

**TECHNICAL ASSISTANCE COMPLETION REPORT**  
**Division: CARM/MKRD**

<b>TA No. and Name</b> TA 3634-CAM "Strengthening Public Financial Management"			Amount Approved: <b>\$1,200,000</b>		
			Revised Amount: 0		
<b>Executing Agency</b> Ministry of Economy and Finance		<b>Source of Funding</b> TASF	<b>TA Amount Undisbursed</b> \$189,190	<b>TA Amount Utilized</b> \$1,010,810	
<b>Date</b>			<b>Completion Date</b>		
			<b>Original</b> 31 January 2004	<b>Actual</b> 31 November 2005	
<b>Approval</b> 22 February 2001	<b>Signing</b> 06 April 2001	<b>Fielding of Consultants</b> January 2002	<b>Closing</b> 31 January 2004	<b>Date Actual<sup>1</sup></b>	
<b>Description (Background and rationale)</b>					
<p>The Royal Government of Cambodia embarked on a comprehensive reform program in 2001 on strengthening fiscal and financial management, and public expenditure management reforms. The Audit Law<sup>2</sup> was passed in 2000, paving the way for the establishment of the National Audit Authority (NAA) as the supreme audit institution in Cambodia. The Government also took an important step in establishing the Economic and Financial Policy, Planning, and Monitoring Unit in the Ministry of Economy and Finance (MEF) to monitor budget implementation in the priority sector ministries<sup>3</sup>.</p> <p>The TA was approved in response to the Government's request for support in the implementation of the aforementioned reforms areas. The TA has two components: Fiscal and Audit Components. It was originally administered by MKOC and was formally delegated to CARM on 20 October 2004.</p>					
<b>Objectives and Scope</b>					
<p>The TA was designed specifically to support MEF and line ministries in fiscal management through the formulation of the Medium-Term Expenditure Framework (MTEF), strategic expenditure analysis, fiscal devolution, institutional development for the newly established NAA to carry out external audit, development of the internal audit functions in key ministries (MEF, and Health), and strengthening of the Finance and Banking Commission (FBC) of the National Assembly for oversight of Government's financial performance. The fiscal component was intended to complement the on-going Technical Cooperation Assistance Program (TCAP) initiated by the IMF and other development partners to comprehensively support budget management. The overall goal of the TA was to improve governance by building a state that is increasingly accountable, transparent, participatory, and predictable.</p>					
<b>TA Inputs and Evaluation</b>					
<b>Audit Component</b>					
<p>A number of inputs were envisaged, including: (i) institutional development for NAA; (ii) establishment of an effective internal auditing function at MEF and the Ministry of Health (MOH); (iii) strengthening capacity of the FBC of the National Assembly; and (iv) redefining the role of the Department of Financial Inspection in MEF.</p> <p>Development of internal audit in the Ministry of Education, Youth, and Sports (MOEYS), which was not originally envisaged in the TA document, was given priority because of large assistance provided by ADB and donors to the education sector. MOEYS officials were also very keen to have an Internal Audit Department established and strengthened despite the absence of the internal audit sub-decree. On the contrary, MOH was not keen to start internal audit until the internal audit sub-decree was approved by the Government. The sub-decree was only approved in February 2005, and by that time, the consulting inputs originally intended for MOH had been utilized to support development of the internal audit function at MEF, since the latter was keen to move ahead even prior to the approval of the sub-decree. The assistance to the FBC was also not undertaken due to the delay in forming the National Assembly and the Government following the national election in 2003. Given the limited time left by then, the TA had focused instead on expanding the capacity building activities for internal audit and inspection at MEF<sup>4</sup>.</p> <p>The international and domestic consultants were given the total of 17.5 months and 24 months of inputs respectively for the above activities and they have utilized these inputs very extensively and productively. All the inputs were delivered satisfactorily. The arrangement to place a local consultant on a permanent basis and international consultant on an intermittent assignment was cost effective and appropriate.</p>					

<sup>1</sup> TA account not closed as claims for final payments are still being processed.

<sup>2</sup> Supported by TA 2566-CAM "Developing Capacity in Audit and Inspection Function"

<sup>3</sup> Education, health, agriculture, and rural development.

<sup>4</sup> Although the TA started in 2002, the initial stage focused on capacity building at NAA, and establishment of an internal audit department in MOEYS. Support to FBC was planned for 2004. This, however, was not possible due to the political impasse in forming the Government and the National Assembly following the 2003 election.

## **Fiscal Component**

The fiscal component concentrated mainly on training programs conducted by the Economics and Finance Institute (EFI) of MEF. The training focused on fiscal policy management, MTEF, local government finance, treasury and public expenditure management for officials from MEF, central and line agencies, and officials from selected provinces. Only limited supported was, however, extended towards process design for MTEF introduction and on budget formulation and strategic expenditure analysis. Hands-on operational advice to MEF was insufficient. Assistance for fiscal devolution was deemed inappropriate in the absence of a clear government vision and framework thereof. Thus, it was justified to postpone this sub-component. The knowledge and expertise of the fiscal adviser was appreciated, but his reporting and counter-parting arrangements were not fully integrated with the main TCAP management architecture. Knowledge transfer was, therefore, limited. This was further constrained by a weak absorption capacity and institutional setup on the MEF's side at that time. The performance of the consultant for the macroeconomic model was effective and highly satisfactory.

Although donors' inputs to TCAP were not systematically harmonized, the TA made a strategic contribution to PFM through the successful introduction of MTEF, including the preparation of a pilot MTEF for 2002 and 2003. While the TA focused on fiscal and public expenditure management, reform of the budget system was left to IMF which was better placed to work on the "nuts and bolts" of the issues.

The TA also helped finance the Public Expenditure Tracking Survey (PETS) in primary education, led by the World Bank. PETS aimed to analyze the possible "breaks in the chain" of service delivery namely the flow of funds to front line service providers and the demand-side failures in the government's Priority Action Program (PAP). The Government implemented PAP aiming at delivering resources to front line service providers in the priority sectors in a timely manner.

Following a mid-term review (MTR) conducted in early 2004, which coincided with the designing phase of a comprehensive Public Financial Management (PFM) reform program, it was decided that development of a macroeconomic model provided a more optimal use of limited funds while support to MTEF would be left to the better resourced multi-donor trust fund. A minor change in scope of the component was made to allow development of the model to take place.

## **Evaluation of Outputs**

### **Audit Component**

The main outputs of the audit component have been delivered satisfactorily. These including developing capacity of NAA and the establishment of internal audit departments in MEF and MOEYS, strengthening the effectiveness of MEF inspection activity and building capacity of these institutions in performing all aspects of audit. NAA's staff were trained on basic principles of audit<sup>5</sup>, and received on-the-job training including the audits of national budget realization for 2001 and 2002, and the audits of the Government agencies<sup>6</sup>. A group of technical staff from the Technical Research Department of NAA were trained to become trainers. The Government's auditing standards and a three-year work plan were developed and are being implemented. A series of workshops and seminars including a seminar on audit law was organized

Through a study tour to Malaysia, NAA senior officials gained significant insight in auditing and accounting practices and the legislative basis for the Government auditing functions, organizational arrangements in the audit office, procedures for reporting to the Parliament and the Public Accounts Committee, procedures used for financial and performance audits, provincial and commune auditing, internal audit arrangements, and training strategies and practices.

The approval by the RGC of the internal audit sub-decree in February 2005 was significant. This paved the way for the establishment of the internal audit departments in line Ministries, including the establishment of the Internal Audit Department in MEF, and revision of the role of the existing Inspection Department in MEF which is directed at investigation of public expenditures of Government's agencies and MEF's departments<sup>7</sup>. The Inspection Department of MEF is expected to play this role until the line Ministries' internal audit departments are fully functional.

The consultants' performances were highly satisfactory. In addition to support given to NAA, they assisted the drafting of the mandate for MEF internal audit, internal control policy statement and internal audit standards, internal audit procedures manual, code of ethics for internal auditors, tax and customs internal audit manual for MEF, and inspection procedures manual for Inspection Department. They also supported MEF in organizing training courses on accounting, auditing, and internal control, English language training, and provided on the job training and field audits of tax and customs departments of MEF, and guided the internal auditors of MEF in documenting systems and procedures in tax and customs offices of central Government agencies and provincial offices. The consultants also assisted in the preparation of a three-year internal audit work plan for MEF, which is being implemented.

### **Fiscal Component**

The training has provided the foundation for government officials, particularly those from MEF, in supporting the MTEF process and subsequent PFM reform programs. It may, however, have been overemphasized in the

<sup>5</sup> Including the functions of the external audit, internal audit and internal control systems, financial audit methodology, government versus private sector auditing, and key features of the Audit Law and other financial laws in Cambodia

<sup>6</sup> Ministries of Agriculture, Telecommunications, Health, Foreign Affairs, Water Supply Authority, Electricity Authority of Cambodia, Tax and Customs Department of MEF, Kandal Provincial Treasury, and the financial statements for 2003 of 166 commune councils.

<sup>7</sup> MEF could also use this Department to investigate other Ministries' financial management if there are allegations of financial abuses.

execution of TA. On the other hand, the fiscal component has been effective in supporting the initial stages of developing a MTEF, although to some extent, this had moved ahead of the wider conditions and requirements necessary to sustain an MTEF process at that time. Nevertheless, MEF management has placed great importance on the role of the MTEF in policy-based budgeting process and this TA has been highly valued for that reason. Work on fiscal devolution did not materialize due to insufficient institutional arrangements to carry this forward.

Despite the limitations of data, a simplified macroeconomic model was developed and MEF appreciated its user friendly interface. However, its capacity and robustness in conducting reliable economic forecasting is limited. The model functions primarily as a simulation tool to enable concerned MEF officials foresee the impacts of changing different policy and macroeconomic scenarios, which are useful in order to make the budget more credible.

The findings from PETS were published in December 2005 in a joint WB-ADB-CDRI<sup>8</sup> report. The report has provided feedback to the redefined PAP approach, and for the initial stage of the PFM reform program to make the budget more credible.

#### **Overall Assessment and Rating**

Despite sensitivities over the establishment of auditing activities for the first time in Cambodia, compounded by a shortage of qualified accounting and audit professionals, the TA was highly successful in laying the foundation for internal auditing and for enabling the NAA to start a program of audit coverage.

Concerned Government officials have acquired better understanding and appreciation of sound internal control, and accounting and auditing systems which are essential elements for good governance. They have also acquired a better understanding of the approaches and techniques in conducting audit reviews, and meeting professional standards. The Government highly appreciated ADB support and is keen to extend the internal auditing systems to line ministries and provincial administration.

The fiscal component has been successful in providing basic training in fiscal policy analysis and expenditure management, formulation of MTEF, and macroeconomic modeling. These are the necessary foundation for the implementation of a comprehensive PFM reform program. They would have generated greater impacts and values had they taken into account a more practical context and absorption capacity of the government institutions.

#### **Major Lessons Learned**

The auditing and internal control concepts introduced by this TA were unprecedented in the recent history of Cambodia. Obtaining a thorough understanding of the principles of internal control, internal audit and auditing of financial statements based on international accounting and auditing standards is no easy task and this takes time. This TA would have had greater impact had other key links been in place such as the accounting framework for Government financial transactions, and the FCB fully operational.

The fiscal component could have paid more attention to developing and introducing the systemic reforms that would justify a more practical training program. Introducing sustainable program for training insufficiently motivated public officials was not adequately addressed. Better background work and analysis of viable ADB interventions in the TA processing stage proved to be crucial. The TA, which required close coordination and follow-up, would have benefited better if administered from resident mission at earlier stage. Future support to PFM needs to be well structured, sequenced, and take into account the ground realities (i.e. institutional/capacity issues) so that it remains relevant and generates sustainable impacts.

#### **Recommendations and Follow-Up Actions**

The progress made under the audit component is noteworthy, but can only be viewed as a starting point. The Government recognizes the future benefits and is willing to establish and implement the accounting regulations, procedures and software systems that are necessary for sound financial management. The Government, however, is hampered by limited resources and low skills in these areas, and continued support from donors is essential. Building on these initial achievements, Germany has already committed to provide long-term support for the NAA. Likewise, Sweden is to provide institutional support to the NAA and FBC under the PFM. It is also expected that financial accountability mechanism will be supported under the PFM (which is being supported by a multi-donor trust).

Future ADB TA that supports the multi-donor reform program like TCAP and PFM warrants careful consideration and selection in terms of component or activity, so as to avoid duplication, ensure relevance and provide maximum impact. The design of training program needs to take into account the poor incentive conditions of the public officials if it is to sustain. ADB intervention in activities that requires statistical inputs needs to be thought through carefully given the lack of quality data, and inadequate collection systems.

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