

**REPORT AND RECOMMENDATION
OF THE
PRESIDENT
TO THE
BOARD OF DIRECTORS
ON A
PROPOSED LOAN
TO THE
KINGDOM OF CAMBODIA
FOR SUBPROGRAM II
OF THE
FINANCIAL SECTOR PROGRAM
AND ON THE
PROGRESS OF SUBPROGRAM I (LOAN 1859-CAM)**

November 2002

CURRENCY EQUIVALENTS

(as of 28 October 2002)

Currency Unit	–	Cambodian Riels (KR)
KR1.00	=	\$0.000262068
\$1.00	=	KR 3,815.80

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF		Asian Development Fund
AusAID	–	Australian Agency for International Development
BSD	–	Bank Supervision Department
CAMINCO	–	Cambodia Insurance Corporation
CBS	–	Center for Banking Studies
COA	–	chart of accounts
FSPL	–	financial sector program loan
FTB	–	Foreign Trade Bank
GDP	–	gross domestic product
IAS	–	international accounting standards
IMF	–	International Monetary Fund
ISA	–	international standards on auditing
MEF	–	Ministry of Economy and Finance
MFI	–	microfinance institutions
MOC	–	Ministry of Commerce
NBC	–	National Bank of Cambodia
PRGF	–	poverty reduction and growth facility
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

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I. THE PROPOSAL

1. I submit for your approval the following Report and Recommendation on a proposed loan to the Kingdom of Cambodia for subprogram II of the Financial Sector Program Loan (FSPL) cluster.¹

II. BACKGROUND

2. The Asian Development Bank (ADB) launched the FSPL cluster for \$30 million from the Asian Development Fund (ADF) to the Government on 15 November 2001. This was ADB's first comprehensive development program for Cambodia's financial sector. The primary goal of the FSPL is to promote the development of a sound, market-based financial system to enhance resource mobilization and support sustainable economic growth by establishing the foundations for banking and insurance and for financial market development. The FSPL focuses on banking, insurance, interbank and money markets, and financial infrastructure such as accounting standards and enforcement mechanisms and promulgation of laws to underpin the commercial activities and financial markets.

3. The FSPL adopted a program cluster approach with three subprograms based on ADB's revised program lending policies.² Each subprogram is expected to be completed within 12 months after corresponding loan effectiveness,³ and each is processed sequentially upon the completion of the previous subprogram. That is, subprogram II will be presented for Board consideration and approval based on progress in implementing subprogram I, the status of proposed policy reform actions, and the readiness of the Government to undertake the proposed reforms. The cluster approach provides for the possibility of refining the proposed policy conditions of subprogram II before presenting subprogram II's loan agreement to the Board for approval to reflect the Government's achievements and changing policy environment. Subprogram III will be processed in a similar manner. The program cluster approach allows flexibility and provides strong leverage to push forward with needed reforms.

4. Since the launch of the FSPL, ADB has closely monitored program implementation and maintained frequent policy dialog with the Government. To assist program implementation, ADB provided two technical assistance (TA) activities. The first TA⁴ aims at bank supervision, accounting, and insurance with capacity building. Implementation of the first TA started in April 2002. The second TA⁵ covers legal components in the FSPL, including secured transactions systems, and commenced in October 2002.

¹ ADB. 2001. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Loan Cluster to the Kingdom of Cambodia for the Financial Sector Program*. Manila. L 1859-CAM.

² ADB. 1999. *Review of ADB's Program Lending Policies*. Manila. R210-99.

³ See paragraphs 130, 133, 135 of ADB. 2001. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Loan Cluster to the Kingdom of Cambodia for the Financial Sector Program*. Manila.

⁴ ADB. 2001. *Technical Assistance to Cambodia for Capacity Building for Banking and Financial Management*. Manila. TA 3769-CAM.

⁵ ADB. 2002. *Technical Assistance to Cambodia for Improving Legal Infrastructure in the Financial Sector*. Manila. TA 3861-CAM.

III. MACROECONOMIC DEVELOPMENTS AND THEIR IMPLICATIONS FOR THE PROGRAM LOAN

5. The FSPL was formulated and launched in a stable political and macroeconomic environment. The country's macroeconomic environment has remained strong due to social and political stability. The economic growth has remained at more than 6% since 1999, well above the average of 4.5% during 1995–1998. This growth rate is good compared to rates of other Association of Southeast Asian Nations (ASEAN) economies.

6. Macroeconomic stability has bolstered strong fiscal and monetary performance. Revenue collection, valued at 11.7% of gross national product (GDP) in 2001, increased from the 11.2% in 2000. Meanwhile, total expenditure remained within budget limits, with the current surplus at 1.3% of GDP and the overall deficit within 6% of GDP, in line with the average level since 1995. On the external accounts, the trade deficit declined from \$263 million in 2000 to \$225 million in 2001. The improved fiscal situation has contributed to stable price levels and exchange rates. Inflation levels have been sharply reduced since 1999. Minor deflation in 2000 and 2001 was due to extensive use of the dollar as currency, limited bank financing of the budget, and the stability of the riel-dollar exchange rate. Exchange rates have been stabilized at around KR3,900 per dollar since 1999, leading to its appreciation against Thai baht and Vietnamese dong.

7. The stable macroeconomic environment has boosted financial intermediation. Total deposits posted a 21.7% increase from KR1,336 billion in 2000 to KR1,626 billion in 2001; during the same period, bank loans increased by 20% to about KR1,124 billion. As of June 2002, bank loans totaled \$238 million and deposits totaled \$531 million equivalent. Public confidence in the banking system appears to be on the increase, as nonenterprise deposits at banks rose to \$122 million, or 29%, as of June 2002 over the previous year. Enhanced public confidence was also reflected in the interest rates movement. The average lending interest rates declined from 18% per annum in 2000 and 2001 to 16% in 2002.

8. Improved public confidence in the financial sector has benefited from recent reform efforts and achievements. In 2002, Cambodia completed the bank relicensing program supported by the poverty reduction and growth facility (PRGF) of the International Monetary Fund (IMF). Under the PRGF, the capital base of the banking system was strengthened and the industry has consolidated from 31 banks in 2000 to 17 banks in 2002. The strengthening of bank supervision and the legal framework for the accounting and auditing system was achieved with ADB assistance, and had a positive impact on public confidence in the financial sector. An important forum for private sector consultation in the banking system was established. The National Bank of Cambodia (NBC) authorized an inclusive bankers association representing all banking institutions. The purpose of the association is to channel the concerns and suggestions of the industry to the authorities.

9. The Government also achieved much in reshaping governance and building the grounds for private sector development. Under IMF's PRGF, the Government initiated comprehensive tax administration and expenditure management reforms while launching civil service reform and military demobilization in 2002. ADB's assistance in public administration, covering customs administration, improved cash management and expenditure procedures, and independence of the National Audit Authority, complements IMF's PRGF. The World Bank continues to assist in forestry management, civil service reform, and governance reform. In July 2002, the Government adopted the second 5-year socioeconomic development plan. The plan presented Cambodia's social and economic targets in various areas to maintain a stable macroeconomic

environment with equity, and with the private sector taking the leading role. The Government has been proactive in undertaking accounting reforms through adoption of an accounting law. Moreover, in anticipation of accession to the World Trade Organization (WTO), the Government has intensified its efforts in bank supervision, trade, public sector accounting and other reforms in 2002. All the Government's efforts demonstrate its commitment and ability to deliver reforms and promote governance.

10. One of the principal risks for the FSPL, perceived when it had been formulated, was unexpected political disturbance. However, during the implementation period of subprogram I, the political environment has remained stable without any significant impact on the Government's performance under the FSPL. The stable macroeconomic environment and enhanced self-confidence reinforced by the recent reform efforts provide an environment conducive to implementing the FSPL, creating a virtuous circle of reform. Enhanced self-confidence of policy-makers enabled public consultation to be established in public policy-making process. A wide range of consultation with the private sector has improved the quality of newly introduced policy reforms and increased the probability that the FSPL will be successfully implemented. Nonetheless, the first year of the FSPL shows (i) the importance of timely provision of technical inputs for the success of needed reforms; and (ii) that institutional and human capacity building remain fundamental constraints, and require continued attention.

IV. PROGRESS OF IMPLEMENTATION OF SUBPROGRAM I

A. Status of Second Tranche Conditions of Subprogram I

11. The second tranche of subprogram I has eight policy conditions. Three relate to establishment of bank supervision and prudential regulations, two address capacity building in the banking sector, two target establishment of the legal basis for an accounting enforcement system, and one supports development of key legal infrastructure. As of October 2002, the Government has complied with all second tranche release conditions under subprogram I (Appendix 1). In view of the satisfactory fulfillment of all the policy conditions, the President has authorized the release of the second tranche of subprogram I of the Financial Sector Program in an amount equivalent to Special Drawing Rights 3,879,000. In accordance with established procedure, the second tranche will be effected not less than 10 working days after the circulation of this report.

1. Strengthening Bank Supervision and Prudential Regulations

12. For the development of bank supervision and prudential regulations, subprogram I includes adoption of the following as conditions for release of the second tranche: (i) procedures and manuals for off-site surveillance and on-site inspection, including standardization of the reports submitted by commercial banks; (ii) a regulation on prompt corrective actions; and (iii) an anti-money-laundering regulation. All of these procedures and regulations are to be applied to microfinance institutions unless NBC has separate ones applicable to them. The three conditions are the core components of the supervisory framework for actual implementation of the supervisory regulations of the law on banking and financial institutions (banking law) and prudential regulations. Especially, the procedures and manuals for bank supervision guide NBC staff in identifying existing and potential problems related to bank operations. The prompt corrective action regulation specifies the corrective actions needed under various circumstances to prevent systemic banking problems through early identification and timely resolution of problem banks. The safeguards under the anti-money-laundering regulation will serve to protect

the banking system from criminal activities, thus enhancing public confidence in the banking system.

13. As of October 2002, NBC has fully complied with these conditions, as it adopted (i) the “Regulation on Standardized Examination Program and Reports,” (ii) the “Regulation on Standardized Surveillance Procedure and Reports,” (iii) “Procedures for the Implementation of the Regulation on the Standardized Examination of the National Bank of Cambodia,” and (iv) “Procedures for the Implementation of the Regulation on the Standardized Surveillance of the National Bank of Cambodia.” For the second condition, NBC approved (i) the “Regulation on Standardized Prompt Corrective Action Procedure,” and (ii) “Procedures for the Implementation of the Regulation on the Standardized Prompt Corrective Action of the National Bank of Cambodia.” And for the third condition, NBC adopted the “Regulation on Standardized Procedure for Identification of Money Laundering at Financial Institutions.” All these regulations were drafted based on the best international practices, tailored to meet the needs of the current situation of the Cambodian banking system. While the achievement is very satisfactory as the first step given the current absorption capacity of NBC’s supervisory staff, these procedures and manuals will need to be refined and upgraded in the future, commensurate with the development of the banking industry and prudential regulations, as well as the gradual building-up of skill of the supervisory staff, as delineated in the Financial Sector Blueprint for 2001–2010.⁶ In particular, the current prompt corrective actions system builds on the unique definition of capital adequacy requirements, given the nascent feature of the banking system. Thus, with the development of the banking industry, the country should upgrade the capital adequacy requirement while refining the prompt corrective actions system.⁷

2. Capacity Building in the Banking Sector

14. The FSPL aims to form a sustainable institutional base for capacity building in the financial sector. For this, subprogram I includes two conditions, one for the central bank and the other for the state-owned Foreign Trade Bank (FTB). For capacity building of the central bank, subprogram I requires NBC to establish the Center for Banking Studies (CBS) as a subsidiary with separate management and accounts. In order to establish an institutional basis for the NBC staff on a sustainable basis, the FSPL envisages two steps: (i) separation of CBS from NBC (under subprogram I), and (ii) upgrading of the CBS training program with a solid funding base (under subprogram II). The separation of CBS from NBC is the first step for a self-sustainable training institution for the NBC staff. The fulfillment of the condition requires NBC to adopt a decision to establish CBS as its subsidiary with separate management and accounts. In October 2002, NBC adopted the “Regulation on the Transformation of the Center for Banking Studies into the Institute for Banking Studies,” which specifies that CBS will become a separate legal entity. More importantly, the Government established a medium-term funding plan to implement the CBS training program. This shows strong Government commitment to build the capacity of central bank staff on a sustainable and long-term basis.

15. The second condition for capacity building is for the strengthening of FTB through a comprehensive training program for its staff. As part of IMF’s bank restructuring program, FTB was separated from NBC in 2001. FTB is the only state-owned commercial bank, and is to be privatized under IMF’s PRGF. The majority of FTB management and staff consist of former central bank officials, and there is accordingly an urgent need to strengthen their capacity and

⁶ The Financial Sector Blueprint was drafted with ADB assistance and adopted by the Government in August 2001.

⁷ In the Financial Sector Blueprint, it is envisaged that the Government will upgrade prudential norms in accordance with the Bank for International Settlement guidelines during 2008–2010.

orientation towards commercial banking. The FSPL supports a comprehensive training program to instill commercial orientation in FTB management and strengthen the capacity of its staff. To comply with this condition, the FTB board of directors needs to approve a training program for its staff. In June 2002, in compliance with the FSPL requirement, the FTB board of directors approved a comprehensive training program, including accounting, risk management, asset and liability management, and management information systems. To ensure the training program is implemented, the Government has been arranging cofinancing with the Australian Agency for International Development (AusAID).

3. Establishing Accounting and Auditing System

16. Subprogram I initiated the establishment of an accounting enforcement system through two conditions: (i) submission of a draft law on corporate accounts, their audit, and the accounting profession (accounting law); and (ii) adoption of international accounting standards (IAS) and international standards on auditing (ISA). The standards will be applied upon the adoption of the law on corporate accounts, their audit, and the accounting profession. The FSPL, a process-driven program cluster, adopts a three-step approach toward the development of an accounting system in Cambodia. At the first stage (subprogram I), the basic legal framework for an accounting enforcement system and developing accounting standards should be established. Since a national accounting enforcement body is not available at this stage, the Ministry of Economy and Finance (MEF) should develop accounting and auditing standards, while preparing for the establishment of a national enforcement body. The purpose at this stage is to (i) identify an applicable set of accounting and auditing standards, (ii) finalize the Khmer version of international accounting and auditing standards, which will be applied when the accounting law and other enforcement body will be in place, and (iii) use the accounting standards as the basis for immediate capacity building activities in preparation for the second stage. The second stage (subprogram II) aims at establishing a national enforcement body (e.g., national accounting council). From this stage, the authorities commence implementation of the adopted accounting and auditing standards with the establishment of an enforcement body. Given the Cambodian situation, however, only banks and financial institutions will be the first target to enforce the accounting standards through prudential regulations. A wide range of enforcement of accounting and auditing standards will be achieved in the third stage when the certified public accountants (CPAs) will be available to corporations. The third stage (subprogram III) targets full implementation with the establishment of accounting profession and its association. From the third stage, the accounting and auditing standards will be fully enforced on all corporations.⁸

17. The two FSPL conditions have been fully complied with. In January 2002, MEF submitted the draft accounting law to the National Assembly. The draft accounting law provides the legal basis for an accounting profession and for a National Accounting Council, which will act as an enforcement body. Further, the Commission for Cambodia Accounting System Reform⁹ of MEF finalized the applicable accounting and auditing standards (15 accounting standards and 10 auditing standards) in Khmer and English in line with principles of IAS and ISA. The commission fully accomplished its first task of developing accounting standards as an interim body in the absence of a national enforcement body. With MEF's adoption of applicable

⁸ By this stage, the law on commercial enterprises will be effective (as one of subprogram II conditions), requiring all publicly-held corporations to disclose audited financial statements.

⁹ The commission is an interim body to undertake the tasks of developing an accounting and auditing system in Cambodia. The commission is chaired by an undersecretary of state of MEF, and has been working on (i) drafting an accounting law, (ii) developing accounting and auditing standards, (iii) establishing a national accounting council, (iv) developing a certified public accountant institute, and (v) capacity building activities.

accounting and auditing standards, the condition is fully complied with, completing the first stage of accounting development. These standards will be the basis for immediate accounting capacity building in Cambodia.¹⁰ The commission's task of developing accounting and auditing standards will be handed over to a national enforcement body.¹¹ As envisaged in the three-step approach of the FSPL, the accounting and auditing standards adopted by MEF's commission are to be implemented when a national enforcement body, or a national accounting council, is established.

4. Development of Legal Infrastructure

18. In line with continued governance reform efforts, subprogram I supports the development of legal infrastructure, as it requires submission of a draft law on commercial enterprises to the National Assembly. The law on commercial enterprises provides a key legal basis for private sector development as well as for banking and corporate financial activities. For example, the banking law builds on the law on commercial enterprises, as banks under the banking law are defined as "companies" incorporated in Cambodia, and all bank restructuring measures (i.e., mergers and acquisitions) are to be implemented in accordance with the relevant provisions of the law on commercial enterprises. Thus, the law on commercial enterprises is a crucial basis for the implementation of the banking law. The condition has been fully complied with, following submission of the draft law on commercial enterprises to the National Assembly by the Ministry of Commerce (MOC) in June 2002.

B. Program Implementation

19. With the Government's strong ownership of policy reform and TA provided by ADB to meet the resource gap in Cambodia, the Government was able to accomplish all the policy reforms as scheduled. Further, ADB has been actively engaged in policy dialog to help resolve problems at an early stage and in a timely manner. Frequent policy dialogue between ADB and the executing and implementing agencies has provided immediate guidance to program implementation, and has enhanced the executing and implementing agencies' confidence in undertaking difficult policy reforms. Discussion with top policymakers clearly showed that frequent policy dialogue was an important factor in successful completion of subprogram I. In addition, the Government's voluntary consultation with key stakeholders in the private sector was important. The Government has been proactive in seeking feedback from the private sector when drafting new policy measures under the FSPL. The Government recognizes the benefits of private sector consultation to ensure successful implementation, and the program, supported by the FSPL, includes a requirement for private sector consultation.¹² The experience of subprogram I illustrated many important lessons for the next subprogram II. Given the limited capacity within the country, to ensure successful implementation of the program, the following factors require continued attention: (i) timely provision of TA, (ii) frequent policy dialog and prompt remedial action to address problems, and (iii) timely consultation with private sector stakeholders.

¹⁰ In anticipation of the establishment of a national accounting council, MEF needs to train prospective staff who will work in the council. The training of new accounting and auditing standards needs to start before the council. The other targets of immediate training include (i) MEF's tax office, and (ii) NBC's supervisory staff.

¹¹ The establishment of a national accounting council is envisaged under subprogram II. MEF has submitted to the Council of Ministers a draft subdecree to establish the council is established.

¹² The condition required NBC to adopt a formal procedure for soliciting comments from the private sector on proposed, laws, regulations, procedures, and policies affecting the banking sector, or revisions to them.

1. Establishing Bank Supervision and Prudential Regulations

20. In 2002, NBC has undergone significant reform in developing its supervisory framework and capacity with support from the FSPL. On- and off-site supervision divisions were established as part of the first tranche release conditions of subprogram I in 2001. With the launching of TA 3769 (footnote 4) in April 2002, NBC started building a detailed framework for the supervision and prudential monitoring of the financial sector. The TA assisted in formulating off-site surveillance and on-site inspection procedures and manuals, the prompt corrective action system, and the anti-money-laundering regulation. The first drafts, presented in July 2002 and reviewed by ADB in the same month, went through an extensive review by NBC management during August and September 2002. In the meantime, from May to October 2002, the TA provided a number of training modules for staff in the Bank Supervision Department (BSD). This covered off-site surveillance, on-site inspection, the prompt corrective actions regulation, and anti-money-laundering.

21. These capacity building efforts were successful and, in October 2002, for the first time since 1996, NBC was able to field an on-site inspection mission to one commercial bank under the guidance of a bank supervision expert funded by ADB. This event is a significant milestone in the development of the banking sector in Cambodia. The achievement further illustrates that policy reform in bank supervision under the FSPL has accelerated beyond program targets, with NBC moving into the implementation phase of the newly adopted supervisory system.

2. Strengthening Capacity Building in the Banking Sector

22. The implementation of significant policy reforms followed by successful capacity building reflects the Government's strong commitment to reform. The decision to separate CBS from NBC was a difficult task for the NBC management, and involved complex and sensitive action in reshuffling of personnel and separation of assets. To facilitate the difficult transitional measures needed, NBC established a task force to manage implementation.

23. The Government's proactive approach to reform was also demonstrated in the FTB training program. The core elements of the training program were drafted with ADB assistance, but the Government has also sought assistance from other external agencies through cofinancing arrangements, e.g. with AusAID. FTB also issued "Instructions on the Implementation of the Training Plan for the Foreign Trade Bank" to ensure proper implementation. These actions have ensured that the training program's scope, intensity, and timing go beyond the program's initial targets.

3. Establishing Accounting and Auditing System

24. With assistance from ADB, MEF has made substantial progress in establishing an accounting and auditing system. In 2001, the World Bank assisted in translating the IAS and ISA into Khmer and ADB delineated a 10-year plan to develop an accounting and auditing system in the Financial Sector Blueprint. In January 2002, a draft law on corporate accounts, their audit, and the accounting profession (accounting law) was submitted to the National Assembly. The law was adopted on 5 July 2002, well ahead of schedule.

4. Development of Legal Infrastructure

25. The law on commercial enterprises was first drafted in 1996 and has been revised through consultation with related government agencies as well as the private sector. MOC

made determined efforts to complete the draft in 2002. In particular, MOC prepared a detailed background paper and explanatory notes, which was instrumental in securing support of the Government and other stakeholders. After nearly 8 months of interministerial discussion, the draft law was submitted to the Council of Ministers for review in February 2002, and then to the National Assembly in June 2002. The Government is seeking to have it passed in early 2003.

V. PROCESSING OF SUBPROGRAM II

A. Progress with Policy Reforms of Subprogram II

26. The Government has made considerable progress in undertaking key policy reforms supported under subprogram II. While such early implementation had been encouraged under the FSPL, the Government's achievements have exceeded expectations.

1. Development of the Bank Sector Infrastructure

27. In continuation of subprogram I, two conditions were proposed to develop the banking sector under subprogram II:

- (i) NBC will adopt a guideline for the arrangement for sharing credit information among the members of the bankers association, and NBC and the bankers association will establish such arrangements; and
- (ii) NBC will adopt a uniform chart of bank accounts and disclosure rules for the commercial banks, consistent with IAS.

28. With ADB TA (TA 3769, footnote 4), an initial policy recommendation to establish the arrangement has been provided to NBC and the bankers association. In addition to close dialogue with NBC management, in September 2002, the TA also conducted workshops for the bankers association. The TA has yet to finalize draft guidelines and simulation plans for establishment of such arrangements. The Government is expected to fulfill this condition within 2003. The arrangement for sharing credit information is to reduce uncertainties regarding lending operations of commercial banks, thus enhancing financial intermediation. To enable the arrangement, NBC needs to establish guidelines under which commercial banks can share credit information among the members of the bankers association. The guidelines should specify the scope, method, and limitations of sharing of credit information.

29. Good progress has been made in the development of a uniform chart of bank accounts. In August 2002, with assistance from TA 3769, NBC developed a draft "Uniform Chart of Accounts for Commercial Banks and Similar Financial Institutions" and a draft "Disclosure Requirements for Commercial Banks and Similar Financial Institutions." The draft chart of accounts (COAs) was sent to commercial and specialized banks for comment in September 2002. The ADB financed accounting expert conducted workshops on how to implement the draft COAs and disclosure rules for staff of the Bank Supervision Department on 26–27 September 2002, and for bankers and auditors on 10–11 October 2002. Five half-day training sessions on the same subject (but with greater technical details) were conducted during 14–18 October 2002 for 20 staff members from the Bank Supervision Department who will be directly involved in the implementation of the COAs. Banks have been encouraged to implement the COAs on a trial basis in the fourth quarter of 2002 for 3 months. Banks are expected to fully implement the COAs from January 2003. Thus, this condition is expected to be complied with within 6 months of loan effectiveness.

30. Given the progress in developing and implementing the COAs, NBC is confident that COAs for commercial banks can be introduced to the Rural Development Bank (RDB) and other specialized banks within 6 months of loan effectiveness of subprogram II. Originally adoption of the COAs by RDB and other specialized banks had been envisaged as components of subprogram III. NBC established COAs for MFIs separately with support from ADB TA.¹³

2. Strengthening Capacity Building in the Banking Sector

31. Following its establishment during subprogram I, it was proposed that CBS would establish a central banking course for NBC professional staff, including a mandatory training program for entry-level professional staff. NBC started a preliminary training course for new recruits on a trial basis in 2001. This course was upgraded on the basis of trials, and instituted as a mandatory training program for entry-level NBC professional staff in 2002. TA financed by ADB has played an important role in helping CBS to upgrade the course design and materials. Funding plans have been prepared by NBC, and CBS is expected to continue to develop into a self-sustaining central banking training institute.

3. Development of the Insurance Sector

32. The program includes two conditions for insurance sector development: (i) adoption of a plan to develop compulsory insurance (such as third-party-liability motor vehicle insurance and contractor's general liability insurance), and (ii) establishment of a joint venture between the state-owned insurance company and a private insurance company.

33. MEF has made significant progress in developing compulsory insurance. Given the complexity of compulsory insurance and the need to coordinate the roles of numerous ministries, the proposed condition originally only required adoption of a working plan to guide MEF and related ministries in developing compulsory insurance. However, MEF has exceeded expectations in terms of progress made. In May 2002, MEF successfully developed a working plan through an interministerial working group comprising all related ministries. It has also begun to implement the plan by adopting key regulations for compulsory insurance with the assistance of ADB TA (footnote 4). In October 2002, MEF, together with the Ministry of Land Management, Urban Planning, and Construction, the Ministry of Public Works and Transport, the Ministry of Interior, and the Ministry of Tourism, adopted three key regulations on compulsory insurance: (i) "interministerial Regulation on Compulsory Insurance for Contractor's General Liability", (ii) "interministerial Regulation on Compulsory Motor Vehicle Third Party Liability Insurance", and (iii) "interministerial Regulation on Insurance for Passenger Transport". Given the progress made, the proposed condition for compulsory insurance can be refined to reflect the Government's achievement as follows: "MEF, in consultation with related ministries, will adopt regulations for the development of compulsory insurance."

34. The second condition intends to restructure the state-owned company, the Cambodia Insurance Corporation (CAMINCO), through a joint venture. As part of its restructuring effort, MEF has made an important step toward restructuring CAMINCO when it set up a reinsurance company, the Cambodia Re, in January 2002, divesting the reinsurance function of CAMINCO. The Cambodia Re became a joint venture in October 2002 when the Government signed a memorandum of understanding with a consortium of five international insurance companies, which holds 20% of Cambodia Re's shares. The consortium includes Asia Insurance Hong

¹³ ADB. 1999. *Technical Assistance to Cambodia for Capacity Building for Rural Financial Services*. Manila. TA 3270-CAM.

Kong, Ltd., Asia Insurance Singapore, Ltd., Central Asia Insurance Company, Bangkok Insurance Company, and AIOI Insurance Company. To complete the restructuring, MEF is seeking a joint venture partner for CAMINCO. To this end, MEF has requested ADB for additional TA to explore options for forming joint ventures and draft a restructuring strategy for CAMINCO. In response, ADB fielded a fact-finding mission in October 2002 for an advisory TA.

4. Establishing Legal Framework for Interbank and Money Market Development

35. For the development of a legal framework for interbank and money markets, the proposed policy matrix for subprogram II includes submission of a draft negotiable instruments law to the National Assembly. When the FSPL was formulated, it was envisaged that the Government would promulgate the payment law and the negotiable instruments law separately. However, NBC subsequently decided to consolidate the legislation and a draft law was prepared with the assistance of IMF. ADB helped prepare explanatory notes for the draft law and the implementing regulation to assist the legislative process and implementation in July 2002. The draft law was submitted to the Council of Ministers, and will be submitted to the National Assembly within 2002.¹⁴

5. Establishing Accounting and Auditing System

36. Following progress during subprogram I, two actions to develop the accounting and auditing system are expected during subprogram II adoption of, (i) an accounting law, and (ii) a subdecree to apply IAS and ISA to all companies incorporated in Cambodia and to establish a national accounting council. MEF is also expected to adopt a regulation to apply accounting standards consistent with IAS and ISA to insurance companies.

37. The National Assembly adopted the law on corporate accounts, their audit and the accounting profession in July 2002, and the draft subdecree was submitted to the Council of Ministers for adoption in October 2002. ADB TA (footnote 4) has had an instrumental role in assisting MEF in drafting the subdecree in August 2002. The draft subdecree covers all enterprises and insurance companies. As a result, the condition for insurance accounting standards can be merged into the draft subdecree. The subdecree has been reviewed by the private sector, including international accounting firms working in Cambodia. The subdecree is expected to be adopted within 3 months, and MEF will be ready to establish a national accounting council within 6 months of loan effectiveness.¹⁵

38. In addition, MEF has been making progress toward establishing an accounting association. With ADB assistance, MEF has completed a draft by-law related to the establishment of an accounting association together with (i) a code of ethics for professional accountants and auditors, and (ii) the structure and function of an education committee of an accounting association. Further, MEF has completed a 3-year funding plan amounting to \$3.7 million,¹⁶ to support the budget of the National Accounting Council, the Khmer Certified Public Accountant Association, and training of accountants and auditors. MEF is confident that the accounting association will be established in 2003. Therefore, while the establishment of an

¹⁴ The timing of actual submission will be determined by the Council of Ministers' decision. According to NBC management, no critical issues have been identified in the review of the Council of Ministers so far.

¹⁵ In anticipation of adoption of the subdecree for the establishment of a National Accounting Council, the ADB TA (footnote 4) also assisted in designing the council in August 2002.

¹⁶ The funding plan was prepared by the Chairman of the Commission for Cambodian Accounting System Reform in September 2002 after the passage of the accounting law.

accounting association is proposed under subprogram III, MEF is confident that it will be established during subprogram II.

6. Development of Legal Infrastructure

39. For the development of legal infrastructure in the financial system, four activities are expected during subprogram II: (i) adoption of a law on commercial enterprises, (ii) adoption of a time-bound action plan to establish a public registry for secured transactions, (iii) submission of a draft secured transactions law to the National Assembly, and (iv) submission of a draft securities and exchange law to the National Assembly.

40. With MOC's efforts, the law on commercial enterprises was submitted to the National Assembly in June 2002. The Committee of Public Works, Transport, Telecommunications, Post, Industry, Mine, Energy, and Commerce of the National Assembly has been reviewing the draft law and hopes to present it to the November plenary session of the National Assembly, which will be the last session in 2002. The Committee is confident that the draft law will be passed by the first quarter of 2003, if not by the session in November 2002.

41. For the development of secured transactions system, ADB launched TA for Improving Legal Infrastructure in the Financial Sector (TA 3861, footnote 5) in October 2002. The TA will help develop a medium-term plan for developing a secured transactions system in Cambodia through extensive consultation with public and private sectors, taking into account the experience in other small transitional economies. The plan is expected to be drafted by March 2003, and thus the adoption of the plan is expected within 2003. Further, MOC is confident that with ADB TA, it will finalize the draft secured transactions law and submit it to the National Assembly within 2003.^{17, 18}

42. The submission of draft law on securities and exchange to the National Assembly is proposed to be shifted to subprogram III. The condition was originally proposed to be included in subprogram II in anticipation of TA to help the Financial Industry Department of MEF draft the law. Until recently, the Government has made vigorous efforts to seek TA to finalize the 1995 draft capital market law,¹⁹ however, this has not materialized yet. The Government requested ADB for TA in September 2002 for this purpose.

B. Refined Policy Matrix and Proposed Loan for Subprogram II

43. The progress in reforms and the Government's growing capacity to implement reforms has helped strengthen the policy matrix for subprogram II. Based on the likely timing of the proposed actions under subprogram II, a two-tranche structure has been proposed for subprogram II. The first tranche will include actions that will be implemented within 6 months of loan effectiveness, and the second tranche will include actions that will be implemented within 12 months of loan effective. Out of 13 actions in the proposed policy matrix for subprogram II under the FSPL, 8 have been complied with or will be complied with within 6 months of loan effectiveness of subprogram II. These 8 will be the first tranche release actions, and the remaining 5 will precede release of the second tranche. The refined policy matrix of subprogram

¹⁷ A secured transactions law was drafted in 1999 with the World Bank's assistance. However, due to lack of continued technical support, the Government was not able to complete the legislative process.

¹⁸ During the inception tripartite meeting for TA 3861, ADB and MOC agreed to coordinate to ensure that the draft secured transactions law is consistent with the draft civil code being prepared with bilateral assistance.

¹⁹ The most salient effort for TA funds by MEF includes (i) MEF's request to the government of the Republic of Korea during 2002, and (ii) TA funding discussion with the Konrad Adenauer Foundation of Germany.

II includes two of the proposed conditions for subprogram III, while one of the proposed conditions for subprogram II (para. 42) is moved to subprogram III in consideration of the timing of needed TA. (A refined policy matrix for subprogram II and III is provided in Appendix 2).

44. The proposed loan for subprogram II of the FSPL will be \$10 million from the ADF, and each tranche of subprogram II will have \$5 million to be released upon compliance with the tranche release conditions. Subprogram II carries the same terms of repayment, interest, and implementation arrangements as those of subprogram I. The first tranche conditions are expected to be met within 6 months of loan effectiveness, and the second tranche release conditions are expected to be met within 12 months of the loan effectiveness. The first tranche conditions include the following:

- (i) NBC will adopt a uniform chart of bank accounts and disclosure rules for the commercial banks consistent with IAS.
- (ii) NBC will apply the uniform chart of bank accounts and disclosure rules for the commercial banks consistent with IAS to RDB and other specialized banks (advanced from subprogram III).
- (iii) NBC will ensure that CBS establishes a central banking course for NBC professional staff, including a mandatory training program for entry-level professional staff.
- (iv) MEF, in consultation with related ministries, will adopt regulations for development of compulsory insurance.
- (v) NBC will submit to the National Assembly a draft law on negotiable instruments and payment transactions.
- (vi) A law on corporate accounts, their audit, and the accounting profession will be adopted by the National Assembly.
- (vii) MEF will adopt a subdecree to apply IAS and ISA to all companies (including insurance companies) incorporated in Cambodia, and will establish a national accounting council to set and interpret standards.
- (viii) A law on commercial enterprises will be adopted by the National Assembly.

45. The adoption of the law on commercial enterprises was originally envisaged to occur before Board consideration of subprogram II. This has not been possible largely because national elections in mid-2003 affected the workload and schedule of the plenary session of the National Assembly. Given the progress in subprogram I²⁰ and in the other reform areas of subprogram II, and the acceleration of reforms originally targeted for completion in subprogram III, it is proposed that the adoption of the law on commercial enterprises will be included as a first tranche condition for subprogram II.

²⁰ The Government completed subprogram I well ahead of the expected time, which was 12 months from loan effectiveness. Since the loan for subprogram I became effective from January 2001, completion is about three months ahead of target.

46. The second tranche conditions include the following:
- (i) NBC will adopt a guideline for the arrangements for sharing credit information among the members of the bankers association, and NBC and the bankers association will establish such arrangements.
 - (ii) MEF will establish a joint venture between the state-owned insurance company and a private insurance company.
 - (iii) MEF will establish an association of accountants and auditors, including:
 - (a) adopting a code of ethics that complies with the requirements of the International Federation of Accountants, and
 - (b) establishing committees on education and ethics within the association (advanced from subprogram III).
 - (iv) MOC will submit to the National Assembly a draft secured transactions law.
 - (v) MOC will adopt a time-bound action plan to establish a public registry for secured transactions, acceptable to ADB.

VI. CONCLUSION

47. Despite limited human resources, the Cambodian authorities have made remarkable progress and demonstrated strong performance in undertaking important policy reforms. These reforms have laid the foundation of a modern financial system. First, the core elements of a robust framework of banking supervision and prudential regulations has been put in place, with NBC launching its first on-site inspection in October 2002. Second, an institutional framework for self-sustainable capacity building has been established. NBC decided to establish CBS as a separate institute with separate management and accounts. Further, NBC decided to support CBS with adequate financial resources. Third, a firm foundation for the accounting and auditing system has been built, with the promulgation of the accounting law and adoption of accounting and auditing standards based on international standards. Fourth, the Government is continuing to build legal infrastructure. The Government has submitted the draft law on commercial enterprises to the National Assembly, which is expected to be adopted soon. In line with reforms in other key areas such as the civil code and civil procedures,²¹ the Government's achievements in accounting law and enterprises law marked a crucial step toward a market-based economy and financial system. In these achievements, the Government's reform efforts have already moved significantly into the second phase of the FSPL.

48. The reforms achieved under subprogram I will be continued under subprogram II. Under the program cluster approach, all three subprograms of the FSPL are designed to address process-driven reforms on a step-by-step basis, with the preceding subprogram providing inputs to the next subprogram. Thus, successful completion of subprogram I has built firm ground for subprogram II. The substantial progress in reforms envisaged under subprogram II provides strong grounds for the formal launching of subprogram II. ADB will continue to maintain close monitoring and policy dialog to ensure the policy reforms of subprogram I to continue to be implemented and upgraded.

²¹ From 15–16 October 2002, the Government conducted 2-day seminars, chaired by the Prime Minister, on the draft civil code and procedures.

49. The Government has supplied to ADB the documentary evidence substantiating the compliance with the second tranche release actions for subprogram I. Further, the Government advised ADB that 8 of the 13 conditions will be complied with within 6 months of loan effectiveness, making the first tranche release conditions, while the remaining 5 conditions are expected to be complied with within 12 months of loan effectiveness.

VII. RECOMMENDATION

50. I am satisfied that the proposed loan would comply with the Articles of Agreement of ADB and recommend that the Board approve the loan in various currencies equivalent to Special Drawing Rights 7,577,000 to the Kingdom of Cambodia for subprogram II of the Financial Sector Program, from ADB's Special Funds resources with an interest charge at the rate of 1% per annum during the grace period and 1.5% per annum thereafter; 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.

Tadao Chino
President

7 November 2002

PROGRESS REVIEW OF FINANCIAL SECTOR PROGRAM LOAN (CLUSTER)

**Table A1.1: Compliance Status of Second Tranche Conditions of Subprogram I
(Loan1859-CAM)**

Conditions	Implementation Status
<p>1. National Bank of Cambodia (NBC) to adopt surveillance and inspection procedures including standardization of the reports submitted by commercial banks. Unless specified otherwise in the NBC regulations, these procedures are also to be applied to licensed microfinance institutions (MFIs)</p>	<p>Fully complied with in October 2002.</p> <p>NBC established on- and off-site supervision divisions as part of the first tranche conditions of subprogram I, but it had to develop surveillance and inspection procedures and manuals to undertake its supervisory function. Under technical assistance (TA) 3769,¹ a bank supervision expert funded by Asian Development Bank (ADB) drafted off-site surveillance and on-site inspection procedures and manuals in July 2002. The regulations related to the adoption of the procedures and manuals include (i) the "Regulation on Standardized Examination Procedure and Report," (ii) the "Regulation on Standardized Surveillance Procedure and Reports," (iii) "Procedures for the Implementation of the Regulation on the Standardized Examination of the National Bank of Cambodia," and (iv) "Procedures for the Implementation of the Regulation on the Standardized Surveillance of the National Bank of Cambodia." In October 2002, NBC adopted these regulations.</p> <p>These draft regulations have gone through an extensive review by NBC management and ADB since July 2002. Through the ADB review, the formats and the contents of the procedures and manuals were substantially improved. Further, TA 3769 supplemented the draft procedures and manuals by providing supplementary reference materials to ensure implementation of the newly adopted procedures and manuals.</p> <p>Extensive workshops and training have been provided regarding the draft procedures and manuals. Following the first one-week workshop in May 2002, an intensive four-week workshop was provided to the staff of the Bank Supervision Department (BSD), covering financial analysis and basic techniques of on- and off-site supervision. Systematic on-the-job training has also been conducted to equip BSD staff with hands-on skills for inspection from early October 2002. Further, at the request of the NBC governor, the bank supervision expert funded by ADB guided an on-site inspection mission to one local bank, which marked NBC's first on-site inspection since the central bank reform in 1996. The focus was put on training the BSD inspection staff on (i) application of inspection procedures and manuals, (ii) interview skills, (iii) documentation of the inspection findings, and (iv) techniques for corrective actions. Under another ADB TA, NBC established a separate set of on-site inspection and off-site surveillance regulations and procedures for licensed MFIs.²</p>
<p>2. NBC to adopt a prompt corrective action system for commercial banks, acceptable to ADB. A similar system is to be applied to licensed MFIs with modified capital adequacy standards</p>	<p>Fully complied with in October 2002.</p> <p>The prompt corrective actions system aims at early identification of problems in bank operations, and is an integral component in bank supervision. Under TA 3769, in July 2002, the ADB expert drafted the (i) "Regulation on Standardized Prompt Corrective Action Procedure", and (ii) "Procedures for the Implementation of the Regulation on the Standardized Prompt Corrective Action at the National Bank of Cambodia" in July 2002. The draft regulation and procedures were reviewed by ADB and the NBC management in July 2002. Further, NBC sent the draft to commercial banks for their feedback. The drafts were well accepted by commercial banks. Following a wrap-up seminar with NBC and commercial banks, NBC adopted the regulation and procedures in October 2002. The training to facilitate the understanding and implementation of the prompt corrective action system was provided in line with training on bank supervision.</p>

¹ ADB. 2001. *Technical Assistance to Cambodia for Capacity Building for Banking and Financial Management*. Manila. TA 3769-CAM.

² ADB. 1999. *Technical Assistance to Cambodia for Capacity Building for Rural Financial Services*. Manila. TA 3270-CAM.

Conditions	Implementation Status
<p>3. NBC is to adopt an anti-money-laundering regulation. Unless specified otherwise in the NBC regulations, this regulation is also to be applied to licensed MFIs</p>	<p>Fully complied with in October 2002.</p> <p>Anti-money-laundering regulation is of special importance in Cambodia in the context of its extensive use of the dollar as currency and nascent surveillance system by the authorities. Thus, in line with establishment of surveillance and inspection framework, adoption of an anti-money-laundering regulation is important to promote investor confidence. The anti-money-laundering regulation focused on establishing a detailed surveillance system with sophisticated reporting requirements over potential money laundering activities through the banking system.</p> <p>The Regulation on Standardized Procedure for Identification of Money Laundering at Financial Institutions was drafted under TA 3769 in July 2002. In finalizing the regulation, NBC conducted a series of consultations with commercial banks and ADB. Feedback from commercial banks was instrumental in completing the implementable regulation. In the final draft, commercial banks' active role was emphasized as they are required to (i) detect and report immediately all suspicious cash transactions regardless of the amount; and (ii) keep records of all transactions above \$10,000 for 10 years, according to a standardized format, which will be subject to NBC's supervisory review. A workshop on the regulation was provided to related government agencies and commercial banks, and NBC adopted the regulation in October 2002.</p>
<p>4. NBC to establish the Center for Banking Studies (CBS) as a subsidiary of NBC with separate management and accounts</p>	<p>Fully complied with in October 2002.</p> <p>CBS was a department of NBC and offered 1.5 year program on banking and financing, targeting mostly NBC staff with high school education. The programs offered by CBS were not able to meet NBC's demand for staff training. Further, because of its organization structure, CBS could not afford to hire full-time instructors, or upgrade its training programs. The Financial Sector Program Loan (FSPL) requires establishing CBS as an NBC subsidiary as the first step for CBS to deliver high quality training programs for NBC staff and to become a self-sustaining training institute for NBC and other government agencies. In July 2002, the "Regulation on the Transformation of the Center for Banking Studies into the Institute for Banking Study" was drafted with ADB assistance. ADB helped NBC finalize the draft through assistance in delineating key steps for implementation. NBC adopted the regulation in October 2002. The regulation specifies that CBS will be established as an independent subsidiary with independent board and management. The transitional measures will be undertaken by relevant NBC departments led by the secretary general, director general, cashier general, and inspector general. In line with the adoption of the regulation, NBC secured a funding plan to ensure the sustainability of CBS. According to the funding plan, a total of \$347,000 for 2002–2005 was allocated to CBS.</p>
<p>5. NBC to ensure that Foreign Trade Bank (FTB) management adopts a comprehensive training program for FTB staff, including accounting, risk management, asset/liability management, and management information system</p>	<p>Fully complied with in June 2002.</p> <p>FTB was separated from NBC in 2001 as the only state-owned commercial bank, and it is to be privatized under the poverty reduction and growth facility program of the International Monetary Fund (IMF). However, the FTB management consists of former central bank officials, and its staff also lacks commercial banking experience. To prepare for restructuring FTB, the FSPL supports a comprehensive training program to instill commercial orientation in FTB management and strengthen the capacity of its staff. Under TA 3769, the ADB-funded training expert drafted a training program including accounting, risk management, asset/liability management, and a management information system in June 2002. On 21 June 2002, instructions on the implementation of the training plan for FTB. The Government has been actively seeking internal and external support for the FTB training program. In particular, the Government has arranged a cofinancing scheme with the Australian Agency for International Development (AusAID). The FTB training program requires \$243,512 from 2003. The Government will finance \$205,712, AAID \$37,500, and FTB \$4,300.</p>

Conditions	Implementation Status
6. MEF to submit to the National Assembly a draft law on corporate accounts, their audit, and the accounting profession	<p>Fully complied with in January 2002.</p> <p>Establishing accounting and auditing standards and their enforcement system is an essential thrust of the FSPL. The first target was to establish the legal base for standard and enforcement system. With assistance from ADB, Ministry of Economy and Finance (MEF) has made substantial progress in establishing an accounting/auditing system. In 2001, the World Bank helped translate international accounting standard (IAS) and international standards on auditing (ISA) into Khmer and ADB delineated a 10-year plan to development on accounting and auditing system in the Financial Sector Blueprint. In January 2002, a draft law on corporate accounts, their audit, and the accounting profession (accounting law) was submitted to the National Assembly, and the law was adopted on 5 July 2002.</p>
7. MEF to adopt IAS and ISA, which will be applied upon the adoption of the law on corporate accounts, their audit, and the accounting profession	<p>Fully complied with in October 2002.</p> <p>In line with the establishment of an accounting enforcement system, subprogram I aimed at developing accounting and auditing standards that would be implemented according to the accounting law. MEF received assistance from the World Bank in developing accounting and auditing standards based on IAS and ISA. Under ADB's TA (TA 3467, footnote 1), a 10-year Financial Sector Blueprint was formulated for developing the accounting and auditing standards and an enforcement mechanism. In October 2002, MEF's Commission for the Cambodia Accounting System Reform finalized in Khmer and English 15 accounting standards and 10 auditing standards drawn from IAS and ISA, to be implemented according to the accounting law. A national accounting council will enforce the standards. The regulation for creation of the council has been submitted to the Council of Ministers for review, and is expected to be adopted by the end of 2002.</p>
8. Ministry of Commerce (MOC) to submit to the National Assembly a draft law on commercial enterprises	<p>Fully complied with in June 2002.</p> <p>The law on commercial enterprises provides the key legal basis for private sector development as well as for corporate financial activities. The law on commercial enterprises was first drafted in 1996 and went through intensive consultation with related government agencies and the private sector. MOC has made a tremendous effort to complete the draft in 2002. In particular, MOC prepared a detailed background paper and explanatory notes, which was instrumental in securing support of the Government and other stakeholders. After nearly 8 months of interministerial debate the draft law was submitted to the Council of Ministers for review in February 2002, and then to the National Assembly in June 2002.</p>

Table A1.2: Progress with Policy Reforms of Subprogram II

Proposed Conditions	Progress Made	Tranche
1. National Bank of Cambodia (NBC) to adopt a guideline for the arrangements for sharing credit information among the members of the bankers association, and NBC and the bankers association to establish such arrangements	<p>Compliance expected within 2003.</p> <p>In October 2002, Asian Development Bank (ADB) technical assistance (TA)¹ provided a concept framework for an arrangement for sharing credit information among commercial banks with NBC's guideline and detailed action plan for creating an arrangement.</p> <p>After review by NBC and the commercial banks, an NBC guideline and the draft action plan will be finalized. NBC and the bankers association are expected to establish the arrangement within 2003.</p>	Second tranche release condition
2. NBC to adopt a uniform chart of bank accounts and disclosure rules for the commercial banks consistent with international accounting standards (IAS)	<p>Compliance expected within 2002.</p> <p>NBC will adopt a uniform chart of accounts (COAs) and disclosure rules that are consistent with IAS within 2002. The draft COAs were sent to users (commercial banks and specialized banks) for comments. An ADB-funded accounting expert has reviewed the feedback from the users, and in September conducted workshops on how to implement the uniform COAs and disclosure rules for staff of NBC's Bank Supervision Department (BSD), and another one in October for bankers and auditors. Other 5 half-day training workshops on the same subject but with more technical details were also conducted in October for 20 selected BSD staff members, who would be directly involved in the implementation of COAs. Banks have been encouraged to implement COAs on a trial basis as of the fourth quarter 2002 for 3 months. All banks are expected to officially adopt COAs in the first quarter of 2003.</p>	First tranche release condition
3. Ministry of Commerce (MOC) to submit to the National Assembly a draft secured transactions law	<p>Compliance expected within 2003</p> <p>The first secured transactions law and the explanatory comments were drafted in 1999 with the World Bank's assistance. However, due to lack of continued technical support, the Government was not able to complete the legislative process. With the ADB TA for Improving Legal Infrastructure in the Financial Sector² in October 2002, MOC is expected to finalize the draft secured transactions law and submit it to the National Assembly within 2003.</p>	Second tranche release condition

¹ ADB. 2001. *Technical Assistance to Cambodia for Capacity Building for Banking and Financial Management*. Manila. TA 3769-CAM.

² ADB. 2002. *Technical Assistance to Cambodia for Improving Legal Infrastructure in the Financial Sector*. Manila. TA 3861-CAM.

Proposed Conditions	Progress Made	Tranche
4. MOC to adopt a time-bound action plan to establish a public registry for secured transactions, acceptable to ADB	<p>Compliance expected within 2003.</p> <p>For the development of secured transaction system, ADB launched TA for Improving Legal Infrastructure in the Financial Sector (footnote 1) in October 2002. The TA will help devise a medium-term plan for developing a secured transactions system in Cambodia through extensive consultation with public and private sectors, taking into account the experience in other small-scale transitional economies. The plan is expected to be drafted by March 2003 and adopted within 2003.</p>	Second tranche release condition
5. NBC to ensure that Center for Banking Studies (CBS) establishes a central banking course for NBC professional staff, including a mandatory training program for entry-level professional staff	<p>Compliance expected in early 2003.</p> <p>After the launching of subprogram I, NBC started a preliminary training course for new recruits on a trial basis in 2001. The training program is mandatory for entry-level NBC professional staff in 2002. CBS has been working to upgrade the course and materials, with ADB assistance. TA 3769 has provided a comprehensive professional training course, with detailed implementation guidelines. With the solid funding plan prepared by NBC (see Implementation Status of Condition 4, subprogram I), CBS will continue to develop into a self-sustainable central banking training institute.</p>	First tranche release condition
6. Ministry of Economy and Finance (MEF) to adopt a regulation to apply accounting standards consistent with IAS and ISA to insurance companies	<p>Compliance expected by December 2002.</p> <p>The Government has included insurance companies into the same decree to apply accounting standards consistent with IAS and ISA to all companies (see condition 11).</p>	Merged with condition 11.
7. MEF to adopt a plan for the development of compulsory insurance	<p>Complied within October 2002.</p> <p>MEF has made progress in developing compulsory insurance such as third-party-liability motor vehicle insurance and contractor's general liability insurance. MEF set up the working plan with an interministerial working group comprising all related ministry staff in May 2002, and has commenced implementation of the plan by adopting key regulations for compulsory insurance with the assistance of ADB TA. In October 2002, MEF, together with the Ministry of Land Management, Urban Planning, and Construction, the Ministry of Public Works and Transport, and the Ministry of Interior, adopted three key regulations on compulsory insurance: (i) "interministerial Regulation on Compulsory Insurance for Contractor's General Liability", (ii) "interministerial Regulation on Compulsory Motor Vehicle Third Party Liability Insurance", and (iii) "interministerial Regulation on Insurance for Passenger Transport".</p> <p>To reflect the Government's progress and achievements, the condition is refined as: <i>"MEF, in consultation with related ministries, to adopt interministerial regulations for development of compulsory insurance."</i></p>	<p>First tranche release condition</p> <p>The refined condition: "MEF, in consultation with related ministries, to adopt interministerial regulations for development of compulsory insurance."</p>

Proposed Conditions	Progress Made	Tranche
8. MEF to establish a joint venture between the state-owned insurance company and a private insurance company	<p>Compliance expected within 2003.</p> <p>Cambodia Insurance Corporation (CAMINCO) was the regulator as well as the operator of insurance business (including reinsurance). In 2001, the regulatory function of CAMINCO was handed over when MEF established an insurance division under the Financial Industry Department as one of policy conditions of subprogram I of the Financial Sector Program Loan (FSPL). In January 2002, MEF was successful in divesting reinsurance function of CAMINCO to establish the Cambodia Re. The Cambodia Re became a joint venture reinsurance company in October 2002 when the Government and Asian Insurance International (an insurance consortium of companies from Hong Kong, China; Japan; Malaysia; Singapore; and Thailand) signed a memorandum of understanding. Asian Insurance International holds 20% of Cambodia Re. To complete the restructuring, MEF is making efforts to find a joint venture partner for CAMINCO. In line with the effort, MEF requested ADB to provide additional TA to explore options. In response, ADB fielded a fact-finding mission in October 2002 for an advisory TA for Improving Insurance Supervision, which will include assistance in drafting MEF's restructuring strategy for CAMINCO in 2003.</p>	Second tranche release condition
9. MOC to submit to the National Assembly a draft negotiable instruments law	<p>Compliance expected within 2002.</p> <p>Until May 2001, International Monetary Fund (IMF) had been pursuing the promulgation of a payment law. After consultation with IMF experts in late October 2001, NBC decided to pursue consolidated legislation for payment system and negotiable instruments, which was included in the FSPL. As a result, NBC and MOC has agreed that NBC will undertake drafting "negotiable instruments and payment transactions law". To reflect the change in the internal arrangement, the implementing agency was changed from MOC to NBC.</p> <p>ADB provided assistance for drafting explanatory notes for the law and an implementing subdecree in July 2002. At the same time, NBC conducted seminars for the Ministry of Justice, MOC, MEF, and commercial banks. The comments focused mostly on the form and editing, and were incorporated. The draft law was submitted to the Council of Ministers in June 2002, and NBC expects the law to be submitted to the National Assembly by the end of 2002.</p>	<p>First tranche release condition</p> <p>The refined condition: "NBC to submit to the National Assembly a draft law on negotiable instruments and payment transactions".</p>
10. Adoption of a law on corporate accounts, their audit, and the accounting profession	<p>Complied with in July 2002.</p> <p>With a multifaceted effort by MEF, the National Assembly adopted the law on corporate accounts, their audit, and the accounting profession in July 2002.</p>	First tranche release condition

Proposed Conditions	Progress Made	Tranche
11. MEF to adopt a subdecree to apply IAS and ISA to all companies incorporated in Cambodia, and to establish a national accounting council to set and interpret standards, etc.	<p>Compliance expected within 2002.</p> <p>MEF drafted a subdecree on the creation of a national accounting council. The subdecree has gone through private sector consultation, including with international accounting firms working in Cambodia. The subdecree was submitted to the Council of Ministers in October 2002, and is expected to be adopted by the end of 2002. Once the subdecree is adopted, MEF will establish the council within 6 months. In August 2002, ADB provided TA to assist in establishment of the council.</p> <p>MEF is also working on the subdecree to apply IAS and ISA to all companies. ADB TA 3769 has played an instrumental role in drafting the subdecree by providing timely and substantive assistance to MEF in August 2002. The draft subdecree covers all enterprises including insurance companies, as result of which the condition for insurance accounting standards (condition 6) can be merged into the draft subdecree.</p> <p>MEF has also completed a 3-year funding plan amounting to \$3.7 million to support the budget of the national accounting council and the Khmer certified public accountant Association and for training of accountants and auditors.</p>	<p>First tranche release condition</p> <ul style="list-style-type: none"> The refined condition: "MEF to adopt a subdecree to apply IAS and ISA to all companies (including insurance companies) incorporated in Cambodia, and to establish a National Accounting Council (NAC) to set and interpret standards."
12. Adoption of a law on commercial enterprises	<p>Compliance expected by the first quarter of 2003.</p> <p>With MOC's efforts, the law on commercial enterprises was submitted to the National Assembly in June 2002, in compliance with the second tranche release condition of subprogram I and it is expected to be adopted within 6 months of loan effectiveness. The Committee of Public Works, Transport, Telecommunications, Post, Industry, Mine, Energy, and Commerce of the National Assembly has been reviewing the draft law. The chairman is confident that the draft will be passed by the first quarter of 2003.</p>	First tranche release condition
13. MEF to submit to the National Assembly a draft securities and exchange law	<p>Compliance expected in 2004.</p> <p>This condition will be postponed to subprogram III. The major constraint for the Government is the weak human resource capacity. Because the concept of capital markets is new in Cambodia, the Government officials need substantial training to understand capital markets and their legal and supervisory framework. The Government has made vigorous efforts to seek TA to finalize the 1995 draft capital market law. The Government has now requested ADB for TA in September 2002.</p>	Move to subprogram III

Proposed Conditions	Progress Made	Tranche
<p>14. NBC to apply the uniform chart of bank accounts and disclosure rules for the commercial banks consistent with IAS to the Rural Development Bank, other specialized banks, and licensed microfinance institutions (MFIs)</p>	<p>Compliance expected within 2002</p> <p>As NBC adopted a separate uniform chart of accounts and disclosure rules for licensed MFIs, the condition will not cover licensed MFIs. The COAs for MFIs were drafted under ADB TA (TA 3270) in line with the Rural Credit and Savings Project (Loan 1818-CAM).³ For details on the implementation, see condition 2. The condition is advanced from subprogram III to subprogram II.</p>	<p>First tranche release condition</p> <p>The refined condition: "NBC to apply the uniform chart of bank accounts and disclosure rules for the commercial banks consistent with IAS to the Rural Development Bank and other specialized banks."</p>
<p>15. MEF to establish an association of accountants and auditors, including</p> <ul style="list-style-type: none"> • adopting a code of ethics that complies with the requirements of the International Federation of Accountants • establishing committees on education and ethics within the Association 	<p>Compliance expected within 2003</p> <p>MEF has been making good progress toward the establishment of an accounting association. With ADB assistance, MEF has completed draft by-law related to the establishment of an accounting association together with (i) a code of ethics for professional accountants and auditors, and (ii) the structure and function of an education committee of an accounting association. Further, MEF has completed a 3-year funding plan amounting to \$3.7 million to support the budget of the national accounting council, the Khmer Certified Public Accountant Association, and training of accountants and auditors.</p>	<p>Second tranche release condition</p>

³ ADB. 2000. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Loan to the Kingdom of Cambodia for Rural Credit and Savings Project*. Manila.

REFINED POLICY MATRIX

Table A2.1: Policy Matrix for Subprogram II

Objectives	The First Tranche	The Second Tranche
Development of the Banking Sector		
Development of Banking Sector Infrastructure and Safety Net	<ol style="list-style-type: none"> 1. National Bank of Cambodia (NBC) to adopt a uniform chart of bank accounts and disclosure rules for the commercial banks consistent with international accounting standard, (IAS) 2. NBC to apply the uniform chart of bank accounts and disclosure rules for the commercial banks consistent with IAS to the Rural Development Bank and other specialized banks 	<ol style="list-style-type: none"> 1. NBC to adopt a guideline for the arrangements for sharing credit information among the members of the bankers association, and NBC and the bankers association to establish such arrangements
Strengthening Capacity Building in the Banking Sector	<ol style="list-style-type: none"> 3. NBC to ensure that the Center for Banking Studies (CBS) establishes a central banking course for NBC professional staff, including a mandatory training program for entry-level professional staff 	
Development of the Insurance Sector		
Establishing a Framework for Compulsory Insurance	<ol style="list-style-type: none"> 4. Ministry of Economy and Finance (MEF), in consultation with related ministries, to adopt regulations for development of compulsory insurance 	
Promoting Private Sector Development		<ol style="list-style-type: none"> 2. MEF to establish a joint venture between the state-owned insurance company and a private insurance company
Development of Interbank and Money Markets		
Establishing a Legal Framework for Money Market Development	<ol style="list-style-type: none"> 5. NBC to submit to the National Assembly a draft law on negotiable instruments and payment transactions 	
Development of Accounting/Auditing and Legal Infrastructure		
Establishing an Accounting and Auditing System	<ol style="list-style-type: none"> 6. Adoption of a law on corporate accounts, their audit, and the accounting profession 7. MEF to adopt a subdecree to apply IAS and international standards on auditing (ISA) to all companies (including insurance companies) incorporated in Cambodia, and to establish a national accounting council to set and interpret standards. 	<ol style="list-style-type: none"> 3. MEF to establish an association of accountants and auditors, including <ol style="list-style-type: none"> (a) adopting a code of ethics that complies with the requirements of the International Federation of Accountants, and (b) establishing committees on education and ethics within the association

Objectives	The First Tranche	The Second Tranche
Development of Legal Infrastructure	8. Adoption of a law on commercial enterprises	3. Ministry of Commerce (MOC) to submit to the National Assembly a draft secured transactions law 4. MOC to adopt a time-bound action plan to establish a public registry for secured transactions, acceptable to ADB

Table A2.2: Policy Matrix for Subprogram III

Objectives	Conditions
Development of the Banking Sector	
Development of Banking Sector Infrastructure and Safety Net	1. Adoption of a secured transactions law 2. National Bank of Cambodia (NBC) to adopt a plan to establish a deposit insurance system for commercial banks 3. Ministry of Commerce (MOC) to establish a public registry for secured transactions
Strengthening Capacity Building in the Banking Sector	4. NBC to ensure that the bankers association establish a banking institute for private bank staff under the bankers association, pursuant to its approved articles of association, and Establish a professional training course for private bank staff; the banking institute should be open to staff of microfinance institutions
Development of the Insurance Sector	
Promoting Private Sector Development	5. Ministry of Economy and Finance (MEF) to adopt a plan to divest its share in the joint venture insurance company
Development of Interbank and Money Markets	
Establishing a Legal Framework for Money Market Development	6. Adoption of a law on negotiable instruments and payment transactions
Development of Accounting/Auditing and Legal Infrastructure	
Development of Legal Infrastructure	7. MEF to submit to the National Assembly a draft securities and exchange law