



# BHUTAN

September  
2016

## Public Financial Management **PERFORMANCE REPORT**

Based on Public Expenditure and Financial Accountability  
2016 Framework

Royal Government of Bhutan  
Ministry of Finance



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**Royal Government of Bhutan – Ministry of Finance**  
Public Financial Management Performance Report based on Public Expenditure and  
Financial Accountability Methodology (PEFA) 2016 Framework  
**Final Report – September 2106**

The quality assurance process followed in the production of this report satisfies all the requirements of the PEFA Secretariat and hence receives the **'PEFA CHECK'**.

PEFA Secretariat

September 7, 2016



# Acronyms and ABBREVIATIONS

AAR	Annual Audit Report
AASBB	Accounting and Auditing Standard Board of Bhutan
ACC	Anti Corruption Commission
ACG	Annual Capital Grants
ADA	Austrian Development Agency
ADB	Asian Development Bank
AFD	Administration & Finance Division
AFS	Annual Financial Statements
AIMS	Audit Information Management System
AIN	Audit Information Number
APA	Annual Performance Agreement
ARA	Audit Recoveries Account
ATR	Action Taken Report
BACS	Bhutan Automated Customs System
BAS	Budget and Accounting System
BCCI	Bhutan Chamber of Commerce & Industry
BCG	Budgetary Central Government
BCSR	Bhutan Civil Service Rules and Regulations
BFA	Government Budget Fund Account
BIT	Business Income Tax
BPC	Bhutan Power Corporation
BPFF	Budget Policy & Fiscal Framework
BTN	Bhutanese Ngultrum
BUP	Budget Utilization Plan
CAB	Contractors' Association of Bhutan
CBAS	Central Budget and Accounting System
CCA	Ministry of Finance Central Coordinating Agency
CCC	Cash Coordinating Committee

CD	Current Deposits
CDB	Construction Development Board
CEO	Chief Executive Officer
CFA	Consolidated Fund Account
CG	Central Government
CGAP	Certified Government Auditing Professionals
CID	Citizenship Identity Card Number
CIT	Corporate Income Tax
COFOG	Classification of Functions of Government
COSO	Committee of Sponsoring Organizations
CSAB	Civil Service Act of Bhutan, 2010
CS-DRMS	Commonwealth Secretariat- Debt Recording and Management System
CSIS	Civil Service Information System
CSO	Civil Society Organization
DDO	Drawing and Disbursing Officers
DHI	Druk Holding and Investments
DLG	Department of Local Governance
DMD	Debt Management Division
DNB	Department of National Budget
DNP	Department of National Properties
DPA	Department of Public Accounts
DRC	Department of Revenue and Customs
DRS	Debtor Reporting System
DT	Dzongkhags Tshogdu
EBU	Extra Budgetary Unit
EC	European Commission
EFTCS	Electronic Fund Transfer and Clearing System
EID	Employee Identity Number
EU	European Union

EUR	Euro
FAM	Finance and Accounting Manual
FDI	Foreign Direct Investment
FIC	Financing Item Code
FMM	Financial Management Manual
FRMAI	Financial Resources Management Accountability Index
FRR	Financial Rules and Regulations
FY	Financial Year
FYP	Five Year Plan
GAO	Gewog Administrative Officers
GARR	General Auditing Rules and Regulations
GCA	Government Consolidated Account
GDG	Gewog Development Grant
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GNH	Gross National Happiness
GNHC	Gross National Happiness Commission
GOI	Government of India
e-GP	e-Government Procurement
GPF	Government Provident Fund
GPMD	Government Performance Management Division
GPMS	Government Performance Management System
GPP	Green Public Procurement
GPPMD	Government Property and Procurement Management Division
GT	Gewogs Tshogde
HEP	Hydro Electric Power
HR	Human Resource
HRD	Human Resource Division
IA	Internal Audit
IAS	Internal Audit Section
IAU	Internal Audit Units
IC	Internal Control
IMF	International Monetary Fund
IMF-GFS	IMF-Government Finance Statistics
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standard

IRB	Independent Review Body
ISSAI	International Standards of Supreme Audit Institutions
JICA	Japan International Cooperation Agency
LC	Letter of Credit Account
LG	Local Governments
LGSP	Local Governance Support Program
LIC DSA	IMF-World Bank Debt Sustainability Framework for Low Income Countries
LLC	Limited Liabilities Companies
LPC	Last Pay Certificate
MDF	Multi Donor Fund
MDTF	Multi-Donor Trust Fund
MFCC	Macroeconomic Framework Coordination Committee
MFCTC	Macroeconomic Framework Coordination Technical Committee
MHCA	Ministry of Home and Cultural Affairs
MOF	Ministry of Finance
MP	Member of Parliament
MTDS	Medium Term Debt Strategy
MTEF	Medium Term Fiscal Framework
MW	Mega Watt
MYRB	Multi-Year Rolling Budget
NICF	National Internal Control Framework
NKRA	National Key Result Area
NPPF	National Pension and Provident Fund
NR	Not Rated
NTC	National Technical Committee
NU	Bhutanese Ngultrum
PAC	Public Accounts Committee
PCA	Post Clearance Audit
PCC	Program Coordination Committee
PE	Public Enterprise
PED	Public Enterprise Division
PEFA	Public Expenditure and Financial Accountability
PEMS	Public Expenditure Management System
PFA	Public Finance Act 2007
PFM	Public Financial Management
PFM-GG	Public Financial Management-Governance Group

PFM-PR	PFM Performance Report
PI	Performance Indicator
PIT	Personal Income Tax
PlaMS	Planning and Monitoring System
PLC	Project Letter of Credit Account
PMF	Performance Measurement Framework
PMO	Prime Minister's Office
PPD	Policy and Planning Division
PPG	Public and Publicly Guaranteed
PPP	Public-Private Partnerships
PPPD	Public Procurement Policy Division
PRR	Procurement Rules and Regulations 2009
PSC	Project Steering Committees
PWA	Public Work Advance
RAA	Royal Audit Authority
RAMIS	Revenue Administration Management Information System
RAS	Revenue Accounting System
RBP	Royal Bhutan Police
RCSC	Royal Civil Service Commission
RGoB	Royal Government of Bhutan
RGR	Government Revenue Account
RMA	Royal Monetary Authority
RMS	Revenue Management System

RNR	Renewable Natural Resources
ROSC	Report on the Observance of Standards and Codes
RAA	Royal Audit Authority
RRCO	Regional Revenue and Customs Office
RSTA	Road Safety and Transport Authority
RTAC	Regional Tax Appeal Committee
SAI	Supreme Audit Institution
SAR	South Asia Region
SDC	Swiss Agency for Development and Cooperation
SECO	State Secretariat for Economic Affairs SECO Economic Cooperation and Development
SKRA	Sectoral Key Result Areas
SNG	Sub-National Government
SOE	State-Owned Enterprises
SDU	Service Delivery Unit
STC	State Trading Cooperation
TMD	Treasury Management Division
TMS	Tax Management System
TPN	Taxpayer Number
TT	Thromde Tshogde
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme



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# Executive SUMMARY

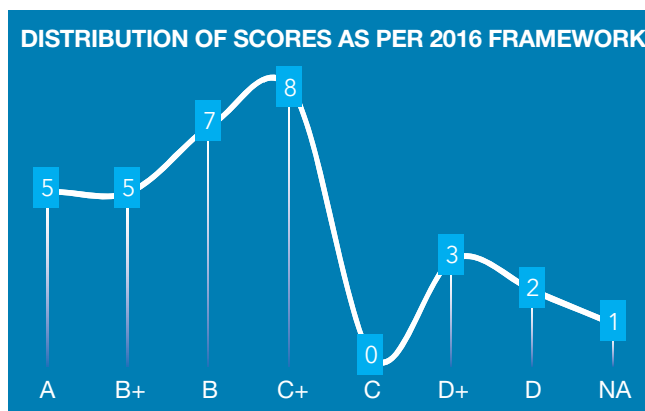
The purpose of the assessment of the Public Financial Management (PFM) performance of the Royal Government of Bhutan (RGoB) was threefold: (i) to assess the quality (strengths and weaknesses) of PFM in the country against generally accepted international standards; (ii) to assess progress since the last PEFA assessment in 2010, and (iii) to provide RGoB and other stakeholders with a common source of information as a basis for further dialogue on PFM reforms. As the last assessment, dated June 2010, used the 2005 framework, the same framework was used for determining progress since 2010.

This assessment was carried out under the approach of full ownership by RGoB and self-assessment by its officials, with technical support from World Bank and IMF. The team, comprising of World Bank staff and consultants, the Regional IMF PFM Advisor and RGoB officials, conducted the assessment initially using the 2015 Testing Version of the PEFA framework and a questionnaire template. Initial drafts were prepared by the designated RGoB officials and discussed and agreed with the World Bank team members. As the final version of the 2016 PEFA framework was launched in February 2016, additional data was collected and the drafts were modified to meet the needs of the new Framework.

The assessment covered all ten ministries of RGoB, oversight institutions such as the Royal Audit Authority and legislative committees, autonomous agencies funded by the RGoB, and local government bodies (dzongkhags, gewogs and thromdes). The latter were considered as deconcentrated units of the central government instead of sub-national governments, in accordance with PEFA criteria. All 31 indicators of the 2016 PEFA Framework were included in the assessment, and each indicator was assessed at the time or period prescribed in the Framework. The budget credibility indicators, for instance, were based on the last three financial years for which reliable revenue and expenditure data were available at the start of the fieldwork in October 2015, viz. FY 2012/13, 2013/14 and 2014/15.

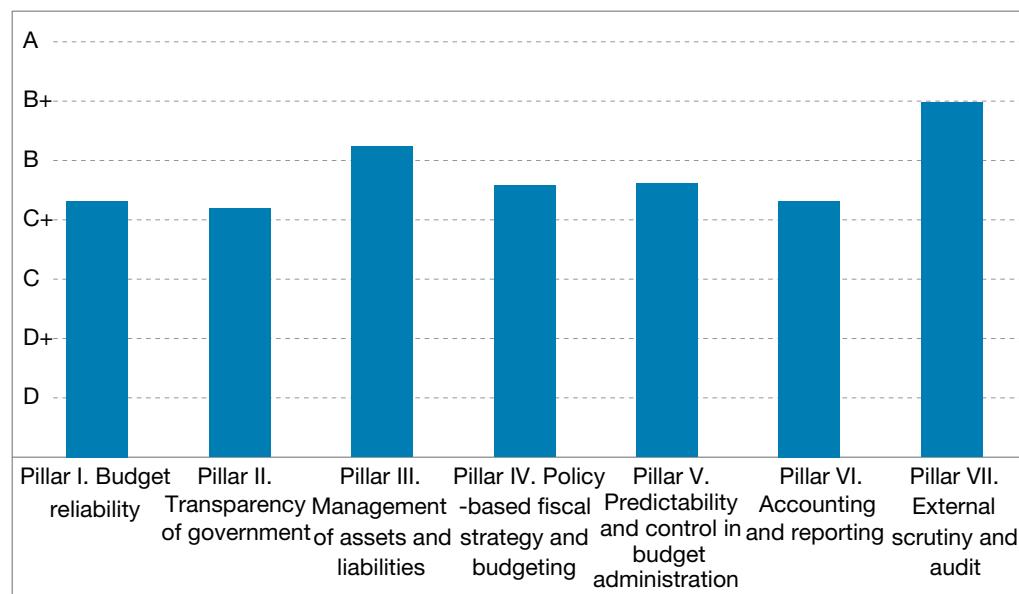
A table giving an overview of scores for each of the PEFA indicators is given at the end of the PEFA summary and a detailed table showing the scores and explanations is provided in Annex 1. The PFM performance for the 31 indicators and their dimensions was assessed and assigned ratings of A to D in accordance with the criteria in the PEFA Framework. The distribution of scores are shown in the figure alongside.

The aggregate scores against each of the seven pillars of PEFA Framework indicates that two pillars are relatively stronger i.e. *Pillar III: Management of assets and liabilities* and *Pillar VII: External scrutiny and audit*. The pillars showing relatively lower scores are *Pillar II: Transparency of government* and



*Pillar VI: Accounting and reporting.* Performance against *Pillar I: Budget reliability* is significantly impacted by the low score on revenue indicator PI-3, which is largely attributable to the unreliability of donor grants. Development partners have a significant influence on PFM performance in two ways. In the first place, donors have provided technical assistance on PFM that may have enabled the Government to meet

## SCORES AGAINST SEVEN PILLARS



the requirements for a higher PEFA score. On the other hand, donors also have an adverse impact where they forecast aid but it is not disbursed, or delayed, often because the government has not met the conditionality requirements.

Strengths and weaknesses identified in the report explains how PFM system performance affects three main fiscal and budgetary outcomes, as discussed below:

**Fiscal discipline** is assisted by the comprehensive coverage of the RGoB's Public Expenditure Management System, orderly execution of the budget, good control over expenditure commitments and fiscal risks, risk-based administration of revenue, timely and reliable financial reporting, and continued improvements in external audit and legislative scrutiny. At the same time, fiscal discipline is undermined by some lack of public transparency in administrative classification in the budget and accounts, which would inform and facilitate public demand for better accountability. It is also reduced by the limited economic appraisal of projects before inclusion in the budget, as the projected social and economic costs and benefits of proposed projects cannot be exposed to wider scrutiny.

**Strategic allocation of resources** is assisted by a strong planning and budgeting system that translates the Five Year Plans into sectoral strategies, programs and annual budgets within a rolling three-year fiscal framework. Favorable factors are the amount of time allowed to agencies to prepare their budgets, and the reliability of resource flows to service delivery units in accordance with annual budgets (at least where resources are domestically funded).

**Efficient use of resources for service delivery** is assisted by competitive procurement, which yields greater value for money. The recent adoption of a performance management system, based on annual performance agreements with the Prime Minister, is potentially a powerful tool for cost control and efficiency savings, though it is not yet fully developed.

The introduction of Annual Performance Agreements is a very important innovation. These are integrated with the budget process but, so far, are only available to the public in a few cases. Accountability would be significantly strengthened if they were published along with financial budgets and out-turns.



The transparency is a vital aspect of PFM performance. Civil society and community organizations can exercise an important role in budget management, both by participation in the budget preparation process and by monitoring actual performance, but only if relevant fiscal information is freely available, timely and reliable. The RGoB issues an Annual Budget Report in both Dzongkha and English languages, which facilitates public discussion of budgets and results.

Since the 2010 PEFA assessment and the implementation of a comprehensive PFM reform program, RGoB has led a wide array of reforms in planning and budgeting, revenue administration, asset and liability management, procurement, internal control, internal audit, reporting, external audit and oversight. In 2013, a new initiative was launched on performance management. Some of these reforms are ongoing or still being consolidated. Their impact on the generic goals of budget management is not measurable but appears to be far-reaching. The following table shows the changes in ratings since the previous PEFA assessment, using 2005 PEFA Framework, which was the basis for the previous assessment.

**TABLE 0.1: COMPARISON OF SCORES FROM 2009 TO 2016, BASED ON PEFA 2005 FRAMEWORK**

Indicators and Dimensions	Scores from Assessment		Description of change
	Previous	Current	
PI-1. Aggregate expenditure out-turn compared to original approved Budget	B	A	↑
PI-2. Composition of expenditure out-turn compared to original approved budget	B	D	↓
PI-3. Aggregate revenue out-turn compared to original approved budget	A	A	↔
PI-4. Stock and monitoring of expenditure payment arrears	NR	NR	
PI-5. Classification of the budget	B	A	↑
PI-6. Comprehensiveness of information included in budget documentation	A	A	↔
PI-7. Extent of unreported government operations	A	B+	↓
PI-8. Transparency of inter-governmental fiscal relations	A	NA	
PI-9. Oversight of aggregate fiscal risk from other public sector entities	D+	B	↑
PI-10. Public access to key fiscal information	B	A	↑
PI-11. Orderliness and participation in the annual budget process	A	B+	↓
PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	B+	B+	↔
PI-13. Transparency of taxpayer obligations and liabilities	B	B+	↑
PI-14. Effectiveness of measures for taxpayer registration and tax assessment	C+	B	↑
PI-15. Effectiveness in collection of tax payments	C+	B+	↑
PI-16. Predictability in the availability of funds for commitment of expenditures	C+	B+	↑
PI-17. Recording and management of cash balances, debt and guarantee	A	A	↔
PI-18. Effectiveness of payroll controls	B+	D+	↓
PI-19. Competition, value for money and controls in procurement	C	B	↑
PI-20. Effectiveness of internal controls for non-salary expenditure	A	A	↔
PI-21. Effectiveness of internal audit	C+	C+	↔
PI-22. Timeliness and regularity of accounts reconciliation	B	B	↔
PI-23. Availability of information on resources received by service delivery units	A	C	↓
PI-24. Quality and timeliness of in-year budget reports	D+	C+	↑
PI-25. Quality and timeliness of annual financial statements	C+	C+	↔
PI-26. Scope, nature and follow-up of external audit	B+	B+	↔
PI-27. Legislative scrutiny of the annual budget law	D+	D+	↔
PI-28. Legislative scrutiny of external audit reports	B+	C+	↓

Since 2010, major reforms have been implemented. The assessment of changes in PFM performance since 2010 shows:

- aggregate expenditure and domestic revenue out-turn remain strong and are further strengthened by implementation of the web-based Multi Year Rolling Budget (MYRB) and Revenue Administration Management Information System (RAMIS);
- adoption of Classification of Functions of Government (COFOG) classification of expenditure;
- introduction of a formula-based system for fiscal transfers to local governments;
- strengthened monitoring of fiscal risk over public enterprises;
- a more active Tax Appeals Board;
- a formal cash flow forecasting system;
- improved effectiveness of internal audit;
- introduction of a formal system of in-year budget execution reporting;
- constitution of a Finance Committee for legislative scrutiny of budgets; and
- a more active Public Accounts Committee for scrutiny of audit reports.

The main areas of challenge are expenditure composition out-turn, controls over payroll, expenditure arrears and public access to information, these provide opportunity to strengthen PEMS and related systems. The opportunity also exists in the areas of internal audit, legislative scrutiny of annual budget laws and quality and timeliness of annual financial statements where reforms are either underway or are to be initiated.

It is always difficult to attribute particular score changes to particular reform activities, but some of the improvements noted (using the 2005 framework, annex 4) can be clearly attributed to the reform program. Examples are the improvement in budget reliability achieved through closer monitoring of out-turns against the Multi-Year Rolling Budget from FY 2010/11 onwards, and the introduction of quarterly Budget Situation Reports from FY 2015/16. Improvements in procurement include the publication of contract awards on the notice boards of procuring entities: the risk of any mis-procurement is reduced by this public exposure. The procurement complaints process, that was new and untried in FY2009/10, is now fully operational. Most other score improvements are more marginal and many improvements will result in future score changes.

Bhutan has always attached great importance to good governance on principles of accountability, transparency and efficiency. The PFM Reform Program prepared in 2010 has been implemented by a committed government and its development partners. To further improve PFM in the country and take forward the reform agenda, this PFM assessment is expected to be used as a basis for a comprehensive, sequenced and time-bound PFM reform action plan to be supported through a PFM Multi Donor Fund<sup>1</sup> (MDF) that is being established.

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<sup>1</sup> MDF means Multi-Donor Fund, referred to by the Bank as Multi-Donor Trust Fund that may receive contribution from more than one donor, whose funds are pooled under a single set of agreed terms and such funds are not earmarked by individual donors for specific categories of expenditure.

**TABLE 0.2: OVERALL SUMMARY OF PFM PERFORMANCE SCORES (2016 FRAMEWORK)**

PFM Performance Indicator		Scoring Method	Dimension Ratings				Overall Rating
			1	2	3	4	
<b>Pillar I. Budget reliability</b>							
PI-1	Aggregate expenditure out-turn	M1	A				<b>A</b>
PI-2	Expenditure composition out-turn	M1	C	B	A		<b>C+</b>
PI-3	Revenue out-turn	M2	C	D			<b>D+</b>
<b>Pillar II. Transparency of government</b>							
PI-4	Budget classification	M1	A				<b>A</b>
PI-5	Budget documentation	M1	A				<b>A</b>
PI-6	Central government operations outside financial reports	M2	B	B	D		<b>C+</b>
PI-7	Transfers to subnational governments	M2					<b>NA</b>
PI-8	Performance information for service delivery	M2	C	D	C	D	<b>D+</b>
PI-9	Public access to information	M1	D				<b>D</b>
<b>Pillar III. Management of assets and liabilities</b>							
PI-10	Fiscal risk reporting	M2	A	NA	A		<b>A</b>
PI-11	Public investment management	M2	C	A	C	C	<b>C+</b>
PI-12	Public asset management	M2	B	C	A		<b>B</b>
PI-13	Debt management	M2	A	A	D		<b>B</b>
<b>Pillar IV. Policy-based fiscal strategy and budgeting</b>							
PI-14	Macroeconomic and fiscal forecasting	M2	A	B	C		<b>B</b>
PI-15	Fiscal strategy	M2	B	C	B		<b>B</b>
PI-16	Medium-term perspective in expenditure budgeting	M2	C	B	C	C	<b>C+</b>
PI-17	Budget preparation process	M2	A	A	D		<b>B</b>
PI-18	Legislative scrutiny of budgets	M1	C	C	C	A	<b>C+</b>
<b>Pillar V. Predictability and control in budget administration</b>							
PI-19	Revenue administration	M2	B	B	A	A	<b>B+</b>
PI-20	Accounting for revenues	M1	A	A	B		<b>B+</b>
PI-21	Predictability of in-year resource allocation	M2	B	B	A	A	<b>B+</b>
PI-22	Expenditure arrears	M1	D*	D			<b>D</b>
PI-23	Payroll controls	M1	D	A	D	C	<b>D+</b>
PI-24	Procurement	M2	C	B	B	A	<b>B</b>
PI-25	Internal controls on non-salary expenditure	M2	A	A	A		<b>A</b>
PI-26	Internal audit effectiveness	M1	B	C	A	C	<b>C+</b>
<b>Pillar VI. Accounting and reporting</b>							
PI-27	Financial data integrity	M2	B	C	B	B	<b>B</b>
PI-28	In-year budget reports	M1	B	C	B		<b>C+</b>
PI-29	Annual financial reports	M1	C	B	C		<b>C+</b>
<b>Pillar VII. External scrutiny and audit</b>							
PI-30	External audit	M1	B	B	A	B	<b>B+</b>
PI-31	Legislative scrutiny of audit reports	M2	B	C	A	A	<b>B+</b>



## 1.1 Rationale and purpose

**The Royal Government of Bhutan (RGoB) places high priority on good governance, and sound public financial management is one of the key elements of good governance.** Over the past decade, Bhutan has been making steady progress in strengthening public financial management covering budget preparation, budget execution, control, reporting and oversight. There is increased legislative oversight on budget approval through a Finance Committee and of audit reports through a Public Accounts Committee. As in other countries, the public at large has become more demanding in terms of transparent and efficient government.

**Bhutan prepared a PFM Reform Program/Strategy in 2012 following a PEFA Assessment.** Bhutan undertook a PEFA assessment in 2010 with support from the World Bank and the report was issued in 2010<sup>2</sup>. Based on the PEFA Report, RGoB prepared, in 2012, a comprehensive, sequenced and time-bound action plan (called PFM Reform Program or Strategy) to bring about improvements in the PFM systems and processes in line with international standards. Evaluation of the progress of the Reform Strategy has been limited to some development partners and its progress is not widely known in public. There is, therefore, an opportunity for an updated and revised PFM Reform Strategy.

**Development partners have actively supported Bhutan's initiatives to strengthen PFM.** The World Bank Group and other development partners, including IMF, EU, ADA, SECO, UNDP and ADB have been actively partnering, largely on a bilateral approach, to strengthen PFM in Bhutan. The interventions include: support in the development of an e-payment gateway, strengthening budget preparation process, treasury management and cash flow forecasting and macro-fiscal management (by the IMF); supporting the development of internal audit, inter-governmental fiscal transfers, implementation of Bhutan Accounting Standards and development of a PFM reform group (by the World Bank); supporting development of a Revenue Administration and Information Management System and an Audit Resource Management System for the supreme audit institution, and technical support on debt sustainability analysis and macro-fiscal regulation (by the ADB); supporting judiciary, CSO and Supreme Audit Institution (ADA) and local government strengthening with support from the European Union. Recently, the seeds for the establishment of a PFM Multi-Donor Fund<sup>3</sup> (MDF) has been sown, led by the World Bank, with the objective of aligning

<sup>2</sup> Bhutan: Public Financial Management and Accountability Assessment (June 2010), Report no. 58444-BT, The World Bank.

<sup>3</sup> Referred to by the World Bank as Multi-Donor Trust Fund or MDTF that may receive contribution from more than one donor, whose funds are pooled under a single set of agreed terms and such funds are not earmarked by individual donors for specific categories of expenditure.

support of development partners in Bhutan for joint dialogue and efforts in implementing an RGoB owned PFM reform strategy.

**RGoB has set up a high level national group to steer the PFM Reform Program and to take it forward.** This is the Public Financial Management- Governance Group (PFM-GG) that is expected to steer the PFM reform action plan of Bhutan and also coordinate the resources required for the implementation of the action plan<sup>4</sup>. The PFM-GG has a role of providing oversight, guidance and monitoring implementation of the RGoB's PFM reform program/action plan.

**In this background, RGoB proposed a PEFA re-assessment (repeat) diagnostic study of the PFM system using the PEFA methodology<sup>5</sup>.**

## **Objectives of the assessment**

**The overall objective of the PEFA assessment is to provide an evidence-based performance assessment to guide the government's PFM reform strategy and potential engagement with its development partners in further strengthening PFM in the country.** The assessment will provide a comprehensive PFM Performance Report (PFM-PR) containing an analysis of the overall performance of the current PFM systems of the country, and to measure progress over time since the previous assessment in 2010. The assessment will help RGoB to update its PFM Reform Action Plan, and sharpen its focus in the areas where reform is needed most, thus contributing to strengthening the PFM environment in the country.

The specific objectives of the re-assessment are to:

- assess the quality (strengths and weaknesses) of PFM in the country following the PEFA framework of 2016;
- establish and explain the level of improvement in PFM performance from 2010 to date by updating the then indicator scores using the same 2005 framework/methodology that was the basis of the initial assessment; and
- provide RGoB and the development partners a basis for further dialogue on PFM reforms and enable updates to the PFM Reform Program and subsequent monitoring.

## **1.2 Assessment management and quality assurance**

**The repeat PEFA assessment was carried out under the approach of full ownership of RGoB and self-assessment by its officials with technical support from the World Bank/IMF team.** The assessment was carried out by a team led by the World Bank and comprised of officials from World Bank, IMF and RGoB. RGoB nominated focal points for the various performance indicators and a nodal

<sup>4</sup> The PFM-GG was formed in Nov 2013 under the Ministry of Finance (MoF), chaired by the Finance Secretary, with representation from all the four departments of MoF, the Accounting and Auditing Standard Board of Bhutan, Public Procurement Policy Division, Internal Audit Service and Policy and Planning Division, with the Chief Accounts Division, Department of Public Accounts being the Member Secretary. The PFM-GG is the apex body leading the PFM reform programs in Bhutan through a PFM Reform Strategy and an Action Plan adopted and updated on a periodic basis (RGoB notification May 2015).

<sup>5</sup> The PEFA Program is a partnership among the World Bank, the European Commission, the UK Department for International Development, Swiss State Secretariat for Economic Affairs, French Ministry of Foreign Affairs, Royal Norwegian Ministry of Foreign Affairs and the International Monetary Fund. A Steering Committee, comprising members of these agencies, manages the Program. A Secretariat is located at the World Bank in Washington, DC.



person for inter-departmental coordination (see Box 1). Data collection, assessment, preparing the write-ups and scoring were done by the RGoB team. The core team of RGoB comprised representatives from budget, revenue, treasuries, accounts, audit, oversight and procurement. The Bank/IMF team (see Box 1) supported through technical inputs and dissemination of scoring methodology and evidence requirements.

**The PEFA assessment commenced in October 2015 and was based on the 2015 Testing version of PEFA.** A planning and preparatory mission, including a launch workshop, was held October 25 to 31, 2015 and attended by the PFM-GG, heads of the departments, Royal Audit Authority and development partners to disseminate the new PEFA framework, the methodology and the expectations from the assessment. During this mission, the Bank/IMF team also held face-to-face interviews with counterparts for a better understanding of the PFM environment which was to help during the review of the indicator write-ups and scoring.

**The World Bank/IMF team provided continuous technical support in the assessment.** The completed templates (questionnaires), write-ups and scoring were reviewed by the Bank/IMF team and gaps in information or additional information required to strengthen the quality of evidence were identified and discussed with the RGoB focal points.

**In mid-assessment, PEFA launched the 2016 upgraded PEFA framework and RGoB agreed to use the latest methodology and the Bank/IMF team supported the transition.** Initial self-assessments were made by RGoB team in accordance with the 2015 Testing Version. The 2016 upgraded version was launched by the PEFA Secretariat on February 1, 2016. As the PEFA assessment was under way and not finalized and based on the guidance provided by the PEFA Secretariat, RGoB and the Bank mutually agreed to follow the final “Framework for assessing public financial management, February 2016, PEFA Secretariat”. Reference was also made to the guidance note – “*Good Practice when Undertaking a Repeat Assessment*” dated February 1, 2010 published by PEFA Secretariat.

**The initial indicator assessment write-ups and scoring were received for all indicators along with the write-ups for other sections and an initial draft of the report has been prepared.** The initial draft of the report has been shared with RGoB which will be followed up with a mission from January 25 to 29 and May 28 to June 3, 2016 for sharing of initial scores based on available evidence, identification of gaps and further information required, briefing on the scores, including progress over time to RGoB counterparts and agreeing on the scores and further work to be done.

**Going forward, the PEFA Performance Report will be updated and revised incorporating the feedback received during the third mission and then subjected to validation process.** This will include quality assurance by peer reviewers from the Bank and development partners (see Box 1) and PEFA Check from the PEFA Secretariat.

## BOX 1: ASSESSMENT MANAGEMENT AND QUALITY ASSURANCE

### PEFA Assessment Management Organization

#### Oversight Team

Chair & Members:

- Mr. Lam Dorji, Hon'ble Secretary, MoF
- Mr. Choiten Wangchuk, Director General, DPA, MoF
- Mr. Lekzang Dorji, Director, DNB, MoF

#### Assessment Manager

- Mr. Fily Sissoko, Practice Manager, PRMM, The World Bank

**Assessment Team Leader and Team Members:** The assessment was carried out by a core team comprising officials from RGoB, World Bank, IMF staff and consultants. The teams from the World Bank took the lead in the assessment, with the IMF participating through its Regional PFM Advisor and RGoB through its officials in various ministries and offices. The assessment team is as follows:

#### The World Bank Group:

- Mr. Savinay Grover, Senior Financial Management Specialist and Task Team Leader
- Mr. Mohan Nagarajan, Senior Economist and Co-Task Team Leader
- Mr. Puneet Kapoor, Senior Financial Management Specialist and Co-Task Team Leader
- Ms. Genevieve Boyreau, Senior Economist
- Mr. Tanvir Hossain, Senior Procurement Specialist
- Ms. Neha Dhoundiyal Gupta, Financial Management Specialist
- Mr. Tony Bennett, International Consultant
- Ms. Tanya Gupta, Financial Management Consultant
- Ms. Justina Parambaloth, Program Assistant
- Ms. Shafali Rajora, Program Assistant

#### IMF:

- Mr. Suhas Joshi, Regional PFM Advisor

#### RGoB:

- Hon'ble Karma Tenzin, MP, NAB and the Chairperson of the Parliament's Finance Committee
- Hon'ble Tashi Dorji, MP, NC and member of the Parliament's Public Accounts Committee (PAC)
- Mr. Yeshe Norbu, Accounts Officer, NAB
- Mr. Tashi Rabten, Legal Asst./PAC Secretary, NAB
- Mr. Rinzin Dorji, Senior Planning Officer, PPD, MoF
- Mr. Norbu Dhendup, Dy. Chief Program Officer, PED, MoF
- Mr. Loday Tsheten, Chief Internal Auditor, CCA, Internal Audit Services, MoF
- Mr. Leki Tshering, Procurement Officer, PPPD, DNP, MoF
- Mr. Namgyel Wangchuk, Chief Budget Officer, DNB, MoF
- Mr. Gyembo, Chief Budget Officer, DNB, MoF
- Mr. Karma Jambayang, Deputy Chief Audit Officer, RAA
- Mr. Karma Loday, Collector, DRC, MoF
- Ms. Lhakpa Bhuti, DRC, MoF
- Mr. Wangdi Gyeltshen, Programme Officer, DLG, MoHCA
- Mr. Tshering Dorji, Chief Programme Officer, DMD, DPA
- Mr. Budhiman Rai, Chief Accounts Officer, TMD, DPA
- Mr. Sonam Tobgyel, Chief Accounts Officer, AD, DPA

## Review of Concept Note and/or Terms of Reference

Date of reviewed draft concept note and/or terms of reference: August, 2015

1. Invited reviewers and Reviewers who provided comments:

- Mr. Sonam Tobgyel, RGoB
- Ms. Karine Olislagers and team, EU
- Ms. Holy Tiana Rame, PEFA Secretariat
- Ms. Grabner Sonja, ADA
- Mr. Franck Bessette, The World Bank
- Mr. Shanker Lal, The World Bank
- Ms. Manvinder Mamak, The World Bank

Date(s) of final concept note and/or terms of reference: October 14, 2015

## Review of the Assessment Report

1. Date(s) of reviewed draft report (s): June 28, 2016

2. Invited reviewers:

- Mr. Sonam Tobgyel, RGoB
- Mr. Shouvik Datta and team, EU
- Ms. Holy Tiana Rame, PEFA Secretariat
- Mr. Johannes Binder and team, ADA
- Mr. Franck Bessette, The World Bank
- Mr. Shanker Lal, The World Bank
- Ms. Manvinder Mamak, The World Bank

## 1.3 Assessment methodology

### 1. Coverage of the assessment

**This assessment is based on the 2016 PEFA framework using all the 31 performance indicators and the scope of the assessment covered the operations of the central government in Bhutan.** This covered all the budgetary agencies of RGoB including the ten ministries, dzongkhags, gewogs, thromdes, oversight institutions such as the Royal Audit Authority and the Parliamentary committees on budget and audit reports, and other semi- or fully autonomous agencies funded by the government.

**Being a repeat assessment, progress over time was also measured since the last PEFA assessment in 2010 on the basis of 2005 PEFA framework used then.** This followed PEFA *Guidance on tracking performance across time: Comparing PEFA 2016 against PEFA 2005 or PEFA 2011* for directly comparing PFM performance with a previous assessment. As it is not possible to track changes in performance by comparing an assessment based on PEFA 2011 or PEFA 2005 with a subsequent (repeat) assessment using PEFA 2016, hence a precise comparison requires that assessments be based on the same PEFA version. Therefore, the progress over time used the same indicator set of PEFA 2005 as used in the 2010 assessment in Bhutan. The results are summarized in Annex 4.

## 2. When performance is assessed

The assessment was carried out using the most recently available data based on the guidance in PEFA 2016. Data for the financial years 2012/13, 2013/14 and 2014/15 was used where three-years data was required and for financial year 2014/15 where data for last completed fiscal year was needed. Dimensions of some indicators (PI-5, 6, 8, 10, 13, 15, 16, 17, 18, and 26) used the data available in the last budget presented in Parliament i.e. for FY 2015/16.

## 3. Sources of Information

The assessment used a range of government documents from various ministries and other budgetary agencies specific for each indicator and also evaluations/assessments or studies made by other development partners. The choice of information was based on the guidance provided in the PEFA 2016. These included the core PFM legal documents, five year and annual plans, budget reports, annual financial statements, and audit reports, information was also obtained or supplemented or validated through interviews or specific queries raised with the stakeholders. A list of documents referenced for the assessment and list of persons met are provided in Annex 3 of the report.

A planning and preparatory mission, including a launch workshop, was held October 25 to 31, 2015 and was attended by the members of PFM-GG, heads of the departments, Royal Audit Authority and development partners, to disseminate the new PEFA framework, the methodology and the expectations from the assessment. The objective of the workshop was to: (i) familiarize the RGoB team with the updated PEFA framework; (ii) understand the information needs; (iii) identify the possible sources of information; and (iv) agree on responsibilities and work schedules. A follow-up PEFA mission was carried out from January 26 to 29, 2016 to hold discussions on draft indicator write-ups and ratings. The mission updated RGoB officials that dzongkhag, gewogs and thromdes could not be considered as sub-national governments for the purposes of PEFA assessment as they do not fall within the definition of sub-national government.

A third field mission was carried out from May 28-June 7, 2016. This was a validation mission for discussions on the first draft report including initial scores based on available evidence, identification of gaps and further information required, including progress over time and agreeing on the scores and further work to be done.

## 4. Other methodological issues for the preparation of report

The main change in the current assessment as compared to the 2010 assessment is in respect of sub-national government. Local governments have not been considered as sub-national governments as done in the earlier assessment. Dzongkhags, gewogs and thromdes are considered as local governments in Bhutan. However, for purpose of PEFA assessment, these bodies could not be considered as Sub-National Government (SNG) since these do not meet the definition of SNG recognized by PEFA, which is based on Government Financial Statistics 2001<sup>6</sup>. These bodies are more in the nature of de-concentrated units of the central government. The officers of these bodies are appointed by the Royal Civil Service Commission (RCSC) and they are financed directly from the central government budget. Hence, for the PEFA assessment, no separate level of SNG has been recognized. A note summarizing the PFM systems in these local bodies, primarily using national systems, is presented in Annex 5.

<sup>6</sup> Supplementary Guidelines for the application of the PEFA framework to Sub-national governments, (January 2013) PEFA Secretariat.

## 2.1 Country economic situation

**Bhutan's record of socio-economic development is remarkable.** A lower middle-income country with an impressive poverty reduction record, Bhutan has achieved or surpassed targets in five of eight Millennium Development Goals (MDGs). Looking forward, the tenets of Bhutan's Gross National Happiness are inherently aligned with the Sustainable Development Goals. Bhutan has peacefully transitioned to a democracy, cut poverty to low levels, and reaped positive results from sustained investment in rural infrastructure, including roads, schools, telecommunications, power, and health centers, across a difficult terrain. Its per capita Gross Domestic Product (GDP) is US\$2,400, the economy has grown on average 7% for the past five years, and this performance is likely to continue. Large hydropower developments, better performance in the tourism sector, and improved services lead the country's economic growth. This constitutes a remarkable record for a small, mountainous, landlocked country of 720,000 people situated between two economic giants (China and India).

**Bhutan follows India's inflation closely.** Bhutan has a fixed exchange rate with India, from which it imports most of its consumption. Consumer price inflation in Bhutan slowed to 3.2% in January 2016, from 4.7 in June 2015 (year-over-year), driven by the decline in oil prices and India's easing of inflation.

**Bhutan has a strong record of poverty reduction, shared prosperity, and gender equality.** Poverty reduction in Bhutan has been rapid and broad-based, and other social indicators have improved. Both consumption-based poverty measures and multi-dimensional poverty indicators show that the percentage of poverty was cut by nearly half in five years: from 23% in 2007 to 12% in 2012. On average, per capita consumption among the bottom 40% of the population has grown faster than for the rest. Bhutan has almost eliminated extreme poverty (US\$1.90 purchasing power parity terms, per day per person) within the living memory of a generation. Primary drivers of rapid poverty reduction and shared prosperity are agricultural commercialization, rural infrastructure, and spillovers from the construction of hydroelectric projects. Bhutan achieved the MDG target for halving extreme poverty ahead of time, reached gender parity in primary education and significantly reduced maternal mortality rates. Bhutan has also made considerable strides in closing gaps in gender equality, making it comparable to that achieved in higher middle income nations. Areas with persisting gender gaps are (i) agricultural land holding and inheritance practices and (ii) labor markets and job quality.

**That said, the reduction in poverty has been accompanied in rural areas by rising vulnerabilities and, in urban areas, by rising youth unemployment, magnified by rural-urban migration.** The chronically poor constituted two-thirds of all poor people in 2012. The absence of formal social protection institutions and targeting mechanisms for identifying the chronically poor contribute to

shackling them in a poverty trap. Urbanization is on the rise, with the capital, Thimphu, attracting most rural migrants. In addition, because Bhutan is heavily dependent on donor support and on hydropower projects under construction, growth has been volatile. Large spillover from hydropower investments (with construction costs equivalent to Bhutan's GDP) and vulnerability of donors' disbursements complicate macroeconomic management and policymaking.

**Bhutan faces a large fiscal gap, with only two-thirds of public expenditures funded by domestic revenues.** Grants finance about 30% of Bhutan's budget, or about two-thirds of capital spending. Moreover, tax revenue has been declining relative to the country's GDP over the last four years, from 15.2% to an estimate of 13.7% in 2015/16.<sup>7</sup> The recent decline in tax revenue (relative to GDP) results not from changes in tax instruments or rates but from policy decisions totally or partially freeing specific groups of tax payers from their obligations. Tax holidays, exemptions and incentives are increasingly common. This results in low implicit tax rates on household income across most population groups.

**On the other hand, public expenditure continues and will continue to increase in the short and medium term.** In the medium term, the social sectors will exert pressures to expand public expenditure, per Bhutan's constitutional commitment to provide free health and educational services to all. In 2015/16 and 2016/17, accelerated implementation of the five-year plan, now at its mid-term, will push up public capital spending, while recurrent spending should remain contained. Overall, the estimated fiscal deficit in 2015/16 is 3.4% of GDP, but the fiscal gap, that is, the extent to which domestic resources finance domestic expenditures, will be much larger, at 14.5% of GDP.

**Bhutan runs a large current account deficit funded by donor assistance.** As of December 2015, the current account deficit was estimated at about 26% of GDP, of which about half was (self-financed) hydropower imports: the remainder was split between fuel and consumption goods, including both private and public imports. The current account deficit is essentially financed by donor resources, to which India contributes the most through loans and grants to finance hydropower development. The resulting trade deficit and need to borrow to finance consumption creates significant national costs. Foreign Direct Investment (FDI) finances a low 8% of the capital account (about US\$20 million). Gross international reserves are currently equal to a comfortable 11.7 months of goods and services imports. At the end of December 2015, international reserves were US\$1,072 million, 77% of which was in convertible currency and the rest in Indian rupees.<sup>8</sup>

**Bhutan's public and publicly guaranteed external debt stood at 99% of GDP by the end of 2015, two-thirds of which relates to commercially profitable hydro projects.** External debt risk of distress is moderate, because these hydropower projects carry their own creditworthiness by promising to produce substantial earnings after covering their debt obligations, with very limited risk for the Bhutanese government (see section 2.2 below). The Indian government largely finances and purchases the electricity generated by these projects, paying in Indian rupees. As a result, a large portion of external debt—58%—is denominated in Indian rupees. Other than for the hydropower projects, external convertible-currency public and publicly guaranteed (PPG) debt stands at a 32.2% of GDP and comes from concessional loans from multilateral financial institutions and bilateral donors (Austria, Denmark, and Japan). Domestic debt stands below 5% of GDP.

<sup>7</sup> Bhutan's fiscal year runs from July 1 to June 30.

<sup>8</sup> The Constitution requires maintaining foreign exchange reserves equal to 12 months of essential imports.



## Outlook

**The medium-term outlook is positive, but macroeconomic pressures on domestic demand will have to be managed** as Bhutan nears the commissioning dates of the three mega- hydropower projects under construction. The impact on Bhutan's economy of the ongoing rebalancing in global markets is expected to remain moderate. These effects will be from lessened tourism earnings and a slowdown in new hydropower project approvals. While debt risk is still moderate, the rapid build-up over recent years calls for caution. Bhutan's debt-carrying capacity will improve in the long run, reflecting significantly higher electricity exports when hydropower projects come online. To provide the basis for financing sound and sustainable development, the financial sector must be deepened.

**Fiscal accounts are projected to remain in check, assuming improvement in tax collection efforts and spending efficiency.** This also assumes continued donor support; some tax efforts and prudent management of current spending, projected to remain stable as a share of GDP (above 16%); and conservative assumptions regarding capital spending funded with foreign aid.

**Over the short to medium term, the current account deficit should reduce slightly, with hydropower projects starting generation and continuous efforts to contain demand for imports.** These include fiscal measures through prudent public spending, new taxation measures on imports of vehicles and fuels, and prudent debt policy to finance capital spending. Export earnings are expected to strike up starting in late 2018 with the commissioning of the Punatsangchhu 2 and Mangdechhu hydropower projects (1,020 MW and 720 MW, respectively), followed by the Punatsangchhu 1 project in 2019 (1,200 MW).

## Government's main economic challenges and government-wide reforms

**To sustain and deepen these achievements, Bhutan faces two challenges: First, in the short to medium term, large macroeconomic imbalances which translate into a twin deficit - a large fiscal gap and a large current account deficit.** Bhutan's large current account deficit stands at about 26% of GDP. This external deficit is reflected in the financing by domestic revenues of only 65% of government spending; the rest is financed by donor resources. Tax collection is as low as 13% of GDP, and the rate has been declining. Given that Bhutan is a small country with an exchange rate pegged to India's rupee, its fiscal policy will play a pre-eminent role in reducing this twin deficit by increasing the revenue effort, enhancing the efficiency of public spending, and managing debt sustainably.

**Second, while the public sector is the preferred employer, private-sector development will be necessary for sustainable growth and job creation.** The government's ability to absorb the new, young workers entering the labor market each year has reached a saturation point. While total unemployment remains low at 2.6%, youth unemployment reached 9.4% in 2014, and it is expected to rise. Currently, the private sector, limited in size, plays a limited role in the economy. In 2014, 99% of the country's approximately 42,000 businesses were micro or small sized; only about 350 were Limited Liabilities Companies (LLC); and a handful were joint-stock companies and partnerships. The competitiveness of Bhutan's nascent entrepreneurial sector is affected by the country's challenging terrain, limited access to finance and markets, a difficult investment climate, and low productivity levels. A simple, predictable, and easily accessible investment climate can contribute to investment attraction and job creation. In addition, a pro-active public policy to crowd-on private investment through smart procurement, shifting finance from the supply of service delivery to the demand side and developing more systematically smart partnerships with the private sector would go a long way. Table 2.1 shows Key Macroeconomic Indicators and Outlook.

**TABLE 2.1: KEY MACROECONOMIC INDICATORS AND OUTLOOK**

Indicator	2012	2013	2014	Estd.	Proj.	Proj.	Proj.
				2015	2016	2017	2018
Gross domestic product (US\$ million at current prices)	1,825	1,781	1,959	2,224	2,432	2,880	3,197
Consumer price index (% change)	9.5	11.8	7.2	5.0	n.a	n.a	n.a
Real annual growth rate	5.1	2.0	4.8	6.3	6.8	7.4	11.0
<b>Balance of Payments (% GDP)</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
Exports	34%	31%	29%	29%	29%	27%	34%
Imports	56%	49%	49%	51%	52%	53%	53%
Trade balance	-22%	-18%	-20%	-22%	-24%	-25%	-19%
Current account balance	-22%	-24%	-25%	-26%	-30%	-30%	-24%
Out of which hydropower	-6%	-14%	-9%	-13%	-15%	-16%	-10%
Reserves (US\$)	674	917	998	958	1,177	1,273	1,503
Exchange rate (Nu/US\$)	53	59	61	64	n.a	n.a	n.a
<b>Public finance (as % of GDP at market prices)</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
Expenditures	38.2	36.2	29.8	27.5	33.1	32.9	30.2
Revenues	22.3	20.9	20.7	20.0	18.7	18.9	19.1
Out of which hydropower	7.5	6.8	8.2	6.3	6.0	5.6	6.5
Grants	13.7	9.5	12.7	7.9	11.0	8.9	10.4
Fiscal balance	-1.1	-4.2	3.8	0.6	-3.4	-5.2	-3.0
Fiscal gap (domestic revenues - expenditures)	-14.7	-14.6	-9.1	-7.5	-14.5	-14.0	-11.2
External PPG debt							
Out of which hydropower publicly guaranteed	75.1	90.9	91.2	94.5	102.8	107.6	99.1
Domestic debt	44.8	51.7	58.1	68.1	78.7	85.0	80.7
<b>Monetary Indicators</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
M2/GDP (%)	59	58	63	58	n.a	n.a	n.a
Growth of M2 (%)	-1	18.6	26.0	5.1	n.a	n.a	n.a
Private-sector credit growth (%)	30.1	7.1	9.4	13.8	n.a	n.a	n.a
Total credit growth (%)	51.3	12.8	7.2	11.4	n.a	n.a	n.a

*Source:* Royal Government of Bhutan, Royal Monetary Authority, Ministry of Finance, and World Bank.

## 2.2 Fiscal and budgetary trends

### 2.2.1 Fiscal performance

Tables 2.1, 2.2 and 2.3 below show RGoB's fiscal performance from 2011/12 to 2014/15. The tables are drawn from annual financial statements and the National Budget Report of the Ministry of Finance (available online). This goes a little wider than the scope of this PEFA report, as general government

includes dzongkhag and gewogs. However, these inclusions do not make any significant difference, as dzongkhag and gewogs collect very little revenue and are largely dependent on central government transfers.

The tables show that domestic revenue to GDP has decline over the last three years, falling from 22.3% to 19.9% of GDP between 2011/12 and 2014/15. Total expenditure has also fallen in line with this decline in revenue falling from 36.9% of GDP to 31.4%. Some of the saving has been on current expenditure (down from 18.3% to 17.6% of GDP) but a significant part of this fall in revenues has been absorbed by a corresponding fall in capital expenditure which has declined from 19.9% to 15.1% of GDP. The overall balance showed a decline from -14.6% of GDP in FY 2011/12 to -11.4% in FY 2014/15. Simultaneously, the inflow of grants has also declined from 13.5% to 9.2% of GDP.

## **2.2.2 Allocation of resources**

Details of functional, economic and program classification of expenditure are available for the period covered by this assessment. As may be seen from Tables 2.1 and 2.2 current expenditure has risen steadily, except in 2013/14, although as a percentage of GDP it has shown a modest decline, except in 2014/15 when it fell by 1%. The wage bill has grown steadily with a sharper increase in 2014/15 although as a percentage of GDP it has shown a steady decline for 2012/13 and 2013/14, rising sharply again in 2014/15. This was the result of civil service pay revision in 2014. Non-wage expenditure has shown a slight increase although as a percentage of GDP it has shown a steady decline, rising only slightly in 2014/15. Capital expenditure has shown a similar trend and has steadily fallen as a percentage of GDP. At the agency level, there is high variance of expenditure (PI-2.1). On an administrative classification, variance of expenditure composition from the budget (current and capital together) was more than 15% in each of the past three years. Much of this appears to be due to major shortfalls in Ministry of Finance expenditure compared with its original budgets although areas like Education, RNR, Transport and Communication and General Public Services have also contributed significantly to the deviation.

## **2.2.3 Fiscal Policy Targets 2014-2018**

In terms of % to GDP, the domestic revenue is expected to be about 17% of the GDP at the end of 11th FYP (FY 2017-18). Since hydropower is the main source of revenue and with expected commissioning of the new mega hydropower projects in the FY 2017-18, the major increase in the revenue is expected in that year.

In the 11th FYP, the Government's main strategic thrust areas to achieve outcomes will be on inclusive social development (poverty reduction, develop health and education sectors), accelerated green economic development and strategic infrastructure development.

Total public debt is projected to increase to 111% of GDP in FY 2017-18. The hydropower debt constitutes the major part of the public debt, which is expected to be about 90% of GDP in FY 2017-18. However, it is not a major concern as hydropower sector generates adequate revenue through export proceeds to service its debt.

The fiscal balance is projected to be in surplus at 2.7% of GDP in FY 2017-18. This is mainly due to expected increase in revenue from hydropower with the expected commissioning of new hydropower projects.

**TABLE 2.2A: GENERAL GOVERNMENT FISCAL PERFORMANCE 2011-14 (MILLION Nu.)**

Particulars	2011/12	2012/13	2013/14	2014/15
	Actual	Actual	Actual	Actual
<b>Total revenue</b>	<b>32,855.982</b>	<b>30,656.117</b>	<b>37,819.123</b>	<b>35,096.050</b>
<b>Tax revenue</b>	<b>14,676.929</b>	<b>15,403.118</b>	<b>16,182.774</b>	<b>18,387.335</b>
<i>Direct taxes</i>	8,987.042	9,390.039	11,132.042	11,626.968
<i>Indirect taxes</i>	5,689.887	6,013.079	5,050.732	6,760.367
<i>Provincial taxes</i>	-	-	-	-
<b>Non-tax revenue</b>	<b>5,571.695</b>	<b>5,609.681</b>	<b>6,979.480</b>	<b>6,643.633</b>
<b>Capital revenue</b>	<b>105.838</b>	<b>88.892</b>	<b>82.356</b>	<b>110.062</b>
<b>Grants</b>	<b>12,501.520</b>	<b>9,554.426</b>	<b>14,574.513</b>	<b>9,955.020</b>
<b>Total expenditure and net lending</b>	<b>33,897.636</b>	<b>34,900.809</b>	<b>33,522.834</b>	<b>33,199.258</b>
<b>Current expenditure</b>	<b>16,705.648</b>	<b>18,096.551</b>	<b>17,941.151</b>	<b>21,032.044</b>
<i>Wage</i>	7,012.836	7,363.355	7,658.545	9,304.837
<i>Non-wage</i>	9,692.812	10,733.196	10,282.606	11,727.207
<i>Provincial expenditure</i>				
<b>Capital expenditure</b>	<b>18,137.114</b>	<b>18,431.264</b>	<b>16,668.752</b>	<b>15,443.805</b>
<i>Locally financed</i>	8,262.232	7,512.114	8,130.961	8,330.837
<i>Externally financed</i>	9,874.882	10,919.150	8,537.791	7,112.968
<b>Net lending</b>	<b>-826.946</b>	<b>-739.889</b>	<b>-1,331.989</b>	<b>-3,687.747</b>
<b>Advance/Suspense (Net)</b>	<b>-118.180</b>	<b>-887.117</b>	<b>244.920</b>	<b>411.156</b>
<b>Overall balance</b>	<b>-1,041.654</b>	<b>-4,244.692</b>	<b>4,296.289</b>	<b>1,896.792</b>
<b>Financing</b>	<b>1,041.654</b>	<b>4,244.692</b>	<b>-4,296.289</b>	<b>-1,896.795</b>
<b>Foreign (net)</b>	<b>-1,007.148</b>	<b>492.306</b>	<b>-867.009</b>	<b>-1,086.409</b>
<i>Loans</i>	6,212.866	16,463.456	1,534.544	1,685.268
<i>Amortization</i>	7,220.014	15,971.150	2,401.553	2,771.677
<b>Domestic (net)</b>	<b>2,048.802</b>	<b>3,752.386</b>	<b>-3,429.280</b>	<b>-810.386</b>

Source: Annual Financial Statements.

**TABLE 2.2B: GENERAL GOVERNMENT FISCAL PERFORMANCE 2011-14 (% OF GDP)**

Particulars	2011/2012	2012/2013	2013/2014	2014/2015
	Actual	Actual	Actual	Actual
<b>Total revenue</b>	<b>36.01%</b>	<b>29.34%</b>	<b>34.32%</b>	<b>28.04%</b>
Of which central government				
<b>Tax revenue</b>	<b>16.08%</b>	<b>14.74%</b>	<b>14.68%</b>	<b>14.69%</b>
<i>Direct taxes</i>	9.85%	8.99%	10.10%	9.29%
<i>Indirect taxes</i>	6.24%	5.76%	4.58%	5.40%
<b>Non-tax revenue</b>	<b>6.11%</b>	<b>5.37%</b>	<b>6.33%</b>	<b>5.31%</b>
<b>Capital revenue</b>	<b>0.12%</b>	<b>0.09%</b>	<b>0.07%</b>	<b>0.09%</b>
<b>Grants</b>	<b>13.70%</b>	<b>9.15%</b>	<b>13.23%</b>	<b>7.95%</b>
<b>Total expenditure and net lending</b>	<b>37.15%</b>	<b>33.41%</b>	<b>30.42%</b>	<b>26.52%</b>
<b>Current expenditure</b>	<b>18.31%</b>	<b>17.32%</b>	<b>16.28%</b>	<b>16.80%</b>
<i>Wage</i>	7.69%	7.05%	6.95%	7.43%

Particulars	2011/2012	2012/2013	2013/2014	2014/2015
	Actual	Actual	Actual	Actual
<i>Non-wage</i>	10.62%	10.27%	9.33%	9.37%
<i>Provincial expenditure</i>				
<b>Capital expenditure</b>	<b>19.88%</b>	<b>17.64%</b>	<b>15.13%</b>	<b>12.34%</b>
<i>Locally financed</i>	9.05%	7.19%	7.38%	6.65%
<i>Externally financed</i>	10.82%	10.45%	7.75%	5.68%
<b>Net lending</b>	<b>-0.91%</b>	<b>-0.71%</b>	<b>-1.21%</b>	<b>-2.95%</b>
<b>Overall balance</b>	<b>-1.14%</b>	<b>-4.06%</b>	<b>3.90%</b>	<b>1.52%</b>
<b>Financing</b>	<b>1.14%</b>	<b>4.06%</b>	<b>-3.90%</b>	<b>-1.52%</b>
<b>Foreign (net)</b>	<b>-1.10%</b>	<b>0.47%</b>	<b>-0.79%</b>	<b>-0.87%</b>
<i>Loans</i>	6.81%	15.76%	1.39%	1.35%
<i>Amortization</i>	7.91%	15.29%	2.18%	2.21%
<b>Domestic (net)_</b>	<b>2.25%</b>	<b>3.59%</b>	<b>-3.11%</b>	<b>-0.65%</b>
<b>GDP figures</b>	<b>91,249.081</b>	<b>104,473.003</b>	<b>110,201.219</b>	<b>125,184.795</b>

Source: Annual Financial Statements.

**TABLE 2.2C: AGGREGATE FISCAL DATA (Nu. MILLIONS AND % OF GDP)**

	2012/13	% of GDP	2013/14	% of GDP	2014/15	% of GDP
Domestic revenue	21,101.691	20.20%	23,244.610	21.09%	25,141.030	20.08%
Tax revenue	15,403.118	14.74%	16,182.774	14.68%	18,387.335	14.69%
Non-tax revenue	5,698.573	5.45%	7,061.836	6.41%	6,753.695	5.39%
Grants	9,562.636	9.15%	14,236.353	12.92%	9,955.021	7.95%
Program grants	2,618.453	2.51%	1,749.693	1.59%	2,125.000	1.70%
Project-tied grants	6,944.183	6.65%	12,486.660	11.33%	7,830.021	6.25%
<b>Total revenue</b>	<b>30,664.327</b>	<b>29.35%</b>	<b>37,480.963</b>	<b>34.01%</b>	<b>35,096.051</b>	<b>28.04%</b>
Recurrent expenditure	18,096.551	17.32%	17,941.151	16.28%	22,521.411	17.99%
Personnel emoluments (codes 01-05)	8,076.200	7.73%	8,426.800	7.65%	10,173.589	8.13%
Goods and services (codes 11-19)	5,078.100	4.86%	3,414.700	3.10%	5,784.795	4.62%
Transfers (codes 21-26 & 61-62)	2,299.751	2.20%	4,009.151	3.64%	4,538.087	3.63%
Interest (code 31)	2,642.500	2.53%	2,090.500	1.90%	2,024.940	1.62%
Capital expenditure (codes 41-63)	18,431.264	17.64%	16,668.752	15.13%	15,443.805	12.34%
Net lending	-1,618.796	-1.55%	-1,425.229	-1.29%	-3,276.591	-2.62%
Total expenditure	34,909.019	33.41%	33,184.674	30.11%	33,199.257	26.52%
Overall balance	-4,244.692	-4.06%	4,296.289	3.90%	1,896.794	1.52%
Financing	4,244.692	4.06%	-4,296.289	-3.90%	-1,896.794	-1.52%
External	667.608	0.64%	-867.009	-0.79%	-911.106	-0.73%
Domestic	-175.302	-0.17%	-175.302	-0.16%	-175.302	-0.14%
Change in balance	3,752.386	3.59%	-3,253.978	-2.95%	-810.386	-0.65%
<b>GDP figures</b>	<b>104,473.003</b>		<b>110,201.219</b>		<b>125,184.795</b>	

Source: AFS Tables 1 and 2 and breakdown of recurrent expenditure from Schedule 2.

In Table 1 of AFS, Other Receipts (net) are deposits, net of repayments, and have been re-classified as domestic financing. Changes in advances are classified under net lending.

**TABLE 2.3: BUDGET ALLOCATION BY SECTORS (Nu. MILLIONS)**

Sectors	2012-13	2013-14	2014-15
<b>Social Services</b>	<b>29%</b>	<b>29%</b>	<b>28%</b>
Health	8%	9%	9%
Education	21%	20%	19%
<b>Economic and Public Services</b>	<b>41%</b>	<b>38%</b>	<b>35%</b>
Agriculture	14%	12%	12%
Trade and industry	3%	2%	2%
Roads	11%	10%	8%
Urban, housing & public amenities	5%	6%	6%
Communications	5%	4%	2%
Energy	2%	2%	3%
<b>Cultural Services</b>	<b>4%</b>	<b>4%</b>	<b>5%</b>
<b>Law and Order Services</b>	<b>10%</b>	<b>6%</b>	<b>5%</b>
<b>General Public Services</b>	<b>16%</b>	<b>23%</b>	<b>27%</b>
<b>Total expenditure</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

*Source:* National Budget Report.

## 2.3 Legal and regulatory arrangements for PFM

Bhutan's political system has evolved from an absolute monarchy into a constitutional monarchy with Parliamentary democracy established through the 2008 Constitution of Bhutan, following a decade of planning and consultations, and the transition happening in a peaceful manner. The first elections were held in 2008 and a new government elected directly by the people was installed on the basis of the constitutional provisions. The next elections were held in 2013. Bhutan has an Election Commission, established by the Constitution, which prepares for and oversees the elections to Parliament and local governments.

The Druk Gyalpo (the King of Bhutan) is the Head of State. The Constitution of Bhutan provides for a government consisting of three main branches – the Legislative, Executive and Judiciary, and an apolitical Monastic Affairs Commission of the state religion.

- The legislative power is vested in Parliament, which consists of the Druk Gyalpo and two houses: the National Council and the National Assembly. Besides its legislative functions, the Parliament reviews the policies, plans and programs of the government and its performance, the implementation of resolutions and laws passed by the Parliament and issues of national importance and performs legislative scrutiny of the budget and the audit reports.
- The executive power is vested in the Council of Ministers headed by the Prime Minister (who is the leader of the party having majority seats in the National Assembly). The Druk Gyalpo appoints ministers from the members of the National Assembly on recommendation of the Prime Minister.
- Judicial authority is vested in the Royal Courts of Justice and comprises the Supreme Court, the High Court, the Dzongkhag Courts, the Dungkhaag Courts, and any other Courts and Tribunals. The appointment of judges, working of the courts and the establishment of the courts are done by the Druk Gyalpo on the recommendation of a National Judicial Commission.



*Other Constitutional bodies:* Bhutan has an Anti-Corruption Commission, established as an independent authority under the Constitution, to take necessary steps to prevent and combat corruption in Bhutan. The Royal Civil Service Commission manages the Civil Service Regulations, which are intended to ensure that only competent staffs are appointed and that their performance meets their job descriptions and performance standards. The promotions and career progress of the staff are also based on their performance. The Gross National Happiness Commission is responsible for setting the planning framework and preparing the five year plans.

The 2008 Constitution lays down the principles for Public Financial Management (PFM). These include articles on passage of money bills and financial bills, finance, trade and commerce, and the establishment of a Royal Audit Authority (“to audit and report on the economy, efficiency, and effectiveness in the use of public resources”), Public Accounts Committee (“to review and report on the Annual Audit Report to Parliament or on any other report presented by the Auditor General”) and other constitutional institutions. **The key principles of public finance followed by RGoB are: 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 only from internal resources of the country.**

The National Internal Control Framework (NICF) sets the control environment and sets the “tone at the top” and all agencies are obliged to follow this. The key legislation on PFM is the Public Finance Act, 2007 passed on June 20, 2007 by the National Assembly that regulates financial management for the effective and efficient use of public resources, accountability and fiscal policy and vests the overall responsibility of managing the public finances with the Council of Ministers. 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 Department of Revenue and Customs of the MoF. These taxes are governed by specific laws.

The Financial Rules and Regulations (FRR) 2001 is a set of over-arching documents governing PFM in Bhutan and consists of a main document, the Financial Management Manual and six technical documents, the Finance and Accounting Manual; the Budget Manual; the Aid & Debt Management Manual; the Property Management Manual; the Procurement Manual; and the Revenue Manual. These cover the following tools of financial management namely: cash flow management; procurement management; asset management; debt or liabilities management; accounting; and budgeting. Further guidance is contained in the Manual on Standard Operating Procedures for Public Debt Management, 2007 and the Revised Procurement Rules and Regulations 2009.

The NICF casts responsibility on ministries and other autonomous agencies to identify and evaluate risks at departmental, divisional and operating unit levels; establish policies, plans, procedures and systems to deal with risks and conduct a self-assessment of the five control components. Risks are identified in budget preparation: both revenue and expenditure are projected under multiple scenarios. RGoB closely monitors the fiscal risks from public enterprises through their annual reports and key data are included and discussed in the Budget Reports and the audit report. Local governments do not generate any fiscal risks as their activities are regularly monitored and they do not borrow. The Public Enterprises Division and Debt Management Division monitor risks arising out of operations of the public enterprises, debt and contingent liabilities while the Department of Revenue and Customs manages risks on taxpayer registration, assessment, collection and audit.



The Public Finance Act, read with the FRR, empowers the MoF to set the government accounting standards and determine the financial reporting framework. Revenue and expenditure accounting and control is done on computerized applications that also determine the control activities.

Ministry of Finance is the parent agency for a government-wide internal audit function. An Internal Audit Central Coordinating Agency reports to the Finance Secretary administratively and to the high level Committee of Secretaries in case of any disrespect or disregard of any internal audit functions and its recommendations.

The Annual Financial Statements (AFS) of the Government are prepared by the Department of Public Accounts, MoF. Audit of the Government in Bhutan is governed by the Audit Act, 2006. The AFS are audited by the RAA, which tables in Parliament an annual audit report on the AFS and reports on its other audit work (e.g. the RAA has recently tabled a report on Public Debt). The RAA places emphasis on personal accountability in holding individuals accountable for their PFM responsibilities and imposing personal sanctions until rectification is complete. Article 25 of the Constitution of Bhutan provides for the appointment of a five-member Public Accounts Committee (PAC) to review and report on the Annual Audit Report of the Royal Audit Authority (RAA) or on any other report presented by the Auditor General. The PAC is a joint committee of both Houses of Parliament (with members from the ruling and opposition parties) and is governed by the Rules of Procedure of the Public Accounts Committee (2015).<sup>9</sup>

## 2.4 Institutional arrangements for PFM

Bhutan is a unitary state. The public sector in Bhutan comprises the central government (including the local governments - dzongkhags, gewogs and thromdes, constitutional bodies and autonomous institutions), which together form the “budgetary sector” and extra-budgetary bodies such as the trust funds and the National Pension and Provident Fund (social security organization), and the state-owned enterprises/corporations. The structure of the public sector is depicted in Table 2.5.

*Ministries/Departments:* RGoB has 10 ministries each divided into several departments. Each Ministry is headed by an elected Minister (political head) with a Secretary being the administrative head. They, together with various divisions (such as policy and planning, administration and finance, human resource, internal audit), form the Secretariat. Broadly, the Secretariat decides the policies while the departments implement the programs.

*Local Government:* Political power is delegated 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 Local Government Act of 2009 establishes local governments at two levels: 20 dzongkhags (first tier local government) with each dzongkhag consisting of gewogs, (second-tier local governments serving groups of communities) total of gewogs being 205. There are four class A thromdes or city corporations which are autonomous while other thromdes or municipalities are part of the dzongkhags.

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<sup>9</sup> The PAC's terms of reference include reviewing and reporting to Parliament on the various reports of the RAA that the PAC may choose to review and accounts of all agencies in which public funds have been invested. The RAA audit reports are scrutinized, debated, and results in hearings. The PAC has the power to summon any person before it to give evidence or produce documents. A ministry or department is represented by its Secretary or Head of Department and, if permitted, a senior officer can represent the ministry/department. The PAC has the power to compel attendance and production of documents.

*Constitutional offices:* There are four constitutional offices in Bhutan – the Royal Civil Service Commission, Anti-Corruption Commission, Election Commission and the Royal Audit Authority. They work independently within the roles defined in the Constitution and Royal Charters.

*Autonomous bodies:* There are 29 autonomous bodies including the Prime Minister’s office, the National Council and Assembly, the Judiciary, office of Attorney General, and the Gross National Happiness Commission besides institutes, councils and the Thromdes.

*Trust Funds:* RGoB has set up five trust funds outside the government for specific mandates in the areas of environment, health, culture, education and telecom.

*State-owned enterprises:* There are nine state-owned enterprises in Bhutan. One of the major public enterprises is Druk Holding and Investments Ltd, which has holdings in another 20 companies. The State-Owned Enterprise sector (SOE) contributes about 41% of the government’s revenue; SOE assets are 192% of the country’s GDP and long-term debt is 27% of GDP. Total equity holding of RGoB is over Nu. 48,000 million. The SOE oversight is exercised by the Public Enterprises Division in the MoF.

The majority of government expenditure is incurred at the level of the 10 ministries; the local governments account for 25% of the expenditure while autonomous bodies account for 11%. In 2013/14, local governments received an allocation of Nu. 16,148 million which was 34% of the total outlay<sup>10</sup>. The PEFA assessment covered the Government sub-sector (budgetary). Public enterprises were covered to the extent of assessing the oversight of the government over this sub-sector.

**TABLE 2.5: STRUCTURE OF THE PUBLIC SECTOR (NUMBER OF ENTITIES AND FINANCIAL TURNOVER)**  
(All figures for 2013/14 in Nu. million)

Year: 2014/15 (numbers)	Public sector				
	Government subsector		Social security funds	Public corporation subsector	
	Budgetary unit	Extra-budgetary unit		Nonfinancial public corporations	Financial public corporations
Ministries (10)	24,218.8				
Constitutional bodies (4)	483.4				
Autonomous bodies (29)	3,991.1				
Dzongkhags (20)	7,648.3				
Gewogs (205)	1,415.8				
Trusts Funds (5)		161.1			
National Pension and Provident Fund (1)			1,279.8		
Public enterprises (9 with direct government holding and 20 with equity held by Druk Holding)				37,082.0	9,043.4 <sup>11</sup>
Others					

**Source:** Budget Report 2015/16 and Annual Financial Statements (audited) 2013/14.

**Note:** Figures for government sector represent expenditure; while for others, the figures are for revenue.

<sup>10</sup> This includes provisions for local governments provided in the budget of ministries.

<sup>11</sup> Bhutan Development Bank; Bhutan National Bank; Bank of Bhutan; Royal Insurance Corpn.

**TABLE 2.6: FINANCIAL STRUCTURE OF CENTRAL GOVERNMENT – BUDGET ESTIMATES****(All figures for 2015/16 in Nu. million)**

Year	Central government			
	Budgetary Unit	Extra-Budgetary Units	Social Security Funds	Total Aggregated
Revenue	41,017.9	-	-	41,017.9
Expenditure	47,348.2	-	-	47,348.2
Transfers to (-) and from (+) other units of general government		-	-	
Liabilities		-	-	
• Projected Public Debt	150,576.7			150,576.7
Financial Assets	-	-	-	-
Non-financial assets	-	-	-	-

**Source:** Budget Report 2015/16 na = not available.

**TABLE 2.7: FINANCIAL STRUCTURE OF CENTRAL GOVERNMENT – ACTUAL EXPENDITURE****(All figures for 2013/14 in Nu. million)**

Year	Central government			
	Budgetary Unit	Extra-budgetary Units Trust Funds	Social security Funds NPPF	Total Aggregated
Revenue	37,819.1 <sup>12</sup>	161.1	1,279.8	-
Expenditure	34,609.9	366.5	70.5	-
Transfers to (-) and from (+) other units of general government	-	-	-	-
Liabilities		-	-	-
• Public Debt	108,370.3			
• RGoB's share of SOE borrowing	26,233			
Financial Assets	(-) 2,562.8 <sup>13</sup>	4327.3	17,498.8 <sup>16</sup>	-
• Cash/Bank balances	943.6 <sup>14</sup>			
• Govt. Equity Holding	813.7 <sup>15</sup>			
	48,032.4			
Non-financial assets		Not available		

**Source:** Budget Report 2015/16 and Annual Financial Statements (audited) 2013/14.

**Note:** As the figures are not comparable/complete, these have not been aggregated.

MoF is responsible for implementing the system of PFM in Bhutan. The Ministry is divided into several divisions on functional lines and administers many key departments (see figure below). MoF has four departments dealing respectively with revenue administration, the budget, accounts and asset

<sup>12</sup> Includes Nu. 14,236 being international grants received.

<sup>13</sup> Balance in Consolidated Account.

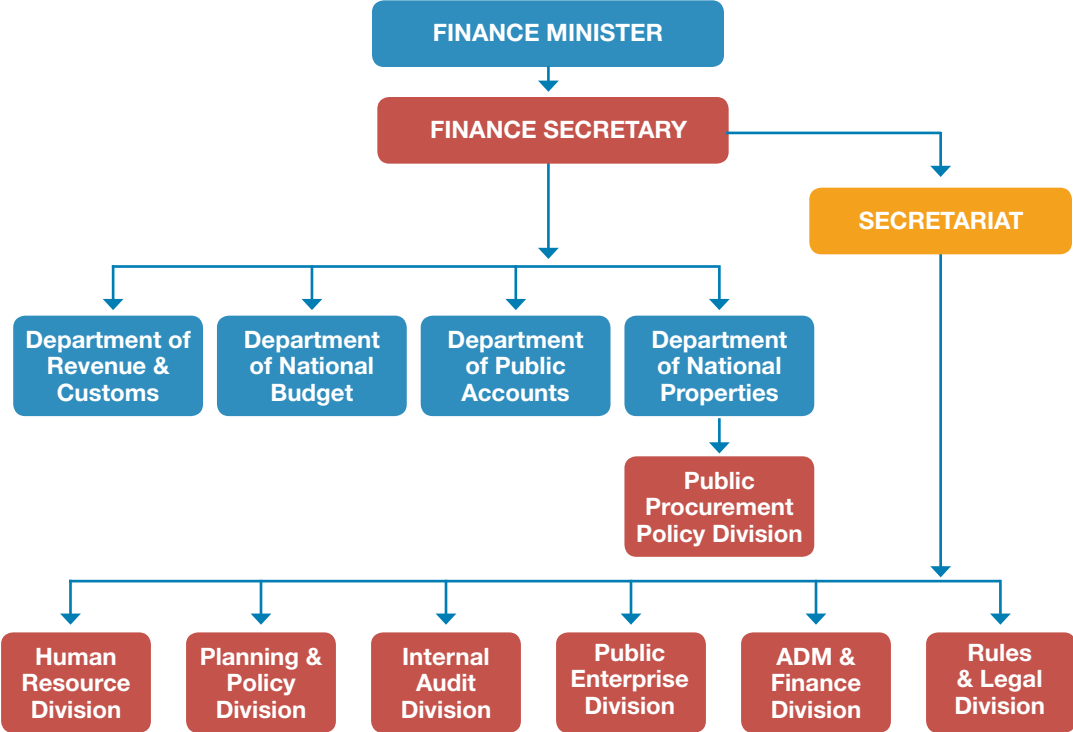
<sup>14</sup> Closing balances with the Bhutan Information and Communication Media Authority, and in the Refundable Deposits Account and the Revolving Fund Account.

<sup>15</sup> Closing balances in 333 Current Deposit Accounts of Gewogs, Judiciary, Municipalities and others held outside the consolidated fund.

<sup>16</sup> Total assets of the Fund.

management. The Public Enterprises Division has oversight of the SOEs and the Central Coordination Unit deals with government internal audit.

**ORGANOGRAM OF MINISTRY OF FINANCE, RGoB**



The Ministries and departments have Administration and Finance Divisions (AFD) and Dzongkhags and Autonomous bodies have Administration and Finance Sections (AFS) to manage their financial affairs. Finance personnel (*budget officials, accounts officials, revenue and customs officials, procurement officials and internal auditors*) are placed in all the budgetary bodies across the country. Accounts personnel are also placed at the lowest level of the administration i.e. Gewog Administration. There are more than 700 National Accounts Service (NAS) personnel in the country. The responsibility of Finance personnel includes mobilization and judicious application of resources, management of the equity portfolio and debts of the Government, proper custody, use and maintenance of Government properties, clear and transparent accounting of all public receipts and expenditures and reporting on them.

The MoF tables before Parliament three key documents: the audited financial statements; the budget policy and fiscal framework statement; and the budget and appropriation bill. The Ministry issues rules and regulations across government. It requires budgetary and other bodies to follow the financial management and accounting policies of the government.

MoF is responsible for preparing the budget which is subject to legislative scrutiny and Parliamentary approval. Recently, a Finance Committee of Parliament has been constituted for review and assessment of the budget proposals. The Policy and Planning Division of the MoF compiles a Budget Policy and Fiscal Framework Statement to match overall expenditure with the availability of resources in the medium term on a rolling basis. A Medium Term Fiscal Framework has been instituted including a system of revenue forecasting based on economic indicators such as GDP, imports and consumption. Projections

are examined by a Macroeconomic Framework Coordination Technical Committee and approved by a Macro Fiscal Coordination Committee. The former also approves the annual capital outlay based on the five-year plan.

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 Government owned public corporation. Audit is conducted by the RAA, which is the Supreme Audit Authority in Bhutan and it has the mandate over the entire public sector.

Bhutan's development planning is guided by the development framework of Gross National Happiness (GNH). The Constitution directs the State "to promote those conditions that will enable the pursuit of Gross National Happiness". A Gross National Happiness Commission (GNHC) has been established, under the Prime Minister, to ensure that GNH is mainstreamed into the government planning, policy making and implementation process. The GNHC has developed a tool (2015) and every project is screened on 22 parameters and scored which sets the priority of selecting (or declining) the project. The Bhutan 2020: A Vision for Peace, Prosperity and Happiness (1999) and the Economic Development Policy (2010) also guides planning in Bhutan that culminates in five year plans. The country is presently implementing the 11th Five Year Plan (2013-2018).

## 2.5 Other important features of PFM and its operating environment

The annual budget prepared by MoF is presented to Parliament and formal approval is accorded by Parliament in its summer session along with a supplementary (revision) budget for the on-going year. Budget formulation, execution and reporting is based on every level of administrative, economic and functional classification using GFS/COFOG-compliant classification. The Budget Policy and Fiscal Framework Statement contains key aggregates of potential deficit, external and internal debt, as well as instruments of financing are also projected. The Budget Report contains the revenue picture and budget ceiling for spending agencies and 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.

The budget is managed by the MoF through its departments. After the budget is approved by Parliament, the Department of National Budget notifies all the budgetary agencies of their approved budgetary provisions. Drawing and Disbursing Officers (DDOs) ensure that all claims/bills are cleared within one month of their receipt.

The Public Expenditure Management System (PEMS), is the basis for budget execution, in-year reporting and annual financial reporting, and covers the revenue and expenditure of all government budgetary bodies - constitutional bodies, autonomous bodies, the judiciary, ministries, dzongkhags and gewogs. Externally financed projects are fully accounted in the Budget Reports and Annual Financial Statements. It is mandatory for all budgetary agencies to initiate, process and complete transactions and accounts in the PEMS on a daily basis. PEMS does not cover the revenues and expenditures of public enterprises, the National Pension Fund and some trusts.

All public monies not allocated to specific purposes by law are deposited in a Consolidated Fund maintained with the central bank. Government receipts and payments are segregated, with payments made from one set of bank accounts and receipts paid into another. Expenditures are limited by the amounts provided in the annual budget and by letters of credit issued by MoF. Letters of credit are

instructions to banks to honor checks drawn on specified accounts up to specified limits. Unless the budget is amended, MoF cannot issue letters of credit that exceed the sums provided in the budget. This system enables individual units to fund their expenditures, with their parent ministries acting as accounting units. A system of in-year budget execution reports has been instituted recently.

Cash balances of the Government are consolidated and monitored daily. The balances in the subsidiary 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 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.

Government revenue and expenditures are managed through computerized applications - PlaMS or Planning and Monitoring System of GNHC; MYRB or Multi Year Rolling Budget System of the Department of National Budget; PEMS or Public Expenditure Management System of the Department of Public Accounts; and RAMIS or Revenue Administration Management Information System of the Department of Revenue and Customs. This is supported by the Civil Service Information System (CSIS) of the Royal Civil Service Commission for payroll accounting.

The AFS has information on revenues, expenditures, grants and loans for each budgetary unit and includes statements of the government's equity portfolio in corporations and financial institutions, government guarantees to various organizations and outstanding public debt. The AFS is normally compiled within six months from close of the financial year and submitted to the RAA for audit.

Internal Audit is guided by a Charter, Code of Conduct and a Manual. Internal audit units in the ministries report directly to the heads of the agencies in which they are established. The audits performed by internal audit are characterized by being both risk-based and transaction-based. They meet the professional standards of internal auditing.

Local governments do not have legislative functions, but they may make rules and regulations consistent with laws made by the Parliament. A system of fund allocation to the local governments has been instituted based on population, poverty index, geographical area and transport cost.<sup>17</sup> There are some extra-budgetary bodies established by law, but funds handled by them are not significant. Revenue and expenditure outside the government's budget is less than 5% of the total.

In a recent development (2014/15), Ministers are now required to sign Annual Performance Agreements (APA) with the Prime Minister with subsidiary APAs signed between the Minister and the Secretaries and between Secretaries and the departmental heads as well. Since 2015/16, all budgeted activities are required to be aligned to their APAs. Achievement of APAs is directly monitored by the Government Performance Management Division under the Prime Minister's Office. The Department of National Budget and the Prime Minister's Office are planning to develop a new system that will be linked to outcome/output based budgeting. Some performance audits have also been done by the RAA.

Key fiscal information is publicly disclosed primarily through the Budget Report and the annual financial statements.

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<sup>17</sup> A discussion on the PFM arrangements of local governments is provided in Annex 5.





### 3.1 Pillar I – Budget reliability (Performance indicators 1 to 3)

#### PI-1: Aggregate expenditure out-turn

##### Dimension to be assessed

##### The difference between actual expenditure and the originally budgeted expenditure

This indicator is intended to assess the accuracy of budgeting and the degree of enforcement of the budget. Table 3.1.1.1 shows the Actual and Budgeted expenditure for the last three years.

**TABLE 3.1.1.1: ACTUAL AND BUDGETED EXPENDITURE FOR LAST THREE YEARS (Nu. MILLIONS)**

	2012/13		2013/14		2014/15	
	Original budget	Actual expenditure	Original budget	Actual expenditure	Original budget	Actual expenditure
Total expenditure	34,515	36,528	36,114	34,610	37098	36,477
Actual/budget %	105.8%		95.8%		98.3%	

**Source:** AFS 2014 & MYRB-PEMS.

**Note:** Expenditure includes debt interest and expenditure for donor funded projects (whether from loans and grants) but not lending by RGoB or RGoB's repayments of loans. Expenditure includes both current and capital expenditure.

Score	Minimum requirements for scores
<b>1.1: Aggregate expenditure out-turn</b>	
A	Aggregate expenditure out-turn was between 95% and 105% of the approved aggregate budgeted expenditure in at least two of the last three years.
B	Aggregate expenditure out-turn was between 90% and 110% of the approved aggregate budgeted expenditure in at least two of the last three years.
C	Aggregate expenditure out-turn was between 85% and 115% of the approved aggregate budgeted expenditure in at least two of the last three years.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for score (with cardinal data used)
PI-1: Aggregate expenditure out-turn compared to original approved budget	A	In only one year, 2012/13, the ratio of actual expenditure to the original budget was outside the range 95-105%

The major variances are due to:

- Incorporation of donor-funded projects finalized and signed after budget approval by the Parliament. Such incorporations are authorized by the PFA 2007, clause 60 on Revision of Budget and Appropriations.
- First year of 11th Five Year Plan (2013-18) was delayed as the Parliament was constituted only in September 2013.
- Slow fund disbursements by the donors.

### ***On-going and planned reforms***

Budget and expenditure management system was transferred from a standalone system to a web-based and real time online system called MYRB (Multi-Year Rolling Budget) since FY 2010/11. This is a major change in the financial management system since the last PEFA exercise in 2010.

Several new reports can be generated through the new system. Generation of financial information has become far more efficient and in real time using MYRB system than it was in the past. The new system has improved monitoring of budget and expenditure, and shortened processing time for incorporation of donor funds. Also, the budget call notification includes submission of pre-requisite documents along with the budget proposals to expedite implementation of the proposed activities. These pre-requisites include social clearance, estimates with drawings and designs, environmental clearance for construction works, etc.

These pre-requisite documents that DNB initiated along with the budget proposals are to reduce the gap between the budget allocation and the actual expenditure by the budgetary agencies. DNB reviews the proposed budget estimates to see that there is no lavish designs and unwarranted size of constructions, etc. before the concerned budgetary agency can award such works. All these strategies are aimed at reducing the variance. Further, agencies are required to sign Annual Performance Agreement (APA) with the Prime Minister wherein all the budgeted activities are required to be aligned to their APA. This will also drastically reduce the variance by curtailing unwanted activities that the agencies propose earlier.

Currently there are three independent systems that should be integrated. However, since these systems were developed independently using different parameters, there are integration issues. To address this, DNB is developing a new integrated system. This system, which seeks to integrate PlAMS, PEMS and MYRB, is expected to address the current integration issues by incorporating relevant parameters.

### **PI-2: Expenditure composition out-turn**

This indicator is intended to measure the extent to which reallocations between budget lines have contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. It is an indicator of adherence to budget policy.

#### **Dimension to be assessed (Scoring Method M1)**

##### ***Dimension 2.1: Expenditure composition out-turn by function***

On an administrative classification, variance from budget of expenditure composition (current and capital) was 6.7% in 2012/13, 15.8% in 2013/14 and 11.1% in 2014/15 (see Annex 6). This is rated C, as variance was less than 15% in two of the last three years.

DNB now reviews the proposed budget estimates to see that there is no lavish design and unwarranted size of constructions, etc. before the concerned budgetary agency can award such works. All these strategies are aimed at reducing variance.

**Dimension 2.2: Expenditure composition out-turn by economic type**

The variance on the economic classification is 8.1%, 10.5% and 4.9% over the last three years (see Annex 6). In 2012/13, the main variance was on interest, which was budgeted at Nu. 2,041 million, whereas actual interest paid that year was Nu. 2,642 million. In 2013/14, capital expenditure funded externally was 31% over the original budget, slightly offset by under-spending on the domestic capital budget. In 2014/15, personnel emoluments were 19% over the original budget. Despite these individually large variances, the overall variance was less than 10% in two years out of three, which gets a B rating.

**Dimension 2.3: Expenditure from contingency reserves**

The contingency fund kept by the Department of National Budget is transferred to the various agencies as required and expenditure booked under the respective implementing agencies. In FY 2013/14, the contingency (Reserve Fund) was Nu. 4,376 million, which was 13% of total expenditure. Though this is a relatively high proportion of total expenditure, no expenditure is booked under contingency budget head. This dimension is, therefore, rated A.

The overall rating for this indicator, using the M1 method of combining the dimensional scores, is C+.

Major sources of deviation are in pay and allowances, travel, office supplies, structure building (roads & bridges), capital grants to NGOs and purchase of vehicles.

There were no major changes made in the economic classification. However, DNB and the Prime Minister’s office will be incorporating a new objective in the MYRB system whereby budgeted activity will be tagged to Annual Performance Agreements (APAs) in the system. This will be initiated only from FY 2016-17. Thereafter, any budget the agency proposes will have to be linked to an overall national target.

Score	Minimum requirements for scores
<b>2.1: Expenditure composition out-turn by function</b>	
A	Variance in expenditure composition by program, administrative or functional classification was less than 5% in at least two of the last three years.
B	Variance in expenditure composition by program, administrative or functional classification was less than 10% in at least two of the last three years.
C	Variance in expenditure composition by program, administrative or functional classification was less than 15% in at least two of the last three years.
D	Performance is less than required for a C score.
<b>2.2: Expenditure composition out-turn by economic type</b>	
A	Variance in expenditure composition by economic classification was less than 5% in at least two of the last three years.
B	Variance in expenditure composition by economic classification was less than 10% in at least two of the last three years.
C	Variance in expenditure composition by economic classification was less than 15% in at least two of the last three years.
D	Performance is less than required for a C score.

### 2.3: Expenditure from contingency reserves

- A Actual expenditure charged to a contingency vote was on average less than 3% of the original budget.
- B Actual expenditure charged to a contingency vote was on average more than 3% but less than 6% of the original budget.
- C Actual expenditure charged to a contingency vote was on average more than 6% but less than 10% of the original budget.
- D Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for score
<b>PI-2: Expenditure composition out-turn</b>	<b>C+</b>	<b>M1 method of combining dimension scores</b>
2.1: Expenditure composition out-turn by function.	C	Variance on administrative classification was less than 15% in two of the last three years.
2.2: Expenditure composition out-turn by economic type.	B	Variance on economic classification was less than 10% in two years out of three.
2.3: Expenditure from contingency reserves.	A	Actual expenditure charged to contingency vote was nil in each year.

### PI-3: Revenue out-turn

This indicator is intended to assess the quality of revenue forecasting by comparing revenue estimates in the original approved budget to actual domestic revenue collection based on tax and non-tax recurrent revenues and grants.

#### Forecasting methodology and assumptions

Revenue forecasting is done by DRC on a medium and long-term basis as part of the Medium Term Fiscal Framework (MTFF) and basically covering the five-year plan period. The forecasting methodology uses economic indicators like GDP, imports and consumption as a base. Normally, revenue projection is intended to cover all recurrent expenditure and part of capital expenditure. DRC's projections are examined by the Macroeconomic Framework Coordination Technical Committee (MFCTC), of which DRC is a member, and approved by Macro Fiscal Coordination Committee (MFCC). Forecasts are re-examined on a quarterly (i.e. October, January, April and June) basis.

It is important to note that the initial forecast or estimates are done on a baseline scenario assuming no policy changes. Any policy changes are incorporated and reflected in the revised revenue. The revenue estimates are revised based on the actual collections for the preceding year and incorporating any policy changes that might impact the revenue. Therefore, if the variation is compared between estimates and the actual revenue then the deviation, as prescribed in the PEFA framework, the deviation is much higher than the variation between revised and actual revenue.

For FY 2012/13 the revenue estimate was based on a broad assumption that the economic activities will continue to perform well, and no major policy changes would take place. The growth in tax revenues (both direct and indirect taxes) was estimated at 13.7% while non-tax revenue was projected to increase by 2.9%. The increase in revenue was expected mainly from Business Income Tax (BIT) and Personal Income Tax (PIT) under tax revenue along with an increase in non-tax revenue. Estimated profit transfer was lower than the revised estimates of FY 2011/12 based on information provided by the RMA.

The estimate for FY 2013/14 projected a 3.3% increase over the previous year. While the direct tax revenue was estimated to be at least the same as the previous year, indirect tax was expected to be lower by 17.4% since in the previous fiscal years two import year's claims of excise refund from Gol were received whereas only one import year was to be received for the year.

The projections for the FY 2014-15 were computed using the effective tax rate incorporating the following policy changes during the year:

- Tax measures impact on sales tax, customs duty and green taxes, arrears of excise duty from Gol, excise duty claims for the year 2013, impact of salary revision on PIT, additional royalty from tourism due to relaxation of minimum daily package rate introduced for tourists from Thailand in order to celebrate Bhutan-Thailand Friendship. Adjustments for the delay in the commissioning of Dagachhu Hydropower Project and on account of Chukha Hydropower Plant's revision of export tariff rates retrospective from January 2013 was received in the previous FY, it was also adjusted from the original revenue estimates.
- The projections for the fiscal year were computed using the effective tax rate incorporating the following changes during the year.
- The remittances from the commissioning of Dagachhu hydropower plant, higher remittances from BPC and profit transfer from the Royal Monetary Authority was included in the projection for the year.
- However, it was noted that the revenue growth may be affected if Dungsam Cement Corporation Ltd. continues to incur losses as there will be no payment of CIT and dividend. Any change in fiscal measures and exemptions would also impact the revenue growth.
- At the time initial projection was being worked on, the GDP was growing by 7% from FY 2014-15 to FY 2015-16, and therefore it was also assumed that domestic revenue would be growing at least by 5% (increase on the 2014-15 projections).

Non-tax revenue was projected to increase by 7.2% mainly on account of higher dividend projections. However, interest receipts from corporations were projected to be lower compared to FY 2013/14 due to a change in the repayment schedule from annual to semi-annual.

It is important to note that the effect on revenue through fiscal measures or policy changes has not been taken into account in the estimation of revenue for FY2014/15.

However, the major deviation noted under indirect taxes particularly on customs duty and green tax is mainly due to introduction of policy changes as part of fiscal measures such as sales tax on telecom services and green tax on fuel along with the revision of sales tax and customs duty on import of vehicles.

Further, arrears of excise duty refund received from GOI BTN 449 million and BTN 150 million as an additional royalty from tourism.

However, BTN 486.7 million on account of delay in commissioning of Dagachhu Hydropower Project and BTN 450 million on account of CHP's revision of export tariff rates retrospective from January 2013 which was received in the previous FY were adjusted from the original revenue estimates and the revenue was revised.

## Institutional arrangements for revenue forecasting

The Ministry of Finance has instituted a Macroeconomic Framework Coordination Committee (MFCC) and Macroeconomic Framework Coordination Technical Committee (MFCTC) comprising members from all relevant agencies for the forecasting of macroeconomic variables. Each member is responsible for maintaining and updating the respective files and the Department of Revenue and Customs (DRC) maintains and updates the revenue file and forecasting of national revenue. The file is documented and maintained in Budget Policy and Fiscal Framework Statement in the excel format.

The forecast done by the MFCTC is put up to the MFCC for endorsement. MFCC is chaired by the Finance Secretary and represented by the head of the department or organization of all the relevant agencies.

The main sources of data on estimates of revenue are a revenue projection file (BPFFS file) which is part of the Medium Term Fiscal Framework (MTFF) exercise and is reported in the annual National Budget Report. Further, the actual collections of revenue are reported annually in the National Revenue Report by the Department of Revenue and Customs (DRC), which is sourced from the Revenue Accounting System of the department. Gross National Happiness Commission (GNHC) is responsible for collecting grants data which are updated before the annual budget ceiling is finalized for each budgetary agency. The projection for Grants in the annual budget is based on the MoU drawn between GNHC and Development Partners. Thereafter the implementing agencies draw up annual work plan for budget estimations that is submitted through annual budget proposals.

The accuracy of revenue forecasting is largely dependent on the information provided by other agencies especially the electricity file since hydro sector is one of the main sources of revenue. The unpredictable nature of certain sources of revenue, unforeseen policy reforms, inadequate information and other external factors affect the reliability of the estimates. From the hydro sector, revenue is received in the form of corporate income tax, dividends and profit transfers.

### *Dimension 3.1: Aggregate revenue out-turn*

Aggregate revenue was 96.4% of original budget in 2012/13, 125.4% in 2013/14 and 113% in 2014/15. This is between 92% and 116% of budget in two years out of three, and is rated C. If the variation in aggregate revenue is considered without taking external grants into consideration the variation in the aggregate revenue would be 99.9%, 106.6% and 101.4% which would be in the range for a score of A.

With decentralization of local government, local taxes are retained by the gewogs to meet local expenditures. Further, with creation of thromdes the taxes collected by the thromdes in the form of land tax, house and building tax and ownership transfer tax are retained to meet their expenditure. Such revenues are not reported and accounted in the national revenue, but they are insignificant (approximately 1% of total revenue).

### *Dimension 3.2: Revenue composition out-turn*

Detailed data on execution of budgeted revenue forecasts is provided in the annual budget report. The main revenue is broken down partly in GFS classification. Annex 6 converts the classification to GFS 2014 classification, and calculates composition variance. Variance was 5.2% in 2012/13, 21.8% in 2013/14 and 16.2% in 2014/15, which is rated D. About half of the total variance was on external grants.



Grants are not entered into the budget unless they are confirmed, DNB incorporates only those projects where 1st tranche of releases are received, yet grant revenue varied compared with the original budget in the years under consideration. The variance in the grant figure is due to non-receipt of funds on time and incomplete procurement and administrative formalities at the agency level. In the last two years grants exceeded the budgeted amounts either because of carryover from previous years or because of conservative budgeting. Without external grants revenue composition would be 2.4%, 3.3% and 4.5% qualifying for a score of A.

Score	Minimum requirements for scores
<b>3.1: Aggregate revenue out-turn</b>	
A	Actual revenue was between 97% and 106% of budgeted revenue in at least two of the last three years.
B	Actual revenue was between 94% and 112% of budgeted revenue in at least two of the last three years.
C	Actual revenue was between 92% and 116% of budgeted revenue in at least two of the last three years.
D	Performance is less than required for a C score.
<b>3.2: Revenue composition out-turn</b>	
A	Variance in revenue composition was less than 5% in two of the last three years.
B	Variance in revenue composition was less than 10% in two of the last three years.
C	Variance in revenue composition was less than 15% in two of the last three years.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for score
<b>PI-3: Revenue out-turn</b>	<b>D+</b>	<b>M2 method of combining dimension scores</b>
3.1: Aggregate revenue out-turn.	C	Actual revenue was between 92% and 116% of budget in two years out of three.
3.2: Revenue composition out-turn.	D	Variance was more than 15% in 2 of the last 3 years.

### *Ongoing and planned reforms*

DRC is improving classification of the main types of revenue according to GFS 2014.

## **3.2 Pillar II – Transparency of public finances (Performance indicators 4 to 9)**

### **PI-4: Budget classification**

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. The budget will be presented in a format that reflects the most important classifications (usually administrative combined with economic, functional and/or programmatic) and the classification will be embedded in the chart of accounts to ensure that all transactions can be reported in accordance with any of the classifications used.



In countries where a poverty reduction strategy is a core element in the government's overall policy framework, the definition of poverty reducing expenditure is normally linked directly to the classification of the budget.

The international standard for classification systems is the Government Finance Statistics (GFS) - [www.imf.org/external/pubs/ft/gfs/manual/index.htm](http://www.imf.org/external/pubs/ft/gfs/manual/index.htm) - which provides the framework for economic and functional classification of transactions. Under the UN-supported Classification of Functions of Government (COFOG) - <http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=4&Lg=1> - which is the functional classification applied in GFS, there are ten main functions at the highest level and 69 functions at the second (sub-functional) level.

No international standard for programmatic classification exists, and this type of classification is used in widely deviating ways across countries.

This assessment is based on the 2014/15 budget formulation, execution and reporting.

***Dimension 4.1: Extent to which the classification system used for formulation, execution and reporting of the central government's budget is consistent with international standards.***

The major changes since 2010 have been that the standalone Central Budgeting & Accounting (CBA) System and Budget and Accounting System (BAS) have been merged as Multi-Year Rolling Budgeting (MYRB) system and made a web-based real time system. Today, financial information can be generated online efficiently. As explained above, budget proposals starting from FY 2010/11 have been done online using the web-based MYRB system.

The primary objective of MYRB is to address the shortcomings of the earlier CBA system, viz.

1. Annual based budget which lacked medium/long-term perspective;
2. Weak linkage between national policy priorities and budget;
3. Resource un-predictability;
4. Line itemized and activity based budgeting. This allowed no flexibility in resource utilization by the implementing agency.

**The classification remains the same since the last PEFA exercise in 2010 as follows:**

1. The three categories of administrative classification are:
  - a. Autonomous agencies
  - b. Ministries
  - c. Dzongkhags and Gewogs
2. Government expenditures are classified into four main economic categories, namely:
  - a. Current expenditure
  - b. Capital expenditure
  - c. Lending
  - d. Repayment

These categories are further classified economically into objects of expenditure in accordance with the chart of accounts (Finance and Accounting Manual). This is for the purpose of assessing and monitoring

the resource allocation and general macro-economic implications of the budget transactions. The economic classification is converted to a GFS classification by a bridging table for the purpose of annual IMF-GFS reporting.

**3. Government expenditure is also classified by activity and sub-activity (Budget Manual).**

A bridging table is used to convert this to a COFOG classification down to sub-functional level, and in some cases to a third level. For instance, the sub-function Pre-primary and primary education (GFS code 70910) is divided between Pre-primary education (70911) and Primary education (70912). Expenditure on primary education in 2013/14 was Nu. 4,858.44m.

**4. Government expenditure is also classified by source of funds (Financing Item Code).**

**5. Government receipts are classified broadly as:**

- a. Taxes and duties
- b. Fees and income from property and enterprises
- c. Proceeds from sale of land and other capital assets
- d. Recovery of on-lending
- e. Grants from multilateral and bilateral sources
- f. Borrowings
- g. Receipts from other sources

A bridging table is used to convert this to the IMF-GFS classification.

Score	Minimum requirements for scores
<b>4.1: Budget classification</b>	
A	Budget formulation, execution, and reporting are based on every level of administrative, economic, and functional classification using GFS/COFOG standards or a classification that can produce consistent documentation comparable with 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 classification.
B	Budget formulation, execution, and reporting are based on administrative, economic (at least “Group” level of the GFS standard—3 digits), and functional/sub-functional classification, using GFS/COFOG standards or a classification that can produce consistent documentation comparable with those standards.
C	Budget formulation, execution, and report in gare based on administrative and economic classification using GFS standards (at least level 2 of the GFS standard—2 digits) or a classification that can produce consistent documentation comparable with those standards.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for score
PI-4: Budget classification.	A	Budget formulation, execution and reporting is based on every level of administrative, economic and functional classification using GFS/COFOG-compliant classification.

**Ongoing and planned reforms**

It is expected that MYRB will improve macroeconomic balance by developing a realistic fiscal revenue framework, improve resource allocation to strategic priorities within and across sectors, increase resource predictability and provide line agencies with budget ceilings and at the same time more autonomy to make decisions for increased efficiency and effectiveness.

With the introduction of Annual Performance Based Budgeting in 2014/15, the Department of National Budget and the Prime Minister’s Office are planning to develop a new system that will be linked to outcome/output based budgeting, which is lacking in the current system. The new initiative will be undertaken after detailed study by the IT personnel of the Prime Minister’s Office and the Ministry of Finance/DNB.

## PI-5: Budget documentation

Annual budget documentation (the executive’s budget proposals for the next fiscal year with supporting documents) for 2015/16, as submitted to the legislature for scrutiny and approval, should allow a complete picture of central government fiscal forecasts, budget proposals and out-turn of the current and previous years.<sup>18</sup>

Since the last PEFA assessment, the major changes are the formation of a Finance Committee in the Parliament to review and assess the budget proposals presented to the National Assembly by the Finance Minister from FY 2015-16. The Finance Committee’s findings and recommendations are also presented to the National Assembly for debate within 10 days from the date of Budget report presentation by the Finance Minister.

For FY 2015/16, the budget documents presented to Parliament were:

- The Annual Financial Statement for financial year 2013/14
- The Budget Report
- Budget Bill
- The Budget Supplementary Appropriation Bill.

This indicator assesses the comprehensiveness of the information provided in the annual budget documentation, as listed below in Table 3.2.5.1.

**TABLE 3.2.5.1: ASSESSMENT OF COMPREHENSIVENESS OF THE INFORMATION PROVIDED IN THE ANNUAL BUDGET DOCUMENTATION**

Basic elements	Provided?
1. Forecast of the fiscal deficit or surplus (or accrual operating result).	Yes, in the annual budget report, Chapter 3
2. Previous year’s budget out-turn, presented in the same format as the budget proposal.	Yes, in the annual budget report, Chapter 1
3. Current year’s budget (either the revised budget or the estimated out-turn), presented in the same format as the budget proposal.	Yes, in the annual budget report, Chapter 2
4. Aggregated budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-4), including data for the current and previous year, in addition to the detailed breakdown of revenue and expenditure estimates.	Yes, in the annual budget report, Chapter 2, 3 and 4.

18 The following terminology is used: Current year (T) is the fiscal year in which the budget proposals are being prepared and usually presented. Next year (T+1) is the budget year or fiscal year for which the annual budget proposals are made. Previous Year (T-1) is the last Fiscal Year completed. Outer Years (T+2, T+3 etc.) are the fiscal years beyond the year for which the annual budget proposals are made. Outer years are relevant for the medium-term budget perspective in PI-14, PI-15 and PI-16.

Basic elements	Provided?
<b>Additional elements</b>	
5. Deficit financing, describing its anticipated composition.	Yes, in the annual budget report, Chapter 3
6. Macro-economic assumptions, including at least estimates of GDP growth, inflation, interest rates, and the exchange rate.	No. The annual budget report, Table 4.4, makes projections of GDP growth and inflation and gives a time series on the exchange rate, but not on interest rates
7. Debt stock, including details at least for the beginning of the current year (presented in accordance with GFS or other internationally recognized standard).	Yes, in Table 4.4
8. Financial assets, including details at least for the beginning of the current year (presented in accordance with GFS or other internationally recognized standard).	No
9. Summary information on fiscal risks (including contingent liabilities such as guarantees, and contingent obligations embedded in Public-Private Partnership (PPP) contracts, etc.)	Yes, in budget report Chapter 6
10. Explanation of budget implications of new policy initiatives and major new public investments, with estimates of the budgetary impact of all major revenue policy changes and/or major changes to expenditure programs.	Yes, in budget report Chapter 3
11. Documentation on the medium-term framework.	Yes, in budget report Chapter 4
12. Quantification of tax expenditures.	Yes, in DRC Annual Reports online at MoF website, and Chapter 4 of FY 2015-16 budget report, Table 4.3: Fiscal incentives.

**Dimension: Share of the above listed information in the executive's annual budget proposals for 2015/16 (in order to count in the assessment, the full specification of the information benchmark must be met).**

In the annual budget document for 2015/16, the following elements are included:

1. **Chapter 1:** Fiscal performance/operation in FY 2013/14.

In this chapter a comparative statement of approved budget with that of actual outcomes for the year is given in summary. Under each head, justifications are given for increase or decrease in expenditure. The amount of domestic and external resources mobilized during the fiscal year.

2. **Chapter 2:** Revised budget of FY 2014/15.

The detailed explanation for the revision of expenditure during the fiscal year is give here.

3. **Chapter 3:** Budget Estimates for FY 2015/16.

The proposal for FY 2015/16 is based on the macroeconomic projection of the Macroeconomic Framework Coordination Committee (MFCC). Accordingly budget ceiling is prepared and sent out to agencies for calling budget proposals. Thereafter agencies prepare their budgets and submit them to DNB online. The final output is the estimates for FY 2015/16 which were approved by the Parliament in June 2015. The chapter also includes budget estimate summary covering revenue and expenditure.

4. **Chapter 4:** Macroeconomic performance and outlook for FY 2015/16.

This chapter presents the macroeconomic performance and outlook for the medium term i.e. GDP growth, consumption and investment, inflation, employment fiscal framework projections

for past two years, current year and the two outer years, fiscal incentives, debt stock, balance of payment, etc. The chapter also includes the fiscal framework for the previous year (actual), current year (revised estimate), budget year and projections for two following years.

5. **Chapter 5:** Royal Monetary Authority

The role played by RMA as the central bank in the economy in regulating the commercial banks.

6. **Chapter 6:** State owned enterprises (see details online)

7. **Chapter 7:** Druk Holdings and Investments (see details online)

8. **Chapter 8:** National Pension and Provident Fund (see details online)

9. **Chapter 9:** Trust Funds (see details online)

10. **Chapter 10:** Hydropower Development in Bhutan (see details online)

These basic elements are complete set in the Government’s annual budget proposals to the Parliament. Besides the National Budget proposal document, a separate Supplementary Appropriation Bill and Budget Appropriation Bill are also submitted to the Parliament for endorsement.

The National Budget Reports are available on the Ministry of Finance website at [www.mof.gov.bt](http://www.mof.gov.bt). Budget documentation includes all four basic elements, and six out of eight of the additional elements.

Score	Minimum requirements
<b>5.1: Budget documentation</b>	
A	Budget documentation fulfills 10 elements, including every basic element (1-4).
B	Budget documentation fulfills 7 elements, including at least 3 basic elements (1-4).
C	Budget documentation fulfills at least 3 basic elements (1-4).
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for score
PI-5: Budget documentation.	A	Budget documentation includes all four basic elements, and six out of eight of the additional elements.

## PI-6: Central government operations outside financial reports

Ex-ante and ex-post fiscal reports to the legislature should cover all budgetary and extra-budgetary activities of central government to allow a complete picture of revenue and expenditures across all categories, as well as financing. This will be the case if extra-budgetary operations (central government activities which are not included in the annual budget law, such as those funded through trust funds, extra-budgetary funds and externally financed projects) are insignificant or if any significant expenditures on extra-budgetary activities are included in ex-ante and ex-post fiscal reports and reported to the legislature.

While having a large number of extra-budgetary or off-budget funds should be discouraged, there can be a case for the selective use of these funds, depending on the institutional and governance arrangements in the country. The use of off-budget funds should be accompanied by mechanisms that promote accountability and efficiency, i.e. be included in regular reports to the legislature. Without such controls, extra-budgetary funds can end up serving corrupt interests, weaken good governance and macro-fiscal stability.

### Dimension 6.1: Expenditure outside financial reports

This dimension assesses the magnitude of operations in FY 2014/15 that are not reported through the RGoB budget and reporting system, i.e. off-budget or off-account or both.

The Public Expenditure Management System (PEMS), which is the basis for budgeting, in-year reporting and annual financial reporting, covers the revenue and expenditure of all government budgetary bodies - constitutional bodies, autonomous bodies, the judiciary, ministries, dzongkhags, gewogs and thromdes. These are all counted as central government (see section 2.3 above). Externally financed projects are fully accounted in the Budget Reports and Annual Financial Statements.<sup>19</sup>

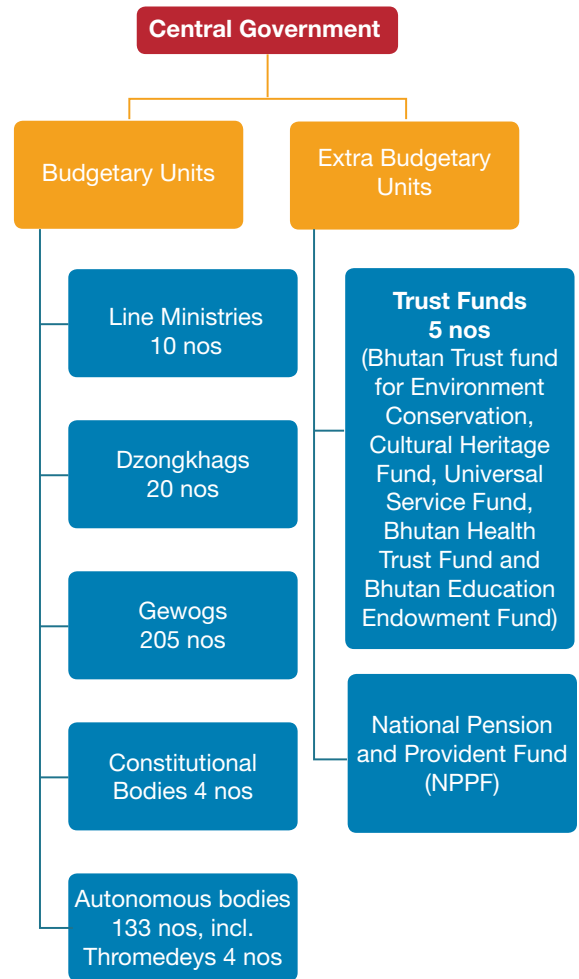
The diagram below shows the structure of central government.

The PEMS does not cover refundable deposits, which are not government money, nor the National Pension and Provident Fund, nor five trust funds.<sup>20</sup> The annual financial statements include a descriptive chapter on the NPPF, and a summary table showing trust fund income, expenditure and balances held, but no detailed statements of income or expenditure.

Nor does the PEMS cover the revenues and expenditures of public corporations, financial or non-financial, as these are outside the RGoB and have separate accountability arrangements. The annual financial statements include some information on the Royal Monetary Authority, but not its financial statements. Information on the performance of state-owned enterprises (SoEs) and linked companies are reported in the Budget Reports. The Budget Report for FY 2015/16 contains detailed write-ups and statistics on the financial performance of the SoEs. A new chapter is dedicated to financial reporting on the Druk Holding and Investments (DHI) in which Government holds more than 90% of the total equity.

The MOF has initiated a report on the hydro-power sector of Bhutan from the FY 2015/16. It reflects the background of the hydro-power projects, financial modalities and

#### BHUTAN – CENTRAL GOVERNMENT UNITS



*Extra Budgetary Unit or EBU is a unit within CG that receives revenue or incurs expenditure that is not in the National Budget or not in the Annual Financial Statements.*

19 As per AFS 2013/14, pp.7/8, grants received do not include certain scholarships provided by development partners, grants for the three HEP projects being constructed (Nu. 9360 million) and roads constructed under GOI project, Dantak (Nu. 825 million). These are not taken into account in scoring because these activities are being undertaken under inter-governmental special arrangements and entirely funded through the respective governments and development partners.

20 Bhutan Trust Fund for Environment Conservation, Cultural Heritage Fund, Universal Service Fund, Bhutan Health Trust Fund and Bhutan Education Endowment Fund (Budget for 2015/16, p.109). Their total income in FY 2014/15 was Nu. 95 million (0.3% of total revenue), and total expenditure Nu. 173 million (0.5% of total expenditure). The NPPF operating and management expenditure, pensions and Provident Fund refunds in 2014/15 was Nu. 716271 million (Annual Report), which was 2.10.8% of total expenditure., Current Deposit accounts are bank accounts operated by CG entities, not accounting units in themselves.



benefits, and the existing and future hydro-power projects. Project information on loan commitments, repayments and loan balances are provided in the AFS and National Budget Reports.

For FY 2014/15, NPPF expenditure was Nu. 716 million and the five Trust Funds had expenditure of Nu. 173 million. Together these extra-budgetary units had expenditure of Nu. 889 million, or 2.6% of total 2014/15 expenditure.

**Dimension 6.2: Revenue outside financial reports**

The main central government budget and accounts include the great majority of revenue. NPPF revenue in 2014/15 (all from investments) was Nu. 1,537 million, and the five Trust Funds had revenue of Nu. 95 million, total Nu. 1,632 million, or 4.5% of total revenue.

**Dimension 6.3: Financial reports of extra-budgetary units**

Extra-budgetary units (EBUs) in the central government of Bhutan appear to be the National Pension and Provident Fund, and the five trust funds mentioned above.

NPPF rules and regulations (sections 92-97) specify that: “The NPPF shall submit annually not later than October 31, a report covering the activities undertaken by the NPPF during the preceding year including information and recommendations on the broad policies for the development of the NPPF. The NPPF shall in each year prepare its annual accounts; namely the Revenue and Expenses Account and Fund Statement separately. The books of accounts and other documents shall be made available for inspection to the Royal Government or its authorized agents at any time during business hour on any working day within a reasonable time. The accounts of the NPPF shall be audited once a year and the correctness and fairness of its accounts and annual statements of financial condition and results of operations ascertained by auditor(s) appointed by the National Pension Board from the panel maintained by the Royal Audit Authority.” The annual reports of NPPF are submitted to the Government and the Parliament on an annual basis and key data are included in the National Budget Report (Chapter 8). The last submission was made for the FY 2013/14 in Budget Report for FY 2015/16, issued in May 2015.

Bhutan’s Trust Funds, all established by Royal Charters, have to submit activity and financial reports within six months of the end of the financial year. (e.g. Bhutan Trust Fund for Environmental Conservation Royal Charter, Section IX). Key data on the Trust Funds for FY 2014/15 are included in the National Budget Report for FY 2015/16 (Chapter 9). Taking the NPPF and Trust Funds together, there is no evidence that their detailed financial reports were submitted to government within nine months of the FY end.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>6.1: Expenditure outside financial reports</b>	
A	Expenditure outside government financial reports is less than 1% of total BCG expenditure.
B	Expenditure outside government financial reports is less than 5% of total BCG expenditure.
C	Expenditure outside government financial reports is less than 10% of total BCG expenditure.
D	Performance is less than required for a C score.
<b>6.2: Revenue outside financial reports</b>	
A	Revenue outside government financial reports is less than 1% of total BCG revenue.
B	Revenue outside government financial reports is less than 5% of total BCG revenue.
C	Revenue outside government financial reports is less than 10% of total BCG revenue.
D	Performance is less than required for a C score.



Score	Scoring Method M2 (AV). Minimum Requirements
<b>6.3: Financial reports of extra-budgetary units</b>	
A	Detailed financial reports of <b>all</b> extra-budgetary units are submitted to government annually within three months of the end of the fiscal year.
B	Detailed financial reports of <b>most</b> extra-budgetary units are submitted to government annually within six months of the end of the fiscal year.
C	Detailed financial reports of the <b>majority</b> of extra-budgetary units are submitted to government annually within nine months of the end of the fiscal year.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for score
PI-6: Central government operations outside financial reports.	C+	M2 method of combining dimension scores
6.1: Expenditure outside financial reports.	B	Expenditure outside government financial reports is less than 5% of total BCG expenditure.
6.2: Revenue outside financial reports.	B	Revenue outside government financial reports is less than 5% of total BCG revenue.
6.3: Financial reports of extra-budgetary units.	D	Financial reports of the NPPF and Trust Funds are submitted to the Government annually and key data are included in the National Budget Report, but not within 9 months of the end of the year.

## PI-7 Transfers to sub national governments

Sub National Government (SNG) in many countries has wide-ranging expenditure responsibilities. Decentralized governance arrangements give rise to a set of intergovernmental financial relations between levels of government including key issues related to the transfer and distribution of funds from central government to SNG, the timeliness and accuracy of information on funds to be transferred, the requirements for reporting from SNG to central government and the risk exposure of central government to SNG operations. By contrast, funding provided to deconcentrated units of central government is not within the scope of this indicator.

In Bhutan, specific laws determine the role and functions of local government, their expenditure responsibilities and arrangements for revenue sharing. In section 2.3 above it is shown that local governments in Bhutan – dzongkhags, gewogs and thromdes, though they have locally elected councils, do not at present meet the criteria of autonomy from central government and are effectively deconcentrated units of central government. This indicator is not strictly applicable. However, for information, it is assessed as though local governments were SNGs. A detailed discussion on financial management in LGs is placed as Annex 5.

Dimension (i) assesses the transparency and objectivity in the horizontal allocation among the first tier of SNGs (dzongkhags). Transfers to support SNG expenditure can be made in the form of unconditional grants, where their final use is determined by the SNG through their budgets, or through conditional (earmarked) grants to SNG to implement selected service delivery and expenditure responsibilities e.g. by function or program, typically in accordance with an agreed regulatory/policy standard. The overall level of grants (i.e. the vertical allocation) is determined by policy decisions at the central government's discretion or as part of constitutional negotiation processes, and is not assessed by this indicator. However, clear criteria, such as formulas, for the distribution of grants among SNG entities

(i.e. the horizontal allocation of funds) are needed to ensure allocative transparency and medium-term predictability of funds available for planning and budgeting of expenditure programs by SNG. All fiscal transfers from central government directly to local governments are taken into consideration.

Dimension (ii) assesses the timeliness of providing information to dzongkhags on their allocations. It is crucial for them to receive firm and reliable information on annual allocations from central government well in advance of the completion (preferably before commencement) of their own budget preparation processes. Information on transfers to SNG budgets should be regulated by the central government's annual budget calendar, which should provide for reliable indications of allocations early in the cycle.

### ***Dimension 7.1: System for allocating transfers***

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

“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 socioeconomic development”.

The PFA 2007 and amended PFA 2012 require 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.”

Under the 11th FYP, which began in FY 2013/14, the RGoB has initiated the following formula-based fiscal transfer allocation for annual grants:

**1. Population:** The population factor is 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, 35% weightage is assigned for population. Local governments administering larger populations receive higher shares of resources.

**2. Poverty:** Poverty criteria used in the 10th FYP have been replaced by a multidimensional poverty index with a weight of 45%.

**3. Geographical area:** The geographical size or area is also a determining factor for resource allocation with 10% of the resources devoted to it. Data for these criteria is sourced from the National Land Commission.

**4. Transport cost:** a new criterion introduced in the 11th FYP is a transport cost index with a weight of 10%. This is included to allow for the higher cost of investments in interior and remote dzongkhags/gewogs that face higher transportation costs.

The formula-based allocation does not apply to class A thromdes. The resource allocations to class A thromdes are based on needs due to the diversity and complexity of their social, economic and environmental issues. Capital budget allocation are based on differences in the level of economic development, particularly with regard to infrastructure, economic opportunities, landscape and social factors amongst the thromdes, which are considered the main players in deciding the amount of resource allocation.

The allocation of current budget is done in a way of filling marginal gaps between the fund balance available with the Thromdes as per the bank statement provided, the amount of projected revenue collection and the fund requirement considering the past expenditure trends. This grant is given to meet the current expenditure of the Thromdes. However, the allocation of capital budget is done based on the five year plan outlays determined by the Gross National Happiness Commission (GNHC) and the annual budget allocation is done by the Department of National Budget (DNB) through an annual ceiling based on the resource envelope determined by the Macroeconomic Fiscal framework Coordination Committee (MFCC) with the concurrence of the Cabinet. Based on the ceilings provided the Thromdes prioritize the capital activities that are reflected in the Five Year Plan. As such funding for the Thromdes is also predictable as it is based on the plan outlay and annual budget ceiling. In the Eleventh Five Year Plan total capital grants to Class ‘A’ Thromdes was to the tune of Nu. 5 billion. Out of this Nu. 2 billion was earmarked for Thimphu as it is the capital city and owing to large population and area. Remaining Thromdes (i.e. Phuentsholing, Gelephu and Samdrup Jongkhar) were allocated Nu.1 billion each.

The Royal Government is very much concerned about the need to develop a proper formula for the resource allocation to the Thromdes. A project is being undertaken in developing a formula based resource allocation to the class A Thromdes funded by the World Bank. It is named as the “Intergovernmental fiscal systems and capacity building”. The main component of the project is to design and implement a Principle Based Framework for grants to urban local governments (Class ‘A’ Thromdes). Table 3.2.7.1 shows the Resource allocation to four Thromdes excluding lending and repayment.

**TABLE 3.2.7.1: RESOURCE ALLOCATION TO FOUR THROMDES EXCLUDING LENDING AND REPAYMENT**

Nu. in millions

Sl. No.	Fiscal Year	Total sector Allocation	Allocation to Thromdes	Percentage
1	FY 2013-14	38,215.04	619.783	2%
2	FY 2014-15	41,356.03	661.118	2%
3	FY 2015-16	49,739.34	689.639	1%

### *Dimension 7.2: Timeliness of information on transfers*

LGs are part of the central government budgets and the budget is prepared line-item wise for each LG. The Budget Call Circular (generally issued in January every year) indicates the overall allocation to each LG in terms of percent of the FYP and this facilitates them to plan their activities and prepare their own budgets (see also PI-17). The Budget Cycle starts on July 1st and ends on June 30th. Budget preparation begins with the Budget Call Circular containing resource allocations issued in December/ January to all budgetary units including local governments. By end of February, the budget proposals are received. Thereafter the proposals are reviewed, discussed and finalized by the Ministry of Finance, endorsed by the Cabinet and submitted to the Parliament.

Financial Year	Date of submission of budget to Parliament	Date of approval of budget by Parliament
FY 2014-15	06/06/2014	09/07/2014
FY 2015-16	25/05/2015	25/06/2015

Score	Scoring Method M2 (AV). Minimum Requirements
<b>7.1: System for allocating transfers</b>	
A	The horizontal allocation of <b>all</b> transfers from central government is determined by transparent and rules based systems.
B	The horizontal allocation of <b>most</b> transfers from central government is determined by transparent and rules based systems.
C	The horizontal allocation of <b>some</b> transfers from central government is determined by transparent and rules based systems.
D	Performance is less than required for a C score.
<b>7.2: Timeliness of information on transfers</b>	
A	The process by which SNGs receive information on their annual transfers is managed through the regular budget calendar, which is generally adhered to and provides clear and sufficiently detailed information for SNGs to allow at least six weeks to complete their budget planning on time.
B	The process by which SNGs receive information on their annual transfers is managed through the regular budget calendar, which provides clear and sufficiently detailed information for SNGs to allow at least four weeks to complete their budget planning on time.
C	Substantial delays may be experienced in implementation of the budget procedures. Information on annual transfers to SNGs is issued before the start of the SNG fiscal year which could be after budget plans are decided.
D	Performance is less than required for a C score.

Not scored as the indicator is not applicable.

## PI-8: Performance information for service delivery

This indicator examines the service delivery performance information in the executive's budget proposal or its supporting documentation, in year-end reports, and in audit reports or performance evaluation reports. It also measures the extent to which service delivery units receive and spend resources allocated in the budget. It contains four dimensions and uses the M2 (AV) method for aggregating dimension scores.

### *Dimension 8.1: Performance plans for service delivery*

The Government has recently (2013) initiated a Government Performance Management System (GPMS), which is managed by the Government Performance Management Division (GPMD), established in March 2015, in the Office of the Prime Minister. With this GPMS, heads of ministries, autonomous agencies (six) and dzongkhags are required to sign Annual Performance Agreements (APAs) with the Prime Minister. Responsibility and accountability for achieving the targets in each APA are devolved to lower levels within the respective ministry or agency<sup>21</sup>. In all, ten ministries, six autonomous agencies and 20 dzongkhags have signed APAs for financial year 2014/15 (being the first year of implementing GPMS) and also for 2015/16. The signing of the APAs is covered by the media.

<sup>21</sup> E.g. in case of Ministries, APA is signed between the Minister and Secretary; between the Secretary and Directors; and between the Directors and Division Heads which is captured in PEMS.

The institutional framework, processes and systems for APA are documented in the “*Guidelines for Preparation, Monitoring and Evaluation of Annual Performance Agreement*” (draft)<sup>22</sup>. Each budgetary unit prepares its individual APA. The Guidelines define the method of preparation and the formats, the process of approval, monitoring and evaluation and timelines. Methodological guidance is provided by the GPMD and all agencies have a focal point for GPMS who is trained on the methodology. The APA consists of objectives, activities, performance targets and indicators which a ministry/agency plans to undertake and achieve during the forthcoming fiscal year. These activities are presently drawn from the 11th Five Year Plan (FYP) which is linked with Sectoral Key Result Areas (SKRA) and National Key Result Areas (NKRA). For the preparation of APAs, the GPMS is used. This system is linked with PlAMS (Planning and Monitoring System of GNHC). When preparing an APA in GPMS, every activity is tagged to NKRA and SKRA of the FYP. This is enabled by the linkage between the GPMS and PlAMS.

It is mandated that targets should be within the resource envelope notified by MoF in the Budget Call Circular. APA preparation starts before budget preparation (in December). The targets are set for the medium term period - for the budget year and next two years. This ensures that the budget proposals of the ministry/agency and the APA are aligned. The MoF also takes into account the APA of an agency in order to align the activities. The budget for 2015/16 was the first budget prepared based on APAs. The Budget Call Notification for that year mandated as follows: *While submitting the budget proposals, the budgetary agencies shall provide a narrative policy statement highlighting the program targets/outputs at the Ministry/Sector level in order to deepen the linkages between the proposed budget and targets to be achieved as per the APA*”.

RGoB has introduced a system of key performance targets in a pre-defined format to bring clarity in what is being measured (i.e. the outputs) and the methodology for measurement for all key service delivery functions. While clear linkages exist between the budget and the forecast targets for the budget year, the targets are presently not part of budget documentation. Links to the APAs are provided on the websites of RGoB, but these are not active; hence, APAs are not effectively available to public. Few agencies have hosted the APAs on their individual websites.

### ***Dimension 8.2: Performance achieved for service delivery***

The GPMS Guidelines prescribe a system of midyear review and a year-end evaluation and assessment process. For midyear review, a Sector level Technical Committee has been instituted. The year-end evaluation is a combination of self-assessment and evaluation by the STC and a National Technical Committee. A system of Composite Score has been prescribed (sum of the products of percent achievement and weight of each indicator) reflecting the degree to which the agency has been able to achieve its planned targets. The assessment/evaluation is on the same indicators as incorporated in the signed APAs because the final progress report on the APA is expected to explain any gap or discrepancy between targets and actual outputs. The results of the evaluation and the recommendations of the STC/NTC will be considered for the next set of APAs.

The actual results are provided in the APAs for the following year. For instance, in the APAs for 2015/16, actual results have been provided for 2014/15 in the same format as the targets for all service delivery functions. Links to the APAs are provided on the websites of RGoB, but these are not active; hence, APAs are not effectively available to public. Few agencies have hosted the APAs on their individual websites.

<sup>22</sup> Based on experience, GPMD will revise the draft guideline which are expected to be finalized by July 2016.

### *Dimension 8.3: Resources received by service delivery units*

Nearly all resources of budgetary units are routed through the budget and withdrawals are subject to the authorization and appropriation rules and procedures. Frontline units such as primary schools and health centers are within the budgets of the gewogs that are part of the national budget. There are various systems by which RGoB can monitor the resources received by the Service Delivery Units (SDU). These systems are PlaMS (Planning and Monitoring System of Gross National Happiness Commission), MYRB (Multi Year Rolling Budget System), PEMS (Public Expenditure Management System) and GPMS (Government Performance Management System). All these systems are interlinked and source data from each other. These systems and their inter-linkages ensure that the resources allocated are used by and for the SDUs. The Department of Public Accounts monitors the expenditure through PEMS where the agencies book their expenditure against their budgets per the MYRB. The Department of National Budget monitors the budget through MYRB by using the expenditure figures from PEMS. Budget is allocated at the level of SDUs.

### *Dimension 8.4: Performance evaluation for service delivery*

GPMD of the Office of Prime Minister is in charge of performance evaluation of all government agencies, but this aspect of the GPMS is yet to be operational. Internal Audit Service is restricted to risk management, control mechanism and governance. The SAI (Royal Audit Authority) is mandated by the Constitution to assess economy, efficiency and effectiveness in the use of public resources. As such it carries out performance audits within the government structure and presently it is the only agency conducting performance evaluations.

Performance audits undertaken by RAA in the last three years include:

1. Performance audit on Mining
2. Performance audit on LPG and SQL
3. Performance Audit on Constitutional Development Grant
4. Performance audit on Energy

Most performance audits on service sectors like health, education and others were carried out before the past three years.

All performance audits include recommendations. The recommendations are developed through a study of best international practices, and adapted to ensure that they are implementable and practical in the Bhutanese environment. Agencies are provided specific recommendations to be implemented. They are required to submit Action Taken Reports on the recommendations.

### *Ongoing and planned reforms*

The last assessment in 2010 was based on reliable information provided by Budget and Accounting System (BAS). Since then, BAS was replaced with MYRB and PEMS systems. These systems are interlinked and also linked with PlaMS (the GNHC planning system) to establish better alignment of planning and budgeting. Recently, all these systems have been linked with GPMS to ensure that resources are spent for intended purposes and deliver the target outputs and outcomes. This will further improve the performance on this indicator.



Score	Scoring Method M2 (AV). Minimum Requirements
<b>8.1: Performance plans for service delivery</b>	
A	Information is published annually on policy or program objectives, key performance indicators, outputs to be produced and the outcomes planned for <b>most</b> ministries, disaggregated by program or function.
B	Information is published annually on policy or program objectives, key performance indicators, outputs to be produced or the outcomes planned for <b>most</b> ministries.
C	Information is published annually on the activities to be performed under the policies or programs for the <b>majority</b> of ministries OR a framework of performance indicators relating to the outputs or outcomes of the <b>majority</b> of ministries is in place.
D	Performance is less than required for a C score.
<b>8.2: Performance achieved for service delivery</b>	
A	Information is published annually on the quantity of outputs produced and outcomes achieved for <b>most</b> ministries disaggregated by program or function.
B	Information is published annually on the quantity of outputs produced or outcomes achieved for <b>most</b> ministries.
C	Information is published annually on performance achieved in terms of activities performed for the <b>majority</b> of ministries.
D	Performance is less than required for a C score.
<b>Dimension 8.3: Resources received by service delivery units</b>	
A	Information on resources received by front-line service delivery units is collected and recorded for at least two large ministries, disaggregated by source of funds. A report which compiles the information is prepared at least annually.
B	Information on resources received by front-line service delivery units is collected and recorded for at least one large ministry. A report which compiles the information is prepared at least annually.
C	A survey carried out in one of the last three years provides estimates of the resources received by service delivery units for at least one large ministry.
D	Performance is less than required for a C score.
<b>8.4: Performance evaluation for service delivery</b>	
A	Independent evaluations of the efficiency and effectiveness of service delivery have been carried out and published for <b>most</b> ministries at least once within the last three years.
B	Evaluations of the efficiency and effectiveness of service delivery have been carried out and published for the <b>majority</b> of ministries at least once within the last three years.
C	Evaluations of the efficiency or effectiveness of service delivery have been carried out for <b>some</b> ministries at least once within the last three years.
D	Performance is less than required for a C score.

Indicator/dimension	Score	Brief justification for score
<b>PI-8: Performance information for service delivery</b>	<b>D+</b>	<b>M2 method of combining dimension scores</b>
8.1: Performance plans for service delivery.	C	Information on policy or program objectives, KPIs and outputs to be produced are contained in the APAs prepared for all ministries and dzongkhags and some autonomous bodies. The APAs are on the website of the GPMS but the links are not active, so they are not effectively published. A few agencies include their APAs on their own websites.
8.2: Performance achieved for service delivery.	D	Information on quantities of outputs is included in the APAs for the following year for all ministries and dzongkhags and some autonomous bodies. The APAs are on the website of the GPMS but the links are not active, so they are not effectively published. A few agencies include information on actual APA results on their own websites.



Indicator/dimension	Score	Brief Justification for Score
8.3: Resources received by service delivery units.	C	Information on resources received by front-line delivery units is collected and recorded for all ministries and dzongkhags. However, a report compiling the information is not prepared.
8.4: Performance evaluation of service delivery.	D	Evaluations of the efficiency and effectiveness of service delivery have been carried out for a few ministries in the last three years.

## PI-9: Public access to key fiscal information

This indicator assesses the comprehensiveness of fiscal information available to the public. There is one dimension for this indicator, divided into 9 elements of information as listed below in Table 3.2.9.1:

**TABLE 3.2.9.1: ASSESSMENT OF COMPREHENSIVENESS OF FISCAL INFORMATION AVAILABLE TO THE PUBLIC**

Basic elements	Public access
<b>1. Annual executive budget proposal documentation:</b> A complete set of executive budget proposal documents (as presented by the country in PI-5) is available to the public within one week of the executive submitting them to the legislature.	<b>No.</b> When the Finance Minister presents the budget to Parliament, there is live media coverage (TV and radio) and it is also covered by the print media for the general public, but the complete budget proposal (National Budget Report) is not available to the public within one week after it is submitted to Parliament.
<b>2. Enacted budget:</b> The annual budget law approved by the legislature is publicized within two weeks of passage of the law.	<b>Yes.</b> The annual National Budget report submitted to the Parliament is made publicly available ahead of approval of the Parliament. With the approval of the Parliament, this report is considered to be the enacted budget. For FY15/16, while the budget was approved on 19 June 2015, it was made available on the website in May, 2015.
<b>3. In-year budget execution reports:</b> The reports are routinely made available to the public within one month of their issuance, as assessed in PI-27.	<b>No.</b> The Department of National Budget issues a quarterly Budget Situation Report. This is made available only for official purposes to monitor the performance of respective sectors.
<b>4. Annual budget execution report:</b> The report is made available to the public within six months of the year end.	<b>No.</b> The annual Budget Report includes a revision of the original estimates before the year end, but there is no annual budget execution report showing actual revenue and expenditure.
<b>5. Audited annual financial report, incorporating or accompanied by the external auditor's report:</b> The report(s) are made available to the public within twelve months of the year end.	<b>Yes.</b> Audited annual financial report which is called Annual Financial Statement (AFS) is also presented to the Parliament and publicly made available in the website of the Ministry of Finance ( <a href="http://www.mof.gov.bt">www.mof.gov.bt</a> ) within twelve months of the year end.
<b>Additional elements</b>	
<b>6. Pre-budget statement:</b> The broad parameters for the executive budget proposal regarding expenditure, planned revenue and debt is made available to the public at least four months before the start of the fiscal year.	<b>No.</b> The Budget Call Circular is made available to the public six months before the start of the new fiscal year and is available on MoF's website, but does not constitute a pre-budget statement as it does not include the broad parameters regarding expenditure, revenue and debt.
<b>7. Other external audit reports:</b> All non-confidential reports on central government consolidated operations are made available to the public within six months of submission.	<b>Yes.</b> The Annual Audit Report is published by the Royal Audit Authority on their website ( <a href="http://www.raa.gov.bt">www.raa.gov.bt</a> and <a href="http://www.bhutanaudit.gov.bt">www.bhutanaudit.gov.bt</a> ) within six months of submission.

Basic elements	Public access
<b>8. Summary of the budget proposal:</b> A clear, simple summary of the Executive’s Budget Proposal or the Enacted Budget accessible to the non-budget experts, often referred to as a ‘citizen’s budget’, and where appropriate translated into the most commonly spoken local language, is publicly available within two weeks of the Executive Budget Proposal being submitted to the legislature and within one month of the budget’s approval respectively.	<b>Yes.</b> Summary of the budget proposal is included in the annual National Budget Report, which is made available to the public in both Dzongkha and English languages.
<b>9. Macroeconomic forecasts:</b> As assessed in PI-14.1, is available within one week of its endorsement.	<b>Yes.</b> The Annual Budget Report includes macroeconomic forecasts underlying the budget estimates.

The Government publishes two out of the five basic elements and three out of four of the additional elements.

Score	Minimum requirements
<b>9.1: Public access to fiscal information</b>	
A	The government makes available to the public in accordance with the specified time frames 8 elements, including every basic element.
B	The government makes available to the public in accordance with the specified time frames 6 elements, including at least 4 basic elements.
C	The government makes available to the public 4 basic elements.
D	Performance is less than required for a C score.

Indicator/dimension	Score	Brief justification for score
PI-9: Public access to fiscal information.	D	Two of the four basic elements are made available to the public.

### 3.3 Pillar III – Management of assets and liabilities (Performance indicators 10 to 13)

#### PI-10: Fiscal risk management

This indicator measures the extent to which fiscal risks to central government are reported. Fiscal risks can arise from adverse macro-economic situations, financial positions of Sub-National Governments (SNG), public corporations, and contingent liabilities from central government’s own programs and activities, including extra-budgetary units. They can also arise from other implicit and external risks such as market failure and natural disasters. The indicator contains three dimensions and uses the M2 (AV) method for aggregating dimension scores.

#### *Dimension 10.1: Monitoring of public corporations*

A Public Enterprise (PE) is either a *Government Company* (with 100% shareholding) or *Government Controlled Company* (with more than 50% shareholding) as defined in the Companies Act of

Bhutan 2000. There are nine public corporations (public enterprises - PEs). One of the major public enterprises is Druk Holding and Investments Ltd, which has holdings in 20 other companies.

PEs have become one of the major sources of revenue for the Government and they contributed more than 41% of the total domestic revenue in 2014. PEs are required to submit their annual financial statements to the MoF. The financial year for all PEs in Bhutan is the calendar year ending December 31. The annual report has to be filed with the Registrar of Companies by May 31 in case of listed companies and by July 31 in the case of unlisted companies. They are monitored by the Public Enterprise Division (PED) in the MoF and PED is in charge of consolidating reports and information sent by PEs. As per the Public Finance Act of Bhutan 2007, they are required to prepare an annual report including the audited financial statements in accordance to the provisions of the Companies Act of Bhutan 2000. The monitoring of PEs is done as per Schedule 14 (ii) 'Minimum audit examination and reporting requirement' under the Companies Act of Bhutan 2000. These are reported by statutory auditors on an annual basis. The Public Finance Act also requires the Finance Minister to present the annual reports of PEs to the Parliament as a whole.

All PEs publish their audited annual financial statements within six months from the end of the year which are included in their Annual Reports. Their annual financial results (assets, reserves and net worth and revenue, expenses and profitability) are consolidated and included in the Annual Budget Report (Annexure 6 and 7), which the Finance Minister presents to the Parliament.

### *Dimension 10.2: Monitoring of sub-national governments*

Dzongkhags, gewogs and thromdes are considered as local governments in Bhutan. However, for purpose of PEFA assessment, these bodies could not be considered as Sub-National Government (SNG) since these do not meet the definition of SNG recognized by PEFA, which is based on Government Financial Statistics 2001<sup>23</sup>. These bodies are more in the nature of de-concentrated units of the central government. The officers of these bodies are appointed by the Royal Civil Service Commission (RCSC) and they are financed directly from the central government budget. Hence, for the PEFA assessment, no separate level of SNG has been recognized.

The central government (MoF) monitors the whole government's fiscal position, which includes that of the local governments and presents it in the annual budget report.

### *Dimension 10.3: Contingent liabilities and other fiscal risks*

The Public Finance Act of Bhutan (section 132) empowers the Minister of Finance to provide a guarantee or indemnity in respect of the performance of budgetary body, state enterprise or organization. There are no contingent liabilities of budgetary bodies and organizations. Contingent liabilities of public enterprises are monitored by the Public Enterprise Division and Debt Management Division in the MoF.

#### **The Department of Public Accounts in the Ministry of Finance consolidates and reports contingent liabilities in detail in the Annual Financial Statements of the Government (AFS 2013/14, Table 25).**

There are no contingent liabilities pertaining to government programs. However, for the contingent liabilities of public enterprises, the risks are assessed and reported. There are also no implicit contingent liabilities on account of pension or legal action against RGoB or those arising from PPPs. Table 3.3.10.1 shows the Identified explicit contingent liabilities as at 30 June 2014.

<sup>23</sup> Supplementary Guidelines for the application of the PEFA framework to Sub-national governments, (January 2013) PEFA Secretariat.

**TABLE 3.3.10.1: IDENTIFIED EXPLICIT CONTINGENT LIABILITIES AS AT 30 JUNE 2014**

Entity/program/project	Risk description and analysis	Estimated amount	How reported
Public Enterprises	Government guarantees	Nu. 974.7 m at 30 June 2014	Detailed in the Annual Financial Statements and also the Budget Report
	Share of exposure of RGoB to PE debt	Nu.26,270.678 million for fiscal year 2013/14	Companies report to PED, MoF. However, from FY 2015/16, they are reported in the Budget Report

Source: AFS RGoB.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>10.1: Monitoring of public corporations</b>	
A	Audited annual financial statements for <b>all</b> public corporations are published within six months of the end of the fiscal year. A consolidated report on the financial performance of the public corporations sector is published by central government annually.
B	Audited annual financial statements are published for <b>most</b> public corporations within six months of the end of the fiscal year.
C	Government receives financial reports from <b>most</b> public corporations within nine months of the end of the fiscal year.
D	Performance is less than required for a C score.
<b>10.2: Monitoring of Sub-National Government (SNG)</b>	
A	Audited annual financial statements for <b>all</b> SNGs are published within nine months of the end of the fiscal year. A consolidated report on the financial position of <b>all</b> SNGs is published at least annually.
B	Audited annual financial statements for <b>most</b> SNGs entities are published at least annually within nine months of the end of the fiscal year.
C	Unaudited reports on the financial position and performance of the <b>majority</b> of SNGs are published at least annually within nine months of the end of the fiscal year.
D	Performance is less than required for a C score.
<b>10.3: Contingent liabilities and other fiscal risks</b>	
A	A report is published by central government annually that quantifies and consolidates information on <b>all</b> significant contingent liabilities and other fiscal risks of central government.
B	Central government entities and agencies quantify <b>most</b> significant contingent liabilities in their financial reports.
C	Central government entities and agencies quantify <b>some</b> significant contingent liabilities in their financial reports.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for score
<b>PI-10: Fiscal risk reporting</b>	<b>A</b>	<b>M2 method of combining dimension scores</b>
10.1: Monitoring of public corporations.	A	Audited annual financial statements are published for all PEs within six months from the close of the financial year and their financial performance is consolidated.
10.2: Monitoring of sub-national governments.	Not applicable	A separate level of SNG has not been recognized for PEFA assessment.
10.3: Contingent liabilities and other fiscal risks.	A	All significant contingent liabilities and other fiscal risks are reported in the annual financial statements of RGoB.

## Ongoing and planned reforms

A Public Debt Policy document has been drafted and submitted for Government approval. This is expected to improve performance on this indicator. Guidelines to clearly define responsibilities for monitoring liabilities against quantitative thresholds are included in the draft Debt Management Policy, which is currently under consideration.

## PI-11: Public investment management

This indicator assesses the economic appraisal, selection, costing, and monitoring of public investment projects by the government, with emphasis on the largest and most significant projects (i.e. major investment projects)<sup>24</sup>. The indicator is assessed through four dimensions and uses M2(AV) method for aggregating the scores.

Capital expenditure as per the Financial Rules and Regulations derived from the Public Finance Act are investments which have future returns. It includes acquisition of goods and services, the benefits of which extend beyond the fiscal year and which add to the assets of the Government. Examples are acquisition of land and buildings, land improvements, buildings and structures, plants, equipment and tools, vehicles, etc. (*Budget Manual*). Capital expenditure includes all investment projects such as construction of roads, bridges, power projects, schools, hospitals, etc, whether big or small.

### Dimension 11.1: Economic analysis of investment proposals

Public investment management function is decentralized in Bhutan and feasibility studies of projects are undertaken at the level of each line ministry/agency. There are guidelines for specific projects such as construction of roads, farm roads, schools, hospitals, hydropower plants, etc. which are issued by the concerned agencies. These guidelines require social and economic impact assessments including health and environmental assessments. Projects have to obtain clearances from relevant agencies in order to be implemented. For example, projects are required to get environmental clearance from the National Environment Commission. All proposals are submitted to the Ministry of Finance and Gross National Happiness Commission (GNHC) for their endorsements. GNHC has a project screening tool comprising of 9 domains, but does not include economic analysis. Appraisal of proposals is primarily done from viewpoint of social and environment aspects.

Major investment projects approved during 2014/15 are shown in Table 11.1.1<sup>25</sup>. Some of the development partners, conduct economic analysis in accordance with their own methodology in which case the analysis is published. Economic analysis was conducted for projects at serial number 12 and 13 in table next page.

24 For the purpose of this indicator, “major investment projects” are defined as projects meeting the following criteria:

- The total investment cost of the project amounts to 1% or more of total annual budget expenditure; and
- The project is among the largest 10 projects (by total investment cost) for each of the 5 largest central government units, measured by the units’ investment project expenditure. The indicator was assessed using a sample of such projects.

25 Economic analysis frequently involves application of specific techniques such as cost-benefit analysis, cost-effectiveness analysis and multi-criteria analysis.

**TABLE 11.1.1: MAJOR INVESTMENT PROJECTS APPROVED DURING 2014/15**

Sl. No.	Project description	Project cost (Nu. in million)
1	School Reform Program	3,487.20
2	Black topping of Gewog Connectivity (GC) roads in 20 Dzongkhags (486 km)	1,400.93
3	Upgradation of Yadi-Lingmethang Highway (138 km)	1,018.60
4	Upgradation of Trongsa-Nangar Highway (55 km)	789.54
5	Upgradation of Simtokha-Wangdue Highway (65 km)	764.22
6	Upgradation of Wangdue-Chuserbu Highway (82 km)	693.64
7	Upgradation/improvement of Trongsa-Chuserbu Highway (45 km)	683.21
8	Urban Water Supply System	600.00
9	Infrastructure development under various colleges, RUB	494.61
10	Urban infrastructure Development projects at Kanglung, Nganglam & Bumthang	400.00
11	Enhancing Rural Livelihoods through enterprise based livestock production in Bhutan	378.00
12	Bhutan Road Connectivity Project	4,140.00
13	Bhutan 2nd Green Power Project	8,361.00
	<b>Total</b>	<b>23,211.53</b>

**Source:** Information from DNB and ADB website for project cost in case of projects at serial 12 and 13 above.

### *Dimension 11.2: Investment project selection*

Overall development in Bhutan is guided by the Economic Development Policy (the last policy was issued in 2010) that sets the agenda and general direction for the development of sectors that have the highest potential. Decisions on major investment projects are taken by the Government through the Cabinet. All proposals are submitted to the Ministry of Finance and Gross National Happiness Commission (GNHC) for their endorsements. The key basis of prioritization of investment projects is the social mandate of the government, availability of resources (RGoB or donor), whether there are future returns, etc. GNHC has a policy screening tool for prioritizing projects and programs while approving proposals - this comprises 22 variables across 9 domains culminating in a consolidated GNH score. Proposals are approved by the Department of National Budget and the GNHC on the basis of standard criteria for project selection, which are published.

During annual budget preparation, agencies are required to include projects in their proposals only if they are in line with the five-year plan and with the annual performance agreements, with priority given to spillover and ongoing activities. They are then entered in the Multi-Year Rolling Budget (MYRB) system. Projects are considered when they are ready to be implemented after completion of all preparatory works including drawing, design and estimate, and after obtaining various clearances. Guidelines are provided in the budget call circular. Proposals are submitted to the Government for final approval and only approved projects are incorporated in the budget. All decisions on investment projects and the prioritizing of projects are based on the feasibility studies and GNH score.

### *Dimension 11.3: Investment project costing*

All investment projects have to be included in the Five Year Plan of the concerned ministries. The investment projects are managed by the concerned ministries with regular consultations with Ministry of Finance and GNHC.



The Public Finance Act requires the submission of the Budget Policy and Fiscal Framework Statement to Parliament showing the priorities of the Government to guide the annual budget and the medium term budget. All multi-year investment projects have a multi-year budgeting plan. Agencies must indicate in their budget proposals if there are any multiyear projects.

The concerned ministries have to prepare detailed documents for each major investment project for the purpose of budgeting which are submitted to the Department of National Budget in the Ministry of Finance. Feasibility study cost estimates are used for budget planning, but estimates of recurrent costs are not included.

Capital costs are included in the forthcoming budget year for those projects that are funded by RGoB, and through external assistance only if agreements have been signed and fund release is confirmed, and major projects are individually listed in the Budget Report as and when funds release for externally funded projects are known, these are included in the in-year budget changes and finally included in the supplementary budget, presented to Parliament in June medium term projections on major investment projects on full cost basis over life is presently not included in the budget documents.

#### ***Dimension 11.4: Investment project monitoring***

The Budget Manual specifies that the goal of the monitoring shall be to check if the physical progress of capital expenditures is in compliance with the reports received from the project managers and Heads of Agencies and monitoring shall be done as a combination of analysis of reports and actual site visits.

Project monitoring is carried out by the Project Steering Committees (PSC) in the agencies concerned to assess the progress of each activity. Independent monitoring is also carried out by the Ministry of Finance and the GNHC. The agencies are required to submit quarterly financial and physical progress reports to the Ministry of Finance. Site visits are also undertaken to monitor the projects. The concerned agencies, MoF and GNHC maintain records on the financial and physical progress of every project.

After every inspection visit to the project sites, the team prepares a progress report. This report is submitted to the higher authority. If there are any major implementation issues, appropriate actions are implemented for the project. While monitoring, any deviations are clearly identified and explained in the reports.

Pursuant to a recent directive from the Government, a focal officer is identified in each ministry to monitor implementation of donor funded projects and update progress. The implementation of these investment projects/programs are linked to the objectives of the Annual Performance Agreements. These focal persons serve as a member of the PSC of the projects as seen from the above mention projects. Auditing of the project is carried out by the Royal Audit Authority and concerned agencies including MoF and GNHC are provided with their findings and recommendations. External funding forms a significant part of financing of capital expenditure. The development partners also undertake extensive monitoring missions of the capital investments financed by them jointly with the implementing units.

Financial and physical progress of major investment projects is monitored at the level of the departments through Project Steering Committees and centrally by MoF and GNHC and the standard procedures are complied with. Information on implementation of such projects is prepared after each monitoring visit and otherwise, but these are not published.



Score	Minimum requirements for scores
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### 11.1: Economic analysis of investment proposals

- A Economic analyses are conducted, as established in national guidelines, to assess **all** major investment projects and the results are published. The analyses are reviewed by an entity other than the sponsoring entity.
- B Economic analyses are conducted, as established in national guidelines, to assess **most** major investment projects, and **some** results are published. The analyses are reviewed by an entity other than the sponsoring entity.
- C Economic analyses are conducted to assess **some** major investment projects.
- D Performance is less than required for a C score.

### 11.2: Investment project selection

- A Prior to their inclusion in the budget, **all** major investment projects are prioritized by a central entity on the basis of published standard criteria for project selection.
- B Prior to their inclusion in the budget, **most** major investment projects are prioritized by a central entity on the basis of standard criteria for project selection.
- C Prior to their inclusion in the budget, **some** of the major investment projects are prioritized by a central entity.
- D Performance is less than required for a C score.

### 11.3: Investment project costing

- A Projections of the total life-cycle cost of major investment projects, including both capital and recurrent costs together with a year-by-year breakdown of the costs for at least the next three years, are included in the budget documents.
- B Projections of the total capital cost of major investment projects, together with a year-by-year breakdown of the capital costs and estimates of the recurrent costs for the next three years, are included in the budget documents.
- C Projections of the total capital cost of major investment projects, together with the capital costs for the forthcoming budget year, are included in the budget documents.
- D Performance is less than required for a C score.

### 11.4: Investment project monitoring

- A The total cost and physical progress of major investment projects are monitored during implementation by the implementing government unit. There is a high level of compliance with the standard procedures and rules for project implementation that have been put in place. Information on the implementation of major investment projects is published in the budget documents or in other reports annually.
- B The total cost and physical progress of major investment projects are monitored by the implementing government unit. Standard procedures and rules for project implementation are in place, and information on implementation of major investment projects is published annually.
- C The total cost and physical progress of major investment projects are monitored by the implementing government unit. Information on implementation of major investment projects is prepared annually.
- D Performance is less than required for a C score.

Indicator/dimension	Score	Brief justification for the score
<b>PI-11: Public Investment Management</b>	<b>C+</b>	<b>Scoring Method M2</b>
11.1: Economic analysis of investment proposals.	C	There are no national guidelines on economic analysis. Some of the development partners conduct economic analysis in accordance with their own methodology in which case the analysis is published.

Indicator/dimension	Score	Brief justification for the score
11.2: Investment project selection.	A	As per current practice, prior to inclusion in the budget, all major investment projects are prioritized by the departments and approved by the Department of National Budget and the GNHC on the basis of published standard criteria for project selection.
11.3: Investment project costing.	C	Capital costs are included in the forthcoming budget year for those projects that are funded by RGoB, and through external assistance only if agreements have been signed and fund release is confirmed. Projects are included in the in-year budget changes as and when these conditions are met and finally included in the supplementary budget presented to Parliament in June. Major activities are individually listed in the Budget Report.
11.4: Investment project monitoring.	C	Financial and physical progress of major investment projects is monitored at the level of the departments through PSCs and centrally by MoF and GNHC and the standard procedures are complied with. Information on implementation of such projects is prepared after each monitoring visit and otherwise, but these are not published.

## PI-12: Public asset management

This indicator assesses the management and monitoring of government assets and transparency of asset disposals. It contains three dimensions and uses the M2 (AV) method for aggregating dimension scores.

### *Dimension 12.1: Financial asset monitoring*

The Ministry of Finance (MoF) and the Royal Monetary Authority (RMA) are in charge of managing government financial assets. The MoF manages assets like loans, receivables owned by the government and equity investment in Public Enterprises (PEs) and other companies, on-lending and loans to PEs, trust funds, etc. and the responsibilities of monitoring of financial assets are clearly established in the Financial Rules and Regulations, 2001 (FRR). RMA manages the official financial assets related to money and banking such as external assets including foreign currency reserves and currency and bullion in accordance with the Royal Monetary Authority Act of Bhutan, 2010.

Criteria for management, monitoring and accounting of financial assets such as bank balances and advances are provided in the Finance and Accounting Manual (part of the FRR), but have not been specified for assets such as equity in public enterprises. Criteria for management of financial assets relating to money and banking are defined under the RMA Act.

Information on financial assets is maintained by concerned agencies for major categories recorded in the annual financial statements which are readily available and the performance is publicly disclosed.

Monitoring and accounting of financial assets are carried out as per the Financial Rules and Regulations 2001 at least on an annual basis.

Records of financial assets are maintained by the concerned agencies and in PEMS, are recognized at acquisition cost and disclosed in the annual financial statements/budget reports including information on performance of major categories of financial assets.

**TABLE 3.3.12.1: CATEGORIES OF NON-FINANCIAL ASSETS**

Categories	Sub-categories	Captured in register(s)	Comments
<b>Fixed assets</b>	<b>Buildings and structures</b>	Stock Registers of concerned user agency and Central Inventory of DNP.	1. Concerned user agency owns and administers. 2. Updated on acquisition and followed up annually by DNP. 3. Assets are valued only on disposal by DNP.
	<b>Machinery and Equipment</b>	Stock Registers of concerned user agency and Central Inventory of DNP.	1. Concerned user agency owns and administers. 2. Updated on acquisition and followed up annually by DNP. 3. Assets are valued only on disposal by DNP.
	<b>Other fixed assets</b>	N/A	N/A
	<b>Weapons systems</b>	N/A	N/A
<b>Inventories</b>		Stock Registers of concerned user agency.	Updated on acquisition.
<b>Valuables</b>			
<b>Non-produced assets</b>	<b>Land</b>	Stock Registers of concerned user agency and Central Inventory of DNP.	1. Concerned user agency owns and administers. 2. Updated on acquisition and followed up annually by DNP. 3. Will be valued by DNP.
	<b>Mineral and energy resources</b>	Recorded by Ministry of Economic Affairs.	Records on mines and hydropower projects are maintained.
	<b>Other naturally occurring assets</b>	N/A	N/A
	<b>Intangible non-produced assets</b>	N/A	N/A

### **Dimension 12.2: Non-financial asset monitoring**

The responsibilities for monitoring non-financial assets are clearly articulated in the Property Management Manual of the Financial Rules and Regulations (FRR). The responsibility for proper accounting, safeguarding and utilization vests with the Head of Office who may delegate, without disowning his/her accountability, to subordinate officials called Property Officers. All non-expendable assets are required to be registered with the Department of National Properties (DNP) in the Ministry of Finance who maintain a central database and assign an identification code to each asset. The Manual also mandates maintenance of fixed assets registers and registers of inventories. The registers are available on request to the concerned authority but these are not publicly disclosed. The rules for monitoring and accounting of assets are given in the Property Management Manual of FRR. In essence, every agency is required to maintain the record of the properties.

The Royal Audit Authority (RAA) of Bhutan has recently developed an assessment tool to promote accountability in the use of public resources called the *Financial Resources Management Accountability Index (FRMAI)*. The Index is based on nine elements and element V pertains to Property Management System ([www.bhutanaudit.gov.bt/frmai](http://www.bhutanaudit.gov.bt/frmai)). The RAA reports that the *Government follows cash basis accounting and capital expenditures are expended on a year-to-year basis. Therefore, the account balances are not carried forward in subsequent years, indicating absence of adequate financial control. It is important that government agencies maintain accurate and up-to-date memorandum records and*

*exercise adequate administrative, supervisory and other controls including physical controls over the custody, use and control of government property.*

To conclude, the Government maintains records of its holding of fixed assets and other non-financial assets and information on their usage and age is collected only partially but is not published.

### **Dimension 12.3: Transparency of asset disposal**

The rules and procedures for sale, transfer and disposal of assets and asset usage rights are clearly established in the Property Management Manual of the FRR and are easily accessible. They do clearly promote competition and transparency.

The responsibilities on sale of non-financial assets are clearly established. The Auction and Records Section under the Government Property and Procurement Management Division (GPPMD) in the Department of National Properties (DNP) specifically caters to the sale of non-financial assets. The decision making process is clear and transparent and exercised by the Auction Committee comprising the Director General of DNP and representatives from the MoF, Road Safety and Transport Authority (RSTA) and the Royal Bhutan Police (RBP).

The fact that there are no audit issues/memos on the disposal of surrendered government properties suggests that the rules are being fully complied with. The DNP prepares an auction report after each auction and submits it to MoF. Information on transfer/disposal is provided to the Legislature through the annual financial statements and budget reports.

The rules for disposal of financial assets relating to money and banking are established in the RMA Act. There have not been any disinvestment in government companies in Bhutan; hence procedures and rules in this area have yet to be established.

The information on sale, rental or transfer of financial and non-financial assets (including sale of and rent from government property and dividend from RGoB's investments in equity shares of government companies) is disclosed in the annual financial statements (e.g. in Schedule 13 to the 2013/14 audited financial statements). Performance relating to treasury bills are discussed in the annual financial statements and the budget report and of other financial assets pertaining to money and banking in the annual report of the RMA.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>12.1: Financial asset monitoring</b>	
A	The government maintains a record of its holdings of <b>all</b> categories of financial assets which are recognized at fair or market value, in line with international accounting standards. Information on the performance of the portfolio of financial assets is published annually.
B	The government maintains a record of its holdings of major categories of financial assets which are recognized at their acquisition cost or fair value. Information on the performance of the major categories of financial assets is published annually.
C	The government maintains a record of its holdings of major categories of financial assets.
D	Performance is less than required for a C score.
<b>12.2: Non-financial asset monitoring</b>	
A	The government maintains a register of its holdings of fixed assets, land, and (where relevant) sub-soil assets, including information on their usage and age, which is published at least annually.

Score	Scoring Method M2 (AV). Minimum Requirements
B	The government maintains a register of its holdings of fixed assets, including information on their usage and age, which is published. A register of land (where relevant) and sub-soil assets is also maintained.
C	The government maintains a register of its holdings of fixed assets, and collects partial information on their usage and age.
D	Performance is less than required for a C score.

### 12.3: Transparency of asset disposal

A	Procedures and rules for the transfer or disposal of financial and non-financial assets are established, including information to be submitted to the legislature for information or approval. Information on transfers and disposal is included in budget documents, financial reports or other reports.
B	Procedures and rules for the transfer or disposal of non-financial assets are established. Information on transfers and disposals is included in budget documents, financial reports or other reports.
C	Procedures and rules for the transfer or disposal of non-financial assets are established. Partial information on transfers and disposals is included in budget documents, financial reports or other reports.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-12: Public asset management</b>	<b>B</b>	<b>Scoring Method M2</b>
12.1: Financial asset monitoring.	B	Records of financial assets are maintained by the concerned agencies and in PEMS. Financial assets are recognized at acquisition cost and disclosed in the annual financial statements/ budget reports including information on performance of major categories of financial assets.
12.2: Non-financial asset monitoring.	C	The government maintains records of holding of its fixed assets and other non-financial assets and information on their usage and age is collected only partially, and is not published.
12.3: Transparency of asset disposal.	A	Procedures and rules for transfer and disposal of financial and non-financial assets are established and information is included in the annual financial statements presented to Parliament.

### Ongoing and planned reforms

The DNP is currently carrying out familiarization training of focal persons in the dzongkhags who will be responsible for the management of the web-based inventory system. With this, it is expected that the overall inventory system containing the records of non-financial assets of the Government would be more dynamic and up to date. The Government Procurement and Property Management Division under the DNP intends to have the web-based inventory system operational during the current financial year. All procurement will then be directly entered in the system and the coverage of the management and statistical reports on non-financial assets is expected to improve substantially.

### PI-13: Debt management

This indicator assesses the management of domestic and foreign debt and guarantees. It seeks to identify whether satisfactory management practices, records and controls are in place to ensure efficient and effective arrangements. It contains three dimensions and uses the M2 (AV) method for aggregating scores.

Poor management and reporting on debt may create unnecessarily high debt service costs and can create significant fiscal risks. Governments that fail to monitor these financial liabilities are unlikely to be able to deliver planned services.

The responsibility for management and reporting of debt in Bhutan is vested with the Debt Management Division (DMD) of the Department of Public Accounts (DPA) with support from the Treasury Management Division (TMD) in respect of domestic debt and Public Enterprise Division (PED) for loan guarantees, all part of the Ministry of Finance. The Debt Management Division is divided into a Front Office, Middle Office and Back Office.

For the first time, the Royal Audit Authority carried out an audit of public debt management in 2014 for the period covering FY 2008/09 to FY 2012/13 (Tenth Five Year Plan). The audit report was discussed in the 5th Session of the Parliament in May 2015 and provided numerous recommendations for overall improvement of public debt management in Bhutan. One of the key recommendations is the need for a Public Debt Policy for Bhutan. The drafting of Public Debt Policy is complete and is presently under consideration by the Government.

### *Dimension 13.1: Recording and reporting of debt and guarantees*

The DMD uses the CS-DRMS (Commonwealth Secretariat-Debt Recording and Management System)<sup>26</sup> for recording and managing external debt. The DMD uses the core functionalities of CS-DRMS to maintain portfolio including on-lending and record transactions of disbursement and debt service payments, but other features such as portfolio analysis, scenario analysis, forecast etc. are not used and are done manually.

Domestic debt in the form of Treasury Bills is recorded by the Treasury Management Division (TMD) using spreadsheets and this is updated at the time of every issue or redemption. Efforts are under way to record details of T-Bills transaction in the CS-DRMS. Debt records are complete, accurate and reconciled on a monthly basis. DMD uses the Period End Processing utility in CS-DRMS for reconciling the external debt data for each creditor.

The external debt reports are generated through CS-DRMS at least quarterly for submission to the Royal Monetary Authority, National Statistical Bureau and other relevant agencies. The DMD also publishes a quarterly Public Debt Report that contains all information on domestic and external debt. The most recent report for the quarter ended December 2015 was finalized in January 2016. Presently, this report is only for internal consumption and is not made publicly available.

Debt data are also used as an input to ascertain macro variables during the Medium Term Fiscal Framework (MTFF) exercise for the Ministry of Finance. As a member of the World Bank Group, Bhutan submits debt data on public and publicly guaranteed debt on a loan by loan basis for the DRS (Debtor Reporting System). Debt data stock, debt service and operations are available in the Annual Budget, Annual Financial Statements (AFS) and also in the annual Statistical Yearbook of Bhutan.

Domestic and foreign debt records are complete, accurate and updated and reconciled on a monthly basis. Integrity of debt data is fairly high and comprehensive. Management and statistical reports covering debt, service, stock and operations are produced at least quarterly.

<sup>26</sup> CS-DRMS is a public debt management system developed by Commonwealth Secretariat and used in a number of countries. CS-DRMS is capable of forecasting, analyzing and reporting of debt related data in addition to recording debt.



### *Dimension 13.2: Approval of debt and guarantees*

The Constitution of the Kingdom of Bhutan and the Public Finance Act 2007 provide clear and transparent criteria and fiscal targets for contracting of loans and issuance of guarantees.

The Constitution, Article 14 provides that: Section 4 - *“The Government, in the public interest, may raise loans, make grants or guarantee loans in accordance with the law”*; section 5 - *“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 section 6 - *“The Government shall ensure that the cost of recurrent expenditures is met from internal resources of the country.”*

The primary legislation that governs public debt contracting is the Public Finance Act, 2007. The contracting of loans and issuance of guarantees are always approved by a single responsible government authority, i.e. the Minister of Finance. The Public Finance Act, Chapter III read with Chapter VII, empowers the Minister of Finance to approve borrowings and issue guarantees, subject to the approval of the Cabinet. Loan guarantees are issued by the Public Enterprises Division (though no guarantees have been issued since 2008).

The Public Finance Act specifies the purposes for which loans may be raised.

- To finance budget deficits;
- To refinance a maturing debt or a loan paid before the redemption date;
- To maintain credit balances in the bank accounts;
- For on-lending to State Enterprises and other legal entities; and
- Any other purposes approved by the Lhengye Zhungtshog (*Cabinet*)

State enterprises and local authorities can borrow only with the approval of the Minister of Finance. Similarly, the Minister of Finance is the sole authority for issuing guarantees for performance of any budgetary body, state enterprise or organization. The controls over the levels for contracting of loans and issuance of guarantees by RGoB are also articulated in the annual Budget Report, which is presented to the Parliament by the Finance Minister. These are made against transparent criteria and fiscal targets. The level of borrowing is also guided by the Five Year Plan (FYP) outlay. For instance, the annual Budget Report for FY 2014/15 provides the following criteria and targets:

- **For sustainable fiscal balance** (i) Domestic revenue to finance some portion of the capital expenditure besides covering current expenditure fully; (ii) Contain fiscal deficit at an average of 3% of GDP during the plan period.
- **For sustainable resource gap:** (i) Avail external borrowings only for socio-economic development programs and projects; (ii) Loan money shall not be used for operation and maintenance, purchase of vehicles, trainings, study visits, road shows, etc.; (iii) Implementation of externally financed projects to commence only upon receipt of funds from the development partners; (iv) Realistic estimates to be prepared to avoid cost overruns, fund release must be obtained prior to implementation; (v) Permit changes in scope of works only after careful technical and financial analysis based on the resources.

Similarly, the annual Budget Report for FY 2015/16 includes the following criteria and targets:

- Maintain fiscal deficit within 3.2% of GDP;
- Generate surplus domestic revenue to increasingly cover part of capital expenditure;



- Maintain non-hydro debt below 35% of GDP; and
- Subsidies provided to agencies with social mandates for capital works and to cover revenue deficit.

The contracting of loans is made against transparent criteria and overall fiscal targets at the portfolio level, as set in the medium-term debt strategy. A Medium Term Debt Strategy (MTDS) for FY2013/14 – FY2017/18 has been developed and includes an action plan of implementation. The MTDS has set targets in terms of various debt indicators to be achieved at the end of 11th FYP. One example of such targets is that the non-hydro debt will be maintained below 26% of GDP at the end of 11th FYP. At the individual loan level, some guidelines are available for assessment of guarantees in PED and operational guidelines for issue of Treasury bills. Two fiscal targets included in the Annual Performance Agreement (APA) of the Department of Public Accounts are: (i) maintain hydro-power debt to GDP ratio at 35% or below; (ii) maintain budgetary debt service to export ratio within LIC DSA threshold, under the overall target set in the debt strategy.

Central government contracting of loans and issuance of guarantees are approved by the Minister of Finance, subject to approval by the Cabinet and are made against transparent criteria and fiscal targets.

### *Dimension 13.3: Debt management strategy*

The Ministry of Finance has prepared a Medium-term Debt Strategy, as a separate document, for the first time in February 2013 covering the period FY 2013/14 to FY 2017/18. It covers all existing central government debt (both external and domestic) including its projection and sets target levels for various debt indicators to be achieved towards the end of FY2017/18 (including interest rate, refinancing and exchange rate). The Strategy was prepared under the guidance of the Macroeconomic Framework Coordination Technical Committee and approved by the Minister of Finance. Though the document states that the Strategy will be reviewed and updated annually, the intent is to update it at least every three years. At present, the document is not published.

The primary objective of debt management in Bhutan is clearly stated in the Strategy to minimize the cost of borrowing with a clear focus on maximizing concessional borrowing from multilateral and bilateral creditors. In the context of Bhutan, with its limited financing choices, the Strategy provides a clear description of the market risks (currency, interest and refinancing risks) and presents the country specific context for the debt portfolio, especially in relation to the hydropower debts with the Government of India (GoI). Since the domestic debt market is almost non-existent in Bhutan, the strategy highlights the issues and challenges, and outlines a roadmap for the gradual development of capital market in Bhutan.

A medium-term debt strategy covering all existing debt is available with a horizon of five years, as a separate document and planned for annual updating, though in actual practice the update will happen every three years. The strategy is approved by the Minister of Finance and sets targets for indicators of interest-rate, refinancing and exchange rate risk. The document is not published.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>13.1: Recording and reporting of debt and guarantees</b>	
A	Domestic and foreign debt and guaranteed debt records are complete, accurate, updated and reconciled monthly. Comprehensive management and statistical reports covering debt service, stock and operations are produced at least quarterly.
B	Domestic and foreign debt and guaranteed debt records are complete, accurate and updated quarterly. <b>Most</b> information is reconciled quarterly. Comprehensive management and statistical reports covering debt service, stock and operations are produced at least annually.

Score	Scoring Method M2 (AV). Minimum Requirements
C	Domestic and foreign debt and guaranteed debt records are updated annually. Reconciliations are performed annually. Areas where reconciliation requires additional information to be complete are acknowledged as part of records documentation.
D	Performance is less than required for a C score.

### 13.2: Approval of debt and guarantees

- |   |   |
|---|---|
| A | Primary legislation grants authorization to borrow, issue new debt and loan guarantees on behalf of the central government to a single responsible debt management entity. Documented policies and procedures provide guidance to borrow, issue new debt and undertake debt-related transactions, issue loan guarantees and monitor debt management transactions by a single debt management entity. Annual borrowings must be approved by government or the legislature.                                     |
| B | Primary legislation grants authorization to borrow, issue new debt and loan guarantees on behalf of the central government to entities specifically included in the legislation. Documented policies and procedures provide guidance for undertaking borrowing, other debt-related transactions and issue loan guarantees to one or several entities. These transactions are reported to, and monitored by, a single responsible entity. Annual borrowings must be approved by government or the legislature. |
| C | Primary legislation grants authorization to borrow, issue new debt and loan guarantees on behalf of the central government to entities specifically included in the legislation. Documented policies and procedures provide guidance for undertaking borrowings, other debt-related transactions and issue loan guarantees to one or several entities. These transactions are reported to, and monitored by, a single responsible entity.   |
| D | Performance is less than required for a C score.  |

### 13.3: Debt management strategy

- |   |  |
|---|--|
| A | A current medium-term debt management strategy covers existing and projected government debt, with a horizon of at least 3 years, is publicly reported. The strategy includes target ranges for indicators such as interest rates, refinancing, and foreign currency risks. Annual reporting against debt management objectives is provided to the legislature. The government's annual plan for borrowing is consistent with the approved strategy. |
| B | A current medium-term debt management strategy, covering existing and projected government debt, with a horizon of at least 3 years is publicly reported. The strategy includes target ranges for indicators such as interest rates, refinancing, and foreign currency risks.  |
| C | A current medium-term debt management strategy covers existing and projected government debt and is publicly available. The strategy indicates at least the preferred evolution of risk indicators such as interest rates and refinancing, and foreign currency risks.   |
| D | Performance is less than required for a C score.   |

Indicator/Dimension	Score	Brief justification for the score
<b>PI-13: Debt management</b>	<b>B</b>	<b>Scoring Method M2</b>
13.1: Recording and reporting of debt and guarantees.	A	Domestic and foreign debt records are complete, accurate and updated and reconciled on a monthly basis. Integrity of debt data is fairly high and comprehensive management and statistical reports covering debt, service, stock and operations are produced at least quarterly.
13.2: Approval of debt and guarantees.	A	Public Finance Act is the primary legislation that grants authorization to borrow and issue new debt and guarantees to the Minister of Finance, subject to approval by the Cabinet, and are made against transparent criteria and fiscal targets.
13.3: Debt management strategy.	D	A medium-term debt strategy covering all existing and projected debt is available with a horizon of five years, as a separate document and planned for periodic updating. The strategy is approved by the Minister of Finance and sets targets for interest rate, refinancing and exchange rate risk. The document is not publicly available.

## *Ongoing and planned reforms*

The Government is considering making the quarterly debt reports publicly available on the website of MoF very soon. A Public Debt Policy including clear direction of fixing limit for borrowing for RGoB is expected to be finalized soon.

### **3.4 Pillar IV – Policy-based fiscal strategy and budgeting (Performance indicators 14 to 18)**

#### **PI-14: Macroeconomic and fiscal forecasting**

This indicator measures the ability of a country to develop robust macroeconomic and fiscal forecasts, which are crucial to developing a sustainable fiscal strategy and ensuring greater predictability of budget allocations. It also assesses the government's capacity to estimate the fiscal impact of potential changes in economic circumstances. It contains three dimensions and uses M2 (AV) for aggregating dimension scores.

##### *Dimension 14.1: Macroeconomic forecasts*

Medium term macro projections are carried out on a quarterly basis and are used for fiscal planning and budgeting processes. The policy level Macroeconomic Framework Coordination Committee (MFCC) and the technical level Macroeconomic Framework Coordination Technical Committee (MFCTC) are responsible for these quarterly macro projections. The Committees are represented by all the key economic agencies like Royal Monetary Authority, Ministry of Finance, Ministry of Economic Affairs, Gross National Happiness Commission, National Statistical Bureau, Tourism Council of Bhutan and Ministry of Labour and Human Resources.

Any projections of economic indicators are done on a set of assumptions that are clearly stated and defined by the concerned member agency of the Committee. These assumptions are conveyed while explaining the variables, which are presented in the annual National Budget Report. The Committee may present various scenarios for policy decision to the Cabinet, but only the baseline scenario is reported in the annual National Budget Report.

##### *Dimension 14.2: Fiscal forecasts*

The Government (Macroeconomic Framework Coordination Committee (MFCC)) prepares forecasts of the main fiscal indicators, including revenues (tax, non-tax, grants), aggregate expenditure and the budget balance, for the budget year and two following fiscal years. These forecasts, together with the underlying assumptions, but not an explanation of the main differences from the previous year's budget, are included in the budget report submitted to the legislature.

##### *Dimension 14.3: Macro-fiscal sensitivity analysis*

The Government prepares for its internal use a range of fiscal forecast scenarios based on alternative macroeconomic assumptions. However, the budget documents do not include a discussion of forecast sensitivities, with the exception of sensitivity of revenues to hydropower projects coming on line. A debt sustainability analysis is produced every two years along with the IMF Article IV report with support of the IMF/WB.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>14.1: Macroeconomic forecasts</b>	
A	The government prepares forecasts of key macroeconomic indicators which, together with the underlying assumptions, are included in budget documentation submitted to the legislature. These forecasts are updated at least once a year. The forecasts cover the budget year and the two following fiscal years. The projections have been reviewed by an entity other than the preparing entity.
B	The government prepares forecasts of key macroeconomic indicators which, together with the underlying assumptions, are included in budget documentation submitted to the legislature. These forecasts cover the budget year and the two following fiscal years.
C	The government prepares forecasts of key macroeconomic indicators for the budget year and the two following fiscal years.
D	Performance is less than required for a C score.
<b>14.2: Fiscal forecasts</b>	
A	The government prepares forecasts of the main fiscal indicators, including revenues (by type), aggregate expenditure and the budget balance, for the budget year and two following fiscal years. These forecasts, together with the underlying assumptions and an explanation of the main differences from the forecasts made in the previous year's budget, are included in budget documentation submitted to the legislature.
B	The government prepares forecasts of the main fiscal indicators, including revenues (by type), aggregate expenditure and the budget balance, for the budget year and two following fiscal years. These forecasts, together with the underlying assumptions, are included in budget documentation submitted to the legislature.
C	The government prepares forecasts of revenue, expenditure and the budget balance for the budget year and the two following fiscal years.
D	Performance is less than required for a C score.
<b>14.3: Macro-fiscal sensitivity analysis</b>	
A	The government prepares a range of fiscal forecast scenarios based on alternative macroeconomic assumptions, and these scenarios are published, together with its central forecast.
B	The government prepares for its internal use a range of fiscal forecast scenarios based on alternative macroeconomic assumptions. The budget documents include discussion of forecast sensitivities.
C	The macro-fiscal forecasts prepared by the government include a qualitative assessment of the impact of alternative macroeconomic assumptions.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-14: Macroeconomic and fiscal forecasting</b>	<b>B</b>	<b>Scoring Method M2</b>
14.1: Macroeconomic forecasts.	A	A government committee prepares 3-year forecasts of key macroeconomic indicators which, together with the underlying assumptions, are included in the Budget Report submitted to the legislature.
14.2: Fiscal forecasts.	B	The Government prepares 3-year forecasts of the main fiscal indicators. These and the underlying assumptions are included in the Budget Report.
14.3: Macro-fiscal sensitivity analysis.	C	The Government prepares for its internal use a range of fiscal scenarios based on alternative macroeconomic assumptions, but not a sensitivity analysis of the impact of alternative assumptions.

## **PI-15: Fiscal strategy**

This indicator provides an analysis of the capacity to develop and implement a clear fiscal strategy. It also measures the ability to develop and assess the fiscal impact of revenue and expenditure policy proposals that support the achievement of the government's fiscal goals. It contains three dimensions and uses the M2 (AV) method for aggregating dimension scores.

### ***15.1: Fiscal impact of policy proposals***

The Government prepares estimates of the fiscal impact of **all** proposed changes in revenue and expenditure policy for the budget year and two following fiscal years. However, only the estimates for the budget year of the fiscal impact of proposed changes in revenue and expenditure policy are submitted to the legislature.

With regard to revenue, if there are any proposed changes in the rates or structure of any taxes, the tax measures are submitted to the Parliament. In FY 2014-15, various tax measures were presented to the Parliament in the National Budget report. In addition to this, any changes with regard to the revenue increase or decrease are also indicated in the National Budget reports.

For the expenditure policy proposals, all the significant proposals for both current and capital expenditure are fully costed for the budget year and are included in the National Budget report submitted to the legislature. For example, introduction of helicopter services in 2015 by the Government was included in the expenditure proposal (National Budget Report for FY 2015-16) which was submitted to the legislature.

The overall fiscal balance is deduced taking into account all these proposed changes both in the revenue and expenditure.

### ***15.2: Fiscal strategy adoption***

The 11th Five Year Plan (July 2013-June 2018) sets fiscal targets such as increasing the coverage of public expenditures by domestic revenues to 85% by June 2018, and limiting on average the fiscal deficit to 3% or less. In addition, the Constitution specifies that the recurrent spending should be funded out of internal resources. The Public Finance Act, section 7, also stipulates that recurrent expenditures should be kept within internal resources. The Budget report 2015/16 reaffirms the commitment to maintaining the fiscal deficit to 3% on average for the Budget year, and stresses that the target of 85% of coverage of public expenditures by domestic revenues is unlikely to be achieved. No fiscal target is discussed relating to revenue or expenditure, nor any change in net financial assets. A medium-term debt management strategy has been prepared with support from ADB. A debt policy is under discussion, setting a threshold for debt stocks.

### ***15.3: Reporting on fiscal outcomes***

The Budget report 2015/16 reaffirms the commitment to maintaining the fiscal deficit to 3% for the budget year. It explains that the target of 85% of coverage of public expenditures by domestic revenues is unlikely to be achieved because of the delay in the commissioning of major hydropower projects. Chapter 2 of the Budget report discusses in detail the fiscal outcomes of the last completed fiscal year and any deviations from the objectives and targets set.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>15.1: Fiscal impact of policy proposals</b>	
A	The government prepares estimates of the fiscal impact of <b>all</b> proposed changes in revenue and expenditure policy for the budget year and two following fiscal years, which are submitted to the legislature.
B	The government prepares estimates of the fiscal impact of <b>all</b> proposed changes in revenue and expenditure policy for the budget year and two following fiscal years.
C	The government prepares estimates of the fiscal impact of <b>all</b> proposed changes in revenue and expenditure policy for the budget year.
D	Performance is less than required for a C score.
<b>15.2: Fiscal strategy adoption</b>	
A	The government has adopted, submitted to the legislature and published a current fiscal strategy that includes explicit time-based quantitative fiscal goals and targets together with qualitative objectives for at least the budget year and the two following fiscal years.
B	The government has adopted and submitted to the legislature a current fiscal strategy that includes quantitative or qualitative fiscal objectives for at least the budget year and the two following fiscal years.
C	The government has prepared for its internal use a current fiscal strategy that includes qualitative objectives for fiscal policy.
D	Performance is less than required for a C score.
<b>15.3: Reporting on fiscal outcomes</b>	
A	The government has submitted to the legislature and published with the annual budget a report that describes progress made against its fiscal strategy and provides an explanation of the reasons for any deviation from the objectives and targets set. The report also sets out actions planned by the government to address any deviations, as prescribed in legislation.
B	The government has submitted to the legislature with the annual budget a report that describes progress made against its fiscal strategy and provides an explanation of the reasons for any deviation from the objectives and targets set.
C	The government prepares an internal report on the progress made against its fiscal strategy. Such a report has been prepared for at least the last completed fiscal year.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-15: Fiscal strategy</b>	<b>B</b>	<b>Scoring Method M2</b>
15.1: Fiscal impact of policy proposals.	B	The Government prepares estimates of the fiscal impact of all proposed changes in revenue and expenditure policy for the budget year and two following fiscal years, but only the estimates for the budget year of the fiscal impact of proposed changes are submitted to the legislature.
15.2: Fiscal strategy adoption.	C	The Government has prepared a fiscal strategy covering the next three years that includes quantitative objectives for fiscal policy, but has not submitted it to the legislature.
15.3: Reporting on fiscal outcomes.	B	Chapter 2 of the 2015/16 Budget report discusses the fiscal outcomes of the last completed fiscal year and any deviations from the objectives and targets set, and explains that the target of 85% of coverage of public expenditures by domestic revenues is unlikely to be achieved because of the delay in the commissioning of major hydropower projects.



## PI-16: Medium-term perspective in expenditure budgeting

This indicator examines the extent to which expenditure budgets are developed for the medium term within explicit medium term budget expenditure ceilings. It also examines the extent to which annual budgets are derived from medium term estimates and the degree of alignment between medium term budget estimates and strategic plans. It contains four dimensions and uses the M2 (AV) method for aggregating dimension scores.

### 16.1: Medium term expenditure estimates

The annual budget report presents estimates for the budget year and the two following fiscal years allocated by economic classification (Section 4.2 of the National Budget 2015-16). The other main elements of annual budget report are provided in PI-5 above.

### 16.2: Medium term expenditure ceilings

Aggregate expenditure ceilings for the budget year and for the two following years are approved by the Government before the first budget circular is issued. Ministry level ceilings are approved for the budget year only.

### 16.3: Alignment of strategic plans and medium-term budgets

Medium-term strategic plans are prepared for some ministries. Some expenditure policy proposals in the annual budget estimates align with the strategic plans. While all government agencies prepare medium-term plans to feed into the five-year plan, strategic plans prepared after the finalization of the five year plans follow new priorities arising from the elected government. That leads to some disconnect between sector strategies and costing and the reality of expenditure policy proposals (e.g. the education blueprint).

### 16.4: Consistency of budgets with previous year estimates

The budget report provide an explanation of most changes to expenditure estimates between the first year following the budget year of the previous medium term budget and the estimate for the budget year of the new medium term budget at the aggregate level (Chapter 2 of the Budget report FY 2015/16).

Score	Scoring Method M2 (AV). Minimum Requirements
<b>16.1: Medium-term expenditure estimates</b>	
A	The annual budget presents estimates of expenditure for the budget year and the two following fiscal years allocated by administrative, economic and program (or functional) classification.
B	The annual budget presents estimates of expenditure for the budget year and the two following fiscal years allocated by administrative <u>and</u> economic classification.
C	The annual budget presents estimates of expenditure for the budget year and the two following fiscal years allocated by administrative <u>or</u> economic classification.
D	Performance is less than required for a C score.
<b>16.2: Medium term expenditure ceilings</b>	
A	Aggregate and ministry-level expenditure ceilings for the budget year and the two following fiscal years are approved by government at least before the first budget circular is issued.
B	Aggregate expenditure ceilings for the budget year and the two following fiscal years, and ministry-level ceilings for the budget year, are approved by government at least before the first budget circular is issued.



Score	Scoring Method M2 (AV). Minimum Requirements
C	Aggregate expenditure ceilings for the budget year and the two following fiscal years are approved by the government at least before the first budget circular is issued.
D	Performance is less than required for a C score.
<b>16.3: Alignment of strategic plans and medium-term budgets</b>	
A	Medium-term strategic plans are prepared and costed for <b>most</b> ministries. <b>Most</b> expenditure policy proposals in the approved medium-term budget estimates align with the strategic plans.
B	Medium-term strategic plans are prepared for the <b>majority</b> of ministries, and include cost information. The <b>majority</b> of expenditure policy proposals in the approved medium term budget estimates align with the strategic plans.
C	Medium-term strategic plans are prepared for <b>some</b> ministries. <b>Some</b> expenditure policy proposals in the annual budget estimates align with the strategic plans.
D	Performance is less than required for a C score.
<b>16.4: Consistency of budgets with previous year estimates</b>	
A	The budget documents provide an explanation of <b>all</b> changes to expenditure estimates between the two fiscal years following the budget year of the previous medium term budget and the estimate for the budget and first following fiscal year of the new medium term budget at the ministry level.
B	The budget documents provide an explanation of <b>most</b> changes to expenditure estimates between the first year following the budget year of the previous medium term budget and the estimate for the budget year of the new medium term budget at the ministry level.
C	The budget documents provide an explanation of <b>some</b> of the changes to expenditure estimates between the first year following the budget year of the previous medium term budget and the estimate for the budget year of the new medium term budget at the aggregate level.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-16: Medium-term perspective in expenditure budgeting</b>	<b>C+</b>	<b>Scoring Method M2</b>
16.1: Medium-term expenditure estimates.	C	The annual budget report presents estimates for the budget year and the two following fiscal years allocated by economic classification.
16.2: Medium-term expenditure ceilings.	B	The Government approves expenditure ceilings for the budget year and for the two following years before the first budget circular is issued, but ministry ceilings are approved for the budget year only.
16.3: Alignment of strategic plans and medium-term budgets.	C	Strategic plans are prepared by some ministries, but medium-term budgets diverge from fixed strategic plans due to changing policies and priorities.
16.4: Consistency of budgets with previous year estimates.	C	The budget report provides an explanation of most changes to expenditure estimates from one year to the next at the aggregate level.

## PI-17: Budget preparation process

This indicator measures the effectiveness of participation by relevant stakeholders in the budget preparation process, including the political leadership, and whether that participation is orderly and timely. It contains three dimensions and uses the M2 (AV) method for aggregating dimension scores.

## 17.1: Budget calendar

Dimensions 17.1 and 17.2 are assessed by reference to the last budget submitted to the legislature at the time of this assessment (November 2015), which was for FY 2015/16.

The FRR 2001 requires the Budget Call Circular to be issued at the latest by end of December or first week of January. For the last Budget submission, the Budget circular was issued on January 7, 2015 by the Department of National Budget, Ministry of Finance for the 2015/2016 Budget preparation. The Circular provided guidelines for budget preparation including budget ceilings for each agency and the agencies have around eight weeks to prepare their budget proposal. All budgetary units completed their estimates on time (March 2, 2015).

## 17.2: Guidance on budget preparation

The Budget Call Circulars for the FY 2015/2016 were comprehensive and clear. They were approved by the Cabinet before being sent to the budgetary units. The circulars reflected ministry ceilings.

## 17.3: Budget submission to the legislature

Article 47 of the Public Finance Act states that the “The Minister of Finance shall present to the Parliament the Government’s Budget Appropriation Bill no later than 5 days preceding the budget year”. The budget is expected to be approved by the Parliament before the start of the financial year on July 1.

The Minister of Finance presented the Government’s Budget Appropriation Bill for 2015/16 to Parliament on May 25, 2015. For 2014/15 it was presented on June 6, 2014, but for 2013/14 it was not presented until September 17, 2013, due to elections intervening. Only for FY 2015/16 has Parliament had over a month to scrutinize the budget proposals.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>17.1: Budget calendar</b>	
A	A clear annual budget calendar exists, is generally adhered to and allows budgetary units at least six weeks from receipt of the budget circular to meaningfully complete their detailed estimates on time.
B	A clear annual budget calendar exists, and is largely adhered to. The calendar allows budgetary units at least four weeks from receipt of the budget circular. <b>Most</b> budgetary units are able to complete their detailed estimates on time.
C	An annual budget calendar exists and <b>some</b> budgetary units comply with it and meet the deadlines for completing estimates.
D	Performance is less than required for a C score.
<b>17.2: Guidance on budget preparation</b>	
A	A comprehensive, and clear budget circular, or circulars, covering total budget expenditure for the full fiscal year, is issued to budgetary units, which reflects ministry ceilings approved by Cabinet (or equivalent) prior to the circular’s distribution to budgetary units.
B	A comprehensive, and clear budget circular, or circulars, covering total budget expenditure for the full fiscal year, is issued to budgetary units, which reflects ministry ceilings submitted to the Cabinet (or equivalent). The approval of ceilings takes place after the circular’s distribution to budgetary units, and before budgetary units have completed their submission.
C	A budget circular, or circulars, is issued to budgetary units, including ceilings for administrative or functional areas. Total budget expenditure is covered for the full fiscal year. The budget estimates are reviewed and approved by Cabinet after they have been completed in every detail by budgetary units.
D	Performance is less than required for a C score.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>17.3: Budget submission to the legislature</b>	
A	The executive has submitted the annual budget proposal at least 2 months before the start of the fiscal year in each of the last three years.
B	The executive has submitted the annual budget proposal at least 2 months before the start of the fiscal year in two of the last three years and submitted it before the start of the FY in the third year.
C	The executive has submitted the annual budget proposal at least 1 month before the start of the fiscal year in two of the last three years.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-17: Budget preparation process</b>	<b>B</b>	<b>Scoring Method M2</b>
17.1: Budget calendar.	A	A clear budget calendar exists and is substantially adhered to. It allows budget units around 8 weeks to complete their detailed estimates.
17.2: Guidance on budget preparation.	A	The budget circular is comprehensive and clear and reflects ministry expenditure ceilings approved by the Cabinet.
17.3: Budget submission to the legislature.	D	The annual budget proposal was not presented to Parliament at least one month before the start of 2 of the last 3 FYs.

## PI-18: Legislative scrutiny of budgets

This indicator assesses the nature and extent of legislative scrutiny of the annual budget. It considers the extent to which the legislature scrutinizes, debates and approves the annual budget, including the extent to which the legislature's procedures for scrutiny are well-established and respected and the existence of rules for in-year amendments to the budget without ex-ante approval by the legislature. It contains four dimensions and uses the M1 (WL) method for aggregating dimension scores. Assessment of the first three dimensions is based on the budget for FY 2014/15; dimension 18.4 is based on the budgets for FY 2012/13, 2013/14 and 2014/15.

### *Dimension 18.1: Scope of budget scrutiny*

Bhutan has a functioning Parliament consisting of the Druk Gyalpo (His Majesty the King of Bhutan), the National Council and the National Assembly. The Constitution of Bhutan mandates that an Annual Budget, with a report on the budget of the previous financial year, shall be presented to the National Assembly by the Finance Minister. The *National Assembly Act of Bhutan, 2008* and the *National Council Act of Bhutan, 2008* read with the *Rules of Procedure of the National Assembly of Bhutan (2014)* contain the provisions for passing of Money Bills, that is, the Budget. The National Assembly "shall be at liberty to discuss the budget as a whole or any principles of Government policy and administration as indicated in and by the budget". After it is passed in the National Assembly, the Budget is presented by the Finance Ministry to the National Council. The latter can pass the bill, with or without recommendations, within five days from presentation (else it is deemed to have been passed). The recommendations are deliberated in the National Assembly, which can accept or reject them. The Budget has to be passed in the same session of Parliament. The Budget after it is passed is submitted to the Druk Gyalpo for assent, when it comes into force.

The Public Finance Act, 2007 requires preparation of a Budget Policy and Fiscal Framework Statement (outlining the Government's framework for the new budget) and the Government's Budget Appropriation Bill (Government's financial performance intentions) to be presented to Parliament. The Budget Manual requires preparation of a Medium Term Framework as a three-year rolling budget. Budget documents in the form of a Budget Report, as provided in the Budget Manual, including annual financial statements, are presented to the National Assembly for legislative approval.

The Budget Report contains the actual fiscal performance of the two years previous to the budget year, the revised estimates of the year previous to the budget year and the estimates for the budget year. It also includes a macro-economic performance and outlook, and performance of the central bank, the state owned enterprises, the trust funds and the hydropower sector. Medium term macroeconomic performance and outlook has projections for the next three years including the budget year - this includes medium-term fiscal framework projections and debt stock.

The National Assembly deliberates on the sectoral allocations but the focus is on providing opinion and explanations on the budget followed by voting of the budget. The National Council also deliberates on the Budget (it has five days to review the Budget) and can pass the Budget with or without recommendations. For instance, the 2013/14 budget was deliberated in the National Council which made many recommendations and these were discussed in the National Assembly. Till the financial year 2014/15, the National Assembly had only four days for budget review including two days for discussions on the budget in the House, after it was presented by the Finance Minister<sup>27</sup>. Subsequently, a nine-member legislative Finance Committee has been constituted in 2015 (as a permanent committee) - this was facilitated by an amendment to the National Assembly Act allowing the budget to be referred to a Legislative Committee. The budget for 2015/16 was the first budget to be referred to the Committee for review<sup>28</sup>. The Committee reported on the budget for 2015/16 and made recommendations, which were discussed in the National Assembly<sup>29</sup>.

The Budget Report covers expenditures and revenues, fiscal policies and medium-term fiscal framework and priorities. However, review by legislature is limited to reviewing details of expenditure and revenue at a stage when detailed proposals have been finalized.

### *Dimension 18.2: Legislative procedures for budget scrutiny*

Legislative review of the Budget is established in the Constitution of Bhutan, the National Assembly and National Council Acts and in the Public Finance Act. The amended Rules of Procedure of the National Assembly of Bhutan provide terms of reference of the Finance Committee. The Finance Committee was constituted in May 2015 as a specialized committee to review the budget with effect from FY 2015/16, but specific rules for the Finance Committee have not yet been established. Moreover, there are no procedures for negotiation or public consultation. The existing procedures for legislative review are respected.

### *Dimension 18.3: Timing of budget approval*

The budget is presented to Parliament in May/June each year. After the Budget is passed by Parliament, it is submitted to His Majesty Druk Gyalpo for assent and then the Budget Appropriation Bill comes

27 For 2014/15, the budget was presented on Jun 6, 2014, discussions were held on Jun 9-10, 2014 and adopted on Jun 10, 2014.

28 For 2015/16, the budget was presented before the National Assembly on May 26, 2015 and referred to the Finance Committee. The National Assembly discussed the budget and the report of the Finance Committee on June 8-9, 2015 and adopted the budget on June 9, 2015.

29 The Finance Committee made 11 recommendations of which the National Assembly resolved 8.

into force. For the purposes of PEFA assessment, the date of approval is taken as the date of approval by the National Assembly (see table below). In two of the last three years (2012/13 and 2014/15), the Parliament approved the budget before the start of the fiscal year. For 2013/14, the budget was passed with delay of over two months due to late formation of the Government after the general elections. For FY 2014/15 and 2015/16, the budget was approved before the start of the financial year.

Budget Year	Date of approval of budget by National Assembly	Date of Assent to Budget Appropriation Bill by His Majesty Druk Gyalpo
2013/14	September 18, 2013	September 26, 2013
2014/15	June 10, 2014	July 8, 2014
2015/16	June 9, 2015	June 19, 2015

### *Dimension 18.4: Rules for budget adjustments by the executive*

There are legal and procedural rules that govern in-year budget amendments by the executive. The Public Finance Act allows re-appropriation and the provisions are contained in the Budget Manual. Budgetary units are allowed to re-appropriate their budget i.e. transfer from one budget head to another, with approval of delegated authorities, but without ex-ante approval of Parliament. A re-appropriation can be done within the approved ceiling, but not on the following items (as per amendment to Budget Manual in 2010).

- from capital to current;
- to new object codes.

No expansion of total expenditure can be made without prior legislative approval.

The Ministry of Finance (MoF) is authorized to determine which objects of expenditure will be amenable to re-appropriation. The MoF can also make “technical adjustments” in respect of incorporation of unbudgeted activity/code, incorporation of external projects, and transfers from reserves.

The delegation of financial powers contained in the Financial Management Manual specifies the approving authorities for re-appropriation:

- Finance Minister can approve re-appropriations within the same program up to Nu. 3.0 million per occasion.
- Finance Secretary can approve re-appropriations within the same program up to Nu. 1.5 million and this power can be delegated to the Director, Department of National Budget.

The Schedule of Delegation of Financial Powers in the FMM specifies the powers of re-appropriations and these were liberalized in 2010. Near full powers have now been delegated down to dzongkhag level in respect of re-appropriation from one object code to another existing object code within the same activity; from one activity to another existing activity within the program or sub-program; from one sub-program to another existing sub-program within the same program; from one program to another existing program; and from one sub accounting unit to another in the same dzongkhag. These powers cannot be delegated. The changes are incorporated in the revised estimates and presented to Parliament as a supplementary bill.

Clear rules exist for in-year budget amendments by the executive with strict limits, extent and nature of amendments and are consistently respected. This is supported by the fact that RAA annual audit report for FY2014 reports an amount of Nu. 0.664 million against violation of budgetary norms.

Score	Scoring Method M1 (WL). Minimum Requirements
<b>18.1: Scope of budget scrutiny</b>	
A	The legislature's review covers fiscal policies, medium term fiscal forecasts and medium term priorities as well as details of expenditure and revenue.
B	The legislature's review covers fiscal policies and aggregates for the coming year as well as details of expenditure and revenue.
C	The legislature's review covers details of expenditure and revenue.
D	Performance is less than required for a C score.
<b>18.2: Legislative procedures for budget scrutiny</b>	
A	The legislature's procedures to review budget proposals are approved by the legislature in advance of budget hearings and are respected. The procedures include arrangements for public consultation and internal organizational arrangements, such as specialized review committees, technical support and negotiation procedures.
B	The legislature's procedures to review budget proposals are approved by the legislature in advance of budget hearings and respected. The procedures include arrangements such as specialized review committees, technical support and negotiation procedures.
C	The legislature's procedures to review budget proposals are approved by the legislature in advance of budget hearings and respected.
D	Performance is less than required for a C score.
<b>18.3: Timing of budget approval</b>	
A	The legislature has approved the annual budget before the start of the year in each of the last three fiscal years.
B	The legislature has approved the annual budget before the start of the year in two of the last three fiscal years, with a delay of up to one month in the third year.
C	The legislature has approved the annual budget within one month of the start of the year in two or more of the last three fiscal years.
D	Performance is less than required for a C score.
<b>18.4: Rules for budget adjustments by the executive</b>	
A	Clear rules exist for in-year budget adjustments by the executive, set strict limits on extent and nature of amendments and are respected in <b>all</b> instances.
B	Clear rules exist for in-year budget adjustments by the executive, and are respected in <b>most</b> instances. Extensive administrative reallocations may be permitted.
C	Clear rules exist which may be respected in <b>some</b> instances OR they may allow extensive administrative reallocation as well as expansion of total expenditure.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-18: Legislative scrutiny of budgets</b>	<b>C+</b>	<b>Scoring Method M2</b>
18.1: Scope of budget scrutiny.	C	Legislative review of the budget for 2014/15 was limited, but included review of expenditure and revenue. From 2015/16, a Finance Committee has been constituted.
18.2: Legislative procedures for budget scrutiny.	C	The legislature's procedures for budget review are firmly established, including review by a recently established specialized committee and are respected, but are not comprehensive as there are no procedures for negotiations or public consultations and for the working of the Finance Committee.



Indicator/Dimension	Score	Brief justification for the score
18.3: Timing of budget approval.	C	The legislature has approved the annual budget before the start of the year for FY 2015/16, within one month of start of financial year for FY 2014/15 and with a delay of over 2 months in FY2013/14 (election year).
18.4: Rules for budget adjustments by the executive.	A	Clear rules exist for in-year budget adjustments by the executive, set strict limits on extent and nature of amendments and are always respected.

### 3.5 Pillar V – Predictability and control in budget execution (Performance indicators 19 to 26)

#### PI-19: Revenue administration

This indicator relates to the entities that administer central government revenues, which may include tax administration, customs administration, social security contribution administration, as well as agencies administering revenues from other significant sources such as natural resources extraction: which may include public enterprises that operate as regulators and holding companies for government interests, in which case the assessment will require information to be collected from entities outside the government sector. A government's ability to collect revenues, which are due, is an essential component of any PFM system, and is also an area where there is direct interaction between individuals and enterprises on the one hand and the state on the other. Both parties have responsibilities: the government must provide those responsible for providing revenues with a clear understanding of their obligations and the procedures to be followed, while ensuring that mechanisms are in place to enforce compliance from those required to contribute the revenues due.

The indicator assesses the procedures used to collect and monitor central government revenues. It contains four dimensions and uses M2 (AV) method for aggregating dimension scores.

#### *Dimension 19.1: Rights and obligations for revenue measures*

Information on taxpayers' duties and rights and procedures are publicly available. All the taxation legislation: Income Tax Act 2001 and the Rules; Sales Tax, Customs and Excise Act 2000 and Rules and any amendment to the Act and rules thereof are publicly available on the Ministry of Finance website (mof.gov.bt) and also copies of Act and Rules can be purchased. The Department of Revenue and Customs (DRC) issues notifications in the media regarding any changes in the legislation and procedures and also from time to time notifies taxpayers on the tax filing due dates.

Regarding the non-tax revenue, information is available in the laws of the respective agencies and on their websites and changes are notified in the media from time to time. For example regarding royalty on mines and minerals, it is covered in the Mines and Minerals Management Act: information on royalty on forestry products is available with the Ministry of Agriculture and Forests. Thus comprehensive legislation and regulations on liabilities and duties and rights are available to the public. The concerned agencies are responsible for disseminating information through the media where necessary.

Within DRC/MOF presently, there are three tiers established for taxpayers to appeal if they disagree with the demand notices issued by the regional revenue and customs office after assessment. The first

tier is at RRCO level (regional tax appeal committee, RTAC) followed by head office level (DRC Appeal Committee) and then at the ministry level (Ministry of Finance- Appeal Board). Taxpayers are required to submit appeals to RTAC within 30 days from the date of issue of the demand notice. If they disagree with the decision of the RTAC, taxpayers can appeal to the DRC Appeal Committee within 30 days for further review. Otherwise the decision of the RTAC is final. Further if the taxpayer disagrees with the decision of DRC Appeal Committee, taxpayer can appeal to the MoF Appeal Board within 60 days from the date of decision of the DRC Appeal Committee. Finally, the taxpayer has an option to appeal to the law courts. However, taxpayers are not barred from filing appeals directly to the law court. During 2014, a total of 2,039 appeal cases were received by the RRCOs, registering a growth of 875% over the previous year's total of 209 cases. Out of the 2,039 cases, 63 cases were forwarded to DRC. BIT taxpayers registered most appeal cases with 1,328 cases followed by CIT with 510 cases and PIT with 201 cases (see Table 3.5.19.1 below).

**TABLE 3.5.19.1: TAX APPEALS DATA**

Particulars	PIT	CIT	BIT	Total
Filers	71559	286	29623	101,468
No. of tax appeals	201	510	1328	2039
Appeals resolved at RRCO level	112	308	963	1383
No of appeals forwarded to HQ	10	23	30	63
Appeals forwarded to Appeals Board	1	5	3	9

*Source:* DRC.

Tax and non-tax revenue accounts for about 72% of total revenue for which up-to-date information and administrative procedures are readily available to the taxpayers and for which there is an established appeal system. Non-tax revenue agencies include Department of Forest, Ministry of Home and Culture Affairs, Department of Geology and Mines, Road Safety and Transport Authority and Department of Trade.

### ***Dimension 19.2: Revenue risk management***

Most revenue is raised through taxes and the major taxes are corporate income tax, business income tax and personal income tax (direct taxes) and sales tax, import duty and excise duty (indirect taxes). All these major taxes are filed on self-assessment basis. In case of direct taxes, taxes are filed on self-assessment basis by those businesses that maintain books of accounts. For small or micro business units which do not maintain any books of accounts, taxes are collected on estimated assessments. However, opportunities are always given to such taxpayers to self-declare their tax liability.

DRC is responsible for administering and monitoring collection of all domestic revenue, both tax and non-tax revenue. The department has eight regional offices where the taxpayers file declarations and make payment of taxes, and more than 80 revenue collecting agencies in all the districts responsible for collecting the non-tax revenue.

Income tax assessment and audits are carried out based on risk indicators like the nature and size of the business, compliance record, last tax assessment conducted, units declaring losses, units claiming substantial tax refund, tax potential, etc. In case of indirect taxes some of the indicators used are Regional Intelligence Liaison Office alert (World Customs Organization), based on tax rates declared on invoice and declaration forms to avoid deflection and evasion, country of origin etc.

Risk management methods are also used at the time of taxpayer registration since the source of Taxpayer Number (TPN) is the Income Tax Division. Adequate measures are taken to ensure that no TPN duplicates are created in the system. Similarly, risk management methods are also used in payment and refund of taxes. In order to mitigate the risk of losing revenue, all the taxpayers who submit tax returns based on self-assessment are either desk-assessed or field-assessed. Based on the merit of each case, tax investigations are also conducted to mitigate risk and also to reduce the chances of any fraudulent practices. Internally, in order to mitigate risk of misuse, tax assessments are carried out. The DRC has an electronic database registration system and a TPN is assigned to each taxpayer. The TPN is used for corresponding with taxpayers. Further, every revenue collecting agency has a unique agency code and is registered in the system.

There is basic general understanding of risk management across all types of taxes and tax audits are carried out for all the units with high revenue potential and high risk of revenue leakage. Further, assessment or tax audit is done based on specific risk indicators to ensure effective and efficient use of limited resources for mobilization of domestic revenue.

However, there is need for further capacity development of officials to be able to assess the efficiency of risk management methods and measures to mitigate risk.

For more than 75% of government revenue, specific risk indicators are used especially for income tax, but for indirect taxes risk management is not comprehensive. There is need for further capacity development of officials to be able to assess the effectiveness of risk management methods and of measures to mitigate risk.

### ***Dimension 19.3: Revenue audit and investigation***

DRC is guided by the Income Tax Act 2001; Sales Tax, Customs and Excise Act 2000; revenue accounting manual and subsidiary rules and regulations.

To deter evasion and non-compliance, Chapter 5 of the Income Tax Act and Chapter 4 of the Sales Tax, Customs and Excise Act of the Kingdom of Bhutan cover the levy of fines and penalties for non-compliance:

- concealment of income (twice the tax amount evaded in the case of income tax);
- under-invoicing, non-declaration or concealment (fine of 50% of the value of the goods in addition to the amount of sales tax, customs and excise duty);
- late payment of taxes (for both direct and indirect taxes, 24% penal interest per annum is imposed on the amount due for the time it is outstanding);
- non-filing of tax return (100% of the gross income);
- failure to maintain books of accounts and documents (fine ranging from Nu. 1000 to Nu. 100,000 for both direct and indirect tax); and
- failure to comply with a notice (fine ranging from Nu. 500 to Nu. 5000 for both direct and indirect tax).

The chapter also includes provisions for prosecution and imprisonment. Chapter 3 of the Sales Tax, Customs and Excise Act covers detention, seizure and confiscation of goods for non-compliance with the rules.

As per the Income Tax Act, a desk assessment must be completed within 90 days and field assessment within two years from the due date of filing. Desk assessment is carried out 100% to determine whether further assessment is required and risk analysis to determine if the unit needs to be identified for field assessment.

Detailed audit planning and execution are reported in the performance indicator report of each division (for income tax, customs and sales tax). Table 3.5.19.2 shows the Tax Audits planned and executed.

**TABLE 3.5.19.2: TAX AUDITS PLANNED AND EXECUTED**

Year	Direct Tax		Indirect Tax		Overall		Executed/ planned
	Audit Planned	Audit Executed	Audit Planned	Audit Executed	Audit Planned	Audit Executed	
2012-2013	57611	56517	417	207	58028	56724	98%
2013-2014	62265	61112	424	273	62689	61385	98%
2014-2015	72988	71895	477	251	73465	72146	98%

*Source:* DRC.

Detailed assessment reports and data on decisions on penalties are maintained by the respective divisions. Final decisions are conveyed to the taxpayers and penalties are realized.

While the DRC and its regional offices are directly responsible for assessment and collection of the taxes, other revenue collecting agencies, governmental departments and agencies, are directly responsible for assessment, collection and deposit of non-tax revenue and other taxes. However, DRC is responsible for monitoring the collection and deposit of both tax and non-tax revenues.

Thus all revenue collecting agencies are accountable to the respective regional revenue and customs offices, which are in turn accountable to the DRC Head Office. The Head Office conducts audits of its regional offices and regional offices conduct audits of the collecting agencies under their jurisdiction to strengthen their internal control systems. Audit of all government agencies is conducted by the Royal Audit Authority.

#### ***Dimension 19.4: Management of revenue arrears***

In DRC, “revenue arrears” refers to the difference between collections and deposits, i.e. revenue in the pipeline. These are reported in the Annual Financial Statement (AFS) published by the Department of Public Accounts. Basically, these revenue arrears pertain to non-deposit of government revenues within the stipulated FY. In addition, there are arrears due to assessments not being collected when they are due. Normally arrears are detected during compilation and reconciliation of national revenue and certain cases are detected through audits. The DRC is responsible to follow up and recover the revenue arrears. Penal interest of 24% is levied for late deposit of revenue. Where cases are not resolved and there is disagreement the cases are also forwarded to the law court.

However with regard to tax arrears, information is reported and published annually in the performance indicator report and detailed records are maintained with the respective regional offices. The stock of arrears at June 30, 2014 is presented below in Table 3.5.19.3:

**TABLE 3.5.19.3: TAX ARREARS**

	Stock of Arrears at end of year (Nu. million)	Total Collection (Nu. million)	Arrears/collection %
Direct Tax FY 2013/14	89.74	23,244.61	0.4%
Other arrears June 30, 2014	7.01	23,244.61	0.03%
Total arrears	96.75	23,244.61	0.4%
Arrears more than 12 months old	9.93		

Source: DRC.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>19.1: Rights and obligations for revenue measures</b>	
A	Entities collecting <b>most</b> revenues use multiple channels to provide payers with easy access to comprehensive and up-to-date information on the main revenue obligation areas and on rights including, as a minimum, redress processes and procedures.
B	Entities collecting the <b>majority</b> of revenues provide payers with access to comprehensive and up-to-date information on the main revenue obligation areas and on rights including, as a minimum, redress processes and procedures.
C	Entities collecting the <b>majority</b> of revenues provide payers with access to information on the main revenue obligation areas and on rights including, as a minimum, redress processes and procedures.
D	Performance is less than required for a C score.
<b>19.2: Revenue risk management</b>	
A	Entities collecting <b>most</b> revenues use a comprehensive, structured and systematic approach for assessing and prioritizing compliance risks for <b>all</b> categories of revenue and, as a minimum for their large and medium revenue payers.
B	Entities collecting the <b>majority</b> of revenues use a structured and systematic approach for assessing and prioritizing compliance risks for <b>some</b> categories of revenue and, as a minimum, for their large revenue payers.
C	Entities collecting the <b>majority</b> of revenues use approaches that are partly structured and systematic for assessing and prioritizing compliance risks for <b>some</b> revenue streams.
D	Performance is less than required for a C score.
<b>19.3: Revenue audit and investigation</b>	
A	Entities collecting <b>most</b> revenue undertake audits and fraud investigations managed and reported on according to a documented compliance improvement plan, and complete <b>all</b> planned audits and investigations.
B	Entities collecting the <b>majority</b> of revenue undertake audits and fraud investigations managed and reported on according to a documented compliance improvement plan, and complete <b>all</b> planned audits and investigations.
C	Entities collecting the <b>majority</b> of government revenue undertake audits and fraud investigations using a compliance improvement plan and complete the <b>majority</b> of planned audits and investigations.
D	Performance is less than required for a C score.
<b>19.4: Revenue arrears monitoring</b>	
A	The stock of revenue arrears at the end of the last completed fiscal year is below 10% of the total revenue collection for the year, and the revenue arrears older than 12 months are less than 25% of total revenue arrears for the year.
B	The stock of revenue arrears at the end of the last completed fiscal year is below 20% of the total revenue collection of the year and the revenue arrears older than 12 months are less than 50% of total revenue arrears for the year.
C	The stock of revenue arrears at the end of the last completed fiscal year is below 40% of the total revenue collection for the year and the revenue arrears older than 12 months are less than 75% of total revenue arrears.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-19: Revenue administration</b>	<b>B+</b>	<b>Scoring Method M2</b>
19.1: Rights and obligations for revenue measures.	B	Entities, which collects majority of the revenue, provides payers with comprehensive information on main of revenue obligations and on their rights including rights of redress.
19.2: Revenue risk management.	B	The DRC uses a structured and systematic approach for assessing and prioritizing compliance risks for some categories of revenue and, as a minimum, for their large revenue payers.
19.3: Revenue audit and investigation.	A	Entities collecting most revenue undertake audits and fraud investigations managed and reported on according to a documented compliance improvement plan, and complete over 90% of planned audits and investigations.
19.4: Revenue arrears monitoring.	A	Revenue arrears is 0.38% of the total revenue collection. Reported revenue arrears are two to seven years old.

### *Ongoing and planned reforms*

DRC is planning and working to develop more comprehensive risk management processes and Post-Clearance Audit (PCA) and to institute a separate intelligence and investigation unit to strengthen audit and investigation processes.

### **PI-20: Accounting for revenue**

This indicator assesses the procedures for recording and reporting revenue collections, consolidating revenues collected, and reconciling the tax revenue accounts. It covers both tax revenues and non-tax revenues collected by the central government, but not grants. This indicator contains three dimensions and uses M1 (WL) for aggregating dimension scores.

Dimension 20.1 assesses the extent to which the Ministry of Finance or a body with similar responsibilities coordinates revenue administration activities and collects, accounts and reports timely information on collected revenue.

Dimension 20.2 assesses the promptness of transfers of revenue collected to the Treasury or other designated agencies. It is essential to ensure that funds are available as soon as possible to support cash management and ultimately spending. This may involve either a system that obliges payments to be made directly into accounts controlled by the Treasury (possibly managed by a bank) or, where the responsible agency maintains its own collection accounts, by frequent and full transfers from those accounts to Treasury controlled accounts (time periods mentioned do not include delays in the banking system). Transfers of revenue collections to the Treasury should be effective and ensure that any revenue float is minimized. Ideally, all revenues should be transferred to the Treasury, but other agencies could be legally designated to receive earmarked revenues directly from the collecting entity (eg. autonomous extra-budgetary funds). Transfers to such designated agencies will be assessed in the same way as transfers to the Treasury.

Dimension 20.3 assesses the extent to which aggregate amounts related to assessments/charges, collections, arrears and transfers to (and receipts by) the Treasury or other designated agencies take place regularly and are reconciled. This will ensure that the collection and transfer system functions as



intended and that the level of arrears and the revenue float are monitored and minimized. It is important that the difference between amounts assessed/levied and received by the Treasury or other designated agencies can be explained. The responsible entity would normally keep records on aggregate amounts levied, and transfers to the Treasury in its accounting system. The responsible entity should also keep records for each payer about amounts levied and paid, but this may be done in other data systems. The responsible entity should be able to aggregate such information, so that it can report how much of amounts levied is (a) not yet due, (b) in arrears (the difference between what is due and what has been paid in) and (c) collected by the responsible agency but not yet transferred to the Treasury. For revenues from extractive industries, the Extractive Industries Transparency Initiative has developed standards for the disclosure and reconciliation of what companies pay and what governments receive.

### ***Dimension 20.1: Information on revenue collections***

The Department of Revenue and Customs (DRC) under the Ministry of Finance is responsible for monitoring the collection and deposit of all domestic revenues both tax and non-tax revenue. The monthly collection data is shared with the Treasury Division of the Department of Public accounts, Ministry of Finance. The DRC also submits a revenue collection report to the Ministry on a quarterly basis i.e October, January, April and June and half yearly basis. Additionally, collection reports are also shared (on an ad hoc basis) with the Ministry of Finance at their request. The DRC publishes an annual national revenue report detailing collections from all revenue sources. The annual national revenue report is a public document and copies are shared with all the government ministries and agencies. A soft copy is available at [www.mof.gov.bt](http://www.mof.gov.bt).

### ***Dimension 20.2: Transfer of revenue collections***

The functions and services of the department are automated or computerized using the Bhutan Automated Customs System (BACS) and Revenue Management System (RMS). BACS is mainly for indirect taxes such as customs and sales tax at the point of entry of goods, while RMS consist of the Tax Management System (TMS – for direct taxes) and Revenue Accounting System (RAS).

All taxes and duties are paid directly to the regional revenue and customs office, and non-tax revenues are paid directly to the respective revenue collecting agencies.

However, with the introduction of Revenue Administration Management Information System (RAMIS) and soft launching of RAMIS direct tax module from January 1, 2015 and soft launching of sales tax at the point-of-sale module and non-tax revenue module from July 1, 2015 the taxpayers are now also able to pay at the commercial banks or use an on-line payment system using internet banking facility. Further, income tax filers can now file their returns on-line and pay taxes on-line.

All taxes, duties or any other revenues are deposited directly in the royal government revenue account maintained with the Bank of Bhutan and on a daily basis revenue is directly transferred to the government consolidated account (Treasury). Therefore, there is no delay in the transfer of revenue to treasury and it is very effective as the collections are transferred on a daily basis.

### ***Dimension 20.3: Revenue accounts reconciliation***

Daily collection report with one day lag is shared with Department of Public Accounts (DPA), Royal Monetary Authority, and Department of National Budget. Monthly and quarterly reconciled figures are

also shared with the treasury division, DPA within the first week of the end of the month and quarter. The reconciliation of revenue collection and deposit is done every day by the Department of Revenue & Customs in the Revenue Administration Management Information System (RAMIS) system. Through the process of monthly and quarterly reconciliation a picture of monthly and quarterly tax arrears becomes available to MoF through the DPA.

In addition a statement reflecting the revenue arrears is shared with the Department of Public Accounts on an annual basis to be incorporated in the Annual Financial Statement within 8 weeks of the end of the fiscal year. The Public Finance Act 2007 mandates that a summary of revenue statement and arrears be submitted at the end of the financial year to the Department of Public Accounts. As the Annual financial statement is published annually therefore it contains revenue information for the fiscal year.

Score	Scoring Method M1 (WL). Minimum Requirements
<b>20.1: Information on revenue collections</b>	
A	A central agency obtains revenue data at least monthly from entities collecting <b>all</b> central government revenue. This information is broken down by revenue type and is consolidated into a report.
B	A central agency obtains revenue data at least monthly from entities collecting <b>most</b> central government revenue. This information is broken down by revenue type and consolidated into a report.
C	A central agency obtains revenue data at least monthly from entities collecting the <b>majority</b> of central government revenue and consolidates the data.
D	Performance is less than required for a C score.
<b>20.2: Transfer of revenue collections</b>	
A	Entities collecting <b>most</b> central government revenue transfer the collections directly into accounts controlled by the Treasury, or transfers to the Treasury and other designated agencies are made daily.
B	Entities collecting <b>most</b> central government revenue transfer the collections to the Treasury and other designated agencies at least weekly.
C	Entities collecting <b>most</b> central government revenue transfer the collections to the Treasury and other designated agencies at least every two weeks.
D	Performance is less than required for a C score.
<b>20.3: Revenue accounts reconciliation</b>	
A	Entities collecting <b>most</b> central government revenue undertake complete reconciliation of assessments, collections, arrears, and transfers to Treasury and other designated agencies at least quarterly within four weeks of the end of quarter.
B	Entities collecting <b>most</b> central government revenue undertake complete reconciliation of assessments, collections, arrears, and transfers to Treasury and other designated agencies at least half-yearly within 8 weeks of the end of the half-year.
C	Entities collecting <b>most</b> government revenue undertake complete reconciliation of collections and transfers to Treasury and other designated agencies at least annually within 2 months of the end of the year.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-20: Accounting for revenue</b>	<b>B+</b>	<b>Scoring Method M1</b>
20.1: Information on revenue collections.	A	Information on revenue collection is reported monthly to MoF and is summarized into a report.
20.2: Transfer of revenue collections.	A	Transfers to the Treasury and other designated agencies are made daily.
20.3: Revenue accounts reconciliation.	B	Complete reconciliation of assessments, collections, arrears, and transfers to the Treasury is made monthly, quarterly and annually within 8 weeks of end of period.

## Ongoing and planned reforms

A new web-based integrated system (Revenue Administration Management Information System - RAMIS) for both direct and indirect taxes is being developed. This will facilitate daily reconciliation since the concept of one centralized RGR account is introduced and the multiple RGR account system is discontinued. But RAMIS is a new system with stability issues and reporting is yet to be finalized.

## PI-21: Predictability of in-year resource allocations

This indicator assesses the extent to which the central ministry of finance is able to forecast commitment and cash requirements and provide reliable information on the availability of funds to budgetary units for service delivery. It contains four dimensions and uses the M2 (AV) method for aggregating dimension scores.

### Dimension 21.1: Consolidation of cash balances

The Constitution of Bhutan provides that all public monies (other than those allocated for specific purposes as per law) shall be deposited in a Consolidated Fund Account (CFA). The CFA is maintained with the Royal Monetary Authority (RMA), which is the designated depository for all budgetary operations of RGoB. The GCA, as the Treasury Single Account, is a set of linked accounts comprising three Government subsidiary bank accounts, viz. Government Revenue Account, Government Budget Fund Account and Non-Revenue Receipts & Deposits Account (*Public Finance Act*).

These accounts are maintained in the Bank of Bhutan Ltd. as the agent bank for facilitating receipt and management of government funds in the CFA. The withdrawals of government funds by the budgetary bodies are made through the Letter of Credit Account (LC) and Project Letter of Credit Account (PLC) mechanism and charged to the total receipts of subsidiary bank accounts. The agent bank passes the net proceeds of these accounts representing the total funds available to the CFA, the principal account of the Government, on a daily basis.

The MoF is the sole authority for authorizing bank accounts for all budgetary bodies and is the designated “steward” for all government bank accounts. It also has the responsibility of setting rules and procedures for the operations and accounting of government bank accounts. A budgetary body is prohibited from operating a bank account without the approval of the MoF (*Public Finance Act*). Guidelines for operation of bank accounts are detailed in the Financial Rules and Regulations (FRR). The Public Finance Act, FRR and Local Government Act, 2009 allow operation of Current Deposits (CD) accounts with Gewogs and Communities, Revolving Funds, Trust Funds, Endowment Funds, foreign currency accounts and bank accounts abroad by budgetary bodies for specific purposes. The consolidation of Trust Funds, bank accounts maintained by virtue of specific provisions in agreements with donors or others, Refundable Deposits Account<sup>30</sup>, Audit Recoveries Account<sup>31</sup> and Escrow Accounts to be held outside the CFA are set out in the PFA and FRR. The balances of these accounts at the end of each financial year are reported in the Annual Financial Statements of the Government. The table below summarizes the bank accounts maintained outside the CFA and disclosed in the AFS as of June 30, 2014. Table 3.5.21.1 shows the Government Bank Accounts outside the Consolidated Fund Account.

30 Maintained with RMA/agent bank for specific purpose money not available for appropriation such as refundable security deposits, earnest money or any other type of refundable receipts.

31 Operated by the RAA for the deposit and management of audit recoveries remitted to it on its instance.

**TABLE 3.5.21.1: GOVERNMENT BANK ACCOUNTS OUTSIDE THE CONSOLIDATED FUND ACCOUNT**

Name of Account	Currency	Balance as of June 30, 2014 (Nu. in million)	No. of accounts
Refundable Deposits Account	Nu.	717.528	1
Bhutan Health Trust Fund	Nu.	881.977	1
Bhutan Trust Fund for Environment Conservation	USD	45.823	1
Cultural Trust Fund	Nu.	52.106	1
Bhutan Information Communication and Media Authority	Nu.	193.31	1
Revolving fund	Nu.	32.729	7
Gewogs Current Deposit Account	Nu.	22.081	205
Municipal Current Deposit Account	Nu.	233.970	15
Judiciary Current Deposit Account	Nu.	27.157	18
Other Current Deposit Accounts <sup>32</sup>	Nu.	530.701	95
<b>Grand Total</b>		<b>Nu. 2,691.559 + USD 45.823 million</b>	<b>339</b>

*Source:* Annual Financial Statements, FY 2013/14.

Closing cash balances of the budgetary bodies are captured and reported through Public Expenditure and Management System (PEMS) and known on a daily basis. The year-end closing cash balances are surrendered to the Department of Public Accounts (DPA) within July of the following financial year and are deposited in the Government Budget Fund Account.

The bank/cash balances are consolidated on a daily basis, but some extra-budgetary funds remain outside the arrangements.

### *Dimension 21.2: Cash forecasting and monitoring*

A full year cash flow forecast is prepared based on the domestic revenue forecast prepared by the Department of Revenue and Customs (DRC), the Budget Utilization Plan (BUP) submitted by the budgetary bodies through PEMS and expected inflow of program grants. The bottom-up approach for preparing the BUP has been implemented from the financial year 2014/15 through the Budget Utilization Plan module in PEMS<sup>33</sup>. All budgetary bodies are required to submit their annual BUP to the Department of Public Accounts (DPA) within one month from the receipt of budget approval through PEMS. Subsequently, budgetary bodies are required to update the BUP on a quarterly basis for the remaining period of the financial year and submit updates to DPA. These take into account the actual cash inflows and outflows for the previous period. Fund release requests by the budgetary bodies are submitted online and fund releases are made based on BUP. Fund releases for the externally funded activities are provided based on the fund balance available with the Government.

The review of cash flow forecasts and Treasury Bills is managed by the Cash Coordinating Committee (CCC), comprising members from the Department of National Budget, RMA and DRC. For the full year BUP, the cash flow forecast is reviewed in early July of the fiscal year. However, subsequent quarterly reviews are done at the start or within the quarter, based on GCA fund position.

<sup>32</sup> These include the Audit Recoveries Account, Escrow Account, Endowment Fund etc.

<sup>33</sup> Prior to 2014/15, attempt was made to prepare the cash forecasts through spreadsheets.

A cash flow forecast is prepared for the fiscal year and updated at least quarterly taking into account the actual inflows and outflows.

### ***Dimension 21.3: Information on commitment ceilings***

The expenditure release process depends on the source of financing:

a) RGoB financing:

Once the expenditure projections are endorsed by the MFCC, the commitment to finance programs from RGoB financing is determined. The Parliament approves the commitments. RGoB financing is reliable and MDAs can implement the programs as approved: the releases are based on the MDAs' Budget Utilization Plans.

b) External financing:

The budget for programs financed by external donors is based on the commitments and agreements signed between the Development Partners (DPs) and RGoB. However, in the past, implementation was delayed due to late disbursement by the DPs resulting in huge under-utilization of the budget<sup>34</sup>. To correct this uncertainty and increase reliability of funds availability, the budget now includes provisions only for those projects for which fund disbursements are confirmed or the alternative of pre-financing from RGoB is arranged, including projects under implementation. As and when the external grants are available, these are released to the concerned agency through Supplementary Authorization, routed through the PEMS, based on approval of the GNHC and MoF. This is a continuous process. The Public Finance Act (section 60 amended) allows the Minister of Finance to authorize supplementary appropriation without recourse to Parliament for expenditures financed by donors or co-financed jointly with RGoB provided all approvals are available. These appropriations are included in the annual Supplementary Appropriation Bill that is presented in Parliament.

The original budget is passed by the Parliament ahead of the start of the fiscal year and the budget notification for its implementation is circulated in the first week of the fiscal year. The MDAs prepare their work plans and submit their budget utilization plans to the Department of Public Accounts, on which disbursement is made.

Funds are released to the budgetary bodies through Letter of Credit/Project Letter of Credit (LC/PLC) authorizations to the respective LC/PLC accounts and payments are made individually by the budgetary bodies within their approved budgets. Fund releases for the RGoB-funded activities are based on the BUPs, which are prepared and submitted by the budgetary bodies based on their approved budget. For externally funded activities fund releases are based on fund balances with the Government. The budgetary bodies have to complete monthly accounts in PEMS for obtaining subsequent fund releases.

The departments are able to plan and commit expenditure for at least six months in advance in accordance with the budgeted appropriations and cash/commitment releases.

### ***Dimension 21.4: Significance of in-year budget adjustments***

Adjustments to budget allocations decided above the level of the ministries are made through Supplementary Appropriations which include supplementary authorizations already granted by MoF in

<sup>34</sup> For instance, during 2013/14, external grants were budgeted for Nu. 8,109.513 million, but actual donor disbursements were Nu. 14,236.353 million. During 2014/15, external grants were budgeted for Nu. 7,360.231 million but revised to Nu. 11,153.268 million.

respect of external grants. Sections 55 to 65 of the Public Finance Act (PFA) 2007 contain both authority and limitations for making adjustments to the budget allocations that are approved by the Parliament, as detailed below:

- Any Supplementary Budgets beyond the total approved amount can only be approved by Parliament in accordance with the Public Finance Act.
- Budgetary bodies seek supplementary appropriations only when circumstances significantly change, and the Lhengye Zhungtshog (the Cabinet) has endorsed the change.
- Budgetary bodies are not allowed to make commitments or incur expenditure against anticipated supplementary budget proposals, but only after the Budget Appropriations Bill has been passed by the Parliament.

Additionally, expenditure beyond that appropriated or for which there is no appropriation can be authorized by the Minister of Finance without recourse to Parliament under two circumstances, as below. These cases have to be included in the supplementary bill for ex-post approval.

- for expenditures that are financed by donors or co-financed jointly with the Government for a development project that has all the required government approvals and such finance is based on agreement between the donors and the government.
- expenditure to be defrayed in case of an emergency or disaster and which cannot be postponed without detriment to the public interest.

The Minister of Finance presents to Parliament Supplementary Budget Appropriation Bills, outlining changes in appropriations and resource estimates with full justification for the revisions. Only one such Bill is submitted to Parliament in the summer session of Parliament along with the budget for the next year and follows the same procedure as the main budget. The Supplementary Bill also includes rationalization and technical adjustments for ex-post endorsement.

Year	Original Budget Nu. million	Supplementary Budget Nu. million	Rationalization/ Technical Adjustments Nu. million	Revised Budget Nu. million
2013/14	39,528.156	5,157.626	(-) 1,578.904	43,106.878
2014/15	40,355.837	4,339.507	(-) 534.813	44,160.531

Significant in-year adjustments to budget allocations take place only once a year above the level of the MDAs and are done in a transparent and predictable way.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>21.1: Consolidation of cash balances</b>	
A	<b>All</b> bank and cash balances are consolidated on a daily basis.
B	<b>All</b> bank and cash balances are consolidated on a weekly basis.
C	<b>Most</b> cash balances are consolidated on a monthly basis.
D	Performance is less than required for a C score.
<b>21.2: Cash forecasting and monitoring</b>	
A	A cash flow forecast is prepared for the fiscal year, and is updated monthly on the basis of actual cash inflows and outflows.



Score	Scoring Method M2 (AV). Minimum Requirements
B	A cash flow forecast is prepared for the fiscal year and updated at least quarterly on the basis of actual cash inflows and outflows.
C	A cash flow forecast is prepared for the fiscal year.
D	Performance is less than required for a C score.
<b>21.3: Information on commitment ceilings</b>	
A	Budgetary units are able to plan and commit expenditure for at least six month in advance in accordance with the budgeted appropriations and cash/commitment releases.
B	Budgetary units are provided reliable information on commitment ceilings at least quarterly in advance.
C	Budgetary units are provided reliable information on commitment ceilings at least one month in advance.
D	Performance is less than required for a C score.
<b>21.4: Significance of in-year budget adjustments</b>	
A	Significant in-year adjustments to budget allocations take place no more than twice in a year and are done in a transparent and predictable way.
B	Significant in-year adjustments to budget allocations take place no more than twice in a year and are done in a fairly transparent way.
C	Significant in-year budget adjustments to budget allocations are frequent, and are partially transparent.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-21: Predictability of in-year resource allocation</b>	<b>B+</b>	<b>Scoring Method M2</b>
21.1: Consolidation of cash balances.	B	The bank/cash balances are consolidated on a daily basis, but some extra-budgetary funds remain outside the arrangements.
21.2: Cash forecasting and monitoring.	B	A cash flow forecast is prepared for the fiscal year and updated at least quarterly taking into account the actual inflows and outflows.
21.3: Information on commitment ceilings.	A	The departments are able to plan and commit expenditure for at least six months in advance in accordance with the budgeted appropriations and cash/commitment releases.
21.4: Significance of in-year budget adjustments.	A	Significant in-year adjustments to budget allocations takes place only once a year above the level of the MDAs and are done in a transparent and predictable way.

## PI-22: Expenditure arrears

This indicator measures the extent to which there is a stock of arrears, and the extent to which any arrears are monitored. It contains two dimensions and uses the M1 method for aggregating dimension scores.

### *Dimension 22.1: Stock of expenditure arrears*

The Finance and Accounting Manual (FAM) of the FRR 2001, Clause 4.1.6 General Procedure for Processing of Claims, requires a Head of Office or an officer authorized by him with powers to draw

and disburse government money to maintain a Bills Inward Register. All claims received or prepared in an office should be registered in the Bills Inward Register; and the register should be reviewed once a month by the Head of Office and the result of the review recorded in the register. Action on settlement or return of any claim received in an office is required to be completed within 30 days of receipt of the claim. The Cabinet has issued directions in 1999 and 2000 to the effect that all Drawing and Disbursing Officers as well as National Finance Service Personnel to ensure that all claims/bills are cleared within one month of their receipt. However there is no reporting to MoF of the status of claims or arrears. Arrears at any point of time are not centrally known.

FAM requires that employee monthly pay bills be prepared and kept ready at least three days before the closing of the month. A party whose payments are in arrears can also claim penalty interest from the government agency that defaults on the payment.

There are no arrears on debt servicing.

### **Dimension 22.2: Expenditure arrears monitoring**

A system has been prescribed for recording commitments or obligations, outside of the system of accounting, to track expenditure arrears at an individual level. No exercise has been undertaken, at a central level, to collate the data on expenditure arrears, if any, and determine the stock of expenditure arrears any time during the last two years.

Score	Scoring Method M1. Minimum Requirements
<b>22.1: Stock of expenditure arrears</b>	
A	The stock of expenditure arrears is no more than 2% of total expenditure in at least two of the last three completed fiscal years.
B	The stock of expenditure arrears is no more than 6% of total expenditure in at least two of the last three completed fiscal years.
C	The stock of expenditure arrears is no more than 10% of total expenditure in at least two of the last three completed fiscal years.
D	Performance is less than required for a C score.
<b>22.2: Expenditure arrears monitoring</b>	
A	Data on the stock, age and composition of expenditure arrears is generated quarterly within four weeks of the end of each quarter.
B	Data on the stock and composition of expenditure arrears is generated quarterly within eight weeks of the end of each quarter.
C	Data on the stock and composition of expenditure arrears is generated annually at the end of each fiscal year.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-22: Expenditure arrears</b>	<b>D</b>	<b>Scoring Method M2</b>
22.1: Stock of expenditure arrears.	D*	For lack of information, the dimension is scored D*.
22.2: Expenditure arrears monitoring.	D	A system has been prescribed for recording commitments or obligations, outside of the system of accounting, to track expenditure arrears at an individual level. No exercise has been undertaken, at a central level, to collate the data on expenditure arrears, if any, and determine the stock of expenditure arrears any time during the last two years.

## **PI-23: Payroll controls**

This indicator is concerned with the payroll for public servants only: how it is managed, treatment of changes and consistency with personnel records management. Wages for casual labor and discretionary allowances that do not form part of the payroll system are included in the assessment of non-salary internal controls, PI-25. It contains four dimensions and uses the M1 (WL) method for aggregating dimension scores.

### ***Dimension 23.1: Integration of payroll and personnel records***

The Royal Civil Service Commission (RCSC) is the central personnel agency of RGoB responsible for the overall recruitment and appointment of civil servants in accordance with the Bhutan Civil Service Rules and Regulations (BCSR) 2012. The personnel records of civil servants are maintained by the RCSC in the form of hard copy personnel files and on a web-based system - the Civil Service Information System (CSIS). In addition, the service book (hard copy) for each civil servant is maintained by the Human Resource Division (HRD) of the respective budgetary body, staffed by officers from RCSC. The personnel records are updated in hard copy personnel files (by RCSC), service book (by HRD) and web-based CSIS (by RCSC and/or HRD). As RCSC is responsible for appointment of all civil servants in the country, it maintains a list of approved positions in each agency, which is reviewed at the time of new appointments to ensure that appointed staff are in accordance with the approved strength.

The monthly payroll is processed in the Public Expenditure Management System (PEMS) by accounts personnel at each budgetary body who are also responsible for regularly updating the payroll data based on the orders issued by the HRD or RCSC. All employees receive their pay and allowances through direct bank transfers.

Presently, there is no integration between the personnel records in CSIS and payroll data in PEMS. Also, neither one-time nor any periodic reconciliation exercise has been undertaken between the two systems.

The payroll and personnel records are not integrated and no reconciliation between the two sets of records has been undertaken.

### ***Dimension 23.2: Management of payroll changes***

The Finance and Accounting Manual states that “all modifications in the 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”.

The pay is disbursed fully on the last working day of each month, with the exception for the last month of the fiscal year where the HoD and DDOs decide on a day not more than 10 days in advance of the close of the month for disbursement of salaries.

Changes to the personnel records and payroll data are made based on the orders issued by the HRD or RCSC. As the two systems (CSIS and PEMS) are not integrated, changes are made separately to the personnel records (responsibility with HRD/RCSC) and payroll data in PEMS (responsibility with accounts personnel at the budgetary body).

The required changes to the personnel records and payroll are updated monthly and in time for the following month's payments in accordance with the rules laid down in FAM. Retroactive adjustments are rare. RAA has not made any observations in this regard.

### ***Dimension 23.3: Internal control of payroll***

Changes in the payroll system are based on the information provided by HRD/RCSC in the form of orders and office communications. RCSC/HRD issue appointment orders (for any new recruitments), transfer orders and separation orders. These orders are the basis for the accounts personnel to make changes in the payroll records and make salary-related payments.

The RCSC conducted a nationwide information correction exercise in all ten ministries, twenty dzongkhags, four thromdes and thirty autonomous agencies from August to November 2014 to correct individual personnel records and update missing information. Further, in December 2014, all civil servants were requested to confirm the accuracy of their data on CSIS. As of June 2015, 67% accuracy in the data was reported. The target is to achieve 95% level accuracy by June 30, 2016 (Annual Administrative Report of RCSC).

A unique Employee Identity Number (EID) is issued by RCSC/HRD to every employee which is used as primary key in the payroll module of PEMS and CSIS. Additionally the Citizenship Identity Card Number (CID) for Bhutanese citizens and the Work Permit Number for non-Bhutanese nationals are also used when registering employees in the CSIS and PEMS.

In the payroll module of PEMS there are two categories of users - system administrator and user. The accountant (user) at the agency level is responsible for adding/removing employees from the payroll based on the information received from the RCSC/HRD. Master-level changes (for instance, pay grade revisions) are done by the system administrator (at DPA) across the application which becomes available to the users at the agency level. Though there is maker-checker control in the payroll module of PEMS in respect of changes in the employee level data, this is not being followed in most budgetary bodies, especially in smaller agencies because of the limited number of personnel, finance and non-finance. Further, non-finance personnel are not familiar with the PEMS and it is not practical for non-finance personnel to be assigned any role in PEMS. Therefore, in smaller agencies one person, usually the finance person, does everything. After payroll processing, a payroll voucher is generated through PEMS, which is reviewed and approved by superiors in hard copy; however this voucher does not contain details of individual employees.

The audit reports of the RAA have raised concerns with regard to the payroll and the RAA has qualified its opinion for the last two years as follows:

- **Qualification in 2012-13:** There were cases of un-reconciled differences between employees' and employers' matching contribution, and instances of excess contributions remitted to NPPF were observed. Pending review and reconciliation of these differences, the auditor could not ascertain the exact extent of impact in the accounts.
- **Qualification in 2013-14:** Mismatch between employees' contributions reported under the receipts and payments statements of the budgetary agencies and monthly Provident Fund schedules generated by the payroll module of the PEMS. Further, inconsistent number of employees under monthly PF schedules was observed.
- **Audit report on Government Payroll and Provident Fund:** In 2013-14 the RAA conducted an audit on the Government Payroll and Provident Fund pertaining to the years 2011/12, 2012/13

and 2013/14 and reported significant findings with respect to payroll controls. Based on the review, the auditor identified irregularities amounting to Nu. 9.6 million in payroll including some arising from duplicate payments. The auditor reported *'huge discrepancies apparently emanating from control weaknesses in the Public Expenditure Management System (PEMS) in fixing and disbursing the personnel emoluments during transfer, training, extraordinary leave and separation of employees. Further, there were also cases of erroneous fixation of pay and remittances being made in contravention to the extant rules. These were the results of inadequacies and failure of controls in the PEMS posing question of system integrity'*.

Upon further review of the issues and assessment of the PEMS control environment, the auditor identified possible causes of such control issues, as follows:

- Lack of controls allowing preparation of payroll in the accounts module of PEMS without using the payroll module.
- Lack of real time data sharing.
- Lack of co-ordination between HRD and accounts personnel at agency level.
- Lack of monitoring at agency level and DPA.
- Weak controls to activate/deactivate employees at the time of transfer/resignation/superannuation resulting in double payments.

It is important to note that the PEMS was initially developed without the payroll module and was included at a later stage. The MoF has taken cognizance of auditor's observations and recommendations and is working on strengthening the system with the formation of a PEMS enhancement Technical Working Group within DPA. The group has been reviewing the PEMS and consulting with finance personnel in the line agencies.

For instance, the Last Pay Certificate (LPC) to be issued at the time of transfer will be generated from the payroll module of PEMS (compared to a manual process earlier) with enhanced controls for marking an employee as active/inactive at the agency level. These initiatives are under test currently and the impact of the same will be noticed going forward.

At the time of assessment, there are serious weaknesses in internal controls in PEMS payroll module.

#### ***Dimension 23.4: Payroll audit***

RCSC has instituted HR audit in 2012 as mandated by the Civil Service Act of Bhutan (CSAB) 2010. To date HR audit has been conducted in 12 agencies including ministries, autonomous agencies and dzongkhags. During FY 2014/15, HR audit was carried out in the Ministry of Foreign Affairs and National Environment Commission. Once the on-going reforms are over, HR audit will be strengthened and will be one of the most important exercises undertaken periodically by the RCSC to ensure that HR actions are done in compliance with the BCSR and the CSAB.

In 2013-14 the RAA conducted a specific audit of the Government Payroll and Provident Fund as a follow-up audit on the discrepancies in the remittances of GPF noted during the audit of the Annual Financial Statements of the Royal Government for the financial year ended 30th June 2013 and NPPF.

As discussed above, nationwide correction surveys are being undertaken by RCSC since 2014 to update the personnel records and 67% accuracy in personnel data was reported of June 2015. The target is to achieve 95% level accuracy by June 2016.

There is no system of annual payroll audits in RGoB. The RAA undertook a detailed review of the payroll in 2013/14 across all central government agencies and reported its findings as a separate chapter in the Annual Audit Report. Also, regular surveys and HR audits are being undertaken by RCSC.

Score	Scoring Method M1 (WL). Minimum Requirements
<b>23.1: Integration of payroll and personnel records</b>	
A	Approved staff list, personnel database and payroll are directly linked to ensure budget control, data consistency and monthly reconciliation.
B	The payroll is supported by full documentation for <b>all</b> changes made to personnel records each month and checked against the previous month's payroll data. Staff hiring and promotion is controlled by a list of approved staff positions.
C	Reconciliation of the payroll with personnel records takes place at least every six months. Staff hiring and promotion is checked against the approved budget prior to authorization.
D	Performance is less than required for a C score.
<b>23.2: Management of payroll changes</b>	
A	Required changes to the personnel records and payroll are updated at least monthly, generally in time for the following month's payments. Retroactive adjustments are rare. If reliable data exists, it shows corrections in a maximum of 3% of salary payments.
B	Personnel records and payroll are updated at least quarterly and require <b>a few</b> retroactive adjustments.
C	Personnel records and payroll are updated at least quarterly and require <b>some</b> retroactive adjustments.
D	Performance is less than required for a C score.
<b>23.3: Internal control of payroll</b>	
A	Authority to change records and payroll is restricted, results in an audit trail and is adequate to ensure full integrity of data.
B	Authority and basis for changes to personnel records and the payroll are clear and adequate to ensure high integrity of data.
C	Sufficient controls exist to ensure integrity of the payroll data of greatest importance.
D	Performance is less than required for a C score.
<b>23.4: Payroll audit</b>	
A	A strong system of annual payroll audits exists to identify control weaknesses and ghost workers.
B	A payroll audit covering <b>all</b> central government entities has been conducted at least once in the last three completed fiscal years (whether in stages or as one single exercise).
C	Partial payroll audits or staff surveys have been undertaken within the last three completed fiscal years.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-23: Payroll controls</b>	<b>D+</b>	<b>Scoring Method M1</b>
23.1: Integration of payroll and personnel records.	D	The payroll and personnel records are not integrated and no reconciliation between the two records has been undertaken.
23.2: Management of payroll changes.	A	The required changes to the personnel records and payroll are updated monthly and in time for the following month's payments in accordance with the rules laid down in FAM. Retroactive adjustments are rare.
23.3: Internal control of payroll.	D	There are serious weaknesses in internal controls in PEMS payroll module and significant observations are made by the auditor on the adequacy of controls to ensure integrity of the payroll data.



Indicator/Dimension	Score	Brief justification for the score
23.4: Payroll audit.	C	There is no system of annual payroll audits in RGoB. The RAA undertook a detailed review of the payroll in 2013-14 across all central government agencies and reported its findings as a separate chapter in the Annual Audit Report. Also, regular surveys and HR audits are being undertaken by RCSC.

### *Ongoing and planned reforms*

Efforts are under way to develop an application program interface to integrate CSIS with other shared systems such as Census Information System for decentralized recruitments and Bhutan Civil Service Examination Systems. Initial dialogue is under way on the possibilities of integrating the CSIS with the payroll system in PEMS once the CSIS is fully updated.

RCSC is in the final stage of validating and updating the CSIS and linking the information on CID from the Department of Registration, Ministry of Home and Cultural Affairs. Once it has completed updating the CSIS, users will not have to make any manual entries. This will save time and resources and improve data reliability, consistency and accuracy.

### **PI-24: Procurement**

Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively in acquiring inputs and achieving value for money in the delivery of programs and services by a government. This indicator examines key aspects of procurement management, focusing on transparency of arrangements, emphasis on open and competitive procedures, monitoring of procurement results and access to appeal and redress arrangements. It contains four dimensions and uses the M2 (AV) method for aggregating dimension scores. The relevant time period is FY 2014/15.

#### *Dimension 24.1: Procurement monitoring*

At present a nationwide comprehensive procurement monitoring system for all type of contracts does not exist. The Ministry of Finance has already awarded the contract to Consulting Firm to design an e-Government Procurement system that shall cover all these aspects by the next year. However since Procurement of works covers almost 50% of the Government Procurement (during the 10th Five Year Plan (2008-2013), works accounts for 47% followed by services with 24% and goods with 18% as per Green Public Procurement in Bhutan-2015 report), the Construction Development Board maintains an online evaluation, monitoring and reporting system and a ciNet system through which data is maintained for Construction works contracts. Most Procuring Agencies have on their own initiative maintained such data on procurement of goods, works and services.

While a centralized data system would provide for monitoring the efficiency and effectiveness of the procurement system, currently data maintained by Procuring agencies have been serving this purpose. Realizing the difficulties in doing so, the e-GP is being initiated by the Ministry of Finance.

#### *Dimension 24.2: Procurement methods*

Open competition is defined as the preferred or default method for procurement in the Procurement Rules and Regulations (PRR) 2009 (revised July 2015) Clause No. 4.2.2.1. A threshold value above which

open competition is the default method is defined in the PRR, which is above Nu. 1M in the case of procurement of Works, and above Nu. 0.2 M in case of Goods and Services. As per the data collected through e-tool database maintained by Construction Development Board covering 1430 contracts, all followed open competition. These 1430 contracts represents all high spending implementing agencies/ ministries. Hence the sample is statistically representable. The procurement of works account for majority of procurement in Bhutan and the e-tool allows for comprehensive web based advertisement and contract management system. The site is [www.cdb.gov.bt](http://www.cdb.gov.bt). Due to lack of MIS for goods and service, for the assessment purpose goods and service data has not been considered. Just to have an idea, a small sample for the Ministry of Education (MoE) for goods and services and Thimphu Thromde for construction works was reviewed. Out of 26 contracts MoE had tendered out in 2014/15, 13 were done through limited bidding, which accounted for 13% of the total procurement value. In the case of Thimphu Thromde, out of 24 contracts, 6 were tendered out through limited bidding and 1 through limited enquiry/shopping, which accounted for 4% of the total procurement value. Limited bidding is a competitive method but for a shorter bidding period of 14 days. Based on these findings, it can be seen that except for those which exceed the threshold value defined in the PRR, all tenders are done through open competition.

While a procurement monitoring system does not exist currently, the Ministry of Finance has already initiated e-GP system, which shall cover all these aspects. A Consulting firm hired by the Ministry is already working on phase-I of the e-GP system and the system development has been completed., From September 2016, the phase –I will be go live as pilot basis for three organizations. The phase-I among others will include business process re-engineering of the public procurement system in Bhutan, Registration on the system, Annual Procurement Plan, Tendering and e-learning. On completion of phase-I, the PPPD will have information and reports on the numbers of tenders processed, types of procurement and details on all other aspects of the tendering process.

However since Procurement of works covers majority of Government Procurement spend, the e-Tool system for evaluation of works tenders maintains such data in respect of works contracts. Hard copy records of all contracts are maintained by the Procuring Agencies in accordance with the Financial and Accounting Manual 2001. The whole process of procurement including information from advertisement to payment and contract management is duly recorded in hard copy filing. This also includes the method of procurement. No issues or concerns on the reliability of these data on awarded contracts were referred to in the Annual Audit Report 2014.

Though the sample data (i.e. 1430 works contract from CDB’s website) showed that more than 80% of total value of contracts followed competitive method but due to the absence of a comprehensive e-GP system this is difficult to substantiate this fact. CDB’s website does not capture data for the contract’s value less than Nu. 4 Million. However these small value contracts represents less than 10% of the total works expenditure. Hence the rating for this dimension is evaluated as “B”.

### ***Dimension 24.3: Public access to procurement information***

The Procurement Rules & Regulations (PRR), Standard Bidding Documents (SBDs) and related guidelines and manuals are available on the Public Procurement Policy Division (PPPD) website and accessible free of charge by all users. These standard documents were also printed and distributed to all Ministries, Dzongkhags and Gewogs in 2012.

As required by the PRR, information on procurement opportunities are made available in the newspapers, on e-Tool system of the CDB for construction works, announced on the TV and also made available on the Procuring Agency’s website. Information on procurement opportunities, amendments to the bidding

documents and any other information can be seen on any government agency website. In addition, the notification on award of contracts is displayed on the notice board of the procuring agency concerned. However, proposal for preparing and making available procurement plans are still at a draft stage. Clause 64 of Rules and Procedures for Independent Review Body 2015 requires that after resolving a complaint, the Independent Review Body (IRB) Secretariat is required to publish on the website of the PPPD, such a summary of decisions made. The IRB was introduced recently and until date received only one complaint, which was resolved as per the IRB Rules and Procedures. The decisions of the IRB is published on the PPPD website.

The Annual Audit Report 2014 does not mention any concerns on reliability of any of the above information published in the media or on the websites of the Procuring Agencies.

Under this dimension, the requirements of (1) legal and regulatory framework for procurement (3) bidding opportunities, (4) contract awards and (5) data on resolution of procurement complaints are met and therefore this dimension is scored B.

#### ***Dimension 24.4: Procurement complaints management***

An Independent Review Body and the Rules and Procedures of the Independent Review Body was introduced in July, 2015. Clause 16 (l) of Rules and Procedures of the Independent Review Body 2015 ensures that no members of the IRB have conflict of interest pertaining to issues to be discussed and refrain from participation in the specific meetings if any and requires that members sign a confidentiality and Declaration of interest form (annexed in IRB Rules and Procedures) in every meeting.

Clause 8.1.3 of the Procurement Rules and Regulations 2009 (revised July 2015) allows a supplier, contractor or service provider, in the event of a perceived breach of a duty imposed upon a Procuring Agency in respect of a specific procurement procedure, to submit a written complaint to the head of the procuring agency responsible for such procedure promptly and in any event within 10 days of the letter of intent to award the contract. However, Clause 32(IV) of Rules and Procedures of the Independent Review Body 2015 requires Bidders to pay a nominal registration fee of Nu. 5000. The intention is not to discourage Bidders to complain but to prevent (least to certain extent) baseless complaints. While developing the Rules and Procedures for Independent Review Body, the Bhutan Chamber of Commerce & Industry (BCCI) and Contractors' Association of Bhutan (CAB) representing the interest of bidding community were actively involved as the main stakeholders at each stage of discussion. In fact, in the initial proposal the BCCI and CAB proposed Nu.10,000 as application fees but this was later reduced to Nu. 5000 by Ministry of Finance so as not to discourage genuine complaints.

The Rules and Procedures of the Independent Review Body 2015 clearly define the processes for submission and resolution of complaints that are clearly defined and publicly available. The Rules and procedures also provide for the IRB to exercise the authority to suspend the procurement process; issue decisions within the timeframe specified in the rules/regulations; and issue decisions that are binding on all parties (without precluding subsequent access to an external higher authority).

Until date, only one complaint was received after establishing the IRB in July 2015. The complaint was reviewed as per the Rules and Procedures of the IRB and the details and decisions taken by the IRB is posted on the PPPD website.

Under this dimension, which is assessed as at the time of assessment, all the requirements of items (1) to (6) are met and therefore this dimension is scored as "A".

Score	Scoring Method M2 (AV). Minimum Requirements
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### 24.1: Procurement monitoring

- A Databases or records are maintained for contracts including data on what has been procured, value of procurement and who has been awarded contracts. The data are accurate and complete for **all** procurement methods for goods, services and works.
- B Databases or records are maintained for contracts including data on what has been procured, value of procurement and who has been awarded contracts. The data are accurate and complete for **most** procurement methods for goods, services and works.
- C Databases or records are maintained for contracts including data on what has been procured, value of procurement and who has been awarded contracts. The data are accurate and complete for the **majority** of procurement methods for goods, services and works.
- D Performance is less than required for a C score.

### 24.2: Procurement methods

The total value of contracts awarded through competitive methods in the last completed fiscal year, represents:

- A 80% or more of total value of contracts
- B 70% or more of total value of contracts
- C 60% or more of total value of contracts
- D less than required for a C score

### 24.3: Public access to procurement information

Key procurement information to be made available to the public comprises:

- (1) Legal and regulatory framework for procurement.
- (2) Government procurement plans.
- (3) Bidding opportunities.
- (4) Contract awards (purpose, contractor and value).
- (5) Data on resolution of procurement complaints.
- (6) Annual procurement statistics.

- A Every key procurement information elements is complete and reliable for government units representing **all** procurement operations and made available to the public in a timely manner.
- B At least four of the key procurement information elements are complete and reliable for government units representing **most** procurement operations and made available to the public in a timely manner.
- C At least three of the key procurement information elements are complete and reliable for government units representing the **majority** of procurement operations and made available to the public.
- D Performance is less than required for a C score.

### 24.4: Procurement complaints management

Complaints are reviewed by a body which:

- (1) Is not involved in any capacity in procurement transactions or in the process leading to contract award decisions.
- (2) Does not charge fees that prohibit access by concerned parties.
- (3) Follows processes for submission and resolution of complaints that are clearly defined and publicly available.
- (4) Exercises the authority to suspend the procurement process.
- (5) Issues decisions within the time frame specified in the rules/regulations.
- (6) Issues decisions that are binding on every party (without precluding subsequent access to an external higher authority).

- A The procurement complaint system meets every criterion.
- B The procurement complaint system meets criterion (1), and three of the other criteria.
- C The procurement complaint system meets criterion (1), and one of the other criteria.
- D Performance is less than required for a C score.

Indicator/Dimension	Score	Brief Justification for the score
<b>PI-24: Procurement</b>	<b>B</b>	<b>Scoring Method M2</b>
24.1: Procurement monitoring.	C	Records are maintained on works contracts showing what is procured, its cost, and who is awarded the contracts. These cover the majority of all procurement.
24.2: Procurement methods.	B	70% or more of total value of contracts are awarded through competitive methods.
24.3: Public access to procurement information.	B	Public has access to information on procurement rules and procedures, bidding opportunities and contract awards and data on resolution of procurement complaints.
24.4: Procurement complaints management.	A	The complaints system meets all six criteria.

### *Ongoing and planned reforms*

The Ministry of Finance has awarded a contract to a consulting firm to design an e-Government procurement system in three phases. The first phase contract is signed and expected to be delivered by December 2016.

### **PI-25: Internal controls on non-salary expenditure**

This indicator measures the effectiveness of general internal controls for non-salary expenditures. Additional, specific expenditure controls on public service salaries are considered in PI-23. It contains three dimensions and uses the M2 (AV) method for aggregating dimension scores.

#### *Dimension 25.1: Segregation of duties*

The manual and guiding documents (for instance, the Internal Control (IC) Framework and Financial Rules and Regulations 2001) issued by the Ministry of Finance establish the need for effective segregation of duties to reduce the risk of error or fraud. The IC Framework specifies that segregation 'includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event'. The Financial Management Manual (FMM) states that 'a system of internal control in an agency shall, among others, ensure that different stages of a transaction process are handled by different persons. In particular, the verifying officer, the sanctioning authority and the disbursement officer shall preferably be different persons'.

Further, the Finance and Accounting Manual (FAM) clearly specifies the rules and regulations on the processing and recording of transactions and the different levels of operation. It stipulates that the following requirements shall be fulfilled for establishment of legitimacy of claims against the Government and making payments out of government funds:

- a. Existence of a sanction of expenditure;
- b. Recording of verification of claims;
- c. Preparation of disbursement voucher;
- d. Approval of expenditure;
- e. Payment.

The above requirements are handled by different people as follows:

- a. Sanctioning Officer:** FAM clause 4.1.7.3 An officer to whom adequate financial powers have been delegated under the relevant rules shall issue a Sanction of Expenditure wherever practicable, on the basis of a proposal submitted by the head of a unit or section and verified by the head of the finance section.
- b. Verifying Officer:** FAM clause 4.1.8.2. An officer delegated with the responsibilities for supervision and/or maintenance of records pertaining to particular activities or functions, shall verify any claims pertaining to those supplies or services delivered, utilities provided or works executed. He/she verifies any claim against the Government in order to establish that the goods or services have been received for the specific purposes and have been recorded in the relevant records.
- c. Preparer:** Based on the above, finance personnel prepare a disbursement voucher for payment or journal voucher for adjustment to be made.
- d. Approving Officer:** FAM defines it as the Head of Office or an Officer designated as the Drawing and Disbursing Officer (DDO) who approves all disbursement/journal vouchers for payment or adjustment.

Likewise for all vouchers there are three levels namely preparation, verification and approval.

The bank accounts of the budgetary bodies are jointly operated by the Head of Office/Head of Administration and Finance Division and the Finance Service Personnel and thus the cheques for all payments have to be signed by both officials.

The budget in the Public Expenditure Management System (PEMS) is sourced from a different but integrated system called Multi-Year Rolling Budget (MYRB) which is updated and maintained by a Budget Officer who is different from the Accounts Officer who prepares vouchers and makes disbursement. Therefore, there is separation of functions between the accounts personnel who make disbursements based on budget allocations by the budget personnel.

There is a Schedule of Delegation of Powers as Appendix I to the Financial Management Manual of the FRR 2001 which specifies different types of delegation and the levels of delegation of financial powers at the level of the Head of Ministry, Secretariat, Autonomous Agency, Department and Dzongkhag.

Segregation of duties is practiced by the officials and evidenced by their signatures on the vouchers and other hard copy documentation. However, the same is not replicated in PEMS, as the preparer of a transaction is allowed to verify and approve the same. For instance, the accountant makes the entry in the PEMS and can approve it himself/herself after obtaining the requisite approvals from the superiors on the hard copy documentation. Thus, evidence of adequate segregation is available in the hard copy files, but not in the audit trail available in PEMS. This risk is however mitigated as the cheque preparation (i.e. payment procedure) follows appropriate segregation of duties, thereby not posing an internal control risk.

There is appropriate and clear segregation of duties and responsibilities laid down in the financial rules and regulations and practiced by various officials throughout the process.



### ***Dimension 25.2: Effectiveness of expenditure commitment controls***

Article 61 of the Public Finance Act states that ‘budgetary bodies shall expend public money only in accordance with an appropriation under the Budget Appropriation Act’.

Similarly, Articles 62 and 63 of the PFA prohibit a budgetary body from carrying out activities for which there is no provision in the Budget Appropriation Act or other lawful authority for making commitments that have financial implications beyond the limits authorized by the Budget Appropriation Act.

Accordingly, system restrictions have been put in place in the Public Expenditure Management System (PEMS) which prevents booking of expenditure beyond the budget appropriation and releases of funds in the bank accounts of the budgetary bodies. Therefore, availability of budget appropriation and release of funds are the determining factors for incurring any expenditure or making commitments by the budgetary bodies. The PFA prohibits budgetary bodies from making any commitments that have financial implications beyond the limits authorized by the Budget Appropriation Act and therefore there is no question of outstanding commitments or over-spilling of commitments beyond the fiscal allocations.

RGoB follows a system of issuing Letter of Credit Account (LC) and Project Letter of Credit Account (PLC) to prevent commitments from exceeding the projected cash availability. LC and PLC Accounts are the drawing sub-accounts of the Government Consolidated Account allotted to the budgetary bodies to facilitate withdrawals of funds for execution of budgetary activities. Through the LC/PLC, the DPA specifies the limit up to which drawing authorities of the budgetary bodies can withdraw funds for their budgeted expenditures. There is no physical cash in these LC and PLC accounts but only a notional drawing limit. Any cheques drawn against these accounts get charged to the Government Consolidated Account on a daily basis.

All payments have to be accompanied by a disbursement voucher prepared from the PEMS, which has a system restriction on the availability of budget appropriation. Further, the budget in the PEMS is sourced from a different but integrated system called Multi-Year Rolling Budget (MYRB), which is updated and maintained by a Budget Officer who is different from the Accounts Officer who prepares vouchers and makes disbursement. Therefore, there is separation of functions between the accounts personnel who make disbursements based on the budget appropriations allocated by the budget personnel.

The Royal Audit Authority (RAA) has not made any observations with respect to the effectiveness of the expenditure commitment controls.

Comprehensive expenditure commitment controls are in place.

### ***Dimension 25.3: Compliance with payment rules and procedures***

The control over payments is built within the system as per the provisions of the existing financial rules and regulations and all budgetary bodies have to adhere to it. All possible checks and balances are built into the system to control and ensure that all payments are made in compliance with the rules and regulations. Some of the system controls are as follows:

- i. No payments can be processed without budget provision.
- ii. Even if there is budget provision, a payment cannot be processed if there is no fund released against the particular activity.

The RAA conducts annual audits that assess the effectiveness of controls and requires recovery of irregular payments. The audit process is a major component in ensuring the adequacy of the control system.

The audit report for the year 2013-14 of the RAA presented to Parliament reported an amount of Nu. 634 million as under observation under the following categories as shown in Table 3.5.25.1.

**TABLE 3.5.21.1: AMOUNT UNDER OBSERVATIONS (NON PAYROLL) IN VARIOUS CATEGORIES**

Category	Amount under Observation (Non Payroll) in Nu. Million
Violation of Laws and Rules	263.796
Shortfalls, Lapses and Deficiencies	135.898
Mismanagement	135.049
Fraud, Corruption and Embezzlement	98.844
<b>Total Amount</b>	<b>633.587</b>

**Source:** Audit Report for the year 2013-14 of the RAA.

This amount represents 1.68% of RGoB's expenditure (excluding payroll and its related expenses amounting to Nu. 37,627 million) for the year 2013/14. The percentage would be 2.72% if financial expenses of Nu. 14,374 million were also excluded.

Compliance with the rules and regulations is high and more than 90% of payments are executed in accordance with regular rules and procedures as noted from the audit reports.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>25.1: Segregation of duties</b>	
A	Appropriate segregation of duties is prescribed throughout the expenditure process. Responsibilities are clearly laid down.
B	Segregation of duties is prescribed throughout the expenditure process. Responsibilities are clearly laid down for <b>most</b> key steps while further details may be needed in a few areas.
C	Segregation of duties is prescribed throughout the expenditure process. More precise definition of important responsibilities may be needed.
D	Performance is less than required for a C score.
<b>25.2: Effectiveness of expenditure commitment controls</b>	
A	Comprehensive expenditure commitment controls are in place and effectively limit commitments to projected cash availability and approved budget allocations.
B	Expenditure commitment controls are in place and effectively limit commitments to projected cash availability and approved budget allocations for <b>most</b> types of expenditure.
C	Expenditure commitment control procedures exist which provide partial coverage and are partially effective.
D	Performance is less than required for a C score.
<b>25.3: Compliance with payment rules and procedures</b>	
A	<b>All</b> payments are compliant with regular payment procedures. <b>All</b> exceptions are properly authorized in advance and justified.
B	<b>Most</b> payments are compliant with regular payment procedures. The <b>majority</b> of exceptions are properly authorized and justified.
C	The <b>majority</b> of payments are compliant with regular payment procedures. The <b>majority</b> of exceptions are properly authorized and justified.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-25: Internal controls for non-salary expenditure</b>	<b>A</b>	<b>Scoring Method M2</b>
25.1: Segregation of duties.	A	Appropriate and clear segregation of duties and responsibilities are laid down in the financial rules and regulations.
25.2: Effectiveness of expenditure commitment controls.	A	Comprehensive expenditure commitment controls are in place.
25.3: Compliance with payment rules and procedures.	A	Compliance to the rules and regulations is high and more than 90% of payments are executed in accordance with regular rules and procedures as noted from the audit reports.

## PI-26: Internal audit

This indicator assesses the standards and procedures applied in internal audit. It contains four dimensions and uses the M1 (WL) method for aggregating dimension scores.

The Ministry of Finance Central Coordinating Agency (CCA) is responsible for administering the internal audit service to all public sector agencies under the Royal Government of Bhutan. Internal audit was first introduced in the year 2000 and ever since its popularity, amidst challenges, as an in-house tool to manage risk, governance and control mechanism in an organization has been surging. Internal audit is one of the important components in the national internal control framework along with the Royal Audit Authority and the Anti-Corruption Commission.

As a coordinating agency, CCA issues internal audit guidelines, coordinates function and monitors and evaluates internal audit activities in agencies. The CCA has issued a Charter, Internal Audit Manual, Code of Conduct and internal control framework. It has also provided standard operating procedure for auditing the procurement system in the country.

### *Dimension 26.1: Coverage of internal audit*

This measures the proportion of total planned expenditure and/or revenue collection covered by annual audit activities.

The Royal Government of Bhutan has functioning internal audit units in all twenty dzongkhags, ten ministries and two autonomous agencies, a total of 32 agencies. However, there are a few autonomous agencies without internal audit units. All 32 functioning units implement audit plans and produce reports annually. The total budget of these agencies constitutes 89.1% of the overall budget of the Government (FY 2015/16). The annual internal audit plans are risk prioritized but implementation is subject to resource availability. Not all risk-inflicted departments/divisions (as per risk assessment by the internal auditors) receive internal audit services. At the national level, the service has a resource gap of 29 internal auditors.

Table 3.5.26.1 below shows the expenditure coverage of internal audit in 2015/16.

**TABLE 3.5.26.1: EXPENDITURE COVERAGE OF INTERNAL AUDIT IN 2015-16**

CG entity with (1) internal auditors placed and (2) approved internal audit plan	Expenditure Nu. Millions	% of Overall Budget
Total government budget for 2015-16 FY	50,713.707	100.0%
Total budget for 10 ministries having IA	33,165.215	
Total budget for 20 dzongkhags having IA	11,563.617	
Total budget for 2 autonomous bodies having IA	466.389	
Total budget subject to internal audit	45,195.221	89.1%

As for the revenue, all revenue for the government is collected by the Department of Revenue and Customs (DRC). Although there is no dedicated IAU in the DRC, there is an IAU under MoF and DRC is covered under MoF.

**Dimension 26.2: Nature of audits and standards applied**

This dimension assesses if internal audit focuses on risk areas of the agency by way of prioritization in the internal audit plan.

Internal audit plans are formulated before the start of the fiscal year based on risk assessment. Internal Audit Service in Bhutan has adopted the International Standards for the Professional Practice of Internal Auditing. There are risk-based audit plans to prioritize agencies and/or programs within the audit universe. However, audit engagements are primarily ex-post reviews of financial compliance.

Theme based audits have been introduced such as on procurement management. Audit areas are specified in the Audit Plan and these are approved by the Secretary of the Department.

Internal audits are primarily focused on financial compliance.

**Dimension 26.3: Implementation of internal audits and reporting**

In 31 IAUs, the plans for FY 2014/15 were almost fully implemented (see table below). For financial year 2014/15, all 32 functioning IAUs completed their plans and submitted reports within a month of every engagement. CCA received a copy of all reports submitted to the respective managements by IAUs.

The Royal Audit Authority is yet to rely on internal audit reports. Internal audit units are not required to endorse a copy of their reports to the Royal Audit Authority. However, the RAA can ask for a copy of internal audit reports from the management should they desire to have one. Table 3.5.26.2 shows the Completion of Programmed Audits during 2014-15.

**TABLE 3.5.26.2: COMPLETION OF PROGRAMMED AUDITS DURING FY 2014/15**

Agency	Audits planned	Audit completed and reports issued
All 10 ministries	9 audit plans	All completed and issued reports
All 20 dzongkhags	20 audit plans	19 completed and issued reports
2 autonomous agencies	2 audit plans	Both completed and issued reports

Out of a total of 31 planned audits, 30 were completed and reports issued (97%) This meets the PEFA requirement for A, where “all” means over 90%.

**Dimension 26.4: Response to internal audits**

The responsible managers generally address internal audit findings involving financial restitution almost immediately. However, recommendations calling for systemic reforms receive lukewarm response in the central agencies. The majority of the findings relate to financial compliance. For example, for FY 2014/15, almost 80% of the findings related to financial compliance. The practice is acute in the dzongkhags, possibly due to the low status of internal auditors vis-à-vis the management.

Score	Scoring Method M1 (WL). Minimum Requirements
<b>26.1: Coverage of internal audit</b>	
A	Internal audit is operational for <b>all</b> central government entities.
B	Internal audit is operational for central government entities representing <b>most</b> total budgeted expenditures and for central government entities collecting <b>most</b> budgeted government revenue.
C	Internal audit is operational for central government entities representing the <b>majority</b> of budgeted expenditures and for central government entities collecting the <b>majority</b> of budgeted government revenue.
D	Performance is less than required for a C score.
<b>26.2: Nature of audits and standards applied</b>	
A	Internal audit activities are focused on evaluations of the adequacy and effectiveness of internal controls. A quality assurance process is in place within the internal audit function and audit activities meet professional standards, including focus on high risk areas.
B	Internal audit activities are focused on evaluations of the adequacy and effectiveness of internal controls.
C	Internal audit activities are primarily focused on financial compliance.
D	Performance is less than required for a C score.
<b>26.3: Implementation of internal audits and reporting</b>	
A	Annual audit programs exist. <b>All</b> programmed audits are completed, as evidenced by the distribution of the reports to their appropriate parties.
B	Annual audit programs exist. <b>Most</b> programmed audits are completed, as evidenced by the distribution of their reports to the appropriate parties.
C	Annual audit programs exist. The <b>majority</b> of programmed audits are completed, as evidenced by the distribution of their reports to the appropriate parties.
D	Performance is less than required for a C score.
<b>26.4: Response to internal audits</b>	
A	Management provides a full response to audit recommendations for <b>all</b> entities audited within twelve months of the report being produced.
B	Management provides a partial response to audit recommendations for <b>most</b> entities audited within twelve months of the report being produced.
C	Management provides a partial response to audit recommendations for the <b>majority</b> of entities audited.
D	Performance is less than required for a C score.

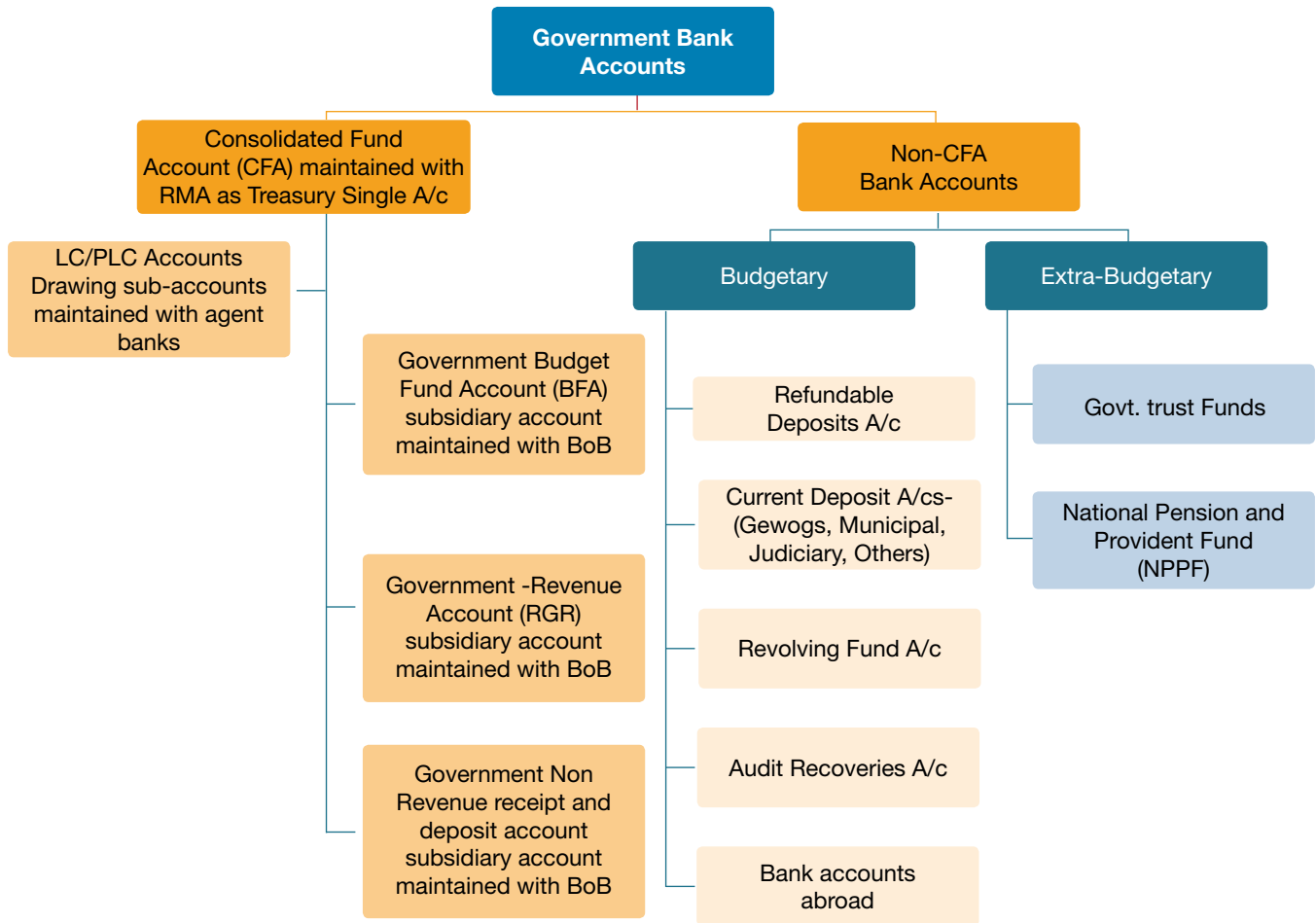
Indicator/Dimension	Score	Brief justification for the score
<b>PI-26: Internal audit</b>	<b>C+</b>	<b>Scoring Method M1</b>
26.1: Coverage of internal audit.	B	Internal audit is operational for CG entities incurring most expenditure and collecting most revenue.
26.2: Nature of audits and standards applied.	C	Internal audit is primarily focused on financial compliance.
26.3: Implementation of internal audits and reporting.	A	All planned audits are completed and reports distributed to the appropriate parties.
26.4: Response to internal audits.	C	Management provides a partial response for the majority of entities audited.

### 3.6 Pillar VI – Accounting and reporting (Performance indicators 27 to 29)

#### PI-27: Financial data integrity

This indicator assesses the extent to which treasury bank accounts, suspense and advance accounts are regularly reconciled and how the processes in place support the integrity of financial data. It contains four dimensions and uses the M2 (AV) method for aggregating dimension scores.

FIGURE 3.6.27.1: CLASSIFICATION OF GOVERNMENT BANK ACCOUNTS



#### Dimension 27.1: Bank account reconciliation

The FAM provides that reconciliation of the principal and subsidiary bank accounts shall be undertaken by the authorized agencies of the MoF while the collection agencies shall follow instructions in the Revenue Manual for reconciliation of revenue sub-accounts (RGR accounts).

Table 3.6.27.1 shows the Frequency of reconciliation of government bank accounts outside the GCA. The constituents of the Government Consolidated Account (GCA) and the regularity of reconciliation are:



- a. The Government Budget Fund Account (BFA) – operated by the DPA and reconciled at monthly intervals.
- b. The Government Revenue Account (RGR) – operated by the DRC and reconciled daily on RAMIS.
- c. The LC/PLC (memorandum) accounts - operated by the designated Accounting Units in all offices and reconciled by the respective office on a monthly basis; the information of reconciliation, however, is not collated by a centralized agency.
- d. Non-revenue account maintained to facilitate the inter-agency transfers. The FAM states that on receipt of the monthly accounts from agencies, the DPA shall check whether the amount shown under the head ‘Deposits: Non-Revenue’ is reconciled with the bank statements and Deposit Invoices received from the Agent Banks. However, information on the regularity of reconciliation is not known.

**TABLE 3.6.27.1: FREQUENCY OF RECONCILIATION OF GOVERNMENT BANK ACCOUNTS OUTSIDE THE GCA**

Name of Account	Currency	No. of accounts	Balance as of Jun 30, 2014 (million)	Balance as of Jun 30, 2015 (million)	Periodicity of Reconciliation
Refundable Deposits Account	Nu.	1	717.528	0.000	No
Bhutan Health Trust Fund	Nu.	1	881.977	1,392.679	At least monthly
Bhutan Trust Fund for Environment Conservation	USD	1	45.823	47.450	At least monthly
Cultural Trust Fund	Nu.	1	52.106	59.704	At least monthly
Bhutan Information Communication and Media Authority (current Account)	Nu.	1	193.31	323.039	At least monthly
Revolving fund (current Account)	Nu.	7	32.729	28.442	At least monthly
Gewogs Current Deposit Account	Nu.	205	22.081	22.329	At least monthly
Municipal Current Deposit Account	Nu.	15	233.970	380.839	At least monthly
Judiciary Current Deposit Account	Nu.	19	27.157	26.777	At least monthly
Other Current Deposit Accounts <sup>35</sup>	Nu.	123	530.701	956.554	At least monthly
<b>Grand Total</b>		<b>374</b>	<b>Nu. 2,691.559 + USD 45.823</b>	<b>Nu. 3,190.363 + USD 47.450</b>	

**Source:** Annual Financial Statements, FY 2013/14 and FY 2014/15.

Reconciliation of current deposit accounts is done at each agency level, but the information is not collated centrally.

<sup>35</sup> These include the Audit Recoveries Account, Escrow Account, Endowment Fund etc.

The reconciliation of the RGR is daily. The BFA, trust accounts, revolving fund and current deposit accounts are reconciled monthly and the reconciliation is completed within 3 weeks of the end of the month. These together constitute 95% of the Government receipts for the year 2013/14.

### ***Dimension 27.2: Suspense accounts***

The Finance and Accounting Manual of the FRR 2001 explains the need for suspense accounts as '*used for temporarily accommodating some expenditure of or amounts payable by the Government until those can be transferred to the rightful activities or paid to the creditors*'.

Accordingly, Suspense Accounts are used for the following transactions:

- a. Stock
- b. Purchases
- c. Public Work Advance (PWA)
- d. Intra-Agency Assignments
- e. Deposit Works
- f. Other Deposits

Further, permanent and temporary advances are also allowed in accordance with the rules in the FAM. Such advances if issued for Government works are treated under Suspense heads for the purpose of accounting.

Permanent advances (*operating like rolling imprest accounts*) are issued to meet recurring expenses in the field units and are settled against '*an account of utilization*' provided at the time of replenishment.

Temporary advances are provided for making disbursements against specific purposes for a specific time and are settled upon receipt of a utilization account immediately upon completion of the assignment, along with refund of any unutilized funds. It has to be refunded immediately if the specific purpose no longer needs to be fulfilled or if it transpires that advance shall not be used during a period of 15 days. A complete liquidation of the temporary advances is required to be done on the close of the financial year.

Any unutilized advances in both the permanent and temporary advance accounts are refunded to RGoB at the close of the financial year.

The FAM further provides that the Head of Office using the suspense account is responsible for timely clearance of such balances and each accounting unit must review the balances and items under suspense to ensure timely action for clearance. Accounting for suspense accounts is done at the individual LC/PLC account of each of the budgetary bodies in PEMS – recording the party name, assignment details and budget line against each transaction. Adjustment is recorded against the respective budget line in PEMS – thereby ensuring that details of unadjusted balances are available for each transaction. At the end of the fiscal year, the unadjusted PWA (except PWA: Employees) accounts balances are carried forward to the subsequent year as opening balance in PEMS. The closing balance of the LC/PLC accounts of these budgetary bodies is arrived at after taking into account all the budgetary actual expenditures plus the advances and suspense balances. As accounting for suspense is done in PEMS electronically, there is no need to reconcile the ledger and control accounts.

Accounting and monitoring of suspense accounts are done on the individual LC/PLC accounts of budgetary bodies. A consolidated statement showing agency-wise aggregate additions and adjustments within the fiscal year in the suspense account is included in the Annual Financial Statements of RGoB. Information on the opening and closing balances of suspense accounts is not disclosed.

During the financial year 2014/15, transactions were recorded in 714 suspense accounts, on which a closing balance was reported in 570 accounts amounting to Nu. 888.5 million. Further, 54 accounts (with a closing balance of Nu. 94 million), were noted where there was no movement during the year (i.e. reporting the same opening and closing balance for 2014/15). Table 3.6.27.2 details the movement of suspense accounts for the last 2 years:

**TABLE 3.6.27.2: MOVEMENT OF SUSPENSE ACCOUNTS FOR LAST 2 YEARS**

(in Nu.)

Year	Opening Balance	Additions during the year	Adjustments during the year	Closing Balance
2013-14	232,800,995	8,400,549,495	8,156,661,248	476,689,242
2014-15	476,689,242	8,186,865,560	7,775,074,517	888,480,285

Source: DPA.

The periodicity of clearance of suspense accounts depends on the terms and conditions of each relevant suspense category. However, at the close of each fiscal year, every accounting unit performs the overall review and reconciliation of suspense accounts to ensure that the balances reflected against assignments and parties are correct.

The accounting for suspense accounts is done in PEMS, thereby eliminating the need for a reconciliation of the Ledger and Control accounts. The suspense accounts are cleared at the end of the financial year.

### **Dimension 27.3: Advance accounts**

Advances provided to Government employees on personal accounts like Travel Advance, Leave Salary etc. are accounted for under Advance accounts. All other advances are recorded under the head 'Suspense Accounts' and are dealt with in dimension 27.2 above. The regulations and accounting of governing advances are provided in the FAM:

- i. Personal advances are processed on the basis of a sanction order documenting the purpose and recovery/adjustment procedure of the advance. The sanction order is issued by a competent authority in accordance with the Delegation of Powers.
- ii. Personal advance of any kind are not sanctioned or paid in case a previous personal advance remains unsettled.
- iii. Balance of advances at the end of a fiscal year is carried forward to the next year.

The accounting units of the respective budgetary bodies provide advances to their employees and are also responsible for ensuring timely liquidation. Accounting for advances is done at the individual LC/PLC of budgetary body in PEMS – recording the nature of advance and budget line against each advance. Adjustment is recorded against the respective budget line in PEMS – thereby ensuring that details of unadjusted balances are available for each transaction. At the year end, the unadjusted advance balances are carried forward to the subsequent year as opening balance in PEMS. The closing

balance of the LC/PLC accounts of these budgetary bodies is arrived at after taking into account all the budgetary actual expenditures plus the advances and suspense. As accounting for advances is done in PEMS electronically, there is no need to reconcile the ledger and control accounts.

Monitoring of Advance Accounts is done at the individual LC/PLC of budgetary body. A consolidated statement showing agency-wise aggregate additions and adjustments within the fiscal year in the Advance Account is included in the Annual Financial Statements of RGoB - information on the opening and closing balances of Advance accounts is not disclosed.

During the financial year 2014-15, advance transactions occurred in 503 operating units (advances given - Nu. 273 million), out of which a closing balance was reported only in 94 accounts amounting to Nu. 10 million, as detailed in the Table 3.6.27.3 below:

**TABLE 3.6.27.3: MOVEMENT OF ADVANCE ACCOUNTS FOR THE LAST 2 YEARS**

In Nu.

Year	Opening Balance	Advances given during the year	Adjustments made during the year	Closing Balance
2013-14	9,368,632	252,711,463	251,709,667	10,370,428
2014-15	10,370,428	272,833,582	273,468,965	9,735,045

Source: DPA.

The accounting for advances is done in PEMS, thereby eliminating the need for a reconciliation of the ledger and control accounts. Most of the advances are cleared in a timely way because anything beyond the prescribed time line attracts penalty interest of 24% per annum as per the resolution of Parliament. This compliance is enforced by the RAA during their annual audit of budgetary bodies.

#### **Dimension 27.4: Financial data integrity processes**

Access rights and privileges to financial records and information is in accordance with the Public Finance Act, financial rules and regulations and other acts and rules in place. Users of the financial management systems like MYRB, PEMS, RAMIS etc. have a unique user identity and password and also different access levels like System Administrator, Department Head, Division Chief, Supervisor, Verifying Officer, Approving Officer etc.

Therefore, access to the records and information in the PFM system is based on the individuals' roles and responsibilities as defined in the FRR and there is no unlimited or unauthorized access to everyone. Access level can be controlled in the system based on role management. Since all transactions in the systems are tagged to the user IDs there is an audit trail in the system. There is an internal audit unit in all ministries and dzongkhags and they have read-only access to the records and information of the agency concerned for review and scrutiny.

Further, the external auditors are given full read-only access to the system and its records while carrying out audit in the budgetary bodies. The reports on all financial transactions are readily available from the system for further analysis and review purposes.

The access and changes to records are restricted by access level controls. An audit trail is available in the financial management systems.

Score	Minimum requirements for scores
<b>27.1: Bank account reconciliation</b>	
A	Bank reconciliation for <b>all</b> active central government bank accounts takes place at least weekly at aggregate and detailed levels, usually within one week from the end of each week.
B	Bank reconciliation for <b>all</b> active central government bank accounts takes place at least monthly, usually within 4 weeks from the end of each month.
C	Bank reconciliation for <b>all</b> active central government bank accounts takes place at least quarterly, usually within 8 weeks from the end of each quarter.
D	Performance is less than required for a C score.
<b>27.2: Suspense accounts</b>	
A	Reconciliation of suspense accounts takes place at least monthly, within a month from the end of each month. Suspense accounts are cleared in a timely way, no later than the end of the fiscal year unless duly justified.
B	Reconciliation of suspense accounts takes place at least quarterly within two months from the end of each quarter. Suspense accounts are cleared in a timely way, no later than the end of the fiscal year unless duly justified.
C	Reconciliation of suspense accounts takes place annually, within two months from the end of the year. Suspense accounts are cleared in a timely way, no later than the end of the fiscal year unless duly justified.
D	Performance is less than required for a C score.
<b>27.3: Advance accounts</b>	
A	Reconciliation of advance accounts takes place at least monthly, within a month from the end of each month. <b>All</b> advance accounts are cleared in a timely way.
B	Reconciliation of advance accounts takes place at least quarterly within two months from the end of each quarter. <b>Most</b> advance accounts are cleared in a timely way.
C	Reconciliation of advance accounts takes place annually, within two months from the end of the year. Advance accounts may frequently be cleared with delay.
D	Performance is less than required for a C score.
<b>27.4: Financial data integrity processes</b>	
A	Access and changes to records is restricted and recorded, and results in an audit trail. There is an operational body, unit or team in charge of verifying financial data integrity.
B	Access and changes to records is restricted and recorded, and results in an audit trail.
C	Access and changes to records is restricted and recorded.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-27: Financial data integrity</b>	<b>B</b>	<b>Scoring Method M2</b>
27.1: Regularity of bank reconciliation.	B	The reconciliation of the RGR is daily and of the BFA, trust accounts, revolving fund and current deposit accounts is monthly. These together constitute 95.2% of the Government receipts for the year 2013-14.
27.2: Regularity of reconciliation and clearance of suspense accounts.	C	The accounting for Suspense accounts is done in PEMS, thereby eliminating the need for a reconciliation of the Ledger and Control accounts. The suspense accounts are cleared at the end of the financial year.
27.3: Regularity of reconciliation and clearance of advance accounts.	B	The accounting for Advances is done in PEMS, thereby eliminating the need for reconciliation of the Ledger and Control accounts. Most of the advances are cleared in a timely way.
27.4: Processes supporting financial data integrity.	B	The access and changes to records are restricted by access level controls. An audit trail is available in the financial management systems.

## PI-28: In-year budget reports

This indicator assesses the comprehensiveness, accuracy and timeliness of information on the budget execution. In-year budget reports must be consistent with budget coverage and classifications to allow monitoring of budget performance and, if necessary, timely use of corrective measures. It contains three dimensions and uses the M1 (WL) method for aggregating dimension scores.

### *Dimension 28.1: Coverage and comparability of reports*

The relevant period for this assessment is FY 2014/15 during which DNB was issuing information in the form of a Quarterly Note Sheet (QNS) for further directives. The QNS included the comparison of the approved budget with the revised budget and actual expenditure of the quarter ended. Expenditures made from transfers to deconcentrated units (the LGs) are included in the QNS.

### *Dimension 28.2: Timing of in-year budget reports*

During 2014/15, the note sheet prepared by DNB on a quarterly basis was issued to MoF within 5 to 6 weeks from the end of the quarter. From FY 2015/16, a Budget Situation Report is being produced quarterly within about four weeks from the end of the quarter, and submitted to MoF. The report for the 1st quarter of FY 2015/16 was submitted to MoF on November 6, 2015.

### *Dimension 28.3: Accuracy of in-year budget reports*

The quality of data is very good as it is the actual data derived from the budget and accounting systems, which are updated daily. Data quality is verified according to procedures stated in the Financial Rules and Regulations. Only after these procedures are completed are they entered into the systems.

The usefulness of the reports is not undermined by inaccuracies or omissions. The report however shows only disbursed expenditure, not outstanding commitments.

Score	Scoring Method M1 (WL). Minimum Requirements
<b>28.1: Coverage and comparability of reports</b>	
A	Coverage and classification of data allows direct comparison to the original budget. Information includes <i>all</i> items of budget estimates. Expenditures made from transfers to de-concentrated units within central government are included in the reports.
B	Coverage and classification of data allows direct comparison to the original budget with partial aggregation. Expenditures made from transfers to de-concentrated units within central government are included in the reports.
C	Coverage and classification of data allows direct comparison to the original budget for the main administrative headings.
D	Performance is less than required for a C score.
<b>28.2: Timing of in-year budget reports</b>	
A	Budget execution reports are prepared monthly, and issued within two weeks from the end of each month.
B	Budget execution reports are prepared quarterly, and issued within four weeks from the end of each quarter.
C	Budget execution reports are prepared quarterly (possibly excluding first quarter), and issued within 8 weeks from the end of each quarter.
D	Performance is less than required for a C score.



Score	Scoring Method M1 (WL). Minimum Requirements
<b>28.3: Accuracy of in-year budget reports</b>	
A	There are no material concerns regarding data accuracy. An analysis of the budget execution is provided by whatever budget classifications are in use. Information on expenditure is covered at both commitment and payment stages.
B	There may be concerns regarding data accuracy. Data issues are highlighted in the report and the data is consistent and useful for analysis of budget execution. An analysis of the budget execution is provided on at least a half-yearly basis. Expenditure is captured at least at payment stage.
C	There may be concerns regarding data accuracy. Data is useful for analysis of budget execution. Expenditure is captured at least at payment stage.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-28: In-year budget reports</b>	<b>C+</b>	<b>Scoring Method M1</b>
28.1: Coverage and comparability of reports.	B	The quarterly note sheet included the comparison of the approved budget with the revised budget and actual expenditure of the quarter ended.
28.2: Timing of in-year budget reports.	C	Quarterly reports are issued within 5-6 weeks of the end of each quarter.
28.3: Accuracy of in-year budget reports.	B	Report data are accurate, but do not include commitment data.

### *On-going and planned reforms*

The Department of National Budget (DNB) started preparing a quarterly Budget Situation Report (BSR) from FY 2015/16. The report comprises information such as the revised budget, expenditure, revenue collected, grants received and the trend for the quarter as against the original projections. Information is at the summary level and administrative headings level. DNB is in charge of preparing and issuing the report and monitoring revenue and expenditure.

Expenditure is classified as current and capital expenditures, by economic code and by activity. Revenue is classified by type.

### **PI-29: Annual financial reports**

This indicator assesses the extent to which annual financial statements are complete, timely and consistent with generally accepted accounting principles and standards. This is crucial for accountability and transparency in the PFM system. It contains three dimensions and uses the M1 (WL) method for aggregating dimension scores.

#### *Dimension 29.1: Completeness of annual financial reports*

The Annual Financial Statements (AFS) of the Royal Government of Bhutan are prepared and published each year. They cover all government budgetary bodies (constitutional bodies, autonomous bodies, judiciary, ministries, dzongkhags, gewogs and thromdes).

Revenue accounting is done by the Revenue Administration Management Information System (RAMIS) maintained by DRC. Expenditure details are obtained from the Public Expenditure Management

System (PEMS) based on the accounting records maintained at agency level. The Budget Fund Account details are obtained from the records maintained by the Treasury Management Division of the Department of Public Accounts. The preparation of the AFS is a manual process of consolidating information from various systems and sources - RAMIS (DRC); MYRB (DNB); CS-DRMS (DMD, DPA); PlaMS (GNHC); PEMS (DPA); Public Enterprise Division, MoF; Bank of Bhutan; National Statistical Bureau.

The AFS contain comparison of actual expenditure with approved budgets, and complete and detailed information on revenues, grants, loans and expenditures. They also include statements of the Government Equity Portfolio in State-Owned Enterprises (SOEs), corporations and financial institutions, government guarantees, government outstanding debt etc.

However, complete information on tangible and financial assets and liabilities (such as balances of advances and suspense accounts) is not provided in the AFS and is not supported by a cash flow statement.

Financial statements covering all budgetary units are prepared annually including a comparison with the budget and information on revenue, expenditure and cash balances.

### *Dimension 29.2: Submission of reports for external audit*

The Finance and Accounting Manual of the FRR 2001 requires that the AFS of the Government be forwarded to the Royal Audit Authority (RAA) for certification within six months after the close of the fiscal year. Accordingly, the AFS of the Government have been prepared and forwarded to RAA for certification annually within six months after the close of the FY. Table 3.6.29.1 shows the Timeliness of submission of financial reports.

**TABLE 3.6.29.1: TIMELINESS OF SUBMISSION OF FINANCIAL REPORTS**

Financial Year	Date of submission of AFS to RAA
2011-12	25th December, 2012
2012-13	31st December, 2013
2013-14	31st December, 2014
2014-15	31st December, 2015

*Source:* DPA.

The AFS are submitted for external audit within six months of the end of the fiscal year.

### *Dimension 29.3: Accounting standards*

The Finance and Accounting Manual of FRR 2001 specifies that the Government accounts shall be maintained on a cash basis and that the total receipts and expenditures of the Government during a financial year shall be the basis for preparation of the AFS. The Manual further specifies the form and content of the AFS. Accordingly, the AFS have been presented in a consistent format over the last three years.

The Statement of Responsibility, signed by the Finance Minister and the Director General Department of Public Accounts, states that the AFS have been prepared in accordance with the provisions of the Public Finance Act and the FRR 2001. The Accounting and Auditing Standard Board of Bhutan (AASBB) was set up in July 2010 and is currently implementing Bhutanese Accounting Standards (BAS)

for private sector accounting. At the moment, there is no plan to develop accounting standards for government accounting.

An attempt was made to apply the International Public Sector Accounting Standard (IPSAS) Cash Basis of Financial Reporting to the AFS for FY 2006/07 by the Ministry of Finance and explore the possibility of moving to/adopting the international standard. No progress, however, has been made and the AFS are prepared based on the country's legal requirements.

Accounting standards are based on the country's legal framework, and applied consistently over time.

Score	Scoring Method M1 (WL). Minimum Requirements
<b>29.1: Completeness of annual financial reports</b>	
A	Financial reports for budgetary central government are prepared annually and are comparable with the approved budget. They contain full information on revenue, expenditure, financial and tangible assets, liabilities, guarantees and long-term obligations, and are supported by a reconciled cash flow statement.
B	Financial reports for budgetary central government are prepared annually and are comparable with the approved budget. They contain information on at least revenue, expenditure, financial assets, financial liabilities, guarantees and long-term obligations.
C	Financial reports for budgetary central government are prepared annually, and are comparable with the approved budget. They include information on revenue, expenditure and cash balances.
D	Performance is less than required for a C score.
<b>29.2: Submission of reports for external audit</b>	
A	Financial reports for budgetary central government are submitted for external audit within 3 months of the end of the fiscal year.
B	Financial reports for budgetary central government are submitted for external audit within 6 months of the end of the fiscal year.
C	Financial reports for budgetary central government are submitted for external audit within 9 months of the end of the fiscal year.
D	Performance is less than required for a C score.
<b>29.3: Accounting standards</b>	
A	Accounting standards applied to <b>all</b> financial reports are consistent with international standards. <b>Most</b> international standards have been incorporated into the national standards. Variations between international and national standards are disclosed and any gaps are explained. The standards used in preparing annual financial reports are disclosed in notes to the reports.
B	Accounting standards applied to <b>all</b> financial reports are consistent with the country's legal framework. The <b>majority</b> of international standards have been incorporated into the national standards. Variations between international and national standards are disclosed and any gaps are explained. The standards used in preparing annual financial reports are disclosed.
C	Accounting standards applied to <b>all</b> financial reports are consistent with the country's legal framework and ensure consistency of reporting over time. The standards used in preparing annual financial reports are disclosed.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-29: Annual financial reports</b>	<b>C+</b>	<b>Scoring Method M1</b>
29.1: Completeness of annual financial reports.	C	Financial statements covering all budgetary units are prepared annually including a comparison with the budget and information on revenue, expenditure and cash balances, but not all financial assets and liabilities.

Indicator/Dimension	Score	Brief justification for the score
29.2: Submission of reports for external audit.	B	The AFS are submitted for external audit within 6 months of the end of the fiscal year.
29.3: Accounting standards.	C	Accounting standards applied to the AFS are based on the country's legal framework, and have been applied consistently over time. The basis is disclosed in the AFS.

### 3.7 Pillar VII – External scrutiny and audit (Performance indicators 30 to 31)

#### PI-30: External audit

This indicator examines the characteristics of external audit. It contains four dimensions and uses the M1 (WL) method for aggregating dimension scores.

A high quality external audit is an essential requirement for ensuring accountability and creating transparency in the use of public funds. Whilst dimension 30.4 is focused on the independence of the external audit function, the first three dimensions focus on audit of the government's annual financial reports. Inclusion of some aspects of performance audit would also be expected of a high quality audit function, but this is covered in PI-8 Performance information for service delivery, dimension 8.4.

#### *Indicator 30.1: Audit coverage and standards*

This dimension assesses key elements of the quality of external audit in terms of the scope and coverage of audit, as well as adherence to auditing standards. The scope of audit indicates the entities and sources of funds that are audited in any given year<sup>36</sup> and should include extra-budgetary funds and autonomous agencies. The latter may not always be audited by the supreme audit institution, the Royal Audit Authority (RAA), as the use of other audit institutions may be foreseen. Where RAA capacity is limited, the audit program may be planned in line with legal audit obligations on a multi-year basis in order to ensure that the most important or risk-prone entities and functions are covered regularly, whereas other entities and functions may be covered less frequently. Audit work should cover all revenue, expenditure, assets and liabilities, regardless of whether all these are reflected in financial reports (see PI-29 Annual financial reports).

Adherence to auditing standards (ref. the International Standards of Supreme Audit Institutions (ISSAI)<sup>37</sup> should ensure a focus on significant and systemic PFM issues in reports, as well as financial and compliance audit activities, such as providing an opinion on the financial statements, the regularity and propriety of transactions and the functioning of internal control and procurement systems.

Article 25 (1) of the Constitution of the Kingdom of Bhutan says that '*There shall be a Royal Audit Authority to audit and report on the economy, efficiency and effectiveness in the use of public resources*'. Further, Article 25 (4) stipulates that '*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*

<sup>36</sup> i.e. fall within the implementation of the overall risk-based audit plan for the given year, regardless of whether or not the plan requires substantive audit work to be carried out on that entity/fund.

<sup>37</sup> The ISSAIs on financial audit are based on the corresponding ISAs, which guide the conduct of the audit of financial statements, including related compliance audit requirements such as consideration of laws and regulations in an audit of financial statements.

*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’.*

Section 39 (h) of the Audit Act of Bhutan stipulates that *‘The Authority shall conduct without fear, favor or prejudice the audits of all entities including non-governmental organizations, foundations, trusts, charities and civil societies fully or partly funded by the Government; whose loans are approved or guaranteed by the Government; and those receiving funds, grants and subsidies directly or through the Government and collections and contributions from people and funds raised through lottery’.* Section 83 of the Audit Act outlines that *‘The Parliament shall appoint independent auditors drawn from professional firms or bodies not within the audit jurisdiction of the Authority for auditing the annual accounts of Royal Audit Authority’.*

Section 41 of the Public Finance Act stipulates that *‘The Royal Audit Authority shall audit the Government’s receipts and payments accounts’.*

In accordance with Section 38 (c) of the Audit Act of Bhutan, which stipulates that *‘the RAA shall conduct in depth audit of any aspects of the accounts, operations, systems and management practices of the agencies’*, the RAA encompasses both the transactions and systems audit in its routine work. There is also a dedicated division within RAA, which performs systems audit.

In accordance with Section 38 (b) there is also a dedicated division that performs performance audit.

In accordance with Section 56 of the Audit Act, which stipulates that *‘The Authority shall establish auditing, reporting standards and practices that will meet the highest auditing and reporting standards’*, the RAA back in 2010 drafted and adopted its own auditing standards, which are compliant with INTOSAI auditing standards. The RAA conducts its audit in accordance with RAA auditing standards.

RAA through its audit reports has been covering several areas of common interest and highlighting systemic issues and risks. Some of the topics that were covered during the last three years were: Payroll and Provident fund; Absorption capacity of the government in undertaking increasing developmental works and related topics; Constituency Developments Grants; Environmental issues in Forestry – NFI, Forest Fires & Watershed Management; Need to develop policy framework for leasing of government land; Need to undertake assessment of environmental and social impact for mining activities; Persistent irregularities in construction works; need to reinforce adherence to Property Management Manual for repair and maintenance of buildings & infrastructures; Review of 10th Five year Plan.

Central government ministries and agencies of RGoB are divided into over 700 auditable units. A review of the said auditable units was carried out based on which it was concluded that during the last three years, (FY 2012/13, 2013/14 and 2014/15) financial reports of central government entities representing more than 75% of expenditure and revenue have been audited.

### ***Dimension 30.2: Submission of audit reports to the legislature***

This dimension assesses the timeliness of submission of the audit report(s) on budget execution to the legislature as a key element in ensuring timely accountability of the executive to the legislature and the public. The Framework requires delays in submission of audit reports to be measured from the end of the period covered (when there is no financial audit involved) or date of the external auditor’s receipt of the respective financial reports (when a financial audit is involved). Where audit reports are made

separately on different agencies/funds of central government, the overall delay may be assessed as a weighted average of the delays on the respective agencies/funds, weighted by the higher of their income or expenditure.

Section 69 of Audit Act stipulates that ‘The Auditor General shall submit the Annual Audit Report (AAR) during the fourth quarter of the fiscal year on the audits carried out during the previous fiscal year’. The RAA meets this requirement. It submits its annual audit report to legislature in the first week of May, which is within six months of receipt of the financial statements in December. Reports are available at [www.bhutanaudit.gov.bt](http://www.bhutanaudit.gov.bt). Table 3.7.30.1 provides the dates of receipt of AFS and submission of audit reports to Parliament.

**TABLE 3.7.30.1: DATES OF RECEIPTS OF AFS AND SUBMISSION OF AUDIT REPORTS TO PARLIAMENT**

Financial Year	Date of submission of annual financial statements by RGoB to RAA	Dates of submission of annual audit reports to Parliament
2011/12	Dec 31, 2012	May 7, 2013
2012/13	Dec 31, 2013	May 8, 2014
2013/14	Dec 31, 2014	May 7, 2015

Source: RAA

**Dimension 30.3: External audit follow-up**

This dimension assesses the extent to which effective and timely follow-up of external audit recommendations or observations is undertaken by the executive and/or audited entity. Evidence of effective follow up of the audit findings includes the issue by the executive or audited entity of a formal written response to the audit findings indicating how these will be or already have been addressed. Reports on follow-up may provide evidence of implementation by summing up the extent to which the audited entities have cleared audit queries and implemented audit recommendations or observations. Note that follow-up to recommendations issued by the legislature is assessed separately under PI-31 Legislative scrutiny of audit reports.

Section 75 of the Audit Act states that ‘All audited entities must respond to the Audit Reports within the time frame as specified:

- a. Response to initial audit observations - within one month of the issue of field audit memos.
- b. Response to agency specific reports - within three months of the issue of the reports by the Authority.
- c. Response to draft Annual Audit Report - within one month of the issue of the draft by the Authority.

In invoking section 75 (b) of the Audit Act, every report issued by RAA has an Action Taken Report (ATR) mandating every audited agency to report to RAA within three months on the actions taken against each audit observation.

The recommendations of RAA to audited agencies are acted upon by the audited agencies. This is ensured through a system of two-layer accountability viz. direct accountability and supervisory accountability. Direct accountability is being fixed on the primary responsible official to act upon the audit recommendation, while the supervisory accountability is fixed on the senior level official who ensures consistent follow-up on the audit recommendations.



Section 76 of the Audit Act provides that ‘*The Lhengye Zhungtshog (Cabinet), ministries, and other concerned authorities shall be responsible to take timely follow-up actions on Audit Reports under this Act*’, and section 77 of the Audit Act stipulates that ‘*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*’.

Also Section 77 empowers the RAA to ask for explanation from non-complying agencies and ministries. Further, the Parliament has empowered the RAA to impose 24% penal interest on outstanding issues with monetary value. Table 3.7.30.2 shows the Value of audit observations, recoveries made and pending audit issues for 2012-2014.

**TABLE 3.7.30.2: VALUE OF AUDIT OBSERVATIONS, RECOVERIES MADE AND PENDING AUDIT ISSUES FOR 2012-2014**

Particulars	As per Annual Audit Report 2012 (Nu. in Millions)	As per Annual Audit Report 2013 (Nu. in millions)	As per Annual Audit Report 2014 (Nu. in Millions)
Value of audit observation reported by RAA	1,166.388	553.571	1,705.502
Recoveries made	147.641	151.214	115.628
Pending	391.007	261.464	634.313

**Source:** Annual Audit Reports.

The follow-up system of the RAA is handled by the Follow-up and Clearance Division headed by an Assistant Auditor General. Its core function is to carry out timely follow-up on unresolved and pending audit issues in accordance with the provisions of the Audit Act of Bhutan 2006.

The RAA had developed Audit Information Management System (AIMS) way back in the 1990s to capture the data from audit reports. The system is still in use as of today. Every audit report of RAA is issued with a unique identification number called the Audit Information Number (AIN), which is generated through the AIMS by the Follow-up Division. A copy of every report issued is shared with the Follow-up Division, which feeds the data from audit reports into the AIMS. The AIMS can generate reports on pending audit issues against every accountable official. Based on the information captured by the AIMS the Follow-up Division carries out periodic follow-up on unresolved and pending audit issues.

The RAA also maintains a bank account called Audit Recoveries Account (ARA) with Bank of Bhutan. All recoveries made through audit are deposited into this account. The ARA is maintained by RAA’s Finance Section and is reconciled periodically.

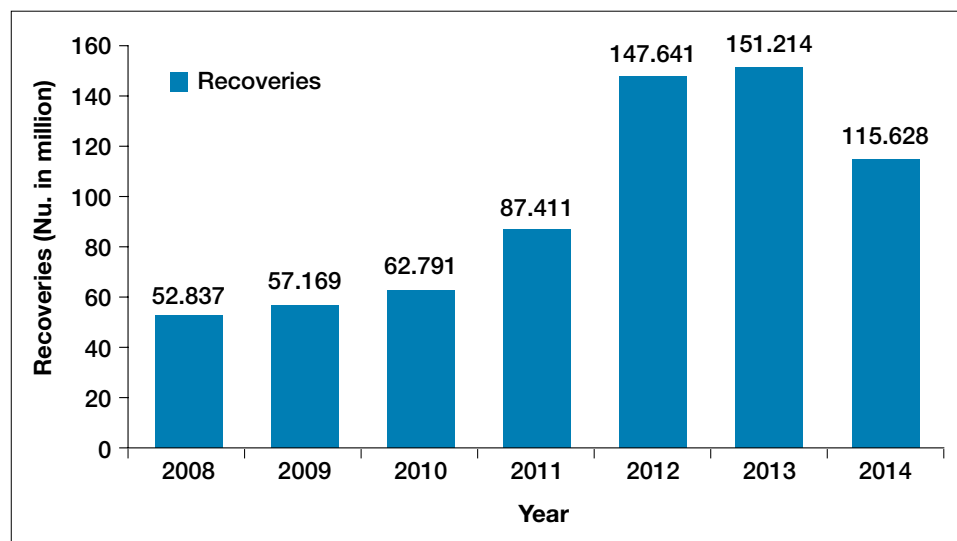
Audit clearance is one of the most effective instruments through which the RAA is able to enforce settlement of pending audit issues. The mandatory requirement of audit clearance for the purpose of training, promotion, further studies, contract renewal, retirement and superannuation for civil servants and for election for politicians facilitates timely follow-up by the RAA.

The graphical presentation in Figure 3.7.30.1 below shows the trend of audit recoveries for the seven years from 2008 to 2014.

### Dimension 30.4: Supreme Audit Institution (SAI) independence

This dimension assesses the independence of the RAA from the executive. Independence is essential for an effective and credible system of financial accountability, and should be laid down in the constitution or comparable legal framework. In practice, independence is demonstrated by the arrangements for the appointment (and removal) of the Head of the RAA, non-interference in the planning and implementation of the RAA's audit work, and

**FIGURE 3.7.30.1: TREND OF AUDIT RECOVERIES FOR THE SEVEN YEARS FROM 2008 TO 2014**



Source: Annual Audit Report 2014.

in the approval and disbursement procedures for the RAA's budget. The RAA's mandate should cover all central government activities and enable the RAA to carry out a full range of audit activities, specifically financial, compliance and performance audit. The RAA should have unrestricted access to documents, records and information. It should be noted that performance audits are covered by PI-8 Performance information for achieving efficiency in service delivery, whereas PI-30.4 S is focused on audit of the government's annual financial reports.

The RAA has full constitutional and legal independence. Article 25 (1) of the Constitution of the Kingdom of Bhutan spells out that *'There shall be Royal Audit Authority to audit and report of the economy, efficiency and effectiveness in the use of public resources'*. Article 25 (4) stipulates that *'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'*.

Article 25 (7) of the Constitution of the Kingdom of Bhutan stipulates that *'The Royal Audit Authority shall function in accordance with the Audit Act'*.

On the coverage of the RAA, Section 39 (h) of the Audit Act stipulates that *'The Authority shall conduct without fear, favor or prejudice the audits of all entities including non-governmental organizations, foundations, trusts, charities and civil societies fully or partly funded by the Government; whose loans are approved or guaranteed by the Government; and those receiving funds, grants and subsidies directly or through the Government and collections and contributions from people and fund raised through lottery'*.

Sections 50 to 53 of the Audit Act provide for RAA's right of access to records, documents and information.

Further, Section 41 of the Public Finance Act stipulates that ‘*The Royal Audit Authority shall audit the Government’s receipts and payments accounts*’.

Section 15 of the Audit Act states that ‘*The Authority shall enjoy full organizational and functional independence including programming, investigative and reporting*’, and Section 16 states that ‘*The Authority shall have full authority to determine and administer its organizational structure, budgetary and personnel requirements*’.

The Auditor General who is the head of the RAA is appointed by His Majesty the King 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 in accordance with the Article 25 (2) of the Constitution of the Kingdom of Bhutan. Sections 12 and 13 of the Audit Act provide for removal of the Auditor General.

The RAA’s Strategic Plan 2010-2015 acts as a guiding document for preparing annual audit plans and audit engagements. For 2014/15 every department, division and regional office signed a performance compact with the Auditor General, based on which the audit engagements were prepared and executed. The RAA also undertook an auditee agency rationalization exercise in which the agencies were grouped and categorized by priority and size (as Priority P1, P2, P3 and Size A1, A2, A3). The P1 agencies needed to be audited annually, P2 agencies need audit once in two years and P3 agencies once in three years. The sizes A1, A2 and A3 determine the number of man-days required to conduct particular audits.

The RAA’s budget for 2014/15 was approved as proposed by the Parliament, which is in accordance with Section 16 of the Audit Act although routed through the Department of National Budget, MoF, being a nodal agency primarily entrusted with responsibilities to look after the budgeting aspects of the spending agencies across the country. The approved budget can be used by the RAA without interference from the Executive. The RAA has operational independence, but HR matters have to be prescribed broadly in accordance with the Civil Service Act. Access to new personnel is controlled by the Civil Service Commission.

The budget is executed according to the budgeting plan as developed by RAA Administration and Finance Division in close coordination with Policy and Planning Division. The approved budget is detailed by activity.

Score	Scoring Method M1 (WL). Minimum Requirements
<b>30.1: Audit coverage and standards</b>	
A	Financial reports including revenue, expenditure, assets and liabilities of <b>all</b> central government entities have been audited using ISSAIs or consistent national auditing standards during the last three completed fiscal years. The audits have highlighted any relevant material issues and systemic and control risks.
B	Financial reports of central government entities representing <b>most</b> total expenditures and revenues have been audited using ISSAIs or national auditing standards during the last three completed fiscal years. The audits have highlighted any relevant material issues and systemic and control risks.
C	Financial reports of central government entities representing the <b>majority</b> of total expenditures and revenues have been audited, using ISSAIs or national auditing standards during the last three completed fiscal years. The audits have highlighted any relevant significant issues.
D	Performance is less than required for a C score.

Score	Scoring Method M1 (WL). Minimum Requirements
<b>30.2: Submission of audit reports to the legislature</b>	
A	Audit reports were submitted to the legislature <sup>38</sup> within 3 months from receipt of the financial reports by the audit office for the last three completed fiscal years.
B	Audit reports were submitted to the legislature within 6 months from receipt of the financial reports by the audit office for the last three completed fiscal years.
C	Audit reports were submitted to the legislature within 9 months from receipt of the financial reports by the audit office for the last three completed fiscal years.
D	Performance is less than required for a C score.
<b>30.3: External audit follow-up</b>	
A	There is clear evidence of effective and timely follow up by the executive, or the audited entity on audits for which follow-up was expected, during the last three completed fiscal years.
B	A formal and comprehensive response was made by the executive, or the audited entity on audits for which follow-up was expected, in a timely manner, during the last three completed fiscal years.
C	A formal response was made by the executive, or the audited entity on audits for which follow up was expected, during the last three completed fiscal years.
D	Performance is less than required for a C score.
<b>30.4: Supreme Audit Institution (SAI) independence</b>	
A	The SAI operates independently from the executive, ensured through legislation, procedures for appointment and removal of the Head of the SAI, the planning of audit engagements, arrangements for publicizing reports as well as the approval and execution of the SAI's budget. The SAI has unrestricted and timely access to records, documentation and information.
B	The SAI operates independently from the executive, ensured through the procedures for appointment and removal of the Head of the SAI, the planning of audit engagements as well as the approval and execution of the SAI's budget. The SAI has unrestricted and timely access to records, documentation and information for <b>most</b> audited entities.
C	The SAI operates independently from the executive, ensured through the procedures for appointment and removal of the Head of the SAI as well as the execution of the SAI's budget. The SAI has unrestricted and timely access to the <b>majority</b> of the requested records, documentation and information.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-30: External audit</b>	<b>B+</b>	<b>Scoring Method M1</b>
30.1: Audit coverage and standards.	B	Financial reports of central government entities representing more than 75% of expenditure and revenue have been audited using national standards during the last three years.
30.2: Submission of audit reports to the legislature.	B	Audit reports were submitted to the legislature within 6 months from receipt of the financial reports by the audit office for the last three completed fiscal years.
30.3: External audit follow-up	A	There is clear evidence of follow-up by RAA on audits.
30.4: Supreme Audit Institution (SAI) independence.	B	The SAI operates independently from the executive, ensured through the Constitution, and there is a process for appointment of the Head of the SAI. There is independence in planning of audit engagements as well as the approval and execution of the RAA's budget. The SAI has unrestricted and timely access to records, documentation and information.

38 Or body responsible for public finance governance.

## PI-31: Legislative scrutiny of audit reports

This indicator focuses on legislative scrutiny of the audited financial reports on central government. It has four dimensions and uses the M2 (AV) method for aggregating dimension scores.

Article 25 of the Constitution of Bhutan provides for the appointment of a five-member Public Accounts Committee (PAC) to review and report on the Annual Audit Report of the Royal Audit Authority (RAA) or any other report presented by Auditor General. The PAC is a joint committee of both Houses of Parliament and is governed by the Rules of Procedure of the Public Accounts Committee (2015). The PAC's terms of reference include reviewing and reporting to Parliament on the various reports of the RAA that the PAC may choose to review and accounts of all agencies in which public funds have been invested. The Audit Act of Bhutan, 2006 mandates that the Auditor General shall endorse copies of the Annual Audit Report to the PAC. The PAC has the power to summon any person before it to give evidence or produce documents. A ministry or department is represented by its Secretary or Head of Department and, if permitted, a senior officer can represent the ministry/department. The PAC has the power to compel attendance and production of documents.

### *Dimension 31.1: Timing of audit report scrutiny*

The current legislation and existing procedures do not state any deadlines for review of audit reports by the legislature. However, Parliamentary resolutions direct the Public Accounts Committee [PAC] to review and report in the subsequent session of the Parliament.

The current legislation and procedures have not established any timelines for review of audit reports by the Parliament. The time for completion of the review by PAC has been a matter of discussion in Parliament. The 1st session of 2nd Parliament (September 2013) had given assent that the PAC review of the annual audit report would be presented in the summer session and of the performance audit reports in the winter session of Parliament. However, the 3rd session resolved that the PAC review of the annual audit reports would be in winter session and that of performance audit in the summer session. The rules of procedure of PAC 2015 reflect these timelines (rule 33 in Chapter 11).

Examination of an audit report takes place immediately after it is received and the legislature usually takes up to three months (up to presentation to the House, see table below) to complete its examination, the time varying with the seriousness and number of issues reflected in the reports. Table 3.7.31.1 shows the Timing of audit report scrutiny.

**TABLE 3.7.31.1: TIMING OF AUDIT REPORT SCRUTINY**

Year	Date of receipt of RAA Annual Audit Report by the PAC	Date of presentation of PAC report on review of audit report in Parliament
2013/14	May 18, 2015 (AAR 2014)	November 23, 2015
2012/13	May 15, 2014 (AAR 2013)	June 16, 2014
2011/12	August 9, 2013 (AAR 2012)	September 20, 2013

*Source:* Annual Audit Reports and PAC.

### *Dimension 31.2: Hearings on audit findings*

The legislative scrutiny function is mandated by the Constitution of Bhutan and rules of procedure of the PAC. The rules mandate that the hearings of the PAC shall be public except in cases which are of secret

or confidential nature in the opinion of the Chairperson of the PAC, or if requested by a witness (rule 26, Chapter 9). The reports of the PAC are presented in Parliament and deliberated and these as well as the audit reports are publicly available in the national language.

In practice, all hearings are public except for specified limited circumstances, and reports of the PAC are discussed in Parliament and are published on the official website of the Parliament.

PAC first reviews the status of audit recommendations implemented by the agencies and then follows with public hearings if necessary prior to the presentation of the final report to the Parliament.

The PAC asks the audited agencies to give explanations and/or summons responsible officers to appear before the Committee to answer the questions or to provide evidence on significant findings. In-depth hearings on key findings take place as and when required, covering a few audited entities. The Committee fixes deadlines and calls responsible officers or sometimes goes to the auditees.

### ***Dimension 31.3: Recommendations on audit by the legislature***

The Audit Act 2006 requires follow-up action, though not the Rules of Procedure of the PAC. However, an Action Taken Report (ATR) is required under the recommendations of the legislature and resolutions/standing orders of the House.

The legislature always issues its recommendations against the audit issues in its reports where the audited agencies need to provide ATRs.

The PAC endorses the recommendations of the RAA and provides its own recommendations, for instance:

- The PAC strongly endorses the recommendations made by the RAA and requests the Government to issue appropriate directives to all agencies to implement them.
- The Ministry of Finance must ensure that the Procurement Rules and Regulations (PRR) are reviewed from time to time with relevant clauses inserted in order to avoid future lapses and wastage of government resources.
- The Public Procurement Policy Division (PPPD), MoF is the central agency that looks into public procurement. It is imperative that this Department is adequately staffed with people who have the necessary qualifications and experience required to discharge this important function effectively. The Royal Civil Service Commission together with the MoF needs to address this urgently.
- Currently, it seems that every procuring agency interprets the PRR differently based on its own needs and convenience. This has led to a situation where there is no uniformity in the implementation of the PRR. Therefore, any agency that seeks to procure consultancy services beyond a threshold amount must obtain a clearance from the PPPD. This threshold amount may be fixed by the MoF in consultation with the various agencies.

There is evidence of executives acting on the recommendations of the PAC and issues have been resolved. Table 3.7.31.2 indicates the resolution of irregularities claimed by the PAC.



**TABLE 3.7.31.2: RESOLUTION OF IRREGULARITIES BY PARLIAMENTARY DIRECTIVE**

Annual Audit Reports (AAR)	Unresolved irregularities reported to the Parliament	Irregularities resolved based on Parliamentary directives as on September 30, 2015	Irregularities balance as on September 30, 2015 (Nu. Millions)
AAR 2011	770.141	478.460	291.681
AAR 2012	391.007	227.897	163.110
AAR 2013	261.464	178.848	82.616

*Source:* Annual Audit Report.

The Parliamentary directive to impose 24% penal interest on overdue outstanding advances and recoverable amounts reflected in the audit reports prompted the audited agencies to initiate actions in settling the audit memo and has made a great impact in resolving a number of pending issues.

For every Parliament Session and through Prime Minister, PAC gets the implementation status of the previous PAC recommendations by the agencies and accordingly incorporates them as a follow-up section in the main PAC report. Thus, PAC recommendations are always recorded and followed up.

**Dimension 31.4: Transparency of legislative scrutiny of audit reports**

The Audit Act 2006, the Rules of Procedure of the PAC 2015 and Parliamentary resolution/directions mandate the legislative scrutiny. All hearings are public except for specified limited circumstances, and reports of the PAC are discussed in Parliament and are published on the official website of the Parliament.

Score	Scoring Method M2 (AV). Minimum Requirements
<b>31.1: Timing of audit report scrutiny</b>	
A	Scrutiny of audit reports on annual financial reports has been completed by the legislature within 3 months from receipt of the reports.
B	Scrutiny of audit reports on annual financial reports has been completed by the legislature within 6 months from receipt of the reports.
C	Scrutiny of audit reports on annual financial reports has been completed by the legislature within 12 months from receipt of the reports.
D	Performance is less than required for a C score.
<b>31.2: Hearings on audit findings</b>	
A	In-depth hearings on key findings of audit reports take place regularly with responsible officers from <b>all</b> audited entities which received a qualified or adverse audit opinion or a disclaimer.
B	In-depth hearings on key findings of audit reports take place with responsible officers from <b>most</b> audited entities which received a qualified or adverse audit opinion or a disclaimer.
C	In-depth hearings on key findings of audit reports take place occasionally, covering <b>a few</b> audited entities or may take place with ministry of finance officials only.
D	Performance is less than required for a C score.
<b>31.3: Recommendations on audit by the legislature</b>	
A	The legislature issues recommendations on actions to be implemented by the executive and systematically follows up on their implementation.
B	The legislature issues recommendations on actions to be implemented by the executive, and follows up on their implementation.

Score	Scoring Method M2 (AV). Minimum Requirements
C	The legislature issues recommendations on actions to be implemented by the executive.
D	Performance is less than required for a C score.
<b>31.4: Transparency of legislative scrutiny of audit reports</b>	
A	All hearings are conducted in public except for strictly limited circumstances such as discussions related to national security or similar sensitive discussions. Committee reports are debated in the full chamber of the legislature and published on an official website or by any other means easily accessible to the public.
B	Hearings are conducted in public with <b>a few</b> exceptions in addition to national security or similar sensitive discussions. Committee reports are provided to the full chamber of the legislature and published on an official website or by any other means easily accessible to the public.
C	Committee reports are published on an official website or by any other means easily accessible to the public.
D	Performance is less than required for a C score.

Indicator/Dimension	Score	Brief justification for the score
<b>PI-31: Legislative scrutiny of audit reports</b>	<b>B+</b>	<b>Scoring Method M2</b>
31.1: Timing of audit report scrutiny.	B	The legislature usually takes up to three months to complete its examination.
31.2: Hearings on audit findings.	C	In-depth hearings on key findings of audit reports take place occasionally, covering a few audited entities or may take place with ministry of finance officials only.
31.3: Recommendations on audit by the legislature.	A	The PAC issues recommendations and systematically follows up on their implementation.
31.4: Transparency of legislative scrutiny of audit reports.	A	All hearings are public except for specified limited circumstances, and reports of the PAC are discussed in Parliament and are published on the official website of the Parliament.

*The objective of this chapter is to present an integrated analysis on the performance of PFM systems in Bhutan on the basis of information provided in the preceding chapters, and to state overall conclusions. In particular, the analysis seeks to assess how the performance of PFM systems may affect the Government's ability to deliver the intended fiscal and budgetary outcomes, and to identify the main weaknesses of the PFM system in that respect.*

## 4.1 Integrated assessment of PFM performance

The indicator assessment is explained in terms of its implications for the seven pillars of PFM performance:

**1. Budget reliability:** In order for the government budget to be useful for policy implementation, it is necessary that it be realistic and implemented as passed. RGoB succeeds in keeping aggregate expenditure close to the approved budget, even though the approved budget does not include donor-funded project expenditure unless it is agreed at the time of budget preparation. As donor agreements are concluded during the year, additional supplementary estimates are prepared for legislative approval, but these are not counted in a PEFA assessment, which is based on original budgets. Since FY 2010/11, budgets have been managed through a web-based and real time online Multi-Year Rolling Budget. This system has improved monitoring of revenue and expenditure and shortened the processing time for incorporation of donor funds. Revenue budgets are similarly reliable in aggregate, particularly on domestic revenue. Most of the budget/actual variance has been due to unreliable projections of donor grants, and their conservative budgeting. The aggregate control of both expenditure (PI-1) and domestic revenue (PI-3.1) facilitates control of the fiscal deficit.

Contingency reserve in the annual budget is relatively high (13% of total expenditure in FY 2013/14), but actual expenditure is charged to the benefitting agencies and the budget is re-allocated accordingly (PI-2.3). This is good international practice, even though it contributes to expenditure variance.

At the agency level, there is high variance of expenditure (PI-2.1). On an administrative classification, variance of expenditure composition from the budget (current and capital together) was more than 15% in each of the past three years. Much of this appears to be due to under-spending by the Ministry of Finance expenditure compared with its original budgets. On an economic classification basis (PI-2.2), there was also significant variance, partly due to the conservative budgeting of donor capital expenditure, as mentioned above.

On the revenue side, the composition of revenue (share of each revenue item in the total, PI-3.2) also varied highly from the original budget, mainly because of the underlying variation in external grants

and partly because original budgets are prepared on a baseline scenario that does not assume any policy changes. External grants are not included in the original budget unless confirmed yet these vary somewhat beyond the control of RGoB. Subsequent policy changes and confirmed grants are reflected in revised estimates later in the year.

**2. Transparency of public finances:** Transparency of information on public finances is necessary to ensure that activities and operations of governments are taking place within the government fiscal policy framework and are subject to adequate budget management and reporting arrangements. Transparency is an important feature that enables external scrutiny of government policies and programs and their implementation.

The Public Expenditure Management System (PEMS) allow the internal tracking of expenditure by administrative agency, by economic character, and by functional purpose (program) (PI-4). The economic classification is broadly aligned with IMF-GFS classification, and the program classification can be bridged to the UN/IMF Classification of Functions of Government (COFOG) classification. The chart of accounts is based on cash basis of accounting and meets the basic needs for accountability and transparency. Government receipts are also broadly aligned with the GFS classification.

Budget documentation is publicly available on the Ministry of Finance website and is of good international standard (PI-5) with one exception: the annual Budget Report and Annual Financial Statements show the past and projected fiscal accounts in economic and functional classification, but not administrative classification. This is available only internally.

Budget documentation covers all central government revenue and expenditure with insignificant exceptions. In this context, 'central government' includes dzongkhags, gewogs and thromdes, which do not meet the PEFA criteria to be classified as sub-national governments and are here treated as deconcentrated entities under central government control (PI-7). Overall, there is good public transparency of key fiscal information (PI-9) which could be further strengthened through public disclosure of in-year and end-year budget execution reports.

A global trend in PFM is the integration of physical performance information with financial data in budgets and budget execution reports so that accountability can be extended beyond the containment of expenditure and include accountability for the outputs resulting from expenditure (PI-8). RGoB is in the vanguard of this trend as it has instituted a Government Performance Management System based on annual performance agreements between the Prime Minister and heads of agencies, which are the basis on which budgets are prepared and approved. Despite the considerable impact of this system on budget management, it has not yet been included in budget documentation and the agreements are only partially available to the public beneficiaries of the agreements. In addition to the performance audits carried out by RAA, independent evaluation of the service delivery is planned under the performance management system by GPMD, PMO.

**3. Management of assets and liabilities:** Effective management of assets and liabilities ensures that risks are adequately identified and monitored, public investments provide value for money, financial investments offer appropriate returns, asset maintenance is well planned, and asset disposal follows clear rules. It also ensures that debt service costs are minimized and fiscal risks are adequately monitored so that they can be mitigated in a timely way.

Fiscal risks to the central government budget are adequately monitored (PI-10). State-owned enterprises in Bhutan send their annual reports, including audited financial statements, to the Ministry of Finance

within six months of the end of the year. Fiscal risks from their operations are monitored by MoF and summary information on the PEs is included in the Annual Budget Report and Annual Financial Statements. MoF monitors local government revenues, expenditure and debt.

An important aspect of PFM that is now brought into the 2016 Framework is the management of public investments in major capital projects (PI-11). In Bhutan, the management of public investments is decentralized to line ministries and agencies, but closely regulated by guidelines issued by the MoF. Projects are subject to independent social and environmental screening, but are not subject to economic analysis (except for large donor-funded projects). Feasibility studies do not routinely include life-time recurrent costs in the evaluation of economic merit. Project monitoring up to the point of capital cost completion is undertaken by the implementing agencies and in parallel by MoF and the Gross National Happiness Commission.

Apart from project work in progress, the Government owns a vast range of financial assets and non-financial (physical) assets (PI-12). The holding ministries and agencies keep records and monitor asset usage and maintenance, again under tight control from MoF (Department of National Properties), though coverage of the records and reports is not yet complete – the Government is working on a web-based inventory system. Public disclosure of non-financial assets is presently not made. Conversely, debt records are complete and accurate, and all decisions on issue of debt or granting of guarantees are made by MoF against transparent criteria and fiscal targets. The score on this indicator (PI-13) is lower than it might be as the debt strategy is not publicly available.

**4. Policy-based fiscal strategy and budgeting:** A strength of Bhutan PFM is its fiscal framework for budget management. Fiscal planning and budgeting are based on quarterly macro projections managed by a cross-government committee, based on a set of assumptions and possible scenarios. Fiscal projections are then based on the macroeconomic projections (PI-14). They inform the preparation of the annual budget and its internal use, but are not published. All proposed changes in expenditure policies are costed for their fiscal impact in the budget year. However, revenue projections in the initial budget are based on pre-existing tax/non-tax policy. Changes in tax/non-tax policy once approved by Parliament are incorporated into the revised budget. Special attention is paid to the projection of debt: a debt sustainability analysis is prepared every other year by MoF, and discussed with World Bank and IMF staff. According to law, recurrent expenditures should be kept within revenues, i.e. no deficit on current account, and the 11th Five Year Plan sets targets for the coverage of total expenditure by domestic revenue (>85%) and the average fiscal deficit (<3%). As mentioned above, a medium-term debt strategy has been prepared but it is not publicly available (PI-13 and 15).

Expenditure is budgeted on a three-year horizon, which rolls over each year (PI-16). A major factor in planning and budgeting is the progress of several hydropower projects, and the timetable for their commissioning. A chapter in the annual Budget Report describes the status of each project. Private-public partnerships are coming into use and a PPP policy has recently been approved by Cabinet. Rules and regulations are being prepared and a PPP unit is about to be set up in the Ministry of Finance. A PPP pipeline and monitoring have yet to be established. By and large, budgets are consistent with previous year projections as they are all based on the same Five Year Plan and strategy statements, subject to policy and program changes from year to year and from original to mid-year revised estimates.

There is a clear budget calendar that is substantially adhered to, and budget agencies are provided politically approved expenditure ceilings before they start their detailed budgeting. This provides enough time (around 8 weeks) for the agencies to decide their priorities (PI-17). The National

Assembly has only a few days to deliberate on proposed allocations, as budgets have to be approved before the financial year starts on July 1 (FY 2013/14 was an exception as the budget process was delayed by elections). The budget for FY 2015/16 was presented one month before July 1, which is an improvement. The scope and depth of legislative scrutiny is expected to be further enhanced by the establishment of a permanent Finance Committee recently (PI-18): rules for its working are being finalized. There are clear rules for in-year budget adjustments by the executive and they are respected.

**Predictability and control in budget execution:** Predictable and controlled budget execution is necessary to ensure that revenue is collected and resources are allocated and used as intended by government and approved by the legislature. Effective management of policy and program implementation requires predictability in the availability of resources when they are needed, and control ensures that policies, regulations, and laws are complied with during the process of budget execution.

Revenue administration in Bhutan meets international standards, being based on a clear legislative framework that is known and accessible by taxpayers, a functioning appeals procedure and a tax audit program based on assessment of risks (PI-19). Revenue accounting is also of good standard, with prompt collection of revenues and transfer to Treasury-controlled accounts, and daily reconciliation of collections and transfers. Accumulated tax arrears are low (< 1% of total revenue collection), but the score (PI-20) is brought down as overall reconciliation of opening revenue arrears, assessments and penalties raised during the year, collections, write-offs and closing. The score for PI-20 would have been higher had overall reconciliation of tax arrears been carried out on a quarterly basis rather than annually.

Bank and cash balances are monitored daily (other than for some extra-budgetary funds) and MoF releases funds in accordance with the budget utilization plans of the spending agencies. This provides a secure basis for both agency planning and procurement and for central cash and debt management. Agencies can plan at least six months in advance. The assessment team did not hear of any delays in funding from domestic sources. The uncertainties and delays on funds for externally-assisted projects have been reduced but are still an issue. The MoF has legal power to exercise discretion in the re-allocation of funds in advance of legislative approval of supplementary appropriations (PI-21). However, there is no central monitoring of expenditure arrears and the stock of arrears is not known (PI-22).

Payroll and procurement are decentralized to line agencies. Payroll management suffers from a lack of integration of agency systems (PEMS) with the Civil Service Information System which has the personnel records: a reconciliation between the two is yet to be undertaken. Serious internal control weaknesses have been reported by the auditors. Strengthening of PEMS and related systems would help in overall efficiency and provide opportunity for strengthening in the areas of internal control, payroll processes (PI-23) and expenditures arrears (PI-22). Procurement suffers from a lack of central monitoring. However, competitive procurement methods appear to be the accepted norm, and there is an independent procurement complaints process, though it is hardly used. Both these areas, which are responsible for most government expenditure, suffer from shortage of trained and experienced personnel. Major new information systems are being developed and existing systems are being upgraded and integrated. There is no system of regular payroll audits or procurement audits outside the general audits of the RAA, though some regular surveys have been undertaken by RCSC (PI-22 and 23).



Expenditure commitment and payment controls (controls based in budget and L/Cs) are well established through Financial Regulations and system controls and are followed in actual practice (PI-25). Acceptance of internal audit has built up in recent years and recommendations are addressed more seriously, though could be strengthened further. Audit now covers almost 90% of government expenditure and all of government revenue. However, internal audit is still primarily focused on compliance with financial regulations and not on the review and analysis of systems (PI-26).

**Accounting and reporting:** Timely, relevant and reliable financial information is required to support fiscal and budget management and decision-making processes.

Financial data integrity in Bhutan is good, based on daily and monthly reconciliation of receipts and payments with bank statements, and control over access and changes to PEMS. Advance and suspense accounts are reconciled and cleared regularly (PI-27).

The DNB has started issuing formal quarterly reports on budget execution with high accuracy of data but based on payments only, not commitments. This is for internal use and is not published (PI-28). Annual financial statements are prepared by DPA and sent to RAA for audit within six months of close of financial year, i.e. by December 31. As mentioned above, these are prepared on a cash basis. They do not cover all financial assets and liabilities in a cash-based system and do not meet the cash-IPSAS international standard (PI-29).

**External scrutiny and audit:** Effective external audit and scrutiny by the legislature are enabling factors for holding the government's executive branch to account for its fiscal and expenditure policies and their implementation.

Bhutan's supreme audit institution, the Royal Audit Authority, has constitutional independence from the executive and fairly complete operational independence. It has unrestricted access to all records and officers, and prepares and implements its own annual audit plan, based on risk criteria. In the last three years, it has covered more than 75% of expenditure and revenue. Audit reports are submitted to the Parliament within six months from submission of accounts for audit. The RAA makes recommendations in its reports and there is evidence of follow up by the responsible managers (PI-30).

Audit reports are scrutinized by the Public Accounts Committee of the Parliament. It holds public hearings with accountable officers, endorses audit recommendations and makes its own recommendations in reports to the National Assembly, which are discussed (PI-31). The external audit and legislative scrutiny of government operations completes the cycle of transparent accountability.

## 4.2 Effectiveness of the internal control framework

Bhutan has always placed high importance on good governance – striving to enhance it on the principles of transparency, accountability and effectiveness. A strong internal control system is integral to promoting the three principles in Bhutan. It is through strong internal control that Bhutan is able to achieve commendable ambitions through economy, efficiency and effectiveness in the procurement and use of resources while managing risk within the risk appetite. Ministry of Finance, as the national custodian of public funds, has continuously sought to build a strong internal control system in the use

of public funds through various means by formulating rules and regulations (financial and otherwise); devising frameworks of management, and instituting and expanding internal audit in all government funded agencies.

Currently in practice, issued by the Ministry of Finance, are the Financial Rules and Regulations 2001, which set up the controls necessary for uniform and accurate financial reporting, the Procurement Rules and Regulations 2009 which together with the standard bidding documents for goods and for works, and the standard request for proposals and services establish the fundamental controls in procurement of goods, services and works; and the Property Management Manual which dictates the controls necessary for safe-keeping of assets, and appropriate disposal of used goods. Also there are the Bhutan Civil Service Rules 2012 of the Royal Civil Service Commission, which spell out internal control measures related to human resource management. Bhutan also has the Anti-Corruption Act of Bhutan 2011, and the Audit Act of Bhutan 2006, both empowered by the Constitution of Bhutan to curb corruption and deter fraudulent practices in the country.

The Ministry (of Finance) has been sensitive to grievances and variations, and difficulties in implementing the rules, and thus revises the rules and issues remedial orders to reduce the difficulties. This led the MoF to develop an overarching *Internal Control Framework* in 2013 to network the numerous internal control measures and leverage their impact on strengthening internal control system. This holistic framework takes stock of all rules governing public spending and classifies them into different stages and managerial levels. Recognizing the importance of the control environment, the framework specifically describes internal control-related measures for the heads of agencies. By highlighting areas where the existing system has failed, the framework also seeks to evaluate and improve systems for internal control.

One prominent output of the good governance drive in the late 1990s was the institutionalization of internal audit in the public sector. It started with 17 internal auditors placed in the then eight ministries. Over the years, the service underwent tremendous professional development - from setting an environment conducive to effective internal audit to enhancing professional competence of the growing number of internal auditors. The Central Coordinating Agency (CCA) within the Ministry of Finance is the central office for internal audit service in the country. CCA has the mandate of promoting the acceptance and utilization of internal auditors in the various agencies. The service now has a formal Charter that formalizes the position of internal audit in the RGoB setting. There is a code of conduct specifically for the internal auditors that prescribes the ethical conduct expected, and a manual to guide internal auditors through the course of audit engagements. Presently there are 48 internal auditors spread across the ten central ministries, two central agencies and 20 dispersed dzongkhags. Four of them are Certified Government Auditing Professionals (CGAP).

Detailed findings concerning the main elements of the five internal control components are summarized in a table (Annex 2) that also highlights any gaps in coverage of the control components by the assessed internal control system.

### 4.3 PFM strengths and weaknesses

This subsection analyzes the extent to which the performance of the PFM system appears to be supporting or affecting the overall achievement of the three main fiscal and budgetary outcomes, as follows:

## 1. Aggregate fiscal discipline

The assessment of budget credibility indicators PI-1, 2 and 3 provides a mixed message. Primarily, aggregate discipline is good in that original revenue and expenditure budgets are closely achieved, but not so good because the composition of revenue and expenditure shows high variances in most years. As the budget is an expression of government policies for the coming year, variance is an expression of the challenge of implementing those policies. High variance/low credibility may be due to challenges in predicting donor support, poor planning and budgeting, or it may be due to variation in the execution of budgets. Execution of policies and programs may of course be prevented by exogenous factors, in which case allocations may be switched to policies and programs that are able to spend them. In such cases, the MoF has legal power to vary allocations within overall limits so that social benefit can be maximized. On the other hand, challenges in implementing budgets may be due to poor discipline by line agencies or poor enforcement by MoF: this is not thought to be the case in Bhutan.

It should be noted that RGoB has made a conscious decision of omission from the allocated initial budget of (1) donor project support that has not been agreed at the time the budget is prepared, (2) revenue policy changes (which are subsequently brought into revised estimates), and (3) contingency reserve. As the budget for contingency is quite high (13% of total expenditure in FY 2013/14), and all contingency expenditure is (correctly) re-allocated to the benefitting ministries, this adds to total variance from the original budget.

Fiscal discipline is assisted by the comprehensiveness of the PEMS, the orderly execution of the budget, timely and reliable financial reporting, and effective external audit and legislative scrutiny. It is reduced by some lack of public transparency in administrative classification in the budget and accounts, and lack of economic appraisal of projects before inclusion in the budget.

## 2. Strategic allocation of resources

Resources are allocated in a rolling three year framework based on the 11th Five Year Plan, which is fixed for the whole period. There are many changes from year to year as program priorities change, more efficient work methods are found, the mix of self-provision and contracting out changes, and relative prices change. Nevertheless, planning and budgeting are bottom-up and can be assumed to reflect the changing realities of what can be done at least twice a year, at budget preparation and at supplementary budget preparation. However, the limited economic analysis of major projects (except some funded by donors) and the institutionalized preference of capital expenditure reduces allocative efficiency<sup>39</sup>. Capital expenditures prioritization is often at the expense of non-wage recurrent expenditure, mainly at the expense of operating and maintenance expenditure, thereby resulting in low levels of productivity of existing assets. Favorable factors are the amount of time allowed to agencies to prepare their budgets and the relative assurance that resources will be released in accordance with the approved budget.

## 3. Efficient use of resources for service delivery

The recent adoption of a performance management system is expected to provide data on output and the corresponding expenditure. This will enable calculation of unit costs and other measures of efficiency in the delivery of public services, keeping in view that costs may be varying based on location

<sup>39</sup> "Meeting the requirement for sustainability of the fiscal balance shall not be achieved at the expense of development projects" (Public Finance Act, section 7.e).

and other factors. Even on a cash basis, it will be possible to make rough comparisons among schools, health centers and other service delivery units. This is potentially a powerful tool of cost reduction.

The largest cost elements in many services are goods and services procured from the private sector. The use of competitive methods of procurement, as practiced in Bhutan, achieves value for money and greater efficiency. Greater public transparency in the delivery of resources to service delivery units (PI-8.3) would promote enhanced efficiency. The RAA’s program of performance audits should do the same.

### 4.4 Performance changes since a previous assessment

This section introduces a dynamic perspective on PFM performance and its impact on achieving the three budgetary outcomes.

As the last assessment was based on the 2005 framework, there are several changes that prevent direct comparison of scores with the 2016 assessment. Apart from four new indicators that were not used in 2010, there are several indicators where the structure changed, dimensions being added or subtracted, and many changes have been made in the calibration and wording of even ‘unchanged’ indicators. Therefore no table of scores in 2010 and scores in 2016 would be meaningful. A change from D to A in a particular area may not imply an improvement in performance, only a change in the way of measuring it.

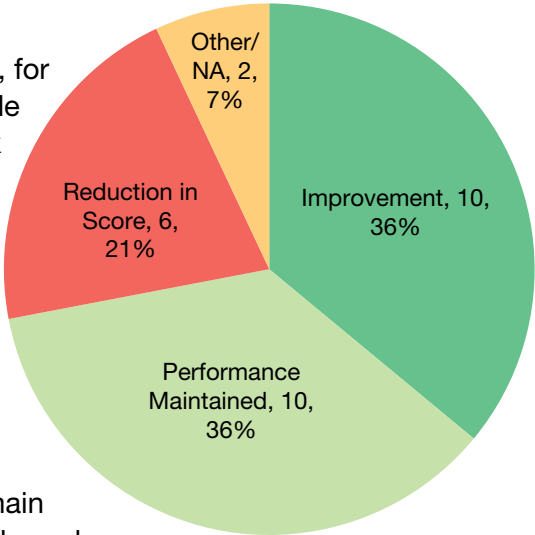
During the current assessment, data was obtained and the performance indicators were assessed using the same 2005 framework so as to measure progress over time. To assess real changes, the comparison has been made between two dates using the same framework, in this case the 2005 framework. Annex 4 lists the scores of all 28 government indicators used for the 2010 assessment, and their corresponding scores today, using the same 2005 framework, and summarized in figure 4.4.1 below.

Since the previous indicators D-1, D-2 and D-3 pertaining to donor practices were not relevant, these were not assessed currently.

Ten scores improved (PI-1, 5, 9, 10, 13, 14, 15, 16, 19 and 24), for six a decline was noted (PI-2, PI-7, 11, 18, 23 and 28 ), while ten did not change, and two could not be compared for lack of information (PI-4 and 8). This result is good: it is difficult to get score improvements across the board, and an excess of improvements over ‘deteriorations’ is commendable. It may also be noted that, even on the same framework, there may have been different interpretations of what the framework required, resulting in scores that are not truly comparable. The column of Annex 4 explaining the changes in scores gives individual details.

Aggregate expenditure and domestic revenue out-turn remain strong and further strengthened by implementation of web-based MYRB and RAMIS. Areas that saw improvement since the previous PEFA assessment are: adoption of COFOG classification, introducing formula-based system for fiscal transfers to local governments, strengthening monitoring of fiscal risk over public enterprises, a more active

**FIGURE 4.4.1: CHANGES IN SCORE FROM 2010 ASSESSMENT**



Tax Appeals Board, formalizing a cash flow forecast system, improving the effectiveness of internal audit function, introducing a system of formal in-year budget execution reporting, constitution of a Finance Committee for legislative scrutiny of budgets and a more active Public Accounts Committee for scrutiny of audit reports.

The main reverses have been in the area of controls over payroll and no real change in coverage of hearings on external audit reports.





## 5.1 Overall approach to PFM reforms

Bhutan has a strong commitment to a Good Governance agenda. Good Governance is the central theme of key strategic documents of Bhutan including the five year plans, the Gross National Happiness (GNH) index and the Bhutan Vision 2020:

- **Bhutan 2020, A Vision for Peace, Prosperity and Happiness** (the Vision) is a twenty year perspective strategy which sets the preferred direction for where Bhutan wants to be in the year 2020 starting from the base year of 2000. In terms of good governance outcomes to be attained by 2020, the Vision anticipates the full development of the country's governance and legal institutions.
- **The 11th Five Year Plan** of Bhutan (2013-2018), the key planning document for the country, makes multiple references to enhancing capacity building, transparency, accountability, efficiency and effectiveness in governance.
- **Gross National Happiness or GNH Index:** Good governance is one of the four pillars of the GNH Index and one of the nine domains within the same index.

### FOUR PILLARS OF GNH



The preparation of the 11FYP was guided by the development philosophy of Gross National Happiness (GNH) based on the above four pillars.

Strengthening Public Financial Management (PFM) is a key element of good governance. As part of the governance agenda, strengthening PFM systems is an area of high priority for the RGoB. Given that the Government is the major controller of public resources, RGoB over the years has been making progress in PFM covering budget preparation, budget execution, control, reporting and oversight. There is increased legislative oversight on budget approval through a finance committee and of audit reports through a public accounts committee. Similar to other countries, public at large has become more demanding in terms of transparent and efficient government. With all strategic documents placing a great importance on good governance, it is clear that PFM within the country is continuously strengthened.

## 5.2 Recent and on-going reform actions

RGoB is pursuing a PFM Reform Action program based on PEFA findings. Based on the 2010 PEFA Assessment Report, RGoB prepared a comprehensive, sequenced and time-bound action plan to bring about improvements in the PFM framework leading to enhancement in quality of public spending.

Key PFM reforms implemented include:

- i. Amendment of the Public Finance Act 2007 in 2012.
- ii. Introduction of web-based application software for PFM and Planning and Evaluation systems viz. Planning and Monitoring System (PlaMS)<sup>40</sup>, Multi-Year Rolling Budget (MYRB) System, Revenue Administration Management Information System (RAMIS), Public Expenditure Management System (PEMS). The PlaMS, MYRB and PEMS are integrated on several aspects.
- iii. Implementation of online fund transfer system through Electronic Fund Transfer and Clearing System (EFTCS) for salaries and other periodic expenses.
- iv. The implementation of a medium-term fiscal framework and the creation of a Macroeconomic Framework Coordination Committee (MFCC).
- v. A National Internal Control Framework developed based on the COSO principles (Dec 2013).
- vi. Internal Audit Charter and Audit Code of Ethics issued (Nov 2014) and Internal Audit Manual developed and operationalized (Mar 2014).
- vii. Audit Resource Management System implemented in RAA.
- viii. A Public Procurement Strategic Framework issued, a Public Procurement Policy drafted and is under consultation and a User Guide for procurement issued in July 2012.
- ix. Strengthening of internal audit and raising its profile and enhancing capacity of staff in terms of numbers and skills.
- x. Phased issue and implementation of accounting and auditing standards for public corporations.
- xi. Strengthening the national procurement system which includes strategic procurement, electronic procurement, framework agreement and capacity building to ensure value for money, economy and efficiency.
- xii. Revised Financial Rules and Regulations (FRR) are in the process of being reviewed and finalized.
- xiii. An Annual Performance Management system introduced with linkages with the budgeting process (2014-15).

The following key reforms are being pursued:

- The integration of PlaMS, PEMS and MYRB.
- Further development of the Government Performance Management System.
- Web-based inventory system under development by DNP.
- DRC is implementing a web-based integrated Revenue Administration Management Information System (RAMIS) and instituting a separate intelligence and investigation unit to strengthen revenue collection.

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<sup>40</sup> The 11th five year plan has been entered in PlaMS.

- Dialogue has started on the integration of the Civil Service Information System with the payroll system in PEMS.
- A central procurement management system (e-GP) is being developed.

### 5.3 Institutional considerations

Strengthening PFM is a continuous process for a growing country and Bhutan is geared towards taking the reform agenda to the next phase. While Bhutan had received reasonable scores against many indicators in the last PEFA assessment, there are certain areas where further strengthening is required. Based on the 2010 PEFA Assessment Report, RGoB prepared a comprehensive, sequenced and time-bound action plan (called PFM Reform Program) to bring about improvements in the PFM framework. The parliamentarians remain a key stakeholder in the PFM reform agenda. The PAC in Bhutan is one of the most active PACs in the region and has been raising key issues within parliament and with the agencies. Till the financial year 2014/15, the National Assembly had only four days for budget review including two days for discussions on the budget in the House, after it was presented by the Finance Minister. Subsequently, a nine-member legislative Finance Committee has been constituted in 2015 (as a permanent committee) - this was facilitated by an amendment to the National Assembly Act allowing the budget to be referred to a Legislative Committee. The budget for 2015/16 was the first budget to be referred to the Committee for review. Bhutan is making steady progress in PFM with various activities being completed and others in progress and there is a strong commitment to PFM reforms backed by sound stakeholder buy-in at the highest level.

**Donors are supporting PFM Efforts:** The World Bank is supporting various initiatives on PFM which include the development of internal audit, implementation of Bhutan Accounting Standards (BAS) in major enterprises, strengthening external audit, intergovernmental fiscal transfers, strengthening of procurement and the development of a PFM reform group. The Asian Development Bank - ADB is working on macroeconomic TA with finance, early warning systems, RAMIS, custom simplification procedures and systems, including risk-based screening and better trade-related agency integration and debt sustainability, DANIDA through its on-going Transition Support Program; the United Nations Development Program recently supported RGoB in preparing the National Internal Control Framework, the ADA through its projects in support of the judiciary, civil society organizations and the Royal Audit Authority; and the Swiss Development Cooperation which also supports select activities in the area of PFM. The International Monetary Fund (IMF) provides a series of technical assistance interventions (in cash management, e-payment, macroeconomic framework, treasury), and supports the provision of a long-term advisor on budgeting issues. In addition, a local governance support program has brought together donors to co-finance support for local governance at the sub-national level. The EU is a key partner and a significant donor to RGoB.

**Forward Thrust on PFM Reforms:** Continuous thrust of reforms requires sustained resources and focused joint efforts of the Royal Government of Bhutan (RGoB) and its development partners (DPs). To this end, RGoB has taken two large initiatives which include formation of a PFM-Governance Group (PFM-GG) and establishment of a PFM – Multi-donor Fund (PFM-MDF). These two initiatives will help the Government to meet the objectives of finding sustained resources to carry out PFM reforms, with Government leadership and ownership and coordination across the various branches of government.

**PFM-GG:** With the formation of the PFM-GG, institutional arrangements are in place to spearhead the PFM reform agenda. PFM-GG, a national level apex committee formed by RGoB, steers the PFM reform action plan of Bhutan and coordinates the resources required for the implementation of the action plan. The PFM-GG was formed in November 2013 under the Ministry of Finance (MoF), chaired by the Finance Secretary, with representation from all the four departments of MoF (Department of National Budget, Department of Public Accounts, Department of Revenue and Customs and Department of National Properties), the Accounting and Auditing Standards Board of Bhutan, Public Procurement Policy Division, Internal Audit Service and Policy and Planning Division, with the Chief Accounts Officer, Department of Public Accounts (DPA) as the Member Secretary. The Accounts Division of DPA acts as the Secretariat for the PFM-GG. The PFM-GG leads the PFM reform programs in Bhutan through a PFM Reform Strategy and an Action Plan adopted and updated on a periodic basis (*RGoB notification May 2015*). The PFM-GG provides oversight, guidance, and revises and monitors implementation of the RGoB's PFM reform program or action plan. To improve coordination across the government, there is clearly scope for expanding PFM-GG membership to RAA, ACC and line ministries.

**Multi-Donor Fund for PFM (PFM-MDF):** A Multi Donor Fund is an effective aid modality instrument to support and spearhead Bhutan's PFM reform agenda. In line with the Paris Declaration on Aid Effectiveness (March 2005) and the commitments at the high level forum on Aid Effectiveness in Accra (2008) and Busan (2011), the World Bank recognizes the advantages of joint cooperation and technical assistance amongst the donors. One of the aid modalities (financing instruments) through which the World Bank endeavors to achieve this is the Multi Donor Fund (MDF) which is funded by donors and administered by the Bank that provides a grant to beneficiaries to implement their reform agenda, thus enhancing country ownership. Bhutan Multi Donor Fund for PFM Reform Program (PFM-MDF or the Program) provides a common platform for the DPs to come together and support RGoB in implementing a RGoB-led PFM Reform Program. The MDF could also support a joint dialogue on PFM reforms amongst the DPs. Through various windows under MDF, DPs are able to provide comprehensive support to RGoB by avoiding duplication, reducing administration costs and providing a platform for other DPs to contribute, who otherwise would not have engaged in PFM individually.

The key objective of the Bhutan PFM-MDF or the Program is to help RGoB implement its PFM Reform Program in a coordinated and holistic basis and to scale it up. This is done through a basket-funding mechanism by establishing an MDF which provides a common platform for DPs to come together by pooling their resources and efforts in strengthening PFM in Bhutan.

The MDF plays a catalytic role in leveraging knowledge and financing by drawing on the best expertise in the field and working closely with a broad range of partners and stakeholders. This MDF or the Program is initially funded by the European Commission (EC) and the Austrian Development Agency (ADA) through a EUR 4 million contribution. Going forward, it is expected that other DPs will join the Program and contribute to the Bhutan PFM-MDF.

The overall development objective of the program is *"to support strengthening the performance, transparency and accountability in public financial management in Bhutan."*

The main areas that are expected to be supported under the PFM-MDF are:

- Window 1: Strengthening Tax, Fiscal and Cash Management, Budget Formulation.
- Window 2: Enhancing Accounting and Reporting Systems.

- Window 3: Scaling up Public Procurement (through automation ensuring economy, efficiency and enhanced transparency).
- Window 4: Strengthening Accountability Institutions.

A Program Coordination Committee (PCC) is being constituted to provide management oversight for the MDF Program. The PCC members will include RGoB, World Bank and donors who are contributors to the MDF. Based on RGoB's PFM Reform Action Plan, which is owned by PFM-GG, reform activities will be prioritized. The PCC will coordinate closely with the Government's PFM-GG. In addition to dialogue with the RGoB, members of the PCC will keep the DPs interested in PFM well informed about the MDF work program in order to promote coordination and cooperation with non-contributing partners.

#### **Transparency of the PFM Program - public accessibility**

After the last PEFA assessment, a workshop was held where several donors participated. After the workshop, RGoB's PFM Reform Action Plan was prepared. Though the said PFM Reform Action Plan is not available on any public platform, it has been shared with the development partners as and when needed and secondly, the financing of the majority of the reform programs is reflected in the RGoB's budget document since these are implemented as recipient-executed projects.

## ANNEX 1: PERFORMANCE INDICATOR SUMMARY

Indicator	Dimension	Score	Description of Requirements Met
<b>1. Aggregate expenditure out-turn</b>	1.1 Aggregate expenditure out-turn	A	In only one year, 2012/13, the ratio of actual expenditure to the original budget was outside the range 95-105%.
<b>2. Expenditure composition out-turn</b>	2.1 Expenditure composition out-turn by function	C	Variance on administrative classification was less than 15% in two of the last three years.
	2.2 Expenditure composition out-turn by economic type	B	Variance on economic classification was less than 10% in two years out of three.
	2.3 Expenditure from contingency reserves	A	Actual expenditure charged to contingency vote was nil in each year.
<b>3. Revenue out-turn</b>	3.1 Aggregate revenue out-turn	C	Actual revenue was between 92% and 116% of budget in two years out of three
	3.2 Revenue composition out-turn	D	Variance was more than 15% in 2 of the last 3 years
<b>4. Budget classification</b>	4.1 Budget classification	A	Budget formulation, execution and reporting is based on every level of administrative, economic and functional classification using GFS/COFOG-compliant classification
<b>5. Budget documentation</b>	5.1 Budget documentation	A	Budget documentation includes all four basic elements, and six out of eight of the additional elements.
<b>6. Central government operations outside financial reports</b>	6.1 Expenditure outside financial reports	B	Expenditure outside government financial reports is less than 5% of total BCG expenditure.
	6.2 Revenue outside financial reports	B	Revenue outside government financial reports is less than 5% of total BCG revenue.
	6.3 Financial reports of extra-budgetary units	D	Financial reports of the NPPF and Trust Funds are submitted to the Government annually and key data are included in the National Budget Report, but not within 9 months of the end of the year.
<b>7. Transfers to sub-national governments</b>	7.1 System for allocating transfers		Not scored as the indicator is not applicable.
	7.2 Timeliness of information on transfers		
<b>8. Performance information for service delivery</b>	8.1 Performance plans for service delivery	C	Information on policy or program objectives, KPIs and outputs to be produced are contained in the APAs prepared for all ministries and dzongkhags and some autonomous bodies. The APAs are on the website of the GPMS but the links are not active, so they are not effectively published. A few agencies include their APAs on their own websites.
	8.2 Performance achieved for service delivery	D	Information on quantities of outputs is included in the APAs for the following year for all ministries and dzongkhags and some autonomous bodies. The APAs are on the website of the GPMS but the links



Indicator	Dimension	Score	Description of Requirements Met
			are not active, so they are not effectively published. A few agencies include information on actual APA results on their own websites.
	8.3 Resources received by service delivery units	C	Information on resources received by front-line delivery units is collected and recorded for all ministries and dzongkhags. However, a report compiling the information is not published.
	8.4 Performance evaluation for service delivery	D	Evaluations of the efficiency and effectiveness of service delivery have been carried out for a few ministries in the last three years.
<b>9. Public access to information</b>	9.1 Public access to information	D	Two of the four basic elements are made available to the public.
<b>10. Fiscal risk reporting</b>	10.1 Monitoring of public corporations	A	Audited annual financial statements are published for all PEs within six months from the close of the financial year and their financial performance is consolidated.
	10.2 Monitoring of sub-national government	Not applicable	A separate level of SNG has not been recognized for PEFA assessment
	10.3 Contingent liabilities and other fiscal risks	A	All significant contingent liabilities and other fiscal risks are reported in the annual financial statements of RGoB.
<b>11. Public investment management</b>	11.1 Economic analysis of investment proposals	C	There are no national guidelines on economic analysis. Some of the development partners conduct economic analysis in accordance with their own methodology in which case the analysis is published.
	11.2 Investment project selection	A	As per current practice, prior to inclusion in the budget, all major investment projects are prioritized by the departments and approved by the Department of National Budget and the GNHC on the basis of standard criteria for project selection which are published.
	11.3 Investment project costing	C	Capital costs are included in the forthcoming budget year for those projects that are funded by RGoB, and through external assistance only if agreements have been signed and fund release is confirmed. Other projects are included in the budget as and when these conditions are met and finally included in the supplementary budget presented to Parliament in June. Major activities are individually listed in the Budget Report.
	11.4 Investment project monitoring	C	Financial and physical progress of major investment projects is monitored at the level of the departments through PSCs and centrally by MoF and GNHC and the standard procedures are complied with. Information on implementation of such projects is prepared after each monitoring visit and otherwise, but these are not published.

Indicator	Dimension	Score	Description of Requirements Met
<b>12. Public asset management</b>	12.1 Financial asset monitoring	B	Records of financial assets are maintained by the concerned agencies and in PEMS. Financial assets are recognized at acquisition cost and disclosed in the annual financial statements/budget reports including information on performance of major categories of financial assets.
	12.2 Non-financial asset monitoring	C	The government maintains records of holding of its fixed assets and other non-financial assets and information on their usage and age is collected only partially, and is not published.
	12.3 Transparency of asset disposal	A	Procedures and rules for transfer and disposal of financial and non-financial assets are established and information is included in the annual financial statements presented to Parliament.
<b>13. Debt management</b>	13.1 Recording and reporting of debt and guarantees	A	Domestic and foreign debt records are complete, accurate and updated and reconciled on a monthly basis. Integrity of debt data is fairly high and comprehensive management and statistical reports covering debt, service, stock and operations are produced at least quarterly.
	13.2 Approval of debt and guarantees	A	Public Finance Act is the primary legislation that grants authorization to borrow and issue new debt and guarantees to the Minister of Finance, subject to approval by the Cabinet, and are made against transparent criteria and fiscal targets.
	13.3 Debt management strategy	D	A medium-term debt strategy covering all existing and projected debt is available with a horizon of five years, as a separate document and planned for periodic updating. The strategy is approved by the Minister of Finance and sets targets for interest rate, refinancing and exchange rate risk. The document is not publicly available.
<b>14. Macro-economic and fiscal forecasting</b>	14.1 Macroeconomic forecasts	A	A government committee prepares 3-year forecasts of key macroeconomic indicators which, together with the underlying assumptions, are included in the Budget Report submitted to the legislature.
	14.2 Fiscal forecasts	B	The Government prepares 3-year forecasts of the main fiscal indicators. These and the underlying assumptions are included in the Budget Report
	14.3 Macro-fiscal sensitivity analysis	C	The Government prepares for its internal use a range of fiscal scenarios based on alternative macroeconomic assumptions, but not a sensitivity analysis of the impact of alternative assumptions.
<b>15. Fiscal strategy</b>	15.1 Fiscal impact of policy proposals	B	The Government prepares estimates of the fiscal impact of all proposed changes in revenue and expenditure policy for the budget year and two following fiscal years, but only the estimates for the budget year of the fiscal impact of proposed changes are submitted to the legislature.

Indicator	Dimension	Score	Description of Requirements Met
	15.2 Fiscal strategy adoption	C	The Government has prepared a fiscal strategy covering the next three years that includes quantitative objectives for fiscal policy, but has not submitted it to the legislature.
	15.3 Reporting on fiscal outcomes	B	Chapter 2 of the 2015/16 Budget report discusses the fiscal outcomes of the last completed fiscal year and any deviations from the objectives and targets set, and explains that the target of 85% of coverage of public expenditures by domestic revenues is unlikely to be achieved because of the delay in the commissioning of major hydropower projects.
<b>16. Medium term perspective in expenditure budgeting</b>	16.1 Medium term expenditure estimates	C	The annual budget report presents estimates for the budget year and the two following fiscal years allocated by economic classification.
	16.2 Medium term expenditure ceilings	B	The Government approves expenditure ceilings for the budget year and for the two following years, before the first budget circular is issued. Ministry ceilings are set for the budget year only.
	16.3 Alignment of strategic plans and medium-term budgets	C	Strategic plans are prepared by some ministries, but medium-term budgets diverge from fixed strategic plans due to changing policies and priorities.
	16.4 Consistency of budgets with previous year estimates	C	The budget report provides an explanation of most changes to expenditure estimates from one year to the next at the aggregate level.
<b>17. Budget preparation process</b>	17.1 Budget calendar	A	A clear budget calendar exists and is substantially adhered to. It allows budget units around 8 weeks to complete their detailed estimates.
	17.2 Guidance on budget preparation	A	The budget circular is comprehensive and clear and reflects ministry expenditure ceilings approved by the Cabinet.
	17.3 Budget submission to the legislature	D	The annual budget proposal was not presented to Parliament at least one month before the start of 2 of the last 3 FYs.
<b>18. Legislative scrutiny of budgets</b>	18.1 Scope of budget scrutiny	C	Legislative review of the budget for 2014/15 was limited, but included review of expenditure and revenue. From 2015/16, a Finance Committee has been constituted.
	18.2 Legislative procedures for budget scrutiny	C	The legislature's procedures for budget review are firmly established, including review by a recently established specialized committee and are respected, but are not comprehensive as there are no procedures for negotiations or public consultations and for the working of the Finance Committee.
	18.3 Timing of budget approval	C	The legislature has approved the annual budget before the start of the year for FY 2015/16, within one month of start of financial year for FY 2014/15 and with a delay of over 2 months in FY2013/14 (election year).
	18.4 Rules for budget adjustment by the executive	A	Clear rules exist for in-year budget adjustments by the executive, set strict limits on extent and nature of amendments and are always respected.

Indicator	Dimension	Score	Description of Requirements Met
<b>19. Revenue administration</b>	19.1 Rights and obligations for revenue measures	B	Entities, which collects majority of the revenue, provides payers with comprehensive information on main of revenue obligations and on their rights including rights of redress.
	19.2 Revenue risk management	B	The DRC uses a structured and systematic approach for assessing and prioritizing compliance risks for some categories of revenue and, as a minimum, for their large revenue payers.
	19.3 Revenue audit and investigation	A	Entities collecting most revenue undertake audits and fraud investigations managed and reported on according to a documented compliance improvement plan, and complete over 90% of planned audits and investigations.
	19.4 Revenue arrears monitoring	A	Revenue arrears is 0.38% of the total revenue collection. Reported revenue arrears are two to seven years old.
<b>20. Accounting for revenue</b>	20.1 Information on revenue collections	A	Information on revenue collection is reported monthly to MoF and is summarized into a report.
	20.2 Transfer of revenue collections	A	Transfers to the Treasury and other designated agencies are made daily.
	20.3 Revenue accounts reconciliation	B	Complete reconciliation of assessments, collections, arrears, and transfers to the Treasury is made monthly, quarterly and annually within 8 weeks of end of period.
<b>21. Predictability of in-year resource allocation</b>	21.1 Consolidation of cash balances	B	The bank/cash balances are consolidated on a daily basis, but some extra-budgetary funds remain outside the arrangements.
	21.2 Cash forecasting and monitoring	B	A cash flow forecast is prepared for the fiscal year and updated at least quarterly taking into account the actual inflows and outflows.
	21.3 Information on commitment ceilings	A	The departments are able to plan and commit expenditure for at least six months in advance in accordance with the budgeted appropriations and cash/commitment releases.
	21.4 Significance of in-year budget adjustments	A	Significant in-year adjustments to budget allocations takes place only once a year above the level of the MDAs and are done in a transparent and predictable way.
<b>22. Expenditure arrears</b>	22.1 Stock of expenditure arrears	D*	For lack of information, the dimension is scored D*.
	22.2 Expenditure arrears monitoring	D	A system has been prescribed for recording commitments or obligations, outside of the system of accounting, to track expenditure arrears at an individual level. No exercise has been undertaken, at a central level, to collate the data on expenditure arrears, if any, and determine the stock of expenditure arrears any time during the last two years.
<b>23. Payroll controls</b>	23.1 Integration of payroll and personnel records	D	The payroll and personnel records are not integrated and no reconciliation between the two records has been undertaken.

Indicator	Dimension	Score	Description of Requirements Met
	23.2 Management of payroll changes	A	The required changes to the personnel records and payroll are updated monthly and in time for the following month's payments in accordance with the rules laid down in FAM. Retroactive adjustments are rare.
	23.3 Internal control of payroll	D	There are serious weaknesses in internal controls in PEMS payroll module and significant observations are made by the auditor on the adequacy of controls to ensure integrity of the payroll data.
	23.4 Payroll audit	C	There is no system of annual payroll audits in RGoB. The RAA undertook a detailed review of the payroll in 2013-14 across all central government agencies and reported its findings as a separate chapter in the Annual Audit Report. Also, regular surveys and HR audits are being undertaken by RCSC.
<b>24. Procurement</b>	24.1 Procurement monitoring	C	Records are maintained on works contracts showing what is procured, its cost, and who is awarded the contracts. These cover the majority of all procurement.
	24.2 Procurement methods	B	70% or more of total value of contracts are awarded through competitive methods.
	24.3 Public access to procurement information	B	Public has access to information on procurement rules and procedures, bidding opportunities and contract awards and data on resolution of procurement complaints.
	24.4 Procurement complaints management	A	The complaints system meets all six criteria.
<b>25. Internal controls on non-salary expenditure</b>	25.1 Segregation of duties	A	Appropriate and clear segregation of duties and responsibilities are laid down in the financial rules and regulations.
	25.2 Effectiveness of expenditure commitment controls	A	Comprehensive expenditure commitment controls are in place.
	25.3 Compliance with payment controls	A	Compliance to the rules and regulations is high and more than 90% of payments are executed in accordance with regular rules and procedures as noted from the audit reports.
<b>26. Internal audit effectiveness</b>	26.1 Coverage of internal audit	B	Internal audit is operational for CG entities incurring most expenditure and collecting most revenue.
	26.2 Nature of audits and standards applied	C	Internal audit is primarily focused on financial compliance.
	26.3 Implementation of internal audits and reporting	A	All planned audits are completed and reports distributed to the appropriate parties.
	26.4 Response to internal audits	C	Management provides a partial response for the majority of entities audited.

Indicator	Dimension	Score	Description of Requirements Met
<b>27. Financial data integrity</b>	27.1 Bank account reconciliation	B	The reconciliation of the RGR is daily and of the BFA, trust accounts, revolving fund and current deposit accounts is monthly. These together constitute 95.2% of the Government receipts for the year 2013-14.
	27.2 Suspense accounts	C	The accounting for Suspense accounts is done in PEMS, thereby eliminating the need for a reconciliation of the Ledger and Control accounts. The suspense accounts are cleared at the end of the financial year.
	27.3 Advance accounts	B	The accounting for Advances is done in PEMS, thereby eliminating the need for reconciliation of the Ledger and Control accounts. Most of the advances are cleared in a timely way.
	27.4 Financial data integrity processes	B	The access and changes to records are restricted by access level controls. An audit trail is available in the financial management systems.
<b>28. In-year budget reports</b>	28.1 Coverage and comparability of reports	B	The quarterly note sheet included the comparison of the approved budget with the revised budget and actual expenditure of the quarter ended.
	28.2 Timing of in-year financial reports	C	Quarterly reports are issued within 5-6 weeks of the end of each quarter.
	28.3 Accuracy of in-year financial reports	B	Report data are accurate, but do not include commitment data.
<b>29. Annual financial reports</b>	29.1 Completeness of annual financial reports	C	Financial statements covering all budgetary units are prepared annually including a comparison with the budget and information on revenue, expenditure and cash balances, but not all financial assets and liabilities.
	29.2 Submission of reports for external audit	B	The AFS are submitted for external audit within 6 months of the end of the fiscal year.
	29.3 Accounting standards	C	Accounting standards applied to the AFS are based on the country's legal framework, and have been applied consistently over time.
<b>30. External audit</b>	30.1 Audit coverage and standards	B	Financial reports of central government entities representing more than 75% of expenditure and revenue have been audited using national standards during the last three years.
	30.2 Submission of audit reports to the legislature	B	Audit reports were submitted to the legislature within 6 months from receipt of the financial reports by the audit office for the last three completed fiscal years.
	30.3 External audit follow-up	A	There is clear evidence of follow-up by RAA on audits.
	30.4 Supreme Audit Institution independence	B	The SAI operates independently from the executive, ensured through the Constitution, and there is a process for appointment of the Head of the SAI. There is independence in planning of audit engagements as well as the approval and execution of the RAA's budget. The SAI has unrestricted and timely access to records, documentation and information.



Indicator	Dimension	Score	Description of Requirements Met
<b>31. Legislative scrutiny of audit reports</b>	31.1 Timing of audit report scrutiny	B+	Scoring Method M2.
	31.2 Hearings on audit findings	B	The legislature usually takes up to three months to complete its examination.
	31.3 Recommendations on audit by the legislature	C	In-depth hearings on key findings of audit reports take place occasionally, covering a few audited entities or may take place with ministry of finance officials only.
	31.4 Transparency of legislative scrutiny of audit reports	A	The PAC issues recommendations and systematically follows up on their implementation.
		A	All hearings are public except for specified limited circumstances, and reports of the PAC are discussed in Parliament and are published on the official website of the Parliament.

## ANNEX 2: SUMMARY OF OBSERVATIONS ON THE INTERNAL CONTROL FRAMEWORK

Internal control components and elements	Summary of observations
<b>1. Control environment</b>	
1.1 The personal and professional integrity and ethical values of management and staff, including a supportive attitude toward internal control constantly throughout the organization	The ethical values embedded in the internal control framework are generally respected by management and staff, as evidenced by the responses to external audit reports, which are generally good, though not always as prompt as expected, there are comprehensive expenditure commitment controls and compliance to rules and regulations is high.
1.2. Commitment to competence	Commitment to competent performance is required by the Performance Management System, which includes regular monitoring and feedback of performance that fails to meet output targets. The Royal Civil Service Commission manages the Civil Service Regulations, which are intended to ensure that only competent staff are appointed and that their performance meets their job descriptions and performance standards. The promotions and career progress of the staff are also based on their performance.
1.3. The “tone at the top” (i.e. management’s philosophy and operating style)	The tone at the top has been set unequivocally by the Gyalpo (King) - <i>“Every individual must strive to be principled, And individuals in position of responsibility must even strive Harder”</i> (His Majesty the King); and <i>“It is the responsibility of every Bhutanese to act against corruption in our country”</i> (His Majesty the Fourth King). In addition, the RGoB attaches great importance to the maintenance of a comprehensive set of rules for the management of public resources, and on their observance. The former is evidenced by the National Internal Control Framework (NICF, a “steel frame of best practices” <sup>41</sup> ); the Public Finance Act, <sup>42</sup> internal audit standards (Manual, Charter, Code of Ethics), the Financial Rules and Regulations (comprising the Financial Management Manual supported by the Finance and Accounting Manual, the Budget Manual, the Aid & Debt Management Manual, Property Management Manual, Procurement Manual and Revenue Manual). Compliance is strengthened by national pride in the uniqueness of this kingdom and strong centralized management, an effective anti-corruption body (ACC) and evidenced by RAA audit reports and Bhutan’s high score on the Corruption Perception Index of Transparency International <sup>43</sup> .
1.4. Organizational structure	There is a clear separation between operating and oversight functions. Internal Audit Unit (Central Coordinating Agency) reports to the Finance Secretary administratively and to the high level Committee of Secretaries (CoS) in case of any disrespect or disregard of any internal audit functions and its recommendations thereof. Internal audit units report directly to the heads of the agencies in which they are established.

41 The NICF was developed with the overall goal to strengthen integrity, transparency, efficiency, effectiveness, participation, accountability and ethical behaviour at all levels of management. All agencies of RGoB (including government owned institutions and corporations, and autonomous agencies) are obliged to institute and institutionalize internal controls and to draw upon the country’s laws, rules, regulations, procedures and policies.

42 The Act seeks to regulate the financial management of the Royal Government of Bhutan in order to promote the effective and efficient use of public resources, strengthen accountability and provide statutory authority and control for sound and sustainable fiscal policy.

43 An average score of 58 points between 2006-2016 with the latest score of 65 being the highest.

Internal control components and elements	Summary of observations
1.5. Human resource policies and practices	Human resource management is decentralized to line agencies which implement rules set by the RCSC. For instance, heads of agencies ensure that the duties of staff are rotated so as to prevent the development of vested interests.
<b>2. Risk assessment</b>	
2.1 Risk identification	The NICF casts responsibility on ministries and other autonomous agencies to identify and evaluate risks at departmental, divisional and operating unit levels; establish policies, plans, procedures and systems to deal with risks and conduct a self-assessment of the five control components. Risks are identified in budget preparation: both revenue and expenditure are projected under multiple scenarios, such as the timing of HEP project commissioning. PED and DMD monitor risks arising out of operations of the public enterprises, debt and contingent liabilities, though there is no mention of PPPs. DRC manages risks on taxpayer registration, assessment, collection and audit.
2.2 Risk assessment (significance and likelihood)	All identified risks are evaluated. The significance and likelihood of risk are distinguished in tax audit planning.
2.3 Risk evaluation	
2.4 Risk appetite assessment	
2.5 Responses to risk (transfer, tolerance, treatment or termination)	No information available
<b>3. Control activities</b>	
3.1 Authorization and approval procedures	Budgets are classified (inter alia) by responsibility centre, so that accountability for both revenue and expenditure against approved budgets is established each year. Controls over expenditure are controlled through computerized systems.
3.2 Segregation of duties (authorizing, processing, recording, reviewing)	Responsibilities for authorization, processing, recording, and reviewing of transactions and custody of relevant assets are prescribed by the FRR 2001, and followed, subject to endemic shortages of skilled staff and absences of key staff.
3.3 Controls over access to resources and records	Procedural and system controls limit access to resources and records, in accordance with the FRR 2001.
3.4 Verifications	Accounting procedures include verifications and reconciliations, such as cash reconciliations with bank statements, debt balance reconciliations with creditors, and advance/suspense balance reconciliations with accountable officers. There is no regular reconciliation/verification of employee records with the payroll. There are serious weaknesses in internal controls in payroll and significant observations are made by the auditor on the adequacy of controls to ensure integrity of the payroll data.
3.5 Reconciliations	
3.6 Reviews of operating performance	There are multiple monitoring and reviewing systems. Operations, processes, activities and performance are reviewed quarterly by the Prime Minister's Office against Annual Performance Agreements, by MOF against annual budgets, and by GNHC against the Five Year Plan. The Government Performance Management System has been reviewing physical and financial performance since 2013/14. There are mid-year reviews and annual progress reports. In addition, there is ex ante scrutiny of budgets and ex post scrutiny of accounts by the legislature.
3.7 Reviews of operations, processes and activities	
3.8 Supervision (assigning, reviewing and approving, guidance and training)	No information available.

Internal control components and elements	Summary of observations
<b>4. Information and communication</b>	Operational and financial information for managers are available through the computerized applications such as MYRB, PEMS and RAMIS.
<b>5. Monitoring</b>	
5.1 Ongoing monitoring	See 3.6 and 3.7 above.
5.2 Evaluations	The GPMS has instituted a system of mid-year and year-end evaluation and assessment process. RAA has started on performance audits, but there is not yet a systematic and comprehensive evaluation function.
5.3 Management responses	Accountable managers submit Action Taken Reports on recommendations by internal and external audit, though not always promptly. These reports are assessed and, if necessary, followed up by auditors and by the PAC.

## ANNEX 3: SOURCES OF INFORMATION

### Annex 3A: Surveys and analytical work

SAI PMF Report, RAA, May 2015
IMF Article IV report data
GPP Bhutan 10 Major Findings and Implications for GPP September 2015
Analysis of data on Construction Development Board (CDB) online database
Data Analysis from the sample contract data of Ministry of Education
PEFA Performance Report June 2010
SAR Report on Public Sector Accounting and Audit, 2009, (ROSC)

### Annex 3B: List of persons met

Ministry of Finance	
Mr. Lam Dorji	Honorable Secretary
Department of Public Accounts, Ministry of Finance	
Mr. Choiten Wangchuk	Director General
Mr. Tshering Dorji	Chief Program Officer
Mr. Sonam Tobgyel	Chief Accounts Officer
Mr. Budhiman Rai	Chief Accounts Officer
Ms. Kuenzang Dema	Accounts Officer
Ms. Yeshey Peden	ICT Officer
Government Performance Management Division (GPMD), Office of the Prime Minister	
Mr. Chencho	Deputy Chief Planning Officer and Head, GPMD
Royal Audit Authority	
Mr. P.M. Pradhan	Deputy Auditor General
Mr. Karma Jambayyang	Dy. Chief Audit Officer
Mr. Sonam Wangdi (Telephonic Discussion)	Senior Audit Officer
Ministry of Education	
Mr. Thinley Rinzin	Planning Officer
Mr. Dochu	Sr. Planning Officer
Ms. Thinley Wangmo	Budget assistant
Mr. Chimi Tshewang	Officiating head of AFD
Mr. Tempa Gyelsthen	
Department of National Budget, MoF	
Mr. Lekzang Dorji	Director
Mr. Namgyel Wangchuk	Chief Budget Officer
Mr. Gyembo	Chief Budget Officer
Central Coordinating Agency, Internal Audit Services, MoF	
Mr. Loday Tsheten	Chief Internal Auditor
Mr. Padam Singh Ghishing	Specialist
Public Enterprises Division	
Mr. Kapil Sharma	Chief Program Officer
Department of Revenue and Customs	
Ms. Lhakpa Bhuti	Dy. Collector
Mr. Sherub Chogyel	BST Division
Mr. Karma Loday	Collector, Revenue Audit and Accounts Division
Ms. Mindrel Zangmo Sherpa	Dy. Collector

<b>Policy and Planning Division, MoF</b>	
Mr. Sonam Tenzin	Chief Planning Officer
Mr. Rinzin Dorji	Sr. Planning Officer
<b>Thimphu Dzongkhag</b>	
Ms. Dechen Pelzom	Accountant
Ms. Tshering Deki	Accounts Officer
Ms. Namgay Donkar	Budget Assistant
Mr. Ugyen	Planning Officer
<b>Department of National Properties</b>	
Dasho Nima Tshering	Director General
Mr. Tashi Tangbi	Engineer
Mr. Karma Wangdi	Chief Procurement Officer
Mr. Leki Tshering	Senior Procurement Officer
<b>Construction Development Board</b>	
Mr. Chencho Tshering	Senior ICT Associate II
<b>RCSC</b>	
Ms. Kuenga Zam	Senior ICT Officer
<b>MoAF (Line Agency)</b>	
Ms. Dema Tshomo	
Ms. Pema Lhamo	Accounts Officer
<b>Bhutan Chamber of Commerce and Industries</b>	
Mr. Chandra Chhetri	
Mr. Yeshi Dorji	

### Annex 3C: Sources of Information

Annual Financial Statements - <a href="http://www.mof.gov.bt">http://www.mof.gov.bt</a>
Bhutan Internal Audit Charter, Code of Conduct, Internal Audit Manual and Internal Control Framework
Budget Manual-2001
Constitution of Bhutan - <a href="http://www.constitution.bt">www.constitution.bt</a>
Finance and Accounting Manual
Financial Rules and Regulations 2001
Public Finance Act 2007
The Audit Act of Bhutan 2006
National Budget reports
11th five-year plan
Procurement Rules and Regulations 2009 (revised July 2015)
Terms of Reference –Independent Review Body
eTool/ciNet – <a href="http://cdb.gov.bt">cdb.gov.bt</a>
Grievance – <a href="http://pppd.gov.bt">pppd.gov.bt</a>
Local Government Act 2009
Revised Guidelines for Public Debt Management, April 2014
Government Order, Establishment of Government Performance Management Division, March 2015
11th Five Year Plan 2013-2018
PEFA Framework for assessing public financial management, 2016
World Bank Country Partnership Strategy August 2014
Annual Financial Statements of the Royal Government of Bhutan for the year ended 30th June 2013, 2014 and 2015
Performance Indicator Report 2013, 2014, Department of Revenue and Customs



## ANNEX 4: COMPARISON WITH 2010 ASSESSMENT

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
PI-1. Aggregate expenditure out-turn compared to original approved Budget.	B	A		
Dimension (i) - Difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges and externally financed project.	B	A	In none of the last three years the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5%. <i>(refer table provided at the end of this Annex).</i>	Improvement in expenditure tracking due to the introduction of a web-based and real time online system called MYRB (Multi-Year Rolling Budget) in FY 2010/11. The new system has improved monitoring of budget and expenditure, and shortened processing time for incorporation of donor funds. The budget call notification now includes submission of pre-requisite documents along with the budget proposals to expedite implementation of activities.
PI-2. Composition of expenditure out-turn compared to original approved budget.	B	D		
Dimension (i) - Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years.	B	D	Variance in excess of the overall deviation in primary expenditure exceeded 10% in all three years. (refer table provided at the end of this Annex).	Composition variance has increased.
PI-3. Aggregate revenue out-turn compared to original approved budget.	A	A		
Dimension (i) - Actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget.	A	A	Domestic revenue (excluding grants) was more than 97% of budget in all the last 3 years.	No change. Note that the assessment on the 2016 Framework was scored C due to high variance of grants. Grants have been excluded in this assessment of change so as to make the scores comparable.
PI-4. Stock and monitoring of expenditure payment arrears.	NR	NR		
Dimension (i) - Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.	NR	NR	Stock of arrears is not known	No change

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
Dimension (ii) - Availability of data for monitoring of the stock of expenditure payment arrears.	D	D	A system has been prescribed for recording commitments or obligations, outside of the system of accounting, to track expenditure arrears at an individual level. No exercise has been undertaken, at a central level, to collate the data on expenditure arrears, if any, and determine the stock of expenditure arrears any time during the last two years. No reliable data on the stock of arrears.	No change
PI-5. Classification of the budget.	B	A		
Dimension (i) - The classification system used for formulation, execution and reporting of the government's budget.	B	A	Budget formulation, execution and reporting is based on every level of administrative, economic and functional classification using GFS/COFOG-compliant classification.	In 2010, it was not possible to classify activities in accordance with COFOG at the sub-functional level. This is now achieved. No other changes in classification.
PI-6. Comprehensiveness of information included in budget documentation.	A	A		
Dimension (i) - Number of the 9 information benchmarks listed below that are included in the budget documentation most recently issued by the central government.	A	A	8 out of 9 benchmarks provided, omitting only financial assets.	In 2009, 7 out of 9 benchmarks were provided, omitting only financial assets and explanation of fiscal impact of new policy initiatives. Significant improvement, though no change in score.
PI-7. Extent of unreported government operations.	A	B+		Scores not comparable (see dimension (i) below).
Dimension (i) - Level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports.	A	B	The NPPF and 5 trust funds are the only extra-budgetary units in central government. In 2014/15 they had expenditure equal to 2.6% of total expenditure.	In the 2010 assessment, the NPPF was not taken into consideration. Scores not comparable.

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
Dimension (ii) - Income/ expenditure information on donor-funded projects which is included in fiscal reports.	A	A	All income and expenditure on donor-funded projects is fully reported.	No change
PI-8. Transparency of inter-governmental fiscal relations	A	NA		
Dimension (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).	A	NA	Not scored as the indicator is not applicable.	Under the 11th FYP, which began in FY 2013/14, the RGoB has initiated a formula-based fiscal transfer allocation for annual grants. LGs treated as SNGs in 2010.
Dimension (ii) - Timeliness of reliable information to lower level governments on their allocations from higher level government for the coming year.	A	NA		As above
Dimension (iii) - Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.	A	NA		As above
PI-9. Oversight of aggregate fiscal risk from other public sector entities.	D+	B		
Dimension (i) - Extent of government monitoring of AGAs and PEs.	C	B	All PEs submit audited financial statements annually to the MoF and their financial performance is consolidated in the National Budget Report. There are no AGAs.	In 2010, there was no consolidated overview of fiscal data and fiscal risk from PEs.
Dimension (ii) - Extent of government monitoring of SN (urban and rural local bodies) governments' fiscal position.	D	NA	There are no SNGs meeting PEFA criteria.	LGs treated as SNGs in 2010. Scores not comparable.
PI-10. Public access to key fiscal information	B	A		
Dimension (i) - Number of the six listed elements of public access to information that is fulfilled.	B	A	5 of the 6 listed elements of information are accessible by the public. The only exception is in-year budget execution reports.	In 2009 out of 6 elements, only 4 were available to the public. Missing in-year budget execution reports and contract awards. The latter are now published on the procuring entities' notice boards.

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
PI-11 Orderliness and participation in the annual budget process.	A	B+		
Dimension (i) - Existence of and adherence to a fixed budget calendar.	A	A	There is a fixed budget calendar and it is substantially adhered to. It allows budget agencies around 8 weeks to prepare their detailed estimates.	No change
Dimension (ii) - Clarity/ comprehensiveness of and political involvement in the guidance on the preparation of budget submissions.	A	A	The budget circular is comprehensive and clear, and includes ministry expenditure ceilings that have been approved by Cabinet.	No change
Dimension (iii) - Timely budget approval by the legislature or similarly mandated body.	B	C	Parliament has approved the budget before the end of June for FY 2014/15 and FY 2015/16. Only for FY 2013/14 was it delayed till September (3 months).	In one year (2013/14) there was a delay of 2 months.
PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting.	B+	B+		
Dimension (i) - Preparation of multi-year fiscal forecasts and functional allocations.	A	A	Fiscal forecasts are prepared on a rolling three-year basis on an economic classification, and the budget report explains most changes in expenditure at an aggregate level.	No change
Dimension (ii) - Scope and frequency of debt sustainability analysis - Dates for debt sustainability analyses.	B	B	A debt sustainability analysis is produced every two years.	No change
Dimension (iii) - Existence of sector strategies with multi-year costing of recurrent and investment expenditure.	A	A	Sector plans are produced, including both capital and recurrent expenditure, and are broadly consistent with fiscal forecasts.	No change
Dimension (iv) - Linkages between investment budgets and forward expenditure estimates.	C	C	The linkage between budget estimates and the costing of recurrent implications of new	No change

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
			policy initiatives in the investment decision making process is weak.	
PI-13 Transparency of taxpayer obligations and liabilities.	B	B+		Improvement in performance
Dimension (i) - Clarity and comprehensiveness of tax liabilities.	B	B	Legislation and procedures for most major taxes are comprehensive and clear, and DRC has limited discretionary powers.	No change
Dimension (ii) - Taxpayer access to information on tax liabilities and administrative procedures.	B	B	The DRC, which collects most revenue, provides payers with comprehensive information on majority of revenue obligations and on their rights including rights of redress.	No change
Dimension (iii) - Existence and functioning of a tax appeals mechanism.	B	A	Tax appeals are administered transparently through three tiers, including an independent institution which is operating satisfactorily.	In 2009, the appeals board had only just been set up. Since then there has been improvement in the effectiveness of the system.
PI-14 Effectiveness of measures for taxpayer registration and tax assessment.	C+	B		Overall improvement
Dimension (i) - Controls in the taxpayer registration system.	C	C	Taxpayers are registered in a database system, but there is no linkage to other government systems to ensure complete coverage.	No change
Dimension (ii) - Effectiveness of penalties for non-compliance with registration and declaration obligations.	B	B	Penalties exist but are not always effective.	No change
Dimension (iii) - Planning and monitoring of tax audit and fraud investigation programs.	C	B	Tax audits and fraud investigations are managed in accordance with an annual audit plan based on specific risk assessment criteria.	Improvement in the planning of tax audits.

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
PI-15 Effectiveness in collection of tax payments.	C+	B+		Overall improvement
Dimension (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).	A	A	Revenue arrears are less than 1% of collections,	No change
Dimension (ii) - Effectiveness of transfer of tax collections to the Treasury by the revenue administration.	A	A	All tax revenue is paid directly into the government revenue account and transferred daily to the Treasury.	No change
Dimension (iii) - Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.	C	B	Complete reconciliation of assessments, collections, arrears, and transfers to the Treasury is made daily, monthly, quarterly and annually within 8 weeks of end of period.	Monthly and quarterly reconciled figures by the DRC are now shared with Department of Public Accounts within a week of the end of the month or quarter. This also generates a periodic tax arrears picture. In addition a statement reflecting the revenue arrears, <i>(which in this case is revenue collected and not deposited in treasury account)</i> is shared with the Department of Public Accounts on an annual basis to be incorporated in the Annual Financial Statement within 8 weeks of the end of the fiscal year. This is an improvement over the previous PEFA assessment.
PI-16 Predictability in the availability of funds for commitment of expenditures.	C+	B+		
Dimension (i) - Extent to which cash flows are forecast and monitored.	C	B	Cash flow forecast is prepared for the fiscal year and updated at least quarterly on the basis of actual cash inflows and outflows.	Improvement through a system of Budget Utilization Plan (BUP) through a module in PEMS.
Dimension (ii) - Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment.	A	A	The departments are able to plan and commit expenditure for at least six-months in advance in accordance with the budgeted appropriations and cash/commitment releases.	No change



Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
Dimension (iii) – Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.	A	A	Significant in-year adjustments to budget allocations take place only once a year and are done in a transparent and predictable way.	No change
PI-17 Recording and management of cash balances, debt and guarantees.	A	A		
Dimension (i) - Quality of debt data recording and reporting.	A	A	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 covering debt, service, stock and operations are produced at least quarterly.	No change
Dimension (ii) Extent of consolidation of the government's cash balances.	B	B	All cash/bank balances are calculated daily and consolidated but extra-budgetary funds remain outside the arrangement.	No change
Dimension (iii) - Systems for contracting loans and issuance of guarantees.	A	A	Government's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets and always approved by a single government entity i. e. the Minister of Finance.	No change
PI-18 Effectiveness of payroll controls.	B+	D+		
Dimension (i) - Degree of integration and reconciliation between personnel records and payroll data.	B	D	The payroll and personnel records are not integrated and no reconciliation between the two records has been undertaken.	Apparent deterioration

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
Dimension (ii) - Timeliness of changes to personnel records and the payroll.	A	A	Required changes to the personnel records and payroll are updated monthly and in time for the following month's payments in accordance with the rules laid down in FAM. Retroactive adjustments are rare. RAA has not made any observations in this regard.	No change
Dimension (iii) - Internal controls of changes to personnel records and the payroll.	B	C	There are serious weaknesses in internal controls in PEMS payroll module, reported on by RAA.	Apparent deterioration based on RAA findings in FY13/14 audit report.
Dimension (iv) - Existence of payroll audits to identify control weaknesses and/or ghost workers.	B	C	There is no system of annual payroll audits in RGoB. The RAA undertook a detailed review of the payroll in 2013-14 across all central government agencies and reported its findings as a separate chapter in the Annual Audit Report. Also, regular surveys and HR audits are being undertaken by RCSC.	Apparent deterioration
PI-19 Competition, value for money and controls in procurement.	C	B		
Dimension (i) - Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases.	D	B	Most of the contracts use competitive tendering process. For works contracts there is an electronic database managed by Construction Development Board (CDB). For goods and service there is no such comprehensive database but hard copy fills are maintained.	Improved Performance. However, implementation of a comprehensive electronic government procurement (e-GP) system with end to end solution (advertisement to contract implementation including open contracting) is very important. In addition to that improvement in CDB's electronic system (integration with e-GP, better information dissemination to public).

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
Dimension (ii) - Justification for use of less competitive procurement methods.	B	C	Lack of central information on use of non-competitive methods.	Procurement regulations set limits on use of less competitive methods. Based on sample data it is observed that implementing agencies are following the rules strictly with adequate justifications. In the absence of a nationwide MIS at the time of assessment, it is not possible to verify. In fact performance has improved compared with 2009 when a different sample approach was taken.
Dimension (iii) - Existence and operation of a procurement complaints Mechanism.	C	A	The complaints process is operational and is overseen by the Independent Review Board.	Improved performance. In 2009 there were no procurement complaint mechanism. In 2015 a comprehensive procurement mechanism has been developed and fully functional.
PI-20 Effectiveness of internal controls for non-salary expenditure.	A	A		
Dimension (i) - Effectiveness of expenditure commitment controls.	A	A	Comprehensive expenditure commitment controls are in place.	No change
Dimension (ii) - Comprehensiveness, relevance and understanding of other internal control rules/procedures.	A	A	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.	No change
Dimension (iii) - Degree of compliance with rules for processing and recording transactions.	A	A	Compliance with rules is fairly high.	No change
PI-21 Effectiveness of internal audit.	C+	C+		
Dimension (i) - Coverage and quality of the internal audit function.	B	B	There are 48 IUAs and IAS now covers 10 ministries, 20 dzongkhags and 2 autonomous agencies representing 89% of the budgeted expenditure.	Improvement of coverage from 70% to 89% but no change in score.

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
Dimension (ii) - Frequency and distribution of reports.	C	C	Internal audit reports are issued to the mgt with a copy to CCA, MoF. CCA consolidates the reports received from IAUs and submits to Cabinet for information and reference. Reports are not copied to SAI are available on request.	Reports issued to management but no consolidated report issued annually. Reports not circulated to SAI and MoF.
Dimension (iii) - Extent of management response to internal audit findings.	B	C	Managements generally acts promptly on financial recoveries however there is lukewarm response when it comes to systemic corrections.	Apparent deterioration of management response.
PI-22. Timeliness and regularity of accounts reconciliation.	B	B		
Dimension (i) - Regularity of bank reconciliations.	B	B	The reconciliation of the RGR is daily and of the BFA, trust accounts, revolving fund and current deposit accounts is monthly. The reconciliation for these accounts is completed within 3 weeks of the end of the period.	No change
Dimension (ii) - Regularity of reconciliation and clearance of suspense accounts and advances.	B	B	The accounting for suspense and advance accounts is done in PEMS, thereby eliminating the need for a reconciliation of the ledger and control accounts. The suspense accounts are cleared at the end of the financial year. Most advances are cleared in a timely way.	No change
PI-23 Availability of information on resources received by service delivery units.	A	C		

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
Dimension (i) - 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.	A	C	Information on resources received by front-line delivery units (in cash and in kind) is collected and recorded in accounting systems (PEMS) for all ministries and dzongkhags. A report compiling the information is not prepared.	A report compiling the information on resources received by service delivery units is not prepared, unlike done at the time of the previous assessment.
PI-24. Quality and timeliness of in-year budget reports.	D+	C+		
Dimension (i) - Scope of reports in terms of coverage and compatibility with budget estimates.	C	C	In 2014/15 DNB was issuing information in the form of a note sheet which included the comparison of the approved budget with the revised budget and actual expenditure of the quarter but only at the payment stage, not commitment stage.	No change.
Dimension (ii) - Timeliness of the issue of reports.	D	B	During 2014/15, a quarterly note sheet was prepared by DNB and was issued to MoF within 5 to 6 weeks from the end of the quarter.	Improvement in in-year reporting.
Dimension (iii) - Quality of information.	A	A	The quality of information is good as actual data is derived from the budget and accounting systems, which are updated daily. Data quality is verified according to procedures stated in the Financial Rules and Regulations.  The usefulness of the reports is not undermined by inaccuracies or omissions.	The MYRB system has significantly improved information quality and timeliness. but no change in score.

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
PI-25 Quality and timeliness of annual financial statements.	C+	C+		
Dimension (i) Completeness of the financial statements.	B	B	Financial statements covering all budgetary units are prepared annually including a comparison with the budget and information on revenue, expenditure and cash balances.	No change
Dimension (ii) - Timeliness of submission of the financial statements.	A	A	The AFS is submitted for external audit within 6 months of the end of the fiscal year.	No change
Dimension (iii) - Accounting standards used.	C	C	Accounting standards applied to the AFS are based on the country's legal framework, and have been applied consistently over time.	No change
PI-26 Scope, nature and follow-up of external audit.	B+	B+		
Dimension (i) - Scope/nature of audit performed (incl. adherence to auditing standards).	B	B	More than 75% of total expenditure of central government entities was audited for FY13/14 <sup>44</sup> .	No change
Dimension (ii) - Timeliness of submission of audit reports to legislature.	A	A	Audit reports are submitted to legislature within 4 months of receipt of financial statements.	No change
Dimension (iii) - Evidence of follow up on audit recommendations.	A	A	There is a clear evidence of effective and timely follow-up.	No change
PI-27 Legislative scrutiny of the annual budget law.	D+	D+		
Dimension (i) - Scope of the legislature's scrutiny.	D	C	National Assembly Act has been amended to allow the budget to be referred to a Legislative Committee. From 2015/16, a nine-member legislative Finance Committee has been constituted. The budget for 2015/16 was	Improvement in legislative scrutiny of the budget following establishment of the Finance Committee.

44 Calculation based on number of auditable units audited during fiscal year 13/14.

Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
			the first budget to be referred to the Committee for review. Legislative review of the budget for 2014/15 was limited, but included review of expenditure and revenue.	
Dimension (ii) - Extent to which the legislature's procedures are well established and respected.	C	B	Simple procedures exist for legislature's budget review and are respected.	Improvement in legislative procedures for scrutiny.
Dimension (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).	D	D	For 2015/16, the budget was presented before the National Assembly on May 26, 2015 and referred to the Finance Committee. The National Assembly discussed the budget and the report of the Finance Committee on June 8-9, 2015 and adopted the budget on June 9, 2015. The Finance Committee had less than a month to review the budget document.	There is progress from the past when there was no Finance Committee, but no change in score as the time allowed is only a few days.
Dimension (iv) - Rules for in-year amendments to the budget without ex-ante approval by the legislature.	A	A	Clear rules exist for in-year budget adjustments by the executive, set strict limits on extent and nature of amendments and are always respected.	No change
PI-28 Legislative scrutiny of external audit reports.	B+	C+		
Dimension (i) - Timeliness of examination of audit reports by the legislature (for reports received within the last three years).	A	B	Audit reports were reviewed within 4 months in two of the last three years and within 6 months in one of the years.	Not much change since the last assessment, which was made on one year's experience only.
Dimension (ii) - Extent of hearings on key findings undertaken by the legislature.	B	C	In-depth hearings on key findings take place with responsible officers from the	No real change, as 2010 assessment was made on limited experience.



Indicators and Dimensions	Scores from Assessment		Explanation of Scores in the Current Assessment	Description of Change
	Previous	Current		
			audited entities as a routine, but cover only a few of the entities that received a qualified or adverse audit opinion.	
Dimension (iii) - Issuance of recommended actions by the legislature and implementation by the Executive.	B	A	The PAC issues recommendations on action to be implemented by the executive, and they are generally implemented. For example, the Parliamentary directive to impose 24% penal interest on overdue outstanding advances and recoverable amounts reflected in the audit reports has prompted action by the auditable agencies.	There is progress since the last assessment.

## CALCULATION OF PI-1 AND PI-2 VARIANCES AS PER 2005 FRAMEWORK

**TABLE 1: FISCAL YEARS FOR ASSESSMENT**

Year 1 =	2012-13
Year 2 =	2013-14
Year 3 =	2014-15

**TABLE 2**

Data for year = 2012-13					
Functional Head	Budget	Actual	Difference	Absolute	Percent
Autonomous and Constitutional Bodies	3,984	5,242	1258	1258	31.6%
Ministry of Home and Cultural Affairs	1,594	1,914	320	320	20.1%
Ministry of Finance (excl. interest)	4,827	3,187	-1640.29	1640.29	34.0%
Ministry of Foreign Affairs	524	538	14	14	2.7%
Ministry of Agriculture & Forest	2,482	2,570	88	88	3.5%
Ministry of Economic Affairs	1,034	774	-260	260	25.1%
Ministry of Works and Human Settlement	4,506	4,665	159	159	3.5%
Ministry of Information and Communication	1,239	1,325	86	86	6.9%
Ministry of Health	1,565	1,799	234	234	15.0%
Ministry of Education	1,088	1,312	224	224	20.6%
Ministry of Labour and Human Resources	436	422	-14	14	3.2%
Dzongkhags and Gewogs	9,193	10,136	943	943	10.3%
Total Expenditure	32472.29	33884	1411.71	5240.29	4.3%
Composition variance	32472.29	33884		5240.29	16.1%

**TABLE 3**

Data for year = 2013-14					
Functional head	Budget	Actual	Difference	Absolute	Percent
Autonomous and Constitutional Bodies	4,421	4,458	37	37	0.8%
Ministry of Home and Cultural Affairs	1,844	1,765	-79	79	4.3%
Ministry of Finance (excl. interest)	6,370	5,883	-486.65	486.65	7.6%
Ministry of Foreign Affairs	573	567	-6	6	1.0%
Ministry of Agriculture & Forest	2,503	2,601	98	98	3.9%
Ministry of Economic Affairs	1,173	702	-471	471	40.2%
Ministry of Works and Human Settlement	4,384	4,027	-357	357	8.1%
Ministry of Information and Communication	1,058	698	-360	360	34.0%
Ministry of Health	1,424	1,444	20	20	1.4%
Ministry of Education	830	867	37	37	4.5%
Ministry of Labour and Human Resources	346	428	82	82	23.7%
Dzongkhags and Gewogs	9,065	9,064	-1	1	0.0%
Total Expenditure Deviation	33990.65	32504	-1486.65	2034.65	4.4%
Composition variance	33990.65	32504		2034.65	6.0%

**TABLE 4**

Data for year = 2014-15					
Functional head	Budget	Actual	Difference	Absolute	Percent
Autonomous and Constitutional Bodies	4,430	5,024	594	594	13.4%
Ministry of Home and Cultural Affairs	2,166	2,141	-25	25	1.2%
Ministry of Finance (excl. interest)	7,441	4,156	-3285.37	3285.37	44.2%
Ministry of Foreign Affairs	662	556	-106	106	16.0%
Ministry of Agriculture & Forest	2885	2739	-146	146	5.1%
Ministry of Economic Affairs	1335	794	-541	541	40.5%
Ministry of Works and Human Settlement	3958	4273	315	315	8.0%
Ministry of Information and Communication	541	918	377	377	69.7%
Ministry of Health	1456	1526	70	70	4.8%
Ministry of Education	1323	1799	476	476	36.0%
Ministry of Labour and Human Resources	446	515	69	69	15.5%
Dzongkhags and Gewogs	8302	10012	1710	1710	20.6%
Total Expenditure Deviation	34945.37	34453	-492.37	7714.37	1.4%
Composition Variance	34945.37	34453		7714.37	22.1%

**TABLE 5: RESULTS MATRIX**

Year	For PI-1		For PI-2
	Total exp. deviation	Total exp. variance	Variance in excess of total deviation
2012-13	4.3%	16.1%	11.8%
2013-14	4.4%	6.0%	1.6%
2014-15	1.4%	22.1%	20.7%

## ANNEX 5: FINANCIAL MANAGEMENT IN LOCAL GOVERNMENT IN BHUTAN

### Overview

1. The Royal Government of Bhutan operates as a unitary state with 3 tiers of government: Central government, dzongkhags, gewogs and thromdes. These are Local Governments (LG) with elected bodies to represent the interests of local communities and fulfil their aspirations and needs. The country has 47 electoral constituencies which directly elect members as representatives for the National Assembly. Each dzongkhag also elects a representative for the National Council comprising 25 members. The dzongkhags elect 20 of the 25 members and 5 eminent members are nominated by the His Majesty the King.
2. LGs have been successfully formed all over the country based on local democratic elections in 2011 and 2012. There are 20 dzongkhags, 205 gewogs and 4 thromdes Class A<sup>45</sup>. LGs are convened within thirty days of the declaration of election results and, unless dissolved sooner, continue for five years from the date of the first sitting. The election of members of the LGs is governed by the electoral laws of Bhutan. Dzongkhag thromdes are considered as a constituent of the dzongkhag and gewogs, for purposes of planning and budgeting, with the exception of the four City Corporations (Class A thromdes)<sup>2</sup> which function as quasi corporations. Their autonomy was granted and operations governed by the Charters, Thromde Act 1999 and Municipal Act 2007. In 2012, the GNHC issued the *Division of Responsibilities between Local Governments and National Government* in an effort to further clarify roles and responsibilities.

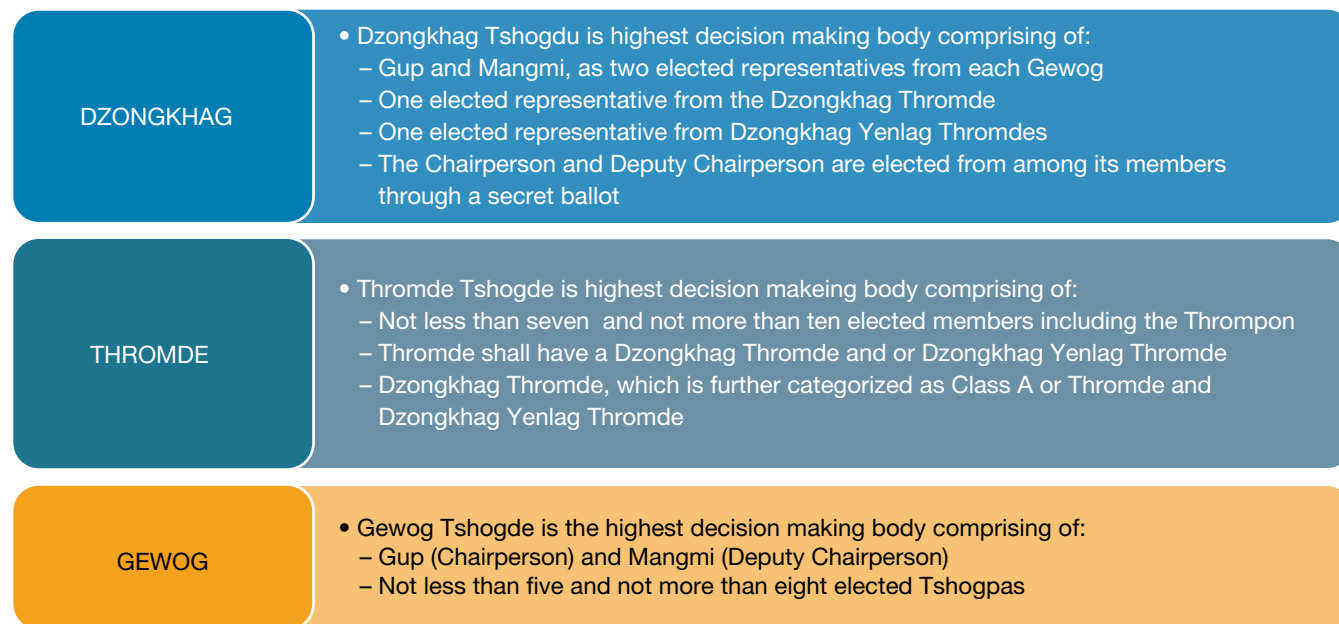
### Legal and Institutional framework

3. The Constitution (Article 22) is dedicated to LGs and provides that power and authority shall be decentralized and devolved to elected LGs to facilitate direct participation of the people in the development and management of their own social, economic and environmental well-being. The objective is to provide democratic and accountable government for the local communities through people's participation in decision making, implementation and delivery of services. Bhutan has LGs in each of twenty dzongkhags comprising Dzongkhags Tshogdu (DT), Gewogs Tshogde (GT) and Thromde Tshogde (TT), as depicted in.
4. Figure 1 below, which are constituted as the highest decision making bodies. These are supported by dzongkhag, gewog and thromde administrations staffed by civil servants. DT and GT are interlinked as Gup and Mangmi are members of the GT and as ex-officio members of the DT.
5. The institutional structure, responsibilities and powers of LGs are enshrined in the Constitution and the *Local Government Act, 2009* (LG Act) as amended by the *Local Government (Amendment) Act of Bhutan 2014*, superseding all previous legislations and read with the *Local Government Rules and Regulations, 2012* (LG Rules), promulgated under section 294 of the LG Act, together provide the constitutional basis, and the legal and regulatory framework for formation and development of LGs in line with the new democratic system introduced in 2008. The LG Act came into force on March 15, 2010.
6. To improve accountability and enhance participatory planning and development, LGs are answerable to the local communities. DT has the power to approve plans, programs and budget prepared by the

<sup>45</sup> Thimpu, Phuentsholing, Samdrup and Gelephu. The other 16 Thromdes are referred to as Class B Thromdes and are under the administrative control of their respective Dzongkhags.

dzongkhag administration, receipts and payments of expenditures, and audit report of dzongkhag and can seek clarifications on any activities. 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. GTs can levy and vary taxes at such rates as may be approved by Parliament.

**FIGURE 1: INSTITUTIONAL FRAMEWORK OF LOCAL GOVERNMENTS IN BHUTAN**



7. RGoB follow unitary system for the financial operations under one framework for all spending agencies at all levels of government. The Government of Bhutan has a record of satisfactory financial management system. This reflects the fact that financial management system of LGs as well as all procedures are same as in central government and managed by the 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 LGs.
8. The parent administrative ministry for overall decentralization policies and frameworks is the Ministry of Home and Cultural Affairs. The Department of Local Governance (DLG) established within the Ministry in 2009 is the focal agency responsible for supporting LGs and has been vested with the responsibilities of support to LGs in planning, monitoring and evaluation, capacity building, maintaining information database of LGs, conducting assessments, and research and analysis. Additionally, the Local Development Division of GNHC is in charge of collaboration on LGs FYPs and annual planning processes. The Department of National Budget and the Department of Public Accounts under the Ministry of Finance are the agencies responsible for inter-governmental fiscal transfers to local governments and monitoring expenditures.
9. RGoB issued the *Thromde Finance Policy in 2012* to establish the financial management practices in thromdes and “empowers the thromdes to levy taxes and duties in accordance with procedures and subject to limitations as may be provided for by the Parliament to provide essential services, promote public participation in decision making and to manage the resources and growth of the thromde in a sustainable manner for the general wellbeing of the residents of the thromde”. The

Finance Policy is applicable to Class A thromdes (as Class B thromdes are under the administrative control of the zongkhags).

## Decentralization and Autonomy of Local Governments

10. Chapter 15 of the LG Act, 2009 grants financial autonomy to LGs to (a) levy, collect and appropriate taxes, fees, tolls, duties and fines in accordance with such procedures 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. The Constitution (Article 22) guarantees that the LGs 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, an entitlement framework has been provided for the LGs in the LG Act. However, most of these remain “entitlements” only as depicted in Table 3 below.

**TABLE 3: ENTITLEMENT FRAMEWORK FOR LOCAL GOVERNMENTS IN BHUTAN AND ACTUAL PRACTICES**

The Legal/Entitlement Framework Related Provision in the Local Government Act of Bhutan, 2009 (section mentioned in brackets)	In actual practice		
	Dzongkhags	Gewogs	Thromdes
<ul style="list-style-type: none"> <li>LGs shall, subject to such limitations as may be provided for by law, <i>be entitled to own assets</i> ..... (s. 219)</li> </ul>	<ul style="list-style-type: none"> <li>Yes, in the form of building, land, equipment etc. and these are recorded in their individual asset registers. Assets can only be transferred/sold subject to rules framed by the government.</li> </ul>	<ul style="list-style-type: none"> <li><i>Yes Can be disposed off subject to policies of the government</i></li> </ul>	
<ul style="list-style-type: none"> <li>LGs <i>shall be entitled</i> to 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 (s. 216)</li> <li>LGs shall be allocated a proportion of the national revenue to ensure self-reliance and sustenance. To this end Local Governments shall receive annual grants from the Royal Government for undertaking plan programmes, activities, and managing and maintaining existing service infrastructures and delivery of services (s. 218).</li> </ul>	<ul style="list-style-type: none"> <li>No own revenue</li> </ul>	<ul style="list-style-type: none"> <li>Yes, taxes levied on land, building, grazing, cattle, etc. at rates approved by Parliament, though amounts raised are very less</li> <li>Taxes levied are retained.</li> </ul>	<ul style="list-style-type: none"> <li>Yes (land tax, urban house tax, under development fees, parking fees, property transfer fee, etc).</li> <li>Taxes levied are retained.</li> </ul>
<ul style="list-style-type: none"> <li>LGs <i>shall have the power to spend funds</i> generated from their local taxes, fees and fines, and from funds allocated by the Royal Government (s. 220) - <i>this will be subject to compliance with Public Finance Act.</i></li> </ul>	<ul style="list-style-type: none"> <li>Source of funds are Annual Capital Grants (ACG) and spending is subject to Annual Capital Grant Guidelines and Financial and Procurement Rules.</li> </ul>	<ul style="list-style-type: none"> <li>Source of funds are Annual Capital Grants and Gewog Development Fund and spending is subject to Annual Capital Grant Guidelines,</li> </ul>	<ul style="list-style-type: none"> <li>Spending is subject to LG Act, FRR, Thromde Finance Policy 2012 and Public Finance Act, 2007.</li> </ul>

The Legal/Entitlement Framework Related Provision in the Local Government Act of Bhutan, 2009 (section mentioned in brackets)	In actual practice		
	Dzongkhags	Gewogs	Thromdes
<ul style="list-style-type: none"> <li>LGs also prepare 5-year plans, annual plans and budgets <i>within the ceiling provided by the Ministry of Finance.</i></li> </ul>	<p><i>The tied portion of the ACG (80%) are used for activities planned and prioritized by the LG; The untied portion is used for activities over and above the plan but decided by the LG based on eligible activities.</i></p>	<ul style="list-style-type: none"> <li>and Procurement Rules and Gewog Development Grant Guidelines.</li> <li>Discretion in the use of funds is available for the Gewog Development Grant up to Nu. 2 million as per their priorities.</li> </ul>	<ul style="list-style-type: none"> <li>Discretion in the use of own revenue and approved government capital grants Financial.</li> </ul>
<ul style="list-style-type: none"> <li>Officials of various sectors and agencies of the Government serving within the jurisdiction of a LG shall be <i>administratively accountable to the head of the LG</i> and technically to the concerned sector or agency (s. 204).</li> </ul>	<ul style="list-style-type: none"> <li>Only Elementary Support Personnel and General Service Carder recruited by the Dzongkhag. Rest all appointed by the RCSC.</li> <li>Supported by sector representatives from the central line ministries and autonomous agencies.</li> </ul>	<ul style="list-style-type: none"> <li>Only Clerk and care taker appointed by the Gewog. Rest all are appointed by the RCSC.</li> <li>Supported by extension representatives of the sector representatives in the Dzongkhag.</li> </ul>	<ul style="list-style-type: none"> <li>Only muster roll workers appointed by Thromde. Rest all appointed by RCSC.</li> </ul>
<ul style="list-style-type: none"> <li>LGs are entitled to incur liabilities by borrowing on their own account, subject to limitations.</li> </ul>	<ul style="list-style-type: none"> <li>No borrowing done so far.</li> </ul>		

**Source:** Compiled from the Local Government Act and information received from Department of Local Government and Thimpu Thromde.

- There have been significant developments within the area of fiscal decentralization and RGoB has introduced many initiatives with support from its development partners. The key initiatives are: a formula-based annual grant system based on Annual Grant Guidelines for Local Governments (Dongkhags and Gewogs (2010); Thromde Finance Policy (2012); the Local Development Planning Manual for Dzongkhags and Gewogs (2010); and Division of Responsibilities between Local Governments and National Government (2012). The flow of funds is guided by the rules and regulations in the fund release guidelines. The allocations are needs-based with inclusion of criteria such as size of population, size of the territory and level of poverty. In the 11th FYP, the current poverty criterion is replaced by a multi-dimensional poverty index and a transportation cost index has been included.
- In the annual national budget, allocations are made directly to the LGs and also in the central ministries for the purposes of implementing on behalf of the LGs (e.g. Education).



**TABLE 4: BUDGET ALLOCATION FOR LOCAL GOVERNMENTS**

Particulars	2015/16 Budget			2014/15 Budget		
	Capital	Current	Total	Capital	Current	Total
RGoB Expenditure Outlay	23476.845	23871.321	47348.166	15,202.327	21,895.682	21,895.682
Allocation for Dzongkhags	3271.478	6145.990	9417.468	1,899.540	5,315.878	7,215.418
Allocation for Gewogs	1884.240	261.909	2146.149	895.817	190.650	1,086.467
<b>Total Allocation</b>	<b>5155.718</b>	<b>6407.899</b>	<b>11563.617</b>	<b>2,795.357</b>	<b>5,506.528</b>	<b>8,301.885</b>
<i>As percent of RGoB outlay</i>	22%	27%	24%	18%	25%	38%
Allocation for Thromdes			1383.023	431.260	617.561	1,048.821
Allocation to Central Agencies	3854.969	–	3854.969	1327.630	1010.550	2338.180

**Source:** Annual Budget Reports and DNB.

For the financial year 2015/16, the combined budget estimates of all activities implemented by the dzongkhags and gewogs is Nu. 11563.617 million (up from Nu. 6,928.205 million in 2009/10 at the time of first PEFA assessment). This constitutes about 24% (26% in 2009/10) of the total RGoB expenditure outlay. Of the total estimated amount, 81% will be implemented by dzongkhags and 19% by gewogs. If allocations for dzongkhags and gewogs in the budgets of central agencies and thromdes are included, the share of LGs in the budget would be 35%.

13. Financial Rules & Regulations, 2001 require that all collection of national revenues and taxes are controlled and deposited into one central account from which the allocations are made for expenditures including for LGs. Gewogs and thromdes are, however, authorized to retain rural and urban taxes only<sup>46</sup>.

### Planning and Budgeting and Funds

14. RGoB's Five Year Plans (FYP) are developed by the Gross National Happiness Commission (GNHC) in consultation with LGs. A system of participatory development was introduced in the 9th FYP based on gewog-led planning i. e. the LGs formulated their own FYPs based on priorities identified by the communities at the gewog level. Devolution of resources and decision making powers to the local level was the key feature in 10th FYP and is supported by the highest political commitment. As espoused in the LG Act, LG bodies have autonomy of planning, regulations and raising taxes as per the rules in force within the existing framework of FYP programs and budgetary ceilings. Planning is guided by the *Local Development Planning Manual (2010)*. In the recent past, there is increased decentralization of financial powers and responsibilities to the lower level of government, which is evidenced by the increase in LG expenditure as a proportion of total government expenditure.

15. Dzongkhags and gewogs 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. Expenditure budget estimates are prepared based on the FYP programs and budget ceilings issued by the Ministry of Finance through the annual Budget Call Notification. The DT is the final decision making body in the dzongkhag and annual work plans and budgets of each dzongkhag are submitted to

<sup>46</sup> Rural taxes comprise land, building, cattle and grazing taxes while urban taxes comprise land and property taxes, property transfer taxes and betterment taxes.



DT for endorsement. Similarly, in case of gewogs, the annual plan and budget for central funding is reviewed and endorsed by the GT. Once the annual work plan and budget are reviewed and endorsed by GT, they are submitted to the DT for endorsement and further submission to DNB in Ministry of Finance, which is responsible for the preparation of national budget. Given the high level of dependence on central funding, the planning and budgeting procedures followed are similar to those of other budgetary agencies. Detailed provisions for approval of budget are provided in the LG Act and RGoB has prescribed formats to be used for this purpose.

16. 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 incorporate own source revenues and calculate a demand for grant from the government equal to the difference between the expenditure budget and revenue. The work plan and budget estimates are endorsed by the Thromde Tshogde (City Council).
17. Gewogs have two principal funding sources, namely funding from central government and retained rural taxes. Central funding is in the form of Annual Capital Grants (ACG) and Gewog Development Grant (GDG)<sup>47</sup>.
  - The ACGs are a share of the national budget based on a Resource Allocation Formula. The current allocation formula is based on population (35% weight); area (10% weight); Multidimensional Poverty Index (45%); and Transport Cost Index (10% weight). The latter two were added in the 11th FYP. These form the basis for the determination of the annual budget ceilings. 80% of the ACG is tied to the 11th FYP and the balance 20% can be used by LGs more flexibly for implementing programs and activities over and above the FYP. The tied portion of the ACG (80%) is used for activities planned and prioritized by the LG. The untied portion is used for activities over and above the plan but decided by the LG based on eligible activities. The resources are divided between dzongkhags and gewogs in the ratio of 60:40, reflecting the estimated division of functional assignments between the two tiers of LG and based on population, poverty incidence and size of territory. A list of eligible and ineligible expenditure that can be financed through ACGs has been provided in the guidelines.
  - In addition to the ACG, each Gewog Development Grants (GDG) of Nu. 2 million per annum to generate income and employment and for disaster relief activities. The GDGs are part of the national budget under a separate budget head and the activities to be carried out are created in the MYRB. Construction of farm roads, water and irrigation schemes and construction and maintenance of religious buildings are the common uses of the GDG.
18. Own retained revenues as arising from rural taxes is another resource to finance the gewog's expenditure. LG 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 egwog. The quantum of retained income from rural taxes at gewog levels is very small and constitutes just 1% of total LG financing and typically in the range of Nu. 20-30,000. The retained taxes are used by the gewogs to meet expenditures on maintenance of gewog infrastructures and approved by the GT. The LG Act, 2009 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.

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<sup>47</sup> Administered through the *Annual Grants Guidelines for Local Governments and Guidelines for Implementation of the Gewog Development Grant*.

## Budget Execution

19. 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 provisions regarding the execution of public works and procurement of services are elaborated in the Procurement Rules and Regulations and the Financial Rules and Regulations. LGs are expressly prohibited by the LG Act from exceeding budgetary ceilings or allowing a bank to be in overdraft and other acts specified in the PFA.
20. In dzongkhags, the 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 is per the framework provided by the Government. The Executive Secretaries and CEOs in thromdes are entrusted and made responsible for execution and implementation of the programs. The Thromde Tshogde (City Council) ensures that implementation is per agreed plans. Dzongkhags and gewogs follow the government budget execution systems which are also followed by Class A Thromdes so far as the government grants are concerned.
21. 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 an Engineering Cell in dzongkhags for all the works both in dzongkhags and gewogs. Engineers are assigned with the responsibility for 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.
22. The procedure for fund releases is well established: fund flows to LGs follow the same processes as for line ministries of RGoB. The release mechanism for capital expenditures has been simplified 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 substantial deviations.

### BUDGET AND ACTUAL EXPENDITURES (IN Nu. MILLION)

Unit	2014/15			2013/14		
	Budget	Expenditure	Expenditure out-turn	Budget	Expenditure	Expenditure out-turn
Dzongkhags	9041.748	8733.298	(-) 3.4%	8102.333	7648.345	(-) 5.6%
Gewogs	1342.873	1278.460	(-) 4.8%	1461.841	1415.833	(-) 3.1%
<b>Total for RGoB</b>	<b>44523.458</b>	<b>39425.329</b>	<b>(-) 11.5%</b>	<b>41362.907</b>	<b>37757.428</b>	<b>(-) 8.7%</b>

Source: Annual Financial Statements.

## Procurement

23. For all RGoB funds, LGs are required to follow the *Procurement Rules & Regulations, 2009* (PRR) issued under the Public Finance Act, as RGoB has not prescribed separate procurement rules for LGs and the PRR applies to all government agencies. The PRR provide threshold limits for each method of procurement and define the constitution of the Tender Committees of the dzongkhags and gewogs. 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 LGs only. Also there is no requirement to prepare procurement plans and there are no commitment controls for checking budget availability before solicitation of tenders.
24. The PRR provide that any work with estimated value of up to Nu. 1.5 million (revised from Nu. 0.5 million since the previous PEFA) can be awarded to the local community provided it is endorsed by GT. The PRR also provide for the delegation of procurement at the LG level. Further, in case of remote areas where there are no potential bidders after open competition, the PRR allow that the work can be directly awarded to a single contractor provided the estimated value of work is less than Nu. 3 million and the quoted/negotiated amount is within the estimate.

## Accounting

25. The Public Finance Act 2007 mandates that all budgetary bodies shall base the accounting records on the accounting standards prescribed by the Ministry of Finance and these apply also to the dzongkhags and gewogs. Detailed accounting rules are elaborated in FRR 2001. Accordingly, accounting is done on PEMS as for all budgetary bodies.
26. The responsibility of maintenance and custody of books and records in dzongkhags is entrusted to the Administrative and Finance Division. In gewogs, gup and gewog accountants are responsible for the accounting records of the central funds; and gup and gewog clerks 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).
27. For the central funds, gewog accountant prepares the accounting record, which is countersigned by the gup, CEO of the gewog. This also includes any donor funds coming to LG through the budget. The gewog clerk prepares and maintains the accounting records for Current Account, which is countersigned by the gup. The dzongkhag's Finance Officer also initially guides and monitors the gewog accountants on management of these financial affairs in gewogs.

## Internal Controls and Financial Reporting

28. Under the present circumstances where the LGs remain wholly dependent upon the central government for their funding, accountability arrangements are designed primarily to provide information on the use of funds provided by the central government so the LGs follow the same system as applicable to budgetary bodies. FRR-2001 lay out transactional control on all government receipts and payments procedures, which apply to all dzongkhags and gewogs.
29. LGs have service delivery standards for payment of bills i.e. within 30 days. Dzongkhags and gewogs have an internal control system for the bill payment process. They have a Bill Register in which all

bills received are entered and dated, to whom the bills are marked for processing the payment, and the date 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 number, amount, date etc.

30. As per Finance and Accounting Manual of FRR 2001, LGs submit monthly accounts on receipt, utilization and deposit of funds in respect of each separate bank account allotted to the parent ministry within 20 days after the completion of the month with a copy to DPA. Each LG institution is required to forward monthly receipt and payment statements produced from PEMS for the funds received from central government for expenditures for programs approved in the budget. In case of dzongkhags, a copy of the expenditure statements pertaining to individual sectors is also sent to the PPDs of the corresponding sector headquarters. Reporting is timely due to the computerization both in dzongkhags and gewogs. Gewog reporting is monitored by the dzongkhags. The financial reporting of the LGs is for each bank account (LC/PLC) 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 are not incorporated in the AFS of the Government (however, balances in these accounts are disclosed in the AFS).
31. LGs do not prepare or publish annual consolidated financial statements. Reports from PEMS are forwarded to Ministry of Finance on a monthly basis and provided for external audit. Expenditures incurred at the LG level for the central government funds are incorporated into the AFS of RGoB. However, progress of implementation along with financial progress of dzongkhags and gewogs are reported to DT and GT respectively.
32. All donor funds for LGs are routed through their budgets and expenditures are reported together in the monthly accounts of the LGs. The accounting treatment for the donor funds is the same except that it is recorded under different Financing Item Code (FIC) to track the source of funds and is applicable to all levels of government. The funds from RGoB sources received from central government are coded under a separate FIC.

## Internal Audit

33. The Public Finance Act 2007, Internal Audit Charter and Code of Ethics and Internal Audit Manual govern the conduct of internal audit in RGoB. In June 2000, RGoB established Internal Audit Units (IAUs) for the first time in several ministries with a total of 17 staff selected from various disciplines within the civil service and the Royal Audit Authority (RAA). The coverage of internal audit was progressively extended to the LGs. Currently, internal audit of all the dzongkhags and gewogs is managed by the Internal Audit Section of Ministry of Home and Cultural Affairs (MHCA). Thimphu City Corporation has an internal auditor in place who carries out its internal audit. There is ample scope for strengthening the internal audit function in the country particularly in terms of quality, nature of audits carried out and response on internal audit observations.

## External Audit

34. The Royal Audit Authority (RAA) is the external independent auditor of the LGs. The RAA presently undertakes an audit of LGs (dzongkhags and gewogs) once every two years. The audits of LGs are conducted in accordance with Generally Accepted Auditing Standards and in conformity with the General Auditing Rules and Regulations (GARR) 2009. These standards require that the RAA plans

and performs the audit to obtain reasonable assurance about whether financial statements are free from material misstatements. An audit includes determining on a test basis, evidence supporting the amounts and disclosures in the financial statements. Audits conducted by RAA for LGs are transaction based covering 100% of transactions. Financial statements of the LGs are prepared and certified by an Audit Team which is included in the audit reports. Audit of LGs has been completed up to FY 2014/15 . The audit report is available in public domain for FY 2013/14.

35. Of the total audit irregularities of Nu. 233.147 million reported in the Annual Audit Report of 2014 (Nu. 932.177 million reported in the Annual Audit Report, 2008), irregularities at dzongkhags and gewogs amounted to Nu. 29. 913 million (Nu. 98.648 million in the 2008 report at the time of the previous PEFA) which is about 13% of total expenditure.
36. A system of resolution of audit observations has been instituted. The Finance Personnel are entrusted with the responsibility to respond to the audit report. Meetings are also held between dzongkhag officials and RAA Audit Team to discuss and resolve the memos. Individual officers responsible for lapses are held accountable and are dealt with. In extreme cases, litigation ensues.
37. Audit irregularities at dzongkhags and gewogs are summarized in Table 5. Fraud, corruption and embezzlement accounted for the largest amount of irregularities. During 2013/14, recoveries from Dzongkhags and Gewogs by the RAA were Nu. 31.765 million representing about 27% of the total recoveries made by the RAA that year.

**TABLE 5: NATURE-WISE AUDIT OBSERVATIONS AT DZONGKHAGS AND GEWOGS IN 2013/14**

Nature of Audit Observation	Nu. million	
	Dzongkhags	Gewogs
<b>1. Fraud, Corruption &amp; Embezzlement</b>	<b>14.912</b>	<b>0.121</b>
1.1 Forgery & tampering of documents	-	-
1.2 Malpractices & abuses	2.206	0.121
1.3 Misappropriation	1.411	-
1.4 Intentional double bookings/irregular/un-authorized payments	0.536	-
1.5 Non/short accounting	10.759	-
<b>2. Mismanagement</b>	<b>0.899</b>	<b>0.106</b>
2.1 Mismanagement of funds	-	-
2.2 Mismanagement of properties	-	-
2.3 Mismanagement of human resources	-	-
2.4 Mismanagement of revenue and taxes	0.899	0.106
<b>3. Violation of laws &amp; rules</b>	<b>3.267</b>	<b>0.200</b>
3.1 Violation of service rules	0.185	-
3.2 Violation of budgetary norms	0.572	-
3.3 Violation of accounting norms	0.083	0.200
3.4 Violation of procurement norms	2.427	-
3.5 Violation of Acts, Directives and Policies	-	-
<b>4. Shortfalls, lapses and deficiencies</b>	<b>8.509</b>	<b>1.899</b>
4.1 Over/inadmissible/irregular/double payments	5.043	1.732
4.2 Non maintenance of records	-	-
4.3 Improper maintenance of records	-	-
4.4 Non/improper recording in books	-	-

Nature of Audit Observation	Dzongkhags	Gewogs
4.5 Non-reconciliation/certification of balances	0.846	-
4.6 Irregularities in advances	1.426	0.167
4.7 Irregularities in recoveries	-	-
4.8 Irregularities in disposal & auction	0.725	-
4.9 Irregularities in property management	-	-
4.10 Non/short deductions	0.290	-
4.11 Non cooperation	-	-
4.12 Shortfalls & uneconomical operations	0.179	-
4.13 Missing documents/receipts	-	-
<b>Total</b>	<b>27.587</b>	<b>2.326</b>

Source: RAA Annual Report 2014.

## Public participation

38. LG annual plans are decided through local community 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 participate in planning. At the dzongkhag level, the DT is the final authority and is responsible for discharging its functions and is accountable to the citizens, and similarly GT at the gewog level.

39. LG Act mandates that the DT meeting should be conducted at least once in every six months. However, the Chairman may convene, if required, additional meetings of DT. Also, GT and thromde tshogde meetings should be held at regular sessions at least three times a year. All sessions of LGs are open to public to participate as audience except for closed door sessions. The LG Act 2009 also requires that all LGs have public notice boards visibly and prominently displayed at the entrance of the office of the LG. 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.

## Public access to fiscal information

40. The LG Act requires the LGs to publish their FYPs, annual plans and budget, publicly announce the dates of their sessions and announce the call for tenders, award of contracts, value of contracts, and projects under implementation through public media and publication of an annual report with prescribed contents. All dzongkhags have their websites, though information disclosed varies. Fiscal information is available as follows:

- The FYPs that provide the outlay for the LGs.
- The Annual Budget Report providing the annual dzongkhag and gewog budget allocation.
- The Annual Financial Statement provides the major items of financial statements for dzongkhags and gewogs.
- The Royal Audit Authority conducts audits of the dzongkhags and gewogs and key audit observations are contained in the Annual Audit Reports:
  - Information on resource allocations 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 biannual Parliamentary session.

- In-year Budget Execution Reports, but these are not compiled and published.
- Data on contract awards at the dzongkhags and gewogs are available in some dzongkhags.
- Annual reports are not available publicly.

## Staffing

41. In Bhutan, all appointments to all public services covering all organizations, institutions and agencies of the RGoB (except those specified) are governed by the rules and regulations framed and administered by the Royal Civil Service Commission (RCSC) which is constituted under a Royal Charter. The *Bhutan Civil Service Rules and Regulations, 2012* provide that “the RCSC shall be the central personnel agency for recruitment and selection of a candidate in consultation with the employing Agency, and for approving the appointment against a position”. The rules further provide that thromdes can recruit, select and appoint non-professional positions in supervisory and support posts and dzongkhags and thromdes can recruit, select and appoint operational staff only.
42. The LG Act provides that officials of various sectors and agencies of the Government serving within the jurisdiction of a LG shall be administratively accountable to the head of the LG and technically to the concerned sector or agency.
43. 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 LG bodies (DT).
44. The Gewog Tshogde is supported by the Gewog Administrative Officer, who is a civil servant. Gewog Administrative Officer acts as the secretary to the GT (LG Act). Not all the gewogs presently have Gewog Administrative Officers (GAO) (193 being placed at present out of 205). The remaining vacancies are due to resignations and administrative issues resulting in termination). Gewogs also have accountants and there are some vacancies in these positions as well.
45. A Thromde Tshogde (City Corporation) 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 thromdes 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.

## Development partner support to decentralization in Bhutan

46. In 2008, RGoB launched the Local Governance Support Program (LGSP) with development partners, which provided a joint framework to support the realization of the good governance goals and objectives of the 10th Five Year Plan, with a focus on the decentralization aspects. The joint program was directly supported by Denmark, Austria, SDC, UNCDF and UNDP while JICA, EU and other development partners provided indirect support as part of their overall contribution to RGoB’s good governance and local government reforms. The program covered a period of five years from July 2008 to June 2013 and had a total budget of USD 17.58 million. The primary objectives of the LGSP included strengthening of local democratic governance; improving the efficiency and effectiveness



of the local governments in delivering their services; and contributing towards achieving the 10th Five Year Plan goal of poverty reduction and the realization of the MDG's. Two major components of LGSP include the Gewog Annual Capital Grant Facility and Capacity Development of local governments.

47. The next phase of LGSP has been launched in 2013 for the years through to 2018 coinciding with the 11th FYP. The program has three major outcomes or 'components': (a) inclusive and equitable socio-economic development at local level; (b) conservation and sustainable use of environment at local level; and (c) strengthening good governance at the local level. The program is supported by Denmark, Switzerland, EU, UNDP and UNCDF.

## To sum up

48. There were significant developments in decentralization in Bhutan during the 10th FYP and RGoB took many initiatives. The introduction of the Resource Allocation Formula (since 2008/09) for budgeting of dzongkhags and gewogs has provided more clarity in terms of resource allocation and has facilitated local level planning. Use of MYRB for planning and PEMS for budget control and execution has resulted in greater efficiency and institutionalized a transparent mechanism and further helped by deployment of accountants to gewogs. Issue of LG Rules and other guidelines also brought clarity to the roles of the LGS.

49. However, weak human capacity in terms of numbers and skills, the inadequate resource base of own-source revenue of the LGs and bureaucratic administrative systems hampering efficiency and effectiveness are issues that need to be addressed by RGoB. The legal and institutional base for own-source revenue characterized by outdated rates and cumbersome collection procedures are areas of potential reforms (there are indications that collection cost of rural taxes by gewogs are more than the revenue). Capacity building is another identified need.

50. An elaborate entitlement framework has been prescribed for LG, but more needs to be done. LGs have limited own resources; most of the central funds are tied though there has been some relaxation on this; movable and immovable property are registered in the name of the LGs, but they have to follow country rules for disposal and they cannot retain the sales proceeds; and LGs cannot select and appoint officers as these have to be done by the RCSC.

## ANNEX 6: CALCULATION OF PI-1, PI-2 AND PI-3 VARIANCES AS PER 2016 FRAMEWORK

Administrative classification (ministry/department/agency)	FY 2012/13				FY 2013/14				FY 2014/15			
	Budget	Adjusted Budget	Actual Expend.	Absolute Variance	Budget	Adjusted Budget	Actual Expend.	Absolute Variance	Budget	Adjusted Budget	Actual Expend.	Absolute Variance
	1	2	3	4	5	6	7	8	9	10	11	12
<b>Autonomous and Constitutional Bodies</b>	<b>3,984</b>	<b>4,464</b>	<b>5,243</b>	<b>779</b>	<b>4,421</b>	<b>4,705</b>	<b>4,474</b>	<b>231</b>	<b>4,430</b>	<b>4,992</b>	<b>5,024</b>	<b>31</b>
Ministry of Home and Cultural Affairs	1,594	1,786	1,914	128	1,844	1,962	1,765	197	2,166	2,442	2,141	300
Ministry of Finance (excl. interest, contingency and lending and repayments)	2,598	2,911	3,187	276	2,939	3,127	5,883	2,756	3,065	3,455	4,156	701
Ministry of Foreign Affairs	524	587	538	49	573	610	567	43	662	746	556	190
Ministry of Agriculture & Forest	2,482	2,780	2,570	210	2,503	2,663	2,601	63	2,885	3,252	2,739	513
Ministry of Economic Affairs	1,034	1,159	774	385	1,173	1,248	702	547	1,335	1,505	794	711
Ministry of Works and Human Settlement	4,506	5,049	4,665	384	4,384	4,666	4,027	639	3,958	4,460	4,273	187
Ministry of Information and Communication	1,239	1,388	1,325	64	1,058	1,126	698	428	541	610	918	308
Ministry of Health	1,565	1,754	1,799	46	1,424	1,515	1,444	71	1,456	1,641	1,526	115
Ministry of Education	1,088	1,219	1,312	93	830	883	867	16	1,323	1,491	1,799	307
Ministry of Labour and Human Resources	436	488	422	66	346	368	428	60	446	503	515	12
<b>Central ministries</b>	<b>17,068</b>	<b>19,122</b>	<b>18,507</b>	<b>0</b>	<b>17,072</b>	<b>18,168</b>	<b>18,981</b>	<b>0</b>	<b>17,839</b>	<b>20,104</b>	<b>19,417</b>	<b>0</b>
<b>Dzongkhags and Gewogs</b>	<b>9,193</b>	<b>10,299</b>	<b>10,136</b>	<b>163</b>	<b>9,065</b>	<b>9,647</b>	<b>9,064</b>	<b>582</b>	<b>8,302</b>	<b>9,356</b>	<b>10,012</b>	<b>656</b>
<b>Total expenditure excluding interest and contingency</b>	<b>30,245</b>	<b>33,885</b>	<b>33,885</b>	<b>2,643</b>	<b>30,558</b>	<b>32,519</b>	<b>32,519</b>	<b>5,631</b>	<b>30,571</b>	<b>34,452</b>	<b>34,452</b>	<b>4,031</b>
<b>PI-2 (i) % variance</b>				<b>7.8%</b>				<b>17.3%</b>				<b>11.7%</b>
Add back contingency	2,229		-		3,431		-		4,376		-	
Add back interest	2041		2642		2125		2090		2151		2025	
<b>Total expenditure</b>	<b>34515</b>		<b>36528</b>		<b>36114</b>		<b>34610</b>		<b>37098</b>		<b>36477</b>	
<b>PI-1 actual/budget</b>			<b>105.8%</b>				<b>95.8%</b>				<b>98.3%</b>	

## Calculation of PI-2 (ii)

	FY 2012-13			FY 2013-14			FY 2014-15					
	Budget	Adj'd Budget	Actual	Absolute Variance	Budget	Adj'd Budget	Actual	Absolute Variance	Budget	Adj'd Budget	Actual	Absolute Variance
Recurrent expenditure-personnel emoluments	7,862	8,895	7,890	1,004	8,247	8,733	8,208	525	8,359	9,318	9,976	659
Recurrent expenditure-goods and services	4,797	5,427	5,173	254	5,173	5,478	5,193	285	5,575	6,214	5,844	371
Recurrent expenditure-transfers	1,394	1,577	1,336	241	1,362	1,442	1,390	52	1,698	1,893	1,942	49
Recurrent expenditure-other, excl. intt.	857	970	1,055	85	952	1,008	1,059	51	1,038	1,157	1,245	88
Interest	2,041	2,309	2,642	333	2,125	2,250	2,090	160	2,151	2,398	2,025	373
<b>Total recurrent expenditure</b>	<b>16,951</b>	<b>19,178</b>	<b>18,097</b>	<b>1,917</b>	<b>17,859</b>	<b>18,911</b>	<b>17,940</b>	<b>1,073</b>	<b>18,821</b>	<b>20,979</b>	<b>21,032</b>	<b>1,540</b>
Capital expenditure-domestically financed only	6,293	7,120	7,512	392	7,850	8,313	8,131	796	7,603	8,475	8,331	144
Donor-funded project expenditure	9,042	10,230	10,919	690	6,974	7,385	8,538	1,767	6,298	7,020	7,112	92
<b>Total allocated expenditure</b>	<b>32,286</b>	<b>36,528</b>	<b>36,528</b>	<b>2,999</b>	<b>32,683</b>	<b>34,609</b>	<b>34,609</b>	<b>3,636</b>	<b>32,722</b>	<b>36,474</b>	<b>36,474</b>	<b>1,775</b>
% variance				8.1%				10.5%				4.9%
<b>PI-2 (ii) Rating is B, as variance was &lt; 10% in 2 years out of 3.</b>												
<b>PI-2 (iii) Expenditure charged to contingency vote</b>			<b>0</b>				<b>0</b>				<b>0</b>	
<b>% of total expenditure</b>			<b>0%</b>				<b>0%</b>				<b>0%</b>	
<b>PI-2 (iii) rating is A, as the expenditure charged to the contingency vote was less than 3% of the original budget.</b>												

PI-3 Calculation GFS code	2012/13			2013/14			2014/15						
	Estimates	Actual	Adjusted Budget	Absolute Variance	Estimates	Actual	Adjusted Budget	Absolute Variance	Estimates	Revised Estimates	Adjusted Budget	Absolute Variance	
111	Direct Tax	9,387.26	9,390.04	9,047.55	342.49	10,342.02	11,132.04	12,964.82	1,832.78	11,793.93	11,822.93	13,322.56	1,499.64
114	Indirect Tax	5,510.81	5,688.80	5,311.38	377.42	4,551.58	4,721.04	5,705.89	984.85	5,361.18	5,878.66	6,056.05	177.39
115	Customs Duty	363.099	305.535	349.96	44.42	406.671	312.788	509.81	197.02	414.243	536.868	467.93	68.93
116	Other Indirect Tax Revenue	21.213	18.751	20.45	1.69	24.503	16.903	30.72	13.81	20.673	20.673	23.35	2.68
142	Admin. Fees & Charges	351.913	331.064	339.18	8.11	437.789	349.215	548.82	199.60	420.782	420.782	475.32	54.54
141	Property income	5372.877	5194.34	5,178.44	15.90	5904.24	6549.25	7,401.60	852.35	6338.44	6000.11	7,159.98	1,159.87
144	Other Non-Tax Revenue	25.062	84.273	24.16	60.12	56.491	81.02	70.82	10.20	107.111	107.111	120.99	13.88
131/133	Grants	10,691.24	9562.636	10,304.34	741.70	8109.513	14236.353	10,166.14	4,070.21	7360.231	11153.268	8,314.21	2,839.06
	<b>Total revenue</b>	<b>31,723.48</b>	<b>30,575.44</b>	<b>30,575.44</b>	<b>1,591.86</b>	<b>29,832.81</b>	<b>37,398.61</b>	<b>37,398.61</b>	<b>8,160.83</b>	<b>31,816.59</b>	<b>35,940.40</b>	<b>35,940.40</b>	<b>5,815.99</b>
	3.1 Actual/budget %		96.4%				125.4%				113.0%		
	3.2 Rev. composition variance				5.2%				21.8%				16.2%

#### Reconciliation with reported revenue

Reported revenue	21,157.46	21,101.69	21,860.89	21,860.89	23,244.61	24,599.03	24,900.12
Deduct capital revenue	125.227	88.892	137.593	137.593	82.356	112.982	112.982
Add grants	10,691.24	9562.636	8109.513	8109.513	14236.353	7360.231	11153.268
Revenue per GFS	31,723.47	30,575.44	29,832.81	29,832.81	37,398.61	31,846.28	35,940.40
141= revenue from Gov't Depts, dividends, transfer of profit and interest receipt from corporations.							

## DISCLOSURE OF QUALITY ASSURANCE MECHANISM (To be filled in by the assessment leader)

The following quality assurance arrangements have been established in the planning and preparation of the PEFA assessment report for the Bhutan, final report dated September 1, 2016.

### 1. Review of Concept Note and/or Terms of Reference

- Draft concept note and/or terms of reference dated August 2015 was submitted for review on August 4, 2015 to the following reviewers:
  1. Mr. Sonam Tobgyel, Royal Government of Bhutan
  2. Ms. Karine Olislagers and team, European Union
  3. Ms. Grabner Sonja, Austrian Development Agency
  4. Ms. Holy Tiana Rame, PEFA Secretariat
  5. Mr. Franck Bessette, Mr. Shanker Lal, Ms. Manvinder Mamak, The World Bank

Final concept note and/or terms of reference: October 14, 2015 forwarded to reviewers, if necessary, on June 24, 2016, including a table<sup>48</sup> showing the response to all comments raised by the reviewers.

### 2. Review of draft report(s)

- Draft report dated June 28, 2016 was submitted for review on July 13, 2016 to the following reviewers:
  1. Mr. Sonam Tobgyel, Royal Government of Bhutan
  2. Mr. Shouvik Datta and team, European Union
  3. Mr. Johannes Binder and team, Austrian Development Agency
  4. Ms. Holy Tiana Rame, PEFA Secretariat
  5. Mr. Franck Bessette, Mr. Shanker Lal and Ms. Manvinder Mamak, The World Bank

### 3. Review of final draft report

A revised final draft assessment was forwarded to reviewers on September 2, 2016 and included a table showing the response to all comments raised by all reviewers.

4. This form, describing the quality assurance arrangements is included in the revised draft report.

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<sup>48</sup> For minor comments (e.g. typos, language) a revised version of the document with tracked changes may suffice.



World Bank/IMF and RGoB PEFA Team Members with Other Government Officials



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