



# Report and Recommendation of the President to the Board of Directors

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Project Number: 49041-002  
September 2016

## Proposed Programmatic Approach, and Policy- Based Loan and Technical Assistance Loan for Subprogram 1 Kingdom of Cambodia: Strengthening Public Financial Management Program

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Asian Development Bank

## CURRENCY EQUIVALENTS

(As of 26 August 2016)

Currency unit	–	riel (KR)
KR1.00	=	\$0.00024
\$1.00	=	KR4,090

## ABBREVIATIONS

ADB	–	Asian Development Bank
BSP	–	budget strategic plan
FMIS	–	financial management information system
GDP	–	gross domestic product
IMF	–	International Monetary Fund
MEF	–	Ministry of Economy and Finance
NAA	–	National Audit Authority
PAM	–	project administration manual
PFM	–	public financial management
PFMRP	–	PFM reform program
SPFMP	–	Strengthening Public Financial Management Program
TA	–	technical assistance
UNICEF	–	United Nations Children's Fund

## NOTES

- (i) The fiscal year (FY) of the Government of Cambodia ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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## PROGRAM AT A GLANCE

1. Basic Data		Project Number: 49041-002	
Project Name	Strengthening Public Financial Management Program, Subprogram 1	Department /Division	SERD/CARM
Country Borrower	Cambodia Kingdom of Cambodia	Executing Agency	Ministry of Economy and Finance
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Public sector management	Public expenditure and fiscal management		30.00
		Total	30.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development Organizational development Public financial governance	Some gender elements (SGE) ✓	
Knowledge solutions (KNS)	Application and use of new knowledge solutions in key operational areas Knowledge sharing activities Pilot-testing innovation and learning		
Private sector development (PSD)	Conducive policy and institutional environment		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		30.00	
Sovereign Programmatic Approach Policy-Based Lending (Loan): Asian Development Fund		26.50	
Sovereign TA loan: Asian Development Fund		3.50	
Cofinancing		0.00	
None		0.00	
Counterpart		0.80	
Government		0.80	
Total		30.80	
9. Effective Development Cooperation			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed programmatic approach for the Strengthening Public Financial Management Program (SPFMP), (ii) a proposed policy-based loan to the Kingdom of Cambodia for subprogram 1 of the SPFMP, and (iii) a proposed technical assistance (TA) loan to the Kingdom of Cambodia for subprogram 1 of the SPFMP.<sup>1</sup>

2. The programmatic approach seeks to increase the availability and efficiency of public services in Cambodia, including services for poor and vulnerable groups, by strengthening public expenditure and revenue management. In support of stage 3 of the government's four-stage Public Financial Management Reform Program (PFMRP, [para 9 and 10]), the proposed program will finance actions and initiatives to strengthen (i) the policy and regulatory framework for expenditure and revenue management, (ii) the procedures and capacities of select line ministries to implement budgeting and expenditure management reforms, and (iii) the capacity of the external audit function.<sup>2</sup> The proposed program is included in the country operations business plan, 2016–2018 for Cambodia of the Asian Development Bank (ADB).<sup>3</sup>

## II. THE PROGRAM

### A. Rationale

3. **Development problem.** Gross domestic product (GDP) grew by an average of over 6% annually between 2007 and 2015 (7% in 2015), with continuing strong revenue growth in 2015 (para. 4). Continuous economic growth helped reduce the poverty rate from 47.8% in 2007 to 13.5% in 2014. However, many Cambodians are only marginally above the poverty line (41% live on less than \$2 a day and 72% on less than \$3 a day).<sup>4</sup> Low inclusiveness, largely because of weak public financial management (PFM) systems, contributes to this continuing vulnerability. Large gaps remain in critical public services, including basic and technical education; health; infrastructure (roads, irrigation, water, electricity, and sanitation); and extension of agriculture and fisheries. These gaps need to be addressed for growth to become more inclusive.<sup>5</sup> A study on Cambodia's poverty dynamics identified weak governance institutions (including weak PFM), and insufficient public services as key medium-term constraints to inclusive growth and poverty reduction. The study pointed out weaknesses in the allocation of public resources, as well as inadequate targeting of the poor and vulnerable groups.<sup>6</sup> While important challenges were met under stages 1 and 2 of the PFMRP, overcoming further weaknesses in PFM—a pillar of governance to improve service delivery—is a high government priority.<sup>7</sup>

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<sup>1</sup> The design and monitoring framework is in Appendix 1.

<sup>2</sup> Government of Cambodia. 2004. *Public Financial Management Reform Program*. Phnom Penh.

<sup>3</sup> Asian Development Bank (ADB). 2015. *Country Operations Business Plan: Cambodia, 2016–2018*. Manila.

<sup>4</sup> Government of Cambodia. 2014. *End Country Report on Achieving Cambodia's Millennium Development Goals*. Phnom Penh. Reductions in poverty are not related to any changes in methodology in poverty measurement.

<sup>5</sup> ADB. 2014. *Cambodia: Country Poverty Analysis*. Manila.

<sup>6</sup> Cambodia Development Resource Institute. 2012. *Understanding Poverty Dynamics: Evidence from Nine Villages in Cambodia*. Phnom Penh.

<sup>7</sup> The government has three related public sector management reform programs in PFM, public administration, and decentralization. The SPFMP will support implementation of stage 3 of the PFMRP with links to decentralization reform. The Government of Germany supports public administration reform.

4. Evidence from Cambodia and other countries indicates that better PFM can create room in the government's budget to provide, and improve the quality of, public services.<sup>8</sup> Domestic revenue collections under the PFMRP rose by 4% of GDP from 2013 to 2015 (with nominal growth of 14.2% in 2015), while operational efficiency gains also provided new fiscal space. However, resource allocation is not yet optimal: current expenditures (8.9% of GDP in 2009; 13.9% in 2015) are growing much faster than capital expenditures (6.0% of GDP in 2004; 7.5% in 2015).<sup>9</sup> Some expenditures have been redirected from low to high priority programs, but this has been insufficient. For example, agriculture spending rose from 0.6% of GDP in 2013 to 0.9% in 2015, while education spending increased from 1.7% of GDP in 2013 to 2.1% in 2015.

5. **Binding constraints.** The government's Rectangular Strategy III, which sets out medium-term policies and priorities, identifies governance, including PFM, as a binding constraint to improving the availability and quality of public services.<sup>10</sup> The public expenditure and financial accountability framework (para. 11) and other assessments, including diagnostics prepared for this program, identify three continuing weaknesses in the PFM system, which will be addressed under the program and are in line with objectives of stage 3 of the PFMRP.<sup>11</sup> Other broader constraints include: low human capacities after decades of conflict, highly centralized public service delivery arrangements; and inadequate infrastructure. These are being addressed by other ADB interventions (para. 15).

6. **National policies, regulatory frameworks, and systems.** The remaining weaknesses include (i) the absence of comprehensive guidelines for budget preparation, execution, and transparent financial and performance reporting; (ii) limited implementation of a financial management information system (FMIS), which is currently confined to the central and provincial departments of the Ministry of Economy and Finance (MEF); (iii) limited development of a medium-term expenditure framework (MTEF) and budgeting to guide program budget preparation and to allocate resources effectively between central and subnational levels; (iv) weak links between the budget and development policies; (v) an incomplete regulatory framework to allow the National Assembly to approve the budget law by programs; (vi) weak capacity for revenue policy formulation and administration at central and subnational levels; (vii) underdeveloped internal audit regulations, including limited guidelines and capacity for audits of internal control systems and information and communication technology; and (viii) an incomplete regulatory framework for public debt management, including for government guarantees.

7. **Weak capacities of line ministries.** Ministries, particularly those delivering key public services, need to improve budgets and expenditure management. Weaknesses include (i) poor budget planning and preparation; (ii) incomplete integration of current and capital budgets; (iii) limited inclusion of gender and poverty in plans and budgets; (iv) weaknesses in preparing and reporting on program budgets; (v) operational challenges of newly established budget entities; (vi) low budget execution capacities and reporting systems, including incomplete

<sup>8</sup> For example V. Fritz, S. Sweet, and M. Verhoeven. 2014. Strengthening Public Financial Management: Exploring Drivers and Effects. *Policy Research Paper*. No. 7084. Washington, DC: World Bank; C. Pimenta and M. Pessoa, eds. 2016. *Public Financial Management in Latin America. The Key to Efficiency and Transparency*. Washington, DC: International Monetary Fund (IMF); and IMF. 2014. Why Public Investment Matters. *IMF Survey Article*. June.

<sup>9</sup> Government of Cambodia, Ministry of Economy and Finance. *Budget Settlement Reports*. Phnom Penh (4 years: 2004, 2009, 2013, 2015).

<sup>10</sup> Government of Cambodia. 2013. *Rectangular Strategy III for Growth, Employment, Equity and Efficiency: 2014–2018*. Phnom Penh. The Rectangular Strategy III is being implemented through the National Strategic Development Plan, 2014–2018 (Government of Cambodia. 2014. *National Strategic Development Plan: 2014–2018*. Phnom Penh).

<sup>11</sup> Government of Cambodia. 2015. *Report of the Evaluation on the Public Financial Management System of Cambodia based on the Public Expenditure and Financial Accountability Methodology*. Phnom Penh.

implementation of new budget classifications and chart of accounts; (vii) limited use of computerized FMIS in line ministries; and (viii) limited budget accountability in line ministries because of ineffective internal controls and low internal audit capacities.

8. **Weak external audit functions.** Weaknesses include limited audit capacities of the National Audit Authority (NAA) particularly in meeting new demands for audit of line ministries in implementing program budgeting in an FMIS environment, and in having to expand audit coverage to include subnational administrations, particularly the districts, which are being empowered with more functions and resources.

9. **Reform agenda.** In 2005, the government initiated comprehensive reforms through the four-stage PFMRP.<sup>12</sup> Stage 1 (2005–2008), which began when PFM systems were seriously deficient, aimed to increase budget credibility by delivering more predictable resources to budget managers, including eliminating chronic cash shortages and payment arrears. Credibility was substantially achieved by 2008 and has been maintained since then through improved revenue mobilization, public debt management, and cash and bank account management.

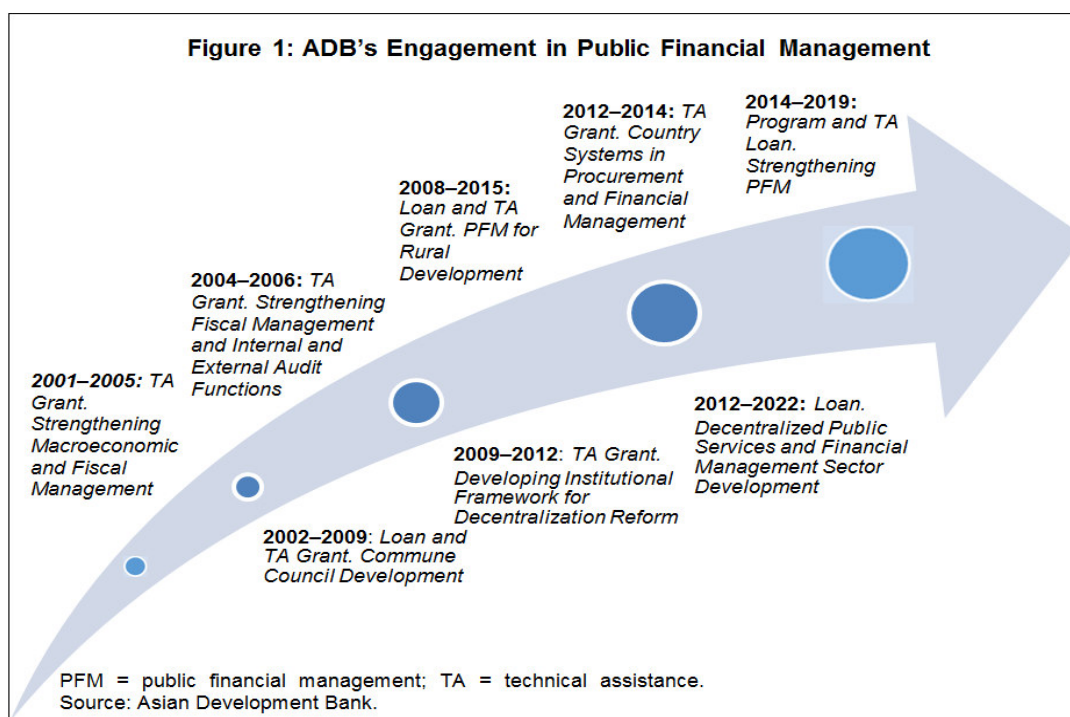
10. Stage 2 (2009–2015) aimed for more effective financial accountability by improving internal controls and management accountability. Progress included (i) budget classifications and chart of accounts consistent with international standards; (ii) 3-year rolling budget strategic plans (BSPs), and piloting of program budgeting; (iii) early work to unify the capital and recurrent budgets; (iv) procurement reform, including adoption and implementation of the Procurement Law (2012); (v) stronger internal controls and internal audit units in MEF and line ministries; (vi) implementation of phase 1 of the FMIS within MEF and its provincial departments; (vii) design and implementation of the medium-term revenue mobilization strategy, 2014–2018; and (viii) capacity development. Stage 3 (2016–2020), which seeks to improve budget–policy links, could not have proceeded without the foundation provided by policy and technical reforms and piloting in stages 1 and 2. Key stage 3 activities to be supported under the proposed program are addressed in paras. 19–25. Stage 4 (2021–2025) aims to improve performance accountability.

11. PFM performance assessments using a public expenditure and financial accountability framework, carried out in 2010 and 2015, confirmed gradual progress under the PFMRP (footnote 11). From 2010 to 2015, Cambodia recorded solid ratings in (i) budget credibility (from C+ to B), (ii) policy-based budgeting (stable at B+), and (iii) comprehensiveness and transparency of the budget (from C to C+). However, ratings were stable on (i) predictability and controls in budget execution (stable at C); (ii) accounting, recording, and reporting (stable at C); and (iii) external scrutiny and audit (not rated in 2015; D+ in 2010). The 2015 assessment recorded an overall average rating of C to C+ in line with other low to middle-income countries. For example, the corresponding overall average rating for the Lao People’s Democratic Republic was C (2010), Myanmar was D+ (2012), and Viet Nam was C+ (2013). Improving the ratings to A and B categories will take time, which the program will pursue.

12. **ADB’s experience and lessons.** ADB has supported PFM and decentralization reforms since around 2001 (Figure 1). Earlier support to PFM focused on macroeconomic management, fiscal policy, financial management, and audit functions. From 2008 to 2015, support focused on stages 1 and 2 of the PFMRP through the PFM for rural development program cluster, which

<sup>12</sup> The Sector Assessment (Summary): Public Sector Management (accessible from the list of linked documents in Appendix 2) provides more on the PFMRP.

provided policy-based lending and several TA interventions.<sup>13</sup> ADB's support to decentralization reforms has focused on administrative, fiscal and PFM arrangements for subnational administrations. Important lessons include: (i) PFMRP is a complex long-term program that has made gradual progress from a very low base after decades of conflict, thus long-term commitment and support are required; (ii) policy-based loans and TA interventions allow policy and regulatory shortfalls at the central level; and weak systems and human capacities in line ministries, to be addressed simultaneously; (iii) improved coordination within MEF, and between MEF and the line ministries, is essential for successful design and implementation of reforms; (iv) PFM reforms at the central level should be closely aligned with subnational PFM systems; and (v) well-designed intergovernmental financing policies are needed to enhance decentralized service delivery.



13. **ADB's value added.** The PFM for rural development program cluster (footnote 13) provided experience in developing policies and a regulatory framework for financial accountability and in supporting selected line ministries (agriculture, rural development, and water resources and meteorology) and the NAA to implement them. The post-program partnership framework for this program cluster enabled broader policy dialogue, leading to the inclusion of four policy actions (FMIS implementation, expansion of internal audit units, strengthening debt management, and regulatory reform for external audit) under subprogram 1; and the development of program impacts, outcomes, and outputs. As the multi-donor trust fund managed by the World Bank, which has supported implementation of stages 1 and 2 of the PFMRP, is expected to end in 2017, the government has requested ADB to take on a greater role in supporting stages 3 and 4 of the PFMRP. ADB adds value by improving the design of reforms and supporting their implementation in

<sup>13</sup> ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster, Grant for Subprogram 1, and Grant Assistance to the Kingdom of Cambodia for the Public Financial Management for Rural Development Program*. Manila; ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster, Grant for Subprogram 2, and Grant Assistance to the Kingdom of Cambodia for the Public Financial Management for Rural Development Project*. Manila.

line ministries, where ADB is the only development partner which has provided focused support; strengthening external audit to include audit of subnational administrations; and aligning PFM reforms at central level with decentralized fiscal and PFM reforms.<sup>14</sup>

14. **The programmatic approach.** The programmatic approach with a policy-based loan and supporting TA interventions as used in the previous PFM for rural development program cluster (footnote 13) is proposed to continue for this program because it will further leverage the implementation of complex medium-term policy reforms of the government. The approach has proved to be effective in supporting the government to implement its long-term PFMRP. The proposed program utilizes two subprograms to support a well sequenced package of policy reforms over the period 2014–2019. Subprogram 1 focused on completion of stage 2 and undertaking advance actions for stage 3, while subprogram 2 actions will support full implementation of stage 3 of the PFMRP. The sequenced approach will significantly improve the policy and regulatory framework for expenditure and revenue management at central level while developing systems and capacities of line ministries to implement the reform agenda. The regulatory regime and capacities of the external audit function will also be strengthened. The medium-term directions and expected results framework will be used to continue ADB's engagement and to assess program effectiveness.

15. **Synergies with other ADB interventions.** The proposed program will continue to support MEF, the NAA, and the three rural development ministries and will expand support to three additional priority ministries: education, youth, and sports; labor and vocational training; and public works and transport. The proposed program will be much broader in technical and agency coverage than the previous one addressing key issues of linking policy and budgets. The program will promote synergies through improved PFM performance with ongoing and future ADB interventions within the six targeted ministries, which are responsible for priority sectors in ADB's current country partnership strategy, 2014-2018.<sup>15</sup> The proposed program will further strengthen synergies with the ADB's support for decentralization with the former targeting the central administration level and the latter targeting the subnational level, with both levels interrelated. The proposed PFM program will support the decentralization program by (i) alignment of central and local PFM systems; (ii) reform of deconcentrated activities of central ministries at the province and district levels; (iii) reforms to the intergovernmental financing system, which will be addressed through proposed MTEF reforms; and (iv) support to the NAA to audit subnational administration finances.

16. **Coordination with development partners.** The PFMRP receives well-coordinated support from development partners through the PFM technical working group, which brings together the government and its development partners to discuss progress and resolve key reform challenges. The proposed program will coordinate closely with development partners including the European Union, the International Monetary Fund (IMF), Japan International Cooperation Agency, the Government of Sweden, the United Nations Children's Fund (UNICEF), the United States Agency for International Development, and the World Bank. The multi-donor trust fund has supported implementation of stages 1 and 2 of the PFMRP, including revenue mobilization and the FMIS, but it is expected to end in July 2017 (para. 13). The European Union and the Government of Sweden, previous donors to the multi-donor trust fund, have

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<sup>14</sup> ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan and Project Loan for Subprogram 2 to the Kingdom of Cambodia for Decentralized Public Services and Financial Management Sector Development Program*. Manila.

<sup>15</sup> ADB. 2014. *Country Partnership Strategy: Cambodia, 2014–2018*. Manila.

developed their own programs to support stage 3 of the PFMRP, which are being closely coordinated with ADB's proposed program.<sup>16</sup>

17. **Economic impact of the program.** The three outputs of the program combined are expected to lead to more responsible aggregate fiscal balances (lower deficits and public debt), better resource allocation through improved prioritization, and greater operational efficiencies. Potential economic gains are to be achieved through resource allocation and efficiency gains by: (i) enhanced revenue mobilization; (ii) full implementation of the FMIS; (iii) introduction of a comprehensive MTEF; and (iv) targeted systems and process oriented PFM reforms (para. 29).

## **B. Impact and Outcome**

18. The impact, which is aligned with the PFMRP, will be effective and efficient public service delivery and inclusive growth. The outcome will be that the efficiency, effectiveness, and accountability of public expenditure and revenue management will be enhanced.

## **C. Outputs**

19. The proposed program will combine support for further development of the policy and regulatory framework led by MEF under stage 3 with the development of systems and capacities of selected line ministries to extend and deepen the implementation of reforms, along with enhancing external audit capacities. Subprograms 1 and 2 are structured around three outputs that address the binding development constraints. Subprogram 1 has 18 completed policy actions implemented from 1 January 2014 to 30 June 2016. Subprogram 2, which contains 21 policy actions, is implemented from 1 July 2016 to 30 June 2019. Subprogram 1 includes an SDR2,501,000 TA loan to support implementation of subprogram 2 reform actions.

### **1. Output 1: Policy and Regulatory Framework for Expenditure and Revenue Management Strengthened**

20. **Policy and regulatory framework for budget–policy links.** This sub-output helped the government improve the policy base of the national budget. Under subprogram 1, the government adopted a new long-term strategy to reform the budget system and reaffirmed its commitment to shift from an input-based and centralized system to a results-based and devolved system. The consolidated action plan of stage 3 was approved by the government in March 2016. Budget circulars were prepared to help line ministries draft 3-year rolling BSPs that link priority programs and actions with budgetary resources. The government also adopted a medium-term revenue mobilization strategy targeting an increase in revenue of 0.5 percentage points of GDP annually. Under subprogram 2, the Public Finance Management Systems Law (2008) will be amended to institutionalize PFM reforms. These will include a provision for the National Assembly to pass the annual budget in a program budgeting format; development of a government-wide MTEF for 2018–2020; and implementation of the strategies and plans prepared under subprogram 1.

21. **Efficiency, effectiveness, and accountability of expenditure management.** This sub-output supported policy actions that improved expenditure management and accountability. Under subprogram 1, a new budget classification and chart of accounts were implemented with the budget presentation in line with international standards. FMIS was developed and stage 1 implementation started in MEF and its 25 provincial treasuries to automate budget execution,

<sup>16</sup> Development Coordination (accessible from the list of linked documents in Appendix 2).

accounting, and financial reporting. Guidelines on policies and principles for internal controls for FMIS were adopted, and MEF started an internal audit of FMIS. Under subprogram 2, comprehensive financial management and internal audit manuals will be developed, and implementation of FMIS will progress and be rolled out to line ministries.

22. **Sound public debt management system.** This sub-output supported strengthening of the public debt management system. Under subprogram 1, an updated public debt management strategy for 2015–2018 was approved, the debt recording and management system was upgraded to improve portfolio monitoring, and the first public debt statistical bulletin was published to provide trend information and enhance the evidence base for policy makers. Subprogram 2 will include (i) development of guidelines on government guarantees, including guarantees on public–private partnership projects, as well as operating procedures for public debt management; (ii) a review of broader policy reforms, including the possible establishment of a domestic market in public debt and higher quality and returns from debt-funded investments; and (iii) further strengthening of government’s debt management capacity.

## 2. **Output 2: Capacity of Selected Line Ministries to Implement Budgeting and Expenditure Management Reforms Improved**

23. **Capability of line ministries in budget formulation and execution strengthened.** This sub-output strengthened the capacities of selected line ministries in formulating and implementing their budgets. Under subprogram 1, all ministries prepared BSPs for 2016–2018. Budget entities were established and program budgeting increasingly implemented by 25 line ministries to improve links between budgetary resources and program goals, and to better integrate recurrent and capital budgets. Under subprogram 2, the BSPs will be updated with poverty covered annually and gender issues increasingly included; program budgeting will be fully implemented in selected line ministries; and financial management manuals for budget preparation, execution, and reporting will be prepared.

24. **Public financial management system at selected line ministries modernized.** This sub-output improved expenditure management and accountability capacities in line ministries. Under subprogram 1, 10 pilot line ministries (including the six ministries to be supported under the proposed program) prepared preliminary annual financial reports in accordance with the planned shift to program budgeting. Internal audit units were established in all government ministries, providing a strong foundation for improving the integrity and quality of the whole PFM system. Subprogram 2 will support six line ministries in (i) preparing annual financial and performance reports in accordance with program budgeting; (ii) preparing FMIS implementation plans, including business process and change-management strategies; and (iii) conducting performance and information and communication technology audits. The implementation of FMIS will pave the way for much-needed automation and modernization in line ministries.

## 3. **Output 3: Capacity of the External Audit Function Improved**

25. This output further developed the external audit capacity of the NAA and reinforced the integrity of the PFM system. Under subprogram 1, a regulation to implement the Audit Law was approved. NAA’s annual report for 2015 was also approved. The annual audit reports of the public finance statements were submitted to the National Assembly within 4 months of receipt from MEF for both FY2013 and FY2014, and were published on NAA’s website. Under subprogram 2, guidelines on financial, compliance, and performance audits will be updated; a manual on conducting audits of subnational administrations (districts) will be completed; and audits of at least 10 districts will be conducted. In coordination with support from the

Government of Sweden, NAA's new strategic plan for 2017–2021 will be prepared and attention to the timely production of annual audit reports continued.

#### **D. Development Financing Needs**

26. Cambodia's gross financing needs remain high. In 2016, with a budget deficit target of 4.6% of GDP, the government will need to borrow about \$820 million. The IMF analysis of debt sustainability in November 2015 found Cambodia at low risk of debt distress. To support its reforms, the government has requested a loan in various currencies equivalent to SDR18,939,000 from ADB's Special Funds resources to help finance subprogram 1. The loan will have a 24-year term, including a grace period of 8 years, an annual interest rate of 1% during the grace period and 1.5% thereafter, and such other terms and conditions set forth in the draft loan agreement. The loan will be withdrawn in a single tranche upon loan effectiveness and used to finance foreign exchange costs of economy-wide imports, excluding ineligible items and imports financed by other bilateral and multilateral sources, and in accordance with ADB's *Loan Disbursement Handbook* (2015, as amended from time to time). The loan closing date is 30 June 2017. A loan of \$30 million has been programmed for 2019 to finance subprogram 2. The loan size is based on the financing needs of the government, the strength of the policy reform package, and its development impact. The government is committed to meeting the full costs of the reforms, which are estimated at \$114.7 million in 2013 prices (para. 29).

#### **E. Implementation Arrangements**

27. MEF is the executing agency for the program. The General Secretariat of the PFM Reform Steering Committee is responsible for overall coordination of program implementation.<sup>17</sup> MEF's Department of Information Technology, General Department of Budget (including the Department of Cooperation and Debt Management), General Department of Internal Audit, and the PFM reform working groups in the selected ministries are the implementing agencies for outputs 1 and 2. The Secretary General of the PFM Reform Steering Committee is the program director and is responsible for outputs 1 and 2. As an independent institution, the NAA is the implementing agency for output 3 and will sign a project agreement with ADB. The NAA's auditor general is the project manager for output 3. Implementation and fund flow arrangements are in the project administration manual (PAM).<sup>18</sup>

### **III. TECHNICAL ASSISTANCE LOAN**

28. The government has requested a TA loan in various currencies equivalent to SDR2,501,000 from ADB's Special Funds resources to be implemented over 3 years to support the reforms under subprogram 2.<sup>19</sup> MEF is the executing agency. The TA loan will finance consulting services, including applicable taxes and duties, bank charges, workshops, seminars, training, and project management support expenses. The TA loan will have a 32-year term, including a grace period of 8 years, an annual interest rate of 1.0% during the grace period and 1.5% thereafter, and such other terms and conditions set forth in the draft TA loan agreement. The TA loan will be implemented from 1 February 2017 to 30 September 2019, with the expected closing date on 31 March 2020. The government will provide in-kind contributions in the form of counterpart staff and various facilities. The TA loan financing plan and investment plan are summarized in part IV of the PAM. Goods will be procured in accordance with ADB's

<sup>17</sup> The PFM Reform Steering Committee is an interministerial body chaired by Minister of MEF.

<sup>18</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

<sup>19</sup> Attached Technical Assistance Loan (accessible from the list of linked documents in Appendix 2).

Procurement Guidelines (2015, as amended from time to time), and consultants will be recruited in accordance with ADB's Guidelines on the Use of Consultants (2013, as amended from time to time).

#### **IV. DUE DILIGENCE**

##### **A. Economic and Financial**

29. Implementation of the proposed program between 2014 and 2019 is estimated to create cumulative net benefits of \$1.18 billion (2013 constant prices) from 2014 to 2024. This is based on estimates of a program impact assessment of cumulative benefits of \$1.29 billion (2013 constant prices). Benefits are estimated to come from the following agreed policy actions: (i) the revenue mobilization strategy (\$739.5 million), (ii) movement to FMIS commissioning (\$259.6 million), (iii) introduction of strategic medium-term budgeting through an MTEF (\$77.1 million), and (iv) selected strategic, systems and process oriented reforms (\$213.7 million). Implementation of the proposed program reforms between 2014 and 2019 is estimated to cost \$114.7 million (2013 constant prices), mainly for implementing the FMIS, line ministries' self-funded support for PFM reforms, and MEF budget support to line ministries. Given the medium- to long-term nature of benefit flows and government long-term commitment to PFM reforms, implementation of the proposed program is assessed to be sustainable over the longer term.<sup>20</sup>

##### **B. Governance**

30. As PFM systems are being developed in procurement and anticorruption environments that are still fragile, program implementation faces fiduciary risks. However, Cambodia has significant experience with budget support loans, and fiduciary arrangements have been gradually improved to ensure that funds are used effectively and efficiently. Mitigating measures focus on supporting implementation of the PFMRP, as reflected in the proposed policy matrix (including improvements in budgeting, internal controls, internal and external audit, and FMIS implementation). These measures and the implementation of decentralization reforms supported by ADB under a separate but complementary program, including clearer assignments of functions and strengthening of PFM systems, have sought to overcome weaknesses and fiduciary risks associated with policy-based lending. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the executing and implementing agencies.

##### **C. Poverty and Social**

31. Although Cambodia achieved consistently high economic growth rates from 2007 to 2015, poverty remains a challenge. Social development and poverty reduction will be achieved mainly through improved and more efficient public services; higher-quality budget allocations linking policy and budgets; increasing inclusion of poverty and gender priorities in line ministries' program budgets; and overall improvements in effectiveness, efficiency, and accountability of public expenditures. The program is categorized as containing some gender elements. The TA loan will support capacity development in line ministries in order to include gender and poverty reduction interventions in their BSPs and program budgets.<sup>21</sup>

<sup>20</sup> Program Impact Assessment (accessible from the list of supplementary linked documents in Appendix 2).

<sup>21</sup> Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

## **D. Safeguards**

32. The program and TA loans are category C for involuntary resettlement, environment, and indigenous people's safeguards as no impacts are expected in these areas.

## **E. Risks and Mitigating Measures**

33. Overall risks for subprogram 1 and the TA loan are assessed as medium. The major risks are (i) low PFM capacities, including an insufficient number of PFM-trained officials, (ii) a slowdown in reforms because of commune and national elections in 2017 and 2018, (iii) slower growth and unfavorable fiscal outcomes caused by external shocks, (iv) limited internal controls and internal audit, (v) weak internal and external reporting, and (vi) weak external audit capacity. The elections risks are mitigated by scheduling approval of subprogram 2 in 2019, well after the elections. Mitigation of all other medium-level risks will be addressed through policy reforms under the proposed program and PFMRP, as well as by capacity building under the TA loan. A risk assessment and risk management plan will be implemented to overcome fiduciary risks in implementing the TA loan. The integrated benefits and impacts of the proposed program are expected to outweigh the costs.

## **V. ASSURANCES**

34. The government and the MEF have assured ADB that implementation of the program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement, as described in detail in the PAM and loan documents.

## **VI. RECOMMENDATION**

35. I am satisfied that the proposed programmatic approach and policy-based loan would comply with the Articles of Agreement of the Asian Development Bank and recommend that the Board approve

- (i) the programmatic approach for the Strengthening Public Financial Management Program;
- (ii) the policy-based loan in various currencies equivalent to SDR18,939,000 to the Kingdom of Cambodia for subprogram 1 of the Strengthening Public Financial Management Program, from ADB's Special Funds resources, with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; for a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board; and
- (iii) the technical assistance loan in various currencies equivalent to SDR2,501,000 to the Kingdom of Cambodia for subprogram 1 of the Strengthening Public Financial Management Program, from ADB's Special Funds resources, with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; for a term of 32 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft technical assistance loan agreement presented to the Board.

Takehiko Nakao  
President

5 September 2016

## DESIGN AND MONITORING FRAMEWORK

Impact the Program is Aligned with			
Effective and efficient public service delivery and inclusive growth (Public Financial Management Reform Program, 2005–2025) <sup>a</sup>			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
<b>Outcome</b> The efficiency, effectiveness, and accountability of public expenditure and revenue management enhanced.	<b>By 2020</b> Improvement in PEFA assessment ratings of the following key summary PFM areas: (i) Budget credibility: from C+ (2015) to B. (ii) Budget policy linkages: from C+ (2015) to B. (iii) Financial accountability: from C (2015) to C+. (iv) External audit: from D+ (2010) to C.	2015 and 2020 PEFA reports.	Commune and national elections in 2017 and 2018 slow reforms. External shocks weaken growth and fiscal outcomes, hampering reforms.
<b>Outputs</b> 1. Policy and regulatory framework for expenditure and revenue management strengthened.	<b>Subprogram 1 (by 30 June 2016)</b> 1a. Consolidated action plan of stage 3 (budget–policy links) of PFMRP for 2016–2020 approved (2013 baseline: N/A). 1b. Medium-term revenue mobilization strategy, 2014–2018 adopted and implemented targeting revenue growing on average of 0.5% of GDP annually (2013 baseline: N/A). 1c. New budget classification (including by ministry, economic, and source of funds) and chart of accounts implemented starting in 2015 budget (2013 baseline: N/A). 1d. FMIS developed and stage 1 implementation started in MEF and 25 provincial treasuries (2013 baseline: N/A). 1e. Policy on principles for internal control of FMIS adopted and implemented (2013 baseline: N/A). 1f. Updated public debt management strategy for 2015–2018 approved (2013 baseline: N/A). <b>Subprogram 2 and TA Loan (by 30 June 2019)</b> 1g. Amendment to Law on State Budget System (2008) prepared to institutionalize PFM reforms including program budgeting (2015 baseline: N/A). 1h. MTRMS implemented with revenues (excluding grants) growing over the medium term on average at 0.5 percentage point of GDP a year—or from a total of 13.5% of GDP in FY2013 to 16.0% of GDP in FY2018 (2013 baseline: 13.5% of GDP).	1a–1l. MEF annual progress reports.	Internal controls and internal audit remain weak. Weak internal and external reporting lessens the transparency and integrity of the PFM system. External audit capacity improves but remains weak, creating fiduciary and development risks. Weak PFM capacities with insufficient PFM-trained officials, especially in line ministries.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
	<p>1i. Comprehensive financial management manual for government budgeting approved (2015 baseline: N/A).</p> <p>1j. Stage 1 of FMIS fully operationalized in MEF and 25 provincial treasuries and stage 2 implementation started for expanding system functionality and coverage to line ministries (2015 baseline: phase 2 not started).</p> <p>1k. Government-wide internal audit manual, including policy and standards for audit of ICT approved (2015 baseline: not prepared).</p> <p>1l. Guidelines approved on (i) government guarantees, including guarantees on PPP projects; and (ii) standard operating procedures for public debt management (2015 baseline: not prepared).</p>		
<p>2. Capacity of selected line ministries to implement budgeting and expenditure management reforms improved.</p>	<p><b>Subprogram 1 (by 30 June 2016)</b></p> <p>2a. 3-year rolling BSPs, 2016–2018 prepared and approved by ministers of relevant ministries (2013 baseline: new item).</p> <p>2b. Budget entities established and program budgeting increasingly implemented by 25 line ministries (2013 baseline: 0).</p> <p>2c. Annual financial reports prepared in accordance with revised budget classifications, including economic format for 10 line ministries (2013 baseline: 0).</p> <p>2d. Internal audit units established in all government ministries (2015 baseline: 90%).</p> <p><b>Subprogram 2 and TA Loan (by 30 June 2019)</b></p> <p>2e. BSPs annually updated and annual program budgeting prepared with poverty and gender issues included by at least six line ministries (2015 baseline: 3).</p> <p>2f. Program budgeting with integrated capital and recurrent budgets fully implemented and issues of gender and poverty included by at least six ministries (2015 baseline: 0).</p> <p>2g. Financial management manuals for budget preparation, execution, and financial and performance reporting prepared in at least six ministries (2015 baseline: 0).</p> <p>2h. Annual financial and performance reports prepared and published by at least six line ministries (2015 baseline: 0).</p> <p>2i. FMIS implementation plans, including business process and change-management strategies, prepared by at least 6 line ministries under phase 2.</p>	<p>2a.MEF annual progress reports.</p> <p>2b–2j. MEF and line ministry annual progress reports.</p>	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
	of FMIS (2015 baseline: 0).  2j. Performance audits and audits of ICT included in internal audit plans and implemented in at least six ministries (2015 baseline: 0).		
3. Capacity of the external audit function improved.	<b>Subprogram 1 (by 30 June 2016)</b> 3a. Regulation for implementing Audit Law approved (2013 baseline: none). 3b. NAA's annual activity report for 2015 approved, in line with implementation of strategic plan, 2012–2016 (2013 baseline: not prepared). 3c. Annual audit report of public finance statements submitted to National Assembly within 4 months of receipt from MEF (2013 baseline: 4 months).  <b>Subprogram 2 and TA Loan (by 30 June 2019)</b> 3d. Updated guidelines on financial audits, compliance audits, and performance audits approved (2015 baseline: no update of guidelines prepared). 3e. Manual on audit of subnational administration (districts) approved, and audits of at least 10 districts completed (2015 baseline: none). 3f. Annual audit report of public finance statements continued to be submitted to National Assembly within 4 months of receipt from MEF (2015 baseline: 4 months).	3a–3f. NAA annual progress reports.	
<b>Key Activities with milestones</b> Refer to the policy matrices.			
<b>Inputs:</b> ADB: \$30.00 million (\$26.50 million for program; \$3.50 million for TA loan) for subprogram 1. Government: In-kind contributions, including for computers for training; ICT equipment for FMIS operations for the six ministries, counterpart staff and office facilities. Indicative ADB funding for subprogram 2 is \$30 million.			
<b>Assumption for Partner Financing</b> Not applicable.			

ADB = Asian Development Bank, BSP = budget strategic plan, FMIS = financial management information system, GDP = gross domestic product, ICT = information and communication technology, MEF = Ministry of Economy and Finance, MTRMS = medium-term revenue mobilization strategy, N/A = not applicable, NAA = National Audit Authority, PEFA = public expenditure and financial accountability, PFM = public financial management, PFMRP = public financial management reform program, PPP = public–private partnership, TA = technical assistance.

<sup>a</sup> Government of Cambodia. 2004. *Public Financial Management Reform Program*. Phnom Penh.

Source: Asian Development Bank.

### **LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=49041-002-3>

1. Loan Agreement
2. Technical Assistance Loan Agreement
3. Project Agreement
4. Sector Assessment (Summary): Public Sector Management
5. Contribution to the ADB Results Framework
6. Development Coordination
7. Attached Technical Assistance Loan
8. Project Administration Manual
9. Country Economic Indicators
10. International Monetary Fund Assessment Letter
11. Summary Poverty Reduction and Social Strategy
12. Risk Assessment and Risk Management Plan
13. List of Ineligible Items

### **Supplementary Documents**

14. Program Impact Assessment
15. Previous Support for Public Financial Management Reform Program by ADB



ព្រះរាជាណាចក្រកម្ពុជា  
MINISTRY OF ECONOMY AND FINANCE

MINISTRY OF ECONOMY AND FINANCE

N° 6331...MEFI/SDICDM

ព្រះរាជាណាចក្រកម្ពុជា  
ជាតិ សាសនា ព្រះមហាក្សត្រ  
KINGDOM OF CAMBODIA  
Nation Religion King

Phnom Penh, August 03, 2016

Mr. Takehiko Nakao  
President  
Asian Development Bank  
No. 6 ADB Avenue, Mandaluyong City  
1550 Metro Manila, Philippines  
Manila, the Philippines

**Subject: Development Policy Letter: Kingdom of Cambodia: Strengthening Public Financial Management Reform Program, Subprogram 1**

Dear Mr. Nakao,

This letter outlines the Royal Government of Cambodia's (RGC) continued commitment to comprehensive public financial management reforms and our request for financial and technical assistance from the Asian Development Bank (ADB). The RGC has made significant progress to implement the Public Financial Management Reform Program (PFMRP) since it was launched in 2004. In 2015, the RGC adopted the Vision on Strategic Goals for Reforming the Budget System (2013-2020) and reaffirmed our commitment to shift from an input-based and centralized system towards a result-based and decentralized system. Stage 3 of the PFMRP was launched (March 2016) through the Consolidated Action Plan Stage 3, which has the core objective of improving links between government policy priorities and the budget.

I would like to request assistance from ADB to support our public financial management reforms in the total amount of \$30 million of which \$26.5 million will support the policy and regulatory reform initiatives under subprogram 1 of the Strengthening Public Financial Management Reform Program, which have been implemented from January 2014 - June 2016; together \$3.5 million technical assistance loan for further development and implementation of policy and regulatory reforms to improve the effectiveness, efficiency and accountability of expenditure and revenue management. The policy initiatives under subprogram 1 and subprogram 2 (together the Program) are described in the attached policy matrix. The Government is firmly committed to funding all proposed actions under the proposed program and more broadly to funding the full PFMRP through the program period 2014-2018 and beyond. I acknowledge the close cooperation and coordination between the government, the ADB and other development partners in supporting the PFMRP.

**Effective and efficient public service delivery and poverty reduction through sustained and more inclusive growth.**

**The RGC continues its strong commitment to implement PFM reforms to sustain growth, deliver better services and reduce poverty.** Commitment and momentum have gained pace from 2015, with the government focusing on the need to pursue more inclusive growth and deliver more effective services to the poor. Broad based consultation on budget preparation and increasing transparency in relation to budget execution has been pursued. At the launching of the consolidated action plan of stage 3, our Samdech Prime Minister stressed the importance of pursuing the PFMRP with vigor and persistence. Arrangements to more formally coordinate with other two closely related governance reform programs of public administration and deconcentration and decentralization have been put in place since 2015.

Significant resources have also been devoted to the design and implementation of phase 1 of the financial management information system (FMIS) implemented in Ministry of Economy and Finance (MEF) and its 25 provincial treasuries. The government is committed to fully funding the phase 2 rollout to all line ministries.

### Macroeconomic Performance

**Strong macroeconomic performance has contributed to reducing the poverty rate from 47.8% in 2007 to 13.5% in 2014.** Cambodia has achieved consistently high rates of GDP growth averaging about 7% annually over the past 10 years. Public sector debt has remained manageable at around 33% of GDP at the end of 2015. Meanwhile, domestic revenues have grown from 13.2% of GDP in 2010 to 17.96% in 2015. The improvements in economic performance have been underpinned by comprehensive reforms under the PFMRP. With scope for further improvements in budget credibility and financial accountability, and an increasing focus on budget-policy linkages, there is an opportunity to have a positive effect on the quality of public service delivery and therefore to achieve more inclusive growth in Cambodia.

### Medium Term Strategy of the Government

**The RGC Rectangular Strategy-Phase III for Growth, Employment, Equity and Efficiency 2014-2018, sets out medium term government priorities and highlights the importance of improved governance.** The strategy is being implemented through the National Strategic Development Plan 2014-2018. Both the strategy and plan identify governance, including public financial management, as a binding constraint to deliver quality public services. Aggregate fiscal discipline has improved, with the overall fiscal deficit markedly reduced from 6.9% of GDP in 2013 to an estimated 2.8% in 2015. Domestic revenue mobilization, while also improving in recent years, is still constrained by limited administrative capacities. Further reforms in the area of contingent liabilities, including guarantees of public private partnership projects, are needed to improve overall public debt management. The absence of modern and automated public financial management systems in line ministries limits the RGC's ability to strategically allocate and monitor public resources and to deliver efficient services. This is especially true for frontline service providers where capacity development is urgently needed and this will be steadily addressed through stages 3 and 4 of the PFMRP. The Government is also pursuing related PFM and governance reforms in deconcentration and decentralization areas and appreciates separate but complementary ADB support being provided here.

### Recent Progress and Further Improvement of the Efficiency, Effectiveness, and Accountability of Public Expenditure Management

**Both the 2015 report of the public expenditure and financial accountability (PEFA) and annual progress report of PFMRP indicated steady progress** in PFM management and in implementing stages 1 and 2 of the PFMRP since the previous report in 2010 though important weaknesses and challenges remain to be addressed over the medium term. Implementation of some reforms under stages 1 and 2 are continuing under stage 3 and preparation for stage 4 will be undertaken.

**Further improvement of policy, regulatory framework and capacities for expenditure and revenue management and accountability are being pursued under stage 3 of the PFMRP.** It will allow existing accomplishments with aggregate fiscal discipline and improved budget, accounting and financial management systems to be complemented by more strategic resource allocation with greater scope to raise the effectiveness and efficiency of expenditures. These reform priorities will be supported by full rollout of the FMIS to line ministries to provide a technical base for improving the quality and integrity of the budget. Stage 3 will, therefore, be critical for improving service delivery, supporting poverty reduction

and inclusive growth with increasing emphasis to be focused on the line ministries to pursue policy focused budgeting.

**Our reform efforts continue to strengthen the policy and regulatory framework for public financial management and increasingly focus on improving budget-policy linkages.** The government has reaffirmed its commitment to shift from an input-based and centralized system towards a result-based and devolved system. Budget circulars were prepared to help line ministries preparing 3-year rolling budget strategic plans (BSPs) that link priority programs and actions with budgetary resources. The government also adopted a medium-term revenue mobilization strategy targeting an increase in revenue of 0.5 percentage point of GDP annually, with impressive results to date. The Public Finance Systems Law (2008) will be amended to institutionalize public financial management reforms including provision for the National Assembly to pass the annual budget in a program budgeting format, while a government wide medium-term expenditure framework for 2018-2020 is being developed.

**Greater efficiency, effectiveness, and accountability of expenditure management are being pursued.** A new budget classification system and chart of accounts has been implemented to move the budget presentation in line with international standards. Stage 1 of FMIS implementation started in MEF and its 25 provincial treasuries to automate budget execution, accounting, and financial reporting. Guidelines on the policies and principles for internal controls for FMIS were adopted, and an internal audit of the FMIS was started by MEF. More comprehensive financial management and internal audit manuals will be developed, and the implementation of the FMIS progressed, including to selected line ministries.

**Sound public debt management systems have been put in place.** An updated public debt management strategy for 2015-2018 has been approved; the debt management and financial analysis recording and management system was upgraded to improve close monitoring of the nature and development of the debt portfolio; and the first public debt statistical bulletin is soon to be published to provide trend information and enhance the evidence-base for policy makers. Guidelines on government contingent liabilities, including guarantees for public private partnership projects, and standard operating procedures for public debt management will be prepared.

**Stage 3 of PFM reforms emphasizes improvements to capacity of the line ministries to implement budgeting and expenditure management reforms.** Preparatory work under stage 2 reforms supported selected line ministries to formulate and implement their budgets by using the BSPs and adopting program budgeting. All ministries have now prepared BSPs for 2016-2018. Budget entities were established and program budgeting is being increasingly implemented in 25 line ministries to improve links between budgetary resources and program goals, and to better integrate the recurrent and capital budgets. The BSPs will be annually updated and poverty and gender issues increasingly included; program budgeting will be increasingly implemented in line ministries; and financial management manuals for budget preparation, execution, and reporting will be prepared nationally in MEF and customized in selected line ministries.

**Public financial management system at selected line ministries are being modernized.** Line ministries are now required to prepare annual financial and performance reports in accordance with the shift to program budgeting in 2015. Internal audit units have been successfully established in all government ministries, which provide a strong foundation for improving the integrity and quality of the whole PFM system. The government for stage 3 also plans to roll out of FMIS to government line ministries. Six line ministries will initially be supported to prepare annual financial as well as performance reports; prepare FMIS implementation plans, including business process and change management strategies; and conduct performance audits and audits of the information and communication technology.

**The need to further improve external audit, so raising the integrity of the PFM system is recognized.** A key regulation to implement the Audit Law was approved in 2015. NAA's annual report for 2015 was also approved. The annual audit report of budget settlement statements was submitted to the National Assembly within four months of receipt from MEF for both fiscal years 2013 and 2014, and published on NAA's website. Guidelines on financial, compliance, and performance audits are to be prepared as well as a manual on conducting audits of sub-national administrations (districts), and audits of at least 10 districts will be completed in the current stage of reforms. NAA's new strategic plan for 2017-2021 will be prepared and attention to sustain recent improvements in the timely production of annual audit reports.

## Conclusion

The RGC will maintain its strong commitment in pursuing the public financial management reform to improve public services, including for poor and vulnerable groups by strengthening the effectiveness, efficiency and accountability of public resources. The RGC will ensure that the PFMRP is adequately funded to enable the important reform agenda to proceed, including funding for the proposed rollout of the FMIS to line ministries. The key reform initiatives outlined above are far from exhaustive. We are nevertheless confident that the reform initiatives supported to date under the program and those anticipated by 2019 are focused on important strategic areas and are expected to have a long term impact in strengthening public financial management within MEF, the line ministries and in the NAA and in more broadly contributing to improved service delivery, stronger and more inclusive economic growth and reductions in poverty levels.

The RGC remains strongly committed to work with ADB over the medium term as these reforms take time to succeed. We would therefore appreciate prompt consideration of the proposed loans and look forward to working together to achieve our shared development objectives.

We look forward to continuing partnership with ADB to assist the Royal Government of Cambodia in meeting our development objectives.

Please accept the assurances of my high consideration.

Yours sincerely, 



Dr. AUN Pornmoniroth  
Senior Minister  
Minister of Economy and Finance

## POLICY MATRIX

### Strengthening Public Financial Management Program

Policy Actions	Subprogram 1 Accomplishments January 2014 - June 2016	Subprogram 2 Milestones (policy triggers in bold) July 2016- June 2019	Medium term directions and expected results (Post Program Partnership Framework)
<b>Output 1: Policy and regulatory framework for expenditure and revenue management strengthened.</b>			
1. A. Improved policy-base of national budget.	<p>1. Concept on Strategic Direction for Reforming the Budget System 2013-2020 published (2015) and implemented to shift from an input-based and centralized system to result-based and devolved system. The strategy provides the roadmap for developing medium term expenditure framework (MTEF); budget strategic plans (BSPs) and program budgeting (PB).</p> <p>2. Consolidated Action Plan (CAP) of stage 3 (budget-policy linkages) of the government's Public Financial Management reform program (PFMRP) for 2016-2020 approved (2016).<sup>a</sup> The CAP provides the authority and plan to drive stage 3 budget reforms.</p> <p>3. Budget circular prepared annually (2015 and 2016) to provide basis for line ministries to prepare 3-year rolling BSPs. Importantly the 2016 circular for the first time set firm, realistic and prioritized ceilings for all ministries allowing for more realistic ministry planning.</p> <p>4. Medium-Term Revenue Mobilization Strategy (MTRMS) 2014-2018 adopted (2014) and implemented. An important element of the PFMRP with major revenue gains – 2.5% of gross domestic product (GDP) targeted from 2014-2018.</p>	<p>1. <b>Amendment to Law on State Budget System (2008) prepared to institutionalize PFM reforms including provision for the National Assembly to pass the annual budget in a program budgeting format (2018).</b></p> <p>2. <b>CAP for stage 3 of the PFMRP implemented and progress reported annually.</b></p> <p>3. Government-wide MTEF for 2018-2020 adopted (2017). Significant net positive resource allocation impacts are estimated for successful movement to MTEF, in line with international experience.</p> <p>4. MTRMS implemented with revenues (excluding grants) growing over the medium term on average at 0.5 percentage point of GDP per year or from a total of 13.5% of GDP in fiscal year (FY) 2013 to 16.0% of GDP in FY 2018 (2013 baseline: 13.5% of GDP).</p>	<p>Strengthened policy and regulatory framework for budget-policy linkages.</p> <p>Public Expenditure and Financial Accountability (PEFA) performance indicators (PIs) will improve from (2015 levels) as follows: <sup>c</sup></p> <p>PI (2) Composition of expenditure outcomes compared to budget (D+).</p> <p>PI (3) Aggregate revenue outcome compared to budget (A).</p> <p>PI (12) Multi-year perspective in fiscal plans, expenditure plans budgets (C+).</p>
1. B. Improved expenditure	5. New budget classification (including by ministry, economic, and source of funds) and chart of	5. <b>Comprehensive financial management manual for government</b>	Improved efficiency, effectiveness, and

Policy Actions	Subprogram 1 Accomplishments January 2014 - June 2016	Subprogram 2 Milestones (policy triggers in bold) July 2016- June 2019	Medium term directions and expected results (Post Program Partnership Framework)
management and accountability systems.	<p>accounts implemented starting in 2015 budget. Important technical reforms needed to progress MTEF, BSPs and PB.</p> <p>6. Financial management information system (FMIS) developed, and stage 1 implementation started in the Ministry of Economy and Finance (MEF) and 25 provincial treasuries to automate budget execution and financial reporting. Very important as the technical backbone and enabler of stage 3 budget, reporting and audit reforms.</p> <p>7. Policy on principles for internal control for FMIS adopted (2014) and implemented (commencing in 2015). Important benefits in removing waste and corruption and improving performance while underpinning integrity of the public financial management (PFM) system.</p>	<p><b>budgeting approved, and used for budget preparation, execution, and financial and performance reporting. Important for consolidating guidelines in one place for training/guidance of line ministries.</b></p> <p>6. <b>Stage 1 of FMIS fully operationalized in MEF and 25 provincial treasuries, including with International Public Sector Accounting Standards (IPSAS)-cash basis financial statements; and stage 2 implementation started for expanding system functionality and coverage to LMs.</b> Estimated to provide major benefits in operating efficiencies; corruption reduction and information to support changes to resource allocation (in line with international experience).</p> <p>7. <b>Government-wide internal audit manual based on international internal auditing standards, including policy on principles for internal control of information and communication technology (ICT) approved.</b></p>	<p>accountability of expenditure management.</p> <p>PEFA performance indicators will improve from (2015 levels) as follows:</p> <p>PI (5) Classification of Budget (C).</p> <p>PI (16) Predictability of funds for commitments (C+).</p>
1.C. Strengthened public debt management.	8. Updated Public Debt Management Strategy 2015-2018 approved. <sup>b</sup>	8. <b>Updated Public Debt Management Strategy 2015-2018 implemented, including approvals of (i) guidelines on government guarantees, including guarantees on public private partnership projects (PPPs); and (ii) Standard Operating Procedures. Better control of contingent liabilities will provide financial efficiencies; while a framework</b>	<p>Sound public debt management system in place.</p> <p>PEFA performance indicators will improve from (2015 levels) as follows:</p> <p>PI (17) Cash management, debt and guarantee</p>

Policy Actions	Subprogram 1 Accomplishments January 2014 - June 2016	Subprogram 2 Milestones (policy triggers in bold) July 2016- June 2019	Medium term directions and expected results (Post Program Partnership Framework)
	<p>9. Debt Management and Financial Analysis System (DMFAS) upgraded to DMFAS 6.0. Has supported cost efficiencies and deficit reduction.</p> <p>10. Publication of the first public debt statistical bulletin, with availability of data as of December 2015 (June 2016).</p>	<p>for PPPs will enhance investment and growth.</p> <p>9. <b>DMFAS implemented with reports on all loans and grants produced monthly.</b></p> <p>10. <b>Publication of subsequent six-monthly public debt statistical bulletins.</b></p>	management (C+).
<b>2. Output 2: Capacity of selected line ministries to implement budgeting and expenditure management reforms improved.</b>			
2.A. Improved capacity of selected line ministries in budget formulation and execution.	<p>11. 3-year rolling BSPs 2016-2018 prepared and approved by relevant line ministries (June 2016). Important pre-requisites for effective MTEF and PB reforms.</p> <p>12. Budget entities established and program budgeting increasingly implemented by 25 line ministries (LMs). An important milestone in the movement to program budgeting, management and reporting.</p>	<p>11. <b>BSPs annually updated, and poverty and gender issues included by at least six LMs. BSPs are important mechanism for changes to resource allocations and to improve operating efficiencies.</b></p> <p>12. <b>Program budgeting with integrated capital and recurrent budgets fully implemented and gender and poverty issues included by at least six LMs. Integral to the success of stage 3 reforms in LMs as input based budgets move to unified program based budgets.</b></p> <p>13. Financial management manuals for budget preparation, execution, and financial and performance reporting prepared in at least six LMs. The Manual is important for consolidating budget reform requirements and as a basis for capacity building in LMs.</p>	<p>Improved capability of line ministries in budget formulation and execution.</p> <p>PEFA performance indicators will improve from (2015 levels) as follows:</p> <p>PI (23) Availability of information on resources received by service delivery units (D).</p>
2.B. Improved capacity of	13. Annual financial reports prepared in accordance with revised budget classifications, including	14. <b>Annual financial and performance reports prepared and published by at</b>	Public financial management system of selected LMs

Policy Actions	Subprogram 1 Accomplishments January 2014 - June 2016	Subprogram 2 Milestones (policy triggers in bold) July 2016- June 2019	Medium term directions and expected results (Post Program Partnership Framework)
selected line ministries in expenditure management and accountability.	<p>economic format for 10 LMs. Will assist to improve transparency and knowledge as a basis for budget reform.</p> <p>14. CAP of stage 3 of PFMRP included extension of FMIS to line ministries. Extension of FMIS to LMs is very important for introducing budget reforms many of which are not possible in manual forms.</p> <p>15. Internal audit units established in all government ministries. Broadening coverage has been important and provides scope for significant benefits through waste reduction, corruption eradication; and better resource allocation.</p>	<p><b>least six LMs. Comprehensive reporting is important for improving resource allocation decision making over time as well as transparency.</b></p> <p>15. <b>FMIS implementation plans, including business process and change management strategies, prepared by at least six LMs under phase 2 of FMIS.</b> Full preparation and change management in LMs will be important for establishing FMIS as the technology backbone to the new budgeting and PFM system. Based on international experience successful rollout will provide significant net benefits</p> <p><b>16. Performance audits and audits of ICT included in internal audit plans and implemented in at least six LMs.</b></p>	<p>modernized.</p> <p>PEFA performance indicators will improve from (2015 levels) as follows:</p> <p>PI (24) Quality and timeliness of in year budget reports of ministries (C+).</p> <p>PI (25) Quality and timeliness of annual ministry financial and performance reports (D+).</p>
<b>3. Output 3: Capacity of the external audit function improved.</b>			
3. Regulatory framework and capacity for external audit strengthened.	16. Regulation for implementing Audit Law approved (2015). This long awaited regulation provides a strong basis for more effective audits.	<p>17. Regulation for implementing Audit Law operationalized through NAA's procedures and the annual audit plan.</p> <p>18. Updated guidelines on financial audits, compliance audits, and performance audits.</p> <p>19. Manual on audit of sub-national administration (districts) approved, and audits of at least 10 districts completed. External audit coverage of sub-national administrations is currently weak and</p>	<p>Enhanced external audit for the integrity of the PFM system.</p> <p>PEFA performance indicators will improve from (2015 levels) as follows:</p> <p>PI (26) Scope, nature and follow up arrangements for external audit (D +).<sup>d</sup></p>

Policy Actions	Subprogram 1 Accomplishments January 2014 - June 2016	Subprogram 2 Milestones (policy triggers in bold) July 2016- June 2019	Medium term directions and expected results (Post Program Partnership Framework)
	<p>17. The National Audit Authority's (NAA) annual report for 2015 approved, in line with implementation of Strategic Plan 2012-2016.</p> <p>18. Annual audit report of public finance statements submitted to National Assembly within 4 months of receipt from the MEF for both fiscal years 2013 and 2014 and published on NAA's website. Timeliness, breadth of coverage and transparency of audit reports is important for underpinning the integrity of the system including in relation to the new budget reforms under stage 3.</p>	<p>requires guidance which the new manual will provide.</p> <p>20. NAA's new strategic plan 2017-2021 approved and annual reports published on NAA's website.</p> <p>21. Annual audit report of public finance statements continued to be submitted to National Assembly within 4 months of receipt from the MEF annually and published on NAA's website.</p>	

<sup>a</sup> Stage 3 comprises: (i) stage 3 objective for improving budget-policy linkages (stage 3 core reform agenda); and (ii) remaining objectives under stage 2 (budget accountability), and stage 1 (budget credibility) of PFMRP.

<sup>b</sup> This is an update of the earlier Public Debt Management Strategy 2011-2015.

<sup>c</sup> Where a particular indicator in 2015 was rated A there is no scope for improvement. The target is that the A rating is maintained.

<sup>d</sup> D+ rating based on 2010 PEFA as this indicator was not rated in 2015.