**AFGHANISTAN RECONSTRUCTION TRUST FUND**

**AFGHANISTAN RURAL ENTERPRISE DEVELOPMENT PROGRAM (AREDP)**

**Proposal to the ARTF Management Committee**

**For Approval of US$16 million**

**MC Meeting Date: August 10, 2010**

<table>
<thead>
<tr>
<th>Applicant:</th>
<th>Islamic Republic of Afghanistan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brief Description:</td>
<td>The Afghanistan Rural Enterprise Development Project (AREDP) seeks to enhance the participation of the rural poor in economic activities by supporting them through business development services, access to finance, and improving market linkages and value chains. An IDA grant of SDR 19 million (US$ 30 million equivalent) was approved by IDA on March 9, 2010. The grant was declared effective on June 14, 2010. The total project cost is US$ 87.2 million. ARTF funding support is part of the project financing plan.</td>
</tr>
<tr>
<td>Project Development Objective:</td>
<td>The overall development objective of the project is to “improve employment opportunities and income of rural men and women, and sustainability of targeted local enterprises.”</td>
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<tr>
<td>Performance Indicators:</td>
<td>The key performance indicators are as follows:\n- 70% of the Enterprise Groups (EGs) will have increased their net revenues by over 50%. At least 35% of these will be female EGs.\n- At least 30% of participating small and medium enterprises (SMEs) and EGs will have increased direct and/or indirect employment by at least 30%. Of these at least 35% will be women.\n- On an average, SMEs will report at least a 50% increase in purchase of inputs from rural areas.\n- 50% of EGs supported by the project will still be operating two years after start up. At least 35% of these will be female EGs.</td>
</tr>
<tr>
<td>Sector:</td>
<td>Rural Development</td>
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<tr>
<td>Project Area:</td>
<td>Six provinces: Balkh, Herat, Nangarhar Parwan, Bamyan, Badakhshan</td>
</tr>
<tr>
<td>Total Project Cost:</td>
<td>US$87.2 million</td>
</tr>
<tr>
<td>World Bank/IDA</td>
<td>US$30 million</td>
</tr>
</tbody>
</table>

1 The results framework with project intermediate outcome indicators is attached as Annex 1.
<table>
<thead>
<tr>
<th>Financing:</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Amount Requested from ARTF:</td>
<td>US$16 million</td>
</tr>
<tr>
<td>Implementing Agency:</td>
<td>Ministry of Rural Rehabilitation and Development (MRRD)</td>
</tr>
<tr>
<td>Implementing Period:</td>
<td>June 2010 – January 2015</td>
</tr>
</tbody>
</table>
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| Reviewed and Cleared by the Administrator: | Loan Department; Legal Department; Procurement, Financial Management, Country Management and Sector Management Units |
I. Introduction

1.1 An IDA grant (H 531) of SDR 19.0 million (US$ 30 million equivalent) for the Afghanistan Rural Enterprise Development Project (AREDP) was approved by the IDA Board of Executive Directors on March 9, 2010; the grant became effective on June 14, 2010.

1.2 The estimated cost of AREDP is US$87.2 million, over a five year period. The project’s financing plan envisages ARTF and bilateral support of US$ 57.2 million to cover the balance project funding requirement. The project will operate in six provinces of Afghanistan – Bamyan, Parwan, Badakhshan, Herat, Balkh and Nangarhar.

1.3 This application seeks the approval of ARTF funding support of US $ 16 million to co-finance project expenditures pertaining to goods, works and consultants’ services for the Project Management Office (PMO) and Provincial Offices (POs); capacity building and training of project staff; community mobilization, training and development of action plans for the Enterprise Groups (EGs), Savings Groups (SGs) and Village Savings and Loans Associations (VSLAs).

1.4 Current Status: The Project Management Office (PMO) in Kabul and Provincial Offices (POs) in Bamyan, Parwan and Nangarhar were established during the project preparation (November 2008-June 2010), using an IDA Project Preparation Advance (PPA) of US$1.12 million and Danish bi-lateral support. Staffing of the PMO and the POs has been ongoing. Key positions at the PMO in the Executive Directorate, Operations, Procurement, Finance and Human Resources units have now been filled. Three international Technical Advisors (TAs) have also been recruited to support the Procurement, Finance and Operations units. The project has also initiated the process of procuring various consultancies, including for carrying out the Provincial Situational Analysis, training of provincial staff, and administering the Partial Risk Guarantee Facility (PRGF). It is expected that the selection of firms for these consultancies will be completed by end-October 2010.

1.4 AREDP has also developed an Annual Work Plan and Budget for Solar Year 1389, which has been reviewed and approved by the World Bank. A Project Procurement Plan (PPP) for SY 1389-90, indicating the source of funding (IDA or ARTF) has also been prepared and approved with the World Bank. A Designated Account (DA) for the IDA grant has been opened and an initial deposit of US$1.4 million received. A separate DA for the ARTF funds will be opened after the approval of this application.

1.5 Using the PPA, the AREDP design was piloted in Bamyan and Parwan provinces. To date, 123 female SGs and 121 male SGs have been formed in Parwan; and 114 female SGs and 103 male SGs have been formed in Bamyan provinces, respectively. All SGs have started saving on a weekly basis; and those in Parwan have also started inter-group lending. So far, out of a total of 50 submitted loan applications, 30 have been approved. With regards to EGs, 36 were formed in Parwan; mainly related to milk production, poultry raising, saffron production, and handicrafts.
A number of key lessons were learned from the pilots implemented in the two provinces. These include: (a) AREDP needs to coordinate its activities with those of other development organizations working in the same areas; (b) having more than one household/family member and/or Village Facilitator in the same SG and/or EG group is unacceptable by communities, due to conflict of interest; (c) a weekly saving threshold of Afs.10 is relatively low, hence some SGs have voluntarily raised it to Afs.30 per week; (d) Islamic lending products are more acceptable in rural Afghanistan than the conventional products proposed under AREDP; (e) properly trained Provincial Enterprise Facilitators (PEFs) are critical to the sustainability of EGs, which require support not only for community mobilization, but also technical skills; and (f) books of record need to be further simplified, since majority of SG members cannot read and write. These lessons-learned will be incorporated into project implementation in the remaining provinces.

II. Strategic Context and Rationale

Key Development Issues

2.1 Over 75% of the people of Afghanistan live in rural areas where agriculture is the primary activity and contributes about one third of the GDP (excluding the opium economy). However, poor governance, weak factor markets, inadequate marketing infrastructure and business development services, and poor post-harvest practices are limiting the economic development potential of this sector and constraining on-farm and non-farm employment opportunities, thus perpetuating poverty in the rural areas. The following are the key issues and challenges:

(a) Poverty and Vulnerability remains widespread. Key findings of the Government’s SY 1386 (2007) National Risk and Vulnerability Assessment (NRVA) indicate that the poverty rate is 42% (approx. 12 million people), with per capita incomes of about US$ 14 per month.

(b) Economic Slowdown and Increasing Insecurity: Afghanistan’s economy as a whole has registered robust growth rates in recent years. These figures, however, largely reflect the booming construction and trade related activities in urban areas and the steep rise in the products of narcotics. There has been little growth of enterprise related activities in rural areas, and most people still live on subsistence farming. Even where the country could be self-sufficient in agriculture products, vast quantities of food and other easily manufactured daily use items are imported, while the export sector remains small and undiversified. Furthermore, the economic and security situation has been particularly challenging since 2008, due to rapid increase in food and fuel prices and sharply increased violence in some provinces.

(c) Spread of Opium Poppy: In conditions of lawlessness and impoverishment, the cultivation of opium poppy has become Afghanistan’s leading economic activity, with the opium economy accounting for more than one-third of estimated total (drug-inclusive) GDP.

(d) Weak Institutions: Unlike many other countries, the incentive structure for agriculture in Afghanistan is largely market driven. As a result, there are no major distortions arising from input subsidies, price support policies, or trade restrictions. The main challenge is
weak institutional capacity. Both public and private sector institutions lack the physical infrastructure, necessary regulatory framework, and the skilled staff to build a modern and competitive agricultural sector.

(e) **Lack of Access to Finance and Poorly Functioning Factor Markets:** There is no formal financial intermediation in rural Afghanistan. Traditional sources (such as moneylenders, family, and friends) and NGO-led micro-finance initiatives under the Micro-Finance Support Facility of Afghanistan (MISFA) are currently the main sources of credit. Years of conflict have also disturbed tenure security, including farm and pasture rights, and weakened the ability of administrators or courts to uphold rights fairly. Furthermore, outreach of formal finance and lending in the SME sector (particularly those focused on manufacturing and value-adding activities with backward rural and agricultural linkages) has been inadequate. Commercial banks have begun operations in the major cities of the country, while mobile telephone-based financial services, which could extend services to smaller towns, have recently begun. However, it will likely be many years before they reach rural Afghanistan.

(f) **Shortage of Business Expertise:** A key obstacle to private sector growth is a shortage of business expertise and knowledge-based business training support, in particular, technical, business management and financial management.

**Government Strategy and Rationale for ARTF Support**

2.2 The Government of Afghanistan National Development Strategy (ANDS) envisions “A society of hope and prosperity based on a strong, private-sector led market economy, social equity and environmental sustainability.” The ANDS strategic vision for the Agriculture and Rural Development (ARD) sector is to ensure the social, economic and political well-being of rural communities, especially the poor and the most vulnerable, while stimulating the integration of rural communities within the economy. The strategy also emphasizes attracting private sector investment to transform agriculture to a high value commercial sector as a source of growth and expansive means of livelihood. Investments to generate alternative livelihoods have been considered key, and the ARD Strategy sets out a series of investments/projects designed to improve the quality of life and provide alternative livelihoods to the rural population. AREDP is listed as one of the projects in the ANDS and has been presented at the Kabul Conference\(^2\) as one of the priorities of the Agriculture and Rural Development Cluster.

2.3 **Rationale for ARTF support to AREDP.** To date, ARTF has played an important role in assisting reconstruction and development of Afghanistan. ARTF has supported a number of national priority projects and programs. Given the magnitude of needs and the overall importance of the ARD for growth and poverty reduction, ARTF will continue to support the Government of Afghanistan’s (GoA’s) priorities for agriculture and Rural Development. Support to AREDP is closely aligned with the financing strategy of ARTF endorsed by the GoA and ARTF donors.

**III. Project Description**

\(^2\) The Kabul Conference took place in July 20, 2010.
3.1 **Project Objective.** The overall development objective of the AREDP is to “improve employment opportunities and income of rural men and women; and sustainability of targeted local enterprises.” This will be achieved by enhancing participation of the rural poor in economic activities, supporting them through business development services and access to finance, and improving market linkages and value chains.

**B. Summary of Project Components**

**Component A: Community-led Enterprise Development (US$37.35 million):** This component aims to create Savings Groups (SGs), Enterprise Groups (EGs) and Village Savings and Loans Associations (VSLAs). These institutions will be assisted to build their own capacities, increase the value of trading, ensure production is oriented towards identified market opportunities, and create access to credit. The project will support approximately 6,500 EGs, comprising approximately 52,000 people3, of whom at least 18,000 (35%) will be women. This Component has three sub-components as follows:

**A1. Community Facilitation:** This sub-component will facilitate the formation and functioning of SGs and EGs within each community, so that men and women who engage in income generating activities can collectively access technical expertise, markets and eventually finance. Through facilitation of good governance practices, the project will ensure that these groups are inclusive, participatory and accountable in nature. AREDP’s entry point will be through the Community Development Councils4 (CDCs), and where possible will build on existing groups and institutions, e.g. Self Help Groups (SHGs), Common Interest Groups (CIGs), Cooperatives etc. The Project will finance male and female Village Facilitators (VFs) in equal numbers, who will be trained and linked to the provincial offices via Internet-capable mobile telephones, and who will work in their own communities. The project will also appoint Provincial Enterprise Facilitators (PEF), who will operate across communities.

**A2. Support to Enterprise Groups:** This sub-component will aim to maximize the economic potential of rural entrepreneurs to improve market access, deliver technical knowledge, raise basic business skills and leverage economies of scale to increase the value of their sales. The project will facilitate a sequenced process to build EGs’ commercial knowledge and enable them to effectively articulate their needs and to identify opportunities. EGs will thus be able to access generic and specialized trainings and other support needed to create, expand and improve their business (e.g. support to carry out their own market research, make study visits to understand business models that they want to replicate). AREDP will deliver training and support services, embedded business development services (i.e. trainings provided by traders, buyers, processors, inputs, suppliers), and through acknowledged local specialists on specific enterprises.

EGs’ growth and progress will be monitored in terms of their aggregate increased sales, net cash flow to the community, and the number of people actively engaged in the supported enterprises. The likely long-term sustainability of the EGs will be gauged by their ability to raise and repay loans, formulate business plans, develop marketing options and have robust institutional capacity. Where applicable and viable, PEFs will promote the formation of Producer

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3 On average 8 persons per EG
4 CDCs are elected representatives of the community, formed under the National Solidarity Program.
Associations (PAs). PAs will be formed by several EGs coming together around a common economic activity for reasons of aggregating demand and supply to eventually become better market players.

**A3. Access to Finance:** This sub-component will create VSLAs, formed from federated SGs, to address the financial needs of EG members for business investment. The project will support and train SGs with an aim to generate savings and carry out internal lending with a repayment rate of no less than 95%. Mature SGs will be encouraged to federate into higher level VSLAs. Office bearers’ of the VSLA will be provided with training in managing finances, appraising small commercial loans and loan recovery. The accumulated savings of VSLAs will be matched by seed capital provided by the project, up to a ceiling of US$10,000. It is estimated that their aggregated loan capital would be between US$21 to US$25 million over the project period, which would be available for on-lending to eligible members. AREDP will monitor the loan portfolio of the VSLAs and their sustainability with a view to link them to formal financial institutions.

**Component B: Small and Medium Enterprise (SME) Development (US$22.3 million):** This component aims to support the emergence of a stronger SME sector with improved trading linkages with the rural economy and adequate access to financial services. The component has the following three sub-components:

**B1. SME Facilitation:** The project will finance a sequenced approach for SME support, i.e. identifying key value chains in each province, working with the stakeholders to identify choke points constricting growth, identifying opportunities for forward/backward linkages and defining skill gaps. An initial provincial situational analysis will identify local financial institutions, business development service suppliers, and opportunities for collaboration with other projects. The selection criteria for SME support is weighted towards those businesses, or sectors, that are judged most likely to create demand for locally produced products and / or generate both direct and in-direct employment.

**B2. Business Development Support for SMEs:** The project will work with sectors and approximately 750 SMEs, which are likely to be key drivers of rural income. It will support them in building necessary skills, promoting market development and particularly encouraging business linkages with the rural economy. Action plans will be developed to enable the SMEs to access the services they need in market development, generic training and specific technical support. These services will be provided through existing suppliers, or where not available, by direct project provision. It is likely that part of the generic business training will be provided through the three pre-selected suppliers of the IFC’s “Business Edge” training projects, provided the courses are proven useful in rural Afghan circumstances. The project will partially finance SME training and business support (to be progressively phased out), and build capacity among existing suppliers of services. The project will also promote innovations and new business models through an annual Innovation Prize of up to US$50,000 for each province, in total.

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5 These Provincial SMEs are by definition Rural and Semi-Urban.
6 The Innovation prize will be particularly supportive of new and innovative approaches for local sourcing of raw materials and products from the rural areas.
amounting to US$1.5 million. Supported SMEs will be monitored for increases in sales, rural purchases, additional employment generated and improvement in their access to formal credit.

**B3. Access to Finance for SMEs:** The project will facilitate improved access to finance by SMEs, through a three-pronged strategy, namely; (i) the risks related to the provision of credit for rural SMEs will be addressed by setting up a risk-sharing mechanism in the form of a partial guarantee; (ii) the lack of institutional capacity and appropriate products and services will be addressed through the provision of support for capacity building and new product development for partner banks; and (iii) the project will assist supported SMEs to identify and present their financing requirements in line with the needs of partner banks. The partner banks will be selected for each province on the basis of pre-determined eligibility criteria that will include track record, commitment, capacity and alignment with the project’s objectives. The project will monitor the change in the levels of SME financing. It is expected that the overall strategy will strengthen SMEs and thus make them more attractive clients for financial institutions.

The capital injection for the partial risk guarantee facility will be a one-time event. The purpose of the facility is to carry a portion of the commercial risk of a given SME loan, while the bank(s): (a) build up their capacity to evaluate such loans; (b) learn to manage the related risks; and while (c) the SMEs receive comprehensive support that will improve their business operations and thus turn them into lower credit-risk customers. It is also expected that over the course of the project period: (i) the portion of the loans to be guaranteed will become smaller, thus making room for more loans; and (ii) the potential losses to be incurred by the facility will not exhaust its capital base before project end.

**Developing Synergies between Components A & B:** The project will facilitate the better integration of key provincial value chains, and through consultations with producers, SMEs and other stakeholders, identify and address major choke points. The project will, amongst other criteria, select to work in areas that have good potential to provide labor and products for these selected value chains. PEFs and BDOs will co-operate to actively promote trading linkages between EGs and SMEs. The Project will aim to leverage the embedded business development skills of SMEs to deliver practical and market oriented trainings to EGs.

**Component C: Project Implementation Support (US$27.59 million):** The component will support MRRD in C1. Project Management: establishing and implementing an effective project management system through, the provision of training and technical assistance, equipment, operating costs, to strengthen the Project Management Office’s capacity in financial management, procurement and technical skills; C2. Monitoring & Evaluation: designing and implementing an efficient monitoring and evaluation system; and C3. Governance & Accountability, Gender and Third Party Audits: designing and implementing the Governance and Accountability Action Plan, Gender Action Plan and carry out external and internal audits.

IV. Project Cost and Financing Plan

4.1 Total project cost is estimated at US$87.2 million with the following details.
<table>
<thead>
<tr>
<th>Project Component</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Community-Led Enterprise Development</td>
<td>37.35</td>
</tr>
<tr>
<td>(ii) SME Development</td>
<td>22.30</td>
</tr>
<tr>
<td>(iii) Project Implementation Support</td>
<td>27.59</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>87.24</strong></td>
</tr>
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### Financing Plan

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>US$ Million equivalent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. IDA Grant H531-AF</td>
<td>30.0</td>
</tr>
<tr>
<td>2. ARTF Grant and Bi-lateral funding</td>
<td>57.2</td>
</tr>
</tbody>
</table>

4.2 **The ARTF Grant:** The US$16 million requested from ARTF will finance the following:

(i) Goods and civil works: For setting up the Project Management Office (PMO) and Provincial Offices (POs), such as the construction of AREDP office building in Kabul; and procurement and installation of internet services;

(ii) Consultancy Services: For the Provincial Situational Analysis, Administrator of the PRGF, capacity building and training of project staff; and mobilization, training and development of action plans for the EGs, SGs and VSLAs; and

(iii) Salaries of International Staff (Individual Consultants) of the Project Management Office.

The estimated allocation of ARTF funding support is shown in the Table below.

<table>
<thead>
<tr>
<th>Category</th>
<th>Estimated Disbursement, USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods and works</td>
<td>1,433,539</td>
</tr>
<tr>
<td>Consultancies</td>
<td>13,111,000</td>
</tr>
<tr>
<td>Individual Consultants (PMO) - International</td>
<td>1,415,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>15,959,539</strong></td>
</tr>
</tbody>
</table>

The detailed procurement plan for the goods, works, and consultancies to be funded by the proposed ARTF grant is attached as Annex 2. A detailed ARTF budget for SY 1389 and cash flow forecasts for SY 1389-91 is provided in Annex 3. AREDP expects to fully disburse the ARTF contribution of US$16 million by end of July 2011.

V. Project Implementation Arrangements
5.1 National Level. Through the PPA, the GoA has already set up the AREDP PMO within MRRD. The PMO is headed by an Executive Director and staffed with the national Technical, Financial Management (FM) and Procurement staff. In addition, the PMO has filled three Technical Assistance (TA) positions - Program Advisor, Operations Advisor, and the Finance and Budget Advisor. The process of recruiting three other TAs, including Business Development, Human Resources, and Access to Finance Specialists has been initiated. The PMO reports to the Project Steering Board (PSB) on the consolidated progress of the project and has responsibility for the overall project implementation, coordination and monitoring. It is also responsible for: (a) assuring steady progress of execution according to an implementation schedule reviewed and approved by the World Bank; (b) regular reporting to the PSB; (c) ensuring adequate and smooth transfer of skills to the national staff; and (d) ensuring that a high ethical standard and transparency is maintained throughout the process.

5.2 Provincial level: At the province level, a Provincial Manager (PM) heads the POs for coordinating, implementing and managing project activities. The POs have a flat and lean structure, comprising mainly of PEFs and BDOs, who will spend significant time in the field. The other staff at the POs will manage support functions like administration, monitoring and learning and management of accounts.

**Procurement Arrangements**

5.3 The procurement arrangements under the ARTF financing will be the same as those applicable to IDA Grants and follow “Guidelines for Procurement under IBRD Loans and Credits (dated May 2004; revised October 2006 and May 2010)” and “Guidelines for Selection and Employment of Consultants by World Bank Borrowers (dated May 2004; revised October 2006 and May 2010)”. In addition, the GoA’s Procurement Law (revised in July 2008 and amended in January 2009) will be applicable. However, in the event of conflict between IDA Procurement/Consultant Guidelines and the GoA’s Procurement Law, the IDA Guidelines shall prevail. The overall Project Procurement Plan (PPP) for AREDP was agreed between the World Bank and GoA during project negotiations, including the need for prequalification, estimated costs, prior review requirements, and time frame. The PPP, which included the goods, works and consultancy services to be financed under IDA Grant, as well as ARTF and Bilateral support, has been updated to reflect actual start of the project implementation. Furthermore, separate an annual procurement plans (FY2010/11) for IDA and ARTF funded activities have been prepared and approved by the Bank. The FY2010/11 procurement plan for ARTF funded activities is attached as Annex 2.

**Financial Management, Disbursement and Audit Arrangements**

5.4 In June 2005, a Public Financial Management (PFM) performance rating system was developed for Afghanistan by the Public Expenditure and Financial Accountability (PEFA) multi-agency partnership Program, which includes the World Bank, IMF, EC, and other agencies. Afghanistan’s ratings against the PFM performance indicators portray a public sector
where financial resources are, by and large, being used for their intended purposes. This has been achieved with very high levels of support to the Ministry of Finance from international firms; and this assistance will continue to be needed if ratings are to be maintained. In view of this, the Bank is financing the Financial Management Advisor (FM) position in the Ministry of Finance, and the Audit Advisor (AA) to assist the Control and Audit Office. The Special Disbursement Unit (SDU) in the Treasury Department (TD) of MoF will open and manage the ARTF Designated Account (DA) at Da Afghanistan Bank (DAB, Central Bank) in the name of the AREDP on terms and conditions satisfactory to Bank.

5.5 At the project level, a Finance and Budgeting Unit (FBU) has been established as part of the Project Support Services Office (PSSO) within the overall PMO at MRRD. The FBU at PMO has both national and international staff. In addition, Finance Officers will also be recruited for the provincial offices. FBU will undertake responsibility of maintaining the project financial management system along with MRRD finance staff, including:

- Furnishing to the Bank not later than forty-five (45) days after the end of each calendar quarter, interim unaudited financial reports for the project covering the quarter. And, furnishing the Bank with audited Financial Statements for each fiscal year not later than six (6) months after the end of fiscal year.

5.6 Fund Flows: Fund management for the project will follow existing procedures of the GoA. As with all public expenditure, all ARTF payments under the AREDP will be routed through DA managed by the Special Disbursement Unit (SDU) of the MoF. The FM Adviser will assist the SDU of the MoF in executing and recording project monthly payments. Requests for payments from DA funds will be made to the SDU by the FBU/MRRD. Funds transfer for the provincial offices’ operational expenditures will be made through the Mustofiat (MoF Provincial Offices). In addition to payments from DA funds, the FBU/MRRD can also request the SDU to make direct payments to consultants or consulting firms, and special commitments for contracts covered by letters of credit. Such requests will follow World Bank disbursement procedures. All ARTF Withdrawal Applications (WA) to IDA, including advances, reimbursement, and direct payment applications, will be prepared and submitted by MoF.

5.7 Accounting and Reporting: The FBU will maintain essential project transaction records using computerized accounting system/Excel spreadsheets and generate required monthly, quarterly, and annual reports.

5.8 The FM Manual, prepared by FBU/MRRD, has been approved by the Bank, and includes: i) roles and responsibilities for all FM staff, ii) documentation and approval procedures for payments, iii) project reporting requirements, and iv) quality assurance measures to help ensure that adequate internal controls and procedures are in place and are being followed.

5.9 The FM Manual also establishes project financial management in accordance with standard GoA policies and procedures including use of the government Chart of Accounts to record project expenditures. The use of these procedures will enable adequate recording and reporting of project expenditures. Overall, project accounts will be maintained centrally in SDU, which will be ultimately responsible for recording of all project expenditures and receipts in the
Government’s accounting system. Reconciliation of project expenditure records with MoF records will be carried out monthly by the FBU. An implementation completion report will be prepared by the MRRD and submitted to the Bank no later than four months following the closing date of the project.

**Disbursement Arrangements:** Disbursements from the grant will use advances, reimbursement, direct payment, and payments under Special Commitments, including full documentation or against statements of expenditures, as appropriate. Project expenditures will be financed by ARTF funds, including taxes.

a) ARTF funds up to 4 months’ worth of project expenditures expected to be financed by funds from the Designated Account will be advanced in due course to a separate DA to be opened in USD at the Da Afghanistan Bank. As with the arrangements for the IDA grant portion for the project, disbursements under this project funded by ARTF will be transaction based, and thresholds for the use of Statement of Expenditures (SOEs) will be the same as those for the IDA portion.

b) Disbursement categories and allocations are the following:

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount of Grant Allocated USD</th>
<th>Percentage of Expenditures to be Financed (inclusive of Taxes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods, works and consultants services, training, Matching Seed Grant and Incremental Operating Costs for the project</td>
<td>15,959,539</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Total Amount</strong></td>
<td><strong>15,959,539</strong></td>
<td></td>
</tr>
</tbody>
</table>

5.10 Audit of Project Funds: The Auditor General, supported by the Audit Agent, is responsible for auditing the accounts of all IDA and ARTF-financed projects. Annual audited project financial statements will be submitted within six months of the close of GoA’s fiscal year. The Bank-funded projects already or currently being implemented by MRRD have no overdue audit reports and interim un-audited financial reports, they also do not have ineligible expenditures. The key issues raised in these projects’ previous years audit reports have been resolved satisfactorily, except for Solar Year 1387, which are currently in the process of being resolved.

**Monitoring and Reporting**

5.13 The AREDP M&E system is being designed around the results framework (Attached as Annex 1) and consists of the following components:(i) Input-Output Monitoring; (ii) Process monitoring; (iii) Thematic studies; (iv) External Impact Evaluation; (v) Social accountability and transparency, including assessing the safeguard and gender aspects of the project. The project is also establishing an Internal Learning system. The M&E Managers (male and female) at AREDP
have overall responsibility for the M&E function, and the detailed reporting and MIS is outlined in the operations manual. The project is exploring the use of mobile telephone-based reporting mechanisms to enable regular data collection as part of the M&E process.

5.14 The achievement of project development objectives and project implementation performance is independently reviewed by the Bank’s task team during periodic and day to day reviews. This is done using the performance indicators of the results matrix and agreed annual/quarterly work plans, procurement plans and quarterly progress reports. The donors co-financing the project through ARTF and bilateral sources, as well as representatives of the donors implementing complementary programs in the sector will be invited to participate in the Bank’s review missions.

VI. Economic and Financial Analysis

6.1 The total cost of the project is estimated to be US$87.24 million. About 43 percent of this amount is allocated for promotion of community-based SGs and EGs development, directly benefiting about 13,000 SGs and 6,500 EGs. Matching seed grants will be provided to VSLAs based on regular savings and good governance, while individual micro-enterprises will be supported based on viable business plans. Such plans will be demand-driven and will cover a range of investments. It was not possible to quantify financial returns for the wide variety of rural enterprises anticipated to be supported through this project at appraisal stage. However, based on the experience of similar projects in the South Asia region, and the nature of investments supported by Microfinance Institutions in Afghanistan, analysis of ‘seed grant’ under Component A was used to determine the financial rates of return on carpet weaving and bee-keeping activities. The rates of return were calculated without reckoning for any subsidized capital. The Internal Rate of Return (IRR) for an investment of US$204 in bee-keeping was 46 percent and for carpet weaving unit with investment of US$1,000 was 47 percent. Similar analysis will be undertaken by VSLAs to evaluate returns from business plans of micro-enterprises before financing the micro-enterprises.

6.2 With regards to SMEs, it was observed that besides providing employment opportunities for local skilled and semi-skilled persons, they also generate large revenues. For example, the 750 SMEs targeted by the project will create average employment for around 22,500 persons, and generate a combined turnover of US$100 million. In addition, linkages between micro-enterprises and SMEs boost the local economy as they further add to the domestic economy. Therefore, AREDP will focus on those value chains with strong backward linkages to rural sectors and provide strong market linkages with micro, small and medium enterprises.

VII. Environmental and Social Aspects

7.1 The MRRD is committed to ensuring that all micro, small and medium enterprises to be supported under AREDP are environmentally and socially sustainable. To minimize any adverse environmental and social impacts of the project an Environmental and Social Management Framework (ESMF) was prepared and cleared by the Bank before project appraisal. The ESMF sets out the procedures for screening all micro, small and medium enterprises for their potential
adverse environmental and social impacts; and proposes the possible mitigation measures. The ESMF includes a negative list of activities that cannot be supported by the project in order to achieve neutral or positive environmental and social impacts. MRRD is in a process of establishing and Environment & Social Management Unit to oversee environment and social issues to ensure compliance.

7.2 AREDP has translated a summary of the ESMF into the two local languages. Copies of the ESMF have been shared with Kabul University, National Environmental Protection Agency (NEPA), AREDP website, and provincial MRRD offices for wider distribution. All project staff will be trained on environment and social safeguard issues and will be responsible for implementation of the ESMF.

7.3 Gender. MRRD is also committed to gender mainstreaming in Components A & B of AREDP, as well as in overall project management. AREDP design pays special attention to the needs of women at community and rural levels. For example, the project include provision for hiring female staff at all levels, encouraging women to actively participate in the project, and encouraging men (as current gatekeepers at all levels) to ‘allow’ women to participate in all interventions offered by this project. The project has set aside a ‘special and additional’ budget to ensure women’s participation, e.g. provision for “mehram” (chaperone), women’s mobility, additional training for community women, female entrepreneurs and female staff, etc.

7.4 AREDP will recruit a qualified gender and enterprise specialist either on full time or retainer basis to guide gender mainstreaming. All staff (male and female), recruited for this project, will be assessed for their commitment, or potential for commitment, to gender equality. Proactive measures will be taken to hire equal numbers of women, particularly at senior levels. Advertisements will specify that ‘women are especially encouraged to apply’ and some jobs will be advertised as ‘for women only’. Female graduates will be encouraged to enter the development sector through internships.

VIII. Sustainability and Risks

8.1 Risks and their Mitigation. The security conditions in the country continue to be a key risk element for all operations in Afghanistan. Besides security, the project faces high and/or substantial risks in respect of governance, implementation capacity and fiduciary management. The project will address the risks through: (i) creating and maintaining community awareness and participation program; (ii) vigorously pursuing implementation of the governance and accountability action plan; and (iii) proactive supervision by the Bank task team. Some of the key risks and mitigation measures are listed in the table below.

<table>
<thead>
<tr>
<th>Risk</th>
<th>Mitigation Measure</th>
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<tbody>
<tr>
<td>1. Pressure on SGs to federate too early and on VSLAs to provide credit without applying agreed upon principles</td>
<td>- Substantial capacity-building of members and management of SGs and VSLAs</td>
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<td></td>
<td>- Set up of an appropriate and transparent governance structure of VSLAs</td>
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| 2. Implementation of partial risk guarantee by contracted Administrator | • Contract with Administrator will include the obligation to assure sufficient technical knowledge and capacity within their staff.  
• Project will closely monitor the PRG contract |
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<tr>
<td>3. Sustainability of BDS suppliers</td>
<td>• Focusing especially on accrediting, training and encouraging local BDS suppliers, especially those active commercially, to provide trainings and support in local languages and at reasonable cost, or as part of a supply agreement</td>
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</table>
| 4. Limited capacity of MRRD on enterprise development, access to finances and forward linkages to markets | • Staff selection through competitive process with emphasis on experience and competence.  
• Bring in expertise and provide opportunities to program staff for continuous learning from other programs in the South Asian region.  
• Strengthen and maintain consistency in management of the PMO with enhanced provision of training.  
• Use of qualified private service providers with a proven track record. |
| 5. Project Financial Management Risk | • Minimize use of Designated Account, maximize direct payments to consultants  
• Presence of FM Agent as the Treasure of MoF responsible for processing payments, transaction recording and reporting  
• Presence of Audit Agent at the Control and Audit Office, responsible for external audit of the project.  
• Utilization of Bank approved financial management manual and ensuring that the financial management of the project is in accordance with the manual  
• Presence of experienced and qualified financial management staff in the proposed implementing entity. |

**List of Annexes**

Annex 1: Results Monitoring Framework  
Annex 2: Procurement Plan  
Annex 3: Project Cash flow & Estimated Disbursement Table
ANNEX 1: RESULTS FRAMEWORK

<table>
<thead>
<tr>
<th>Project Development Objective</th>
<th>Project outcome indicators</th>
<th>Use of project outcome information</th>
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<tr>
<td>Improved employment opportunities and income of rural men and women, and sustainability of targeted local enterprises.</td>
<td>70% of the Enterprise Groups (EGs) will have increased their net revenues by over 50%. At least 35% of these will be female EGs; At least 30% of participating SMEs and EGs will have increased direct and/or indirect employment by at least 30%. Of these at least 35% will be women; On an average, SMEs will report at least a 50% increase in purchase of inputs from rural areas; 50% of EGs supported by the Project will still be operating 2 years after start-up. At least 35% of these will be female EGs.</td>
<td>The overall strategy will be reviewed at the MTR against the PDO indicators and baseline. Strategies, interventions and funds will be re-aligned during project implementation according to the findings and effectiveness of management, SMEs and village savings and credit associations</td>
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<tr>
<th>Intermediate Outcomes</th>
<th>Intermediate Outcome Indicators</th>
<th>Use of Intermediate Outcome Monitoring</th>
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<tr>
<td>Component A Community-led Enterprise Development</td>
<td>A.1) 50% of EGs have accessed and repaid loans; A.2) 50% of EGs have improved products and diversified marketing strategies; A.3) At least 70% of viable Savings Groups (SGs) federate into VSLAs; A.4) At least 60% of VLSAs have an accumulated loan-able capital of at least $15,000; A.5) At least 70% EGs and VSLAs maintain accurate and up-to-date records of accounts, and have a good governance structure(^8) in place; and at least 80% VSLAs receive seed capital grant; A.6) VSLAs maintain at least 95% repayment rate on loans and at any given time have at least 60% of loan-able funds are in circulation.</td>
<td>Monitor the sustainability of village savings and credit associations and their engagement in income generating activities. Review, at two-year intervals of implementation, the strategies of community mobilization, linkages and access to financial resources, advisory services and overall effectiveness of community level rural enterprises. If found to be less than expected, analyze the constraints and for redesigning the strategies.</td>
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\(^8\) Good governance structure: includes a Savings Group that has an elected governing body in place; holds regular meetings, maintains transparent accounts, minutes, and information is available to all members; men and women are equally represented; and the SG is represented in the VSLA.
| Component B  
SME Development & Innovation Grant | B.1) At least 50% increase in purchases from rural areas by supported SMEs;  
B.2) At least 30% increase in direct and/or indirect employment;  
B.3) At least 50% of SMEs meet the partial guarantee scheme criteria, apply for a loan, and receive it;  
B.4) At least 5 SME's per province per year apply for the innovation grant and 1 SME per province per year introduces a business innovation. | Monitor the support and viability of SME’s as clients of commercial banks;  
At MTR, revisit the SME development strategy and revise it if less than 75% of the targeted SMEs are demonstrating improved sales or productivity.  
At MTR, revise project value chains, strategies to establish business linkages, and SME business plans, if progress significantly less than the expected level. |
| --- | --- | --- |
| Component C  
Program Management Support | C.1) Dissemination of improved database of local businesses by project management leads to progressive increase in trading transactions reported by provincial office;  
C.2) Project management’s analysis and promotion of viable business models leads to at least 2 business models taken up as investments per year;  
C.3) Project management’s development and accreditation of technical and professional service providers results in at least 20 project supported BDS service providers providing paid-for services in each province;  
C.4) Project management takes and records all necessary actions related to findings of regular Monitoring, Evaluation and Learning reports;  
C.5) All complaints received by Project and field staff are addressed within an established timeframe and according to agreed standards;  
C.6) Project management satisfactorily addresses the findings of the statutory audit conducted by the Auditor General for all IDA-financed/managed projects; and findings from an additional commercial audit to be undertaken on a yearly basis. | To ensure that an effective project management system is established, and experiences and learning are factored into decision making for improved project performance.  
Effectiveness of project management systems, the ability to generate learning and incorporate experiences into strategic decision making, will be reviewed every six months. |