

## IV. Accounting and Auditing Standards

This chapter describes the accounting and auditing standards that govern the preparation of external financial reports and the audit of those reports. The chapter is structured as follows:

### Part One: Accounting Standards

- 1 – Introduction
- 2 – Differences between General Accounting Plan and IAS
- 3 – International Accounting Standards
- 4 – Public Sector Accounting Standards

### Part Two: Auditing Standards

- 5 – Introduction
- 6 – Standards Included in the New Audit Law
- 7 – International Auditing Firms

## **Part One. Accounting Standards**

### **1. Introduction**

The only “formalized” accounting system in Cambodia is the Cambodia General Accounting Plan, which has been explained in Chapter II. A brief summary of the differences between International Accounting Standards (IASs) and the Cambodian system is included in this chapter.

### **2. Differences between General Accounting Plan and IAS**

A brief summary of the differences between the Cambodia General Accounting Plan and IASs is as follows:

- The Cambodian form of balance sheet requires some modification to conform to IASs, however in general terms the information is readily available to make such reclassifications. There is no split between long and short-term assets and liabilities in the balance sheet however this information is included as a footnote in the Cambodian Plan.
- The Income Statement in the Cambodian Plan is recorded using expense items rather than on a functional basis. The conversion to functional classifications may be difficult and time consuming.

- Some items classified as extraordinary items in the Cambodian Income Statement are normal operating items under IAS and this would involve a further reclassification.
- Disclosure notes relating to Long-Term Debt regarding due dates, interest rates, currency split and type of debt are not required in the Cambodian Financial Statements.
- Last-in-First-out (LIFO) is not an acceptable method of stock inventory valuation under the Cambodian Standards; however, this method of stock valuation is included in most accounting textbooks used in Cambodian institutes.

From 1979 to 1996 there was an Accounting Department within the Ministry of Economy and Finance (MEF) that was responsible for the preparation of Public Accounting and General Accounting Standards, including accounting for the private sector. Since 1996 there has been no department established to provide guidance on accounting standards.

### **3. International Accounting Standards**

#### The 1995 Working Group

The organization and regulation of accounting in Cambodia is incomplete and unstructured. This was also the case in 1995 when the Government decided to form a working group to review the then current state of accounting laws and regulations and devise a program for the introduction of IASs in Cambodia.

By late 1995 a draft decree and ministerial order had been prepared which, if promulgated, would have established an Accounting Standards Setting Committee responsible for the introduction of standards based on IAS. However, the Government decided to terminate the program and the decree and ministerial order were never issued.

#### French Government Assistance

In mid-1999 the MEF formally requested the French Government for assistance in upgrading the Cambodian Accounting Standards to IAS. The French Government agreed to this request and it was decided to utilize existing grants to fund the study in four parts: -

- Public Sector Accounting
- Private Sector Accounting
- Revenue Mobilization Through Taxation
- Computerization for MEF

The study was carried out in late 1999 by the French consultant *Conseil National de la Compagnie Nationale* and a set of documents was submitted to the MEF in March 2000. If implemented the documentation will assist in upgrading the present Cambodian system to IASs. The recommendations in the submission were mainly aimed at the private sector and included a framework for the preparation and presentation of financial statements, which were similar to those approved by the Board of the International Accounting Standards Committee in April 1989 and published in July 1989. The underlying framework included reference to the objectives of financial statements, underlying assumptions, qualitative characteristics of financial statements, and the elements of financial statements.

The French study also included a set of recommended IASs that were deemed appropriate for the Cambodian situation. These will be considered for adoption by the MEF once the sub-decree on Accounting becomes law. The recommended Cambodian Accounting Standards are as follows:

1. Presentation of Financial Statements (similar to IAS 1)
2. Inventories (similar to IAS 2)
3. Revenue (similar to IAS 18)
4. Depreciation Accounting (similar to IAS 16)
5. Provisions, Contingent Liabilities and Assets (similar to IAS 37)
6. Capital and Reserves (similar to IAS1, Standard 74)
7. Property, Plant and Equipment (Similar to IAS 16)
8. Intangible Assets (similar to IAS 38)
9. Construction Contracts (similar to IAS 11)
10. Accounting for Government Grants (similar to IAS 20)
11. Changes in Accounting Policy (similar in part to IAS 8)
12. Net Income (similar in part to IAS 8)
13. Borrowing Costs (similar to IAS 23)
14. Events After the Balance Sheet Date (similar to IAS 10)
15. Leases (similar to IAS 17)
16. The Effects of Changes in Foreign Exchange Rates (similar to IAS 21)
17. Simplified Accounting Systems for Small Companies (this is more in the nature of a guideline rather than an Accounting Standard)

### World Bank Assistance

The World Bank is assisting the Royal Government of Cambodia with the development of a system of financial accountability under IDF Grant No.TF027305.<sup>4</sup> This project is being accomplished under the Government's accountability development program which includes:

- The design of appropriate accounting and auditing education and training programs
- The establishment of an independent Financial Accounting and Auditing Standards Board to advise the Government on draft laws and regulations to introduce accounting, auditing and financial reporting standards consistent with IASs, issued by the International Accounting Standards Committee (IASC), and International Standards on Auditing, issued by the International Auditing Practices Committee (a subcommittee of the International Federation of Accountants).
- The establishment of an Institute of Certified Public Accountants in Cambodia.

## **4. Public Sector Accounting Standards**

### Introduction

The International Federation of Accountants has released the first eight International Public Sector Accounting Standards (IPSASs) designed to enhance the accountability and financial management of governments worldwide. The release of these documents means that for the first time there is an authoritative set of independent financial reporting standards for governments. The Standards are based on Cash or Accrual – there are no Standards for Modified Cash or Modified Accrual.

IPSASs 1-8 are the first in a set of accrual-based accounting standards applicable to the public sector and will contribute significantly to the provision by governments of comparable, relevant and understandable financial information.

The IPSASs are based on the International Accounting Standards (IASs) issued by the International Accounting Standards Committee (IASC). The IASs are adapted as necessary to reflect their application to the public sector.

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<sup>4</sup> Grants from World Bank International Development Fund that are only available to countries with very low GDPs.

The Public Sector Committee (PSC) of the International Federation of Accountants also recognizes that many governments may not yet be in a position to adopt the accrual-based IPSASs. To assist these governments, the PSC has developed an exposure draft ED 9 *Financial Reporting under the Cash Basis of Accounting*. This sets out the requirements for the presentation of the primary financial statement under the cash basis of accounting, as well as the statement's structure and minimum content requirements. The requirements that are likely to emerge in this standard should lead to transparency where governments remain on the cash basis of reporting.

Building on the momentum of the recently released first set of final IPSASs, the International Federation of Accountants (IFAC) Public Sector Committee (PSC) released a further six new exposure drafts. The exposure drafts are another key step in the PSC's efforts to develop a comprehensive body of international accounting standards for governments around the world.

In addition to the new standards and exposure drafts, the Public Sector Committee has released a study, *Governmental Financial Reporting: Accounting Issues and Practices*. The new study aims to assist governments in the preparation of their financial reports and contains a detailed description of the common bases of accounting used by governments: cash accounting and accrual accounting, as well as a brief discussion of common modifications to the cash and accrual bases. The study also provides examples of actual financial statements prepared under each basis of accounting. A Summary of PSC Study 11, IPSASs 1-8 and EDs 9-15 are as follows:

- IFAC PSC Study 11 *Governmental Accounting Issues and Practices* aims to assist governments in the preparation of their financial reports and contains a detailed description of the common bases of accounting used by governments: cash accounting (including modified cash accounting) and accrual accounting (including modified accrual accounting). The Study also provides examples of actual financial statements prepared under each basis.
- IPSAS 1 *Presentation of Financial Statements* prescribes the overall considerations for the presentation of financial statements, guidance for the structure and minimum requirements for the content of financial statements prepared under the accrual basis of accounting.
- IPSAS 2 *Cash Flow Statements* requires the provision of information about the historical changes in cash and cash equivalents of an

entity by means of a cash flow statement that classifies cash flows during the period from operating, investing and financing activities. Cash flow information allows users to ascertain how a public sector entity raised the cash it required to fund its activities and the manner in which that cash was used.

- IPSAS 3 *Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies* requires the classification and disclosure of extraordinary items and the separate disclosure of certain items in the financial statements. It also specifies the accounting treatment for changes in accounting estimates, changes in accounting policies and the correction of fundamental errors.
- IPSAS 4 *The Effect of Changes in Foreign Exchange Rates* deals with accounting for foreign currency transactions and foreign operations. IPSAS 4 sets out the requirements for deciding which exchange rate to use and how to recognize in the financial statements the financial effect of changes in exchange rates.
- IPSAS 5 *Borrowing Costs* prescribes the accounting treatment for borrowing costs and generally requires the immediate expensing of borrowing costs. However, the Standard permits, as an allowed alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.
- IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities* requires all controlling entities to prepare consolidated financial statements that consolidate all controlled entities on a line-by-line basis. The Standard also contains a detailed discussion of the concept of control as it applies in the public sector and guidance on determining whether control exists for financial reporting purposes.
- IPSAS 7 *Accounting for Investments in Associates* requires all investments in associates to be accounted for in the consolidated financial statements using the equity method of accounting, except when the investment is acquired and held exclusively with a view to its disposal in the near future in which case the cost method is required.
- IPSAS 8 *Financial Reporting of Interests in Joint Ventures* specifies proportionate consolidation as the benchmark treatment for accounting for such joint ventures entered into by public sector entities. IPSAS 8 also permits – as an allowed alternative – joint

ventures to be accounted for using the equity method of accounting.

- ED 9 *Financial Reporting under the Cash Basis of Accounting* sets out the overall considerations for the presentation of the financial statements under the cash basis of accounting, guidelines for their structure, and minimum requirements for their content.
- ED 10 *Revenue from Exchange Transactions* proposes requirements for the accounting treatment of revenue arising from exchange transactions and addresses the issue of revenue recognition for these transactions.
- ED 11 *Inventories* proposes the accounting treatment for inventories under the historical cost system.
- ED 12 *Construction Contracts* proposes requirements for the accounting treatment of revenue and costs associated with construction contracts.
- ED 13 *Financial Reporting in Hyperinflationary Economies* proposes requirements for financial reporting under conditions of hyperinflation.
- ED 14 *Property, Plant and Equipment* proposes the accounting treatment for property, plant and equipment, including the timing of their initial recognition, and the determination of their ongoing carrying amounts and related depreciation.
- ED 15 *Leases* proposes requirements for the accounting treatment of leasing transactions.

## **Part Two. Auditing Standards**

### **5. Introduction**

Cambodia has not yet adopted any form of government auditing standards nor has it formally adopted international auditing standards. The Government has not yet established a body to be responsible for formulating and monitoring auditing standards.

When the National Audit Authority is operational and established as the Supreme Audit Institution in Cambodia, it should become a member of the International Organization of Supreme Audit Institutions (INTOSAI) and adopt the INTOSAI Standards as a base for the development of government auditing standards.

## **6. Standards Included in the New Audit Law**

In the new Audit Law, provision has been made for accepting IASs as promulgated by the International Federation of Accountants and these Standards must be adopted by the National Audit Authority when conducting the audit of State-owned enterprises.

## **7. International Auditing Firms**

International auditing firms conduct their audits in accordance with the procedures contained in the International Standards on Auditing that are established by the International Auditing Practices Committee and promulgated through IFAC. These Standards have been adopted because of the international acceptance of them by the parent organizations.