



# EXECUTIVE SUMMARY

1. This assessment of public sector accounting and auditing is generally meant to assist with the implementation of more effective public financial management (PFM) by means of better quality accounting and public audit processes. It is intended to provide greater stimulus for more cost-effective outcomes of government spending. The specific objectives are (a) to provide the country's accounting and audit authorities and other interested stakeholders with a common well-founded knowledge as to where local practices stand in accordance with the internationally developed standards of financial reporting and audit; (b) to assess the prevailing variances; (c) to chart paths to reduce the variances; and (d) to provide a continuing basis for measuring improvements.

2. Adoption of international standards for accounting forms the basis of competent financial reporting and transparency. The International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) has developed a core set of accrual-based International Public Sector Accounting Standards (IPSAS) and also a comprehensive IPSAS on the cash basis of accounting. These IPSAS establish an authoritative set of independent international financial reporting standards for governments and others in public sector organizations. The study has taken the international standards as axiomatic with any acceptable options incorporated in the standards. The study has not assessed whether or not the country should adopt a limited version of the standards, as the processes of developing the standards have already considered any acceptable options that can be incorporated into the text of the standards, but they do not override authoritative national standards issued by governments, regulatory or professional accounting bodies. Application of IPSAS will support developments in public sector financial reporting directed at improving decision making, financial management, and accountability and it will be an integral element of reforms directed at promoting social and economic development. The IPSASB has also developed guidance on the transition from cash- to accrual-based reporting.<sup>1</sup> The traditional emphasis on cash accounting has been found inadequate through failure to recognize true costs, and all assets, and liabilities. Cash accounting can too easily neglect asset management, accumulating arrears, future liabilities (e.g., pensions), and contingent liabilities (e.g., guarantees).

3. Annex A explains the methodology used for the study. Annex B provides a summary of accounting and auditing standards referred to in this study. Annexes C and D provide country accounting and auditing legislation, respectively. Annex E includes a description of the benefits of accrual accounting.

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<sup>1</sup> *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities, IFAC Public Sector Committee, December 2003.*

The desired actions indicated by this assessment are summarized below.

4. **For reliability, the requirements for public sector accounting and reporting should be specified by law.** The Financial Rules and Regulations 2001 are currently in place. A draft Public Finance Bill has been prepared for presentation to the incoming legislature. Passage of this legislation would provide a sound framework for PFM development. An Accounting Standards Board should be set up to give advice on the establishment of accounting standards for both the private and public sectors. This Board should include representatives from public and private enterprises, the Ministry of Finance, and the Royal Audit Authority (RAA).
5. **There is a need to improve the reliability and consistency of reporting by using the format of the Cash Basis IPSAS.** An implementation time table for adoption of Cash Basis IPSAS is needed. The Government's reporting does not at present comply with the formats of the Cash Basis IPSAS, Part 1, but the information is generally available to do so. Further examination will be needed to assess the steps to consolidate controlled entities. The IPSASB encourages governments to progress to the accrual basis of accounting and to harmonize national requirements with the IPSAS. A longer-term goal will be to move to accrual-based reporting, but in the early stages the optional information set out in IPSAS, Part 2, may be reported on a progressive basis.
6. **There is a need to improve the current budget and accounting computer systems to provide a fully linked system that enables monthly and annual reporting at entity and national level.** Program changes are underway to support electronic transfer of accounting reports on a monthly basis from all accounting offices. Scoping studies are being made of the communications links that are needed and will provide an estimation of the hardware, communication, and software requirements. There is a need for some reassessment of the system to establish how it will support the accounting and reporting requirements of the proposed Public Finance Act. This Act will require half-yearly and annual ministerial reports on the actual performance against that specified in the budget. To achieve better budget performance, the accounting system needs to provide managers with frequent information on progress against budgets at the portfolio level and below.
7. **Increased attention needs to be given to reporting issues for public enterprises.** The state-owned enterprises tend to apply unspecified accounting standards. The International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) issued by the IFAC should be adopted by the Royal Government of Bhutan (RGoB) and be specifically referred to in the financial statements as having been adopted. The relevant schedule of the Companies Act should be so amended. The proposed Accounting Standards Board would advise the Ministry of Finance and the Royal Audit Authority on the implementation of the ISA.
8. A Supplementary Table of Standards and Gaps at the end of this report provides a matrix detailing the current standards, the present position, and options for improvements, separately, for accounting and auditing. A summary of the accounting issues is shown in Table ES1, while Table ES2 covers those related to auditing.
9. **Adoption of the international standards for auditing provides the basis for assuring competent financial reporting and transparency if supported by enforcement of a code of ethics.** The International Organization of Supreme Audit Institutions (INTOSAI) has produced a Code of

**TABLE ES1. SUMMARY OF ACCOUNTING STANDARDS ISSUES**

<b>Standard</b>	<b>Current status</b>	<b>Activity required to adopt international standards</b>
1. Does the Public Sector Accounting Law adopt IPSAS?	No.	The proposed Public Finance Act provides for the Chief Accounting Officer to set accounting standards. Once in place then IPSAS should be specified.
2. Does education and training of accountants accord with IES?	Broadly yes, but enhancements are needed to provide sufficient capacity.	Training needs analyses need to be completed and training courses and resources modified to meet the requirements.
3. Does the Code of Ethics match the international standards?	Broadly but not in sufficiently specific terms for accountants.	Part A of the IFAC Code of Ethics for Professional Accountants should be adopted suitably amended for Bhutan.
4. Is there a body to prescribe public sector accounting standards?	No. The proposed Public Finance Act provides for the Chief Accounting Officer to set accounting standards.	It would be desirable to establish a formal Board or Committee to advise on the establishment of accounting standards for both the private and public sectors.
5. Are the financial statements in accord with the international standards?	No.	The RGoB should adopt Part I of the Cash Basis IPSAS for the Government's accounts. Consolidation of controlled entities, such as public enterprises, should be considered when feasible.
6. Is the statement of Cash Receipts and Payments in IPSAS form?	No.	The information for these requirements is available and a Cash Basis IPSAS statement should be included in the annual accounts.
7. Are accounting policies and explanatory notes required?	No.	
8. Are other disclosures in accord with IPSAS?	No.	
9. Does the government issue a consolidated financial statement which consolidates all controlled entities?	No.	Implementation plan and time tables are needed for consolidation of controlled entities into the cash basis statements.

Ethics as a statement of values and principles to guide the daily work of the auditors; and a set of Auditing Standards that contain the postulates and principles for carrying out the audit work. The INTOSAI proposes that auditors need a subsidiary level of guidance to provide practical assistance to supreme audit institutions (SAI) in implementing the auditing standards in their individual constituencies. This lower level of guidance is provided by the International Standards of Auditing (ISA) prepared by the

IFAC's International Auditing and Assurance Standards Board (IAASB).

**10. There is a need to adopt the practices set out in the IFAC-issued International Standards on Auditing in the new auditing manuals.** The current auditing approach is based on the Auditing Standards of Bhutan, which are in line with the INTOSAI Auditing Standards. However, INTOSAI Auditing Standards are too general to support the development of adequate manuals. New laws and manuals are in development and should mandate the adoption of international auditing standards. The implementation of the Audit Act and the modern audit methodologies needs to rely on the IFAC-issued International Standards on Auditing for efficient audit processes.

**11. Improvement of accounting and auditing skills would benefit from some external support to academic bodies.** Improved compliance with international standards requires properly trained accounting and auditing staff. Recent reviews found that Royal Institute of Management (RIM) qualifications need to be upgraded and supported with further in-service training in the core competencies needed for public sector accounting and reporting. Both accounting and auditing knowledge and skills need to be adequate for all audit staff. The Royal Institute of Management is developing its courses to support training of potential recruits and current staff for the Royal Audit Authority. Strengthening this training support through association with a foreign accounting institution would be helpful.

**TABLE ES2. SUMMARY OF AUDITING STANDARDS ISSUES**

<b>Standard</b>	<b>Current status</b>	<b>Action to move toward international standards</b>
1. Is the SAI statutory framework in accord with the needs of the INTOSAI Auditing Standards?	Not until the new Audit Act was passed following the conduct of the assessment.	Implementation of the new Audit Act will provide a sound framework.
2. Is there a body to prescribe public-sector auditing standards?	RAA does this currently.	There is a need for a Standards Board to assist.
3. Have INTOSAI and IFAC audit standards been adopted?	RAA has adopted the INTOSAI Auditing Standards	IFAC ISAs have not been adopted and action should be taken to adopt them.
4. Has a code of ethics equivalent to the INTOSAI standards been adopted?	Yes.	Enforcement will support transparency.
5. Is the accountability process in the SAI in accord with INTOSAI Auditing Standards?	Yes.	
6. Does the SAI legal framework meet the INTOSAI standards for independence and powers?	No.	Implementation of the new Audit Act will provide a sound framework.
7. Does education and training of auditors accord with INTOSAI and IES standards?	No.	Training needs analyses of staff and linkage with a foreign accountancy institution to assist the Royal Audit Authority with capacity development Should be instituted.

<i>Standard</i>	<i>Current status</i>	<i>Action to move toward international standards</i>
8. Is the SAI equipped with the audit methods and technologies to meet INTOSAI Auditing Standards?	Broadly.	New audit manuals are in process of development and the technology needs will emerge from these.
9. Does the SAI have the quality assurance programs to meet international standards?	Yes.	
10. Do the processes for planning, supervision, evaluation of internal control, assessment of compliance with laws and collection of audit evidence for the audits meet international standards?	No.	New audit manuals being developed should improve these processes. The manuals should adopt guidance from the relevant ISA.
11 Does the audit analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with?	No.	The RGoB needs to adopt IPSAS for reporting.
12 Does the auditor prepare an audit opinion on the financial statements in a form that conforms to international standards?	No	The form of report needs to be adjusted to accord with ISA 700.
13. Does the consideration of fraud and error in an audit of financial statements accord with international standard?	Broadly yes.	Further adoption of the relevant ISA will improve performance.
14. Are the Auditor General's reports made public?	Yes.	
15. Is the process for taking action on audit recommendations sufficiently effective to meet international standards?	Yes, in the absence of an effective legislative scrutiny.	Parliamentary scrutiny is a crucial component of the process of responding to audit scrutiny.

12. A summary of the auditing issues is shown below, in Table ES2.

**13. Improve public financial management through making managers of budget and accounting systems accountable for internal controls.** Public financial management relies on a comprehensive and timely accounting and financial reporting system, which is supported by a competent audit function that assures that the system is working properly and that the information is reliable. The RAA report on the 2002-03 annual accounts (submitted January 4, 2005) proposed a position of a Chief Financial Officer (CFO) to head a separate Department of Public Accounts in the Ministry of Finance. This position has been separated from the budget function. The proposed Public Finance Act imposes substantial reporting requirements on portfolio ministers. A CFO for each portfolio would be needed to manage this. Accountable officers for the public finance system should maintain systems of internal

financial controls that manage risks, and prepare the accounts for signature. Specific identification of CFOs officers with overall responsibility will help ensure effective implementation. In addition, the budget monitoring system should be computerized and supported by timely accounting information.

**14. The Royal Government of Bhutan should prepare a PFM indicators survey for monitoring progress in adopting and applying international standards.** Use of the PFM performance measurement framework developed by the Public Expenditure and Financial Accountability (PEFA)<sup>2</sup> program, suitably extended, would be a good basis to develop and measure progress in the full cycle of PFM reform that encompasses budget formulation, accounting and audit, legislative scrutiny, and remedial action

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<sup>2</sup> The PEFA Program is a partnership among the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the Strategic Partnership with Africa, IMF, and the World Bank. A Steering Committee, comprising members of these agencies, manages the Program. A secretariat is located at the World Bank in Washington, DC.