

2

PUBLIC SECTOR ACCOUNTING

A. Institutional Framework for Public Sector Accounting

7. The institutional framework should include adherence to IFAC-issued International Accounting Standards (IAS) and qualified accounting staff to provide the timely, relevant, and reliable financial information needed to support all fiscal and budget management, decision-making, and reporting processes. The diagnostic questionnaires that were used in this assessment have collected information on the current arrangements and the apparent gaps in accounting laws and regulations, education and training of public sector accountants, application of a code of conduct, and numbers and characteristics of public sector accountants.

1. Accounting Laws and Regulations

8. **The accounting laws and regulations should be more prescriptive about the use of international accounting standards.** A draft Public Finance Act is being circulated for comment. Passage of this Act will provide for a good PFM foundation. Bhutan's Financial Rules and Regulations 2001, specify the current accounting practices, internal control procedures, reporting requirements and timetables, and responsibilities for financial management in all agencies. The accounting system is focused on ensuring due control over and reporting against budget appropriations, and audited annual accounts are essentially a budget realization statement. The International Public Sector Accounting Standards (IPSAS) issued by the International Public Sector Accounting Standards Board (IPSASB) of the IFAC are not adopted or complied with in preparing the annual accounts. However, in practical terms, the provisions of the Financial Rules and Regulations 2001 have facilitated a flexible reporting environment. Since much of the information seems available, there is scope for the Ministry of Finance to format annual financial statements using Cash Basis IPSAS, Part I. This will be in line with the proposed Public Finance Act, which provides for the chief accounting officer to prescribe accounting standards.

9. **Enacting the proposed Public Finance Act can provide a firm basis for more effective enforcement and clarify the financial accountabilities of responsible parties.** Audit reports show some lack of financial discipline and a lack of proper training for finance personnel, which has led to practical problems in implementing Financial Rules and Regulations 2001. There is a need for a better framework of financial accountability through a modern financial reporting framework, as proposed in the Public Finance Act. Producing annual reports for each ministerial portfolio will provide a basis for holding senior managers accountable for their operations and use of budget funds. The Auditor General



will need to specify the actions that departments should take to correct any accounting effects that lead to audit findings. Currently the accounts are only available at year-end. The computer accounting system needs to be enhanced and connected to enable monthly reporting at entity level. Networking and other system improvements are needed.

10. As the relevant authority, the Auditor General should require public enterprises to report in accordance with international accounting standards. Public enterprises are not supported by a set of Bhutan Accounting Standards. It is up to the enterprise and its auditors to decide which set of accounting standards are used to report in accordance with generally accepted accounting principles. Public enterprises are required by the Bhutan Companies Act 2000 to provide an annual report, including a balance sheet and a profit and loss account. The Companies Act includes a schedule of the audit requirements that specifies reporting in accordance with generally accepted accounting principles. This schedule is subject to amendment by the Auditor General.

2. Education and Training

11. Accounting courses need to be upgraded. A training needs analysis conducted in 2004 by the Australian Society of Certified Practising Accountants (CPA Australia) found a need for the Royal Institute of Management accounting courses to be modified to provide the basic accounting competencies required by the Confederation of Asian and Pacific Accountants (CAPA) standards. The RIM qualifications provide a basis for an effective National Finance Service but need to be upgraded and followed up with further in-service training in the core competencies needed for public sector accounting and reporting.

12. There is no regular system or mechanism to provide public sector accountants with continuing professional development and training. The use of a comprehensive graduated framework of professional accountancy qualifications is needed. The training needs analyses by CPA Australia found that the National Finance Service should review its functional and skills requirements as a professional accounting service. The Royal Public Service Commission has introduced a formalized position classifications system for the National Finance Service. The UK Association of Chartered Certified Accountants (ACCA) offers a worldwide Professional Scheme and Certified Accounting Technician Scheme, as does the public sector program of the Chartered Institute of Public Finance and Accountancy (CIPFA) in the United Kingdom. Cooperation with these or similar bodies and the Royal University of Bhutan could provide a cost-effective mechanism for providing a wide range of levels of accountancy training.

13. The Government should develop a strategy to develop adequate accounting and financial professionalism. The training needs analyses by CPA Australia proposed a professional accounting body in Bhutan to support the National Finance Service. The Royal Public Service Commission has decided to establish an Accounts and Finance Division in its new Position Classifications System, a step forward in creating a professional body of accountants in the National Finance Service. The Government should respond to the proposals put forward in the CPA Australia report on strategic pathways to developing adequate accounting and financial professionalism.

14. A training program that meets the IFAC International Education Standards (IES) for Professional Accountants is needed for public sector accountants and auditors. The

recommendations of the CPA Australia report should be assessed by the Auditor General and the Ministry of Finance with a view to establishing a Bhutan Institute of Accountants. The professional leadership capacity of the Royal Institute of Management and the National Finance Service should be strengthened in order to train and manage the professional development of public sector accounting staff. There are approximately 585 accounting staff in the Bhutan public sector. The Royal Institute of Management requires higher-level training for professional development and professional membership qualifications. The ACCA is a body that could provide substantial support to the Bhutan accounting profession. Plans to adopt the ACCA or the CIPFA public sector program for local conditions would provide the path for sustained, improved training. The plan would be to use the existing local training institutions within the Royal University of Bhutan to teach the appropriate curricula with the guidance of the international affiliate.

3. Code of Conduct

15. **A public sector accounts code of ethics is needed.** Public sector accountants must adhere to the Civil Service Code of Conduct and Ethics stipulated in the Bhutan Civil Service Rules 2002. But the Civil Service Code is less prescriptive than the standard code for professional accountants, thus a special code is needed. The new Audit Act includes a specific code of conduct for auditors. This should be mirrored in a similar code for accountants, which can be based on Part A of the IFAC Code of Ethics for Professional Accountants. The cultural support that a strongly directed Code of Ethics can create would be helpful in maintaining good public financial management.

4. Public Sector Accountant Arrangements

16. **External and internal audits are not as effective as they should be in ensuring that systems of internal financial controls work well.** For each public sector body that prepares annual accounts, there should be a professionally qualified Chief Financial Officer (CFO) to shoulder overall responsibility for maintaining systems of internal financial controls that manage risks, and for preparing the reports and accounts for signature by the chief executive officer. The audit results are not being sufficiently translated into remedial actions. For this work to be done properly, the CFO needs to be given specific responsibility. The RAA report on the 2002-03 annual accounts (submitted on January 4, 2005) proposed the creation of a post of CFO as head of a separate Department of Public Accounts in the Ministry of Finance; this has been separated from the budget function. The proposed Public Finance Act imposes substantial reporting requirements on portfolio ministers, and a CFO for each portfolio will be needed to manage this.

B. Accounting Standards as Practiced

17. The diagnostic questionnaires have facilitated the collection of information on the current arrangements and the apparent gaps for setting public sector accounting standards, besides presenting financial reports. Out of this exercise came recommended activities that will help bring local standards into line with international standards.

1. Setting Public Sector Accounting Standards

18. **More formalized arrangements are needed for setting accounting standards for the public and private sectors.** The proposed Public Finance Act provides for annual audited financial



statements and for a Chief Accounting Officer (CAO) in the Ministry of Finance who shall prescribe accounting standards for use by all budgetary bodies. It would be desirable to establish a formal board to advise on the establishment of accounting standards for both the private and public sectors. This proposed Accounting Standards Board should include representatives from public and private enterprises, the Ministry of Finance, and the Royal Audit Authority. The preference would be for this Board to adopt all IAS, IFRS, and IPSAS for the relevant bodies, but specify appropriate exemption periods for particular standards or clauses where difficulty in implementation is envisaged. Consultation and cooperation with other boards or committees in the Region on their practices could assist in this process in the initial and early stages.

2. Presenting Financial Reports

19. **The annual consolidated financial statements need adjustment to accord with Cash Basis IPSAS, Part I.** In his report on the 2002-3 financial statements, the Auditor General recommended that notes to the accounts should form an integral part of the financial statements and that the financial position should be presented in the form of a balance sheet and other accounts. The Royal Government of Bhutan should adopt Part I of the Cash Basis IPSAS for Government accounts. Consolidation of controlled entities such as public enterprises should be considered when feasible. Time tables are needed for consolidation of controlled entities into the cash basis statements as per 1.6.5 of the Cash Basis IPSAS (e.g. public enterprises), and for the longer-term transition path to the adoption of accrual-based IPSAS.

20. **Increased attention should be given to reporting issues for public enterprises.** State-owned enterprises tend to apply unspecified accounting standards of their own choosing. This does not give the consistency required for proper interpretation of accounts. It is important that a specific set of accounting standards be used for preparation of financial statements and for the audit of those statements. The use of 'generally accepted accounting standards' does not provide any reference to the specific set of explanations and definitions that are available in formally issued accounting standards. These explanations are a useful reference point for readers and users of the accounts. The IAS and IFRS should be adopted by the Royal Government and be specifically referred to in the report on the financial statements as having been adopted. The relevant schedule of the Companies Act should be so amended. The proposed Accounting and Auditing Standards Board would advise the Ministry of Finance and the Royal Audit Authority on the implementation of the international standards.