

Royal Government of Cambodia
Public Financial Management Reform Steering Committee


Budget System Reform Strategy (2018-2025)
"Effectiveness, Accountability and Transparency"

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Chapter 1

Background of the PFM Reform in Cambodia

The Royal Government of Cambodia (RGC) has launched the Public Financial Management Reform Program (PFMRP) in 2004 with the objective to transform the public financial management system of Cambodia step-by-step to meet the international best practices and standards. The PFMRP has been designed as a comprehensive and long-term undertaking, sequenced in four platforms and four stages. The first stage (2005-2008) of the reform focused on the first platform on increasing budget credibility the second stage (2009-2015) focused on the second platform on increasing financial accountability, while further enhancing the achievements of the first platform and preparing the foundation for the third platform; the third stage (2016-2020) will focus on the third platform on establishing budget-policy linkages, while further strengthening the achievements of the first two platforms and paving the way for implementing the fourth platform. The fourth stage (2021-2025) will focus primarily on building the fourth platform of public financial management reform program, i.e. increasing performance accountability, while further strengthening the achievements of the three previous platforms.

1.1. Platform and Stage Strategy and Progress of the PFM Reform

As mentioned above, the implementation of the PFMRP is undertaken stage wise approach with each stage focusing on one specific platform while continuing to strengthen previous platforms and also stay ready to build the foundation for the next platform. As it is a long-term reform program, such an approach is conducive for gradual implementation to ensure strong and effective linkages from one platform to another. To achieve the above objective, a “**Public Financial Management Reform Program (PFMRP) Steering Committee**” has been established to assume responsibility of formulating, implementing and monitoring the implementation of the PFMRP. The Steering Committee is chaired by His Excellency Senior Minister of the Ministry of Economy and Finance (MEF) and a permanent General Secretariat with the task of coordinating the implementation of the whole PFMRP. Corresponding with this, each Line Ministry has also created a PFM Working Group, chaired by a Secretary/Under-Secretary of State, to oversee the reforms under their respective mandates. Each stage has a **Consolidated Action Plan (CAP)** as a guide for implementing reform activities. Those CAPs are reviewed annually with discussion and consultation with all ministries, institutions and stakeholders. After the successful completion of the Consolidated Action Plan for Stage 1 (CAP-1) and Stage 2 (CAP-2) in 2015, the Ministry of Economy and Finance (MEF) assessed public financial management system by using the “Public Expenditure and Financial Accountability Assessment Framework” (**PEFA Assessment Framework**) with the involvements of the IMF’s regional public financial management adviser and other international experts. The results from this assessment have become the necessary basis for the preparation of Consolidated Action Plan for Stage 3 (CAP-3) which was launched at the beginning of 2016. Overall, the progress in the first platform and the first stage of PFMRP implementation was very good. Remarkable progress includes the success of resource mobilization, budget preparation became more comprehensive and realistic and enhanced

effectiveness of budget implementation. As a matter of fact, tax revenue outturn grew at an average of 17.5% annually, while non-tax revenue increased by 16.9% annually. On budget formulation side, budget cycle was defined more clearly, Budget Strategic Plan (BSP) and new economic classification were introduced, capital expenditure information was included in draft Annual Budget Law, and the summary of Annual Budget Law was prepared and disseminated more widely to the public. In respect of budget execution, Treasury Single Account (TSA) which merged all government accounts was created and an integrated external funding data system was developed. At the same time, mid-year reviews were conducted at the beginning of the second semester, in-year additional credit was limited not to exceed the non-allocated credit amount, non-wage expenditure execution was improved, and procurement measures were updated to include the requirement for procurement plans, reports and post-implementation monitoring. Quarterly revenue and expenditure program has now become part of the routine work, cash management units have performed well their tasks, and arrears have been completely eliminated. Under Stage 1, six preparatory works for next platform were carried out, namely the development of medium-term revenue mobilization strategy, expenditure tracking surveys in education and health sectors, introduction of internal audit, development of program budgeting pilots, development of Financial Management Information System (FMIS) implementation plan, and preparation of capacity development strategic plan.

Subsequently, the second phase focuses on platform 2, which was to build Financial Accountability. Under this, a new budget classification was introduced. At the same time, the functions of auditing, reporting and transparency, the facilitation of budget operation and implementation as well as other tools to promote accountability were enhanced and strengthened. Overall, to develop platform 2, necessary components of public financial management system and FMIS were launched to strengthen lines of accountability for financial management.

The second phase was considered to be essentially successful, although some activities were not completed fully as planned, such as the delay in launching FMIS and the development of other financial accountability instruments. FMIS was launched on a pilot basis at the end of 2015, comprising of six functions namely budget allocation, general ledger, expenditure commitment and procurement, account receivable, account payable and cash management. At the same time, the achievement of budget credibility was essentially maintained with improved revenue mobilization, efficient budget execution and strengthened cash management. The implementation of new budget classification and chart of accounts saw good progress, and function of internal audit was also further strengthened. Moreover, the implementation of program budgeting was piloted in 2008 at eight ministries and agencies and was subsequently expanded to 10 ministries by 2015 to fully implement it. These experiences provided an important basis for scaling up the full implementation of program budgeting to all ministries and institutions in the third stage of public financial management reform.

In conclusion, the implementation of CAP 1 and CAP 2 as of the end of 2015 formed necessary and sufficient basis for the implementation of platform 3, i.e. establishing Budget-Policy linkages in stage 3 (2016-2020) and further enhancing the implementation of the first two platforms.

1.2. Components and Objectives of Stages 3 and 4

CAP 3 of Stage 3 of the PFMRP, launched in March 2016, focused primarily on budget- policy linkages with five objectives. Objective 1: Keep strengthening budget credibility by strengthening management of revenue, debt and cash, and improving budget execution. Objective 2: Continue strengthening financial accountability through improving budget classification implementation; launching the new budget system and operation system, strengthening reporting system and financial accountability, and enhancing the functions of internal audit. Objective 3: Focus on budget-policy linkages by rolling out full program budgeting and covering more budget entities, improving budget comprehensiveness and integration, defining clear roles and responsibilities of MEF, line ministries and legislative bodies, developing medium-term expenditure framework (MTEF), developing Monitoring & Evaluation (M&E) system, and implementing financial decentralization. Objective 4: Prepare the foundation for the introduction of performance accountability including performance budgeting framework, defining lines of performance budget accountability; launching performance auditing framework and capacity development plan. Objective 5: Support the reform program by building capacity and incentivizing the reform and strengthening the capacity for the implementation of Stage 3.

Stage 4 is performance accountability, which is expected to be completed by 2025. The objectives of CAP for stage 4 have not been defined yet.

1.3. Constraints in Achieving Objectives in Platforms 3 and 4

Platform 3 is expected to make a good progress, but improving the quality of program structure, budget integration and enhancing budget comprehensiveness remain challenging. In practice, moving from input-based to program-based approach is not much difficult, but changing from program budgeting to performance budgeting would be difficult if performance accountability remained weak. Budget system reform which focuses on the key elements of the budget cycle, such as development of strategic plan, budget formulation, budget execution, monitoring and oversight as well as auditing is the core of the PFMRP. This reform is accompanied by other interconnected components, such as resources mobilization, FMIS, state property management, cash flow management and financial accounting and reporting. These components have critical impacts and could pose constraints in achieving the objectives of moving the budget system reforms forward. Hence, the lack of effective mechanism for coordinating and monitoring the reform of budget system with other interlinked reforms may pose a risk to achieving the objectives of platforms 3 and 4 as well as the overall objective of the PFMRP. Moreover, along with the implementation of platform 3, there are aspects of platform 1 and 2 which still requires further improvements, especially for ensuring revenue sustainability, enhancing the efficiency of budget execution, including further strengthening of the procurement system. It is very important to ensure budget credibility and a well-functioning FMIS for performance accountability.

At the same time, besides the PFMRP, there are other major relevant areas of reforms, especially the decentralization and deconcentration reforms being undertaken by other ministries and institutions of the Royal Government of Cambodia (RGC) , which may influence the process of budget system reforms as well as in achieving the objectives of platform 3 and 4. In addition, there is a need to improve and enhance the effectiveness of the NSDP as a basis for linking budget

to policy, and strengthening and enhancing the role of independent auditing. Unless these reforms are implemented in tandem and well-coordinated with the reforms under Stage 3 and 4, the objectives of the PFMRP may not be achieved. Human resources management in the public sector is not sufficiently developed and this would be a major constraint in achieving the objectives across all platforms and stages. Public administration system reforms will need to be further accelerated to make civil servants accountable for their performances. As a matter of fact, it is not expected that an effective performance-based human resources management system of the public sector can be put in place in the short to medium term in Cambodia. Further concerted efforts will be required to move public administration reforms forward, especially during the implementation of stages 3 and 4.

1.4. Review of Timeframe

On the sub-national administrative system, even though [its budget] functions have not yet been differentiated from one another, a unified framework of budget system has yet to be defined. The planning process of both national and sub-national [budgets] levels needs to be aligned and mutually complemented to achieve common objectives. At the subnational level, the roles and responsibilities should be more clearly defined as a basis for better preparation of accountability framework and more targeted budgeting for better accountability.

The overall progress in the implementation of the PFMRP has been encouraging. In addition, adopting a step-by-step approach or phase-shift approach of public financial systems has enabled a more dynamic process which allowed changes or strengthening of the CAP, based on practical experience.

However, an evaluation of the progress of the Public Financial Management Reform Program using **Public Expenditure and Financial Accountability Framework** in 2015 provided valuable lessons and pointed out the challenges of implementing reform program for stages 3 and 4. The evaluation highlighted that achieving the third stage in 2020 will be linked and complemented with the progress of public administration reform and the progress of reform of decentralization and deconcentration. At the same time, a review of the program budget implementation by the World Bank in 2016 under the framework of the Public Financial Management Reform Program, as part of the mid-term review of the concept note on the Strategic Direction of Budget System Reform in Cambodia 2013-2020, has drawn on lessons from international experiences on program budgeting and suggested future directions in the implementation of program budgeting in Cambodia. The study shows that the implementation of full program budgeting is only achievable in the context of an overall result-based management system, which has not yet been implemented in Cambodia, and based on the lessons learned and past experiences, the current framework for the implementation of the performance accountability framework is too ambitious. The review therefore concluded that the full implementation of performance-based budgeting management by 2020 is unrealistic. The RGC, therefore, needs to review more thoroughly and within appropriate timeframe to ensure the success of the budget system reform in Cambodia.



Chapter 2

The Direction of Budget System Reform

The Law on Public Finance System, adopted in 2008, paved the way for the budget system reform with the introduction of Budget Strategic Plan (BSP) and the piloting of Program Budgeting. In June 2013, the RGC approved the ***“Concept Note for Strategic Direction of Cambodia’s Budget System Reform 2013-2020”*** to guide and direct the implementation of Stage 3 of the PFM RP. The Concept Note is a key document for steering budget system reforms to date. The implementation over the last three years, especially after the piloting of full-fledge Program Budgeting in some Line Ministries (LMs), the RGC has a better understanding about the challenges in the implementation of Performance Budgeting (PB). During that time, the management and senior officials of MEF undertook study visits to a number of selected countries to gain insights from their experiences in the application of performance budgeting. The knowledge gained from these study visits, coupled with the findings of the Program Budgeting Review, have drawn an overall conclusion that the ***Strategic Direction of Budget System Reform of Cambodia needs to be adjusted to become more realistic and practical***. This Chapter reviews the relevant objectives of the current Concept Note, the experiences and lessons from practical implementation from other countries, the justification for a move toward performance informed budgeting in 2025, and an explanation of the strategic objectives of 2018-2025 Budget System.

2.1. Review of the “Concept Note for Strategic Direction of Cambodia’s Budget System Reform 2013-2020”

“The Concept Note for Strategic Direction of Cambodia’s Budget System Reform 2013-2020” sets out the objectives of gradual changes from “an input based and centralized budget system towards a performance based and decentralized budget system” by 2020. With this goal, the Concept Note sets out the objectives and scope of the reforms under the framework of the budget cycle namely budget formulation, approval, execution and performance monitoring and evaluation. Up to this point, the objectives and scope related to the first three stages are generally still appropriate in the current context of the Financial System Reform. Particularly, the establishment of a performance monitoring and evaluation system as an objective of Stage 4 there is not much activity yet. However, the findings on the experiences in the implementation of program and performance budgeting from the study visits to other countries that implement program and performance budgeting pointed out the necessity to review the objectives and the scope of the reforms to be appropriate with current best international practices. Particularly for budget system at the sub-national level, the Concept Note pointed to the reform directions aligned with the national budget system as follows:

The objectives of the sub-national policy need to be aligned with the national policy objectives/priorities and in accordance with the administrative management structure that defines the roles, authority, and the responsibilities of sub-national administration.

- Gradual changes of the budget cycle of the sub-national administration needs to be aligned with the national budget cycle.
- The financial accounting system and management of the sub-national administration needs to be aligned with the national level by using the same budget classification, chart of accounts and reporting formats. For this direction, the finding from the studies suggested that the objectives and scope of the reforms on the sub-national budget system remain valid and relevant and do not need any revision.

In order to achieve the objectives of the Budget System Reform 2020, the RGC shall set out a number of strategies, such as the strengthening and improving the effectiveness of the Budget Strategic Plan (BSP), extending the implementation of the Piloting of Program Budgeting, launching Budget Entities, implementing a new budget classification along with the revised chart of accounts, as well as, enhancing and expanding the implementation of the FMIS, coupled with the preparation for the implementation of a performance-based budget system from year 2020 onward. Overall, this Concept Note proved useful in guiding budget system reforms based on a step by step and gradual implementation approach in line with PFMRP and up to now it is proved to be in the right direction. This kind of approach provided for sufficient time for changes in the budget system and enabled all stakeholders to learn and gain practical experiences from one stage to another.

2.2. Progress and Challenges of Cambodia’s Budget System Reform

After two years of piloting comprehensive program budgeting, the review findings both, by PFMR Steering Committee and the World Bank (WB) under the PFMRP framework, concluded that ***“Cambodia had made good progress in implementing program budgeting”***. The review found that one of the key progress was the introduction of the Budget Strategic Plan (BSP). The setting of policy goals, programs, and indicators in the BSP were recognized as a positive feature for further promoting the focus on performance. Improving the conditions of budget estimation provided enabling environment for budget planning.

In fact, after completing the piloting stage of partial program budgeting in 2014, the full-fledge piloting of program budgeting was introduced to 10 LMs in 2015 and expanded to 36 LMs/institutions in 2017, along with initial implementation in six provincial administrations as well. Following this direction, all ministries and institutions will be required to implement full program budgeting by 2018. They will be required to prepare their annual budget by policy objectives, programs, sub-programs and activities for budget negotiation, and be directly implemented by the budget entities of LMs and institutions of the RGC. However, during this piloting period, budget will continue to be prepared on line item basis and remains the official budget document to be submitted to the Legislative Body for review and approval.

The roll-out of the program budgeting and budget entities is working well with annual budget preparation becoming more comprehensive and realistic. The determination of the number of policy objectives, programs, sub-programs in the BSP have made the preparation and

implementation of program budgeting more efficient and manageable. In addition, MEF provided substantial amount of training, technical support and guidance to LMs which improved the implementation of program budgeting, and in turn, the implementation of program budgeting gained active support and participation from LMs, both at political and technical levels.

Seven budget classifications namely economic, administrative, functional, geographical, program, source of budget, and project classification were put into practice. FMIS was officially launched in 2015 and deployed to all general departments of MEF and all capital and provincial treasuries in 2016.

In addition to the progress outlined above, the review highlighted some shortcomings that need to be addressed as follows:

- The BSP was prepared without limiting expenditure ceiling, which allows LMs to use it as a tool to increase their budget request in an unreasonable manner. When the BSP was first introduced, the proposed budget was as much as 100% over the budget of the previous year. By 2015, the increase in the proposed budget in the BSP reduced significantly but in some cases, they still exceeded by 40% to 50%. This caused difficulty in allocating budget to the right targets, and caused the budget negotiation to concentrate more on the economic classification rather than the program classification.
- The estimate for capital expenditure remained unclear and government personnel expenditure and large spending items, which are subject to public procurement procedures were still not broken down by programs.
- The contents of BSP remains poor due to the limited knowledge of the concept and different capacities across ministries and institutions resulting in poor program structure.
- Performance Indicators (PIs) were not well defined due to capacity constraints and the mechanisms for collecting and reporting information in the LMs remained fragmented. On the other hand, the lack of regular and reliable data is also a main reason for making the report on key performance indicators unable to be used for the purpose of effective budget planning.
- Insufficient human resources and limited capacity constitutes a barrier to the performance accountability of each program. In addition, an effective human resources management system in the public sector based on performance is not expected to be achieved before or by 2020.

Overall, the budget system based on full performance could be achieved only in the whole context of performance-based management system where program managers have full control over resources, where performance can be measured and where accurate reports are available, where program are evaluated regularly, and where managers are held accountable for results and incentivize them to perform. For Cambodia, key elements for the basis of the above-mentioned result-based management system are missing or insufficiently developed, which constrains the move towards achieving comprehensive performance-based budgeting in the medium term.

2.3. Performance Budgeting Model and International Experiences

In fact, there is no clear definition or technical standards for performance-based budgeting system. Performance budgeting reform is sometimes called “Performance or Result Based Budgeting System”, “Program Budgeting System” or “Performance Informed Budgeting System”. Many countries, both developing and developed, have been using different models of performance budgeting system based on the country’s stage of development, its institutional setup, and legislative power. Based on a publication by IMF, performance budgeting can be categorized into three models as follows:

- **Presentational Performance Budgeting:** In this model, performance information is illustrated in budget documents or other government documents. Performance information refers to target or result or both and it is included as background information for accountability and for discussion with legislators and the public on public policies. Such performance information does not have any formal impact over the decisions made in the budgeting process.
- **Performance Informed Budgeting:** In this model, budget resource preparations are indirectly linked to the proposed performance or past achievements by ministries and government agencies. Performance information has an important role, but does not have a pre-determined weight, nor being an absolute factor for making decision on budget allocation. In this sense, performance information is not the only basis, but it needs to be used along with other information related to political and economic aspects and policy priorities for decision making on budget or resource allocation.
- **Direct Performance Budgeting or Performance Based Budgeting:** In this model, resource allocation is made directly and explicitly based on unit of performance to be achieved, generally referring to outputs achieved in the year.

Experiences of OECD member countries showed that implementing “direct performance budgeting or performance-based budgeting” is difficult, even in the countries with a lot of resources and strong institutions. These budgeting models are used in only very few OECD countries, while most of them are moving towards implementing “Performance Informed Budgeting”.

Lessons learnt from the study visits to Sweden, France, Malaysia, and Thailand showed similar challenges and problems, especially at the budget preparation stage. These countries refer to their national agenda or priorities, then break it/them down into programs and sub-programs to execute them. The level of utilization of performance information varies from one country to another and they are used in directing budget negotiation and for performance monitoring. Sweden is one of the most developed countries in using performance information, but the budgeting system of this country has its unique characteristic inherited from the evolution of social, political, economic and cultural system over a long period of time. Thailand and Malaysia make minimal use of performance information for annual budget preparation and negotiation, but they utilize it widely for reporting purposes. In contrast, in France, performance information is widely used in budgeting process, but budget allocation does not entirely depend on

performance information. Please refer to Annex 1 which provides more detailed information on the experiences of OECD countries, Sweden, France, Malaysia, and Thailand.

Overall, based on experiences of the four above countries, the budgeting reform in France provides a valuable lesson in guiding for budgeting reform in Cambodia as Cambodia has been using a budgeting system quite similar to the French system and Cambodia's budget reforms have evolved in a similar direction and approach as that of the current French budgeting system. Hence, France's budgeting model could be regarded as the appropriate basis for Cambodia to consider in its reform of its budget system.

2.4. Options for Cambodia

Up to now, under the current framework of PFMRP, Cambodia has been working to reform its budget system towards "Result-based or Performance Budgeting". While the reforms were considered to be on the right track, the current critical issue for Cambodia is to review this ambitious goal based on its own experiences of actual implementation and based on recent international best practices. International experiences have shown that most countries faced difficulty in implementing performance-based budgeting system, although they have a lot of resources, and generally retreated from the "full-fledged performance-based budgeting system" to "performance informed budgeting". Countries that achieved better progress in implementing performance-based budgeting system was that their budgeting system was a part of a comprehensive result-based management system. In the result-based management system, planning, human resource management as well as budget management are directed and aligned among themselves to achieve the policy objectives of the government with reliable database system for decision making. Heads of budget entities are well trained and delegated with sufficient authority to manage budget and resources. Currently, Cambodia lacks these prerequisite requirements as a basis for implementing result-based management system. This means that Cambodia is not yet ready to implement performance-based budgeting system in the medium-term. In other words, "direct performance budgeting system", which is a model of performance budgeting system, will not be an option for Cambodia. A study reviewing program budgeting conducted by experts from the World Bank under the framework of the PFMRP recommended that RGC should adjust the direction of its budget system reform from "Performance or Result Based Budgeting System" to "Performance Informed Budgeting". The evaluation based on the experiences gained over 3 years in piloting full fledge program budgeting and the recent developments of budgeting system reform in other countries also concluded the same as the World Bank study. Cambodia has therefore decided to choose the model of "Performance Informed Budgeting" as a specific goal to develop its budgeting system based on international best practice. From now on, budget system in Cambodia will be called "Performance Budgeting-PB"

2.5. Setting New Direction and Timeframe for Budget System Reform

The Concept Note on the Strategic Direction of Cambodia's Budget System Reform (2013-2020) has set the target of achieving "Performance Based Budgeting" by 2020. However, based on the review study as mentioned above, it concludes that this timeframe is not appropriate in the

Cambodian context. Thus, with the decision to choose “Performance Budgeting” as the specific goal, RGC has decided to develop a long term and comprehensive budget system reform strategy with appropriate timeframe to make gradual and realistic change of the system.

As the Budget System Reform is at the heart of PFMRP, it could not be isolated and out of synergy with the other reforms under the PFMRP. This reform will require the support from other major reforms such as public administration reform, decentralization and de-concentration reform, strengthening national strategic development plan and strengthening audit function. In this regard, the strategy for this reform must provide a holistic approach to ensure that other reforms under PFMRP and other major reforms of the RGC, are mutually linked, synchronized and complementary to each other. The strategy of the Cambodian Budget System Reform will mainly focus on national budget system but also provide the principles and guidance for budget system reform of the sub-national administration in order to achieve the collective results and policy objectives of the nation through the integration of planning, budget management, and reporting system by using a harmonized approach. This approach shall not affect the ongoing reform process of decentralization and de-concentration but at the same time help further smoothing functions transfer and delegation of budget execution to sub-national administration. Based on overall assessment of the current status and the complexity of the reforms that will be implemented in the framework of “Performance Budgeting” system, the most appropriate time frame to achieving this goal is 2025. The Budget System Reform Strategy will therefore cover the reform agenda from 2018 - 2025 known as the “Budget System Reform Strategy 2018-2025 (BSRS)” as an orientation principle for public financial management of RGC, and requires all stakeholders to review their own reforms to be consistent both in term of principle and timeframe matching with this strategy.



Chapter 3

The Strategy for Budget System Reform 2018 to 2025

The fundamental objective of the Budget System Reform Strategies 2018-2025 is to move forward to implement Performance Budgeting in accordance with the strategic direction of policy-budget linkages and performance accountability by 2025. Under this system, the budget is prepared based on the program, along with measures that are to be achieved based on a clear performance framework. In this endeavor, the budget preparation process will be made more open and transparent and budget reviews by the legislative body will be further enhanced. At the same time, budget practice will be more effective through improvements and simplification of expenditure procedure, timely reporting in conformity with international standards, modernization of internal control in all government ministries and institutions, together with improved monitoring and evaluation framework. In this sense, human resource skills and information technology systems will be progressively upgraded to support these changes. This Chapter outlines the reforms of four key elements of the budget cycle and defines their directions for 2025. To ensure effective and sustainable reforms, each key element will need to be institutionalized. In addition, there are a number of other reforms in the PFM system which are not considered as the key elements but have significant impacts, linkages, or interrelationships with the budget system as a supportive infrastructure. Those elements are not subject to detailed discussion under this strategy as their reforms are already covered in strategic documents or are covered in other plans under CAP 3 of the PFMRP.

3.1. Strategic Planning Stage

The one-year budget preparation cycle is too short a timeframe because phasing out of programs or introducing new ones, generally, would need more than a year. In this regard, the annual budget cannot reflect changes in the direction of expenditure effectively unless a medium-term forecast is expected. Therefore, a medium-term annual budget perspective is necessary. Currently, Cambodia has included a medium-term perspective in preparing its Annual Budget. The Macroeconomic and Public Fiscal Framework are prepared from top-down and in line with macroeconomic outlook, RGC's priority policies, and trends of revenue and expenditure. In particular, the "Medium-term Budget Framework" is prepared based on macroeconomic and public finance framework to provide information to the ministries/institution on the indicative and priority expenditure as well as the potential revenue of the fiscal year and the next two years for the preparation of Budget Strategic Plan.

The objective for 2025 is to institutionalize medium-term budget planning and be introduced to all ministries/institution for implementation. The medium-term budget planning will consist of the following 3 elements:

- medium-term macroeconomic and public finance framework;
- medium-term budget framework; and
- budget strategic plans of ministries/institutions/provincial levels

The above framework and these plans will be prepared and updated annually on a three-year rolling perspective. Medium term budget plans shall be comprehensive, covering all types of financing sources, including external financing, and all forms of spending including current expense, capital expense, investment, grants, cash transfers, and subsidies. Along with the institutionalization of the medium-term budget planning above, the reform of the budget system may lead to a need to revisit the current calendar of the annual budget preparation.

3.1.1. Macroeconomic Framework

Macroeconomic model provides a key basis to forecast the growth by sector of the economy, inflation, interest rates, exchange rates and potential revenues and expenditure, etc. based on assumptions of the sectoral interaction in the economy as well as the impact from any eventual shocks of the world economy. The reliability of the forecasts will depend on the economic model and assumptions which may reflect the actual status of the economy. The outcomes of these projections are the basis for defining the macroeconomic and public finance policy framework. The objective for 2025 is to improve the quality of macroeconomic forecasting by strengthening forecasting methodology, capacity building, facilitating and exchanging of information between relevant government agencies, including the MEF, the National Bank of Cambodia (NBC) and the Ministry of Planning (MOP). In addition, international institutions can also play a complementary role and provide technical support. In this regard, the quality of macroeconomic and public finance data must be further improved in a timely manner and be more accurate.

3.1.2. The Medium-Term Fiscal Framework

The Medium-Term Fiscal Framework (MTFF) focuses on adhering to fiscal objectives and disciplines such as restricting the size of public debt, targeting of budget deficits or strictly limits spending on some specific expenses etc. This framework will determine the amount of total revenue and total expenditure for the medium term which is a basis of expenditure ceiling of the four broad sectors namely General Administration, National Defense and Security, Social and Economic sectors. This framework will be prepared based on assumptions of prudent macroeconomic forecasts, especially, with respect to revenue and expenditure forecasting.

The actual result of public finance performance may differ greatly from the planned figures due to unforeseen deviations from the forecast of economic growth, changes in terms of trade, realization of government guarantees, occurrences of natural disasters, etc. In this regard, information on financial risks could help managing risks, improving economic efficiency and reducing the cost of borrowing. Presenting accurate and comprehensive financial risk information to decision makers will permit thorough scrutiny and make quality decisions, especially the decision with the regard to the level of risks appetite that the government should take. In addition, the transparency of this work will promote policy responsiveness in a timely, smooth and effective manner. The Financial risk document will be attached to the medium-term fiscal framework. This financial risk document aims to show the possibility of changes in the budget outcomes resulting from changes of the macroeconomic conditions and assumptions. The MEF will be responsible for assessing and reporting financial risks. Other ministries and institutions including the NBC and ministries and institutions which possess state owned

enterprises and sub-national administrations shall also be responsible for identifying risk targets and putting them under control. A coordinating mechanism will be established to exchange, track, and monitor information on fiscal risks with all line ministries and agencies. The Medium-Term Fiscal Framework and risks statement will be submitted to the Plenary Session of the Council of Ministers for review and approval before formulating budget strategic plans and annual budget.

3.1.3. The Medium-Term Budget Framework (MTBF)

The Medium-Term Budget Framework (MTBF) is an important tool for enforcing budget ceilings by sectors and by Ministries/Institutions in line with the RGC policy priorities and national development goals. The MTBF will be prepared in the four sectors namely General Administration, National Defense and Security, Social and Economic sectors and will be broken down by Ministry and Agency. The basis of consideration in MTBF will be the need for ongoing program expenditures and estimation of spending requirements for new programs or policies. In addition to expenditure allocations by sector and line ministry, the MTBF will be prioritized by a simplified economic classification, such as wage, non-wage, capital expenditure, loan guarantees, etc. This will ensure budget linkages to the RGC economic policy and priorities and help to control and monitor the ceilings of each type of expenditure. The budget ceiling under the framework of MTBF will become the reference for Ministries/Institutions to prepare their budget strategic plans and annual budget.

The medium-term budget framework will be prepared in consultation with line ministries and institutions with respect to new expenditure proposals and adjustments in expenditure priorities under the guidance and decision of the Prime Minister.

3.1.4. Budget Strategic Plan

The Budget Strategic Plan (BSP) is a three-year rolling plan which Ministries and Agencies need to prepare annually thorough a top down approach by linking policy priorities of the Ministries and Agencies to sectoral goals and National Strategic Development Plan (see Appendix 2.3 on National Strategic Development Plan). The BSP will be prepared in accordance with policy and program objectives with descriptions and rationale, sources of financing, key performance targets, performance objectives, timeframe and budget requirements. The BSP will be based on the expenditure ceiling prescribed in the medium-term budget framework. When preparing BSP, it is also necessary to consider the requirement for program funding on recurrent basis (e.g. wage expenses, operational expenses, maintenances, utilities etc.), the proposed policy and other programs which are not directly related to outcomes. However, it is subjected to prior approval of MEF. For such programs, the emphasis will be on inputs, outputs and operational efficiency improvement, rather than policy performance and program effectiveness. BSPs need to be comprehensive through progressive expansion by including coverage of all sources of financing (e.g. state budget, Development Partner [DP] budgets, owned-sources of revenues etc.) and all types of expenditure (e.g. current expense, capital expense, grant financing, subsidies, resources transfer etc.). In this regard, BSP is an important tool for integrating current and capital budgets.

Currently, the medium-term investment plan for financing by borrowings, a large share of capital budget coming from direct external financing, is prepared separately for each partner under the MEF cooperation. These investments are integrated into the list of the Three-Year Rolling Public Investment Program by the Ministry Planning, together with the public investment projects financed under grants from development partners through the Council for the Development of Cambodia. The MEF is responsible for the preparation of the annual budget for capital expenditures for investments financed by external financing based on three-year rolling list of public investment projects. Besides, for the domestically financed capital budget, there is no medium-term plan yet, and currently the MEF is responsible for allocating it to ministries/institutions in line with the Law on Public Finance System 2008. The challenges of fully integrating both types of financing are:

- The Medium-term budget plans and public investment plans have two different time frames as large investment projects will be subject to special approvals, based on their long-term financial obligations which are beyond the standard timeframe of budget planning;
- The two different planning processes (public investment programming and recurrent budget formulation) are carried out by two different agencies and at different timelines.

Among others, the objective of BSP is to improve the financial integration of both current and capital budgets during annual budget formulation. Project proposals shall be prepared by the Ministries/institutions being part of BSP preparation, and justifications for achieving respective program objectives are necessary. In this regard, it is necessary to develop a clear Public Investment Management Framework (PIM) as the basis for the preparation and approval of the medium-term investment budget.

3.2. Budget Preparation and Approval

3.2.1. Annual budget preparation process

The annual budget is currently prepared on an incremental basis to support the continuation of the public service from another year, even though program budgeting has been implemented for some time. The budget is adjusted based on wage increases, the net increase of personnel, previous year's budget implementation, and unexpected price changes. Each Ministry and institution can request additional budget consistent with their BSP and within the incremental rate set forth as ceiling for LMs. LMs shall defend their proposals with MEF at budget discussion meeting which currently focuses on sensitive inputs and outputs.

Annual budget will reflect both the linkages between sector policies and MTF and between MTBF and budget strategic plan. Sector policies and MTF are developed based on the national policies (Rectangular Strategy and National Strategic Development Plan) as illustrated in Figure 1. Moreover, Figure 2 illustrates the relationship between policy structure (policies objectives, programs, sub-programs, activities cluster and activities) and organizational management structure (leadership, management, and technical level) with clear roles and responsibilities, in transparent and accountable manner.

The objective for 2025 is that the discussion on budget proposal, both current and capital budget, will principally be based on program performance; especially on the new proposed budget which will contribute towards achieving program objective, output, outcome and improve efficiency of program implementation. The discussion on proposed budget will remain on annual incremental basis but with increased flexibility. LMs must make every effort to reduce the previous-year budget, so that the saving can be reallocated as much as possible.

Figure 1: Linkage of National Priorities and Sector Policies

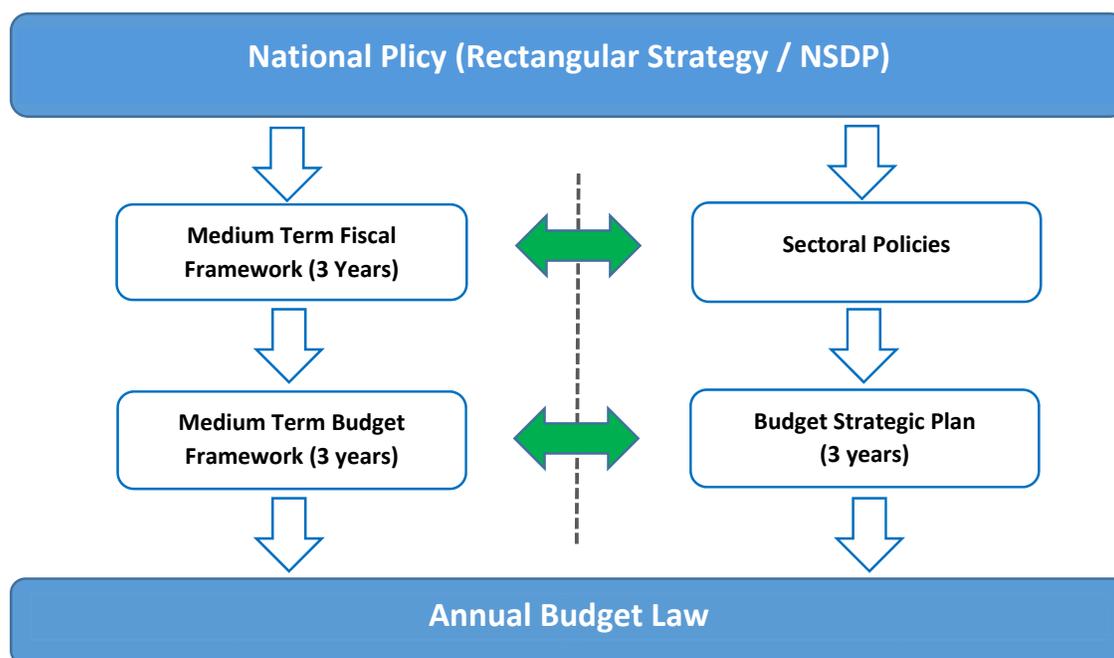
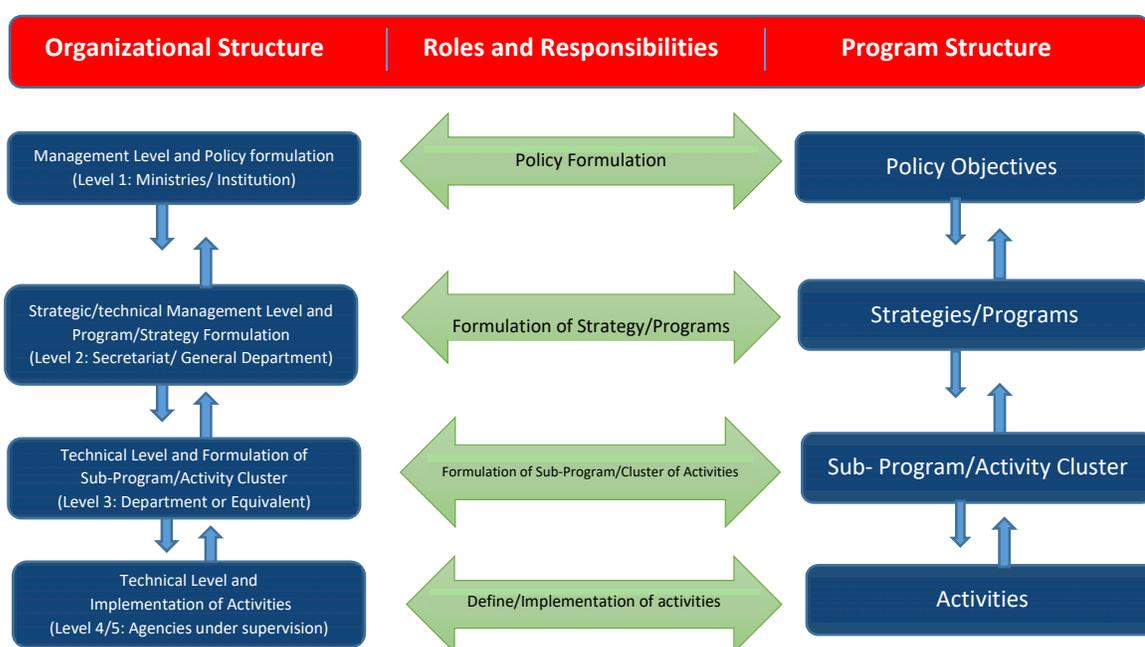


Figure 2: Linkage of Organizational Structure, Role and Responsibility, and Program Structure



LMs are required to identify potential savings that could be subjected for reallocation. The current input-based budget negotiations process will gradually shift towards negotiations which are primarily based on program outputs and outcomes.

Meanwhile, budget preparation will fully utilize all the seven budget classifications within the FMIS. These budget classifications comprise of economic, administrative, functional, geographical, program, source of funds, and project classification. The control of economic classification will only apply on certain types of expenditure, allowing for greater flexibility in the use of funds for implementing programs, sub-programs and cluster of activities.

3.2.2. Budget Scrutiny and Approval

The process of approving an annual budget is sequenced following the calendar for drafting Annual Budget Law. Generally, this principle has been adhered to and each ministry/institution shall have a period of more than six weeks to prepare their respective budgets. After the government's endorsement, the draft Annual Budget Law (or called Law on Financial Management) is submitted to the Legislative Body for review and approval.

Currently, the scrutiny of the draft Annual Budget Law at the Legislative Body is done in the Economic, Finance, Banking and Auditing Committee, so called the second Committee, with the participation of other relevant committees. The MEF is responsible, on behalf of LMs, for defending the draft Annual Budget Law, both in the second Committee and at the Plenary Session of the Legislative Body, in accordance with the Law on Public Finance System 2008.

In 2025, the scrutiny of the Annual Budget Law, including the Revised Budget Law and Budget Settlement Law, by the Legislative Bodies will be revised and further strengthened. Budget debates at the program level will be held at the relevant specialized Committees of Legislative Bodies which is organized by the National Assembly and can be participated by relevant specialized Committees of the Senate. In principle, the LMs will be responsible for defending their budgets at the program level at the respective specialized Committee meetings. The annual budget discussion at the Plenary Session of the Legislative Bodies will focus on policy objectives at the ministry/institutional level and the overall budget envelop. The MEF will be responsible for defending the ministerial level budget envelop in the Second Committee and at the Plenary Session of the Legislative Bodies. The Second Committee meeting will decide on the overall budget preparation before the draft Annual Budget Law is presented to the Plenary Session of the Legislative Bodies.

Over time, the National Assembly will approve, chapter-by-chapter, the draft law that annexed with policy objectives and program classification as well as simplified economic classification. By 2025, the draft Annual Budget Law will include performance information as an annex, which will play an important role in providing program information for scrutiny purposes.

3.3. Budget Execution and Control

3.3.1. Expenditure authorization

Under the current system, LMs, being principal authorizer, are required to obtain commitment from MEF before entering into spending. After the official adoption of the Annual Budget Law and issuing the budget book, ministries/institution can request for petty cash. Other standard types of operating expenditures are implemented through the commitment and public procurement procedures. Once goods and services have been received and verified, LMs has to issue payment order requests and submit to the MEF Financial Controller (FC) along with supporting documents. After being examined by the FC attached to the LMs and approved by MEF management with different level of authorization, the stamped payment order requests along with supporting documents are submitted to the General Department of National Treasury (GDNT) for verification and disbursement to suppliers. For provincial budget, the control mechanism and implementing procedures are similar to those of the LMs. The heads of LMs provincial departments act as authorized budget entities and the provincial department of economy and finance is responsible for verification and stamping on expenditure commitment and payment order requests, and provincial department of treasury act as Public Accountants (PA) to verify and made disbursement.

The objective for 2025 is that once the Budget Law is approved, the budget will be the basis of authorization for spending commitment of the LMs for the whole year. The authorization for spending commitment will be based on quarter/semester expenditure allotment up to the agreed budget limit, except for exceptional, uncleared and/or highly sensitive spending items, which will be subject to prior-approval of the commitment from MEF. The quarter/semester expenditure allotment refers to the distribution of resources based on programs, budget entities, spending items, and periods. The procedures of budget implementation will be modernized and streamlined through an improved FMIS to bring efficiency, transparency and accountability. Based on this direction the usage of cash advance, which have not yet been recorded as expenses as currently practicing, will be progressively reduced.

3.3.2. Budget Execution Control

Currently, the budget expenditure control of LMs is implemented through a centralized mechanism in stages including commitment, procurement, payment order and disbursement. Both budget execution and its control are processed manually as the FMIS is not fully operational yet. In addition, the virement is not flexible.

Until now, the budget controls of LMs and provincial departments are implemented based on Sub-Decree No. 81 ANKR, dated November 16, 1995 on the Establishment of Financial Inspection on the State Budget Expenditure at Ministries, Municipalities/Provinces, Autonomous Cities, Phnom Penh Municipality, and Public Administration Organizations, and Sub Decree 82 ANKR. BK, dated November 16, 1995 on General Regulations of Public Accounting. These two Sub Decrees which have been implemented over more than 20 years are not comprehensive enough to respond to the evolution of Budget Control System in line with international best practices, in

particular concerned roles of FC and PA. Accordingly, both Sub Decrees will be reviewed and eventually revised.

The objective for 2025 is to simplify the budget control system by putting in place a clear and short procedure for budget control both at the LMs and at the MEF. At the same time, FMIS shall be fully functional, so that it can be used as a tool for automated monitoring and controlling functions aiming to increase operational efficiency and at the same time provide greater flexibility for budget management and execution. In line with this direction, the functions of national budget control will be delegated to operational levels to accelerate budget execution—in timely manner, efficient, and clear accountability—with the principles of performance budgeting. Accordingly, the mechanism for national budget control will be the following:

- Establish a centralized mechanism for budget execution control at the LMs, which combine both financial control and procurement functions, under direct supervision of MEF.
- Establish a mechanism for budget execution at the provincial department of economy and finance by delegating authorities and responsibilities for financial control and procurement.

To ensure checks and balances, the roles of PA will be kept as currently practice, to verify the compliance with public accounting and cash management rules, but shall be reduced to the minimum by preparing concise and efficient legal framework as well as the implementation of FMIS and E-Transfer. As soon as system of budget management is improved to the international best practices and the capacity of institutions is getting better, PAs shall decentralize their roles to the LMs/Institutions in order to lighten and improve efficiency of the control mechanism, which is a precondition for the LMs/Institutions having full accountabilities on financial and non-financial performance.

In addition to the budget control function, the above mechanism shall also carry out the roles of monitoring non-tax revenue collection and state properties management.

3.3.3. Procurement

The Law on Public Procurement was enacted in January 2012 and the MEF is preparing to finalize all related regulations to implement this Law. However, the existing regulatory framework do not clearly separate the functions of procurement regulator and the procurement implementation entities.

The objective for 2025 is to improve the transparency mechanism through the establishment of a regulatory framework under which, the MEF will function as the regulator and procurement auditor while the procurement entities will be responsible and accountable for carrying out the procurement. Complaints and grievance handling mechanisms will be improved and made independent with the creation of a sanction regime. The rules, regulations and procedures for public procurement will be harmonized to increase competitiveness, transparency and efficiency.

3.3.4. Disbursement Control

Currently, in accordance with the Sub Decree 82 ANKR. BK, dated November 16, 1995 on General Regulations of Public Accounting, the GDNT of the MEF is acting as PA and is also responsible for checking and verifying compliance of financial procedures before disbursing cash against payment orders.

The objective for 2025 is to move towards the simplified disbursement control framework and procedures through FMIS, while payment will be disbursed through E-Transfer. The roles and functions of PAs will be reviewed according to the revised new legal framework concerning PA as mentioned in section 3.3.2.

3.3.5. Financial Inspection

In performance budgeting, budget management will shift from a centralized system where expenditure control is highly centralized at MEF, to a decentralized system where LMs/institutions have higher autonomy in control their budget. To ensure checks and balances, post-expenditures control will be more critical. Hence, the General Inspectorate Department of the MEF, which has empowered by legislature to conduct financial inspection on LMs/institutions and public entities, will need to improve and enhance its financial inspection function. Likewise, to ensure efficiency and cost savings, the financial inspection shall be carried out in responding to the necessity, reports from PA and complaints or information on irregularities.

3.4. Budget Monitoring and Evaluation

3.4.1. Reporting System

3.4.1.1. Financial Reporting

Currently, Cambodia uses “modified cash basis” accounting system for recording and reporting purpose. However, the accounting system does not comply with International Public Sector Accounting Standards (IPSAS), which requires a Statement of Cash Flows and Payments (including opening and closing cash balances), consolidated statement of all administrative bodies that are part of the central government under the Government Finance Statistics (GFS) definition, a statement of accounting policies, and extensive explanatory notes.

The objective for 2025 is to fully meet with Modified Cash-IPSAS for the financial reporting for every line ministry/institution. However, the general national accounting system will continue to use modified cash basis. With the improved FMIS, the financial monitoring will facilitate real-time financial reports based on the user needs. The system will be able to generate weekly, monthly, quarterly and annual reports in any classification required. The financial monitoring will be improved and integrated with the fiscal report.

3.4.1.2. Performance Reporting

As part of the implementation of program budgeting, LMs are required to provide semi-annual and annual performance report in the format provided by the MEF. Currently, the compliance rate is low. Thus, the strengthening of the performance reporting system and increasing the compliance rate are necessary because these are the pre-conditions for establishing a well-functioning monitoring and evaluation (M&E) system.

The objective for 2025 is to improve performance reporting for all program and sub-program levels under a well-functioning M&E system.

3.4.2. Monitoring and Evaluation

A well-functioning performance-based management system requires regular monitoring and evaluation. This system provides the feedback into decision making at each level, informing the progress, efficiency, and effectiveness of each program and, more importantly, taking timely corrective measures if programs are not well performing or over-performing. Reasons for under (or over) performing maybe due to poor program design, inappropriate/unreasonable targets, poor program management, or insufficient resources.

Each of these requires different management responses, which may or may not have any budget implications. At present, monitoring system of LMs and MEF are not comprehensive enough. In the case of evaluation, the National Audit Authority (NAA) has carried out performance audit, but on a limited basis and mainly focuses on financial audits. At the same time, systematic procedures on program evaluation do not exist as yet.

The internal audit arrangement at the LMs currently plays a very limited role in performance auditing. Its role will need to be strengthened and reoriented towards assessing performance of budget entities and service delivery. The objective for 2025 is to achieve systematic performance monitoring and evaluation that is consistent with international best practices. This will require the preparation of relevant standards and guidelines, raising awareness and building capacity of auditors in performance auditing.

In principle, MEF will carry out regular semi-annual and annual monitoring of the implementation of program budgeting to examine if the intended purpose and results are being achieved. Each LM will also monitor their program implementation on a regular basis to determine if the objectives and expected results are being met. Both the monitoring, by the MEF and LMs, would lead to program adjustments. The LMs may carry out more in-depth assessment, if necessary, to determine the effectiveness of each program.

Every program should be subject to regular monitoring, but evaluation will only be carried out on selected programs, as and when required. Program evaluation requires a cross section of skills covering both financial and specific sector technical skills. This tends to be costly and so comprehensive program evaluation should be targeted at programs that have high value, high

risk or high political importance or significant performance issues. Currently, broader program evaluation is done on an ad-hoc basis and largely supported by DPs.

By 2025, there will be a comprehensive and specific program monitoring and evaluation framework which will include the following major components:

- Semi-annual and annual performance monitoring,
- In-depth monitoring of effectiveness of program design and implementation
- Partial in-depth monitoring of rolling program focused on program design and effectiveness,
- Comprehensive program evaluation based on necessity and post-execution evaluation on selective basis

Respective line ministries must do regular monitoring and can eventually do in-depth reviews so that timely and effective measures can be put forward if any program is off track.

The MEF monitors program execution and may carry out basic review of program performance based on budget execution data and performance, in order to use this information to assist in budget allocation but will not be a factor in deciding the allocation. Selective programs may be subject to comprehensive evaluation, if needed, in order to explore and find the causes of variances between budget plans and actual outcomes by checking expenditures and performance indicators. The ex-post evaluation to gather experiences and lessons will be carried out on some programs on a selective basis.

The NAA is responsible for carrying out independent reviews of program performance in accordance with its mandate. These may include validation of spending, program effectiveness, audit of non-financial performance indicators as well as the review of program design and management (Please see more detail in Annex 2.4 on independent audit in performance budget system).

In accommodating the above requirements, all the relevant LMs/institution (the MEF, LMs, and NAA) need to follow the above monitoring and evaluation framework in a consistent and coherent manner to enhance effectiveness and avoid overlapping.

3.4.3. Public Expenditure Reviews in Sector or sub Sector

The review of public expenditure may be done in the context of sector, sub-sector or ministry/institution, with the objective of aligning expenditure with policy priorities and identifying the targets for cost savings. The MEF may select targets and timeframe, if needed, but generally once every 5 years.

3.5. Enabling Infrastructure

3.5.1. The legal framework for budget

Currently, Cambodia is implementing centralized and input-based budget management system, in compliance with the Law on Public Finance System 2008 and this law sets a stage for the government to prepare for program budgeting, a step towards performance and decentralized budgeting system with the key reform elements as described earlier of this chapter. In this sense, a clear and comprehensive legal framework is needed to implement performance budget system. The current Law on Public Finance System will need to be amended.

3.5.2. Skills and capacity in budget management

The modernization and enhancement of the budget system will require substantial investment in public financial management (PFM) skills development. Important areas that require skills upgrades are:

- Budget analysis
- Accrual accounting and financial reporting
- Financial management Information technology (IT)
- Procurement
- Project management
- Monitoring and Evaluation (M&E)

Human resource capacity building is a long term and non-stop process. The human resource development strategic plan must be prepared in the early stage of the execution of this system reform strategy to upgrade and retain key PFM skills in public administration. The key elements of this strategic plan will include the specifying/codifying of key competencies, developing effective recruitment procedures and mechanism, providing systematic training and career development supports.

3.5.3. Financial Management Information Systems (FMIS)

The FMIS project was formulated as an important element within the second stage of PFMRP to support public financial management, especially for the management of budget. FMIS is an integrated system that will cover budget formulation, budget execution, accounting, reporting, monitoring and audits. It will also bring about the changes in the business processes.

In the framework of FMIS execution, the current chart of accounts classifies expenses based on economic, geographical, program, administrative, functional, project, and sources of fund classifications. These classifications are consistent with the international standards of classification in the government finance statistics (GFS).

The immediate benefits envisaged from using FMIS are improvements in budget formulation and execution through streamlined and automated payments, accounting and budget reports. The strategy on FMIS development is set out in two-phase, of which phase one is intended to

implement the main functions of budget execution within MEF. Phase two will include Budget Planning and Formulation, Procurement, Fixed Assets and Inventory, along with the extension of FMIS uses to LMs including capital and provincial administrations.

The FMIS will automate the budget preparation process, facilitate the transfer of approved budget allocations to budget entities, and will gradually become the main tool for managing and controlling expenditures of the LMs including capital and provincial administrations by 2025. Moreover, FMIS could be required to interface and synchronize with the Cambodia performance management system.

3.5.4. Change Management and Communications

The implementation of these major reforms in budget management requires public servants to transform their working environment, individually and organizationally. Change efforts can produce high-levels of anxiety and worries in the working performance that can lead to resistance or creation of barrier, either openly or silently. Thus, it is very essential to communicate the necessities and importance based on the clear reasons, right principles, and balancing perspectives to alleviate potential fears and encourage participation in the reforms.

The critical success factors to change includes effective communication on the vision and direction of changes, nature of changes, timeframe, and key areas of change to the LMs and within the LMs, themselves, from management levels to general public servants. Moreover, communication must be explicit on the real benefits of changes from the current budget management system to a new system while building trust to enhance the effectiveness, transparency, and accountability of budget management.

3.5.5. Enhancement of Transparency

Transparency and disclosure are key elements in performance budgeting. The broader aspects of budget like Macroeconomic Framework, MTFF, MTBF and elements related to fiscal risk will be disclosed by the MEF. Once the annual Budget Law is approved, related budget documents and the budget book will be disclosed to the public. These disclosures will be made through the MEF websites. Likewise, the LMs will disclose their budgets on their respective websites. Overall, these public disclosures will contribute to transparency enhancement and provide a basic reference and justification for performance budget execution. In addition, the use of the FMIS will further improve transparency.

3.6. Sub-National Budget System Reform

There are two levels of public administration in Cambodia, namely the National Level Administration and the Sub-National Level Administration (SNA). Both administrations have one common purpose of realizing national policy priorities. In this sense, it is important to integrate the budgets of the two administrations. It is also important to ensure consistency in the principles and approaches of budget management. Thus, this section will focus on reforms of budget system, which are the integration and alignment of the principles and requirements for budget

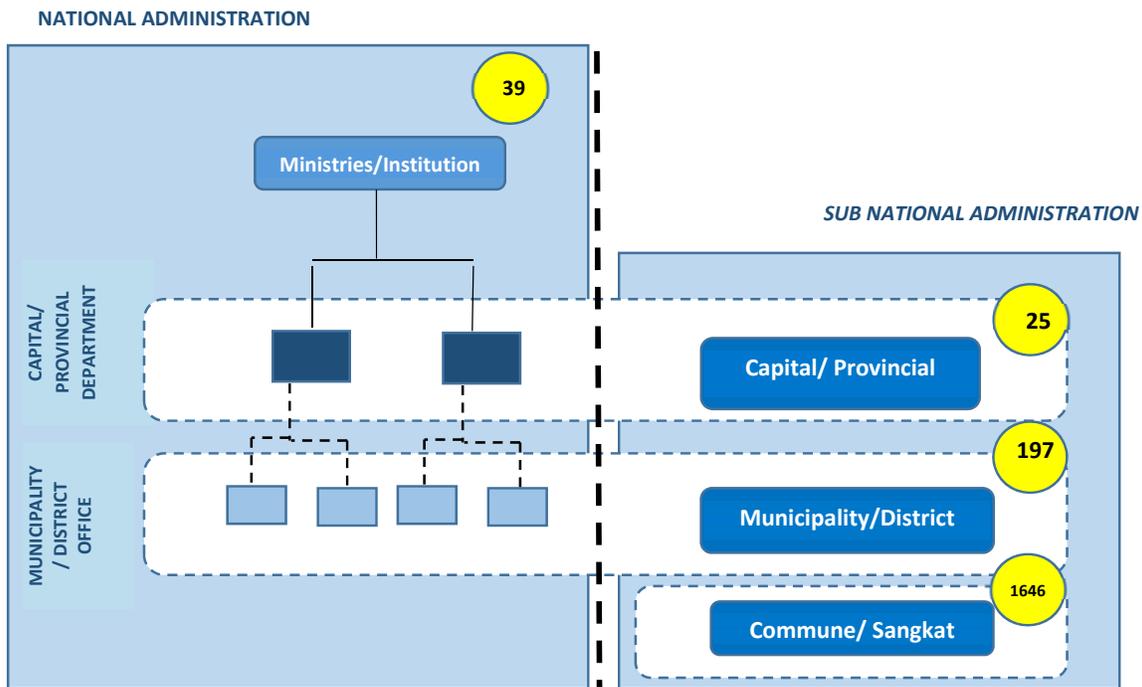
preparation, management and reporting between the National Level and the SNA level under the single Law on Public Finance System.

After exploring the budget systems of SNAs in many countries, it suggested that there were a lot of similarities between the sub-national administration system in Cambodia and France. In this sense, the French SNA model provided a conceptual basis for formulating budget system of SNA in the context of Cambodia, especially in the areas of execution and controls.

3.6.1. Conceptual Framework

Currently, the structures and linkages of both public administration arrangements in Cambodia are shown in Figure 4. Heads of LMs' provincial departments are appointed by their respective ministers after being nominated by the provincial governors. At the capital and provincial level, the provincial governors are appointed by the Royal Decree, while chairperson of capital/provincial council are chosen by their respective councilors that are elected by indirect vote. The governors of municipal, district, and khan are appointed by the sub-decree and the chairperson of district/municipality council are chosen by their respective district/municipality councilors that are elected by indirect vote.

Figure 4: Linkages between the two levels of Administration for the Implementation of National Policy Priorities

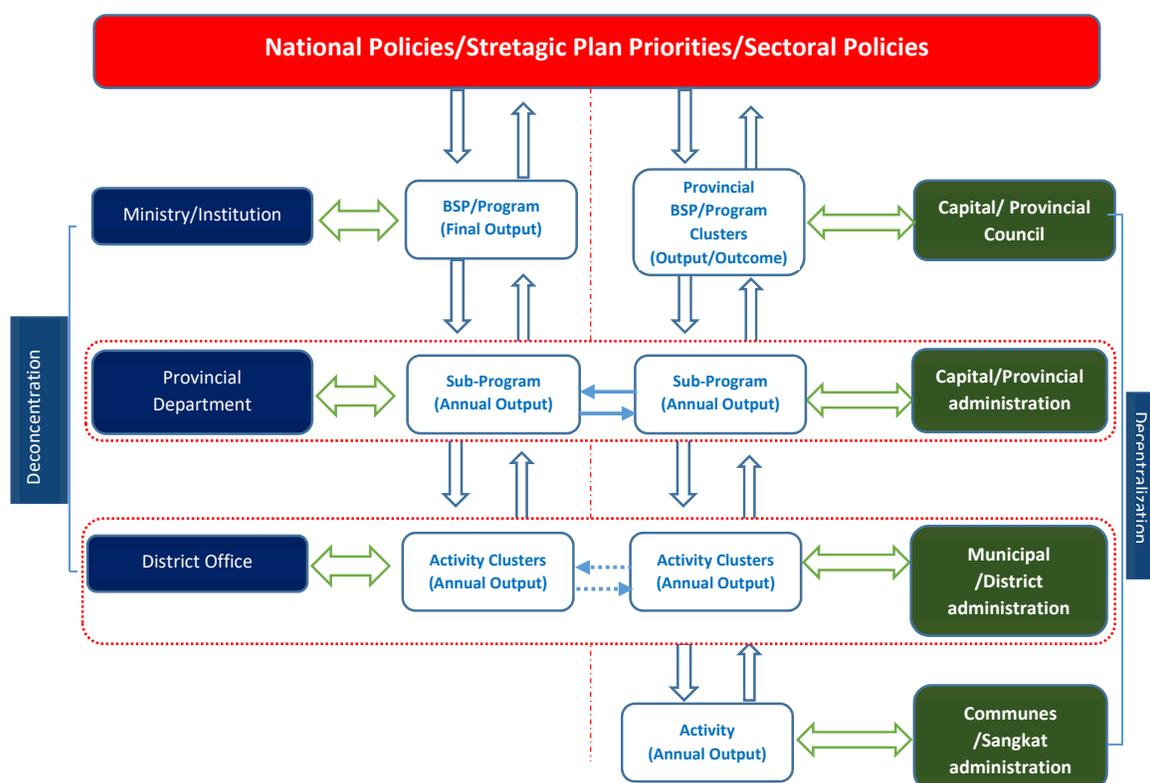


Among others, the capital, provincial, municipal, district, commune and *sangkat* councils have responsibility to review and approve development plans and annual budget plan (Please see more detail in annex 2.2 on background of decentralization and de-concentration reforms). The governors of the capital, provincial, municipal, district and Khan and chiefs of commune and

sangkat are responsible for the prepare and execute the annual budget plan and development plan.

Currently, financial control is centralized by pre-control mechanism at the Provincial Department of Economy and Finance (PDEF) covering both decentralized budget and de-concentrated budgets for capital, provincial, municipality, district, and khan. As an exception, the budget for commune and *Sangkat* is directly executed by their respective Chiefs. The provincial treasury plays the role as Public Accountant and makes disbursement for the three levels of Sub-National Administration.

Figure 5: Conceptual Framework for Budget Integration of National and Sub-National administration



The budget reform will integrate the National and the Sub-national administration budgets by aligning the program activities according to the administrative arrangements as shown in Figure 4. The main objective of the integration is to enhance interrelation and complimentary between program activities of the SNA levels and those of the national level, in realizing the overall objectives of the NSDP (Annex 2.3 explains further on NSDP). The introduction of program budgeting at the SNA level will provide the necessary mechanism for such integration. Figure 5 shows programs at the two level of administration, which collectively contribute to the sectoral objectives and achieving the national policy priorities. For budget of Provincial Line Departments, LMs and SNAs must work together in planning process and in achieving overall sectoral objectives. For SNA budget, the SNA programs must plan to meet their respective priorities and align them with sectoral objectives, which in-turn will contribute to achieving national priorities.

At the present, the Macroeconomic and Fiscal Policy Framework is the guide for formulating budget strategic plan both the LMs and the SNAs. Within this process, there is a coordination mechanism to incorporate sectoral programs into programs at the SNA level; however, its effectiveness is still limited. The budget formulation and approval processes are driven by the national level where SNA budgets are allocated as block without breakdown and detailed by program. The Governors of each province must submit their proposed budgets to the MEF for negotiation. Budget execution, accounting and reporting are based on the centralized approach. Financial transactions—including revenues, expenditures and cash—and accounting are centralized at provincial treasury. The MEF conducts financial inspections, while independent audit is carried out by the NAA.

The strategic direction of the Budget System Reform is to introduce program budgeting and gradually move to performance budgeting by 2025. In principles, the same purposes and frameworks of program budgeting and performance budgeting are applicable for both national and sub-national administrations. Therefore, the key elements of national budget system reforms outlined above in this Chapter will also guide the directions of reforms in the Sub-National Budget, but SNA budget reform may need a longer timeframe and a customization to fit its context. In this regard, SNA budget system—which is integrated and aligned with the requires and principles of budget formulation and execution of the National budget system—will be developed under a single Law on Public Financial System.

3.6.2. The preparation of capital/provincial Budget Strategic Plan (BSP)

Currently, once the Macroeconomic and Fiscal Policy Framework has been defined, the Royal Government will issue the circular on the preparation of national BSPs. Based on that circular, the MEF will issue another circular on the preparation of capital/provincial BSPs. The BSPs are prepared at the provincial level based on SNA programs and the SNA priorities while aligning to national priorities/NSDP that are reflected in each of the capital/provincial development plan and investment programs. The Capital and Provincial BSPs are submitted to their respective councils for review and endorse before they are sent to the MEF. The development plan of SNA is a five-year development plan which is the result of the integration of all level of SNA. Capital/Provincial administrations will prepare a SNA development plan every five years and submit to the capital/provincial councils for review and endorse before they are submitted to the Ministry of Interior for discussion and approval. These development plans are prepared separately and put forward for their respective councils for review and endorse before submitting to capital/provincial administration for consolidation. The development plans of municipality, district, khan and development plans of commune and sangkat are not consolidated in the capital/provincial BSPs.

Currently, there is a lack of horizontal alignment of the programs/plans between the sub-national and provincial departments' budgets, due to insufficient consultation and collaboration between the LMs and the SNAs. The current practices, therefore, do not provide a good integration basis between national and sub-national planning.

The objective is to gradually improve budget strategic planning process at the capital/provincial level by 2025, to have it in place as an integrated process that effectively links the programs/plans under the SNA budget to the national priorities/NSDP. The preparation of capital/provincial BSPs will be guided by the MTBF that will define a budget ceiling for each LM and capital/provincial administration. The capital/provincial BSPs will be horizontally integrated for the SNA budget, and aligned vertically to sector priorities of the LMs at national level in terms of provincial department budget. The process of horizontal integration and vertical alignment is made with the objective of using limited resources to generate the maximum results for the benefit of the SNAs. This will require improved consultation and coordination between the LMs and SNAs during the strategic planning process and support for the capacity building of SNAs.

For improved budgetary discipline, the MEF will prescribe a budget ceiling for the SNAs which will guide the preparation of the capital/provincial BSPs. The capital/provincial BSPs will align and integrate with capital/provincial policies to support sector policy and outcomes as shown in Figure 5 above. The municipal/district and commune/sangkat level will plan their own interventions in support of Capital/Provincial policy priorities that will eventually contribute to sector and national priorities. Because the Capital/Provincial BSPs are prepared based on sector priorities from the national level downward, these BSPs will also need to offer the flexibility to include local priorities needs and requests from municipal, district, khan, commune, and sangkat administrations which is the bottom up.

3.6.3. Budget Preparation, Negotiations and Approval at SNA Level

Currently, although there are two different processes of budget preparations at the LMs and SNAs, they will eventually intersect with one another at the capital/provincial level. The capital/provincial departmental budgets are prepared by their respective LMs based on top-down planning approach, guided by national priorities, which will be negotiated and agreed by the MEF, and approved as part of the national budget by the Legislative Body. Capital/provincial budgets are prepared and submitted to their respective provincial councils for deliberation and endorsement. These budgets are then submitted to the MEF for negotiation, verification and consolidated in the draft Annual Budget Law. On the other hand, the total budget for municipal/district/Khan and the total budget for commune/Sangkat are allocated based on a specific proportion of the current national revenue. The size of the allocation is determined by a specific formula, based on population size, poverty index and number of councils and number of communes/Sangkat (for municipal/district) or number of villages (for commune/Sangkat). The capital/provincial administration provides technical support in the preparation of the municipal/district budgets. After review and endorse by the municipal/district council, the PDEF consolidates each provincial budget then submit it to the MEF. Each commune/Sangkat prepares their own budgets, then submit them to their respective councils for review and endorse, which is then submitted to the capital/provincial level for review and verification for compliance. Provincial budget is approved as a block which is a part of the National Budget by the Legislative Body. Provincial departments of LMs are not involved in this budget preparation process. Although there is a well-structured process for budget preparation, negotiations and approval at

the SNA level, the SNA budgets still lack quality, comprehensiveness and the policy-budget linkages.

The objective is to make provincial budgets more comprehensive by 2025, with the enhancement of policy-budget linkages. Capital and current expenditures will be integrated. The negotiation process of the capital/provincial budgets will be reoriented towards program outputs. Since the Chart of Accounts will be unified and FMIS will be deployed to capital/provincial administrations, the budget classifications will be the same as that for the national level as well. There will be only one Annual Law on Financial Management which will incorporate the SNA budget with the national budget. The capital/provincial budget will be reflected in aggregation for each province and will be broken down into current and capital budgets and shown in the annex of the law. However, municipal/district and commune/Sangkat budgets will be reflected in aggregate which is the result of detail allocation to each administration based on an allocation formula and based on performances. In the future, as the SNA budget management system makes improvements, the principles for preparation and approval of budgets will need to be re-examined in order to align it with the international best practices.

Overall, the reforms in concerning to budget preparation, negotiations, and the verification by MEF, and the submission to Council of Ministers and the Legislative Body for reviews and approvals will need to be more aligned with the underlying principles of the corresponding reforms in the national budget system.

3.6.4. Execution and Monitoring of Budget at SNA Level

3.6.4.1. Expenditure Authorization

In the current system, the capital/provincial administrations and municipality/district administrations must request to the PDEF for expenditure commitment before spending, except the commune/Sangkat administrations that are given autonomous over their expenses. Following the adoption of the Annual Budget Law and after the budget books are issued, the sub-national administrations can request for cash advance. For other expenses, the expenditure commitment procedures and public procurement procedures need to follow. When capital/provincial administration and municipality/district administration receive and verify their goods and services, they must issue payment order with supporting documents and submit to the PDEF. After the review and approval by the PDEF, the payment order, along with the supporting documents, will send to the Provincial Treasury for review, settlement, and disbursement.

The objective in 2025 is to allow the allocated budget of SNAs to become the basis for expenses authorization for the full year, after adoption of the Annual Budget Law. The authorization plan for expenditure will be prepared as trimester/semester allotment, based on the pre-defined principles, except some expenses that have high value and/or are highly sensitive, which will be the subject to prior-commitment from the PDEF. The trimester/semester expenditure allotment is the distribution of resources, in accordance with programs, budget entities, nature of expenses, and timeframe. Budget execution procedures will be modernized and streamlined

further through the enhancement of FMIS to ensure effectiveness, transparency and accountability.

The key success factor of performance budgeting system is the delegation of power to the front-line managers in managing their resources in the best possible way to achieve their performance. Based on this principle, capital/provincial administrations should be fully responsible and accountable for all matters pertaining to their own financial execution and controls. At the commune/sangkat administration, since the commune/sangkat councils are elected by the people, social accountability at commune/sangkat administrations is the most priority.

3.6.4.2. Budget Monitoring at SNA levels

Currently, the SNA budgets are monitored based on centralized mechanism, from commitment stage to procurement, payment order and disbursement stages, except for the administration budget of the commune/sangkat. The budget monitoring is carried out similar to the national level, based on Sub-Decree No. 81 dated 16-November-1995 on the Establishment of National Budget Financial Controls at the Ministry level, municipal, provincial, autonomous municipal, capital and public administration entities, and Sub-Decree No. 82 dated 16-November-1995 on General Orders of Public Accountants. The virement process is not flexible enough.

The objective for 2025 is to accelerate and simplify the implementation of sub-national administration budget by delegate authority, based on the progress of decentralization and de-concentration reforms and consistent with international best practices, to capital/provincial administrations, municipal/district administrations, and commune/Sangkat administrations in order to improve effectiveness and accountability in line with the conceptual framework of performance budgeting.

In line with this direction, for the capital/provincial budget, which PDEF assumes both financial and procurement control, will be delegated more authorities and responsibilities from the MEF. In addition to expenditure control, the non-tax revenues collection and the state properties management will be consolidated into the roles and responsibilities of PDEF. Similar to the National Budget, the PA's function will continue as a separate mechanism similar to the current practice to verify the accuracy of the spending, in accordance with the rules of public accounting and cash management, but the verification process will be reduced to a minimum through concise and effective legal arrangements and with the use of FMIS and E-Transfer. In future, when the budget management system has improved to the level of international best practices and capacity of related entities increased, the PA's function at the capital/provincial Treasury will be integrated with the functions of budget control of the PDEF in order to ensure effectiveness and responsibility under MEF at one place, which will be a pre-requisite condition for SNA to have more financial and performance accountability.

For municipal/district and commune/sangkat budget, the budget control shall be carried out by Capital/Provincial Treasury in its role as the public accountant. Additionally, to accelerate and facilitate the implementation of the budget, especially to streamline disbursement process, public accountant could be recruited at the municipal/district administrations eventually based

on capacity and necessity. The budget execution of municipal/district administration and commune/sangkat administration is subject to the post-reviews.

In this regard, to ensure check and balance, it is necessary to promote the role and responsibility of the general inspectorate of the MEF. However, to ensure effectiveness and save maximum cost, the financial inspection will minimally perform its function, based on the necessities, reporting from public accountant, and addressing the complaints or irregularities. The framework and the detailed procedures for the financial inspection on SNA budget execution at the capital/provincial, municipal/district levels, and commune/sangkat administration will be defined separately.

3.6.5. Reporting System, Monitoring and Evaluation of Budget at SNA Level

Currently, the reporting system for the SNA budget is still rudimentary and irregular. The SNA will need to adopt a similar reporting system to that of the national level, but simpler and more appropriate to the responsibilities and legalities of the sub-national levels. Figure 5 shows the key roles of the SNAs in achieving program objectives and providing service delivery.

The reporting regime for budget program clusters under the SNA will be prepared bottom-up. The commune/sangkat administrations will report outputs of the activities to their respective commune/sangkat councils, while the municipal/district/khan administration will report the progresses of sub-programs to their respective councils. The capital/provincial administrations will consolidate, both the financial reports and the program performance, and report to their respective councils and the MEF. For SNA budget, the evaluation will be carried out by program clusters to assess the quality of service delivery and customer satisfaction at the capital/provincial level.

The objective by 2025 shall gradually institutionalize the reporting regime of the SNA and improve the capacity of SNA in performance reporting at the capital/provincial level.



Chapter 4

The Road Map toward the Strategic Goal 2025

Chapter 2 has already highlighted the need for a move in the budget system reform toward the performance budgeting system, specifically to “**Performance-informed Budgeting**”. This new strategic direction is in view of more realistic, comprehensive and accurate objectives for the budget system reform in Cambodia for a period from 2018 to 2025. Chapter 4 sets out reform activities through simplified, realistic and sequenced approach to achieve all the objectives set out chapter 3.

The strategy has retained the original objective of implementing full program budgeting, which adopted programs as a tool for linking budget to policy objectives by the year 2020, and then, will start to implement performance budgeting from 2022 onwards by gradually strengthening performance/outcomes information and accountability to have adequate time to be ready for implementing full performance budgeting from 2025. The above objective is consistent with PFMRP Stage 3, budget-policy linkages (2015-2020), and with PFMRP Stage 4, performance accountability (2021-2025).

4.1. Scope

Chapter 4 highlights the road map in the framework for implementing national budget system reform strategy, which is centered on 4 key elements which are strategic planning; budget preparation and approval; budget execution and financial controls; and monitoring reports and evaluation as stated in Chapter 3. In the meantime, there is also a road map for some key enabling infrastructure reforms.

The road map in Chapter 4 does not cover budget system reform at sub-national administration, as this task will be prepared separately. However, it will be based on key principles and the framework set out in paragraph 3.6 of Chapter 3 and guided by the directions and targets in the road map for the national budget system reform, that will be illustrated in this chapter. Meanwhile, this chapter does not include the road map for other relevant reforms such as State Property Management, Cash Flow Management, Accounting Standards and Financial Report Standards, Internal Audit Reforms and Independent Performance Audit, which also contribute to the budget system reform. These reforms will be addressed separately under the consolidated action plan of PFMRP Stage 3 and 4. However, the elements of these reforms have to be reviewed when the Law on Public Financial System is amended in 2020 with the related legal framework in order to support the change of budget system.

4.2. The Road Map

4.2.1. Strategic Planning

Strategic planning will be strengthened through the implementation of the macro-economic framework, the medium-term fiscal framework (MTFF), the medium-term budget framework (MTBF) and the budget strategic plan (BSP).

- **Macro-economic framework and MTFF:** the quality of these frameworks will be improved through capacity building and better coordination amongst MEF, MOP and NBC. The Economic and Financial Policy Committee is an effective mechanism to lead the review, discussion and decision-making prior to the submission to the Council of Ministers for review and final endorsement.

- **Medium-term Budget Framework:** the current MTEF will be revamped and retitled as Medium-term Budget Framework by setting the budget ceiling that has to be strictly adhered and followed by sectors, line-ministries and municipal and provincial administrations.

The MTFF and the MTBF will become a system with integrated and inter-dependent characteristic that will formally commence as prescribed in Chapter 3 from 2021 onwards.

- **Budget Strategic Plan:** the quality of the BSP will be improved with focus on two important aspects, 1) review and reinforcement of the program structure, especially in relation to the policies and related programs by ensuring these aligned to the National Strategic Development Plan. The performance information will also be improved as the basis for performance-based management; 2) integration of capital expenditure into the BSP in order to have comprehensive information for both capital and current expenditure. *These two tasks have to be achieved by 2020.*

While focusing on two tasks above, the quality of BSP will be improved through capacity building of the staff of the MEF including the budget analysts and budget managers as well as all budget entities at the line-ministries. All these will include the update of ***the guideline on the BSP and guideline on the budget preparation*** that will be implemented from 2018 onwards and plan for subsequent training programs.

4.2.2. Budget Preparation and Approval

The annual budget preparation will be strengthened with the improved quality of the BSP. In this context, in preparation of implementing performance budget, full program budgeting needs to be strengthened and rolled out to all line ministries by 2018 and rolled out to all provincial/municipal administrations by 2020, and at the same time accomplishing full integration of current and capital budget by 2020.

With strengthening and expanding program budgeting, budget classification system will be expanded to use all the seven classifications (Economy, Administration, Function, Geography,

Program, Source of Fund and Project) by integrating it into the FMIS, which will be implemented starting 2018, and completed by 2022.

For the purpose of improving annual budget formulation, the preparation and the introduction of budget ceiling for line ministries will start in 2018 and fully and effectively implemented in 2021. Line ministries will need to attach their procurement plan with budget request from 2019 onward.

As highlighted in the chapter 3, one of the objectives of the strategy are that when the Annual Budget Law is adopted, budget appropriation will be basis of authorization for all line ministries. In this context, cash advance will be implemented under clear and comprehensive legal framework by 2020, instead of current practice where inter-ministry Prakas is annually prepared. Moreover, instead of the current practice where the annual procurement plans are prepared and approved after budget negotiations and draft Annual Budget Law, the review and decision on procurement plans will be made during budget negotiation with the LMs, and it will serve as the basis for MEF's endorsement from 2020.

The framework of the budget negotiation will be further strengthened by focusing more on performance, including both outputs and outcomes of programs. More weights will be shifted from input to output in 2019 and to outcomes from 2021 onward. Additionally, "Performance Agreement" between the MEF and LMs will be implemented starting 2019 onward, by reflecting the result to be achieved in budget year. The performance agreement will be expanded to include outcomes in the budget formulation from 2023.

To fully adopt performance budgeting by 2025, budget scrutiny and approval process will be done in stages. In 2021, the draft Annual Budget Law, with program details and simplified economic classification, will submit to the Council of Ministers for review and endorse, but the draft Annual Budget Law, with existing economic classification, will submit to the Legislative Body for review and adoption. The draft Annual Budget Law, with program details and simplified economic classification, will submit to the Legislative Body for review and adoption in 2022.

Within scrutinize and adoption process, the draft Annual Budget Law will include performance information as annex and submit to the Council of Ministers for review and endorsement starting 2022. This is to present within the Royal Government on its comprehensiveness and usefulness in order to collect feedback and make revision, before include performance information as an annex the draft Annual Budget Law to be submit to the legislative body for discussion and adoption in 2024.

4.2.3. Budget Execution and Control

The process of expenditure commitment and disbursement will be streamlined and improved efficiency through easing procedure and replacing manual work with FMIS by 2025. Currently, FMIS has been rolled out to 10 LMs in 2017 and will be rolled out to all LMs by 2020, before the fully automated the procedures with FMIS.

The current guideline on expenditure and financial control procedures, especially Sub Decree 81 and 82 mentioned in Chapter 3 as well as other concerned rules and regulations, shall be reviewed to simplify internal control system and working procedure with clear designation of roles and duties between MEF, LMs, and sub-national administration. This task will begin in 2018 and fully implemented by 2022. The internal control system, including monitoring function, will be redesigned and incorporated into FMIS by 2025.

The central budget control mechanism, which is under MEF for both financial and procurement control, will be delegated and attached to the LMs. The pilot will begin in 2022 and gradually roll out until 2025.

4.2.4. Procurement

To accelerate, streamline and improve procurement procedures in line with the strategy direction detailed in Chapter 3, the decisions rights and responsibilities on procurement will be gradually delegated to LMs, SNAs and other public institutions. At the same time, procurement audits will be strengthened by 2025 to ensure a clear accountability framework.

In this context, the procurement function which is part of budget control mechanism as stated in Chapter 3 will start to pilot and gradually roll out from 2022 to 2025. The strategy for Public Procurement System Reform will be prepared separately based on the above framework and objective.

4.2.5. Disbursement Control

The disbursement control procedure will be shortened and streamlined both at MEF and LMs from 2018 onward to fully automate with FMIS by 2025. LMs will be required to prepare budget operational plans starting from 2022 as a guide for budget implementation, and this plan will be mandatory by 2025 onward. At that time, cash management, payment order management, and supporting documents will be controlled and verified through FMIS, which is the basis for payment through Electronic Fund Transfer (EFT).

4.2.6. Monitoring and Evaluation

A clear monitoring framework and procedures will be established for monitoring financial and program performance. The preparation of the guidelines for this will commence in 2018 and will be finalized by 2020. Quarterly, semi-annual and year-end financial reporting based on the current accounting standards will become mandatory from 2021 and on Modified Cash-IPSAS Financial Reporting standards by 2025. For performance monitoring and reporting, the LMs will be required to report on KPIs on a quarterly and year-end basis by 2022.

A basic monitoring and evaluation framework will be developed by 2019 which will be piloted by 2023. LMs can carry out their program evaluations in the middle of each year based on reports and internal discussion when necessary. This basic framework will gradually evolve into a fully functioning M&E System after 2025.

4.2.7. Enabling Infrastructure

- Budget Legislation

The comprehensive reviews of Public Finance System Law (2008) will commence in 2018 to allow for sufficient time to complete all the preparatory work before the submission of the amended Law to the legislative body for review and adoption in 2020. Under this amendment, calendar of the whole budget preparation process—from the Medium-Term Fiscal Framework, Medium-Term Budget Framework, Budget Strategic Plans and Annual Budget Law, budget negotiation, budget balancing and submission to the Council of Ministers to the submission to the Legislative Body—will be reviewed and revised as necessary to provide sufficient times for each stage within budget preparation and adoption processes.

- Accountability Framework

As PFM Reform is progressing well toward performance accountability. Internal and performance audit will play an important role in moving towards performance evaluation of service delivery and the performance of budget entities. In this direction, guideline principles and performance audit procedures will be incorporated into internal audit framework by 2021. However, independent performance audit will gradually become a mainstream work of National Audit Authority (NAA).

4.3. Timeframe and Implementation Approach

The implementation of the road map for the BSRS 2018-2025 is divided into two main Phases, the first Phase 2018-2021 will focus on building the basic foundation for starting the implementation of performance budgeting, and the second Phase 2022-2025 will focus on pilot implementation of performance budgeting before moving toward the full implementation of the performance budgeting system after 2025. Based on this, the budget system reform is consistent with the timeframe of the PFMRP with Stage 3 (2015-2020) – policy-budget linkages, and Stage 4 (2021-2025) – performance accountability.

Similar to the PFMRP, the BSRS 2018-2025 will use the “Building Block” approach by reforming some key components simultaneously yet step by step through building on the past achievements, and at the same time laying out the foundation for the next stage. In accordance with this approach, the detail roadmap which shows the sequencing of the reforms and how these actions will lead to the ultimate goal which is stated in detail in Appendix 3.

To turn the road map of the BSRS 2018-2025 into action, all LMs and Agencies shall prepare specific action plans on a timely basis to be implemented within the framework of the consolidated action plan under the PFMRP. The Public Financial Management Reform Steering Committee will play the oversight role in monitoring the progress of the budget system reforms. The General Secretariat of this Steering Committee will monitor the implementation and coordinate the implementation of the budget system reforms and other reforms.

4.4. Risk Analysis

As budget reforms are broad based, having linkages with many other reforms, and interlocked, the implementation of the budget reforms would have potential risks or implementation delays. There are many factors contributing to these risks. If reforms in the enabling infrastructure or other reforms under the PFMRP are delayed, the budget system reforms shall can delays as well. In that sense, the reforms include revenue mobilization, FMIS, public assets management, cash flow management, accounting standards, and financial statements requires a closely aligned, linked, and intertwined as they are of critical importance to the success of the budget system reforms.

The RGC is also undertaking a number of reforms in other key areas outside the mandate or jurisdiction of the MEF. These include Decentralization and De-concentration Reform, Public Administrative Reform, the NSDP Reform, and Audit Reform which will have significant impact on the success or failure of the budget system reforms (please refer to Appendix 2 on the inter-linkages with budget system). Any delays or slow pace of these reforms will impact on the effectiveness of the budget system reforms. This could be avoided if there is close coordination and cooperation among the respective LMs responsible for each area.

The Election in 2018 is a political turning point which could disrupt the pace of the reforms as a result of certain subjective and objective factors, in particular individual mindsets and time pressure. On top of that, any eventual post-election changes related to the managements of certain ministries, senior officials and officials with other relevant skills could be a major obstacle to the anticipated reforms.

LMs reforms, in particular, changes in administrative structure to be consistent with program structure are one of the crucial factors to be considered to ensure effectiveness of performance budgeting implementation. Delays or hold up the reforms due to lack willingness will impact on the achievement of budget system reforms.

Effectiveness and comprehensiveness of the capacity building program and the effectiveness of the change management programs are among the most necessary tasks to prevent and resolve those above risks. Hence, they must be closely monitored. Meanwhile, there need to be joint responsibility in implementation, coordination and monitoring of the budget system reforms, as pointed out in the Road Map. This will be done by the General Secretariat of the PFMR Steering Committee.

Risks identification and steps taken to mitigate them will be elaborated in the detailed action plan. Regular monitoring and reporting of the implementation of budget system reforms is very crucial. These will be closely monitored and addressed in annual meetings of PFMRP and during the mid-term review of the implementation of the BSRS 2018-2025.



Chapter 5

Conclusion

The 13-year journey to date in implementing the PFMRP has been satisfying, particularly the essentially progresses in platform 1 and 2, as well as the good progress made in the implementation of platform 3. The achievements that have been made to date are the results of the active and responsible involvement in taking ownership by the ministries and institutions, as well as the consistent support and unwavering commitment from the leaders and policymakers of the RGC.

After being officially launched in 2004, the progress of PFMRP was slow in the first few years of its implementation as MEF required time to understand and absorb the new concepts and knowledge, study the new systems evolving as international best practice, draw on its own practical experiences as well as experiences from those countries which have taken steps well ahead of Cambodia, and balance all of these to best fit into the Cambodian context. The pace of reforms accelerated, particularly in the last few years as the pre-requisites for the implementation of program, which is the core element of the reform in Stage 3, were essentially completed, and the progress made in institutionalizing them. At the same time, LMs and institutions gained better understanding and adapted to the new concepts and ideas, in particular, the importance of the linkages between budget and policy.

Under the long-term vision of Cambodia to become upper middle-income country by 2030 and higher-income by 2050, the PFMRP can be considered as a determinant, while the budget systems reform will be a key tool to achieve this vision. Therefore, the PFMRP will continue to play a critical and core reform agenda for achieving platform 4 objectives by 2025.

However, in the coming years, the budget systems reform will likely face some major challenges. First, the reform agenda was too optimistic and unrealistic, while understanding of the value of reform and the path to achieve them are still limited. Second, the pace of reforms between the national budget system and other related key areas of reforms is not in tandem with and pace of one another and inter-linked. Third, human capital and institutional capacity development does not match with full-blown reforms, and this will take a longer time-frame, more resources, and mutual willingness from stakeholders, especially from all the leaders of LMs and institutions. Fourth, the reform process is dynamic as international practices is also evolving in an ever-changing global landscape.

With the above challenges, the goal of the reforms to implement “**Performance Based Budget System**”, which was set in the Concept Note for Strategic Direction of Cambodia’s Budget System Reform 2013-2020, will not be achieved by 2020. Therefore, based on the study from selected international country practices and especially from our own experience in implementing program budgeting, Cambodia has decided to adjust the direction of the reforms to “**Performance informed budgeting**”, which will still be referred to as **PB**.

This document sets out the new strategic framework and the roadmap to achieve the strategic goal of a fully integrated PB system that will establish policy-budget linkages and achieve performance accountability by 2025. Based on the achievements from Stage 1 and 2, and the progress made in Stage 3 of the PFMRP with the aim of to achieving success in Stage 4, i.e. performance accountability, this strategic framework focuses on 4 key components of the Budget System including: (1) Strategic Budget Planning which is comprehensive, integrated, and a clear risk management and medium-term budget framework; (2) Preparation and approval of annual budget, focusing on programs and the programs' objectives; (3) Execution and control of the budget which need to be accelerated and modernized through the streamlining of implementation procedure and the utilization of IT system for public financial management; and (4) Monitoring and evaluation based on essential framework for preparing timely, accurate and comprehensive report, and along with gradual transition toward the fully functional M&E system.

The strategic direction for the Sub-National Budget (SNA) System reform to be carried out in the same manner as the National Budget System reforms, driven by the common purposes of achieving national objectives and priorities. Hence, the SNA budget system reform must be in tandem with the principles, framework and approaches, and consistent with the National Budget system. The Strategy therefore points out the major areas to be aligned and harmonized in the strategic planning and the budget cycle namely preparation, approval, execution, and M&E. These are fundamental frameworks for preparing Sub-National Budget System Reform Strategic Plan.

A clear Road Map with timelines has been developed to outline the reform actions following the common approach, practicality and sequential transition to achieve the strategic outcomes of the Budget System Reform Strategy; and the implementation is divided into two major Phases: Phase 1 from 2018-2021, is to essentially achieve policy-budget linkages and Phase 2 from 2022-2025, is to achieve PB , which are consistent with Stage 3 and 4 of the PFMRP.

Overall, this Strategy outlines ambitious goals and at the same time show the major risks which could be encountered during its implementation. Nevertheless, Cambodia has to overcome them in order to achieve its goals. This is consistent with the current situation, where Cambodia has reached the stage of development and the new trends in international public financial management.

Leadership and ownership of key stakeholders along with valuable knowledge support from the Development Partners (DPs), are the key factors that will contribute to the success of the Budget System Reform. More precisely, the resolute support and guidance from Prime Minister, **Samdech Akka Moha Sena Padei Techo Hun Sen, Prime Minister of the Kingdom of Cambodia**, the Commander-in-Chief, has provided accelerated momentum to make PFM an outstanding success. This factor will no doubt provide hope to Cambodia to implement the Budget System Reform with effectiveness, accountability and transparency toward achieving the goal of 2025 in line with best international practice.



Appendix 1: International Experiences in Performance Budgeting

Budget System Reform Strategy 2018-2025 is the comprehensive long-term strategy document for budget reform in Cambodia. In principle, budget reforms do not have any one common standard, since each country's reforms are based on its own historical context, political setup, and institutions. However, in order to be realistic, this strategy document was prepared with in depth analysis and consideration of international best practice, especially on common practices in OECD countries. Additionally, budget reforms in Sweden and France, which have two separate modern budgeting system; and in the regional countries such as Thailand and Malaysia, which have gone through budget reforms and performance budgeting practices before Cambodia, were also analyzed.

1.1. Member Countries of OECD

According to IMF publication, nearly all OECD member countries have developed and used performance indicators (PIs) and many have sought to integrate performance information into the budget process. Actually, 67% of the OECD countries use performance indicators against targets when negotiating budget, but not across all line ministries (LMs). Eight countries use this for more than 80% of the LMs and six other countries, for less than 20% of the LMs. 67% of the countries use performance evaluation report as a basis for budget negotiations. Of which, six countries used this for more than 80% of the LMs, while seven countries for less than 20% of the LMs.

OECD countries have a long history of conducting program and policy evaluations. Each LMs mostly use the information from evaluation for managing their programs, setting targets for the following year, justifying budget allocations or making changes to the programs and to a lesser extent cutting expenditures. In these countries, the Central Budget Authorities use evaluation information for managing expenditure, program changes and reallocating resources between programs and LMs. However, these countries acknowledge that the use of performance indicators in budgeting preparation still faces a lot of challenges while politics is a key factor.

1.2. Sweden

Sweden, in the early 1980s, enjoyed the largest budget surplus among all OECD countries. However, from 1993 to 1995, with the country experienced a deep economic crisis that resulted in the largest ever budget deficit. To address the crisis, Sweden established a Commission of Inquiry and by the late 1990s significant budget reforms were introduced that brought the budget back to balance.

The key elements of the reforms included the adoption of a multi-year budget framework, a top-down budget process, delegation of authority to lower levels, and strong fiscal discipline with the introduction of aggregate budgets for broad spending areas. The new budgeting system in Sweden was divided into three levels. The first level constitutes the articulation of the government's fiscal policy objectives in macroeconomic terms; the second level determines the maximum aggregate level of expenditure for public finance policy objectives based on economic assumptions; and the third level allocates budget package to each of the 27 Expenditure Areas.

Another key feature of the budget system is budgeting for a surplus target which is mandated by law over each budget cycle.

Sweden follows a stringent top down budget process. The Cabinet considers the budget proposals from all ministries and collectively agrees on the total annual expenditures plus the expenditures for the next 2 years separated into package for each of the 27 Expenditure Areas within the overall budget aggregates. Before 15th April, the Government submits the Spring Fiscal Policy Bill to Parliament which discusses and approves the key aggregate figures in the budget framework by end of June, a process introduced to maintain budget discipline. The approvals are made at the level of each Expenditure Area among the 27 expenditure areas without further detailed allocation and the total level of expenditures for the coming year and the following years are controlled within the maximum specified level in the multi-year budget framework.

Once the figures for the 27 Expenditure Areas are approved, in principle, the Ministry of Finance would not take part in the detailed budget formulation process and the sector ministers become responsible for allocating detailed funds within specific appropriations in their respective Expenditure Area. The detailed budget proposal is again submitted to the Cabinet in early September after which the Budget Bill, which include PI for each Expenditure Areas, is presented to Parliament by late September. Parliamentary committees play a key role in scrutiny and much of the fundamental work in reviewing budget proposal are taken place in these specialized committees. The Finance Committee of the parliament is responsible for the overall budget proposal and for recommending to Parliament the level of overall aggregate expenditures and the aggregate expenditures for each of the 27 Expenditure Areas. The Sector Committees are responsible for scrutinizing budget allocation within their respective Expenditure Areas. At the local government, Sweden has 290 local administrations using 45 percent of the total budget.

In respect of monitoring and evaluation of performance, the Budget Act requires the Government to report to the Parliament on the performance/impact in terms of implemented policies and measures. This work is mainly carried out by the National Audit Authority through performance audits and financial audits. At the beginning of each year, the Ministry of Finance placed strong emphasis on performance information, but the experience did not yield much success as there LMs reacted strongly against the use of performance information. Moreover, such practice causes the generation of too many pieces of information and the passing of budgeting bill consists of voluminous documents which was simply unfeasible for the Ministry of Finance to verify and process. Parliament also voiced concern about the quality of the performance information attached to the budget documents as well. In this sense, the importance of performance information for budget allocation and approval remained limited which is yet to respond to the concept of performance budgeting.

1.3. France

The French performance budget system was introduced in January 2006 under a budget organizational law called the "Constitutional By law on Budget Acts (LOLF)". Under the new rules of this law, the Parliament approves and provides ministers with overall budgets by attaching with the respective objectives and the indicators for measuring performance. Ministers and

program managers are required to make a commitment to reach specific results as stated in the annual performance plan (APP) which is attached to draft Annual Budget Law. The APP presents budget allocation for each program, the performance indicators and the expected results.

Under the reform, budgets are organised around the purpose of expenditure to meet political objectives. Allocation of budget by types of expenditures has been replaced by a budget preparation presented in the form of broad public policies called 'Missions'. Missions are implemented through a series of 'programs' 'with clearly defined outcomes, outputs and delivery action plans. These plans are called sub-programs or actions. The budget preparation process follows a top down approach where results are guided and cascaded from the top, based on national priorities (missions). To make public spending more efficient, performance goals are defined, and the results measured at two levels: at parliamentary and governmental level as a basis for better budget preparation and allocation process, and within the ministerial/institutional framework for the efficient management of the programs. The budget structure and the performance framework are defined at three levels as follows:

- Missions: There are thirty-one (31) missions that correspond to the state's major public policy. Each mission contains a set of programs and the Parliament approves the budget down to the program level. The approval is done in one vote on the general budget, the annex budget and the special accounts. The approval covers commitment authorisation, cash-limit appropriation and the ceiling for employment. The Parliament approves the draft Annual Budget Law at a mission level that, yet the parliament has the authority to make adjustments to allocate budgets from one program to another in the same mission which consists in draft law. Ministers can make budget reallocation from one program to another program of the budget of their ministry, however total reallocations cannot exceed 2% of the total budget of the ministry. This also applies to appropriations made for personnel expenditure for each program. After the approval, the government issues a Decree to allocate appropriations by programs and personnel expenditure by the respective programs.
- Programs: There are 122 programs describing the responsibility for policy implementation and each program is supported by sub-programs or actions which are managed by a program coordinator appointed by the minister concerned. Program coordinators receive an overall budget which enables them to use those resources to achieve the objectives.
- Sub-programs/Actions: There are 500 sub-programs or actions which describe the programs in greater detail. The actions provide program managers with information regarding the use of the budget resources. By describing the budget at the objectives level, it makes the state's missions and public service goals become fully transparent.

Parliament receives comprehensive budget documentation twice a year namely the Budget Review Bill (for the previous year) and the Budget Bill (for the next budget year). To be able to systematically verify the planned budget with the actual execution, the LOLF requires the submission of the previous year performance report and the previous Budget Review Bill into the plenary meeting before the Parliament accepts the budget bill for the following year. The

Parliament will not vote on the new Budget Bill until the Budget Review Bill is debated and voted on.

Outcome for the previous year must be submitted to the parliament in April and the draft of the Annual Budget Law must be submitted in October. By doing this, Parliament can review the report of the previous year before making any decisions for the next year. The program strategy, objectives and the relevant indicators are presented to the Parliament in the APP which is attached to the budget bills. Each program's strategy and objectives are defined together by the relevant Ministers with the help of the program coordinators and are subject to debate in the Parliament as part of the budget approval process.

After approval of the Parliament, the program coordinators/program managers are delegated with sufficient managerial flexibility to make decision and use the allocated resources to manage the program towards attaining the approved program objectives. With this high degree of autonomy, the program coordinators/program managers are held accountable for results. In accordance with the control protocol (control protocol), commitments must be based on the discussion between the Financial Controller (FC) and the relevant ministries/institutions following the threshold and the nature of the expenditure. If the amount exceeds the threshold, a *visa or avis* will be required from the FC before making a commitment. In terms of payments, a *visa* is necessary before the PA is allowed to make any payments exceeding the threshold.

The expenditure process in the French system is articulated by a strict distinction between the person who initiates the decision to spend (*l'ordonnateur*) and the person handling the payment itself (*le comptable*). This principle aims at minimizing fraud and misuse and increasing compliance with the Annual Budget Law. The *ordonnateur* is an administrator of funds, yet not entitled to actually handle the funds, he/she *has* the responsibility for deciding on revenue and/or expenditure. The *comptable* has a passive role, where he/she controls budget based on the approval of the *ordonnateur*, handles bookkeeping, and makes payments. The role of the *comptable* (PA) is clearly defined in Article 31 of the Constitutional by law on Budget Act. The *comptable* is not authorized to make any decisions regarding the use or management of these funds except in cases where the rules are violated.

In the French model, D&D reforms are primarily based on the actual need for delegation and the capacity of the regional administrations to undertake their functions effectively. Programs revolving around national strategies are always centrally managed. As a matter of fact, health and education programs are taken care of and implemented at the national level. Supporting components such as managing facilities and building are decentralized to the regional administrations but with specific guidelines. In the health sector, larger regional hospitals are managed centrally since they contribute directly to the overall national health strategy, while the smaller clinics and health centers at the districts and communes have been decentralized. The decisions on D&D are based on discussions and done on a case by case basis.

Once the budget has been executed, performance results are included in an Annual Performance Report (APR) to be attached to the Budget Review Act. The APR is built on the same model as the

APP to make it easier to compare approved budget with actual execution. The State's Audit Office also prepares an annual report on the results of budget with the review of the program's objectives and results. Moreover, there is also an interdepartmental Audit Committee that additionally audits the quality of performance information. Despite these reforms and revised business processes, the performance results are not used much as a basis for the discussion in the Parliament as this information have no direct link to resource allocation. While the reforms provided a high degree of autonomy to program coordinators/program managers to use the allocated resources, a lot of difficulties were encountered in making them accountable for results.

1.4. Thailand

Thailand moved out of line-item budgeting system to Planning-Programming Budget System (PPBS) in 1982, then, moved to performance-based budgeting in 1989 which evolved to a Strategic Performance-based Budgeting (SPBB) system in 2003. SPBB focuses on outputs and outcomes rather than inputs in order to improve the public management and fulfill state agency missions within the limited resources provided. The main emphasis of this system is on policies and strategic delivery targets. De-concentration and decentralization to provinces and municipals are key features of this system.

Policy initiatives included a clear public finance policy framework, national policies and priorities were driven top-down and allocations are strategic in nature. The Thai model was also equipped with bottom up approach based on the needs at the implementation level which are then integrated into the top down approach. In terms of management, it is decentralized with sufficient flexibility given to program managers to manage their resources by themselves. The decentralized initiative is accompanied with a good governance framework, good internal controls and disclosure of all transactions. Thailand used budget ceilings as an integral tool in budget formulation process and linked the performance framework down to the implementation level.

The SPBB had faced a number of challenges in its implementation since 2003. While the SPBB system focuses on outputs and outcomes, in practice the budgeting process is fundamentally input based with limited focus on performance. Budget to policy linkages remain input based weak and decided by central agencies with limited consideration given to implementing entities. There were also difficulties in determining the right indicators in measuring performance, lack of technical expertise, information overload, capacity building issues and the constant temptation to move back to line-item by both in executive and legislature level.

The resources/budget allocations are not totally based on PIs or conditional on the achievement of performance targets but other economic, political and policy factors are taken into consideration in the decision-making process.

The decentralization reform in Thailand started in the late 1990s, through the amendments of the constitution in 1997 which addressed the issues of transfer of functions, delineation of authority, allocation of taxes and duties and the institutional setup for Regional Administration

(provincial) and Local Administration. This was followed by the adoption of the Decentralization Act in 1999. The administrative structure of Thailand involves 20 Ministries, and 76 Provinces which comprised of a total of 877 Districts. This is further broken down to 7,255 Communes and 74,944 Villages. Local governments were administered by way of Provincial Administrative Organizations, Municipalities and Sub-District Administrative Organization. The Decentralization Act identified 245 functions to be transferred and sharing revenue up to 25% of total revenue to Local Government Organizations (LGOs). It also outlined the criteria for transferring personnel from national agencies to Local Government Organizations (LGOs) as well.

Thailand has made good progress in providing the enabling environment for decentralization, and budgets were detailed down to the village levels. Despite this, the process of decentralization faced many challenges both in its practical execution and politically. This could be attributed to weakness in intergovernmental linkages, regulations that stifled local autonomy, financial gaps in local government expenditure and issues pertaining to capacity and governance.

1.5. Malaysia

Malaysia moved to Result-Based Management (RBM) by beginning with Program Planning Budgeting System (PPBS) in 1969, then moving to a Modified Budgeting System (MBS) before evolving to the current Outcome-based Budgeting (OBB) System in 2013 after piloting it for one year. The key focus was in strengthening the linkages between national policy priorities and resources using six key transformation levers to guide the development of the new budgeting system namely focusing on performance; vertical alignment of national priorities and ministry activities; managing cross-cutting sector initiatives; coordinating capital and recurrent spending; delegating authority with accountability for results; and monitoring and evaluation system.

In the earlier budgeting systems, PIs were used extensively in the early stages for resource allocation. However, as it progressed, under OBB, PIs were used in planning for achieving better service and program delivery. Greater emphasis is placed on performance monitoring and evaluation. Program Managers are required to sign on performance agreements in which the performance areas are presented in detail together with the achieving targets and resource allocation. Accountability has been improved significantly in this process. However, there is a lack of transparency to certain extent in the overall budget process and the consultations among stakeholders due to time constraint.

Overall, Malaysia has been relatively successful in the implementation of performance budgeting in the region. Similar to OECD countries and Thailand, resource/budget allocations are not dependent only on PIs as other economic, political and policy factors are also taken into consideration before making decision.

In terms of de-concentration and decentralization, financial management in Malaysia has been highly centralized. Critical programs covering health, education, agriculture, rural development, infrastructure, security, and trade have been centrally driven by federal departments at the sub-national level.



Appendix 2: Other Related Key Areas of Reform

The reforms in the Budget System cannot happen in isolation and out of sync with other key reform areas being undertaken by other ministries or institutions, especially, public administration and D&D reforms. The budget reforms will also need to be linked and supported by these reforms and the effectiveness of the reforms is largely based on the close coordination among the responsible institutions and the level of alignment among themselves. In general, this appendix will look at the relation and the result of D&D and public administration reforms under PFMRP and in particular, their links to the budget system reform.

In addition, this appendix will also discuss the roles of NSDP which has critical links to budget strategic plan that serves as a tool to ensure effective budget integration in the budget planning process. Meanwhile, in PB framework where authority has been increasingly delegated to ministries, institutions, and executing entities, the roles of independent audit will be the responsibility of the National Audit Authority (NAA) which is also an important mechanism to ensure financial accountability and performance. Therefore, these two tasks must be reformed in order to strengthen and enhance effective support to budget system reform.

2.1. Public Administrative Reform

The improvements in public sector performance have been incremental and slow largely as a result of the wholesome destruction of the civil service and institutions during the civil strife in the 1970s and 1980s. While there have been marked improvements, human resources management in the public sector is still not sufficiently developed to ensure the delivery of public services efficiently. In recognizing the constraints and the need for a modern and efficient public service, the RGC has committed to reform public administration by placing public administrative reform at the core of the RS III. In this regard, the Ministry of Civil Service (MCS) was established to develop and strengthen the civil service through public administration reform program. The MCS and the Committee for Public Administrative Reform has developed the National Program for Administrative Reform (NPAR) 2015-2018, building on the achievements of the previous public administrative reforms.

The NPAR 2015-2018 which was approved by the RGC on 9th January 2015 has three main objectives:

- Promote high quality, simple, effective, reliable, prompt and responsive and convenient public service, with active participation from service users.
- Strengthen human resources management to improve civil servants' performance, with strict adherence to the culture of service, ownership, loyalty and professional consciousness.
- Reform the pay system to ensure equity, improve productivity and work effectiveness as well as to ensure coherence and consistency of salaries and other benefits between civil servants and the armed forces.

The implementation of the NPAR (2015-2018) has made remarkable progress, but there are some challenges that require systematic and comprehensive measures. These include oversight of operations and functional analysis of ministries, institutions and entities at both national and sub-national levels, rationalization of the size of public service, and organizational structure of ministries, institutions, and sub-national administrations. A review of the management and functions of civil servants and the public administration, and the lack of integration of this reform into action plans of

ministries, institutions, both at national and sub-national levels. However, by the end of 2018, the Ministry of Public Service and the Committee for Public Administrative Reform expects to achieve further progress in the following areas:

- The salaries of civil servants and the armed forces are to be consistent with each other and increased to more than 1 million riels in line with the minimum wage in 2018
- The civil servants' salaries are disbursed timely through the banking system, at the latest, in the fourth week of each month. as well as the management of the pay for contracted personnel and overtime pay to teachers via IT system.
- The Human Resource Management (HRM) Approach is fully developed and broadly implemented both at national and sub-national administrations
- The Performance Management System (PMS) will be approved and gradually introduced to national and sub-national administrations.
- Initiating the Implementation of the 'Best Entity Evaluation in Public Service Delivery' for Education and Health sectors.

In line with the RGC's focus on result-based approach to public sector reforms and the introduction of PB, the MCS has prepared a Vision and Strategy for Public Administration Reform 2019-2028 to transform the public administration into an effective public service provider and a reliable partner towards serving the people better. This Strategy targets a number of key goals:

- Setting up a public service system focused toward human resources management based on the qualifications of the position.
- Develop a planning system for official cadre at the national and sub-national level which is consistent with the budget plan
- Rationalize the size of public service and institutional structures to respond effectively to job requirements
- Develop and implement comprehensive and systemic capacity building programs for leadership, management, and skills enhancement
- Develop and implement incentive-based performance management systems and capacity building programs.
- Develop a salary system which supports productivity, professionalism, leadership and management skills
- Upgrade and make Human Resources Management Information System (HRMIS) fully operational in all ministries, institutions at the national and subnational levels
- Improve the quality of public services through the use of information technology, integration mechanism, and the one-window service mechanism.

The above strategy will have significant bearing on BSRS 2018-2025, especially the PMS, which will be essential for performance accountability under PB system. Its introduction and implementation in the public sector including the SNAs will need close alignment moving toward PB by 2025 under the framework of budget system reform 2018-2025. At this moment the timeframe for implementing the strategy of MCS from 2019 to 2025 has not been illustrated clearly yet. In this regard, MEF will need to engage a lot more with MCS to push for a Road Map which is consistent with BSRS 2018-2025.

The capacity building of the civil servants at national and SNA levels needs to be further improved to meet the requirements of Human Resources for PB. This will involve identification of the skills and qualification requirements. The general upgrading of knowledge and skills in different disciplines will be a mandate of the MCS. Hence, the cooperation and collaboration between MEF and MCS is necessary.

The introduction of BSP and PB will be able to facilitate the determination of the size of the civil service and the skill sets needed, especially to implement the programs under BSP. The performance of each program will in turn form the basis of performance evaluation of the program managers, his/her staff and the entire LMs and institutions. The integration of the performance aspects of PB into the public administrative reforms will facilitate the effectiveness of the two reform areas, i.e., public financial management reform and public administrative reform which are related and interdependent.

Under PB system, managers and/or budget entities will be given sufficient flexibility and authority to manage their resources to improve performance but will be held accountable for results. These resources primarily include personnel and finance. Aspects of financial management will be simplified and strengthened under budget system reform initiatives by delegating authority to program managers. Therefore, reforming public service management, as indicated above and the effective implementation of this reform, will support the successful implementation of the PFM reform in general, and specifically the BSRS.

Overall, the significant relationship between BSRS 2018-2025 and the Public Administrative Reform Vision and Strategy 2019-2028 requires attention to ensure that the directions set by the two-reform areas are appropriately aligned with one another. However, the timeline for alignment and effective implementation of these strategies remains a challenge, for the successful implementation of PB.

2.2. Decentralization and De-concentration (D&D)

The legal framework for De-concentration and Decentralization (D&D) reforms is defined by the 2008 Law on Administrative Management of the Capital, Provinces, Municipalities, Districts and Khans and the 2001 Law on Commune and Sangkat Administration and Management. The two Laws provide for the devolution of functions and assignments to various levels of SNA. Two strategic documents that have been developed to guide the implementation of the 2008 Organic Law are **the 2005 D&D Strategic Framework** and the - **National Program for Sub National Democratic Development 2010-2019** (2010). While the 2010 National Program provides a reasonable strategic framework, some aspects of the “Unified Administration” are not clearly articulated yet and the roles, functions and authorities of different tiers of government require further clarity.

The D&D reforms are led by the Ministry of Interior (MOI) with the main implementation and coordination role assigned to the National Committee for Democratic Development (NCDD). The nature of this reform is very complex as it involves many provinces, ministries and institutions. At the same time, D&D reform also involves public administrative reform being undertaken by the MCS and the PFMRP by the MEF.

The sub-national administrative reform has been moving forward, but constrained by the lack of capacity. However, this is expected as decentralization is always a slow and calibrated process. In moving forward, underlying governance arrangements and institutional capacities for reforms will need to be further strengthened.

In terms of financing arrangements for Sub-National Administrations (SNAs), in principle all SNAs receive subsidies or transfers of resources to cover expenditure gaps from the national level. Currently there are a total of 185 D/M and 1,646 C/S that are funded almost entirely by transfers from the government. A substantial portion of the total provincial funding is sourced from tax and non-tax revenues, while the rest comes through government transfers, driven by necessities and actual availability of national budget. The sub-national budget system reform strategy as defined in Subsection 3.6 of Chapter 3 of this document, will be an effective solution to help improve the intended purpose of public service delivery at this level of administration.

Like any decentralization reform, there are inherent risks in transferring the functions. Public service delivery will deteriorate without corresponding funds and lack of capacity of the institutions and this in turn, will affect the quality of the whole administration. International experiences show that there are risk in the processes of transferring functions to SNAs. As stated earlier, there are similarities between the SNA structure in Cambodia and that of France where the experiences of D&D in France are based primarily on the nature of the functions to be delegated and the capacity of the regional authorities to undertake them effectively and efficiently. Hence, the capacity of SNA and the efficiency and effectiveness in the delivery of programs are the key criteria for determining the transfer of functions. There is no automatic transfer of functions. Programs of strategic nature revolving around national strategies will be nationally managed. For example, the national strategic programs involving health and education are driven and implemented nationally. Supporting programs such as managing facilities and building may be decentralized to the regional authorities but with specific guidelines. Decisions regarding the decentralization or deconcentration of programs are made based on consultations with all stakeholders and on a case by case basis based on the criteria stated above.

The issuance of the Sub Decree No. 06 ANK.BK dated 5th January 2017 on conditional functional transfer was a consensus solution from all stakeholders which served as a risk management mechanism for the delegation of authority to the sub-national administration. Nevertheless, the effective implementation of this Sub Decree remains a challenge. To support the sub-national budget system reform, Cambodia would consider the following long-term measures as priorities:

- Readiness and mature system and management structure
- Increased capacity and skills to sufficient levels
- Promote and tighten financial compliance
- Develop a clear framework for accountability and responsibility

Overall, despite the challenges in the implementation of the D&D reforms that may affect the PFM reform, there will be no serious implications for the BSRS 2018-2025 if the Sub Decree No. 06 ANK.BK

is effectively implemented, and the sub-national budget system reform strategy framework prescribed in the BSRS 2018-2025, is followed.

2.3. National Strategic Development Planning (NSDP)

Planning is an integral part of the budget building and justification process. This task is considered as a key component of PB both at the national level and institutional levels. Most developing countries prepare and use a medium-term national development plan to guide sector planning, provide clear focus on sector priorities and guide the implementation levels in their deliverables to respond to national priorities. The purpose of the BSP in PB is to strengthen and improve the strategic linkages between medium term national development plans and the annual budget plans. The comprehensiveness and quality of the medium-term national development plan is therefore of paramount importance and necessary for the strategic allocation of the budget.

In Cambodia, the current National Strategic Development Plan (NSDP) 2014-2018, guided by the Rectangular Strategy III (RS III), was prepared in consultation and collaboration with key stakeholders and sets out the medium-term priorities and macro development priorities along with associated Outcomes and Key Performance Indicators (KPIs). The NSDP has also considered the Sustainable Development Goals (SDGs) within the local context calling it the Cambodian Sustainable Development Goals (CSDGs). The NSDP could assist the LMs and SNAs as follows:

- Clearly establish their respective priorities and come up with plan, programs, and projects (Public Investment Program including DP funded projects) to achieving those priority goals;
- Collectively, LMs and SNAs are able to harmonize and align their performance towards achieving national priorities;
- Identify common cross sectoral achievements for better management to prevent overlapping of work and resource wastage; and
- Focus on results which enable LMs and institutions to better allocate their resources and further enhance the management of programs and projects.

Currently, there are some weaknesses in the alignment of sector- based plans with the NSDP. As NSDP does not cover all LMs priorities, some activities undertaken by LMs are not captured in the plan. Conversely, some are listed in the sector plan, but not aligned with the priorities within the NSDP. The NSDP also lacks clear focus in some areas which are largely a result of incorporating unrealistic priorities and compromises with LMs. As the budget system moves towards PB, the collaboration and coordination among the key central agencies are necessary to improve the quality of the NSDP preparation which can provide a basis for stronger linkages between sector priorities and results. For LMs and their subordinated entities, each program must be better aligned with the sector priorities as prescribed by the NSDP and all the outputs that contribute to achieving final outcomes must be clearly identified under their respective programs. This will require the harmonization of processes and procedures between the departments involved and central agencies which are responsible for developing NSDP. Without these improvements, the BSPs will become less appropriate and effective.

Overall, NSDP is an important and integral part of PB and its quality and clarity will improve the preparation of BSP, the key strategic planning document at the sector level. The NSDP will be rationalized to focus on the key measurable national objectives/priorities that can be clearly identified and with the view to reduce unrealistic priorities. All sector level objectives and programs will be mapped in detail and aligned towards these national priorities. The strengthening of the institutional and coordination mechanism for the preparation of the NSDP to facilitate a better fit with PB is necessary.

2.4. Independent Audit in Performance Budgeting System

The National Audit Authority, which is established by legislation, reports directly to the legislative body, and carries out independent audits on the operations of the Government generally focusing on compliance, including financial, legal and procedural. However, over time when implementing programs and performance budgeting, independent audit needs to expand its scope to cover performance audits aimed at improving accountability, integrity and good governance. NAA has currently started doing some performance audits.

NAA conducts financial audits supported by clear proof in conformity to public accounting before submitting reports to the legislative body. Management Audits include aspects of organizational management, budget controls, expenditure and revenue controls, loan and investments controls as well as assets and store management. The outcome of these audits is reported directly to the relevant Minister, Head of institutions concerned to provide first-hand feedback and clarification. Performance audits will review project and program performance against planned targets and objectives. In most developing countries, performance audits are not broadly undertaken due partly to resource constraints and capacity issues.

The NAA in Cambodia was established through legislation in March 2000 with the mandate to carry out independent audits on various institutions of the RGC on accounting records, financial statements, monitoring system, and. Since its establishment, its capacity has been enhanced to focus mainly in conducting financial audits of government LMs and agencies. As the budget system moves to PB, the NAA will play a greater role in conducting performance audits.

The BSP will provide performance information by ministries, programs and sub-programs. More importantly it is based on program logic which connects resource uses (inputs) to results. With the increased availability of performance information, the conduct of performance audits becomes more feasible across policies, programs and sub programs.

NAA has instituted reforms by itself toward performance audits under Stage 3 of the PFMRP and its capacity has been increased gradually over time during the implementation of Stage 4 on performance accountability. Hence, at the initial stages performance audits will be carried out on a selective basis. In this sense, NAA and MEF must ensure close coordination by identifying the sequence of reform allowing NAA to have sufficient time to improve their capacity and conduct their activities following the timeframe to implement PB system from 2021-2025.

In summary, the reforms being undertaken by NAA towards performance auditing is in the right direction and time line to ultimately achieve the performance accountability under Stage 4 of the PFMRP. Under Stage 3, it will be vital for NAA to strengthen its institutional capacity to set itself in a position to conduct performance auditing occasionally and on a selective basis. The reforms in the internal audit functions will be institutionalized through revisions and enhancement of its functions to incorporate internal audit on performance and comprehensive skills training to improve institutional capacity. As explained above, the timelines for the reforms by NAA and the strengthening of internal audit function to be appropriate and consistent with the BSRS 2018-2025.



Appendix 3. Road Map toward the Strategic Goal 2025 (from Program Budgeting to Performance Budgeting)

No.	Reform Element	Responsible Executing Agencies	Start	End	Objectives
I	Strategic Planning				
1	Macroeconomic and Medium-Term Fiscal Framework (MTFF)	MEF	2018	2021	<ul style="list-style-type: none"> Improve the quality and reliability of macrocosmic forecasting by reliable estimating multi-year revenues and expenditures Institutionalize the mechanisms for macroeconomic framework preparation Become an effective base for preparing medium-term budget framework at the sector level.
			2021	2025	<ul style="list-style-type: none"> Submit the Macroeconomic and Fiscal Framework to the Council of Ministers for review and approval
2	Medium-term Budget Framework (MTBF)	MEF	2018	2021	<ul style="list-style-type: none"> Become an effective and clear base for preparing budget strategic plan and annual budget. Promote more efficient use of resources through more stable and predictable budget allocation on multi-year basis down to sector level and line ministries/institutions.
3	Budget Strategic Plan (BSP)	MEF	2018	2020	<ul style="list-style-type: none"> Improve the quality and comprehensiveness of BSP <ul style="list-style-type: none"> Enhance policy-program linkages Integrate current and capital expenditure Base on budget ceiling defined in MTBF
			2018	2022	<ul style="list-style-type: none"> Improve performance information to move toward the implementation of Performance Budgeting.
II	Budget Preparation and Approval				
1	Annual Budget Preparation	MEF/LMs-Institutions/Municipal, Provincial Administration	2018	2020	<ul style="list-style-type: none"> Expand program budgeting preparation to all ministries-institutions in 2018 and to all municipal and provincial administrations in 2020
		MEF/LMs-Institutions	2018	2021	<ul style="list-style-type: none"> Integrate current and capital expenditure to make a comprehensive budget by reflecting all types of revenues and expenditures in the budget

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No.	Reform Element	Responsible Executing Agencies	Start	End	Objectives
			2018	2025	<ul style="list-style-type: none"> Determine budget ceiling for ministries-institutions
			2019	2025	<ul style="list-style-type: none"> Link procurement plan with annual budget request
			2019	2020	<ul style="list-style-type: none"> Link Cash advance plan with annual budget request
			2021	2025	<ul style="list-style-type: none"> Start implementing performance budgeting for all line ministries-institutions
2	Budget Negotiation and Approval	MEF/LMs-Institutions	2018	2021	<ul style="list-style-type: none"> Improve budget negotiation framework by giving weight on outputs Start giving weight on performance information from 2021
			2021	2025	<ul style="list-style-type: none"> Send the draft of Annual Budget Law by programs and economic classification to the Council of Ministers
			2022	2025	<ul style="list-style-type: none"> Send the draft of Annual Budget Law by programs and economic classification to the Legislative Body
			2019	2025	<ul style="list-style-type: none"> Arrange for agreement on outputs Arrange for agreement to include outcomes from 2023 onward
			2022	2025	<ul style="list-style-type: none"> Submit the draft of Annual Budget Law with attachment of performance information to the Council of Ministers
			2024	2025	<ul style="list-style-type: none"> Submit the draft of Annual Budget Law with attachment of performance information to the Legislative Body
III	Budget Execution and Monitoring				
1	Monitoring Budget Execution	MEF	2018	2021	<ul style="list-style-type: none"> Develop regulatory framework for executing performance budgeting to be introduced from 2022
			2022	2025	<ul style="list-style-type: none"> Pilot management mechanism of budget execution which consolidates financial monitoring function and procurement by attaching with line ministries-institutions

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No.	Reform Element	Responsible Executing Agencies	Start	End	Objectives
2	Procurement	MEF	2018	2025	<ul style="list-style-type: none"> Increase the rights to make decision and responsibility on procurement gradually to ministries-institutions, sub-national administrations and similar public entities, along with the strengthening procurement audit.
			2018	2018	<ul style="list-style-type: none"> Develop a strategy of public procurement reform, 2018-2025, which includes harmonizing harmonized standard operating procedures.
3	Disbursement Control	MEF	2018	2025	<ul style="list-style-type: none"> Compress and expedite procedure of disbursement through regulatory framework for performance budget execution to move toward automation via FMIS in 2025
			2018	2020	<ul style="list-style-type: none"> Prepare a joint, comprehensive, and clear regulatory framework for Cash advance
			2022	2025	<ul style="list-style-type: none"> Prepare and execute budget operation plan of line ministries-institutions
IV	Monitoring and Evaluation	MEF	2019	2022	<ul style="list-style-type: none"> Develop a basic M&E framework from 2019 and pilot it in 2023.
			2021	2025	<ul style="list-style-type: none"> Institutionalize financial statements <ul style="list-style-type: none"> Based on current accounting standard from 2021 Based on Modified Cash-IPSAS from 2025
V	Enabling Infrastructure				
1	Budget Regulatory Framework	MEF	2018	2020	<ul style="list-style-type: none"> Amend the Law on Public Financial System 2008 to ensure that the execution of performance budget has a clear regulatory framework
2	Accountability Framework	MEF	2018	2021	<ul style="list-style-type: none"> Develop and incorporate performance audit guidelines and procedures into internal audit framework for implementation from 2022
3	Financial Management Information System (FMIS)	MEF/LMs-Institutions	2017	2020	<ul style="list-style-type: none"> Extend FMIS to other line ministries-institutions
			2018	2022	<ul style="list-style-type: none"> Extend the 7 budget classifications in FMIS
			2021	2025	<ul style="list-style-type: none"> Incorporate budget preparation function in FMIS and execute in line ministries-institutions

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No.	Reform Element	Responsible Executing Agencies	Start	End	Objectives
			2022	2025	• Incorporate internal control system in FMIS with monitoring and evaluation function
			2024	2025	• Run full automation of disbursements through FMIS
4	Capacity building programs and Performance Budgeting Training Course	MEF/LMs-Institutions	2020	2025	• Provide training on relevant principles and procedures for the preparation of performance budget
			2022	2025	• Provide training on principles and procedures for performance budget expenditure
			2020	2025	• Enhance budget analysis skills and budget managers in performance budget management

