

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) Cambodia

ACCOUNTING AND AUDITING
May 15, 2007

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EXECUTIVE SUMMARY

This report provides an assessment of accounting and auditing practices within the corporate sector in Cambodia with reference to the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), and the International Standards on Auditing (ISA) issued by the International Federation of Accountants (IFAC). This assessment is positioned within the broader context of the Cambodia's institutional framework and capacity needed to ensure the quality of corporate financial reporting

Cambodia is putting in place an institutional framework with regard to accounting, auditing, and financial reporting practices. However, institutional weaknesses in regulation, compliance, and enforcement of standards and rules still exist. The accounting and auditing statutory framework suffers from inconsistencies among different laws. Although the national accounting standards and auditing standards are based on IFRS, and ISA, respectively, they appear outmoded and have gaps in comparison with the international equivalents. There are varying compliance gaps in both accounting and auditing practices. These gaps could primarily stem from lack of clearer understanding by professional accountants, inadequate technical capacities of the regulators, absence of implementation guidance, lack of independent oversight of the auditing profession, and shortcomings in professional education and training. There is little awareness of the importance of quality financial information in Cambodia. Financial reporting is driven primarily by complying with requirements of shareholders, obtaining bank loans, and satisfying the taxation regime. Auditing in Cambodia is perceived as an exercise of little value. The law does not outline which standards should be followed in conducting audits. Cambodia's accounting profession is largely dominated by the members of the Association of Chartered Certified Accountants of the United Kingdom. The Kampuchea Institute of Certified Public Accountants and Auditors is in its early stage of development and should be geared to contribute in creating an enabling environment for high-quality corporate financial reporting and auditing practices in the country.

The policy recommendations are aimed for consideration by Cambodian authorities. These principle-based policy recommendations include improving statutory framework, strengthening monitoring and enforcement mechanism, upgrading academic and professional education and training, instituting an arrangement for independent oversight of auditing profession, capacity building of regulators and the professional body, adoption of full IFRS and ISA, upgrading the licensing procedures for accountants and auditors in practice, introducing a Cambodian professional qualification examination with focus on adequate level of practical training, issuing and disseminating implementation guidance on applicable standards, enhancing the delivery of continuing professional education, and ensuring adherence to code of ethics. Considering the limited capacity of Cambodian institutions, the recommendations are premised to integrate with regional initiatives, where possible and to building on the existing systems and promote a gradual and continuing process of improvement.

PREFACE

There is a broad agreement among members of the international financial community that the observance of international standards and codes is pivotal in strengthening national and international financial architecture. In a world of integrated capital markets, financial crises in individual countries can imperil international financial stability. At the international level, international standards enhance transparency. They help to better identify weaknesses that could contribute to economic and financial vulnerability, foster market efficiency and discipline, and ultimately contribute to a global economy that is more robust and less prone to crisis. At the national level, international standards provide a benchmark that can help identify vulnerabilities as well as guide policy reform. To best serve these objectives, however, the scope and application of such standards needs to be assessed in the context of a country's overall development strategy and tailored to individual country circumstances.

Following the Asian financial crisis in 1997, the international community recognized the real need to assess the degree to which a country observes the internationally recognized standards and codes. The World Bank and the International Monetary Fund (IMF) instituted *Reports on the Observance of Standards and Codes (ROSC)* that assess key areas in a country's economic well-being: accounting and auditing, anti-money laundering and combating the financing of terrorism, banking supervision, corporate governance, data dissemination, fiscal transparency, insolvency and creditor rights, insurance supervision, monetary and fiscal policy transparency, payments system, and securities regulation.

The ROSC Accounting & Auditing review focuses on the institutional framework regulating the accounting and auditing practices, comparability of national accounting and auditing practices with international standards and good practices using International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks, and evaluates the effectiveness of enforcement mechanisms for ensuring compliance with applicable standards and codes.

This ROSC Accounting and Auditing review was carried out in active collaboration with the Government of Cambodia through the National Accounting Council (NAC) and with assistance of stakeholders including the Kampuchea Institute of Certified Practicing Accountants and Auditors, Department of Finance and Industry of the Ministry of Economy and Finance, National Bank of Cambodia, National Audit Authority of Cambodia, and Phnom Penh Chamber of Commerce. It included discussions with representatives of the profession, banks, insurance companies, corporate entities, state-owned enterprises, audit firms, microfinance institutions, corporate accountants and academics. The NAC guided and facilitated the study process with leadership from H.E. Ngy Tayi, Under-Secretary of State and Chairman of the NAC, with support from H.E. Keat Reasmey, Secretary General, and Messrs Alexander Sun, Sar Kinal and Seng Tola of the NAC.

The review benefited from inputs and suggestions from peer reviewers: Georges Barthes de Ruyter, former Chairman of the International Accounting Standards Committee; Richard L. Symonds, Senior Counsel, Legal Private Sector Development; Donald Mphande, Senior Financial Management Specialist, East Asia Pacific; and Thomas Rose, Adviser, Financial Sector, East Asia Pacific. This report owes very much to the outstanding administrative support of Sophear Khiev, World Bank office in Phnom Penh, Cambodia. The report was prepared by a team comprising Jennifer Thomson, Senior Financial Management Specialist, East Asia Pacific Financial Management (Task Team Leader); M. Zubaidur Rahman, Program Manager, Financial Management Unit, OPCS (Study Adviser and Team Member); and Dr. Humayun Murshed, International Consultant.

ABBREVIATIONS AND ACRONYMS

ACCA	Association of Chartered Certified Accountants (UK)
ASEAN	Association of South East Asian Nations
CPD	Continuing Professional Development
CPA	Certified Practicing Accountant
EAPCO	East Asia Pacific IAS International Accounting Standard
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IASCF	International Accounting Standards Committee Foundation
IFAC	International Federation of Accountants
IFRIC	International Financial Reporting Interpretation Committee
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
ISA	International Standard on Auditing
KICPAA	Kampuchea Institute of Certified Public Accountants and Auditors
MEF	Ministry of Economy and Finance of Cambodia
NAC	National Accounting Council of Cambodia
NBC	National Bank of Cambodia
NGO	Nongovernmental organizations
ROSC	Reports on the Observance of Standards and Codes
SME	Small and Medium Size Enterprises
SOE	State-owned enterprise

I. INTRODUCTION

1. This assessment of accounting and auditing practices in Cambodia is part of a joint initiative of the World Bank and the International Monetary Fund (IMF) to prepare *Reports on the Observance of Standards and Codes* (ROSC). The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting and involves a review of both mandatory requirements and actual practice. It uses International Financial Reporting Standards (IFRS)¹ and International Standards on Auditing (ISA)² as benchmarks, and draws on international experience and good practices in the field of accounting and audit regulation. The assessment uses a diagnostic template developed by the World Bank to facilitate collection of data. The data is complemented by the findings of a due diligence exercise based on a series of meetings with key stakeholders conducted by World Bank staff. The intended audience of the ROSC includes national and international market participants with an interest in the corporate financial reporting regime of Cambodia. An overview of the ROSC Accounting and Auditing and the detailed presentation of methodologies are available in the World Bank Group website.³

2. **Post-Conflict Development.** Cambodia is a small, predominantly rural country of 13.4 million people with gross national income per capita of US\$320.⁴ The country is at a development crossroad as it moves away from a post-conflict situation toward a more normal development paradigm.⁵ Over two decades of conflict that ended in 1991 confounded many of the country's important institutions of governance and management. As a post-conflict and low-income country, Cambodia clearly faces profound development challenges. Yet at the same time, the country has made important progress in ensuring peace and security, rebuilding institutions, and establishing a stable macroeconomic environment, and a liberal investment regime.⁶

3. **Economic Growth.** Since the early 1990s, Cambodia has enjoyed over a decade of high average economic growth—7.1 percent—driven largely by construction; tourism; and, since the late 1990s, a rapidly emerging garment sector. There is an increase in private investment in response to an improved investment climate, as government reforms begin to show results. Budgetary performance continued to improve in 2005 with the overall fiscal deficit estimated at 3.1% percent of gross domestic product, narrower than the average of the previous 5 years.⁷ A gradual improvement in revenue mobilization, due to additional tax measures and strengthened revenue administration, was accompanied by lower overall spending.

¹ IFRS correspond to the pronouncements issued by the International Accounting Standards Board (IASB) and International Accounting Standards (IAS) issued by its predecessor, the International Accounting Standards Committee (IASC), as well as related official interpretations.

² ISA are issued by the International Auditing and Assurance Standards Board (IAASB) within the International Federation of Accountants (IFAC).

³ Access ROSC Accounting and Auditing at www.worldbank.org/ifa/rosc_aa.html.

⁴ Data from www.doingbusiness.org.

⁵ *Country Assistance Strategy for the Kingdom of Cambodia*, World Bank, 2005.

⁶ *Cambodia: Ex Post Assessment of Longer-Term Program Engagement*, IMF, 2004.

⁷ *Development Outlook 2006*, Asian Development Bank.

4. **Governance.** Notwithstanding these achievements, the development agenda remains large. Poverty rates remain high with 35-40 percent of the population remaining below the poverty line, and 15-20 percent in extreme poverty; inequality appears to be increasing. Achieving many of the Millennium Development Goals of Cambodia will be difficult unless there are improvements in accountability and governance. Weak institutions and limited mechanisms of accountability, which are legacies of Cambodia's recent history, contribute to high levels of corruption evidence suggests seriously constrains economic growth, private sector development, and poverty reduction. Poor governance is a primary constraint on development in general, and on the World Bank Group's program in particular.⁸ High quality accounting and auditing together with transparent sound corporate reporting are critical to enhancing governance and the environment for economic growth and financial stability.

5. **Banking.** Cambodia's financial sector is at a rudimentary stage, with limited financial intermediation and low public confidence.⁹ The country had a mono-banking system when the National Bank of Cambodia (NBC) operated through its provincial branches. Structural reforms were initiated in 1989 through a Government decree to establish a two-tier banking system by separating the function of commercial banks from the National Bank of Cambodia. This decree allowed the formation of private commercial banks as limited liability companies. In 2000 the Government embarked on a comprehensive bank restructuring program with the IMF assistance in order to enhance public confidence in banking. As of December 31, 2006, Cambodia has 15 commercial banks, 5 specialized banks, 17 licensed microfinance institutions, 24 registered microfinance nongovernmental organizations (NGOs), and 4 insurance companies. In the rural areas, banking services are even scarcer; the microfinance operations of NGOs are the de facto providers of credit there. About 90 NGOs, supported by international funding agencies, provide microfinance to nearly 471,000 poor households; most borrowers are women.

6. **Capital Markets.** There are no capital markets in Cambodia. Proper development of capital market requires appropriate legal and accounting infrastructure, necessary regulatory and institutional structures, and human resource capacity. Having made progress in governance reform (with assistance from international development partners, including the World Bank and Asian Development Bank), the Government is moving toward capital market development. It has established a capital market unit in the Ministry of Economy and Finance (MEF). The Government is also considering creating an independent securities supervisory body responsible for overseeing the functions of capital market.

⁸ The Cambodia Country Assistance Strategy focuses on improving governance and combating corruption as the country's central development challenge.

⁹ *Cambodia: Financial Sector Blueprint for 2001-2010*, Asian Development Bank, 2001.

7. **Private Sector.** The structure of Cambodia's private sector is characterized by a high degree of informality and little long-term investment in productive sectors.¹⁰ Generally speaking, the typical firm is family owned; therefore, there is often no separation between management and ownership. The SMEs, which dominate the private sector in Cambodia, operate in an uncertain environment and limited assets to use collaterals and shorter credit histories make it more difficult for these entities to obtain financing from institutional sources. Diversifying the private sector is an important agenda of the National Poverty Reduction Strategy. Most observers agree that Cambodia has the potential to grow through post-harvest agro-industry.¹¹ The growth of the private sector over the past decade has been remarkable in light of the destruction wrought by years of conflict and has proven that private investment can create jobs at wage levels that can reduce poverty.¹² A number of international firms have already made substantial investments in Cambodian infrastructure.

8. **Strategy.** Several of the following key components of the Cambodian Government's strategy to reduce poverty and support the country's economic development depend on strong financial reporting, accounting, and auditing practices by the private sector:

- *Creating a better investment environment in order to improve competitiveness and achieve sustained economic growth.* Enhanced financial transparency is critical to attracting foreign direct investment. This can only be achieved by maintaining sound financial reporting practices within the private sector. As Cambodia moves towards further reforms in order to foster an investment-friendly climate these efforts should be supported through enhanced financial transparency and improved accounting and auditing practices. Accounting and auditing should contribute to the reform process by adequately serving the needs of providers and users of financial information and helping the market economy grow.
- *Tax reform in order to enhance mobilization of internal resources.* The reliability of financial information produced by corporate taxpayers is essential to enable the government to enhance tax revenue generation.
- *Privatization program.* Success will largely depend on the active involvement of international investors and industrial groups, which in turn will call for strengthening corporate financial reporting practices in Cambodia. From the Government's standpoint, accessing reliable financial information will be a key to maximizing revenues derived from these transactions and to monitor these activities once privatized. Financial transparency and adequate financial

¹⁰ *Cambodia: Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy for Cambodia*, World Bank, 2004.

¹¹ *Cambodia: Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy for Cambodia*, The World Bank, 2004.

¹² *Cambodia: Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy for Cambodia*, The World Bank, 2004.

disclosures should be required in state-owned enterprises in order to facilitate good governance, fiscal discipline, and optimum allocation of scarce resources.

- *Strengthening bank supervision, as part of structural reforms.* Strong accounting and auditing practices are essential elements, as emphasized by the recommendations of the Basel Committee on Banking Supervision.
- *Improving access to financing for the small and medium enterprise sector* by providing banks and venture capitalists with standardized, useful, and reliable information.

II. INSTITUTIONAL FRAMEWORK

A. Statutory Framework

9. This section outlines the legal principles applicable with regard to accounting, auditing, and financial reporting and an introduction to issues concerning the institutional framework.

10. **Law on Commercial Enterprise and Law on Corporate Accounts, their Audit and the Accounting Profession.** Basic requirements for accounting, financial reporting, and auditing in Cambodia are set out in the Law on Commercial Enterprises (*the Company Law*) and the Law on Corporate Accounts, their Audit and the Accounting Profession (*the Accounting Law*).

11. **Inconsistencies.** The Company Law and the Accounting Law require companies incorporated in Cambodia to prepare annual financial statements along with providing requirements for preparation, presentation, and publication of financial statements, disclosures, and auditing for the companies. Some of the legal inconsistencies between the two laws in terms of accounting, auditing, and financial reporting requirements are cited below:

- The Company Law requires business entities to prepare comparative financial statements “for the current financial year and prior financial year.”¹³ There is no

¹³ “The aim is to indicate the nature of inconsistencies between the applicable laws. Article 224 of the Company Law states, “At every general meeting of shareholders, the directors shall present an annual financial statement to the shareholders. The statement shall include.....comparative financial statements for the current financial year and the prior financial year”. However, there is no such indication in the Accounting Law. Article 8 under the Chapter 3 of the Accounting Law states, “The financial statements shall include the balance sheet, the income statement, the cash flow statement, and explanatory notes.” and the Article 11 under the same chapter states, “the duration of the accounting period shall be twelve months. The accounting period shall begin on the first day of January and end on 31st day of December of the same year.”

such requirement set by the Accounting Law implying that the enterprises will only prepare the current year's financial statements.

- The Accounting Law states all enterprises attaining certain thresholds are subject to statutory audit, conducted by the members of Kampuchea Institute of Certified Public Accountants and Auditors (KICPAA).¹⁴ The Company Law exempts audit requirement for a company that has “not issued securities to the public, or that does not have any outstanding securities held by more than one person.”¹⁵ This may lead to a situation where large business entities having significant public interests will be outside of the statutory audit requirements.

Neither the Company Law nor the Accounting Law mentions whether these differing provisions will be superseded by the enactment of any one of these laws. Article 9 of the Accounting Law requires that financial statements are to be prepared in the local Khmer language and in Riels.

12. The Company Law regulates business activities in Cambodia. The Law recognizes four types of business entities:

- *General partnership* is set up under an agreement between two or more legal entities and/or natural persons, who are jointly and severally liable for the firm's commitments, and undertaken to conduct a certain business under a common name.
- *Limited partnership* is formed under an agreement between two or more parties for the purpose of conducting business under a joint name, in which at least one—the general partner—is jointly and severally liable for partnership's commitment, and at least one person—the limited partner—is limited to a contracted investment.
- *Private limited companies* have shares that are not publicly tradable. These companies have a limited number of shareholders (not exceeding 30). Private limited companies generally have a unitary board (board of directors).
- *Public limited companies* have shares that may be publicly tradable. These companies generally have a large number of owners. Public limited companies, including banks and similar financial institutions and insurance companies, have a two-tier management structure (board of directors and supervisory board).

13. Cambodia's laws and regulations do not provide a robust statutory framework in the area of accounting and auditing. Apart from inconsistencies among laws, in many cases the laws appear to be indistinct and do not cover pertinent crucial issues, thus leaving room for misinterpretation. In order to establish a strong corporate financial reporting regime, Cambodia should address significant issues in design and strengthening of suitable institutions to implement and enforce accounting, auditing, and financial reporting requirements in line with international good practices.

¹⁴ These thresholds are yet to be defined by the MEF

¹⁵ Article 230, Law on Commercial Enterprises

14. **The Company Law and Accounting Law have requirements that shareholders approve the financial statements of a company and establish that members of the board of directors are responsible for the probity of legal entity and financial statements.** Members of boards of directors are responsible for preparation of the entity's financial statements and required to submit these statements (audited where applicable) for approval to the general shareholders' meeting within six months of the financial year-end. Failure to present financial statements for shareholders' approval may lead to a fine or imprisonment or both.¹⁶ The right of shareholders to approve the legal entity financial statements is important in that it allows the "owners" of the company to check on the performance of management and its stewardship of the entity's resources. Except for banks and similar financial institutions there is no legal requirement for the Cambodian entities to file their annual financial statements to any authority of Cambodia.

15. **While the Accounting Law mandates the use of Cambodian Accounting Standards for preparation of legal entity financial statements, small and medium enterprises are subject to simplified accounting requirements.** Article 4 of the Accounting Law requires that enterprises must comply with "Cambodian Accounting Standards, the principles of which are proclaimed by the Ministry of Economy and Finance and in line with International Accounting Standards." Parallel to this, since June 2006 the Ministry of Economy and Finance allows the small and medium enterprise, fulfilling any two of the following thresholds, to follow simplified financial reporting requirements and prepare their financial statements using the MEF-issued *Financial Reporting Template for Small- and Medium-Sized Enterprises*:

- Total maximum number of employees is from 11 to 100.
- Annual turnover is from 100 million Riels to less than 250 million Riels.
- Total assets are from 100 million Riels to 250 million Riels.

This is an appropriate step since IFRS-based standards seem not only unnecessarily onerous for small and medium enterprises but also inapplicable. The IFRS should be used unchanged as the standards for public interest entities,¹⁷ and separate standards should apply for other entities. Experience shows that this can ensure greater success and an improved compliance culture.

16. **The Accounting Law mandates the National Accounting Council (NAC) to act as policy overseer in the field of accounting.** The National Accounting Council was established as an MEF division under the Accounting Law in 2003 as the official standard-setting body along with the authority of reviewing "all draft laws and regulations which consist of provisions pertaining to the preparation of accounting work

¹⁶ Article 296, Law on Commercial Enterprises and Article 18 of the Accounting Law

¹⁷ Within this report, public interest entities are those in which the general public has an interest by virtue of the nature of their business size, their number of employees, or their range of stakeholders. Examples include banks and similar financial institutions, insurance companies, investment funds, pension funds, publicly traded companies, and large enterprises, including large state-owned enterprises.

for all enterprises or economic activities.”¹⁸ However, it does not have an explicit mandate for monitoring and enforcing applicable accounting standards in Cambodia. The National Accounting Council is composed of representatives of various ministries, KICPAA, National Bank of Cambodia, academia, and the business community. In order to discharge its mandated responsibilities, the National Accounting Council requires significant capacity building.

17. The Accounting Law gives legal mandate to the KICPAA for regulating the accountancy profession under MEF supervision. The KICPAA was established by the Accounting Law in 2003. The fundamental objective of this institute is to act as a body for determining and maintaining adequate professional standards for its members and awarding the license for its members engaged in the public accountancy practice. KICPAA functions through its Governing Council which comprises nine elected members. The major statutory functions of the KICPAA Council include designing and implementing policies regarding admission of membership, administering programs for members’ professional development, ensuring adherence to professional ethics and standards, and taking disciplinary actions against erring members. KICPAA is a member of ASEAN Federation of Accountants but not a member of the International Federation of Accountants (IFAC).

18. The National Accounting Council has issued Cambodian Standards on Auditing. There is no legislation establishing which audit standards to apply for statutory audits. Auditors in Cambodia purport to comply with the Cambodian Standards on Auditing. However, there is no legal authority for this approach.

19. Except for banks and similar financial institutions, there is no requirement for companies to file their annual financial statements. This has seriously constrained the availability of financial information about important business entities operating in Cambodia. Due to the absence of such legal requirement, many business enterprises appear to be reluctant even in preparation of their financial statements. Due to non-availability of financial statements, it is difficult for public users and potential investors to compare the quality of financial statements and assess the financial standing of a given enterprise thereby limiting informed decision-making. Furthermore, it is an impediment to transparency in the corporate sector and can have detrimental effects on the country’s investment climate. Except in the case of banks, the ROSC team had considerable difficulties in accessing legal entities’ financial statements. From the discussions held during the ROSC due diligence mission, it was inferred that many corporate entities view the preparation of financial statements as merely ritual, and mainly necessary either for taxation purposes or obtaining bank financing.

20. There is no legal requirement for group of companies to prepare consolidated financial statements. For the companies with subsidiaries in Cambodia, there is no legislative requirement for consolidation. This represents a serious shortcoming in the regulatory framework as non-consolidated financial statements provide an incomplete

¹⁸ Article 7, Law on Corporate Accounts, their Audit and the Accounting Profession.

view of company's financial performance and position. Whenever applicable, the presentation of consolidated financial statements should be mandated by the law.

21. **The Law on Banking and Financial Institutions (the Banking Law) set the requirements for financial reporting by banks and microfinance institutions and related regulations issued by the National Bank of Cambodia.** Under the Banking Law and related regulations, banks and microfinance institutions must issue audited financial statements by March 31 of each calendar year. The financial statements must comply with the requirements of Cambodian Accounting Standards; however, "in the event the accounting requirements imposed by the National Bank of Cambodia are different from those of the Cambodian Accounting Standards, the NBC requirements will prevail and take precedence over the Cambodian Accounting Standards."¹⁹ Banks and microfinance institutions are also subject to monthly financial reporting, including statement of assets and liabilities, detailed information on loans and deposits, and various financial ratios. The National Bank of Cambodia prescribes the chart of accounts and formats for banks and microfinance institutions in order to prepare their financial statements.

22. **Banks comply with the NBC-mandated filing requirements.** Banks must publish and submit their audited annual financial statements together with the auditor's report to the National Bank of Cambodia by June 30 of each calendar year. Legal entity financial statements of some banks are available on their websites.

23. **The National Bank of Cambodia approves the appointment of statutory auditors to perform the audit of financial statements of banks and microfinance institutions.** Given the low capacity of audit firms this pre-approval process is a good ex ante monitoring of the audit quality. Before December 31 of each calendar year, banks and microfinance institutions must notify the National Bank of Cambodia with the name of the selected statutory auditors for its approval. There is no clearly defined approval process adopted by the National Bank of Cambodia. It maintains a list of selected qualified auditors, which includes both local and members of international audit firm networks. In practice, banks and large microfinance institutions select and ask NBC approval for local member firms of international audit firm networks that are operating in the Cambodian audit market. The National Bank of Cambodia has the right to reject the statutory auditors selected by the banks without assigning any reason. Banks and microfinance institutions are required to change their statutory auditors every three years.

24. **The Insurance Law sets out the various compositions of technical provisions relating to insurance contract but not the measurement principles and disclosure requirements with respect to financial reporting.** Insurance companies are not required to comply with specific accounting, auditing, and financial reporting requirements. The Financial Industry Department of the Ministry of Economy and Finance has not yet prepared insurance accounting regulations concerning financial statements. In Cambodia, no insurance companies publish their annual financial

¹⁹ This is outlined in the *Prakas* (official pronouncement) by the National Bank of Cambodia issued on December 25, 2002.

statements. This practice seriously limits provision of any information of significant public interests.

25. Cambodian tax law requires companies to submit annual financial statements with their annual tax returns. The companies derive corporate income for tax purposes after adjusting relevant figures from their general purpose financial statements, as per applicable provisions and allowances under the tax law.

26. The Law on Audit established the National Audit Authority and empowers the Auditor General to conduct audits of state-owned enterprises. The audit conducted by the Auditor General's Office primarily focuses on the compliance with rules governing SOE financial management. The National Audit Authority has developed a set of audit guidelines geared toward acquiescence of pertinent rules and regulations. The government staff responsible for providing guidance on conducting SOE audits needs better exposure to relevant public sector accounting and auditing pronouncements by the International Federation of Accountants. It should be noted that limited information is publicly available on the financial position and performance of state-owned enterprises.

B. The Profession

27. The public accountancy profession in Cambodia is at an early stage of development. The Kampuchea Institute of Certified Public Accountants and Auditors is unable to move the profession forward or project its image as an effective regulator of the public accountancy profession in Cambodia. This is primarily due to its lack of technical capabilities and scarce governance structure. The KICPAA governance primarily rests on volunteers from its members. It does not have technical resources to provide guidance to its members on important issues for implementing applicable accounting and auditing standards in Cambodia and for instituting adequate quality assurance arrangements with respect to performance of its members. Assessed in comparison with IFAC's Statements of Membership Obligation, the KICPAA falls short of public expectations for a professional body.

28. All KICPAA members hold foreign accountancy qualifications. The KICPAA membership recognizes foreign professional accountancy qualifications for membership without requiring further examination.²⁰ At present, all KICPAA members hold foreign accountancy qualifications. A large majority are qualified under the Association of Chartered Certified Accountants (ACCA) of the United Kingdom. The ACCA has a discernible presence in Cambodia. With the unavailability of local qualifications, ACCA qualifications are becoming increasingly popular in Cambodia primarily due to its international marketability. There is an increasing tendency among the aspiring accountants in Cambodia to obtain ACCA professional qualifications, however, many Cambodian find it expensive to pursue this qualification.

²⁰ Currently KICPAA does not have any list of recognized professional accounting qualifications. However, the current membership draws from the accountancy professional bodies of Australia, England and Wales, New Zealand, as well as the Association of Chartered Certified Accountants, United Kingdom.

29. **Beginning in 2010, only professional accountants who are Cambodian citizens can undertake audit attestation services.** The KICPAA members with 3 years of practical training in the field of accounting and auditing are eligible to undertake audit services. Currently, most of the 29 KICPAA members are foreigners. All current members can undertake audit services regardless of their nationalities. However, by a legislative order beginning January 1, 2010, the Ministry of Economy and Finance mandates that only qualified members of KICPAA, who are Cambodian citizens, can provide audit services.

30. **The actual market for audit services in Cambodia is relatively small due to a relatively low demand.** There are 9 audit firms operating in Cambodia, including members of the large international accounting firm networks. Most banks, as well as large corporate entities, are audited by local members of international firm networks. The local audit firms are small, mainly with one partner, and mostly concentrate on tax cases along with performing bookkeeping services and conducting audits for small companies.

31. **Except for large entities, the corporate sector in general does not have access to professionally qualified accountants.** The accountants for many corporate entities, including some banks, lack the required skills to prepare financial statements in accordance with applicable accounting and reporting requirements. Consequently, compliance by preparers of financial statements with applicable requirements in many cases is limited. Furthermore, the limitations in legal and regulatory environment provide little incentive for company directors to ensure that financial statements are prepared as per established standards.

32. **There is no system in place to ensure that auditors comply with the IFAC Code of Ethics for Professional Accountants.** Among auditors with whom the ROSC team met there is a varying degree of awareness of the actual content of the ethical standards. Without any means of ensuring auditors are working in compliance with ethical standards, the public cannot be assured of the Cambodian auditors' genuine commitment and adherence to internationally agreed standards of integrity and objectivity, professional competence and due care, confidentiality, professional behavior, and technical standards. In essence, so far the KICPAA has not undertaken any effort to ensure compliance with the code of ethics.

33. **The independence of auditors from the audited entities is not effectively practiced.** The current practice in Cambodia of independence in auditing is not in line with the requirements of the IFAC Code of Ethics for Professional Accountants. While there are factors outside the profession which directly affect auditors' ability to act independently (e.g., the limited capacity in many companies to prepare proper financial statements), the possible breaches of independence requirements adversely affect the perceived value of audit. Additionally, many stakeholders perceive that auditors' involvement in both audit and tax advocacy may threaten auditors' independence.

34. **Cambodia's relevant laws do not provide for significant penalties against negligent auditors.** Certain factors appear to adversely affect auditors' accountability.

There is no legal requirement to take professional liability insurance. This tends to limit auditor's accountability and in many cases has created an environment of unconcern toward risks of malpractice suits by auditors. Moreover, Cambodia has not yet experienced any litigation against auditors.

35. The statutory audit firms lack capacity while some promote “sleeping partners.” Many audit firms, including the members of large international firm networks, do not have an adequate number of qualified staff to conduct work. Consequently, most actual audits are being carried out by trainee accountants. Furthermore, there are cases where audit firms are using the name of persons, who are not present in Cambodia. This arrangement promotes the “sleeping partner,” joining a firm in name only without actual work to boost the size of a firm to gain business.

36. Management tends not to take full responsibility for preparing financial statements. Some stakeholders have cited instances when company management has either partly or fully relied on auditors to also prepare financial statements. This may be due to the lack of qualified professionals available for preparing financial statements and corporate management's misperception about the role of auditors. The latter point arises from company directors' lack of knowledge on auditing procedures thus impairing significantly their fiduciary responsibility. In order to be compliant with the independence rules, auditors should not audit the financial statements that they prepare.

37. The mandate of KICPAA does not specifically include serving the public interests. The duties of KICPAA as outlined in the Accounting Law fundamentally imply representing the KICPAA members and promoting their professional interests. The mandate of a professional auditors' association should be as much to defend the public's interests as their own. Hence the Accounting Law should make it an explicit duty of KICPAA to serve the audit profession's public who rely on the objectivity and integrity of auditors, including clients, credit grantors, governments, employers, employees, investors, and the business and financial communities. Also, government regulation of the profession through the Ministry of Economy and Finance cannot be considered as a substitute for public oversight. Any effective system of public oversight must include representatives from these stakeholder groups since no single stakeholder has a sufficiently broad scope to reflect adequately these diverse interests.

C. Professional Education and Training

38. Accounting education and training lacks the focus on skills necessary for discharging professional obligations. In opinions expressed to the ROSC team, many stakeholders felt that the overall quality of accounting education and training in the country was not sufficient to produce skilled professional accountants and auditors. Poor communication skills, insufficient practical exposure, and lack of arrangements for enhancing trainee accountants' broad-based knowledge and critical thinking ability have been identified as major contributing factors for poor quality. In essence, the accounting education in Cambodia does not adequately provide broader exposure to the necessary conditions for functioning as professional accountants; being capable of handling

challenges; and, particularly in line with emerging international developments, considering the implications of such challenges in the context of Cambodia.

39. The accounting curricula in Cambodia do not adequately prepare students in international good practices and IFAC's education standards. Most Cambodian universities offer an accounting curriculum; the same universities define the subject content with no minimum requirements. No effort has been made to harmonize the accounting curricula and establish minimum requirements for type and content of courses on accounting and auditing. The accounting curricula do not focus on IFRS and ISA but are restricted to accounting technicalities and basic procedural aspects of auditing. Moreover, most accounting textbooks lack adequate focus on the international accounting and auditing, in particular the practical application of IFRS and ISA. Some universities' curricula started integrating Cambodia Accounting Standards and Cambodia Standards on Auditing. However, the capabilities of teaching practical implications of these standards remain a concern. From interviews with university staff, the ROSC team found little academic-side involvement with the international professional accounting organizations. Universities do not subscribe to publications of the International Accounting Standards Board (IASB) and have not made attempts to implement IFAC's recommendations for accounting and auditing education.

40. There are significant challenges to overcome in the education, training and certification of professional accountants and auditors in Cambodia. Cambodia does not have in place its own curriculum and professional examination. KICPAA has a joint examination scheme with ACCA and also has entered into an agreement with the CPA, Australia. As of September 2006, there were 510 students registered for professional examination, most of them studying for ACCA qualification. Many of these students are either sponsored by private sector enterprises, including multinational companies, or by the Ministry of Economy and Finance. The passing rate for the ACCA examination is less than 4 percent. Training is provided by private tuition providers, but there are no available means to monitor the quality of these tuition providers.

41. Practical training requirements for registering a professional accountant as an independent auditor need strengthening. Prior to obtaining a practicing license, a candidate is required to have 3 years of practical training under the supervision of a qualified person in an approved training provider. KICPAA does not have any mechanism to screen practical training providers on their suitability to provide appropriate experience and does not monitor the quality of practical training.²¹

42. Continuing professional development programs do not sufficiently cover applicable standards and ethics. KICPAA members have been required recently to participate in a continuing professional development (CPD) program. The program does not stipulate specific hours of attendance and does not conform to the relevant IFAC pronouncement. KICPAA does not have any mechanism to enforce continuing

²¹ IFAC has outlined practical experience requirement in IES 5, *Practical Experience Requirements*. The standard requires that the professional body should ensure all candidates receive adequate practical experience.

development as a requirement of professional membership. The seminars focus more on general issues rather than industry-specific practical implementation of applicable accounting and auditing standards. The programs as they exist are inadequate for members to develop or maintain sufficient theoretical knowledge and professional skills. There is a clear need for improvement in the content, structure, and delivery of the CPD program. Regular checks and random audit of compliance with continuing professional development would ensure that members are indeed fulfilling this requirement.

43. Professionals working in small accountancy firms largely lack capacity to undertake audits in line with international good practices. Many practitioners in small- and medium-size firms in Cambodia are handicapped by their lack of access to current literature on the applicable accounting and auditing standards and codes. These practitioners are constantly struggling to keep their client base and earn enough to stay afloat. Such a situation could limit the quality of auditing in the country.

44. The university education in accounting lacks adequate coverage on professional values and ethics. Formal education can significantly sharpen aspiring accountants' awareness of ethical problems and can influence their reasoning and judgment with respect to ethical dilemmas. For this reason, the IFAC recommends teaching professional ethics separately in the pre-qualifying education of professional accountants.²² However, the academic accounting curriculum does not provide adequate coverage on professional ethical dimensions.

D. Setting Accounting and Auditing Standards

45. Accounting and auditing standards are issued by the National Accounting Council. Article 7 of the Accounting Law empowers the National Accounting Council to issue accounting standards in Cambodia. Accounting standards are prepared on the basis of the text of IFRS/IAS translated into local Khmer language, with some adaptations or modifications. However, in cases of auditing standards, no modifications are made to the International Standards on Auditing. The National Accounting Council has adopted 15 accounting standards and 10 auditing standards. Draft standards are not open for comment. Instead advice is sought informally from experienced individuals in accounting and auditing. Without consultative due process, the standard-setting process in Cambodia lacks involvement and input of public interest.

46. There is no explicit legal backing for the setting of auditing standards in Cambodia. In order to give the adequate legal and regulatory backing, legislative provision should be enacted empowering the National Accounting Council to issue auditing standards.

47. Although the National Accounting Council is mandated to set the accounting standards, it lacks resources. With limited budget from the state and too few staff,

²² IFAC IES 4, *Professional Values, Ethics, and Attitudes*; and IFAC Educational Guideline No. 10, *Professional Ethics for Accountants: The Educational Challenge and Practical Application*.

NAC operations are constrained. This hinders the timeliness of important NAC activities, which include timely adoption of standards, updating Cambodian standards based on changes in the international standards, and issuing guidance with respect to practical application of these standards. For example, the Council does not review accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance, with a view to reaching consensus on the appropriate accounting treatment. Therefore, preparers of financial statements generally go to the auditors to develop interpretations. Developing interpretation capacity within the National Accounting Council is expected to facilitate consistent interpretation and application of applicable accounting and auditing standards.

48. Accounting standards of banks and similar financial institutions are supplemented by NBC-issued regulations but with confusion as to the authoritative source of their standard-setting. The National Bank of Cambodia issues prudential regulations that have an impact on preparation of general purpose financial statements. Furthermore, regulations assert that the prudential requirements of the National Bank of Cambodia will prevail over Cambodian Accounting Standards in cases of contradiction in preparation of financial statements. The differences between these two accounting frameworks, could, in some cases, present a contradictory reporting framework for the banking sector. Such confusion could lead to inconsistencies in application of accounting regulations across banks limiting transparency and comparability. Or, it could result in forcing preparation of two sets of financial statements. Furthermore, it remains unclear as to which accounting profit, based on Cambodian Accounting Standards or National Bank of Cambodia requirements, will be the basis for tax calculation or profit distribution.

E. Enforcing Accounting and Auditing Standards

49. The Accounting Law does not provide a clear and effective mechanism for enforcing the corporate accounting, financial reporting, and auditing requirements. Article 18 of the Accounting Law outlines the provision of fine or imprisonment or both for noncompliance with Cambodian Accounting Standards.²³ Up to the present, there are no known noncompliance cases. This situation is compounded by lack of an effective audit pillar to report noncompliance. The Accounting Law does not define which entities are to ensure enterprises' compliance with applicable accounting, financial reporting, and auditing requirements; and what type of control the authorities should exercise in that matter. This has resulted in complete absence of monitoring and enforcement activities with regard to applicable standards. The consequence is that investors and bankers are deprived of a broad range of information that allows peer group financial analyses within a specific economic sector. This is seen by many agents in the financial system as an impediment to their investing or lending activities and ultimately hampers enterprises' access to capital.

²³ For noncompliance with Cambodian Accounting Standards, the maximum fine is 10 million Riels or 2 years imprisonment, or both.

50. **Priorities in enforcement for the National Bank of Cambodia is with prudential reporting rather than general purpose financial reporting.** The Banking Law establishes the authority to enforce accounting regulations and conduct supervision. Supervisors conduct on-site examination on each bank once per year. While this establishes a regular review of compliance with applicable accounting regulations, the National Bank of Cambodia focuses more on prudential reporting than on general purpose financial reporting. Consequently, misstatements and errors in general purpose financial statements may remain undetected or not known to the public unless prudential considerations warrant it.

51. **The NBC staff involved in enforcement activities need adequate technical accounting expertise.** There is a clear need for enhancing NBC staff's technical capabilities, particularly in terms of practical application of accounting standards with regard to monitoring and enforcement of financial reporting requirements. Banking supervisors have expertise in the legal and compliance issues outlined in different official pronouncements of the National Bank of Cambodia and can challenge banks where differences arise. However, they need to have sufficient technical accounting knowledge in order to effectively monitor and enforce compliance with regard to applicable accounting and auditing standards.

52. **It is unclear what sanctions could be imposed in the event a bank did not comply with accounting and financial reporting requirements.** The Banking Law establishes sanctions for not complying with provisions of the law, regulations and guidance. Such sanctions would include among others, administrative fines and penalties, and revocation of licenses. A range of sanctions may be imposed for departure from the approved chart of accounts. In order to ensure better compliance with the general purpose financial reporting requirements, more clarity of the sanctions regime is necessary under the banking legislative framework. Clarity of requirements and sanctions is an important underpinning of any enforcement framework as it makes clear to participants the obligations and penalties for noncompliance.

53. **The insurance regulator does not monitor compliance by insurance companies with accounting standards mainly due to its lack of technical capacity.** There is no qualified actuary or professionally qualified accountant on the staff of the MEF Financial Industry Department. This lack of expertise seriously limits capacity to verify whether the provisions relating to insurance contracts are correctly calculated, which is one of the most sensitive aspects of accounting by insurance companies. The number of staff of the concerned regulator – Financial Industry Department of Ministry of Economy and Finance is too small to allow effective on-site inspections.

54. **The KICPAA does not have any arrangement for quality control review of audit firms.** The KICPAA does not have the capacity to carry out necessary quality control review of monitoring and enforcement activities. Auditors are not subject to practice review, and there is no effective mechanism for disciplinary action in cases of violation of applicable standards. An independent review mechanism can ensure that

audit firms have adequate quality control arrangements that comply with international good practices.

55. Lack of implementation guidance is constraining full compliance of accounting and auditing standards. In Cambodia, neither the KICPAA nor other organizations issues guidance on implementation of Cambodian Accounting Standards and Cambodian Standards on Auditing. This has contributed in some cases to the knowledge gap among preparers and auditors of financial statements. Consequently, it raises a possibility of applying the standards inconsistently and resulting in compliance gaps between standards requirements and actual practices. Lacking access to modern audit practice manuals, many audit practitioners are unable to deal with important concepts like audit risk, audit planning, internal control, materiality, documentation, going concern, and quality control. With KICPAA-implemented guidance, the auditors can audit with applicable rules and standards. This guidance should incorporate cases and illustrations relevant to Cambodia and focus on industry-specific experience.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

56. Cambodian Accounting Standards were developed on the basis of International Accounting Standards, but they have not been expanded or updated for several years. The 2002 version of IAS was used to develop the Cambodian Accounting Standards. Since that time, the International Accounting Standards Committee (IASC) and its successor the International Accounting Standards Board (IASB) have issued several new standards, and updated or repealed a number of the pre-existing ones. None of the changes made to previously adopted IAS are reflected in the national standards, and later international standards have no equivalent in Cambodia. As a consequence, many of the newly issued standards are not applied in Cambodia, and some national IAS-equivalent standards are out of date. In addition, the interpretations issued by the Standing Interpretations Committee and its successor International Financial Reporting Interpretation Committee (IFRIC), which are integral components of IFRS, have not been adopted in Cambodia. This leaves preparers of financial statements without the needed guidance for applying Cambodian Accounting Standards in specific circumstances.

57. The absence of accounting standards in sensitive areas poses a serious threat to the quality of the financial information in the corporate sector. This is a major shortcoming of the Cambodian standards since proper reporting of sensitive and frequent transactions cannot be made. For instance, although construction is one of the booming industries in the country, due to the absence of any related accounting standards, there is likely to be a situation where incorrect reporting will take place.

58. Some banks and companies in Cambodia prepare separate sets of financial statements under IFRS and Cambodian Accounting Standards to satisfy the needs of shareholders or lenders. This is the case for enterprises that have foreign shareholders or have borrowed from international creditors, including multilateral or bilateral donors. While this contributes to the quality of the financial information, it has

the drawback of obliging those companies to keep two different sets of financial statements—one for statutory purposes, the other for investors and lenders—and different accounting records. It creates a disincentive for regulators and stakeholders to strengthen the statutory financial reporting regime and represents an additional administrative burden for those companies.

59. Companies and their auditors face practical difficulties in implementing Cambodian Accounting Standards. Discussions by the ROSC team with representatives of companies and auditors revealed some implementation problems with Cambodian Accounting Standards. Most of these problems arise from lack of adequate expertise among corporate accountants who find it difficult to prepare financial statements in accordance with the national requirements. Moreover, Cambodia accountants in some cases lack industry-specific knowledge with regard to application of relevant Cambodian Accounting Standards. The ROSC team observed this problem is more pervasive in the insurance industry in Cambodia.

60. Based on the review of the accounting and reporting requirements set by the National Bank of Cambodia, there are significant differences between the actual reporting requirements and IFRS pertaining to the banks. The IFRS require an entity, which purports to comply with IFRS, to make an explicit and unreserved statement of compliance in the notes to its financial statements. In order to affirm IFRS compliance, an entity must comply 100 percent with all the recognition, measurement, and disclosure provisions of the standards and interpretations. If an entity complies with 99 percent of IFRS requirements, it cannot affirm compliance with IFRS. It is for this reason that under IAS 1, *Presentation of Financial Statements*, there is a fundamental requirement that all standards within IFRS be fully complied with; the main reason being that applying only part of the standards may produce incomplete and misleading information. Although all banks and similar financial statements are claiming that they comply with IFRS, in reality there exist differences between disclosed accounting policies and actual practices. The major differences noted by the ROSC team follow:

- *Determination of the allowance for loan losses.* Banks and microfinance institutions are required to calculate impairment in the unsecured portion of loans and receivables on the basis of provisioning matrix and guidance on assessing borrower's repayment capacity, approved by the National Bank of Cambodia. This leads to a range of fixed provisioning rates for the number of days a loan has been classified as nonperforming. While this might be relevant for prudential purposes, the regulator's formulaic approach may not comply with IAS 39, *Financial Instruments: Recognition and Measurement*, which requires impairment or loan losses to be calculated as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred), and discounted at the financial asset's original effective interest rate. The ROSC team is concerned that the disclosed accounting policy seems to be based on compliance with IAS 39 when the banks are in effect applying a different policy. Furthermore, an overly formulaic approach to loan

classification and provisioning may result in an under-/overstatement of actual economic losses, with consequential impact on capital adequacy, taxation, and interest rate pricing.

- *Income from loan origination fees.* Banks in Cambodia generally account for loan origination fees on a cash basis and do not follow the guidance of IAS 18, *Revenue*, with regard to the appropriation of loan origination fees. Financial service fees should be distinguished between fees that are an integral part of a financial instrument’s effective interest rate, fees that are earned as services provided, and fees that are earned on the execution of a significant act. Loan origination fees charged by banks are an integral part of establishing loan; therefore, these fees should be deferred and recognized as an adjustment to the effective yield.

61. **The review of sample audited financial statements issued by corporate entities in Cambodia evidenced some compliance gaps.** The World Bank ROSC team reviewed 28 sets of financial statements (13 commercial banks, 5 specialized banks, 4 microfinance institutions, and 6 limited liability companies). Complemented by interviews with corporate accountants, practicing auditors, academics, bankers, and regulators, the ROSC review revealed instances of compliance gaps.²⁴ The review focused on issues of presentation and disclosure but did not cover compliance with “recognition and measurement” requirements of accounting standards, which are not detectable through such review of financial statements. Although few financial statements had a high degree of compliance, there were several instances of accounting policies and disclosures that did not comply with IFRS/IAS. A selection of compliance gaps found in the review follow:

- *Presentation of financial statements.* Noncompliance with IAS 1, *Presentation of Financial Statements*, could seriously impair the use of financial statements. Some companies did not provide prior period information (either in financial statements or in the accompanying notes). This impedes understanding performance of the reporting entities and evolution of their financial position. Additionally, certain elements of the financial statements, including financial instruments, accounts receivables or payables, and intangible assets were not shown on the face of the balance sheet. Also, some companies did not present their required statement of changes in shareholders’ equity.
- *Insufficient disclosure of accounting policies.* The notes to the financial statements did not always include required disclosures, especially regarding (a) revenue recognition; (b) useful lives of property, plant, and equipment; (c) leases; (d) employee benefits; and (e) determination of the fair value of

²⁴ Compliance gaps refer to the deviation of actual practices from the applicable accounting standards. Since Cambodian Accounting Standards are based on IFRS/IAS, and some important areas have no equivalent national standards, the compliance assessment is undertaken on the basis of IFRS/IAS in order therefore to make the review more comprehensive.

financial instruments. Lack of clarity and precision in disclosure of accounting policies leads to noncompliance with IAS 1.

- **Related party.** Many entities, including some financial institutions, omitted important disclosures such as relationship and transactions, pricing policies, volumes of related party transactions, and corresponding amounts. Adequate disclosure of material related party relationships and transactions is essential to users' understanding of a company's financial position and results, and for minority investors' confidence that they will receive fair treatment. Inadequate disclosure in this regard leads to noncompliance with IAS 24, *Related Party Disclosures*.
- **Employee benefits.** Inadequate disclosure as to whether actuarial or any other forms of valuation had been used to quantify outstanding liabilities for post-employment benefits does not adhere to requirements of IAS 19, *Employee Benefits*.
- **Inventory.** Failing to follow all requirements related to measuring and disclosing inventories at the lower of either cost or market value does not comply with IAS 2, *Inventories*.
- **Contingent liabilities.** Some companies did not adequately disclose contingent liabilities, making their financial statements noncompliant with IAS 37, *Provisions, Contingent Liabilities, and Contingent Assets*.
- **Impairment losses.** Potential failures to recognize impairment losses on property, plant, and equipment could result in overstated assets. Most of the financial statements did not indicate whether the long-term assets were impaired and therefore not complying with IAS 36, *Impairment of Assets*. Failure to comply with this standard could create a misconception that the carrying amounts of property, plant, and equipment in audited financial statements are overstated.
- **Disclosures in financial statements.** Contrary to the requirement of IAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, some financial institutions did not make adequate disclosure with regard to (a) gains/losses from dealings in securities and foreign currencies; (b) methods of calculating fair values of each class of financial assets and liabilities; (c) information relating to loans and advances on which interest is not being accrued; (d) information on the amounts set aside for general banking risks; (e) significant concentration in the distribution of assets, liabilities, and off-balance sheet items; (f) amount of significant net foreign currency exposure; and (g) irrevocable commitments to extend credit.²⁵

²⁵ IAS 30 has been replaced by IFRS 7, effective January 2007.

- ***Operating expenses usually capitalized.*** In a few cases, it was apparent from the notes to the financial statements that operating expenses (start-up, reorganization, or advertising) had been capitalized, though under IAS 38, *Intangible Assets*, these should have been expensed as incurred. While the amounts involved were not necessarily material, such an accounting practice in direct contradiction with applicable principles is detrimental to the readers' confidence in the reliability of the financial statements.
- ***Other.*** The review also noted the following: (a) in a number of instances, no explanation or details were provided for significant balances or income statement elements. (b) In some cases, the required information on operating leases was not disclosed. (c) In evaluating the deferred tax liability, the companies failed to consider certain elements necessary for accurate computation of such liability, resulting in their understatement by a material amount. (d) Although there are indications that some sample companies had long-term borrowings from banks, disclosure on restricted assets pledged as securities was lacking. (e) Some financial institutions did not provide an analysis of assets and liabilities into relevant maturity groupings.

62. Evidence suggests the lack of adequate capacities to prepare IFRS-based financial statements. In a number of sample financial statements, it was unclear who had prepared the IFRS-based financial statements. The ROSC team's discussions with company management during its due diligence mission led it to believe that the companies may not have adequate resources or ability to prepare IFRS-based financial statements. It is possible therefore that the auditors either prepared or provided assistance with the preparation of such financial statements. This raises a significant independence issue that was subsequently confirmed on a few occasions as to whether the actual accounting policies followed by the companies comply with the "boilerplate" disclosures in IFRS-based financial statements.

63. The ROSC review revealed that general purpose financial statements are often influenced by taxation considerations. In order to satisfy the requirements of taxation authorities with regard to the recognition of taxable revenues and deductible expenses, the preparers of general purpose financial statements often tend to deviate from applicable financial reporting standards, preferring to follow the taxation regulations. As a result, treatment of certain items (e.g., depreciation, revenue recognition, provisions) in the general purpose financial statements may be different from that which should apply under the IFRS/IAS. Transparency and accountability suffer from this emphasis on tax and deviation from applicable financial reporting standards.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

64. **Cambodia Auditing Standards, which are based on International Standards on Auditing, are not up to date.** Cambodia Standards on Auditing correspond to the version of ISA released by IFAC in 2002. Since 2002, the International Auditing and Assurance Standards Board has promulgated several ISA statements while no equivalent updates have been made in Cambodia. Many critical matters are left uncovered by the national standards. Without the updates to reflect internationally agreed standards, audit practice in Cambodia faces reduced quality. Moreover since Cambodia does not have an equivalent standard that conforms to International Standards on Quality Control, Cambodia Standards on Auditing cannot be regarded as conforming to the ISA.²⁶

65. **The environment in which the auditing process is developed in Cambodia does not appear to be conducive to compliance with auditing standards.** The ROSC team heard from interviewees of several factors that seem to explain the difficulties or disincentives in complying with established auditing standards:

- ***Lack of understanding of the audit process by corporate entities.*** Representatives of audit firms recognized a difficulty with companies that are not familiar with or equipped to accommodate external audit.
- ***Lack of practical experience and technical expertise for applying auditing standards and enforcing accounting standards.*** Because accounting curricula are not oriented toward practical application of the auditing standards and continuing education and training is not effectively provided, auditors may experience difficulty in applying applicable standards.
- ***Limited role of governance structures among companies.*** Except for the banks, audit committees are infrequent in Cambodia since corporate entities are not required to establish them. Yet audit committees are believed to play an important role in ensuring that external auditors fulfill their responsibilities to deliver an audit that meets the needs of the stakeholders.
- ***Absence of monitoring and effective sanctions.*** There is no monitoring of the compliance with auditing standards and to ensure that practicing auditors in Cambodia observe quality assurance procedures. Also the law does not explicitly set sanctions against auditors. Not publishing the financial statements of most companies reduces the possibility that infringement by auditors of their responsibilities are uncovered, thereby weakening auditors' incentives for quality.

66. **Differences in the technical proficiency, level of experience, and level of resources across audit firms result in significant differences in audit quality.** In general, application of auditing standards differs among audit firms of different sizes. To assess actual auditing practices, the ROSC team interviewed practicing auditors and

²⁶ *A Guide for National Standard Setters That Adopt IAASB's International Standard But Find It Necessary to Make Limited Modifications*, Policy Position, IFAC, July 2006.

senior leaders of the auditing profession. Facilitated discussions were conducted with the partners representing large- and medium-size audit firms. It appeared that auditors associated with international accounting firm networks generally tend to follow auditing standards. Nevertheless, there were instances where some of these firms apparently could not ensure a proper quality audit. Smaller audit firms find it difficult to bear the cost of implementing auditing standards in an adequate fashion. Various stakeholders suggested that improved audit supervision by the audit partners, instead of relying significantly on the trainee accountants, would improve the application of auditing standards.

67. The development and dissemination of implementation guidance will facilitate better application of auditing standards. Most of the audit firms, except those associated with the international accounting firm networks, do not have access to quality audit practice manuals. In the absence of proper guidance, auditors generally find it difficult to deal with important concepts such as audit risks, audit planning, internal control, materiality, documentation, and going concern. This difficulty is further aggravated when the auditors do not have adequate industry-specific knowledge. Improvements in the audit quality can largely be achieved by the development and dissemination of practical guidance on the implementation of auditing standards.

68. There is a concern about close relationships between auditors and clients. Many stakeholders expressed concerns about close relationships between some auditors and their clients. This may cause undue influence on auditors, resulting in noncompliance with appropriate audit procedures. It was observed that in some cases, auditors have the tendency of bringing material deficiencies to the attention of management through management letter rather than giving a qualified audit opinion.

69. In many cases, actual practices diverge from International Standards on Auditing. The following are the few examples of auditing non-compliance in Cambodia:

- Audit risk and audit materiality are not determined in accordance with the standard and not considered when conducting the audit.
- Documentation practices fail to provide audit evidence to support the audit opinion in most enterprises, apart from banks.
- Meaningful analytical procedures are difficult due to absence of industry information.
- Apart from the firms with international affiliations, most firms due to lack of capacity do not comply fully with ISA on quality control. Second partner peer reviews are generally not done.
- Auditors sometimes find it difficult to obtain audit evidence and so rely on management representations, particularly for related party transactions, and contingent liabilities.
- Professional clearance (usually as communication with retiring auditor) is not always done as most retiring auditors do not respond to such requests.

- Shortage of expertise in information technology (especially in medium and small firms) erodes audit quality.
- It is not always possible to obtain audit evidence that the opening balance does not contain material misstatements that affect the current period's financial statements.

70. **Lack of understanding by directors and members of management about the purpose of audits sometimes makes it difficult for auditors to obtain appropriate audit evidence.** Many auditors claimed that some directors and members of top management often fail to appreciate adequately the purpose and value of auditing. Such situations limit access to evidence in forming professional judgments. Despite the arduous efforts by some auditors to carry out audits in accordance with international good practices, they view this task as a major constraint in discharging their professional responsibilities.

V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

71. **There is a general perception that, with the exception of banks, the financial statements in Cambodia are of low quality.** The higher quality of the banks' financial statement has been attributed primarily to relatively closer monitoring and enforcement by the NBC. On the other hand, the perceived poor quality of the financial statements of other entities, in general, stems from limited demand for financial information from third parties, dominance of tax reporting in the absence of other demand, limited or no enforcement by the appropriate authorities, and limited capacity of auditors and accountants.

72. **Banks do not rely on the financial statements presented by potential borrowers in determining whether to extend credit.** Although, entities are required to submit their financial statements as part of the loan application process, banks generally base their lending decisions on other factors, including amount of collateral, business forecasts, and site visits. The majority of corporate lending is generally based on the borrower's capacity to post collateral rather than its ability to service the debt. (Financial analyses supporting lending decisions are limited; as such, audited corporate financial statements' figures often matter little in the lending process.)

73. **The users believe that financial statements audited by large firms meet higher standards of financial reporting.** Interviews and discussions with various stakeholders, including bankers, revealed that a higher degree of reliance is placed on the financial statements that are audited by the members of international accounting firm networks. Contrary to that position, some stakeholders considered an audit in most cases does not add value, but is only a requirement for the company to win a contract or to obtain a bank loan.

74. **Representatives of the audit profession expressed the view that auditing was not highly valued.** They perceived there was no pressure from the market to improve the

quality of audit and improvement would not occur until the market valued the audit function more highly. Most of the enterprises in Cambodia tend to raise capital by borrowing secured by assets rather than on the strength of financial statements. This point of view was consistent with the views expressed by bankers.

75. **The financial statements of corporate entities are not readily available due to the perception that they are confidential.** With the exception of banks and similar financial institutions, corporate entities were reluctant to share copies of financial statements with the ROSC team. There is a general perception among the owners and top management of corporate entities that the information in financial statements is confidential and should not be shared with anyone outside the company. Perhaps companies do not give out financial statements because they do not want people to know what they are doing and why. This reflects a secretive corporate structure. Also, it indicates attaching relatively low importance to the use of financial information in the business decision-making process.

VI. POLICY RECOMMENDATIONS

76. The recommendations of this ROSC are interrelated and mutually supportive and are designed to collectively improve the financial reporting environment in Cambodia. The policy recommendations emerge from the ROSC review of accounting and auditing practices in Cambodia, as well as the valuable inputs received from the various stakeholders. These primarily principle-based recommendations take a holistic approach and are expected to provide input in preparing a Country Action Plan geared toward the sustainable high-quality corporate financial regime in Cambodia. In implementing the recommendations, the Country Action Plan should identify specific activities to be undertaken under the supervision of a national stakeholder group and possibly with the assistance from the World Bank and other development partners. The national stakeholder group should be comprised of representatives from the regulators, KICPAA, academia, banks, insurance companies, and the chamber of commerce. Based on the successful experience of other countries, this stakeholder group should own the country action plan and develop strategies for implementation. The group will work under the Ministry of Economy and Finance.

77. The recommendations are aimed at Cambodia's implementation authorities. The following points have been taken into account in designing the policy recommendations:

- Modernizing the statutory framework in order to improve corporate accounting, auditing, and financial reporting practices;
- Building capacities for professional accountants and auditors and regulators;
- Emphasizing the case for strengthening the capacity of national institutions involved with corporate accounting and auditing practices in Cambodia;
- Achieving greater financial transparency in the corporate sector and limiting tax evasion through ensuring proper calculation of corporate profits;

- Promoting a gradual process of improvement in the monitoring and enforcement activities in the context of accounting and auditing of the public interest entities.

78. **The policy recommendations should be integrated, wherever possible through regional initiatives.** This has led to development of recommendations covering various areas which may appear costly to the relative size of the Cambodian economy. It is envisioned that with regional integration the cost of implementing many of the policy recommendations would be substantially reduced and would reap increased benefits. It should be noted that establishing a framework for regional integration may not be easy; however, considering relatively limited institutional capacities, it will be Cambodia's interest to promote the case for regional collaboration to strengthen corporate accounting and auditing practices through benefiting from the regional expertise.

79. **Revise the Accounting Law.** The Accounting Law should be thoroughly revised to (a) place greater emphasis on financial reporting, (b) provide legal backing for the use of IFRS and ISA, and (c) outline an appropriate framework for monitoring and compliance. This should be focused on enhancing the statutory framework governing accounting, auditing, and financial reporting using a holistic approach taking into account other laws and regulations, including Company Law, Banking Law, Tax Law, and others. This legal rationalization should underscore the overall principles and purposes of financial reporting, consistent with IASB framework for the presentation and preparation of financial statements. Detailed forms and requirements should be dealt with at the level of secondary regulations.

80. **With regard to revising the Accounting Law, the authorities may want to create a multi-disciplinary group** involving different stakeholders in order to undertake the following major functions:

- Comprehensive review of all legislation related to accounting, auditing, and financial reporting in order to identify vague or conflicting requirements.
- Specify mandatory IFRS and ISA application in totality only for public interest entities in Cambodia. These entities should be defined through an analysis of the business structure in Cambodia. Where the regulators need additional information for prudential supervision purposes, this should be an addition to the IFRS.
- Specify simplified financial reporting requirements for small and medium-sized enterprises (SMEs). The SME-thresholds should be provided by law.
- Clearly mandate obligatory preparation of consolidated financial statements for group companies fulfilling the criteria of public interest entities.
- Provide an appropriate governance structure and level of independence to KICPAA in line with international good practices.
- Expand the mandate of National Accounting Council to set auditing standards in Cambodia in collaboration with KICPAA in addition to its current mandate for setting accounting standards.

- Provide legal backing for establishment of an arrangement for audit practice review. In this regard, rationalization of different legislative provisions is necessary for giving the review arrangement adequate power.
- Promote public interest responsibilities of professional accountants and auditors in Cambodia. Appropriate attention should be given to redefine the role of professional accountants and auditors, taking into consideration accountants' professional obligations to protect public interests, adapt governance of KICPAA in line with international developments, enforce professional ethics requirements, and enhance discipline among members.
- Provide regulators with adequate authority to sanction appropriately for violations of applicable accounting and auditing standards and rules for ensuring effective monitoring and enforcing actions.
- Incorporate appropriate provisions outlining auditors' independence. Legislation should prohibit in particular the auditors' involvement in preparing financial statements of audit clients. Additionally, as a means to enhance their accountability with shareholders, external auditors should be required to attend annual general meetings to answer shareholders' questions.
- Establish legal backing for thresholds for simplified financial reporting requirements, suggested by the Ministry of Economy and Finance, and give those enterprises that fall under those thresholds exemption from annual statutory audits.
- Require public interest entities to make their legal entity (and consolidated) financial statements readily available to the public within a reasonable period after the balance sheet date.
- Mandate appropriate requirements for filing of financial statements for all entities that are subject to annual statutory audit.
- Harmonize accounting, auditing and financial reporting legislation with the tax framework. Guidance will need to be given on how to reconcile the accounting profit/loss with the taxable profit/loss. In absence of guidance, entities often intermingle tax and accounting standards when preparing financial statements.

81. Create a sustainable accounting and auditing standard-setting structure. The standard-setting structure should establish a framework of cooperation between NAC and KICPAA. Accomplishing this plan would entail the following:

- Expand the National Accounting Council to include a broader range of stakeholders in order to systematically address the needs of private and public sector stakeholders in the standard-setting process, including the appropriateness of the scope of IFRS and ISA application.
- Develop an arrangement for continuing development and issuance of simplified financial reporting requirements for SMEs, in line with the pronouncements of IASB.

- Define a framework of effective working relations based on mutual support and cooperation to facilitate the process of setting standards. Mobilize funding and technical expertise in order to ensure that the accounting and auditing standards are up to date and to develop a Khmer-English reference guide
- Document, disseminate and implement a clear strategy for the adoption of standards, which includes an effective consultative process. This will help address the low-level awareness and implementation of accounting and auditing standards currently exhibited in the country.
- Explore synergies with respect to translating accounting and auditing standards according to International Accounting Standards Committee Foundations (IASCF) and IFAC translation policies.
- Make banking and insurance regulators engage in international forums exploring the relationship between prudential and general purpose financial statements in order to design prudential filters. This would address regulators' concerns about the challenges of establishing compatibility between regulatory accounting principles and general purpose financial reporting requirements.

82. Allocate a specific recurrent budget to carry-out standard-setting responsibilities in a timely fashion. Budgets are mainly required for translation of IFRS, including related IASB pronouncements and IFRIC interpretations, into local Khmer language. Increased resources through specific allocation in the government budget would allow the NAC and KICPAA to translate the necessary material, and if necessary, to prepare specific guidance to facilitate its use; and also involve a wider range of stakeholders at an early stage of the process.

83. Plan transition for full implementation of IFRS. There should be a detailed transition plan in place for full implementation of IFRS in public-interest entities. Cambodia should approach this implementation plan with a phased comprehensive program. The country can learn from some ground realities—few stakeholders are ready to use IFRS; developing and implementing training and materials requires significant time; and international experience in industrialized countries (e.g., European Union countries, Australia, and New Zealand) shows that switching over to IFRS requires intensive and sustained efforts on the part of companies and auditors. The phased approach will also require appropriate training programs for preparers and auditors.

84. Establish systematic, institutionalized, monitoring and enforcement mechanisms to ensure compliance with accounting and auditing standards. High-quality financial reporting cannot be ensured by only adopting international standards. To a large extent, quality depends on designing and implementing a proper monitoring and enforcement system. There are three crucial links in the enforcement process, and each must be strengthened:

- Company directors with legal obligations to prepare the financial statements must ensure that accounting staff apply standards properly.

- Statutory auditors must discharge their professional responsibilities independently in order to provide assurance that financial statements comply with all applicable standards and portray “true and fair” view of enterprises’ conditions and results of the operations.
- Both self-regulatory organizations (e.g., KICPAA) and statutory regulators (e.g., NAC and NBC) must ensure proper compliance with the standards and consistently take actions against violators. To ensure effective enforcement, the regulators in particular need adequate capacity, authority, and independence. Since they cover a wide range of sophisticated and complicated activities, their actions should not be constrained by lack of appropriate human and financial resources. Strengthening the enforcement mechanism through increasing capacity of the regulators and granting them more authority in dealing with infractions of accounting and auditing standards is particularly important for Cambodia to supplement Government’s efforts to promote investment and to consolidate a sound financial sector. Also, as indicated earlier, there is a clear need for updating legislation to outline the authority of regulatory bodies (NAC, NBC, and Financial Industry Department) to enforce accounting and auditing standards and to modernize the sanctions currently existing in order to make them better deterrents.

85. Augment the NAC powers and capacity for enforcing accounting standards and financial reporting requirements. Efforts should be made to broaden NAC powers to effectively monitor and enforce applicable accounting, auditing, and financial reporting requirements primarily for public interest entities. Legislation should give the NAC adequate power to require submission of audited financial statements by public interest entities and all other companies that are subject to annual statutory audit. In order for the National Accounting Council to carry out its supervisory and enforcement functions, a financial reporting review panel should be set up with adequate numbers of technically qualified people who are charged with the following: (a) reviewing financial statements filed with the National Accounting Council; (b) requesting any additional information from companies and their auditors; (c) conducting on-site inspections at companies, on as and when needed basis; and (d) imposing legal and administrative sanctions for noncompliance. The review panel may include accounting experts drawn on part-time basis from various sectors of the economy. To ensure the transparency of the process, deter enterprises from noncompliance, and foster users’ confidence in the effectiveness of the regulatory regime, the National Accounting Council should report each calendar year on enforcement actions conducted, issues addressed, and sanctions taken.

86. Establish an audit oversight unit within the NAC organizational framework. Given the lack of adequate numbers of experienced and professional accountants in Cambodia, it is important to operationally an oversight arrangement with the involvement of specialists drawn from international and/or regional institutions. In this regard, an effective partnership with KICPAA has to be developed for designing oversight principles and other operational procedures. Efforts should be made to learn from international experiences and to use regional capacity to make this oversight unit

effectively operational. Expertise from the region can be drawn upon while gradually building Cambodia's capacity for undertaking independent oversight of auditors. Possibilities of regional joint efforts should be explored and supported to increase capacity of professional accountancy bodies and regulators in the region. Steps should be taken to plan and persuade other ASEAN countries to establish an organization within the ASEAN mantle from where the expertise could be borrowed by Cambodia and other countries that have limited institutional capacity to carry out monitoring and enforcing activities effectively. Main activities of the oversight unit of NAC would include the following:

- ***Audit practice review.*** Specialists of the unit will be responsible for conducting practice reviews of the auditors of public interest entities, ensuring each audit firm is reviewed at a reasonable, regular interval. After completion of the initial review, recommendations should be provided to the audit firms for overcoming detected shortcomings concerning quality assurance arrangements. The practice review should evaluate an audit firm's quality assurance arrangements, its audit approach, and the working papers with regard to selected audit engagements. The policies and procedures for carrying out audit practice review activities will be developed by the unit with support from regional and international sources.
- ***Investigation.*** Valid complaints against auditors and audit firms and any irregularities identified from the reviews of financial statements and audit practices should be investigated.
- ***Disciplinary power.*** Following reviews, steps should be taken for appropriate sanctions on relevant parties in order to ensure compliance with the auditing requirements.
- ***Help desk.*** The unit should not only enforce disciplinary actions against the wrong doers, it should also institute a system through which required advice/help could be given with regard to better compliance of the auditing requirements. This will help in building capacities of the small and medium-sized audit firms in particular.
- ***Reporting to the public.*** The findings and decisions of the unit, including sanctions taken against errant auditors, should be made public. This would increase confidence in audited financial information on the part of both domestic and international users.

87. Strengthen KICPAA through twinning arrangements and regional integration initiatives. The KICPAA governance structure needs to be improved and its capacity needs to be built in line with international good practices. In this regard, necessary steps should be taken to fully comply with the 7 IFAC Statements of Membership Obligation. The KICPAA should carry out its responsibilities for adoption and dissemination of IFRS and ISA. It should enhance its capacity by seeking cooperation with other professional

bodies in the Association of South East Asian Countries (ASEAN) and by establishing twinning arrangements with a developed professional accountancy body. A long-term twinning arrangement with a strong partner would foster best practice transference to the KICPAA.

88. Take steps for improving the capacity of NAC, NBC, and Financial industry Department. Generally ineffective regulatory regimes provide a false sense of security to stakeholders; therefore, it is important to strengthen the capacity of the regulators for determining the degree of compliance with the applicable standards, not only in appearance, but also in substance. Capacity improvement of these regulators should primarily focus on the following:

- Recruiting technically qualified personnel,
- Practical training on implementation of IFRS and ISA, and
- Providing administrative support and logistical arrangements.

In order to supplement capacities of banking and insurance regulators in particular to detect infractions, auditors should be prepared to play “whistle-blower” in order to provide early signals for initiating necessary corrective measures by the regulators. Since the financial sector’s vulnerabilities can have quick multiplier effects, appropriate whistle-blowing by auditors would help to make the financial sector regulation more efficient and effective. Added to this benefit, there could be a synergy between the requirements of prudential regulations and those for the general purpose financial reporting. Although at this point it is difficult to outline an exhaustive list where the whistle blowing could be done, however, it should focus on issues that may limit the case for producing transparent and reliable financial information and thereby mislead the users of financial statements

89. Strengthen the capacity of the National Audit Authority. It is important to establish a high-quality corporate financial reporting practice in the state-owned enterprises. Immediate steps should be taken to recruit experienced, professionally qualified accountants who will be responsible for overseeing the conduct of the audit of state-owned enterprises. The staff of the National Audit Authority should be given adequate training on practical implementation of IFRS, ISA, and IFAC pronouncements on public sector accounting through professional development training by the NAC and KICPAA as well as through its own training initiatives.

90. Take steps for building capacity of small audit firms to improve audit quality. There should be an initiative for assisting small firms to develop capacity for providing quality audit and assurance services, and also to take the necessary steps for developing viable audit practices through merger or establishment of network arrangement. A review of audit quality and detailed discussions with partners of individual audit firms should be held. Specific recommendations should emerge and steps taken to ensure compliance with IFAC requirements on audit quality control and to assist individual audit firms in building capacity regarding quality assurance arrangements.

91. **Enhance academic and professional education and training.** This plan would require focusing on the following:

- **University curriculum.** Ensure that there is greater consistency in the accounting curriculum at universities. The accounting curriculum should include practical application of IFRS, more business administration, and case studies to best prepare accountants (rather than bookkeepers) for careers in corporate Cambodia. The ROSC team recommends that a panel of experts review and update the accounting curriculum in order to incorporate IFRS and ISA and practical-oriented teaching at the undergraduate university level. The ethical dimensions of business management, corporate finance, and accounting and auditing should be taught with case studies in undergraduate programs. Particular attention should be given for improving communication and critical thinking skills. A plan should be undertaken to train university teachers to increase the effective teaching of practical implementation issues relating to IFRS and ISA.
- **Regulators.** Provide meaningful theoretical and practical training to the staff of all regulators so that they can enforce applicable accounting, financial reporting, and auditing standards. The relevant staff of these regulatory agencies should have adequate exposure to practical dimensions of accounting and auditing requirements. Furthermore, they should undertake industry-specific training to update their skills.
- **Corporate accountants and auditors.** Improving preparers' and auditors' knowledge of standards should be a prerequisite for implementing international standards in Cambodia's private sector. This should be done through design of specific training programs.
- **Continuing professional education.** KICPAA should arrange delivery of high-quality training programs on practical implementation aspects of accounting and auditing standards and code of ethics for professional accountants. It should develop an effective means for monitoring and enforcement of the requirements on continuing professional development of the practicing members.

92. **Develop professional examination for Cambodian accounting practitioners and link it with regional professional bodies.** KICPAA should take steps to develop its own curriculum and examination system for aspiring professional accountants. In this regard, emphasis should be made on practical implications of accounting and auditing and adequate on-the-job training requirements. The KICPAA should collaborate with other professional bodies in the ASEAN region, possibly with the help of the ASEAN Federation of Accountants in developing uniform arrangement or regular professional examination. In addition, further efforts should be made to put in place IFAC-recommended practical training for aspiring professional accountants in Cambodia.

93. **Issue practical application guidance on IFRS and ISA.** The KICPAA should issue implementation guidance on IFRS and ISA illustrating local cases. The implementation guidance should be prepared and disseminated in consultation with

relevant staff of IASB and IFAC. The KICPAA should ensure that all standards, interpretations and other guidance, are promptly available to its members.

94. Upgrade the procedure for obtaining licenses by the accountants and auditors engaged in public practice. The KICPAA should streamline its licensing procedure by aligning its practical training arrangements with IFAC requirements and recommendations. Furthermore, KICPAA should develop a sound mechanism for renewing practice licenses of auditors in public practice on the basis of their periodic performance evaluation.

95. Introduce awareness programs for improving the degree of compliance with IFRS requirements. The KICPAA and other regulators should work jointly to design awareness programs highlighting the significance of compliance with accounting and auditing standards and to improve information dissemination channels. Shareholders, directors, and top officials from the corporate sector should be briefed adequately on their responsibilities to ensure compliance with standards and enforcement process, including legal implications. Also, benefits of compliance with standards and best practices should be highlighted in such programs. In addition, these programs should include cases focusing on emerging international developments and the role of transparent financial reporting in attracting both strategic and portfolio investors.

96. Provide guidance on proper implementation of the IFAC Code of Ethics for professional accountants. For purposes of ensuring ethical standard and independence of practicing auditors in line with international good practices, the KICPAA should issue detailed guidance using local examples focusing on various issues covered by the IFAC's code.²⁷ Guidance notes, using live cases, should address issues covering threat to auditor's independence in a Cambodian-identified environment.

97. Establish governance structures within public interest entities. Like some banks, Cambodian public interest entities should establish audit committees that can play a role in monitoring the effectiveness of audit process, especially with regard to auditors' compliance with independence requirements. In this regard, a ROSC Corporate Governance assessment should be conducted in Cambodia.

98. Obtain IFAC membership. KICPAA should start the process of obtaining IFAC membership. Gaining IFAC membership would help KICPAA to obtain exposure to international developments and capitalize on other allied membership benefits. This will also enhance the KICPAA image as a professional body. Furthermore, such membership would facilitate creating a better enforcement and compliance culture with regard to accounting and auditing practices in Cambodia.

²⁷ The *Code of Ethics for Professional Accountants*, developed by IFAC's International Ethics Standards Board for Accountants (formerly the Ethics Committee), establishes ethical requirements for professional accountants and provides a conceptual framework for all professional accountants to ensure compliance with the five fundamental principles of professional ethics: integrity, objectivity, professional competence and due care, confidentiality, and professional behavior. Under the framework, all professional accountants are required to identify threats to these fundamental principles and, if there are threats, apply safeguards to ensure that the principles are not compromised.


99. Some of the recommendations of this ROSC will require technical assistance.

This technical assistance could be required in any of the following areas:

- Modernizing statutory framework,
- Building institutional capacities,
- Improving education and training,
- Adopting international standards,
- Developing and issuing implementation guidance on applicable accounting and auditing standards,
- Instituting audit oversight arrangement, and
- Establishing local professional examination system.

It may not be possible to implement many of the policy recommendations without support from international development agencies. While arranging technical assistance, it will be necessary to prioritize implementation steps. Immediate priorities should include, among others: modernizing statutory framework, and building technical capacities for corporate accountants, auditors, and regulators. It is envisaged that enhancing accounting and auditing practices in Cambodia will not only strengthen the basic foundation of financial and private sector development, but also contribute to strengthening the governance and accountability arrangements in the country.

APPENDIX A

CAMBODIA ROSC - ACCOUNTING AND AUDITING: SUMMARY OF RECOMMENDATIONS					
Description of Action	Para No.	Responsibility	Timing of effective implementation		
			Short-term (within 1 year)	Medium-term (1 to 2 years)	Long-term (2 to 4 years)
MODERNIZING STATUTORY FRAMEWORK					
<p>1. Revision of Accounting Law focusing on the following:</p> <ul style="list-style-type: none"> ▪ Mandatory application of IFRS and ISA for the public interest entities in Cambodia. Public interest entities should be defined through an analysis of the business structures in Cambodia. ▪ Continue developing simplified financial reporting requirements and defining thresholds for SMEs. ▪ Preparation of consolidated financial statements by public interest group companies ▪ Requirement for filing of annual financial statements for entities subject to annual statutory audit to the appropriate authorities. ▪ National Accounting Council to be mandated to set the auditing standards. ▪ Independent audit oversight arrangement and mechanisms, including sanctions, for ensuring monitoring and enforcement. ▪ Appropriate governance structure and level of independence to KICPAA in line with international practices, promoting public (state and private) interest responsibilities of professional accountants, and auditors' independence. <p><i>It is suggested that a multi-disciplinary group be created involving different stakeholders to coordinate and oversee the review and update of the Accounting Law and harmonize all legislation related to accounting, auditing, and financial reporting.</i></p>	80	Ministry of Economy and Finance, NAC and KICPAA			

CAMBODIA ROSC - ACCOUNTING AND AUDITING: SUMMARY OF RECOMMENDATIONS

Description of Action	Para No.	Responsibility	Timing of effective implementation		
			Short-term (within 1 year)	Medium-term (1 to 2 years)	Long-term (2 to 4 years)
ACCOUNTING AND AUDITING STANDARD SETTING STRUCTURE					
<p>1. Creating a sustainable accounting and auditing standard setting structure through:</p> <ul style="list-style-type: none"> ▪ including more stakeholders in the NAC Council ▪ defining an arrangement for continuing development and issuance of simplified financial reporting requirements for SMEs, in line with the pronouncements of IASB ▪ defining a framework for effective working relations among regulators and KICPAA ▪ mobilizing funding and technical support and establishing synergies for translating the standards into local Khmer Language and developing a Khmer-English reference guide ▪ implementing a clear strategy for adoption of standards including establishing a wider consultation process particularly addressing compatibility between regulatory accounting principles of banking and insurance and general purpose financial reporting requirements <p><i>Explore synergies with respect to translating accounting and auditing standards according to International Accounting Standards Committee Foundations (IASCF) and IFAC translation policies</i></p>	81	MEF and NAC			
<p>2. Allocating specific recurrent budget for timely standard setting processes.</p>	82	MEF and NAC			
<p>3. Transitional Plan for full implementation of IFRS</p>	83	NAC			


CAMBODIA ROSC - ACCOUNTING AND AUDITING: SUMMARY OF RECOMMENDATIONS

Description of Action	Para No.	Responsibility	Timing of effective implementation		
			Short-term (within 1 year)	Medium-term (1 to 2 years)	Long-term (2 to 4 years)
CAPACITY BUILDING FOR ENSURING COMPLIANCE WITH ACCOUNTING AND AUDITING STANDARDS					
<p>1. Augmenting NAC powers and capacity for enforcing accounting standards and financial reporting requirements through legislative enactment to:</p> <ul style="list-style-type: none"> ▪ requiring submission of audited financial by public interest entities and all other companies that are subject to annual statutory audit ▪ setting up a review panel with adequate number of technically qualified people for: (a) reviewing financial statements and requesting any additional information; (b) conducting on-site inspections; and (c) imposing legal and administrative sanctions for noncompliance, (d) recommending legal and administrative sanctions for noncompliance. ▪ NAC reporting annually on enforcements actions reviewed, issues addressed, and sanctions taken 	84 and 85	NAC			
<p>2. Strengthening KICPAA through twinning arrangements and regional integration initiatives within ASEAN region</p>	87	MEF, NAC, and KICPAA			
<p>3. Improving the capacity of NAC, National Bank of Cambodia, Financial Industry Department, and National Audit Authority through:</p> <ul style="list-style-type: none"> ▪ recruiting technically qualified people ▪ imparting practical training on implementation of IFRS and ISA, and IFAC pronouncements on IFAC requirements ▪ providing administrative and logistic support 	88 and 89	NAC, NBC, MEF – FID and NAA			
<p>4. Developing initiatives for building the capacity of small audit firms with a focus of audit quality control and assurance arrangements</p>	90	NAC and KICPAA			

CAMBODIA ROSC - ACCOUNTING AND AUDITING: SUMMARY OF RECOMMENDATIONS

Description of Action	Para No.	Responsibility	Timing of effective implementation		
			Short-term (within 1 year)	Medium-term (1 to 2 years)	Long-term (2 to 4 years)
ACADEMIC AND PROFESSIONAL EDUCATION AND TRAINING					
1. Improving accounting degree curriculum and teaching delivery focusing on consistency in the accounting curricula, practical implementation aspects of IFRS and ISA, corporate finance, ethics and business management for accountancy and auditing careers	91	Ministry of Education, NAC and KICPAA			
2. Providing meaningful theoretical and practical training to the staff of regulators to equip them to enforce applicable accounting, financial reporting and auditing standards, particularly industry specific requirements	91	KICPAA, NAC, NBC, MEF-FID			
3. Improving corporate accountants and auditors' knowledge on standards	91	KICPAA			
4. Developing means to deliver high-quality training programs for CPD for accountants and auditors, particularly in relation to IFRS, ISA and IAS practical implementation guidance. Developing monitoring systems for enforcing CPD requirements	91	KICPAA			

CAMBODIA ROSC - ACCOUNTING AND AUDITING: SUMMARY OF RECOMMENDATIONS

Description of Action	Para No.	Responsibility	Timing of effective implementation		
			Short-term (within 1 year)	Medium-term (1 to 2 years)	Long-term (2 to 4 years)
OVERSIGHT ARRANGEMENT FOR AUDIT PROFESSION					
<p>5. Establishing an audit oversight unit within the NAC organizational framework by using regional capacity and learning from international experiences for:</p> <ul style="list-style-type: none"> ▪ conducting practice reviews of auditors of public interest entities at regular intervals ▪ investigating valid complaints against auditors and audit firms and irregularities from review of financial statements and audit practices ▪ imposing appropriate sanctions on relevant parties for ensuring compliance with auditing requirements ▪ instituting a system for providing advice/help to support better compliance with auditing requirements ▪ reporting to the public about the activities of the unit. 	86	NAC			

CAMBODIA ROSC - ACCOUNTING AND AUDITING: SUMMARY OF RECOMMENDATIONS

Description of Action	Para No.	Responsibility	Timing of effective implementation		
			Short-term (within 1 year)	Medium-term (1 to 2 years)	Long-term (2 to 4 years)
DEVELOPMENT OF ACCOUNTANCY PROFESSION AND PROMOTING BETTER COMPLIANCE CULTURE					
1. Developing professional examination for Cambodian accounting profession and link it with regional professional bodies	92	KICPAA/NAC			
2. Issuing practical application guidance on IFRS and ISA and implementation of the IFAC Code of Ethics	93 and 96	KICPAA			
3. Upgrading the procedure for obtaining (and renewing) licenses by professional accountants and auditors in public practice	94	KICPAA			
4. Introducing awareness programs for improving the degree of compliance with accounting and auditing standards, particularly IFRS, and improve information dissemination channels	95	NAC, KICPAA, NBC and MEF-FID			
5. Establishing governance structures within public interest entities	97	NAC, Public Interest Entities			
6. Obtaining IFAC membership	98	KICPAA and NAC			

APPENDIX B

CAMBODIAN ACCOUNTING STANDARDS		
IAS equivalent	Cambodian Accounting Standards (CAS)	Effective Date (dd/mm/yyyy)
IAS 1	CAS 1 Presentation of Financial Statements	16/10/2003
IAS 2	CAS 2 Inventories	16/10/2003
IAS 7	CAS 7 Cash Flow Statements	16/10/2003
IAS 8	CAS 8 Net Profit and Loss for the Period, Fundamental Errors and Change in Accounting Policies	16/10/2003
IAS 10	CAS 10 Events after the Balance Sheet Date	16/10/2003
IAS 12	CAS 12 Income Taxes	16/10/2003
IAS 16	CAS 16 Property, Plant and Equipment	16/10/2003
IAS 18	CAS 18 Revenue Recognition	16/10/2003
IAS 21	CAS 21 Foreign Currencies	16/10/2003
IAS 24	CAS 24 Related Party Disclosures	16/10/2003
IAS 25	CAS 25 Accounting for Investments	16/10/2003
IAS 27	CAS 27 Consolidated Financial Statements	16/10/2003
IAS 30*	CAS 30 Banks and Financial Institutions	16/10/2003
IAS 37	CAS 37 Provisions, Contingent Liabilities and Contingent Assets	16/10/2003
IAS 38	CAS 38 Intangible Assets	16/10/2003

* Superseded by IFRS 7, effective 2007

Cambodian Accounting Standards are applicable to all entities.

APPENDIX C

CAMBODIAN AUDITING STANDARDS		
ISA equivalent	Cambodian Standards on Auditing (CSA)	Effective Date (dd/mm/yyyy)
200	CSA 200 Objective and General Principles Governing and Audit of Financial Statements	16/10/2003
210	CSA 210 Terms of Audit Engagements	16/10/2003
230	CSA 230 Documentation	16/10/2003
240	CSA 240 Fraud and Error	16/10/2003
300	CSA 300 Planning	16/10/2003
320	CSA 320 Audit Materiality	16/10/2003
500	CSA 500 Audit Evidence	16/10/2003
560	CSA 560 Subsequent Events	16/10/2003
570	CSA 570 Going Concern	16/10/2003
700	CSA 700 The Auditor's Report on Financial Statements	16/10/2003