

Cambodia

# Country Governance Risk Assessment and Risk Management Plan

ADB

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Asian Development Bank

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Asian Development Bank  
6 ADB Avenue, Mandaluyong City  
1550 Metro Manila, Philippines  
Tel +63 2 632 4444  
Fax +63 2 636 2444  
[www.adb.org](http://www.adb.org)

For orders, please contact:  
Department of External Relations  
Fax +63 2 636 2648  
[adbpub@adb.org](mailto:adbpub@adb.org)

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**Fiscal Year (January 1–December 31)**

# Currency Equivalents

(as of 21 October 2011)

Currency Unit	–	riel/s (KR)
\$1.00	=	KR4,104
KR1.00	=	\$0.00024

## Abbreviations

ACU	–	Anti-Corruption Unit
ADB	–	Asian Development Bank
CPS	–	country partnership strategy
DPP	–	Department of Public Procurement
FMIS	–	financial management information system
GACAP II	–	Second Governance and Anticorruption Action Plan
GDP	–	gross domestic product
GGF	–	good governance framework
GRARMP	–	governance risk assessment and risk management plan
IMF	–	International Monetary Fund
IPA	–	independent procurement agent
IRRPP	–	Implementing Rules and Regulations for Public Procurement
MEF	–	Ministry of Economy and Finance
MOEYS	–	Ministry of Education, Youth and Sports
MPWT	–	Ministry of Public Works and Transport
MRD	–	Ministry of Rural Development
NAA	–	National Audit Authority
NACC	–	National Anticorruption Council
NCDD	–	National Committee for Subnational Democratic Development

NGO	-	nongovernment organization
NPAR	-	National Program for Administrative Reform
OECD	-	Organisation for Economic Co-operation and Development
PEFA	-	public expenditure financial accountability
PFM	-	public financial management
PFMRDP	-	Public Financial Management for Rural Development Project
PFMRP	-	Public Financial Management Reform Program
RMP	-	risk management plan
SNA	-	subnational administration

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# Executive Summary

This is the first country-level governance risk assessment and risk management plan (GRARMP) for Cambodia. It has been prepared using the Second Governance and Anticorruption Action Plan (GACAP II) of the Asian Development Bank (ADB) and its implementation guidelines. The assessment is risk-based and looks both at risk in relation to fiduciary matters and broader governance risks to achieving satisfactory development outcomes. The approach is based around three core governance areas: public financial management (PFM), procurement, and corruption. Over time, governance assessments of key sector risks and program and project fiduciary risks in Cambodia will be carried out following the GACAP II guidelines. The existing good governance framework (GGF) methodology (which was introduced in 2007 prior to adopting the Guidelines for Implementing GACAP II) in place for monitoring governance risks in ADB-financed projects in Cambodia is likely to be phased out. This governance risk assessment is one of the diagnostic studies prepared to inform ADB's country partnership strategy (CPS) 2011–2013. It was developed concurrently with the CPS and discussed extensively with all relevant government stakeholders. To a large extent, approaches to mitigating major governance risks can only be successfully pursued if adequate resources and financing are provided. Thus, the recommendations of the risk assessment and risk management plan are related to future funding under the CPS.

Cambodia's political and institutional history has been dominated for long periods by conflicts, which were frequently based on ideology and quests for political power and security. Emergence of a unified state with fragile democratic underpinnings is mainly confined to the post-Khmer Rouge period. 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 reform.

Development planning and economic management approaches emphasize governance reform (particularly in a succession of medium-term planning documents). However, these plans have not always been backed by sufficient resources and commitments to achieve their stated objectives. Nevertheless, slow progress with governance has not hindered strong economic growth and poverty reduction over most of the past decade, with the exception of 2 years of stress (2008–2009) during the global downturn. However, despite generally sound economic management over this difficult period, revenue collection, while improving, remains low by regional standards. This places heavy reliance on official development assistance, disbursed primarily through inefficient and ineffective dual approaches to budgeting. While Cambodia's economy has grown strongly without significant governance reform, there is nothing to suggest that both governance and growth improvements cannot both be pursued in the period ahead.

After the brief introduction summarized above, section II of this governance risk assessment report provides the country overview and broad context for assessing governance in Cambodia. Section III provides the main body of the report and is divided into the three core parts of the assessment—PFM, procurement, and corruption.

The PFM assessment indicates gradual progress in its strengthening, mainly under the government's Public Financial Management Reform Program (PFMRP). A 2010 public expenditure financial accountability (PEFA) framework assessment was used as a key basis for assessment, along with recent

internal and external reviews of the PFMRP. Overall, PEFA ratings (based on a ratings scale of A to D) indicate a mixed but improving performance for Cambodia. Of the 29 items rated, only 2 (6.9%) are rated A; of the others, 4 are rated B (13.8%), 15 are rated C or C+ (51.7%), and 8 are rated D (27.6%). Both mean and median ratings tend toward Cambodia being a C-level PFM country, which is close to the norm for low-income countries at similar stages of development. To lift Cambodia's ratings into the A and B categories, a range of reform areas need to be addressed, and this will take time. A comparison of the 2010 PEFA results with an earlier country financial accountability assessment undertaken in 2002 indicates significant improvement (including progress with budget formulation, internal controls, treasury operations and cash management, accounting systems, and internal and external auditing).

A 2010 independent external assessment of progress with the PFMRP, which is based on a four-platform approach, also reveals steady improvement. The overall assessment indicates that platform 1 (enhanced credibility of the budget) is essentially complete (though with some items to be consolidated). Platform 2 activities (enhanced accountability and control, particularly in line ministries) commenced in December 2008. After some delays, platform 2 is managed under a streamlined activities list known as Catalyst Measures to Accelerate Platform 2 Implementation. The 2010 external assessment reviewed 33 platform 1 and commencement of platform 2 program activities undertaken over 2007–2009. Progress was rated on 29 performance indicators with the following results: 15 indicators have largely or mostly been met; 7 indicators have been partly met; 3 indicators have not been met; and 4 indicators could not be measured.

From the two recent PFM assessments and discussions with key government, development partners, and other stakeholders, an assessment was made of the main PFM risks likely to be experienced by the government and ADB in the future. These risks are elaborated upon in more detail in parts III, V, and VI of the assessment. The main broad risk areas are

- (i) legislative gaps, including implementing regulations under the 2008 Law on the Public Finance System, the implementing sub-decrees for the 2011 Law on the Financial Regime and Asset Management for Sub-national Administrations (the Law on Sub-national Finance), and tax and audit laws which require deepening;
- (ii) ratios of tax and nontax revenues to gross domestic product which, while improving, remain low by regional standards;
- (iii) technical weakness in the chart of accounts, accounting standards, and cash management;
- (iv) management of devolution to line ministries under platform 2;
- (v) management of major decentralization and deconcentration reforms, including functional and financial devolution to provinces and districts;
- (vi) implementing a complex financial management information system across ministries;
- (vii) inadequate civil service arrangements, including personnel management, wage policies, and overlaps in functional responsibilities;
- (viii) dual recurrent and development budgeting;
- (ix) weak internal auditing and reporting;
- (x) weak external auditing;
- (xi) slow implementation of the PFMRP; and
- (xii) need for significant PFM-capacity building at all levels of government.

The procurement assessment, which used a number of recent procurement diagnostic studies of the World Bank, ADB, and the Organisation for Economic Co-operation and Development (OECD), indicates limited recent tangible progress but concludes that significant reform work is well under way and could see important progress in the period ahead. A 2010 OECD baseline indicators study of procurement scored Cambodia at 1.5 points overall out of a possible 3 points, suggesting that the country is a middle-of-the-road procurement country. Legislative and institutional arrangements scored better (2 out of 3 for each) than was the case for operational practices, system transparency and integrity arrangements (1 out of 3 for each).

From the recent procurement assessments and discussions with key government, development partner, and other stakeholders, an assessment was also made of the main procurement risks likely to be experienced by the government and ADB over the coming years. Again, these risks are elaborated upon in more detail in parts III, V, and VI of the assessment, but briefly they are

- (i) a weak and fragmented legal system, with a draft law and separate foreign and domestic regulatory tracks;
- (ii) dual roles of the Ministry of Economy and Finance as a regulator and monitor also involved in individual procurement transactions;
- (iii) major operational inefficiencies and delays;
- (iv) use of noncompetitive bidding in some public procurements;
- (v) informal leakages;
- (vi) weak mechanisms for complaints and appeals;
- (vii) the exemption of key ministries from regulatory procedures;
- (viii) internal and external auditing that gives only minor attention to procurement systems and risks;
- (ix) limited audits of externally financed projects by the National Audit Authority (NAA);
- (x) lack of internet-based procurement;
- (xi) low penalties and lack of enforcement for breaches;
- (xii) the need for procurement capacities to be further developed at all levels of government, especially in line ministries and subnational administrations; and
- (xiii) little role for civil society in observing procurement processes or committees.

The anticorruption assessment (based on recent studies, surveys, and discussions with stakeholders) indicates important recent legislative and institutional developments that have prospects for future improvement but which have not yet achieved significant results. However, although some recent perception surveys suggest lower- and middle-level corruption is modestly improving, corruption remains a principal concern in Cambodia. Important new legislative developments have included penalty provisions in the new Law on the Public Finance System (2008), strengthening the penal code in relation to corruption offenses (2009), and passing the new Anti-Corruption Law (2010). Institutional work now focuses on the development of the Anti-Corruption Unit (ACU) provided for under the new law.

From the recent corruption assessments and discussions with key government, development partner, private sector, and civil society stakeholders, an assessment was made of the main corruption risks likely to be experienced in the future by the government and ADB. These broad risks are described in detail in parts III, V, and VI of this assessment, but briefly they are

- (i) corruption that remains significant and difficult to mitigate in the short term;
- (ii) stabilization of lower-level corruption, but no indication that this applies at higher levels;
- (iii) a legal framework that continues to be weak;
- (iv) major challenges in building capacities in the new ACU;
- (v) a legal and judicial sector (police, prosecutors, and courts) that remains weak but is critical to pursuing prosecutions;
- (vi) possible political interference with the ACU and oversight agencies such as the NAA;
- (vii) cultural constraints to questioning authority;
- (viii) fiduciary risks in some ADB priority sectors (education, public works, agriculture and rural development, private sector, and finance); and
- (ix) governance risks resulting from inadequate civil service management practices.

Section IV of the assessment briefly summarizes the main ongoing government reform programs that are of most relevance to the core governance areas of interest to ADB and also explores important interrelationships between them. The main reform programs are

- (i) the PFMRP,
- (ii) the Decentralization and Deconcentration Reform Program,
- (iii) the National Program for Administrative Reform, and
- (iv) the Legal and Judicial Program.

While development partners support the implementation of these reform programs, progress has been uneven. Gradual progress has been made on the PFM and decentralization and deconcentration reform programs. The National Program for Administrative Reform has also made some progress, but further development is required in areas relating to public service delivery, human resources management, capacity development, and compensation. There is concern too about the speed and depth of the legal and judicial reform program. Also, success of the NPAR (personnel management), PFMRP (resources), and decentralization and deconcentration reforms (subnational administration reforms) are mutually reinforcing and interdependent.

Section V summarizes the main risks and grades them according to seriousness and whether or not they are likely to be mitigated during the CPS period 2011–2013. The main risks align with the lists above for PFM, procurement, and corruption. In all, 30 risks are included: PFM (13 risks), procurement (9 risks), and corruption (8 risks). The final risks are presented in table form in section V.

Section VI summarizes the most serious risks and presents them in a risk management plan matrix, which sets out ADB mitigating actions (where feasible). The most serious risks and proposed ADB mitigation actions are presented in this section. There are 12 serious risks, divided into PFM (6 serious risks), procurement (2 serious risks), and corruption (4 serious risks). While quite a large number of ADB mitigation actions are listed in the matrix, in most cases the intended ADB actions fall into the following broad areas:

- (i) additional technical and financial support through activities of key government reform programs, particularly the PFMRP and the Decentralization and Deconcentration Reform Program;
- (ii) mainstream governance support for all ADB priority sectors (to address PFM, decentralization and deconcentration, procurement, and corruption risks at the sector level);
- (iii) longer-term support for internal and external auditing;
- (iv) support for updating the standard operating procedures, the procurement manual, and the financial management manual for externally assisted projects, and training government officials to use them under the ADB Public Financial Management for Rural Development Project (PFMRDP), (ADB 2008); and
- (v) support for the initial activities of the ACU (in collaboration with other development partners).

Appendixes 1–3 provide very preliminary risk assessments for three priority sectors in the CPS—education, transport, and the private sector. While sector assessments are not essential for the preparation of a countrywide assessment under the GACAP II guidelines, the preliminary exercise at the sector level has provided useful inputs for the country assessment. While less work on risk assessments and risk management plans (RMPs) has been done for these sectors, recent sector assessments, road maps, etc., provide useful insights into the nature of governance risk in these sectors. The nature of risk is somewhat different between major service delivery and infrastructure sectors (such as education and transport) and more policy-based sectors (such as private sector development). Nevertheless, Cambodia has very centralized PFM and procurement systems (and reform programs), and many of the risk issues found in the country-level GRARMP are very closely related to risks at the sector level. Significant additional

governance assessment work will be needed at the sector and program and project levels before putting in place a comprehensive set of country, sector, and program and project risk assessments and RMPs for ADB operations in Cambodia.

Appendix 4 reviews the existing GGF approach to risk mitigation measures at the project level and compares this to the risk assessments and RMPs under GACAP II. The risk assessments and RMPs under GACAP II look more broadly at governance risks at the country, sector, and program and project levels, while the GGFs focus mainly on governance risks at the project level. Nevertheless, at the program and project level, the two approaches have many similarities. It is therefore recommended that the GGF be gradually phased out and replaced by GACAP II risk assessments and RMPs at all levels. However, unless resources can be devoted to preparing the risk assessments and RMPs for both ongoing and new programs and projects, a gradual transition will be needed, with both GGFs and risk assessments and RMPs in operation until the GGFs are fully phased out.

1. This country governance risk assessment and risk management plan (GRARMP) for Cambodia has been prepared to inform the country partnership strategy (CPS) for 2011–2013. The plan aligns closely with the priority sector strategies prepared for the CPS and the resources allocated in the CPS to support governance improvement. It was also discussed extensively at all stages with all relevant government stakeholders.

2. This country-level assessment closely follows the Second Governance and Anticorruption Plan (GACAP II) (ADB 2006, 2008d) framework and guidelines of the Asian Development Bank (ADB) for preparing country-level governance risk assessments. In particular, it focuses closely on risk assessments and risk management plans (RMPs) for the three governance pillars of public financial management (PFM), procurement, and combating corruption. As set out in subsequent sections, the assessment draws on recent diagnostic studies undertaken in PFM, procurement, and corruption in Cambodia.<sup>1</sup> A list of publications reviewed appears in the References section.

3. This GRARMP report covers the main requirements of GACAP II for country-level assessments: country overview, findings, ongoing reforms, a summary risk management matrix, and a risk management plan. In addition, the terms of reference required addressing a number of matters beyond the normal GACAP II requirements for country-level assessments. These are addressed in four appendixes. Appendixes 1–3 provide preliminary risk assessments for the three priority sectors in the CPS. Appendix 4 reviews the current good governance framework (GGF) approach to managing and monitoring governance risk at the program and project levels, and makes recommendations for phasing it out and replacing it with the GACAP II approach.

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<sup>1</sup> Use of recent diagnostics and materials was supplemented by extensive dialogue and discussions held during two field missions, the first of which was for 18 days in May–June 2010, and the second for 12 days in mid-October 2010. Findings were presented in a retreat (June 2010) for a large group of ADB staff and advisers involved in preparing the CPS. This was followed up in October 2010 by two small group discussions with development partners and with nongovernment organizations (NGOs). Two workshops to review the draft assessment were held in May 2011 for officials from government and institutions.

## A. Preparation of the Second Governance and Anticorruption Action Plan Assessment in Cambodia

4. This is the first country governance risk assessment and risk management plan (GRARMP) prepared for Cambodia under the Second Governance and Anticorruption Action Plan (GACAP II) guidelines. The purpose of GACAP II is “to improve ADB’s performance in the implementation of the governance and anticorruption policies in the sectors and sub-sectors where ADB is active...and...to design and deliver better quality projects and programs” (GACAP II, para. 4). GACAP II is based around three core governance themes viewed as critical to poverty reduction and development effectiveness: public financial management (PFM), procurement, and combating corruption. These three themes apply at national and subnational levels and in ADB priority sectors, as well as at the project and program levels. The guidelines provide for a risk-based approach to governance assessment. Risk is dealt with in the context of reduced development effectiveness as a result of country and/or ADB systems allowing leakage or suboptimal use of national and/or ADB resources intended to promote development. GACAP II provides for the identification of such risks and, where feasible for ADB, for plans to mitigate the risks. ADB’s GACAP II approach explicitly calls for the use of related assessments where available and relevant. Public expenditure financial accountability assessments (PEFAs), for example, are particularly important and are normally expected to remain relevant for 3–4 years. The latest Cambodia Public Expenditure Financial Accountability (PEFA) assessment (Ministry of Economy and Finance 2010) was issued in 2010, based on research carried out in 2009. It is quite likely that reforms implemented since then will lead to improvements in the rankings.

5. A cascading approach to governance assessments is provided for with country-level GRARMPs. At a later stage, this guides the preparation of sector risk and program and project assessments and management plans. Cambodia’s first GACAP II assessment is a country-level assessment and risk management planning document addressing the first phase of this cascading approach. However, to the extent possible, preliminary sector-specific risks have been assessed for priority sectors under the country partnership strategy (CPS) 2011–2013 (Appendixes 1–3). Full sector risk assessments and management plans (and program and project assessments) will be addressed at a later stage under the GACAP II cascading arrangements.

6. As set out in the GACAP II guidelines, ADB uses a number of measures to monitor governance risks and develop risk management plans. These are country and sector assessments and plans, and program and project assessments and plans. At the country and sector levels, the quality and relevance of the risk management plans (RMPs) are assessed to provide inputs to the CPS and take into account key governance issues in the country portfolio review missions. At the program and project levels, risk assessments and RMPs are included in reports and recommendations of the President to the Board of Directors and should also be included in project administration manuals. The RMPs must be regularly monitored and reviewed during project review missions and, where appropriate, the risk assessments and RMPs will be revised. Insofar as they affect the risk assessments and RMPs, the outcomes of these project review missions must be reported to the government and be included in the aide-mémoire and the project performance report. These monitoring arrangements essentially overlap with approaches

to monitoring governance matters through good governance frameworks (GGFs), which are the responsibility of mission leaders. GACAP II essentially provides a mechanism for GGFs to be replaced at the project level by risk assessments and RMPs. An assessment of the GGF approach adopted by the Cambodia Resident Mission is provided in Appendix 4.

## B. The Historical and Political Context

7. Governance risks need to be considered in the context of the distinctive historical and political features that have shaped modern governance arrangements in Cambodia. For much of Cambodia's history, governance was structured along decentralized territorial lines, with particular regions and their leaders being very strong and independent for extended periods. The movement to a unified state with strong, central control and basic democratic forms of governance is relatively new, and mainly since the traumatic Khmer Rouge period (1975–1979). The nascent movement to democratic arrangements and citizen participation through national and subnational administration elections and decentralized communes are even more recent. Common governance themes through most historical periods have been

- (i) recurring conflicts in order to secure particular regions, and more recently, the nation;
- (ii) ensuring security through strong links between the dominant political party, government, and business;
- (iii) wide acceptance by citizens of the directives of political and government leaders, with little citizen participation until quite recently;
- (iv) limited experience with holding managers accountable for results or with the requirements of modern PFM or procurement systems;
- (v) continuing strong, centralized territorial management, through centrally appointed governors and officials with links to political leaders and senior government officials; and
- (vi) recent heavy reliance on foreign funding for a dual-stream national budget.

8. While moves to strengthen democratic forms of governance are well under way, they need to be considered in the context of the past and current reality of a state with fragile democratic and governance underpinnings. Governance reforms are likely to be pursued if they enhance Cambodia's international reputation and quest for external financing. However, tensions can arise in the design and implementation of governance reforms, especially when the interests of political leaders are not being met. While the identification of governance risks under the GACAP II methodology was relatively straightforward, implementing effective mitigating actions has proven more difficult. Delays have often led development partners to revert to their own parallel systems in order to reduce fiduciary risk, and this in turn has often been at the cost of development effectiveness. If aid is to achieve better results, more trusting approaches in governance and fiduciary arrangements are needed by both government and development partners.

## C. Cambodia's Current Development Strategies

9. The government adopted the Rectangular Strategy for Growth, Employment, Equity, and Efficiency Phase 2 (Royal Government of Cambodia 2008) to guide national development. The Strategy remains central to the National Strategic Development Plan Update (2009–2013), (Royal Government of Cambodia 2010). With the overall goal of “poverty reduction and economic growth through enhancement of agricultural sector development,” the Rectangular Strategy is founded on principles of good governance, peace, political stability, social order, macroeconomic stability, partnership, and economic integration. Thus the Rectangular Strategy and successive development plans highlight the need to improve the governance environment, including implementation of the first (2001–2004) and second (2005–2008) governance action plans and their five crosscutting reform areas. These are

- (i) administrative reform and anticorruption measures;
- (ii) legal and judicial reform;



- (iii) decentralization and deconcentration;
- (iv) economic and financial reform; and
- (v) social sector development and reforms in the armed forces, land policies, and natural resources management.

Governance action plans also recognize that reform is a lengthy and challenging process due to the need to build institutional and human capacity. Nevertheless, many of the reform areas are progressing less quickly than envisaged, although progress is being made in core planning and toward the goals of poverty reduction and economic growth. However, a positive correlation between governance reform and economic development is not always observed; indeed, despite high economic growth from 1998–2008, relatively modest gains have been achieved in governance reforms.

## D. The Economic Context

10. Before the significant global economic downturn in 2008–2009, Cambodia's economy performed exceptionally well, with real annual gross domestic product (GDP) growth averaging 9.1% over 1998–2008. The economy then faced two independent external shocks: a spike in inflation from much higher global oil and food prices in mid-2008, and the onset of the global financial crisis beginning in late 2008 that led to a severe downturn in growth. Through late 2008 and 2009, the two global crises created major challenges for Cambodia's economic management. Key growth sectors—particularly garments, tourism, and construction—declined, though agriculture, which employs the bulk of the population, held up somewhat better. Expansionary monetary and fiscal policies (on both the revenue and expenditure sides) boosted domestic demand and helped prevent a major recession, with GDP growth virtually stagnant for 2009. In 2010, GDP growth returned to a reasonable 6.3%, with ongoing recovery in the garment and tourism sectors, and, to a lesser extent, in construction. Government macroeconomic management during this challenging period has been favorably recognized by international institutions, including the 2010 International Monetary Fund (IMF) Article IV mission.

11. As well as returning to solid (though still below potential) economic growth, inflation declined from 35.6% at the end of May 2008 to 3.1% at the end of 2010. Deflation actually set in for part of 2009 during the depths of the contraction. The finance sector withstood the crisis reasonably well, with no systemic or major institutional failures. Fiscal policies remain accommodative and the government has recognized a need to reduce fiscal deficits of around 6%–7% of GDP to levels closer to balance, as prevailed in the pre-crisis period. Public sector debt remained modest at around 28% of GDP in 2010, though the external balance was critically dependent on official aid inflows, with current account deficits of around 11.0%. Successful macroeconomic management during the most challenging economic environment in decades is a major positive indicator of improving governance in Cambodia. ADB guidelines stress the importance of PFM in relation to governance improvements, and the starting point for improved PFM must be a sound macroeconomic base. The international community should give due credit to Cambodia for this aspect of its governance arrangements in response to a global crisis which had its roots in poor economic governance in Europe and the United States.

## E. The Institutional Context for Governance Reform

12. Governance reform occurs in a complex environment where there is a close interaction between the ruling political party and government leaders at all levels—central, provincial, municipal, district, and commune. Business is also closely linked to both political and government leaders. Institutional arrangements are often described in the Cambodian literature in terms of patron–client relationships

influenced by political connections.<sup>2</sup> Even where formal and legalized accountability arrangements are in place, informal arrangements often override these and reinforce the political leadership. While strategic and policy documents since the development of the Rectangular Strategy place governance at the center of the government's stated intentions, implementation has only occurred gradually. Nevertheless, Cambodia must be viewed in the context of its history, and it cannot simply be judged through the prism of western culture and values. Within the areas of PFM, procurement, and anticorruption assessed in this report, there are complex institutional arrangements (section III reviews these arrangements in some detail). In general, all three demonstrate strong elements of central control at bureaucratic and political levels. The Ministry of Economy and Finance (MEF) has been dominant in terms of PFM and procurement policies and practices. The Office of the Prime Minister, the Council of Ministers (including the Council for Administrative Reform), and ministers in the legal and judicial sector have controlled the broader agenda in relation to public administration reform and corruption matters.

## F. ADB's Country Partnership Strategy 2011–2013

13. The CPS 2011–2013 was endorsed by the ADB Board in July 2011, following government endorsement in May 2011. The CPS focuses on five priority sectors—transport; water supply, sanitation, and urban development; agriculture and natural resources; education and training; and finance—and a facilitating sector—public sector management. The CPS poverty alleviation objective will be achieved through two strategic objectives: (i) inclusive economic growth through investments in physical infrastructure, support to vocational training, support to agriculture and irrigation, finance sector development, integration into regional economies, and support to the private sector and economic diversification; and (ii) social development and equity, through basic education, water supply and sanitation services, social protection measures, and community-based development in the Tonle Sap provinces. Five drivers of change in ADB's Strategy 2020 (ADB 2008f) are introduced as crosscutting in the CPS strategic framework: private sector development and private sector operations, governance, gender equity, knowledge solutions, and partnerships. The CPS builds on the earlier country strategy and program 2005–2009 (ADB 2005) (extended to 2010 in the midterm review in 2007) (ADB 2007a) to pursue more rigorous direct and indirect forms of support for better governance. The CPS fully addresses key governance risks identified in GRARMP, which include direct governance interventions supported in the pipeline (PFM, procurement, and anticorruption) and attempts to mainstream governance issues in all the priority sectors and at the project and program levels.

14. Four crosscutting themes or challenges are embodied in the CPS: environment and climate change, decentralization, urban–rural links, and regional cooperation. This framework and the related pipeline of planned assistance emphasizes good governance through support to PFM at national and subnational levels, to the decentralization program, and to anticorruption initiatives. The public sector management facilitating sector will include a broad range of initiatives, including

- (i) decentralization and deconcentration: implementing the first 3 years (2011–2013) of the National Program for Sub-National Democratic Development, which includes strengthening the subnational administration fiscal legislation and PFM capacities; clarifying the assignment of functions; and funding local infrastructure, better aligning sector interventions with the decentralization and deconcentration reforms, particularly specific and/or conditional funding through the Sub-National Investment Facility;

<sup>2</sup> Three main political parties have dominated Cambodian politics since the early 1990s: the Cambodian People's Party (CPP), FUNCINPEC (Front Uni National pour un Cambodge Indépendant, Neutre, Pacifique, et Coopératif), and the Sam Rainsy Party (SRP) opposition party. The Norodom Ranariddh Party (split from FUNCINPEC) and the Human Rights Party were established prior to the 27 July 2008 parliamentary election. In the 2008 election, the fourth since the Paris Peace Accords of 1991, the CPP won 90 seats out of 123, giving it more than the 50+1 majority required under the Constitution to form a government. FUNCINPEC is still a minor coalition partner.

- (ii) PFM reforms: continuing support in the rural development ministries, financial accountability framework (accounting and internal control systems), strengthening internal and external auditing, raising the MEF's debt management capacities, and strengthening standard operating procedures;
- (iii) anticorruption measures: implementing the Anti-Corruption Law, which includes strengthening the Anti-Corruption Unit; and
- (iv) capacity building: in economic policy, change management, and leadership.

15. The GACAP II arrangements will be applied at the project level to better mitigate fiduciary risks through tighter PFM and procurement arrangements and monitoring, including strengthening complaint handling mechanisms and sanctions and penalties—all of which are high priorities for ADB. The CPS programs \$70 million over 3 years (14.5% of the total) directly devoted to public sector management through two decentralization and deconcentration projects (in 2012 and 2013) and a project to promote economic diversification. While this level of technical and investment funding may not appear to fully match the strategic emphasis of the CPS on governance, it should be noted that sector interventions will include significant support to improve governance through institutional development. In addition, preparatory work for programs directly supporting governance reform in the next CPS will be carried out.

## A. Public Financial Management

### 1. Overview of Recent Diagnostic Studies

16. The various components of public financial management (PFM) assessed below (paras. 17–20) draw closely on recent substantive diagnostic work in the PFM field, particularly a 2010 public finance management assessment, based on the public expenditure financial accountability (PEFA) assessment framework (Ministry of Economics and Finance 2010) and a 2010 external review of the government’s Public Financial Management Reform Program (PFMRP). Quarterly monitoring reports of the PFMRP and interviews with key government and nongovernment stakeholders are also incorporated.

17. Table 1 summarizes the overall ratings<sup>3</sup> for key components of PFM under the PEFA assessment. While individual parts of PFM ratings are discussed in more detail below (paras. 21–30), the overall ratings indicate a mixed assessment for Cambodia. Of the 29 items rated, only 2 (6.9%) are rated A; 4 are rated B (13.8%), 15 are rated C or C+ (51.7%), and 8 are rated D (27.6%). While single systemwide ratings are not recommended under the PEFA assessment methodology, both mean and median ratings rate Cambodia as a C-type of PFM country.<sup>4</sup> The ratings indicate that there is a broad range of reform areas to address before Cambodia can lift most of its ratings into the B and A categories, and this is likely to take considerable time. This governance assessment found a wide range of PFM weaknesses that are strategically important for risk management. As this is the first PEFA assessment for Cambodia, it is not possible to make direct comparisons with earlier PEFA assessments. Nevertheless, given that significant progress has been made since commencement of the PFMRP in 2004, it seems likely that PEFA assessment scores in the early to mid-2000s would have been significantly lower than the 2010 scores. This is borne out by comparing the 2010 study with a 2002 financial accountability assessment. While comparisons between studies conducted with different ratings systems are difficult to make, quite significant improvement appears to have been made since the rather gloomy 2002 assessment. These improvements apply to virtually all of the major areas of fiduciary risk identified in 2002, including weaknesses in budget formulation, internal controls, treasury operations (especially in cash management), accounting systems, and internal and external auditing.

18. The government-led PFMRP is one of four pillars for improving good governance. The PFMRP is supported by a large number of development partners, under an umbrella arrangement. The project commenced in late 2004 and envisaged progress through four successive platforms over 2004–2015:

- (i) increased budget credibility to deliver reliable and predictable resources to budget managers;

<sup>3</sup> Note that the PEFA assessment ratings system provides for both overall single dimension ratings and multidimension ratings where performance in one aspect of the rating is likely to affect performance in other areas of the ratings. For simplicity of presentation, only the overall rating is provided in Table 1, but a “+” sign is shown where other dimensions of scoring for that particular rating are higher. The overall PEFA assessment ratings range from D (the worst possible) to A (the best possible).

<sup>4</sup> This is a fairly common single-level rating for a low-income country such as Cambodia and should not be construed as meaning Cambodia is too far from the norm for countries at a similar stage of development.

**Table 1** Overall Public Expenditure Financial Accountability Framework Assessment Ratings, 2010

Public Financial Management Component	Rating
<b>A. Credibility of the Budget</b>	
A1. Aggregate expenditure outcome compared to original approved budget	B
A2. Composition of expenditure outcome compared to original approved budget	D
A3. Aggregate revenue out-turn compared to original approved budget	A
A4. Stock and monitoring of payment arrears	C+
<b>B. Comprehensiveness and Transparency</b>	
B1. Classification of the budget	C
B2. Comprehensiveness of information in budget documentation	B
B3. Extent of unreported government operations	C
B4. Transparency of intergovernmental fiscal relations	C+
B5. Oversight of aggregate fiscal risk from other public sector entities	C+
B6. Public access to key fiscal information	C
<b>C. Policy-Based Budgeting</b>	
C1. Orderliness and participation in the annual budget process	A
C2. Multiyear perspective in fiscal planning, expenditure policy, and budgeting	B
<b>D. Predictability and Control in Budget Execution</b>	
D1. Transparency of taxpayer obligations and liabilities	B
D2. Effectiveness of measures for taxpayer registration and tax assessment	C
D3. Effectiveness in collection of tax payments	D+
D4. Predictability in availability of funds for commitment of expenditures	C+
D5. Recording and management of cash balances, debt, and guarantees	C+
D6. Effectiveness of payroll controls	D+
D7. Competition, value for money, and controls in procurement	C
D8. Effectiveness of internal controls for nonsalary expenditure	C
D9. Effectiveness of internal audit	D+
<b>E. Accounting, Recording, and Reporting</b>	
E1. Timeliness and regularity of accounts reconciliation	C
E2. Availability of resource information received by service delivery units	C
E3. Quality and timeliness of in-year budget reports	C+
E4. Quality and timeliness of annual financial statements	D+
<b>F. External Scrutiny and Audit</b>	
F1. Scope, nature, and follow-up of external audit	D+
F2. Legislative scrutiny of annual budget law	Not Rated
F3. Legislative scrutiny of external audit reports	Not Rated
<b>G. Development Partner Practices</b>	
G1. Predictability of direct budget support	C
G2. Development partner financial information given for budget reporting on project and program aid	D
G3. Proportion of aid that is managed by use of national procedures	D

Source: Ministry of Economy and Finance. 2010. *Public Financial Management Assessment of Cambodia—Based on the PEFA*. Phnom Penh.

- (ii) more effective financial accountability through improving internal controls and holding managers accountable;
- (iii) improved linkage of priorities and service targets to budget planning and implementation; and
- (iv) integration of accountability and review processes for both financial and performance improvements.

While some blurring of activities between platforms has emerged, the government and its external reviewers regard platform 1 as essentially complete (though with some items to be consolidated over time), with platform 2 activities formally commencing in December 2008. A very long list of activities initially planned for platform 2 was recently condensed into a shorter list known as the Catalyst Measures to Accelerate Stage 2 Implementation. In this regard, the key output areas currently being pursued are as follows:

- (i) **Platform 1 consolidation:**
  - (a) strengthening revenue policies (particularly nontax revenues),
  - (b) cash management, and
  - (c) procurement.
- (ii) **Platform 2 catalysts:**
  - (a) identifying budget entities and/or managers;
  - (b) internal controls for line ministries;
  - (c) budget classifications;
  - (d) national accounting standards;
  - (e) implementing the financial management information system (FMIS);
  - (f) pursuing a range of capacity building measures;
  - (g) devolved institutional strengthening, functional reviews, change management, and FMIS piloting;
  - (h) implementing further wage incentives (temporarily through the Priority Operating Costs Scheme); and
  - (i) strengthening reform program management.

19. The recently completed external advisory panel assessment of progress with the PFMRP reviewed 33 program activities (platform 1 and commencement of platform 2) undertaken over 2007–2009, and rated progress in relation to 29 indicators or subindicators as follows: of the 29 indicators, 15 had been met or mostly met, 7 had been partly met, 3 had not been met, and 4 could not be measured. Good progress was recorded with regard to

- (i) tax revenue administration,
- (ii) budget preparation,
- (iii) budget execution,
- (iv) macro-fiscal discipline,
- (v) debt management,
- (vi) streamlining the commitments and payments system,
- (vii) decreasing the use of cash transactions,
- (viii) consolidating bank accounts and strengthening the Treasury single account,
- (ix) reporting,
- (x) linking civil service recruitment to the budget,
- (xi) capturing externally financed investment in financial plans and statements, and
- (xii) developing systems and human capacities.

20. Nevertheless, ongoing weaknesses in some areas were noted and foreshadowed as major challenges for the consolidation of platform 1 and the implementation of platform 2. These included

- (i) developing the internal audit function;
- (ii) further strengthening revenue administration, especially compliance;
- (iii) further improving cash and bank account management;
- (iv) addressing delays in functional reviews and change management planning for the FMIS;
- (v) implementing a difficult and complex decentralization and deconcentration program;
- (vi) implementing institutional reforms in response to the FMIS and decentralization and deconcentration reforms, and devolving more responsibilities to line ministries;
- (vii) further strengthening external audit and legislative oversight; and
- (viii) addressing the need for better harmonized and coordinated development partner support to the program, including greater use of general budget support to reduce high transaction costs, pursue increased use of government systems, and record development partner expenditures in the public accounts (enhanced use of general budget support is likely to require further progress with PFM reforms to increase development partners' confidence in Cambodia's fiduciary systems and PFM performance).

## 2. Legislative and Policy Framework

21. The Law on the Public Finance System (2008) is basically modern (though highly centralized) in nature and, with some exceptions, provides an adequate basis for progressive implementation of the PFMRP. More than 2 years later, not all of the required enabling subdecrees have been finalized, including arrangements for streamlined budget execution, which continues to occur in line with earlier subdecrees. The 1997 Laws on Taxation and Customs (and related subdecrees, guidelines, etc.) regulate the collection of tax and customs revenues, while a government order (2006) regulates nontax revenue collections. The Audit Law (2000) regulates external and internal audit matters. Subdecrees (2006) provide some further details on audit procedures, etc., but they are brief and further subdecrees are being worked on, particularly for the external audit function under the National Audit Authority (NAA). There are significant legal and policy issues in relation to the reform of procurement arrangements (these are covered in detail in paras. 34–48). Very significant policy and legislative issues remain to be resolved with regard to the implementation of decentralization and deconcentration reforms. The revised Constitution (1999) and the Law on Administrative Management of the Capital, Provinces, Municipalities, Districts, and Khans (Organic Law 2008) provide the core foundations for the decentralization and deconcentration reforms. The Law on Administrative Management of Communes and Sangkats (2001) is also of fundamental importance as it ushered in the commencement of local-level democracy, albeit with the provision of limited authorities, functions, or funds.

22. There is the need to harmonize the implementation of the Organic Law (2008) and the Law on the Public Finance System (2008), with the latter taking a far more centralist approach to the preparation and approval of subnational administration (SNA) budgets and also to PFM. The new Law on Subnational Finance provides an important opportunity for harmonization. There are also many issues to resolve with regard to the assignment of taxes to SNAs, with one recent proposal being to devolve powers in relation to property taxes. In summary, important areas of risk in the legal and policy areas relate to

- (i) finalizing subdecrees for the Law on the Public Finance System;
- (ii) gradually strengthening the main taxation, customs, and nontax revenue laws and enabling regulations;
- (iii) providing more procedural substance under the Audit Law;
- (iv) harmonizing the implementation of the Organic Law and the Law on the Public Finance System; and

- (v) finalizing the subdecrees related to the Law on Sub-national Administration Finance, including those that will address
  - (a) revenue assignments;
  - (b) the system of fiscal transfers between central and subnational levels; and
  - (c) the regulation of planning, budgeting, and public financial management arrangements in the SNAs.

### 3. Institutional Arrangements and Capacity

23. The Ministry of Economy and Finance (MEF) exercises strong central control over public finance matters, including the PFMRP. A dual budget system has emerged, with the MEF in charge of preparing and managing the recurrent budget while the Ministry of Planning ostensibly has powers to prepare and manage a public investment program. Most externally financed investments involve development partners dealing with line ministries, the Council for the Development of Cambodia, and the MEF's Department of Investment Cooperation. This department prepares and manages the externally financed development budgets. The MEF's Financial Affairs Department, General Department of Treasury, Public Procurement Department, and the Cash Management Units are all closely involved with budget execution. The Financial Affairs Department has financial controllers located in 21 key ministries, which is indicative of the central control model which has been applied, though significant devolution of responsibilities to line ministries is planned under platform 2 of the PFMRP. The Taxation and Customs and Excise departments are also part of the strong MEF structure.

24. Complex arrangements are in place to manage the PFMRP, decentralization and deconcentration, and public administrative reform. For the PFMRP, amended arrangements have recently been put in place to increasingly involve the line ministries under platform 2. The key arrangements include

- (i) the Economic and Financial Policy Committee chaired by the minister of economy and finance and including ministers and/or high-level officials from line ministries,
- (ii) the MEF Reform Commission chaired by the MEF secretary of state with all MEF directors as members,
- (iii) the Public Finance Management Reform Steering Committee chaired by the MEF secretary of state and including directors general and/or secretaries general in charge of budget and finance matters in all line ministries,
- (iv) the Steering Committee Secretariat,
- (v) PFM reform working groups in all ministries chaired by line ministry representatives to the PFM reform steering committee, and
- (vi) the technical working group to allow interface with the development partners' working group on the PFMRP.

The National Committee for Subnational Democratic Development (NCDD), which is an interministerial body led by the Ministry of Interior, is responsible for implementing the decentralization and deconcentration reforms. The NCDD aims to play a cross-government coordination role through its four main senior-level subcommittees (policy, functions, finance, and personnel). The NCDD faces many challenges in trying to ensure that related reforms, especially in public administration and PFM, are closely integrated with decentralization and deconcentration reform efforts. Public administrative reform, decentralization and deconcentration, and the PFMRP are mutually reinforcing, and hence close coordination among these reform initiatives is critical.

25. In summary, institutional and capacity challenges present significant risks, particularly as more responsibilities and accountability are devolved from the MEF to the line ministries and SNAs. The most important risks will include managing the implementation of a new FMIS across many



ministries; managing the decentralization and deconcentration reforms, including functional and financial devolution to provinces and districts; and developing appropriate, sustainable, and broadly based wage incentives for civil servants.

#### 4. Budget Formulation

26. Platform 1 of the PFMRP has focused on budget credibility for more than 5 years and solid achievements have been made. The recent PEFA assessment exercise has rated revenue forecasting performance as A, mainly because of very conservative approaches to revenue forecasting. Aggregate expenditure control has also been solid (rated B). As a result, the significant problems with payment arrears experienced in the early 2000s have been eliminated, which is a major achievement. However, there continue to be major deviations between original budget allocations and the final funds received, though most deviations led to more funds than those planned. In large part, this reflected overly conservative revenue forecasts (allocative performance is rated as D). In general, the linkage of policy to budgeting has scored well (A for orderliness in process and B for developing a multiyear perspective). However, sub-items relating to the lack of integration between the capital and the recurrent budgets score less well (at C).

27. Development of medium-term budget strategic plans for most ministries and costed sector strategies for priority sectors (including health and education) are seen as having contributed to better and more credible budget formulation. While revenue administration and revenue collection performance have improved in recent years, ratios of tax and nontax revenues to gross domestic product (GDP) in Cambodia remain quite low by international standards, and lifting revenue performance remains a critical challenge and a risk to better budget formulation. In terms of comprehensiveness and transparency in budget formulation and presentation, the picture is somewhat mixed. Information included in the budget is graded as relatively comprehensive (B). However, budget classification systems remain inadequate (C) because they do not yet adequately provide for programs or for classification of functions of government functional reporting. Efforts are being made to address continuing significant off-budget transactions (revenue collections withheld by ministries; operations of public sector entities, enterprises, and institutions; and significant amounts for transactions directly managed by development partners, mainly grants or technical assistance).

#### 5. Budget Execution

28. Predictable and well-controlled budget execution arrangements generally scored poorly in the PEFA assessment, though better than in the 2002 country financial accountability assessment. Slow progress is not entirely surprising as many of the execution and accountability issues are to be addressed in the second and third platforms of the PFMRP. In terms of revenue execution, the transparency of taxpayer obligations and liabilities scored relatively well (B) with few exemptions or discretionary items in a relatively clear Taxation Law and through reasonable distribution of tax information. However, appeals mechanisms, especially in Customs, are not yet adequate. Other revenue areas were less well rated, particularly (i) measures for taxpayer registration and assessment that are inadequate, especially due to the absence of taxpayer registration numbers for personal salary taxes (presently the law does not require individual registration for salary tax), difficulties in imposing penalties for nonregistration, particularly in Customs, and limited fraud and tax audit investigation capacities, especially in Customs (rated C); and (ii) effectiveness in taxation collection that is particularly weighed down by high and growing tax arrears levels and limited capacity for collecting tax arrears (rated D+).

29. In terms of expenditure, budget execution remains relatively weak, with C and D grades in all the categories reviewed. This includes

- (i) predictability in availability of funds (C+) due to limited capacities with cash flow planning and wide use of the contingency component of the reserves allocation;

- (ii) recording and management of cash balances, debt, and guarantees (C+) due to limited availability of management reports and failure to record contingent liabilities in the case of guarantees for hydro-electricity projects;
- (iii) low effectiveness of payroll controls (D+) due to long delays in updating personnel records and because the NAA and internal auditors have not yet conducted any payroll systems audits;
- (iv) inadequate competition and value for money in procurement (C);
- (v) low effectiveness of internal controls for nonsalary expenditure (C) due to poor controls over the single-line, domestically financed, investment budget, excessive signatory requirements for small transactions causing processing delays (these have been significantly reduced in recent years), the presence of off-budget revenue items, and insufficient controls over some advances (addressed in subdecree 155 on advances in 2009); and
- (vi) low effectiveness of internal auditing (rated D+) due to limited capacities for systems or performance audits, limited scope and distribution of internal audit reports, and apparent limited follow up on internal audit reports and recommendations.

## 6. Intergovernmental Financial Arrangements

30. The PEFA assessment methodology gives a somewhat superficial analysis of intergovernmental relations and does so purely from a central government perspective. Of the three sub-areas reviewed,

- (i) the formula for calculating grants to communes was not regarded as fully transparent (rated C), because the population and poverty data used is not published;
- (ii) communes are considered to receive information from central government on their transfer levels on a timely basis (rated A); and
- (iii) consolidated reporting of commune financial performance was considered inadequate or not reported (rated D).

Beyond matters reported in the PEFA assessment, there are many difficulties in existing deconcentrated financing arrangements for central government ministry offices located in provinces and districts, including

- (i) very constrained operational funding (particularly at district levels) that greatly limits capacity to provide services; and
- (ii) negligible access to capital and development funding.

Where funding (mainly via externally financed projects) is available, it tends to be closely managed by the ministry head office in Phnom Penh. There has also been quite limited central, provincial, or district support to developing capacities of the communes, including capacities to design and implement projects. Revised financial arrangements for the new phase of decentralization and deconcentration reforms are still being worked out under the new Law on Subnational Finance, and arrangements for central transfers, SNA management, and reporting are likely to involve significant risks and challenges.

## 7. Budget Accounting and Reporting

31. Budget oversight for risks from other public entities and enterprises is not sufficiently monitored, consolidated, and reported on (rated C). Public access to fiscal information is also only rated C- as full budget documentation is only available to the public after approval of the budget by the National Assembly. However, in terms of end-of-year financial reports and external audits, some improvement has recently occurred through public release of the audited 2006 public accounts. The 2007 and 2008 accounts have been audited, though are not yet finalized and released (and are waiting for adjustments by the MEF). Other indicators in relation to accounting and reporting are in the C and D grades, including

- (i) lack of timeliness and regularity of accounts reconciliation (C), mainly due to deficient procedures with advances;
- (ii) inadequate information available to service delivery units (C) due to poor information flows, especially for investments;
- (iii) inadequate quality and timeliness of in-year budget reports (C+), including problems of recording actual expenditures with regard to orders and commitments, and slowness in receiving information on investment and project spending from project implementation units, and
- (iv) inadequate quality and timeliness of annual financial statements (D+) due to
  - (a) poor quality and incomprehensive consolidation of information
  - (b) missing or partial information on externally financed projects,
  - (c) taking more than 15 months for annual statements to be submitted to the NAA, and
  - (d) lack of clear national or international accounting standards.

## 8. External Audit and Oversight

32. The scope, nature, and follow up on external auditing, scores poorly at D+. Considerations were:
- (i) only around 50% of central government entities are covered by an external audit and the breadth of audit work undertaken within entities is limited;
  - (ii) there are delays in getting final audited reports to the National Assembly; and
  - (iii) there is limited keeping of records or information to confirm the extent of follow up on findings and recommendations made to the National Assembly.

Since the PEFA assessment report was completed, decisions have been taken to make the annual financial audit statements public, and the statement for 2007 has been released. In late 2010, draft sub-decrees on detailed audit procedures and standards, on procedures for internal and external audit interfacing, and on a protocol of engagement between the NAA and the National Assembly, including arrangements for follow up actions regarding audit findings and recommendations, were at their final stages. The NAA was peer reviewed by the Office of Auditor General of New Zealand, and has adopted actions to implement the main findings and recommendations. For projects financed by ADB, the MEF Department of Investment and Cooperation contracts out the audits to private audit firms. The NAA plays a very limited oversight role for the audits which external auditing firms submit to the MEF and ADB. Given NAA constraints and concerns about the private auditing profession in Cambodia, one short-term measure might be for ADB to train private auditing firms to better understand ADB's requirements for high-quality audits. Despite the PEFA assessment's D+ rating, the NAA has made solid progress in recent years and, given its important strategic role in monitoring and managing governance risks, further ADB support in the years ahead is warranted.

## 9. Development Partner Practices

33. Development partner's practices score poorly under the PEFA assessment, as follows:
- (i) predictability of direct budget support scores C; while the level of direct budget support is not significant, its' scheduling has been unpredictable;<sup>5</sup>
  - (ii) financial information provided by development partners for budget reporting scored D, particularly in relation to grants and technical assistance and some investment financed by the People's Republic of China; and

<sup>5</sup> However, in conflict with this finding, a Paris Declaration monitoring survey conducted in 2009 suggested the predictability rate in Cambodia was 93%.

- (iii) the proportion of aid that is managed by national procedures is very low indeed (mainly limited to budget support, which is only about 5%–10% of development partner assistance) and thus scores D.<sup>6</sup>

The PEFA assessment is quite critical of development partner practices, arguing that projects are uncoordinated and there is excessive use of technical assistance. The report argues that if development partners are serious about implementing the Paris Declaration, they will need to take on more risk and provide more financing in the form of direct budget support, which would allow for better-allocated budgets, including provision of scope for broadly based increases in civil service wages. Greater use of government systems could significantly reduce the transaction costs of doing business. The report argues that the fiduciary risks to development partners have been somewhat overstated and need to be considered in relation to the higher risks of diminished development effectiveness if existing practices continue.

## B. Procurement

### 1. Overview of Recent Diagnostic Studies

34. The procurement section of this assessment has relied heavily on recent detailed procurement assessments undertaken for Cambodia, including

- (i) a 2004 World Bank country procurement assessment report (World Bank 2004),
- (ii) a 2010 preliminary procurement baseline indicators study prepared under the Organisation for Economic Co-operation and Development (OECD) guidelines,<sup>7</sup> and
- (iii) a draft procurement study as part of the 2010 World Bank Integrated Fiduciary Assessment and Public Expenditure Review.<sup>8</sup>

The assessment also benefited from discussions with senior procurement officials in the MEF (both the MEF's Department of Public Procurement [DPP] and the Department of Investment and Cooperation) and with a number of consultants and the procurement specialist working on procurement reform and capacity building, including those employed by ADB, IMF, and the World Bank. Most findings of the assessment are presented in paras. 35–48.

35. The 2004 country procurement assessment report pointed to major legislative, institutional, and capacity concerns in Cambodia's procurement arrangements. Issues included

- (i) a fragmented legal framework which lacked the presence of a clear and authoritative guiding law;
- (ii) procedures and guidelines that were far from international best practice;
- (iii) major concerns with arrangements for public–private partnerships, build–operate–transfer arrangements, etc., where concessions were possible without competitive selection and negotiation;
- (iv) fragmented and weak arrangements for SNA procurement, particularly at the commune level;
- (v) limited capacities at all levels, but particularly in the line ministries; and

<sup>6</sup> The Cambodia Resident Mission considers this rating is not relevant to ADB-financed projects which use government standard operating procedures and related systems for domestic competitive bidding (though ADB procedures are still used for international competitive bidding).

<sup>7</sup> As summarized in Appendix 1 of the External Advisory Panel (2010). Note that a more detailed study under the OECD guidelines is due to be completed in 2011.

<sup>8</sup> No report on this study is yet available, though broad issues and likely findings were discussed with those involved in the study.

- (vi) the dual roles of the MEF which, through the Department of Public Procurement and the Department of Investment and Cooperation, was heavily involved in procurement while at the same time attempting to play a monitoring and regulatory role.

The main recommendations were for a strong guiding procurement law supported by a single set of implementing regulations and procedures, with the MEF withdrawing from procurement by devolving responsibility to line ministries, and instead taking on a key regulatory and monitoring role. To support such changes, considerable training and capacity building will be needed. While elements of the 2004 recommendations have been implemented (e.g., more detailed procedures and guidelines for externally financed investments and some further devolution to the ministries), many key parts of the legal, institutional, and capacity building recommendations are still to be completed.

36. Using OECD guidelines, the 2010 baseline indicators study scored Cambodia overall at 1.5 points out of a possible 3.0, indicating that Cambodia is a middle-of-the-road country. The legislative and institutional arrangements scored better than operational practices, system transparency and integrity. Different elements of this study are reported in subsequent subsections, which basically follow the four OECD pillars. Table 2 presents the high-level results.

**Table 2** Ratings Using the Organisation for Economic Co-operation and Development Procurement Baseline Indicators

OECD Pillar	Rating (from 0 to 3)
1. Legislative and Regulatory Framework	2
2. Institutional Framework and Management Capacity	2
3. Procurement Operations and Market Practices	1
4. Integrity and Transparency in the Procurement System	1
<b>Overall Rating</b>	<b>1.5</b>

Source: Appendix 1 of the External Advisory Panel. 2010. *External Advisory Panel Report on the Public Financial Management Reform Program*. Phnom Penh.

37. As well as detailed procurement assessments, additional reporting suggests that there are major challenges in implementing the procurement arrangements currently in place. A 2011 MEF request for additional procurement training listed some of the challenges identified in the joint ADB–World Bank 2009 and 2010 portfolio reviews. These reviews blame procurement delays for slow project implementation, and procurement deficits include lack of a unified set of procurement rules and procedures, lack of skilled human resources, and lack of adequate enforcement. The need for greater transparency in public procurement is a common perception in Cambodia. However, the government has begun to put policies and procedures in place to improve governance, including passing and implementing the 2010 Anti-Corruption Law. While the World Bank's independent procurement agent (IPA), introduced for World Bank-financed projects in Cambodia in 2006, may reduce corrupt practices in procurement, the World Bank's fiduciary supervision mission in April 2009 concluded that using the IPA has significantly reduced government capacity. IPA arrangements, which were introduced as a result of irregular practices in seven World Bank projects, are described as slow and cumbersome and not sustainable; they reduce government ownership of the process and lead to aid ineffectiveness. To complement overall procurement reforms under the PFMRF, comprehensive support for developing human resources and institutional capacity is clearly needed.

38. ADB considers the most important difficulties in procurement to be
- (i) slow decision making by the procurement review committees,<sup>9</sup>
  - (ii) MEF involvement in procurement review committee decision making,

<sup>9</sup> The MEF reported that efforts are being made to improve this by delegating greater decision-making authority to staff who attend procurement review committee meetings.

- (iii) the absence of an institution for training procurement professionals, and
- (iv) too little use of advance procurement and other avenues for speeding up consultant recruitment.

As set out in more detail in Appendix 4, ADB responded to concerns about fiduciary aspects of procurement by introducing good governance frameworks (GGFs), starting in 2007. These aim to develop appropriate fiduciary safeguards, both at the time of project approval and also for the purposes of monitoring fiduciary risks during project implementation.

## 2. Legislative and Regulatory Framework

39. As in many countries, the legal and regulatory procurement framework is fragmented, particularly with regard to domestically and internationally financed procurements. There is further fragmentation, depending on whether international projects are bilateral or multilateral. As discussed, the World Bank's previous arrangements for a harmonized approach have been compromised by its move to an IPA in 2006. While attempts had been made for many years to unify procurement processes through use of a single strong law, no such law or guidelines are in place yet. The main regulatory framework for domestically financed procurement falls under the Procurement Sub-decree (1995) and the detailed instructions issued in a prakas (ministerial regulation) (1995 and updated in 1998 and 2010). The Implementing Rules and Regulations for Public Procurement (IRRPP), Subdecree 105 (2006) bound all government entities (including the subnational authorities) to the same procurement regulatory regime, though with important exemptions for defense, police, and projects with social content. A 2006 prakas also provided for some devolution of procurement from the MEF to agreed line ministries—based partly on performance-driven thresholds for different types of procurement. A draft prakas was under preparation in late 2010 to establish public procurement committees and procedures for SNA levels, as part of the decentralization and deconcentration reforms. Standard operating procedures, a procurement manual, and a financial management manual were issued for externally assisted projects by a 2006 subdecree, and initially applied to projects financed by the World Bank and ADB. These manuals were under review in 2011, and by the end of the year were likely to undergo revisions for thresholds and other matters. International competitive bidding for World Bank and ADB projects is not directly addressed in these manuals; instead such procurement relies on the broader ADB–World Bank procurement guidelines.

## 3. Institutional Framework and Capacity

40. At the central government level, the MEF has been the lead agency with regard to procurement policy, operations, monitoring and regulation. This has been divided into domestically financed procurement being managed by the DPP, and externally financed procurement being managed by the Department of Investment and Cooperation (for projects executed directly by the Government of Cambodia). Since 2006, there has been gradual devolution of responsibilities for procurement from the MEF to the line ministries, which are each required to prepare an annual procurement plan.

41. The joint annual portfolio reviews between ADB, the World Bank, and the MEF indicate major bottlenecks in both domestic and internationally financed project procurement, suggesting weak capacities in the regulatory regime. Capacity constraints occur in both the MEF and the line ministries but are particularly severe in many line ministries. This is especially the case for ministries that have limited experience or training in the systems in place and where senior ministers and officials lack willingness to delegate responsibilities. In terms of auditing, all procurement is potentially subject to internal auditing. Regarding external auditing, the NAA tends to focus on domestically financed procurement, while most foreign-financed external audits are subcontracted by the MEF to private (usually international) audit companies. Development partners have raised concerns about the high costs (but paradoxically low quality) of private auditors, and the NAA's inadequate resources and capacity. Partly as a result, the

NAA has started to gradually include audits of selected externally financed projects in its annual audit plan, though it will take some time to develop the capacities needed to expand such activities. A special Procurement Audit Office has been in place in the DPP since 2000 and though early assessments indicated it had limited staff and capacities to monitor procurement government-wide, it has conducted procurement audits in around 18 ministries, and in almost all 24 provinces, at subnational levels. While the IRRPP provides for complaints to be lodged with the executing agency and the DPP, there is no independent mechanism for considering and adjudicating such complaints.

42. A complaints handling mechanisms workshop was organized by ADB and the World Bank in June 2010 with 75 participants from executing agencies. This workshop was held because people negatively affected by external projects tend to have little knowledge of the complaints process. Workshop feedback indicated that (i) complaints mechanisms will not work unless they are executed agency-wide; and (ii) disclosure policies are elaborated, e.g., by wider use of project websites and disclosure tracking sheets for review by executing agencies and ADB mission leaders.

#### 4. Procurement Operations

43. As discussed previously, difficulties with regulatory, institutional, and capacity arrangements impact procurement operations, frequently leading to delays, irregularities, and problems with procurement and thus with the disbursement of funds in government and externally financed projects. Compliance performance indicators, as provided for under OECD guidelines, have not yet been prepared but are likely to indicate low operational efficiency scores once these are calculated.

44. Operations proceed most smoothly under the guidelines for domestically financed projects (and the recent issue of an IRRPP should support this, providing adequate training is provided in their usage). However, greater domestic efficiency is often achieved through use of shortcuts that breach the guidelines (such as excessive use of force account procurements). The PEFA assessment indicates that, of contracts reviewed by the DPP during 2006–2008, only 34% of contracts that should have used competitive bidding actually did. Much of the use of noncompetitive force account tendering occurs through provincial public works departments, which cite exceptional reasons for not going through competitive bidding, as provided for in an “exceptions list” in the prakas.

45. Of the two procurement systems for externally assisted projects, the standard operating procedures and their associated documents are widely considered to be more efficient than the World Bank’s IPA approach, which has experienced major inefficiencies.<sup>10</sup> Nevertheless, the standard operating procedures are being revised to address such issues as threshold levels, contract management, complaints handling mechanisms, and the structure of procurement committees. However, no fundamental restructuring of the existing approach is likely. ADB gives increased attention to supporting and monitoring procurement and has in place two full-time positions at its Cambodia Resident Mission to support project-related procurements, though such intensive resources are not available for procurement management of programs or projects handled by ADB staff in Manila.

46. Other operational difficulties common to both the domestic and international procurement guidelines include

- (i) limited understanding of the rules and guidelines in many line ministries and inadequate training in relation to their usage, though since 2010, the ADB-financed PFMRDP<sup>11</sup> has provided the training, primarily for the three rural development ministries;

<sup>10</sup> One recurring complaint of development partners and government officials in relation to the PFMRP has been extreme delays in procurement through the World Bank-managed trust fund account for the PFMRP.

<sup>11</sup> ADB. 2009f. *Strengthening Public Financial Management for Rural Development*. Manila.

- (ii) ineffective systems for storage and retrieval of key procurement documents and contracts;
- (iii) limited use of computers at any stage of the procurement cycle;
- (iv) inadequate procedures and mechanisms for receiving and dealing with complaints and disputes;
- (v) inexperienced members of procurement review committees who lack knowledge about how to evaluate bids and proposals, despite the fact that (in the case of externally financed projects) the standard operating procedures and procurement manual set out the roles, responsibilities, and procedures with reasonable clarity (suggesting that further capacity building is needed);
- (vi) considerable confusion in the roles and responsibilities of project directors, project managers, project staff, and consultants;
- (vii) slow decision making due to the involvement of many government officials in the procurement review committees; and
- (viii) heavy reliance on international consultants to expedite the work of procurement review committees.

## 5. Integrity of Public Procurement

47. Few, if any, complaints are received by executing agencies and, even when complaint mechanisms are known, potential complainants are afraid of retaliation by authorities and/or contractors. Much of the public sector leakage that occurs in Cambodia is thought to occur in and around the systems applied in both domestically and externally financed procurement. Significant leakage is also thought to occur after the awarding of contracts, suggesting that contract management by executing agencies is weak and that penalties are seldom enforced. (Issues of corruption in procurement and other areas are discussed in more depth in section III-C.) The broad perception of public procurement in Cambodia is that it lacks transparency and integrity. However, though corruption is thought to be sizable, allegations are rarely proved or acted on. Procurement specialists with significant experience in Cambodia are suspicious that tendering agencies and bidders engage in a wide range of irregular practices, including,

- (i) rigged specifications,
- (ii) limited publicity of bid opportunities,
- (iii) collusion between bidders and procurement review committees (or key members),
- (iv) a wide expectation on the part of all bidders that the winner will have to pay a fair margin if selected, and
- (v) falsification of key information in bid evaluation reports.

Also, there are suspicions (as yet not acted on) that some executing agency senior officials control some local consulting firms, who then tie up with foreign consulting firms when bidding on projects.

48. Other technical issues that are thought to constrain good procurement include

- (i) lack of enforcement mechanisms and weak and/or nonapplied penalties (which until the recent passing of the Anti-Corruption Law have mainly been of an administrative nature);
- (ii) weak oversight, especially for domestically financed procurement, with a need to strengthen internal, special, and external audits of procurement systems and capacities as well as technical audits;
- (iii) the absence of provisions in procurement regulations adequately addressing conflicts of interest, and of specific penalties to punish fraud and corruption in public procurement (while such provisions are called for in the Anti-Corruption Law, they will also eventually need to be addressed in the proposed procurement law);
- (iv) limited civil society involvement as observers and under the new procurement law;
- (v) lack of professional accreditation or a code of ethics for public procurement practitioners (though in 2010 the MEF sought World Bank support for this); such might be considered as one of the legal instruments for the procurement law;



- (vi) urgent need to develop more effective mechanisms for processing complaints and appeals; and
- (vii) risk averse lower-level executing agency staff who request numerous procurement “no objections” from ADB and the World Bank, even when not required, and thus slow project implementation.

## C. Corruption

### 1. Overview of Recent Developments

49. Corruption at all levels has long been regarded as the main area of concern for improving the business environment and overall governance in Cambodia, and this remains the case. Important new legislative developments have emerged, including the Public Finance System Law (2008), strengthening of the penal code in relation to corruption offenses (2009), and the passing of the Anti-Corruption Law (2010). Institutional work is now focusing on the early development of the anticorruption unit provided for under the new law. While no major new diagnostic studies on corruption appear to have been undertaken, development partners have become more active in this field in recent years and have been further energized following adoption of the Anti-Corruption Law. Important work in developing international responses to corruption in Cambodia through the commissioning of a report (and related workshops) by the U4 Anti-Corruption Resource Centre in Bergen has been undertaken by development partners, led by the Swedish International Development Cooperation Agency (Sida) and Danish International Development Assistance (Danida) (U4 Anti-Corruption Resource Centre 2010a). Also, regular surveys of citizens’ perceptions of corruption continue.

### 2. Public Perceptions

50. While citizen perception surveys typically place Cambodia among the lowest two deciles of countries in the world in terms of corruption ratings, domestic perceptions of lower-level corruption seem to have stabilized somewhat and suggest a modestly improving situation in recent years. Results of various recent rating exercises are as follows:

- (i) Transparency International’s Corruption Perceptions Index scored Cambodia at 2.3 out of a possible 10.0 in 2005, 2.1 in 2006, 2.0 in 2007, 1.8 in 2008, 2.0 in 2009, and 2.1 in 2010.<sup>12</sup> This places Cambodia in the lowest two deciles in terms of international rankings.
- (ii) A 2010 survey of 2,031 Cambodian households on perceptions of everyday corruption, conducted by PACT (an advocacy nongovernment organization [NGO]) with Danida support (Confederation of Danish Industry 2010), concluded that corruption remains a serious issue for citizens (second only behind the high cost of living). However, householder corruption perceptions have improved moderately compared to a similar survey conducted 5 years earlier. Conclusions of the 2010 survey indicate that
  - (a) there was high awareness of the Anti-Corruption Law (77%);
  - (b) people do not accept corruption, though gift-giving to officials is an accepted custom;
  - (c) fewer bribes are being paid, though the need to provide incentives remains widespread;
  - (d) trust in government institutions, especially local institutions, has increased;

<sup>12</sup> See [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi](http://www.transparency.org/policy_research/surveys_indices/cpi). Transparency International is explicitly specified as an independent source in the Second Governance and Anticorruption Action Plan’s implementing guidelines.

- (e) though their ratings have improved, the police, judges and courts, public registry, taxation, and customs, as well as the education system, continue to be perceived as the most corrupt institutions;
  - (f) people using government services are those that pay the most (women pay more than men); and
  - (g) urban citizens pay more bribes than rural citizens (though as a proportion of income rural citizens pay more).
- (iii) Trends in the World Bank Governance Indicators (subcomponent on control of corruption) have declined over the past 10 years, with Cambodia assessed as 8.6% in 2009, down from 22.8% in 2000 (World Bank 2010b). Interpretation of this score indicated that in 2009, Cambodia ranked higher than only 8.6% of the 213 countries included in that year's survey.
- (iv) In the World Bank's 2009 Enterprise Survey (World Bank 2009b), more than 50% of firms identified corruption as the major constraint to investment and doing business in Cambodia.

### 3. Legislative and Policy Framework

51. Until quite recently, the legislative and policy framework for seriously addressing corruption in Cambodia was quite weak. High-level policy pronouncements, such as the Rectangular Strategy and successive national development plans, did give significant attention to addressing governance and corruption issues as core constraints on development. However, they had not been backed by solid legislative and institutional reforms. An earlier anticorruption unit was established under the Council of Ministers in 2006 but was not effective. Legal and judicial reform has been implemented to address corruption, including through the provision of enhanced integrity in key areas, including the police, courts, prosecutors, and judges. Unfortunately, of the various reform programs, this is broadly perceived as the least effective of all and a major bottleneck to reducing incentives to undertake corrupt activities. The implementation of public administration reform has made progress on a number of fronts, but low civil service wages are not favorable for anticorruption practices. Furthermore, sanctions under the public sector financial management legal framework have been quite weak until recently, though introduction of the Audit Law and the new Law on the Public Finance System provide a basis for stronger oversight and enforcement to stop public financial management (PFM) irregularities. Details on issues concerning the development of the PFM legal and regulatory regime and oversight agencies (particularly the NAA) were discussed in section III-A.

52. After more than a decade of unsuccessful attempts to develop an effective anticorruption legal framework, the Anti-Corruption Law was promulgated on 17 April 2010, following the passage of the Penal Code (2009), which defines corrupt acts that are criminal offenses (the code became effective in October 2010). While experts in anticorruption legislation rarely agree on all matters (and a number of clauses in the new law have certainly been criticized), there is fairly broad agreement that the Cambodian Anti-Corruption Law is of some considerable substance. It should have a serious impact on the corruption environment, provided it is not subjected to political interference and the institutional arrangements are properly resourced financially and in terms of skilled and professional workers. The main short-term test of the law will be the manner and extent to which the newly established National Anticorruption Council (NACC) and the ACU are able to successfully pursue their mandated tasks and achieve early successes.

53. The following are important features of the Anti-Corruption Law:

- (i) corrupt offenses as defined in the law are criminal offenses under the Penal Code;
- (ii) measures to combat bribery by foreign firms are defined (Article 33);
- (iii) a National Anti-Corruption Council oversees an independent ACU, which will implement policies, conduct investigations, pursue prosecutions, etc.;
- (iv) finance will come from the national budget and technical and financial support will be provided by the international community;

- (v) specified persons (including politicians, ministers, senior civil servants, police, military, the judiciary, etc.) are all required to lodge (and regularly update) statements of personal assets and liabilities (note that spouses and related parties are not required to lodge statements and statements can only be referred to if a formal investigation or prosecution is under way);
- (vi) wide powers are given to professional staff of the ACU (as judicial police officers) to conduct investigations. This is in line with procedures in the Penal Code, with prosecutions eventually pursued in the criminal court by the public prosecutor;
- (vii) significant penalties are provided for convicted offenders (including those who do not submit financial statements or submit them falsely), including fines and jail sentences that range from 7 days to 15 years (depending on the nature of the offense);
- (viii) courts can order seizure of all assets found to be derived from corrupt activity; and
- (ix) extradition proceedings and mutual judicial assistance may be pursued if offenders have fled abroad.

#### 4. Integrity Institutions, Systems, and Administrative Capacities

54. Important institutions that are part of the system for providing oversight and integrity in Cambodia are as follows: the inspectorate of the MEF (which has investigative powers right across the public sector);<sup>13</sup> internal auditing within the MEF, in line ministries, and in SNAs; the NAA; the police; public prosecutors; the judiciary; and the new NACC and ACU. (The PFM oversight agencies have been addressed separately in section III-A.) Ongoing efforts at strengthening inspection, internal audit, and external audit will be crucial for development of the institutional framework needed to improve accountability in the public sector.

55. Anticorruption work requires good coordination and cooperation with the police, prosecutors, and the court system. The new anticorruption framework established in Cambodia provides investigators with certain policing powers but does not provide for special prosecutors, courts, or judges. At times it is likely that ACU investigators will need the support of the police in the course of their investigations and in making arrests. The court system, specifically prosecutors and judges, must be efficient, competent, transparent, and accountable. The report of the Technical Working Group on Legal and Judicial Reform indicates that such attributes are not adequately present in Cambodia.

56. In the short run, progress with implementing the ACU is likely to be the most important institutional matter regarding anticorruption activities. The ACU is just completing its establishment in terms of office accommodation and movement to fuller staffing levels. As noted, it does have a relatively strong legal framework to work within and much will depend on its resourcing and management and staff skills and commitment. Important elements of the start-up phase include the following:

- (i) finalization of a mission statement and medium-term strategic action plan by the NACC and finalization of a 2-year action plan by the ACU;
- (ii) developing a three-pronged strategic approach—education, prevention, law enforcement—and public support;
- (iii) developing strong partnerships with others in interlinked agencies (justice, defense, interior, line ministries, SNAs, civil society, media, etc.);
- (iv) finalizing the ACU organizational structure, based on four vice-presidents and two main general directorates, with a number of key departments—including administration and finance; staff (personnel) and training; security; asset and liability declaration; legal

<sup>13</sup> Parts of MEF's inspection responsibilities are likely to be gradually reduced over time as the internal audit units now being established in the line ministries become stronger.

- affairs, complaints, and international cooperation; education, prevention, and obstruction; technology and analyses; and investigation and intelligence—and offices in all provinces and municipalities;
- (v) developing work systems and procedures;
  - (vi) recruiting staff, starting with the transfer of 50 staff from the predecessor Anti-Corruption Unit and it is hoped that a further 200 staff will be employed in the near future, with final estimated staff numbers of around 500;
  - (vii) setting the ACU's minimum level of budget at 0.02% of gross domestic product (GDP), starting in 2011;
  - (viii) quickly establishing a system for receiving complaints;
  - (ix) quickly moving toward early processing and investigation of complaints;
  - (x) as part of prevention, establishing systems for monitoring ministerial anticorruption plans;
  - (xi) launching the assets declaration system;
  - (xii) studying areas highly vulnerable to corruption;
  - (xiii) establishing a team to monitor licensing and contracts; and
  - (xiv) developing, and commencing to implement, a strong public education program.

57. In terms of administrative capacity, the new ACU has many challenges to overcome and it remains to be seen if it can become administratively and operationally effective. It has renovated rundown office buildings and needs to move from an initial staff of around 50 to around 250 persons. However, it will not be easy to recruit and train a further 200 skilled professionals (mainly lawyers and finance professionals). There is also an initial lack of equipment, and development partners are being asked to support office establishment, equipment acquisition, and the provision of training and capacity building for staff.

## 5. Rule of Law

58. The legal framework for anticorruption management and also to some extent for PFM sanctions, has only very recently been established. Accordingly, it is not yet possible to determine if such laws will be effectively implemented. More broadly speaking, there are instances in Cambodia where the laws are not impartially applied or are inadequately enforced to suit the needs of interest groups. Examples include confiscation of lands, breaches of taxation and customs laws, and bribes paid to police to avoid fines and other penalties due under the law. Limited progress of reforms in the Legal and Judicial Reform Program provide evidence of constraints experienced in applying the rule of law in Cambodia. Public perceptions of high levels of corruption in the police, prosecutors, and the courts are also testament to limitations in the rule of law.

## 6. Voice and Accountability

59. Cambodia is a new democracy and Cambodians are not accustomed to voicing their concerns to authority either through advocacy or democratic processes. However, with some growth in the strength of civil society, including NGOs and the media, there is greater willingness to speak out against corruption. Development of communes, and related decentralization and deconcentration reforms that are currently under way, could enhance participation and the “voice” of local people, as well as the accountability of elected and nonelected officials. However, a significant body of literature on the nature of entrenched patron–client relationships in Cambodia indicates that achieving accountability is likely to be slow, as those outside the dominant political structures have few political rights or voice.

60. A number of development partners have sought to increase the people's voice through reducing or abandoning supply-side interventions and pursuing demand-side approaches. One 2010 demand-side study indicated that civil society is weak in Cambodia for three main reasons:

- (i) many citizens, particularly those in rural areas, do not have a culture of questioning authority;
- (ii) many NGOs appeal to development partners in an attempt to leverage reforms (e.g., they find it difficult to question government); and
- (iii) sections of civil society, such as chambers of commerce, are highly politicized (U4 Anti-Corruption Resource Centre 2010d).

In addition, many NGOs are not familiar with government standard operating procedures and development partner processes, which restricts their capacity to act against irregularities.

## IV

# Ongoing Reforms

61. Governance reforms occur in the context of broad national planning and a complex and formalized series of related government reform programs. The overall framework is provided for in the Rectangular Strategy and the National Strategic Development Plan, with broad objectives for growth and poverty reduction underpinned by strategic principles of good governance, peace, political stability, social order, macroeconomic stability, partnership, and economic integration. Efforts to improve the governance environment were set out in the first and second Governance Action Plans (2001–2004 and 2005–2008), which provided for five crosscutting reform areas:

- (i) administrative reform and anticorruption;
- (ii) legal and judicial reform;
- (iii) decentralization, deconcentration, and police affairs;
- (iv) economic and financial reform; and
- (v) social sector development and reforms in the armed forces, in land policies, and in natural resources management.

Largely because of development partners' continuing role in financing the public sector development budget in Cambodia, very formalized and complex bureaucratic arrangements (the likes of which are not seen in many countries) have been put in place to prepare, manage, and evaluate different fields of reform, including governance-related reforms. The main formal reform programs closely related to this current assessment are the National Program for Administrative Reform (NPAR), the Legal and Judicial Reform Program, the Decentralization and Deconcentration Reform Program, and the Public Financial Management Reform Program (PFMRP).

62. All four of these reform programs have related technical working groups (forums for the government and development partners to discuss sector and/or program developments) and development partner working groups (which allow development partners to discuss among themselves sector and/or program matters). The government and development partners also meet through the broader-based Government–Donor Coordination Committee. Some sectors have implemented sector-wide approaches that provide harmonized arrangements for channeling external support to reform programs. Other development partners employ delivery models that are consistent with a program-based approach. Development partners are well represented in all four governance-related reform programs, with formal participation typically of 10–16 development partner members, though two or three usually take the lead for particular sectors.

63. The findings reflected above in section III of this report summarize assessments of progress in the design and implementation of relevant parts of the four government reform programs. Thus, it is not considered necessary to go deeply into the nature of the four programs here. Briefly, the PFMRP is most central to this governance assessment in that it covers the main areas of public financial management (PFM) and procurement that have been assessed, and it addresses important areas of auditing and oversight. This program has been running since late 2004 and is assessed as stable and well regarded, though platform 1 of the reforms has taken longer than anticipated (5 years) and the recently commenced platform 2 is more challenging and may well take longer unless there are calls for urgency. The Decentralization and Deconcentration Reform Program, which has a close relationship with the PFMRP, has been running for a similar period. It is also assessed as stable and well regarded, though preparation of the 10-year national program and the initial 3-year implementation plan have progressed

slowly, in part because not all government ministries are moving at the same pace. Large challenges lie ahead in implementing the Decentralization and Deconcentration Reform Program, implying significant risks but also opportunities for enhancing accountability. The administrative reform program is of crucial importance to outcomes for PFM, decentralization and deconcentration, and corruption reduction, particularly through the development of modern, merit-based, and transparent personnel management practices; a legal framework to support the deployment of civil servants; and developing a civil-service-wide wage system, consistent with macroeconomic stability, equity, and efficiency.

64. The NPAR has made progress on a number of fronts but further development is required in areas relating to public service delivery, human resources management, capacity development, and compensation. The Legal and Judicial Reform Program has important implications for addressing corruption in Cambodia, including through the provision of enhanced integrity in key areas, including the police, courts, prosecutors, and judges. Significant progress is required in this program, which is broadly perceived to have made the least progress of all of the various government reform programs, and is a major bottleneck to reducing incentives to undertake corrupt activity.

65. Under the governance action plans and the four reform programs mentioned, it was recognized at the outset that reform would be lengthy and challenging due to the need to build institutional and human capacities. Nevertheless, as elaborated in the findings in section III, many reform areas are progressing less quickly than initially hoped. The immediate challenge, therefore, is to build on earlier work and increase the speed and quality of reforms in all four areas.

# Summary Country Risk Matrix

	Risk Identified	Likely	Relatively Serious	Not Mitigated During CPS	Major Risk (all 3 ticked)
<b>A. PFM</b>					
<b>1. Legislative and Policy Framework</b>					
1.1	Subdecrees and prakas (ministerial regulations) under the Law on the Public Finance System are not complete and there also is the need to harmonize the implementation of this law and the Law on the Financial Regime and Asset Management for Sub-national Administrations (Law on Sub-national Finance). Legal uncertainties mean risks to sound PFM.	✓	✓	✓	
1.2	The Law on Sub-national Finance was adopted in 2011. Implementing subdecrees, including a subdecree on district and municipality funds, and prakas are required. The longer it takes to approve these implementing legal instruments, the more risks these would pose to the quality of PFM at subnational levels.	✓	✓		
<b>2. Institutional Arrangements and Capacity</b>					
2.1	Challenges in devolving responsibilities and accountabilities from the MEF to line ministries, including implementation of a new devolved FMIS. Risks that platform 2 of the PFMRP will be slow and difficult.	✓	✓		
2.2	Challenges in managing the decentralization and deconcentration reforms, including functional and financial devolution to provinces and districts. Risks of slow implementation of decentralization and deconcentration reform with continued inadequate public services at decentralized levels.	✓	✓		
2.3	Personnel management and public sector wages policies may remain inadequate. The risks of such systems include low labor productivity and disincentives for anticorruption practices.	✓	✓	✓	✓
<b>3. Budget Formulation</b>					
3.1	Ratios of tax and nontax revenues to GDP remain very low. Slow implementation of tax policy reforms reinforce risks of non-sustainable budgets and continued weak public services delivery, especially if development partner fatigue sets in further.	✓	✓	✓	
3.2	Major structural issues persist in formulating the budget, including uncertainties over entity allocations, dual capital and development budgets, a chart of accounts at an early stage of implementation, and many off-budget transactions. All mean risks for budget effectiveness.	✓	✓	✓	

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## Continued

	Risk Identified	Likely	Relatively Serious	Not Mitigated During CPS	Major Risk (all 3 ticked)
4.	<b>Budget Execution</b>				
4.1	Inefficiencies in tax and customs revenue administration and collections systems add to risks of unsustainable budgets and continued weak delivery of public services.	✓	✓	✓	
4.2	Technical areas of budget execution and control remain weak, including cash planning, debt management and credit line reporting, payroll controls and audits, and control of the domestic investment budget. Failure to address these weaknesses diminishes budget effectiveness and integrity.	✓	✓		
4.3	Internal auditing is improving but still weak. Without effective internal audit units in all line ministries there are risks that further devolution of powers to ministries will occur without adequate accountability and control mechanisms.	✓	✓		
5.	<b>Budget Accounting and Reporting</b>				
5.1	Internal and external budget reporting is improving but still weak. Internal budget reporting, especially for investments, is limited while the quality and timeliness of annual financial statements needs strengthening. There are risks to the transparency, integrity, and accountability of PFM if reporting does not improve.	✓	✓	✓	
6.	<b>External Audit and Oversight</b>				
6.1	External auditing is improving but still weak. Strengthening the NAA must address wider entity coverage, better quality audits, backlogs, and follow-up of findings and recommendations. Without an effective NAA there are risks of leakages and perceptions of a low-integrity system. The NAA should gradually expand the scope of audit of externally financed projects. Development partners should consider direct funding for external audits of externally assisted projects.	✓	✓		
7.	<b>Development Partner Practices</b>				
7.1	Development partners' practices fall short of international best practice, including low and unpredictable budget support, limited on-budget reporting, low use of government procedures, and excessive use of small projects and TA. Risks here include a poorly structured and dualistic budget and weak personnel and wages policies.	✓	✓		
B.	<b>Procurement</b>				
1.	<b>Legislative and Regulatory Framework</b>				
1.1	Fragmentation of the legal framework for procurement resulting in inefficiency and leakages in procurement. There is need for a single integrated law and regulations that cover external and domestic procurement at all central and subnational levels, including externally assisted projects.	✓	✓	✓	
2.	<b>Central Institutional Framework and Capacity</b>				
2.1	There is no independent regulator or monitor of procurement and there is a need for more effective complaints and appeals mechanisms. Reforms are required to avoid the risks of conflicts of interest and leakages.	✓	✓	✓	

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## Continued

	<b>Risk Identified</b>	<b>Likely</b>	<b>Relatively Serious</b>	<b>Not Mitigated During CPS</b>	<b>Major Risk (all 3 ticked)</b>
2.2	Striking a balance between rigid international procurement systems and Cambodian capacities is needed in revised procurement manuals and procedures. Risks to low fiduciary standards need balancing against risks of delays and development opportunity costs for rigidity.	✓	✓		
2.3	Further devolved capacity building is needed in line ministries and SNAs. Without better systems, including e-procurement, stronger institutions, and human capacities and career development, there are risks of both inefficiencies and irregularities in procurements.	✓	✓		
2.4	Internal and external audit gives low attention to procurement systems and major procurement risks. There are risks that if internal and external audit capacities remain inadequate, there will be no sustainable control or oversight of domestic or foreign procurements.	✓	✓		
<b>3. Procurement Operations</b>					
3.1	Low operational efficiencies prevail, especially as responsibilities are devolved, including inexperience of project personnel and procurement review committees. Without procedures suitable for Cambodia and devolved capacity building, there are risks of big procurement delays.	✓	✓		
3.2	Significant domestically financed procurement occurs through noncompetitive and irregular and/or informal procedures. This involves risks to systems integrity and in relation to corruption and leakages.	✓	✓	✓	
<b>4. Integrity of Public Procurement</b>					
4.1	Poor perceptions prevail on public procurement processes with risks that private investors and development partners will reduce Cambodian investments or alternatively will incur high transaction costs and experience delays through use of excessively rigid fiduciary controls.	✓	✓	✓	
4.2	Until recently, weak sanctions and policing has occurred for procurement offenses. While new penal provisions and the Anti-Corruption Law strengthen sanctions, there are risks that those transgressions will continue if the laws are not strictly applied.	✓	✓		
<b>C. Corruption</b>					
<b>1. Legislative and Policy Framework</b>					
1.1	While new finance, criminal, and anticorruption laws have recently been passed, the finalization of implementing regulations and operating procedures is necessary. If the legal framework is not quickly completed, there are risks that this will prevent improved laws from becoming operational.	✓	✓		
<b>2. Integrity Institutions, Systems, and Administrative Capacities</b>					
2.1	The ACU faces significant challenges in getting fully established and becoming effective. Inadequate resources and insufficient capacity building make it difficult for the ACU to achieve its objectives.	✓	✓		

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	<b>Risk Identified</b>	<b>Likely</b>	<b>Relatively Serious</b>	<b>Not Mitigated During CPS</b>	<b>Major Risk (all 3 ticked)</b>
2.2	Related legal institutions, <sup>a</sup> especially police, prosecutors, and judges, will need to become more effective if they are to support the ACU. There are risks that these institutions will remain weak and perceived as corrupt, thus frustrating efforts to prosecute corruption.	✓	✓	✓	✓
2.3	Personnel management and public sector wages policies may continue to be inadequate. The current systems, including low civil servants' wages, do not discourage corrupt practices.	✓	✓	✓	✓
<b>3. Rule of Law</b>					
3.1	Political and cultural pressures may make it difficult for the new ACU to pursue high-level corrupt persons. The risk is that investigations and/or prosecutions will not proceed against well-connected officials.	✓	✓	✓	✓
<b>4. Voice and Accountability</b>					
4.1	People are not used to speaking out against corruption. There are risks that complaints that are made are not effectively addressed.	✓	✓		
4.2	Civil society and NGOs are weak and often not listened to even when allowed to speak. There are risks that civil society organizations will not be able to undertake effective advocacy.	✓	✓	✓	
<b>5. Public Perceptions</b>					
5.1	While perceptions of lower-level corruption may be stabilizing, corruption remains a problem in many public agencies. High risks are perceived in priority sectors. Failure to change perceptions of corruption will reinforce corrupt activities.	✓	✓	✓	✓

<sup>a</sup> Other PFM institutions, including internal and external audit agencies and inspectorates, are also important for addressing corruption. These have been separately dealt with in para. 32 of main text.

ACU = Anti-Corruption Unit, CPS = country partnership strategy, GDP = gross domestic product, FMIS = financial management information system, MEF = Ministry of Economy and Finance, NAA = National Audit Authority, NGO = nongovernment organization, PFM = public financial management, PFM RP = Public Financial Management Reform Program, SNAs = subnational administrations, TA = technical assistance.

	Major Risks <sup>a</sup>	ADB Actions	Indicator(s)
1.	<b>PFM Procurement</b>		
1.1	Challenges in devolving responsibilities and accountabilities from MEF to the line ministries, including implementation of a new devolved FMIS. Risks that the implementation of platform 2 of the PFMRP will be slow and difficult.	<p>ADB will be more active in policy dialogue in the implementation of PFMRP.</p> <p>Support for rolling out the PFMRP's platform 2 to three rural development ministries<sup>b</sup> under the ADB-financed Public Financial Management for Rural Development Program (PFMRDP) and a follow-on PFMRDP subprogram 2, which was approved in 2010.</p> <p>All new programs and projects to consider opportunities for direct support to sector ministry's to implement relevant platform 2 catalytic actions.</p>	<p>Steady growth in inputs to PFMRP plus quarterly monitoring of trends in progress indicators for catalytic actions in platform 2 of PFMRP.</p> <p>Twice-yearly TA reviews charting progress in implementing catalytic actions in three rural development ministries.</p> <p>Review documentation prepared and monitored as part of preparing risk assessments and risk management plans for RRP.</p>
1.2	Challenges in managing the decentralization and deconcentration reforms including functional and financial devolution to provinces and districts. Risks of slow implementation of decentralization and deconcentration reform with continued inadequate public services at decentralized levels.	<p>More active engagement in policy dialogue on decentralization and deconcentration reforms.</p> <p>Direct support for the implementation of the IP3 including technical assistance (functional assignments and fiscal decentralization) and infrastructure investment through new decentralization and deconcentration funding mechanisms.</p> <p>All new programs and projects to consider opportunities for direct support to specific sector ministry implementation of the relevant parts of the IP3, particularly in planning for devolution of functional, financial, and personnel responsibilities to subnational authorities.</p>	<p>Steady growth in inputs to decentralization and deconcentration reforms plus quarterly monitoring of trends in PIs for programmed actions in first 3 years of the National Program for Sub-National Democratic Development (IP3).</p> <p>Quarterly decentralization and deconcentration TWG and TA reviews charting progress in implementing the IP3.</p> <p>Regular project reviews of investment funding.</p> <p>Review documentation prepared and monitored as part of preparing risk assessments and risk management plans for RRP in priority sectors.</p>

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Major Risks <sup>a</sup>	ADB Actions	Indicator(s)
1.3 Personnel management and public sector wages policies may remain inadequate. The risks of such systems include low labor productivity and civil service disincentives for anticorruption efforts.	ADB has not been a lead development partner in public administration or civil service wage reform, but will support the strengthening of civil service effectiveness and efficiency through capacity development of senior and mid-level government officials in economic policy management, change management, and leadership under the second PFMRDP.	A broad systemwide approach to civil service wages policy reform is in place and agreed to by government by the end of 2012.
1.4 Although improving, ratios of tax and nontax revenues to GDP remain very low. Slow tax policy reforms will reinforce risks of nonsustainable budgets and continued weak public services delivery, especially if development partner "fund fatigue" sets in further.	ADB is not a lead development partner in reform of tax policies and administration, but will keep abreast of developments.	New multi-development-partner program prepared by 2013 providing for major reform of tax policies and administration in the Taxation Department in the MEF.
1.5 Internal auditing is improving but still weak. Without effective internal audit units in all line ministries, there are risks that further devolution of powers to line ministries will occur without adequate accountability and control, including inadequate auditing of procurement systems and high-value procurements.	<p>ADB will provide continuing support for strengthening internal audits of MEF and the three rural development ministries and explore options to include strengthening of technical audits.</p> <p>All new programs and projects to review prospects of direct support to internal audit departments in priority sector ministries.</p>	<p>Regular quarterly reports of progress through TA operating in internal audit units in MEF and the three rural development ministries.</p> <p>Review documentation prepared and monitored as part of preparing risk assessments and RMPs for RRs in priority sectors.</p>
1.6 External auditing is improving but still weak. Strengthening the NAA must address wider coverage, better audit quality, backlogs, and follow-up of findings. An effective NAA is critical for system integrity. NAA should also gradually commence an active role in audits of externally financed projects.	<p>ADB has provided modest support to capacity building in NAA, which is mainly funded as an adjunct to the PFMRDPs. ADB will consider additional support for the NAA's active involvement in auditing of externally financed projects.</p> <p>Consideration of ADB funding for audit of ADB-financed projects.</p>	Provision of institutional strengthening of the NAA beyond 2013.

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Major Risks <sup>a</sup>	ADB Actions	Indicator(s)
<b>2. Procurement Component</b>		
<p>2.1 Further devolved capacity building is needed in line ministries and SNAs. Without better systems—including e-procurement, stronger institutions and human capacities, and career development—there are risks of both inefficiencies and irregularity in procurement.</p>	<p>Closely linked to PFM component 1.1, ADB will more actively support PFMRP platform 2 through the development partner working group on PFM (including support to devolution of procurement responsibilities).</p> <p>Provide direct support to three rural development ministries under the PFMRDP to implement procurement reforms devolved to line ministries under the PFMRP's platform 2.</p> <p>All new programs and projects to consider opportunities for direct support to priority sector ministries to implement the PFMRP platform 2 procurement reforms.</p> <p>Support for PFM system development at subnational levels.</p>	<p>Steady growth in inputs to PFMRP for procurement plus quarterly monitoring of trends in progress indicators for procurement-related actions in platform 2 of PFMRP.</p> <p>Six-monthly TA reviews charting progress in implementing procurement reforms in three rural development ministries.</p> <p>Review documentation prepared and monitored as part of preparing RAs and RMPs for RRP.</p> <p>Progress reports of the first 3 year implementation plan (2011–2013) of the National Program for Sub-national Democratic Development.</p>
<p>2.2 Low operational efficiencies prevail, especially as responsibilities are devolved, including inexperience of project personnel and procurement review committees. Without procedures suitable for Cambodia and devolved capacity building, there are risks of big procurement delays.</p>	<p>ADB will continue to support revising and training on the standard operating procedures, PM, and FMM for externally assisted projects.</p>	<p>Annual TA reviews indicate satisfactory progress with legal, regulatory, and institutional reforms.</p> <p>New procurement laws, guidelines, and manuals in place by the end of 2012.</p>
<b>3. Corruption Risks</b>		
<p>3.1 The newly established ACU faces significant challenges to get fully established and operational. Inadequate resource and capacity makes it difficult for the ACU to achieve its objectives.</p>	<p>ADB will provide TA to support the ACU in 2011 to consider longer-term capacity building support for the ACU in collaboration with interested development partners.</p>	<p>Multidonor program for supporting capacity building in the anticorruption institution prepared by the end of 2011.</p> <p>Annual reports and joint reviews by government and development partners of the ACU from the end of 2011 reveal steady progress with development of capacities and the attainment of results.</p>
<p>3.2 Related legal institutions, especially police, prosecutors, and judges, will need to become more effective if they are to support the ACU. There are risks that these institutions will remain weak and corrupt and thus frustrate efforts to prosecute corruption.</p>	<p>ADB will not become a lead development partner in the legal and judicial sector reform program but will continue to closely monitor sector progress through government and development partner working groups, particularly so far as implications for the work of the ACU are concerned.</p>	<p>Monitoring of quarterly and annual monitoring reports of government legal and judicial agencies and development partners leading in the legal and judicial sector.</p>

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	Major Risks <sup>a</sup>	ADB Actions	Indicator(s)
3.3	Personnel management and public sector wages policies may remain inadequate with risks of disincentives for anticorruption practices where many civil servants do not earn an adequate living wage.	This corruption-related risk mirrors the risk to PFM under 1.3 above. The proposed ADB actions are identical.	As per 1.3 above under PFM risks.
3.4	While perceptions of corruption may be stabilizing, corruption remains a problem in public agencies. High risks are perceived in priority ADB sectors—education, public works, private sector, finance, taxation, and customs. Failure to change perceptions of corruption will reinforce corrupt activities.	<p>ADB will continue to monitor regular surveys being undertaken in Cambodia on various perceptions of corruption (business surveys, consumer surveys, citizens surveys) with particular reference to the ADB priority sectors</p> <p>All new programs and projects to consider opportunities for improving perceptions about corruption. Where relevant, appropriate surveys could be commissioned through the ACU.</p>	<p>Periodic corruption perception surveys (as relevant to particular sectors) to be monitored by governance specialists at the Cambodia Resident Mission and to be incorporated into the regular reviews of programs and projects</p> <p>Review documentation prepared and monitored as part of preparing risk assessments and risk management plans for RRP.</p>

<sup>a</sup> Carried forward from section V.

<sup>b</sup> Ministry of Agriculture, Forestry and Fisheries; Ministry of Rural Development; and Ministry of Water Resources and Meteorology.

ACU = Anti-Corruption Unit, ADB = Asian Development Bank, FMIS = financial management information system, FMM = financial management manual, GDP = gross domestic product, IP3 = 3-Year Implementation Plan of the National Program for Sub-National Democratic Development, MEF = Ministry of Economy and Finance, NAA = National Audit Authority, PFM = public financial management, PFMRP = Public Financial Management Reform Program, PM = procurement manual, RA = risk assessment, RMP = risk management plan, RRP = report and recommendation to the President, SNAs = subnational administrations, TA = technical assistance, TWG = technical working group.

# Appendix 1

## Preliminary Assessment of Risks and Risk Management Approaches Specific to the Transport Sector

### A. Overview of ADB Approach to Governance in the Transport Sector

1. Much past and recent Asian Development Bank (ADB) involvement has been through various transport sector project loans (13 project loans between 1992 and 2010)<sup>14</sup> and related technical assistance. Most project loans were approved prior to the 2007 introduction of good governance frameworks (GGFs) for ADB-financed projects and also before the Guidelines for Implementing Second Governance and Anticorruption Action Plan GACAP II (ADB 2008). Despite the importance of good governance in the transport sector, neither method was ever retrospectively fitted to past sector loans, and thus monitoring and evaluation of governance matters in recent documents—such as midterm reviews, sector assessments, and country assistance program evaluations—have been piecemeal and not as systematic as either the GGF or GACAP II methodologies. Until recently, ADB mission leaders have apparently not been monitoring and reporting systematically on GGFs. Successive project designs have recognized important elements of sector governance to some extent (e.g., the Road Asset Management Project [ADB 2007f]<sup>15</sup> focused on privatizing force account units to enable better provision of road repairs, maintenance funding, and sector planning) and recent assessments have provided some insights into sector weaknesses and risks.

2. Recent project designs (e.g., the Rural Roads Improvement Project [ADB 2010i]<sup>16</sup>) do explicitly provide for governance treatment through both the GGF and GACAP II methodologies, though the matrixes presented are somewhat problematic, with the GGF largely being a copy of the “boilerplate” approach used in the majority of sectors and projects in Cambodia, and the GACAP II approach mainly cross-referencing the GGF. Full sector or program governance risk assessments or risk management plans do not appear to have been undertaken yet, perhaps because recent interventions have been more project based than sector-wide program based. As a result, it is difficult to discern sector governance issues and risks from the various design and review assessment documents because they are all project-centric in nature. Furthermore, it also remains to be seen whether recent modestly explicit treatment of governance matters in project preparation eventually extends to more rigorous review and evaluation work at the sector level.

<sup>14</sup> The transport sector is a priority under the country partnership strategy for Cambodia 2011–2013, and much of ADB’s recent spending has been in this sector.

<sup>15</sup> ADB. 2007f. *Report and Recommendation of the President to the Board of Directors for the Proposed Loan and Administration of Grant from the Government of Australia for the Kingdom of Cambodia: Road Asset Management*. Manila.

<sup>16</sup> ADB. 2010i. *Report and Recommendation of the President to the Board of Directors for the Proposed Loan for the Kingdom of Cambodia: Rural Roads Improvement Project*. Manila.



## B. Indicative Governance Risks and Risk Management Approaches in the Transport Sector

3. In general, sector planning, budgeting and public financial management has improved.<sup>17</sup> Apart from recent railways rehabilitation and earlier projects in airport development, most recent funding has been for the roads subsector. Institutionally, work on national and provincial roads has been focused in the Ministry of Public Works and Transport (MPWT) while work on rural roads is the responsibility of the Ministry of Rural Development (MRD). Various projects and technical assistance (particularly the recent Road Asset Management Project) have sought to strengthen the legal and regulatory and planning framework, sector planning, budgeting, and public financial management (PFM) performance in the MPWT. Without such reforms, the private sector is said to be wary of participating in public-private partnerships. Similar strengthening, but to a lesser extent, has occurred in the MRD.

4. Nevertheless, beyond noting weaknesses, project preparation and review documentation has not emphasized issues of sector planning and PFM management (including procurement) in the key institutions. Without further detailed governance assessment at the sector level it is difficult to precisely identify all current PFM weaknesses and risks. Given the significant use of project implementation units, the issue of wage supplementation for project-related government personnel is a major policy matter (and risk) for a sector that is so project focused (ADB project officials tend to pay project subsidies to ensure that a project succeeds, irrespective of the distortions this causes). Further, PFM challenges that have been recently addressed relate to providing sufficient funding for road repairs and maintenance and allowing competitive approaches to procuring contractors (e.g., through period contracts rather than forced account appointments). However, many local roads are deteriorating faster than maintenance programs can maintain them.

5. The project and program administration units have been established, and the government's standard operating procedures and the associated procurement and financial management manuals for externally assisted projects (Ministry of Economy and Finance 2005a-c)<sup>18</sup> have been used to mitigate the project and program fiduciary risks in the sector. While audits and operational reviews of various project loans typically disclose minor PFM and procurement irregularities, there have been very few large scandals or cancellations of major procurements or projects. Nevertheless, a relatively significant number of contractors (mainly domestic ones) have been blacklisted for bidding and/or implementation irregularities. However, only a small number have been charged with criminal offenses. Most concerns have been in the MRD, where special investigations by the Office of Anticorruption and Integrity of ADB were conducted in 2007–2008. Most significant contracts, especially through the MPWT, go to international tendering and are won by international contractors, with no significant blacklisting of international contractors to date. Project implementation units, mainly staffed by consultants, have been the standard method of procurement and project management at both national and provincial levels, with generally poor integration with government personnel and PFM systems. Of greater expressed concern than fiduciary aspects of project management, has typically been a lack of advance actions and long delays in implementation, particularly through procurement contracting delays.

6. The decentralization and deconcentration reforms already involve increased risks and challenges for ADB and government management, and these will intensify over time as the reforms

<sup>17</sup> This appendix does not, in any sense, represent a full evaluation of transport sector governance risks and risk management approaches. Given the significant ADB resources devoted to this sector, a comprehensive assessment of sector risks and risk management approaches is warranted at some time in the near future.

<sup>18</sup> Ministry of Economy and Finance. 2005a. *Financial Management Manual for Externally Assisted Projects and Programs in Cambodia*. Phnom Penh; Ministry of Economy and Finance. 2005b. *Procurement Manual*. Phnom Penh; Ministry of Economy and Finance. 2005c. *Standard Operating Procedures*. Phnom Penh.

intensify. Very small-scale transport infrastructure is already being provided through the communes, and over time responsibilities for local road construction and maintenance will likely pass to provinces and districts. At present, the MPWT and MRD are not well advanced in their planning for decentralizing functions from their deconcentrated units in the provinces and are likely to need support in preparing their strategic plans and budgets. Similarly, the provinces, and particularly the districts, are not yet well equipped for the challenges of PFM-related investment planning and assets management for the transport sector. Without the development of appropriate systems and skills, there are risks of both financial and technical weaknesses in terms of road management.

7. Corruption perception surveys suggest mid-level corruption is significant in the construction and roadwork sector. This includes matters such as collusion between bidders, use of inferior materials, nepotism, kickbacks in the provision of wage incentives to government staff linked to projects, and forced and/or noncompetitive procurement under government procurement systems. While some of these risks are beyond the full control of ADB interventions, a number of them should be considered as sufficiently important to be directly addressed in a sector-level, GACAP II type of risk management plan that should then be fed into broader program-type mitigation approaches that are less project-centric in nature. Such sector-level risk assessments and risk management plans are an integral part of the GACAP II approach. However, these will require proactive responses by ADB managers to ensure they are actually undertaken for all high-priority sectors, especially transport where risks appear to be quite high.

8. Future funding proposals warrant more detailed analysis of governance weaknesses and risks. Despite a long ADB involvement in project-centric transport funding, the analysis of governance-type institutional and capacity development needs for the sector is quite weak and warrants further development at the sector level in the near future.

# Appendix 2

## Preliminary Assessment of Risks and Risk Management Approaches Specific to the Education Sector

### A. Overview of ADB Approach to Governance in the Education Sector

1. Much past and recent involvement has been through two education sector development programs (ADB 2001, 2004)<sup>19</sup> and related projects and technical assistance.<sup>20</sup> Both past sector programs were approved prior to the introduction of good governance frameworks (GGFs) (2007) and the Second Governance and Anticorruption Action Plan (GACAP II) implementing guidelines (2008). Despite the importance of good governance in the education sector, neither method was ever retrospectively fitted to the sector, and thus monitoring and evaluation of governance matters in recent documents—such as midterm reviews, sector assessments, and country assistance program evaluations—have been rather ad hoc and not as systematic as either the GGF or GACAP II methodologies. Nevertheless, project and program designs have recognized important elements of sector governance (e.g., the Enhancing Education Quality Project [ADB 2007g]<sup>21</sup>) and recent reviews and assessments did provide useful insights into sector governance weaknesses and risks. Work has commenced on preparation of the Third Education Sector Development Program (with focus on lower secondary and continuation of support to technical and vocational training). Early indications (e.g., from the memorandum of understanding on terms of reference for the project preparatory technical assistance) are that more specific governance treatment through the GACAP II approach will occur in design, though it remains to be seen whether this extends over time through to review and evaluation work for the program.

### B. Indicative Governance Risks and Risk Management Approaches in the Education Sector

2. Improved sector planning and budgeting and public financial management (PFM) generally have been moderately important components of past programs and projects, mainly through strengthening

<sup>19</sup> ADB. 2001. *Report and Recommendation of the President to the Board of Directors on the Proposed Loans for the Kingdom of Cambodia for the Education Sector Development Program*. Manila; and ADB. 2004. *Report and Recommendation of the President to the Board of Directors on the Proposed Loans for the Kingdom of Cambodia for the Second Education Sector Development Program*. Manila.

<sup>20</sup> The country partnership strategy for Cambodia 2011–2013 prepared sector analyses on education and on technical and vocational education and training.

<sup>21</sup> ADB. 2007g. *Report and Recommendation of the President to the Board of Directors on the Proposed Asian Development Fund Grant for the Kingdom of Cambodia: Enhancing Education Quality Project*. Manila.

of the Department of Planning in the Ministry of Education, Youth and Sports (MOEYS).<sup>22</sup> This has included support in planning, budgeting, and budget execution skills as well as pursuing sector-wide approaches with development partners and the government. More specifically, support has included

- (i) support to medium-term budgeting;
- (ii) devolving service delivery (and PFM) responsibilities to provincial and school levels and improving the efficiency of the payments system, including through involvement of MOEYS in the priority action program accelerated payments system and attempts (not fully successful) to implement a management information system, which needs to be extended to a financial management information system; and
- (iii) fledgling work on performance-based budgeting.

Future risk management approaches, while recognizing that MOEYS is regarded as one of the better PFM performers of the line ministries, will also need to consider further major challenges to cope with added responsibilities and accountabilities of MOEYS under platform 2 of the Public Financial Management Reform Program. Improvements will be needed at all levels of MOEYS and deconcentrated and decentralized units, including in planning, budgeting, budget execution, internal control and audit, transparent reporting, and external audit. It will also be important to ensure that adequate resource allocation from all tiers of budget financing (recurrent and development) flows appropriately to assessed and prioritized needs of the education sector (e.g., to teacher training and disadvantaged areas with low teacher numbers).

3. The project and program administration units have been established and the government's standard operating procedures and associated procurement and financial management manuals for externally assisted projects (Ministry of Economy and Finance 2005a–c)<sup>23</sup> have been used to mitigate the project and program fiduciary risks in the sector. To the extent that program financing has been for general budget support, the fiduciary risks need to be reviewed against the background of the whole government PFM and procurement systems in Cambodia, which have been assessed in the main body of this report. While the various reviews and assessments do point to minor concerns with corruption in the formal procurement processes, such as in the cost and quality of school buildings procured (and concerns over irregular arrangements outside the formal system), there have been no major project management or procurement scandals, and generally, the establishment of project administration units appears to have worked well in creating fiduciary safeguards for project financing. However, other efficiency concerns are repeatedly mentioned throughout the various reviews and assessments. These include

- (i) extreme slowness to implement, especially for projects (procurement of textbooks, school buildings, etc.);
- (ii) high transactions costs of the approach in establishing project administration units; and
- (iii) very poor integration and harmonization with government systems, especially for technical assistance and grant-funded modalities.

The ADB-funded projects have received informal reports about local executing agency site surveyors (from provincial education departments) coming under pressure from powerful local contractors to certify work of inferior quality.

<sup>22</sup> This appendix does not, in any sense, represent a full assessment of the education sector governance risks and risk management approaches as the time available has not permitted this. A comprehensive assessment of sector risks and risk management approaches is being undertaken in 2011 as part of preparation of the Third Education Sector Development Program, which will directly address key sector and program governance risks.

<sup>23</sup> Ministry of Economy and Finance. 2005a. *Financial Management Manual for Externally Assisted Projects and Programs in Cambodia*. Phnom Penh; Ministry of Economy and Finance. 2005b. *Procurement Manual*. Phnom Penh; Ministry of Economy and Finance. 2005c. *Standard Operating Procedures*. Phnom Penh.

4. In 2009, the Office of Audit and Investigation carried out a project procurement related audit for the Second Education Sector Development Project. In some cases, the audit found less-than-adequate quality of work for school buildings and less-than-rigorous internal financial control mechanisms for financial management. These issues had not been picked up by external auditors and the Office of Audit and Investigation decided not to actively pursue its findings.

5. The decentralization and deconcentration reforms are likely to create additional challenges, even though the education sector is more advanced than most in terms of deconcentrating responsibilities to its provincial branches and particularly in terms of more direct dealings with schools-based management. The main future challenges will lie in movement from deconcentrated to decentralized approaches through greater involvement of elected councils at provincial and district levels, and also in further strengthening fiduciary aspects of PFM at school management levels. Risks can be partly addressed by supporting effective finalization of the assignment of functions between different levels of government in the education sector (already partly being addressed by ADB support to the education sector), while ensuring that stronger fiduciary and performance-based arrangements are put in place at the provincial, district, and school levels.

6. Corruption perception surveys suggest minor to lower-level corruption is prevalent in the sector. This includes matters such as

- (i) appointment, transfer, or promotion of teachers and administrators;
- (ii) special out of hours tutoring fees;
- (iii) examination results fees;
- (iv) textbook and written materials fees;
- (v) high teacher absenteeism;
- (vi) ghost schools and teachers on the payroll; and
- (vii) forced and/or noncompetitive procurement under the government's domestic procurement systems.

While a number of these corruption risks are beyond full control of ADB interventions, a number of them could be considered as sufficiently important to be directly addressed in the design of the third sector development program (e.g., personnel management and pay issues as part of broader civil service reforms, including reforms to teacher wage policies that represent a major part of the broader policy issue).

7. Future program and project development warrants close direct consideration of governance weaknesses and risks. The memorandum of understanding for the terms of reference on the project preparatory technical assistance indicates that institutional development and capacity building for decentralization will be one important component developed, including broad aspects of better PFM and public administration at all levels of operation (province, district, and school). This seems appropriate and indeed worthy even of expanded approaches. It will need to be followed through over time to ensure there is adequate monitoring during implementation and that, where general budget program support is linked to agreed policy actions, such actions include important strategic requirements for sector governance improvements over time.

# Appendix 3

## Preliminary Assessment of Risks Specific to the Private Sector Development Driver of Change

### A. Overview of ADB Approach to Governance in the Private Sector

1. Apart from an earlier project providing lines of credit through the finance sector, much recent Asian Development Bank (ADB) support to the private sector has been through policy-based program financing and related technical assistance.<sup>24</sup> Significant support was approved prior to the introduction of good governance frameworks (GGFs) (2007) and also before the Second Governance and Anticorruption Action Plan (GACAP II) implementing guidelines (2008). Neither of these methods has ever been used retrospectively for past sector support, and thus monitoring and evaluation of governance matters in recent documents—such as midterm reviews, sector assessments, and country assistance program evaluations—have been rather ad hoc and not as systematic as either the GGF or GACAP II methodologies. Nevertheless, such reviews and assessments have provided useful insights into finance and private sector weaknesses and risks. More recent programs, including the Promoting Economic Diversification, Subprogram 2 (ADB 2010j),<sup>25</sup> provide for specific governance treatment through the GACAP II approach and also cross-references the GGF approach. However, it remains to be seen whether over time this extends through to subsequent review and evaluation work for the program.

### B. Indicative Governance Risks and Risk Management Approaches in the Private Sector<sup>26</sup>

2. Improved sector planning and budgeting and public financial management (PFM) generally have not been distinguishing features of the private sector approach. This is understandable given that the emphasis is on the private sector and not the public sector, and given that funding is provided mainly as general budget support without significant specific project forms of assistance. While recent projects have used the Ministry of Commerce and other agencies as the principal executing agency, the PFM performance of the Ministry of Commerce and others has typically not been an issue as it

<sup>24</sup> The country partnership strategy for Cambodia 2011–2013 lists the private sector as one of five drivers of change. The private sector is characterized as crosscutting in terms of ADB sectors, though it is closely related to the finance, trade and industry, and public sector management sectors.

<sup>25</sup> ADB. 2010j. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan and Grants for Subprogram 2 for the Kingdom of Cambodia: Promoting Economic Diversification Program*. Manila.

<sup>26</sup> This appendix does not, in any sense, represent a full assessment of private sector governance risks as time has not permitted this. A comprehensive assessment of sector risks and risk management approaches may be of lower priority given the significant ADB use of general budget support, policy-based financing provided through the private sector.

is not a big spending or service delivery unit. Rather, the interest is largely in policy and regulatory reform and related institutional, systems, and human resources capacity building. Nevertheless, the policy approaches adopted, particularly in terms of improving the overall operating environment for private business, do recognize the importance of a sound PFM environment for supporting private investment. Furthermore, particular elements of the PFM system—such as taxation and customs policies and administrative capacities (including support for installing the Automated System for Customs Data [ASYCUDA] customs processing and revenue system)—have been important components of the policy framework being supported.

3. Because there has been no recent project financing related government procurement, procedures applied to ADB-financed procurements have not been a central issue. Because most funding is in the form of general budget support, there is no direct project procurement risk for ADB, beyond limited amounts of technical assistance that is all directly procured by ADB and is without recent incidents. Provision of general budget support opens sector financing to all the risks of the total government system of PFM. These broad Cambodian system risks have been addressed in the main body of this assessment report. The private sector is of course often involved in the provision of goods and services to the public sector and thus has an interest in the procurement systems used by the government, including for ADB-financed projects. The private sector is widely regarded as being actively involved from time to time in both formal and informal procurement irregularities, and elements of the private sector are not in favor of reforms that will change current informal approaches to doing business. Without reforms affecting both the public and private sectors, it is likely that inappropriate procurement practices will continue. This seems to be recognized by recent ADB private sector interventions, though it has not been central to policy reforms being pursued at this time.

4. Private sector policies being pursued by ADB interventions generally recognize the significance of decentralization and deconcentration reforms and in part have targeted improved business climates in decentralized locations. While development of the private sector is not central to objectives of the decentralization and deconcentration reforms, there are risks that failure of the reforms—leading, for example, to further performance declines in decentralized service delivery and infrastructure—will further constrain the capacity for small-scale businesses to grow and create jobs in decentralized locations.

5. Corruption perception surveys suggest that collusion of politicians, bureaucrats, and private businesspersons constitutes a major feature of corruption in Cambodia. This creates major risks for developing an efficient and corruption-free private sector that provides an environment conducive to both domestic and foreign investment. The types of risks and risk management actions that are suitable for private sector development are broadly those set out in the countrywide assessment in the body of the text. They include strengthening the legal and judicial sector, lowering informal transactions costs, and making the new Anti-Corruption Law and institution work.

6. Future program development warrants close direct consideration of governance weaknesses and risks in order to improve the environment for private sector development. In general, countrywide risks and risk management plans outlined in the body of this assessment should be closely related to private sector requirements. In this sense, the preparation of a separate broad GACAP II private sector assessment may not be a very high priority. However, project-specific assessments and occasional assessments of key parts of the private sector (e.g., the construction industry, agricultural suppliers) are likely to prove useful, especially if linked to related sector reviews.

# Appendix 4

## Assessment of the Good Governance Framework Approach

1. This assessment has given particular consideration to merits of the special good governance framework (GGF) approach adopted for projects financed by the Asian Development Bank (ADB) in Cambodia and compares it to the standardized Second Governance and Anticorruption Action Plan (GACAP II) approach to governance risk assessment and risk management. In doing so, desk reviews have been undertaken of the GGFs used in two specific projects: the Tonle Sap Lowland Rural Development Project (ADB 2007e), and the Emergency Food Assistance Project (ADB 2008h).<sup>27</sup> In addition, GGFs for a further seven sector interventions were reviewed and discussions were held with key sector program officers as to the relevance and utilization of the GGFs. Reviews were also undertaken of the small number of new GACAP II assessments that have been undertaken in recent years for Cambodian sectors and projects.

2. Since around 2007, ADB has required GGFs for all programs and projects in Cambodia. Note that such GGFs for Cambodia were not a general requirement for governance assessment within ADB—the general ADB requirement since around 2008 has been for preparation of GACAP II risk assessments and risk management plans at country, sector, and program or project levels. Since around 2008 when GACAP II became operational, project proposals for Cambodia have typically included documentation for both the GGF and the GACAP II approaches. The dual and partly overlapping approaches to governance assessment and management has caused some confusion, both for those preparing reports and recommendations of the President for Board approval and for those involved in monitoring and evaluating governance performance.

3. The GGFs are developed in matrix format with the main matrix columns providing for risks and issues, actions to mitigate risks, the responsible agency in government, and the target and frequency of delivery. In a small number of cases reviewed, a fifth column has subsequently been added, which reviews progress over time in relation to each issue or risk. GGFs are developed using a standardized template with 15 risk issues reviewed under six core headings and sub-issues or risks as follows:

- (i) procurement (corruption, procedures, capacities, plans, informal payments),
- (ii) financial management (internal control, capacities, cash transactions, allowances to government staff, advances),
- (iii) disclosure (conflict of interest, transparency, and disclosure),
- (iv) complaints (complaint mechanisms),
- (v) code of ethical conduct (enforcement of civil service code of conduct), and
- (vi) sanctions (adequacy of project sanctions).

<sup>27</sup> ADB. 2008h. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan and Asian Development Fund Grant for the Kingdom of Cambodia: Emergency Food Assistance Project*. Manila.



4. It should be noted that the GGFs do not address broad issues of governance systemwide (they are not prepared on a countrywide or sectorwide basis) but focus narrowly on fiduciary aspects of programs and projects funded by ADB. All GGFs provide a written caveat along the lines that, in the event of discrepancy between government and ADB procedures for the joint financing agreement, the ADB procurement guidelines and guidelines on the use of consultants will prevail.

5. In contrast, the GACAP II approach is not narrowly based along project fiduciary lines but assesses risks and prepares risk management plans in relation to assessed risks that can lead to diminished development outcomes as a result of misuse of either government or ADB resources. Nevertheless, the approach is to focus on areas most relevant to ADB's sphere of influence. Furthermore, the GACAP II approach is a cascading one with different assessments and plans prepared at the country, sector, and program or project levels. As one gets down to the project level (which focuses only on ADB project system risks), the GACAP II and GGF methodologies become much more similar. However, at the program level, the GACAP II approach requires assessment of both national country systems and ADB project systems. While fiduciary assessment in relation to the use of ADB resources is part of the GACAP II governance assessment, it is not the only part at the country, sector, and program levels, but it does become more so at the project level. At higher levels, the central element is the impact of governance on development. GACAP II divides its assessment into three core areas: PFM, procurement, and corruption. It further divides each of these into 4–6 dimensions, as set out in detail in the body of this report.

6. While some have argued that the GGFs and GACAP II are essentially different ways of looking at the same thing, that is not entirely the case at the country, sector, or program levels. However, there is much similarity at the project level. While the GGF looks at narrow aspects of fiduciary assessment (along the lines that internal and external auditors might do), GACAP II at higher levels looks at similar aspects of governance but in a broader development context. However, at the project level (as distinct from countrywide and sectorwide assessments) the GACAP II and GGFs are much closer in approach. The GACAP II approach provides a clear framework for monitoring risks at the project level through inclusion in reports and recommendations of the President, in project administration manuals, and through regular review during project review missions.

7. A review of the various GGFs suggests that there is extensive reliance on compliance with actions that are exhortative but not directly or easily measurable or time-bound (e.g., “ensure full compliance with the procurement manual procedures”).<sup>28</sup> In most cases reviewed, there is very little difference between different project GGFs in terms of the standardized words used in relation to the mitigation of risk (which in a large number of cases are simply extracted from the government standard operating procedures and procurement manuals for externally assisted projects). However, there are some examples of specially designed practices and some GGFs include a special final section for risks and/or issues identified as specific to that project that are different from earlier boilerplate provisions. Furthermore, there seems to have been very little understanding by ADB mission leaders that GGF monitoring is part of their duties. A recent Cambodia Resident Mission survey of 50 ADB aide-mémoire found that only one aide-mémoire mentioned GGFs. Aide-mémoire, memoranda of understanding, and back-to-office reports suggest that governance issues are usually not discussed in structured ways during loan review missions or midterm reviews. To date, no project completion reports have been prepared for projects with GGFs, and it is clear that without some change in emphasis, it is unlikely that the GGFs will be treated as high priority.

8. Interviews with Cambodia Resident Mission sector staff revealed that GGFs are mainly used as part of project preparation and approval and are not significantly used as tools for ongoing monitoring and evaluation of the fiduciary or broader governance performance of projects. Although it is still early days

<sup>28</sup> These are standard compliance measures in all the GGFs of ADB-financed projects and programs for Cambodia since 2007.

in the use of GACAP II, it also does not yet appear to be a tool that is being used widely in ADB-financed projects in Cambodia for governance monitoring purposes (although, as elaborated upon in paras. 10–11 GACAP II guidelines do provide clear procedures to apply to monitoring and revising the risk assessments and risk management plans over time, with different requirements for monitoring at country, sector, program, and project levels).

9. The frequency and quality of either fiduciary project or broader development governance monitoring will depend on the time ADB staff devote to these tasks. There is also a question of whether monitoring should be the responsibility of specialist governance staff, sector program officers, operational managers, or, in the case of the GGFs (and increasingly the risk management plans), should be contracted out to external auditors. Contracting out would require adequate funding, and this will only be available if senior management gives high priority to monitoring governance matters and risk mitigation plans. Funding options (such as through technical assistance) appear to exist and warrant further discussion with ADB management. Two procurement specialists have recently been placed at the Cambodia Resident Mission to assist with procurement related to projects.

10. Clear procedures for monitoring are set out in the GACAP II guidelines. These differ between (i) country and sector assessments and plans, and (ii) program or project assessments and plans. At the country and sector levels, the quality and relevance of the risk management plan are assessed as part of finalizing the country partnership strategy, and monitoring continuing relevance and progress against agreed actions occurs as part of country portfolio review missions, with adjustments made as necessary to the risk management plans. At the program and project level, risk assessments and risk management plans are included in reports and recommendations of the President and should also be included in project administration manuals. Actions in the project risk management plans must be regularly monitored and reviewed during project review missions and, where appropriate, the risk assessments and risk management plans should be revised. Outcomes of these project review missions, insofar as they affect the risk assessments and risk management plan, must be reported to the government counterpart and be included in the aide-mémoire and the project performance report. Unfortunately, this does not appear to be happening. These monitoring arrangements essentially overlap with approaches to monitoring governance matters through GGFs, and GACAP II essentially provides a mechanism for GGFs to be replaced by risk assessments and risk management plans at the project level.

11. On balance, the following are recommended:

- (i) Remove the requirement for GGFs for new programs and projects approved but ensure that GACAP II risk assessments and risk management plans are completed at the program and project approval stage, and that these are adapted as necessary to include any specific features of GGFs that ADB considers should continue to be monitored at the project and program levels.<sup>29</sup> Ideally, risk assessments and risk management plans should also be prepared for all ongoing as well as new projects and programs, though this will take considerable time and resources. To the extent that resources do not

<sup>29</sup> One issue for ADB management to resolve is where final responsibilities and powers lie in terms of preparing, approving, and monitoring risk assessments and risk management plans. While the GACAP II guidelines already largely address responsibility issues, such matters may warrant further discussion and agreement between the Cambodia Resident Mission and the Southeast Asia Department. There are likely to be differences in approach between country-level assessments (to be prepared and monitored as part of the country partnership strategy exercises) and sector and program and project assessments and risk management plans. At the program and project levels, there is a case that those preparing the program or project should also be responsible for ensuring preparation of the risk assessment and risk management plan. However, there is also a case for the Cambodia Resident Mission, with its local knowledge, to be integrally involved and perhaps to have final sign-off rights. The Cambodia Resident Mission is also keen to ensure that future terms of reference for consultants fully and properly set out the responsibilities of consultants in implementing and monitoring governance-related matters (including their roles in facilitating quality procurements).

- allow all ongoing programs and projects to be retrofitted with risk assessments and risk management plans, there may be need for a transition period where GGFs are used to monitor ongoing projects, while all newly approved projects and programs are monitored by risk assessments and risk management plans, with GGFs eventually being phased out.
- (ii) Put in place clear monitoring arrangements and responsibilities in line with the GACAP II guidelines. At the project level this will mean inclusion in reports and recommendations of the President and project administration manuals, with formal monitoring (and if necessary revision) occurring at the time of project reviews with results communicated to the government, in aide-mémoire and in project performance reviews. At the country level, the risk assessments and risk management plans are to be prepared and approved at the time of the country partnership strategy preparation, while reviews (and if necessary revisions) occur following portfolio reviews. Staffing responsibilities at the program and project levels are largely likely to fall to sector program and project management staff in Manila and Phnom Penh (depending on where responsibility for management and monitoring for particular programs or projects is located) to be integrated into normal program and project reviews. Where necessary for complex or difficult matters, outsourcing to governance and/or audit experts, both inside and outside of ADB, as appropriate, may need to be considered. The prescribed approaches to monitoring and reporting are only likely to be successful if there are adequate resources made available for necessary tasks and if ADB considers the approach to be worthwhile and thus insists on compliance by managers and staff. In terms of resources, consideration could be given to providing technical assistance, as required, to recruit governance and/or audit experts who will monitor critical programs and projects, including those where ADB mission leaders are not yet fully meeting their governance monitoring responsibilities.

# Appendix 5

## Persons Met During the Missions in May–June and October 2011

Name	Position and Institution
<b>A. Government Officials</b>	
Chea Vuthna	Director, Internal Audit Department, Ministry of Economy and Finance
Chhay Kim	Deputy Auditor General, National Audit Authority
Chhay Nuppakun	Director, Technical Department, National Audit Authority
Chou Kimleng	Undersecretary of State, Ministry of Economy and Finance
Hang Chuon Naron, PhD	Secretary of State, Ministry of Economy and Finance
Hiv Sovann	Advisor to Prime Minister and First Deputy Chairman of National Treasury, MEF
Keat Chea	Senior Officer, Cambodia Investment Board
Keo Chea	Director of Audit Department 3, National Audit Authority
Long Atichbora	Director, Technical Department, National Audit Authority
Luk Nhep	Secretary General, National Audit Authority
Ngan Chamroeun	Deputy Director General, Ministry of Interior and NCDD-S
Ngo Hongly	Secretary General, Council for Administrative Reform
Nguonphan Sophea	Chief of Administration, Anti-Corruption Institution
Ouk Saravudh	Secretary General, National Audit Authority
Panhha Orn	Assistant to Senior Minister, CAR, Council of Ministers
Pen Thirong	Director, Department Investment and Cooperation, MEF
Sak Setha	Secretary of State, Ministry of Interior
Sar Sambath	Permanent Member, Anti-Corruption Institution
Sok Saravuth, PhD	Director, Budget Department and Manager, PFM Reform Committee, MEF
Tou Chhorn	Director Audit Department 2, National Audit Authority
Veng Sakhon	Secretary of State, Ministry of Water Resources and Meteorology
Vongsey Vissoth	Secretary General, Ministry of Economy and Finance
<b>B. Other Persons Met</b>	
Asplund, Eva	Country Director, Sida, Embassy of Sweden
Baranes, Sophie	Deputy Country Director, UNDP
Beans, Georgia	Country Representative, PACT <sup>a</sup>
Benicy, Alain	Adviser, Administrative Reform, Council for Administrative Reform
Bloom, Karin Schelzig	Social Sector Specialist, Cambodia Resident Mission, ADB

*continued on next page*

## Continued

Name	Position and Institution
Brimble, Peter	Senior Country Economist, Cambodia Resident Mission, ADB
Broch, Peter	Senior Transport Economist Cambodia Resident Mission, ADB
Chantha Kim	Programs Officer, Regional Cooperation, Cambodia Resident Mission, ADB
Doung, Poullang	Economics and Financial Sector Specialist, Cambodia Resident Mission, ADB
April, Leah	PFM Program Officer, World Bank
Engquist, Michael	Human Rights and Good Governance Adviser, Danida, Danish Embassy
Gagnon, Eric	Senior Procurement Specialist, Cambodia Resident Mission, ADB
Garvey, Stephanie	Democracy and Governance Officer, USAID, Embassy of USA
Grayling, Tim	Infrastructure Adviser, Program Support Division, NCDD
Guimbert, Stephane	Senior Country Economist, World Bank
Hem, Chanthou	Project Implementation Officer, Cambodia Resident Mission, ADB
Ikemoto, Nao	Senior Natural Resources Management Specialist, Cambodia Resident Mission, ADB
Kamayana, Putu	Country Director, Cambodia Resident Mission, ADB
Keng Bun Chhoeuth	Country Director, Cambodian Organization for Research and Development
Klindt Petersen, Jesper	Portfolio Management Specialist, Cambodia Resident Mission, ADB
Long, Piseth	Project Implementation Officer, Cambodia Resident Mission, ADB
Ly, Sodeth	PFM Specialist, World Bank
Maugham, Stewart	Accounting Specialist, ADB TA Strengthening Public Financial Management for Rural Development
Nida Ouk	Senior Project Implementation Officer, Cambodia Resident Mission, ADB
Nguon Meng Tech	Director General, Cambodia Chamber of Commerce
Patel, Natin Kumar	Procurement Adviser, IMF Financing Schemes, MEF
Praivan, Limpanboon	Director, Civil Society Program, Asia Foundation
Sarath, Chhay	Coordinator, Cambodians for Resource Revenue Transparency
Sideth, Sam	Education Specialist, Cambodia Resident Mission, ADB
Sisombat, Lili	Country Representative, International Finance Corporation, World Bank
Sullivan, Hal	Procurement Specialist, ADB TA: Strengthening Public Financial Management for Rural Development
Wingfield, Tom	Governance Adviser, Department for International Development of the United Kingdom

<sup>a</sup> PACT is an international advocacy nongovernment organization.

ADB = Asian Development Bank, CAR = Council for Administrative Reform, IMF = International Monetary Fund, MEF = Ministry of Economy and Finance, NCDD-S = National Committee for Sub-National Democratic Development Secretariat, PFM = public financial management, TA = technical assistance, UNDP = United Nations Development Programme, USA = United States of America, USAID = United States Agency for International Development.

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## **Cambodia: Country Governance Risk Assessment and Risk Management Plan**

This publication assesses the governance risks for activities of the Asian Development Bank (ADB) in Cambodia and recommends risk mitigation measures for the public sector. It follows the Guidelines for Implementing ADB's Second Governance and Anticorruption Action Plan (GACAP II), focusing on public financial management, procurement, and anticorruption.

The assessment explores the status of public procurement, internal controls, and the accountability framework for public expenditures, including internal audit and external audit capacities. It also examines the adoption of the Anti-Corruption Law in 2010.


This publication dealing with improving public sector accountability should interest government officials, policy makers, bilateral and multilateral development partners, and nongovernment organizations.

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Asian Development Bank  
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