GAP ANALYSIS

Significant Differences Between IPSAS and Cambodian Government Financial Report Presentation and Accounting for Financial Performance

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ABBREVIATIONS

ACAR	Accounting and Auditing Regulator
GART	Guidelines for Accounting and Recognition of Tax and Customs Revenue, Draft dated 20 May 2022, Version 0.9
GARN	Guidelines for Accounting and Recognition of Non-Tax Revenue Draft dated 20 May 2022, Version 0.6
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IPSAS	International Public Sector Accounting Standards
LAA	Law on Accounting and Auditing
MEF	Ministry of Economy and Finance
MO	Ministry Order
PAE	Public Administration Establishment
ROSC	Report on the Observance of Standards and Codes
SOE	State Owned Enterprises

1. SUMMARY

The Cambodian Ministry of Economy and Finance (MEF) has formally and publicly committed to implementation of International Public Sector Accounting Standards (IPSAS), most recently in the MEF Strategy on the Implementation of Accrual Basis Public Sector Accounting Standards in Cambodia 2021- 2031. Implementation will be carried out primarily by the General Department of the National Treasury which has the role of public accountant, supported by the national accounting standard setter and regulator, the Accounting and Auditing Regulator (ACAR).

To support planning for the implementation of IPSAS, this report identifies significant differences between current Cambodian government financial report presentation and accounting for financial performance (income and expense) and the requirements of accrual IPSAS. Recommendations to achieve compliance with IPSAS are provided. There are three significant recurring and pervasive issues.

First, the MEF must decide how IPSAS compliant financial reporting will fit into a framework of public general purpose financial reporting. The MEF is encouraged to align with the international practice of submitting audited general purpose financial reports to the National Assembly. This may be done by incorporating the financial report into the existing budget settlement law or by revising the budget settlement law financial reports to conform to IPSAS requirements. Another approach is to establish a process of reporting that is parallel to but separate from the budget settlement law process.

Second, government financial reporting must identify and consolidate all government controlled entities. There are significant and growing government income, expense and liabilities that are not consolidated or reported in GDNT accounts. Non-consolidated entities include state owned enterprises, the National Bank of Cambodia, liabilities of the National Social Security Fund, and liabilities of the government employee pension, and public autonomous establishments such as national universities and hospitals.

Third, there is inconsistent and incomplete aggregation and classification of expenditure, especially expenditure that does not pass through the GDNT. In the budget settlement law, there is a significant (e.g. over 5 trillion Cambodian Riel, $1.3 billion United States dollars in 2021) category of expenditure referred to as “foreign financed capital expenditure” that does not pass through the GDNT and is not classified in accordance with the government chart of accounts. Also, there is incomplete aggregation of expenditure by nature of expense or function. Finally, there is inconsistent classification of expenditure, such as significant amounts of capital expenditure being presented as current expenditure and vice versa.

2. BACKGROUND AND OBJECTIVE

In Cambodia, the Accounting and Auditing Regular (ACAR) is the standard setter for financial reporting standards for both the public sector and private sector (MEF, 2016). ACAR is a component of the Non-Banking Financial Services Regulator which is under the Ministry of Economy and Finance. The General Department of the National Treasury (GDNT) of Cambodia has the role of public accountant and operates as a general department of the Ministry of Economy and Finance (MEF). The GDNT prepares the financial reports on behalf of the MEF. The primary public financial report of MEF is the annual budget settlement law which is presented by the MEF to the National Assembly Committee 2 (National Assembly, n.d.). The ACAR and MEF have officially adopted International Public Accounting Standards (IPSAS) as the basis for Cambodian government accounting standards, with implementation to be staged over time.

The purpose of this gap analysis report is to assist the Cambodian Ministry of Economy and Finance, the ACAR, and the General Department of the National Treasury to implement the Strategy on the Implementation of Accrual Basis Public Sector Accounting Standards in Cambodia 2021- 2031 (MEF, 2021) by noting and highlighting significant differences between current government financial report presentation and accounting for financial performance (income and expense) and the requirements of accrual International Public Sector Accounting Standards. The MEF, ACAR, and GDNT may use this report to be aware of these differences and plan for policy adjustments to bring Cambodian public financial reporting into compliance with IPSAS.

3. SCOPE AND LIMITATIONS

This review compares Cambodian national general purpose financial report presentation and accounting for financial performance (income and expense) and IPSAS. The accrual IPSAS published by the International Public Sector Standards Board (IPSASB) in May 2022 are used. IPSAS requirements are reviewed against the Cambodian 2021 Cambodian budget settlement law promulgated in December 2022 (GDNT, 2022), which is the primary national financial report published by the Cambodian government.

The GDNT has in recent years produced an unaudited cash basis financial report claiming compliance with cash basis IPSAS which is given internally to the Minister of MEF (author personal communication with GDNT officials); this cash basis report is not public and does not fulfill the purpose of government general purpose financial reporting and is thereby excluded from this review.

For this report IPSAS requirements were compared against Cambodian government financial reporting as presented in the annual budget settlement laws, the government chart of accounts and related policies. Related policies include the MEF Ministry Order 1212 that establishes the government chart of accounts, a draft Guidelines for Accounting and Recognition of Tax and Customs Revenue (GART), and a draft Guidelines for Accounting and Recognition of Non-Tax (GARN). As the government has neither disclosed any statement of financial position nor disclosed any draft or pro-forma statement of financial position, this report focuses on financial statement presentation and accounting for financial performance.

This review was primarily a desk review requiring significant judgment by the author. There was limited stakeholder participation; stakeholder input was limited to clarification of accounting policies and practices reflected in the budget settlement law and Ministerial Order 1212. There may be transactions that are relevant to IPSAS compliant financial reporting that are not reflected in the budget settlement law or Ministerial Order 1212 and are therefore excluded from this review. The perception of users of the government general purpose financial report of what information is useful and relevant is an important consideration in financial reporting, but is not assessed in this review.

4. FINANCIAL REPORT PRESENTATION

Government financial statements are normally submitted to the parliament of a country. Cambodia does not yet submit international standard financial statements to its national assembly; only an idiosyncratic Cambodian "budget settlement law" is submitted to the National Assembly. A fundamental gap for the Cambodian government in complying with IPSAS is that IPSAS applies to general purpose financial reporting, typically that which is public and submitted to the National Assembly.

For the fiscal years 2018, 2019, and 2020, the General Department of the National Treasury has submitted an unaudited cash basis financial report directly to the Minister of the Ministry of Economy and Finance (author communication with GDNT officials) with claims of compliance with cash basis IPSAS. Also, the GDNT has presented the Minister with a basic unaudited statement of financial position. However, these internal reports submitted to the Minister are not public and are not intended to be general purpose financial reports. These internal reports are not known to be of much practical use to the Minister's office itself. Instead the preparation of these private financial reports from GDNT to the Minister's office have played a role of practice in preparing IPSAS style financial statements.

To be purposeful, IPSAS is meant to apply to general purpose financial reporting. The Cambodian government's primary general purpose financial report is the budget settlement law, for which no claim to IPSAS compliance or compliance with any other standard has been made. Thus, if the Cambodian government wishes to comply with the objective of IPSAS to produce general purpose financial reports, a critical decision must be made to either:

1. Apply IPSAS to the budget settlement law financial report or to include an IPSAS compliant financial report as an appendix to the budget settlement law; or
2. Create a new legal framework to publicly issue an IPSAS compliant financial report separate from the budget settlement law

The concept of general purpose is a core component of the IPSAS objective, IPSAS conceptual framework, and the IPSAS standards. For example, IPSAS standard 1, paragraphs 2 and 3 state:

> This standard shall be applied to all general purpose financial statements prepared and presented under the accrual basis of accounting in accordance with IPSAS. General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their particular information needs. Users of general purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media and employees.

The internal financial report submitted solely to the Minister does not meet the definition of general purpose described above and the government is encouraged to refrain from public claims of compliance with either IPSAS cash basis standards or IPSAS accrual basis standards until they are applied to a publicly available general purpose financial report such as the budget settlement law financial report.

The Cambodian government is encouraged to structure its budget settlement law financial report and contents to follow best practice. An example report approved by the parliament of Australia is illustrated in Table 1 on the following page.

Figure 1: Australian Government Financial Report to Parliament Structure

Consolidated Financial Statements
for the year ended 30 June 2022

December 2022

1. Cover page identifying the financial report, reporting period and issue date

Discussion and Analysis

Net operating balance

The Australian Government's net operating balance was a $20.5 billion deficit for the year ended 30 June 2022, an improvement of $110.0 billion against the 30 June 2021 result.

Table 4: Operating statement

	2021-22 $b	2020-21 $b	Change $b	Change %
Revenue	623.2	541.2	82.0	15.2
Expenses	643.7	671.6	(28.0)	4.2
Net operating balance	**(20.5)**	**(130.5)**	**110.0**	**84.3**
Less Net acquisitions of non-financial assets	11.1	8.5	2.6	29.4
Fiscal balance	**(31.5)**	**(139.0)**	**107.4**	**77.3**

2. Commentary providing an analysis of government income, expenditure and balances

Auditor-General for Australia

Australian National Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Minister for Finance

Opinion

In my opinion, the Consolidated Financial Statements which include the Australian Government and the General Government Sector Financial Reports for the year ended 30 June 2022:

3. Audit opinion on compliance with financial reporting standards

Statement of Compliance

The annual Consolidated Financial Statements of the Australian Government are required by section 48 of the *Public Governance, Performance and Accountability Act 2013.*

In my opinion, the attached annual Consolidated Financial Statements of the Australian Government, which includes the whole of government and general government sector financial statements:

(a) comply with Australian Accounting Standards; and

(b) present fairly the Australian Government's financial position as at 30 June 2022 and its financial performance and cash flows for the year then ended.

Katy Gallagher

Senator the Hon Katy Gallagher
Minister for Finance

16 November 2022

4. Statement of compliance with financial reporting standards signed by the Minister of Finance

Consolidated financial statements

Australian Government operating statement
for the year ended 30 June 2022

	Note	2022 $m	2021 $m
Revenue from transactions			
Taxation revenue	2A	549,394	479,916
Sales of goods and services	2B	37,244	33,450
Interest income	2C	12,974	6,723
Dividend and distribution income	2C	8,846	7,620
Other	2D	14,755	13,474
Total revenue		**623,213**	**541,183**
Expenses from transactions			

5. The financial statements

Note 1: Basis of financial statements preparation

1.1 Purpose

The purpose of this note is to outline the basis on which the financial statements for the Australian Government (whole of government) and the general government sector (GGS) have been prepared.

Significant accounting policies that are relevant to understanding the financial statements are provided throughout the notes to the financial statements. Except as otherwise noted, the accounting policies detailed in this note and throughout the financial statements are applicable at both the whole of government level and for the GGS.

1.2 Statement of compliance

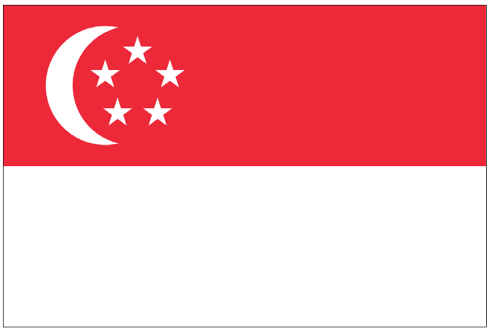
6. Notes to the financial statements

Note. Extracts from 2021-2022 Commonwealth Consolidated Financial Statements published by the Ministry of Finance of the Commonwealth of Australia.

The example of Australia above is typical of countries around the world. A list of the main financial report contents for the governments of Singapore, the Philippines, Malaysia, Canada, and New Zealand are shown in Table 1 below.

Table 1: Main contents of national level government financial reports of Singapore, the Philippines, Malaysia, Canada and New Zealand

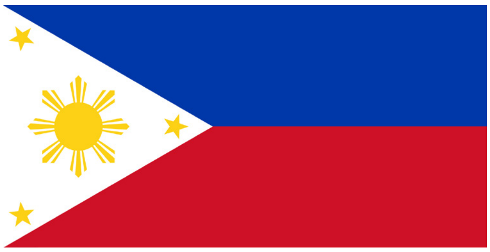
Singapore



1. Letter from Accountant General submitting financial report to the Minister of Finance
2. Auditor Opinion
3. Accounting policies and notes
4. Budget Outturn statement
5. Revenue statements
6. Fund statements
7. Deposit account statement
8. Statement of assets and liabilities
9. Expenditure by sector statement

Accountant-General's Department, 2022

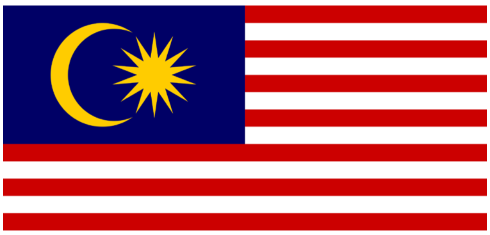
Philippines



1. Letters from Commission on Audit submitting financial report to the President, President of Senate, Chair of Senate Finance Committee, and others
2. Executive summary
3. Financial highlights
4. Financial statements and notes
5. Budget report
6. Report on national debt
7. Summary of audit opinions for each entity

Republic of the Philippines Commission on Audit, 2022

Malaysia



1. Executive summary
2. Report of the Accountant General
3. Discussion and commentary
4. Audit report
5. Statement by the Secretary of the Treasury and the National Accountant
6. Financial statements and notes

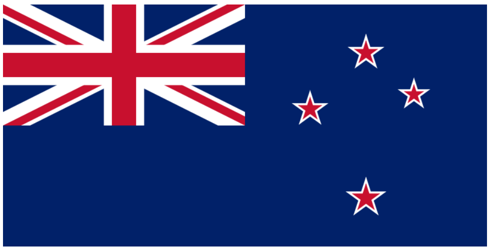
Ministry of Finance Malaysia, 2022

Canada

1. Letter from the President of the Treasury to the Governor General of Canadian Parliament
2. Discussion and analysis
3. Letter of responsibility by Secretary of the Treasury, Deputy Minister of Finance and others
4. Audit opinion
5. Financial statements and notes
6. Disclosure for consolidated entities
7. Reports on debt, cash, foreign exchange and other assets and liabilities

Department of Finance of Canada, 2021

New Zealand



1. Statement of the Minister of Finance
2. Statement of responsibility by: Minister of Finance and Secretary to the Treasury
3. Commentary on the financial statements
4. Audit report
5. Financial statement and notes
6. Supplemental statements on unappropriated expenditure, emergency expenditure, and trust money
7. Fiscal analyses

Treasury of the Government of New Zealand, 2022

Compared to the disclosures for each country in the table above, Cambodia has room to improve. Cambodia does not yet disclose any audit opinion on the government budget settlement law financial report, nor are there explanatory notes to explain the basis of preparation. There are no letters of responsibility attached to the report. Also, Cambodia's budget settlement law does not include the substantive analysis and discussion that accompany other countries' financial reports.

As discussed above, Cambodia's most critical issue is whether or not to prepare general purpose financial reports and how to present such reports to the National Assembly and the public. In addition to this critical issue, there are some additional financial reporting presentation issues that the Cambodian government will need to resolve to achieve compliance with IPSAS. There are three main additional issues. First, the Cambodian government needs to disclose its original budget amounts as well as final budget amounts; the Cambodian government budget is amended during the year and these amendments and changes need to be disclosed. Currently the budget settlement law only compares the final "budget" amounts with "actual". Second, there need to be explanatory notes attached to the financial report, explaining the basis of reporting, accounting policies, key estimates and judgments and other disclosures. Third, the financial report needs to consolidate all controlled entities. Currently, there are many government controlled entities such as the National Bank of Cambodia, state owned enterprises (SOE) and public administrative entities (PAE) that are not consolidated. In consolidating, intra-group transactions need to be eliminated, such as government payment of VAT and other taxes. These issues and others are summarized in Table 2 below.

Table 2: Key presentation differences between current Cambodian government financial reporting and IPSAS

Current Practice	IPSAS Requirement	Recommendations
1. Components of Financial Statements The public government financial report is the budget settlement law, consisting of three main types of budget comparison statements: (a) Summary statements of surplus or deficit (b) A statement of revenues, and (c) Statements of expenditure Separately, the GDNT has provided to the Minister of Economy and Finance an IPSAS style cash basis financial report and an annual balance sheet and income statement. These are not public.	**IPSAS 1, Paragraph 21** A complete set of financial statements comprises: 1. A statement of financial position; 2. A statement of financial performance 3. A statement of changes in net assets/equity 4. A cash flow statement 5. A comparison of budget and actual amounts; 6. Notes.	1. The government should establish a process for submitting a full set of audited general purpose IPSAS compliant financial statements to the National Assembly. 2. After submission of the financial statements, the statements need to be publicly released in an efficient manner, such as posting on government websites.
2. Statement of Budget Comparison The budget settlement law presents a comparison between the budgeted amounts and the actual amounts. There is no distinction between original and final budget.	**IPSAS 24, Paragraph 14** An entity shall present a comparison of the budget amounts for which it is held publicly accountable, including: (a) The original budget amounts; (b) Final budget amounts; (c) The actual amounts; and (d) An explanation of material differences between the budget and actual amounts.	1. To comply with IPSAS, the financial reports needs to present both the original budget and final budget amounts in the budget comparison. 2. A report explaining material differences should be reviewed and summarized into an explanation of differences that would be appropriate for general purpose financial statements and made public as part of the financial report.
3. Explanatory Notes There are no notes attached to the Cambodian public sector financial statements which might inform users how the statements were prepared. A related issue is that even if the Cambodian government seeks to follow IPSAS, it will not be able to claim compliance with IPSAS for several years.	**IPSAS 1, Paragraphs 21, 27** Explanatory notes are a compulsory component of the financial report. It is in the notes that an entity whose financial statements comply with IPSASs shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IPSASs unless they comply with all the requirements of IPSASs.	1. To comply with IPSAS, a statement of compliance is required in the notes. 2. It is essential that the Cambodian public sector financial statements include notes which include a description of the accounting policies and standards employed.

4. Timeliness The budget settlement law is significantly late (up to 1 year after the reporting period). Timeliness is affected by a number of late payments being made and reported after year-end, especially from the Ministry of Foreign Affairs (due to embassies and missions abroad), the Ministry of Interior and the Ministry of Defence.	**IPSAS 1, Paragraph 69** An entity should be in a position to issue its financial statements within six months of the reporting date.	The government is encouraged to make an explicit plan to incrementally improve the timeliness of financial reporting.
5. Changes in Accounting Policies, Errors The government applies new policies and corrects prior period errors prospectively.	**IPSAS 3, Paragraph 24** When an entity changes an accounting policy or corrects a material prior period error, it shall apply the policy and correct the error retrospectively by restating the comparative amounts.	Prior period errors and changes in policy should be accounted for retrospectively when material.
6. Consolidation of Controlled Entities Most government bodies are consolidated into the national accounts. However, many controlled entities are excluded from the consolidation. For example the following entities are not consolidated: the National Bank of Cambodia, universities, state owned enterprises, hospitals. Unconsolidated state owned enterprises hold significant levels of debt, much of which is guaranteed by the national government. For example, as of December 31 2021, the Phnom Penh Water Supply had $198 million in loan debt (Phnom Penh Water Supply, 2022).	**IPSAS 35, Paragraph 5** Consolidated financial statements shall include all controlled entities of the reporting entity. Control is assumed if the reporting entity has the power to appoint and remove the top management and has the ability to extract economic benefits from the entity.	1. All government controlled entities need to be identified and consolidated. 2. A timeline should be developed for consolidating controlled entities 3. Uniform accounting policies need to be implemented for all consolidated entities
7. Elimination of Intra-Group Balances Transactions between entities have not been identified and eliminated. For example, government paid taxes such as VAT are recorded as revenue. Also, transfers to state-owned enterprises are recorded as an expense.	**IPSAS 35, Paragraph 40(c)** Balances, transactions, revenues, and expenses between entities within the economic entity shall be eliminated in full.	Transactions and balances between consolidated entities need to be eliminated.
8. Presentation of Totals and Sub-totals Currently the budget settlement financial report uses an idiosyncratic method of totalling such that the top of the report is the total and items are added up from the bottom of the page, often without horizontal lines to indicate totals and subtotals.	**IPSAS 1, Paragraph 112, 113** In IPSAS 1 paragraphs 112 and 113 and in practice around the world for both the private sector and public sector, the total of items is shown on the bottom of the page with horizontal lines to indicate a subtotal or total.	It is recommended that the Cambodian government budget reports and other financial reports use the normal top-to-bottom ordering of items where the subtotals and totals are shown on the bottom of each statement. This will make it easier for users and the public who are familiar with this more normal practice.

5. ACCOUNTING FOR EXPENSES

Government accounting policies that prescribe accounting treatments are set forth in the 2017 Ministry of Economy and Finance Order 1212 On Putting the Chart of Accounts for Public Sector Into Practice. Ministry Order 1212 focuses on use of accounts and recording in accounts without setting any requirements for financial reporting format or contents. Thus, Ministry Order 1212 explains how to record amounts into each account, but does not explain or provide guidance on how these accounts are compiled, presented or disclosed.

It should be noted that Ministry Order 1212 itself is not internally consistent. The numbering and names of the accounts in the chart of accounts do not consistently match the number and names of accounts in Ministry Order 1212 Annex 2 Account Treatment of the Budget Accounting Plan of the Administration of National and Subnational Levels. A review of the inconsistencies in Ministry Order 1212 is out of the scope of this report. ACAR and GDNT are encouraged to review and revise the Account Treatment of the Budget Accounting Plan of the Administration of National and Subnational Levels to achieve consistency with the chart of accounts in addition to consistency with IPSAS.

Overall, the current chart of accounts and policies are designed to enable accrual accounting, with a broad range of accounts to record assets, liabilities, equity, income and expense. Also, a number of improvements have been made since a 2011 gap analysis (Barnett, 2011), such as recognizing grant income as income rather than directly into equity, as had been the previous practice. The current chart of accounts can be aligned with IPSAS with incremental changes.

The government of Cambodia has for many years recorded expenditures in its budget settlement reports, distinguishing between current expenditure and capital expenditure. As per the MO 1212, expenses of the government of Cambodia are recorded and presented in the chart of accounts in “Level 6: Current Expense” and chart of account “chapters” 60-68. The MO 1212 includes a description of the policies and definitions for each type of expense account. The expense accounts are mostly aligned with IPSAS, but significant expenses have been omitted, offsetting of intra-group expenses is insufficient, and the presentation and aggregation of expenses needs to be improved. Below are the key recommendations to align Cambodian government expense accounting with IPSAS, followed by a table summarizing significant issues.

5.1 Government employee pension expenses should be recognized on an accrual basis

Most Cambodian government officials, teachers, police, administration personnel and others enjoy the right to receive a pension from the Cambodian government. Cambodia recognizes pension costs on a cash basis, when the benefits are paid out. This results in an understatement of both the expense and related liability for government pensions. IPSAS 25 Employee Benefits requires that long-term employment benefits and post-employment benefits be recognized on an accrual basis using the unit credit method, the same as IFRS.

Because Cambodian financial reporting does not recognize the accrued expense or liability, policymakers may not appreciate the size of the liability and the cost of the pension benefits until it becomes a significant burden in later years. Thus, to comply with IPSAS and give useful information to policymakers, it is recommended to account for the benefits on an accrual basis and to engage an actuary to assist in measuring the liability.

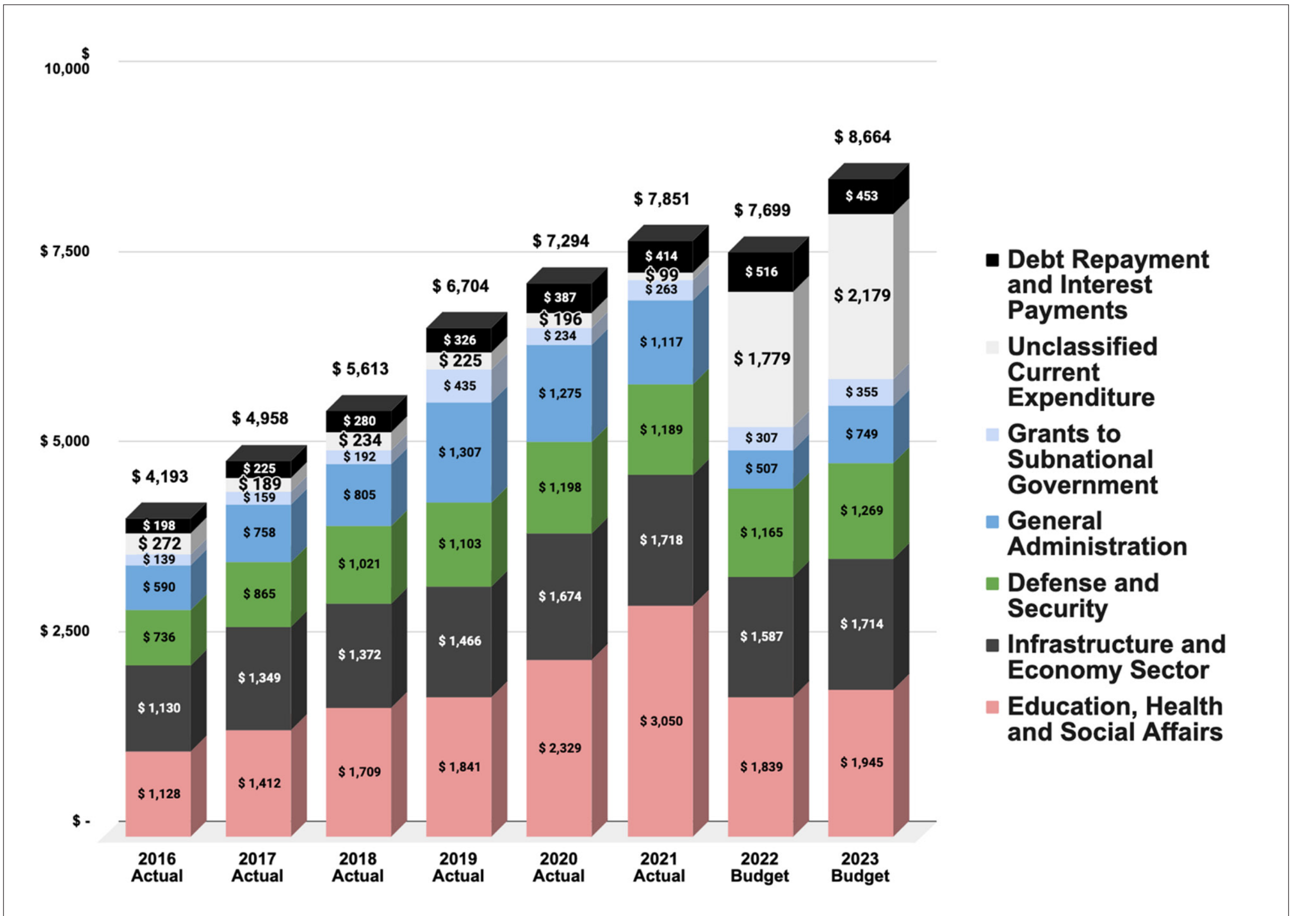
5.2 National pension scheme liabilities and other social benefits under the National Social Security Fund should be expenses on an accrual basis

National Social Security Fund expenses are currently recorded on a cash basis. The National Social Security Fund operates under the control of the Royal Government of Cambodia and the government has an obligation to ensure social transfers and social benefits legally required by the fund. These obligations will significantly increase from year to year, especially with the 2022 implementation of the national pension scheme as per the 2022 Ministry Orders 168, 169, and 170, which will result in significant expenditure once a disbursement procedure is in place. Obligations under the National Social Security Fund should be recognized as an expense following accrual accounting under IPSAS 19 and IPSAS 42.

5.3 Classification, grouping and presentation of expenses should be consistent and complete

The government currently presents expenditure according to function, with ministries grouped together as expense units under these categories: General Administration, Security and Defense, Social Affairs, Economic Sector. However, there remains a significant amount of expenses that are "unclassified" and users are unaware of the function or nature of such unclassified expenditure and are unable to evaluate those amounts.

Figure 2: Cambodian government budget expenditure 2016-2021 in millions of United States Dollars



Source: Author's calculations based on the Cambodian government budget settlement laws for the fiscal years 2016 - 2021 and the finance management budget laws for 2022 and 2023

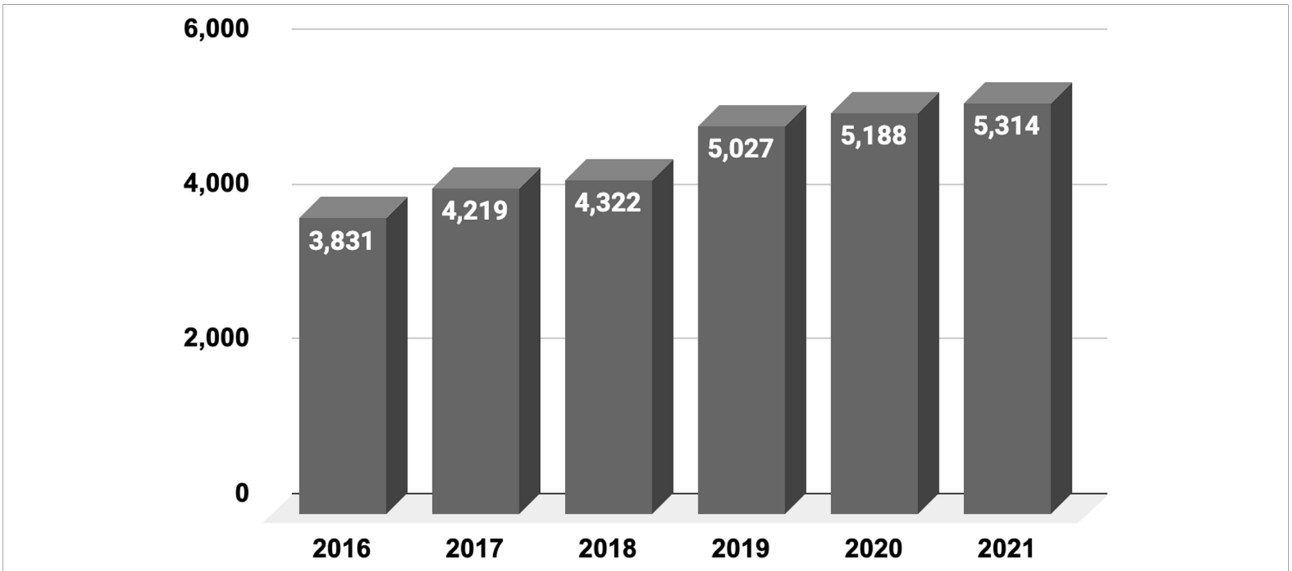
As shown in Figure 2 above, most of the unclassified budget expenditure is classified in the budget settlement law which reports the actual expenditure. However, there still remains a significant portion ranging from $99 to $272 million United States dollars which is not classified. The government is encouraged to classify these expenditures with appropriate aggregations; any remaining amounts should be disclosed with notes explaining their nature and purpose.

Classification of expenditures are not consistent and do not follow commonly accepted nomenclature. For example, "capital expenditure" normally denotes expenditure related to purchase or construction of non-current assets. However, the Cambodian government includes as "capital expenditure" most non-routine projects and activities. These are detailed in the annual government budget settlement law in Table C3. For example 2021 expenditures for fighting COVID-19 were classified as "capital expenditure" though they did not result in any long-term assets. This inconsistent classification of expenditure will mislead users about the nature of government expenditures.

Government public financial reports do not fully aggregate expenses. For example, the current and "capital" expenditures of ministries and other government entities are presented separately in the budget settlement laws. There is one table reporting a ministry's current expenditures (Table C1) and a separate table reporting the same ministry's non-routine "capital" expenditures (Table C3) such that a user needs to laboriously add the two figures in order to know a ministry's total expenses.

Finally, classification of expenses passing through the GDNT are recorded and classified differently than expenses that occur outside of the GDNT. That is, the "capital expenditure" outside the treasury are not classified by the standard chart of accounts and therefore the aggregate numbers presented in those accounts are incomplete and understated. As shown in figure 3 below, the amount of expenditure that is outside the GDNT and therefore not classified by the GDNT chart of account is significant and a large proportion of the national budget.

Figure 3: Cambodian government budget expenditure outside of the General Department of the National Treasury 2016-2021 in billions of Cambodian riel



Source: Author's calculations based on the Cambodian government budget settlement laws for the fiscal years 2016 - 2021

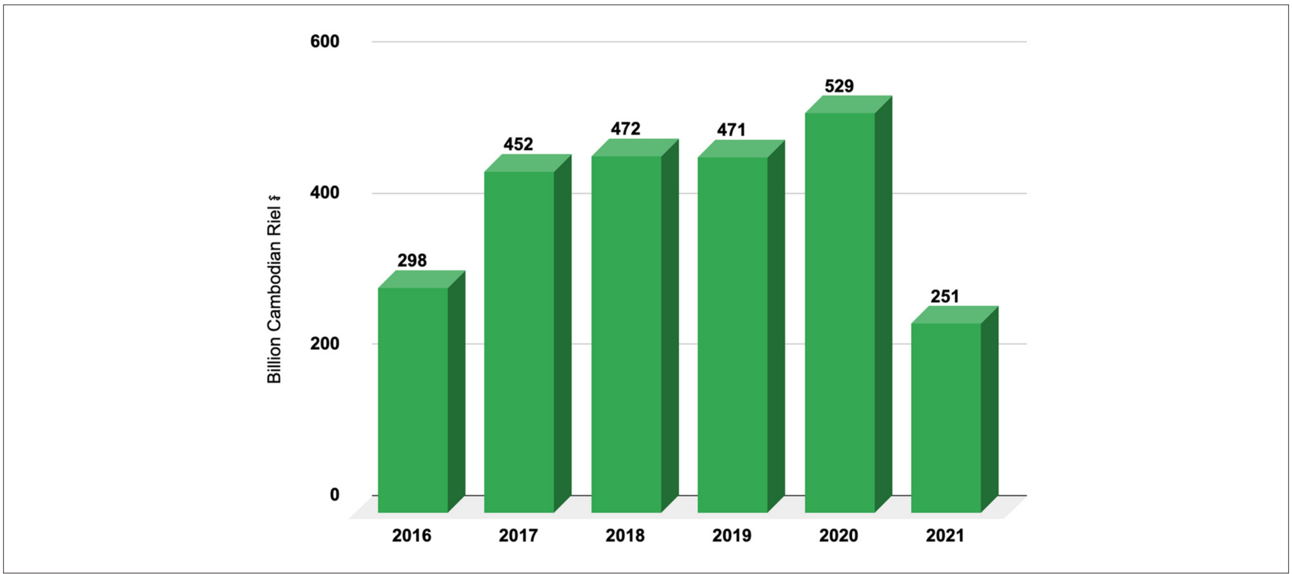
As shown in the figure above, the amount of expenditure outside of the GDNT and not classified in accordance with the chart of accounts is more than five trillion Cambodian riel, which is approximately $1.3 billion United States dollars.

5.4 Intragroup Expenses Such as Tax expense should be Offset

The national government and its various ministries under the authority of the National Assembly are a single economic entity and comprise the reporting entity for financial reporting. The financial report is prepared on a consolidated basis. Following the IPSAS principles on consolidation in IPSAS 35 Consolidated Financial Statements, intragroup income and expenses are offset. Intragroup income is offset because the entity cannot generate income by paying itself. Likewise, the related expense is offset since in paying itself, the resources embodied in that payment are still held by the government and remain a government resource.

The government of Cambodia pays a variety of taxes to itself, including VAT. The figure below shows the tax income that the government has recorded for current expenditure as reported in the budget settlement laws for the years 2016-2021.

Figure 4: Cambodian government current tax expenditure reported as an expense in the budget settlement laws for 2016-2021



Source: Author's calculations based on the Cambodian government budget settlement laws for the fiscal years 2016 - 2021

The figure above shows that the amount of tax paid is material and overstates the cost of services provided by the government. The actual tax "paid" by the government is likely to be higher than the above because the figures above exclude tax paid by the government for its capital expenditure, a figure that is not publicly available.

6.5 Allow for an annual allowance for bad debts to recognize bad debt expense on a more timely basis

In IPSAS, impaired receivables must be written down to their recoverable amount; however, the present government accounting policies violate this principle by delaying recognition of non-collectible receivables to up to 10 years. The government appears concerned about prematurely writing off bad debt, presumably with the concern that the debtor may avoid his/her responsibility. However, there is an easy solution to avoid writing off the debt until a later time by recognizing a general allowance for bad debts without writing off the individual debtor (the allowance is a contra-receivables account), and then later writing-off bad debts upon reaching the period required by regulations. In this way, the debtors' names are kept in the books and are responsible for their debts, but the creation of a general allowance allows the government to show the true value of receivables that may truly be collected for use by the government.

Table 3: Summary of significant differences between Cambodian government accounting for expenses and the requirements of IPSAS

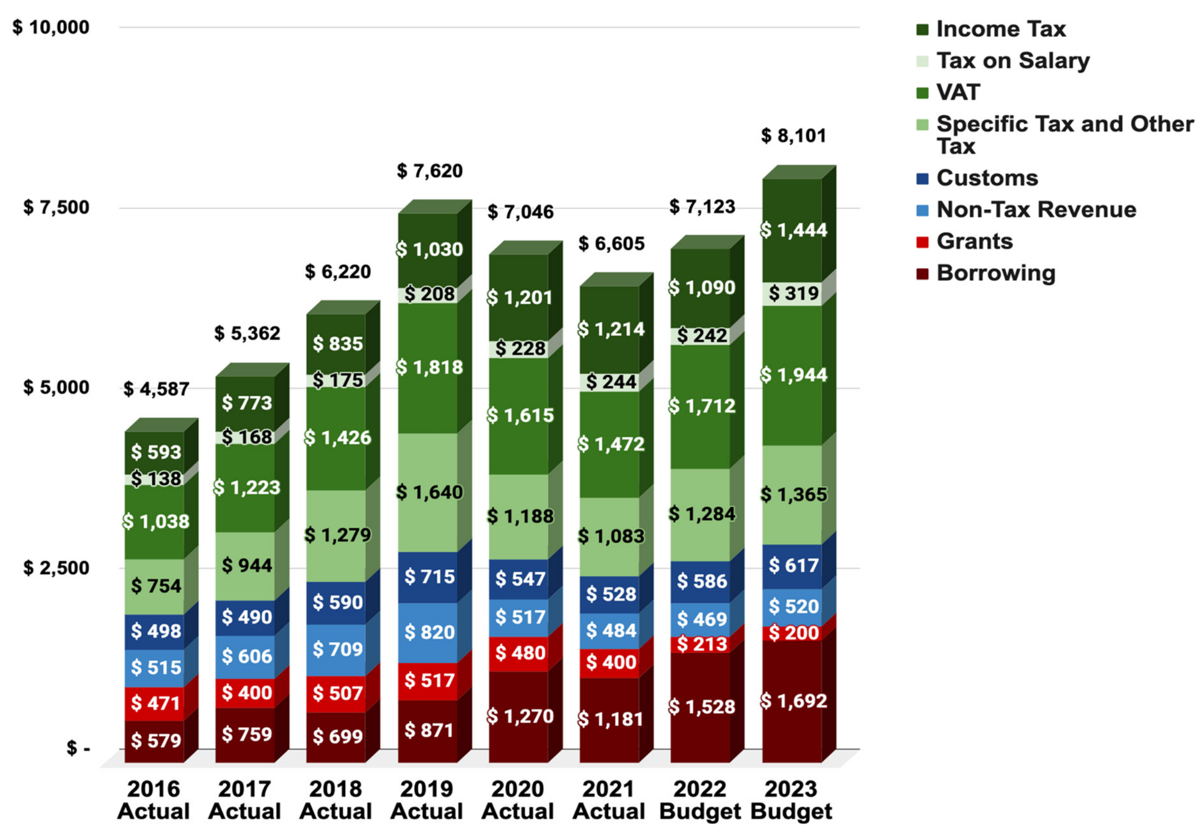
Current Practice	IPSAS Requirement	Recommendations
1. Pension benefits are expensed on a cash basis The cost of long term employee benefits is recognized in the period in which it is paid. Government employees enjoy the benefit of a defined benefit plan when they retire. However, there is no accounting recognition of the government liability to pay these benefits. The cost of long term employee benefits is recognized in the period in which it is paid.	**IPSAS 25** Long term employee benefits are recognized as an expense in the time of service of the employee, not when the employee is paid the retirement benefit. At the same time that an expense is accrued, a corresponding liability is recognized. IPSAS 25	When long term benefits are not recognized as an expense in the period of employee service, the cost of government operations is understated. Recognizing the expense and liability of long term benefits will present fairly the cost of government operations. Also, it will enable managers to assess the sustainability of such benefits as well as government solvency.The GDNT is encouraged to engage an experienced actuary to measure the liability and expense. This liability and expense needs to be recognized in the financial statements.
2. National Social Security Fund Expenses are recorded on a cash basis The benefits paid out by the national social security fund are currently recorded and presented on a cash basis; there is no accrual of expenses or related liability. Benefits include and will include cash transfers as well as provision of health services and medicine by state operated hospitals and clinics.	**IPSAS 42, Paragraphs 10-21; IPSAS 19, Paragraphs 22, 44** IPSAS 42 governs social benefits involving cash transfers. IPSAS 42 requires that a liability and expense are recognized when there is a present obligation to pay social benefits. IPSAS 19 covers other liabilities of uncertain timing or amount, similarly requiring recognition of a liability and expense when there is a present obligation arising from past events.	Payments and services under the National Social Security Fund are steadily growing. Operation of the National Social Security Fund is still in its early stages and it is a good time to begin measuring its obligations using actuarial methods in accordance with IPSAS so that policymakers and the public can be aware of the growing impact of this obligation.
3. Classification and presentation of expenses Not all expenditure is classified into expense accounts, especially expenditure that does not pass through the GDNT. Non-routine expenditure is classified as capital expenditure despite not resulting in acquisition of non-current assets; similarly, purchase of non-current assets are often classified as current expenditure.	**IPSAS 1, Paragraph 42, 45, 109** Presentation of items in the financial statements shall be presented consistently and expenses are aggregated according to either their nature or expense.	Not fully aggregating expenses of a similar nature or function can mislead users. A consistent aggregation of expenses and disclosing an analysis of expenses according to their nature or function will help users evaluate the performance of the reporting entity.

4. Offsetting of Intra-group transactions Intra-group expenses are not offset, such as tax paid.	**IPSAS 35, Paragraph 40(c)** Balances, transactions, revenues, and expenses between entities within the economic entity shall be eliminated in full.	Intra-group expenses, such as payment of tax by the government to itself, do not represent an outflow of resources and overstate expenses. In its national level consolidated financial report, the government is encouraged to offset its intra-group expenses.
5. Bad debt expense In both current practice and also the draft accounting policy for revenue (i.e. GARN paragraph 2.2.3), the government defers recognition of bad debt up to 10 years.	**IPSAS 41, Paragraphs 41, 72-83** An impairment expense for receivables must be recognized when there are expected credit losses. When the credit risk of a receivable increases significantly, a loss allowance equal to the lifetime credit losses of the receivable is recognized.	Excessive delay in recognizing bad debts overstates the government surplus because non-collectible revenues are recorded as revenue without an offsetting expense. The misstatement grows year by year as the annual budget revenues grows year by year. The government is encouraged to recognize bad debt expenses on a timely manner.
6. Interest expense is expensed at the nominal concessional rate Cambodia typically borrows at concessional interest rates and also receives long periods of deferred payment of interest. The interest payments and related loan commitment fees and service charges are accounted for on a cash basis.	**IPSAS 5, Paragraph 5, 6, 14; IPSAS 41, Paragraphs 9, 57, AG 118-125, AG 156-159** Borrowing costs are interest and other expenses incurred by an entity in connection with the borrowing of funds and shall be recognized as an expense in the period in which they are incurred. Loan liabilities are initially recognized at their fair value. In the event that a loan is issued to the government at a concessional rate, the fair value (present value of discounted cash flows) will be less than the funds received and the difference is recognized as income.	The government may identify its material borrowing related costs and amortize them over the life of the loan (as an allowance offsetting the balance of the loan) so that borrowing cost expenses approximate the effective interest rate. The government may review its concessional loans and identify the difference with the fair market terms. The government may consider whether it is relevant or practicable to comply with IPSAS and recognize a gain on recognition of a concessional loan liability.

6. ACCOUNTING FOR INCOME

Accounting policies for income is described in MEF Ministry Order 1212 as well as in the draft Guidelines for Accounting and Recognition of Tax and Customs Revenue V0.9 (GART) and the Guidelines for Accounting and Recognition of Non-Tax Revenue V0.6 (GARN). The draft guidelines of the GART and GARN are intended to soon replace the requirements for accounting for revenue in the MO 1212. Therefore, this section focuses on the differences between the requirements of the GARN, GART and IPSAS. This section begins with primary general recommendations to the GART and GARN, followed by a summary of several specific issues. The measurement, recognition and timing of tax revenues will have a significant impact on reported government income.

Figure 5: Cambodian government current and capital receipts in millions of United States dollars



Source: Author's calculations based on the Cambodian government budget settlement laws for the fiscal years 2016 - 2021 and the finance management laws for 2022 and 2023

6.1 Include an explicit reference to IPSAS

It is not possible for the accounting guidelines to foresee and cover every possible future transaction and type of revenue. Therefore users will benefit by referring to the original IPSAS standard from time to time to resolve an issue or to seek clarification. Therefore, it is advised that the accounting guidelines explicitly state that the policies follow IPSAS that are in effect.

6.2 Expand the GART Sections on Accounting for Tax and Customs Revenue to Include Tax and Customs Related Transfers and explicitly state in GART Section 1.3 Scope that the guidelines do not cover transfers not related to tax and customs

The GART policy on recognition of tax and (GART Sections 1 and 2) does not cover tax and customs related transfers such as fines and penalties, but it does include a "Section 3: Transfers" which is intended to cover accounting for all transfers. However, it is not practical to include accounting for all transfers in the present GART guidelines since the scope of transfers is quite broad, including grants, donations and gain on concessionary loans which are not related to tax and customs and is not appropriate for a policy on accounting for tax and customs. Therefore, there is no need to include "Section 3: Transfers" which currently does not include sufficient guidelines for recognition or measurement.

Instead, in Chapter 1, Section 1.3, the scope should limit these guidelines to cover only transfers related to penalties and fines related to tax and customs. Following this, the recognition and measurement criteria in GART Section 1 and Section 2 should be expanded to cover fines and penalties related to taxes and customs.

6.3 Develop a policy to deal with accrued revenue

In the GARN, a number of accounting policy examples show recognition of revenue based on the date of an invoice and do not contemplate accrued revenue. GARN examples 1 and 2 in GARN Section 4.3.2 and examples 1 and 2 in GARN section 4.3.3 are not in compliance with IPSAS since they show revenue recognition on the date of the invoice being issued. However, at the end of the period there may be accrued revenue that has not yet been invoiced. A similar problem may exist for the right to a share of profits described in GARN section 4.3.4, recognition of accrued income may be necessary. Therefore, it is advised to develop a method to record accrued revenue at the end of the period and any reversals at the commencement of the following period.

6.4 Explicitly state that income tax revenue is not recognized in the period of the taxable event because the amounts cannot be reliably measured and revise recognition timing in GART Section 2.1.3

There is a problem in that according to IPSAS 23 and ED 71, tax revenue must be recognized in the period of the taxable event. In the case of corporate income tax, the taxable event in a given year (e.g. 2022) is the profit earned in that year. However, the corporate income tax is paid the following year, with a deadline by March of the following year (e.g. March 2023). Therefore, strictly following IPSAS, the revenue must be recognized in the year of the taxable event (2022). New Zealand, for example, uses forecasting methods to make an estimate of the corporate income tax owed to the government. Any resulting differences are recorded as a change in estimates. Another approach is to initially book an estimate and make an adjustment when the corporate income taxes are declared and paid (adjusting event).

However, an easier solution used by Australia and Canada is to delay the recognition of the revenue with the explanation "the corporate income tax is not yet reliably measured". Therefore, for these two countries, they do not recognize the corporate income tax in the year of the taxable event because they do not know clearly the amount of the revenue until they receive the corporate income tax declarations and payments.

Therefore, following the Australian and Canadian approach, it is recommended to revise the timing for recognition in 2.1.3 to be "Recognized on or after the taxable event at the earliest the amount of tax due may be reliably measured, the earlier of (a) submission of a tax declaration, or (b) point of receipt".

Table 4: Significant Differences Between the GART and GARN and the requirements of IPSAS

Current Practice	IPSAS Requirement	Recommendations
1. GARN and GART policy examples written in USD In the draft revenue accounting guidelines, there are examples in denominations of USD.	**IPSAS 4, Paragraph 24** IPSAS requires transactions to be recorded in the functional currency of the reporting entity.	Use the Functional Currency in all GART and GARN Examples The functional currency of Cambodian government entities will be Cambodian riel. Therefore, it may be misleading to users if there are example journal entries in USD.
2. GART Section 3.6 recognizes prepayment of tax on income as a liability In Cambodian tax law, companies may use prepayment of tax on income to offset an equal amount of corporate income tax payment which is paid several months after year end. In the event that income tax is greater than the prepayment, the prepayment becomes a minimum tax retained by the government. In no case is the amount refunded.	**IPSAS Conceptual Framework Paragraph 5.16** In IPSAS, a liability is defined as "a present obligation of the entity for an outflow of resources that results from a past event".	**Recognize prepayment of tax on income in the period collected** There is no present obligation for an outflow of resources because: (a) if the company has a loss the government has the right to retain the amount; and (b) if the company has a profit in the current period, that prepayment is a payment of tax arising from a taxable event in the current period and should be recognized in the current period. Even if the prepayment was deemed to be an unearned income liability, it would be a contingent liability (not requiring entries) because it could not be reliably measured due to its dependence on uncertain future events (whether or not and much profit the company can generate in future years).
3. GART Section 2.1.2(c) sets as a tax revenue recognition criteria that the government establish procedures for taxpayers to calculate their tax obligations accurately The inclusion of this as a recognition criteria appears to be a typo in the draft policy.	**IPSAS 23, Paragraph 31** IPSAS requires that tax revenue be recognized when the taxable event occurs, the tax basis is identified, the fair value of the asset can be recognized, and it is probable that there is an inflow of resources.	**Delete GART 2.1.2(c)** GART Section 2.1.2(c) does not represent recognition criteria and is misleading to list as a criteria. It is only a general suggestion and should be deleted.
4. The draft policies on accounting for revenue include references to modified cash accounting	**IPSAS 1, Paragraphs 2 and 7** IPSAS explicitly states that it follows accrual accounting for transactions, recording transactions when they occur, not necessary when cash is paid or received.	**Remove GART reference to modified cash accounting**

5. GARN Step 4 in Section 2.1.2 requires that all revenue be recognized on a gross basis	**IPSAS 9, Paragraph 12; IPSAS 16, Paragraph 80; IPSAS 17, Paragraph 86** While in general IPSAS recognizes revenue in the gross amount receivable, there are cases in which gross receipt of funds may include amounts collected on behalf of a third party, which are excluded from revenue as per IPSAS 9, paragraph 12. Also, revenue arising from advance gross payments for exchange transactions is deferred until the related obligation is satisfied. Also, IPSAS requires gains and losses on disposal of investment property and PPE to be recorded on a net basis.	**Delete the GARN second paragraph in Step 4 to remove the blanket requirement to account for revenue on a gross basis**
6. GARN Section 3.3 gives an example of a security deposit as a form of deferred revenue	**IPSAS 9, Paragraph 28** Revenue for exchange transactions involves consideration transferred in exchange for goods or services, recognized when the risks and rewards of ownership have passed to the buyer.	**Delete the example in GARN Section 3.3 and include an appropriate example** The example in Section 3.3 is intended to be an example of unearned income. However, it is not unearned income, it is a deposit liability because at the time of receiving the deposit, there has not yet been any event giving the government the right to receive those funds.
7. Recognition Timing of Non-Exchange Revenue Revenues are recognized by the GDNT on a modified cash basis, not an accrual basis. For example, the 2022 corporate income tax is recognized as a 2023 revenue when it is paid in March 2023. Tax receivables are accrued every year for taxes that have been assessed but not paid; however this amount has not been recognized as revenue. Also, a large portion of this tax receivable is uncollectible.	**IPSAS 23, Paragraph 59** An inflow of resources from a non-exchange transaction… shall be recognized as an asset when, and only when: (a) It is probable that the future economic benefits or service potential associated with the asset will flow to the entity; and (b) The fair value of the asset can be measured reliably. *IPSAS 23, Paragraph 31* An entity shall recognize an asset in respect of taxes when the taxable event occurs and the asset recognition criteria are met.	**Recognize income on an accrual basis** For taxes for which there are material differences between cash and accrual accounting, policies need to be set in place to capture non-exchange revenues on an accrual IPSAS basis. **Create a policy explanation as to why revenue for income tax is recognized in the following year** In the case of corporate income tax, it may be reasonable to delay recognition until the amounts are declared and paid as that is the point at which the amount may be reliably measured. The accounting policy should communicate this reasoning.

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