AFRICAN DEVELOPMENT FUND

PROJECT : LOSEOTHO TAX MODERNISATION PROJECT

COUNTRY : LESOTHO

PROJECT APPRAISAL REPORT

ECGF/RDGS/PGCL

November 2017

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Currency Equivalents

(August 2017)
1 UA = USD 1.394
1 UA = LSL 20.267

Fiscal Year

1st April – 31st March

Weights and Measurements

1 metric tonne = 2204 pounds (lbs)
1 kilogramme (kg) = 2.200 lbs
1 metre (m) = 3.28 feet (ft)
1 millimetre (mm) = 0.03937 inch (“)
1 kilometre (km) = 0.62 mile

Acronyms and Abbreviations

ADB	African Development Bank
ADF	African Development Fund
ATAF	Africa Tax Administration Forum
AFS	Africa Regional Technical Assistance Centre-South
CPIA	Country Policy and Institutional Assessment
CSP	Country Strategy Paper
DP	Development Partners
DPCF	Development Partners Consultative Forum
ECGF	Governance and Public Financial Management Coordination Office
EU	European Union Delegation
FDI	Foreign Direct Investment
GoL	Government of Lesotho
GDP	Gross Domestic Products
IMF	International Monetary Fund
LRA	Lesotho Revenue Authority
LTMP	Lesotho Tax Modernisation Project
MDA	Ministries, Departments and Agencies
MoDP	Ministry of Development Planning
MoF	Ministry of Finance
NSDP	National Strategic Development Plan
PAR	Project Appraisal Report
PCR	Project Completion Report
PCN	Project Concept Note
PD	Presidential Directive
PFM	Public Financial Management
PFM-PSIR	Public Financial Management and Public Sector Improvement and Reform
PIU	Project Implementation Unit
PMU	Project Management Unit
RDGS	Regional Development and Business Delivery Office - South
SACU	Southern African Customs Union
SBD	Standard Bidding Document
UA	Units of Account
USD	United States Dollars
UNDP	United Nations Development Program
WB	World Bank

Loan Information

Client's information

RECIPIENT : The Kingdom of Lesotho

EXECUTING AGENCY : Lesotho Revenue Authority

Financing plan

Source	**Amount (UA)**	**%age**	**Instrument**
ADF Loan	5.00 Million	90%	ADF Loan
GoL Contribution	0.56 Million	10%	N/A
TOTAL COST	5.56 Million	100%	

ADF's key financing information

	ADF Loan: UA 5 million
Currency	Units of Account (UA)
Commitment fee	0.5%
Service charge	0.75%
Interest rate	1%
Tenor	30 years including 5 year grace period

Timeframe - Main Milestones (expected)

Concept Note approval	March 2017
Appraisal	March 2017
Project approval	November 2017
Effectiveness	January 2018
Mid-term Review	June 2019
Completion	December 2020
Closing date	June 2021

Project Summary

Paragraph	Topics covered
Project Overview	*Project name*: Lesotho Tax Modernisation Project (LTMP) *Geographic scope*: Entire country *Implementation timeframe*: 2018-2020 *Total Project cost*: UA 5.56 million *Expected Outcomes and Outputs*: The project is expected to deliver quantifiable results including: increase in tax to GDP ratio from 23.8% to 26%, increase in revenue collection from small tax payers from LSL12.6 million (2015) to LSL 0.5 billion in 2022, and reduction in cost of compliance and time to register for tax (from 164.6 hours to 12 hours) and time to pay tax (from 16 hours to 6 hours). These will be achieved through the following output level results: (a) a new e-taxation and VAT compliance technology solutions installed, (b) e-taxation and VAT compliance regulations adopted, (c) enabling legislation for small tax payers adopted, (d) streamlined tax procedures adopted, and (e) human resource capacity strengthened. *Project direct beneficiaries:* The direct project beneficiaries are the LRA, and the Ministry of Finance through institutional capacity building support and technical assistance to improve revenue collection capacity. The indirect beneficiaries are the private sector (taxpayers) through a simplified tax regime and streamlined tax procedures for small business taxpayers. To the extent that the increased tax revenues are channelled to social and economic expenditure that will directly benefits the poor segments of the society.
Needs Assessment	Lesotho's major source of revenue for financing government expenditures comes from SACU, but it is prone to risks related to volatility of the commodity market and fluctuating transfers. According to the Article IV consultation report of June 2015, Lesotho's SACU revenues were expected to fall by about 12 percentage points of GDP between 2014/15 and 2017/18, with much of this drop expected to be long lasting. After falling by 3½ percentage points of GDP in 2015/16 (to just over 25% of GDP), they are projected to plunge another 8½ percentage points to about 16.5% of GDP in 2016/17. Although a modest rebound is expected in 2017/18, SACU revenues are projected to remain relatively low (below 20% of GDP) over the foreseeable future, largely due to the slowdown in import growth in South Africa. Despite having substantial international reserves and fiscal buffers, a major fiscal adjustment over the medium term is needed to maintain macroeconomic stability. The adjustment should come from expenditure measures, particularly by containing the wage bill (19% of GDP in 2016/17), improving the quality of public investment, improving business environment, and strengthening tax administration reform. The current low levels of domestic revenues, and suspension of budget support have negative implications on the country's capacity to finance its development program. In this regard, the GoL prioritized LRA modernization program to enhance domestic revenue mobilization. Among the activities envisaged is enhancing the performance and efficiency of LRA to address two critical challenges: *first*, inappropriate tax regime and/or ineffective administration leading to low voluntary compliance and low revenue yields. Low voluntary compliance is exacerbated by tax regulations that impose a heavy burden or high compliance costs, and contributes to low revenue yields, which in turn create opportunities for rent-seeking activities. *Second*, the inherent institutional weaknesses of the tax collection authority. LRA need significant strengthening, in terms of training, business process improvement, operational manuals and IT, in order to render them fit for purpose in terms of meeting the revenue mobilization targets of government. In this regard, GoL has requested the Bank to support government efforts in strengthening tax administration capacity in order to reduce dependence on volatile SACU revenue.
Bank's Added Value	The proposed operation will complement and enhance the effectiveness of the Bank's ongoing projects by focusing on the domestic resource mobilisation to implement the national development plan. The ongoing projects focus on infrastructure (power and water), enterprise development, and public finance management reform. There are also synergies with the ongoing donor funded programs, in particular the Public Sector Modernisation Project financed by the World Bank, and the IMF Regional Technical Assistance Centre for Southern Africa (AFRITAC South). Furthermore, the Bank has a considerable experience and expertise in tax administration reform, gained from designing and implementing similar initiatives in member countries.
Knowledge Management	The Project will contribute to knowledge building particularly in the areas of tax administration and domestic resource mobilisation. The Bank will capture and disseminate knowledge and experience through sharing the findings of supervision missions, progress reports, and the Project Completion Report. Lessons learned and experience gained will be available to inform future policy operations.

Result-based Logical Framework

Country and project name: Lesotho Tax Modernisation Project
Purpose of the project: To strengthen tax revenue administration capacity and improve revenue collection to finance development

	RESULTS CHAIN	PERFORMANCE INDICATORS			MEANS OF VERIFICATION	RISKS/MITIGATION MEASURES
		Indicator (including CSI)	Baseline	Target		
IMPACT	Improved effectiveness of tax administration to create fiscal space for development and ensure macroeconomic stability	Tax revenue to GDP ratio (excluding grant and SACU)	23.8% (2015)	26% (2022)	MoF, LRA & IMF reports	Risk #1: Political instability. Mitigation: Government with support from SADC is engaged in political dialogue processes, and reform implementation which are is critical for the country's political stability. The Newly elected Prime Minister confirmed government commitment to implement reform and SADC's recommendation for a comprehensive political and security reform. Risk #2: insufficient commitment and capacity to implement reforms. Mitigation: The project will provide capacity building support to assist change champions and reinforce their commitment to implement reform. Risk #3: Delay in project start-up and procurement. Mitigation: Adopt a streamlined conditions for first disbursement and use of existing PMU and project management staff with many years of project implementation experience and experience with ADB project Risk #4: LRA not having a substantive Commissioner General and a Board. Mitigation: Discussions with the Ministry of Finance to appoint a new Board and Commissioner General
		Increase tax revenue collected from small taxpayers	LSL 12.6m (2015)	LSL 0.5 billion (2022)		
OUTCOMES	Enhanced tax administration capacity of LRA	Reduce VAT tax gap	23% (2015)	17% (2021)	LRA and MoF annual reports	
		Reduce average time to (a) register for tax; (b) file tax return; and (c) pay tax	(a) 164.6 hrs (b) 24 hrs, and (c) 16 hrs (2015)	(a) 12 hrs (b) 6 hrs, and (c) 6 hrs (2021)		
OUTPUTS	**Component 1: Enhancing Tax Modernisation**					
	1.1 e-Taxation introduced	E-taxation technology solution installation	None (2016)	New e-taxation system in place (2020)	LRA progress and supervision mission reports	
		# of LRA staff trained on the new technology solutions or e-taxation	None (2016)	100 LRA staff trained (50% female) by 2020		
	1.2 VAT compliance enhanced	IT solutions for VAT compliance	None (2016)	VAT non-compliance detective solutions installed (2020)		
		# of LRA staff trained and taxpayers attended the education program	None (2016)	150 LRA staff trained and 1000 taxpayers attended the education program (50% female) and by 2020		
	1.3 Improved tax base	Streamlined tax procedures and simplified tax regime	None (2016)	Streamlined procedures adopted (2019)		
	Component 2: Institutional Strengthening					
	2.1 Enabling legislations developed	Enabling legislation for small business taxpayers Bill drafted	None (2016)	A new tax regime for small and informal tax payers adopted (2019)	LRA progress and supervision mission reports	
		E-tax and VAT compliance regulations drafted	None (2016)	e-taxation and VAT compliance regulation adopted (2019)		
	2.2 Enterprise data warehouse and business intelligence capacity enhanced	Business intelligence capacity	None (2016)	Enterprise data warehouse introduced by 2019		
	2.3 LRA's Gender mainstreaming and human resource capacity enhanced	Gender strategy and implementation guideline	None (2016)	Gender strategy and implementation guideline adopted by LRA (2019)		
		# of staff trained on new tax regime, and tax audit	None (2016)	200 LRA staff trained (50% female), 2020		
	Component 3: Project Management					
	3.1 Implementation progress reports	Number of progress reports produced (quarterly)	None	12 reports (2018-2020)	LRA progress reports	
		Audit reports	None	3 reports (2019 - 2021)		

KEY ACTIVITIESS	COMPONENTS	INPUTS
	Component 1: Improving the tax administration infrastructure (UA 4.0 million): technical assistance, acquisition of modern technology, business process re-engineering, taxpayer education program, and staff training. Component 2: Institutional strengthening (UA 1 million): technical assistance, enabling legislation, and human resource capacity building and training Component 3: Project management (UA 560,000): project management, monitoring and coordination, procurement, audit and reporting.	Inputs : - Funding in million UA ADF : UA 5 million GoL : UA 0.56 million Total project cost: UA 5.56 million

Table 1: Project Time Frame/Implementation Schedule
Lesotho Tax Modernisation Project

Activities/Years	2017	2018				2019				2020				Action by
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Project Processing and Management														
Loan approval														AfDB
Signing Loan Agreement														AfDB & GoL
Project Effectiveness and Launching														AfDB & GoL
Supervision and Monitoring														AfDB
Mid-term Review														AfDB
Project Completion Report														AfDB & GoL
Component 1: Enhancing Tax Modernisation														
A. Procurement														GoL
B. Technical Assistance														GoL
C. Training														GoL
Component 2: Institutional Strengthening														GoL
A. Procurement														GoL
B. Technical Assistance														GoL
C. Training														GoL
Component 4: Project Management														GoL

REPORT AND RECOMMENDATION OF THE MANAGEMENT OF THE ADB GROUP TO THE BOARD OF DIRECTORS ON A PROPOSED ADF LOAN TO LESOTHO FOR THE TAX MODERNISATION PROJECT

Management submits the following Report and Recommendation on a proposed ADF Loan of UA 5.00 million to the Kingdom of Lesotho to finance the Tax Modernisation Project (LTMP).

I. STRATEGIC THRUST AND RATIONALE

1.1 Project Linkages with Country Strategy and Objectives

1.1.1 **The operation is aligned with the country's development strategy**. Lesotho's long-term development agenda is laid out in the Vision 2020 and the National Strategic Development Plan (NSDP, 2012-2018). The primary objective of the NSDP is to create jobs, to reduce poverty and achieve sustainable development. It also seeks to establish the pre-conditions for an inclusive growth and faster job creation through focusing on six strategic priorities (Box 1). To this end, the Lesotho Revenue Authority (LRA) has adopted a strategic plan (2014-19) which highlights the need to increase efforts for mobilization of domestic revenue to ensure the NSDP is adequately funded, and to manage the risk around the uncertainty of SACU transfers. It provides a framework on which to base revenue administration reform interventions by development partners including the Bank. The strategic plan also identifies the main challenges and opportunities for domestic resource mobilization, and priorities in the short to medium term including measures to broaden tax base, modernize LRA's processes and systems, and strengthening institutional and human resource capacity. The proposed Project will thus directly address challenges and priorities sets out in the LRA's strategic plan.

Box 1: NSDP six strategic goals

- pursue inclusive economic growth and create 50,000 private sector jobs over 5 years
- develop key infrastructure;
- enhance the skills base, technology adoption and foundation for innovation;
- Improve health, combat HIV and AIDS and reduce vulnerability;
- Reverse environmental degradation and adapt to climate change; and
- Promote peace, democratic governance and build effective institutions

Source: NSDP 2012/13 – 2017/18

1.1.2 **The Project fits firmly with the objectives and priorities of the Lesotho Country Strategy Paper (CSP, 2013-2017),** specifically with Pillar II (Institutional Capacity Building) by providing targeted institutional capacity building support to improve efficiency and effectiveness of the country's revenue administration. The operation is also aligned to the Bank Group's Ten Year Strategy (2013-22) and the Governance Strategic Framework and Action Plan (GAP II, 2014-18) priority areas (strengthening domestic resource mobilization under Pillar I), and the High Fives (Improve Quality of Life for Africans) by improving effectiveness of tax administration to create fiscal space for development and ensure macroeconomic stability.

1.1.3 **Complementarity and synergy with ongoing operations:** The proposed operation will complement the effectiveness of the Bank's ongoing projects by strengthening Government capacity to raise domestic revenue and providing fiscal space for priority public expenditures including counterpart funding for ongoing operations. The Bank is currently co-financing public financial management reforms that focus on improving transparency and accountability in the way public funds are allocated and spent. It also complements the World Bank's ongoing assistance to customs modernization.

1.2 Rationale for Bank's Involvement

1.2.1 **Lesotho's fiscal situation is under severe stress and an effective fiscal consolidation measure remain paramount to the government's goal of enhancing service delivery and reducing poverty, while strengthening macroeconomic and financial stability.** Real GDP growth averaged about 4.5% a year from 2010 to 2014. Following South Africa's economic slowdown, Lesotho's SACU revenues declined from 30% of GDP in 2012/13 to 25.7% in 2015/16, and projected to decline sharply to about 16.5% in 2016/17. Excessive dependence on the SACU receipts, and textile exports to the United States continues to make the country vulnerable to external setbacks. The decline could be long-lasting, following the weakening of the long-term growth trend of South Africa, and lower global growth prospects. Consequently, a substantial fiscal adjustment may be required to preserve fiscal and macroeconomic sustainability, including measures to contain recurrent expenditures[1], and improve tax administration and revenue collection. In line with the proposed Project, the IMF has acknowledged that addressing the fiscal deficit is the most pressing macroeconomic priority, and emphasized the need to implement tax reforms and strengthen tax administration capacity.

1.2.2 **The Lesotho Revenue Authority continues to make good progress in implementing tax administration reform and modernisation.** In its strategy, LRA aims to optimize revenue collection while at the same time reducing the cost of collection and burden of compliance through adopting a modern technology and improving business processes and procedures. Over the past three years, LRA has made progress in a number of areas including: improvement in revenue collection, introduction of VAT, implementation of ASYCUDA World, and effectiveness of its border management processes. A summary of progress of the modernisation program is presented in Box 2 below. Nevertheless, more effort is required to improve efficiency and effectiveness to deliver better service and enforce compliance.

Box 2: LRA Modernisation Program Overview and Key Achievements

In 2008, the LRA embarked on a modernisation program which started with development of an Enterprise Architecture design initiative with the aim to address inefficiency and transparency in tax administration and reduce the cost of tax collection to government and tax payers. This culminated in a broader modernisation agenda which covered Customs, Domestic Taxes and Business Support Modernisation.

- **Tax modernisation:** through the implementation of the Oracle Enterprise Taxation and Policy Management (ETPM) System, the following milestones have been achieved: (a) automation of the Taxpayer registration process and the re-registration of Taxpayers; (b) automation of new VAT processes supported by the ETPM system; (c) automation of new Income Tax forms and processes including Fringe Benefit Tax (FBT), Pay As You Earn (PAYE), Personal Income Tax (PIT), and Company Income Tax (CIT); and (d) the roll-out of integrated payments module for most (95%) of the payments received by the LRA.
- **Customs modernisation:** the main achievements under the customs modernisation component are: (a) implementation of modernised customs procedures at all the commercial border posts across the country, supported by the ASYCUDA World system; (b) introduction of a central clearance centre for clearance of goods that pass through the borders; (c) the establishment of a multi-agency trade portal; (d) acquisition and implementation of compact mobile scanners, and a baggage scanner at the international airport; and (e) development of new Customs Administration Bill as enabling legislation for Customs modernisation.
- **Business Support Modernisation:** progress include: (a) introduction of an electronic records management system for improved safeguarding of LRA records and minimisation of paper handling; and (b) implementation of a business intelligence platform for basic reporting.

The performance of the LRA on revenue collections has grown steadily at an average of 13% per annum from 2003 to 2015. The growth rate of the tax register has also been significant during the same period, leap frogging from 3,749 in 2003 to 98, 237 taxpayers in 2015. Despite good performance in revenue collection, more effort is required to cope with a rapidly changing business environment, and continue to increase the revenue base to create fiscal space for government investments in key public services and infrastructure. One of the critical

[1] The extraordinarily large government wage bill should be central to the adjustment effort. Lesotho wage bill has grown to 19% of GDP.

issues is the need to improve efficient and effectiveness of LRA to deliver improved service to all Taxpayers through implementation of the modernisation program including adopting electronic platform, strengthening auditing and taxpayer education program for compliance and robust regulatory framework to broaden tax base.

1.2.3 **The Government is committed to implement tax administration reform as a key tool for achieving sustainable economic development.** It has prioritized LRA modernization program to enhance domestic resources mobilization. Among the activities envisaged: enhancing the performance and efficiency of LRA to address two critical challenges: *first*, inappropriate tax regime and/or ineffective administration leading to low voluntary compliance and low revenue yields. Low voluntary compliance is exacerbated by tax regulations that impose a heavy burden or high compliance costs, which in turn create opportunities for rent-seeking activities. *Second*, the inherent institutional weaknesses of the tax collection authority. LRA need significant strengthening, in terms of business process improvement, human resource capacity building and use of modern IT systems. The Project will support effective implementation of tax reform including measures to enhance compliance and broadening the revenue base.

1.2.4 **The proposed Project aims at strengthening the revenue collection capacity of LRA.** More specifically, the LRA is expected to increase revenue collection through (a) introduction of modern information technology initiatives to increase voluntary compliance and improve service delivery, (b) improving the tax regime and business process; and (c) strengthening its tax audit system to enforce tax compliance. In this regard, the operation is highly relevant to sustain tax reform in Lesotho. *First*, current gains with the ongoing LRA modernization program reforms need to be consolidated and remaining gaps need to be addressed to enhance efficiency and effectiveness in revenue collection. *Second*, the Bank has a considerable experience in supporting tax administration reforms in member countries: Kenya, Swaziland, Togo, Zimbabwe, Malawi, and Tanzania (Technical Annex A.2). *Third*, need for increased capacity. LRA is the main responsible agency to collect tax, and there is a pressing need to significantly and rapidly increase the technical, administrative, and domestic revenue collection capacity of LRA, especially in light of the revenue potential. *Fourth*, the implementation of the modernisation agenda has been led by the LRA and funded largely by the GoL. Due to a decline in the SACU revenues and the impact on its revenue, the Government of Lesotho is unable to fund all of the planned reforms at the pace desired by the LRA. In this regard, the Government requested the Bank to provide targeted technical assistance to consolidate the LRA modernisation program.

1.3 Donors Coordination

1.3.1 **There is strong commitment by development partners to coordinate their support to Lesotho's domestic resource mobilization effort.** The design of the proposed operation has been developed in close cooperation and consultation with other development partners. Donor Coordination across sectors is assured through the Development Partners Consultative Forum, and it provides a platform for dialogue between donors and the GoL. The Bank Group, through the RDGS, participates in this Forum and meets on quarterly basis. There also exists the Public Financial Management and Public Sector Improvement and Reform Steering Committee which the Bank is a member. The Africa Regional Technical Assistance Centre-South (AFS) is the main partner supporting the revenue modernization program in Lesotho, while the World Bank is providing support to customs automation (ASYCUDA World) in the context of doing business reform and trade facilitation (Appendix III). LRA Modernization Steering Committee has been established to provide strategic guidance, to coordinate and oversee project implementation. Quarterly review meetings are proposed to further enhance coordination with AFS, World Bank, AfDB and other partners to ensure synergy and complementarities.

II. Project Description

2.1 Project Objectives and Components

2.1.1 The overall development objective is to promote economic growth and poverty reduction by improving effectiveness of tax administration to create fiscal space (i.e. increased tax revenues) to finance the country's development plan. The specific objective is to strengthen tax administration capacity by expanding the tax base, modernising collection and compliance procedures, amending and consolidating the legal framework, and strengthening the institutional framework.

2.1.2 The Project has three components: (a) Enhancing tax modernisation, (ii) Institutional strengthening, and (iii) Project Management Support. Reflecting the lessons of past support, more emphasis will be given to strengthening national capacity and ownership of the Project as well as adopting innovative approaches to capacity building through peer learning and partnering with other Revenue Authorities in the continent. The major activities are summarized below:

Component 1: Enhancing tax modernisation

2.1.3 This component has three sub components: (a) introduce e-taxation that will allow online tax services (including registration, taxpayer relationship management, filing and payment); (b) adopt VAT non-compliance detection solution to increase VAT collection and enhance compliance and enforcement capacity; and (c) broaden tax base through simplified tax regime for small taxpayer.

2.1.4 *Sub component 1.1: Introduce e-taxation*. The objective is to improve the process and reduce cost for paying tax and tax collection. Key activities under this sub-component are: (a) technical assistance to review, redesign and develop business process and requirements for e-taxation; (b) acquisition of hardware and software for e-taxation which will consist of eRegistration, eFiling, and ePayment modules; and (c) stakeholder consultation, awareness raising and taxpayers education program. The implementation of the e-taxation system is going to involve tight integration with the existing Enterprise Taxation and Policy Management (ETPM) system to ensure that all the required business rules are enforced on registration, filing and payments when these processes are kept online. This will enable taxpayers to register online, to make payments online, to file returns online and improve the capability to issues tax certificate clearance and interact with taxpayers online.

2.1.5 *Sub component 1.2: Adopt VAT non-compliance detection solution*. The objective is to strengthen tax collection capacity by improving business process and capability for VAT non-compliance detection and enforcement. Key activities under this sub-component are: (a) technical assistance to review, and redesign the VAT compliance process and appeal process; (b) acquisition of a new VAT non-compliance detection modules for integration into ETPM; and (c) implement an effective stakeholder engagement and communication plan as well as taxpayers education program. This will help to increase VAT collections and compliance by reducing cost and improving data processing efficiency.

2.1.6 *Sub component 1.3: Broaden tax base.* The objective is to improve revenue collection by introducing a simplified tax regime and streamlined tax procedures for small taxpayers. This will reduced cost of paying tax including reduction in time it takes to file income tax return. It will also promote inclusive growth through the development of small business who requires taxpayers registration and tax clearance certificate to be able to access finance and training initiatives form small and medium enterprises. Key activities under this sub-component are: (a) provide technical assistance to develop a simplified tax regime and streamlined tax procedures; (b) procurement and introduce a small taxpayer's management module; (c) implementation support and rolling out the simplified tax regime and streamlined tax procedures; and (d) implement taxpayers education program.

Component 2: Institutional strengthening

2.1.7 This component has three sub components: (a) Enabling legislation; (b) Enterprise data warehouse and business intelligence; and (c) Gender mainstreaming and human resource capacity building.

2.1.8 *Sub component 2.1: Enabling legislation.* The objective is to support effective implementation of the tax modernisation program. The existing legal framework does not provide a mandatory use of e-taxation, compliance and enforcement of tax laws and regulations including VAT, and income tax for small taxpayers. Key activities under this sub-component will focus on the provision of technical assistance to review, develop and support the enactment of enabling legislation for effective implementation of e-taxation, VAT non-compliance detection solutions, and simplified tax regime for small taxpayers.

2.1.9 *Sub component 2.2: Enterprise data warehouse and business intelligence.* The objective is to develop capability for business intelligence and analysis where all the data from various data sources within and outside LRA will be consolidated in one place, and then analyzed and generate reports on current data, historical data and future trends. This will strengthen the organizational capacity to analyze and produce accurate reports on tax revenue to inform policy making, planning, monitoring and evaluation. Under this component, the project will finance technical assistance to assist in designing and implementation of an enterprise data warehouse and business intelligence solution.

2.1.10 *Sub component 2.3: human resource capacity building and gender mainstreaming*. The objective is to build human resource capacity to manage and sustain tax modernization and reform in Lesotho, as well as mainstream gender across LRA. Key activities include: (a) technical assistance to review and design organization structure and job profiles, and support leadership in change management; (b) prepare and rollout staff training program related to e-taxation, VAT non-compliance detection solutions, audit skills, new tax regime and procedures for small taxpayers; (c) undertake skill audit, develop training plan and training of trainers, and leadership development program; (d) develop gender mainstreaming strategy and guideline for LRA; (e) tax audit tools/manual and specialized training on special sector audit such as mining and telecom industries; and (f) engage technical assistance or technology implementation partners to advise, support and oversee the implementation of IT for tax modernization.

Component 3: Project Management Support

2.1.11 The objective is to strengthen project implementation, coordination and monitoring and evaluation capacity. Under this component, the Project will co-finance the operating costs of the PMU, staff salaries, and the costs of annual audits of project accounts.

Table 2: Project Description

No.	Component	Key activities
1	Enhancing tax modernisation (UA 4 m)	**Sub-component 1.1: E-Taxation**. Activities include: • Technical assistance to redesign business processes and development of business requirements for e-taxation including online tax registration, including online filing, and payment portal; • Procurement of hardware and software for e-taxation design and implementation; • Recruitment of local IT consultants to support system design and roll-out; • Stakeholder awareness raising and taxpayers education program workshops. **Sub-component 1.2: VAT compliance**. Activities include: • Development of a comprehensive tax compliance strategy; • Provision of TA for introduction of VAT non-compliance detection solutions; • Procurement of VAT non-compliance detection solutions (appropriate IT solutions/equipment); • Recruitment of local consultants to support design and roll-out of a VAT non-compliance detection solutions; • Stakeholder engagement, and taxpayers' education program. **Sub-Component 1.3: broaden tax base:** Activities include: • Provision of technical assistance for developing a simplified tax regime and streamlined tax procedures for small business taxpayers including hiring a local consultant(s) to support design and roll-out of simplified tax regime; and • Training and taxpayers education to support the rolling out of a simplified tax regime and streamlined procedures for small business.
2	Institutional strengthening (UA 1 m)	**Sub-Component 2.1: Enabling legislation.** Activities include: • Provision of technical support for development and enactment of enabling legislation for e-taxation, VAT non-compliance detection solution, and simplified tax regime for small taxpayers. **Sub-Component 2.2: Enterprise Data Warehouse and Business Intelligence**. Activities include: • Engagement of a consultant to assist in designing an enterprise data warehouse and business intelligence system and social network analysis tools. **Sub-Component 2.3: Human resource capacity and Gender Mainstreaming.** Activities include: • Undertake a Skills Audit and development of Training Plan, ToT program, and Leadership Development Program • Train staff in change management, business process re-engineering and taxation, tax audits, and investigation to enforce compliance • Develop tools for audit of special sectors such as mining and telecom industry. • Engagement of a technology implementation partner (consultant) to advise and oversee the implementation of the modernization roadmap; • Development of Gender Strategy and Guidelines for LRA • Implement tax payers education and outreach program
3	Project Management (UA 560,000)	• Project management and coordination • Monitoring and evaluation • Project audit

2.2 Technical Solution Retained and Other Alternatives Explored

2.2.1 During project identification, preparation and appraisal, a number of options were explored regarding the areas of intervention, the scope of the activities, and implementation arrangements. As regards the implementation modalities, it was determined that the use of existing Project Management Office (PMO) will enhance sustainability and avoid start-up delays. The Project will also provide complementary capacity building support which entails (i) the introduction of new IT solution and integration with the existing ICT platform to ensure sustainability, (ii) strengthening human resource capacity and engagement with taxpayers through taxpayers education program to enhance compliance culture, (iii) improving business process and customs services, and (iv) strengthening intelligence and compliance functions and capabilities. Based on experience and lessons from the previous tax administration project, the proposed operation will be guided by: (a) selectivity and complementarity – to consolidate gains made so far and complement the on-going activities in customs reform, the operation will focus on strengthening the internal revenue collection and VAT compliance systems to help increase tax collection; and (b) supporting the effort to broaden tax base by streamlining the tax regime and procedures for small taxpayers. A summary of the technical consideration and project design options is presented in Table 3 below.

Table 3: Project Alternatives Considered and Reasons for Rejection

Alternative	Brief Description	Reason for Rejection
Establishing a parallel implementation arrangement/unit (PIU) solely for the project	Instead of setting up a parallel PIU, it is proposed to use the existing Project Management Office within LRA to coordinate, execute, monitor project implementation and carry out procurement and fiduciary functions of the project	Setting up a parallel PIU will take time and leading to start-up delays. The proposed arrangement will enhance in-house capacity to sustain reform implementation and achieve value for money as it allows effectively utilising existing staff and structures, and reduce transaction costs. Furthermore, existing resources for project management (staff, office, and transport facilities) will be optimized in addition to significant Project implementation cost savings.
Capacity building support through provision of ICT for tax administration and introduction of electronic toll collection (e-toll) system to raise additional revenue	The scope of the initial proposal for revenue modernisation was dominated by the acquisition of ICT and less on the institutional change required to improve efficiency and effectiveness on tax administration. The initial proposal also entails the introduction of e-toll system as a means to increase revenue but may undermine the limited capacity of LRA.	The e-toll component is dropped as it believed to be managed better in partnership with the private sector. While technology can be both a facilitator and a driver of change, it is not a substitute for the development of sound institutional, organisational and operational systems. A well balanced strategy is needed to ensure changes are institutional in nature rather than simply instrument-driven. While investments in technology is significant, the Project is designed in a way that the organisational and functional changes are the actual drivers of the reform process. To this end, the project entails ICT, human resource capacity building, business process re-engineering, strengthening business intelligence and compliance functions.
ISP that include support to several institutions	Government requested for capacity building support to a number of institutions. However, the operation is focusing on one key institution responsible for domestic revenue administration and critical interventions that would complement previous and ongoing reforms and ensure sustainability.	The recent OPEV evaluation and lessons from previous tax administration projects suggest that (a) the need to avoid the risk of spreading projects too thinly across many beneficiary institutions, particularly where the overall funding envelope is limited; and (b) the project design and focus should help to address institutional factors that hinder the sustainability of tax administration reform. The proposed operation is focused and provide targeted support to tax modernisation in Lesotho.

2.3 Project type

2.3.1 **The proposed operation is an Institutional Support Project designed to address weaknesses and targets areas for improvement that are linked to the main causes of weak tax administration in Lesotho.** Building on the experience of Phase 1 of Tax Modernisation Program, LRA had clearly identified and prioritised the project activities. To this end, the Project is focusing on improving efficiency and services delivery, increasing VAT compliance, and broadening tax base. Further, it will support LRA to consolidate and deepen reform by focusing on (a) redesigning and upgrading business process, (b) developing an enabling legal and institutional framework, (c) introduction of modern information and communication technology to increase tax compliance and efficiency in tax administration, and (d) promoting peer learning and experience sharing with similar national revenue authorities in the region. The Bank will thus play a critical role in strengthening effectiveness and efficiency of LRA to achieve improvements in tax collection which is critical for fiscal consolidation and macroeconomic stability while creating fiscal space for the national development plan.

2.4 Project Cost and Financing Arrangements

2.4.1 **The estimated total cost of the Project is UA 5.56 million (including 10% GoL's contribution).** A price and physical contingency of 7%, have been factored in the Project cost. Tables (4a) and (4b) present the estimated project cost by component and sources of finance, whereas Tables (4c) and (4d) present the estimated Project costs by Category of Expenditure. Details of the Project cost by component and expenditure category are also presented in Technical Annex B2.

Table 4(a): Project cost estimates by component

	(LSL Million) inc. Contingency			(UAC Million) inc. Contingency				
	Local	Foreign	Total	Local	Foreign	Total	% Foreign	% of Total
Component 1:Enhancing E-tax Modernisation								
1.1 Introduce E-taxation	3.60	18.50	22.10	0.20	1.04	1.24	0.84	22%
1.2 Enhance VAT compliance	2.67	37.00	39.67	0.15	2.08	2.23	0.93	40%
1.3 Broaden tax base	3.20	6.20	9.40	0.18	0.35	0.53	0.66	9%
Sub Total	**9.47**	**61.70**	**71.17**	**0.53**	**3.47**	**4.00**	**87%**	72%
Component 2:Institutional Strengthening								
2.1 Enabling legislation	0.50	5.00	5.50	0.03	0.28	0.31	0.91	6%
2.2 Enterprise Data Warehouse and Business Intelligence introduced	0.00	10.22	10.22	0.00	0.57	0.57	100%	10%
2.3 Human resource capacity and Gender Mainstreaming	1.06	1.06	2.12	0.06	0.06	0.12	0%	2%
Sub Total	**1.56**	**16.28**	17.84	0.09	0.92	1.00	**91%**	18%
Component 3: Project management								
3.1 Project Management and Coordination	10.00	0.00	10.00	0.56	0.00	0.56	0%	10%
Sub Total	**10.00**	**0.00**	**10.00**	**0.56**	**0.00**	**0.56**	**0%**	10%
Grand Total	**21.03**	**77.98**	**99.01**	**1.18**	**4.38**	**5.56**	**79%**	100%

Table 4(b): Sources of financing

	(LSL Million) inc. Contingency				(UAC Million) inc. Contingency			
Source of Finance	**Local**	**Foreign**	**Total**	**Percent**	**Local**	**Foreign**	**Total**	**% of Total**
ADF Loan	11.03	77.98	89.01	90%	0.62	4.38	5.00	90%
GoL Contribution	10	0	10	10%	0.56	0.00	0.56	10%
Total	21.03	77.98	99.01	100%	1.18	4.38	5.56	100%

Table 4(c): Project cost by category of expenditure

	(LSL Million)			(UAC Million)				
Category of Expenditure	**Local**	**Foreign**	**Total**	**Local**	**Foreign**	**Total**	**% Foreign**	**% of Total**
A. Goods	-	67.21	67.21	-	3.78	3.78	68%	68%
B. Services	10.30	5.67	15.97	0.58	0.32	0.90	6%	16%
C. Operating Cost	9.35	-	9.35	0.53	-	0.53	0%	9%
Baseline Cost	19.65	72.88	92.53	1.10	4.10	5.20	74%	93%
Physical & Price Contingencies (7%)	1.38	5.10	6.48	0.08	0.29	0.36	5%	7%
Grand Total	21.03	77.98	99.01	1.18	4.38	5.56	79%	100%

Table 4(d): Project Expenditure Schedule

	(LSL Million) inc. Contingency				(UAC Million) inc. Contingency			
	2018	**2019**	**2020**	**Total**	**2018**	**2019**	**2020**	**Total**
Component 1:Enhancing E-tax Modernisation								
1.1 Introduce E-taxation	2.10	13.00	7.00	22.10	0.24	0.50	0.50	1.24
1.2 Enhance VAT compliance	9.67	15.00	15.00	39.67	0.23	1.00	1.00	2.23
1.3 Broaden tax base	2.40	5.50	1.50	9.40	0.23	0.30	-	0.53
Sub Total	14.17	33.50	23.50	71.17	0.70	1.80	1.50	4.00
Component 2:Institutional Strengthening								
2.1 Enabling legislation	1.50	3.00	1.00	5.50	0.10	0.15	0.06	0.31
2.2 Enterprise Data Warehouse and Business Intelligence introduced	2.22	6.00	2.00	10.22	0.07	0.25	0.25	0.57
2.3 Human resource capacity and Gender Mainstreaming	1.00	1.00	0.12	2.12	0.05	0.05	0.02	0.12
Sub Total	4.72	10.00	3.12	17.84	0.22	0.45	0.33	1.00
Component 3: Project management								
3.1 Support to the PMO	3.00	3.50	3.50	10.00	0.16	0.20	0.20	0.56
Sub Total	3.00	3.50	3.50	10.00	0.16	0.20	0.20	0.56
Grand Total	**21.89**	**47.00**	**30.12**	**99.01**	**1.08**	**2.45**	**2.03**	**5.56**

*Note: Exchange Rates 1UA= 1.394347 USD; 1 UA = 20.26666 LSL and *All figures includes contingencies*

2.5 Project's Target Area and Population

2.5.1 The Project's main benefit is higher tax revenue, which will help the Government of Lesotho sustain macroeconomic stability and economic growth, with potential to expand the tax base and tax collections further. By their nature, therefore, these direct and indirect benefits are expected to accrue to the general society and economy, rather than to easily identifiable sectors. Nevertheless, at least two identifiable sectors can be expected to benefit from tax administration reform and modernisation. First, taxpayers (businesses) will benefit from a more efficient LRA business process and procedures, which will reduce their compliance costs and facilitate their business operations. Second, to the extent that the increased tax revenues are channelled to social and economic expenditures that directly benefit the poorer segments of society, tax reform and modernisation will lead to further improve in the overall social wellbeing. In addition, LRA will benefit from the planned capacity building support.

2.6 Participatory Process for Project Identification, Design and Implementation

2.6.1 Extensive consultations with stakeholders were undertaken during Project identification and preparation to foster a broad consensus on the main components of the Project and critical reform implementation issues to ensure value addition of the ongoing reform efforts. Consultation were held with key stakeholders including Government departments, business community and development partners in Lesotho. For example, consultations were held with (a) Government departments including the Ministry of Finance, Ministry of Development Planning, Central Bank of Lesotho, (b) the private sector representatives such as the Lesotho Chamber of Commerce and Industry, and (c) development partners including the World Bank, UN, EU, IMF, and US Embassy. Issues raised that informed the design of the ISP, include: (a) close attention to private sector participation through effective taxpayer education and taxpayer service program to improve service delivery; (b) focus on voluntary compliance through improvements in business process and procedures, legal framework, administration and quality of services, taxpayer education and fair grievance redressal; and (c) successful tax administration reform and modernisation require more than computerisation and physical upgrading, it also entails institutional change affecting organisation and human resource development. In this regard, essential reform measures to improve business process and tax procedures, enabling legislation, auditing for compliance, human resource development and change management are key components of the Project. The consultations with stakeholders will continue during project implementation through taxpayer's education program, and project steering committee with representatives from business community.

2.7 Bank Group Experience and Lessons Reflected in Project Design

2.7.1 The Bank's current portfolio in Lesotho comprise 5 operations amounting to UA 34.22 million (Annex II), and consist of 4 sectors: water and sanitation (26.59%), power (22.79%), multi-sector (28.7%), and ICT (21.9%) and. The design of this operation is guided by findings from various analytical and diagnostic reports (Technical Annex B.1), as well as consultations during the Project preparation and appraisal missions. The proposed operation draws on lessons from the ongoing projects, country portfolio performance review (2016/17) as well as the underpinning analytical works (Annex IV). The main lessons are: avoidance of start-up delays; addressing implementation capacity constraints; alignment with the national priorities and reinforce ownership; spreading too thinly across a sector; and enhanced dialogue and regular supervision and monitoring of portfolio (Table 5). Lessons learned from ongoing and previous TAX administration reform include: modernising for compliance through adopting electronic platform, taxpayer education, audit skills, easing compliance for small taxpayers and robust regulatory framework to broaden tax base (Technical Annex B.1).

Table 5: Lessons learned from the previous and ongoing Bank interventions

Key Lessons Learned	Actions Taken to integrate lessons learnt
(a) Avoidance of start-up delays by simplifying the conditions precedent to first disbursement.	The Project will be implemented by an existing PMU which has experience in project management. Cabinet approval of the Project and loan will be done before negotiations in order to reduce the time it takes for Project effectiveness and first disbursement. Consultation was also held with the Public Debt Management and Planning Departments in the Ministry of Finance who provided assurance that actions will be taken to address the main causes for start-up delay taking into account lessons from previous operations.
(b) Need to address implementation capacity constraints by reinforcing the financial management and procurement team of the PMU	The PMU's capacity was assessed during appraisal and appropriate recommendations have been taken on board in the project design. Draft ToRs and specifications are being developed to mitigate potential delays in procurement. Training will be organized to key LRA staff to address the potential difficulties of LRA staff in adjusting to the new Bank procurement procedures.
(c) Strengthen country ownership and leadership by ensuring alignment with the strategic plan and capacity building requirements	The Project is fully aligned with country development objectives. See paragraph 9.1.2.

(d) Avoid spreading of activities too thinly across many components/activities and beneficiary institutions by ensuring the intervention targets a few critical interventions	The Project has three components and 80% of the financial and technical supports is targeted towards two areas of intervention (e-taxation and VAT compliance) within the broader tax modernization program. .
e) The need for close Project supervision to address portfolio management issues timely with a view to achieving the desired results.	As part of Project monitoring arrangement, RDGS will continue to play an active role in the country portfolio management and more frequent project implementation support and supervision missions.

2.8 Project's Performance Indicators

The key performance indicators identified, and the expected outcomes at Project Completion, are set out in the Result-based Logical Framework (Section VII). The Project will help increase the effectiveness of tax administration to ensure sustained fiscal consolidation and macroeconomic stability. The outcome of the Project is a modern, effective and efficient LRA that achieves improvement in tax collection by broadening the tax base, increase in number of registered tax payers, and reduction in cost of compliance. The Project will have the following outputs: (a) e-taxation solution adopted, (b) VAT compliance solution introduced; (c) e-taxation and VAT compliance legislations enacted; (d) streamlined tax regime and procedures for small taxpayers adopted; (e) taxpayer services of the LRA enhanced; and (f) the tax audit capacity of LRA strengthened.

III PROJECT FEASIBILITY

3.1 Economic and Financial Performance

3.1.1 While it is difficult to carry out credible and rigorous cost-benefit and financial analyses for institutional support project, the economic and financial benefits, and ramifications, accruing from the Project will be much higher than the UA 5 million. Whereas the costs are quantifiable (section 2.4), the benefits are both direct and indirect, ultimately delivered from improved capacity in tax administration and increased fiscal space. The economic justification of the proposed Project is its positive fiscal impact resulting from administrative reforms aimed at improving effectiveness in tax administration and broadening tax base. It is conservatively estimated that the reforms will result in a permanent increase in tax revenue of about 1.2% of GDP by 2021. This projection reflects increase due to overall economic growth, and impact of reform and modernisation in tax administration. Overall, the benefits of the Project will be derived from (a) enhanced institutional capacity and effectiveness of LRA; (b) improved business process for small taxpayers and informal sector; (c) improved compliance and business intelligence capacity; and (f) enhanced partnership and participation of the private sector through taxpayers' education and taxpayers services program.

3.2 Environmental and Social Impacts

3.2.1 Environment and Climate Change: The proposed Project is environmentally classified as Category 3. The Project will not have a negative impact on the environment as its activities are limited to modernisation of tax administration. The activities envisaged under the Project are focusing on acquisition of information technology hardware and software, technical assistance, human and institutional capacity building, which will not have negative impact on the environment and climate change.

3.2.2 Social: In view of the country's low income and high poverty levels, achieving inclusive growth is a fundamental requirement for progress in poverty reduction. In its long-term development plan, the Government of Lesotho takes a comprehensive approach to poverty reduction. The NSDP entails (a) pursue inclusive economic growth and create jobs for women and youth; (b) develop skills and technology; (c) improve health and combat HIV/AIDS; (d) reverse environmental degradation and adapt to climate changes; and (e) promote governance and building effective institutions including reforming revenue administration and linking government spending with national development programs. The Government of Lesotho aims to reform and modernise the tax administration system to increase revenue collection, while reducing dependence on SACU transfers. Tax administration reform and modernisation can help the Government achieve the poverty reduction objective of its NSDP by (i) assisting in maintaining the fiscal and macroeconomic stability that is a precondition for sustainable growth, and (ii) helping produce revenues needed for expanding social services. A reformed tax administration will also help spur private sector-led growth.

3.2.3 Impact on Gender: A preliminary assessment on gender shows that the project will contribute to gender equality (Technical Annex B.6). Lesotho is the highest ranked African country with regards gender equality[2]. The country's strong gender policy has resulted in high enrolment rates for both genders. Lesotho remains a low-gender gap country and is ranked 38 out of 142 countries in the overall Gender Gap Index for 2014. While women are highly present in the economy, dominating the formal SMME, and informal sector, their incomes are generally lower than men, and they remain economically disadvantaged by unequal access to property and finance. The 2012 study on taxation of the information sector found that business ownership in Lesotho is more or less evenly divided between males and females. However, business with higher annual turnover were far more likely to be owned by men. Women were more likely to own survivalist business enterprises with turnover less than LSL 200,000; while 77% of business with over LSL 1 million annual turnovers were owned by men. The Project will therefore help to reduce the compliance and administrative costs of the small business and women entrepreneurs as it will introduce a simple record keeping and tax procedures for small business taxpayers. The Project will endeavour to have gender balance to ensure that men and women benefit from the Project initiatives, in particular the simplified tax regime and streamlined tax procedures for small business taxpayers. The Project will contribute to better gender outcomes by improving service delivery to women entrepreneurs who are engaged in small business. Within LRA, female represents 54.26% of the work force, 33% of the senior management, and 75% of the Board of Directors. All project support will endeavor to mainstream gender balance to ensure that men and women benefit from the Project support including training of women taxpayers and owners of small businesses. In addition, the Project will also provide technical assistance to develop gender strategy and implementation guideline for LRA in accordance with the National Gender Policy.

3.2.4. Involuntary Resettlement*:* The Project will not result in any population displacement.

IV IMPLEMENTATION

4.1 Implementation Arrangements

4.1.1 The Project will be implemented over a period of three years between January 2018 and December 2020. LRA will be the executing agency. The Project Management Office (PMO) within LRA, headed by Senior Manager for Revenue Modernization Program, will spearhead Project implementation and oversee the day-to-day management and execution of Project activities including planning, coordination, preparation of tender document/specifications and terms of references, contract management, change management and communication, monitoring and result reporting. Project Steering Committee will be in place to provide strategic oversight and guidance to the project. The committee shall meet every quarter to

[2] 2016 Global Gender Gap Report

review annual work plans, implementation progress reports and resolve implementation problems affecting project progress.

4.2 Financial Management and Audit Arrangements

4.2.1 The overall FM for the project will be managed within the existing PMO under the overall responsibility of the Financial Manager as the head of the finance unit. The Financial Management Accounting Unit (FMAU) within LRA's PMO is staffed with a team of ten (10) accounting staff at various levels (Finance Manager, Finance Accountant, Payroll Accountant, Fixed Assets Accountant, and other accounting officers etc.) with varied qualifications and headed by a Senior Manager Finance (SMF). The team has prior experience from implementing donor-funded projects including the World-Bank. There is a functional computerized accounting system (ORACLE e-Business) to record and process transactions for financial reporting purposes. The control environment from budget preparation, execution and reporting is adequate; and the Unit is up to date with its annual audit obligations. In this regard, the Bank will make use of the existing systems within the LRA to handle the Project's financial management (FM) including accounting for project resources and submitting the required financial reports to the Bank. The overall conclusion of the assessment is that LRA's capacity to handle the FM aspects of the Project, satisfies the Bank's minimum requirements. The overall FM risk for the Project is assessed as Moderate.

4.2.2 The Project would make use of the Bank's various disbursement methods including (i) Direct Payment, (ii) Special Account (SA) and (iii) Reimbursement methods in accordance with Bank rules and procedures as laid out in the Disbursement Handbook as applicable. The Bank will issue a Disbursement Letter of which the content will be discussed and agreed with Government of Lesotho (GoL) during negotiations. In accordance with the Bank's financial reporting and audit requirements, the Project will be required to prepare and submit to the Bank Interim Quarterly Financial Progress report (IQFPR) not later than forty-five (45) days after the end of each calendar quarter. Annual financial statement prepared by the Project and audited by the Office of the Auditor General (OAG) as per their mandate or by a private audit firm with the involvement of OAG, including the auditor's opinion and management letter will be submitted to the Bank not later than six (6) months after the end of each fiscal year throughout project implementation. The results of the assessment and the agreed FM, disbursement and auditing arrangements for the proposed Project are summarised in the Technical Annex B4.

4.3 Procurement Arrangements

4.3.1 Procurement function will be the responsibility of the Supply Chain Management Department (SCMD) of LRA. Procurement of goods (including non-consultancy services), and the acquisition of consulting services, financed by the Bank for the project, will be carried out in accordance with the *"Procurement Policy and Methodology for Bank Group Funded Operations" (BPM)*, dated October 2015 and following the provisions stated in the Financing Agreement. Specifically, Procurement would be carried out as follows:

- **Bank Procurement Policy and Methodology (BPM):** Bank Standard Procurement Methods and Procedures (PMPs), using the relevant Bank Standard Solicitation Documents (SSDs). Contracts on this project to be procured under the BPM will mainly constitute consultancy services which will involve Technical Assistance and capacity support to the implementing institutions. These consultancy services will mainly be acquired using the *Quality and Cost Based Selection (QCBS) Method and Selection Based on Consultant's qualification (CQS) and Selection Method for Individual Consultants* as appropriate. In the case of contracts for goods the *International Competitive Bidding (ICB), National Competitive Bidding (NCB) and Shopping* methods under BPM will apply as appropriate.

- **Borrower Procurement System (BPS):** Specific Procurement Methods and Procedures under BPS comprising the National Procurement Procedures. No contracts will be procured using the BPS. However, the operational costs involving Project Management expenses, training/ workshops and project staff remuneration will follow the internal administrative and financial procedures of the LRA.

4.3.2 **Procurement Risks and Capacity Assessment (PRCA):** the assessment of procurement risks at the Country, Sector, and Project levels and of procurement capacity at the Executing Agency (LRA), were undertaken for the Project and the findings have informed the decisions on the procurement arrangements being used for specific transactions or groups of similar transactions under the project. The appropriate risk mitigation measures and details of the procurement management arrangement is presented in Technical Annex B5.

4.4 Monitoring and Evaluation: The monitoring and evaluation system will be based on the result measurement framework. The PMO will be responsible for managing and reporting on results in collaboration with stakeholders and core project implementation team. The periodic performance assessment and result reporting will be carried out by the PMO. Quarterly and annual project implementation reports will also be prepared and submitted to the Bank. The Bank will carry out a monitoring and supervision mission at least twice a year. A project completion report will be prepared to evaluate progress against outputs and outcomes and draw lessons for possible follow-up operation. Table 6 presents the Project implementation and monitoring schedule.

Table 6: Project Implementation Schedule

Task / Milestone	Responsible Party	Time Frame
Project Approval	AfDB	November 2017
Loan Effectiveness	AfDB/GoL	January 2018
Project Launching	AfDB/GoL	February 2018
Procurement of goods and services	GoL	April 2018 to June 2020
Technical assistance and training	GoL	June 2018 – June 2020
Annual Audit Report	GoL	June 2019, 2020, and 2021
Supervision Mission	AfDB/GoL	June/December 2018, 2019 & 2020
Mid-term Review	AfDB/GoL	June 2019
Project Completion Report	AfDB/GoL	June 2021

4.5 **Governance:** The LRA is a semi-autonomous agency established by an Act of Parliament in 2001 as the principal entity responsible for the assessment, collection and remittance of public revenues in the country, through effective implementation and administration of the Customs and Excise, Income Tax and VAT legislations and regulations. It is established to enhance efficiency and effectiveness of revenue collection and to provide improved services to the public with the highest standards of financial integrity and corporate governance. Despite operating outside the framework of the Civil Service, LRA is fully accountable to Parliament through the Minister of Finance. The Authority is governed by a Board of Directors (7-members) and headed by a Chief Executive or Commissioner General. The Project is in line with the Government's broader efforts to improve governance and reduce corruption. To this end, the Project will help LRA to foster active participation of taxpayers; strengthen the accountability and reporting requirements; and introduce electronic tax administration (online services) to reduce direct contact and opportunities for corrupt practice and relations between tax officers and taxpayers, as well as improve service delivery in general. The Project will address potential fiduciary risks through strengthening the procurement, financial management and audit capacity. The capacity of the PMO has been reviewed to assess the strength and weakness in financial management, procurement, and monitoring and evaluation. Furthermore, the implementation and project management modalities of this

Project will be complemented by the Bank's supervisions missions to ensure monitoring and result reporting. An independent audit of project financial reports and procurement reviews will be undertaken every year.

4.6 **Sustainability:** The impetus for tax administration reform and modernization in Lesotho is coming from the highest levels of Government. The proposed operation responds to demand-led interventions informed by the LRA strategic plan and national development plan, as well as outcomes of consultations with key stakeholders. By supporting LRA to improve compliance and tax administration capacity, the Project will help Government establish a sustainably higher and more predictable level of tax revenues. Significant attention has been given to sustainability in the Project design. To this end, the strong institutions building component of the Project is aimed at ensuring sustainability over the medium term. Government commitment to the ongoing tax modernization plan is necessary for long-term sustainability, specifically with respect to assuring full funding of LRA's operational budget, thus permitting LRA to hire, motivate and retain qualified staff.

4.7 Risk Management

Table 7: Risks and Mitigation Measures

Risk	Level	Mitigation
Political instability may affect pace of project implementation.	Moderate	National dialogue and reform implementation monitored by SADC remains a priority, after the successful elections and formation of the new coalition government. Following the political unrest prior and after elections including the killing of the military commander in early September 2017, the New Government confirmed its commitment to implement constitutional, security sector, political, media and public service reforms and requested support from SADC and development partners, to implement reforms which are critical to maintain stability in the Kingdom of Lesotho.
Insufficient commitment and capacity to implement reforms	Moderate	The Project will provide technical assistance and capacity building support during project implementation. The PMU has many years of experience in Project implementation and has already earned the confidence and trust of the government authorities.
Delay in project start-up and procurements	Moderate	Use of an existing PMU staffed by professionals with many years of project management experience and the Bank's project implementation support and supervision mission will help to reduce the potential risk in start-up and procurement delay.
LRA not having a substantive Commissioner General and a Board.	High	Discussions with the Ministry of Finance to appoint a new Board and Commissioner General

4.8 **Knowledge Building:** The proposed Project will build knowledge and skills in specific areas related to tax administration, change management, project monitoring and reviews. Through the targeted technical assistance component of the Project, it enables knowledge and experience sharing to enhance continuous improvement and sustainability of tax reform. Implementation of the proposed Project will focus on addressing the capacity constraints in tax administration. This will be achieved in a number of ways: First, the support to LRA will entail computerisation and use of new information technology, institutional change affecting organisation and human resource development. Second, to foster a culture of compliance among taxpayers, the Project will support LRA to establish an effective taxpayer education and service program as well as a plan to foster partnership with the private sector for improved information dissemination. Third, the Project also supports the development of simplified tax forms and streamlined procedures to ease taxpayers' compliance burden, and continuous systematic assessment of the information and training needs of taxpayers and tax administration personnel.

V LEGAL INSTRUMENTS AND AUTHORITY

5.1 Legal Instrument

The legal instruments for the project will be the Loan Agreement between the Kingdom of Lesotho ("Borrower") and the African Development Fund (the "Fund") for a Loan of UA 5.0 million.

5.2 Conditions Associated with Bank's Intervention

5.2.1 Conditions Precedent to Entry into Force: The entry into force of the Loan Agreement shall be subject to the fulfilment by the Borrower of the provisions of Section 12.01 of the General Conditions Applicable to Loan Agreements and Guarantee Agreements of the Bank.

5.2.2 Conditions Precedent to First Disbursement: The first disbursement of the loan shall be conditional upon the entry into force of the Loan Agreement, as provided for in Section 12.01 of the General Conditions Applicable to Loan Agreements and Guarantee Agreements.

5.3 Undertakings

i) The Borrower shall prior to the request for disbursement into the special accounts provide evidence of having opened: (a) a foreign currency denominated special account in Central Bank of Lesotho to receive the proceeds of the Loan, and (b) a local currency account in Lesotho Maloti in a bank acceptable to the Fund.

ii) The Borrower shall maintain the existence and function of the Project Steering Committee and Project Management Office including continuing to pay staff salaries, throughout the life of the Project.

5.4 Compliance with Bank Policies

The project complies with all applicable Bank policies.

VI RECOMMENDATION

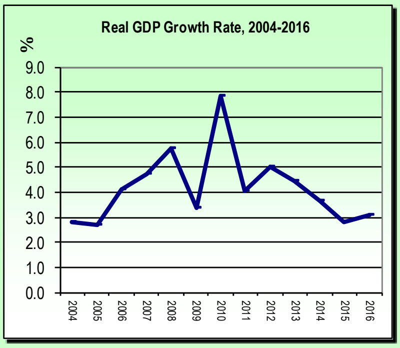
6.1 Management recommends that the Board of Directors approve the proposed ADF Loan of UA 5.00 million to the Kingdom of Lesotho for the purposes, and subject to the conditions, stipulated in this report.

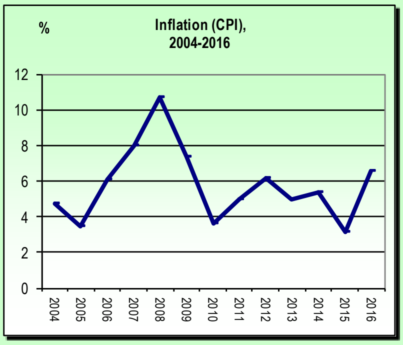
Appendix I

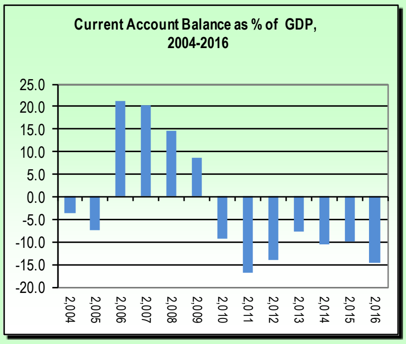
Lesotho

Selected Macroeconomic Indicators

Indicators	Unit	2000	2011	2012	2013	2014	2015	2016 (e)
National Accounts								
GNI at Current Prices	Million US $	1,077	2,785	3,004	3,229	2,805	...	...
GNI per Capita	US$	580	1,370	1,460	1,550	1,330	...	...
GDP at Current Prices	Million US $	783	2,523	2,384	2,218	2,181	1,994	1,730
GDP at 2000 Constant prices	Million US $	783	1,210	1,270	1,327	1,375	1,414	1,458
Real GDP Growth Rate	%	5.7	4.0	5.0	4.5	3.6	2.8	3.1
Real per Capita GDP Growth Rate	%	4.7	2.9	3.7	3.2	2.4	1.6	1.9
Gross Domestic Investment	% GDP	42.1	22.4	27.2	33.1	34.0	33.7	36.2
Public Investment	% GDP	3.2	9.7	11.6	14.2	14.4	14.3	15.0
Private Investment	% GDP	38.9	12.7	15.7	18.9	19.6	19.4	21.2
Gross National Savings	% GDP	42.0	20.4	26.9	24.7	23.4	24.1	27.8
Prices and Money								
Inflation (CPI)	%	6.2	5.0	6.1	5.0	5.3	3.1	6.6
Exchange Rate (Annual Average)	local currency/US$	6.9	7.3	8.2	9.7	10.9	12.8	15.1
Monetary Growth (M2)	%	41.0	29.0	2.7	23.2	4.3	5.5	8.1
Money and Quasi Money as % of GDP	%	43.5	57.5	55.3	62.3	58.8	57.7	60.7
Government Finance								
Total Revenue and Grants	% GDP	48.3	62.8	52.4	52.3	65.6	60.4	60.4
Total Expenditure and Net Lending	% GDP	55.0	56.7	56.1	60.7	62.9	59.8	62.7
Overall Deficit (-) / Surplus (+)	% GDP	-6.7	-4.3	-3.8	4.9	-2.5	0.6	-3.1
External Sector								
Exports Volume Growth (Goods)	%	26.1	18.6	-0.9	9.6	13.2	15.1	4.5
Imports Volume Growth (Goods)	%	-2.4	8.6	9.7	9.9	7.7	7.8	5.5
Terms of Trade Growth	%	1.6	-1.7	-0.2	-2.9	-1.3	6.4	-6.0
Current Account Balance	Million US $	-69	-429	-332	-174	-232	-196	-255
Current Account Balance	% GDP	-8.8	-17.0	-13.9	-7.9	-10.6	-9.8	-14.8
External Reserves	months of imports	4.9	4.0	4.6	5.5	5.8	5.0	5.9
Debt and Financial Flows								
Debt Service	% exports	125.7	3.3	3.2	4.6	4.1	4.0	4.8
External Debt	% GDP	76.5	30.4	33.9	37.9	42.0	47.5	56.5
Net Total Financial Flows	Million US $	11	283	294	335	117	80	...
Net Official Development Assistance	Million US $	37	257	276	321	107	83	...
Net Foreign Direct Investment	Million US $	32	149	138	123	162	169	...







Source : AfDB Statistics Department; IMF: World Economic Outlook, April 2017 and International Financial Statistics, April 2017;
AfDB Statistics Department: Development Data Portal Database, March 2017. United Nations: OECD, Reporting System Division.

Notes: ... Data Not Available (e) Estimations (p) Projections Last Update: June 2017

Appendix II: Similar Projects Financed by other Development Partners

DONOR	PROJECT TITLE	AMOUNT	INTERVENTION AREAS
World Bank	Support to Private Sector Competitiveness and Economic Diversification Project	USD 14 million	Investment climate reform Linkages between SME and large enterprises SME skill training
	Support to PFM reform implementation	UAD 5 million	Budget management, cash management, accounting and IFMIS
IMF	AFRITAC South	-	Technical assistance in tax and customs administration Technical assistance in PFM reform

Appendix III: Bank Group Portfolio Status

	Sectors/Operations	Approval Date	Final Date of Disbursement	Funding	Million UA	Disbursement Rate	Age
	COMMUNICATION SECTOR						
1	eGovernment Infrastructure				**7.50**	**21%**	3.9
	ADF Loan	10/21/2013	8/31/2018	Loan	2.70	12.06%	
	ADF Grant	10/21/2013	8/31/2018	Grant	4.80	26.10%	
	MULTI-SECTOR / ECONOMIC GOVERNANCE						
2	Institutional Support Project				**2.60**	**44.26%**	3.9
	ADF Grant	10/14/2013	6/30/2017	Grant	2.60	44.26%	
3	Economic Diversification Support Project				**7.22**	**1.36%**	0.8
	ADF Loan	16/12/2016	12/20/2020	Loan	5.00	0.13%	
	ADF Grant	16/12/2016	12/20/2020	Grant	2.22	4.14%	
	WATER SUPPLY & SANITATION SECTOR						
4	Lesotho Lowlands Rural Water & Sanit. Project				**9.19**	**10.33%**	3.9
	ADF Loan	10/3/2013	9/30/2018	Loan	6.52	7.45%	
	RWSSI	10/3/2013	9/30/2018	Grant	2.67	17.32%	
	Energy						
5	Urban Distribution Rehabilitation and Transmission Expansion Project				**7.78**	**0.3%**	0.8
	ADF Loan	16/12/2016	12/20/2020	Loan	7.78	0.3%	
	TOTAL				**34.29**	**11.06%**	**4.9**
	Total Loan				24.10	7.31%	
	Total Grant				10.19	20.00%	

Appendix IV: Analytical Work and Underpinnings

Component	Analytical Work	Institution
Strategic Framework	National Strategic Development Plan (2013-2017)	GoL
	Lesotho Revenue Authority Strategic Plan (2014 – 2019)	Lesotho Revenue Authority
	Lesotho Revenue Authority – Modernization of Processes and Systems (Nov. 2015)	Lesotho Revenue Authority
	Tax Modernisation Program Phase II (June 2017)	Lesotho Revenue Authority
Sector Analytical Reports	Taxation of the Informal Sector in Lesotho, 2012	Lesotho Revenue Authority
	African Tax Outlook, 2016, and 2017	African Tax Administration Forum
	Lesotho, Issues in Tax Policy and Mining Fiscal Regimes, 2013	IMF
Others	2015 Article IV Consultation Report	IMF

Appendix V: General Map of Lesotho