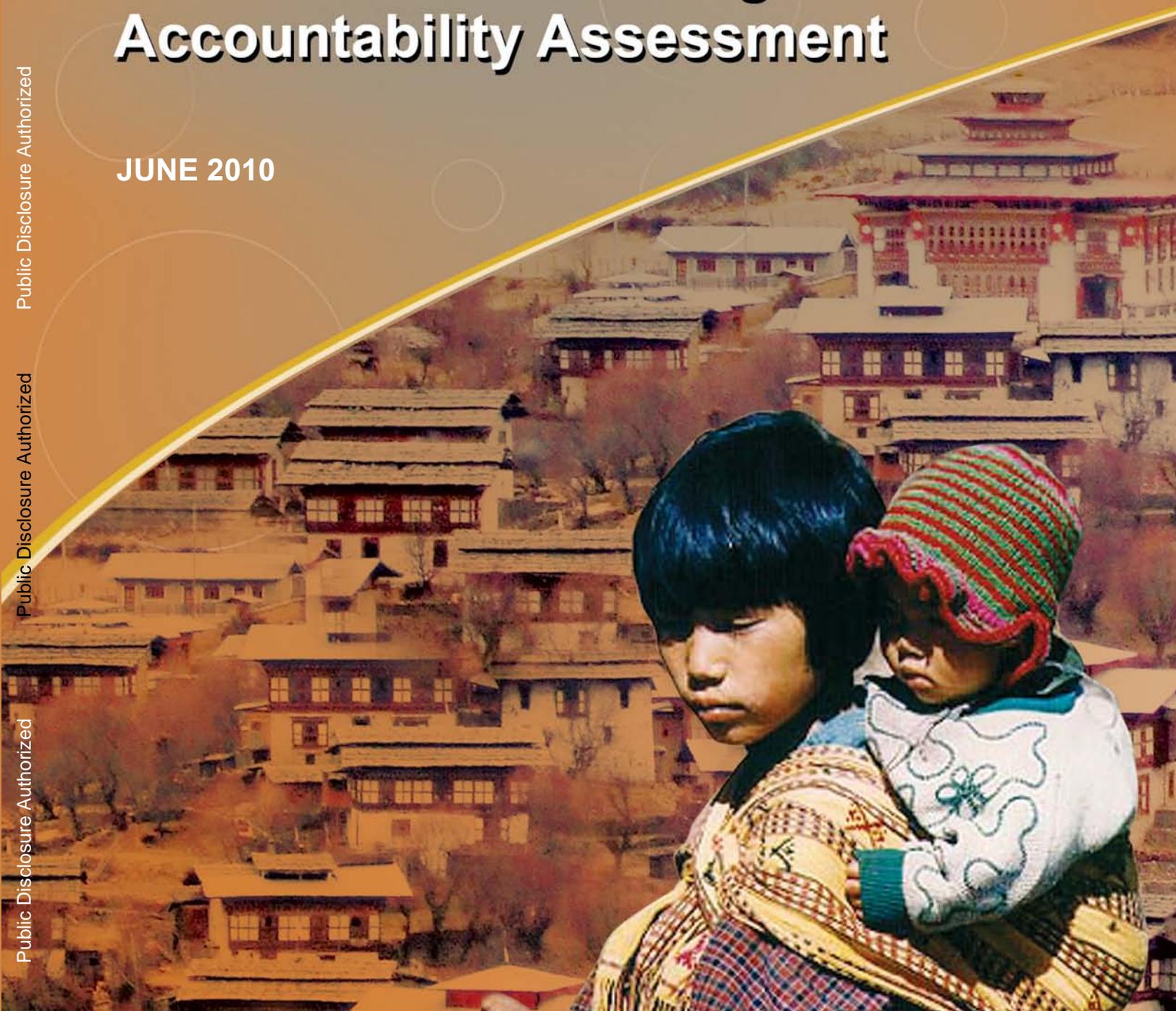


# Bhutan

## Public Financial Management Accountability Assessment

JUNE 2010

Public Disclosure Authorized  
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The World Bank



Danida



**Report No. 58444-BT**

# **Bhutan**

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**June 2010**



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**CURRENCY EQUIVALENTS**

January 1, 2010

1 US Dollar = 46.53200 Bhutan Ngultrum

1 Bhutan Ngultrum (BTN) = 0.02149 US Dollar (USD)

**FISCAL YEAR**

July 1 –June 30

FISCAL YEAR JULY 1 - JE 30

# ABBREVIATIONS AND ACRONYMS

AAR	Annual Audit Report
ADB	Asian Development Bank
AFS	Annual Financial Statements
AGA	Autonomous Government Agencies
AIMS	Audit Information Management System
BACS	Bhutan Automated Customs System
BAS	Budgeting and Accounting System
BBS	Bhutan Broadcasting Service
BIT	Business Income Tax
BoB	Bank of Bhutan
BPFSS	Budget Policy and Fiscal Framework Statement
CAATs	Computer Assisted Auditing Tools
CAD	Central Accounts Department
CAS	Country Assistance Strategy
CBAS	Central Budgeting and Accounting System
CBS	Core Banking Solution
CD	Current Deposit
CFAA	Country Financial Accountability Assessment
CIPS	Chartered Institute of Purchasing and Supply
CIT	Corporation Income Tax
CMR	Child Mortality Rate
COFOG	Classification of Functions of Government – international standard
CPIA	Country Performance Indicator Assessment
CS-DRMS	Commonwealth Secretariat - Debt Recording and Management System
DDO	Drawing and Disbursing Officers
DPA	Department of Public Accounts
DPG2	Development Program Grant 2
DRC	Department of Revenue and Customs
DSA	Debt Sustainability Analysis
FCB	Food Corporation of Bhutan

FD	Finance Department
FIC	Financing Item Code
FM	Finance Minister
FRR	Financial Rules and Regulations
FYP	Five-Year Plan
FY	Financial Year
GARR	General Auditing Rules and Regulations 1989
GBFA	Government Budget Fund Account
GCA	Government Consolidated Account
GDP	Gross Domestic Product
GFS	Government Finance Statistics – international standard
GNHC	Gross National Happiness Commission
GNI	Gross National Income
GYT	Gewog Yargey Tshochung
HRD	Human Resource Divisions
ICBPP	Institutional Capacity Building Project in Procurement
IACS	Internal Audit Coordination Section
IFRS	International Financial Reporting Standards
IMR	Infant Mortality Rate
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standard
JICA	Japan International Cooperation Agency
M1	Scoring method where each dimension is scored separately and the overall score is given by the lowest scoring dimension
M2	Scoring method where each dimension is scored separately and the overall score is given by averaging of the dimension scores as per a PEFA Framework table of scoring rules
MDA	Ministries, Departments and Agencies
MDG	Millennium Development Goals
MoF	Ministry of Finance
MoHCA	Ministry of Home and Cultural Affairs
MP	Member of Parliament
MTFF	Medium Term Fiscal Framework
MYRB	Multi Year Rolling Budget
NA	National Assembly
NGO	Non Government Organization
NMES	National Monitoring and Evaluation System
NRA	Non-Revenue Receipts and Deposits Account
Nu	Ngultrum
PAC	Public Accounts Committee
PE	Public Enterprise

PED	Public Enterprise Division
PEFA	Public Expenditure and Financial Accountability
PEMS	Public Expenditure Management System
PFA	Public Finance Act
PFM	Public Financial Management
PIS	Personnel Information System
PIT	Personal Income Tax
PlaMS	Planning and Monitoring System
PLC	Project Letter of Credit
PPPD	Public Procurement Policy Division
RAA	Royal Audit Authority
RCSC	Royal Civil Service Commission
RGoB	Royal Government of Bhutan
RGR	Royal Government Revenue
RMA	Royal Monetary Authority
RMS	Revenue Management System
RRCO	Regional Revenue and Customs Office
SAI	Supreme Audit Institution
SN	Sub National
STCA	Sales Tax Collecting Agents
STS	Sales Tax System
TPN	Taxpayer Number
UNDP	United Nations Development Program
WCO	World Customs Organization
WFP	World Food Program

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# FOREWORD AND ACKNOWLEDGEMENTS

This assessment of public financial management in Bhutan has been completed by using the Public Expenditure and Financial Accountability Performance Measurement Framework. The assessment was conducted in the last half of 2009 by a core team from the Royal Government of Bhutan (RGoB) in consultation with the World Bank South Asia Region Financial Management Unit. The core team comprised staff from the Department of National Budget, Department of Public Accounts, Department of Revenue & Customs, Internal Audit Division, Policy and Planning Division, Public Procurement Policy Division, Royal Audit Authority, and the Public Accounts Committee and was headed by Mr. Nim Dorji, Director, Department of Public Accounts. These officers consulted as necessary with other government agencies in Bhutan in making the assessments against the dimensions and indicators in the Framework.

A preliminary planning workshop had been held in Thimphu in early July 2009 to discuss the PEFA framework with the RGoB Team, work through the information collection methods and identify the sources of information and timelines. A further two-day consultation workshop was conducted on October 19-20 in Thimphu for the World Bank, RGoB team members and representatives of the donor partners in Bhutan to examine and review the preliminary assessments and discuss key areas of improvements that emerge from the assessment.

The report is a composite assessment of the centralized public financial management system that covers central government and local governments in Bhutan. One part of the assessment dealt particularly with public financial management issues in local government and this material is set out in Annex 2.

The report has been prepared under the management of Manvinder Mamak, Senior Financial Management Specialist, South Asia Region Financial Management Unit (SARFM) in consultation with Ananya Basu, Senior Economist, South Asia Economic Policy and Poverty Sector (SASEP) and K Sankaravadelu, Procurement Specialist, South Asia Procurement Services Unit (SARPS). This team was assisted by Michael Jacobs (Consultant) and Lekzang Dorji, RGoB on secondment to SARFM Unit, World Bank. Published data in the Budget Reports, Tax Reports, Annual Financial Statements, and Annual Audit Reports were drawn upon to validate numerically based indicators.

Comments on the report have been received from Dr. Chhewang Rinzin and Lham Nidup (external reviewers for RGoB), Mr. Grayson Clarke (Consultant, DANIDA), Frans E. Ronsholt (PEFA Secretariat) and two other reviewers from the World Bank, Manuel Vargas (OPCFM) and Tanuj Mathur (SARFM).

The Bank would like to thank all the stakeholders involved for their contribution, particularly the donor partners in Bhutan. Representatives from DANIDA, UNDP, JICA and HELVETAS participated in the workshops and consultations, and representatives from ADB and EU provided off line support through the process. In addition, DANIDA contributed by financing the local costs of organizing the workshops and consultation meetings in Thimphu.



# SUMMARY ASSESSMENT

## PEFA Framework

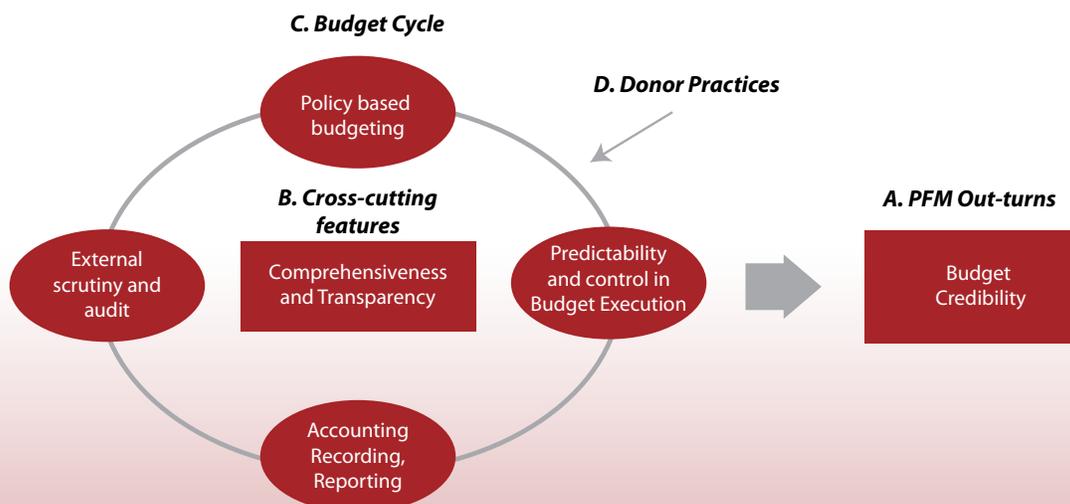
This summary assessment uses indicator-led analysis to provide an integrated assessment of the Public Financial Management (PFM) system which draws on international standards developed by various development partners. The purpose is to measure PFM performance across a wide range of development over time. The PEFA methodology includes the best conditions that some OECD countries demonstrate and in this assessment it is important to consider the Bhutanese context – that it is a small country, traditionally with an agricultural base society with relatively lesser industry and commerce. It is unable to support a financial sector infrastructure in terms of accountancy and audit standard setting and the availability of international standards is of great assistance.

The 31 indicators for the PFM system focus on the basic qualities of a PFM system operating to existing good international practices, and assessments are classified A (excellent), B (good), C (opportunities for some improvement) and D (in need of substantial improvement in some areas and/or information not available for the assessment). Each indicator may have 1-4 dimensions each of which is assessed independently. The overall score for the indicator is based on the scores for the constituent dimensions in accordance with scoring rules established in the PEFA PFM Framework document. In some circumstances a + sign is added where the indicator takes on the score of the lowest scoring dimension but other dimensions have higher scores. The indicators cover:

- The results of the PFM system in terms of actual expenditures and revenues by comparing them to the original approved budget, as well as level of and changes in expenditure arrears.
- Transparency and comprehensiveness of the PFM system.
- The performance of the key systems, processes and institutions in the budget cycle.
- The elements of donor practices which impact the performance of the PFM system.

The assessment in this paper presents from the PFM Performance Measurement Framework for each of the 31 indicators the main best practice issues and the dimensions to be assessed; and then follows with an analysis of performance in Bhutan against these dimensions based on available evidence. The

### STRUCTURE OF THE PERFORMANCE INDICATOR SET



outcome from this assessment will help provide a roadmap for improvements that can usefully serve as the baseline against which future PFM performance can be monitored. The assessment also included a process for obtaining a listing of suggestions for improvements for poor performing indicators. These will be used during further consultations with development partners on the results of this PFM review. Of particular importance are the following:

**PI-9:** Oversight of aggregate fiscal risk from other public sector entities – there is a good deal of monitoring of fiscal reporting from public enterprises and local governments. Because of the contributions made by public enterprises and the plans for greater devolution to local governments it would be desirable to meet the PEFA target that the central government consolidates fiscal risk and unfunded liabilities issues into a report at least annually.

**PI-12:** Multi-year perspective in fiscal planning, expenditure policy and budgeting – increased focus would be valuable on control over capital projects and recurrent cost requirements including those exercised at Dzongkhag level.

**PI-15:** Effectiveness in collection of tax payments – better integration is needed of assessments and revenues to ensure control over arrears.

**PI-19:** Competition, value for money and controls in procurement – the importance of procurement is such that current reform plans are of high priority

**PI-21:** Effectiveness of internal audit – Royal Audit Authority reports show that there continue to be irregularities and the proposed expansion of internal audit is a necessary management tool to address these concerns directly, including an evident need to cover local government where irregularities are relatively more frequent and there is an intention to increase devolution.

**PI-24:** Quality and timeliness of in-year budget reports – strong control over budget execution is needed as there is a need to achieve budget outcomes more closely and control the fiscal deficit. PI-1 shows that the budget is under-achieved by more than 5% in each of the 3 years 2005-2008. PI-24 shows poor performance in providing in-year budget reports. The accounting systems should be developed to issue quarterly budget reports to give managers more information to assist them to improve budget execution and review.

**PI-25:** Quality and timeliness of annual financial statements – improved budget and expenditure management systems are providing better information and it is practical for the RGoB's annual financial statements to adopt IPSAS standards, starting with the Cash Basis standard. This would provide greater transparency on the overall financial position.

**PI 27:** Legislative scrutiny of the annual budget law - the current scope of the legislature's scrutiny is a very limited review and it would be more effective for a responsible Parliamentary Committee to review a preliminary budget proposal before the Finance Minister's presentation of the Final Budget to the Parliament

## Performance indicator results

Results for the PEFA Indicators and their dimensions with the less favorable results highlighted shown in the table below. It should be noted that in some cases a poor overall score for an indicator is caused by poor performance in one of the dimensions of the indicator and other dimensions can be performing well so it is necessary to look at the detailed results also. It is also important to note that the standards in the PEFA framework are in the nature of best practice and the diagnosis is mainly aimed at identifying where reform attention is worth consideration by the Government.

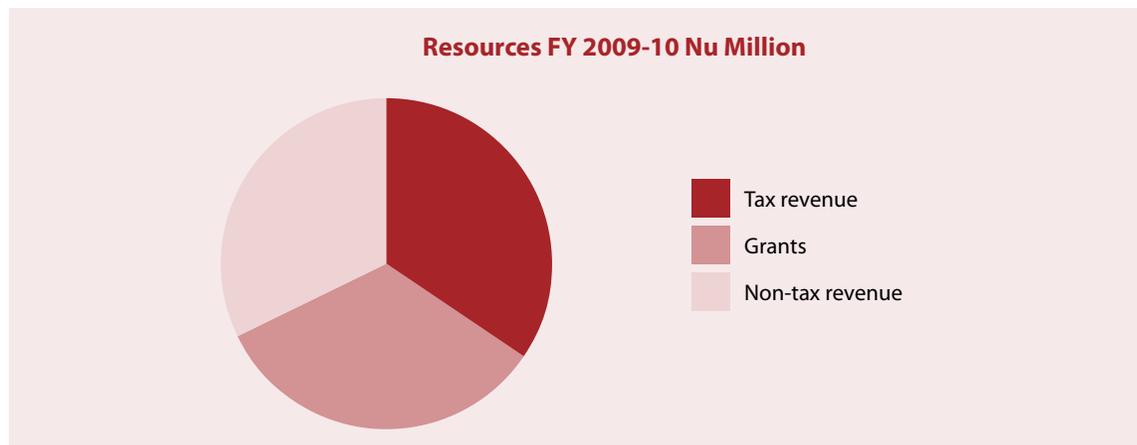
Indicator	Overall Score	Dimensions rating			
		i	ii	iii	iv
<b>A. PFM OUT TURNS; Credibility of the Budget</b>					
PI-1. Aggregate expenditure out-turn compared to original approved budget	B	B	-	-	-
PI-2. Composition of expenditure out-turn compared to original approved budget	B	B	-	-	-
PI-3. Aggregate revenue out-turn compared to original approved budget	A	A	-	-	-
PI-4. Stock and monitoring of expenditure payment arrears	NA	NA	D	-	-
<b>B. KEY CROSS CUTTING ISSUES: Comprehensiveness and Transparency</b>					
PI-5. Classification of the budget.	B	B	-	-	-
PI-6. Comprehensiveness of information included in budget documentation	A	A	-	-	-
PI-7. Extent of unreported government operations	A	A	A	-	-
PI-8. Transparency of inter-governmental fiscal relations	A	A	A	A	-
PI-9. Oversight of aggregate fiscal risk from other public sector entities	D+	C	D	-	-
PI-10. Public access to key fiscal information	B	B	-	-	-
<b>C. BUDGET CYCLE</b>					
<b>C (i) Policy-based Budgeting</b>					
PI-11. Orderliness and participation in the annual budget process	A	A	A	B	-
PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	B+	A	B	A	C
<b>C (ii) Predictability and Control in Budget Execution</b>					
PI-13. Transparency of taxpayer obligations and liabilities	B	B	B	B	-
PI-14. Effectiveness of measures for taxpayer registration and tax assessment.	C+	C	B	C	-
PI-15. Effectiveness in collection of tax payments	C+	A	A	C	-
PI-16. Predictability in the availability of funds for commitment of expenditures	C+	C	A	A	-
PI-17. Recording and management of cash balances, debt and guarantees	A	A	B	A	-
PI-18. Effectiveness of payroll controls	B+	B	A	B	B
PI-19. Competition, value for money and controls in procurement	C	D	B	C	-
PI-20. Effectiveness of internal controls for non-salary expenditure	A	A	A	A	-
PI-21. Effectiveness of internal audit	C+	B	C	B	-
<b>C (iii) Accounting Recording and Reporting</b>					
PI-22. Timeliness and regularity of accounts reconciliation	B	B	B	-	-
PI-23. Availability of information on resources received by service delivery units	A	A	-	-	-
PI-24. Quality and timeliness of in-year budget reports	D+	C	D	A	-
PI-25. Quality and timeliness of annual financial statements	C+	B	A	C	-
<b>C (iv) External Scrutiny and Audit</b>					
PI-26. Scope, nature and follow-up of external audit	B+	B	A	A	-
PI-27. Legislative scrutiny of the annual budget law	D+	D	C	D	A
PI-28. Legislative scrutiny of external audit reports	B+	A	B	B	-
<b>D. Donor Practices</b>					
PI-D1. Predictability of direct budget support	C+	A	C	-	-
PI-D2. Donor financial information provided for budgeting and reporting on project/ program aid	D+	A	D	-	-
PI-D3. Proportion of aid that is managed by use of national procedures	C	C	-	-	-

The Country Financial Accountability Assessment (CFAA) completed in February 2002 identified financial human resource development as one of the priority areas. The CFAA had several recommendations amongst which are adopting the international accounting standards in major public enterprises, drafting laws on financial management and combating corruption, and implementing a fully integrated computerized government accounting system. All of these have been shown in the PEFA review to have been addressed. The passage of the Public Finance Act can be regarded as a milestone in this direction, as it sets the institutional and legal framework for financial management. The adoption of a computerized Budgeting and Accounting System (BAS) in ministries / agencies, and a Central Budgeting and Accounting System (CBAS) in the Department of Public Accounts and the Department of National Budget has brought about significant improvements in the financial management system.

For Bhutan, this assessment of PFM has great relevance in the context of the new democratization of the political processes, the new Parliament and a strong movement towards devolution through the Local Government Act 2009. Thus the results shown for the indicators must be seen in the context of new and developing political engagements and processes. The budgetary system is intended to support budgetary outcomes in three areas - aggregate fiscal discipline, strategic allocation of resources and efficient service delivery; and any apparent defects need to be looked at against these intentions.

## Aggregate fiscal discipline

Chapter 2 of the Report examines the economic situation and notes that Bhutan's management of fiscal deficits has come under pressure and Bhutan is vulnerable to external factors on account of its dependence on non-tax revenues including from hydropower revenues for its recurrent budget and external assistance for its development budget. The National Budget for 2009-10 notes that although the Government's policy is to limit the deficits to generally not more than about 5 % of GDP, this particular budget projects a slightly higher deficit of over 6 % so fiscal discipline and budget execution need close attention to rein in these deficits and develop sustainability. The 2009-2010 budget shows that tax revenues, non-tax revenues and grants provide roughly equal shares of resources to fund the planned outlays for current and capital expenditures:



Continued growth would be assisted by the programs for improving PFM, especially in managing fiscal space through improvements in tax and non-tax revenue management, outlays controls and public enterprise risk management. It is useful to examine the extent to which the measured performance of the PFM system that is shown in Chapter 3 of the Report supports the overall achievement of budgetary outcomes. The assessment considers the systems for national Government and for local Government.

In respect of aggregate fiscal discipline, Pls 1 though 3 covering credibility of the budget show that the overall budget out turn for the national Government is reasonably well controlled at aggregate levels with

spending and revenue generally meeting original budget intentions. However there is room to consider whether more aggressive budget review processes could do more in re-allocating likely under spending to other areas of emerging needs with a consequent beneficial effect on service delivery. The lack of in-year budget reports shown by PI 24 shows the opportunities for improving the information available for review of budget execution. The lack of capacity to systematically monitor expenditure payment arrears shown by PI 4 is probably a minor concern as Ministry opinion is that there are unlikely to be substantial extended arrears but data is not available and an exercise is needed to verify this opinion and to identify any areas of relative weakness.

On the revenue side of budget execution, PIs 13 through 15 are generally good but show some scope for improved systems to enhance revenue management and improve revenue estimating to increase control over fiscal discipline. The Government is working on measures to broaden the sales tax base, rationalize indirect tax rates, and improve tax administration. Harmonization of personal, business and corporate income tax rates is also under consideration.<sup>1</sup>

## Strategic allocation of resources

For the systems available to manage the strategic allocation of resources the budget development process scores very well in PIs 5 through 8, and 10 covering budget classifications, comprehensiveness and transparency and PIs 11 and 12 covering policy-based budgeting. However there is a substantial deficiency in the effectiveness of the role of the Parliament in participating in budget development under PI 27. The Parliament would be expected to play a greater role in the strategic allocation of budget resources.

The total contribution from Public Enterprises (PE) in the form of dividends etc was Nu. 4,033.014 million constituting more than 32 % of the total domestic revenue in 2008 so RGoB is heavily reliant on its PEs. There are also substantial subsidies to some PEs. The results in PI 9 where fiscal risks in PEs and other local governments are not specifically monitored should be addressed.

On the expenditure side of control over budget execution, PIs 16 and 17 show a deficiency in cash flow forecasting but a good cash balances management system through a single treasury account. Optimum cash management would be assisted by the development of a cash forecasting framework based on comprehensive and high frequency data on cash inflows and outflows.<sup>2</sup> The lack of in-year budget reports shown by PI 24 produces a lack of information on cost of programs and use of resources undermines the ability to allocate resources to government priorities. The PEFA Framework considers that regular information on budget execution allows monitoring on the use of resources, and facilitates identification of bottlenecks and problems which may lead to decisions that create significant benefits in the strategic allocation of resources through the executed budget to better implement the RGoB's objectives.

## Efficient service delivery

In respect of efficient service delivery there is relatively poorer performance in some aspects of the payroll and procurement controls in PIs 18 and 19 and the accounting standards used for Annual Financial Statement reporting in PI 25. Examination of the variances between budget and expenditure in individual ministries showed in PI 2 shows wide differences between ministries indicating that some ministries may suffer disproportionately in service delivery. Budget execution controls need to be better to prevent important service priorities being under-achieved. Again PI 24 on in-year budget reports shows the opportunity to provide greater clarity and better management.

<sup>1</sup> Page 13 Staff Report for the 2009 Article IV Consultation with Bhutan Dec 7, 2009, IMF

<sup>2</sup> Page 12 Staff Report for the 2009 Article IV Consultation with Bhutan Dec 7, 2009, IMF

PIs 20 through 22 and 26 for internal control, internal audit and external audit and PI 28 for legislative scrutiny of audit reports show that the systems of checks and balances in the accounting and external scrutiny dimensions of the PFM system are generally working well to ensure that the individual expenditures are well controlled and scrutinized; however there are opportunities for wider use of internal audits and improved sharing of internal audit results between the oversight agencies MoF and RAA. These audit agencies are the main safeguard for efficient and rule-based management of resources, without which the value of services is likely to be diminished and a reform aim to reach A ratings for all dimensions for PIs 21 (Internal Audit) and 26 (External Audit) would be highly beneficial for ensuring better service delivery performance through the PFM system.

PI 19 shows a need for improvements in information on the use of competitive tendering in the procurement processes and the adequacy of a complaint system to ensure proper processes in procurement systems. Effective procurement practices are crucial for service delivery. Annex 3 shows the detailed findings from an assessment of the national procurement systems using an extensive baseline indicators methodology. Key findings are:

- the legislative and regulatory framework for public procurement in Bhutan has undergone significant improvements in recent years and some minor adjustments will create a procurement system fully in line with international standards – use of an Act rather than MoF rules for procurement regulations, modification of standard bidding documents to align with the procurement rules, elimination of exemptions from the procurement rules, stronger rules for public advertising, better record-keeping on procurement activities, and a Procurement Users Guide.
- the establishment of the Public Procurement Policy Division (PPPD) in August 2008 strengthens the institutional framework and management capacity for public procurement. Improvements would come from a more independent PPPD, stronger requirements for procurement plans by agencies and better links to budgets, an Integrated Financial Management Information System, implementation of the e-GP system to create efficient open public automated procurement systems, more procurement training, and specific quality standards.
- good foundations for sound procurement operations through the career ladder of procurement position and a well-functioning procurement market. Capacity improvements in both the procuring agencies and the private sector to improve knowledge of government procurement processes would enhance performance as would more efficient delegation arrangements for procurement decisions.
- the Royal Audit Authority and the Anti Corruption Commission support the integrity and transparency of the procurement system. Continuing issues are the adequacy of internal audit, the complaints and arbitration mechanisms, and a Code of Ethics directly relevant to procurement officers.

PIs D1 through D3 show that reporting by donors on project expenditure could be improved and the improvements in the procurement systems needed under PI 19 could help with donor reliance on country systems.

## Overall reform processes

Chapter 4 of the Report examines the Government's reform processes and the way in which the results of this exercise can be incorporated into the reform program. While this report has concentrated on an overall assessment of PFM in Bhutan covering the national and local levels the activity was designed to provide an explicit assessment of local government. As much of the PFM activities at the local level are part of the national system the PI ratings in the report cover the system as a whole. Nevertheless as local government devolution is an important government focus there is value in making specific comments on the local level PFM.

Annex 2 assesses PFM at the local government level and concludes that the local governments have been primarily functioning as de-concentrated arms of the central government, almost completely dependent on the central government for fund, and the central PFM framework accords adequate levels of control and oversight. The local governments have substantial discretion to determine and implement the local area development plans. There however, remain significant weaknesses in implementation capacity at the local government level, as evidenced by substantial levels of budgetary under spend and a very low reliance on local revenue generation. Decentralization plans to help build greater participation, ownership and transparency of local development programs will need to include a review of the adequacy and appropriateness of the present financial management staff resourcing and systems at the local level. External audit notes weak internal controls in local government and there has been no internal audit so PFM control is at risk.

## Opportunities for improvement

Indicators where there are significant opportunities for improvement for the various indicators are as follows:

### ***Credibility of the Budget:***

PI-1: Aggregate expenditure out-turns compared to original approved budget:

Local Government budget management capacity needs to be increased as devolution proceeds. A more realistic approach to budgeting for local governments would be assisted by a multi-year framework for budget development to allow improved phasing of expenditures and preparation for resource utilization in the regions.

PI-4: Stock and monitoring of expenditure payment arrears:

Survey unpaid overdue bills and consider the need for improved central monitoring of the decentralized system of arrears recording.

### ***Comprehensiveness and Transparency:***

PI-9: Oversight of aggregate fiscal risk from other public sector entities:

Improve the monitoring for the fiscal positions of autonomous government agencies, public enterprises and lower level governments.

### ***Policy-based Budgeting:***

PI-12: Multi-year perspective in fiscal planning, expenditure policy and budgeting:

Improve the consideration of recurrent cost implications of development projects in the implementation of medium term expenditure frameworks.

### ***Predictability and Control in Budget Execution:***

PI-14: Effectiveness of measures for taxpayer registration and tax assessment:

Improve the linkages of tax data bases with other government data bases, base audit programs for point of entry on a more sophisticated risk assessment process and consider the need for additional technical equipment in physical checking of entries. Require local governments to estimate local taxes for inclusion in local government budgets

PI-15: Effectiveness in collection of tax payments:

Improve the arrears information to support arrears reconciliations for some taxes.

PI-16: Predictability in the availability of funds for commitment of expenditures:

Provide cash flow forecasts through the year more comprehensively.

PI-18: Effectiveness of payroll controls:

Increase the degree of integration and auditing of payroll and personnel records.

PI-19: Competition, value for money and controls in procurement:

Monitor the degree of competition in procurement and review the performance of the impending system for handling complaints. A detailed separate complementary report using the OECD/DAC evaluation method is available at Annex 3 for the procurement function.

PI-21: Effectiveness of internal audit:

Expand Internal Audit coverage to the local governments and provide an annual report on the overall coverage of internal audit; and consider whether internal audit reports should be made available to MoF and RAA as a routine. Sharpen the role and responsibility of Internal Audit to include reporting regularly on the adequacy of the system of internal control and including a summary in the annual Ministry / Agency report

### ***Accounting Recording and Reporting:***

PI-24: Quality and timeliness of in-year budget reports:

Use the accounting systems to issue quarterly budget reports to improve budget execution and review.

PI-25: Quality and timeliness of annual financial statements:

Adopt IPSAS for annual financial statements reporting as a routine. The first step should be to adopt the IPSAS Cash reporting standard and provide material in supplementary notes to explain the RGoB's overall financial position.

### ***External Scrutiny and Audit:***

PI-27: Legislative scrutiny of the annual budget law:

Allow at least one month for the Legislature to review the Budget and improve the scrutiny procedures. The current scope of the legislature's scrutiny is limited review and ratification of the budget presented by the Finance Minister in the session so additional focus on review is needed. To assist the review processes a responsible Parliamentary Committee should review a tabled or preliminary budget proposal before the Finance Minister's presentation of the Final Budget to the Parliament.

**Donor Practices:**

PI-D2: Donor financial information provided for budgeting and reporting on project/ program aid:

Seek and monitor reports from donors on disbursement progress. Contributions from the Government of India are an important component of the budget and collaboration in reporting would improve information flows.

PI-D3: Proportion of aid that is managed by use of national procedures:

Provide a government procurement system that donors can rely on.

**Prospects for Reform Planning and Implementation**

The Government's extensive reform programs set out in Chapter 4 show a strong willingness to adopt the steps that will secure these improvements. A consultation workshop with the RGoB and development partners on the implications arising from this assessment is planned for early after finalization of this report. A strong foundation is already in place for PFM and the Tenth Five Year Plan includes a core principle for strengthening good governance. Various systems modifications in budgeting, accounting and auditing are already underway and these programs can be informed by the detailed results of the assessments against relevant indicators and the identified weaknesses. Opportunities to maximize donor coordination and to strengthen the capacities of RGoB staff will be a key element of effective reform programs. The precedent by which staff qualifying for the international certificates provided by the Chartered Institute of Purchasing and Supply (CIPS) through various training initiatives is supporting improved procurement capacities may be emulated in the accounting and auditing professions.

# 1. INTRODUCTION

## Background and objectives

While economic growth is considered important, the Royal Government of Bhutan (RGoB) is concerned with preserving its culture, environment, and identity. Creating an atmosphere where every individual can seek and achieve happiness has been chosen as a major goal and Bhutan is pursuing a holistic path of change framed by a unique and homegrown development vision: Gross National Happiness. This political philosophy balances spiritualistic and material advancement through sustainable socio-economic development; conservation and sustainable use of the environment; promotion of culture; and good governance.

Bhutan's Poverty Reduction Strategy Paper and its 10<sup>th</sup> Five Year Plan includes improving quality of life and income, especially for the poor; promoting private sector growth and employment; strengthening governance, particularly at the decentralized level; and promoting culture and environmental conservation. The World Bank's concessionary lending provides interest-free loans with current project portfolio of \$73 million focusing on education, health, private sector, and rural development. In addition, a Development Policy Financing for Institutional Strengthening was disbursed in June 2009 in the amount of \$20.2 million.

The country has seen significant political changes and transitions in recent years. The new democratic system comprises a National Council and a National Assembly, and elections for the National Council were held on December 31, 2007, and for the National Assembly on March 24, 2008. The ruling party, Druk Phuensum Tshogpa, currently holds 45 of the 47 seats in the National Assembly.

Strengthening of the PFM systems is an area of high priority for the RGoB, given that the government is the major controller of public resources. The Bank's 2006 Country Assistance Strategy (CAS) supports expanding access to better infrastructure and quality of social services, and connecting communities to markets; promoting private sector development and employment; and strengthening management of public resources, and monitoring and evaluation of development outcomes. The Bank will also provide support to the Bhutanese Government's efforts to promote decentralization, good governance, and environmental management.

The Country Financial Accountability Assessment (CFAA) completed in February 2002<sup>3</sup> identified action needed on key aspects of accountability—human resources, the legal framework for financial management and audit, and accounting, reporting and auditing systems and standards. Basic financial controls were found to be in place, yet there was evidence of untimely, unsupervised transactions and un-reconciled accounts. Efforts were being made to encourage fiscal transparency, but limited resources constrained progress. Despite these shortcomings, the CFAA found that public resources are generally spent effectively and judiciously, and there was a sound framework of ethical values and behavior. An assessment in 2006<sup>4</sup> identified steps that would bring the country into closer conformance with the international standards for accounting and auditing. The most important steps for accounting were to

<sup>3</sup> *Bhutan: Report on Observance of Standards and Codes (ROSC) - Accounting & Auditing April 2009*

<sup>4</sup> *Public Financial Management Performance Measurement Framework, June 2005, PEFA Secretariat, World Bank, Washington DC, USA - PEFA includes World Bank, IMF, European Commission, UK, France, Norway, Switzerland and SPA Strategic Partnership with Africa [www.pefa.org](http://www.pefa.org)*

report the Government's annual accounts using the formats of the Cash Basis International Public Sector Accounting Standard (IPSAS), improve the current budget and accounting computer systems to enable better monthly and annual reporting at entity and national level and to ensure that all public enterprises use International Financial Reporting Standards (IFRS) for their annual accounts, The most important steps for auditing were to implement the Audit Act using the most up to date auditing standards provided by the International Organization of Supreme Audit Institutions (INTOSAI), and to improve training through upgrading the Royal Institute of Management (RIM) qualifications and developing further in-service training in the core competencies needed.

A separate assessment of accounting and auditing practices in Bhutan<sup>5</sup> with respect to public and private enterprises conducted by the World Bank in April 2009 concluded that the accounting and auditing practices in Bhutan suffer from weaknesses in regulation, compliance and enforcement of standards and rules. The absence of a well-developed accounting profession and the poor quality of accounting education and training have resulted in a complete dependence on professional accountants from outside the country, mainly from India, to take care of the country's corporate financial reporting and auditing requirements. By default, the regulation of the audit profession is left to the Royal Audit Authority (RAA) which is clearly not equipped nor mandated for the task. Absence of properly defined standards on accounting and auditing means that preparation of financial statements and conduct of audits, even for listed companies, are not uniform and generally incomplete. There is an overall lack of awareness of the need to be in compliance with internationally accepted standards. The scope of audit for a statutory auditor, as defined in Schedule XIV of the Companies Act 2000, is very wide and onerous. In addition to certification of financial statements, the scope envisages that the auditors shall undertake propriety audit, performance audit, management audit and compliance audit. Consequently, the expectations from an auditor go well beyond the role traditionally associated with statutory auditors. The report highlights the need for setting up of a dedicated Accounting and Auditing Oversight Board (AASB) as an independent standard setting and audit regulating body on the lines of UK's Financial Reporting Council (FRC). The AASB should adopt the IFRS in full for all listed companies and public interest entities. For all other private entities, including medium and small enterprises, the AASB should adopt the IFRS for Private Entities. Many of the recommendations from the report are being initiated and undertaken by the Accounting & Auditing Standards Board (AASB) that is being established with technical assistance provided under the ADB-funded Financial Sector Development Project. The recommendations are onerous to be implemented in full and it would be likely that the process will be gradual.

The CPIA for 2008 found that the RGoB is also making a good progress in the area of PFM reforms but mentioned the need to manage the fiscal implications of a substantial pay increase for civil servants. It rated fiscal policy well noting the intention to minimize fiscal volatility by enhancing the BPFPS to include monitoring of budget execution on a quarterly basis. Quarterly reports on revised budget and revenue figures will be developed by the Department of National Budget, a major government department, and will be submitted internally to the Finance Minister and Finance Secretary, who will help identify suitable policy responses to emerging situations. This will be submitted to the Cabinet if required, and will be critical for improved policy responsiveness.

Since these reviews, the RGoB has made very good progress in taking forward the PFM reforms agenda and many of the steps taken in the areas of budget execution, monitoring, and cash management have produced visible positive results, providing a strong trajectory for further improvements in financial management. The passage of the Public Finance Act is a milestone in this direction, setting the institutional framework for financial management. The computerized Budgeting and Accounting System (BAS) in ministries / agencies, and the Central Budgeting and Accounting System (CBAS) in the

<sup>5</sup> This work was largely completed under the management of and by an officer of the MoF seconded to the World Bank's Washington Office for training

Department of Public Accounts and the Department of National Budget has brought about significant process improvements. Significant progress has also been made in public procurement through the establishment of the Public Procurement Policy Division under the MoF to manage a reform program, set policy, and monitor procurement outcomes. The Parliament has appointed a Public Accounts Committee (PAC) with a mandate to review and report on the Auditor General's AAR and other reports.

This document contains the report on a diagnostic study of PFM using a Performance Measurement Framework developed by the Public Expenditure and Financial Accountability (PEFA) development partners<sup>6</sup>. The assessment was a self-assessment conducted by the RGoB with the active support and cooperation of a World Bank and DANIDA team through introductory and assessment workshops and consultations on indicator assessments. The study makes an objective assessment of the system, lists its strengths and weaknesses and identifies areas in need of strengthening. This will provide a background for framing a continuing reform strategy. On an overall basis, and in context of RGoB's harmonization strategy, this will also help to provide additional information for increasing the reliance on country systems.

## Process and methodology

The Concept Note for the study was evolved through discussions between the World Bank and RGoB. The RGoB nominated a senior official in the MoF as the nodal officer for the study to advice on arrangements within the government, and Core Team of RGoB officers to conduct the assessments. The study commenced with a short one day workshop in July 2009 in Thimpu, attended by officials of MOF and the Royal Audit Authority (RAA) and the World Bank/DANIDA teams. There were presentations by Bank staff on the PEFA Framework to orient the RGoB Core Team on the methodologies involved and the practical use of assessment questionnaires by members of the core team to work through the information requirements and the indicator scoring methods. The indicators were allocated to individual members of the Core Team for subsequent evaluation.

The workshop identified the best sources of information and responsibility/time lines for collection of information and was followed by Bank members visiting Core Team members in their departments for preliminary assessment of some of the main indicators.

The Core Team members in the Department of National Budget, Department of Public Accounts, Department of Revenue & Customs, Internal Audit Division, Policy and Planning Division, Public Procurement Policy Division, Royal Audit Authority, and the Public Accounts Committee worked through questionnaires to collect the information needed to support appropriate ratings for the dimensions for each of the indicators. A second one day workshop was undertaken in October 2009 to work through the results of the assessment questionnaires and finalize the scorings subject to any further information collection identified during the workshop. The Core Team undertook further work to finalize ratings where more data was needed. The revised questionnaires were used to prepare a draft report for the RGoB to consider. Following revision based on RGoB comments, the draft version of the report was then peer reviewed and sent to the PEFA Secretariat and subsequently further amended in light of additional comments and suggestions made. After discussion with RGoB the final version of the report was produced.

## Scope

The scope of the PFM review comprised budget preparation and approval, cash and debt management, budget execution /expenditure management including procurement, internal controls, accounting and financial reporting, audit and legislative oversight. The assessment was primarily at the national level

covering the ten Ministries of the RGoB, but also included local rural and urban government levels. Public spending at these levels has been increasing and is largely funded by the Central Government but also by some local revenues. The review of local government PFM practices covered the second level of Government by examining the PFM performance of the two Thromdes (the City Corporations Thimphu and Phuntsholing) and the two largest Dzongkhags (Thimphu and Paro); and the third level of Government by examining the Gewogs of Thimphu and Paro (Shaba, Dotey, Chang, Geney).

The local governments operate within the same framework of rules and procedures as the central government agencies. However, systems and human resource capacity are more limited at local level and information on such limitations will be important considerations in the implementation of the Local Government Act 2009. For these reasons, Annex 2 of this report contains a detailed note on the assessment<sup>7</sup> and includes explanations of the administrative and PFM arrangements.

Semi or fully autonomous agencies that implement central government policy are mainly financed by the central government funding measures and are also covered. For institutions functioning outside this framework, including partly or fully owned public sector undertakings, the study only assessed the RGoB's system of monitoring and managing fiscal risks that may arise from budget transfers from the Central Government.

As a parallel exercise, the World Bank has undertaken a separate detailed assessment of the procurement system in Bhutan using the OECD-DAC methodology for Assessment of National Procurement Systems. The key results of the assessment are summarized in Annex 3 covering:

- legislative and regulatory framework
- institutional framework and management capacity
- procurement operations and market practices
- Integrity and transparency of the procurement system.

The table below shows that of the FY 2009-10 budget expenditure estimates of the bodies mentioned about 25% of the total budget expenditures will be implemented by local governments.

(In Nu. million)

	Budget Estimate	% of Total Expenditure
Total Current Expenditure	13,594	49.58%
Total Capital Expenditure	13,827	50.42%
<b>Total Expenditure</b>	<b>27,421</b>	<b>100.00%</b>
of which:		
Dzongkhags Current Expenditure	3,758	13.70%
Dzongkhags Capital Expenditure	2,242	8.18%
Gewogs Current Expenditure	135	0.49%
Gewogs Capital Expenditure	791	2.88%
Total Dzongkhags and Gewogs	<b>6,928</b>	<b>25.27%</b>
Subsidies to State Enterprises	649	2.37%

Source Budget Papers

Activities implemented by gewogs include construction of farm roads, gewog offices, irrigation channels, water supply. Activities which are larger and/or cover more than one gewog or which are beyond the

<sup>7</sup> This work was largely completed under the management of and by an officer of the MoF seconded to the World Bank's Washington Office for training

capacity of a gewog are implemented by the dzongkhags. Besides what the local authorities implement, there are many other activities in the gewogs and dzongkhags which are implemented by the central organizations. The amount shown above does not include such activities implemented by dzongkhags and central agencies. Including all such activities, the actual investment in the local areas is considerably higher. The National Budget Report for FY 10 notes that most of the gewogs and dzongkhags do not have adequate numbers of technical manpower to carry out many activities, and as a result most of the activities spill over to the next financial year.

The major subsidy recipients are:

- Druk Air for its interest on loans for the purchase of aircraft, (Nu.132.678 million),
- Bhutan Broadcasting Service Corporation (Nu. 90 million),
- Rural Life Insurance scheme (Nu.34.268 million) and rural house insurance scheme (Nu.7.152 million),
- Thimphu Thomdey (Nu. 30.100 million) and
- Bhutan Postal Corporation for the City Bus Service and for rural mail delivery. (Nu. 12.589 million).

## 2. COUNTRY BACKGROUND INFORMATION

### 2.1. Description of Economic Situation

The Kingdom of Bhutan is a small landlocked country located in the eastern Himalayas, bordered by India and China. Bhutan is home to a population of about 683,407 according to the National Statistics Bureau report 2009, spread over an area of 38,394 sq. km., with about 70% of the land area under forest cover. Much of the population lives in the central highlands, and almost two-thirds are classified as rural inhabitants. The terrain is mostly hilly, with alpine peaks in the north, and some sub-tropical plains in the south. Transport is difficult. Per capita gross national income (GNI), one of the highest in South Asia, has consistently risen from \$730 in 2000 to \$1,900 in 2008.

The parliamentary system is very new to Bhutan as part of a transition to a democratic constitutional monarchy and has substantial roles in the reform processes. The Parliament of Bhutan is the highest legislative body in the country and was established in 2008 under the Constitution. It consists of His Majesty the Druk Gyalpo, the National Council and the National Assembly. As well as its legislative functions the Parliament has the functions of reviewing the policies, plans and programs of the Government; the performance of the Government: the implementation of resolutions and laws passed by the Parliament; and issues of national importance. The Public Accounts Committee is one of fourteen standing committees of the National Assembly. An important function of the committees is to scrutinize government activity including legislation, the conduct of public administration and policy issues. Committees may oversee the expenditure of public money and they may call the Government or the public service to account for their actions and ask them to explain or justify administrative decisions.

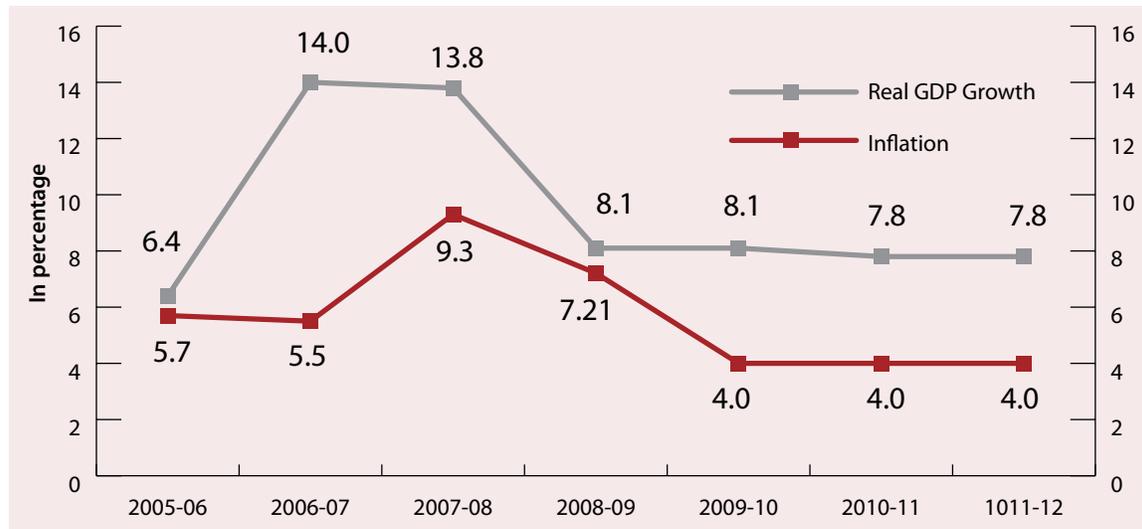
The Courts in Bhutan includes the Supreme Court, the High Court, the Dzongkhag Courts, the Dungkhaig Courts, and any other Courts that may be established from time to time by His Majesty the Druk Gyalpo on the recommendation of the National Judicial Commission. Bhutan scores well on the WBI Governance Indicators for "rule of law" (61st percentile) and "control of corruption" (75th percentile), and the legal framework is generally sound. The independence of the Drangpons (Justices) of the Supreme Court and the High Court shall be guaranteed, provided that a Drangpon may be censured or suspended by a command of the Druk Gyalpo on the recommendation of the National Judicial Commission for proven misbehavior, which, in the opinion of the Commission, does not deserve impeachment.

Parliament may, by law, establish impartial and independent Administrative Tribunals as well as Alternative Dispute Resolution centres. The Druk Gyalpo shall, by warrant under His hand and seal, appoint an eminent jurist as the Attorney General on the recommendation of the Prime Minister. The Attorney General as the chief legal officer shall be the legal advisor to and legal representative of the Government. The Royal Government of Bhutan has 10 ministries which work in bringing the goal of Gross National Happiness closer to reality. The Royal Audit Authority is an independent authority headed by the Auditor General to audit and report on the economy, efficiency, and effectiveness in the use of public resources. There is an Anti-Corruption Commission, as an independent authority to function in accordance with the Anti-Corruption Act and take necessary steps to prevent and combat corruption.

PFM performance impacts the achievement of development outcomes through its effects on aggregate fiscal discipline, strategic allocation of resources and service delivery. Therefore PFM reforms should be considered in the context of current information on the fiscal position and other key economic and social indicators relating to the economic situation.

Figure 4.1 below taken from the RGoB Budget Report FY 10 predicts moderation in growth and inflation and the PFM system needs to support these intentions

FIGURE 4.1: REAL GDP GROWTH AND INFLATION



**Bhutan is managing its reserves and debt position.** In the external sector, the overall balance of payments is projected to remain positive with significant flow of loans and grants despite the negative current account balance. Therefore, the gross international reserves will continue to be built up and sustain around 7 months of imports of total goods and services in the next three fiscal years. The projected debt stock is 18% higher as compared to the previous FY due to the expected disbursement of the ADB loan for Dagachhu Hydropower project. Further, with the implementation of the mega-hydropower projects, external debt stock is projected to grow at a faster rate than the GDP. Nevertheless, of the total external debt stock, 61% comprises of bilateral loans for hydropower projects which should be serviced from future revenue generation. The non-hydropower loans account for about 39% of the estimated GDP and are borrowed from International Financial Institutions at highly concessionary terms. External debt outstanding as percentage of estimated GDP for the FYs 2010-11 and 2011-12 is projected at 58% and 63% respectively. The total debt service ratio is projected to gradually come down from 8.0 % in FY 2010-11 to around 6.8 % in the medium term.

**Bhutan's management of fiscal deficits has come under pressure.** One of the main aspects of the Government's fiscal policy is to maintain the fiscal deficit to a sustainable level of the GDP, and hence, the fiscal deficit is projected at 3% in the FYs 2010-11 and 2011-12. However, for FY 2009-10, the fiscal deficit is currently projected at about 7%, well above the implicit government policy of a 5% limit. The World Bank's October 2009 Economic Update found that Bhutan's economy was largely isolated from the global economic crisis, and is showing signs of recovering from limited negative impacts on tourism and the steel industry. Growth is projected to slowdown from 9% during the 9th Five-Year Plan (FYP) (2002-2007) to below 8% during the 10th FYP (2008-2013). However, the government's plans for hydropower development are expected to yield dividends in growth and revenue beyond the 10th FYP. The country has a significant feasible hydropower potential of around 23,760 MW, of which just a little over 5% only has been tapped so far. The IMF 2009 Article IV Consultation noted that vigilance in fiscal policy and spending prioritization are critical for ensuring macro-economic stability.<sup>8</sup>

**Bhutan's goals include reducing poverty.** Bhutan is characterized by good progress in human development, particularly in urban areas, and the increasing availability and use of public services throughout the country. However, these changes have been slower to reach the more remote areas due to the rugged terrain and limited trained human resources. The expansion of infrastructure is a requirement for broader economic and social transformation. Despite rapid expansion of the road network, more than 50% of the population lives half a day's walk from the nearest motor road. The 10FYP (2008-2013) is currently under implementation, and constitutes the basis for the country's poverty reduction strategy. The Plan's overall objective is to reduce poverty from 23.2% in 2007 to 15% by 2012-13 and lack of job opportunities for urban youth can lead to pressure on the public sector to absorb greater numbers of staff than is necessary placing pressure on the recurrent budgets. The overall status of significant millennium development goals is shown in the table below.

### Summary Status of Key Millennium Development Goals

MDG Statement	Recent Performance
Halve, between 1990 and 2015, the proportion of the poor.	<ul style="list-style-type: none"> <li>• Employment to population ratios have not significantly improved – for 15+ 54% in 1990 and 58% in 2008; for 15-24 43% in 1990 and 43% in 2008.</li> <li>• The poverty headcount at \$1.25 a day was 26% in 2005</li> <li>• GNI per capita has increased from 560 current USD in 1990 to 1,900 in 2008</li> </ul>
Achieve universal primary education by 2015.	<ul style="list-style-type: none"> <li>• Primary completion rate has increased from 29% in 1995 to 83% in 2008</li> </ul>
Eliminate gender gaps in education by 2005.	<ul style="list-style-type: none"> <li>• Female to male enrollment ratios increased from 76 in 1990 to 100 in 2008 for primary enrollment; from 82 in 2000 to 93 in 2008 for secondary enrolment; and from 2 in 1990 to 9 in 2008 for tertiary enrollments.</li> </ul>
Reduce infant and child mortality rates by two-thirds between 1990 and 2015.	<ul style="list-style-type: none"> <li>• CMR has fallen from 148 per 1,000 in 1990 to 84 in 2008. IMR has fallen from 91 in 1990 to 56 in 2008.</li> </ul>
Access to reproductive health services for all by 2015.	<ul style="list-style-type: none"> <li>• Births attended by a skilled health staff have gone up from 15% in 1995 to 56% in 2005. Pregnant women receiving prenatal care has increased from 51% in 2000 to 88% in 2008</li> <li>• Adolescent fertility rate has declined from 75 births per 1,000 women aged 15-19 in 1995 to 38% in 2008</li> </ul>
Reduce by half the proportion of people without safe drinking water between 1990 and 2015.	<ul style="list-style-type: none"> <li>• Population without access to safe water has remained at 19% between 2000 and 2008.</li> </ul>

Source: World Bank report

## 2.2. Description of Budgetary Outcomes

Budgetary outcome information is shown in the two tables below covering budget actuals and budget allocations to sectors. In the FY 2007-08, there was a fiscal surplus of Nu. 404 million, with total realized resources being Nu. 18,317 million against a reported expenditure of Nu.17,913 million. However, the year ended with a resource gap of Nu. 916 million due to the loan repayment of Nu.2,077 million. During

the FY, the domestic revenue not only covered the recurrent expenditure but was also able to finance a small portion (5.5%) of the capital expenditure.

#### Government Budget Actuals (Nu million)

	2005-06	2006-07	2007-08
Total revenue	13,595	16,673	18,317
-Own revenue	7,046	10,224	12,346
-Grants	6,425	6,393	5,935
<b>Total expenditure</b>	<b>13,531</b>	<b>15,292</b>	<b>17,913</b>
Fiscal Balance (inc. grants)	-318	1,381	404
Fiscal Balance (% of GDP)	0.2	3.0	0.7

#### Actual budgetary allocations by sectors as a percentage of total budget (Nu million)

	2007-08	2008-09	2009-10
Health	12	8	7.6
Education	18	14	17.5
Agriculture	12	10	11.2
Mining and Manufacturing	4	1	1.8
Roads	7	10	9.0
Housing & Community Amenities	5	5	4.3
Communications	4	2	3.3
Energy	5	5	2.5
Cultural Services	3	2	3.5
General Public Services	21	24	23.8
National Debt Services	8	20	15.6

Source: Budget Papers<sup>9</sup>

The Bhutan Economic Brief for October 2009 notes that the RGoB seeks to maintain sound macroeconomic performance over the medium term, and targets limiting the overall deficit (including grants) to less than 5% of GDP. The fiscal deficit is expected to average about 4.6% during the 10FYP. However, in 2009/10, the projected fiscal deficit is about 6.9% of GDP, reflecting: (i) an 18% increase in current expenditure over 2008/09 revised estimates, largely due to increased civil servant salaries, balanced somewhat by lower capital spending, and (ii) a projected decrease in grants (particularly those from India). Grants are projected to pick up again from 2010/11, and, combined with slow growth in projected expenditures, are expected to contribute to fiscal deficits lower than 5% in the remaining years of the 10FYP.

Electricity and budgetary grants are the main projected sources of domestic revenue during the 10FYP, and attainment of fiscal goals depends critically on timely availability of these revenues. Budgetary grants account for almost 40% of Bhutan's aggregate revenues during the 10FYP. About 80% of these budgetary grants during the 10FYP are expected to be tied to specific projects, while the remainder is classified as programmatic support. India alone accounts for almost 70% of budgetary grants during the 10FYP. At the same time, the share of electricity (taxes plus dividends) in aggregate revenue is estimated to rise from about a quarter in 2008/09 to over a third by the end of the 10FYP.

Revenues from personal income tax and business income tax are projected to show modest increases, growing at between 6 and 10% annually during the 10FYP. As a share of aggregate revenues, however, non-electricity domestic revenues decline in importance from about a third in 2008/09 to about a quarter by 2012/13.

### 2.3. Description of the Legal and Institutional Framework for PFM

Bhutan's political system has evolved from an absolute monarchy into a constitutional monarchy, following a decade of planning and consultations. After 34 years on the throne, the Fourth King, Jigme Singye Wangchuck, stepped down on December 9, 2006, in favor of his son, Jigme Khesar Namgyel Wangchuck. The new democratic system comprises of a National Council and a National Assembly among others. The Constitution was adopted in 2008 and a new government that is elected directly by the people installed on the basis of the constitutional provisions. The territory of Bhutan comprises twenty dzongkhags (first tier local governments) headed by dzongdas with each dzongkhag consisting of gewogs (second-tier local governments serving groups of communities) and Thromdes (city corporations).

Regarding public financial management issues the 2008 Constitution of the Kingdom of Bhutan includes articles on passage of money bills and financial bills, finance, trade and commerce, and the Royal Audit Authority. The Public Finance Act of Bhutan passed on 20 June, 2007 by the National Assembly, regulates financial management for the effective and efficient use of public resources, accountability and fiscal policy. Laws covering Income Tax, Sales Tax, and Customs and Excise govern revenue collection. The Local Government Act 2009 provides that local governments shall not be law-making bodies and thus shall not have legislative functions while they may make rules and regulations consistent with law made by the national parliament.

A Consolidated Fund is used for all public monies not allocated to specific purposes by law. The Government is required to exercise proper management of the monetary system and public finance, ensure that the servicing of public debt will not place an undue burden on future generations, and finance recurrent expenditures from internal resources of the country. It does this through a centralized system operated by the MoF which has various computerized budget and accounting systems. Local Government expenditures are also managed through the MoF systems. The Royal Monetary Authority is the Central Bank. The Government's banking services for payment and revenue collection are managed by the Bank of Bhutan, a 100% Government owned public corporation.

The 2002 Country Financial Accountability Assessment found that Bhutan's financial controls are simple but effective. Government receipts and payments are carefully segregated, with payments made from one set of bank accounts and receipts paid into another. Expenditures are limited by the amounts provided for in the annual budget and by letters of credit issued by the Ministry of Finance. Letters of credit are instructions to banks to honor checks drawn on specified accounts up to specified limits. Unless the budget is amended, the ministry cannot issue letters of credit that exceed the sums provided for in the budget. This system enables individual units to fund their expenditures, with their parent ministries acting as accounting units.

The Financial Rules and Regulations (FRR) 2001 cover the tools of financial management:

- a) Cash flow management;
- b) Procurement management;
- c) Asset management;
- d) Debt or liabilities management;
- e) Budgeting.

The FRR 2001 consists of a main document, the Financial Management Manual and six technical documents, the Financial Accounting Manual, the Budget Manual, the Aid & Debt Management Manual, the Property Management Manual, the Procurement Manual and the Revenue Manual. Further guidance

is contained in the Manual on Standard Operating Procedures for Public Debt Mgt, 2007 and the Revised Procurement Rules and Regulations 2009.

The PFA 2007 provides financial management, reporting and audit requirements. The budget is managed by the MoF through its departments. A Budget Policy and Fiscal Framework Statement is compiled by the Policy and Planning Division of the MoF to match overall expenditure with the availability of resources in the medium term on a rolling basis. The key aggregates of potential deficit, external and internal debt, as well as instruments of financing are also projected. These projections are part of the Finance Minister's bi-annual Budget Report to the Parliament (which is available on the Ministry of Finance's website). Major taxes levied in the country are Corporate Income Tax, Business Income Tax, and Personal Income Tax under Direct Taxes; Sales Tax, Import Duty and Excise Duty under Indirect Taxes, and managed by the Revenue and Customs Department of the MoF. In addition there are substantial receipts from State owned Enterprises and Grants from international donors.

The Budget Report provides a revenue picture and a budget ceiling for spending agencies; revises the budget ceiling in the current fiscal year; and, amends the budget ceiling estimates for the next year. It also clarifies the major differences in expenditure from the time of budgeting at the beginning of the previous fiscal year to its revision in the middle of the current year and the final actual outcomes for both expenditure and revenue accounts. After the budget is approved by the Parliament, the Department of National Budget notifies all the budgetary agencies of their approved budget. The recurrent expenditure budgets are released to gewogs on a half yearly basis and for other budgetary agencies on a quarterly basis. The releases for capital expenditures are made on agency request. Drawing and Disbursing Officers (DDOs) ensure that all claims/bills are cleared within one month of their receipt.

A cash basis of double entry accounting manages the cash balances of the Government bank accounts, which are consolidated regularly. The balances in the subsidiary principal accounts the Budget Fund Account, Government Revenue Account, Non-Revenue Receipts and Deposits Account are consolidated daily into the Government Consolidated Account. The daily cash position of the budgetary operations of the Government is ascertained from this account. The cash balances with the various budgetary agencies are reported on a monthly basis through the submission of the monthly accounts and at the end of the fiscal year this consolidated figure is reported as the closing cash balance of the Government in the consolidated receipts and payments statement of the Government.

The Annual Financial Statements (AFS) of the Government has information on revenues, expenditures, grants and loans. It also includes statement of the Government Equity Portfolio in corporations and financial institutions, a statement of Government Guarantees to various organizations, and a statement of government outstanding debt. The AFS is audited by the RAA which also tables an annual audit report on its other audit work including its work in monitoring the system of internal controls. A high level of personal accountability for PFM is achieved through the activities of the RAA in holding individuals accountable for their PFM responsibilities and imposing personal sanctions until rectification is complete.

## 3. ASSESSMENT OF PFM SYSTEMS, PROCESSES AND INSTITUTIONS

### 3.1. Budget Credibility

#### PI-1 Aggregate expenditure out-turn compared to original approved budget

Overall rating category 'B'

**Dimensions to be assessed:** the difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges and externally financed project expenditure)

The ability to implement the budgeted expenditure is a crucial factor in supporting the government's ability to deliver the public services for the year as expressed in policy statements, output commitments and work plans. The indicator reflects this by measuring the actual total expenditure compared to the **originally** budgeted total expenditure (as defined in government budget documentation and fiscal reports) but excludes two expenditure categories over which the government will have less direct control - (a) debt service payments, and (b) donor funded project expenditure, the management and reporting of which are typically under the donor agencies' control to a high degree.

Scoring of this indicator is as below.

Score	Minimum Requirements (Scoring Method M1)
A	In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure.
B	In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 10 % of budgeted expenditure.
C	In no more than one of the last three years has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure.
D	In two or all of the last three years did the actual expenditure deviate from budgeted expenditure by an amount equivalent to more than 15% of budgeted expenditure.

Details of the budget estimates and actual expenditure figures for national aggregate expenditures excluding debt service payments, and donor funded project expenditure are provided in the table below, showing moderate under-runs. It is worth noting that for each year there was under-expenditure rather than over-expenditure so budget control is tight at the national level. This may also be affected by cautious budgeting and the inclusion of items in year which may have only a part year impact or no chance of being implemented.

**Aggregate national expenditure – exc. debt service and donor funded (Nu in million):**

Particulars	2005-06	2006-07	2007-08
Budgeted	9,654	11,502	13,304
Actual	8,980	10,650	12,206
Difference between budget and actual	6.98%	7.41%	8.26%

Source: Budget Papers

Brief Explanation	Score (M1)
The A rating is not achieved as all of the 3 years deviate by more than 5% but none exceed 10% so a B rating is appropriate. It is worth noting that for each year there was under-expenditure rather than over-expenditure so budget control is tight.	B
<b>Overall Rating for the National Government</b>	<b>B</b>

**PI-2 Composition of expenditure out-turn compared to original approved budget**

Overall rating category 'B'

Where the composition of expenditure varies considerably from the original budget figures, the budget will not be a useful statement of policy intent. Measurement against this indicator requires an assessment of expenditure out-turns against the original budget at a sub-aggregate level. This is an important indicator to assess the extent of budget realism for different budget heads (including development and non-development). This indicator measures the extent to which reallocations between budget lines have contributed to variances in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. To make that assessment, the variance in the expenditure composition is calculated and compared to the overall deviation in primary expenditure for each of the last three years. The variance has been calculated as the weighted average deviation between actual and originally budgeted expenditure for the budget lines calculated, taken as a percentage of the budgeted expenditure, using the absolute value of the deviation.

Dimensions to be assessed: extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years

Functional classifications are represented by the functional departments' expenditures. The expenditures and the calculated composition variances are shown below.

**Expenditures by functional classification (Nu in million)**

Functional classification	2005-06		2006-07		2007-08	
	Budget	Actual	Budget	Actual	Budget	Actual
Autonomous Bodies	682	740	1,082	1,080	1,323	1,653
Ministries of Home and Cultural Affairs	656	635	735	737	1,035	867
Ministry of Finance	929	805	1,511	1,009	2,480	1,384
Ministry of Foreign Affairs	239	224	250	236	242	281
Ministry of Agriculture	824	789	944	871	1,003	949
Ministry of Economic Affairs	492	419	460	290	545	255
Ministry of Works and Human Settlement	1,289	1,291	1,503	1,338	1,646	1,881
Ministry of Information and Communication	266	206	214	213	210	171

Functional classification	2005-06		2006-07		2007-08	
	Budget	Actual	Budget	Actual	Budget	Actual
Ministry of Health	725	710	713	762	744	661
Ministry of Education	258	203	276	243	236	224
Ministry of Labour and Human Resources	143	120	196	178	162	163
Dzongkhags and Gewogs	3151	2836	3619	3691	3676	3717

Source: Budget Papers

### Variance in expenditure composition (%)

	2005-06	2006-07	2007-08	3 years
	% Variance			Average
Autonomous Bodies	8.46	0.20	24.87	11.18
Ministries of Home and Cultural Affairs	3.15	0.37	16.20	6.57
Ministry of Finance	13.30	33.26	44.22	30.26
Ministry of Foreign Affairs	6.20	5.36	15.89	9.15
Ministry of Agriculture	4.26	7.72	5.41	5.79
Ministry of Economic Affairs	14.70	36.83	53.22	34.92
Ministry of Works and Human Settlement	0.15	10.98	14.28	8.47
Ministry of Information and Communication	22.49	0.21	18.81	13.83
Ministry of Health	1.99	6.78	11.13	6.63
Ministry of Education	21.49	12.00	5.25	12.92
Ministry of Labour and Human Resources	15.93	8.91	0.57	8.47
Dzongkhags and Gewogs	9.99	2.01	1.12	4.37
<b>Composition Variance</b>	<b>8.2</b>	<b>9.6</b>	<b>17.58</b>	<b>12.86</b>

MoF advised that some of this variation was due to use of contingency and emergency funds, particularly the large variation in MoF expenditures.

Scoring of this indicator is as below.

Score	Minimum Requirements
A	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure (as defined in P1) by no more than 5 percentage points in any of the last three years.
B	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in no more than one of the last three years.
C	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last three years.
D	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in at least two out of the last three years.

Year	For PI-1 total expenditure deviation	Total expenditure variance	For PI-2 variance in excess of total deviation
2005-06	7.0%	8.2%	1.2%
2006-07	7.4%	9.6%	2.2%
2007-08	8.3%	18.0%	9.7%
<b>Brief Explanation</b>			<b>Score (M1)</b>
Excess variation was more than 5% in one year.			B
<b>Overall Rating for the National Government</b>			<b>B</b>

Data was not readily available for assessment of the local Government performance for this indicator.

### PI-3 Aggregate revenue out-turn compared to original approved budget

Overall rating category 'A'

Accurate forecasting of domestic revenue is a critical factor in determining budget performance, since budgeted expenditure allocations are based upon that forecast. A comparison of budgeted and actual revenue provides an overall indication of the quality of revenue forecasting and achievement.

Dimensions to be assessed: actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget.

The main sources used for the assessment of this dimension are National Budget Reports and National Revenue Reports. The information on the actual collection reported in the National Revenue Report is from the Revenue Accounting System of the Department of Revenue and Customs (DRC). The figures in the system are reconciled with the Bank of Bhutan. Information on budgets are published in the National Budget Report and sourced from a revenue projection file which is a part of the Medium Term Fiscal Framework (MTFF) exercises.

Scoring of this indicator is as below.

Score	Minimum requirements
A	Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years.
B	Actual domestic revenue collection was below 94% of budgeted domestic revenue estimates in no more than one of the last three years.
C	Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in no more than one of the last three years.
D	Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in no two or all of the last three years.

### Revenue Collection

Year	2006-07	2007-08	2008-09
Budget estimates	9,619	11,608	13,848
Actual	10,082	12,346	14,049
Revenue as a percentage of budget estimates	104.8%	106.4%	101.4%

Source: National Revenue Reports and National Budget Reports

Brief Explanation	Score (M1)
Actual domestic revenue collection was not below budget in any year.	A
<b>Overall Rating</b>	<b>A</b>

For local Government local taxes are imposed on houses, cattle and land. Such taxes are collected based on the records of number of houses, cattle and land as registered in each gewog. Therefore, estimation of the revenue is straightforward; i.e. existing rates multiply by number of cattle, houses and acreage and type of land as recorded in the gewog. However, the amounts are very small and estimates are typically not included in the annual budget. These retained taxes are used by the Gewogs to meet expenditures on maintenance or establishment on an ad hoc basis.

#### PI-4 Stock and monitoring of expenditure payment arrears

Overall rating category is 'N/A' because of the lack of formal systems to record overdue bills and calculate stock of arrears but there is strong confidence in the MoF that the true rating would be 'A' on account of the adequacy of monitoring of bills due.

Expenditure payment arrears are the expenditure obligations that have been incurred by government for which payment to the employee, supplier, contractor or loan creditor is overdue. It constitutes a form of non-transparent financing. A high level of arrears can indicate a number of different problems such as inadequate commitment controls, cash rationing, inadequate budgeting for contracts, under-budgeting of specific items and lack of information.

Dimensions to be assessed: (i) the stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock (ii) Availability of data for monitoring of the stock of expenditure payment arrears.

There is no system of recording commitments or obligations under the present system of accounting which would formally track such arrears. The Clause 4.1.6.3 of the FAM of the FRR2001 states that "Action on settlement or return of any claims received in an office shall be completed within 30 days of receipt of the claim". The above has been further reinforced by the MoF vide Circular No. MOF/GEN/2000/9532 dated February 3, 2000 whereby all Drawing and Disbursing Officers (DDOs) as well as National Finance Services (NFS) Personnel are directed to ensure that all claims/bills are cleared within one month of their receipt. Further, there are no payment arrears with regard to employees and debt servicing as payment for these are made well within the due dates. The FAM 4.2.2.1 of the FRR2001 requires that the employee monthly pay bills have to be kept ready at least 3 days before the closing of the month. Also there are rules in place whereby a party whose payments have been in arrears can claim penalty interest from the Government agency that default the payment. Therefore, in compliance to the provisions of FRR2001 and the standing circulars cited above, it can be fair to conclude that financial regulations explicitly rule out arrears and even if there are some exceptional incidences of payment arrears it will be very insignificant and therefore below 2% of the actual total expenditure.

Scoring of this indicator is as below.

Score	Minimum Requirements
A	(i) The stock of arrears is low (i.e. is below 2% of total expenditure). (ii) Reliable and complete data on the stock of arrears are generated through routine procedures at least at the end of each fiscal year (and includes an age profile).

Score	Minimum Requirements
B	<ul style="list-style-type: none"> <li>(i) The stock of arrears constitutes 2-10% of total expenditure; and there is evidence that it has been reduced significantly (i.e. more than 25%) in the last two years.</li> <li>(ii) Data on the stock of arrears are generated annually, but may not be complete for a few identified expenditure categories or specified budget institutions.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) The stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has been reduced significantly in the last two years.</li> <li>(ii) Data on the stock of arrears have been generated by at least one comprehensive ad hoc exercise within the last two years.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) The stock of arrears exceeds 10% of total expenditure.</li> <li>(ii) There is no reliable data on the stock of arrears from the last two years.</li> </ul>

Brief Explanation	Score (M1)
The figure for the quantum of stock of arrears is not available.	NA
There is no reliable data for stock of arrears as it is not generated and there has been no survey	D
Overall Rating	NA

This indicator assessment is somewhat unsatisfactory as there are procedural indications that arrears are very low but there is no formal data. A survey of unpaid bills should be conducted to clarify the situation and if overdue arrears are greater than 2% there should consideration of developing a monitoring system.

## 3.2. Comprehensiveness and Transparency

### PI-5 Classification of the budget

Overall rating category 'B'

A robust classification system allows the tracking of spending on the following dimensions: administrative unit, economic, functional and program. Where standard international classification practices are applied, governments can report expenditure in GFS format and track poverty-reducing and other selected groups of expenditure. Under the UN-supported Classification of Functions of Government (COFOG), which is the functional (or socioeconomic objectives) classification applied in GFS, there are ten main functions at the highest level and 69 functions at the second (sub-functional) level.

**Dimensions to be assessed:** The classification system used for formulation, execution and reporting of the government's budget.

The Budget Manual explains that structure of the RGoB budget covering the budget for the national and local Governments is in accordance with the Program Budget Model, is result oriented by nature, and includes the concept of performance budgeting according to which the allocation of resources and spending thereof shall be linked to the expected results and actual outcomes. Emphasis can move from the categories of spending to achieving specific measurable outcomes.

Receipts are classified into taxes, fees, grants, and other revenues consistent with the GFS Revenue Classification.

Expenditures are classified into current expenditure, capital expenditure, lending and repayment and these categories are further classified into:

- a functional classification of the purposes of the outlays
- an economic classification of the kinds of transactions, and
- An object (line-item administrative) classification that identifies the types of goods and services acquired or transfers made.

The budget functional classification captures sector-wise budget allocation and is consistent with the top level Classification of Functions of Government (COFOG) as follows:

COFOG Top Level Classification	RGoB Classification Elements
01 - General public services	General public services
02 - Defense	
03 - Public order and safety	Law and order services
04 - Economic affairs	Economic and Public Services
05 - Environmental protection	
06 - Housing and community amenities	Housing and community amenities
07 - Health	Health
08 - Recreation, culture and religion	Religion and cultural services
09 - Education	Education
10 - Social protection	

The COFOG sub-functional classification is not followed. An example<sup>10</sup> is:

- 709 Education
- 7091 Pre-primary and primary education
- 7092 Secondary education
- 7093 Postsecondary non tertiary education
- 7094 Tertiary education
- 7095 Education not definable by level
- 7096 Subsidiary services to education
- 7097 R&D Education
- 7098 Education n.e.c.

The RGoB budget economic classification can be mapped using the Government Financial Statistics (GFS) classification assistant mapping system to GFS categories of expenditure. Budget formulation and budget execution are based on an administrative classification of national and local Government ministries and entities.

Although the Government of Bhutan is following the GFS format, there is no one-to-one match. The move towards the full GFS system is still evolving as per the country's need and capacity.

<sup>10</sup> Government Finance Statistics Manual 2001 page 83

Scoring of this indicator is as below.

Score	Minimum Requirements (Scoring Method M1)
A	The budget formulation and execution is based on administrative, economic and sub-functional classification, using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards. (Program classification may substitute for sub-functional classification, if it is applied with a level of detail at least corresponding to sub-functional.)
B	The budget formulation and execution is based on administrative, economic and functional classification (using at least the 10 main COFOG functions), using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards.
C	The budget formulation and execution is based on administrative and economic classification using GFS standards or a standard that can produce consistent documentation according to those standards.
D	The budget formulation and execution is based on a different classification (e.g. not GFS compatible or with administrative break-down only).

For an 'A' rating the sub-functional COFOG and GFS classifications are required. The Bhutan budget system does not yet reach this level of consistency but does map onto the functional and GFS economic and administrative classifications.

Brief Explanation	Score (M1)
The uniform countrywide system of classification of accounts is consistent with the COFOG/GFS structures at the functional level.	B
Overall Rating	B

For lower level Governments the same system is used. Dzongkhags prepare and submit sector budget proposals in consultation with the respective sectors at the centre and budgets for activities at gewog level are based on gewog plans. The budget identifies the outlays planned for implementation by the dzongkhags and gewogs. The distribution in the 2008-09 budgets between dzongkhags and gewogs is 83 % and 17 % respectively.

#### PI-6 Comprehensiveness of information included in budget documentation

Overall rating category 'A'

Annual budget documentation submitted to the legislature should allow a complete picture of government fiscal forecasts, budget proposals and out-turn of previous years.

**Dimensions to be assessed:** Number of the 9 information benchmarks listed below that are included in the budget documentation most recently issued by the central government.

Of the nine elements required in the budget documentation, only the last, new policy explanations, is not included in full in the budget report and some aspects of financial assets are not included (item 5):

1. As required by Article 46 of the PFA, 2007, the National Budget Report includes the Budget Policy and Fiscal Framework statement covering revenue, grants/aids, loans and expenditure. The estimation of both revenue and expenditure is made after considering economic growth, inflation, exchange rate, debt, etc.

2. The fiscal deficit defined in the National Budget Report is presented in GFS format.
3. The annual budget report summary exhibits the composition of the deficit financing which includes external borrowings, repayments and resource gap met through domestic borrowings.
4. The annual National Budget Report provides detailed information on the debt stock and debt flows.
5. There is a separate chapter on performance of State owned enterprises in the National Budget Report, but it does not capture financial assets of the whole government.
6. The National Budget Report presents not only the budget of the year 1+2 forward years but also presents the expenditures of the past year in the same format.
7. The revised budget estimates as against the original budget estimates are also presented in the same format as the National Budget Report.
8. The National Budget Report presents summarized budget data for both revenue and expenditure according to the main heads of the classifications, including data for the current and previous year.
9. The Speech of the Finance Minister highlights the economic performance of the past year and the future outlooks; it does not highlight the implications of the new policy initiatives.

Scoring of this indicator is as below.

Score	Minimum Requirements (Scoring Method M1)
A	(i) recent budget documentation fulfils 7-9 of the 9 information benchmarks
B	(i) recent budget documentation fulfils 5-6 of the 9 information benchmarks
C	(i) recent budget documentation fulfils 3-4 of the 9 information benchmarks
D	(i) recent budget documentation fulfils 2 or less of the 9 information benchmarks

Brief Explanation	Score (M1)
The recent budget documentation fulfils seven of the nine information benchmarks.	A
Overall Rating	A

### PI-7 Extent of unreported Government operations

Overall rating category 'A'

Budget estimates, in-year execution reports, year-end financial statements and other fiscal reports for the public, should cover all budgetary and extra-budgetary activities of government to allow a complete picture of government revenue, expenditures across all categories, and financing.

**Dimensions to be assessed:** (i) level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports (ii) income/expenditure information on donor-funded projects which is included in fiscal reports.

For dimension (i) apart from security restrictions on defense expenditure details, there are no significant government operations that are unreported (less than 1%). Hence, the rating assigned for dimension (i) is "A". Specific expenditures that are relevant are:

- The AFSs of the Government also contain brief statements on the Trust Funds which are outside the budget. Any activities funded from these trust funds are incorporated into the Budget and funds are channeled through the normal budgetary procedures. The AFSs also include statements of Current Deposit (CD) Accounts operated by various agencies.
- Till now the gewogs (205) are permitted to retain their rural taxes in a separate CD account. This can be used for carrying out some minor repair and maintenance works in their gewogs. These expenditures which are outside the government budgetary operations are not captured in the AFSs of the government. The new LG Act 2009 requires the LGs to begin preparing AFSs and these should be comprehensive of local taxes.
- There are also CD accounts. Some are operated by the Judiciary mainly to hold the litigation fees till the verdict is passed. These are escrow money which has to be refunded to the parties based on the verdict and therefore there is no expenditures from these CD accounts and therefore these are also excluded from the annual reports. Another CD account is the Tourism Development Fund operated by the Bhutan Tourism Council collecting tourist entry taxes to fund the Association of Bhutan Tour Operators.
- Likewise there are some generated fund like the World Food Program (WFP) generated Fund, the Kennedy Round II (KR-II) generated fund from sale of agricultural machineries, and the Tourism Development Fund. However, for the utilization of funds from these accounts the activities have to be budgeted and the funds are channeled through the normal government treasury system and the expenditures are accordingly captured and reported in the budgetary operations.

For dimension (ii) all donor funds irrespective of the funding source are routed through the Government budgetary mechanism and all expenditures information are also reported in the fiscal reports. Further, any direct disbursements made by donors are also incorporated in the respective agencies' monthly accounts as assistance in-kind. Therefore, rating for dimension (ii) is "A".

Scoring of this indicator is as below.

Score	Minimum requirements (Scoring Method M1)
A	<ul style="list-style-type: none"> <li>(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure).</li> <li>(ii) Complete income/expenditure information for 90% (value) of donor-funded projects is included in fiscal reports, except inputs provided in-kind OR donor funded project expenditure is insignificant (below 1% of total expenditure).</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 1-5% of total expenditure.</li> <li>(ii) Complete income/expenditure information is included in fiscal reports for all loan financed projects and at least 50% (by value) of grant financed projects.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 5-10% of total expenditure.</li> <li>(ii) Complete income/expenditure information for all loan financed projects is included in fiscal reports.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes more than 10% of total expenditure.</li> <li>(ii) Information on donor financed projects included in fiscal reports is seriously deficient and does not even cover all loan financed operations.</li> </ul>

Brief Explanation	Score (M1)
The level of unreported extra-budgetary expenditure is below 1% of total expenditure.	A
Donor-funded project expenditure is budgeted and fully reported.	A
Overall Rating	A

### PI-8 Transparency of inter-governmental fiscal relations

Overall rating category 'A'

While the performance indicator set is focused on PFM by the higher level of government, lower levels of government have wide-ranging expenditure responsibilities. Clear criteria, such as formulas, for the distribution of grants ensure allocative transparency and medium-term predictability of funds available for planning and budgeting of expenditure programs by lower level governments. It is also crucial for governments to receive firm and reliable information on annual allocations well in advance of the completion (preferably before commencement) of their own budget preparation processes.

**Dimensions to be assessed:** (i) Transparent and rules based systems in the horizontal allocation among *lower level* governments of unconditional and conditional transfers from *higher level* government (both budgeted and actual allocations). (ii) Timeliness of reliable information to *lower level* governments on their allocations from *higher level* government for the coming year (iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.

Re Dimension (i) rules transparency, the allocation of resources for local government and the central government is based on established rules and formulas and an 'A' rating is appropriate. The existing system of inter-government fiscal transfers is constitutionally required and uses a formula - see Box - that enables the local bodies to discharge their statutory and delegated functions. The Local Government Act 2007 provides for expanded powers of local governments for the development, management and administration of areas under their jurisdiction.

#### System of Intergovernmental Fiscal Transfers in Bhutan

Article 9, Principles of State Policy, and Clauses 7 & 8 of the Constitution of Bhutan states:

*"The State shall endeavor to develop and execute policies to minimize inequalities of income, concentration of wealth, and promote equitable distribution of public facilities among individuals and people living in different parts of the Kingdom". "The State shall endeavor to ensure that the dzongkhags are treated with equity on the basis of different needs so that the allocation of national resources results in comparable socio-economic development"*

The PFA 2007 requires:

*"The Kingdom of Bhutan shall have a sound system of public finance, based on the principles of: (a) Efficiency; (b) Economy; (c) Effectiveness; (d) Equity; (e) Sustainability; (f) Transparency and (g) Accountability"*

The State has responsibility for mobilizing and allocating resources to the SN and to the Central Governments. The SN and Central Governments prepare annual plans and budgets are based on their priorities. At the Central level, the Budget Policy and Fiscal Framework provide a 3 year forecast of both revenue and expenditures. The annual budget ceiling is allocated by MoF through its Budget Policy and Fiscal Framework Statement based on the availability of resources. The priorities in SN Government are drawn up from their Five Year Plan Documents, debated in local development committees and submitted to the National Assembly.

Under the 10<sup>th</sup> FYP the RGoB has initiated the following formula based fiscal transfer allocation for annual grants:

1. **Population:** The population factor will be calculated based on actual residency and not the number of people registered with the 2005 Population and Housing Census as the source of data. From the overall resource envelope, 70% weightage is assigned for population. Local Governments administering to larger populations receive a higher share of resources.
2. **Poverty:** Local Governments that administer regions with weak food security will receive higher allocation of resources. Food security has been taken as a proxy indicator for incidence of poverty. 25% of the total resource envelope will be allocated to factor in the local food security context. This data shall be sourced from Bhutan Living Standard Surveys, 2007.
3. **Geographical Size:** The Geographical size and area will also be a determining factor for resource allocation with 5 % of the resources devoted to it. Data for these criteria will be sourced from the National Land Commission.

The criteria will be refined and changed over time as the development situation changes and the information on which the criteria are based become more detailed and disaggregated.

Re Dimension (ii) timeliness of information, the Budget Cycle starts on 1st July and ends on 30th June. The Budget preparation begins with the Budget Call Circular containing resource allocations is issued in December/January to all budgetary units including local Governments. By end of March, the budget proposals are received, discussed and the budget proposal is submitted to Parliament for approval.

Re Dimension (iii) sector information, the RGoB follows the IMF Classification of Sectoral Budget Allocations. The sector wise allocations as a percentage to all SN Governments is consolidated and presented to the Parliament every year. The consolidation of the AFS starts after the end of the financial year and is completed within six months as expenditures for both SN and Central government is maintained under the same database in the Centralized Budget and Accounts System (CBA).

Scoring of this indicator is as below.

Dimension	Minimum requirements for dimension score: Scoring Methodology M2
<b>(i) Transparency and objectivity in the horizontal allocation among lower level governments</b>	<b>Score = A:</b> The horizontal allocation of almost all transfers (at least 90% by value) is determined by transparent and rules based systems
	<b>Score = B:</b> The horizontal allocation of most transfers (at least 50% of transfers) is determined by transparent and rules based systems.
	<b>Score = C:</b> The horizontal allocation of only a small part of transfers (10-50%) is determined by transparent and rules based systems.
	<b>Score = D:</b> No or hardly any part of the horizontal allocation of transfers is determined by transparent and rules based systems.

Dimension	Minimum requirements for dimension score: Scoring Methodology M2
<b>(ii) Timeliness of reliable information to lower level governments on their allocations</b>	<p><b>Score = A: lower level</b> governments are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting processes.</p> <p><b>Score = B: lower level</b> governments are provided reliable information on the allocations to be transferred to them ahead of completing their budget proposals, so that significant changes to the proposals are still possible.</p> <p><b>Score = C:</b> Reliable information to <b>lower level</b> governments is issued before the start of the fiscal year, but too late for significant budget changes to be made.</p> <p><b>Score = D:</b> Reliable estimates on transfers are issued after <b>lower level</b> government budgets have been finalized, or earlier issued estimates are not reliable.</p>
<b>(iii) Extent of consolidation of fiscal data for general government according to sector categories</b>	<p><b>Score = A:</b> Fiscal information (ex-ante and ex-post) that is consistent with government fiscal reporting is collected for 90% (by value) of <b>lower level</b> government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year.</p> <p><b>Score = B:</b> Fiscal information (ex-ante and ex-post) that is consistent with government fiscal reporting is collected for at least 75% (by value) of <b>lower level</b> government expenditure and consolidated into annual reports within 18 months of the end of the fiscal year.</p> <p><b>Score = C:</b> Fiscal information (at least ex-post) that is consistent with government fiscal reporting is collected for at least 60% (by value) of <b>lower level</b> government expenditure and consolidated into annual reports within 24 months of the end of the fiscal year.</p> <p><b>Score = D:</b> Fiscal information that is consistent with government fiscal reporting is collected and consolidated for less than 60% (by value) of <b>lower level</b> government expenditure OR if a higher proportion is covered, consolidation into annual reports takes place with more than 24 months delay, if at all.</p>
<b>Brief Explanation</b>	
The allocation of resources for the SN governments is based on the Plan and the established transparent rules and formulas.	
The SN governments are informed of the budget ceiling through budget call circulars after which they begin budget preparation.	
SN expenditures are consolidated into the Annual Report within 6 months of year end.	
Overall Rating	

### PI-9 Oversight of aggregate fiscal risk from other public sector entities

Overall rating category 'D+'

A Government will usually have a formal oversight role in relation to other public sector entities and should monitor and manage fiscal risks arising from activities of lower levels of government, autonomous government agencies (AGA) and public enterprises (PE). Government should require and receive quarterly financial statements and audited year-end statements from AGAs and PEs that it controls, and monitor performance against financial targets. Where lower level governments can generate fiscal liabilities for the government, their fiscal position should be monitored, at least on an annual basis, again with

consolidation of essential fiscal information. Fiscal risks can be created by SN government, AGAs and PEs and inter alia take the form of debt service defaulting (with or without guarantees issued by central government), operational losses caused by unfunded quasi-fiscal operations, expenditure payment arrears and unfunded pension obligations.

**Dimensions to be assessed:** (i) Extent of government monitoring of AGAs and PEs (ii) Extent of government monitoring of SN (urban and rural local bodies) governments' fiscal position.

Dimension (i) – Rated C. All the AGA are governed by the normal Government budgetary procedures and they report to the MoF in the same way as other budgetary spending agencies as well as providing audited annual financial statements whose results are included in the National Budget tabled in the Parliament..

The Government receives a large contribution from PEs. There are 16 companies in which the Government has the majority share (12 fully-owned and 4 semi-owned), and minority share-holdings in five companies. The Government's assets in the various corporations are on a net worth basis Nu.25,866 million or 41.7 % of GDP as of December 2008. The total contribution from the companies in the form of dividend and CIT was Nu.4,033 million constituting more than 32% of the total domestic revenue in 2008. The hydroelectric generating companies, now consolidated under one company as Druk Green Power Corporation, continued to be the largest source of the Government's revenues. It contributed Nu.2,702 million in the form of taxes and dividends.

Except for the Bhutan Broadcasting Service (BBS) and the Food Corporation of Bhutan (FCB), which posted a combined loss of Nu.5.74 million, (BBS: Nu. 4.4 million and FCB: Nu. 1.34 million) all other incorporated companies posted positive results during 2008. During the year, the Government provided subsidies for BBS amounting to Nu. 78.44 million for current expenditures and Nu. 28.27 million for capital expenditures.

Government guarantees are listed in the Annual Financial Statements of the Government. Total guarantees were Nu 3,367 million, mainly for Druk Air Corporation, Bhutan Development Finance Corporation and Bhutan Ferro Alloys.

RGoB has formed Druk Holding and Investments Limited (DHI) to be the holding company of Government companies and Government-controlled companies. The selection criterion for transfer to DHI was primarily decided by the commercial nature of the companies' operations. Application of this criterion meant that companies with social mandates stayed with the RGoB. DHI's portfolio comprises of 12 companies, including six fully-owned companies and six linked companies. As part of its role to improve company performance, DHI intends to set targets through compacts that have been signed with companies with targets for financial, operational, customer service, corporate governance and physical expansions. This may well improve reporting.

The Public Enterprises are being monitored by the Public Enterprise Division (PED) in the Ministry of Finance. Article 93 of the PFA of Bhutan 2007 requires the PEs to prepare an annual report including the audited financial statements in accordance with the provisions of the Companies Act 2000 and Article 94 requires the Finance Minister to present the annual reports of SOEs as a whole to the Parliament but there is no consolidated report on fiscal risks arising from the PEs. Therefore, the rating for dimension (i) is "C".

Dimension (ii) – Rated D. Dzongkhags and gewogs are governed by the provisions of the PFA2007 and FRR2001. Therefore, like any other budgetary agencies, they are also required to report to the DPA, MOF on a monthly basis and their financial statements are consolidated into the whole of Government AFSs. However, currently there is no system for central government to regularly monitor the fiscal position of the sub-national level of government and consolidate the fiscal risks. Therefore, rating for dimension (ii) is "D".

Summary scoring of this indicator is as below.

Score	Minimum requirements
A	<p>(i) All major AGAs/PEs submit fiscal reports to governments at least six-monthly, as well as annual audited accounts, and government consolidates fiscal risk issues into a report at least annually.</p> <p>(ii) Lower level governments cannot generate fiscal liabilities for State government OR the net fiscal position is monitored at least annually for all lower levels of government and state government consolidates overall fiscal risk into annual (or more frequent) reports.</p>
B	<p>(i) All major AGAs/PEs submit fiscal reports including audited accounts to state governments at least annually, and state government consolidates overall fiscal risk issues into a report.</p> <p>(ii) The net fiscal position is monitored at least annually for the most important lower levels of government, and the State government consolidates overall fiscal risk into a report.</p>
C	<p>(i) Most major AGAs/PEs submit fiscal reports to state governments at least annually, but a consolidated overview is missing or significantly incomplete.</p> <p>(ii) The net fiscal position is monitored at least annually for the most important lower levels of government, but a consolidated overview is missing or significantly incomplete.</p>
D	<p>(i) No annual monitoring of AGAs and PEs takes place, or it is significantly incomplete.</p> <p>(ii) No annual monitoring of lower level governments' fiscal position takes place or it is significantly incomplete.</p>

Brief Explanation	Score (M1)
There is no consolidated report on PE fiscal risk.	C
Monitoring of the fiscal position of local government bodies is significantly incomplete. There is no consolidated overview of fiscal risks is compiled in a report.	D
Overall Rating	D +

### PI-10 Public access to key fiscal information

Overall rating category 'B' for the national Government

Transparency will depend on whether information on fiscal plans, positions and performance of the government is easily accessible to the general public.

**Dimensions to be assessed:** Number of the six listed elements of public access to information that is fulfilled

#### National Government Assessment:

1. Annual Budget Reports are available when tabled via the Ministry of Finance, RGoB's website at: [www.mof.gov.bt](http://www.mof.gov.bt). Print copies are also available on request from the Ministry.
2. In-year budget execution reports are not published, although data is available. The Department of

Public Accounts' via its Public Expenditure Management System (PEMS) is in the process of developing in-year budget reports.

3. Year-end AFSs are available via the Ministry of Finance, RGoB's website at: [www.mof.gov.bt](http://www.mof.gov.bt). Print copies are also available on request from the Ministry.
4. Annual Audit Reports by the RAA are available online at: [www.bhutanaudit.gov.bt](http://www.bhutanaudit.gov.bt) and/or [www.raa.gov.bt](http://www.raa.gov.bt)
5. List of contracts awarded: The Public Procurement Policy Division (PPPD) of the MoF maintains select government contract information. The Construction Development Board (CDB) also maintains information on the award of public contract. However at present, both agencies do not make this information available to the public.
6. Resource availability documents for primary service units at detailed level: information is publicly available (on request) through the annual Budget Appropriations for Fiscal Year document released by the Department of National Budget. The GNHC's Five Year Plan documents (available at [www.pc.gov.bt/10thplan.asp](http://www.pc.gov.bt/10thplan.asp)) contain supplementary budget information on long-term resource availability for primary sectors.

The information in the four documents available to the public i.e. 1, 3, 4, and 6 is comprehensive and highly comprehensible. The medium of written communication is English. The National Budget Report is also printed in Dzongkha. All reports follow a standard format with proper briefs, summations, and annexes. Information for documents 1, 3, and 4 (budgets, financial accounts and audit reports) are publicly available online at the respective agencies' website (<http://www.mof.gov.bt>; <http://www.raa.gov.bt>). They are also available on request from the agency. The Budget Reports and AFS are made available to the public within a reasonable period of time after the Finance Minister's report to the bi-annual sessions of the Parliament - within one month to six months. The Audit Report is also presented to the Parliament, after which it is made available online and in-print to the public.

All documents are currently available to the public at a cost no greater than what it costs the Royal Government. Often it is circulated free (in print and) online disregarding the costs of compiling these reports. All government reports are printed by Kuensel Corporation Ltd.

Items 2 and 5 - in-year budget reports and the list of contracts awarded are maintained but not made publicly available at present. The Department of Public Accounts of the MoF is in the process of developing the in-year budget reports through the Public Expenditure Management System. On the list of contracts, the procurement department of the MoF maintains a select list of government contracts. The Construction Development Board maintains information on contracts awarded.

Scoring of this indicator is as below.

Score	Minimum Requirements (Scoring Method)
A	The government makes available to the public 5-6 of the 6 listed types of information
B	The government makes available to the public 3-4 of the 6 listed types of information
C	The government makes available to the public 1-2 of the 6 listed types of information
D	The government makes available to the public none of the 6 listed types of information

Brief Explanation	Score (M1)
The government makes available to the public four of the six listed elements of information for national and local levels of Government.	B
Overall Rating	B

### 3.3. Policy Based Budgeting

#### PI-11 Orderliness and participation in the annual budget process

Overall rating category 'A'

The performance assessment framework notes that the Department of the National Budget (DNB) of the MOF is the driver of the annual budget formulation process, but effective participation in the budget formulation process by all ministries, departments and agencies (MDAs) as well as the political leadership, impacts the extent to which the budget will reflect macro-economic, fiscal and sector policies.

**Dimensions to be assessed:** (i) Existence of and adherence to a fixed budget calendar (ii) Clarity/ comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (iii) Timely budget approval by the legislature or similarly mandated body.

Bhutan has gone through a recent change in democratization and legislature and these participation processes are in an early phase so the assessment of this indicator is an important one for parliamentary engagement in PFM in Bhutan.

Article 46 of the PFA requires submission to the Parliament of the Budget Policy and Fiscal Framework Statement (BPFSS) by the Minister of Finance. The framework includes strategic priorities by which Government was guided in preparing the budget for the financial year and for the 2 outer years. The BPFSS includes budget ceilings for all budgetary agencies, which are drawn from the Five Year Plan (FYP) documents approved by the Government. The Ministry of Finance prepares the BPFSS and the expenditure are drawn from the Plan document, while independent revenue projection is made for the coming year based on which a budget ceiling is derived for the MDAs. The budget for the local government is prepared and approved like that of the central agencies so the following assessment for the three dimensions is appropriate for all levels of Government:

- (i) The FRR 2001 requires the Budget Call Circular to be issued at the latest by end of December or latest by first week of January and this was achieved by the Department of National Budget, Ministry of Finance. The Circular provides guidelines for budget preparation including budget ceilings for each agency and the agencies have six weeks to prepare their budget proposal.
- (ii) The Budget Call Circulars for the FY 2007-08 and 2008-09 were approved by the Cabinet before being sent to the line agencies. However, the Budget ceiling for the FY 2009-10 was not specifically submitted to the Cabinet because the ceilings were drawn from the 10th Plan Outlay, which was already approved by the Government.
- (iii) The legislature approves the budget before the start of the fiscal year, but there was a delay of two months in FY 2008-09. Article 47 of the Public Finance Act, states that the "The Minister of Finance shall present to the Parliament the Government's Budget and Appropriation Bill no later than 5 days preceding the budget year. Therefore, the budget is expected to approve by the Parliament before the start of financial year. The delay for FY 2008-09 is not expected to be repeated as the Assembly has decided to have the budget presentation in the beginning of the session rather than at the latter part of the session to avoid delay in approving the budget.

Scoring of this indicator is as below.

Dimension	Minimum requirements for dimension score Scoring Methodology M2
<b>(i) Existence of and adherence to a fixed budget calendar</b>	<p><b>Score = A:</b> A clear annual budget calendar exists, is generally adhered to and allows MDAs enough time (and at least six weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time.</p> <p><b>Score = B:</b> A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs reasonable time (at least four weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time,</p> <p><b>Score = C:</b> An annual budget calendar exists, but is rudimentary and substantial delays may often be experienced in its implementation, and allows MDAs so little time to complete detailed estimates, that many fail to complete them timely.</p> <p><b>Score = D:</b> A budget calendar is not prepared OR it is generally not adhered to OR the time allowed for MDAs' budget preparation is clearly insufficient to make meaningful submissions.</p>
<b>(ii) Guidance on the preparation of budget submissions</b>	<p><b>Score = A:</b> A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent) prior to the circular's distribution to MDAs.</p> <p><b>Score = B:</b> A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before MDAs have completed their submission.</p> <p><b>Score = C:</b> A budget circular is issued to MDAs, including ceilings for individual administrative units or functional areas. The budget estimates are reviewed and approved by Cabinet only after they have been completed in all details by MDAs, thus seriously constraining Cabinet's ability to make adjustments.</p> <p><b>Score = D:</b> A budget circular is not issued to MDAs OR the quality of the circular is very poor OR Cabinet is involved in approving the allocations only immediately before submission of detailed estimates to the legislature, thus having no opportunities for adjustment.</p>
<b>(iii) Timely budget approval by the legislature</b>	<p><b>Score = A:</b> The legislature has, during the last three years, approved the budget before the start of the fiscal year.</p> <p><b>Score = B:</b> The legislature approves the budget before the start of the fiscal year, but a delay of up to two months has happened in one of the last three years.</p> <p><b>Score = C:</b> The legislature has, in two of the last three years, approved the budget within two months of the start of the fiscal year.</p> <p><b>Score = D:</b> The budget has been approved with more than two months delay in two of the last three years.</p>

Brief Explanation	Score (M2)
(i) A clear annual budget calendar exists, is applied and gives agencies six weeks to respond.	A
(ii) A clear budget circular is includes ceilings approved by Cabinet.	A
(iii) The legislature approves the budget before the start of the fiscal year, but a delay of up to two months has happened in one of the last three years.	B
Overall Rating	A

### PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting

Overall rating category 'B+'

Expenditure policy decisions have multi-year implications, and must be aligned with the availability of resources in the medium-term perspective. Therefore, multi-year fiscal forecasts of revenue, medium term expenditure aggregates for mandatory expenditure and potential deficit financing (including reviews of debt sustainability involving both external and domestic debt) should be the foundation for policy changes.

**Dimensions to be assessed:** (i) Preparation of multi-year fiscal forecasts and functional allocations  
(ii) Scope and frequency of debt sustainability analysis - Dates for debt sustainability analyses  
(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure  
(iv) Linkages between investment budgets and forward expenditure estimates.

Dimension (i) – Rated A. Forecasts of fiscal aggregates are prepared for 3 years on a rolling basis. As mandated by the Public Finance Act 2007 a Budget Policy and Fiscal Framework Statement (BPFSS) and the Medium Term Fiscal Framework (MTFF), which are compiled by the Policy and Planning Division of the MoF matches overall expenditure with the availability of resources in the medium term on a rolling three year basis. The BPFSS is prepared and presented by Finance Minister bi-annually to the Parliament along with other budget documents and the BPFSS is approved by the Parliament. The key aggregates of potential deficit, external and internal debt, as well as instruments of financing are projected in the BPFSS and these projections are part of the National Budget Report to the Parliament which is available on the Ministry of Finance's website at <http://www.mof.gov.bt>. Links and explanations between the multi-year estimates and the budget figures are contained in the Budget Report. The Budget Report outlines the Royal Government's financial position in the two years before and two years after the current fiscal year on a rolling 1 + 2 basis. The 'budgeted' figure for the forthcoming fiscal year forms an indicative basis for government finances for that year. The Government's annual Budget Call Notification circulated to all government agencies soliciting budget proposals for the upcoming fiscal year is also based on the estimations of the BPFSS. A direct year-on-year comparison of BPFSS tables in the BRs also demonstrates that estimations made in any one year become the basis of the following year's budget. The explanation of differences between the multi-year estimates and the allocations in a budget year is provided in the National Budget Report. budget projections (in the BPFSS and by the Department of National Budget (DNB), Ministry of Finance) undergo at least three iterations in any one fiscal year – the first 'budgeting' phase (budgeted) that estimates budget for the upcoming fiscal year; a 'revision' phase halfway through a fiscal year; and, a 'revised budget estimates' phase (revised) at the end of the fiscal year. As the income and expenditure dynamics change, the budget and the BPFSS are constantly updated as well. The changes are explained in the Budget Report.

Thus the Budget Report provides a revenue picture and a budget ceiling for spending agencies; revises the budget ceiling in the current fiscal year; and, amends the budget ceiling estimates for the next year.

It also explains the major differences in expenditure from the time of budgeting at the beginning of the previous fiscal year to its revision in the middle of the current year and the final actual outcomes for both expenditure and revenue accounts. Further, the Multi-Year Rolling Budget (MYRB) system currently in the process of development by the Department of National Budget, and the Public Expenditure Management System of the Department of Public Accounts is expected to further strengthen expenditure projections in the medium term.

Dimension (ii) – Rated B as debt sustainability analysis (DSA) for all public and publicly-guaranteed external and domestic debt is carried out by the Department of Public Accounts, MoF in joint consultation with international aid agencies, at least once every two years. The report on “Bhutan: Joint Bank-Fund Debt Sustainability Analysis (October, 2007)” and the Joint IMF/World Bank Debt Sustainability Analysis 2009 are the most recent. Another RGoB DSA has also been conducted by a consultant for internal use by the Department of Public Accounts. .

Dimension (iii) – Rated A. A sector wise strategy or development plan representing at least 75% of primary expenditure with a full costing of recurrent and capital expenditure, and which is consistent with the fiscal forecasts of BPFSS, exists within the frameworks of both the AFS as well as the Budget Appropriations documents, the Finance Minister’s Budget Report to the Parliament and the Five Year Plans. These reports are available on the Ministry of Finance’s website. The full costs of all forward expenditures, i.e. recurrent and capital are presented in separate volumes of the Budget Appropriation (BA) report for each Sector, Autonomous Agencies, and Dzongkhags (and Gewogs). The sector wise allocations for fiscal year 2009-10 shown below are taken from the Budget Report and represent about 84% of total primary recurrent and capital expenditure. This is consistent with the overall fiscal forecasts.

### Sector Allocation for FY 2009-10

Sectors	Current	Capital	Total	%
Social Services	4,410	3,210	7,620	25.06
Health	1,396	914	2,310	7.60
Education	3,013	2,296	5,309	17.46
Econ. & Public Services	2,729	6,995	9,723	31.98
Agriculture	1,446	1,947	3,392	11.16
Mining & Manufacturing	224	313	537	1.77
Roads	252	2,471	2,723	8.96
Housing & Community	372	909	1,281	4.21
Communications	380	635	1,016	3.34
Energy	55	719	774	2.55
Religion & Cultural Services	486	585	1,070	3.52
Law & Order Services	1,420	830	2,250	7.40
General Public Services	2,789	2,208	4,997	16.44
National Debt Services	1,762	2,981	4,742	15.60
Repayment	1,762	2,287	4,049	13.32
Lending	0	694	694	2.28
TOTAL	13,594	16,808	30,402	100

Source: Budget Report

This dimension looks for expenditure policy decisions or options to be described in sector strategy documents, which are fully costed in terms of estimates of forward expenditures (including expenditures both of a recurring nature as well as those involving investment commitments and their recurrent cost implications) to determine whether current and new policies are affordable within aggregate fiscal targets. On this basis, policy choices should be made and indicative, medium-term sector allocations be established. The Tenth Five Year Plan 2008-2013 contain descriptions of strategies, policies and targets for the individual sectors along with indicative financial outlays, This statement of sector strategies is given effect in the various budget documents and the full costing of recurrent and capital expenditure is projected annually (with revisions during the winter session of the national Parliament). Therefore, this dimension is rated A.

Dimension (iv) – Rated C. The majority of important investment decisions are based on relevant sector strategies and local development plans outlined in the Five Year Plans and reiterated by the Finance Minister's Annual Budget Report to the bi-annual Parliament sessions. The five year plans envision investment expenditure in the long-run, and the Budget Report seeks to keep these investments on track in the medium term. Investment expenditure and recurrent expenditure budgeting processes are executed together, and is largely driven by the mandates of both the "Constitution of the Kingdom of Bhutan" and the "PFA 2007", which stipulates that "recurrent expenditure will be met from the internal resources of the country." This condition therefore highlights the need to consider the implications of capital investment decisions in the long run. Major emphasis is also laid on investment in health, education, and the infrastructure sectors, all of which have specific sector goals and strategies.

However, a clear, strategy-linked selection criterion for selecting investments and clear forward estimates that includes an explicit costing of investments and their recurrent cost implications is currently underdeveloped. The budgets do not cover forecast for recurrent cost on new investment. For example for expansion of school; there will be capital budget on infrastructure only and recurrent cost maintenance and expandable item not included. This is generally true of not only minor investment decisions, but also major investment expenditure. It is important to note here that the national budgeting process (the Department of National Budget, Ministry of Finance) nevertheless incorporates an incremental cost approach when projecting recurrent expenditure during the budget process. This covers – to a degree – the cost (recurrent) implications of new investment decisions. How much of the recurrent cost implications of new investments this strategy covers is not clear. Further, the PFA 2007 also stipulates that, "Meeting the requirements for sustainability of the fiscal balance shall not be achieved at the expense of development projects" (Page 4). Clearly, the RGoB foresees exceeding the PFA 2007 stipulation stated above that recurrent costs are met from internal resources.

Therefore, although forward budget estimates do to some extent reflect the recurrent cost implications of new investment decisions through such processes as the DNB's incremental cost approach; at present the linkage between budget estimates and an explicit costing of the recurrent implications of new policy initiatives in the investment decision making process is judged as weak. Therefore, a rating is C is assigned to this dimension.

Summary scoring of this indicator is as below.

Dimension	Minimum requirements for dimension score Scoring Methodology M2
<b>(i) Multi-year fiscal forecasts and functional allocations</b>	<b>Score = A:</b> Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least three years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences explained

Dimension	Minimum requirements for dimension score Scoring Methodology M2
	<p><b>Score = B:</b> Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least two years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences are explained.</p> <p><b>Score = C:</b> Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis.</p> <p><b>Score = D:</b> No forward estimates of fiscal aggregates are undertaken</p>
<b>(ii) Scope and frequency of debt sustainability analysis</b>	<p><b>Score = A:</b> DSA for external and domestic debt is undertaken annually.</p> <p><b>Score = B:</b> DSA for external and domestic debt is undertaken at least once during the last three years.</p> <p><b>Score = C:</b> A DSA for at least for external debt undertaken once during last three years.</p> <p><b>Score = D:</b> No DSA has been undertaken in the last three years</p>
<b>(iii) Existence of costed sector strategies</b>	<p><b>Score = A:</b> Strategies for sectors representing at least 75% of primary expenditure exist with full costing of recurrent and investment expenditure, broadly consistent with fiscal forecasts.</p> <p><b>Score = B:</b> Statements of sector strategies exist and are fully costed, broadly consistent with fiscal forecasts, for sectors representing 25-75% of primary expenditure.</p> <p><b>Score = C:</b> Statements of sector strategies exist for several major sectors but are only substantially costed for sectors representing up to 25% of primary expenditure OR costed strategies cover more sectors but are inconsistent with aggregate fiscal forecasts.</p> <p><b>Score = D:</b> Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure.</p>
<b>(iv) Linkages between investment budgets and forward expenditure estimates</b>	<p><b>Score = A:</b> Investments are consistently selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.</p> <p><b>Score = B:</b> The majority of important investments are selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.</p> <p><b>Score = C:</b> Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases.</p> <p><b>Score = D:</b> Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared.</p>

Brief Explanation	Score (M2)
(i) Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least three years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences explained.	A
(ii) Debt sustainability analysis has been undertaken every second year.	B
(iii) Sector strategies are prepared for all sectors as part of the planning process.	A
(iv) Budgeting for investments and recurrent expenditure are separate processes with no recurrent cost estimates being shared	C
Overall Rating	B +

### PI-13 Transparency of taxpayer obligations and liabilities

Overall rating category 'B'

Effective assessment of tax liability is subject to the overall control environment that exists in the revenue administration system but is also very dependent on the direct involvement and cooperation of the taxpayers from the individual and corporate private sector. Their contribution to ensuring overall compliance with tax policy is encouraged and facilitated by a high degree of transparency of tax liabilities, including clarity of legislation and administrative procedures, access to information in this regard, and the ability to contest administrative rulings on tax liability.

**Dimensions to be assessed:** (i) Clarity and comprehensiveness of tax liabilities.(ii) Taxpayer access to information on tax liabilities and administrative procedures.(iii) Existence and functioning of a tax appeals mechanism.

This indicator is important for the national Government as the vast majority of revenue is raised through national taxes. It is not applicable for lower level government as taxes that exist in local government are not major taxes such as income tax and sales tax etc. Existing local taxes are imposed at very low rates on houses, cattle and land, and revenue collected is minimal. Such taxes are collected based on the records of number of houses, cattle and land as registered in each Gewog.

The major taxes levied are corporate income tax, business income tax, and personal income tax under direct taxes; and sales tax, import duty and excise duty under indirect taxes. In FY 2008/09, direct taxes contribute 30.8% while indirect taxes contribute 15.3% to the total revenue. Non-tax revenue constitutes the other 53.9% of the total revenue. The percentage of total revenue to GDP in the FY 2008/09 is calculated to be 24.2 where percentage of tax revenue to GDP is 11.2 and non-tax revenue to GDP is 13.1. DRC collects and administers the taxes through 8 regional offices located in the various regions of the country through the following divisions; Tax Administration, Sales Tax, Customs and Revenue Accounts & Audit.

The functions of the department are mostly computerized with development of two main computerized systems viz: Bhutan Automated Customs System (BACS) and Revenue Management System RMS). BACS is mainly for Customs and sales tax collected at the point of entry of goods while RMS consists of Tax Management System and Revenue Accounting system.

There is an opportunity to simplify sales tax and customs duty, where there are as many as 8 different rates in the existing structure. DRC is aware of some disadvantages and distortions resulting from such system and currently an exercise to rationalize the rates is in process.

Dimension (i) Rated B as legislation and procedures are clearly stated with limited discretionary powers but there are some gaps. Income tax assessments and the collection process are guided by Income Tax Act 2001, Rules and the Manuals. Sales Tax, Customs and Excise are guided by the Sales Tax, Customs and Excise Act 2000, Rules and Manuals thereof.

Legislations and procedures are clearly stated with limited discretionary power but not comprehensive enough in the following areas; the Income Tax Act does not comprehensively cover international taxation, amalgamation and mergers, and personal income tax, and the Indirect Tax legislation does not comprehensively cover sales tax on point of sales or the core values of the World Customs Organization Revised Kyoto Convention.

Discretionary powers for direct tax exist only in the area of estimated assessment where there are no books of accounts maintained. Assessing officials are given powers to either waive off or decrease or collect the same amount of taxes as in the previous income year in the following situations:

1. If there was death or prolonged illness in the family owing which the business remained closed.
2. If burglary or theft cases have taken place.
3. If the taxpayer is stuck by natural calamities such as earthquakes, flood and fire outbreaks.

Other than the above, there are no discretionary powers granted to the direct tax officials. Whatever waivers considered are through appeal processes/mechanisms at three levels; RRCO, Department and Ministry Tax appeal board level. For indirect taxes discretions (public interest exemptions) are rarely used and are granted only after being thoroughly vetted only and through several layers of recommendations.

Some problems are seen in the area of un-incorporated and small businesses. For effective monitoring, these units are categorized into non-estimated units (those maintaining books of accounts) and estimated units (those not maintaining books of accounts). In 2007 83.9% of BIT taxpayers paid under the estimated category so there are problems of estimation. Although the requirements are clearly specified in the legislation, small businesses are not able to fulfill the book keeping requirements mainly due to lack of accounting knowledge. Annual assessments are carried out on an estimated basis or at best judgment based; hence a certain amount of discretion is inevitable. The Chapter on General Provisions in the Rules on the Income Tax Act 2001 section 1.4 states clearly, under what circumstances and how the estimated assessment should be carried out. For uniformity, estimated assessments are conducted using information on imports and exports, records on tax deducted at source, taxes paid in the preceding years, taxes paid by similar units and information declared by taxpayers themselves.

Dimension (ii) – Rated B as available resources constrains adequate education campaigns. All notifications covering major taxes including the tax dates are disseminated through both print and broadcast media. Information regarding the administrative procedures is also dispersed through brochure and pamphlets and also available on MoF web ([www.mof.gov.bt/drc](http://www.mof.gov.bt/drc)). Information is propagated using simplified language in the form of frequently asked questions. Tax education campaigns are conducted whenever the changes are introduced in the tax system. Tax education campaigns usually cover 8 regional offices in the country. Seminars/workshop on specific tax issues for taxpayers are conducted whenever it is necessary. There is no special information desk as such, however, there is an independent Public Information Service Division in the head office of the department with dedicated telephone line. This unit at present exists only in the Head office. Taxpayer's education programs at present are seriously constrained by lack of resources.

Dimension (iii) – Rated B as the Tax Appeals Board was set up in 2009 and it is too early to fully assess effectiveness. Tax Appeal Committees were formed formally in the year 2002 with enactment of the

Income Tax Act in 2001 and the Sales Tax, Customs and Excise Act 2000. However the Tax Appeal Board was established recently in early 2009. Taxpayers can appeal at three different stages; viz. Regional Tax Appeal Committee, DRC Tax Appeal Committee and Tax Appeal Board (Ministry level). Ministerial Appeal Board has members from other organizations independent of the Revenue Department.

Tax Appeals are usually heard first at the regional offices and then forwarded to the higher level if the taxpayer is not happy with the decision. Taxpayers can file their appeal within 30 days from the date of issue of demand notice from revenue offices and re-appeal within 30 days if disagreed with the decision passed by the Committees. In case of the disagreement with the decision of the Tax Appeal Board at the Ministry level, the taxpayer has the option to go to the court of law.

Appeal procedures and time frames are clearly specified in Chapter 7 Section 47 of the Income Tax Act 2001 and Chapter 6 Section 22 of the Sales Tax, Custom and Excise Act 2000. Decisions by the Appeal Committees and the Appeal Board are made as per the provisions of the Acts. However, the Tax Appeal Board was only established recently and there is scope for further improvement in the existing system.

Information on number of cases dealt at different level of committee, time mandated and the average time taken are provided in the table below:

Appeal Committee	No. of cases dealt with		Time mandated	Time taken
	Direct Tax FY 2008	Indirect Tax (FY 2008-2009)		
Regional	151		30	10-15
Head office	53	20	60	15-20
Ministry(Appeal Board)	0	0	60	30

Summary scoring of this indicator is as below.

Dimension	Minimum requirements for dimension score
<b>(i) Clarity and comprehensiveness of tax liabilities</b>	<p><b>Score = A:</b> Legislation and procedures for all major taxes are comprehensive and clear, with strictly limited discretionary powers of the government entities involved.</p> <p><b>Score = B:</b> Legislation and procedures for most, but not necessarily all, major taxes are comprehensive and clear, with fairly limited discretionary powers of the government entities involved.</p> <p><b>Score = C:</b> Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary powers of the government entities involved.</p> <p><b>Score = D:</b> Legislation and procedures are not comprehensive and clear for large areas of taxation and/or involve important elements of administrative discretion in assessing tax liabilities.</p>

Dimension	Minimum requirements for dimension score
<p><b>(ii) Taxpayers' access to information on tax liabilities and administrative procedures</b></p>	<p><b>Score A:</b> Taxpayers have easy access to comprehensive, user friendly and up-to-date information tax liabilities and administrative procedures for all major taxes, and the RA supplements this with active taxpayer education campaigns.</p> <p><b>Score = B:</b> Taxpayers have easy access to comprehensive, user friendly and up-to-date information tax liabilities and administrative procedures for some of the major taxes, while for other taxes the information is limited.</p> <p><b>Score = C:</b> Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date.</p> <p><b>Score = D:</b> Taxpayer access to up-to-date legislation and procedural guidelines is seriously deficient.</p>
<p><b>(iii) Existence and functioning of a tax appeals mechanism</b></p>	<p><b>Score A:</b> A tax appeals system of transparent administrative procedures with appropriate checks and balances, and implemented through independent institutional structures, is completely set up and effectively operating with satisfactory access and fairness, and its decisions are promptly acted upon.</p> <p><b>Score = B:</b> A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed.</p> <p><b>Score = C:</b> A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent and effective.</p> <p><b>Score = D:</b> No functioning tax appeals system has been established</p>

Brief Explanation	Score (M2)
(i) Legislation And Procedures For All Major Taxes Are Comprehensive And Clear, With Strictly Limited Discretionary Powers Of The Government Entities Involved.	B
(ii) Taxpayers Have Easy Access To Comprehensive, User Friendly And Up-To-Date Information Tax Liabilities And Administrative Procedures For Some Of The Major Taxes, While For Other Taxes The Information Is Limited.	B
(iii) A Tax Appeals System Of Transparent Administrative Procedures Is Completely Set Up And Functional, But It Is Either Too Early To Assess Its Effectiveness Or Some Issues Relating To Access, Efficiency, Fairness Or Effective Follow Up On Its Decisions Need To Be Addressed.	B
Overall Rating	B

### PI-14 Effectiveness of measures for taxpayer registration and tax assessment

Overall rating category 'C+'

Maintenance of a taxpayer database based on a unique taxpayer identification number is an important element of any tax control system, and is most effective if linked to other government registration systems. Revenue authorities should ensure compliance with registration requirements through occasional surveys of potential taxpayers e.g. by selective, physical inspection of business premises and residences.

**Dimensions to be assessed:** (i) controls in the taxpayer registration system (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations (iii) Planning and monitoring of tax audit and fraud investigation programs.

Dimension (i) – Rated C on account of control weaknesses in the taxpayer registration system arising from partial linkages among the various databases. The department has an electronic database registration system and a Taxpayer Number (TPN) is assigned to each taxpayer. The TPN is used while corresponding with taxpayers. Taxpayers are registered for the individual taxes but this registration is not fully linked to relevant government organizations. For instance the registration system is linked partially with financial institutions and the Budget Accounting System. The Department of Trade has a business registration system but not a central civil registration system. There is no systematic survey of potential taxpayers being carried out but information on taxpayers is gathered and monitored through periodic tax audits.

The Sales Tax System (STS) is currently under pilot implementation and currently has no linkages with any other systems and agencies. Under this system the Sales Tax Collecting Agents (STCA) ID is generated based on the TPN issued by the Tax Administration Division through extension of additional code in the STS. However, the STS have no linkages with the BACS, with regard to import/export and internal market data for transit of goods and these needs to be carried out further. The sales tax /customs duty exemptions and refund interfaces needs to be further linked and integrated with the STS/BACS. Further the agency codes in both the BACS and RMS need to be reviewed, standardized and enhanced.

Dimension (ii) – Rated B as completeness would require some penalty for non-registration. The main penalties are imposed on offenses such as non-filing and non declaration, late payment, concealment or mis-declaration/under invoicing and non maintenance of books of accounts and failure to comply with the notice. All these penalties are enforced actively at present and are therefore effective. Appeals are mostly for waiver of penalties which the department is authorized to waive as per Section 28 Chapter 5 under Fines and Penalties of Income Tax Act and Section 24 under Chapter 6 of the General Provisions, Sales Tax, Customs and Excise Act. There is no penalty on non-registration in the existing system.

For late payment of both direct and indirect taxes, the penalty imposed is 24% per annum on the amount due and proportion of time it is outstanding.

Other penalties for direct taxes are –

- 100 % of the gross income for non-filing of tax returns.
- Nu. 100 per day for late submission up to 3 months; thereafter it is treated as non-filing.
- Twice the tax amount estimated as evaded, for income concealment
- Fine ranging from Nu.1000 to Nu. 100,000 for failure to maintain books of accounts and documents.

Fine ranging from Nu.500 to Nu.5000 for failure comply with notice.

**Indirect taxes -**

- 50% of the value of the goods under-declared, under invoiced, mis-declared, non-declared, concealed and for misuse of exemptions and permits.
- Fine ranging from Nu. 1000 to Nu. 100,000 for failure to maintain books of accounts and documents.
- Fine ranging from Nu. 500 to Nu. 5000 for failure comply with notice.

The existing interest rate charged by bank for commercial overdraft is 13.75% per annum. Therefore, the penalty for late payment of taxes is sufficient enough to have an impact on compliance, if enforced stringently. The penalty collected and additional tax collected through audits/inspections in the last three years is provided below.

Year	Penalty collection <i>Nu million</i>	Collections from audits/inspections <i>Nu million.</i>	% of Penalty Collection to total collection	% of collection from audit/ inspection to total collection
2005	1.670	61.922	0.1	5.0
2006	4.359	56.105	0.2	3.0
2007	5.105	98.894	0.2	4.4

Dimension (iii) – Rated C because of some gaps in the risk assessment criteria.

**Direct Tax:** There is continuous tax audit in forms of desk as well as field audit under direct taxes. Audit coverage under desk audit is extensive as indicated in the Performance Indicator Reports of the Tax Administration. In addition there are 390 field audits. There is also good practice of audit plan and risk assessment criteria used in direct taxes. Self-assessment is applied to all income taxes such as PIT, BIT and CIT. Tax desk audit coverage is as below.

**Tax Audit for Direct Taxes for Income Year 2006**

	Total returns filed	Returns Audited	Coverage (%)
Desk Audit	24607	24470	99

**Indirect Taxes:** For sales tax is collected from the point of sale, there is continuous sales tax assessment in the form of periodic desk and field assessment and audit. The tax audits are based on proper planning and certain risk assessment criteria, and conducted on a periodic basis. Investigations and surprise visits are also made based on the risk assessment. Information on the number of tax audit conducted is not compiled in the present practice although the information is there with the RRCOs.

For tax collected at the point of entry for customs and sales tax, there is no proper risk management applied at present. Taxpayers are assessed based on the self declaration made at the entry points. Physical checking of baggage is undertaken at the entry point as no appropriate technology based screening infrastructure is in place.

Summary scoring of this indicator is as below.

Dimension	Minimum requirements for dimension score	Scoring Methodology M2
(i) <b>Controls in the taxpayer registration system.</b>	<b>Score = A:</b> Taxpayers are registered in a complete database system with comprehensive direct linkages to other relevant government registration systems and financial sector regulations.	

Dimension	Minimum requirements for dimension score Scoring Methodology M2
	<p><b>Score = B:</b> Taxpayers are registered in a complete database system with some linkages to other relevant government registration systems and financial sector regulations.</p> <p><b>Score = C:</b> Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers.</p> <p><b>Score = D:</b> Taxpayer registration is not subject to any effective controls or enforcement systems</p>
<b>(ii) Effectiveness of penalties for non-compliance with registration and tax declaration</b>	<p><b>Score = A:</b> Penalties for all areas of non-compliance are set sufficiently high to act as deterrence and are consistently administered.</p> <p><b>Score = B:</b> Penalties for non-compliance exist for most relevant areas, but are not always effective due to insufficient scale and/or inconsistent administration.</p> <p><b>Score = C:</b> Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance.</p> <p><b>Score = D:</b> Penalties for non-compliance are generally non-existent or ineffective (i.e. set far too low to have an impact or rarely imposed).</p>
<b>(iii) Planning and monitoring of tax audit programs.</b>	<p><b>Score A:</b> Tax audits and fraud investigations are managed and reported on according to a comprehensive and documented audit plan, with clear risk assessment criteria for all major taxes that apply self-assessment.</p> <p><b>Score = B:</b> Tax audits and fraud investigations are managed and reported on according to a documented audit plan, with clear risk assessment criteria for audits in at least one major tax area that applies self-assessment.</p> <p><b>Score = C:</b> There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria.</p> <p><b>Score = D:</b> Tax audits and fraud investigations are undertaken on an ad hoc basis if at all.</p>

Brief Explanation	Score (M2)
Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers.	C
Penalties for non-compliance exist in most relevant areas but not non-registration.	B
There is a continuous program of tax audits and fraud investigations, but not all audit programs are based on clear risk assessment criteria.	C
Overall Rating	C+

**PI-15 Effectiveness in collection of tax payments**

Overall rating category 'C+'

Accumulation of tax arrears can be a critical factor undermining high budgetary outturns, while the ability to collect tax lends credibility to the tax assessment process and reflects equal treatment of all taxpayers, whether they pay voluntarily or need close follow up. Aggregate reporting on tax assessments, collections, arrears and transfers to (and receipts by) the Treasury must take place regularly and be reconciled, where appropriate, in order to ensure that the collection system functions as intended, that tax arrears are monitored and the revenue float is minimized.

**Dimensions to be assessed:** (i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years). (ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration;. (iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.

Dimension (i) – Rated A. For direct tax, information on tax arrears is readily available and report published every year, regional offices maintains the detail records manually; for indirect tax, there is no published report, however regional offices maintain information manually and information are available. Figures on debt collection ratio (i.e. the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year) are not available. The stock of tax arrears as of Income Year 2007 for both direct and indirect taxes and its percentage to total collection in 2007 is provided below

Tax type	Stock of Arrears (million)	Total collections (million)	% Arrears to Total collections
Direct taxes - FY 2007	28.892	2,234	1.29%
Direct taxes - FY 2006	109	1,897	5.75%
Indirect taxes	1.177	838.872	0.14%

The improvement between 2006 and 2007 suggests that the debt collection ratio is better than 80% but the data is not adequate to provide accurate figures for debt collection ratios. Since the percentage of stock of arrears to the total collection in the most recent year is under 2% for both tax types, the score for this dimension is A as per the rating rule - the total amount of tax arrears is insignificant (i.e. less than 2% of total annual collections).

Dimension (ii) - Rated A. Taxes are paid to the regional offices of the department and from there it is deposited directly into Royal Government Revenue (RGR) Account maintained with the Bank of Bhutan. The revenue collected in the RGR is directly transferred to Government Consolidated Account on daily basis. There is no delay involved in the transfer of revenue to treasury in the present system and it is very effective as the collections are transferred on a daily basis.

Dimension (iii) - Rated C because the reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place annually. Reconciliation between collection and the transfer to treasury is done on monthly basis, within a month of the end of previous month. There is reconciliation between arrears records, collection and tax assessments by different tax type at the regional level but not within the year at the national level in a systematic manner. However, differences between the tax assessed and the transfer to the treasury if any can be explained and the annual report contains reconciled arrears information within 3 months.

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<ul style="list-style-type: none"> <li>(i) The average debt collection ratio in the two most recent fiscal years was 90% or above OR the total amount of tax arrears is insignificant (i.e. less than 2% of total annual collections).</li> <li>(ii) All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily.</li> <li>(iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least monthly within one month of end of month.</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) The average debt collection ratio in the two most recent fiscal years was 75-90% and the total amount of tax arrears is significant.</li> <li>(ii) Revenue collections are transferred to the Treasury at least weekly.</li> <li>(iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least quarterly within six weeks of end of quarter.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) The average debt collection ratio in the two most recent fiscal years was 60-75% and the total amount of tax arrears is significant</li> <li>(ii) Revenue collections are transferred to the Treasury at least monthly.</li> <li>(iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least annually within 3 months of end of the year.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collections).</li> <li>(ii) Revenue collections are transferred to the Treasury less regularly than monthly</li> <li>(iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually or is done with more than 3 months' delay.</li> </ul>

Brief Explanation	Score (M1)
(i) The total amount of tax arrears is less than 2% of total annual collections.	A
(ii) Revenue collections are transferred to the Treasury daily.	A
(iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least annually within 3 months of year end.	C
Overall Rating	C+

### 3.4. Predictability and Control in Budget Execution

#### PI-16 Predictability in the availability of funds for commitment of expenditures

Overall rating category 'C+'

Effective execution of the budget requires that the spending ministries, departments and agencies (MDAs) receive reliable information on availability of funds within which they can commit expenditure for recurrent and capital inputs. This indicator assesses the extent to which the FD provides reliable information on the availability of funds to MDAs that manage budget heads.

Dimensions to be assessed: (i) Extent to which cash flows are forecast and monitored. (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment (iii) Frequency

and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs

Dimension (i) – Rated C. RGoB does not presently have an institutionalized process for cash forecasting. Once the Budget is passed by the Parliament it becomes a law and the budgetary agencies have the legal right for the approved amount. Thus at this level the approved budget as the annual forecast of cash inflows and outflows, so information on cash availability is known at the beginning of the fiscal year. The DPA is aware of the need for cash flow forecasting systems and has decided to initiate pilots in this respect. The funding for the approved budgeted expenditure is assured through a mechanism in place to monitor the bank balances on daily basis by DPA.

With respect to cash management, daily inflows through various sub-accounts like Government Budget Fund Account, Government Revenue Account, Non-Revenue, Receipts & Deposit Accounts and outflows via LC withdrawals by various budgetary agencies are consolidated and the net figure at the end of the day is transferred to the Government Consolidated Account at the Royal Monetary Authority (RMA) with an information copy to DPA. DPA does record the GCA balances on a daily basis and monitors the position.

Dimension (ii) – Rated A. After the budget is approved by the parliament, the Department of National Budget (DNB) notifies all the budgetary agencies and distributes budgets booklets and also in soft copy to respective agencies. Therefore, the agencies know their approved budget and releases. The recurrent expenditure budgets are released on a quarterly basis (25% of total recurrent budget) except for Gewogs it is on a half-yearly basis (50% of recurrent budget). Therefore, agencies can reliably know how much forward commitment they can afford to make for recurrent expenditures at least for some three months (six months for Gewogs) ahead. The releases for capital expenditures are made as and when agencies request for fund releases. However, since the approved budget signals the available amounts for expenditures, spending agencies, in general, can access the resources for forward commitments.

Dimension (iii) - Rated A - Within the approved budget the Ministries, Department and Agencies (MDAs) have the full authority to make technical adjustment to their budget as per the revised delegation of Financial Powers (MOF Circular No. MOF/R.4/136 dated 4th July 2007). MDAs have to submit re-appropriation requests to Ministry of Finance with full justification. As per article 60 of the PFA 2007 the Minister of Finance may authorize a supplementary appropriation without recourse to the Parliament for expenditures that are financed by donors or co-financed jointly with the government for a developmental project that has all the required Government approvals. Similarly, article 66 permits the Minister of Finance to authorize budget appropriation for expenditures due to an emergency or disaster which cannot be postponed without detriment to the public interest. The Minister of Finance has to present the revised budget to the Parliament for ratification through the revised Budget and Appropriation Bill. Therefore, significant adjustment to budget allocations which are decided above the level of management of Ministries, Departments and Agencies are infrequent and transparent.

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<ul style="list-style-type: none"> <li>(i) A cash flow forecast is prepared for the fiscal year, and are updated monthly on the basis of actual cash inflows and outflows.</li> <li>(ii) MDAs' are able to plan and commit expenditure for at least six month in advance in accordance with the budgeted appropriations.</li> <li>(iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a transparent and predictable way.</li> </ul>

Score	Minimum requirements (Scoring methodology: M1)
B	<ul style="list-style-type: none"> <li>(i) A cash flow forecast is prepared for the fiscal year and updated at least quarterly, on the basis of actual cash inflows and outflows.</li> <li>(ii) MDAs are provided reliable information on commitment ceilings at least quarterly in advance.</li> <li>(iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a fairly transparent way.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) A cash flow forecast is prepared for the fiscal year, but is not (or only partially and infrequently) updated.</li> <li>(ii) MDAs are provided reliable information for one or two months in advance.</li> <li>(iii) Significant in-year budget adjustments are frequent, but undertaken with some transparency.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) Cash flow planning and monitoring are not undertaken or of very poor quality.</li> <li>(ii) MDAs are provided commitment ceilings for less than a month OR no reliable indication at all of actual resource availability for commitment.</li> <li>(iii) Significant in-year budget adjustments are frequent and not done in a transparent manner.</li> </ul>

Brief Explanation	Score (M1)
(i) Cash flow planning is inadequate.	C
(ii) Spending units are provided reliable information to plan and commit substantial expenditure at least six months in advance.	A
(iii) Significant in-year budget adjustments are occasional, but undertaken in a fairly transparent manner.	A
Overall Rating	C +

### PI-17 Recording and management of cash balances, debt and guarantees

Overall rating category 'A'

Debt management, in terms of contracting, servicing and repayment, and the provision of government guarantees are often major elements of overall fiscal management. Poor management of debt and guarantees can create unnecessarily high debt service costs and can create significant fiscal risks.

**Dimensions to be assessed:** (i) Quality of debt data recording and reporting (ii) Extent of consolidation of the government's cash balances (iii) Systems for contracting loans and issuance of guarantees.

Dimension (i) – Rated A - Debt data are updated and reconciled on a monthly basis The RGoB uses the CS-DRMS (Commonwealth Secretariat - Debt Recording and Management System) for recording and management of both external and domestic debt. The debt reports are generated at least quarterly for submission to MoF, Royal Monetary Authority, National Statistical Bureau and other relevant agencies. The debt reports are used for the preparation of Annual Budget and AFSs. Debt data inputs are provided to assist the MTFF exercise for MoF.

Dimensions (ii) – Rated B because some extra-budgetary funds like the Current Deposits (CD) accounts of the Revolving Fund remain outside the consolidation arrangement. The cash balances of the other Government bank accounts are consolidated regularly. The balances in the subsidiary principal accounts like the Budget Fund Account, Government Revenue Account, Non-Revenue Receipts and Deposits Account are consolidated daily into the Consolidated Account. The daily cash position of the budgetary operations of the Government is ascertained from this account. The cash balances with the various budgetary agencies are reported on a monthly basis through the submission of the monthly accounts and at the end of the fiscal year this consolidated figure is reported as the closing cash balance of the Government.

Dimension (iii) – Rated A. Controls over the levels for contracting of loans and issuance of guarantees by RGoB are made as per the provisions laid down in Article 14 of the Constitution (The Government shall exercise proper management of the monetary system and public finance. It shall ensure that the servicing of public debt will not place an undue burden on future generations) and the PFA. Chapter VII of PFA 2007 provides for clear and transparent criteria and fiscal targets:

- recurrent expenditure shall be met from the internal resources of the country
- over the medium term, the current operating deficit, as determined in the Budget Policy and Fiscal Framework Statement shall be maintained near zero
- fiscal policies shall be consistent with a reasonable degree of predictability about the level and stability of tax rates for future years and shall be consistent with the requirements for macro-economic stability
- the level of public debt shall be contained such that it will not create undue burden on future generations and threaten national solvency.

The contracting of loan and issuance of guarantees are always approved by a single responsible government entity, the MoF. Local authorities/provincial government may borrow only from the MoF. In the case of commercially viable local community enterprises, local authorities may borrow from financial institutions subject to the approval from MoF (Chapter VII, Clause 131, PFA 2007).

Summary scoring of this indicator is as below.

Dimension	Minimum requirements for dimension score Scoring Methodology M2
<b>(i) Quality of debt data recording and reporting</b>	<p><b>Score = A:</b> Domestic and foreign debt records are complete, updated and reconciled on a monthly basis with data considered of high integrity. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least quarterly</p> <p><b>Score = B:</b> Domestic and foreign debt records are complete, updated and reconciled quarterly. Data considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least annually.</p> <p><b>Score = C:</b> Domestic and foreign debt records are complete, updated and reconciled at least annually. Data quality is considered fair, but some gaps and reconciliation problems are recognized. Reports on debt stocks and service are produced only occasionally or with limited content.</p> <p><b>Score = D:</b> Debt data records are incomplete and inaccurate to a significant degree.</p>

Dimension	Minimum requirements for dimension score Scoring Methodology M2
<b>(ii) Extent of consolidation of the government's cash balances</b>	<b>Score = A:</b> All cash balances are calculated daily and consolidated.
	<b>Score = B:</b> Most cash balances calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement.
	<b>Score = C:</b> Calculation and consolidation of most government cash balances take place at least monthly, but the system used does not allow consolidation of bank balances
	<b>Score = D:</b> Calculation of balances takes place irregularly, if at all, and the system used does not allow consolidation of bank balances.
<b>(iii) Systems for contracting loans and issuance of guarantees.</b>	<b>Score = A:</b> State government's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity.
	<b>Score = B:</b> State government's contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and always approved by a single responsible government entity.
	<b>Score = C:</b> State government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria or overall ceilings.
	<b>Score = D:</b> State government's contracting of loans and issuances of guarantees are approved by different government entities, without a unified overview mechanism.

Brief Explanation	Score (M2)
(i) Debt records are complete, updated and reconciled monthly with reliable quarterly debt reports.	A
(ii) All cash balances are calculated daily and consolidated, except extra-budgetary funds that remain outside the arrangement.	B
(iii) Government contracting of loans and issuance of guarantees are always approved by a single responsible government entity, and are decided on the basis of clear criteria.	A
Overall Rating	A

### PI-18 Effectiveness of payroll controls

Overall rating category 'B+'

The wage bill for public servants is usually one of the biggest items of government expenditure on the recurrent side. This indicator is concerned with the payroll for public servants.

**Dimensions to be assessed:** (i) Degree of integration and reconciliation between personnel records and payroll data. (ii) Timeliness of changes to personnel records and the payroll (iii) Internal controls of changes to personnel records and the payroll; (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.

Dimension (i) – Rated B - The overall personal records of all the civil servants are maintained by the Royal Civil Service Commission (RCSC) in the Personnel Information System (PIS). Also the Human Resource Divisions (HRD) of respective Ministries, Department and Agencies maintain Personnel Records for their respective organizations. The payroll is processed using the computerized system of the Budget and Accounting System (BAS). There is a consolidated database for the civil servants with the RCSC at a national level and a clear linkage exists between the RCSC PIS and the HRD of respective entities and the Payroll system. Firstly, without RCSC order, no HRD of any agency can include any individual in the payroll system, secondly, without internal order from the HRD no finance department can enrol anybody in the payroll system and finally, without RCSC order DPA will not release budget for payroll payment. Personnel and payroll data integrity is high and reconciliation takes place on monthly basis. Hence, this dimension should be rated 'B'.

Dimension (ii) – Rated A. The systems of personnel records and of payroll are maintained separately. Any changes in the payroll data are based on the information and records received from the personnel records system. Since the payroll records have to be updated in time to enable processing of pay bills changes in the personnel records and payroll are timely. This is required by clause 4.2.2.1 (c) of FAM, FRR2001 which states that all modifications in establishment including leave, absence, new appointment etc. communicated to the accounting units up to the 20th of the month shall be incorporated in the payroll for the same month; modifications communicated after the 20th of the month shall be incorporated in the succeeding month's payroll. Since all salary payments have to be processed through the payroll system of the BAS, changes have to be incorporated in order to facilitate generation of pay bills. Employees have to be paid at the end of every month and therefore it can be concluded that personnel records in the payroll are updated on a timely basis for which rating of "A" is assigned.

Dimension (iii) – Rated B Though the personnel records and the payroll system are two separate system there is routine internal control on personnel records and payroll because any changes in the payroll system have to be based on the information provided by HR division from the personnel records. Employment ID No. issued by the personnel records is also the main and unique No. used in the payroll system. Therefore, an appropriate internal control system is in place for any changes required in the personnel records and the payroll.

Dimension (iv) – Rated B. The RAA conducts annual audits of the spending agencies and during that time payroll audit is also being covered and any control weaknesses and existences of ghost workers would be identified.

Scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<ul style="list-style-type: none"> <li>(i) Personnel database and payroll are directly linked to ensure data consistency and monthly reconciliation.</li> <li>(ii) Required changes to the personnel records and payroll are updated monthly, generally in time for the following month's payments. Retroactive adjustments are rare (if reliable data exists, it shows corrections in max. 3% of salary payments).</li> <li>(iii) Authority to change records and payroll is restricted and results in an audit trail.</li> <li>(iv) A strong system of annual payroll audits exists to identify control weaknesses and/or ghost workers.</li> </ul>

Score	Minimum requirements (Scoring methodology: M1)
B	<ul style="list-style-type: none"> <li>(i) Personnel data and payroll data are not directly linked but the payroll is supported by full documentation for all changes made to personnel records each month and checked against the previous month's payroll data.</li> <li>(ii) Up to three months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally.</li> <li>(iii) Authority and basis for changes to personnel records and the payroll are clear.</li> <li>(iv) A payroll audit covering all state government entities has been conducted at least once in the last three years (whether in stages or as one single exercise).</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) A personnel database may not be fully maintained but reconciliation of the payroll with personnel records takes place at least every six months.</li> <li>(ii) Up to three months delay occurs in processing changes to personnel records and payroll for a large part of changes, which leads to frequent retroactive adjustments.</li> <li>(iii) Controls exist, but are not adequate to ensure full integrity of data.</li> <li>(iv) Partial payroll audits or staff surveys have been undertaken within the last 3 years.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) Integrity of the payroll is significantly undermined by lack of complete personnel records and personnel database, or by lacking reconciliation between the three lists.</li> <li>(ii) Delays in processing changes to payroll and nominal roll are often significantly longer than three months and require widespread retroactive adjustments.</li> <li>(iii) Controls of changes to records are deficient and facilitate payment errors.</li> <li>(iv) No payroll audits have been undertaken within the last three years.</li> </ul>

Brief Explanation	Score (M1)
(i) There are reconciliations between the human resource database of RCSC and the personnel records of HRD and the payroll systems of respective agencies.	B
(ii) Required changes to the personnel records and payroll are updated monthly, generally in time for the month's payroll.	A
(iii) Authority and basis for changes to personnel records and the payroll are clear.	B
(iv) A payroll audit covering all central government entities has been conducted in stages at least once in the last three years.	B
Overall Rating	B +

### PI-19 Competition, value for money and controls in procurement

Overall rating category 'C'

Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively and efficiently. Open competition in the award of contracts has been shown to provide the best basis for achieving efficiency in acquiring inputs for and value for money in delivery of programs and services by the government.

**Dimensions to be assessed:** (i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases. (ii) Justification for use of less competitive procurement methods (iii) Existence and operation of a procurement complaints mechanism.

Annex 3 contains the results of an assessment using the OECD-DAC methodology for Assessment of National Procurement Systems, which offers a detailed and operational framework for assessing national public procurement systems vis-à-vis international good practice. The ratings for PI 19 were assessed by the team that completed this review.

Dimension (i) – Rated D. Under Pillar III of the Procurement Assessment in Annex 3 – Procurement Operations and Market Practices – the assessment found that the procurement market in Bhutan is also rather well-functioning. In most areas, the competition for public contracts is high, and there are few major systemic constraints inhibiting the access of the private sector to partake in competition for and implementation of public contracts. In contrast to other industries, the construction industry in Bhutan is characterized by a comparatively strong collaboration between the government and private sector. This is mainly due to the role played by the Construction Development Board (CDB), which is mandated with the dual role of overseeing and promoting the construction industry through policy reforms, registration of contractors, and dispute resolution. In practice, the CDB is in close dialogue with the Construction Association of Bhutan, through which contractors voice concerns about their access to the procurement market. However the assessment found that there was inadequate data to assess the extent to which competitive methods were followed.

The use of open competition for award of contract is the most common method of procurement. However, there is no collated data to relate the use of open competition in terms of percentage. The Team was of the view that had data been available; the use of open competition for award of contract would fall in the range of 90 to 95 per cent. With the current Procurement Reform underway, the PPPD is looking forward to developing a system to capture all these information in future.

Dimension (ii) – Rated B. Less competitive methods are allowed as per para 4.2.5 of PRR 2009

- In the case of purchases up to a maximum of Nu 0.02 million for the purposes of the day to day administration;
- In the absence of at least three bids following the application of Limited Enquiry methods, provided the terms of bidding documents have not changed;
- Where, for technical reasons or for reasons connected with the protection of industrial property rights, the contract may be executed by only one supplier or contractor, provided that there is no suitable substitute;
- The use of less competitive methods are always justified and administrative approval as per the financial powers delegated by the FRR 2001 is always sought from the competent authority before initiating any procurement with less competitive methods;
- No field or case level verification on the frequency and number of non competitive methods or on the manner in which these cases are justified.

Dimension (iii) – Rated C. Annex 3 reports on the Arbitration Framework available in the filed of construction contracts but notes “There is currently no arbitration law in Bhutan, and the country is also not a member of the New York Convention on enforcement of international arbitration awards. As a result, Bhutan also does not have any procedures (except for works) to enable the winner in a dispute to seek enforcement of the outcome by going to the courts, or to monitor dispute resolution processes and address performance issues.”

A right to review for participants in the procurement process is duly established in the PRR (8.1) but there is no data on timeliness:

- Rule 8.1.5 establishes that following review by the procuring agency, the complainant may request a review carried out by the Independent Review Body established by the Ministry of Finance.
- The decisions of the Independent Review Body are subject to review by the court (PRR rule 8.1.9).
- The subject matter open to review is clearly defined in the PRR. A review may cover all the duties of the procuring agency under the PRR (PRR rule 8.1.1 through 8.1.3).
- Judicial review may only cover questions of law (PRR rule 8.1.9).
- The procuring agency must issue a decision within 15 days after submission of the complaint (PRR rule 8.1.4). There are no timeframes established for the decisions of the independent review body.

The procedure for award of contracts at the lower level government is the same as that of the central level. However, as per clause 3.1.1.4 (i) c of the PRR 2009 any work with an estimated value of Nu.0.5million can be awarded to the local community provided it is endorsed by Gewog Yargey Tshochung (GYT). Further, in case of remote areas where there are no potential bidders after open competition, the work can be directly awarded to the single contractor provided the estimate value of work is within 3 million and the quoted/negotiated amount is within the estimate (clause 4.2.5.2 (h)). Again, there is no data to find out the percentage of works that have been awarded using this method.

Score	Minimum requirements (Scoring methodology: M1)
<p><b>(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases</b></p>	<p><b>Score = A:</b> Accurate data on the method used to award public contracts exists and shows that more than 75% of contracts above the threshold are awarded on the basis of open competition.</p> <p><b>Score = B:</b> Available data on public contract awards shows that more than 50% but less than 75% of contracts above the threshold are awarded on basis of open competition, but the data may not be accurate.</p> <p><b>Score = C:</b> Available data shows that less than 50% of contracts above the threshold are awarded on an open competitive basis, but the data may not be accurate.</p> <p><b>Score = D:</b> Insufficient data exists to assess the method used to award public contracts OR the available data indicates that use of open competition is limited.</p>
<p><b>(ii) Justification for use of less competitive procurement methods</b></p>	<p><b>Score = A:</b> Other less competitive methods when used are justified in accordance with clear regulatory requirements.</p> <p><b>Score = B:</b> Other less competitive methods when used are justified in accordance with regulatory requirements.</p> <p><b>Score = C:</b> Justification for use of less competitive methods is weak or missing.</p> <p><b>Score = D:</b> Regulatory requirements do not clearly establish open competition as the preferred method of procurement.</p>

Score	Minimum requirements (Scoring methodology: M1)
<b>(iii) Existence and operation of a procurement complaints mechanism</b>	<b>Score = A:</b> A process (defined by legislation) for submission and timely resolution of procurement process complaints is operative and subject to oversight of an external body with data on resolution of complaints accessible to public scrutiny.
	<b>Score = B:</b> A process (defined by legislation) for submitting and addressing procurement process complaints is operative, but lacks ability to refer resolution of the complaint to an external higher authority.
	<b>Score = C:</b> A process exists for submitting and addressing procurement complaints, but it is designed poorly and does not operate in a manner that provides for timely resolution of complaints.
	<b>Score = D:</b> No process is defined to enable submitting and addressing complaints regarding the implementation of the procurement process.

Brief Explanation	Score (M2)
(i) Insufficient data are available to assess this dimension	D
(ii) Regulations cover the use of less competitive methods	B
(iii) Timeliness is uncertain in redress of complaints	C
Overall Rating	C

### PI-20 Effectiveness of internal controls for non-salary expenditure

Rating 'A'

**Dimensions to be assessed:** (i) Effectiveness of expenditure commitment controls.  
(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures.  
(iii) Degree of compliance with rules for processing and recording transactions.

The RAA conducts annual audits that assess the effectiveness of controls and require recoveries of irregularities. The audit process is a major component in ensuring the adequacy of the control system. Results from the 2008 Annual Report of the RAA showed that most of the irregularities in the budgetary agencies were slow repayments of advances (Nu. 81 million of the total of Nu. 116 million irregularities).

Irregularities by category of irregularities

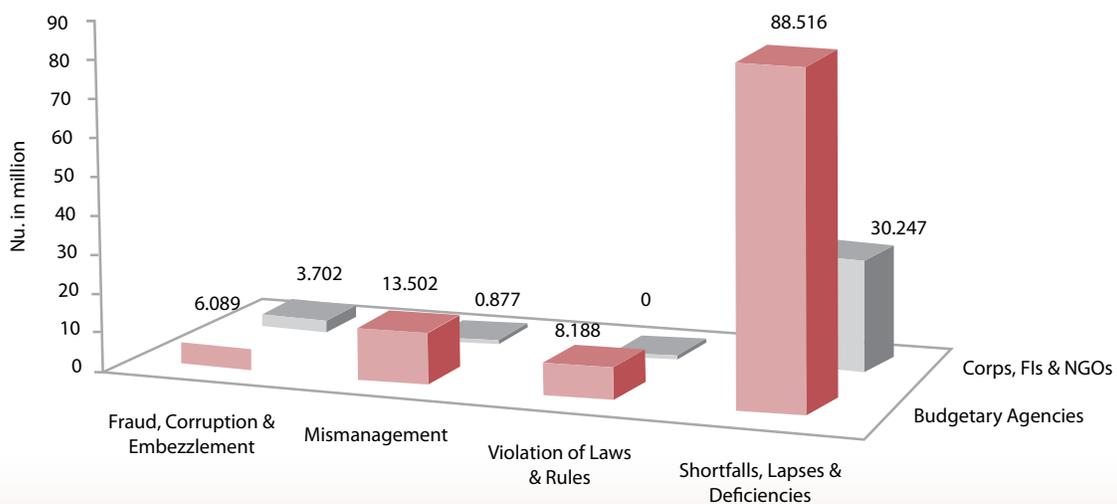
Category	Nu. Million
1 Fraud, Corruption & Embezzlement	6.089
1.1 Malpractices & abuses	3.152
1.2 Misappropriation	2.600
1.3 Non/Short accounting of funds	0.337
2 Mismanagement	13.502
2.1 Mismanagement of funds	10.423

Category	Nu. Million
2.2 Mismanagement of properties	0.324
2.3 Mismanagement of revenues & taxes	2.755
3 Violation of Laws & Rules	8.188
3.1 Violation of budgetary norms	0.000
3.2 Violation of accounting norms	4.440
3.3 Violation of procurement norms	3.748
4 Shortfalls, Lapses & Deficiencies	88.516
4.1 Over/inadmissible/irregular/double payments	4.352
4.2 Non production/missing documents	0.562
4.3 Non/short deductions	0.352
4.4 Irregularities in property management	0.720
4.5 Non-refund of unspent balances	0.313
4.6 Shortfalls & uneconomic operations	0.480
4.7 Irregularities in advances	81.737
<b>TOTAL</b>	<b>116.295</b>

Source: RAA Annual Report 2008

The following chart shows the irregularities by type, indicating that violation of laws and rules are quite low:

#### IRREGULARITIES BY OBSERVATION CATEGORY BIFURCATED INTO BUDGETARY AGENCIES AND CORPORATIONS, FINANCIAL INSTITUTIONS AND NGOs



Source: RAA 2008 Annual Report

Dimension (i) – Rated A. As per Article 61 of the PFA2007 the budgetary bodies shall expend public money only in accordance with an appropriation under the Budget and Appropriation Act. Similarly, Article 63 of the PFA prohibits budgetary bodies from making commitments that have financial implications beyond the limit authorized by the Budget and Appropriation Act. Further, the present computerized

government Budget and Accounting System (BAS) restricts incurring of expenditure beyond the budget appropriation. Therefore, all this limits the commitments to available budget appropriation although there is no system of recording the expenditure commitments in the present government accounting system. At times the Accounting Unit uses the BAS not at the point of transaction to process payment; rather it is used as a tool for recording expenditure at the end of the month, transferring the record from the manual cash book to BAS. Significant use of this would result in weaker commitment controls.

Dimension (ii) – Rated A. Internal control rules and procedures consists of a set of rules and regulations for processing and recording transactions specified in the FRR2001 which are understood by those directly involved in their application. In respect of bank accounts under FAM 1.6.1.3 of FRR2001 the bank accounts allotted to the Budget Agencies shall generally be operated jointly by the Head of Office/Head of AFD and the Finance Service officer. Annual RAA reports on all agencies show the internal control system is comprehensive and well understood, although there are irregularities – amounting to Nu. 932 million for 2008.

Dimension (iii) – Rated A. Compliance with rules is very high and any use of simplified and emergency procedures is very minimal or insignificant, if any. Any such deviation will be revealed by the RAA in their annual reports.

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<ul style="list-style-type: none"> <li>(i) Comprehensive expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations (as revised).</li> <li>(ii) Other internal control rules and procedures are relevant, and incorporate a comprehensive and generally cost effective set of controls, which are widely understood.</li> <li>(iii) Compliance with rules is very high and any misuse of simplified and emergency procedures is insignificant.</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) Expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations for most types of expenditure, with minor areas of exception.</li> <li>(ii) Other internal control rules and procedures incorporate a comprehensive set of controls, which are widely understood, but may in some areas be excessive (e.g. through duplication in approvals) and lead to inefficiency in staff use and unnecessary delays.</li> <li>(iii) Compliance with rules is fairly high, but simplified/emergency procedures are used occasionally without adequate justification.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) Expenditure commitment control procedures exist and are partially effective, but they may not comprehensively cover all expenditures or they may occasionally be violated.</li> <li>(ii) Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance.</li> <li>(iii) Rules are complied with in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations is an important concern.</li> </ul>

Score	Minimum requirements (Scoring methodology: M1)
D	(i) Commitment control systems are generally lacking OR they are routinely violated. (ii) Clear, comprehensive control rules/procedures are lacking in other important areas. (iii) The core set of rules are not complied with on a routine and widespread basis due to direct breach of rules or unjustified routine use of simplified/emergency procedures.

Brief Explanation	Score (M1)
i. Expenditure commitment control procedures exist and are effective, but may occasionally be violated.	A
ii. Internal control rules and procedures consist of basic set of rules for processing and recording transactions, which are understood by those directly involved in their application.	A
iii. Compliance with rules is fairly high	A
Overall Rating	A

### PI-21 Effectiveness of internal audit

Overall rating category 'C+'

Regular and adequate feedback to management is required on the performance of the internal control systems, through an internal audit function (or equivalent systems monitoring function). Such a function should meet international standards provided by the Institute of Internal Auditors.

Dimensions to be assessed: (i) Coverage and quality of the internal audit function. (ii) Frequency and distribution of reports. (iii) Extent of management response to internal audit findings.

Dimension (i) – Rating B. Internal audit is operational for the majority of central government entities (measured by value of revenue/expenditure), and substantially meet professional standards. It is focused on systemic issues (at least 50% of staff time). MoF is the parent agency for Government Internal Auditors. 18 Internal Auditors operate in 9 of the 10 Ministries. On average 70 % of the budget is covered by internal audit over the last 3 years. An assessment of a sample of Ministry audits for 2008 showed slightly higher weighting toward system over transaction audits overall:

Agency	Transaction Audits	System Audits	No. of Internal Auditors
Ministry of Agriculture	7	1	2
Ministry of Home and Cultural Affairs	1	10	4
Ministry of Finance	5	5	2

Dimension (ii) - Rating C - The reports are issued to management as and when an audit is done but there is no consolidated report issued annually. The report is issued to the head of the agency with a copy to the audited unit within the agency. Reports are not circulated to the SAI and Ministry of Finance, but SAI can get access to Internal Audit Reports from the Agency.

Dimension (iii) – Rating B. Internal Audit recommendations are addressed in all the Ministries and acted upon with accordance to their significance and approximately 70% of the recommendations are acted upon immediately

Although there are few Internal Auditors in each Ministry, the outcome or effectiveness is felt in the Ministries. There is approval for the establishment of Internal Audit Services in all Dzongkhags and this would further strengthen the effectiveness of the Internal Audit Services. There is also a plan to recruit more Internal Auditors in the Ministries and in the Dzongkhags. .

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<ul style="list-style-type: none"> <li>(i) Internal audit is operational for all central government entities, and generally meet professional standards. It is focused on systemic issues (at least 50% of staff time).</li> <li>(ii) Reports adhere to a fixed schedule and are distributed to the audited entity, MoF and the SAI.</li> <li>(iii) Action by management on internal audit findings is prompt and comprehensive across central government entities.</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) Internal audit is operational for the majority of central government entities (measured by value of revenue/expenditure), and substantially meet professional standards. It is focused on systemic issues (at least 50% of staff time).</li> <li>(ii) Reports are issued regularly for most audited entities and distributed to the audited entity, the MoF and the SAI.</li> <li>(iii) Prompt and comprehensive action is taken by many (but not all) managers.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) The function is operational for at least the most important central government entities and undertakes some systems review (at least 20% of staff time), but may not meet recognized professional standards.</li> <li>(ii) Reports are issued regularly for most government entities, but may not be submitted to the MoF and the SAI.</li> <li>(iii) A fair degree of action taken by many managers on major issues but often with delay</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) There is little or no internal audit focused on systems monitoring.</li> <li>(ii) Reports are either non-existent or very irregular.</li> <li>(iii) Internal audit recommendations are usually ignored (with few exceptions).</li> </ul>

Brief Explanation	Score (M1)
(i) Audits substantially meet professional standards	<b>B</b>
(ii) Reports are issued to the audited entity, but not to the MoF or RAA. However, MoF and RAA can have the reports if need be.	<b>C</b>
(iii) Prompt and comprehensive action is taken by most managers.	<b>B</b>
Overall Rating	<b>C+</b>

### 3.5. Accounting, Recording and Reporting

#### PI-22 Timeliness and regularity of accounts reconciliation

Rating 'B'

Reliable reporting of financial information requires constant checking and verification of the recording practices of accountants.

**Dimensions to be assessed:** (i) Regularity of bank reconciliations (ii) Regularity of reconciliation and clearance of suspense accounts and advances.

Dimension (i) Rated B. as all treasury bank accounts are reconciled on a monthly basis within 4 weeks. As per FAM 11.1.6.1 of the FRR2001: The reconciliation of Government Consolidated Account (GCA) shall involve reconciliation of the following two sub-principal accounts operated by the Department of Public Accounts (DPA) and Department of Revenue and Customs (DRC).

- The Government Budget Fund Account (GBFA) shall be reconciled with the bank statements by the DPA. The GBFA is reconciled on a monthly basis
- The Government Revenue Account (RGR) shall be reconciled with the bank statements by the DRC. RGR is also reconciled on a monthly basis.

The individual banks statements are reconciled with the statements from the Central Accounts Department (CAD) of the Bank's Headquarters. This is reconciled on a monthly basis. All the Letter of Credit (LC) and Project Letter of Credit (PLC) accounts operated by various budgetary agencies are reconciled within 7 days of closing the month. Though the GCA balance is ascertained on a daily basis and its sub-accounts like GBFA, RGR and NRA are reconciled on a monthly basis, the actual GCA reconciliation is presently done only at the end of the Fiscal Year (FY).

Dimension (ii) – Rated B as a reconciliation and clearance process has been undertaken in the last year. Some accounts have uncleared balances brought forward.

The Advance and Suspense Accounts are categorized as follows:

- i. Personal Advances
- ii. Suspense:
  - a. Stock
  - b. Purchases
  - c. PW Advances
  - d. Intra-Agency Assignments
  - e. Deposit Works
  - f. Other Deposits

The closing balances are arrived at after taking into accounts all the budgetary actual expenditures plus the advances and suspense's. The unadjusted balances of advances and suspense in BAS are carried forward in subsequent years for necessary adjustments. The consolidated Advance and Suspense Account for the FY 2007-2008 reduced to Nu. 25.721 million as compared to Nu. 486.688 million in FY 2006-2007 but increased to 196 million for FY 2008-09. The reduction followed the decision of the parliament to settle the outstanding advances at the earliest and follow up by the RAA. Budgetary agencies do have all the details of the advances and suspense in their books of accounts but there is no central record. Clearly, continued attention is needed.

Summary scoring of this indicator is as below.

Dimension	Minimum requirements for dimension score Scoring Methodology M2
<b>(i) Regularity of bank reconciliations</b>	<p><b>Score = A:</b> Bank reconciliation for all central government bank accounts take place at least monthly at aggregate and detailed levels, usually within 4 weeks of end of period.</p> <p><b>Score = B:</b> Bank reconciliation for all Treasury managed bank accounts take place at least monthly, usually within 4 weeks from end of month.</p> <p><b>Score = C:</b> Bank reconciliation for all Treasury managed bank accounts take place quarterly, usually within 8 weeks of end of quarter.</p> <p><b>Score = D:</b> Bank reconciliation for all Treasury managed bank accounts take place less frequently than quarterly OR with backlogs of several months.</p>
<b>(ii) Regularity of reconciliation and clearance of suspense accounts and advances</b>	<p><b>Score = A:</b> Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within a month from end of period and with few balances brought forward.</p> <p><b>Score = B:</b> Reconciliation and clearance of suspense accounts and advances take place at least annually within two months of end of period. Some accounts have un-cleared balances brought forward.</p> <p><b>Score = C:</b> Reconciliation and clearance of suspense accounts and advances take place annually in general, within two months of end of year, but a significant number of accounts have un-cleared balances brought forward.</p> <p><b>Score = D:</b> Reconciliation and clearance of suspense accounts and advances take place either annually with more than two months' delay, OR less frequently.</p>

Brief Explanation	Score (M2)
(i) At aggregate level the reconciliation is done on an annual basis but at the detailed level (individual bank accounts) the reconciliation are done on a monthly basis within 4 weeks.	B
(ii) A process of reconciliation and progressive clearance of suspense accounts has been done within the last year.	B
Overall Rating	B

### PI-23 Availability of information on resources received by service delivery units

Overall rating category 'A'

Problems frequently arise in front-line service delivery units providing services at the community level in obtaining resources that were intended for their use. Tracking of such information is crucial in order to determine, if the PFM systems effectively support front-line service delivery.

**Dimensions to be assessed:** Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (focus on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is responsible for the operation and funding of those units.

All spending by budgetary agencies are subject to the budget, which is expressed in very detailed appropriations and authorized through allotment process under the responsibility of the Ministry of Finance. Therefore, the front-line service delivery unit like primary schools and primary health clinics fall under the concerned gewog's budget. The gewog's budgets are broken down into detailed activities. This information is widely available through the budget documents and facilitates timely withdrawal of funds for use by the frontline agencies.

The Government BAS provides reliable information on resources received in cash and in kind by all levels of budgetary agencies for all funding sources.

Scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics. The information is compiled into reports at least annually.
B	Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by either primary schools or primary health clinics with information compiled into reports at least annually; OR special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by both primary schools and primary health clinics (including by representative sampling).
C	Special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by either primary schools or primary health clinics covering a significant part of the area OR by primary service delivery units at local community level in several other sectors.
D	No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last 3 years.

Brief Explanation	Score (M1)
Routine budget and accounting systems provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics across the country. The information is compiled into reports at least annually.	A
Overall Rating	A

#### PI 24 Quality and timeliness of in-year budget reports

Overall rating category 'D+'

The ability to implement the budget requires timely and regular information on actual budget performance to be available both to the FD and to the MDAs for managing the affairs for which they are accountable. The indicator focuses on the ability to produce comprehensive reports from the accounting systems on all aspects of the budget.

**Dimensions to be assessed:** (i) Scope of reports in terms of coverage and compatibility with budget estimates (ii) Timeliness of the issue of reports (iii) Quality of information

Dimension (i) – Rated C. The report on actual budget performance covers all the budgetary agencies and is compatible with the budget estimates for the period reported. All the required information is available in the system and the Finance Department is able to produce in-year (quarterly/half-yearly) budget reports. Accounting policy of the RGoB is ‘cash basis’ not on ‘accrual bases. As such the accounting system in use or the principle of accounting does not allow recording and reporting of future commitments. However, since there is no mechanism of commitment accounting and expenditures are captured only at the payment stage, the rating of “C” is assigned for this dimension.

Dimension (ii) – Rated D - Though the releases for recurrent expenditures are made on quarterly or half-yearly basis, the budgetary agencies are required to submit the accounts on receipts and expenditures of government resources on a monthly basis in respect of individual bank accounts allotted to them. Therefore, all the information on government receipts and expenditures are received at the DPA on a monthly basis and can be consolidated for the whole government on a monthly basis. However, neither PFA2007 nor FRR2001 require an in-year budget report. Nevertheless, DPA, MOF has once produced an in-year (half-yearly) budget report as a requirement to be fulfilled for the Development Policy Grant II (DPG-II) assistance from the World Bank. Since this report was produced only once and thereafter it was discontinued the rating for dimension (ii) is allotted “D”.

Dimension (iii) – Rated A. as the data are generated from the computerized government budget and accounting system (BAS) software and validated into the centralized budget and accounting (CBA) system so there are no material concerns regarding the data accuracy.

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<ul style="list-style-type: none"> <li>(i) Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages.</li> <li>(ii) Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period.</li> <li>(iii) There are no material concerns regarding data accuracy.</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) Classification allows comparison to budget but only with some aggregation. Expenditure is covered at both commitment and payment stages.</li> <li>(ii) Reports are prepared quarterly, and issued within 6 weeks of end of quarter.</li> <li>(iii) There are some concerns about accuracy, but data issues are generally highlighted in the reports and do not compromise overall consistency/ usefulness.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both).</li> <li>(ii) Reports are prepared quarterly (possibly excluding first quarter), and issued within 8 weeks of end of quarter.</li> <li>(iii) There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness.</li> </ul>

Score	Minimum requirements (Scoring methodology: M1)
D	<ul style="list-style-type: none"> <li>(i) Comparison to the budget may not be possible across all main administrative headings.</li> <li>(ii) Quarterly reports are either not prepared or often issued with more than 8 weeks delay.</li> <li>(iii) Data is too inaccurate to be of any real use.</li> </ul>

Brief Explanation	Score (M1)
(i) Information is captured only at the payment stage and not at commitment stage	C
(ii) In-year reports have been prepared but not currently.	D
(iii) There are no material concerns regarding data accuracy	A
Overall Rating	D+

### PI-25 Quality and timeliness of annual financial statements

Overall rating 'C+'

Consolidated year-end financial statements are critical for transparency in the PFM system. To be complete, they must be based on details for all ministries and departments

**Dimensions to be assessed:** (i) Completeness of the financial statements (ii) Timeliness of submission of the financial statements (iii) Accounting standards used.

Dimension (i) – Rated B. The Annual Financial Statement (AFS) of the Government which is prepared annually covers all government budgetary agencies. It has complete information on revenues, expenditures, grants and loans. It also includes statements of the Government Equity Portfolio in corporations and financial institutions, Government Guarantees, government outstanding debt etc. However, in the absence of full information on financial assets and liabilities a rating assigned for dimension (i) is "B". However as required by Property Management Manual (FRR 2001), all spending agencies maintain Assets Register, which is regularly scrutinized by external audit.

Dimension (ii) – Rated A. The AFSs of the Government are prepared annually within 6 months after the close of the fiscal year. For FY 2006-07 and 2007-08 they were submitted to RAA December 28, 2007 and December 30, 2008

Dimension (iii) – Rated C. The financial statements are presented in a consistent format over time as stipulated in the FRR2001. Currently Bhutan does not have any National Accounting Standard of its own so no accounting standards are disclosed but reference is made to the FRR and the PFA 2007 as the basis on which the accounts are prepared. Only recently MOF has started a process of developing Bhutan Accounting Standards. However, in parallel to the existing reporting format, the DPA has made an attempt to apply the International Public Sector Accounting Standard (IPSAS) Cash Basis of Financial Reporting; using IPSAS Part 2 format for the FY 2006-2007 onwards. The 2008 RGoB report 'Introduction of Accruals Accounting' highlighted differences between the current AFS and IPSAS 2. So a rating of "C" is assigned.

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<ul style="list-style-type: none"> <li>(i) A consolidated government statement is prepared annually and includes full information on revenue, expenditure and financial assets/liabilities.</li> <li>(ii) The statement is submitted for external audit within 6 months of the end of the fiscal year.</li> <li>(iii) IPSAS or corresponding national standards are applied for all statements.</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) A consolidated government statement is prepared annually. They include, with few exceptions, full information on revenue, expenditure and financial assets/liabilities</li> <li>(ii) The consolidated government statement is submitted for external audit within 10 months of the end of the fiscal year.</li> <li>(iii) IPSAS or corresponding national standards are applied.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) A consolidated government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete, but the omissions are not significant.</li> <li>(ii) The statements are submitted for external audit within 15 months of the end of the fiscal year.</li> <li>(iii) Statements are presented in consistent format over time with some disclosure of accounting standards.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) A consolidated government statement is not prepared annually, OR essential information is missing from the financial statements OR the financial records are too poor to enable audit.</li> <li>(ii) If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the fiscal year</li> <li>(iii) Statements are not presented in a consistent format over time or accounting standards are not disclosed.</li> </ul>

Brief Explanation	Score (M1)
(i) A consolidated government statement is prepared annually. They include, , full information on revenue, expenditure and with exceptions regarding financial assets/liabilities	B
(ii) The statement is submitted for external audit within 6 months of the end of the fiscal year	A
(iii) Statements are presented in a consistent format over time with some disclosure of accounting standards.	C
Overall Rating	C+

### 3.6. External Scrutiny and Audit

#### PI-26 Scope, nature and follow up of external audit

Overall rating 'B+'

A high quality external audit is an essential requirement for creating transparency in the use of public funds.

**Dimensions to be assessed:** (i) Scope/nature of audit performed (incl. adherence to auditing standards). (ii) Timeliness of submission of audit reports to legislature. (iii) Evidence of follow up on audit recommendations.

Dimension (i) – Rated B because central Government entities representing at least 75% of total expenditures are audited annually:

- Total value of expenditures for entities audited during the fiscal year 2007-08 (incl. AGAs, but excluding Dzongkhags & Gewogs) = Nu. 13,516.564 million\*
- Total value of expenditures of central Government entities for the fiscal year 2007-08 (incl. AGAs, but excluding Dzongkhags & Gewogs) = Nu. 17,658.533 million\*\*
- Percentage of entities audited (by value of expenditure) = 76.54%

(\*Source: Annual Audit Schedule 2007-08; <http://www.bhutanaudit.gov.bt>)

(\*\*Source: Audited Annual Financial Statements of the RGoB for the year ended 30th June 2008)

Besides the expenditures incurred by the government agencies, the RAA also audits both state-owned and private/public listed companies, and also NGOs, Revolving Fund, etc. whose expenditures are not captured in Government Financial Statements.

Section 72(1) of the Companies Act of the Kingdom of Bhutan 2000 provides that:

“Every company shall, at each Annual General Meeting, appoint auditors or joint auditors, out of the panel of auditors maintained by the RAA, to hold office from the conclusion of that meeting until the conclusion of the next Annual General Meeting.” Based on this provision, it is a statutory requirement to audit all listed companies annually and also the State-owned companies.

Section 38 of the Audit Act 2006 provides for a wide scope for the audit and states that:

“The functions of the Authority shall be to:

- (a) Carry out financial, propriety, compliance, special audits and any other form of audits that the Auditor General may consider significant and necessary;
- (b) Conduct Performance audit to ascertain and report on the economy, efficiency and effectiveness of the operations of agencies audited”.

Thus the RAA, as the Supreme Audit Institution (SAI) for Bhutan has a vast mandate to carry out any type of audit as deemed appropriate by the RAA. Article 25, of the Constitution of the Kingdom of Bhutan (2008) and Section 3 of the Audit Act 2006 sets out the mandate and objectives of the audits as follows:

“There shall be a Royal Audit Authority to audit and report on the economy, efficiency, and effectiveness in the use of public resources.”

The RAA has institutionalized the Department of Performance and Thematic Audits which performs performance audits, including environmental audits, IT audits and system audits. During every session of the Parliament, at least one or two performance audit reports are discussed. The RAA conducts thematic audit on topics such as, procurement, air-ticketing, farm roads, health sectors.

Regarding auditing standards, Section 57 of the Audit Act 2006 provides that “The Authority shall publish standards and practices in appropriate manner to make the proposal known to the public and invite comments before adopting such standards.” In line with this provision, the RAA adopted its auditing standard which is adapted from the International Organization of Supreme Audit Institutions (INTOSAI)

Auditing Standards in 2009. Prior to this standard, the RAA used the Bhutan General Auditing Rules and Regulations 1989 (GAAR).

For local Governments, the RAA has a policy of carrying out audit of dzongkhags at least once in two years; and for 2007-08, 14 of the 20 dzongkhags were audited.

Dimension (ii) – Rated A as the four month time line for tabling of the audit reports in the National Assembly is achieved. For the audit of financial accounts, Section 11.1.1.2 of FRR 2001 requires “The statements (AFS) shall be audited and certified by the Royal Audit Authority before submission to the Government. The audit shall be completed within four months after preparation of the statements.” Section 69 of the Audit Act 2006 mandates general audit reporting arrangements: “The Auditor General shall submit the Annual Audit Report during the fourth quarter of the fiscal year on the audits carried out during the previous fiscal year”. The AAR 2008 covering audits conducted the period from 1st January 2008 to 31st December 2008 was transmitted to the Parliament on 6th May 2009 which is also essentially within the four months of the end of period covered by the audit program

Dimension (iii) – Rated A as the response on audit observations is well managed. Section 75 of the Audit Act provides that

“All entities must respond to the Audit Reports within the time frame as specified here under:

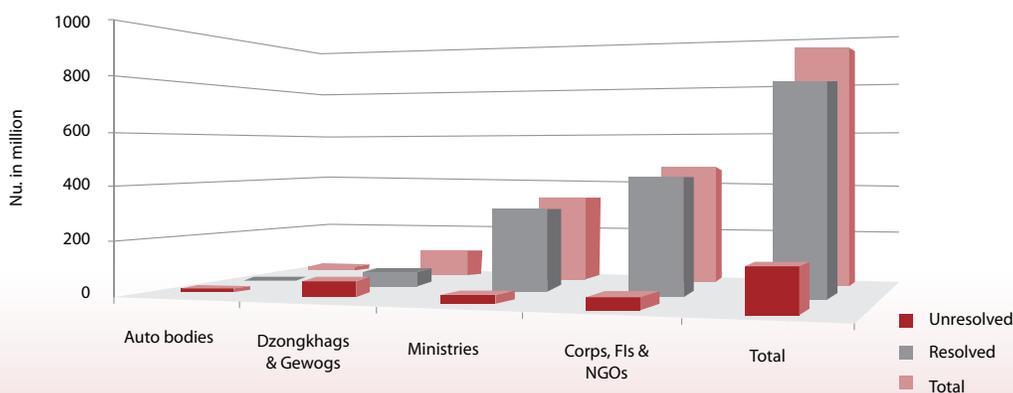
- Response to initial audit observations – within one month of the issue of field audit memos.
- Response to agency specific reports – within three months of the issue of the reports by the Authority
- Response to draft AAR– within one month of the issue of the draft by the Authority”

Other responsibilities are:

Section 76: “The Lhengye Zhungtshog (Cabinet Ministers), Ministries, and other concerned authorities shall be responsible to take timely follow-up actions on Audit Reports under this Act.”

Section 77: “The Royal Audit Authority shall issue reminders on reports not being acted upon and if there be further non-compliance and non co-operation, a defaulting auditee must be questioned and required to submit explanation.”

COMPARATIVE FIGURES OF SIGNIFICANT IRREGULARITIES REPORTED DURING THE YEAR



Source: Annual Audit Report 2008

The RAA monitors timely follow-up actions through its database system – the Audit Information Management System (AIMS) tracks all pending audit issues and actions to disallow civil servants of Audit

Clearance. This is a mandatory requirement for the approval by the RAA of any promotion, training, further studies, for claiming retirement benefits and also for candidates aspiring to be politicians.

Follow-up reports on unresolved audit reports are issued (e.g. status as on 15th April 2009) was issued by the RAA on 12th May 2009 as an output from the AIMS. The 2008 Audit Report showed the following table of follow-up results indicating a very effective follow up record:

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<ul style="list-style-type: none"> <li>(i) All entities of central government are audited annually covering revenue, expenditure and assets/liabilities. A full range of financial audits and some aspects of performance audit are performed and generally adhere to auditing standards, focusing on significant and systemic issues.</li> <li>(ii) Audit reports are submitted to the legislature within 4 months of the end of the period covered and in the case of financial statements from their receipt by the audit office.</li> <li>(iii) There is clear evidence of effective and timely follow up.</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) Central government entities representing at least 75% of total expenditures are audited annually, at least covering revenue and expenditure. A wide range of financial audits are performed and generally adheres to auditing standards, focusing on significant and systemic issues.</li> <li>(ii) Audit reports are submitted to the legislature within 8 months of the end of the period covered and in the case of financial statements from their receipt by the audit office.</li> <li>(iii) A formal response is made in a timely manner, but there is little evidence of effective systematic follow up.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only.</li> <li>(ii) Audit reports are submitted to the legislature within 12 months of the end of the period covered (for audit of financial statements from their receipt by the auditors).</li> <li>(iii) A formal response is made, though delayed or not very thorough, but there is little evidence of any follow up.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) Audits cover central government entities representing less than 50% of total expenditures or audits have higher coverage but do not highlight the significant issues.</li> <li>(ii) Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audit of financial statements from their receipt by the auditors).</li> <li>(iii) There is little evidence of response or follow up.</li> </ul>

Brief Explanation	Score (M1)
(i) Government entities representing at least 75% of total expenditures <sup>12</sup> are audited annually covering revenue, expenditure, assets and liabilities. A full range of financial audits and some performance audit are performed, audit reports focus on significant and systemic issues and auditing standards are generally adhered to.	B
(ii) Audit reports are submitted to the Legislature within 4 months of the end of the period covered.	A
(iii) There is clear evidence of effective and timely follow up.	A
Overall Rating	B+

### PI-27 Legislative scrutiny of the annual budget law

Overall rating 'D+'

The power to give the government authority to spend rests with the legislature, and is exercised through the passing of the annual budget law. If the legislature does not rigorously examine and debate the law, that power is not being effectively exercised and will undermine the accountability of the government to the electorate.

**Dimensions to be assessed:** (i) Scope of the legislature's scrutiny. (ii) Extent to which the legislature's procedures are well established and respected. (iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined); (iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.

Dimension (i) Rated D - The legislature reviews the budget but only at a stage where detailed proposals have been finalized and there are no powers to modify the budget; rather the Parliament ratifies the budget. Experience of the past three sessions wherein the budget was deliberated, indicates a process of opinion sharing by the MPs on the budget presented by the FM rather than a deliberation on possible amendments to the budget through proposed changes in budget allocations under different ministries, agencies, dzongkhags, gewogs etc., and under different activities of expenditures.

Dimension (ii) Rated C – The legislature's procedures for budget review are still evolving and are not detailed. They are currently encapsulated in the following Constitutional and PFA requirements for tabling and passage, with little details about review processes:

- Article 13 (5): 'Where a Bill has been introduced and passed by one House it shall present the Bill to the other House within thirty days from the date of passing and that Bill may be passed during the next session of Parliament. In the case of budget and Urgent Bills, they shall be passed in the same session of Parliament.'
- Article 14 (8): 'The annual budget, with a report on the budget of the previous fiscal year, shall be presented to the National Assembly by the Finance Minister.'
- Article 14 (10): 'Any expenditure not included in the budget, or in excess of the budget appropriation, as well as the transfer of any fund from one part of the budget to another, shall be made in accordance with the law.'

- Compliance to Section 13 of the PFA of Bhutan, 2007 which requires presentation of the audited AFSs, the Budget Policy and Fiscal Framework Statement, and the Budget and Appropriation Bill.

The annual budget is formally approved by the Parliament in its summer session and a supplementary (revision) budget, with changes from initial budget allocations, if any, is approved by the Parliament in its winter session.

Dimension (iii) Rated D - Generally, only a week has been provided to the Members of Parliament (MPs) before presentation of annual budget to the House of Parliament. Experience from the past sessions indicates that the annual budget is approved as soon as the presentation is completed in both the Houses of the Parliament, i.e., a maximum of two days of presentation in the National Assembly followed by another day of presentation in the National Council so long as there is no controversy over the budget heads and amounts mentioned in the Annual Budget Report. So it takes about three days to officially declare budget as approved by the Parliament.

The present procedures do not provide adequate time for the legislature to review the budget proposal. In fact, it is not truly a budget proposal but a presentation of a final budget for the forthcoming financial year for formal ratification by the Parliament.

The budget cycle involves five phases as under:

1. Budget Preparation;
2. Budget Approval;
3. Budget Execution – Releases of Funds;
4. Budget Accountability; and
5. Interim Revisions.

The Legislature has no involvement during the budget preparation stage and only accords a formal approval of the Annual Budget Report presented as per Section 13 of the PFA to the Parliament by the FM. Legislature also accords formal approval for Supplementary Budget report presented to the Parliament by the FM in the winter session.

Dimension (iv) Rated A because of a well-regulated system- There are provisions in the prevailing Budget Manual (July 2001) of the MoF which allows interim revisions of the budget. Generally it is not allowed for government agencies to spend more than what the Parliament has appropriated. However, owing to changing circumstances when revision would be a necessity, such revisions shall be submitted for approval to the Cabinet (Council of Ministers) and the Heads of agencies depending upon the delegation of financial powers at various levels in the government.

The revisions undertaken are incorporated in the Revised Estimates, which is presented at the subsequent Parliament session for ratification along with the new budget. The Parliament approves the new budget in the form of a Supplementary Budget for the year.

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<p>(i) The legislature's review covers fiscal policies, MTFP and medium term priorities as well as details of expenditure and revenue.</p> <p>(ii) The legislature's procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures.</p>

Score	Minimum requirements (Scoring methodology: M1)
	<ul style="list-style-type: none"> <li>(iii) The legislature has at least two months to review the budget proposals.</li> <li>(iv) Clear rules exist for in-year budget amendments by the executive, set strict limits on extent and nature of amendments and are consistently respected.</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue.</li> <li>(ii) Simple procedures exist for the legislature's budget review and are respected.</li> <li>(iii) The legislature has at least one month to review the budget proposals.</li> <li>(iv) Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) The legislature's review covers details of expenditure and revenue, but only at a stage where detailed proposals have been finalized.</li> <li>(ii) Some procedures exist for the legislature's budget review, but they are not comprehensive and only partially respected.</li> <li>(iii) The legislature has at least one month to review the budget proposals.</li> <li>(iv) Clear rules exist, but they may not always be respected OR they may allow extensive administrative reallocation as well as expansion of total expenditure.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) The legislature's review is non-existent or extremely limited, OR there is no functioning legislature.</li> <li>(ii) Procedures for the legislature's review are non-existent or not respected.</li> <li>(iii) The time allowed for the legislature's review is clearly insufficient for a meaningful debate (significantly less than one month).</li> <li>(iv) Rules regarding in-year budget amendments may exist but are both very rudimentary and unclear OR they are usually not respected.</li> </ul>

Brief Explanation	Score (M1)
(i) The legislature's review is extremely limited.	D
(ii) Procedures govern presentation and passage of the budget and less the review process	C
(iii) The Legislature has little time for review of the Budget	D
(iv) The PFA provides for a well regulated and respected budget amendment system.	A
Overall Rating	D+

### PI-28 Legislative scrutiny of external audit reports

Overall rating category 'B+'

The legislature has a key role in exercising scrutiny over the execution of the budget that it approved. A common way in which this is done is through a legislative committee(s) or commission(s) that examines the external audit reports and questions responsible parties about the findings of the reports.

**Dimensions to be assessed:** (i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years). (ii) Extent of hearings on key findings undertaken by the legislature. (iii) Issuance of recommended actions by the legislature and implementation by the executive.

Dimension (i) Rated A – The Public Accounts Committee (PAC) begins review of the AAR soon after it is received from the RAA in April, and presents its report to the Summer Session, which is convened in May/June. The first PAC of the first democratically elected Parliament was formed only in April 2009. It had presented its first report to the Parliament in July 2009. The resolution from the Parliament on the PAC's report was sent to RAA for necessary follow-up with the concerned agencies in early August 2009. Therefore, there is no comparative report for the earlier years since this is the first year of PAC's existence.

Dimension (ii) Rated B - The system to conduct hearings, where necessary, is being established and there is little completed experience during the life of the new Parliament since April 2009. However, for the earlier legislatures up to 2007 PAC MPs conducted hearings depending on the severity of the audit observations, e.g., there are previous instances, wherein the PAC have conducted hearings and issued some directives in cases of controversial observations for audit of some dzong construction cases.

Dimension (iii) Rated B – Rated B as experience is limited but prospects are good. The implementation by the respective agencies to the recommendations from RAA is already encouraging. The response to Parliamentary comments on suspense accounts and advances have been effective and the view is that the speed of response by the agencies to the legislature's recommendations is likely to be even higher than for the recommendations from RAA.

Summary scoring of this indicator is as below.

Score	Minimum requirements (M1)
A	<ul style="list-style-type: none"> <li>(i) Scrutiny of audit reports is usually completed by the legislature within 3 months from receipt of the reports.</li> <li>(ii) In-depth hearings on key findings take place consistently with responsible officers from all or most audited entities, which receive a qualified or adverse audit opinion.</li> <li>(iii) The legislature usually issues recommendations on action to be implemented by the executive, and evidence exists that they are generally implemented.</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) Scrutiny of audit reports is usually completed by the legislature within 6 months from receipt of the reports.</li> <li>(ii) In-depth hearings on key findings take place with responsible officers from the audited entities as a routine, but may cover only some of the entities, which received a qualified or adverse audit opinion.</li> <li>(iii) Actions are recommended to the executive, some of which are implemented, according to existing evidence.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) Scrutiny of audit reports is usually completed by the legislature within 12 months from receipt of the reports.</li> <li>(ii) In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with MoF officials only.</li> <li>(iii) Actions are recommended, but are rarely acted upon by the executive.</li> </ul>

Score	Minimum requirements (M1)
D	(i) Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. (ii) No in-depth hearings are conducted by the legislature. (iii) No recommendations are being issued by the legislature.

Brief Explanation	Score (M1)
(i) Examination of audit reports by the Legislature through the PAC is within a few weeks.	A
(ii) In depth hearings on key findings take place with responsible officers from the audited entities, but cover only some of the entities.	B
(iii) Actions are recommended to the Executive, which are generally implemented according to available evidence.	B
Overall Rating	B+

### 3.7. Donor Practices

#### D-1 Predictability of direct budget support

Rated: C+

**Dimensions to be assessed:** (i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body). (ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)

Dimension (i) Rated – A as per the calculation shown below which shows that in none of the last three years has direct budget support outturn fallen short of the forecast by more than 5%. According to the rating scheme this rates an A score.

The Royal Government of Bhutan receives Budgetary Support from a few donors, most especially the Government of India (GOI), and to a much lesser degree the World Bank and DANIDA. Unlike GOI and World Bank, DANIDA provide budget support for a specific sector like health and education. Budgetary Support received during the last three fiscal years is presented below.

#### Statement of Estimated Budgetary Support and Actual Receipts for the past three Fiscal Years

(Amount in millions of Ngultrum)

	2007-2008			2006-2007			2005-2006		
	Forecast	Actual	Deviation	Forecast	Actual	Deviation	Forecast	Actual	Deviation
GOI	1,100.00	1,100.00	0.00%	1,050.00	1,100.00	4.76%	1,750.00	1,700.00	-2.86%
DANIDA	162	102.412	-36.78%	144	179.001	24.31%	144	168.898	17.29%
World Bank (DPGs)	-	-		494.703	494.703	0.00%	710.258	710.258	0.00%
<b>Total</b>	<b>1,262.00</b>	<b>1,202.41</b>	<b>-4.72%</b>	<b>1,688.70</b>	<b>1,773.70</b>	<b>5.03%</b>	<b>2,604.26</b>	<b>2,579.16</b>	<b>-0.96%</b>

Source: Budget documents (DNB) and Annual Financial Statements (DPA)

Dimension (ii) Rated - C as quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 50% in

two of the last three years as per the calculation shown below.

Data for year = 2005-06						
Quarter of fiscal year	agreed forecast (amount)	actual disbursed (amount)	planned quarter for actual (*)	actual delayed in each period	delayed amount as share of total	cumulative delayed amount as share
quarter 1	651.065	450.000	651.065	201	7.8%	7.8%
quarter 2	651.065	531.173	651.065	120	4.6%	12.4%
quarter 3	651.064	493.863	651.064	157	6.1%	18.5%
quarter 4	651.064	1104.120	651.064	-453	-17.6%	
total for the year	2604.258	2579.156	2604.258	25	1.0%	38.8%

Data for year = 2006-07						
Quarter of fiscal year	agreed forecast (amount)	actual disbursed (amount)	planned quarter for actual	actual delayed in each period	delayed amount as share of total	cumulative delayed amount as share
quarter 1	422.176	338.021	422.176	84	4.7%	4.7%
quarter 2	422.176	330.476	422.176	92	5.2%	9.9%
quarter 3	422.176	335.503	422.176	87	4.9%	14.8%
quarter 4	422.176	769.703	422.176	-348	-19.6%	
total for the year	1688.704	1773.703	1688.704	-85	-4.8%	29.5%

Data for year = 2007-08						
Quarter of fiscal year	agreed forecast (amount)	actual disbursed (amount)	planned quarter for actual	actual delayed in each period	delayed amount as share of total	cumulative delayed amount as share
quarter 1	315.500	275.000	315.500	41	3.4%	3.4%
quarter 2	315.500	295.962	315.500	20	1.6%	5.0%
quarter 3	315.500	275.000	315.500	41	3.4%	8.4%
quarter 4	315.500	356.450	315.500	-41	-3.4%	
total for the year	1262.000	1202.412	1262.000	60	5.0%	16.7%

Results Matrix	D-1 dimension (i)		D-1 dimension (ii)	
	year	deviation of actual budget support from forecast	in-year disbursement delays for budget support	
	2005-06	1.0%	38.8%	
	2006-07	-5.0%	29.5%	
	2007-08	4.7%	16.7%	
Scores	Score for dimension (i):		<b>A</b>	
	Score for dimension (ii):		<b>C</b>	
(Scoring Method M1)	Overall score for indicator D-1:		<b>C+</b>	

Source: Budget Fund Account & AFS, DPA

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<p>(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 5%.</p> <p>(ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years.</p>

Score	Minimum requirements (Scoring methodology: M1)
B	<ul style="list-style-type: none"> <li>(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 10%.</li> <li>(ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 15%.</li> <li>(ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 50% in two of the last three years.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) In at least two of the last three years did direct budget support outturn fall short of the forecast by more than 15% OR no comprehensive and timely forecast for the year(s) was provided by the donor agencies.</li> <li>(ii) The requirements for score C (or higher) are not met.</li> </ul>

Brief Explanation	Score (M1)
(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 5%.	A
(ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years.	C
Overall Rating	C+

## D-2 Donor financial information provided for budgeting and reporting on project/ program aid

Overall rating category 'D+'

Dimension (i) Rated A - All foreign aid (grants and loans) are channeled through the normal budgetary mechanism of the Government. Based on the government's budget calendar and the project agreements, the donors provide a budget estimates for the projects with the breakdown consistent with the government's budget classification that they intend to finance during the fiscal year.

Dimension (ii) Rated D - The Government BAS captures all the information related to external assistances and the system tracks the information by donors as well as by projects. All external assistances are tagged to a specific code called the Financing Item Code (FIC) and therefore, information on receipts, expenditures and the balances available against specific FIC can be easily traced from the BAS. However, there has been no established process of donors providing regular reports on disbursement status to the government agencies implementing the projects. Thus rating for dimension (ii) is "D"

Therefore, overall rating is "D+"

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	<ul style="list-style-type: none"> <li>(i) All donors (with the possible exception of a few donors providing insignificant amounts) provide budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification.</li> <li>(ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 85% of the externally financed project estimates in the budget, with a break-down consistent with the government budget classification.</li> </ul>
B	<ul style="list-style-type: none"> <li>(i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification.</li> <li>(ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 70% of the externally financed project estimates in the budget with a break-down consistent with the government budget classification.</li> </ul>
C	<ul style="list-style-type: none"> <li>(i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid for the government's coming fiscal year, at least three months prior its start. Estimates may use donor classification and not be consistent with the government's budget classification.</li> <li>(ii) Donors provide quarterly reports within two months of end-of-quarter on the all disbursements made for at least 50% of the externally financed project estimates in the budget. The information does not necessarily provide a break-down consistent with the government budget classification.</li> </ul>
D	<ul style="list-style-type: none"> <li>(i) Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior its start.</li> <li>(ii) Donors do not provide quarterly reports within two month of end-of-quarter on the disbursements made for at least 50% of the externally financed project estimates in the budget.</li> </ul>

Brief Explanation	Score (M1)
(i) All donors (with the possible exception of a few donors providing insignificant amounts) provide budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification	A
(ii) Donors do not provide quarterly reports.	D
Overall Rating	D+

### D-3 Proportion of aid that is managed by use of national procedures

Overall rating category 'C'

Government systems for management of funds are those established in the general legislation (and related regulations) and implemented by the mainstream line management functions of the government. The requirement that authorities use different (donor-specific) procedures for the management of aid funds diverts capacity away from managing the state systems. The use of national procedures mean that the banking, authorization, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds.

**Dimensions to be assessed:** Overall proportion of aid funds to central government that are managed through national procedures.

Almost all the resources are channeled through the Government Treasury System and the Government budgetary mechanism as per the provisions of the Constitution 2008, PFA 2007, FRR 2001 and other existing circulars, rules and regulations, procedures etc on the financial management system. Information on receipts, disbursement, procurements and reporting are generated from the government BAS so country procedures are used for payment/accounting, audit and reporting. In respect of procurement some projects (mostly loan financed), for which there are requirements specified in the project agreement, have to follow donor specific procedures on procurement and the procurement for these funds, amounting to less than 50% of aid funds, uses the donor procurement procedures. Therefore the rating for this dimension is assigned "C".

Summary scoring of this indicator is as below.

Score	Minimum requirements (Scoring methodology: M1)
A	90% or more of aid funds to government are managed through national procedures.
B	75% or more of aid funds to government are managed through national procedures.
C	50% or more of aid funds to government are managed through national procedures.
D	Less than 50% of aid funds to government are managed through national procedures.

Brief Explanation	Score (M1)
(i) Some aid funds to government have to use donor procedures and are not managed through national procurement procedures	C
Overall Rating	C

## 4. GOVERNMENT REFORM PROCESS

### 4.1. Summary of Reform Measures

The Tenth Five Year Plan stated that the core principles of Bhutan's development planning have essentially focused on fulfilling the fundamental objectives of achieving broad based and sustainable growth, improving the quality of life, ensuring the conservation of the natural environment, preserving the country's rich culture and strengthening good governance. Government decided that the Tenth Plan would introduce a new planning framework and accordingly, approved the adoption of the results-based management planning framework.

Results-based management planning in essence refers to the context wherein a sector or agency ensures that its processes, products and services contribute to the achievement of clearly stated results, with the latter defined as the effects of a development program, project or activity.

To further improve public expenditure management, the MoF has adopted a medium term fiscal framework and a multiyear rolling budget for macroeconomic and fiscal management. The concept note for the first development policy credit notes that the adoption of a computerized Budgeting and Accounting system (BAS) first in the Department of National Budget and Aid Coordination and then in ministries and agencies has brought about significant improvements in the financial management system.

Key elements in PFM reform are:

Introducing web-based application software for PFM and planning evaluation systems.

Integrating the budgeting, accounting and reporting processes contained in the multiyear rolling budget system and the public expenditure management systems and devolving them into spending agencies by 2011 subject to IT infrastructure provision. The MoF has already defined the systems design.

Adopting international accounting, reporting and auditing standards for the public and the private sectors through the ADB financed Financial Sector Development Program. The DPA has already piloted IPSAS Cash Basis accounts. The RAA is working on a new Financial Audit Manual for 2010/11.

Expansion of the system of Internal Audit and an increase in resources. Already operating from MoF in 9 of the 10 ministries, there are plans to extend into local Government.

Bolstering the transparency, accountability and efficiency of the procurement system. Already there is a new manual and more recently revised standard documents that regularize procurement processes and a Public Procurement Policy Division in MoF to manage the reforms.

### 4.2. Institutional Factors supporting Reform

#### **Government leadership and ownership.**

The Royal Government's economic objective is to build a strong and vibrant economy based on the principles of equity and justice with opportunity and security for all in Bhutan. Reform planning is taking place within the overall planning and budget setting processes with the special involvement of the Gross National Happiness Commission (GNHC) and the Ministry of Finance. Programs of governance reform through local government devolution are beginning. The Government's ownership is managed through its long term planning and its resource allocation processes. Resource allocation has been based on the Budget Policy and Fiscal Framework Statement (BPFSS), a simple macroeconomic framework and debt

sustainability, using the MoF planning and budgeting system. This ownership extends down to local Government through a consultative budget process by which local governments respond to projected resource availability and the need to enhance local budgets; and the Dzongkhags and Gewogs receive annual grants directly from the Government determined on a formula that takes into consideration geographic area, poverty incidence and population. Local governments need to build capacity for planning and implementation.

### **Coordination across Government**

Five year plans are prepared under the management of the GNHC and these plans feed into the reform management processes as well as budgeting and program management processes. The 10<sup>th</sup> Plan – for 2008 to 2013 – refers to the reforms that have occurred in democracy and governance and states that democracy must be translated effectively into jobs, adequate resources for a decent living and freedom from poverty. The 10<sup>th</sup> Plan has poverty reduction as the main objective and the plan provide the strategic framework to do this through multiple reform programs. Thus the Plan and the GNHC provide overall coordination across Government; and uses a results based management planning framework by which a sector or agency ensures that its processes, products and services contribute to the achievement of clearly stated results, defined as the effects of a development program, project or activity.

There is a formal monitoring process using the National Monitoring and Evaluation System (NMES). The NMES consists of two main components the M&E institutional set-up and procedures and a web-based computerized system, the Planning & Monitoring System (PlaMS). Institutionally the Public Finance Act 2007 and the Local Government Act 2008 have initiated substantial PFM and governance reform programs.

A Technical Support Sub-Committee has been established to assist the high level Accounting and Auditing Reform Committee to advise the Ministry of Finance on the development/adoption of international accounting and financial reporting standards for the public and private sector.

### **Sustainability of the reform process**

Many of the reforms have been institutionalized by establishment of systems to conduct good practice processes; e.g. the various planning, budgeting and accounting systems and these have an in-built sustainability provided adequate training and technical support arrangements are made. The PEFA review showed that the critical systems, rules and procedures are generally in place; however, when it comes to implementation, human resource capacity in terms of competency and professionalism tends to affect the effectiveness of performance. Continuing reform for creating an efficient, effective, transparent and fair national procurement system is being managed under the Institutional Capacity Building Project in Procurement (ICBPP) through a joint process involving the World Bank and the MoF Public Procurement Policy Division. Part of this project is working towards staff qualifying for the international certificates provided by the Chartered Institute of Purchasing and Supply (CIPS) through various training initiatives so sustainability in procurement reform is developing a sound base.

# ANNEX 1: SUMMARY AND EXPLANATION OF INDICATOR SCORES

Indicator	Rating	Brief Explanation
<b>A: PFM Out-turns</b>		
1. Aggregate expenditure out-turn compared to original approved budget	B	Each of the 3 years at national level show under-expenditure by more than 5% but none exceed 10% so a B rating is appropriate.
2. Composition of expenditure out-turn compared to original approved budget	B	Variations in the composition of out-turn were more than 5% in one of the 3 years therefore rating B. The main cause of variation was the inclusion in the Ministry of Finance budget of contingency and emergency funds that were expended by other agencies.
3. Aggregate revenue out-turn compared to original approved budget	A	Revenues were greater than estimates for each of the 3 years so a rating of A is merited. Under-estimates were moderate ranging from 1.4% to 6.4%.
4. Stock and monitoring of expenditure payment arrears	NA	Because there was no system for central monitoring of arrears there was no data on the level of arrears, despite general confidence that arrears are low.
<b>B: Key Cross Cutting Issues</b>		
5. Classification of the budget	B	Under the UN-supported Classification of Functions of Government (COFOG), which is the functional classification applied in GFS, there are ten main functions at the first level and 69 functions at the second (sub-functional) level. The COFOG standards are not used at the sub-functional classification in the budget.
6. Comprehensiveness of information included in budget documentation	A	Of the nine elements required in the budget documentation, only the last, new policy explanations, is not included in full in the budget report and some aspects of financial assets are not included.
7. Extent of unreported government operations	A	The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant
8. Transparency of inter-governmental fiscal relations	A	A formula based fiscal transfer allocation is used for annual grants to sub-national levels of government. Five Year Plan Documents are submitted to the National Assembly
9. Oversight of aggregate fiscal risk from other public sector entities	D+	The Government should require and receive quarterly financial statements and audited year-end statements from AGAs and PEs that it controls, and monitor performance against financial targets. There is a need to produce a consolidated reports for the public enterprises to obtain a higher rating.
10. Public access to key fiscal information	B	Of the 6 types of report that should be available publicly two, in year budget execution reports and contract awards, are not available.

Indicator	Rating	Brief Explanation
<b>C: Budget Cycle</b>		
11. Orderliness and participation in the annual budget process	A	The Budget Policy and Fiscal Framework Statement include strategic priorities to guide the budget for the financial year and for the 2 outer years. Consultation, guidance and legislative approvals are all in accordance with the budget call circulars
12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	B+	Debt sustainability reviews are conducted every two years rather than annually as required for an A rating; recurrent cost implications of investment expenditure plans are not fully incorporated into budgets
13. Transparency of taxpayer obligations and liabilities	B	Taxpayer education is an important part of facilitating taxpayer compliance with registration, declaration and payment procedures. There are some gaps in the education programs available for tax legislation, and the work of the appeals board is too recent for proper assessment
14. Effectiveness of measures for taxpayer registration and tax assessment	C+	Maintenance of a taxpayer database based on a unique taxpayer identification number is an important element of such a control system, but is most effective if combined with other government registration systems that involve elements of taxable turnover and assets (such as e.g. issue of business licenses, opening of bank accounts and pension fund accounts). There is a need to link the registration and assessment systems to other government databases. The audit program should be more risk-based.
15. Effectiveness in collection of tax payments	C+	The ability to collect tax lends credibility to the tax assessment process and reflects equal treatment of all taxpayers. Aggregate reporting on tax assessments, collections, and arrears must be reconciled to ensure that the collection system functions as intended. Arrears are not reconciled or centrally monitored as would be needed for an A rating.
16. Predictability in the availability of funds for commitment of expenditures	C+	Effective execution of the budget requires that the spending ministries, departments and agencies (MDAs) receive reliable information on availability of funds within which they can commit expenditure for recurrent and capital inputs. The extent to which cash flows are forecast and monitored is inadequate to rate well.
17. Recording and management of cash balances, debt and guarantees	A	Cash balances of Government bank accounts are consolidated regularly except for minor extra-budgetary funds in the Revolving Fund
18. Effectiveness of payroll controls	B+	The payroll is processed using the computerized system of the Budget and Accounting System. Payroll audits should be undertaken regularly to identify ghost workers, fill data gaps and identify control weaknesses. There are no specific MoF payroll audits although RAA has some coverage.

Indicator	Rating	Brief Explanation
19. Competition, value for money and controls in procurement	C	There is no central monitoring of procurement methods applied by government agencies to assess the degree of use of open competition. Nor is there data on the timelines of the appeals processes.
20. Effectiveness of internal controls for non-salary expenditure	A	Strong controls and audits are in place to reduce irregularities and obtain recoveries where there are irregularities.
21. Effectiveness of internal audit	C+	Internal Audit is in place in Ministries under an MoF central unit. There is a need to introduce local government audit coverage. More generally internal audit reports should be available to MoF and the RAA and be summarized in annual reports for agencies and as a whole.
22. Timeliness and regularity of accounts reconciliation	B	Reliable reporting of financial information requires constant checking and verification of the recording practices. Bank reconciliations are monthly but suspense accounts and advances need more frequent reconciliation.
23. Availability of information on resources received by service delivery units.	A	Budgetary agencies budgets are expressed in very detailed appropriations and the front-line service delivery unit like primary schools and primary health clinics fall under the concerned gewog's budgets which are broken down into detailed activities. The BAS provides reliable information on resources received.
24. Quality and timeliness of in-year budget reports.	D+	The ability to implement the budget requires timely and regular information on actual budget performance to be available both to the FD and to the MDAs for managing the affairs for which they are accountable. No routine in-year budget reports
25. Quality and timeliness of annual financial statements	C+	In order to be useful and to contribute to transparency, financial statements must be understandable to the reader, and deal with transactions, assets and liabilities in a transparent and consistent manner. This is the purpose of financial reporting standards. The DPA has made an attempt to apply the International Public Sector Accounting Standard (IPSAS) Cash Basis of Financial Reporting and this may be made routine to achieve a higher rating.
26. Scope, nature and follow-up of external audit	B+	There is a strong external audit function covering Government entities representing at least 75% of total expenditures annually; reporting in a timely way and providing very effective follow-up. An A rating requires annual coverage of all entities.
27. Legislative scrutiny of the annual budget law	D+	If the legislature does not rigorously examine and debate the law, that power is not being effectively exercised and will undermine the accountability of the government to the electorate. Inadequate time is provided for legislative review of the proposed budget.
28. Legislative scrutiny of external audit reports	B+	The PAC is newly formed but procedures are proceeding well

Indicator	Rating	Brief Explanation
<b>D: Donor Practices</b>		
D-1 Predictability of direct budget support	C+	Direct budget support constitutes an important source of revenue for central government. Predictability of inflows of budget support is important for fiscal management and annual outturns are in line with budgets. Quarterly disbursement estimates and actuals show delays that reduce the rating.
D-2 Reporting on project/ program aid	D+	There has been no established process of donors providing regular reports on disbursement status to the government agencies implementing the projects.
D-3 Proportion of aid that is managed by use of national procedures	C	Any donor requirements that authorities use donor-specific) procedures for the management of aid funds diverts capacity away from managing the national systems. In substantial areas there is a requirement to use donor procurement systems.

# ANNEX 2: NOTE ON ASSESSMENT OF PUBLIC FINANCIAL MANAGEMENT IN LOCAL GOVERNMENTS

## Overview

1. The Royal Government of Bhutan operates as a unitary state with 3 tiers of government: Central, Dzongkhags/Thromdes and Gewogs. Dzongkhags/Thromdes and Gewogs are sub-national or local governments with elected bodies to represent the interests of local communities and fulfill their aspirations and needs. The institutional structure, responsibilities and powers of the local governments have been enshrined in the Local Government Act, 2009 (LG Act).
2. The country has a total of 47 electoral constituencies (cluster of more than one Gewogs) which directly elect members as representatives for the National Assembly (Lower House). Each Dzongkhag also elects a representative for the National Council (Upper House) comprising of 25 members. The Dzongkhags elects 20 of the 25 members and 5 are eminent members nominated by the King.
3. There are 20 Dzongkhags and 205 Gewogs. Local Governments, unless dissolved sooner, continue for five years from the date of the first sitting, and are convened within thirty days of the declaration of election results. The election of members of the Local Governments is governed by the electoral laws of Bhutan.

### DZONGKHAG

- Dzongkhag Tshogdu highest decision making body comprising of:
  - Gup and Mangmi as the two elected representative from each Gewog;
  - One elected representative from that Dzongkhag Thromde; and
  - One elected representative from Dzongkhag Yenlag Thromdes

### THROMDE

- Thromde Tshogdu highest decision making body comprising of:
  - Not less than seven and not more than ten elected members, including the Thrompon
  - Thromde shall be a Dzongkhag Thromde or Dzongkhag Yenlag Thromde
  - Dzongkhag Thromde, which shall be further categorized as Class A or Class B Thromde and Dzongkhag Yenlag Thromde

### GEWOG

- Gewog Tshogde highest decision making body comprising of:
  - Gup and Mangmi; and
  - Not less than five and not more than eight elected Tshogpas

## Legal and Institutional framework

4. The Constitution (Article 22) states that Bhutan shall have Local Governments in each of twenty Dzongkhags comprising of Dzongkhags Tshogdu (DT), Gewogs Tshogde (GT) and Thromde Tshogde (TT). Power and authority are decentralized and devolved to elected Local Governments to facilitate the direct participation of the people in the development and management of their own social, economic and environmental well-being. The objective of the new arrangement is to provide democratic and accountable government for the local communities through people's participation in decision making, implementation and delivery of services.
5. The legislation governing the Local Government (Dzongkhags and Gewogs) have been Dzongkhag Yargye Tshogdu Charthim 2002 and Gewog Yargey Tshogchung Chathrim 2002. The LG Act, 2009 has been enacted and superseded all provisions of the above Charthims.
6. Local Government comprises Dzongkhag Tshogdu (DT), Gewog Tshogde (GT) and Thromde Tshogde (TT) which are constituted as the highest decision making bodies. The Dzongkhags Tshogdu comprises Gup and Mangmi (Gewogs elder) from each Gewog, one elected representative from Dzongkhags and Thromde and one elected representative from Dzongkhags Yenlag Thromde. The Chairperson and Deputy Chairperson of the DT are elected from among its members through a secret ballot. The Gewog Tshogde is comprised of Gup, Mangmi and no less than 5 and more than 8 elect Tshogpas (Village Representative). Gup is the Chairperson of GT. DT and GT are interlinked as Gup and Mangmi are representative in both the bodies. Thromde Tshogde shall consist of not less than seven and not more than ten elected members, including the Thrompon (elect member and the chairperson).
7. To improve accountability and enhance participatory planning and development, the local government bodies have been granted recognition and are answerable to the local communities. DT has the power to approve plans, programs and budget prepared by Dzongkhag Administration, seek clarifications on any activities, receipt and payment of expenditures, and audit report of Dzongkhag. Similarly GT has power to formulate five year plan, approve the Gewog's annual plan and budget, and administer the use of the fund from current account. Also GT, at such rates as may be approved by Parliament, levy taxes on land, building and cattle.
8. The Local Government Act 2009 envisages different categories of Dzongkhag Thromdes viz. Class A, B and Dzongkhags Yenlag Thromdes. All class B and Yenlag Thromdes shall function either under Dzongkhag Administration or the Gewog Administration, as decided by the Government. Therefore, it will be part of DT or GT. There will be establishment of Thromde Tshogde only for Class A Thromdes and will have operational autonomy.
9. Chapter 15 of the LG Act, 2009 grants financial autonomy to Local Governments to (a) levy, collect and appropriate taxes, fees, tolls, duties and fines in accordance with such procedure and subject to limitations as may be provided for by law; and (b) own assets and incur liabilities by borrowing on their own account. However, in other sections of the Act, the authority to levy taxes has been limited to only Gewogs and Thromdes and the authority to borrow remains restricted to Thromdes only.

## Funds and expenditure profile of Dzongkhags/Thromdes and Gewogs

10. The Constitution (Article 22) guarantees that the Local Governments would be supported by the Government in the development of administrative, technical and managerial capacities and structures which are responsive, transparent, and accountable. For this purpose, the Local Governments are:
  - (b) entitled to levy, collect, and appropriate taxes, duties, tolls, and fees in accordance with such procedure and subject to limitations as may be provided for by Parliament by law;
  - (c) entitled to

adequate financial resources from the Government in the form of annual grants; (d) allocated a proportion of national revenue to ensure self-reliant and self-sustaining units of local self government; and (e) entitled to own assets and incur liabilities by borrowing on their own account subject to such limitations as may be provided for by Parliament by law.

11. As per the Financial Rules & Regulations, all collection of national revenues and taxes are controlled and deposited into one central account from where the allocations are made for expenditures including for Local Governments. Gewogs and Class A Thromdes are authorized to retain rural and urban taxes<sup>11</sup> only.
12. For the financial year 2009-10, the combined budget estimates of all activities implemented by the Dzongkhags and Gewogs is Nu. 6,928.205 million. This constitutes about 26% of the total RGoB expenditure outlay and is an increase of 11% over their revised budget of the FY 2008-09. Of the total estimated amount, 87% will be implemented by Dzongkhags and 13% by Gewogs.

### Allocation for Dzongkhags and Gewogs in National Budget

	2009-10 (Budget Estimates)			2008-09 (Revised Budget)			Increase	
	Capital	Current	Total	Capital	Current	Total	Amt	%
Total RGoB Expenditures Outlay	13,827.312	13,594.134	27,421.446	11,910.83	15,047.60	26,958.429	46.017	2%
Total allocation for dzongkhags	2,242.875	3,758.801	6,001.676	1,830.503	3,220.275	5,050.778	950.898	19%
Total allocation for gewogs	791.232	135.297	926.529	811.418	114.930	926.348	0.181	0%
Combined allocation for dzongkhag /gewogs	3,034.107	3,894.098	6,928.205	2,641.921	3,335.205	5,977.126	951.079	16%
As % of Total RGoB Expenditure	22%	29%	25%	22%	22%	22%		
Outlays								
of which, % of dzongkhag share	74%	97%	87%	69%	97%	85%		
of which, % gewog share	26%	3%	13%	31%	3%	15%		

### PFM framework in Local Governments

13. The government follow unitary system for the financial operations under one framework for all spending agencies<sup>12</sup> at all levels of government. The Government of Bhutan has a record of satisfactory financial management system. This reflects the financial management system of local government as well as all procedures are same and managed by same pool of finance personnel. There is an established and comprehensive legal framework governing its budget system. Legal frameworks emanate from the Constitution, Public Finance Act 2007 and FRR 2001 and clearly define and establish the roles and responsibilities of different Ministries, Autonomous Agencies and Local Governments<sup>13</sup>.

### Planning and Budgeting

14. RGoB's Five Year Plans are developed by the Gross National Happiness Commission (GNHC) in consultation with Local Governments. The allocation criteria across the local governments are typically based on size of population, geographical area and incidences of poverty. These form the basis for the determination of the annual budget ceilings.

<sup>11</sup> Rural taxes comprise of land, building, cattle and grazing taxes while urban taxes comprise of land and property taxes, property transfer taxes and betterment taxes.

<sup>12</sup> Ministries, Autonomous Agencies and Local Governments.

<sup>13</sup> Dzongkhags, Thromdes and Gewogs.

15. Devolution of resources and decision making powers to the local level is the key feature in 10<sup>th</sup> Five-Year-Plan (FYP) and is supported by the highest political commitment. As espoused in the LG Act, Local Government bodies have autonomy of planning, regulations and raising taxes as per the rules in forces within the existing framework of 10<sup>th</sup> FYP programs and budgetary ceilings.
16. Budget preparation for RGoB has been historically input focused and incremental with little prioritization of expenditures. The use of budget as a tool for implementing strategies towards achievement of policy goals of the government has been limited, but in last few years the implementation of Multi-Year Rolling Budget (MYRB) process had been conceived and begun. It is expected to overcome above shortfalls as MYRB embraced the elements of performance budgeting.
17. The procedures for budget formulation and implementation are comprehensively documented in the Budget Manual 2001. The budget integrates all the expenditures including donor funded activities for all level of governments. The government emphasis on the decentralization and empowering the people has also seen progress in the recent past in areas of financial management too. In the recent past, there is increased decentralization of financial powers and responsibilities to the lower level of government and is evidenced by the increase in local governments' expenditure as a proportion to the total government expenditure.
18. Dzongkhags do not have substantial revenue resources of their own and prepare budget proposals for central funding and submit the same to the Ministry of Finance, RGoB. Dzongkhags' expenditure budget estimates<sup>14</sup> are prepared based on the Five Year Plan programs and budget ceilings issued by the Ministry of Finance through Budget Call Notification. The DT is the final decision making body in the Dzongkhags and annual work plan and budget of Dzongkhag are submitted to DT for endorsement. However, the Dzongkhags budget proposals are not necessarily deliberated upon in DT unless there are serious issues which require discussions.
19. Gewogs have two principal funding sources, funding from central and retained rural taxes. For the central funding, the Gewogs prepare the budget proposal for submission to MoF. They involve all the stakeholders in the Gewogs. Given the high level of dependence on central funding, planning and budgeting procedures are limited to the central funds and adopt processes that are similar to that of other budgetary agencies. RGoB prescribed formats are used for the purpose. The annual plan and budget for central funding is reviewed and endorsed by the GT as per the mandates prescribed in the Chathrimis and now by LG Act. Once annual work plan and budget are reviewed and endorsed by GT, it is submitted to the DT for endorsement and further submission to DNB in Ministry of Finance, who is responsible for the preparation of national budget.
20. Own retained revenues as arising from rural taxes, is another resource to finance the Gewog's expenditures. Local Government taxes are imposed on houses, cattle and land. Such taxes are collected based on the records of number of houses, cattle and land as registered in each Gewog. Though estimation of the revenue is straightforward; i.e. existing rates multiplied by number of cattle, houses and acreage and type of land as recorded in the Gewog, however, so far, as gathered from the Gewogs, annual revenue estimates are not prepared. The quantum of retained income from rural taxes at Gewog levels is very small<sup>15</sup> and typically not included in the annual budget. The retained taxes are used by the Gewogs to meet expenditures on maintenance of Gewog infrastructures and approved by the GT. The newly passed LG Act, 2009 however, now mandates that a detailed plan for the use of such funds be prepared and approved by the GT, along with a work plan for the implementation of the activities. The annual average revenue for the Gewogs for past few years is as per the below table.

<sup>14</sup> The processes followed for preparation of annual budgets was confirmed during the field visits to Thimphu and Paro Dzongkhags.

<sup>15</sup> As confirmed from field visits to the 5 Gewogs under assessment

**Gewog – Average Annual Own Revenues**

Gewogs	Average Annual Own Revenue
Shaba	Nu.0.025 m
Dotey	Nu.0.017 m
Tsento	Nu.0.035 m
Chang	Nu.0.007 m
Gayney	Nu.0.008 m.

21. Dzongkhags Thromdes are considered as a constituent of the dzongkhag and gewogs, for purposes of planning and budgeting, with the exception of Thimphu and Phuentsholing City Corporations (Class A Thromdes) which function as quasi corporations. Their autonomy was granted and operations governed by the Charters, Thromde Act 1999, Municipal Act 2007, etc promulgated at different times, now superseded by the LG Act, 2009.
22. The City Corporations finance their annual programs with their own revenue and subsidy grant from government especially for capital investments. They prepare the annual budgets which incorporates own source revenues and put forth as a demand for grant from the government, the difference of the expenditure budget and revenue. The work plan and budget estimates are endorsed by the Thromde Tshogde (City Council).
23. Public access to key fiscal information is as follows:
  1. The Finance Minister’s Annual Budget Report is available via the Ministry of Finance website and this documents the annual dzongkhag and gewog budget information.
  2. In-year Budget Execution Reports are not compiled although data is available.
  3. The Central Government Annual Financial Statement is made available to the public online at <http://www.mof.gov.bt> and on request from the Department of Public Accounts. This report includes the major items of financial statements for dzongkhags and gewogs.
  4. The Regional Offices of the Assistant Auditor General (OAAG) conducts audits for the dzongkhags and gewogs. Audit information on specific dzongkhags and gewogs are contained in the “Annual Audit Reports” available online at <http://www.raa.gov.bt>.
  5. Data on contract awards at the dzongkhags and gewogs are not compiled and published.
  6. Information on resource allocation to primary service units at the dzongkhag and gewog levels is publicly available through the annual “Budget Appropriations for Fiscal Year” document released by the Department of National Budget. The report is released subsequent to approval of the bi-annual Parliamentary session.

Information on dzongkhag finances are primarily encapsulated in three documents published by the Ministry of Finance: 1) the Finance Minister’s Budget Report; 2) the AFSs; and, 3) the Budget Appropriations document. The RAA’s AAR provides information on specific dzongkhag audits. However, information pertaining to budget execution and contract awards is currently not available publicly. Public information available on dzongkhags are nevertheless, not comprehensive. They comprise mainly the recurrent and capital expenditure and outlays for individual dzongkhags without detailed fiscal plans, positions, or performances on activities undertaken in the dzongkhag. For this, the Gross National Happiness Commission’s Five Year Plan documents available publicly online at the Commission’s website (<http://www.pc.gov.bt>) further supplements financial information on specific dzongkhags. The document is available in English.

All documents mentioned above are published in English at regular intervals. They are available to the public through the Ministry of Finance's and the RAA's website or on request from the respective departments. The documents are usually released within a few months after approval by the bi-annual legislative session.

### **Key Issues**

- a) *The hard budget ceilings on a year to year basis means that often deferred/spill over activities cannot be included in the annual budgets.*
- b) *Ad hoc programs emerging during the year and the roles played by the line ministries pose problems in implementation of budget.*
- c) *There is a lack of capacity in Dzongkhags and Gewogs in terms both quantity and quality of staff.*
- d) *There is low mobilization of local revenues in City Corporations as local revenue policies frameworks are weak leading to high dependence on the government for subsidy. The property tax rates have remained unchanged since 1992 and the tax base has not been revised to reflect the growth of the cities in recent times.*
- e) *The systems and practices for administration of own source revenues are grossly inadequate to meet the needs of the growing cities. Both the cities use manual systems of billing and for collection of taxes.*
- f) *There is need for more transparent principles of fiscal transfers to Thromdes from the government.*

### **Budget Execution**

24. Budget execution is limited to implementation of the programs for which there are budget appropriations reflected in the Budget and Appropriation Act. The budget is prepared line item wise for each Dzongkhag, Gewog and Thromde showing the details of activities with appropriations. The provision regarding the execution of public works and procurement of services are elaborated in the Procurement Rules and Regulations, Financial Rules and Regulations which were revised from time to time to make it suitable for use with time and change.
25. In case of Dzongkhags, Dzongdag, the Dzongkhag's Chief Executive Officer (CEO) together with Sector Heads are responsible for execution and implementation of the annual budget. The DT monitors and evaluates implementation of activities. In Gewogs, Gups and Gewog functionaries implement the programs. GT monitors and ensures that implementation of programs are as per the framework provided by the government. The Executive Secretaries, CEOs in Thromdes are entrusted and made responsible for execution and implementation of the programs. The Thromde Tshogde (City Council) ensures that implementation is as per agreed plans.
26. In the Dzongkhags the works are executed either through contractors or departmentally depending upon the capacity and nature of the work. In the Gewogs, works are executed through participation of the beneficiaries in case of maintenance works and through contractors for major investment works. Preparation of estimates, technical sanctions, maintenance of measurement books, issuing the completion reports and supervision of works for quality control are done through Engineering Cell in Dzongkhags for all the works both in Dzongkhags and Gewogs. Engineers are assigned with the responsibilities of work inspection. Each engineer cannot be assigned more than 5 works in a year to ensure quality. Thromdes execute the works either through contractors or departmentally. They have their own set of engineers.

27. The procedure for fund releases is well established; fund flows to local governments follow the same processes as for line ministries of RGoB. The release mechanism for capital expenditures has been simplified substantively and entails submitting a request to Department of Public Accounts, MoF indicating the amount and readiness for implementation of work. All releases are made electronically through the prevalent method of Letters of Credit (LC). The recurrent budgets are released quarterly for Dzongkhags and half yearly for Gewogs subject to timely submission of monthly accounts. Budget results and the percentage differences between the budget estimates and actual expenditure figures for aggregate expenditures excluding debt service payments, and donor funded project expenditure for a small sample of dzongkhags and gewogs provided in the tables below, show some substantial deviations.

#### Budget and Actual Expenditures (in Nu million)

	2005-06		2006-07		2007-08	
	Budget	Actual	Budget	Actual	Budget	Actual
Thimphu Dzongkhag	256.202	227.421	299.57	337.440	342.684	254.619
Chang Gewog	0.503	0.499	2.51	1.146	2.106	1.618
Ganey Gewog	1.959	0.550	2.69	1.257	2.676	2.378
Paro Dzongkhag	144.417	151.901	165.44	174.804	179.662	191.131
Dotey Gewog	4.079	2.896	2.34	2.823	1.266	1.516
Tsento Gewog	2.053	0.392	4.96	2.863	1.065	0.940
Shaba Gewog	2.016	1.485	4.16	3.723	1.402	1.217

Source: Budget Papers

#### Percentage Deviations of Actual from Budgeted Expenditure

	2005-06	2006-07	2007-08
Thimphu Dzongkhag	-11.23%	12.64%	-25.70%
Chang Gewog	-0.80%	-54.34%	-23.17%
Ganey Gewog	-71.92%	-53.27%	-11.14%
Paro Dzongkhag	5.18%	5.66%	6.38%
Dotey Gewog	-29.00%	20.64%	19.75%
Tsento Gewog	-80.91%	-42.28%	-11.74%
Shaba Gewog	-26.34%	-10.50%	-13.20%

#### Key issues

- There is still a problem of getting release for deposit works and non-revenue releases in time. This is due to the mandatory requirement of bank statements from Banks which is not within the control of the Dzongkhags and Gewogs.*
- The implementation capacity in Dzongkhags and Gewogs are low due to capacity of engineering cell. All drawings and estimates of works in Dzongkhags and Gewogs are done by Engineering Cell in Dzongkhags.*
- There is a need of separate Engineer for each Gewogs.*
- Major hindrances to timely implementation arise from the several levels of clearances required from different ministries and agencies.*

## Payment of bills

28. The assessment of two dzongkhags (Paro and Thimphu) and five gewogs (Shaba, Dotey and Tsento under Paro Dzongkhag and Chang and Gayney under Thimphu Dzongkhag) found that they were proud of their service delivery standards. As against the 30 days time period for payment of bills they clear almost all the bills within 10 days from receipt. They also stated that now with the decentralization people know when their bills are due and they are ready to take the defaulters to court if there are any delays.
29. Both dzongkhags have an internal control system for the bill payment process. They have a system of Bill Register where all bills received are entered and dated, to whom the bills are marked for processing the payment and when the bills are cleared and paid. The payment date can also be verified from the Cheque Book Register which shows when the cheque is written and also from the Voucher details which shows date of Voucher, Cheque No., Amount and date etc.
30. Gewogs have very few activities and payments are cleared within 1 - 2 days. Presently the fund releases to the gewogs for the recurrent expenditure are made on a half-yearly basis and therefore there is no reason why payments will be in arrears. All dzongkhags and gewogs visited shared the same views.
31. Further, to speed up the releases the DPA in consultation with the BoB has set up a dedicated facsimile machine at DPA through which all the releases to the Bank branches other than Thimphu and Phuentsholing are transmitted through this dedicated facsimile. Currently release of funds for capital activities are made on a case by case basis within one to two days of the receipt of a simple request letter.

## Procurement

32. For all RGoB funds, local governments are required to follow the Procurement Rules & Regulations (PRR), 2009. The Rules provide threshold limits for each method of procurement and defines the constitution of the Tender Committees. RGoB has not prescribed separate procurement rules prescribed for local governments and as a default, RGoB rules apply to all procurements, regardless of the source of the funds.
33. RGoB PRR does not require the preparation of procurement plans as part of the budgeting process and consequently, LGs do not prepare procurement plans. Nor is there a requirement to confirm budget availability before solicitation of tenders. The procurement processes are manual and not interfaced with the computerized budgeting and accounting systems. These weaknesses apply to procurement across RGoB and are not limited to local governments only.
34. As per clause 3.1.1.4 (i) c of the Procurement Rules & Regulations (PRR) 2009 any work with estimate value of Nu. 0.5 million can be awarded to the local community provided it is endorsed by Gewog Yargey Tshochung (GYT) and now GT under LG Act. Further, in case of remote areas where there is no potential bidders after open competition, the work can be directly awarded to the single contractor provided the estimate value of work is within 3 million and the quoted/negotiated amount is within the estimate (clause 4.2.5.2 (h)).
35. As per the Annual Audit Report 2008, irregularities with respect to dzongkhag operations aggregated to Nu. 58.205 million (50% of the total irregularities of Nu. 116.295 for the year). Many of the noted irregularities relate to contract management and outstanding advances including non recovery of advances to contractors, excess payments to contractors, payment for materials not received, non levy of liquidated damages etc. Similar irregularities are also noted with respect to Gewog operations, though the scale and aggregate of irregularities noted remains small.

### Key issues:

- a) *The local government require capacity building in procurement especially on the new procurement rules.*

## Accounting

36. Article 122, Public Finance Act 2007 states that all budgetary bodies shall base the accounting records on the accounting standards prescribed by the Ministry of Finance. The detail rules and formats to maintain the accounting records are elaborated in FRR 2001. For its functions as a deconcentrated arm of the central government, local governments follow the accounting system applicable to all budgetary bodies in Bhutan. At dzongkhag, Gewog and Thromdes, books of accounts are maintained in the computerized system called Budgeting and Accounting System (BAS), which follows cash-based double entry method.
37. The responsibility of maintaining and custody of books and records in Dzongkhags are entrusted with the Administrative and Finance Division. In Gewogs, Gup and Gewog Accountant are responsible for the accounting records of the central funds; and Gup and Gewog clerk are responsible for the Current Account (Dzongkhags and Gewog Charthrims). Key books/records are generally maintained in both Dzongkhags and Gewogs. In Dzongkhags, accounting records are prepared by the designated accountant and countersigned by the Accounts Officer and Dzongrab (Drawing and disbursing Officer).
38. For the central funding, Gewog Accountant prepares the accounting record and is countersigned by the Gup, CEO of the Gewog. This also includes any donor funds coming to local government through budgeting process. The Gewog clerk prepares and maintains the accounting records for Current Account and countersigned by the Gup. The Dzongkhags Finance Officer also initially guides and monitors the Gewogs Accountants on management of these financial affairs in Gewogs.
39. In both Dzongkhags (Thimphu and Paro) and Gewogs (Shaba, Dotey and Tsento under Par, and Chang and Geney under Thimphu), the bills are paid within timeline stipulated in FRR 2001 so long the bills are with complete documentation and there is adequate budget provision. It is found out that there are no payment arrears generally. Gewogs have fewer activities and payments are cleared within 1 - 2 days.
40. In Thromdes, a subsidy is budgeted and released as 'grants in aid' under the budget head for 'Common Public Expenditure' under the Department of Public Accounts (DPA), MoF. Subsidy is treated as expenditure when it is released to Thromdes and consolidated later in the Annual Financial Statement of the government. Thereafter, the onus to account the usage of revenue and subsidy from government rests with Thromdes. The Thromdes deposits subsidy grant together with own revenue into their Reserve Fund account from where it is drawn for expenditure. The rule of lapse of the fund released by Ministry of Finance as subsidy does not apply to Thromdes.
41. Prior to 2005, Thimphu Thromde used an off-the-shelf accounting system called 'Tally' for accounting for expenditure, revenue and reporting. This system facilitated the preparation of the financial statements like, balance sheet, trial balance, and income and expenditure statement. The system also facilitated reporting of the budget estimates and expenditure by functional service. However, they shifted the use of accounting system to Government Budgeting and Accounting System (BAS) which is used by all government agencies for budgeting and accounting. This was done as per the requirement of Royal Audit Authority (RAA) as RAA is mandated to audit Receipt and Payment Statement of all the agencies including Thromdes produced through the BAS. The Tally does not facilitate the production of Receipt and Payment Statement.

### Key issues:

- a) *In Thromdes, the financial management system needs to be put in place which will adopt commercial principles of accounting for revenue, expenditures and asset management. The present system BAS is basically for the public financial management of government and will not facilitate the generation of financial reports required for entities like Thromdes which aim for financial sustainability.*

## Internal and External Reporting

42. In the present circumstances wherein the local governments remain wholly dependent upon the central government for its funding, accountability arrangements are designed primarily to provide information on the use of its funds to the central government.
43. As per FAM 9.1.1.1 and 9.1.1.2 of FRR-2001, the Heads of office/ accounting units are required to submit monthly accounts on receipt, utilization and deposition of funds separately in respect of each of the banks accounts allotted to them to the respective AFD/AFS of the Ministry/Organization concerned within 20 days after the completion of the month with a copy to DPA. This framework also applies to the Local Governments. Each Local Government institution is required to forward monthly receipt and payment statements produced from BAS for the funds received from central government for expenditures for programs approved in the budget. Reporting is timely with the computerization both in Dzongkhags and Gewogs. Gewog's reporting is monitored by the Dzongkhags. The financial reporting of the local governments is by the different Bank Account (LC/PLC) wise managed by the Dzongkhags and Gewogs. The reports of expenditures of the current account of Gewogs are submitted to GTs with a copy to Dzongkhags. These reports are not required to be submitted to DPA and not incorporated in the Annual Financial Statement of the Government.
44. Local Governments do not prepare or publish annual consolidated financial statements. BAS reports are forwarded to Ministry of Finance on a monthly basis and provided for external audit purposes. Expenditures incurred at the local government level for the central government funds are incorporated into the annual financial statements of RGoB. However, progress of the implementation along with financial progress of Dzongkhags and Gewogs are reported to DT and GT respectively.
45. All donor funds for local governments are routed through their budget process, and expenditures are reported together in the monthly accounts of the local governments. The accounting treatment for the donor funds is the same except it is recorded under different financing item code (FIC) to track the source of funds and is applicable to all level of government. The funds from RGoB sources received from Central are also coded under separate FIC.

### **Key issues:**

- a) *Annual financial statements should be produced by all Local Governments and Gewogs on an annual basis for monitoring, planning and statistical purpose to assess the development status of the local government.*
- b) *The annual financial statements produced by Gewogs and Thromdes should be complete and include the income and expenditures from own sources of funds. While the primary audience for the financial statements should be the constituents of the local governments, a copy of the annual financial statements should also be forwarded to the related Ministries in the Central Government which are responsible for policy determination.*

## Audit

46. Article 25, Section 2 of Constitution of Kingdom of Bhutan, 2008 provides for independent Audit Authority which states, "The Royal Audit Authority shall be an independent authority headed by the Auditor General who shall be appointed by the Druk Gyalpo from a list of eminent persons recommended jointly by the Prime Minister, the Chief Justice of Bhutan, the Speaker, the Chairperson of the National Council and the Leader of the Opposition Party". Article 25- Section 4 states "The

Royal Audit Authority shall, without fear, favor, or prejudice, audit the accounts of all departments and offices of the Government including all offices in the Legislature and the Judiciary, all public authorities and bodies administering public funds, the police and the defense forces as well as the revenues, public and other monies received and the advances and reserves of Bhutan”.

47. The above articles in the Constitution mandate the formation of a separate and independent audit agency under the control of Auditor General to undertake the audit at all levels of the government. The Royal Audit Authority (RAA) derives its authority from the Audit Act of Bhutan 2006. The Audit Act requires the RAA to conduct the audit of Government and other agencies under its audit jurisdiction and report without fear, favor or prejudice on the economy, efficiency and effectiveness in the use of public resources<sup>16</sup>. FRR 2001 also provides the responsibilities to RAA to carry out the audit of the financial transaction of budgetary agencies and local governments.
48. Given the human resources constraints, the RAA presently undertakes an audit of Local Governments (Dzongkhags and Gewogs) once every two years. The audits of Local Governments are conducted in accordance with the Generally Accepted Auditing Standards and in conformity with the General Auditing Rules and Regulations (GARR) 2009. These standards require that the RAA plans and perform the audit to obtain reasonable assurance about whether financial statements are free from material misstatements. An audit includes determining on the test basis, evidence supporting the amounts and disclosures in the financial statements.
49. Of the total audit irregularities of Nu. 932.177 million reported in the Annual Audit Report, 2008, irregularities at dzongkhag/gewog level amounted to Nu. 98.648 million (about 10%). Of this, irregularities amounting to Nu. 35.850 million were resolved during the year. Audit conducted by RAA for Local Governments is transaction based covering 100% of transactions. Financial statements of the Local Governments are prepared and certified by Audit Team which is included in the Audit Reports.

#### Annual Audit Report 2008 - Summary of significant audit irregularities

Agency/Group	Total significant irregularities reported	Total resolved	% resolved
Ministries	337.927	307.691	91.05
Dzongkhag/Gewogs	98.648	35.850	36.34
Autonomous Bodies	29.408	6.147	20.90
Corporations, Financial Institutions and NGOs	466.194	431.368	92.53
<b>Total</b>	<b>932.177</b>	<b>781.056</b>	<b>83.79</b>

Amounts in Nu in million

50. In the Dzongkhags, the Dzongrab<sup>17</sup> together with the Finance Personnel are entrusted with the responsibility to respond to the audit report. For instance in Paro Dzongkhag, the Finance Officer is made responsible to follow up on the fresh audit memos and the Budget Officer for old memos. Meetings are also held between Dzongkhags officials and RAA Audit Team to discuss and resolve the memos.

<sup>16</sup> Article 25, Section 1, Constitution of Kingdom of Bhutan also states “There shall be a Royal Audit Authority to audit and report on the economy, efficiency, and effectiveness in the use of public resources”. Article 25, Section 7 also provides, “The Royal Audit Authority shall function in accordance with the Audit Act” and authorize to carry out the audit as per the Audit Act”.

<sup>17</sup> Dzongrab is drawing and disbursing officer in Dzongkhags

Individual officers responsible for lapses are held accountable and are dealt with. In extreme cases, litigation ensues. Similarly, in Thimphu Dzongkhag, Dzongrab and the Accounts Officer are primarily entrusted with responsibilities to follow on the audit issues and put up in the meetings to be resolved.

51. A quick review of the detailed data on audit irregularities for the last three years at dzongkhag & gewog levels indicates that management of advances and taxes remains an area of major weakness.

#### Summary of Audit Irregularities, as per Annual Audit Report 2008 (Nu. in million)

	AAR 2008		AAR 2007		AAR 2006	
	Dzongkhag	Gewog	Dzongkhag	Gewog	Dzongkhag	Gewog
<b>Fraud &amp; Corruption</b>	<b>2.276</b>	<b>2.034</b>	<b>7.373</b>	<b>1.515</b>	<b>6.854</b>	<b>2.565</b>
- Forgery & tampering with documents			0.268			0.331
- Payment for works not executed and goods not received					0.537	0.597
- Malpractices & abuses	1.085	1.728	2.174	0.461		
- Misappropriation	1.169	0.160	4.617	0.620	0.601	0.158
- Fictitious Expenditure					4.846	0.795
- Misrepresentation of facts					0.040	0.020
- Non and short accountal	0.022	0.146	0.314	0.434	0.830	0.664
<b>Mismanagement</b>	<b>11.046</b>	<b>0.220</b>	<b>0.386</b>	<b>0.315</b>	<b>0.539</b>	<b>0.000</b>
- Mismanagement of funds	10.423			0.056	0.243	
- Mismanagement of properties		0.052			0.080	
- Mismanagement of revenues & taxes	0.623	0.168	0.386	0.259	0.216	
<b>Violation of laws &amp; rules</b>	<b>0.792</b>	<b>1.909</b>	<b>1.480</b>	<b>0.154</b>	<b>0.601</b>	<b>4.071</b>
- Violation of Service rules					0.071	
- Violation of Procurement norms	0.136	1.758	0.427	0.087		3.959
- Violation of Budgetary norms	0.656	0.151	1.053	0.067	0.530	0.112
<b>Shortfalls, lapses &amp; deficiencies</b>	<b>44.091</b>	<b>0.430</b>	<b>30.960</b>	<b>1.345</b>	<b>43.735</b>	<b>4.860</b>
- Over/inadmissible/irregular/double payments	0.539	0.100	3.528	0.128	11.985	2.345
- Non/short deductions	0.110		0.039		1.246	0.076
- Non-reconciliation of accounts					0.045	0.036
- Non-imposition of liquidated damages					1.468	0.132
- Shortfalls and uneconomic activities			0.123	1.141		
- Irregularities in construction			0.172			
- Irregularities of advances and taxes	43.314	0.330	27.098	0.031	28.841	2.271
- Missing records/receipts	0.128			0.045	0.150	0.000
<b>Total</b>	<b>58.205</b>	<b>4.593</b>	<b>40.199</b>	<b>3.329</b>	<b>51.729</b>	<b>11.496</b>

Source: RAA Annual Report 2008

#### Key issues

- With increases in the funding to local governments, it would be important that the audits be conducted annually.
- RAA requires to adopt modern risk based approaches to audit and certification of the complete annual financial statements.

## Internal Audit

52. Public Finance Act 2007, Internal Audit Charter, and Code of Ethics and Standards, May 2007 govern conduct of the internal audits. The internal audit cell was established in Ministries since the start of 9<sup>th</sup> Five Year Plan. Although Internal Audits of all the Dzongkhags and Gewogs are featured under the plans of Internal Audit Section of Ministry of Home and Cultural Affairs (MHCA) due to the lack of staff in the Internal Audit Section of MHCA, to date no internal audit has been carried out at local government level. Similarly, no internal audit was carried out in City Corporations. Thimphu City Corporation is in the process of recruiting the internal auditor as they have the post approved for it.

### Key issues

- a) *The local governments should have internal auditors to carry out internal audits regularly. This will help to streamline the financial management system.*
- b) *With appointment of internal auditors in local governments, their capacity building is also required to efficiently carry out the internal audit works in context of local government.*

## Internal and External Controls

52. FRR-2001 lays out transactional control on all government receipts and payments procedures and applies to all Dzongkhag and Gewogs. The transactional control framework is considered adequate and reflects best practice. However, there are concerns over weak compliance of the procedures in practice as evidenced by the observations on audit irregularities. The RAA in its audit reports pointed out that it is of the opinion that internal controls in Local Governments including supervisory controls and monitoring of activities are generally weak (Audit report of Paro Dzongkhag).

### Internal control for bill payments

In both Thimphu and Paro dzongkhags, there is an internal control system for the bill payment process. They have a system of Bill Register where all bills received are entered and dated, to whom the bills are marked for processing the payment and when the bills are cleared and paid. The payment date can also be verified from the Cheque Book Register which shows when the cheque is written and also from the Voucher details which shows date of Voucher, Cheque No., Amount and date etc.

All vouchers are generated from BAS and manual registers are also maintained for control. No payment can be processed without the budget appropriations.

## Public participation

53. Field visits indicate that there is adequate participation of the Local Governments in development plans and implementation. All the annual plans are decided through local legislative bodies and institutions (DT and GT). The DT and GT meeting are most important mechanism through which people can exert influence and also carry out the oversight functions and have participatory planning. At the Dzongkhags level, the DT is the final authority and has both the responsibilities to discharge its functions and accountabilities to the citizens and similarly GT in the Gewogs level.

54. LG Act 2009 mandates that the DT meeting to be conducted at least once in every six months. However, the Chairman may convene, if required, additional meeting of DT. Also, GT and Thromde Tshogde meetings should be held at regular sessions of at least thrice a year. All sessions of Local Governments are open to public to participate as audience except for closed door sessions. The new LG Act 2009

also requires that all Local Governments have public notice boards visibly and prominently displayed at the entrance of the office of the Local Government. Agenda for the next session, annual budget, annual work plan and call for tenders and other relevant information must be displayed on public notice boards.

### **Key issues**

- a) *Public participation will be improved with further training and inclusion of literate members on the local legislative bodies and institutions.*
- b) *The social audit process should be introduced for the program carried out in the Gewogs.*

## **Staffing**

55. The Dzongkhag Tshogdu is supported by a Tshogdrung, who is a civil servant. The Dzongdag is CEO and together with his team representing the technical sectors of line ministries are responsible for implementation and administration of Dzongkhag plans. He is accountable to local government bodies (DT).
56. The Gewog Tshogde is supported by the Gewog Administrative Officer, who is a civil servant. Gewog Administrative Officer shall act as the secretary to the GT (LG Act).
57. Thromde Tshogde (City Corporations) is supported by the Executive Secretary, who is a civil servant. The Executive Secretary acts as the secretary to the Thromde Tshogde. All the staff in Thromde are civil servants and responsible and accountable to Thromde Tshogde. The Thromde Tshogde constitutes of Thrompon (elect) as the chairperson and members representing different constituencies in the Thromde.

### **Key issues**

- a) *Not all the Gewogs presently have Gewog Administrative Officers (GAO)*
- b) *GAOs are fielded after a short training and are not well versed. They need rigorous trainings in all areas of administration and finance as he has to guide and advise the other Gewog functionaries and Gup.*

## **Conclusion**

58. The Royal Government of Bhutan operates on the unitary system with three tiers of self-governing institutions – Central, Dzongkhag/Thromde and Gewogs. Although local level democratic (political) decentralization and administrative autonomy has been enhanced and the principles of democratic and decentralized governance formally enshrined under Article 22 of the Constitution, the process of decentralization is not entirely complete. The major challenges that has chronically affected the pace and quality of decentralization has been the weak institutional and human capacity at local levels; the inadequate resource base of local economies and institutions; and often the bureaucratic administrative systems and procedures that hamper the efficiency and effectiveness of local administration. Consequently, the local governments have hitherto been primarily functioning as deconcentrated arms of the central government.
59. In this arrangement, dzongkhags and gewogs have operated in a manner similar to other budgetary agencies with respect to the public financial management. The Financial Rules & Regulations 2001 which define the budgeting, accounting, internal controls and financial reporting requirements apply equally to the local governments. Dzongkhag and Gewogs prepare their annual development plans

in line with the successive five year plans within the budget ceilings provided annually by the Ministry of Finance and these budgets are incorporated within the National Budget approved by the National Assembly (Parliament). The approved budgets for the dzongkhags and gewogs are individually reflected in the annual budgets, thereby providing transparency, credibility and predictability of the available financial resources. Fund releases are made through the LC system into bank accounts operated by the local governments. Dzongkhags and Gewogs maintain the books of accounts on RGoB's computerized Budget & Accounting system (BAS), forwarding the monthly financial data to the Department of Public Accounts for consolidation. RGoB prepares its annual financial statements incorporating the expenditures of the three tiers and places the same before the National Assembly. The Royal Audit Authority conducts audits for all dzongkhags and gewogs, although on a cycle of two years and incorporates its observations into an annual audit report which is placed before the National Assembly.

60. The two Thromdes (Thimphu and Phuntsholing) have been exceptions to this process, partly on account of the semi autonomous status accorded by law to the City Corporations. The annual allocations from RGoB (based on annual plans net of own sources of revenue) to the two Thromdes are budgeted as 'grants in aid' in RGoB's annual budget and fund releases are accounted for as expenditures. The two City Corporations maintain their accounts and prepare annual financial statements for submission to its Council (copied to the Ministry of Works & Human Settlements).
61. In the present circumstance wherein the local governments remain almost completely dependent on the central government for fund, this framework is robust and accords adequate levels of control and oversight to the central government. Within the budget ceilings, the local governments have substantial discretion to determine and implement the local area development plans. Within the constraints of the small size of the civil service, RGoB faces substantial challenges with respect to the implementation capacity at the local government level as evidenced by consistent levels of budgetary under spends.
62. Notwithstanding the above strengths, it is evident that the present framework in its design has a few fundamental inconsistencies with Bhutan's vision 2020 of fully and effectively empowered local governments responsible for its development planning and management functions and for the Bhutanese people to genuinely "own" the development process, thereby helping fulfill both long term national goals and local aspirations and priorities. These inconsistencies that arise from the present design of the public financial arrangements as well as its practice are: (a) accountability from the local government for use of public funds flows primarily upwards for the use of public resources, often at the cost of compromising with the aspirations and needs of the communities that they serve; (b) accountability arrangements for own sources of funds (however small) remain unclear; these are not normally reported to central government and not included in the central government annual financial statements. The use of own funds are generally on ad-hoc basis for small maintenance of infrastructure etc. It is not clear if complete annual financial statements are prepared at the local government (incorporating the central funds and own revenues) level; (c) there are presently no practice at the local government level of displaying or disseminating information either through formal or informal processes on the state of financial affairs to its constituents or communities at large.
63. Bhutan's historic transformation into a constitutional monarchy and adoption of the new Constitution has further institutionalized the system of local governments in Bhutan. The recently passed Local Government Act 2009 provides the supportive legal basis for the functioning of the local government with a strong system of gewog and dzongkhag councils and administration. Following the recommendations of the Good Governance (GG+) Report 2005, RGoB has initiated a process of reviewing the functional and fiscal assignments. The Tenth Plan will see greater autonomy in the way

Local Governments plan and manage their development programs. This will manifest in a new Inter Governmental Fiscal Transfer mechanism i.e. the Annual Grant System which will allow for better and predictable development programming and facilitate a more responsive, realistic and meaningful planning and budgeting exercises. This is also envisaged to help build greater participation, ownership and transparency of local development programs.

64. These developments present a special opportunity to RGoB to review the adequacy and appropriateness of the present financial management staff resourcing and systems at the local government level in a manner that will ensure greater efficiency, effectiveness, accountability and participation of beneficiaries.

# ANNEX 3: FINDINGS OF THE ASSESSMENT OF NATIONAL PROCUREMENT SYSTEMS USING THE BASELINE INDICATORS OF THE OECD-DAC METHODOLOGY

The assessment has been carried out by the World Bank in June 2009 as part of the program on Use of Country Procurement System. The assessment uses the OECD-DAC methodology for Assessment of National Procurement Systems<sup>18</sup>, which offers a detailed and operational framework for assessing national public procurement systems vis-à-vis international good practice.

The OECD-DAC assessment framework is structured under four pillars:

- Pillar I: Legislative and regulatory framework
- Pillar II: Institutional framework and management capacity
- Pillar III: Procurement operations and market practices
- Pillar IV: Integrity and transparency of the procurement system

The four pillars are sub-divided into 12 indicators and a total of 54 sub-indicators, or so-called Baseline Indicators (BLIs), together measuring the quality of legal and regulatory frameworks, formal arrangements, structures, policies, and strategies guiding all key aspects of the national public procurement system. The assessment result for each indicator is summarized in a score between 0 (not achieved) and 3 (fully achieved).

Indicator	Achieved Score	Required Score
1.a) Scope of application and coverage of the regulatory framework and public access to legislation	2	3
1.b) Procurement methods	3	2+
1.c) Advertising rules and time limits	1	3
1.d) Rules on participation and qualitative selection	3	3
1.e) Tender documentation and technical specifications	2	3
1.f) Tender evaluation and award criteria	3	3
1.g) Submission, receipt and opening of tenders	3	3
1.h) Complaints system structure and sequence	2	3
2.a) Implementing regulation that provides defined processes and procedures	3	2
2.b) Model tender documents for goods, works, and services	3	2
2.c) Procedures for pre-qualification	3	2+
2.d) Procedures for contracting for services or other requirements in which technical capacity is a key criterion	3	2+

<sup>18</sup> Methodology for Assessment of National Procurement Systems, Version 4 (OECD-DAC, 17 July 2006)

Indicator		Achieved Score	Required Score
2.e)	User's guide or manual for contracting entities	2	2
2.f)	Existence and coverage of General Conditions of Contracts (GCC) for public sector contracts	3	3
3.a)	Procurement planning and data on costing are part of the budget formulation and multiyear planning	0	2
3.b)	Budget law and financial procedures support timely procurement, contract execution, and payment	3	2
3.c)	Procurement actions not initiated without budget appropriations	0	2
3.d)	Systematic completion reports are prepared for certification of budget execution and for reconciliation of delivery with budget programming	2	2
4.a)	Normative/regulatory functions are established and assigned (to one or several agencies) in the legislative and regulatory framework	3	3
4.b)	The responsibilities include at least those required in this sub indicator	2	2
4.c)	Adequacy of organization, funding, staffing, and level of independence and authority (formal power) to exercise the duties under (b)	1	2
4.d)	Separation and clarity so as to avoid conflict of interest and direct involvement in the execution of procurement transactions	3	3
5.a)	System for collecting and disseminating procurement information and accessibility	0	2
5.b)	Systems and procedures for collecting and monitoring national procurement statistics	0	2
5.c)	Strategy and training capacity to provide training, advice and assistance to develop the capacity	0	2
5.d)	Quality control standards and staff performance evaluation for capacity development	0	2
6.a)	Adequacy of procurement competence among government officials	2	2
6.b)	Procurement training and information programs	0	2
6.c)	Norms for the safekeeping of records and documents related to transactions and contract management	0	2+
6.d)	Provisions for delegation of authority	2	2
7.a)	Effective mechanisms for partnerships between the public and private sector	1	2
7.b)	Private sector institutions are well organized and able to facilitate access to the market	2	2
7.c)	Systemic constraints inhibiting the private sector's capacity to access the procurement market	2	2+
8.a)	Procedures are clearly defined for undertaking contract administration responsibilities	0	2
8.b)	Contracts include adequate dispute resolution procedures	0	3
8.c)	Procedures exist to enforce the outcome of the dispute resolution process	0	3

Indicator	Achieved Score	Required Score
9.a) Legal framework, organization, policy, and procedures for internal and external control and audit of public procurement	2	2+
9.b) Enforcement and follow-up on findings and recommendations of the control	0	2+
9.c) The internal control system provides timely information on compliance to enable management action	2	2+
9.d) The internal control systems are sufficiently defined to allow performance audits to be conducted	0	2
9.e) Auditors are sufficiently informed about procurement requirements	1	2
10.a) Decisions are deliberated on the basis of available information, and the final decision can be reviewed and ruled upon by a body (or authority) with enforcement capacity under the law	2	3
10.b) Capacity of the complaint review system and enforcement of decisions	0	3
10.c) Fairness of the complaints system	0	3
10.d) Public access to decisions	0	2
10.e) Independence of the administrative review body	0	3
11.a) Publication and distribution of information	0	2+
12.a) Legal provisions on corruption, fraud, conflict of interest, and unethical behaviour	1	3
12.b) Definition in legal system of responsibilities, accountabilities, and penalties for fraudulent or corrupt practices	2	3
12.c) Enforcement of rulings and penalties	2	2+
12.d) Measures exist to prevent and detect fraud and corruption in public procurement	3	3
12.e) Stakeholders support the creation of a procurement market known for its integrity and ethical behavior	0	2
12.f) Mechanism for reporting fraudulent, corrupt, or unethical behaviour	3	3
12.g) Codes of Conduct/Codes of Ethics for participant and provision for disclosure for those in decision making positions	0	2

The key findings under each pillar are detailed in the sections below.

## Pillar I: Legislative and regulatory framework

The legislative and regulatory framework for public procurement in Bhutan has undergone significant improvements in recent years. In particular, the Procurement Rules and Regulations (PRR) first issued in 2007, and updated in April 2009, provide a clear, comprehensive, consolidated, and up-to-date basis for sound and efficient public procurement and offers the foundation for a national procurement system broadly in line with international good practice.

Secondly, and in line with the requirements of the PRR, a set of Standard Bidding Documents (SBDs) for procurement of goods and works, and Standard Request for Proposals (SRFP) for consultancy services has been issued in Bhutan, also effective from April 2009. The newly introduced SBDs have a wide coverage and are largely modelled based on international standards, and as such constitute a significant step forward compared to the national sample bidding documents dating back to 1988, which they replace.

Despite these overall positive trends, the findings of the assessment suggest that a number of minor adjustments to the legal and regulatory framework are still required to create a procurement system fully in line with international standards.

The main weaknesses to be addressed in this respect are:

- **Foundation of PRR in the Public Finance Act:** The Public Finance Act fully delegates the responsibility for issuing rules to the Ministry of Finance by an enabling provision. Further to the enabling provision, the Ministry of Finance has established detailed and specific rules on procurement in the PRR. While the PRR is itself a document of high standard, it could provide an enhanced perception of legitimacy, if the foundations of the legal framework were to be contained in an Act passed by the legislature, rather than in rules issued by the Ministry of Finance. The Ministry of Finance has several other important functions besides issuing procurement rules – and is itself a procuring entity – and this could possibly foster a perception of a conflict of interest among the general public.
- **Alignment of SBDs with PRR:** The contents of the SBDs are currently not fully aligned with the contents of the PRR, which introduces a degree of legal uncertainty. In particular, the Instructions to Bidders in the SBDs contain additional exclusion criteria which are not found in the PRR. If a bid was rejected with reference to one of these additional exclusion grounds, the bidder may be able to contest the rejection, claiming that the PRR did not authorise the PPPD to introduce additional exclusion grounds.
- **Coverage of all procurement using national budget funds:** Although the PRR (rule 1.1.2.1) cover procurement of goods, works, and services, they also contain certain exemptions which – if applied – will mean that not all procurement using national budget funds is covered. In particular, corporations and financial institutions fully or partly owned by the Government, trust funds, and welfare funds may adopt their own rules and regulations. In practice, some corporations such as the Bhutan Power Corporation, do apply their own procurement rules and regulations, though the assessment has not been able to identify any examples of government owned institutions using the national budget, which apply own rules and regulations. It is, however, a common interpretation that the PRR does not rule this out.
- **Advertisement:** Public advertisement is required for open bidding and for pre-qualification under the limited bidding procedure (PRR rule 5.1.2.1 and 2.2.1.3). However, limited bidding without prequalification is allowed in certain cases, and in those cases the PRR only requires the procuring agency to notify a selection of previously registered bidders (PRR rule 5.1.2.1 and rules 4.2.3.1 and 4.2.3.2). Though PPPD's practice is to always advise procuring agencies to advertise limited tenders, the PRR contain a loophole in this area.
- **Use of time limits:** The PRR establish the minimum time limits for submission of bids (rule 5.1.3.1), but these are fairly short and are not likely to be sufficient for procurements with some level of complexity. Moreover, the PRR do not contain a requirement to extend the timeframes when international competition is sought. Combined with the fact that the deadlines are short in the first place, this is assessed to put international bidders at a disadvantage.
- **Citing international standards in specifications:** The PRR do not contain a general obligation to use neutral specifications citing international standards (such as ISO standards) when possible.
- **Record keeping:** The PRR contain no specific requirements on keeping of records of procurement proceedings, including which records should be kept, for which purposes, and for which period of time. They also do not indicate whether, and for whom, procurement records should be made available for review. Though such requirements can currently be found in the legal and regulatory frameworks of review and audit bodies, it is desirable that they also be mentioned directly in the PRR, so as to clearly define the scope of access, and also ensure access by bodies (such as the Independent Review Body) with no separate set of rules.

- Procurement user's guide: No guidelines or manual have yet been developed to guide procuring agencies in procurement processes, though most procuring agencies agree that such guidelines are a much needed support in the agencies' execution of procurements. PPPD intends to employ a consultant to prepare such a manual, but no timeline has been established for this activity.

## Pillar II: Institutional framework and management capacity

The establishment of the *Public Procurement Policy Division* (PPPD) in August 2008 represents a milestone in the strengthening of the institutional framework and management capacity for public procurement in Bhutan. With the emergence of the Division, a number of procurement regulatory and oversight functions have been elevated to a higher strategic level, and as such, the first step has been taken towards a well-regulated and closely monitored procurement system.

The assessment team has, however, also identified a number of weaknesses relating to the institutional framework and management capacity for public procurement in Bhutan. In particular, the following key issues are noted:

- Independence of PPPD: As a Division under the Ministry of Finance, reporting to the Secretary of the Ministry of Finance, the PPPD formally has a high level and authoritative standing in Government (PRR rules 8.2.1.1 and 8.2.1.2). In practice, however, PPPD administratively falls under the Department of National Properties, and the Head of PPPD refers to the Head of the Department of National Properties and not directly to the Secretary. This condition, together with the fact that PPPD does not have the authority to publicly address matters relating to public procurement, but is required to refer all such matters to the Secretary (who may however choose to delegate), is in practice assessed to put at risk the independence of the body. The issue of independence is further exaggerated by the fact that no rules on the financing of the PPPD are established in the PRR, hence making the financing of PPPD subject to easily changeable administrative decisions.
- Procurement planning: The legal and regulatory framework in Bhutan presently does not include any requirement for preparation of procurement plans. In practice, procurement planning is often non-existent. In effect, procurement officers are often only informed about specific user needs, once these are imminent, resulting in delays and emergency procurements using non-preferred procurement methods.
- Linkages between public procurement and the broader public financial management framework: The integration of public procurement in the broader public financial management framework is rather weak in Bhutan. As indicated above, procurement planning is not adequately integrated in the budgeting process. Moreover, there is no provision in law requiring certification of availability of funds before solicitation of tenders' takes place. And although completion reports are prepared and used to certify budget execution, they are not used to reconcile the delivery with the budget programming.
- Monitoring of procurement practices and performance: The limited linkages between the public procurement system and the broader public financial management framework are also reflected in the fact that no integrated financial management information system (IFMIS) exists in Bhutan. This in turn also creates limited opportunity for PPPD to monitor procurement practices and performance across procuring entities. There is currently no system in operation to collect data on procurement practices and performance in Bhutan, but to be able to address this area in the future, PPPD has made a request to the Royal Civil Service Commission for six additional staff members to the organisation, specifically with a view to establish a monitoring unit within PPPD.
- Publication of procurement information: Procurement information, such as advertisements, tender documents, and notifications of award, are currently not published in any consolidated and easily

accessible place. In June 2007, an e-GP readiness assessment was conducted with the assistance of the World Bank. The assessment recommended that a strategic plan for the implementation of e-GP be developed, and that roles and responsibilities for this process be defined. The e-GP system to be established would among other things provide a platform for publication of all available procurement information. However, little activity has taken place since the assessment. With the recent establishment of PPPD in August 2008 and the new PRR and SBDs in place, however, PPPD intends to revitalise the process. To fill the gap for procurement information in the meantime, PPPD plans to create a dedicated procurement information website, which can serve as a centralised forum for information to interested stakeholders on the procurement system, including such information as the legal documentation, SBDs, advertisements, information on PPPD's activities, etc.

- **Procurement training programmes:** Though PPPD and other stakeholders to the procurement system in Bhutan have carried out a smaller number of training and capacity development activities targeting the public and private sector, no permanent and relevant training programmes for new and existing staff in government procurement presently exist. Considering that lack of qualified procurement professionals is one of the single most important weaknesses associated with the procurement system in Bhutan, the lack of such training programmes constitutes a major challenge and one that must be addressed urgently. To promote development in this area, the World Bank in 2008 provided a grant of approx. USD 1.5 million to Bhutan for an Institutional Capacity Building Project for Procurement, which among other things will aim to institutionalise a national procurement training regime. The project commenced in June 2009 and is implemented by PPPD, in collaboration with the Royal Civil Service Commission, the Royal University of Bhutan and the Royal Institute of Management. When the training programme has been established and trainers been trained (expected in 2010/11), both the Royal University of Bhutan and the Royal Institute of Management should be able to offer in-service and (secondarily) pre-service training on public procurement targeting both the public and private sector. The scope of training is yet to be determined.
- **Quality standards:** The quality of procurement performance is sought addressed at the individual level through a Performance Appraisal System introduced by the Royal Civil Service Commission. In practice, however, the system is often not used by procurement officers, or only used partly or superficially without serving its intended purpose. At the same time, the system is not complemented by quality standards for procurement at the organisational level (e.g. standards for processing procurement actions), which makes it difficult to monitor the large-scale effect of individual performance trends, and hence to use performance information to manage for results.

### **Pillar III: Procurement operations and market practices**

As the government institution in charge with managing human resources across the civil service in Bhutan, the Royal Civil Service Commission plays a major part in ensuring that the necessary framework is in place to attract, recruit, and retain professionals for positions of procurement officers in procuring agencies. The Royal Civil Service Commission does so through a comprehensive human resource management system, which includes a career ladder of procurement position, associated job descriptions, competitive recruitment for available jobs, and performance monitoring through a Performance Appraisal System. As such, the foundations for sound *procurement operations* are in place in Bhutan.

At the same time, the *procurement market* in Bhutan is also rather well-functioning. In most areas, the competition for public contracts is high, and there are few major systemic constraints inhibiting the access of the private sector to partake in competition for and implementation of public contracts.

In contrast to other industries, the construction industry in Bhutan is characterised by a comparatively strong *collaboration between the government and private sector*. This is mainly due to the role played by

the Construction Development Board (CDB), which is mandated with the dual role of overseeing and promoting the construction industry through policy reforms, registration of contractors, and dispute resolution. In practice, the CDB is in close dialogue with the Construction Association of Bhutan, through which contractors voice concerns about their access to the procurement market.

At the same time, the assessment team notes the following key issues relating to the procurement operations and market practices in Bhutan:

- **Procurement skills and competencies in procuring agencies:** While most government ministries have dedicated procurement officers, procurements in smaller procuring agencies are carried out by ad hoc staff in non-procurement job functions, which more often than not lack the knowledge to undertake the activity. With the exception of the advisory services provided by PPPD, access to professional staff that can provide this knowledge is close to non-existent, due to the lack of a trained procurement profession in Bhutan. The problem is made worse by the fact that even procurement officers in positions dedicated to the job often do not have any educational background in procurement or public financial management related subjects, and also have often not been offered any training on or introduction to the procurement system of Bhutan. It is planned that the World Bank supported Institutional Capacity Building Project for Procurement (see section 4.3) will address this challenge.
- **Private sector capacity to participate in competition for public contracts:** The private sector in Bhutan consists mainly of small or medium-sized family run companies, and to a lesser extent larger enterprises. While it is assessed that most companies have a basic understanding of how to participate in the competition for public contracts, it is clear that, particularly among SMEs, the capacity to responsively participate in public procurement can be enhanced. Evidence of this is found in the high ratio of non-responsive bids (often up to 50%) still received by procuring agencies. To raise awareness, a number of two days trainings recently carried out by the CDB towards small and petty contractors, but the demand still vastly exceeds the available training supply targeting the private sector. In addition, the World Bank supported Institutional Capacity Building Project for Procurement (see section 4.3) will include activities aimed to establish the training need for the private sector and design training activities targeting this group specifically.
- **Public private partnerships:** There is no mechanism for public private partnerships established by law in Bhutan. The concept of public private partnerships is still relatively new, and there is a lack of national expertise and private sector investment capacity in the area. However, public private partnership initiatives are expected to crop up in the near future with the Ministry of Economic Affairs mandated with the responsibility of introducing this area. As the regulatory body for public procurement, PPPD would be a natural partner in pursuing this area.
- **Private sector access to the procurement market:** Despite the generally good access to the procurement market in Bhutan, a few constraints inhibiting private sector access do exist. One of them is the challenge of getting access to credit, which in particular affects the large number of small companies without any assets, for which bid securities of 10% of the contract value represent a major challenge. Another challenge inhibiting the private sector's access to the procurement market, and in effect competition on works, is the ceiling related to "works in hand" imposed by the CDB. This is especially limiting for petty contractors (Category D), which cannot participate in tenders as long as they have one contract under implementation. This in turn leads to costly implementation gaps between contracts for the affected contractors.
- **Delegation of procurement decision making:** The PRR (section 3.1) contains detailed provisions for delegation of procurement decision making authority through existence of Tender Committees at different levels. The level of Tender Committee required is determined based on the risks and monetary

sums involved, and include Gewog Tender Committees (county level), Dzongkhag Tender Committees (district level), and Field Level Tender Committees in Departments, Departmental Tender Committees, Ministerial Tender Committees, Autonomous Bodies Tender Committees, and Higher Level Tender Committees for the Autonomous Bodies, and Inter-Ministerial Tender Committees. However, it is questionable whether the added checks and balances introduced in Higher Level Tender Committees for the Autonomous Bodies and Inter-Ministerial Tender Committees make up for the delayed decision making, they often cause. The assessment findings indicate that in practice the high-level committees often appear to veil accountability by distributing it between several actors rather than making the specific procuring agency clearly accountable for its actions.

- **Contract administration:** Contract administration remains a major challenge. Specifically, supervision of civil works is mainly carried out by government supervisors and inspectors, who often have to manage several civil works supervisions simultaneously, with limited attention to detail as a consequence. At the same time, the thoroughness of quality control of goods varies, due to the fact that quality control is in practice carried out by officers of the procuring agency, which often lack the necessary skills.
- **Arbitration framework:** In the field of construction, disputes occurring during the performance of a contract can be handled through arbitration in Bhutan. For this purpose, the Construction Development Board has appointed a National Arbitration Committee guided by the CDB Manual<sup>19</sup>. The manual makes appropriate provisions for neutrality of arbitrators, expediency and due process, however, as a government body under the Ministry of Works and Human Settlement, both CDB and private sector associations point to the risk of conflicts of interest associated with this arrangement. Moreover, a more general framework for dispute resolution in the post-contractual phase does not exist in Bhutan. There is currently no arbitration law in Bhutan, and the country is also not a member of the New York Convention on enforcement of international arbitration awards. As a result, Bhutan also does not have any procedures (except for works) to enable the winner in a dispute to seek enforcement of the outcome by going to the courts, or to monitor dispute resolution processes and address performance issues.

## Pillar IV: Integrity and transparency of the procurement system

The integrity and transparency of a public procurement system in Bhutan hinges on a number of control mechanisms, including an effective audit system, an efficient appeals mechanism, a comprehensive information sharing system enabling civil society, media, and other interested stakeholders to conduct social audit, and an effective anti-corruption framework. Without such control mechanisms, flaws in the procurement system may not be detected and addressed.

In practice, two institutions stand out as being of particular importance to the integrity and transparency of the procurement system in Bhutan. Firstly, the *Royal Audit Authority* in Bhutan stands out as a highly respected authority generally renowned among all stakeholders for its independent, timely, comprehensive, and competent audits. At the time of writing, the Royal Audit Authority employs 167 auditors, which cover all procuring agencies and operate according to a detailed, risk-based audit framework. Moreover, the Royal Audit Authority has developed a specific Construction Audit Manual and Procurement Audit Manual to guide the auditing of procurement processes.

Secondly, the Anti-Corruption Commission, though not as adequately staffed as the Royal Audit Authority, is assessed to play a key role as a protector of the transparency and integrity of the procurement system in Bhutan. Established in 2006, the Anti-Corruption Commission is a young, yet highly visible body. The organisation's contribution to the fight against corruption in Bhutan, including in public procurement,

has so far included the establishment of a comprehensive National Anti-Corruption Strategy<sup>20</sup> with buy-in from the highest level of Government, a secure and popular whistleblower mechanism, and significant awareness raising efforts. Moreover, evidence suggests that the Anti-Corruption Commission has, at least partly, been able to enforce the Anti-Corruption Act. As such, approx. 9% (124 of 1576) of all reports of corruption received by the Anti-Corruption Commission in the period 2006-2008 were investigated or forwarded to the Office of the Attorney General or public agencies for further action. In the same period, 23 cases have been referred to court, out of which judgment has so far been passed by court for 15 cases. All of these judgments have led to conviction, with court sentences ranging from 3 months to 9.5 years.<sup>21</sup>

The assessment team has also encountered a number of weaknesses relating to the established control mechanisms. The following key issues are noted:

- **Internal audit framework and capacity:** Since 2007, the Ministry of Finance in Bhutan has been the parent agency administering the Internal Audit Services across public agencies in Bhutan. In 2008, this responsibility was followed up by an Internal Audit Charter, Standards, and Code of Ethics for the Government Internal Audit Services to function efficiently and effectively in the agencies. As these documents are rather general in nature, it is the intention of the Internal Audit Services to issue an Internal Audit Manual separately. This has, however, not yet happened, which means that the procedures for planning, conducting, and following up on internal audits are left largely at the discretion of the individual auditors. With only 18 internal auditors covering all public agencies, of which 50% are recruited directly from graduation without the necessary skills, the current internal audit function in Bhutan is highly fragile and largely unable to meet the required standards.
- **Independent Review Mechanism:** The PRR (rule 8.1.5) establishes that complaint decisions made by the procuring agency (as the first tier of complaint) can be brought for a review procedure before an Independent Review Body (acting as the second-tier complaint level) established by the Ministry of Finance. In practice, however, no Independent Review Body has yet been established, and as such, no capacity currently exists to handle complaints efficiently. The PPPD is currently making plans for the establishment of an independent review panel selected from a quasi-permanent list of individuals, which would be appointed and administered by the PPPD. A set of rules for the Independent Review Body is already included in the PRR to support this process, though additional rules on relevance of evidence, publication of and timeframes for decisions, and balanced and unbiased decision making will need to be established.
- **Conflict of interest:** While the PRR requires procuring agencies to ensure against cases of conflict of interest, the cases of conflict of interest described by PRR are fairly limited. As such, the PRR or any other legal or regulatory framework in Bhutan requires the procuring agency to ensure against awarding contracts to former public officials who have only recently left office.
- **Code of Ethics:** The Bhutan Civil Service Rules and Regulations include a Code of Conduct applicable to all employees of all agencies within the civil service of Bhutan. The Code of Conduct requires all civil servants, including decision makers, to declare their financial assets, and defines accountabilities for failure to declare assets by the employees of an agency, but does not include any provisions specifically addressing civil servants involved in PFM or public procurement. Similarly, no Code of Ethics specifically targeting procurement officers have been developed to help prevent unethical or corrupt practices among this high-risk group of civil servants.

<sup>20</sup> National Anti-Corruption Strategy Framework (Anti-Corruption Commission, June 2009)

## ANNEX 4: SOURCES OF INFORMATION

Annual Audit Schedule, RAA (2007-08)
Annual Financial Statements - <a href="http://www.mof.gov.bt">http://www.mof.gov.bt</a>
Bhutan Economic Brief
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Budget Manual
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