

FINANCIAL MANAGEMENT ASSESSMENT

EXECUTIVE SUMMARY

The financial management assessment (FMA) was prepared in February 2020 in accordance with the Asian Development Bank's (ADB's) Guidelines for Financial Management and Analysis of Projects and Financial Due Diligence: A Methodology Note.¹ The FMA considered the capacity of Electricité du Cambodge (EDC), the executing agency and implementing agency, including funds-flow arrangements, staffing, accounting and financial reporting systems, financial information systems, and internal and external auditing arrangements, and the performance of the executing agency with the financial management and reporting obligations under previous ADB loan and grant agreements.

Based on the assessment, the key financial management risks identified are described below, followed by the risk management plan. The financial management assessment indicates that the overall combined risk is moderate with the project-specific risks being low. Overall combined risks can be reduced to low through appropriate mitigation actions. EDC has committed to making the necessary changes to the terms of reference for the external auditor. EDC itself is familiar with ADB requirements and procedures and has satisfactorily implemented previous ADB projects.

Risk Assessment

Risk Description	Risk and Impact	Likelihood	Rating
Country-specific weak PFM systems, particularly governance, transparency and accountability of public expenditures	Substantial – <i>chances of error, fraud or misappropriation remaining undetected</i>	Likely	Substantial
Shortage of external skills in financial management and auditing. Delays in submission of externally audited project accounts and annual audit may not meet ADB requirements	Moderate – <i>chances of error, fraud or misappropriation remaining undetected</i>	Unlikely	Moderate
Government may be unable to meet funding obligations due to budget constraints	Moderate – <i>delays in implementation</i>	Unlikely	Moderate

ADB = Asian Development Bank, PFM = public financial management.

Source: Asian Development Bank²

Risk Assessment and Risk Management Plan

Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
Inherent Risk		
Country-specific – weak PFM system, particularly governance, transparency and accountability of public expenditures	Substantial	ADB continues to support on-going efforts to strengthen PFM through technical assistance, including a proposed Technical Assistance Facility ^a
Entity-specific – shortage of skills in financial management, management	Low	EDC staff are familiar with ADB requirements from previous projects. Capacity will be further uplifted with

¹ ADB. 2015. *Financial Management Technical Guidance Note – Financial Management Assessment*. Manila

² ADB cochairs the Public Financial Management Reform Program and the Sub-National Democratic Development (decentralization reform) technical working groups.

Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
accounting, financial reporting and internal audit		assistance from ADB, by attending trainings. The accounting department is currently fully staffed. Spot and random checks of expenditures during review missions.
Overall inherent risk	Moderate	
Project Risk		
Implementing Entity – malpractice and abuse of PFM rules by employees	Low	EDC has strengthened internal audit controls in compliance with the Program Action Plan under Loan 3789-CAM. This required auditing of individual projects, which was previously not undertaken, and the provision of training in ADB requirements to all internal audit staff by December 2018.
Funds Flow – government may be unable to meet funding obligations due to budget constraints	Low	Project financing plan has been agreed with the government and restricted to a few project components to ensured availability of counterpart financing
Staffing – EDC has limited staff capability in financial management, accounting, budgeting, internal controls and financial reporting.	Moderate	EDC staff are familiar with ADB requirements from previous projects and have been trained in ADB project accounting and reporting requirements. Further training will be conducted during the project implementation
Accounting policies and procedures – Project accounting procedures introduces operational risk through manual processes.	Low	Use of MS Excel for project financial management rather than accounting software creates some risk. This is mitigated by requirements to transfer all data annually from MS Excel files to EDC's accounting software and internal and external audits of the consistency and accuracy of data entries. Only authorized project managers and finance officers are permitted to enter data.
Internal audit – previously weak internal audit department	Low	The internal audit department has been made fully operational since end-2018 in compliance with the Program Action Plan under Loan 3789-CAM. This required auditing of individual projects, which was previously not undertaken, and the provision of training in ADB requirements to all internal audit staff by December 2018.
External audit – delay in the submission of externally audited project accounts due to limited capacity, annual audit may not meet ADB requirements	Moderate	Under current projects, externally audited project accounts have been submitted within 6–7 months (covenant of 6 months). EDC will apply CPSAS for reporting, in compliance with RGC instructions, from 2020 accounts, which meets ADB requirements for a fair presentation accounting framework. EDC

Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
		will also provide financial projections in accordance with ADB requirements
Reporting and monitoring – unreliable reports due to errors and limited staff capability in ADB financial reporting requirements	Low	EDC staff are familiar with ADB requirements from previous projects and have been trained in ADB project accounting and reporting requirements. Project accounts are subject to internal and external audit. Further training will be conducted during the project implementation
Information systems – accounting data not adequately safeguarded	Low	Regular back-ups to secured locations are undertaken. Access to financial management software and systems is limited to authorized project manager and financial officers.
Overall Project Risk	Low	
Overall (Combined) Risk	Moderate	

ADB = Asian Development Bank, CPSAS = Cambodian Public Sector Accounting Standards, EDC = Electricité du Cambodge, PFM = public financial management, RGC = Royal Government of Cambodia.

^a ADB. 2019. *Technical Assistance for Strengthening Project Readiness, Procurement and Financial Management in Southeast Asia*. Manila.

Source: Asian Development Bank

EDC has agreed to implement a time-bound action plan to address identified areas for improvement. The proposed time-bound action plan is outlined below.

Time-Bound Action Plan

Areas for Improvement	Mitigation Action	Responsibility	Timeframe
EDC's project financial statements follow the cash-basis in compliance with the Cambodia Public Sector Accounting Standard (CPSAS) and to be audited by external auditor	TOR for new external auditor, to be appointed in 2020, to include: <ul style="list-style-type: none"> • Project financial statements to be audited in accordance with CPSAS to comply with ADB's requirement for a fair presentation accounting framework including an auditor's opinion • The project financial statements to include a statement of budgeted against actual expenditures. • The project financial statements to include a reasonable assurance by the external auditor that the loan proceeds were used only for the purposes of the project, of compliance with financial covenants contained in the loan agreements and the degree of compliance. 	EDC	Before loan effectiveness

Areas for Improvement	Mitigation Action	Responsibility	Timeframe
Official confirmation of the exemption of payments under ADB projects from withholding tax will be obtained from MEF	<ul style="list-style-type: none"> • EDC to submit letter to MEF requesting exemption of withholding tax. • MEF subsequently to issue confirmation of exemption from withholding tax in the form of an official letter to EDC. 	EDC and MEF	Before loan effectiveness
Financial projections will contain the required information to assess the financial position of EDC and compliance with agreed covenants	<ul style="list-style-type: none"> • EDC to submit to ADB, on an annual basis by 31 December, summary financial statements (income statement, balance sheet, statement of cash flows) projections for the current and following fiscal year that enable assessment of projected compliance with agreed covenants 	EDC	December 2020 and annually thereafter
EDC accounting and internal audit staff will be trained in ADB requirements and procedures	<ul style="list-style-type: none"> • EDC to ensure all staff involved in financial management and accounting for the proposed project and internal audit staff have received training or will do so within one year of loan effectiveness for existing staff and within one year of joining for new staff 	EDC	Annually

ADB = Asian Development Bank, CPSAS = Cambodian Public Sector Accounting Standards, EDC = Electricité du Cambodge, TOR = terms of reference.

Source: Asian Development Bank.

I. INTRODUCTION

1. The financial management assessment (FMA) was prepared in February 2020 in accordance with the Asian Development Bank's (ADB's) Guidelines for Financial Management and Analysis of Projects and Financial Due Diligence: A Methodology Note. The FMA considered the capacity of Electricité du Cambodge (EDC) as the executing agency, including funds-flow arrangements, staffing, accounting and financial reporting systems, financial information systems, and internal and external auditing arrangements, and the performance of the executing agency with the financial management and reporting obligations under previous ADB loan and grant agreements.

II. PROJECT DESCRIPTION

2. The Grid Reinforcement Project (the project) will support Electricité du Cambodge (EDC), the state-owned power utility, in improving transmission network capacity and stability. The project is aligned with the following impact: adequate and reliable power supply from environmentally sustainable energy sources ensured. The project will finance the following outputs:

3. **Output 1: 115 kilovolt and 230 kilovolt grid infrastructure expanded and reinforced.** The proposed project will support the expansion of 115 kV and 230 kV overhead and underground transmission lines and associated substations in Phnom Penh, Kampong Chhnang, and Kampong Cham provinces. It will add 13 circuit-kilometer (cct-km) of 230 kV transmission lines, 36.7 cct-km of 115 kV transmission lines, 1,475 megavolt-ampere to 230 kV/ 115 kV/ 22 kV substation transformer capacity and 350 megavolt-ampere to 115 kV/ 22 kV substation transformer capacity.

4. **Output 2: First utility-scale energy storage system provided.** The project will support EDC in installing the first utility-scale battery energy storage system (BESS) in Cambodia. The pilot BESS will be capable of storing 16 megawatt-hour (MWh). This is a desirable size to support the applications of (i) smoothing output at 80% from a 60MW solar park, (ii) providing 0.5 hour of curtailment reserve to address daily power shortcuts, (iii) providing primary frequency control, and (iv) deferring upgrades in transformer capacity at GS6 substation (nearby substation) Such stacking of multiple services is a standard feature of BESS installations and the project will enable EDC to test the requirements, for and benefits of, BESS in providing the combined set of services as a precursor to scaling-up its use in the future.

5. The project will support EDC in implementing the project components with a focus on procurement and contract management, construction supervision, testing and commissioning, implementation, updating and monitoring of social and environmental safeguards, implementation of gender and social equality dimensions, project performance monitoring and evaluation. Project implementation consultants will complement existing staff of EDC, thus ensuring a high degree of project implementation efficiency.

III. COUNTRY ISSUES

6. Country issues that could impact on the effective financial management of the project are concerned with (i) public financial management (PFM), (ii) limited management and skills capacity, (iii) the country environment, and (iv) ADB's country portfolio performance.

A. Public Financial Management

7. Public financial management in Cambodia remains weak. Project appraisal and budgeting is poor and systems for monitoring, reporting and auditing expenditures are generally rated as being inadequate.

8. The most recent Public Expenditure and Financial Accountability (PEFA) performance assessment for Cambodia was published in 2015¹ and aims to facilitate the implementation of PFM reforms. A summary of the Performance Measurement Framework is provided in Table 1, with A indicating the highest score. Overall, the Performance Measurement Framework shows a relatively weak assessment for Cambodia, with 5 indicators rated A or B and 25 indicators rated C, C+, D or D+. The government systems score high on the ability to deliver aggregated budget as planned (A), transparency of inter-governmental fiscal relations (B) and participation in the annual budget process (A).

9. A significantly weaker performance is observed in categories related to the budget cycle (predictability and control in budget execution; accounting, recording and reporting), composition of expenditure out-turn compared to original approved budget and public access to key fiscal information. Additionally, the financial management system shows weak performance in categories related to donor practices. The review noted that there are “*low levels of support to or trust in the functioning of government systems from development partners.*”

10. In comparison with the 2010 PEFA report, improved performance has been noted for seven government indicators, mostly related to aggregate fiscal discipline and supervision of budget execution. Performance deterioration has been observed in three areas related to resource allocation and budget transparency. No significant change has been found for 14 government indicators and another four indicators were not directly comparable.

Table 1: Summary of Performance Measurement Framework

Indicators	Score
1. Credibility of the budget	
Aggregate expenditure out-turn compared to original approved budget	A
Composition of expenditure out-turn to original approved budget	D+
Aggregate revenue out-turn compared to original approved budget	A
Stock and monitoring of expenditure payment arrears	D+
2. Comprehensiveness and transparency	
Classification of the budget	C
Comprehensiveness of information included in budget documentation	C
Extent of unreported government operations	C
Transparency of intergovernmental fiscal relations	B
Oversight of aggregate fiscal risk from other public sector entities	C+
Public access to key fiscal information	D
3. Budget cycle	
(i) Policy-based budgeting	
Orderliness and participation in the annual budget process	A
Multiyear perspective in fiscal planning, expenditure policy, and budgeting	C+
(ii) Predictability and control in budget execution	
Transparency of taxpayer obligations and liabilities	C+
Effectiveness of measures for taxpayer registration and tax assessment	D+
Effectiveness in collection of tax payments	D+

¹ Government of Cambodia, General Secretariat of Steering Committee of the Public Financial Management Reform. 2015. [Report of the Evaluation on the Public Financial Management System of Cambodia](#). Phnom Penh.

Indicators	Score
Predictability in the availability of funds for commitment of expenditures	C+
Recording and management of cash balances, debt and guarantees	C+
Effectiveness of payroll controls	D+
Competition, value for money, and controls in procurement	D+
Effectiveness of internal controls for non-salary expenditure	C
Effectiveness of internal audit	C
(iii) Accounting, recording and reporting	
Timeliness and regularity of accounts reconciliation	C
Availability of information on resources received by service delivery units	D
Quality and timeliness of in-year budget reports	C+
Quality and timeliness of annual financial statements	D+
(iv) External scrutiny and audit	
Scope, nature, and follow-up of external audit	NR
Legislative scrutiny of the annual budget law	C+
Legislative scrutiny of external audit reports	B
4. Donor practices	
Predictability of Direct Budget Support	D
Financial info provided by donors for budgeting/reporting on project/program aid	D+
Proportion of aid that is managed by use of national procedures	D

Source: Government of Cambodia, Ministry of Economy and Finance. 2015. [Report of the Evaluation on the Public Financial Management System of Cambodia](#). Phnom Penh.

11. In its December 2019 Article IV consultation², the International Monetary Fund (IMF) commented on the lack of effective planning and budgeting for public investment management, stating that: *“Overall, while institutions to support infrastructure governance processes are in place, their effectiveness is hampered by fragmentation and limited coordination. The preparation of the capital budget is not based on individual projects. Rather, the capital budget is appropriated as lump sums and allocation to individual projects only occurs after the overall budget is approved, preventing coordination with the recurrent budget”*.

12. According to the World Bank’s 2019 Public Expenditure Review³, Cambodia has made progress in the implementation of the Public Financial Management Reform Program, with increased scrutiny of public sector expenditures. The introduction of a Financial Management Information System (FMIS) is expected to increase transparency and make public spending more efficient.

13. Some of the identified concerns are being addressed through ongoing support from the ADB. The current Country Partnership Strategy (CPS) for 2019–2023⁴ has identified the need to support public sector management reforms, including improving screening of investments, drawing on the lessons of the preceding CPS 2014–2018. Specific activities under the CPS include:

- i) Updating standard operating procedures and manuals for financial management and procurement to improve the fiduciary controls, building the capacity of ministries and government agencies and encouraging the development of an electronic procurement system once an independent procurement regulatory agency is established.

² IMF. 2019. [Cambodia: 2019 Article IV Consultation](#). Washington, D.C.

³ World Bank. 2019. [Improving the effectiveness of Public Finance: Cambodia Public Expenditure Review](#). Washington, D.C.

⁴ ADB. 2019. [Country Partnership Strategy: Cambodia, 2019–2023](#). Manila.

- ii) For financial management, supporting the alignment of the National Financial Reporting Standards with the International Public Sector Accounting Standards (IPSAS).

14. On 6 June 2019, the Royal Government of Cambodia issued a new regulation (*prakas*) on the application of Cambodia Public Sector Accounting Standards (CPSAS) to development partner-financed projects.⁵ The CPSAS follow IPSAS and meet ADB's requirements for a fair presentation accounting framework. A subsequent letter from the National Accounting Council, dated 28 January 2020, requires development partner-financed project financial statements to be prepared in accordance with CPSAS from 1 January 2020 onwards.

15. Support to Cambodia in improving project readiness, procurement and financial management, following the activities identified in the CPS, forms part of the Strengthening Project Readiness, Procurement and Financial Management in Southeast Asia Transaction Technical Assistance Facility.⁶

B. Management and Skills Capacity

16. Capacity in project management, procurement and public sector audits remains weak. The number of professional accountants is far lower than required: only 161 certified public accountants as of 2017 in a then-population of 13.39 million.⁷

17. Government structures significantly lag in terms of project monitoring and auditing. While auditing procedures exist in theory, in practice the quality of internal and external audits leaves much room for improvement. Effective measures for project handover and evaluation are also insufficient. In addition, further improvements in accounting and financial reporting procedures are necessary and should include the adoption of common IT and accounting systems and asset management registries. Although the timeliness of financial statements has improved, the adherence to international auditing standards remains insufficient and needs to be strengthened along with the assertion of independence of audit opinions.

18. ADB is providing training to government and state-owned enterprise officials in ADB reporting requirements, procurement procedures and CPSAS under two ongoing technical assistance activities: Strengthening Project Readiness, Procurement and Financial Management in Southeast Asia Transaction Technical Assistance Facility, and Strengthening Capacity for Improved Implementation of Externally Funded Projects in Cambodia.⁸

C. Country Environment

19. Cambodia's country environment remains challenging. Poor governance ratings, failures to fully implement procurement regulations and the need to strengthen anti-corruption efforts have been persistent concerns.

⁵ Prakas 545 dated 6 June 2019 on "Implementation of Cambodia Public Sector Accounting Standards (CPSAS, cash-based) applied to development partners-funded projects, including those implemented by SOEs".

⁶ ADB. 2019. [Technical Assistance for Strengthening Project Readiness, Procurement and Financial Management in Southeast Asia](#). Manila.

⁷ World Bank. 2017. [Audit Quality Assurance in Cambodia Leads to Public Trust and Investor Confidence](#). Washington, D.C.

⁸ ADB. 2017. [Strengthening Capacity for Improved Implementation of Externally Funded Projects in Cambodia](#). Manila.

20. **Governance.** Cambodia's political, legal and judicial systems continue to evolve following the end of conflicts in the early 1990s. Most aspects of governance need to recognize ongoing informal links between the dominant political party, medium-sized and large businesses, and senior levels of government. Furthermore, there is a limited tradition of accountability for performance through either financial oversight or political mechanisms. However, political leaders place importance on international recognition and external financing, and these provide incentives for governance reform⁹.

21. Cambodia scores below the Association of Southeast Asian Nations (ASEAN) average on all indicators included in the World Bank's World Governance Indicators database, excepting political stability. Its scores are particularly low compared to other ASEAN countries with respect to rule of law and control of corruption. The country's rank in the World Bank's Doing Business index¹⁰ has been essentially unchanged over the past 5 years.

Table 2: Association of Southeast Asian Nations Governance Indicators, 2018

	Voice & Accountability	Political Stability / No Violence	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Brunei	-0.84	1.20	1.25	0.69	0.63	0.80
Cambodia	-1.22	0.11	-0.57	-0.50	-1.11	-1.33
Indonesia	0.18	-0.53	0.18	-0.07	-0.31	-0.25
Lao PDR	-1.74	0.42	-0.67	-0.79	-0.84	-0.98
Malaysia	-0.08	0.24	1.08	0.68	0.62	0.31
Myanmar	-0.89	-1.31	-1.07	-0.75	-1.03	-0.59
Philippines	0.04	-1.12	0.05	0.05	-0.48	-0.54
Singapore	-0.06	1.51	2.23	2.13	1.84	2.17
Thailand	-1.01	-0.73	0.35	0.11	0.02	-0.40
Viet Nam	-1.45	0.20	0.00	-0.39	0.00	-0.49
ASEAN average	-0.71	-0.02	0.28	0.11	-0.07	-0.13
Cambodia percentile rank	14	51	32	33	11	9

ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic.

Notes: The governance indicators are measured on a scale of -2.5 (weak) to +2.5 (strong) with a higher score indicating better governance. The percentile rank among 215 countries ranges from 0 (lowest) to 100 (highest).

Source: World Bank. [Worldwide Governance Indicators](#) (accessed 20 December 2019).

22. **Procurement.** There are two procurement oversight and regulatory bodies under MEF; the Department of Public Procurement and the Department of International Cooperation and Debt Management for externally financed projects. Procurement regulations are well-developed and significant progress has been made in terms of implementing competitive bidding procedures. However, implementation capacity in general remains weak. There is widespread use of noncompetitive procurement methods, no independent procurement regulator or anticompetition commission, and low levels of identification and prosecution of procurement irregularities. The oversight responsibilities of the National Audit Authority (NAA) remain unclear and do not extend over all ministries and government institutions. The NAA is also constrained by inadequate resources and capacity and a perceived lack of independence.

23. Improvements are underway. The government is in the initial stages of assessing the requirements for establishing a single procurement regulatory agency. The Public Procurement System Reform Strategy 2019–2025 was adopted in 2019 with measures including preparing annual procurement plans, increasing transparency, accountability, and competitiveness through e-procurement systems and aligning with the new FMIS.

⁹ ADB. 2012. [Cambodia: Country Governance Risk Assessment and Risk Management Plan](#). Manila.

¹⁰ World Bank. 2019. [Ease of Doing Business](#). Washington, D.C.

24. **Anti-corruption.** The implementation of the Law on Anti-Corruption and establishment of the Anti-Corruption Unit (ACU) in 2010 has contributed to the strengthening of anti-corruption measures. However, significant challenges remain. ADB's Risk Assessment and Risk Management Plan for the CPS 2014–2018¹¹ stated that: “*The ACU...is partially operational. The ACU has made some initial progress such as in making arrests of high-ranking police, court, and government officials who were prosecuted and imprisoned. However, the ACU still faces challenges with regard to operational effectiveness, carrying out anti-corruption activities, and implementing the Anti-Corruption Law systematically.*”

25. Cambodia continues to languish in the bottom quintile of countries measured by Transparency International's Corruption Perceptions Index, placing 161st of 180 countries in 2018 with no significant change in its assessed score over the last five years. It also scores poorly on budget openness and transparency and was in the bottom quintile of the 115 countries surveyed under the open budget initiative. The IMF's 2019 review concluded that: “*Reducing corruption is a strategic government priority and steps have been taken to strengthen anti-corruption efforts. However, further advances are needed to improve anti-corruption institutions, strengthen the anti-corruption framework and address shortcomings in the AML/CFT¹² regime.*”

D. Asian Development Bank Country Portfolio

26. At the end of 2018, Cambodia's portfolio comprised 33 ongoing projects (with 67 loans or grants and two program loans) with a total commitment of \$1.63 billion. Infrastructure was the largest part of the portfolio at 54.6%, mainly water and urban sanitation (27.4%) and transport (27.2%). There has been a shift from sector-type projects to projects that are multisectoral in nature with an emphasis on cross-cutting areas such as climate change, human development, and links between urban, rural and regional development.

27. Contract award and disbursement ratios are below the ADB-wide average, although in line with Southeast Asia Department (SERD)-wide ratios. Performance has not noticeably improved over the last five years. The speed of start-up compliance has improved, with the average time from loan signing to effectiveness falling from 5.5 months in 2014 to 3.6 months in 2018. Projects at implementation risk represented 30% of the total in 2018, again above the ADB-wide average but below the SERD-wide average. The draft Joint Country Portfolio Performance Review, 2016–2017 by ADB, World Bank and the Japan International Cooperation Agency identified the key areas for improvement as: project preparation and design, disbursement, procurement, inconsistencies in the quality of consulting services, and social and environmental risk (including resettlement).

Table 3: Key portfolio performance indicators for Cambodia, 2014–2018

Item	2014	2015	2016	2017	2018
Financial Performance^a					
Contract award ratio ^b (%)	25.1	25.6	24.8	30.0	15.7
SERD-wide contract award ratio (%)	-	-	-	21	17
ADB-wide contract award ratio (%)	27.8	26.1	29.7	27.6	25.7
Disbursement ratio ^c (%)	22.2	19.6	24.2	23.0	22.8
SERD-wide disbursement ratio (%)	-	-	-	16	17
ADB-wide disbursement ratio (%)	25.7	29.5	27.3	25.8	27.7
Start-Up Compliance					

¹¹ ADB. 2014. [Country Partnership Strategy, 2014–2018: Risk Assessment and Risk Management Plan](#). Manila.

¹² Anti-money laundering / Countering the financing of terrorism.

Item	2014	2015	2016	2017	2018
Loans (Approved ^d Signed ^e)	7 7	5 1	10 13	3 1	8 11
Average time from approval to signing (months)	1.7	1.8	1.4	1.5	1.5
Average time from signing to effectivity (months)	5.5	4.7	3.9	3.9	3.6
Portfolio Rating^f					
On track [number]	20	15	20	15	19
Potential problem [number (%)]	5 (18.5)	9 (34.6)	5 (19.2)	4 (18.2)	4 (14.8)
Actual problem [number (%)]	2 (7.4)	2 (7.7)	1 (3.8)	3 (13.6)	4 (14.8)
Projects with implementation risk (%)	25.9	42.3	23.1	31.8	29.6
SERD-wide projects with implementation risk (%)	21	32	19	35	36
ADB-wide projects with implementation risk (%)	19.8	24.2	19.7	27.4	24.5

ADB = Asian Development Bank; SERD = Southeast Asia Department.

^a Covers project loans and grants only.

^b Contract award ratio is the ratio of total contracts awarded during the year to the total value for contract awards available at the beginning of the year, including newly committed projects (loans and grants) during the year.

^c Disbursement ration is the ratio of the total disbursements during the year (including disbursement from newly committed projects during the year) to the undisbursed balance at the beginning of the year.

^d Number of loans (grants) including supplementary financing approved during the year (includes additional financing).

^e Number of loans (grants) including supplementary financing signed during the year.

^f Covers all loan and grant projects (including cofinancing).

Source: ADB. 2019. [Cambodia: Validation of the Country Partnership Strategy Final Review, 2014–2018](#). Manila.

IV. PROJECT FINANCIAL MANAGEMENT SYSTEM

A. Overview of the Executing Agency

28. EDC is a wholly state-owned limited liability company, established by Royal Decree 0396/10 dated 9 March 1996. It is jointly supervised and controlled by MEF and the Ministry of Mines and Energy (MME) of the Royal Government of Cambodia. EDC is governed by a seven-member Board of Directors with representatives of MME, MEF, the Council of Ministers, the Ministry of Justice, EDC's employees and the Chamber of Commerce of Cambodia. The Board also includes the Royal Government of Cambodia Delegate in Charge of Managing EDC, who functions as the Managing Director.

B. Strengths

29. EDC staff are familiar with ADB requirements and are currently implementing the Cambodia Medium-Voltage Sub-Transmission Expansion Project (Loan 2979-CAM)¹³ and the Cambodia National Solar Park Project (Loan 3789-CAM).¹⁴ Previously, EDC implemented the Cambodia Greater Mekong Subregion Transmission Project (Loan 2052-CAM)¹⁵ and the Cambodia Provincial Power Supply Project (Loan 1794-CAM).¹⁶ Project Completion Reports for these two latter projects rated EDC's performance as *satisfactory* and identified no concerns with EDC's financial management. All these projects have been implemented under a direct payment mechanism.

30. The audited financial statements for the Cambodia Medium-Voltage Sub-Transmission Project as submitted by EDC to ADB for June 2013 to December 2015 and for the full years of 2016, 2017 and 2018 have been reviewed. These have been approved in June of the following year and submitted to ADB in June or July compared to the covenanted six months. All statements

¹³ ADB. [Cambodia: Medium-Voltage Sub-Transmission Project](#).

¹⁴ ADB. [Cambodia: National Solar Park Project](#).

¹⁵ ADB. [Cambodia: Greater Mekong Subregion Transmission Project](#).

¹⁶ ADB. [Cambodia: Provincial Power Supply Project](#).

are audited by KPMG Cambodia. All statements are complete and accompanied by a management letter. The auditor's opinions on the statements identified no concerns.

31. The Program Action Plan under the Cambodia National Solar Park Project included requirements for EDC to include the project within the scope of the Internal Audit Department and to fully adopt financial accounting software and automation of financial statements across all EDC branches. Both requirements have been complied with in full.

C. Areas for Improvement

32. The 2019 inception mission review of EDC's alignment with ADB's reporting requirements under the National Solar Park Project identified three areas for future improvement. EDC has confirmed its intention to address all three areas as part of the previously planned change of external auditor in 2020, when it will become possible to revise the terms of reference for the auditor in accordance with the template provided by ADB. The three areas for future improvement are:

- i) **Application of a fair presentation accounting framework.** EDC's previous practice was to prepare project financial statements on a modified cash basis under a compliance accounting framework in accordance with the TOR approved by ADB for the external auditor at the time of appointment. The National Solar Park Project review identified the need to adopt a fair presentation accounting framework in accordance with ADB requirements which will allow the auditor to issue an acceptable opinion on the financial statements. The same requirement will hold under the proposed Grid Reinforcement Project. This will be met by compliance with the recently-issued prakas on the preparation of project financial statements in accordance with CPSAS for development partner-funded projects, which is to take effect from 1 January 2020.
- ii) **Comparison with budget.** The project financial statements should include a statement of budgeted against actual expenditures. This is missing from the 2018 project financial statements as submitted.
- iii) **Reasonable assurances.** The project financial statements should include a reasonable assurance by the external auditor that the loan proceeds were used only for the purposes of the project, of compliance with financial covenants contained in the loan agreements and the degree of compliance. This is missing from the 2018 project financial statements as submitted.
- iv) **Financial projections.** Financial projections for the current and following year should be provided by 31 December of each year for the purposes of reviewing compliance with financial covenants contained in the loan agreements. EDC has only provided a forecast income statement and not projections of its balance sheet, statement of cash flows or degree of compliance with covenants.

33. The external auditor for the Medium-Voltage Sub-Transmission Expansion Project has, in their Management Letters for 2017, made the following recommendations:

- i) **Project accounting software.** Project accounts are currently managed in MS Excel and subsequently transferred to EDC's accounting software system for the purposes of preparing financial statements. The Management Letters recommended the use of accounting software for all projects. EDC has explained that its current approach enables project accounts and other project management information to be consolidated into a single tool. The use of MS Excel also

facilitates translation between Khmer and English. Both internal and external auditors verify that data is accurately transferred to the accounting software system and investigate any inconsistencies. Access to project accounts is limited to project managers and designated financial officers.

- ii) **Clarification of withholding tax exemption.** The Management Letters noted that MEF had not issued an official confirmation of the exemption of payments under ADB projects from withholding tax. This is still outstanding.

34. The 2018 Management Letter also recommended more accurate estimation of annual project expenditures to better understand the causes of variances from actual expenditures. EDC has explained that actual expenditures can vary greatly from budget due to factors outside of its control, such as delays in land acquisition, and it is this uncertainty that explains the large differences seen in project budgets and expenditures.

D. Personnel, Accounting Policies and Procedures, Internal and External Audit

35. EDC's accounting department is currently fully staffed. All staff members have appropriate qualifications and experience and are employed on a full-time basis with low rates of turnover.

36. EDC has established appropriate accounting systems and processes including implementing a full chart of accounts. Monthly reconciliation of actual and reported bank and cash balances takes place and annual reconciliation of physical inventories. All invoices are checked against purchase orders and receiving reports before being approved for payment. Withdrawals from EDC's bank accounts must be authorized by either the Managing Director or Deputy Managing Director.

37. EDC's financial statements are currently audited by KPMG Cambodia and are prepared in compliance with Cambodian International Standards on Auditing and Cambodian International Financial Reporting Standards (CIFRS) for SMEs.¹⁷ The CIFRS for SMEs are understood to exactly follow International Financial Reporting Standards for SMEs without modification. The auditors have identified no matters of concern in their opinions attached to the audited financial statements for the most recent four years (2015 to 2018) for which these are available. The same external auditors prepare project financial statements.

38. EDC's internal audit department became fully-operational at end-2018 complying with the Program Action Plan under Loan 3789-CAM. It reports to the Managing Director (EDC has no separate audit committee) and currently has 21 staff. The internal audit department conducts regular audits of all EDC branches and of individual projects, as well as targeted audits where concerns are identified. The internal audit department is supplemented by an MOU with the ACU allowing this entity to receive complaints relating to EDC for investigation and to protect the anonymity of informants.

E. Financial Reporting, Use of Information Technology

39. EDC uses the SUM commercial accounting software package. Project accounts are recorded separately using MS Excel and consolidated into entity accounts annually. EDC is able to produce the required financial reports for ADB and is compliant with ADB's requirements, subject to the comment above.

¹⁷ International Federation of Accountants. [Cambodia: Legal and Regulatory Environment](#).

1. Disbursement Arrangements for ADB, SCF, and CEF Funds

42. The loans and grant proceeds will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time)²⁰, and detailed arrangements agreed upon between the government and ADB. Online training for project staff on disbursement policies and procedures is available.²¹ Project staff are encouraged to avail of this training to help ensure efficient disbursement and fiduciary control.

43. **Direct payment procedure.** Payment for goods and works (engineering, procurement and construction [EPC] contracts and EPC operations and maintenance [O&M] contract) and consulting services will be disbursed by ADB through direct payment procedure. EDC will be responsible for (i) preparing disbursements projections, (ii) collecting and retaining supporting documents, and (iii) preparing and sending withdrawal applications to the MEF for onwards submission to ADB. Each withdrawal application must include the claim and invoice from the contractor or consultant and approved by the MEF's and EDC's authorized representative.

44. **Reimbursement procedure.** The reimbursement procedure may be used to pay for eligible expenditures as specified under retroactive financing and that have been incurred and paid for by EDC out of its own resources. Under this procedure, ADB's payments will be made to EDC's bank account. This procedure will require submission of full supporting documentation. A signed withdrawal application must be submitted to ADB together with the required supporting documents. To substantiate the requested disbursement is for eligible expenditures incurred and paid, the following supporting documents must be submitted to ADB together with the withdrawal application: (i) for consultant service provider advance payment: consultant service provider's invoice (indicating date, amount, and bank account details) and official receipt, bank transfer record or other proof of payment; and (ii) for contractors advance payment: contractor's invoice (indicating date, amount, and bank account details) and official receipt, bank transfer record or other proof of payment. In addition, the following supporting documents should be retained by EDC for annual audit of project financial statements and/or ADB's review: (i) for consultant service provider advance payment: contract terms and conditions which refer to payment of advance, breakdown of amount due, and other documents as required in the contract; and (ii) for contractors advance payment: contract terms and conditions which refer to payment of advance, breakdown of amount due, and other documents as required in the contract. Such records²² should be retained for at least 1 year following receipt by ADB of the final audited project financial statement or 2 years after the loan closing date, whichever is later.

45. Before the submission of the first withdrawal application, the borrower should submit to ADB sufficient evidence of the authority of the person(s) who will sign the withdrawal applications on behalf of the government, together with the authenticated specimen signatures of each authorized person. The minimum value per withdrawal application is stipulated in the *Loan Disbursement Handbook* (2017, as amended from time to time). Individual payments below such amount should be paid by EDC and subsequently claimed to ADB through reimbursement, unless otherwise accepted by ADB. The borrower should ensure sufficient category and contract balances before requesting disbursement. ADB's Client Portal for Disbursement (CPD) system

²⁰ The handbook is available electronically from the ADB website (<https://www.adb.org/documents/loan-disbursement-handbook>).

²¹ Disbursement eLearning (https://wpqr4.adb.org/LotusQuickr/disbursement_elearning).

²² Following general business practices, ADB may accept digital form of the records, if appropriate controls are in place to avoid alteration to the original.

has been rolled out in Cambodia and the use of ADB's Client Portal for Disbursements (CPD)²³ system is encouraged for submission of withdrawal applications to ADB.

2. Disbursement Arrangements for Counterpart Fund

46. Counterpart funds will finance the costs for (i) land acquisition and safeguard mitigation measures (EDC), (ii) contingency (EDC), (iii) taxes and duties (government), and (iv) financial charges during implementation (government). EDC will receive a customs and sales tax exemption from the government on imported goods which is considered a counterpart fund contribution. Disbursement and liquidation of counterpart fund will follow government procedures.

V. RISK DESCRIPTION AND RATING

47. Based on the assessment, the key financial management risks identified are described in Table 4. The risk mitigation measures or risk management plan is outlined in Table 5.

Table 4: Risk Assessment

Risk Description	Risk and Impact	Likelihood	Rating
Country-specific weak PFM systems, particularly governance, transparency and accountability of public expenditures	Substantial – <i>chances of error, fraud or misappropriation remaining undetected</i>	Likely	Substantial
Shortage of external skills in financial management and auditing. Delays in submission of externally audited project accounts and annual audit may not meet ADB requirements	Moderate – <i>chances of error, fraud or misappropriation remaining undetected</i>	Unlikely	Moderate
Government may be unable to meet funding obligations due to budget constraints	Moderate – <i>delays in implementation</i>	Unlikely	Moderate

ADB = Asian Development Bank, PFM = public financial management
Source: Asian Development Bank.

Table 5: Risk Assessment and Risk Management Plan

Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
Inherent Risk		
Country-specific – weak PFM system, particularly governance, transparency and accountability of public expenditures	Substantial	ADB continues to support on-going efforts to strengthen PFM through technical assistance, including a proposed Technical Assistance Facility ^a
Entity-specific – shortage of skills in financial management, management accounting, financial reporting and internal audit	Low	EDC staff are familiar with ADB requirements from previous projects. Capacity will be further uplifted with assistance from ADB, by attending trainings. The accounting department is currently fully staffed. Spot and random checks of expenditures through review missions.
Overall inherent risk	Moderate	

²³ The CPD facilitates online submission of WA to ADB, resulting in faster disbursement. The forms to be completed by the Borrower are available online at <https://www.adb.org/documents/client-portal-disbursements-guide>

Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
Project Risk		
Implementing Entity – malpractice and abuse of PFM rules by employees	Low	EDC has strengthened internal audit controls in compliance with the Program Action Plan under Loan 3789-CAM. This required auditing of individual projects, which was previously not undertaken, and the provision of training in ADB requirements to all internal audit staff by December 2018.
Funds Flow – government may be unable to meet funding obligations due to budget constraints	Low	Project financing plan has been agreed with the government and restricted to a few project components to ensure availability of counterpart financing
Staffing – EDC has limited staff capability in financial management, accounting, budgeting, internal controls and financial reporting.	Moderate	EDC staff are familiar with ADB requirements from previous projects and have been trained in ADB project accounting and reporting requirements. Further training will be conducted during the project implementation
Accounting policies and procedures – Project accounting procedures introduces operational risk through manual processes.	Low	Use of MS Excel rather than accounting software creates some risk. This is mitigated by requirements to transfer all data annually from MS Excel files to EDC's accounting software. Internal and external audits ensure consistency and accuracy of data entries. Only authorized project managers and finance officers are permitted to enter data.
Internal audit – previously weak internal audit department	Low	The internal audit department has been made fully operational since end-2018 in compliance with the Program Action Plan under Loan 3789-CAM. This required auditing of individual projects, which was previously not undertaken, and the provision of training in ADB requirements to all internal audit staff by December 2018.
External audit – delay in the submission of externally audited project accounts due to limited capacity, annual audit may not meet ADB requirements	Moderate	Under current projects, externally audited project accounts have been submitted within 6–7 months (covenant of 6 months). EDC will apply CPSAS for reporting, in compliance with RGC instructions, from 2020 accounts, which meets ADB requirements for a fair presentation accounting framework. EDC will also provide financial projections in accordance with ADB requirements
Reporting and monitoring – unreliable reports due to errors and limited staff capability in ADB financial reporting requirements	Low	EDC staff are familiar with ADB requirements from previous projects and have been trained in ADB project accounting and reporting requirements. Project accounts are subject to internal and external audit. Further training will be

Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
		conducted during the project implementation
Information systems – accounting data not adequately safeguarded	Low	Regular back-ups to secured locations are undertaken. Access to financial management software and systems is limited to authorized project manager and financial officers.
Overall Project Risk	Low	
Overall (Combined) Risk	Moderate	

ADB = Asian Development Bank, CPSAS = Cambodian Public Sector Accounting Standards, EDC = Electricité du Cambodge, PFM = public financial management, RGC = Royal Government of Cambodia.

^a ADB. 2019. [Technical Assistance for Strengthening Project Readiness, Procurement and Financial Management in Southeast Asia](#). Manila.

Source: Asian Development Bank.

VI. PROPOSED TIME-BOUND ACTION PLAN

48. The proposed time-bound action plan is outlined below.

Table 6: Time-Bound Action Plan

Areas for Improvement	Mitigation Action	Responsibility	Timeframe
EDC's project financial statements follow the cash-basis in compliance with the Cambodia Public Sector Accounting Standard (CPSAS) and to be audited by external auditor	TOR for new external auditor, to be appointed in 2020, to include: <ul style="list-style-type: none"> Project financial statements to be audited in accordance with CPSAS to comply with ADB's requirement for a fair presentation accounting framework including an auditor's opinion The project financial statements to include a statement of budgeted against actual expenditures. The project financial statements to include a reasonable assurance by the external auditor that the loan proceeds were used only for the purposes of the project, of compliance with financial covenants contained in the loan agreements and the degree of compliance. 	EDC	Before loan effectiveness
Official confirmation of the exemption of payments under ADB projects from withholding tax will be obtained from MEF	<ul style="list-style-type: none"> EDC to submit letter to MEF requesting exemption of withholding tax. MEF subsequently to issue confirmation of exemption from withholding tax in the form of an official letter to EDC. 	EDC and MEF	Before loan effectiveness

Areas for Improvement	Mitigation Action	Responsibility	Timeframe
Financial projections will contain the required information to assess the financial position of EDC and compliance with agreed covenants	<ul style="list-style-type: none"> EDC to submit to ADB, on an annual basis by 31 December, summary financial statements (income statement, balance sheet, statement of cash flows) projections for the current and following fiscal year that enable assessment of projected compliance with agreed covenants 	EDC	December 2020 and annually thereafter
EDC accounting and internal audit staff will be trained in ADB requirements and procedures	<ul style="list-style-type: none"> EDC to ensure all staff involved in financial management and accounting for the proposed project and internal audit staff have received training or will do so within one year of loan effectiveness for existing staff and within one year of joining for new staff 	EDC	Annually

ADB = Asian Development Bank, CPSAS = Cambodian Public Sector Accounting Standards, EDC = Electricité du Cambodge, MEF = Ministry of Economy and Finance, TOR = terms of reference.

Source: Asian Development Bank.

VII. SUGGESTED FINANCIAL MANAGEMENT COVENANTS

49. The covenants of the Cambodia National Solar Park Project (Loan 3789-CAM) should be used for the project. Specifically, (i) EDC as the executing agency shall generate funds from internal sources equivalent to not less than 25% of the annual average of EDC's capital expenditures for that fiscal year, (ii) the net revenues of EDC as the executing agency shall be at least 1.3 times its debt service requirements, (iii) the ratio of debt to equity for EDC as the executing agency shall not exceed 70:30, and (iv) total accounts receivable shall not exceed the equivalent of three months' average sales revenues. These covenants ensure that EDC will remain able to fully service the project loan.

50. With regards to project reporting, the following requirements will apply:

- i) EDC will cause the detailed project financial statements to be prepared in accordance with CPSAS and an independent auditor to issue an audit opinion acceptable to ADB.
- ii) The audited project financial statements together with the auditor's opinion will be presented in the English language to ADB within 6 months from the end of the fiscal year by the EDC.
- iii) The audited entity financial statements will be submitted in the English language to ADB within one month after their approval by the relevant authority.
- iv) The audit report for the project financial statements will include a management letter and auditor's opinions, which cover (a) whether the project financial statements present an accurate and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting standards; (b) whether the proceeds of the loan and grant were used only for the purpose(s) of the project; and (c) whether the borrower or executing agency was in compliance with the financial covenants contained in the legal agreements (where applicable).

VIII. CONCLUSION

51. The financial management assessment indicates that the overall risk is moderate with the project-specific risks being low. Areas for improvements involve the improvement of project auditing and financial reporting to fully comply with ADB's requirements. EDC has committed to making the necessary changes to the terms of reference for the external auditor. EDC itself is familiar with ADB requirements and procedures and has satisfactorily implemented previous ADB projects.