

I. Introduction

1. Study Background

The 1997 financial crisis in Asia exposed structural weaknesses in the banking and corporate sectors of affected countries, owing largely to poor governance, lack of transparency, and weak supervision and regulation.³

The Asian Development Bank (ADB) has been taking a number of initiatives to assist Developing Member Countries (DMCs) in overcoming these structural problems. The focus on improved governance includes enhancing the effectiveness of public administration and development management at the sector level and in national institutions in the DMCs. Where appropriate, institutional development of the local and provincial agencies and the private sector is also covered. A sound regulatory financial framework and its enforcement, capable institutions, skilled human resources, and effective monitoring and supervision are important prerequisites to an efficient financial structure.

Regional Technical Assistance (RETA) No. 5877 – *Strengthening Financial Management and Governance in Selected DMCs* – was approved by ADB for the purpose of carrying out initial studies to identify gaps and weaknesses in financial management and governance and to recommend courses of action to overcome these problems.

2. Objectives

ADB has demonstrated its stand on the importance of good governance, through effective financial management, for sustained economic development. This RETA involved a diagnostic review of the existing accounting and auditing support, and standards in the selected DMCs. After carrying out this diagnostic review, the study assessed the need for assistance to improve the current situation. Objectives were to:

- (i) assess the capability and capacity within each country to provide efficient and effective accounting and auditing support, to meet international standards and best practices, and address the issue of training and capacity enhancement

³ Zhuang, Juzhong, David Edwards, David Webb and Ma. Virginita Capulong. 2000. *Corporate Governance and Finance in East Asia: A Study of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand*. Asian Development Bank: Manila.

- (ii) determine the existing accounting and auditing standards of each country
- (iii) assess the degree of deviation from International Accounting and Auditing Standards (IAAS) while identifying weaknesses and possible corrective options
- (iv) discuss the fieldwork findings and introduce the concepts of the international standards through workshops
- (v) develop reference materials for potential users of the IAAS, and
- (vi) determine the level and type of assistance needed by each country in order to provide acceptable accounting and auditing support to the private and public sectors.

3. Scope

The RETA involved an in-depth study of the key issues relating to accounting and auditing support in the selected DMCs, identified gaps and weaknesses that need to be addressed to improve accounting and auditing support, and developed assistance programs in collaboration with other donors to rectify the identified weaknesses. Cambodia was one of seven countries participating in the RETA.

4. Country Case Studies and Workshops

The first part of this study examined the current accounting and auditing structure and systems adopted in Cambodia. It also:

- (i) analyzed the political, institutional, and regulatory and legal framework on accounting and auditing practice in Cambodia and the level of enforcement of existing laws, rules, and regulations;
- (ii) identified gaps and weaknesses in accounting and auditing support available and deviations from international standards; and
- (iii) identified alternative options to remedy the identified weaknesses, with the objective of eventually doing away with these.

The second part of this study disseminated the findings of the country research through in-country workshops. Each workshop provided a cross-section of views on the findings of the research and established ways to move forward to improve financial management and governance in the country. After carrying out the assessment of accounting and auditing support in Cambodia, the study findings and recommendations were discussed at a workshop in Phnom Penh on 6 July 2000, and at an international conference at ADB Headquarters in

Manila from 16 - 18 October 2000. This report incorporates feedback from the Workshop and the Conference.

5. ADB Focus on Financial Governance in Cambodia

The focus of ADB's operational strategy in Cambodia is poverty reduction and good governance is a core part of this strategy. This RETA complements other ADB interventions, which will lead to improved financial governance including a proposed TA for Strengthening Capacity in Public Finance Management and a proposed TA for Capacity Building in the Audit Function Stage II.

6. Cambodia

Cambodia is a monarchy with a population 11,561,000 people. The annual population growth rate is 2.5 percent. The capital is Phnom Penh and there are three other major municipalities; Sihanoukville, Kep, and Pailin. There are 20 provinces each administered by a governor. There are 183 districts, 1,609 communes, and approximately 13,500 villages. The area of Cambodia is approximately 181,000 sq. km.

Cambodia is situated in the Lower Mekong region between Thailand in the west, Viet Nam in the east, and Lao PDR in the north. The GDP per capita is approximately US\$256, making it one of the poorest countries in the Asian region. One third of Cambodia's people live in poverty. A great deal of the country's infrastructure has been destroyed by decades of conflict.

Cambodia's infrastructure must be improved, especially in rural areas, to create the environment for private sector investment. The agricultural sector accounts for 40 percent of GDP. Public administration needs improvement and the civil service is overstuffed and underpaid. Real wages are extremely low and below the poverty line. Technical and management skills need improvement and the country relies heavily on expatriate assistance. The best prospects for development are in agriculture, textiles, and tourism.

The main religion is Buddhism, and other faiths include Roman Catholicism and Islam. Table 1 describes adult literacy rates by sex and stratum (1999 Census).

Table 1: Adult Literacy Rates (percent)

Gender	Cambodia	Phnom Penh	Other Urban	Rural
Total Population	71.2	87.3	72.0	69.2
Male	82.9	94.3	83.3	81.5
Female	61.1	81.0	62.3	58.7