

PUBLIC FINANCIAL MANAGEMENT ASSESSMENT

Background

1. The government has been implementing reforms to improve governance, public sector management, and public services. The Rectangular Strategy III for Growth, Employment, Equity and Efficiency (2014-2018), which is being implemented through the National Strategic Development Plan (2014-2018), has included public financial management (PFM), decentralization and deconcentration, public administration, and legal and judicial matters. Both PFM and decentralization and deconcentration reforms have made steady progress in recent years. Public administration reform has emerged with a clearer and more substantive agenda since 2013. Progress in legal and judicial reform has been more moderate.

2. The public financial management reform program (PFMRP) has been implemented in four stages since 2005. Some important challenges in budget credibility and accountability have been addressed under stages 1 and 2 respectively, while remaining works in these areas will be continued under stage 3 (budget-policy linkages). Overcoming further weaknesses in these areas and in performance accountability (stage 4) to improve public services is the priority of the government reform agenda.

3. **Stage 1 (2005–2008)** commenced at a time when PFM systems were seriously deficient and aimed initially to increase budget credibility so as to deliver more predictable resources to budget managers including elimination of chronic cash shortages and payment arrears. Budget 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. Resulting fiscal discipline has underpinned macro-economic stability and high economic growth. Key elements of stage 1, including revenue mobilization and public debt management, continued to be monitored and consolidated under stages 2 and 3 of the PFMRP.

4. **Stage 2 (2009–2015)** aimed for more effective financial accountability through improving internal controls and holding managers accountable. Stage 2 also comprised consolidation of budget credibility reforms under stage 1 and advance works under stage 3 in such areas as BSPs and program budgeting. Important progress included: (i) design of budget classifications and chart of accounts broadly consistent with international public sector accounting standards (IPSAS); (ii) early design of three-year rolling budget strategic plans (BSPs), and preliminary trialing of annual program budgeting based on BSPs and budget entities; (iii) early work to unify the capital and recurrent budgets; (iv) procurement reform including adoption and implementation of the Procurement Law (2012); (v) strengthening of internal controls and internal audit units in the Ministry of Economy and Finance (MEF) and line ministries; (vi) implementation of phase 1 of the financial management information system (FMIS) initially within MEF, including MEF provincial departments; (vii) designing and early implementation of the medium term revenue mobilization strategy in 2014; and (viii) long term capacity development. Consolidation of unfinished works under stage 1 including the revenue mobilization and public debt management; and stage 2 such as the new budget classifications, new chart of accounts, FMIS, internal control and internal audit, and external audit will continue into stage 3.

5. **Stage 3 (2016–2020)**, which aims at improving budget-policy linkages, could not have proceeded without the foundation provided by policy and technical reforms and piloting undertaken under stages 1 and 2 and which continue to be monitored and consolidated under stage 3. Key activities under stage 3 include intensification of: (i) BSPs, program budgeting

including budget integration, implementation of budget entities and new business processes particularly FMIS reforms; (ii) linking the medium term expenditure framework (MTEF), BSPs and program budgeting; (iii) further improving budget transparency; (iv) implementing phase 2 of the FMIS and planning its extension to line ministries; (v) further work to raise the quality of external auditing; (vi) pursuing more substantive fiscal decentralization; and (vii) preparing for stage 4 (2021–2025) which will focus on development of frameworks for performance accountability.

Assessment of Public Financial Management

6. In 2015, the Royal Government of Cambodia conducted an evaluation of its Public Financial Management System. This evaluation was based on the Public Expenditure and Financial Accountability (PEFA) Methodology and the results have compared with the previous PEFA which was conducted in 2010.

Overview of Results of the 2015 Assessment

7. **National budget.** Policy-based budgeting is comprehensive, organized in several distinct stages with appropriate involvement of both the top political level and the individual line ministries, and it is completed in a timely manner every year. Performance is strong and has been maintained since 2010. However, the medium-term aspects of policy-based budgeting are performing less well and little progress has been noted since 2010. As a result, it may be difficult to sustain support to policy priorities in the medium to long term. Sector strategies with a full costing in line with fiscal aggregates are still the exception. Budgeting of recurrent and capital project expenditure have been and remain separate processes and are not strongly linked. Whilst a medium-term budget framework is prepared annually, the links between the estimates from one year to the next are weak. An exception is the annual analysis of debt sustainability which has remained strong as the government has enhanced its internal capacity to complete the process.

8. Moreover, overall budget credibility remains strong as regards budget outturns at the aggregate level for both domestic revenue and domestically financed expenditure. While performance in this respect was already noted as good in 2010, the recent PEFA documented continuing improvements. Further, these results were not affected by externally financed expenditure despite the poor predictability of budget support. First, budget support is a minor part of budget financing, and second, external project funding has generally met aggregate budgeted amounts. Nevertheless, in-year reallocations of budget appropriations are frequent and significant as a result of the extensive powers of the minister and can lead to significant deviations between specific outturns and specific budgeted allocations. Thus strategic budget credibility is low.¹

9. However, all of the indicators covering budget predictability and control in budget execution are low although particular aspects of many of the indicators have improved. Revenue administration appears little changed since 2010. The law on taxation has a number of gaps, provides the administration with extensive discretion and despite a provision for an independent tribunal, one has not been implemented. Efforts are being made to give taxpayers

¹ Budget credibility has deteriorated as regards the intended strategic allocation of resources to the main budget entities. This raises concerns as the 2010 PEFA noted this same problem and expenditure arrears are high. As systems to monitor arrears are incomplete, the overall level of arrears and its developments from year to year are not known.

access to relevant information but human and financial capacity constraints combine to ensure information is not comprehensive or up-to-date. A lack of proactive approaches to capturing all businesses by the taxnet, inadequate levels and enforcement of penalties for non-compliance as well as the absence of a risk-based taxpayer audit program ensure that compliance with tax registration and filing is low. Tax collection could also be improved significantly. Tax arrears remain high despite slight improvements in collection rates, and monitoring is hampered by a lack of frequent full reconciliations of collections with tax assessments and arrears. However, the revenue float remains low as collections are transferred to the national treasury with little delay.

10. In addition, the comprehensiveness and transparency of the budget generally score in low range. Comprehensiveness of the budget is still being undermined by the failure to include significant elements of government operations in the key fiscal reports of government –mainly as regards the operations of public administrative entities and externally funded projects. The budget and accounts classification systems are very basic and only cover administrative and economic classification. While considerable efforts to add functional and program classification have been expended, these new parts of the classification system have yet to be fully developed and rolled out across budget entities. Meanwhile, budget transparency exhibits slippage. The amount of key information in the budget plan submitted to the legislature (and publicized after legislative approval) has been reduced. Moreover, the public's access to key fiscal information has also been compromised due to longer delays in making the requisite information available – despite the reports being produced for internal use in a timely manner.

11. **Cash and debt management.** Cash flow forecasting is also performing well and has improved in recent years. Line ministries and other budget entities are able to plan their expenditure commitments at least quarterly in advance. Debt management systems are fair, but of minor importance due to the relatively low level of government debt. A Treasury Single Account is used to consolidate cash balances and has performed well since 2010.

12. **Procurement.** However, procurement is not transparent and no independent procurement review body has been established. Monitoring of compliance with procurement regulations is hampered by lack of data. Internal controls suffer from a number of weaknesses. In the area of staff salaries, personnel and payroll data is not directly linked and comprehensive payroll audits are not conducted. Moreover, payroll changes are often delayed and result in payment arrears. Internal controls of non-salary expenditure are not comprehensive and audit reports indicate frequent non-compliance with the rules. The internal audit function is still in its infancy. However, increasing attention to systemic issues by the internal audit units, rather than transaction based audits, represents a positive development.

13. **Inter-governmental relations.** However, systems related to the central government's interaction with subnational administrations at the commune/*sangkat* level represent a notable exception and perform much better. Intergovernmental relations between central government and communes/*sangkats* remain transparent and predictable as transfers to communes and *sangkats* are rules based and the indicative transfer estimates are provided well on time and are reliable. In addition, the oversight of the fiscal operations of communes/*sangkat* ensures that the central government does not face fiscal risks from those entities. Yet, the central government is unable to report strategic budget allocations to sectors or programs at the aggregate level of general government. Classification systems are different at central government and sub-national administrative levels and neither one include comprehensive functional or sector classifications. Monitoring of fiscal risk from commercial public enterprises has also remained weak as no

overview of fiscal risks is prepared and reported –an issue worsened by lack of ceilings for issue of guarantees by the government.

14. **Budget oversight.** The oversight functions of the national legislature are performed generally well. However, the involvement of the legislature in the budget process is limited as its review of the budget plan is performed at a stage where all details have already been prepared by the government. Further, the minister for economy and finance enjoys extensive powers to reallocate funds without prior legislative approval. It is not possible to judge the degree of change since 2010 as the two indicators on legislative oversight were not assessed in 2010.

15. The performance indicators for accounting, recording and reporting generally scored low, but positive developments are noted. Bank reconciliations are comprehensive and timely, as are in-year budget execution reports (Table of Fiscal and Economic Operations of the Government reports). In particular, the preparation of annual financial statements has seen distinct improvements in both timeliness and disclosure of accounting standards. Indicators for external scrutiny and audit, institutional coverage of external audit and adherence to international audit standards remain low, but audits of the annual financial statements are completed in a timely manner which represents a significant improvement.

Conclusion

16. Policy-based budgeting remains sound and budget credibility in the aggregate has been maintained. However, budget predictability remains low due to weak tax administration and the out-sized and unilateral ability of the executive to re-allocate budget amounts. However, progress is noted. Budget comprehensiveness and transparency, while low, exhibit improvements. Cash flow forecasting is sound and supported by a Treasury Single Account. Intergovernmental relations between central government and communes/*sangkats* remain transparent and predictable as transfers to communes and *sangkats* are rules based and the indicative transfer estimates are provided well on time and are reliable. The oversight functions of the national legislature are performed generally well but more needs to be done to strengthen accounting, recording and reporting. Recognizing these weaknesses, the government has prepared essential new features for financial accountability which are ready to be integrated into the current system together with the financial management information system. Preparation for the next stage public financial management reforms has been completed. However, political support for successful and sustainable reforms is not yet assured. To ensure the accuracy, efficiency, and effectiveness of public financial management, staff at all levels of the individual ministries must have the capacity and willingness to implement the reforms.

Synergies with ADB Support to Decentralization

17. ADB supports both PFM and decentralization reforms in Cambodia. The Public Financial Management Reform Steering Committee, which is chaired by MEF, leads the PFMRP, while the National Committee for Sub-National Democratic Development, which is chaired by the Ministry of Interior, leads decentralization reforms. ADB support to decentralization has been ongoing since 2002, including: (i) loan and TA grant support to assist in the construction of offices for commune councilors and to provide capacity building support for commune councilors (2002–2009); (ii) TA grant support to develop an institutional framework for decentralization reforms and to commence the preparation of future ADB support to decentralization (2009–2012); and (iii) ongoing support is being provided through the Decentralized Public Services and Financial Management Sector Development Program with policy reforms under subprograms 1 and 2 supporting reforms to the assignment of functions,

the intergovernmental financing arrangements, the PFM system at subnational level, and the establishment and operations of a subnational investment facility. Future support to PFM will need to coordinate closely with planned and ongoing interventions in sector ministries, and monitor closely the assignment of functions to subnational administrations, and implications for the resources of line ministries. The proposed Strengthening Public Financial Management 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.