



Progress Report on Tranche Release

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Armenia: Infrastructure Sustainability Support Program (Second Tranche)

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 29 September 2015)

Currency Unit	–	dram (AMD)
AMD1.00	=	\$0.0021
\$1.00	=	AMD475.0000

ABBREVIATIONS

ADB	–	Asian Development Bank
GDP	–	gross domestic product
ISSP	–	Infrastructure Sustainability Support Program
MOF	–	Ministry of Finance
MOTC	–	Ministry of Transport and Communication
MTEF	–	medium-term expenditure framework
RAMS	–	road asset management system
SCWE	–	State Committee for Water Economy
TA	–	technical assistance

NOTE

(i) In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. In August 2014, the Asian Development Bank (ADB) approved a loan to the Republic of Armenia for the Infrastructure Sustainability Support Program (ISSP).¹ ISSP supports the government in its efforts to improve road and water service provision through results-based public management and financing reforms. The program is focused on critical expenditures, sustainability, and life-cycle costing to ensure investments in these two sectors are prioritized more robustly and are fully sustainable. Improved public financial management in these sectors will mean users benefit from more reliable and expanded services, while taxpayers will receive greater value for money in sector investments. The program comprises a SDR31,770,000 (\$49 million equivalent) loan from ADB's Special Funds and a \$900,000 technical assistance (TA) grant to support implementation. The program loan has two tranches, with funds released after compliance with specific policy actions. The loan became effective on 19 December 2014 and the first tranche of SDR12,967,000 (\$20 million equivalent) was disbursed on 22 December 2014.

II. MACROECONOMIC AND FISCAL DEVELOPMENTS

A. Macroeconomic Situation

2. Economic growth in Armenia has recovered, following a 14% contraction in 2009.² In 2014 growth in Armenia slowed slightly to 3.5% as compared to 3.3% in 2013, driven by agriculture and services.³ Agriculture expanded by 7.8% in 2014 and services rose by 5.8%. Private consumption expanded by 0.4% in 2014, slightly under the 0.9% expansion in 2013. Higher government spending helped counterbalance subdued private consumption—public consumption increased by 6.4% in 2014—while investment fell by 2.6%, reflecting deficiencies in the investment environment and structural weaknesses (footnote 3). The growth outlook remains uncertain, primarily due to the slowdown in Armenia's main trading partners (the Russian Federation and the European Union). Growth is expected to slow to 1.6% in 2015 before recovering to 2.3% in 2016 (footnote 3); growth in 2015 is expected to come mostly from agriculture and services. Industry is unlikely to grow as strongly as it has in the past, mostly because of a depressed demand for exports. A summary of Armenia's economic indicators is in Table 1.

3. Average annual inflation decreased to 3% in 2014 from 5.8% in 2013, as a result of favorable global prices, declining domestic demand and increased domestic food production. The 12-month inflation rate (December to December) was 4.6%, within the 2.5%–5.5% target band of the Central Bank of Armenia. The central bank has used interest rates to counter pressure on prices and on the exchange rate, raising interest rates by 375 basis points to 10.5% (in several steps) from December 2014 to February 2015; it subsequently decreased the rate by 25 basis points to 10.25% in August 2015. Inflation is forecast to be 4.6% in 2015 before subsiding to 4.1% in 2016 (footnote 3). Inflationary pressures are intensifying because of depreciation of the Russian Federation ruble, which flows through to the Armenian dram. This will likely mean that monetary policy will remain tight in 2015 before returning to a neutral stance over the medium term.

¹ ADB. 2013. *Report and Recommendations of the President to the Board of Directors: Proposed Policy-Based Loan and Technical Assistance Grant for the Infrastructure Sustainability Support Program*. Manila.

² International Monetary Fund. 2015. *2014 Article IV Consultation and First Review Under the Extended Arrangement*. Washington D.C.

³ ADB. 2015. *Asian Development Outlook 2015*. Manila.

Table 1: Country Economic Indicators

Item	2010	2011	2012	2013	2014
A. Income and Growth^a					
1 GDP per Capita (\$, current)	2844.0	3362.8	3511.6	3680.1	3863.6
2 GDP Growth (% , in constant prices)	2.2	4.7	7.2	3.3	3.5
a. Agriculture	(16.0)	14.0	9.5	7.6	7.8
b. Industry	5.7	(0.0)	5.7	0.5	(2.3)
c. Services	4.7	6.1	6.9	2.8	5.8
B. Savings and Investment^b (current and market prices, % of GDP)					
1 Gross Domestic Investment	32.9	27.3	25.3	22.3	21.1
2 Gross National Saving	19.9	14.7	15.4	14.7	13.8
C. Money and Inflation (annual % change)					
1 Consumer Price Index (period average)	8.2	7.7	2.6	5.8	3.0
2 Total Liquidity (M2X)	11.8	23.7	19.5	14.8	8.3
D. Government Finance (% of GDP)					
1 Revenue and Grants	22.6	23.3	22.2	23.5	23.6
2 Expenditure and Onlending ^c	27.6	26.1	23.6	25.1	25.5
3 Overall Fiscal Surplus (Deficit)	(5.0)	(2.8)	(1.4)	(1.6)	(1.9)
E. Balance of Payments					
1 Merchandise Trade Balance (% of GDP)	(22.3)	(20.8)	(19.9)	(18.8)	(17.7)
2 Current Account Balance ^d (% of GDP)	(13.6)	(10.4)	(10.0)	(7.6)	(7.3)
3 Merchandise Export (\$) Growth (annual % change)	54.8	19.5	5.9	7.9	3.8
4 Merchandise Import (\$) Growth (annual % change)	14.0	8.5	2.4	2.8	0.7
F. External Payments Indicators					
1 Gross International Reserves (\$ million) (in months of imports)	1865.8 4.9	1932.5 4.7	1799.4 4.2	2251.6 5.0	1489.4 3.3
2 External Public Debt Service (% of exports of goods and services)	4.1	3.7	8.2	27.3	6.8
3 Total External Public Debt (% of GDP)	34.7	36.4	35.4	34.7	37.1
G. Memorandum Items					
1 GDP ^a (drams billion)	3460.2	3777.9	4266.5	4555.6	4843.2
2 Exchange Rate (period average, drams per \$)	373.7	372.5	401.8	409.6	415.9
3 Population (million) ^d	3.1	3.0	3.0	3.0	3.0

() = negative, GDP = gross domestic product

^a The data series for 2012–2014 have been revised in accordance with the System of National Accounts 2008 requirements, introduced by the National Statistical Service in 2015.

^b Officially reported savings–investment balance does not exactly equal the officially reported current account balance.

^c The overall balance does not include net lending.

^d Including official transfers.

Sources: Central Bank of Armenia, Ministry of Finance, National Statistical Service.

4. In late 2014, a sharp fall in the Russian Federation ruble–dollar exchange rate fueled a 15% depreciation of the Armenian dram. To help restore exchange rate stability, the central bank intervened regularly in the foreign exchange market. The central bank doubled the reserve ratio for foreign exchange deposits from 12% to 24% before easing it to 20% in early 2015. The central bank interventions in the foreign exchange market caused gross international reserves to fall sharply to \$1.5 billion at the end of 2014 (equivalent to 3.3 months of imports), from \$2.2 billion a year earlier (equivalent to 5 months of imports) (footnote 3). In 2014, the current account deficit narrowed slightly to 7.3% of gross domestic product (GDP), compared to 7.6% in 2013. The increasing deficit reflected lower remittance inflows and a larger trade deficit. In 2015, the current account deficit is forecast to widen to 8.7% of GDP before narrowing to 8.3% in 2016.

5. Prior to the global financial crisis, gross public debt fell from 40% of GDP in 2003 to 16% of GDP in 2008 (footnote 2). This significant reduction primarily reflected the strong economic

growth during this period. In 2014, this ratio was 43.6% of GDP, up from 40.9% in 2013. The rise was primarily driven by the depreciation of the dram, and leaves little room below the official debt ceiling of 50% of GDP. Under the International Monetary Fund's debt sustainability analysis, public debt is expected to remain in the range of 44%–46% of GDP until 2016 and then gradually decline to 43.6% of GDP in 2019 (footnote 2). The debt sustainability analysis concludes that public debt is sustainable but could be reduced through prudent fiscal policy.

6. The fiscal deficit was 1.9% of GDP in 2014, lower than the government's forecast of 2.3% of GDP. The fiscal deficit was lower than expected primarily due to lower capital expenditure. Tax revenues rose by 6.1% but operational expenditure also increased, including for higher social costs and a pay increase for public servants. Fiscal reforms continue, with the Ministry of Finance (MOF) and the State Revenue Committee merging in 2014. The government is pursuing new revenue avenues, including new tax measures for high-wealth individuals and legislative changes to improve customs operations and trade.

B. Public Financial Management

7. Armenia has undertaken a number of important reforms in public financial management since 2003. The most important of these reforms was the introduction of program budgeting to enhance the substantiation, effectiveness, and efficiency of public expenditure. Pilots began in 2003, and by 2011 all state institutions were engaged in the process. From 2005 to 2014 the format of budget documents and methodological guidelines were developed, training and on-the-job support provided, and programs were developed along with output indicators to ensure sufficient accountability and assist in program monitoring. Despite significant progress, a number of implementation issues remain.

- (i) Program budgeting has been undertaken alongside traditional input-based budgeting, which has increased the documentation and workload of officers in the MOF and line agencies.
- (ii) Program budgeting methodology and program classifiers have been regularly revised and updated, which has slowed implementation.
- (iii) Capacity constraints, particularly in line agencies, inhibit implementation and are likely to persist for some time.
- (iv) The quality of program budgeting information is low, which limits its effectiveness.
- (v) Institutional issues in the MOF and line agencies, such as internal controls and management systems, need to change to meet the requirements of program budgeting.
- (vi) A number of other measures are required to improve strategic planning, program evaluations, program costing, external audits, and flexibility in budget decisions.

8. Tranche 2 of the ISSP has supported the government's efforts to implement program budgeting. At a general level in the road transport and water sectors, the ISSP has helped to improve internal audit functions, align the water sector agencies in a more coherent manner, and increase transparency in financial information. More specifically:

- (i) key performance indicators were developed for the road transport and water sectors and used in the medium-term expenditure framework (MTEF), and linked to the budget to improve government monitoring and oversight;
- (ii) the government developed a more explicit policy related to its ownership functions in the water sector, and this was communicated to water operators;
- (iii) water sector subsidy objectives and classifications were stated in the budget;

- (iv) provisions were made for adequate financing of water sector maintenance and loan servicing for future public–private partnerships;
- (v) the State Committee for Water Economy (SCWE) used the financial information framework when contributing to the development of the annual MTEF report;
- (vi) water sector financing flows were included in the budget message;
- (vii) the government outlined its intentions regarding water tariff changes in relation to its ownership functions and the sector’s financial position; and
- (viii) audit committees were appointed in the Ministry of Transport and Communication (MOTC) and SCWE, with risk-based audit plans adopted in the water and roads sectors and a practice-based component introduced into the certification of internal auditors.

C. Water sector

9. For many years following the collapse of the economy of the former Soviet Union most of the water supply and sanitation systems in Armenia were in disrepair. The country was faced with increasing demand, deteriorating assets, and dilapidated infrastructure, which resulted in steadily decreasing and costly provision of services. Despite an abundance of water in the country, for almost all Armenians water was available for only a few hours a day. In recent years, Armenia has made significant strides in reforming the water sector by developing policies, enacting laws, and awarding lease and management contracts to private water operators to improve water service provision.⁴ The management and lease contracts expire in May 2016. The government has decided to unify the sector further and procure a single 15-year lease contract, with a single tariff, beginning in June 2016.

10. During implementation of tranche 2 of the ISSP, the Ministry of Territorial Administration undertook a functional review of key water sector agencies and aligned the Water Code (2002) with the recommendations of the functional review. The government approved a water supply and sanitation sector strategy with a financing plan, and intends to align the Water Code (2002) with these recommendations. The SCWE developed a water assets register protocol. ADB also supported SCWE in populating the assets registry, including developing software for easy management of the registry.

D. Road transport sector

11. The present road network coverage and capacity are sufficient. Nevertheless, maintaining the capacity and efficiency of the international road corridors, which are considered lifelines of the economy, remains a major challenge. Many secondary and local roads feeding the international road corridors and major economic centers require rehabilitation or reconstruction. Limited preventive and periodic maintenance has resulted in deterioration of the roads, which require expensive reconstruction. This approach to road maintenance requires greater resources over the long term. Shifting from reconstruction to more timely preventive and periodic maintenance will enable the government to use its limited budget more efficiently, and quickly reap high economic returns from a better road network.⁵

12. During ISSP tranche 2 implementation: (i) the government approved a road maintenance strategy with a financing plan; (ii) MOTC adopted a new tool for road investment prioritization,

⁴ Z. Tokhmakhian. 2012. *Armenia Takes on Water Management Challenges: Public–Private Partnerships in Water Sector*. Washington, D.C.: The World Bank. <https://openknowledge.worldbank.org/handle/10986/20606> License: CC BY 3.0 IGO

⁵ ADB. 2011. *Armenia’s Transport Outlook. Transport Sector Masterplan*. Manila.

based on new techniques developed with the support of ADB; (iii) the Roads Council validated maintenance expenditures using new techniques developed with the support of ADB;⁶ (iv) a complete video road inventory was compiled to support better investment decisions, using equipment purchased with ADB TA; and (v) MOTC continued to monitor road quality using the international roughness index.⁷

III. PROGRAM IMPLEMENTATION

13. Of the 21 policy actions for the release of tranche 2, 19 have been fully complied with and 2 have been partly complied with (Table 2). Appendix 1 shows the status of implementation of the policy actions for tranches 1 and 2. To support the government's implementation of the tranche 2 policy actions, a \$900,000 TA package was approved with the loan. A mixture of international and national specialists worked with the government, ensuring that international best practices were incorporated where appropriate and any recommendations were tailored to local conditions. ADB supported the government in implementing all of the policy actions. International specialist expertise was particularly useful in (i) preparing a water supply and sanitation strategy with a financing plan, (ii) preparing a road maintenance strategy and financing plan, (iii) ensuring key performance indicators were integrated into the medium-term expenditure framework for the road transport and water sectors, (iv) providing continuous on-the-job support to the internal audit units in SCWE and MOTC, and (v) legal drafting support for legislative changes.

Table 2: Status of Compliance with Policy Actions of the Second Tranche^a

Policy Actions	Status of Compliance
Output 1: Sector management systems improved	
1. MTA led functional review of key water agencies completed	Fully complied with
2. Water supply and sanitation sector strategy with financing plan approved	Fully complied with
3. Government decision taken to align the Water Code (2002) and related legal acts with functional review and water sector strategy recommendations	Partly complied with
4. Provisions for adequate financing of maintenance and loan servicing identified in future water PPP contracts	Fully complied with
Output 2: Strategies and processes to allocate investments more efficiently developed	
5. Road maintenance strategy with financing plan approved	Fully complied with
6. RAMS-based road maintenance expenditure validated by the Roads Council	Fully complied with
7. A KPI-based MTEF adopted for road and water sectors with quality indicators	Fully complied with
8. An explicit policy statement on government's shareholder role in the water sector included in the MTEF	Fully complied with
9. Water sector subsidy objectives explicitly stated in the budget and classified accurately	Fully complied with
10. Government policy on its shareholder role in the water sector formally communicated to water operators' Board members	Fully complied with
11. Financial information framework for MTEF 2015–2017 used by SCWE and MOF	Fully complied with
12. Actions and targets with tariffs based on shareholder role and sector's financial position developed by SCWE and MOF	Fully complied with
13. Water sector financing flows (including exemptions) explicitly presented	Fully complied with

⁶ Under tranche 1, one of the policy actions was to establish a ministerial body on national road maintenance to provide better oversight of road maintenance expenditure. This ministerial body is the Roads Council.

⁷ Under tranche 1, the government adopted an annual monitoring process using the international roughness index, which was also used as a key performance indicator in the MTEF.

Policy Actions	Status of Compliance
in the government's 2015 budget message	
Output 4: Monitoring systems strengthened	
14. Video inventory of the entire road network maintained	Fully complied with
15. Risk-based audit planning adopted in road and water sectors	Fully complied with
16. RAMS, including video inventory, adopted as a tool for investment decisions	Partly complied with
17. Annual IRI monitoring process implemented	Fully complied with
18. Water asset register protocol for assets managed by state-regulated operators completed	Fully complied with
19. Budget-linked regular road and water sector KPI monitoring (including IRI) endorsed by the government	Fully complied with
20. Audit committees appointed in MOTC and SCWE with independent non-executive members	Fully complied with
21. A practice-based component in the certification for internal auditors of MOTC piloted	Fully complied with

IRI = international roughness index, KPI = key performance indicators, MTEF = medium term expenditure framework, MOF = Ministry of Finance, MOTC = Ministry of Transport and Communications, MTA = Ministry of Territorial Administration, PPP = public-private partnerships, RAMS = road asset management system, SCWE = State Committee for Water Economy

^a There were no tranche 2 policy actions for Output 3: Regulatory frameworks improved.

Source: Asian Development Bank.

A. Output 1: Sector management systems improved

14. **Policy action 1.** A working group was established led by the first deputy minister of the Ministry of Territorial Administration, including the first deputy minister of Nature Protection, deputy minister of Finance, deputy chairman of SCWE, deputy chairman of the Public Services Regulatory Commission, and the first deputy mayor of Yerevan. The working group and relevant agencies reviewed the Water Code (2002) and other legal acts, agency responsibilities in the drinking water sector were examined, and overlaps and gaps were analyzed. Recommendations were put forward to the government for legislative changes to align the Water Code (2002) more closely to the functions of the government agencies in the water sector and eliminate duplication of responsibilities. The government approved the recommendations for legislative changes. This policy action is fully complied with.

15. **Policy action 2.** The government is adopting a new model for the drinking water sector from June 2016 (para. 9), and undertook a number of studies to design the architecture for this sector. ADB supported SCWE in preparing a strategy that incorporated the key recommendations from the studies, looked at investment needs in the sector, and developed a plan to finance this using different scenarios. The strategy was approved by the government and will help guide SCWE in its policy work over the medium term. This policy action is fully complied with.

16. **Policy action 3.** The functional review recommendations were approved by the government and changes to various legislation were forwarded to Parliament for consideration, which approved the changes. The water strategy was approved in August 2015, and more work is needed before legislative changes can be made. The chair of SCWE wrote to ADB explaining that an important recommendation was to include a new chapter on water sanitation in the Water Code (2002). Before this is presented to Parliament, this chapter must be drafted and consulted more broadly. Such a significant change was not envisaged when designing the program and appropriately the government needs more time to complete this work. ADB is

supporting the government in this process. SCWE expects the draft legislation to be presented to Parliament by early 2016. This policy action was partially complied with.

17. **Policy action 4.** To help ensure financial sustainability of the water sector under a single lease contract, the single tariff needs to be able to finance the total cost of water provision, including maintenance and loan servicing. The government passed a decree outlining the financing arrangements for the sector, which will form part of the bidding documents for the single operator. The single operator is likely to have a 15–20 year lease contract. This policy action is fully complied with.

B. Output 2: Strategies and processes to allocate investments more efficiently developed

18. **Policy action 5.** The allocation of scarce resources for road maintenance in Armenia needs to be more robust, and based on technical evaluations. ADB worked with the Armenian Roads Division within MOTC to develop a road maintenance strategy that models the impacts on the road network of given levels of investment. A financing plan was then developed based on the different scenarios, including MOTC's preferred level of investment. The strategy was approved by the government. This policy action is fully complied with.

19. **Policy action 6.** Under policy action 6, the government developed a partial road asset management system based on new techniques developed (using the international roughness index) and new tools (video inventory hardware and software) procured with assistance from ADB. For road expenditures in 2014, the Road Council validated the investment allocation using this revised road asset management system. This policy action is fully complied with.

20. **Policy action 7.** To support the government's implementation of program budgeting, ADB worked with MOTC and SCWE to develop relevant and robust key performance indicators for the MTEF. The indicators focused on both technical and financial aspects of MOTC and SCWE's work. ADB also worked with MOF to ensure understanding of the indicators and how MOTC and SCWE would report against these indicators. The indicators were accepted and published in the MTEF. This policy action is fully complied with.

21. **Policy action 8.** The government owns the drinking water infrastructure, but has not been explicit or transparent about its intentions as owner. The government has been much more strategic about its role as service provider and regulator, taking steps such as contracting private operators to deliver drinking water and devolving regulatory authority to the public sector regulatory commission. The network infrastructure has sizeable worth—investment is required to maintain its condition, and funds need to be allocated to expand service provision. The government has to outline its intentions more transparently in this regard. Under ISSP, the government has become more transparent about its intent as an infrastructure owner. ADB worked with MOF to develop statements on its role as owner of drinking water assets and what the government hopes to achieve over the medium term, which were then published in the MTEF. This policy action is fully complied with.

22. **Policy action 9.** Water tariffs do not meet the full costs of water provision. The consequences of this include under-investment in infrastructure, expenditure focused on urgent issues rather than long-term maintenance, and deterioration of the network. The government also has a complex set of subsidies to help meet some of the under-financing in the drinking water sector. The subsidies are piecemeal and poorly targeted. ADB worked with SCWE and

MOF to untangle these subsidies, and then state them in a transparent manner in the MTEF.⁸ This policy action is fully complied with.

23. **Policy action 10.** Following policy actions 8 and 9, SCWE formally sent the government's intentions related to its ownership functions in the water sector and a breakdown of financing in the sector that included forecasts to the boards of Armenian Water and Sewerage, Lori Water and Sewerage, Shirak Water and Sewerage and Nor Akunq. This policy action is fully complied with.

24. **Policy action 11.** This policy action was a prerequisite to policy actions 7, 8 and 9. ADB worked with MOF and SCWE to develop performance indicators, more clearly define the ownership functions, and clarify the financing arrangements in the water sector. This framework will continue to be used and developed further in future MTEFs. This policy action is fully complied with.

25. **Policy action 12.** To reinforce the need to ensure financial sustainability in the drinking water sector, the government placed actions and targets for water tariffs in its budget message. ADB worked with MOF and SCWE to develop this excerpt for the budget message. This policy action is fully complied with.

26. **Policy action 13.** Similar to policy action 12, ADB worked with MOF and SCWE to include tables and language about the current explicit and implicit financing flows in the drinking water sector, which were included in the budget message. This policy action is fully complied with.

27. **Policy action 14.** To enable MOTC to prioritize its expenditure in a more technical manner, it needs to have a better understanding of the condition of its road network. With the support of ADB, video survey equipment was supplied to the Armenian Roads Division to survey the entire road network. This video survey contributed to the development of baselines for the international roughness index indicator in the MTEF and enabled partial development of a road asset management system. Although the policy action required surveying of the entire road network, some roads (451 kilometers) could not be surveyed for security reasons, or due to their being impassable or privately owned. This policy action is fully complied with.

C. Output 4: Monitoring systems strengthened

28. **Policy action 15.** In MOTC and SCWE, the internal audit units had only been recently established in line with requirements related to implementation of program budgeting. ADB supported the establishment of these two internal audit units by providing dedicated local audit support to assist them in developing policies and procedures, assist with specific audits, and provide some on-the-job training to unit staff. One of the actions included working with these audit units to develop risk-based audit plans for 2015. This policy action is fully complied with.

29. **Policy action 16.** Initially, the government intended to procure software and hardware to improve the comprehensiveness and efficiency of their current road asset management system (RAMS). This equipment will take raw data from various sources and provide more technical and robust results to allocate expenditure. The procurement of this equipment has taken longer than expected due to insufficient interest from potential vendors. The government has now

⁸ The subsidies included loans to water service companies on interest free terms, direct subsidies, management fees, government loans from international organizations for infrastructure expenditure, and grants.

actively sought out potential vendors and is confident that procurement should be completed by the end of 2015 or early 2016. MOTC wrote to ADB explaining the delays, and that its current RAMS has been improved by using tools developed under ISSP. Specifically, indicators on road quality (international roughness index) were uniformly used across the whole road network, and the road video inventory helped compare sections of road more efficiently and robustly manner. Though a more comprehensive RAMS was not in place as envisaged, the current RAMS was improved upon, including using the road video inventory, to enable partial compliance with this condition. This policy action was partially complied with.

30. **Policy action 17.** Under tranche 1, MOTC developed a process to annually monitor the condition of the road network, particularly in terms of the international roughness index for the MTEF. Under tranche 2, MOTC continued implementation of the monitoring framework. ADB has worked with MOTC to review their implementation of this work. This policy action is fully complied with.

31. **Policy action 18.** A basic element in enabling SCWE to understand the condition of the water network—and thus where best to prioritize expenditure—is to have a complete inventory of the assets. ADB worked with SCWE to develop a protocol that would record the assets, and then sought data from the water providers to populate the asset registry. ADB also assisted SCWE in populating the asset registry and training staff in use of the asset registry. This policy action is fully complied with.

32. **Policy action 19.** To ensure that MOTC and SCWE continue to implement policy actions 7 and 17 (regular road and water sector indicator monitoring), the government issued a decree requiring each of these agencies to report quarterly to MOF on these indicators. This policy action is fully complied with.

33. **Policy action 20.** To ensure that the right institutional structure was established for the internal audit committees in SCWE and MOTC, each agency had to establish an audit committee to review the internal audit reports. To ensure that the reports would receive sufficient attention, each agency also appointed independent non-executive members to their internal audit committee who were familiar with the sector, but external to the agency. This policy action is fully complied with.

34. **Policy action 21.** The certification of internal auditors is centralized within the MOF. The certification process was theory based, and did not involve a practical element. ADB worked with MOF to develop a practice-based element to the certification process, and MOF then issued a decree to enforce it. This policy action is fully complied with.

35. A TA supported the government in meeting the policy actions. A combination of national and international experts worked with government officials in this work, but also undertaking various capacity building activities. Specifically with regard to internal audit, audit specialists worked consistently with both MOTC and SCWE in developing, implementing and reporting on their work plans. Workshops were also held on the water and sanitation strategy with financing plan and the road maintenance strategy with financing plan. The TA was welcomed by the government and contributed to the success of this program.

IV. THE PRESIDENT'S RECOMMENDATION

36. In view of the substantial progress made in implementation of the Infrastructure Sustainability Support Program, as evidenced by full compliance of 19 policy actions and partial

compliance of two policy actions for the release of the second tranche, the President recommends that the Board approve, on a no-objection basis:

- (i) the waiver of full compliance of two tranche release policy actions that have been partly complied with; and
- (ii) the release of the second tranche in the amount of SDR18,802,997.07 for the Infrastructure Sustainability Support Program.

POLICY MATRIX

TRANCHE 1			TRANCHE 2		
Policy Actions	Status of implementation (as of 1 July 2014)	Documentary Evidence	Policy Actions	Status of implementation	Documentary Evidence
Output 1: Improved sector management systems					
Roads:					
To enable informed and efficient management of the road sector, (i) the Government establishes the Road Council, the MOTC-led advisory body for coordination of road maintenance (1.1) and (ii) MOTC organogram and departmental terms of reference are each updated to streamline the road sector agencies (1.2)	<p>(1.1)^a Complied with. The Government Decree #264-A on the establishment and the charter of the Road Council was approved on 13 February 2014.</p> <p>(1.2) Complied with. The Government Decree #268-N was approved on 13 March 2014 and published in the Official Gazette on 26 March 2014. MOTC ministerial order N132-A was signed upon promulgation of the decree, as per government procedures. MOTC provided the updated organogram, departmental terms of reference.</p>	<p>(i) Published Government decision</p> <p>(ii) Published Government decision approving the establishment of a regulatory body in MOTC, and MOTC ministerial order approving updated organogram and departmental terms of reference by function and accountability</p>			
Water:					
To streamline water supply agencies' responsibilities and functions, MTA initiates a review of key water sector agencies by function and accountability (1.3)	<p>(1.3) Complied with. The Government approved a resolution mandating the MTA to conduct a review of the functions performed by key water sector agencies and the terms</p>	Government resolution mandating MTA to conduct the review (including MTA terms of reference)	To facilitate long-term planning for the water supply sector, the Government approves each of (i) a sector strategy with financing plan (1.4); (ii) the streamlining of water	<p>(1.4) Complied with. The government approved the Water and Sanitation Strategy with Financing Plan on 13 August 2015 as per Government Decree N38.</p>	(i) Published Government protocol decision

TRANCHE 1			TRANCHE 2		
Policy Actions	Status of implementation (as of 1 July 2014)	Documentary Evidence	Policy Actions	Status of implementation	Documentary Evidence
	of reference for the review as per the Prime Minister's Order N134-A dated 24.02.2014 and a working group established with Government Decree #192-A on 17 March 2014. The working group held its first meeting on 17 March and the meeting minutes were provided to ADB.		sector agencies' functions (1.3); and (iii) alignment of the Water Code 2002 and related legal acts with the functional review recommendations and sector strategy (1.5)	<p>(1.3) Complied with. Recommendations of functional review approved by the government on 11 December 2014 as per Government protocol decision 52-37.</p> <p>(1.5) Partially complied with. Government decision on 22 May 2015 taken to align Water Code (2002) from function review as per Government decree N29.6. Government yet to take decision on aligning Water Code (2002) to Water Strategy. Government informed ADB it will make this decision in 2015, after work on new sanitation chapter is drafted and consulted on.</p>	<p>(ii) Published Government protocol decision</p> <p>(iii) Published Government protocol decision</p>
Output 2: - Strategies and processes for greater allocative efficiency in investment decisions					
			<p>Roads:</p> <p>To improve the allocative efficiency of investment decisions in the road sector, the government adopts a Financing Strategy for Road Maintenance with 2015 budget targets</p>	<p>(2.1) Complied with. Government approved the road maintenance strategy with financing plan on 25 June 2015 as per government decree 873-N.</p>	Government Protocol Decision; Annex to 2015 road maintenance program submitted to MOF/Government

TRANCHE 1			TRANCHE 2		
Policy Actions	Status of implementation (as of 1 July 2014)	Documentary Evidence	Policy Actions	Status of implementation	Documentary Evidence
			<p>(2.1)</p> <p>Road Council, the MOTC-led advisory body, validates RAM-based road maintenance expenditure (2.2)</p> <p>The Government adopts a key performance indicator (KPI)-based MTEF 2015-2017 for road sector with quality indicators (2.3)</p> <p>Water:</p> <p>To improve policy effectiveness, transparency and accountability in the water sector, (i) the Government explicitly presents in its budget message a policy statement on its shareholder role (including its financial objective as shareholder) in the water sector and the objectives of the water sector subsidies (2.4), (ii) SCWE and MOF develop actions and targets with tariffs based on its shareholder role and</p>	<p>(2.2) Complied with. On 30 September 2014, the Roads Council approved the 2015 road maintenance program. Minutes of Road Council meeting provided.</p> <p>(2.3) Complied with. Government adopted new KPIs for the road sector and were published in the 2015 – 2017 MTEF.</p> <p>(2.4) Complied with. MOF included a policy statement on its shareholder's role in the water sector in the 2015-2017 MTEF and budget message.</p> <p>(2.5) Complied with. MOF included a policy statement on its subsidy objectives in the water sector in the 2015-2017 MTEF.</p>	<p>Signed copy of Road Council minutes.</p> <p>Published 2015-2017 MTEF.</p> <p>Published 2015-2017 MTEF.</p> <p>Published 2015-2017 MTEF.</p>

TRANCHE 1			TRANCHE 2		
Policy Actions	Status of implementation (as of 1 July 2014)	Documentary Evidence	Policy Actions	Status of implementation	Documentary Evidence
			the sector's financial position (2.5) and (iii) the Government adopts a KPI-based MTEF 2015-2017 for water sector with quality indicators (2.3)		
Output 3: Regulatory Frameworks					
Roads:					
To improve service standards and better safeguard user rights, (i) regulatory functions of MOTC specified for interstate, republic and local roads (3.1) and (ii) MOTC formally sets-up a sector regulator for the entire road network of Armenia (3.2)	<p>(3.1) Complied with. Government Decree #265-N was approved on 13 February, as amended with Government Decree (#268-N) on 13 March 2014. It was published in the Official Gazette N15 (1028) on 26 March 2014.</p> <p>(3.2) Complied with. MOTC ministerial order was adopted by the Order 132-A on 8 April 2014 upon promulgation of Decree #268-N, as per government procedures.</p>	<p>(i) Published Government Decree (ii) Published Government Decree MOTC Order</p>			
To enhance its role as regulator of the road sector, a streamlined user feedback and grievance redress system adopted by MOTC (3.3)	<p>(3.3) Complied with. Adopted by the MOTC Order 88-A on 11 March 2014 and posted on their website. (May be accessed at http://mtc.am/pages.php?lang=1&id=196&page_name=seniority_decision)</p>	<p>MOTC Order on adoption of the user feedback and grievance redress system MOTC website screenshots showing public disclosure of the system</p>			

TRANCHE 1			TRANCHE 2		
Policy Actions	Status of implementation (as of 1 July 2014)	Documentary Evidence	Policy Actions	Status of implementation	Documentary Evidence
<p>Water:</p> <p>To enhance its role as regulator of the water sector, PSRC adopts a streamlined user feedback and grievance redress system (3.3)</p>	<p>(3.3) Complied with. Adopted by the PSRC Order 56-HN on 20 February 2014, as amended by the PSRC Order 68-HN on 7 March 2014. It was posted on their website. (May be accessed at http://psrc.am/am/?nid=87)</p>	<p>Updated PSRC Order on user feedback and grievance redress mechanism, and PSRC website screenshot showing public disclosure of such mechanism</p>			
Output 4: Implementation monitoring systems					
<p>Roads:</p> <p>Video inventory created for 1,500km of interstate and republic roads, and 100% of roads rehabilitated in Armenia in 2013, to be maintained by ARD and PIU, MOTC in a video library (4.1)</p> <p>To enable better informed decision-making for policy and investment purposes, annual international roughness index (IRI) monitoring process adopted (4.5)</p>	<p>(4.1) Complied with. CDs with required video samples of geo-referenced road footage and list for 1500 km of maintained and 100% (119 km) of rehabilitated roads were provided by MOTC in February and March 2014, with MOTC Chief of Staff letter 09/17/3231-14 certifying the submission.</p> <p>(4.5) Complied with. Government Decree #263-N was approved on 13 March 2014 and published in the Official Gazette N15 (1028) on 26 March 2014.</p> <p>The process was adopted</p>	<p>CD providing at least 1 minute of video footage of each road section, with each such road section identified</p> <p>Map/list of roads stretches with completed video processing</p> <p>Updated Published Government decision</p>	<p>Roads:</p> <p>Video inventory created of the entire road network, to be maintained by ARD and PIU, MOTC in a video library (4.1)</p> <p>To enable better informed decision-making for policy and investment purposes, (i) road asset management system, including a road video inventory, adopted as a tool for investment decisions</p>	<p>(4.1) Complied with. 7024km of video inventory provided to ADB. 451km not recorded due to security reasons, some roads do not exist and some roads are private roads..</p> <p>(4.4) Partly complied with. New RAMS equipment not procured due to insufficient vendor interest. Current RAMS improved by using new tools developed under ISSP, including the road video</p>	<p>Hard drive of 5 minutes of footage from each section provided</p> <p>Government wrote to ADB explaining delays in procurement of new RAMS equipment, but how it used new techniques developed under ISSP to better allocate road maintenance</p>

TRANCHE 1			TRANCHE 2		
Policy Actions	Status of implementation (as of 1 July 2014)	Documentary Evidence	Policy Actions	Status of implementation	Documentary Evidence
<p>To improve service provision and transparency, MOTC approves and implements (through corresponding updates to its website) a comprehensive public information plan (PIP) for the road sector (4.13)</p> <p>Water:</p> <p>To improve policy effectiveness, transparency and accountability in the water sector, SCWE approves calculation framework for calculation of water</p>	<p>by the MOTC Order 131-A on 8 April 2014, upon promulgation of Decree 263-N.</p> <p>(4.13) Complied with. PIP was adopted by the MOTC Order 56-A on 18 February 2014, as amended with the Order 90-A on 13 March 2014.</p> <p>(4.2) Complied with. The framework was adopted by the SCWE Order 208-A on 28 December 2013, as amended by the SCWE Order 33-A on 11 March 2014.</p>	<p>MOTC ministerial order approving PIP, which shall indicate the information to be disclosed and frequency of disclosure; MOTC website screenshots showing disclosure of information pursuant to PIP</p> <p>SCWE Order on calculation framework</p>	<p>(4.4), and (ii) annual IRI monitoring process implemented from 2015 onwards (4.5)</p> <p>Budget-linked regular road sector KPI monitoring (including IRI) endorsed by government (4.8)</p> <p>To improve service provision and transparency, MOTC discloses all required information in accordance with its approved PIP (4.13)</p> <p>Water:</p>	<p>inventory.</p> <p>(4.5) Complied with. ARD currently conducts IRI monitoring for about 1500 kms annually</p> <p>(4.8) Complied with. KPIs have been developed and incorporated into MTEF.</p> <p>IRI measurements are being conducted by ARD in about 1500 kms annually. This is in line with Government decree.</p>	<p>expenditure.</p> <p>ADB prepared report on continued ARD implementation of IRI monitoring process.</p> <p>Published Government decision</p>

TRANCHE 1			TRANCHE 2		
Policy Actions	Status of implementation (as of 1 July 2014)	Documentary Evidence	Policy Actions	Status of implementation	Documentary Evidence
<p>sector's financial position and financing flows (cash and non-cash) (4.2)</p> <p>To improve oversight and management of drinking water supply assets, SCWE approves an asset management action plan (4.6)</p>	<p>(4.6) Complied with. The Action Plan was adopted by the SCWE Order 14-A on 31 January 2014.</p>	<p>SCWE Order approving the action plan</p>	<p>To improve oversight and management of drinking water supply assets, SCWE completes assets register of assets managed by state regulated operators (4.7)</p> <p>Budget-linked regular water sector KPI monitoring endorsed by Government (4.8)</p>	<p>(4.7) A template for an assets registry was developed and SCWE protocol approved on 2 April 2015 for it to be populated. SCWE has requested data from the water operators and the registry is now being populated.</p> <p>(4.8) KPIs have been developed and government decree approved on 18 December 2014. KPIs incorporated into MTEF</p>	<p>SCWE protocol with registry template and requirement for data from water operators approved.</p> <p>Government decree N1515 published and inclusion in MTEF 2015-2017 confirmed.</p>
<p>To improve service provision and transparency, SCWE and PSRC each approves and implements (through corresponding updates to its website) a comprehensive public information plan (PIP) (4.13). PIP for SCWE shall require disclosure of, among others, the latest complete audited financial statements of the water operators (Closed Joint Stock Companies) on its</p>	<p>(4.12) Complied with. Most recent audit reports of all 5 operators for FY2012 are published on the SCWE website as of 13 March 2014. (May be accessed at http://www.scws.am/index.php?menu1=240&menu2=241; http://www.scws.am/index.php?menu1=240&menu2=244)</p> <p>(4.13) Complied with. PSRC PIP was adopted by the PSRC Order 56-HN on 20 February 2014,</p>	<p>SCWE and PSRC Orders approving PIPs, which shall indicate the information to be disclosed and frequency of disclosure SCWE and PSRC website screenshots showing actual disclosure of information pursuant to PIP</p>			

TRANCHE 1			TRANCHE 2		
Policy Actions	Status of implementation (as of 1 July 2014)	Documentary Evidence	Policy Actions	Status of implementation	Documentary Evidence
<p>website (4.12). PIP for PSRC shall require disclosure of, among others, composition, and comparison of tariffs between various operators (4.14)</p> <p>Roads and Water:</p> <p>To improve qualifications of internal auditors, the govt adopts a requirement for all qualified internal auditors to pass continuous professional development (CPD) programs each year, in order to remain qualified (4.10)</p>	<p>as amended by the PSRC Order 68-HN of 7 March 2014. SCWE PIP was adopted by the SCWE Order 20-A on 14 February 2014, as amended by the SCWE Order 34-A on 11 March 2014.</p> <p>(4.14) Complied with. PSRC functions and tariff policy set forth with the PSRC Order 56-HN on 20 February 2014, and as amended by the PSRC Order 68-HN on 7 March 2014. (May be accessed at http://psrc.am/am/?nid=87)</p> <p>(4.10) Complied with. Government Decree #176-N was approved on 13 February 2014 and published in the Official Gazette issue N10 (1023) on 5 March 2014.</p>	<p>Published Government decision (www.arlis.am)</p>	<p>Roads and Water:</p> <p>To improve standards of certification for internal auditors, the Government will pilot the inclusion of a practice-based component in the certification for the internal auditors of MOTC (4.11)</p>	<p>(4.11) MoF decree approved on 27 January 2015 approving inclusion of practice-based component in training for internal auditors.</p>	<p>- MOF ministerial order 26-N on piloting practical component for certification of internal auditors received.</p>

TRANCHE 1			TRANCHE 2		
Policy Actions	Status of implementation (as of 1 July 2014)	Documentary Evidence	Policy Actions	Status of implementation	Documentary Evidence
			To improve internal audit effectiveness and oversight, appoint audit committees in MOTC and SCWE and include non-executive members in their composition (4.9) MOTC and SCWE approve risk-based audit annual plans for road and water sectors (4.3)	(4.9) SCWE and MOTC internal audit committees in place and have non-executive members from a NGO. (4.3) Risk-based audit plans developed for 2015.	SCWE and MOTC have provided decrees which established the internal audit committees and also the decree for the external member. SCWE and MOTC approved risk based audit plans and provided to ADB.

ADB = Asian Development Bank, ARD = Armenia Road Directorate, CDTA = capacity development technical assistance, GPS = global positioning system, IRI = international roughness index (meter/kilometer), KPI = key performance indicator, MOF = Ministry of Finance, MOTC = Ministry of Transport and Communication, MTA = Ministry of Territorial Administration, RAM = road asset management, MTEF = medium-term expenditure framework, PIP = public information plan, PIU = project implementation unit, PSRC = Public Services Regulatory Commission, SCWE = State Committee on Water Economy, TA = technical assistance, TOR = terms of reference

^a The notation (1.1) and subsequent numbering of the same format refer to the policy conditions as listed in the program design and monitoring framework.