover this scope
- Subject to decision of the MSG, the Secretariat may be mandated to open a discussion with the Speaker of the Lower House of Parliament and his equivalent in the Upper House, to ensure that there is an open information flow to the relevant Parliamentary Committee or nominated Parliamentarian, ensuring an active invitation to participate.
- The representation of the private sector in the MSG should be formalised. To date very effective coordination of private sector companies has been exercised through ACCI. New challenges will emerge when the international tenders for new extractive operations (in mining and for hydrocarbons) come into operation and it will be necessary to evaluate the representation of major international companies alongside the medium and small scale mining sector.
- Funding for the AEITI Secretariat should be underpinned by a Government guarantee, to ensure that consistent structure and performance of this unit can be maintained and is not subject to potential changes of perception by the donor agencies.

While the Validators consider that Afghanistan has taken steps which bring it close to compliance with this requirement, there are a number of specific factors related to the longer term sustainability of the MSG which must still be addressed. These concerns are those related to the need for revised governance structures and a process of internal review of performance and effectiveness, leading to a clear constitution with clarity on the process for participation and representation of the civil society and extractive industry constituencies.

Afghanistan is not yet in compliance with this requirement.

2.5 EITI REQUIREMENT 5

The multi-stakeholder group, in consultation with key EITI stake-holders, should agree and publish a fully costed work plan, containing measurable targets, and a timetable for implementation and incorporating an assessment of capacity constraints.

Progress

In the interval between the application for joining the EITI process as a Candidate Country (16 March 2009) and acceptance as a Candidate Country (11 February 2010) a work plan and budget were prepared. This plan was prepared under the auspices of the National Coordinator, drawing on resources provided by the Ministry of Finance, and was presented to the provisional MSG for discussion on 11 November 2009. Following further group review and approval on 17 November 2009, the plan was submitted to the EITI International Secretariat.

Following confirmation that the country had been accepted for EITI Candidate status, the meeting of the provisional MSG on 17 February 2010 endorsed formal adoption of the Country Work Plan.

The MSG was formally constituted during late 2010. During the early part of 2011 the work plan was the subject of update and amendment (led by Deputy National Coordinator, with amendments in January 2011) and was discussed and approved in the MSG meeting of 06 June 2011. Funding sources for the principal programmes and tasks were identified and were reported as adequate for the proposed budget.

A comprehensive review and update of the Work Plan was prepared up to September 2011, for detailed review and discussion in the MSG meeting of 28 September 2011. This edition of the Work Plan captured the completion of the Reporting Template in August 2011, the preparation and approval of the Terms of Reference for the Reconciler and the issue of a call for expressions of interest in September 2011. Funding for the Reconciler was identified as committed by the World Bank (Sustainable Development of Natural Resources Program). Corresponding to the already achieved timetable, the projected visit of the Reconciler would result in the publication of the First and Second Reconciliation Reports in November 2011 and February 2012 respectively. This version of the Work Plan (update September 2011) projects the completion of the engagement of the Validator by May 2012 and also the production of a timetable for undertaking the Third Annual Reconciliation Report from April 2012.

A further update was undertaken for the MSG meeting of 12 May 2012 with subsequent annotations to update progress at September 2012; this is the latest version of the Work Plan as currently available on the AEITI website. This version of the Work Plan reflects the difficulties (lack of response to invitations to tender) to locate a Reconciler and the engagement of Moore Stephens in February 2012. The First Reconciliation Report was published and disseminated on 01 August 2012 and the Second Reconciliation Report at the end of September 2012. At the date of this version of the Work Plan, the difficulties of engaging a Validator to work in Afghanistan are highlighted and no commitments are identified beyond response to Validator's comments and the preparation of the potential Third Annual Reconciliation Report.

The May 2012 Work Plan documents that funding for the engagement of the Validator had been agreed (55% of budget to be paid by Government, 45% by HAKARAT funding) and that the ToR for the Validator were approved by the MSG and the EITI International Secretariat in March 2012. The invitation for proposals was issued on 09 April 2012, but at the revision date of the plan no expression of interest had been received from any of the accredited Validators.

It is evident that a major factor in the overall delay of implementation of the Work Plan, currently running at approximately 10 months behind the schedule of the September 2011 Amended Plan, has been due to the difficulty of engaging a Reconciler and a Validator willing to work in Afghanistan. This scale of delay is also reflected in the delayed issue of the First and Second Reconciliation Reports, respectively with delays of nine and seven months against the projected schedule of the September 2011 Amended Plan.

It is observed that the impact of external influences on the progress of the Work Plan schedule may have generated a lack of momentum and paralysis of the planning process in the most recent period of AEITI activity, and in particular since May 2012. Both the September 2011 and May 2012 versions of the Work Plan extend only to completion of the Validator's visit and response to recommendations in the Validation Report. In both plans an original scheduled timing of the Third Reconciliation Report for May 2012 is noted as delayed, and beyond this there is no schedule of further activity nor funding sources for the third report or future outreach, communications or capacity-building activities. At the date of the present Validation report it can be stated that there is no forward-looking Work Plan in place.

With respect to the implementation of the Work Plan objectives in the period from November 2009 through to May 2012, it is noted that:

- The preparation and discussion of materiality thresholds and templates, engagement with private sector companies and the steps to implement a compliant reconciliation process were achieved against a targeted timetable
- An international consultant was engaged under donor funding (GIZ), one of whose objectives was to assess capacity constraints and assist development of capacity building programmes; documentation of capacity constraints and a coherent training capacity building programme have not been made available and therefore do not provide a framework for the various training and capacity building programmes undertaken to date.
- A programme of training and capacity building was implemented, primarily drawing on World Bank (MDTF/SDNRP) and HAKARAT funding, and has included international visits, workshops and taught courses, all of which included representatives of CSOs and private sector companies; the scope and appropriateness of these training programmes are commented with respect to requirements 6 and 7.
- A Communications Strategy forms a significant element of the Work Plan and all objectives in the timeframe are reported as met; the dissemination of documents in local languages, including both of the Reconciliation Reports has been implemented. A commitment to a local language popular radio programme covering the mineral sector and transparency has

been made for dissemination in 2013; however, it is noted this does not figure in the current Work Plan.

Subsequent to the completion of the Validation Visit an amended Work Plan has been provided by the AEITI Secretariat to the Validators, received on 22 January 2013. This plan is indicated to have been agreed on 25 December 2012, but no documentation of MSG discussion or approval of this has been provided. As at 03 February 2013, the AEITI website was posting the “Amended Work Plan” as the version of May 2012. In consequence it is considered inappropriate for the Validators to comment in detail on this latest version, although it is noted that activities for training and reconciliation in 2013 are indicated only as pending.

Opinions of Stakeholders

Commentary by the majority of stakeholders did not focus specifically on the Work Plan as a tool for planning and evaluating progress of the EITI process, in part reflecting the relatively high turnover of CSO representatives in the MSG and that a number of those interviewed did not participate constructively in the discussions of the amended Work Plans of September 2011 and May 2012.

Nevertheless, all interviewed stakeholders expressed concern for completion of programme items to budget and schedule, and in some cases particularly noted the need for monitoring of compliant performance of programmes with respect to the scope of training and capacity building.

Validator’s evaluation

The AEITI Work Plan has been employed as a key element for planning, monitoring and control of the EITI process in the period November 2009 through to late 2011, as evidenced by several update amendments of the plan and confirmed by minutes of the corresponding MSG meetings.

The delays experienced in the AEITI programme due to the difficulties of engaging accredited Reconciler and Validator companies may have contributed to a paralysis of the planning process and development of the Work Plan since May 2012.

It is concluded that the MSG and the AEITI Secretariat are not currently employing the Work Plan as a vehicle for planning and strategy for a long-term sustainable and adequately funded future implementation of the EITI process. Meeting notes and minutes during the latter half of 2012 indicate concerns and forward planning for essential EITI tasks, but without mention or reference to the Work Plan.

Given the earlier use and development of the Work Plan, it is concluded that Afghanistan is in a state of near-compliance with this requirement, but there is a need for a major re-focus on the Work Plan as an essential tool for the EITI process.

The need for a re-focus and detailed amendment of the Work Plan must address the following:

- The continuity of the EITI process in to the future, requiring an ongoing commitment to undertake annual reconciliation reports, with adequate funding for the engagement of an accredited Reconciler and the employment of suitably qualified auditors, if necessary, to ensure resolution of discrepancies identified in the reconciliation process. Timing and funding for the activities for the Third Reconciliation Report has not been established.

- The introduction of an effective process specifically for monitoring of progress against the Work Plan and for proposing amendments to the plan, to be presented regularly for discussion and approval by the MSG; it is suggested this may be achieved by the designation of a working group within the MSG, to include representatives of all constituencies
- A review of capacity constraints within the MSG to ensure all nominated members are able to contribute fully to the activities of the MSG; this may require to be a recurrent process. An objective review of the scope and performance of training and capacity building programmes and the degree to which these meet targets for scope, delivery and outcomes; the conclusions of the international consultant engaged in June 2011 (deployed June-October 2011) have not been circulated or apparently acted upon, such that this activity can be considered not to have been implemented
- An objective review of whether outreach and information dissemination programmes meet targets set within a Communications Strategy for 2013. The Secretariat has provided to the Validator on 29 January 2013 the Civil Society Coalition Annual Work Plan (2013) which provides a comprehensive basis for outreach in the first quarter of 2013 with follow-up; there is however no indication of its acceptance by MSG or whether it requires funding allocated through the EITI process. Related to this is the lack of a Communications Strategy programme extending into 2013.

It is concluded that Afghanistan is not in compliance with this requirement in respect of a Work Plan prepared for future activities in 2013; commitment by the MSG to demonstrate re-focus of the Work Plan for the future is required for full compliance.

2.6 EITI REQUIREMENT 6

The Government is required to ensure that civil society is fully, independently, actively and effectively engaged in the process.

Progress

CSOs have been actively involved in the EITI process from the beginning in the implementation of the initiative. CSOs formed part of the provisional MSG formed to guide the initial application to join the EITI process and became a clearly defined constituency within the formally constituted MSG from June 2010. At this stage the selection of CSO participants reflected those that had expressed an active interest in the sector, although apparently no formal selection process was applied. Two CSOs who were present at the first provisional MSG meeting, Integrity Watch Afghanistan (IWA) and Afghan Civil Society Forum, have continued to be active participants throughout the EITI process and are represented at the present time on the MSG.

Concerns regarding the functional effectiveness of the MSG were addressed in a new MoU and ToR which were agreed 04 June 2011 and ratified in the MSG meeting of 05 June 2011. In the ToR, the participation of Civil Society in the MSG was determined to comprise six seats of a total of 22, one of which would be occupied by a representative of academia. The suggestion was made in this meeting that the representation of CSOs on the MSG should be managed by the Civil Society Coalition, a grouping of CSOs with particular interest in the EITI process and generally coordinated by IWA.

There is no formal relationship between the MSG and the Civil Society Coalition, although it appears that there is consensus in the MSG that the civil society representation should be managed through the Civil Society Coalition. The Civil Society Coalition has made available to the AEITI Secretariat a copy of the Charter signed on 08 December 2011 covering internal governance for representation on the MSG. In this the Civil Society Coalition confirms that it will be represented by six seats, to be occupied for each MSG meeting. Members nominated to MSG will be rotated, to ensure wide representation across the range of member organisations, such that for each meeting two new members will occupy the seats of rotated members. All signatories commit to disseminate information on the EITI process as widely as possible.

With respect to the representation of CSOs in the MSG, a number of concerns arise as a result of this:

- In the MSG the range of interest group, and the geographical areas from which they come, are necessarily limited to those CSOs which have been invited or have chosen to participate in the Civil Society Coalition; apparently the MSG has not sought to extend its collaboration beyond those CSOs which may be linked to the Civil Society Coalition. At the time of the Validators' visit it was not clear how many CSOs in total belong to the coalition; information supplied subsequent to the visit has stated both 18 and 33 members although these have not been identified. Minutes of recent coalition meetings in mid-2012 indicate that representatives of up to 6 individual CSOs may attend. Minutes also indicate that the coalition is seeking to extend its membership.

- The nomination of CSO members to the MSG and the apparent concept of rotation of their attendance is outside the control of the MSG; this has given rise to a situation where it is not clear precisely who are the CSO members of the MSG, and attendance of individuals may be very intermittent, and in consequence there are occasions where individuals have claimed to be ignorant of recent developments. In discussion with the Secretariat, it was suggested that any interference by Government on this pattern might be seen to be coercion. The Secretariat has made available, as at 22 January 2013, a diagram of permanent members of the MSG, including six CSO members of six different CSOs, but there is no record of MSG discussion of this representation or agreement on these participants; the participants are termed “permanent” but it is not clear if this relates to the tenure defined under the MSG ToR or whether this is overridden by the constitution of the Civil Society Coalition.
- Information dissemination from the MSG and specifically from the Secretariat has become channelled down a route of communication primarily with IWA, seen as the coordinating group for the Civil Society Coalition. The effectiveness of such information dissemination is therefore outside the control of the MSG.
- Some CSO stakeholders have expressed concern that notice of meetings, minutes for approval and documents for discussion have been distributed with very short and inadequate notice, and in part at least, this is attributed to the route of distribution through IWA as a third party intermediary.

Outside the context of AEITI, it has been confirmed by MoM, and reported in the minutes of the Civil Society Coalition, that the MoM undertakes consultative sessions with a group of CSOs on issues of mining policy and implementation; it is understood this relates primarily to social issues of resettlement and community development. The Ministry has shared this list with the Civil Society Coalition. Commentary in the Civil Society Coalition minutes of 27 June 2012 indicates that those CSOs involved in consultation with the MoM are not members of the Civil Society Coalition.

Discussion with members of the Civil Society Coalition, in particular IWA and Open Society Foundation, has emphasised that they are aware of the need to expand the Coalition. It was reported that a conference has been scheduled at a date shortly after the present Validation visit to review the scope of membership and the Coalition Charter. Minutes of Coalition Members Meetings indicate the intent of this group to communicate to a wider range of CSOs working throughout the country. A minuted action of June 2012 was to organize a meeting with ACBAR (Agency Coordinating Body for Afghan Relief) which represents the greatest number of CSOs and NGOs operating in Afghanistan. To date it appears this has not yet been organised.

The Civil Society Coalition is documented (minutes of 27 June 2012) to have particular interests and objectives for a Capacity Building Plan. In the context of interviews with stakeholders and the record of training and capacity building undertaken under the aegis of AEITI, it is apparent that although considerable efforts for training and capacity building have been made, no comprehensive analysis of capacity building needs has yet been undertaken and corresponding plan adopted by the MSG.

Notwithstanding any concerns of the criteria for representation of CSOs in the MSG, CSO representatives have been consistently present and active contributors in the meetings of the MSG, as evidenced by minutes and by interview statements. CSO representatives have also been active

participants in the informal working groups which have from time to time been established to generate material on reporting templates and materiality thresholds, to review TOR and selection of the Reconciler and Validator and also to investigate discrepancies in the reconciliation exercise; reports and meeting attendance lists of these working groups have been reviewed.

The Civil Society Coalition is an organisation at arms-length from the MSG, with which it currently has no formal agreed linkage, although the coalition appears to operate only with the objective of participating in the EITI process. Its members operate with total independence from any Government sponsored influence and in stakeholder interviews, those CSOs in the MSG assert, without exception, that they operate without Government influence.

The MSG has actively engaged in a Communications Strategy to achieve outreach to wider civil society. A Communications Specialist was engaged as part of the AEITI Secretariat in the latter part of 2010 and a wide-ranging Communications Strategy document was approved, after extensive discussion by the MSG, in the MSG meeting of 21 December 2011. An important element of the programme was a contract engagement of the BBC Afghan Education Programme to incorporate key messages of the EITI process in the popular local language drama “New Home, New Life”; commitment of funding for this component was confirmed in minutes by the World Bank (MDTF) although this is not clearly identified in the Work Plan. Other achievements include a dedicated website with updated news and progress bulletins, widespread dissemination in English language and local language press of the milestone conferences and presentations of AEITI progress through to publication of the EITI Reports, the setting up of billboards and poster displays in all major cities and most recently, the preparation of the First EITI Report in Pashto and Dari languages and the distribution of over 3,500 copies to media centres, universities and Government agencies in all the major centres throughout the country. The Second EITI Report is in the process of translation. The Communications Strategy is under active review.

Minutes of the MSG document a significant difference of opinion between the MoM and one of the CSOs, IWA, which published a critique of the tender process for the Hadjigak Iron Ore Project⁴. These differences were openly expressed and in stakeholder interviews it was suggested that this may have resulted in a temporary restriction of access for IWA to individual meetings with MoM officials, but no restriction or repercussions appear to have affected the continued participation of IWA in the MSG. In stakeholder interviews IWA did not quote this as a constraint on their freedom to express opinions and IWA continues to be an active member of MSG, working in close collaboration with the Secretariat and Government agencies.

Opinions of Stakeholders

The Validation team has conducted interviews with all the CSOs identified as current members of the MSG, following a uniform questionnaire within a structured interview format. Those CSOs which claim to be part of the MSG and which have been the subject of interview are:

- Humanitarian Organization for Local Development
- Open Society Foundation
- Afghanistan Civil Society Forum

- Human Rights Research and Advocacy
- Integrity Watch Afghanistan
- Welfare Association for the Development of Afghanistan (WADAN)

In addition interviews were conducted with two CSOs which are currently not members of the MSG:

- Afghanistan Watch; this CSO has only relatively recently developed capacity and interest to develop a programme in the extractive industries and would be interested to join the MSG; and
- Khorasan Charity Organisation; previously represented on the MSG, but of its own volition no longer wishes to participate in the MSG or Civil Society Coalition; its primary objectives are in the field of Education and Women's Rights.

A contact was identified with a CSO with special interest in Women's Rights, and an invitation extended to meet for discussion of the EITI process but their representative failed to follow up this invitation.

The Validators note that all representatives of CSOs who consented to join discussion and interview were Kabul based, and apparently the greater part of the work programme of these individuals is also carried out in Kabul.

All interviewed representatives of the CSOs consider themselves well, or moderately well informed on the EITI process. With respect to the function of the MSG and the role of CSOs within this, the following summarises the expressed observations and opinions:

- Interviewees confirmed that MSG meetings are held regularly and they do not identify a lack of communication between the component constituencies in the MSG.
- All the respondent CSOs affirm that they are free to express opinions in the MSG, although one expressed some qualification, and from a number of sources comment was made regarding the impact of the IWA Report on Hadjigak Iron Ore Project, noted above
- There was satisfaction expressed regarding Government commitment to work with CSOs for EITI implementation. Nevertheless a number of respondents mentioned the need for financial and logistical assistance from Government, particularly for those CSOs operating in distant provinces. The receipt of some capacity building and training assistance was acknowledged.
- A number of respondents mentioned the need for adequate capacity-building and training for CSOs, with particular mention of training on financial reporting
- There was general agreement that the original invitation to CSOs to join the MSG was open and transparent although a number of respondents indicated they were not at that time active in the EITI process; the majority of respondents consider the current selection of representatives is also transparent, although notably there were two qualified responses

one of which questioned the role of the Civil Society Coalition as an effective means of disseminating information on meetings and selecting representatives in the MSG.

- All respondents agreed that they were informed of meetings in advance, variously quoting the notice period as from 2 days to one week; one interviewee strongly expressed dissatisfaction with the amount of time to review documents prior to their discussion in the forthcoming MSG meeting.
- The one interviewed CSO which was not a member of the MSG and is interested to become so, suggested that there were other CSOs active in the country who would also be interested in either directly participating or knowing more regarding the EITI process, but that information received on this was inadequate.
- All CSOs expressed their belief that the EITI process can make a positive impact on local communities, making the point that each CSO has other specific commitments to social development as part of their remit and that EITI is a significant reinforcement to this remit
- All identified their obligation and role to disseminate information to wider civil society; it was stated by a number of respondents that dissemination to some provinces was poor due to travel and communications access.
- Most representatives consider their CSO has participated in the dissemination of information, particularly for specific objectives, such as the dissemination of the First EITI Report; however, some representatives appear to be unaware of the Communications Strategy
- The concepts of EITI are in general entirely new and unfamiliar to the general public, which therefore requires a greater dedication of effort and resources for dissemination of information. In addition illiteracy at national level approaches 70% and this coupled with the isolation and insecurity in many parts of the country means that communication of the EITI message is still only partially achieved. One respondent noted that advertising “EITI” was sometimes meaningless to rural communities and more basic stress on transparency in administration was necessary.

Validators’ Evaluation

Civil Society, as represented by the CSOs active in the MSG, is undoubtedly independently and actively engaged in the EITI process.

The Validators have expressed above their qualifications with respect to the operational effectiveness of the MSG and the role of Civil Society within this (Requirement 4), and the comprehensiveness of the Work Plan (Requirement 5). These qualifications reflect aspects of the engagement of Civil Society in the EITI process which should be improved and are implicit in the evaluation of this requirement.

In summary, remedial action requires to be planned and implemented with respect to:

- The relationship between the Civil Society Coalition and the MSG, in terms of how this governs the range of CSOs actively participating in the EITI process, the role of media and academia in the MSG, the regular attendance of individuals on a continued basis which ensures accumulated experience of the process;
- The effective communication between the Secretariat and the CSO members of the MSG of all relevant notices, working group papers and minutes for approval
- An effective assessment of capacity building and training requirements to ensure delivery of an effective programme in support of all CSOs which will deliver information on EITI to the wider civil society
- Monitoring and evaluation of programmes planned and costed in the Work Plan, particularly for delivery of the Communications Strategy and its impact and effectiveness to reach those populations in areas of the country identified as currently only poorly covered

The Civil Society Coalition offers a vehicle for coordination of CSOs which is independent of Government and can support effective representation in the MSG and effective communication to the wider CSO community. However, this requires to be formalised by an MoU which identifies clearly the obligations of the Civil Society Coalition, including internal governance to select representatives on the MSG, the requirement to incorporate representation from academia and the media and the requirement to seek actively to incorporate also CSOs active in all the ethnic and linguistic areas of the country.

It is concluded that Afghanistan is not yet compliant with this requirement, on the grounds that the MSG, and effectively the Government, have not formalised the basis of CSO participation in the EITI process, while displaying confidence but no formal interaction with the Civil Society Coalition that it will manage the interests of the civil society constituency.

2.7 EITI REQUIREMENT 7

The government is required to engage companies in the implementation of the EITI.

Progress

Extractive industries companies have been actively involved in the EITI process from the beginning in the implementation of the initiative. At the time of the initial decision by Government to commit to participation in the EITI process, an informal group of stakeholders was invited to participate in initial meetings. The private sector representation included the Afghanistan Chamber of Commerce and Industry (ACCI), which incorporates a number of medium/small scale extractive industry companies, also the principal new entrant company for large scale mining, MJAM consortium of China, and an Afghan company with a licence for gold mining, although not yet in production, West Land General Trading.

Minutes record the attendance of other extractive industry companies at MSG meetings during 2011. The agreement of revised MOU and ToR for the MSG was signed in June 2011 on behalf of the private sector companies by ACCI, Mir Group and Equity Capital Group. Subsequently in September 2011 the private sector membership of the MSG was defined by a signed accord as the representatives of ACCI, Mir Group, Equity Capital Mining, Afghanistan Investment Company (AIC), the MJAM consortium and Ariana Saza Gravel Company. At the time of issue of ToR for the Validator, private sector membership of the MSG was documented as three representatives of ACCI, a representative of Mir Group and a representative of the MJAM consortium.

A standard MoU document has been prepared which will be the basis of agreements between the Government (MoM and MoF) and individual companies, and defines the obligations of both parties to promote and comply with the EITI process. The first of these has been signed in October 2012 with ACCI. In addition, the MoM has committed that all new tendered contracts will incorporate agreements by the new licensee to commit to abide by the principles of the EITI process. New contracts have been available for inspection with these conditions for EITI compliance with respect to the Hadjigak Iron Ore, Badakhshan Gold and Afghan-Tajik Basin Hydrocarbons tenders.

Representatives of the private sector companies have participated in a number of the capacity-building programmes delivered as part of the EITI programme, notably the visit to Mongolia in October 2010, the three-day workshop with the EITI National Coordinators of Kyrgyzstan and Mongolia in March 2011 and a Training Course on Extractive Industries held in Dubai in September 2012.

The extractive industries sector in Afghanistan is in a state of flux. The traditional composition of the sector is of medium to small scale operations. Contracts between MoM and these operating entities are necessarily relatively simple and in local languages. Many of those smaller operators which apparently hold licences are apparently inactive at least in terms of production returns and tax payments and it appears that regulatory communication with these companies is difficult either because of the remoteness of the operations, intermittent operational activity or limited MoM resources in areas of low security. Communication of Government policy on EITI in remote areas is

primarily linked to the capability of MoM to maintain provincial offices and to assert Government control of resources. MoM policy and implementation, as confirmed in the Baseline Study Report commissioned by AEITI MSG, is of continued strengthening of provincial offices.

MoM National Policy distinguishes artisanal mining, which shall be available to Afghan citizens only, small scale mining, for which contracts may be let on application and may be undertaken by national or international operators, and medium and large scale extractive industry which is let under international competitive tender.

MoM has implemented policy to communicate its commitment to EITI to all new entrants to the medium and large scale extractive industries, requiring EITI compliance in all new contracts. For the current reconciliation exercise, the MSG has identified those companies which have made relevant payments to Government in the reporting periods and, having established materiality thresholds, has held workshops with companies selected to report under the EITI.

Six companies were identified as meeting the threshold criteria for overall contributions to Government and these have been specified, with contact information, in the TOR for the Validators. Standard company self-assessment forms were sent to each of these companies and, as in the majority of cases these had not been prepared in advance, assistance and explanation was offered to assist completion of the forms during face-to-face interviews during the Validators' visit. Copies of completed forms are attached in Appendix 3.

Opinions of Stakeholders

Interview of all the companies which have reported in the reconciliation exercise has confirmed that all are strongly committed to the successful implementation of EITI.

A number of the companies have commented on the need for capacity building in the medium scale national companies for financial management, accountancy and understanding of the role and standards of audit; this is consistent with the observations of other stakeholders in the CSOs and Government.

Validators' Evaluation

The Validators recognise the need for a continuing commitment, building on what has been achieved so far, with respect to:

- Capacity building for financial management throughout the medium scale extractive industry companies
- Communication and outreach to the small scale mining sector throughout the country.

Effective steps have been taken for implementation of this requirement. It is considered that Afghanistan is compliant with this requirement.

2.8 EITI REQUIREMENT 8

The Government is required to remove any obstacles to the implementation of the EITI.

Progress

The Government has endeavoured to remove obstacles to the implementation of EITI, in particular as regards the legal and regulatory framework.

A review of the relevant legal and regulatory framework has been undertaken by Adam Smith International (ASI) in a report titled “A Review of the Consistency between Afghanistan’s Tax and to Mining Laws” dated November 2011 and submitted to the MoF and MoM. This report has specifically addressed the provisions of the laws with regards to confidentiality of information and the requirements to become “EITI Compliant”. Arising from this review a number of recommendations were made and steps have been taken to introduce amendments; the current status may be summarised:

- The Minerals Law (2009) only allows for confidentiality of technical, geological and mining information submitted to the MoM but there is no confidentiality constraint on the release of financial information from MoM to MoF
- There is no confidentiality provision in the Hydrocarbons Law (2009)
- The Income Tax Law (2009) provides for confidentiality of information and prevents the disclosure of taxpayer’s tax information to others, including the MoM unless authorised by law.
- The Customs Code prevents disclosure of payers’ customs information to others including the MoM.
- The ASI Report recommends further review whether the legal framework precludes public disclosure of taxpayer information and assessment of the options to amend the Income tax Law and Customs Code or alternatively to provide the legal authority for disclosure of taxpayer information in amendments to the Mineral Law and the Hydrocarbons Law.
- An amendment of the Minerals Law has been drafted in 2012, and includes a specific requirement for licence holders to be compliant with EITI standards and emphasises transparency criteria to apply to the management of mineral revenues between MoM, MoF and the license holder. The Draft Amended Minerals Law encountered opposition in Parliament and the relevant Ministers have been insistent on these elements in the amended draft and re-submission is pending.
- A MoU document between Government and individual companies has been drafted, and to date (at October 2012) has been signed only by ACCI, which has been taken to represent its members in the extractive industries. Commitments to support the EITI process, and to transparency and disclosure are clearly stated, although an undertaking to complete the

reporting template based on accounts audited to international standards or to achieve this within six months of signature of the MoU, is almost certainly unrealistic for medium to small scale companies.

Progress of the EITI process has not been constrained by the availability of financial resources, which have been sourced from a combination of donor sources and Government own funding. Longer term sustainability will require funding to support minerals administration through MoM provincial offices, with outreach to the small scale mining sector and also the extensive capacity building to provide adequate financial capabilities in medium and small scale mining operators.

In the course of the Validation visit, review with members of MSG and other stakeholders has identified other obstacles which impede compliant implementation of EITI standards as follows:

- The current standard of the Cadastre function and reliable recording of production data and the cross reference to revenue is inadequate, requiring investment both in the inspection resources in provincial offices and in central management of the records
- Accountancy standards, capability and practice in the private sector are inadequate to support the requirements of transparency
- There is severely limited audit capability at national level and audit to international standards is currently effectively inaccessible to medium and smaller scale companies, for which the services of major international audit companies are beyond reach on the basis of cost, financial management capability and linguistic constraints.

Opinions of Stakeholders

All stakeholders, comprising both those in and outside the MSG, believe that the Government is actively endeavouring to remove obstacles to implementation of EITI.

However, all stakeholders agree to the existence of a greater or lesser number of constraints which reflect the current political reality of the country in terms of stability and the reliability of cadastre records, the current capacity of companies to respond to the necessary standards of financial management and audit procedures and the political realities for Government to achieve the level of consensus in Parliament to ensure timely introduction of legal amendments.

Validators' Evaluation

Removal of obstacles to the EITI process is a work in progress being undertaken by Government. At the time of the Validators' visit obstacles identified in the legal and regulatory framework had not yet been removed by legal amendments. With respect to discussion with the Reconciler and the assessment in the two Reconciliation Reports, it is concluded that for those companies engaged in the reconciliation process, the legal framework presented no obstacle to comprehensive reporting within the EITI reporting process. Government sources raised no obstacles on account of the legal and regulatory framework.

With respect to other obstacles which have been identified, many of these require longer term solutions, such as achieving financial management capability in the private sector, which cannot be

resolved only by decree. For these elements a comprehensive strategy to achieve progress will be a necessary step to confirm compliance with this requirement.

Afghanistan has made progress but is not yet in compliance with this requirement.

2.9 EITI REQUIREMENT 9

The multi-stakeholder group is required to agree a definition of materiality and the reporting templates.

Progress

- a. The AEITI Secretariat initiated discussions with MoM and the Revenue Department of the MoF in February 2010 for construction of the reporting template and identification of revenue streams to be included. Copy correspondence demonstrates that this process of discussion drew on experience and review offered by international advisors working in the MoM and MoF. An initial draft was circulated on 02 March 2011 to members of the MSG and to international observers, including World Bank and representatives of the aid agencies of Australia, Germany and US, and to the national donor funding agency, HAKARAT. The discussions led to revision of the revenue codes relating to Extractive Industries within the Treasury. The format of the templates also incorporated suggestions from international NGOs and in particular Revenue Watch. The draft reporting template was presented to the full MSG in its meeting of 05 June 2011, at which it was approved.
- b. A Working Group of the MSG was constituted in June 2011 to address the definition of the materiality threshold for the First Reconciliation Report; it incorporated members of the private sector companies, CSOs and included an international advisor on the EITI process. A primary task was the identification and listing of those companies which had made significant total contributions (tax plus non-tax payments) to Government in the accounting years 1387 (to 20 March 2009), 1388 (to 20 March 2010) and 1389 (to 20 March 2011). A total of 17 companies were identified with annual total payments to Government ranging from Afs. 7,700 to Afs. 580.3 M. Meetings of the Working Group in June and July 2011 discussed that the data obtained from the Revenue department might not be comprehensive, and that the list covered companies that ranged between comparatively very large and very small. Proposals were made that there should be a First Reconciliation Report covering the years 1387 and 1388 and a Second Reconciliation Report covering only 1389. An objective for the two reports was that the reporting companies should comprise a limited number of companies with good prospects of a clear reconciliation process, and that subsequently the materiality threshold should be lowered to include more companies making smaller payments to Government. The following proposal was discussed in detail in the MSG meeting of 09 August 2011 and agreed as the basis for materiality for inclusion in the reconciliation exercise 1387 - 1389:

“all mining companies, regardless of whether they are state-owned or private sector or whether they pay non-tax or tax or both, whose annual payments to the Government equal or exceed 7.5 million Afs must be reconciled. And if any company carries out both construction and excavation activities and its non-tax payments are greater than or equal to 7.5 million Afs per year, it must also be included.”

- c. The discussion and agreement of the templates by the MSG in the meeting of 05 June 2011 and the agreement of the materiality threshold for the three years 1387 -1389 in the meeting of 09 August 2011 were supported by Working Group review of key issues which may be summarised:
- The revenue streams were finalised to those in the reporting templates publicly accessible on the MoM website. Payments to be reported by Government included: payments to the MoM which were identified in nine categories of non-tax payments, payments to the Ministry of Finance Revenue Department either through the Large Tax Payers Office (LTO) or Small Tax Payers office (STO) in seven categories of tax payment, payments to the Customs Department which covered Export Duties and Import Duties. Company reporting forms covered payments to Government of non-tax payments to MOM, tax payments to LTO or STO and payments to the Customs Department in the same categories as for Government reporting and also included provision for separate payments to other Government entities (e.g. Municipality Tax) and social contributions. It is noted by the Validator that all discussion of tax payments related to the LTO, but that the Reconciliation Reports show that two of the companies (Khoshak Brothers and Mesaq Sharq) pay tax through the STO.
 - The decision on those companies that would report was made in the MSG meeting of 09 August 2011, based on those companies identified as making total tax and non-tax payments to Government, in the three years under report, above the materiality threshold determined by MSG. Discussion covered the fact that the MoM had originally operated an Extraction Department, undertaking operations directly under Government ownership, but that this had been converted to an administrative unit only, from 1389, although significant and material payments had been recorded for this company in 1388 and 1389. The MSG agreed that this unit would be excluded from the 1387-1388 report and all subsequent reporting.
 - The Government entities required to report were identified and confirmed in the MSG meeting of 09 August 2011 as MoM, LTO of the MoF Revenue Department and also the Customs Department. It was specifically noted in this meeting that Customs payments at province or regional levels were excluded at this time because reliable accounting systems were not yet in place, but this should be reviewed by the MSG.
 - Discussion in the MSG of 05 June 2011 addressed the time period to be covered by the first Reconciliation Reports. The 1387 period was included to allow an appreciation of historic perspective. The current threshold and the six reporting companies would apply for the 1388 and 1389 periods but it was planned that a lower threshold would apply for later reporting, requiring a greater number of companies to report.
 - Minutes of the Working Group meeting of 11 July 2011 document discussion on the disaggregation of data in the EITI Report and the strong advocacy of the CSOs that there should be disaggregated reporting, which was not opposed by the companies.
- d. The MSG has not excluded any specific revenue streams from inclusion in reporting. Non-tax payments to the MoM comprise royalties, surface fees for the licence area, lease of Government land, rent of Government buildings, license fees, permitting fees, bid fees, premium and bonus payments at tender award, and penalties payable to MoM, in particular overproduction penalties. Tax payments comprise income tax, business receipt tax (BRT), salary withholding tax,

rent withholding tax, contract withholding tax, dividends payable to Government, profit payable to Government by state-owned companies and also any penalties.

The First Reconciliation Report includes a comparative analysis of the scale of payments in the two reporting periods 1387, 1388. With the exception of the large “windfall” element of Premium and Bonus payment on award of a major international tender, by far the principal revenue streams to MoM are royalties and surface fees. A more complex picture emerges for payments to the MoF Revenue Department, with large discrepancies in the allocation of income tax payments and BRT as understood and reported by the companies and the MoF. This analysis is complicated by the payment to the MoF (LTO) of profit earned by the one reporting state-owned company (Northern Coal Enterprise), which represents the largest single payment category reported by the companies, although not identified as such in LTO revenues.

- e. Payments by companies at local or regional level are apparently limited to Municipality Tax and possibly some Customs payments. The MSG excluded the latter in the meeting of 09 August 2011 because “proper accounting systems at the province/regional level (were) not in place during the agreed timeframe and so the required data is not available at the moment.” This decision was not explicitly based on a judgement of the materiality of such payments but the intent was clearly stated that this payment category should be reviewed in 2012. There is no record of such a review. Municipality Tax payments have been recorded by one of the companies (Northern Coal Enterprise) and these remain unreconciled as no corresponding report at municipal level is available. The MSG addressed the materiality of payments at regional and local level, but on the basis of lack of reliable information prior to the reporting exercise, provision was made in the templates for recording of these categories but no threshold of materiality was determined prior to the reporting exercise.
- f. No in-kind payments are recorded with reference to the reporting companies. The AEITI Secretariat, on behalf of the MSG Working Group, made specific enquiries (13 April 2011) regarding in-kind payment of gold production made by one gold company to MoM; no specific reply has been identified. The Baseline Study engaged by AEITI indicated that only two official licences for gold mining had been issued by MoM, to West Land General Trading Company (WLGT) and secondly to Afghan Krystal Natural Resources Company Ltd (AKNRC). Both these companies hold licences requiring standard royalty payments based on the value of gold produced; only WLGT appears in the list of 17 companies making payments to Government, although at a level below the threshold for reporting. There is no record of discussions in MSG meetings, and interview with reporting companies did not register, any in-kind settlements to reflect the costs and social benefits of new infrastructure developed by mine projects. The Income Tax Law (2009) makes specific provision for deduction of expenses for construction of infrastructure by a QEIT, and as such must be reflected in the tax payments recorded by the LTO.
- g. The MSG (09 August 2011) discussed the definition of social contributions and their inclusion in the reporting templates. It was determined that this would require further deliberation by the Working Group but agreement was reached that, in the first instance, social payments and contributions should be included in the reporting templates but this would be for information only and they would not initially be reconciled. The reporting templates make provision for

reporting of social payments but none of the reporting companies identify payments in this category in the First and Second Reconciliation Reports.

- h. The reporting templates have been designed to provide space for reporting of payments which do not fall within the standard categories. The discussions within MSG and its Working Group during 2011, make clear that the reporting categories for the First and Second Reconciliation Reports are a first step to transparency and improved and more comprehensive reporting will be introduced for the next reconciliation exercise.

Opinions of Stakeholders

Minutes of the MSG meetings confirm extensive discussion of the reporting templates and corresponding revenue streams and of the materiality thresholds, all of which have been specifically agreed by the MSG.

A number of members of the present MSG were actively engaged in the discussions of templates, revenue streams and materiality and have confirmed the process undertaken by the MSG in stakeholder interviews.

Validators' Evaluation

The process to compose reporting templates and revenue streams was transparent and based on consensus of the members of the MSG and also drew upon experience of international advisors and observers. The template has proved effective for the First and Second Reconciliation Reports.

The definition of the materiality threshold was the result of extensive discussion and reached a pragmatic conclusion which permitted that a relatively small number of companies were required to report in the First and Second Reconciliation Reports. The objective is clearly stated that in subsequent reconciliation reports the materiality threshold must be reviewed and adjusted downwards to capture a progressively wider section of extractive industry.

The Validators have noted the discussion on the selection of reporting companies (paragraph c, point 2, above) and the exclusion of the Extraction Department of MoM, which while not contrary to this specific requirement, is nevertheless discussed as a non-compliant decision for Requirement 11.

The Validators observe that the currently reported reconciliation exercise reflects an early stage in the projected development of the extractive industries in Afghanistan. As new contracts already under negotiation become active and enter production, a much more profound approach to revenue streams and materiality will become necessary (to take account of hydrocarbons production, large mine developments with social and community commitments, treatment of trading companies dealing in otherwise undeclared gold and gemstone production). The MSG and AEITI must take steps to ensure capacity building and adequate experience to develop the reporting procedures as the extractive industries sector matures.

Afghanistan is in compliance with this requirement.

2.10 EITI REQUIREMENT 10

The organisation appointed to produce the EITI reconciliation report must be perceived by the multi-stakeholder group as credible, trustworthy and technically competent.

Progress

Draft Terms of Reference for the Reconciler were drafted by the AEITI Secretariat with assistance from international advisors in August 2011 and were e-mailed to a large address list, stated to include all members of MSG, for comment and approval and also to representatives of World Bank, with copy to the EITI International Secretariat. Funding for the Reconciler was to be through the SDNRP funding facility of the World Bank, requiring procurement under World Bank procedures. Following a World Bank “no objection” to the invitation for expressions of interest, this invitation was issued on 17 September 2011. A Joint Technical Evaluation Committee was established, to include three representatives of the MSG, one from each constituency, one representative from the World Bank SDNRP and one member of the AEITI Secretariat.

In the event it is reported that only one compliant expression of interest was received, from the Azerbaijan office of the international company Moore Stephens. Extensive discussions were held in a meeting of the Joint Technical Evaluation Committee on 23 November 2011 in which it was concluded that, given the constraints of the overall time schedule, approval could be given to proceed to request a proposal from the one interested party; the relevant competence and experience of Moore Stephens was noted. No objections were obtained from World Bank and the MoM. The decision to proceed with one request for proposal was communicated and discussed in the MSG meeting of 21 December 2011; the proposal was due on 28 December 2011. Following review of the proposal and approval by the Joint Technical Evaluation Committee and the SDNRP of the World Bank, as funding agency, a contract was signed with Moore Stephens on 02 February 2012.

Opinions of Stakeholders

In interviews with members of the MSG, a number confirmed their participation in review of the ToR for the Reconciler and in discussions on the receipt of the expression of interest and subsequent decisions to proceed with acceptance of the proposal from Moore Stephens. These interviewees expressed their agreement that the Reconciler was credible, trustworthy and technically competent. Other members of the MSG, and in particular the CSOs, confirmed their view that the Reconciler was credible and technically competent.

Validators' Evaluation

Afghanistan is in compliance with this requirement.

2.11 EITI REQUIREMENT 11

The Government is required to ensure that all relevant companies and Government entities report.

Progress

In the process of setting up the reporting structure for the AEITI, a Baseline Study Report (Reclusive Resources: Afghanistan's Mineral Wealth and the Imperative of Formalization and Transparency, prepared by Qara Consulting) was commissioned and a scoping exercise was carried out to identify the extractive industry companies reporting contributions to Government agencies.

A total of 17 companies were identified which made annual payments to Government and ranged between comparatively very large and very small size. Discussions on the materiality threshold for reporting reached a decision to set a threshold of total payments to Government, comprising tax and non-tax payments, which would define a number of companies that was manageable with good prospects of a clear reconciliation process; for subsequent reconciliation exercises the materiality threshold is to be lowered to include more companies making smaller payments to Government.

In the MSG Working Group meeting of 11 July 2011, some qualifications were expressed that the initial list of 17 companies may not be comprehensive and the possibility was recognised that not all material payments may have been provided by the Government revenue collecting departments. MoM maintains a list of current contracts, or mining licences, which currently record some 82 operations, more than one of which may be held by a single company. However, it appears that there is no current up-to-date database of operational licences with details of activity status, annual production and liability for payment to regulatory authorities.

The process of selection of reporting companies was complicated by the fact that the initial list of 17 companies contained two entities under state ownership and also included a number of construction companies in which the extractive activities of construction materials was subsidiary to other activities. Also the one apparent oil company, Kam Oil was reported by the Minister of Mines not to be an extraction company but that it had a contract for distribution and sale of crude oil.

In the MSG meeting of 09 August 2011 it was decided that the Extraction Department of the MoM should be removed from the list, as all direct extraction by Government agencies had ceased in 1389 and the department had been restructured in to a purely administrative unit. However, significant and material payments had been recorded for this company in 1388 and 1389. The MSG agreed that this unit would be excluded from the 1387-1388 report and all subsequent reporting.

With respect to construction companies, the definition of the materiality threshold required that this threshold should apply where non-tax payments, in effect licence related payments to the MoM, attain the threshold.

For the reconciliation reporting for the periods 1387, 1388 and 1389, six companies were defined as making contributions over the defined threshold and were therefore required to report. At this point the reporting obligation was consensual; all the reporting companies were invited to

participate in a briefing meeting of 28 February 2012, at which 5 attended and confirmed their commitment to report to the EITI process. The selected six companies included one company under direct Government ownership, Northern Coal Enterprise, all others being in the private sector.

The relevant Government agencies which report revenues from these companies are the MoM, the LTO and STO of the MoF and the Customs Department. In the MSG meeting of 09 August 2011 it was proposed and agreed that any payments to provincial or regional revenue collecting units would not be reconciled as reliable accounting systems were not place, although the MSG should review this if material payments were identified.

Completed company reports were received from 5 of the 6 selected companies. The one company which failed to report, Wens Logistic, was investigated by the MoM and was found to be non-compliant in numerous aspects of its licence obligations and the operations by this company were closed in September 2012 (letter documentation in local language has been shown to Validators; Validators also received verbal confirmation by the Minister 12 December 2012). Government departments reported receipts from Wens Logistics to the Reconciler, but these receipts were not included in the EITI reconciliation reports, apparently on the grounds that they would distort the reconciliation process related to the reporting companies.

The Government has undertaken a number of steps to ensure EITI compliance and reporting by extractive industries companies:

- The MoM has recently (2012) developed a new Mining Policy, currently posted on its website, which states the commitment to EITI principles; it is MoM policy that all new contracts for projects let under tender now include the requirement that the operator reports in compliance with requirements of the EITI process. All current contracts are published on the MoM website
- An amendment to the Minerals Law (2009) has been drafted with specific reference (Article 96) to the MoM support to implementation of the EITI in order to ensure transparency in all revenues received by the Government; this amendment has been submitted to Parliament and met opposition and will be re-submitted with the same reference to EITI
- A standard MoU format has been prepared to be signed between the Government ministries, MoM and MoF, and individual companies, which requires the submission of completed AEITI reporting templates, based on accounts audited to international standards, with waiver of any confidentiality provisions. As at October 2012, one MoU only had been signed, with ACCI on behalf of the extractive industry companies it represents.

Opinions of Stakeholders

All interviewed stakeholders indicate their belief that the Government is taking effective steps to ensure all companies report. Nevertheless, it was widely expressed that the minerals sector is particularly difficult to administer due to the number of activities taking place in areas beyond Government control, or under the control of local powerful interests or warlords, or in remote areas where reporting of activities is deliberately misrepresented and subject to corrupt influence. Particular reference was made to illegal chromite mining in the south of the country (referenced in the IWA Hadjigak Report) although the MoM records no national production of chromite, also of the

gemstone and lapis lazuli mining industry, a substantial part of which production is traded through the Afghan Emerald Company which collects a tax payable to Government but does not appear as a contributor to Government extractive industry revenues.

Validators' Evaluation

The process of arriving at the list of 6 companies defined as making material payments to Government for the reporting exercise of 1387 – 1399 is well-documented. There is a specific concern that one company, identified as the Extraction Department of MoM, apparently made significant material payments in the years 1388 and 1389 (from the records of the analysis of payments made by the MSG Working Group) but was excluded from the reporting and reconciliation exercise because this department since 1389 had changed function and is reportedly no longer managing direct production of mines in Government ownership. The exclusion of this company was proposed by the Minister of Mines and there is no record of dissent or questioning by MSG members on this decision.

All relevant Government agencies in receipt of material revenues, recorded as payments by the Companies, have reported.

A number of concerns remain which require resolution for comprehensive reporting in future reconciliation exercises:

- The database of companies is not comprehensive in terms of active operations, the corresponding production records and liability to tax and non-tax payments; this is required to provide a reliable basis of identifying those companies to be assessed for inclusion in later cycles of reconciliation reporting, particularly with respect to medium-size companies
- Incomplete records and information have generated questions on the status of activities and companies believed to be active but which have not appeared in the list of companies making revenue payments. This is the case of the Afghan Gas Enterprise, which was the recipient of USAID training in December 2010 although it was reported to AEITI that the company was barely functioning
- There remain areas of extractive industry activity which appear to be poorly regulated and correspondingly opaque; for example it is reported that there is a robust sector of gemstone production and at least one agency, the Afghan Emerald Company trades in this production and collects payments on behalf of Government for products on which no royalty has yet been paid; records of payments to MoM have been provided by MoM showing very small levels of annual payments (Afs 200 – Afs 3,262) for the periods under reconciliation. This company was not identified in the list of 17 companies making payment to Government agencies.
- Widely published reports (notably from the US West Point CTC: Afghanistan's Conflict Minerals) make claims of extensive uncontrolled and unreported mineral exploitation both in insurgent areas beyond Government control and as criminal activity in areas ostensibly under Government administration; these claims also draw upon frequent reports made in the local media.

The requirement that all companies making material payments must report has not been met because one company failed to do so. Nevertheless steps were taken by Government to verify the status of this company, leading to its closure. All other companies and the corresponding Government agencies have reported.

The Validators consider that compliance with this requirement cannot be recognised due to the following:

- the absence of a database with details of production from active extractive industry companies,
- the decision to exclude the Government-owned Extraction Department of MoM,
- there is no record of deliberation by MSG or investigation of the status of some apparently significant companies (e.g. Afghan Gas Enterprise, Afghan Emerald Company) in the initial assessment of potentially contributing companies.

Afghanistan is not in compliance with this requirement; concerns are also noted which will affect compliance in future reconciliation periods.

2.12 EITI REQUIREMENT 12

The Government is required to ensure that company reports are based on accounts audited to international standards.

Progress

The Government has enacted legislation requiring holders of mineral rights to report their financial accounts audited to international standards. **Article 83** (2) of the Minerals Law of 2009 states the following: "Holders of Mineral Rights shall present their balance sheets based on the income tax law and other applicable laws and in accordance with International Accounting Standards (IAS) that is from time to time promulgated by the International Accounting Standards Board, unless provided for otherwise in this law".

A proposed 2012 amendment to the Minerals Law includes a new article as follows: "The Ministry of Mines, the Ministry of Finance, holder of a license, contractor or other relevant agencies, shall, for the purpose of transparent and effective management of mining revenues, comply with the financial reporting requirements and standards of the EITI." The proposed set of 2012 amendments encountered opposition in Parliament but this will again be submitted for parliamentary approval, including the quoted article.

The contract formats now required by the MoM for new contracts let under international tender include an article requiring the new license holder to comply with EITI standards for the reporting of payments to Government, although this does not explicitly refer to the requirement for accounts to be audited to international standards, nor does this specify EITI-compliant standards defined in Afghanistan.

A standard MoU format has been prepared to be signed between the Government ministries, MoM and MoF, and individual companies, which requires the submission of completed AEITI reporting templates, based on accounts audited to international standards, with waiver of any confidentiality provisions. To date, at October 2012, one MoU only had been signed, with ACCI on behalf of the extractive industry companies it represents.

Although enacted and drafted law and regulations reflect the commitment of the Government to achieve this requirement, there is nevertheless, and particularly among donor agencies, a recognition that Afghanistan is a post-conflict country with weak professional capacity and institutions. An international donor project (USAID project "Capacity Development Project – Private Sector Accounting Reform" in collaboration with Ministry of Finance) has recommended establishing an Institute of Accountants and Auditors of Afghanistan (IAAA) to function as a self-regulated independent professional body. This remains in discussion but has not yet been achieved. It is also reported that there has been consideration between the MoF and donor agencies of the concept of a Government controlled Accounting and Auditing Board to regulate the accounting profession.

A new proposed law on Accounting and Auditing has also been developed through a donor sponsored project (Capacity Development Project of ADB and sponsored by the MoF) and has provisions for

maintaining books of account, preparation of financial statements, and the manner of performing audits of financial statements. It also requires financial statements to be prepared in compliance with IFRS and audits to be conducted in accordance with ISA. Large entities are required to employ the accrual basis of accounting, while SME entities have the option to adopt the cash basis of accounting. The draft law lays down eligibility criteria for auditors and entrusts licensing of auditors to the MoF.

In the MSG meeting of 09 August 2011 it was noted that local Afghan companies generally do not comply with requirements for audit to international standards. It was further noted that the EITI validation would require that the MSG should agree an action plan to address those cases where companies do not have accounts audited to international standards. It was proposed that an appropriate strategy should be decided in the context of the Reconciliation exercise.

In the First Reconciliation Report the Reconciler reinforces the recommendation that the audits of extractive companies are carried out according to ISA. The recommendation comments further:

“We understand that for the purposes of this Reconciliation, the extractive companies have not subjected their reports to specific audit, neither have their accounts been subjected to the general audit procedures in accordance with ISA. Therefore, we recommend that the Government agrees a plan with the extractive companies to achieve this task against a fixed deadline. We recommend providing only audited amounts in the reports submitted by both the Government agencies and the extractive companies. The extractive companies can either have their general accounts audited and extract the EITI related numbers therefrom, or subject their EITI reporting templates to a special examination and certification by the independent auditors. We understand that the financial statements prepared in conformance with International Financial Reporting Standards (IFRS) are prepared under the accrual basis of accounting, whereas the EITI reporting is carried out under the cash basis. Therefore, in practice this process might be implemented by the extractive companies obtaining from their external auditors a separate opinion stating that the information they report under EITI is derived from and/or consistent with their general purpose audited financial statements. This could be a special procedure request added to the terms of reference addressed by the external auditors. The external auditors could easily relate the cash basis information to the audited accrual basis records.”

Opinions of Stakeholders

In interviews with the reporting companies, all confirmed their intention to comply with the audit requirement to international standards in the future for the next reconciliation reports.

In discussion with other members of the MSG there is an awareness of the importance of this requirement and the need to develop a strategy to ensure that EITI reporting by extractive companies' are based on accounts audited to international standards, particularly if new companies are to be included in the next reconciliation exercise.

Validators' Evaluation

The requirement for audit of corporate accounts is in general poorly established in Afghanistan. Statutory audits are not legislated even in the new corporate legislation, other than in insurance and banking law, and thus there is limited demand for audit services. There is no corporate regulator in Afghanistan. Da Afghanistan Bank (DAB) is the banking regulator and has a relatively proactive offsite and onsite supervision process.

On the other hand, the provisions of the recently published (applicable but not yet enacted by Parliament) Law of Corporations and Limited Liability Companies (2007) override the provisions of the Commercial Code of 1955, in so far as they relate to corporations and limited liability companies. This new law requires companies to deliver to their shareholders at least 15 days before the annual general meeting, financial statements duly compliant with the accounting standards set forth by the International Accounting Standards Board. It is understood that the external audit requirements applicable to commercial entities are contained in the following laws:

- i. Commercial Code of 1955
- ii. Law of Corporations and Limited Liability Companies of 2007
- iii. Banking Law of Afghanistan of 1976 (amended in 1977 and 2003)
- iv. Insurance Law of 1989 (amended in 2005)
- v. Law of State Owned Enterprises of 1991 (amended in 2005)

During the present Validation process, it was noted that only one extractive industry company, the MJAM consortium, has apparently complied with this requirement, and have indicated that their accounts are subject to external audit to international standards by KPMG. Review of their completed template submissions indicates there is no certification that the EITI reported figures are from the audited accounts. One other reporting company, Mesaq Sharq, submitted their EITI report stating their accounts are certified by their local external auditor although this audit is not in compliance with ISA.

While the five companies who have reported in the reconciliation process for the three years 1387, 1388, 1389 all confirm their commitment to comply with the requirement for independent audit to international standards for the next reporting periods, there is no plan to address this requirement for other companies which are likely to be involved in the next reconciliation exercise, in line with the stated policy of adjusting the materiality threshold to amplify the list of reporting companies.

This group of companies who can be expected to be included as new entrants in the next reconciliation exercise have apparently been operating under the Minerals Law of 2009, but all evidence from the limited audit resources in the country suggests that they are not in compliance with the law in terms of the audit standard of their accounts.

The Validators consider it essential for compliance with this requirement that there is an action plan proposed and driven by the MSG:

- To ensure that those companies which have reported in the first two reconciliation exercises are engaged in active review of the steps to achieve audit compliance, identifying

any impediments or difficulties and assisting with capacity building and the identification of suitable audit services before the next reconciliation exercise; and

- to ensure that a wider group of companies, planned to participate in the next reconciliation exercise, are introduced to the audit standard requirement, with appropriate capacity-building, in order to ensure a high level of compliance in the next reconciliation exercise.

Afghanistan is not yet compliant with this requirement.

2.13 EITI REQUIREMENT 13

The Government is required to ensure that Government reports are based on accounts audited to international standards.

Progress

The Government reports that were used for the reconciliation reports for 1387, 1388 and 1389 were submitted stamped and signed by the relevant senior managers of the governmental agencies (Head of Revenue of MoM; general managers of LTO, STO and Customs Department).

It has been explained that government statements and records are subject to examination by the Control & Audit Office (CAO) and the Internal Audit Department in the respective ministries (MoF, MoM), but the role of the CAO and Internal Audit Department is to review the compliance with the internal control environment as well as the accounting records on behalf of the Public Accountants. It is therefore more control-oriented management of public accounts rather than an audit in itself.

The 1981 Control and Audit Law directs the CAO to organize the audit and control affairs of public properties. Today, the CAO has audit authority over state entities within the central and provincial governments as well as public enterprises and has more than 350 employees.

The Government uses a uniform public accounting manual which is in general compliance with international practice. In addition, it has used an automated accounting system (Afghanistan Financial Management Information System - AFMIS) since 2002, which is now operational in all primary budget management units in Kabul and in all provincial mustofiats. The various tax offices (Large Tax Payers Office; Medium Tax Payers Office; Small Tax Payers Office) under the MoF are moving to implement an automated integrated system (Standard Integrated Governmental Tax Administration System -SIGTAS) under the supervision of Adam Smith International and this is expected to be live and fully implemented during the 1st quarter of 2013.

The Public Financial Management and Expenditure Law (PFMEL) of 2005 and the Procurement Law of 2008 establish the legal basis for continued reform. Activities of the Local Government Municipalities fall under the Municipal Law of 2000. The key gap is modern legislation on the conduct of external audit, which it is claimed will be addressed in the near future with passage of a new Audit Law; this was scheduled to be presented to Parliament in 1389 (2010/2011) but appears to be delayed.

Since 1384 (2005), the Audited Annual Appropriation Statements of the Government (Qatia) have been submitted to Parliament within six months of the end of each fiscal year, in accordance with the PFMEL. Central Government Financial Statements are published each month within 25 days of month end. All Government bank accounts are reconciled regularly, and budgetary units reconcile their revenues and expenditures monthly with the records of the MoF. The Chart of Accounts incorporates International Monetary Fund Government Finance Statistics (GFS) classifications, including the United Nations Statistics Division Classifications of the Functions of Government (COFOG). Following the appointment of an IMF GFS Correspondent in early 2010, Afghanistan has submitted IMF High Frequency reports and has been included in the IMF International Finance Statistics publication since March 2010.

Opinions of Stakeholders

In interviews with a number of members of the MSG there was awareness that under the current legal framework Government accounts are not audited by an external body or to international audit standards. However, the MSG members affirmed their satisfaction that the data transmitted by the Government through the EITI reports is consistent with the data issued by the Government in the annual public accounts. In addition, the MSG is satisfied with the audit of Government accounts through the CAO and the Internal Audit Departments of the MoF and MoM.

Validators' Evaluation

In the report by the Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR) issued in April 2010, it is stated that "the CAO has severe internal capacity constraints and relies heavily on support from foreign consultants and advisors. The CAO's staff lack specialization and training – particularly in the areas of professional standards, English language, and computer skills- resulting in CAO's inability to independently conduct audits that meet international standards".

The World Bank is currently providing assistance through the Afghanistan Public Financial Management Reform Project.

It is reported that there is a Government programme to upgrade the public financial management including the capacity of the CAO and capacity and resources of the tax offices. However, the Government has not yet passed appropriate legislation (e.g. the new Audit Law) requiring reported financial accounts to be audited according to international standards.

A number of members of the MSG expressed satisfaction with the standard of reporting of the submissions from Government, noting the Government's statements were signed off by a senior official and that the figures have been properly prepared and can be used effectively for the reconciliation. However, there is no record of formal agreement in a plenary MSG meeting regarding the audit of Government figures.

The recommendation in the First Reconciliation Report is noted:

"With regard to Government agencies, it is recommended that the reliable and auditable data is presented to Afghanistan's Supreme Audit Institution, the Control and Audit Office (CAO), and subjected to an audit/examination in accordance with the internationally recognised Government auditing standards (such as the International Standards of Supreme Audit Institutions – ISSAI, promulgated by the International Organization of Supreme Audit Institutions – INTOSAI). It will be efficient to attach auditor confirmation letters and/or audited accounts to the reports mentioned above."

The Validators take note that the Reconciliation Report and its recommendations have been approved by the MSG and that to date formal steps have not yet been taken to demonstrate the audit process, and additionally the proposed audit legislation has not yet been passed by Parliament. It is concluded that Afghanistan is not yet in compliance with this requirement.

2.14 EITI REQUIREMENT 14

Companies comprehensively disclose all material payments in accordance with the agreed reporting templates.

Progress

The reporting templates and revenue streams in the templates were discussed extensively in full MSG meetings and by the Working Group and were formally approved in the MSG meeting of 09 August 2011. The Reconciler also confirmed these conformed to technical guidelines in the Inception Report dated March 2012.

At commencement of the reconciliation assignment a training workshop on the reconciliation process was held on 02 April 2012, attended by members of the MSG and other representatives of Government ministries, CSOs and the extractive industry companies. The workshop particularly addressed the requirement for comprehensive disclosure of all material payments on the templates.

Moore Stephens engaged the services of a respected Afghan academic with experience of financial management, Mr Shah Mahmood, of the Department of Economics, Nangarhar University, Jalalabad, who undertook visits to each of the reporting companies to gather and refine information in the reporting templates. This information was transmitted to the Baku offices of Moore Stephens, where it was processed and entered into the reconciliation format developed by Moore Stephens.

The First and Second Reconciliation Reports include the following statement from the Reconciler:

“The information on the Reporting Template includes relevant details on each payment and the recipient of the relevant payment from the extractive industry entities. We have provided brief information on the main types of payments. We have received all the reports with the signature of responsible persons. All the reports have been stamped and indicated the dates of filling.”

Working Group meetings of the MSG on 06 and 12 June 2012 reviewed the reconciliation statements with representatives of the reporting companies; no case of non-disclosure of material payments was identified.

Opinions of Stakeholders

The formal public presentation of the First Reconciliation Report on 05 August 2012 demonstrated satisfaction with the reconciliation process and the disclosure of payments by the companies. Interviews with individual MSG members confirm a general level of satisfaction with the reporting of the extractive industry companies.

Validators' Evaluation

The Validators have been able to inspect copies of the original reporting templates submitted by the extractive industry companies; these confirm apparently comprehensive disclosure within the template categories. However, the recommendations of the Reconciler highlight the need to move from paper-based accounting and the need for training in accounting systems. In direct consultation with the Reconciler, the point was made to the Validators that both parties, the Government agencies and extractive industry companies, lack proper accounting records.

In view of the large discrepancies which remain to be resolved, where there are material differences whose origins are as yet unknown, it is premature to confirm that the companies have comprehensively disclosed all material payments.

Afghanistan is not yet in compliance with this requirement.

2.15 EITI REQUIREMENT 15

Government agencies comprehensively disclose all material revenues in accordance with the agreed reporting templates.

Progress

The Reconciliation Reports document the receipt of reports referring to three categories of Government Agency:

- Ministry of Mines
- Ministry of Finance (Revenue and Customs Departments)
- Other Government Agencies.

Review of the Reconciliation Reports however indicates that no information was submitted by “Other Government Agencies”. Payments reported by the extractive companies to “Other Government Agencies” refers to a municipality tax incurred each year by one of the reporting companies (Northern Coal Enterprise) and a foreign permit payment incurred in one year by one other company (Mesaq Sharq). All payments to “Other Government Agencies” remain unresolved.

The returns from Government agencies which figure within the Reconciliation Reports are from:

- Ministry of Mines
- Ministry of Finance Large Taxpayer Office (LTO)
- Ministry of Finance Small Taxpayer Office (STO)
- Ministry of Finance Customs Department.

The Reconciliation Reports report that following the initial reconciliation exercise, discrepancies were reported to the relevant companies and Government agencies, with the invitation to submit additional information to allow adjustment of apparent discrepancies. With respect to information provided by Government agencies a number of apparent gaps in reporting of revenue can be identified of which the largest are:

- One of the largest discrepancies relates to the reporting by the Government-owned company Northern Coal Enterprise (NCE) of profit in the year 1388 of Afs 449.0 M which is claimed to have been paid to the LTO; this is not recorded by LTO and remains unreconciled. In 1387 profit of Afs 299.1 M was paid to the LTO and confirmation of payment is recorded by the Reconciler; in 1389 a profit payment of Afs 782.4 M (including a pre-payment) was reported by NCE but not initially reported by LTO although later accepted as reconciled by the Reconciler on adjustment.

- In the reconciliation report for 1389 the MJAM Consortium report a payment of Afs 57.0 M in the category of “Interest tax” to LTO, which remains unresolved with no explanation of this category of payment in the LTO report.
- In the years 1387 and 1388, there are substantial discrepancies with respect to payments to LTO by the MJAM Consortium, in particular as regards “Salary Withholding Tax” in 1387 and “Contract Withholding Tax” in 1388, neither of which were recorded in the LTO report. For both years the Reconciler notes with the respect to this company in the Reconciliation Report- “We have not obtained any evidence or explanation from the Government Agencies”.

Opinions of Stakeholders

The formal public presentation of the First Reconciliation Report on 05 August 2012 demonstrated satisfaction with the reconciliation process and the disclosure of payments by Government agencies.

In individual interviews with members of the MSG, those representing CSOs showed a general confidence with respect to Government reporting. While there was no strong expression of dissatisfaction from company representatives there was concern at the level of unresolved discrepancies.

Validators’ Evaluation

In view of the size of discrepancies for each of the three years under report, all of which indicate companies claim to have paid more than reported by Government (over-reporting by the companies or under-reporting by Government agencies), and also a number of specific large payments which appear unreported in Government reports, it is not possible for the Validators to take a unqualified view that all material revenues have been disclosed by the relevant Government agencies. Until there are clear conclusions for the discrepancies identified in the two Reconciliation Reports, supported by independent review, it is not possible to conclude on compliance with this requirement.

Afghanistan is not yet compliant with this requirement.

2.16 EITI REQUIREMENT 16

The multi-stakeholder group must be content that the organisation contracted to reconcile the company and Government figures did so satisfactorily.

Progress

The data acquisition and processing of report templates by the Reconciler, Moore Stephens, was carried out during the period April – May 2012. Moore Stephens engaged the services of a respected Afghan academic with experience of financial management, Mr Shah Mahmood, of the Department of Economics, Nangarhar University, Jalalabad, who undertook visits to each of the reporting companies to gather and refine information in the reporting templates. This information was transmitted to the Baku offices of Moore Stephens, where it was processed and entered into the reconciliation format developed by Moore Stephens. The results of the reconciliation process and the draft report format were discussed between the Moore Stephens reconciliation team and the MSG on 29 May 2012 and a full day workshop was held on 30 May 2012 for the MSG, reporting companies and international observers to review the results and outstanding discrepancies.

The Reconciliation Report describes the working pattern in which, as discrepancies were identified by Moore Stephens, they requested additional information and supporting information from the extractive industry companies and Government agencies. A Working Group of the MSG met on a number of occasions during June 2012 to attempt to identify the reasons for, and resolve, the discrepancies identified in the reconciliation process. The conclusions of these review meetings were transmitted to the Baku office of Moore Stephens and where possible were incorporated in the report format and adjustments for the First and Second Reconciliation Reports.

In the Working Group meeting for resolution of discrepancies in the reconciliation reports, held on 03 July 2012 approval of the work performed by Moore Stephens was formally documented-

“We undersigned hereafter as members of the MSG acknowledge and agree with the AEITI reconciliation process done by Moore Stephens. The data collection, review and reconciliation of the Government and Extractive entities for the years 1387, 1388 and 1389 as well as the usage of the AEITI standard reporting template have been carried out in accordance with the Terms of Reference. We are quite content with the assignment done by Moore Stephens.”

On behalf of the MSG this was signed by ten members consisting two members of Government agencies, four representatives of CSOs and four representatives of three different mining companies.

The First AEITI Reconciliation Report was presented in a public and widely reported conference in Kabul on 01 August 2012, presided jointly by the Minister of Finance, Minister of Mines and Minister of Economy.

Opinions of Stakeholders

In interviews with members of the MSG, a number made specific reference to their appreciation of the work carried out by Mr Shah Mahmood on behalf of the Reconcilers, in terms of visiting the reporting companies on numerous occasions and ensuring compliant completion of the templates; he also participated in a number of workshops with MSG acting on behalf of the Reconcilers. Views expressed by individual stakeholders are in agreement with the statement of satisfaction expressed by the MSG with respect to the performance of the Reconcilers, Moore Stephens.

Validators' Evaluation

The reconciliation process described in the Reconciliation Reports placed considerable reliance on the collection of further supporting data and explanatory records, with the intervention of the MSG, during the secondary stage of reconciliation, in an attempt to resolve discrepancies through adjustments prior to final reporting. This is a departure from usual reconciliation practice whereby the reconciler manages this phase of the process independently; however, the Validators view this as an unavoidable step reflecting the difficulties of obtaining reliable data due to the poor communications in much of Afghanistan, the linguistic difficulties and the generally poor level of financial management and accounting practice.

Compliance with the requirements for contents of the EITI Reconciliation Report were not met (Requirement 18 c.ii requires the country, here interpreted as the Government, to include a list of all companies active in each extractive sector as an annex to the EITI Report (including the source of the list) and to provide additional detail regarding their activities during the reporting period (e.g. exploration, feasibility, development, construction, production, decommissioning etc). The difficulties of comprehensive identification of extractive industry activity in Afghanistan have been commented in Section 1.4 of this report. The requirement for provision of this information lies with Government.

In view of the explicit statement of approval by the MSG, the Validators consider that Afghanistan is in compliance with this requirement.

2.17 EITI REQUIREMENT 17

The Reconciler must ensure that that the EITI Report is comprehensive, identifies all discrepancies, where possible explains those discrepancies, and where necessary makes recommendations for remedial actions to be taken.

Progress

The First Reconciliation Report covering years 1387 (to 20 March 2009) and 1388 (to 20 March 2010) was published in July 2012 and presented in a public conference in Kabul on 01 August 2012. The Second Reconciliation Report covering financial year 1389 (to 20 March 2011) was published in October 2012. Both Reconciliation Reports were published first in English language and subsequently printed and published in two local languages, Pashto and Dari. Both reports are available on the AEITI website.

The MSG, by means of a materiality threshold, determined that six extractive industry companies should report in the reconciliation periods covered by the First and Second Reconciliation Reports. The reports make clear that one of the companies, Wens Logistic, did not submit its reporting templates for these periods and therefore could not be included in the reconciliation exercises. However, although the company did not submit returns, in fact the reporting Government agencies did report receipts of payment from the company; these were not recorded in the Reconciliation Reports.

During the 1387 period four companies were the subject of reconciliation (Mesaq Sharq was not yet in production in this period) and for 1388 and 1389 five companies were the subject of reconciliation.

The conclusions of each of the reporting periods are summarised as follows (all financial reporting in Afghani – Afs):

Year 1387 (to 20 March 2009)

Government Agencies	Revenue reported by Government Agencies	Payment reported by Companies	Discrepancies	Subsequent Adjustment	Unresolved Discrepancies
Ministry of Mines	4,080,927,719	4,089,322,538	(8,394,819)	8,088,434	(306,385)
Ministry of Finance – LTO	431,493,065	439,257,924	(7,764,859)	-	(7,764,859)
Ministry of Finance – STO	-	1,797,875	(1,797,875)	-	(1,797,875)
Ministry of Finance – Customs	7,107,206	-	7,107,206	-	7,107,206
Other Govt. Agencies	-	4,048,680	(4,048,680)	-	(4,048,680)
TOTAL	4,519,527,990	4,534,427,017	(14,899,027)	8,088,434	(6,810,593)

Unresolved discrepancies were identified for each of the four reporting entities, ranging from Afs 0.89M to 5.86M, in all cases representing either over-reporting by the companies or under-

reporting by the Government agencies. In each case the Reconciler makes clear that a number of meetings were held to endeavour to resolve the discrepancies but that satisfactory explanations were not received and therefore the discrepancies remain unresolved.

Year 1388 (to 20 March 2010)

Government Agencies	Revenue reported by Government Agencies	Payment reported by Companies	Discrepancies	Subsequent Adjustment	Unresolved Discrepancies
Ministry of Mines	36,344,184	39,372,879	(3,028,695)	945,565	(2,083,130)
Ministry of Finance – LTO	312,307,369	594,794,285	(282,486,916)	-	(282,486,916)
Ministry of Finance – STO	216,962	2,780,389	(2,563,427)	197,418	(2,366,009)
Ministry of Finance – Customs	7,088,488	-	7,088,488	-	7,088,488
Other Govt. Agencies	-	1,240,000	(1,240,000)	-	(1,240,000)
TOTAL	355,957,003	638,187,553	(282,230,550)	1,142,983	(281,087,567)

Unresolved discrepancies were identified for each of the five reporting entities, ranging from Afs 0.04M to 276.63M, in all cases representing either over-reporting by the companies or under-reporting by the Government agencies. In each case the Reconciler makes clear that a number of meetings were held to endeavour to resolve the discrepancies but that satisfactory explanations were not received and therefore the discrepancies remain unresolved.

Year 1389 (to 20 March 2011)

Government Agencies	Revenue reported by Government Agencies	Payment reported by Companies	Discrepancies	Subsequent Adjustment	Unresolved Discrepancies
Ministry of Mines	37,007,173	37,903,154	(895,981)	(7,688,888)	(8,584,869)
Ministry of Finance – LTO	1,030,231,750	1,095,089,746	(64,857,996)	7,743,437	(57,114,559)
Ministry of Finance – STO	168,078	4,200,754	(4,032,676)	4,032,676	-
Ministry of Finance – Customs	1,234,006	-	1,234,006	-	1,234,006
Other Govt. Agencies	-	3,914,136	(3,914,136)	-	(3,914,136)
TOTAL	1,068,641,007	1,141,107,790	(72,466,783)	4,087,225	(68,379,558)

Unresolved discrepancies were identified for four of the five reporting entities, discrepancies ranging from Afs 0.05M to 65.33M, in all cases representing either over-reporting by the companies or under-reporting by the Government agencies. In each of the cases of discrepancy the Reconciler makes clear that a number of meetings were held to endeavour to resolve these but that satisfactory explanations were not received and therefore the discrepancies remain unresolved.

The Reconciler commented that the difficulties for resolving the discrepancies were in part due to lack of adherence to deadlines by both the companies and Government agencies and also that insufficient supporting documents were provided.

The Reconciler has made recommendations as follows:

With respect to timing of the reconciliation exercise and period of appointment of Reconciler-

- We believe that in the future it would be more effective to carry out the reporting and reconciliation process and publish the annual report within maximum 9 months of the year end. This would ensure a better participation of both extractive companies and Government Agencies and provide more up-to-date information to stakeholders. Also tax regimes can change over time and can confuse the reporting.
- We recommend appointing person responsible for dealing with the responsible persons of extractive companies to reconcile the amounts paid and received. It is advisable to complete the reconciliation process prior to the external reconciliation. It will reduce the number of unresolved discrepancies at the initial stage
- We recommend changing the principles of paper-based accounting to more effective accounting programs which will cause to development of accounting system and transparent recording system
- We recommend organising even more seminars and training for the participants of the reconciliation process. The purpose of training should be related to the accounting systems and principles on International Standards.

With respect to ensuring all relevant extractive companies report-

- Therefore we recommend that the Government utilises its regulatory powers to make it compulsory that all the extractive companies report according to the EITI criteria and utilise the agreed reporting templates. In the future, where legally and technically feasible, automated on-line disclosure of extractive revenues and payments by the Government and extractive companies on a continuous basis can be considered. Such continuous reporting can be an integral part of the EITI process
- We also recommend that, following the first reconciliation exercise, the AEITI Secretariat creates a database of participants. The Secretariat should then liaise with the Governmental bodies to ensure it obtains adequate information regularly and updates its database accordingly. To this end we believe that it is vital that any new entrants to the extractive sector are registered with the AEITI Secretariat as part of the process before or at the same time as they obtain their operating licence. A quarterly review with the Governmental bodies of the list of extractive companies licensed to operate in the sector is recommended.

With respect to supporting data-

- We recommend a review of the procedures for communicating in particular with those who do not comply with the EITI rules. A regular compulsory briefing or training seminar for the newcomers might be an option.

With respect to information on the reporting template-

- Key deadlines should be highlighted along with key contact persons of the Independent Reconciler and AEITI Secretariat.

With respect to Workshops-

- It will be useful to document the Workshop discussions and re-send the Memorandum of Discussion to all the parties that attended the workshops
- The timing of the reconciliation and individual deadlines should be agreed with all the Extractive Industry Entities and Government Agencies in order to ensure that the reconciliation process is undertaken at a time suitable for all parties. It will be helpful to draw attention of the parties submission deadlines specifically
- Questions and answers should be accommodated throughout the workshops to identify and address potential issues.

With respect to reporting based on audited figures and/or certification of reporting templates by external (independent) auditors-

- It is highly recommended that the audits of the extractive companies are carried out according to the International Standards of Auditing (ISA) issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). The audits should be conducted by the reputable internationally recognised firms of auditors. We understand that for the purposes of this Reconciliation, the extractive companies have not subjected their reports to specific audit, neither have their accounts been subjected to the general audit procedures in accordance with ISA. Therefore, we recommend that the Government agrees a plan with the extractive companies to achieve this task against a fixed deadline. We recommend providing only audited amounts in the reports submitted by both the Government agencies and the extractive companies. The extractive companies can either have their general accounts audited and extract the EITI related numbers therefrom, or subject their EITI reporting templates to a special examination and certification by the independent auditors. We understand that the financial statements prepared in conformance with International Financial Reporting Standards (IFRS) are prepared under the accrual basis of accounting, whereas the EITI reporting is carried out under the cash basis. Therefore, in practice this

process might be implemented by the extractive companies obtaining from their external auditors a separate opinion stating that the information they report under EITI is derived from and/or consistent with their general purpose audited financial statements. This could be a special procedure request added to the terms of reference addressed by the external auditors. The external auditors could easily relate the cash basis information to the audited accrual basis records. With regard to Government agencies, it is recommended that the reliable and auditable data is presented to Afghanistan's Supreme Audit Institution, the Control and Audit Office (CAO), and subjected to an audit/examination in accordance with the internationally recognised Government auditing standards (such as the International Standards of Supreme Audit Institutions – ISSAI, promulgated by the International Organization of Supreme Audit Institutions – INTOSAI). It will be efficient to attach auditor confirmation letters and/or audited accounts to the reports mentioned above.

With respect to Conclusions-

- AEITI Multi Stakeholder Group should appoint an appropriate party to continue working with the Extractive Industry Entities and Governmental Agencies to address all unresolved discrepancies highlighted in our report. This will allow AEITI Multi Stakeholder Group conclude on the reasons for the discrepancies, in case we are not able to reconcile these due to the lack of adherence to deadlines by the Extractive Industry Entities and Government Agencies and insufficient supporting documentation being provided
- A report on the conclusion of the investigation should be issued to the Extractive |Industry Entities and Government Agencies that highlights to them the common reasons for discrepancies and action plans to address them. The report should also include the type of evidence that was used to resolve the discrepancies as this information would prove invaluable to the presentation orientation and the information pack discussed earlier. The report should also be furnished to the Independent reconciler who would be expected to perform the next Independent Reconciliation to orientate them regarding the potential challenges early in the reconciliation.

Following publication of the reports, there have been well documented MSG-organized internal meetings and working groups to endeavour to resolve the discrepancies. Assertions have been made that most discrepancies have been resolved, but no evidence-based resolution has been documented.

Opinions of Stakeholders

The MSG has expressed satisfaction with the two Reconciliation Reports; the first, for reporting years 1387 and 1388, was approved in the MSG meeting of 29 May 2012 and the second, for reporting year 1389, was approved in the meeting on 13 October 2012.

There are still significant unresolved discrepancies in the two Reconciliation Reports and the AEITI Secretariat have indicated that there is continuing internal work to resolve and document these. After discussion during the Validators' visit, the need for any resolution of discrepancies to be

verified by an external independent auditor was reviewed and draft ToR for this role have been prepared.

Validators' Evaluation

Unresolved total discrepancies between the Government and company figures were 0.15% in the 1387 report, 44% for 1388 and 6% in 1389. The Reconciler reports that it has not been able adequately to explain the greater part of the discrepancies. For this reason the report cannot be considered to be comprehensive.

The recommendations of the Reconciler were very wide-ranging and cover some organisational aspects for the next reconciliation exercise while other recommendations are more fundamental to the next steps to resolve the discrepancies revealed in the reconciliation exercise covered by their reports. The immediate requirement is to achieve public and acceptable resolution of the latter and the Validators comment on progress on the recommendations for this objective in the following table.

	Summary of Reconciler's Recommendations for immediate effect	Status of progress to address recommendations
1.	Appointment of an appropriate party to continue working with companies and Government agencies to address all unresolved discrepancies highlighted in the reconciliation reports.	Working Groups have worked internally to try to resolve discrepancies, as has personnel of MoM. However, these efforts are not independent and any statement that the discrepancies were resolved would lack transparency unless performed or verified by an independent external auditor. Draft ToR for an independent audit report on the conclusions for reasons for the discrepancies have been prepared but not yet finalised No substantive progress yet
2.	Appointing a person (within the AEITI/MSG structure) who would be responsible for dealing with the persons in the companies responsible for reporting and providing supporting data with the intention of performing an initial reconciliation process prior to the presenting templates to the external auditor	No person has yet been appointed with responsibility to oversee the management of the reporting by the companies and the comprehensiveness of reporting and provision of supporting data. To date no progress
3.	Organisation of more training and seminars for persons engaged in the reconciliation process (this can be interpreted as not relating only to Secretariat and MSG, but also to financial management personnel in the companies)	No further training or seminars have taken place since publication of the Reconciliation Reports. Current Work Plan provides no evidence of planning or cost assessment and sourcing for future training specific to this scope.

		To date no progress
4.	Preparation of a database of all companies which potentially will be required to report in future reconciliation exercises. (This links with the recommendation for communicating with new extractive companies and provision of training seminars for new companies and review with non compliant companies)	No steps have been demonstrated to create a comprehensive database of all those companies operating, with relevant production statistics, in the extractive sector and which may in future be required to report in the next reconciliation exercise. To date no progress
5.	Taking steps to achieve reporting by companies and Government Agencies on the basis of audited figures, or certification of reporting templates by external independent auditors	Steps have been taken to incorporate requirements in amended legislation, new contracts and through MoUs with companies. However these steps may elicit agreement in principle but do not address practical solutions taking account of poor financial management and limited numbers and access to auditors in Afghanistan. A coherent strategy for training, capacity-building and support is required. Steps to improve contractual and regulatory framework have been taken
6.	A report should be prepared at the end of the the investigation of discrepancies which documents the reasons for discrepancies and action plans to eliminate them	To date no coherent documentation with common agreement on the reasons for discrepancies. Given that a large part of the discrepancies fall within the reporting of the LTO, it will be important that there is a specific objective in this agency to resolve the discrepancies; this was not apparent in the Validators' visit. To date no progress

In view of the Reconciler's comments on the lack of documentation from the extractive entities and Government agencies, the unresolved explanation for the discrepancies, and effectively the lack of progress against the recommendations of the Reconciler, we conclude that Afghanistan is not in compliance with this requirement.

2.18 EITI REQUIREMENT 18

The government and multi-stakeholder group must ensure that the EITI Report is comprehensible and publicly accessible in such a way as to encourage that its findings contribute to public debate.

Progress

The First AEITI Reconciliation Report, covering the Afghan financial reporting periods 1387 and 1388, was presented in a public conference of over 300 attendees at the Intercontinental Hotel, Kabul on 01 August 2012; the meeting was presided by three Government Ministers on a panel comprising representatives of leading CSOs and extractive industry companies. The report has been translated and published in Pashto and Dari languages and the public presentation included simultaneous translation with wide reporting on television, radio programmes and in local language press. The representatives of CSOs publicly endorsed the transparency of the report.

The First AEITI Reconciliation Report was printed in numerous copies and has been distributed in English and the two main local languages. The AEITI Secretariat prepared a detailed schedule for distribution of copies to each province of the country, with the number of copies destined for distribution to universities, media centres, regional offices of CSOs and NGOs and Government regional departments including regional offices of MoM. A total of over 3,500 copies of the report have been distributed.

The Second AEITI Reconciliation Report was published in October 2012 and presented in a public disclosure meeting of 13 October 2012 chaired by the Minister of Mines. The Second AEITI Reconciliation Report has been translated in Pashto and Dari languages and is in the process of distribution to the same recipients as the first report.

The two AEITI Reconciliation Reports are publicly available on the AEITI website: www.aeiti.af; the second report is also currently published on the MoM website: www.mom.gov.af

Opinions of Stakeholders

Members of the MSG have expressed satisfaction with the two Reconciliation Reports and have entered discussion of the discrepancies demonstrating their confidence that the reports are clear and set out adequately the principles and results of the reconciliation process.

Validators' Evaluation

Only limited reliance on web-based dissemination of information should apply in Afghanistan, given the relatively limited internet access in many parts of the country, particularly in insurgent or conflict zones. With respect to the AEITI website, internet usage in 2011 is recorded as only 4.2% (from: <http://www.internetworldstats.com/asia/af.htm>).

While a considerable effort has been made to prepare and disseminate paper copies of the report in comprehensible format, the documentation of public debate with respect to EITI in Afghanistan is thus far limited. The Validators were able to take a view, albeit limited by linguistic, travel and communications constraints, of the priorities of national debate during the validation visit. At a time

of acute security and social concerns (e.g. women's rights) it is apparent that the level of debate will be governed to some extent by the intensity of external events. In stakeholder interviews, several of the CSOs asserted that they had organised distribution of reports and pamphlets and initiated debate in some provincial areas. If the dissemination efforts are sustained by the AEITI/MSG and by the CSOs, the Validators consider that an effective level of debate will ensue although still not yet particularly vibrant.

The Validators recommend that targeted briefings are organised for Parliamentarians and also Government officials as a means of furthering the level of public debate.

With respect to the specific items listed for this requirement, a significant issue lies in the absence in the Reconciliation Reports of the listing of all licensed and registered companies involved in the extractive sector. The shortcomings and the need for a comprehensive appreciation of the extractive industries sector have been addressed with respect to Requirement 11, and the need for a database of relevant companies also with respect to Requirement 17.

Taking account of the efforts made to distribute the Reconciliation Reports and feed these into the arena of public debate, the Validators consider that Afghanistan is in compliance with this requirement.

2.19 EITI REQUIREMENT 19

Oil, gas and mining companies must support EITI implementation.

The contact list provided as part of the Validator's Terms of Reference provided details of representatives of three companies (ACCI, Mir Group, MCC-MJAM) who are stated to be members of the MSG and also the contacts for five of the six companies selected to participate in the reconciliation reporting; this represents four companies (Afghan Investment Company – AIC; Khoshak Brothers; Mesaq Sharq; Northern Coal Enterprise) which were additional to the two extractive industry companies in the MSG.

No contacts were provided for the company Wens Logistics, which had been selected to participate in the reconciliation exercise but did not report; investigation by MoM found this company non-compliant in many respects with the terms of its operating licence and the company and its operations had been shut down by MoM before the Validation visit.

Efforts were made to contact each of the identified extractive industry companies, with questionnaires, in advance of the Validator's visit. In the event none of the companies either received the questionnaires or responded to them before the visit. During the visit six of the companies, of which five were reporting in the reconciliation exercise, made themselves available for interview with members of the validation team and the questionnaires were completed during the interviews.

Whereas this requirement aims that all companies operating in the relevant sector should respond, the characteristics of the Afghan extractive industry sector and the difficulties to achieve a response from all operating companies have been discussed in the response to Requirement 11. The evaluation of this requirement is therefore based on the on the response of the six companies selected by the MSG to participate in the reconciliation exercise, and in addition reference is made also to Mir Group, an active member of ACCI, which although not part of the reconciliation exercise, has submitted a company questionnaire.

The company self-assessment forms are attached to this Report as Appendix 3. The responses of these companies to the questions of the self-assessment form are summarised in the following table:

Company	Responses to Questions on Self-Assessment Forms					Comments
	1	2	3	4	5	
Afghanistan Investment Co - AIC	✓	✓	✓	x	✓	Accounts not audited to ISA
Khoshak Brothers	✓	✓	✓	x	✓	Accounts not audited to ISA
MCC-MJAM Consortium	✓	✓	✓	✓	✓	Accounts audited by independent international auditor - KPMG
Mesaq Sharq	✓	✓	x 1387 ✓ 1388 ✓ 1389	x 1387 x 1388 x 1389	x 1387 ✓ 1388 ✓ 1389	Company not producing in 1387; accounts audited by external auditor but not audited to ISA
Mir Group	✓	✓				Member of ACCI; Member of MSG; not included for reconciliation reporting
Northern Coal Enterprise	✓	✓	✓	x	✓	State-owned company; accounts audited only internally; not to ISA
Wens Logistic	x	x	x	x	x	Company closed down by MoM in Sept/Oct 2012

✓ = yes

x = no

From the tabulated summary of responses the following conclusions are apparent and have been the subject of discussion with the individual companies in the interviews during the Validation visit:

- All the companies that have reported have expressed their support for the EITI process. The extent of their public statements has been very much controlled by the normal language in which they perform their corporate business and the media outlets available to them. With the exception of the MCC-MJAM consortium, all the companies carry out their business in local languages and their statements appear limited to their company reports; none have web-sites. All, however, have participated in the public conferences on disclosure of the Reconciliation Reports.
- Five companies submitted reporting templates; Wens Logistic failed to report and Mir Group did not qualify as a reporting company as its total payments to Government are below the materiality threshold. Mesaq Sharq company was founded only in 2008 and was not fully operational in the 1387 financial reporting year, for which it did not report payments; the company submitted compliant statements for the two subsequent periods.

- Only the MJAM consortium employs external auditors who perform in accordance with ISA; all other reporting companies were unable to provide reports based on accounts audited to international standards
- All reporting companies have cooperated in the Validation visit and have made themselves available for meetings and discussion of their reporting templates.

2.20 EITI REQUIREMENT 20

The Government and multi-stakeholder group must take steps to act on lessons learnt, address discrepancies and ensure that EITI implementation is sustainable. Implementing countries are required to submit Validation reports in accordance with the deadlines established by the Board.

With respect to Requirement 5, the Validators have noted that the Country Work Plan is not being used effectively, since May 2012, as a vehicle for planning future activities, for recognising and recording essential steps and corresponding funding needs to ensure the sustainability of the EITI process in the future.

Without an updated Country Work Plan there is no formal documentation of the understanding and commitment of the MSG to undertake measures that ensure effective resolution of discrepancies in the first two Reconciliation Reports and to implement a plan for sustainable continuity of the EITI process.

However, despite the lack of an updated formal Work Plan, there is nevertheless substantive evidence of the recognition that lessons must be learnt from the reconciliation work performed to date and that there should be provision for the next reconciliation exercise. In this respect relevant actions have included:

- A Working Group has held a number of sessions since June 2012, with minutes and records of at least three meetings, which has endeavoured to resolve the discrepancies in the First Reconciliation Report; the meetings have involved representatives of the CSOs in the MSG, the companies for which the reports have been under review and representatives of the reporting Government agencies;
- In an apparently separate exercise, the MoM has reported to the Validators that it has been working to resolve discrepancies and considers that it has now resolved all major issues; it is assumed that this refers only to discrepancies of non-tax payments to MoM;
- The agenda of the MSG meeting of 22 September 2012 indicates discussions on
 - Production of the Third Reconciliation Report and the procurement process of the Reconciler for this report
 - the recommendations made by Moore Stephens and the actions to respond to these
 - The threshold to apply for the next reconciliation exercise, with the intent to increase the number of reporting extractive companies.

While there appears to be a recognition of tasks to be undertaken, from discussions with stakeholders and the agenda of recent MSG meetings, there is an apparent lack of a coherent strategy to learn lessons and improve the level of reporting and diminish areas of discrepancy. This lack of strategy also means that there is no clear evidence that the views of all the constituent parts

of the MSG are incorporated in an approach to learn lessons, develop improved management of the EITI process and monitor performance of the process.

Specific recommendations from the Reconciler which need to be addressed are noted as follows:

- the MSG needs to appoint an appropriate party to continue working with the extractive entities and government agencies to address all unresolved discrepancies highlighted in the reconciliation reports.
- The MSG should appoint a person to oversee the preparation of the reconciliation process prior to submitting the documentation for external reconciliation with adequate workshops and training for all the parties involved.
- The audits of the extractive companies need to be carried out according to the International Standards on Auditing.
- A report on the conclusion of the Reconciliation Report should be issued to the extractive companies and to the Government agencies that highlights the common reasons for discrepancies and action plans to resolve them. The report should also include the type of evidence that was used to resolve the discrepancies.
- The MSG should organise more seminars and training sessions for participants in the reconciliation process.

Progress in responding to these recommendations is summarized as follows:

- During the preparation of this report a member of MoF has shown draft terms of reference which have been prepared for an independent audit and report on the process of clarification of discrepancies already performed by MoM, representatives of MoF and members of MSG. These ToR have been finalized and issued and the Secretariat reports an independent auditor has been appointed, but with reference to the Work Plan, no specific funding has yet been allocated for this task. Nevertheless it is apparent that the MSG is endeavouring to ensure that unresolved discrepancies can be identified and publicly explained.
- To date no specific person has been appointed to oversee the preparation of the reconciliation process. The Validators note that during the latter part of 2010 and the early part of 2011 there was a Financial Specialist attached as a permanent officer of the AEITI Secretariat. This person has since departed but there appears to be no policy or plan to fill this post.
- The lack of recognized audit standards applied to the financial accounts of the extractive industry companies reflects a much wider problem of audit process and standards at national level. The new contracts let to international tender all demand compliance both with EITI and the submission of reporting information audited to international standards. It is apparent, as noted with the mining company MJAM, that companies with the resources to compete in international tender have an understanding of financial management and international standards of audit and are able to comply without difficulty. The problem is however much greater with respect to smaller and medium-sized companies, nearly all of whom are Afghan companies operating and reporting in local language with their commercial base in the provinces, sometimes with low standards of financial management

and with a poor understanding of the demands of the audit process and with limited access to practicing auditors. The Minerals Law under which these latter companies operate requires that holders of mineral rights present balance sheets in accordance with IAS, but clearly the majority of companies covered by this law are unable to comply with this requirement.

- There are currently no steps to prepare a comprehensive internal report, to Government agencies and extractive companies which participated in the reconciliation, on the conclusions of the reconciliation process and the reasons for discrepancies. However, the draft ToR referred to in the first paragraph above indicate the intent to achieve an independently audited public statement on the reasons for the identified discrepancies.
- While there has been a programme of training throughout the period of the reconciliation reporting, this has been of a more general nature, and to a large extent focused on members of the AEITI Secretariat and members of the MSG. There have been only limited efforts to provide training and capacity building directed specifically to the entities, Government agencies and extractive sector companies, which must report in the reconciliation process. In particular, in the medium-sized private sector companies there appears to be a profound need for further comprehensive training in the requirements of the EITI process and the reconciliation reporting.

3 TABLE SUMMARISING THE EVALUATION

Requirement		Met or Unmet?
SIGN-UP		
1.	The government is required to issue an unequivocal public statement of its intention to implement the EITI.	✓
2.	The government is required to commit to work with civil society and companies on the implementation of the EITI.	✓
3.	The government is required to appoint a senior individual to lead on the implementation of the EITI.	✓
4.	The government is required to establish a multi-stakeholder group to oversee the implementation of the EITI.	X
5.	The multi-stakeholder group, in consultation with key EITI stakeholders, should agree and publish a fully costed work plan, containing measurable targets, and a timetable for implementation and incorporating an assessment of capacity constraints.	X
PREPARATION		
6.	The government is required to ensure that civil society is fully, independently, actively and effectively engaged in the process.	X
7.	The government is required to engage companies in the implementation of the EITI.	✓
8.	The government is required to remove any obstacles to the implementation of the EITI.	X
9.	The multi-stakeholder group is required to agree a definition of materiality and the reporting templates.	✓
10.	The organisation appointed to produce the EITI reconciliation report must be perceived by the multi-stakeholder group as credible, trustworthy and technically competent.	✓
11.	The government is required to ensure that all relevant companies and government entities report.	X
12.	The government is required to ensure that company reports are based on accounts audited to international standards.	X
13.	The government is required to ensure that government reports are based on accounts audited to international standards.	X
DISCLOSURE		
14.	Companies comprehensively disclose all material payments in accordance with the agreed reporting templates.	X
15.	Government agencies comprehensively disclose all material revenues in accordance with the agreed reporting templates.	X
16.	The multi-stakeholder group must be content that the organisation contracted to reconcile the company and government figures did so satisfactorily.	✓

Requirement		Met or Unmet?
17.	The reconciler must ensure that that the EITI Report is comprehensive, identifies all discrepancies, where possible explains those discrepancies, and where necessary makes recommendations for remedial actions to be taken.	X
DISSEMINATION		
18.	The government and multi-stakeholder group must ensure that the EITI Report is comprehensible and publicly accessible in such a way as to encourage that its findings contribute to public debate.	✓
19.	Oil, gas and mining companies must support EITI implementation.	N/A
20.	The government and multi-stakeholder group must take steps to act on lessons learnt, address discrepancies and ensure that EITI implementation is sustainable. Implementing countries are required to submit Validation reports in accordance with the deadlines established by the Board.	N/A

✓ = met

X = not met

4 SCOPE OF AEITI PROCESS

4.1 ENGAGEMENT BY CIVIL SOCIETY ORGANISATIONS

Representatives of CSOs have been closely engaged in the development and process of implementation of the AEITI since its inception.

Afghanistan presents unique challenges for representation of Civil Society at national level, reflecting the security situation and the significant area of the country where Government authority is not exercised, linguistic and tribal divisions, issues of women's rights, tortuous terrain and the difficulties of communications. Despite these difficulties, a considerable number of CSOs have been identified who have been either directly or indirectly associated with the EITI process; nine CSOs were contacted as part of the Validation visit, of which eight were available for interview.

In this report, the Validators have commented on the arrangements for formal representation of CSOs in the MSG and in particular the organisation of the Civil Society Coalition as the medium to arrange this representation. Nevertheless, minutes have been inspected which demonstrate the active and committed interest of the members of the Civil Society Coalition, independently of the MSG, to progress the AEITI process.

The interviewed representatives of CSOs, nine individuals, all affirmed the activity of the CSOs in the dissemination of information on the EITI process and in the distribution of pamphlets and more recently, the copies of the two Reconciliation Reports.

Other members of the MSG, including representatives of Government agencies, the ACCI and the AEITI Secretariat are all positive regarding the important and essential contribution of the CSOs in all stages of the EITI process achieved to date, as is confirmed by inspection of the minutes of the MSG and its Working Groups.

4.2 ENGAGEMENT BY EXTRACTIVE INDUSTRY COMPANIES

The extractive industry sector of Afghanistan is undergoing important change as the Government lets to tender a number of major resource exploitation projects for mineral and hydrocarbon exploration and extraction. These international tenders will see the entry into Afghanistan of major international companies, from a diverse range of political and commercial cultures. Nevertheless, the Government, through existing legislation and new and transparent contracts, can ensure that such new entrants comply with the standards of AEITI. The response of the earliest international entrant to the mining sector, the MJAM-MCC consortium, is encouraging and indicative that new entrants to the sector will welcome and embrace the commitment to transparency implicit in compliance with AEITI.

The traditional profile of extractive industries in Afghanistan, in quarrying and mining, is of small and medium scale companies, with limited resources and capability in terms of trained administrative personnel. Many of these companies are, on paper, relatively new. The Validators consider that the greatest challenge to achieve widespread engagement of extractive industry companies resides in the involvement of the small and medium scale companies.

An important consideration has been expressed in the Baseline Study Report – Reclusive Resources³, contracted by the AEITI MSG:

“A general trend observed during the course of this research project was the irrelevance of documented law to actual extraction. Most executives and officials of local mining companies declared ignorance about the provisions of the Minerals Law. At best, quarry owners and mining license holders were somewhat familiar with the terms of the license and/or authorisations they had secured from MoM..”

It should be noted that the above observation relates only to the 10 provinces in which there was sufficient security and Government control for the survey to be performed. It can be assumed that there is a considerable volume of quarrying and mining being carried out in areas which are only superficially under Government control and in other areas which are outside this control.

There is clearly a great challenge for the Government and specifically the MoM to exert control and influence over a large sector of extractive industry purely for the purposes of administration and regulation of the sector.

This may explain the major disparity between those companies identified in the AEITI reconciliation exercise, apparently with difficulty, as making payments to Government, in contrast to the much larger number of contracts recognised by MoM as reflecting mineral extraction activity.

The companies which have participated in the EITI reconciliation exercise all apparently operate within areas of effective Government control, around Kabul and in the north and east of the country. These comprised five medium sized companies, excluding the international; company MJAM-MCC, and of these one was stated-owned (Northern Coal Enterprise). Of the four private sector medium-sized companies, one did not respond in the reconciliation process and was found to be comprehensively non-compliant with the Minerals Law and has since been closed down.

The three private sector medium-sized companies which responded in the reconciliation exercise have all expressed and demonstrated explicit support and engagement in the AEITI process. Similarly, ACCI, which represents a number of smaller and medium-scale extractive industry companies in the area of Government control is highly supportive and closely engaged in the AEITI process.

While there is clear evidence of the commitment of the Government to promote and ensure engagement of the extractive companies with the process, the extent of this engagement may be summarised in the following observations:

- The posture of the first of the larger international extractive industry companies is encouraging and suggests that there will be a high level of engagement with the AEITI programme by new entrants in this sector

- The administration and regulation of small and medium-scale companies, to ensure compliance with the Minerals Law and Mining Regulations, is clearly only partly effective even in areas under Government administration. Where such companies operate without compliance with the legal and regulatory framework there can be no expectation of their recognition of the AEITI. In contrast, where small and medium-scale companies operate in compliance with the legal and regulatory framework, there appears to be a clear understanding and engagement with the AEITI process, as understood with interviews with such companies
- There appears to be a significant level of extractive industry activity, in quarrying and mining, in areas which are either outside the area of effective Government control or where there is only superficial enforcement of the legal and regulatory framework, and in these areas there is likely to be no understanding of EITI.

4.3 IMPACT OF AEITI WITH REGARD TO DISCUSSIONS WITH STAKEHOLDERS

There is wide and general agreement expressed by all stakeholders interviewed during the validation process, including MSG members, other members of Government agencies, private sector companies, CSOs and international observers, that the AEITI has generated a major impact on the national debate on transparency and the fight against corruption.

The stakeholder interviews have also underlined the recognition, by virtually all parties, of the rather unique challenges facing Afghanistan which impact on the reach of the AEITI process in terms of communication to Civil Society equally in all parts of the country and of the compliance of the extractive industries sector, notorious for unregulated activity in remote and inaccessible areas.

Despite these difficulties, a number of the stakeholders referred to this being one of the few messages of practical action to demonstrate a commitment from Government to transparency, and by extension, to combat corruption. There was a general and strongly expressed opinion that this process must continue with vigour, as a building block for good governance in Afghanistan.

4.4 SUSTAINABILITY OF THE PROCESS UNDER DISCUSSIONS WITH STAKEHOLDERS

While it was strongly expressed by all interviewed stakeholders that the AEITI process should continue, and no practical constraints were identified for its sustainability, nevertheless the Validators identify a relatively superficial appreciation of the steps necessary to ensure that the process is sustainable. For example, no particular concerns were expressed with respect to the functionality of the MSG and the initiatives that it must continue to generate, nor with respect to the Work Plan, which has not been updated for future actions and the necessary funding has not been identified.

The Validators offer the opinion that this may be a reflection of a society in which many initiatives are driven by donor aid, giving the impression that there is no shortage of funds and policy initiatives are sometimes driven by the agenda of the donor agencies.

Review of the minutes of the MSG indicates that many of the initiatives and programmes for compliance by AEITI are driven by the enthusiasm and commitment of a small number of senior

officials in Government, transmitted through the AEITI Secretariat. In other words the MSG is not yet functioning as an entity with its own momentum and initiatives, and correspondingly is more often responding to initiatives suggested externally. In this case, sustainability is more heavily dependent upon the objectives of a few individuals in Government agencies rather than the MSG.

The Validators have commented above (see Requirement 4 and Requirement 6) with respect to the need for the CSO constituency of the MSG to be more forceful in its overview of the business and governance of the MSG and for driving the agenda of the MSG for compliance with the long term objectives of the AEITI.

Discussions with some stakeholders have identified concerns regarding the role and resources of the AEITI Secretariat. It is clearly the case that at the time of most productive activity of the MSG, during 2011, the Secretariat staffing comprised a National Coordinator, Deputy National Coordinator, Communications Specialist and a Financial Specialist, in addition to an administrative manager and support staff. At the time of the Validation visit, this had shrunk to the National Coordinator alone, with support of the administrative manager and staff. It was apparent that in part the replacement of staff, and the staff selection process, was subject to review and interference by the donor organisation which had assumed the responsibility for financing the staffing and administration of the Secretariat. This situation needs to be redressed with secure funding for the Secretariat, without the intervention of external agencies.

4.5 ACTIONS AND INNOVATION OF THE MSG GOING FURTHER THAN THE EITI REQUIREMENTS

To date the actions of the MSG have been driven primarily by the aim of compliance with the requirements of the EITI Principles and the EITI Rules.

As a reflection of the difficulty of assessing the actual status of the mining industry across the country, the AEITI MSG engaged a Baseline Study Report³: Reclusive Resources – Afghanistan’s Mineral Wealth and the Imperative of Formalization and Transparency, prepared by Qara Consulting Inc., October 2011.

Although not a direct initiative of the MSG, the active participation in the EITI process by the Minister of Mines and representatives of MoM on the MSG is reflected in extensive briefing and discussion of the policy and initiatives of the MoM, amongst which the publication of all mining contracts, licenses and authorisations on the MoM website figures in a number of the minutes of the MSG. In a similar collaboration, members of the MSG have attended the public opening of tenders for new mining contracts.

5 CONCLUSIONS

5.1 GENERAL EVALUATION OF THE IMPLEMENTATION OF EITI

5.1.1 PROGRESS AND COMPLIANCE

Of the 18 assessed requirements, 8 have been met while the remaining ten are in a state of more or less proximity to completion. Specifically three of the unmet requirements are assessed as close to compliance although requiring a focussed initiative to achieve compliance.

Review of the ten unmet criteria indicates that they can be considered in three categories:

- Those that can be readily resolved by attention to issues of focus and internal governance. It is this group of Requirements which are considered to be near compliance- Requirement 4, Requirement 5 and Requirement 6. As commented further below, the core issue for these requirements is that the MSG needs to be reinforced with a clearer constitutional framework, ensuring a more forceful contribution from the CSO constituency and a recognition of the responsibilities of the MSG, in particular with respect to the Work Plan. In addition Requirement 17 remains unmet in part because the MSG did not exert its management responsibilities for the reconciliation process, to ensure that discrepancies were clearly identified and explained in the Reconciliation Report and that steps are taken to implement the Reconciler's recommendations.
- Those that can be relatively readily resolved, either in part or in full, by Government action, which is currently pending or held up. This refers to Requirement 8, Requirement 11, Requirement 13 and Requirement 15. For Requirements 8 and 13, draft law, respectively the amended Minerals Law and the Audit Law, are reportedly in the process of discussion prior to submission to Parliament, and once implemented will represent a significant step to resolving these requirements. There are other areas in which an energetic initiative from Government agencies is required and can be considered readily achievable:
 - Effective management of the Cadastre function of MoM, with an effective database of companies operating in the extractive industries sector, with clear definition of their role (exploration, exploitation, value-added downstream processes, trading of mineral products) where they generate payments recorded by MoM. This will assist compliance with Requirement 8 and Requirement 11 and provide a basis for discussion and clarification for any companies that may be considered exempt from participating in the reporting and reconciliation exercise
 - A serious and committed approach to the submission of reports from Government agencies, taking account of the recommendation by the Reconciler, that even where there are questions as to the audit process in Government agencies, whether managed by internal audit departments or the CAO, there should at least be a clear statement of the audit process applied to the reported figures. A significant number

of discrepancies have occurred in the published Reconciliation Reports which refer to apparently incomplete reporting by the Government agencies, which remain to be resolved.

- Those that reflect the level of development in Afghanistan generally and the unique challenges presented by its post-conflict history and continuing security situation. These are issues which will probably require longer-term initiatives to meet completely the criteria for compliance. This refers in particular to Requirement 11, Requirement 12 and Requirement 13. There are clearly extractive industry operations taking place in parts of the country where Government control is inadequate to ensure compliance with reporting obligations. Even within areas of Government control, the failed experience of obtaining reports from Wens Logistics illustrates difficulties which may be encountered. Related to this is the level of financial management competence in many extractive companies through the country, particularly those of medium scale. The absence of professional bodies, with corresponding standards covering accountancy and audit, is a major constraint on the accessibility of competent financial management professionals and of independent audit services. As a separate issue, the audit process for Government agencies and the role of the CAO is under review with international agencies and it is likely that adequate resolution will require a time scale of years.

One requirement, Requirement 14, remains unmet primarily because of the continuing existence of unresolved discrepancies in the Reconciliation Reports, to the extent that it is not possible to determine compliance with a level of discrepancy which may be from company or Government reporting.

5.1.2 OVERALL ASSESSMENT OF PROGRESS

In the opinion of the Validators, the overall assessment of progress towards EITI compliance must be judged against the recent history of Afghanistan and the challenges the country continues to face. Effective parliamentary Government can be considered to have been established only since 2004, and much of the legislation upon which the principles of EITI must be based has been enacted only since that date. Furthermore, the mountainous terrain, tortuous lines of communication, linguistic diversity, ethnic and tribal divisions and the existence of areas of insecurity, some of which are outside Government control, present particular problems to maintain the rule of law and for effective outreach and dissemination of information.

Against this background, the effort and achievements in aiming for EITI validation have been energetic and committed and are worthy of recognition. There is undoubtedly a range of remaining issues which must be resolved before compliance with EITI validation is achieved, and the challenge for the AEITI MSG and the Government is to maintain the level of energy and commitment, with a clear focus on what steps need to be taken both in the short term and to achieve a long-term sustainable process.

With respect to those issues, identified above as requiring longer-term initiatives to achieve full compliance, the Validators offer the opinion that there is need for clear recognition by AEITI MSG and the Government that these issues exist and that there is a need to put in place a clearly defined

and measurable strategy to achieve milestones and deliver compliance. This level of commitment could then be judged as part of sustainable performance of the EITI process in to the future.

It is relevant also to note the opinions of donor agencies and independent international observers (e.g. World Bank, U.S. Embassy) that the EITI process has been an important, high impact influence on good governance and that every effort should be made to ensure that the process continues.

5.2 LESSONS LEARNT FROM THE IMPLEMENTATION OF THE PROCESS

1. Time management for the procurement process for engagement of Reconciler and Validator

The delayed completion of the Validation process, with respect to the original Work Plan, has generated a number of consequences, of which the most important is the loss of momentum in the AEITI process during 2012, with lack of attention to the Work Plan and consequent lack of planning for sustainable future continuity of the process.

A major contributory factor to the delayed validation stage has been the difficulty to engage a Reconciler and a Validator to complete their respective tasks given the current security climate in Afghanistan. The lesson is that the planning and time allocation of the procurement process, where third party external services are required, must take account of the need for sufficient negotiation time, and if necessary the need for re-issued calls for Expressions of Interest.

2. Proactive assistance to companies to assist completion of reporting templates

The Reconciler's Reports of the process for gathering of information from the companies makes clear the effort that was required to obtain adequately completed reporting templates with supporting information. The Reconciler was fortunate to count on the services of an energetic and proactive representative in Afghanistan, who was able and willing to make, sometimes, several visits to the local offices of the reporting companies to ensure that adequate information was submitted.

This reflects the relatively poor level of financial management in the medium scale companies and the difficulties for effective communication to companies whose corporate business is almost entirely carried out in local language. While, on this occasion the proactive contact with the companies was made by the local representative of the Reconciler, this is an area in which well-focussed outreach and assessment of capacity constraints on behalf of the AEITI would facilitate a more complete and better supported level of reporting by the companies.

5.3 RECOMMENDATIONS

The following recommendations are offered as important steps to strengthen the AEITI and facilitate its progression to compliant validation:

1. The constitutional framework of the MSG needs to be reinforced through a new MoU and TOR) There should be clear identification of those who are members of MSG, to ensure that there is certainty that members receive notifications of meetings and discussion & other

papers, and that voting rights are protected.,Members should have a clear responsibility to communicate beyond their representative constituency; and the MSG needs to clarify its stated intention to involve representatives each of academia and the media and how this will be achieved

2. The relationship between the MSG, with ultimate responsibility for the AEITI process, and the AEITI Secretariat, as a supporting function to facilitate delivery, requires clarification with appropriate clear documentation
3. The role of CSOs within the MSG needs to be strengthened. This is in part a matter of training and capacity building, so that MSG representatives are able to contribute knowledgeably and effectively to debate inside and outside the MSG. Equally, the basis for selection of representatives needs to be open and clearly set out, and there needs to be continuity in representation (i.e. nominated representatives) with adequate communication of MSG discussions to civil society, and the inclusion of wider civil society concerns relating to the extractive sector in MSG discussions.
4. The MSG must recognise their responsibility for maintenance and regular review of the Work Plan as a tool for planning sustainable and measurable continuity of the EITI process
5. The MSG must undertake a comprehensive Assessment of Training and Capacity Building Needs. Training to date has been relatively unstructured and directed primarily to members of the AEITI Secretariat and MSG. A wider focus of this assessment would be to review what training would benefit those individuals in the reporting companies and Government agencies to achieve a more robust and better documented level of reporting.
6. The MSG Communications Strategy requires review and update, with particular focus on determining what needs to be communicated to the wider society in Afghanistan on the AEITI process, who will deliver this communication and how the effectiveness of this communication effort can be assessed
7. The AEITI Secretariat needs to be supported to a level that ensures continuity of personnel and that all key posts are filled by suitably qualified personnel. Staffing levels and the selection of personnel should not be left to the vagaries of individual donor agencies,
8. The AEITI Secretariat requires the post of a Financial Specialist to be re-staffed, to fulfil one of the Reconciler's recommendations, for an individual to take personal responsibility for management of the template reporting process, noting capacity constraints were these affect comprehensive response for the templates.
9. The AEITI Secretariat requires the post of a Communications Specialist to be re-staffed.
10. The MoM should assist the more comprehensive implementation of the EITI process by ensuring the Cadastre function maintains an effective database of all companies operating in the extractive industries and liable to make payments to Government, identifying clearly the scope of the business (e.g. exploration, exploitation, value-added processing of mineral products, trading of mineral products); this will ensure that informed decisions are made with respect to those companies that should be reporting in the reconciliation process and

should clarify any doubts as to reasons why some companies may not be reporting in the process

11. The two sponsoring ministries of the AEITI process, MoF and MoM, should clearly identify those issues which are essential for successful implementation for the EITI process and in which proactive Government initiatives are required to promote solutions and remove obstacles. Specific issues in this category are the need for enactment of the amended Minerals Law and of the new Audit Law; related to the latter is the need to establish and promote an independent professional body for accounting and audit professionals with corresponding standards. A clearly stated objective and strategy to achieve the objective will be an important element of achieving validation.
12. The shortcomings of the Government audit process and the role of the CAO have been the focus of other internationally supported initiatives in Afghanistan. It will be appropriate that this is identified by the ministries sponsoring the AEITI process, with appropriate strong representation in Cabinet that the Government audit process is identified as a potential constraint on achieving validation.
13. In line with the recommendation of the Reconciler, it is important that the outstanding discrepancies from the first three reconciliation exercises (First and Second Reconciliation Reports) are clearly and publicly resolved, and that this is signed off through an independent third party audit

6 APPENDICES

6.1 APPENDIX 1 COPIES OF WORK PLANS FOR 2009-2012

6.2 APPENDIX 2 TIME-LINE RECORD OF KEY AEITI ACTIONS AND EVENTS 2009 - 2012

6.3 APPENDIX 3 COLLATED COMPANY FORMS

6.4 APPENDIX 4 LIST OF RESPONDENTS AND INTERVIEWEES

¹ Summaries of Important Areas for Mineral Investment and Production Opportunities of Nonfuel Minerals in Afghanistan (Peters, King, Mack & Cormack, editors). USGS Open-File Report 2011-1204

² Assessment of Undiscovered Petroleum Resources of Northern Afghanistan, 2006. USGS Fact Sheet 2006-3031

³ Reclusive Resources: Baseline Study Report on Afghanistan's Mineral Wealth and the Imperative of Formalization and Transparency. Prepared by QARA Consulting Limited under contract to AEITI Secretariat. October 2011

⁴ Hadjigak- The Jewel of Afghan Mines. Working Paper prepared by Integrity Watch Afghanistan, July 2011

⁵ A Review of the Consistency between Afghanistan's Tax and Mining Laws. Report prepared for the Ministry of Finance and the Ministry of Mines of the Government of the Islamic Republic of Afghanistan. Adam Smith International, November 2011

⁶ Afghanistan's Control and Audit office requires operational and budgetary independence, enhanced authority and focused international assistance to effectively prevent and detect corruption. Paper prepared by Office of Special Inspector General for Afghanistan Reconstruction, 09 April 2010.