དངུལ་རྩིས་ལྷན་ཁག།

ROYAL GOVERNMENT OF BHUTAN
MINISTRY OF FINANCE
TASHICHHO DZONG

Foreword

The Kingdom of Bhutan is a young constitutional democracy that is fortunate enough to have inherited and created some excellent regulations, agencies and manuals for laying a foundation for good governance. However, there exists a gap in the implementation when it comes to risk assessment and the institutionalization of strong internal controls that would act as a catalyst for more efficient, effective, transparent and accountable government.

The National Internal Control Framework supported by UNDP and the Ministry of Finance in the Royal Government of Bhutan is an endeavour to plug this gap. The framework rests on the foundation provided by the Constitution and existing government manuals and builds on this to provide a practical management tool that senior heads of agencies can use to improve the everyday working of their organizations, making them more result oriented and accountable.

The framework adds value to the proposed Performance Management System of the Royal Government of Bhutan, synchronizes with the plans for a paperless office in the government space, helps stop irregular or fraudulent practices from festering and snowballing into major corruption and allows for coordinated harmonization and interlinkages between the various agencies in the government. The framework also integrates well with the goals of the eleventh Five Year Plan that aims at making Bhutan self-reliant with inclusive green socio-economic development.

True democracy arrives when each individual and agency forming part of the government are alive to their responsibility for better public service and accountability so as to ensure that the benefits of good governance reach each and every citizen. By providing a steel frame of implementable best practices that serves as a reference point for all right thinking public servants, the National Internal Control Framework is a positive step towards better governance and inclusive development in Bhutan.

This document is the result of the cooperation and support from the Ministries and agencies of the Royal Government and constitutional bodies primarily Anti-corruption Commission, Royal Audit Authority, Royal Civil Service Commission and Office of the Attorney General. In this context this framework document seeks to supplement the efforts of these agencies to foster efficiency, effectiveness, transparency, and accountability in the country. I urge all agencies in the country to adopt this document for management excellence and effective delivery of public services.

9/12/13

Namgay Dorji
Minister, Ministry of Finance,
Royal Government of Bhutan

Post Box No 270. Tel # 00975-2- 328910. Fax: 328910. www.mof.gov.bt

Table of Contents

Abbreviations

ACC	Anti Corruption Commission
CCA	Central Coordinating Authority
COSO	Committee of Sponsoring Organizations
IAS	Internal Audit Service
INTOSAI	International Organization of Supreme Audit Institutions
MoF	Ministry of Finance
NICF	National Internal Control Framework
NACSF	National Anti Corruption Strategic Framework
PFA	Public Finance Act
PMM	Property Management Manual
PRR	Procurement Rules and Regulations
PFM	Public Sector Financial Management
RAA	Royal Audit Authority
RCSC	Royal Civil Service Commission
RGoB	Royal Government of Bhutan

1. Introduction

A National Internal Control Framework (NICF) is generally adopted by governments in pursuit of accountability, transparency, efficiency and effectiveness. The Royal Government of Bhutan (RGOB) has constantly brought about major reforms to decentralize power and responsibility to the people. The country has embarked upon unprecedented political and socio-economic development that calls for efficient and effective governance[1]. The Government has placed the highest importance on enhancing good governance based on the principles of transparency, accountability, efficiency and effectiveness . A strong internal control system is one of the essential requirements towards achieving this goal.

With the institution of parliamentary democracy and associated devolution of power, internal controls need to be instituted at various levels of the government machinery so as to optimize efficient and effective use of resources while maintaining transparency, accountability and adherence to professional practices. Currently, internal control measures exist in a scattered fashion. In the absence of a holistic internal control framework, the existing measures are ineffective or weakly enforced. There is a need for strong systems of internal control that enable efficient use of public resources and service delivery thereby enhancing public trust in government institutions. Further, internal controls at various levels of management would help reduce irregularities and corruption thereby supplementing the role of the Royal Audit Authority (RAA) and the Anti Corruption Commission (ACC) of Bhutan.

This National Internal Control Framework (NICF) document has been developed with the overall goal of assisting all agencies and organizations in the Royal Government of Bhutan strengthen integrity, transparency, efficiency, effectiveness, participativeness, accountability and ethical behaviour at all levels of management. In instituting and implementing internal controls, all agencies in the Royal Government, government owned institutions and corporations, and autonomous agencies are obliged to draw upon the country's laws, rules, regulations, procedures and policies that underpin this document as well.

---

[1] *Good Governance Plus document (2005) of Royal Government of Bhutan calls for Promoting Administrative and Financial Efficiency, Accountability and Transparency*

[2] *The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a voluntary private-sector organization, established in the United States, dedicated to providing guidance to executive management and governance entities on critical aspects of organizational governance, business ethics, internal control, enterprise risk management, fraud, and financial reporting. COSO has established a common internal control model against which companies and organizations may assess their control systems. COSO was formed in 1985 to sponsor the National Commission on Fraudulent Financial Reporting (the Tread way Commission). The Treadway Commission was originally jointly sponsored and funded by five main professional accounting associations and institutes headquartered in the United States: the American Institute of Certified Public Accountants (AICPA), American Accounting Association (AAA), Financial Executives International (FEI), Institute of Internal Auditors (IIA) and the Institute of Management Accountants (IMA). The Treadway Commission recommended that the organizations sponsoring the Commission work together to develop integrated guidance on internal control. These five organizations formed what is now called the Committee of Sponsoring Organizations of the Treadway Commission.*

[3] *The International Organization of Supreme Audit Institutions (INTOSAI) is the professional organization of Supreme Audit Institutions (SAIs) in countries that belong to the United Nations or its specialized agencies. SAIs plays a major role in auditing government accounts and operations, and in promoting sound financial management and accountability in their governments. INTOSAI supports its members in this task by providing opportunities to share information and experiences about the auditing and evaluation challenges facing them in today's changing and increasingly independent world.*

In developing this document, the Ministry of Finance, through the UNDP assisted project titled 'Strengthening of transparency, efficiency, effectiveness, participation and accountability in governance', conducted a series of exercises including an initial assessment carried out through a stock taking workshop, stakeholder consultations, review of existing legal provisions, mandates of relevant government agencies and international literature on internal controls. In aligning with international standards and practices for internal control, this framework is based on the widely accepted model of the Committee of Sponsoring Organization (COSO)[2] and INTOSAI[3] guidelines on internal control standards for the public sector.

The specific objectives of the NICF Document are to:

- provide an overall framework for implementing and maintaining effective internal controls;
- describe internal control related measures for heads of all agencies in government, and government owned or administered agencies to implement;
- describe appropriate internal control practices for major functional areas;

The term "head of agency" as used in this document refers to the Secretary at the Ministry level and the Dzongdag at the district level.

1.1 What is internal control?

Internal control is an integral part of the management process by which an organization governs its activities and operations to effectively and efficiently accomplish its mission. The purpose of control processes therefore is to support the organization in the management of risks and the achievement of its established and communicated objectives. If the control system is ineffective, then the management system will also be ineffective. The people factor is critical to an effective control system – their honesty, integrity, competence, experience, and loyalty. If these "soft" control qualities are lacking, then the quality of internal controls becomes highly unreliable because people are critical –they being the ones who develop, implement, maintain and monitor compliance with controls.

1.1.1 Objectives of the internal control are to

a. Safeguard assets

b. Check accuracy and reliability of accounting data

c. Ensure economical, efficient, effective and ethical operations

d. Comply with laws, rules and regulations

e. Adhere to managerial policies

Internal control procedures and practices are prescribed by Central Agencies, Ministries or other competent authorities and implemented by management at all organizational levels to ensure the following:

1. Information – data capture, maintenance and transmission is current, relevant, accurate, reliable and timely for all users and decision makers.

2. Staff Conduct – compliance with the government code of ethics, policies, plans, procedures and laws and regulations.

3. Government resources – all assets and resources are to be safeguarded against theft, sabotage, and deterioration: they must be acquired economically, and used efficiently and effectively.

4. Risk identification – Ministries and other autonomous agencies must 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.

5. Operational and Accounting records – maintain reliable, accurate, complete, up-to-date records; no falsification of hidden/unrecorded activities, bank accounts, funds or assets; no unrecorded liabilities or off- book transactions;

6. Operating Manuals – all business/operating units must develop manuals outlining checks and balances for specific crucial operations in documented form.

7. Staff Training – all staff must be given appropriate and continuous training.

8. Letter of Representation – must be submitted by managers to senior management attesting to the proper discharge of assigned responsibilities.

2. A Managerial Guide to Internal Control Formulation and Practice

The four basic functions of management are usually described as planning, organizing, leading and controlling. Internal control is an intrinsic component of the fourth function i.e. controlling. Adequate internal controls allow managers to delegate responsibilities to staff and contractors with reasonable assurance that what they expect to happen, actually does happen. Internal control is therefore an integral part of managing an organization. It comprises the plans, methods and procedures used to meet missions, goals and objectives and in so doing, support performance-based management systems. Internal controls also serves as the first line of defence in safeguarding assets and preventing and detecting errors and fraud.

In short, internal controls which are synonymous with management control help government managers achieve desired results through effective stewardship of public resources.

In its simplest form therefore, internal control is what we do to see that the things we want to happen will happen and the things we don't want to happen won't happen. Internal controls are therefore common sense applied in a management context- (i) what an entity worries about going wrong, (ii) what steps have been taken to assure that it does not go wrong and (iii) how do you know that things are under control?

The average Ministry has a number of responsibilities (committing funds, recruiting staff, contracting for supplies and services, approving actions, registering transactions and events, deploying resources and controlling, supervising and reporting on implementation of policies). If these responsibilities are fulfilled properly, the result will be effective control over resources, decisions and activities and the achievement of ministry objectives. If not, abuses will proliferate and efficiency decline.

Internal controls help bring order, direction and consistency to lives and organizations. The internal controls outlined in the National Internal Control Framework attempt to blend international standards and best practices with the environment and background specific to the Royal Kingdom of Bhutan. The National Internal Control Framework serves as a starting point and foundation for the formulation, management, direction and adoption of specific operational internal control guidelines for each individual agency that would meet the governance requirements of the various organizations viz. Ministries, districts and sub-district level units, constitutional bodies and autonomous organizations within the Royal Government of Bhutan.

The guidelines outlined below cover both important general functions and also specific internal control requirements for procurement, financial management, property management, human resource management, information technology and internal audit functions so that the mapping of these becomes a starting point for generating further detailed specific operational frameworks. This framework as outlined below aims to serve as a guide for managers.

2.1 Background and Role of Key Internal Control Principles

Bhutan has many foundational documents and frameworks that underpin good governance and democratic functioning. The National Internal Control Framework attempts to provide a clear framework supplementing and building upon systems and guidelines already in place.

The key principles outlined in the National Internal Control Framework represent good practice for evaluating and improving systems for internal control. These principles are designed to facilitate the evaluation and improvement of existing internal control systems by highlighting areas where the practical application of such guidelines often fails in many organizations. The principles highlight the requirements and needs of functioning in the Bhutan context and emphasize the importance of building up on frameworks, documentation and practices already in place while exploring inter-linkages and cooperative, responsive interactions among agencies. The National Internal Control Framework emphasizes on the following:

a. Internal control should be used to support the organization in achieving its objectives by managing its risks, while complying with rules, regulations, and organizational policies. The organization should therefore make internal control part of risk management and integrate both in its overall governance system.

b. The organization should determine the various roles and responsibilities with respect to internal control, including the governing body, management at all levels, employees, and internal and external assurance providers, as well as coordinate the collaboration among participants and stakeholders.

c. The governing body and management should foster an organizational culture that motivates members of the organization to act in line with risk management strategy and policies on internal control set by the governing body with a view to achieving the organization's objectives. The tone and action at the top are critical in this respect.

d. The governing body and management should link achievement of the organization's internal control objectives to individual performance objectives. Each person within the organization should be held accountable for the achievement of assigned internal control objectives.

e. The governing body, management, and other participants in the organization's governance system should be sufficiently competent to fulfill the internal control responsibilities associated with their roles.

f. Controls should always be designed, implemented, and applied as a response to specific risks and their causes and consequences.

g. Management should ensure that regular communication regarding the internal control system, as well as the outcomes, takes place at all levels within the organization to make sure that the internal control principles are fully understood and correctly applied by all.

h. Both individual controls as well as the internal control system as a whole should be regularly monitored and evaluated. Identification of unacceptably high levels of risk, control failures, or events that are outside the limits for risk taking could be a sign that an individual control or the internal control system is ineffective and needs to be improved.

i. The governing body, together with management, should periodically report to stakeholders the organization's risk profile as well as the structure and factual performance of the organization's internal control system.

2.2 The Significance of the Internal Control Principles

When applied effectively in organizations, the internal controls principles help avoid many common pitfalls.

a. *From compliance to performance enabler*

Internal control is often perceived and treated as a compliance requirement rather than as an enabler of improved organizational performance. Effective internal control can help organizations improve their performance by enabling them to take on additional opportunities and challenges in a more controlled way. Therefore, organizations need to have a better understanding of how organizational performance relates to effective risk management and the role and effectiveness of internal control.

b. *Responsibility of line management instead of being sidelined*

Responsibility for internal control should reside with those who have the highest level of authority for achieving the organization's objectives instead of being delegated to staff who lack executive powers. This helps reiterate the importance—at the highest levels—of internal control.

c. *Turning a poor "tone at the top" into a motivational culture*

Poor "tone at the top" is a significant factor in organizational failures; conversely, recognizing positive performance can have a significant impact on strengthening internal control.

d. *Rewarding risk taking and internal control*

In order to get the appropriate attention of executive and line management, as well as of all other employees, internal control objectives should not only be linked to the organization's objectives but also to individual performance objectives.

e. *Insufficient internal control competence is also a risk*

There is a risk that people with assigned internal control responsibilities might not have sufficient knowledge, experience, skills, or time to adequately fulfill those responsibilities. This can seriously weaken and even jeopardize the effectiveness of the internal control system, which can in turn damage an organization. To counter this, sufficient internal control competence needs to be ensured throughout the organization.

f. From being in control to achieving one's objectives

Controls are a means to an end—the effective management of risks, enabling the organization to achieve its objectives. Prior to designing, implementing, applying, or assessing each specific control, organizations first need to know what risks, or combinations of risks, the control is supposed to modify.

g. Embedding internal control: from the shelf to the minds of employees

Internal controls can only work effectively when they, together with the risks they are supposed to modify, are clearly understood by those involved. Controls should not be documented and communicated in isolation but integrated, through formal and informal channels, into the elements of the management system in which they are intended to operate, including the related objectives, activities, processes, systems, risks, and responsibilities.

h. From "out of date" to "up to date"

If a problem with an individual control or the internal control system occurs, the organization needs to be made aware as soon as possible, so that further damage can be prevented or contained and the issue rectified. In many cases, however, not enough attention is given to defining what, exactly, should be monitored and evaluated with respect to internal control, how this should be done, and by whom.

i. Reporting on structure and performance

Organizations should transparently report on the structure and performance of their governance, risk management, and internal control system in their various reports to internal and external stakeholders, such as through their periodic accountability reports or on the organization's website.

2.3 Existing Legal Provisions and Measures for Internal Control in the Royal Government of Bhutan

The National Internal Control Framework 2013 does not exist in isolation but has as its foundation the various constitutional and legal documents, manuals and rules and regulations that guide good governance and the functioning of the Royal Government of Bhutan.

2.3.1 Constitutional Provisions

Article 25 of the Constitution of Bhutan states there shall be Royal Audit Authority to audit and report on the economy, efficiency, and effectiveness in the use of public resources.

Article 26 of the Constitution of Bhutan states there shall be a Royal Civil Service Commission, which shall promote and ensure an independent and apolitical civil service that will discharge its public duties in an efficient, transparent and accountable manner.

Article 27 of the Constitution of Bhutan states there shall be an Anti-Corruption Commission, headed by a Chairperson and comprising two members, which shall be an independent authority and shall take necessary steps to prevent and combat corruption in the Kingdom.

2.3.2 The Ministry of Finance (MOF), as the custodian of the Public Finance Act 2007 is mandated to:

- Set rules for financial management and internal control systems and monitoring the performance of such systems [Section 23(e)].

- Administer the Internal Audit Service, and issuing Internal Audit guidelines [Section 23(o)].

- Issue Financial Rules and Regulations and such other rules, manuals, directives, decrees, instructions or notifications and amendment/cancellation [Section 24(a)].

- Interventions may include steps for withholding of funds to address serious or persistent material breach of this Act by a budgetary body or a state enterprise [Section 24 (e)].

- As per Section 3.3.9 of FMM, FRR 2001 states "All Agencies shall be responsible to establish proper working systems and procedures including transparent and well defined controls and checks within the respective Agencies for achieving, as far as practicable, the financial management and accountability objectives of the Government.

Financial, procurement, and property management (pertaining to the mandates of Ministry of Finance)

i. Public Financial Management System

- The Public Finance Act (PFA) of the Kingdom of Bhutan, 2007 and its Amendment of 2012

- The Financial Rules and Regulations (FRR), 2001

ii. Procurement Management

For effective procurement of goods, works and services by all government agencies including Armed Forces, the internal control measures in place are Procurement Rules & Regulations (PRR), 2009, Standard Bidding Documents for goods, Standard Bidding Documents for works and Standard Request for Proposals for Services.

iii. Property Management

A major portion of the total resources of the Government is spent every year on acquisition, improvement or construction of various kinds of properties. The expenditures incurred on such purposes reflect equivalent amounts of increases in assets of the Government. Therefore, the Property Management Manual (PMM) seeks to outline controls measures in place so as to ensure a) proper recording of fixed assets and inventory, b) Physical verification of fixed assets and inventory on annual basis and c) a proper system for disposal of obsolete, uneconomical or unnecessary assets.

2.3.3 Human Resource Management System (*Pertaining to the Royal Civil Service Commission*)

Internal control measures that underlie human resource management are outlined under the Civil Service Act of 2010 and Bhutan Civil Service Rules (BCSR) 2012.

2.3.4 National Anti-corruption Strategy Framework (*pertaining to mandates of Anti-corruption Commission*) is another bulwark of internal control and better accountability and transparency in Bhutan and will support the norms and good practices outlined in the National Internal Control Framework.

2.3.5 Implementation of the National Internal Control Framework

It is the obligation of every civil servant to promote efficiency, transparency, accountability and effectiveness in carrying out their responsibilities specified in but not limited to the BCSR job description[4]. Individuals holding leadership and supervisory positions have an even greater responsibility towards institutionalizing internal control measures to promote efficiency, transparency, accountability and effectiveness.

2.3.6 Other Tools for Assessing or Improving the Efficacy of Internal Control

The National Anti- Corruption Strategic Framework (NACSF) and its corruption prevention tools are instruments that the ACC requires be adopted to operationalize internal control measures. The Anticorruption Commission requires all Ministries and agencies in the Kingdom to adopt diverse approaches and tools to prevent and curb corruption. The NACSF corruption prevention tools include integrity pact, Asset Declaration, Standard Cost Model to reduce Administrative Burden (AB), Service Standard, Conflict of Interest, Code of Ethics and Corruption Risk Management[5].

Further, the Civil Service Values and Code of Conduct under section 37, 38 and 39 of the Civil Service Act of Bhutan 2010 are other measures that must be adopted and adhered to so as to ensure the highest standard of integrity the delivery of public services.

2.4 The Five Major Elements Underpinning the National Internal Control Framework

The COSO Report describes the internal control process of consisting of five interrelated components that are derived from and integrated with management processes. These components define the standards for internal control and provide the basis against which internal controls are to be evaluated. These standards apply to all aspects of a department's operations: administrative, financial and programmatic and provide a general framework. Management is responsible for developing the detailed policies, procedures and practices to fit their department's operations and mission.

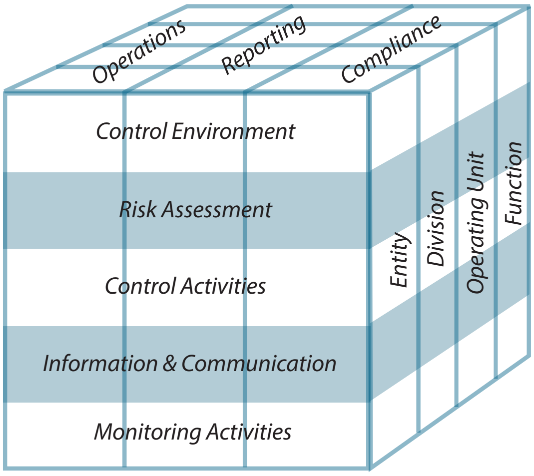
According to COSO, an Internal Control Framework consists of five interrelated components that define a recommended approach for implementing internal controls in government and provide a basis for evaluating them. Management is responsible for developing the detailed policies, procedures and practices which need to be integrated into the organization's operations.

There is a direct relationship between the general objectives an organization strives to achieve

[4] *http://www.rcsc.gov.bt/Job-Description.asp*

[5] *Refer http://www.acc.org.bt/pdf/2009/Final%20NACSF%202009.pdf for detailed outline of corruption preventive tools.*

and the internal control components needed to achieve those objectives. This inter-relationship is best depicted by the three dimensional cube matrix (below):



COSO cube (2013 edition)

The four general objectives – accountability and reporting; compliance with laws and regulations; ethical, economical, efficient and effective operations; and safeguarding of resources – are represented by the vertical columns, the five components by the horizontal rows, and the organization or entity and its divisions and departments are represented by the third dimension of the matrix. Each component row cuts across and applies to all four general objectives. Similarly, all four components are relevant to each objective. The manner in which management applies the internal control structures will depend on organization structure, risk profile, operating environment, size, complexity, activities, degree of regulation etc.

2.5 The Five Major Elements of the Internal Control Framework are outlined below:

2.5.1 Control Environment

Management and employees should establish and maintain an environment throughout the organization that sets a positive and supportive attitude towards internal control and conscientious management.

The control environment sets the tone of the department and influences the effectiveness of internal controls within the department. The control environment is the foundation for all other components of internal control, providing discipline and structure and encompassing both technical competence and ethical commitment. If this foundation is not strong or if the control environment is not positive, the overall system of internal control will not be as effective as it should be. Many factors affect the control environment, including the following:

i. Ethical Values and Integrity

A positive control environment is the foundation for all other standards. It provides discipline and structure as well as the climate which influences the quality of internal control. Several key factors affect the control environment.

One key factor is the integrity and ethical values maintained and demonstrated by management and staff.

Ethical values are the standards of behavior that form the framework for employee conduct and guide employees when making decisions. People in a department have personal and professional integrity when they adhere to ethical values. While it is management's responsibility to establish and communicate the ethical values of the department, it is everyone's responsibility to demonstrate integrity.

Management plays a key role by providing leadership in setting and maintaining the department's ethical tone ("tone at the top") by:

- Providing guidance for proper behavior through policy statements, codes of conduct and by behavioral example.
- Removing or reducing temptations for unethical behavior.
- Establishing methods for reporting ethical violations and consistently enforcing disciplinary practices when appropriate.

ii. Government Management's Philosophy and Operating Style

This factor reflects management's basic beliefs regarding how the people and activities of a department should be managed. This factor determines the degree of risk the department is willing to take and management's philosophy towards performance-based management. Management's philosophy and style can be demonstrated in such areas as:

- acceptance of regulatory control imposed by others;
- management's attitude toward internal and external reporting;
- the use of aggressive or conservative accounting principles;
- the attitude of management toward information technology and accounting functions;
- management's support for and responsiveness to internal and external audits and evaluations.

iii. Commitment to Competence

Competence is a characteristic of personnel in the organization who possess and maintain the skill, knowledge and ability to perform their assigned duties as well as understand the importance of developing and implementing good internal control.

Management's commitment to competence includes identifying appropriate knowledge and skills needed for various jobs and hiring staff with the necessary skills and knowledge. Management also needs to ensure that current staff receives adequate and needed on-going training and supervision, as well as candid and constructive counseling and performance appraisals.

iv. Structure

Structure refers to the management's framework for planning, leading and controlling operations to achieve the department's objectives.

The organizational structure should clearly define key areas of authority and responsibility and establish appropriate lines of reporting. An organizational chart can provide a clear picture of the functional sub-units of a department and the relationships among them. Management should provide policies and direct communications to ensure that employees are aware of their duties and responsibilities, understand how their individual actions interrelate and contribute to the department's objectives, and recognize how and for what they will be held accountable.

The environment is also affected by the manner in which the agency delegates authority and responsibility throughout the organization. This delegation covers authority and responsibility for operating activities, reporting relationships, and authorization protocols.

Good human capital policies and practices are another critical environmental factor. This includes establishing appropriate practices for hiring, orienting, training, evaluating, counseling, promoting, compensating, and disciplining personnel. It also includes providing a proper amount of supervision.

A final factor affecting the environment is the agency's relationship with the legislature and central oversight agencies such as the Royal Audit Authority and the Anti-Corruption Commission. The legislature mandates the programmes that agencies undertake and monitors their progress and central agencies provide policy and guidance on many different matters. In addition, the internal audit and internal senior management councils and committees can contribute to a good overall control environment.

2.5.2 Risk Assessment

Internal Control should provide for an assessment of the risks that an organization faces from both external and internal sources.

A precondition to risk assessment is the establishment of clear and consistent agency objectives at both the organization level and at the activity (program or function) level. Risk assessment is the identification, analysis, and management of risks relevant to the achievement of the department's goals and objectives such as those defined in the strategic and annual performance plans of the RGoB.

Risks include internal and external events or circumstances that may occur and adversely affect operations. Once risks are identified, management should consider their impact (or significance), the likelihood of their occurrence, and how to manage them.

Management needs to comprehensively identify risks and should consider all significant interactions between the entity and other parties as well as internal factors at both the entity-wide and activity level. Risk identification methods may include qualitative and quantitative ranking activities, management conferences, forecasting and strategic planning, and consideration of findings from audits and other assessments.

i. Risk Identification

Managers can start by analyzing the two circumstances most likely to threaten the achievement of objectives, change and inherent risk. The examples listed below are not all-inclusive, nor will every item apply to every agency.

The risk to accomplishing objectives increases dramatically during a time of change.

Because governmental, economic, industry, regulatory, and operating conditions continually change, mechanisms should be provided to identify and deal with any special risks prompted by such changes.

Also, because any change increases risk, managers must diligently monitor and assess all significant changes within their departments. Some examples of change that expose a department to increased risk are:

- Changes in personnel.
- Changes in the regulatory environment.
- New or revamped information systems and technology.
- Rapid growth or expansion of operations.
- Moving to a new location.
- New programs or services.
- Reorganizations within or between departments/agencies.

Activities with inherent risk have a greater potential for loss from fraud, waste, unauthorized use, or misappropriation due to the nature of the activity or asset. Cash, for example, has a much higher inherent risk for theft than a paper cutter or stapler does. Other examples of situations that may involve inherent risk:

- Complexity increases the danger that a program or activity will not operate properly or comply fully with applicable regulations.
- Third party beneficiaries are more likely to fraudulently attempt to obtain benefits when those benefits are similar to cash.
- Decentralization increases the likelihood that problems will occur.
  However, a problem in a centralized system may be more serious than a problem in a decentralized system because if a problem does exist, it could occur throughout the entire department.
- A prior record of control weaknesses will often indicate a higher level of risk because adverse situations tend to repeat themselves.
- Failure to remedy control weaknesses identified by auditors often result in the same weaknesses reoccurring in future years.

In further attempting to identify risks from both internal and external events, managers can ask the following questions:

a. "What obstacles could stand in the way of achieving your objective?"

b. "What can go wrong?"

c. "What is the worst thing that has happened?"

d. "What is the worst thing that could happen?"

ii. Risk Analysis

Once risks have been identified, they should be analyzed for their possible effect. Risk analysis generally includes estimating the risk's significance, assessing the likelihood of its occurrence, and deciding how to manage the risk and what actions should be taken. The specific risk analysis methodology used can vary by agency because of differences in agencies' missions and the difficulty in qualitatively and quantitatively assigning risk levels.

iii. Risk Management

The role of executive management is crucial in risk management. The management and senior officials should provide guidelines to managers throughout their agency or department to help them determine the level and the kinds of risk that are acceptable and not acceptable.

Performing risk assessments assists managers in prioritizing the activities where controls are most needed. Managers use risk assessments to determine the relative potential for loss in programmes and functions and to design the most cost-effective and productive internal controls.

By using these guidelines and the risk assessment information specific to their organization or agency, managers should determine whether to:

- Accept the risk: Do not establish control activities
- Prevent or reduce the risk: Establish control activities
- Avoid the risk (if possible): Do not carry out the function

The acknowledgement and acceptance of certain levels and kinds of risk is considered a department's risk appetite. When preventing risk or reducing it to an acceptable level, management should identify the most effective and efficient control activities available for managing the risk. Specifically, management should answer the following questions:

a. What is the cause of the risk?

Management should consider the reason the risk exists to help identify all the possible control activities that could prevent or reduce the risk.

b. What is the cost of control vs. the cost of the unfavorable event?

Management should compare the cost of the risk's effect with the cost of carrying out various control activities, and select the most cost-effective choice.

c. What is the priority of this risk?

Management should use a prioritized list of risks to help decide how to allocate resources among the various control activities used to reduce the risks. The higher the priority, the greater the resources allocated to the control activities intended to reduce the risk.

Management should maintain its analysis and interpretation as part of its documentation of the rationale that supports its risk management decisions. These documents must be created and given due consideration as part of the annual planning and budgeting process in the agencies.

Once established, the documents must be revisited at least annually to ascertain their topicality and relevance. Management should review these decisions periodically to determine whether changes in conditions warrant a different approach to managing, preventing and reducing risk.

2.5.3 Control Activities

Internal control activities help ensure that the management's directives are carried out. The control activities should be effective and efficient in accomplishing the agency's control objectives.

Control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives, such as the process of adhering to requirements for budget development and execution. They help ensure that actions are taken to address risks. Control activities are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results.

Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation. Control activities may be applied in a computerized information system environment or through manual processes.

Activities may be classified by specific control objectives, such as ensuring completeness and accuracy of information processing.

When designing and implementing control activities that are applicable at every level of the organization, management must seek to balance cost and benefit and try to obtain the maximum benefit at the lowest possible cost. A few simple rules to follow are:

- The cost of the control activity should not exceed the cost that would be incurred by the department if the undesirable event occurred.

- Management should build control activities into business processes and systems as the processes and systems are being designed. Adding control activities after the development of a process or system is generally more costly.

- The allocation of resources among control activities should be based on the significance and likelihood of the risk they are preventing or reducing.

  Many different control activities can be used to counter the risks that threaten a department's success. Most control activities, however, can be grouped into two categories:

  - **Prevention** activities are designed to deter the occurrence of an undesirable event. The development of these controls involves predicting potential problems before they occur and implementing ways to avoid them.

  - **Detection** activities are designed to identify undesirable events that do occur, and alert management about what has happened. This enables management to take corrective action promptly.

Costs and benefits should be assessed before control activities are implemented. Management should also remember that an excessive use of controls could impede productivity. No one control activity provides all of the answers to risk management problems. In some situations, a combination of control activities should be used, and in others, one control activity could substitute for another.

The following are descriptions of some of the more commonly used control activities. The list is not exhaustive, but indicative.

Examples of Control Activities:

- Top level reviews of actual performance,
- Reviews by management at the functional or activity level,
- Management of human capital,
- Controls over information processing,
- Physical control over vulnerable assets,
- Establishment and review of performance measures and indicators,
- Segregation of duties,
- Proper execution of transactions and events,
- Accurate and timely recording of transactions and events,
- Access restrictions to and accountability for resources and records, and
- Appropriate documentation of transactions and internal control.

Certain categories of control activities common to all agencies. Examples include the following:

Top level reviews of actual performance	Management should track major organization or agency achievements and compare these to the plans, goals, and objectives established under the planning process.
Reviews by management at the functional or activity level	Managers also need to compare actual performance to planned or expected results throughout the organization and analyze significant differences.
Management of human capital	Effective management of an organization's workforce—its human capital—is essential to achieving results and an important part of internal control. Management should view human capital as an asset rather than a cost. Only when the right personnel for the job are on board and are provided the right training, tools, structure, incentives, and responsibilities is operational success possible. Management should ensure that skill needs are continually assessed and that the organization is able to obtain a workforce that has the required skills that match those necessary to achieve organizational goals. Training should be aimed at developing and retaining employee skill levels to meet changing organizational needs. Qualified and continuous supervision should be provided to ensure that internal control objectives are achieved. Performance evaluation and feedback, supplemented by an effective system, should be designed to help employees understand the connection between their performance and the organization's success. As a part of its human capital planning, management should also consider how best to retain valuable employees, plan for their eventual succession, and ensure continuity of needed skills and abilities.
Controls over information processing	A variety of control activities are used in information processing. Examples include edit checks of data entered, accounting for transactions in numerical sequences, comparing file totals with control accounts, and controlling access to data, files, and programs.
Physical control over vulnerable assets	An agency must establish physical control to secure and safeguard vulnerable assets. Examples include security for and limited access to assets such as cash, securities, inventories, and equipment which might be vulnerable to risk of loss or unauthorized use. Such assets should be periodically counted and compared to control records.
Establishment and review of performance measures and indicators	Activities need to be established to monitor performance measures and indicators. These controls could call for comparisons and assessments relating different sets of data to one another so that analyses of the relationships can be made and appropriate actions taken. Controls should also be aimed at validating the propriety and integrity of both organizational and individual performance measures and indicators.

Segregation of duties	Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include 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.
Proper execution of transactions and events	Transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. This is the principal means of assuring that only valid transactions to exchange, transfer, use, or commit resources and other events are initiated or entered into. Authorizations should be clearly communicated to managers and employees.
Accurate and timely recording of transactions and events	Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded.
Access restrictions and accountability for resources and records	Access to resources and records should be limited to authorized individuals, and accountability for their custody and use should be assigned and maintained. Periodic comparison of resources with the recorded accountability should be made to help reduce the risk of errors, fraud, misuse, or unauthorized alteration.
Appropriate documentation of transactions and internal control	Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained. These examples are meant only to illustrate the range and variety of control activities that may be useful to agency managers. They are not all-inclusive and may not include particular control activities that an agency may need. Furthermore, an agency's internal control should be flexible to allow agencies to tailor control activities to fit their special needs. The specific control activities used by a given agency may be different from those used by others due to a number of factors. These could include specific threats they face and risks they incur; differences in objectives; managerial judgment; size and complexity of the organization; operational environment; sensitivity and value of data; and requirements for system reliability, availability, and performance.

2.5.4 Information and Communication

Information should be recorded and communicated to management and others within the organization who need it and in a form and within a time frame that enables them to carry out their internal control activities and other responsibilities.

For a department to run and control its operations, it must have relevant, valid, reliable, and timely communications relating to internal and external events. Managers must be able to obtain reliable information to determine their risks and communicate policies and other information to those who need it.

i. Information

Managers need operational and financial data to determine whether they are meeting their department's strategic and annual performance plans and if they are meeting their goals of accountability for effective and efficient use of resources. Operating information is also needed to determine whether the department is achieving its compliance requirements under various statutes and regulations. Financial information is needed for both external and internal uses. It is required to develop financial statements for periodic external reporting, and, on a day-to-day basis, to make operating decisions, monitor performance, and allocate resources. Pertinent information should be identified, captured, and distributed in a form and time frame that permits people to perform their duties efficiently. Moreover, effective management of information technology is critical to achieving useful, reliable, and accurate recording and communication of information.

ii. Communication

Effective communications should occur in a broad sense with information flowing down, across, and up the department. In addition to internal communications, management should ensure there are adequate means of communicating with, and obtaining information from, external stakeholders (e.g. recipients, vendors, other organizations and departments) that may have a significant impact on the department achieving its goals. Management should establish communication channels that:

- Provide timely information.
- Inform employees of their duties and responsibilities.
- Enable the reporting of sensitive matters including fraudulent or unethical behaviors.
- Enable employees to provide suggestions for improvement.
- Provide the information necessary for all employees to carry out their responsibilities effectively.
- Convey top management's message that internal control responsibilities are important and should be taken seriously; and
- Convey and enable communication with external parties.

Communication is not an isolated internal control component. It affects every aspect of a department's operations and helps support its system of internal control. The feedback from this communication network can help management evaluate how well the various components of the system of internal control are working.

2.5.5 Monitoring

Monitoring is the review of the organization's activities and transactions to assess the quality of performance over time and to determine whether controls are effective.

Monitoring is a basic management duty included in routine financial and program activities such as ongoing supervision, reconciliations, comparisons, performance evaluations, and status reports. Internal control systems should generally be designed to ensure that ongoing monitoring occurs in the course of normal operations. Proper monitoring ensures that controls continue to be adequate and function properly.

i. Focus Areas

The monitoring performed by a department should focus on the following major areas:

- Control Activities - Control activities are established to prevent or reduce the risk of problems occurring. If these activities fail, the department becomes exposed to risk. Therefore, management should establish procedures which monitor the effectiveness of control activities and the use of control overrides. Effective monitoring gives management the opportunity to identify and correct any control activity deficiencies or problems and to minimize the impact of unfavorable events.
- Mission - Monitoring activities should include the development and review of operational data that would allow management to determine whether the department is achieving its mission. This can be achieved by periodic comparison of operational data to the department's strategic plan.
- Control Environment - Executive management should monitor the control environment to ensure that managers at all levels are maintaining established ethical standards of behavior and that staff morale is at an appropriate level. Managers should also ensure that the staff is competent, that adequate training is provided and that management styles and philosophies foster accomplishment of the department's mission.
- Communication - Managers should periodically verify that employees are receiving and sharing information appropriately, and that this information is timely, sufficient and appropriate for the users. Management should ensure that there are open lines of communication, which encourages reporting of both positive and negative results.
- Risks and Opportunities - Managers should also monitor the department's internal and external environment to identify any changes in risks or the development of opportunities for improvement. If changes are identified, managers should take appropriate action to address these new conditions. Management should recognize that delays in responding to risks could result in damage to the department or a missed opportunity that may result in lost revenue or unattained cost savings.

ii. Internal Evaluations

Controls need to be monitored for effectiveness ("Are they are operating as intended?") and to ensure they have not become obsolete. Separate evaluations of control activities can also be useful by focusing directly on the controls' effectiveness at a specific time. The scope and frequency of separate evaluations should depend primarily on the assessment of risks and the effectiveness of ongoing monitoring procedures. Separate evaluations may take the form of self-assessments or the direct testing of internal controls. Deficiencies found during ongoing monitoring or through separate evaluations or testing should be communicated to those responsible for the function and to at least one higher level of management. Serious matters should be reported to top management.

iii. Audit Responsiveness

Monitoring of internal control should include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved. Managers are to (1) promptly evaluate findings from audits and other reviews, including those showing deficiencies and recommendations reported by auditors and others who evaluate the department's operations, (2) determine proper actions in response to findings and recommendations from audits and reviews, and (3) complete, within established time frames, all actions that correct or otherwise resolve the matters brought to management's attention. The resolution process begins when audit or other review results are reported to management, and is completed only after action has been taken that corrects identified deficiencies, produces improvements, or demonstrates that the findings and recommendations do not warrant management action.

2.6 Limitations

Internal controls provide only reasonable, not absolute, assurance. Human factors are some of the major limitations. The following are some of the limiting factors:

- Judgment- Managers in a well-controlled organization can make bad decisions.
- Breakdowns- People with control responsibilities may not carry them out effectively.
- Management override- A manager may intentionally go outside established practices for inappropriate purposes.
- Collusion- Two people can collaborate to subvert controls.
- Cost vs. benefits- Resources are limited. Managers properly accept a degree of risk when the cost of controlling that risk exceeds the benefit.

(Source: COSO framework)

3. General Elements of Internal Control–Best Practices from an Agency Wide Perspective

3.1 Control Environment

- The head of the agency should ensure that the agency has a written mission statement containing the purposes, goals and objectives.

- The head of the agency should ensure that the department has an up-to-date organization chart.

- The head of the agency should encourage written policies and procedures for all major areas of the department

- Senior management should encourage regular staff meetings and ensure that all financial operations –centralized and decentralized – are monitored by a central office.

- Managers should be provided with clear goals and directions from the governing body or the top management of the agency.

- The agency should have a structured orientation process to inform new hires of relevant agency wide policies and procedures and expectations from government employees.

- The senior management must effectively communicate expectations for employee conduct to staff in accordance with the guidelines established in RCSC's code of conduct.

- The head of the agency must ensure that all supervisors and managers have sufficient working knowledge of the agency's personnel policies and procedures.

- The senior management must emphasize and see to it that sufficient training opportunities are provided so as to improve competency and update employees on policies and procedures.

- The head of the agency must put in place a written "fraud" policy that focuses on the agency's employees and its internal operations. The senior management must put in place practices so as to periodically remind and urge agency employees to report suspected fraud, waste or abuse to the agency management, or to the auditors so as to ensure an environment where there is zero percent tolerance for corruption.

- The head of the agency must prioritize the presence of a functioning internal audit staff to review the operations of the department. The senior management must ensure that the internal audit staff reports to the head of the agency or to an official independent of the operations under review so as to assure internal audit's independence and objectivity.

3.2 Risk Assessment

- The senior management must utilize methods such as cross-training, strategic hiring practices, detailed procedure documentation, enhanced supervision, etc. to help mitigate the risk associated with sudden or significant changes in key personnel
- In the event of an emergency, the head of the agency should have considered contingency plans (e.g., continuity of operations plans) to ensure the continuity of mission critical functions and services
- For their areas of responsibility, the head of the agency should encourage managers to attempt to identify the department's exposures to fraud (i.e. how fraud could be committed) and the symptoms that might indicate fraud has occurred and document and respond to these.
- The head of the agency must make it a point that employees are encouraged to take earned vacation time in order to improve operations through cross-training while enabling employees to overcome or avoid stress and fatigue.
- Senior management identifies and analyzes risks relating to change, such as new technology, new regulations, restructuring, and rapid growth and prepares strategies to deal with these.
- The agency or department has a process in place to identify new (or changed) laws or statutory requirements that could affect the department's operations.
- Before committing resources to new projects or initiatives, the head of the agency and senior management assess the potential impact on its current operations.

Indicators of Weak Controls

• Government policies set out in Acts, Rules, Statutes and Regulations [Weak control: policies poorly understood, improperly followed]
• Employees' Codes of Conduct [Weak Control: violation of codes]
• Clear Organizational Chart [Weak Control: a confused hierarchy]
• Internal pre-control system such as budget, treasury etc. [Weak control: wrong budgetary assumptions; inadequate treasury control]
• Identification and control of internal and external risk factors such as personal policies, economic changes, natural disasters and calamities etc. [Weak control: potential or real risk factors not controlled or provided for]
• Cost-Benefit Analysis (CBA) of major activities [Weak control: absence of CBA]
• Commitment to change [Weak control: a rigid system not responding to change]

3.3 Control Activities

- The head of the agency ensures that to the extent possible, responsibilities are divided so that no single employee controls all phases of a transaction.
- The agency adopts a policy that unless all transactions are already approved by a senior manager, it is required that transactions exceeding a specified money threshold should be escalated to a higher-level manager for additional approval.
- The head of the agency ensures that there are documented procedures for all of the department's critical functions and key activities.
- The head of the agency ensures that staff are provided with all pertinent policies & procedures that may affect performance of the employee's duties.
- The agency management makes it a point that policies & procedures are reviewed at least annually (and updated as necessary) to ensure they are still relevant and in conformance with governing laws or regulations.
- When an employee leaves government service, or transfers to another position, the agency completes and retains an "employee separation checklist" (or similar) so as to help ensure that government assets and systems are protected and all government owned property is returned.
- The head of the agency ensures that documented policies and procedures addressing the handling of confidential or sensitive information are in place and serve as a strict reference point.

3.4 Information and Communication Systems

- The senior management effectively communicates expected behaviors to staff in accordance with the rules established for electronic communications and internet use.
- There are controls in place to ensure information systems and data are protected from unauthorized access, theft, or malicious acts.
- The head of the agency establishes processes that ensure that information systems' controls effectively prevent and/or detect missing or invalid data.
- Critical data files are backed up and stored in a separately secure area to provide for a full recovery of the data, if necessary.
- Senior management lays down policies that ensure that only authorized staff have information system override privileges.
- The agency has a comprehensive policy on password protection and on information that can be shared outside the organization.
- The senior management asks for reports on ongoing activities of the organization in a manner that pertinent, specific and strategic information comes to them rather than all information and data possible.

3.5 Monitoring

- The head of the agency institutes processes to ensure that the internal control structure is supervised and reviewed by management to determine if it is operating as intended.
- The senior management solicits input from staff on opportunities to improve the effectiveness of controls.
- The agency uses performance-based data or other measures to annually compare its actual performance with programmatic goals and objectives.
- The senior management as per laid down agency policy distributes copies of internal/ external audit reports & reviews to appropriate staff and ensures that any required corrective action is taken in a timely manner.
- The head of the agency submits copies of external audit reports, including any substantiated fraud, and action taken thereon semi-annually to the Ministry of Finance.
- The senior management encourages the agency to utilize external data or sources (e.g. peer groups, surveys, industry standards, etc.) to corroborate the validity of internally generated information.
- The senior management actively monitors the performance of staff that perform vital functions, especially in those areas where non-performance could adversely affect risk.

Understanding the link between Weak Internal Control and Fraud

Weak internal controls not only permit fraud, they actually encourage it.

Costs of Fraud

- Loss of public confidence in the government
- Loss of reputation of the innocent
- Delayed punishment of the perpetrator

Fraud Prevention

- Management's commitment to maintain good internal controls
- Elected officials' support for management's commitment to controls

How to control the fiduciary risk of fraud

- Follow up on adverse indicators
- Check the control documents
- Careful examination of unusual transactions
- Analytical review of transactions through sources

Most common types of fraud

- Missing assets/inventory
- Pilfering
- Inflated travel claims
- Double payments
- False claims
- Payroll fraud

Bypassing the regulatory framework is the most common anatomy of any fraud. An audit trail must be built into systems through control documents such as cash book, stock ledger, bin cards etc.

4. Financial Management Internal Controls-Best Practices

- The head of the agency should ensure financial management related internal controls are instituted in accordance with the rules and regulations outlined in existing manuals and the Public Finance Act of Bhutan 2007 and its amendment in 2012.

- The head of the agency should direct optimum utilization of resources and promote efficiency, accountability and transparency in the interest of the government. He should ensure (i) the installation and implementation of adequate systems of internal control within the agencies including the subordinate units to prevent misuse, misappropriation and wastage of government funds and introduce accountability at every level; (ii) formulation of their Master plan, 5 year plan, rolling and annual budget proposals of the Ministry; (iii) proper execution of the functions in accordance with the approved budget allocation and the rules and regulations prescribed in the respective manuals.

- The head of the agency should also ensure that power for issue of financial sanctions and/or incurring expenditure shall be provided for all different levels of authority. To enhance efficiency and expedite decision making, certain powers may be delegated to subordinate officers, through written orders, which shall clearly specify the nature of power delegated, position of the subordinate to whom delegated and ceiling in Ngultrum(s).

- The head of the agency may administer the budget of the Department through Heads of Offices without disowning his own responsibility

- The head of the agency should institute processes to control expenditure to achieve economy and ensure optimum utilization of resources.

- The head of the agency should accord financial and technical sanction and administrative approval for activities in accordance with the rules and in documented form.

- The head of the agency should facilitate and arrange for the audit of the financial affairs and operations of organizations and units under his purview by inviting auditors, settle financial disputes and audit observations by interpreting rules, recovering dues, processing write-off of irrecoverable dues, replying to audit memos and by coordinating and conducting regular meetings between the Royal Audit Authority and Departments/Ministry.

- The head of the agency should also mobilize funds from the Ministry of Finance and external donor agencies in accordance with institutionalized practices and norms.

- The head of the agency should institute systems so as to prevent and detect loss, waste and misuse of Government funds by imposing financial by-laws, introducing internal control systems, and by taking appropriate actions against defaulters.

- The head of the agency should ensure that there are well documented processes to ensure adherence to rules and instructions relating to the formulation of the budget and responsibilities of different functionaries in this regard.

- The head of the agency should encourage the development of skills in his organization regarding the use of forecasting methods such as statistical modeling, trend analyses, historical data etc. to develop both its estimates for the annual budget exercise and also to monitor performance against budget.

- The senior management in the organization should establish capacity development processes and put mechanisms in place to verify that spending authority budgeted from grants and other fund sources are supported by reasonable revenue estimates based on the best available information.

- The head of the agency should ensure that specific staff are assigned responsibility to regularly (preferably monthly or more often, but at least quarterly) compare actual expenditures and revenues with budgeted amounts throughout the year.

- The head of the agency and senior managers should review the control records and reporting systems instituted so as to watch the progress of revenue and expenditure against allocated funds and ensure that variation is kept to a minimum.

- The head of the agency should institute a culture of accountability for financial transactions within the organization by seeking explanations, when necessary, for significant or unusual variances (surplus or deficit) and noticing and taking corrective action as appropriate.

- The head of the agency should also lead by example in monitoring the progress of expenditure vis a vis estimates and ensure that there are no wide variations in expenditure categories and these remain within the approved estimates.

- The head of the agency should institute verification and monitoring related internal control processes and documentation so as to avoid persistent savings under any major head of expenditure which would be indicative of poor pre-budget scrutiny.

- The head of agency should ensure that the budget estimation process should be characterized by consistency and conformity in the figures and estimates summarized and received from all levels and units within the agency.

- The head of the agency should ensure that internal controls and required administrative machinery is in place to exercise expenditure control and monitor expenditure incurred by the agency and its field units, if any.

- In case the agency issues grants of government funds to sub-recipient individuals and agencies or units, the head of the agency should ensure that there is a tracking system in place and a written policy that defines the procedures to monitor sub-recipients.

- The review utilization of government funds by sub-recipient units and departments must be documented and periodically audited. If required, time bound targets for monitoring, mid-term evaluations and detailed impact studies must be prescribed.

- The head of the agency must institute reporting mechanisms so that changes in time schedule, financial position and objectives of original proposals are brought to the timely notice of the central agency.

- The head of the agency should ensure that a mechanism exists to check that funds are spent effectively and that the data and facts relating to physical and financial performance are reported correctly.

- In case of duplication of schemes and objectives implemented by agencies, the senior managers must coordinate to ensure value for money and effective implementation and weeding out of ineffective programmes and projects.

- The head of the agency should invariably call for post-completion review of projects and programmes so as to create an institutional learning and historical record and ensure accountability for performance.

- The head of the agency should ensure that no grants or funds are sanctioned to agencies or units of governance where there is reasonable doubt or suggestion of corrupt practices unless the institution has been cleared of the charges or allegations. The integrity diagnostic tools and anti-corruption initiatives and instruments prescribed by the Anti Corruption Commission should be made use of and become an inherent part of the organizational culture under senior management's leadership.

- The head of agency should ensure that there is a system of transparency and duly authenticated records regarding financial flows and transactions are made available easily to external and internal audit.

- Internal controls governing effective communication must be put in place so as to ensure timely release of funds and communication thereof to all officers concerned.

- A mechanism to prevent diversion of funds and exercise effective control over expenditure must be instituted and monitored by the head of the agency.

- Rush of expenditure towards the end of the financial year should be avoided through monitoring and institution of internal controls.

- The head of the agency should ensure that compliance with economy norms are part of the agency's code of conduct and that the austerity and cost cutting measures as announced by the government should be effectively communicated throughout the organization. It is senior management's responsibility to ensure that these austerity measures are implemented through specific orders and instructions both in the agency and in attached and subordinate offices as well.

5. Property Management-Internal Controls & Best Practices

5.1 Objective

The agencies concerned are responsible for developing and maintaining processes that are in compliance with all laws, administrative requirement and ethical standards pertaining to property management. The agencies are responsible for conducting the purchasing function in a manner which results in the most effective and efficient use of state funds.

5.2 Risks

- Lack of complete knowledge regarding the properties of the Royal Government of Bhutan
- Absence of an updated inventory
- Lack of proper handing over and irregular transactions related to property
- Absence of current physical verification of expendable and non-expendable property leading to loss of parts, or overlooking of complete asset receipt

5.3 Definition

Property management is the proper accounting, safeguarding, utilization of all Government properties accompanied by recording in relevant records at cost of acquisition or at assessed value and with sufficient diligence and care through a proper handing and taking over mechanism and physical verification followed by regular maintenance of inventory.

5.4 Best Practices include

Written procedures exist for the property management function covering the acquisition, improvement and construction of properties, upkeep of proper inventories of all Government properties, establishment of and adherence to maintenance schedules, provisions for economic and rightful utilization and establishment of accountability for the management of properties. [Documentation]

There should be a clear outline of key areas of authority and responsibility with regard to the different facets of the property management function. All assets and properties purchases, receipts, disposals etc. must be approved by a designated person with proper authority. [Authorization]

The Head of office may, without disowning his own responsibility, delegate the authority and responsibility for safe custody and utilization of properties to subordinate officials referred to as Property Officers. However, there will be a system of reporting which is instituted which keeps the Head of Office informed of all property management related issues that may arise in the course of the Property Officer's exercise of their delegated powers. [Authorization & Information and Communication]

All agencies and departments comply with the requirements outlined in the Property Management Manual, 2001 of the Royal Government of Bhutan, the Procurement Manual and the Financial Management Manual. [Compliance]

The Manual must be revisited and reviewed every three years so as to ensure its topicality and relevance. [Verification]

The Property Management Manual points out that the rules are not meant to be exhaustive or comprehensive as it is recognized that much will depend on the administrative and internal control measures adopted by the individual line agencies. [Control Environment]

A major portion of the total resources of the Government is spent every year on acquisition, improvement or construction of various kinds of properties. The expenditures incurred on such purposes reflect equivalent amounts of increases in the assets of the Government. It is therefore important for the Government to maintain an updated inventory of its properties at all times and ensure that these are properly maintained and utilized for rightful purposes, that their ownership does not get diluted and that there is always an officer who remains accountable in respect of a property. [Risk Management & Monitoring]

All non-expendable property purchased or acquired by the government agencies must be registered in a centralized inventory and allotted an identification code.
[Documentation & Verification and Reconciliation]

The Department of National Property must outline and develop a system of reporting for an Annual Inventory Statement of the Government Property so as to allow the government and its agencies to allocate resources for repair and maintenance, replacements, additional procurement and future planning for property management.
[Risk Management & Documentation]

All requisite clearances from other divisions (such as Information Technology division for procurement of computers) should be initiated and completed prior to any procurement process. [Authorization & Compliance]

Procurements by construction should be conducted in accordance with rules under Chapter VI-Works Procedure and Accounting of the Finance and Accounting Manual.
[Compliance]

All Government agencies engaged in production or manufacture underlying acquisition shall be responsible for maintaining proper records to account for the items produced/manufactured by the Agency and their disposal. [Documentation]

All cases of confiscation//seizure of property shall be conducted in accordance with the relevant laws, rules and orders of the Government and a receipt must be issued for the confiscated/seized property as outlined in the Property Management Manual of the Royal Government of Bhutan. [Compliance & Internal Controls-Reconciliation and Verification]

All property acquired through donation/grants/gifts must be reported to the Head of Office within the specified time as outlined in the rules [Compliance]

The head of the office shall emphasize on quality assurance regarding processes adopted by receiving periodic reports indicating inspection, verification and examinations of properties have been carried out. [Verification]

All issue of property must be accompanied by the required forms, documentation and specific cost charging norms as specified in the rules. [Compliance]

The Heads of Technical Departments and Dzongkhags are required to plan, develop and maintain suitable central inventories with pertinent details and when required, updated maps as specified in the rules. [Compliance]

The Head of the agency must emphasize on the maintenance of Fixed Assets Registers to record all non-expendable properties. The register must be kept up to date and depreciation applied as provided in the relevant rules. [Compliance]

The heads of the departments/agencies must provide details of non-expendable properties acquired, received, transferred and disposed or written off to the DNO, as and when the transactions take place. [Compliance]

The head of the agencies and the departments should conduct regular training and awareness programmes based on the existing rules and regulations in all government agencies so as to ensure awareness and conformity to the rules. [Commitment to Competence]

All heads of offices should review and observe the accepted maintenance schedules of Government properties as outlined in the rules and regulations. These schedules must be subject to periodic feedback and review. [Compliance]

The Head of office should ensure that all government properties are used for the purposes for which they were acquired and issued and that the properties are safeguarded from loss, misuse and authorized disposal through proper internal control systems. The Head of Office must also ensure that utilization of all Government property is monitored and controlled as per existing rules so as to avoid irregular, excessive and unnecessary expenditure.

[Monitoring & Compliance]

Physical verification of properties must be undertaken at least once a year and in addition, at any time as ordered by the Head of the agencies in accordance with formal, written due procedures for its performance being outlined in the rules. This physical verification must be conducted by an official who is independent of the custodial or record keeping functions and independent of the department being inventoried.

[Monitoring & Compliance & Separation of duties]

The physical inventory count sheets must be signed, dated by the person supervising the counts and retained according to the agencies' record retention procedures. [Documentation]

Management and heads of agencies must assess inventory policy and procedures periodically. [Monitoring]

A property acknowledgement system must be maintained upon receiving of the properties and their verification as required by the rules. [Compliance]

All surplus, obsolete, damaged or unserviceable properties must be physically verified by appointed three member inspection committees with cogent reasons specified as per the rules. All gains and losses must be properly recognized from disposals of fixed assets and property. [Compliance]

The disposal and transfer of property should be accompanied by due adherence to specified processes and documentation as required under the relevant rules and regulations and must be approved by a designated person with proper authority. [Compliance]

The Department of National Property shall verify the Statement of non-expendable properties and compile a report of all non-expendable properties agency wise at the end of the fiscal year. It shall also receive and check a copy of the updated Asset Inventory documents submitted by all heads of departments and agencies while submitting budget proposals. [Monitoring and Compliance]

All required rules as prescribed in the Finance and Accounting manual must be followed prior to allowing for clearance and relief from accountability of Government Property. [Control Environment & Compliance]

Adequate storage facilities with physical controls and proper authorizations must be put in place by the heads of agencies so as to prevent leakages and wastage and ensure adequate security of assets. [Control activities]

Heads of offices and agencies must issue guidance rules so that department personnel are aware that personal use of expendable and non-expendable properties is prohibited. [Control environment]

The department must maintain a list of keys and lock combinations assigned to employees (and contractors) that is inclusive of the agencies entire operations. [Physical controls]

All agencies must have an official assigned responsibility for property and fixed asset accounting. [Authorization]

All acquisition costs of capital assets and properties must be outlined and gains and losses properly recognized from disposals of property and fixed assets. [Reconciliation]

All un-located assets must be investigated, findings documented and appropriate action taken. [Verification & Reconciliation]

There must be a manual system of reporting based upon data integrity, physical verification and required authorizations so as to ensure that the Department of National Property has an updated list of all properties of the government at any given time. This system of reporting must be continued until it is possible to maintain all information online. [Documentation & Monitoring]

All attempts to establish online reporting systems and web based modules using information technology must be accompanied by a proper strategy, time frame for completion and a System Development Life Cycle document that is accepted by the senior management. [Risk Management& Documentation]

There should be proper general and application controls in place and management must have access to required manuals and the source code for any application developed.

[Documentation & Risk Management]

All attempts to use information technology for reporting must be accompanied by discussions and agreement between internal and external stakeholders, establishment of an audit trail and free flow of information and harmonizing with other agencies and within the agency. [Information and Communication]

Over reliance on one person to maintain or create an Information Technology based online property management system or database must be avoided. The head of the agency must ensure that there are alternate options and trained personnel available so that work or systems do not breakdown in the event of individual error, fraud or withdrawal from the project. [Risk Assessment & Management]

6. Procurement-Internal Controls & Best Practices

6.1 Objective

- Agencies are responsible for developing and maintaining procurement processes that are in compliance with all laws, administrative requirements, and ethical standards pertaining to purchasing and procurement. All departments are responsible for conducting the purchasing function in a manner which results in the most effective and efficient use of state funds.

6.2 Risks

- Unauthorized, unnecessary, or fraudulent purchases
- Improper charges to departmental budgets
- Excessive costs incurred
- Payments made for items or services not provided
- Goods purchased for personal use
- Post award of tender processes not monitored effectively
- Relationships with contractors characterized by subjectivity and bias
- No quality checks to ascertain nature of service or goods provided
- Lack of adherence to service standards and time frames –leading to contractors facing delay in payments and making consequent offers of gratification to officials
- Lack of understanding of contract provisions by contractors and no action taken by government officials to keep them aware or informed of the requirements as per rules.

6.3 Definition

- Purchasing is the process of procuring quality goods and services, delivered in a timely manner, at the most cost-effective price from reliable sources.

6.4 Best Practices Include

Written procedures exist for the purchasing function. Procedures should address procurement strategies and administrative requirements, employee's authorization levels to initiate/execute purchases, contract requirements, receiving and verification of goods & services, and payment processing and approval. [Documentation]

There must be a procurement plan that outlines the strategic requirement and the details of the procurement sought to be made during the course of the financial year. This plan should be comprehensive and based on inputs from all units of the agency and must reduce emergent or just in time purchases with their accompanying cost escalations to a minimum. [Documentation & Risk Management]

The Public Procurement Rules and Regulations must be revised periodically and the time frame must be specified through executive order. As per 4.1.1.3 of the PRR states the threshold values shall be reviewed from time to time and, if necessary, revised by the Ministry of Finance in relation to the consumer price index. The threshold values for all levels of tender Committees are last revised in July 13, 2011. [Risk Assessment & Compliance]

No one employee should have complete control over the entire purchasing function. The responsibilities for purchasing, receiving, and approving payments for goods and services should be assigned among different employees. [Separation of Duties]

All agencies comply with the requirements of the Procurement Rules and Regulations 2009 which aim at ensuring the transparency of Government procurement through the application of standard procurement procedures; achieving uniformity of the procurement procedures of Government Agencies; achieving economy and efficiency in the procurement of goods, works and services; and ensuring fair and equal access to the suppliers, consultants and contractors for award of contracts for supply of goods, services or works. [Compliance]

All agencies comply with all policies and procedures established in the Specifications for Building and Road Works published by the Standard and Quality Control Authority of the Ministry of Works and Human Settlement, prescribing the standard specifications for an item of work. [Compliance]

All agencies and departments comply with the requirements, thresholds, and limitations of applicable Blanket Delegations of Authority (BDAs) as issued by the relevant authorities from time to time. All delegations of authority including financial authority must be documented. [Authority & Compliance]

All procurements and purchases should be made by a competitive process, even when not expressly required, to ensure the prudent and efficient use of government funds.
[Documentation]

Procurements, regardless of funding source, are made from vendors who are not suspended or debarred from the federal or district level procurement process and excluding all contractors featured in the debarment registry maintained by the Public Procurement Policy Division of the Ministry of Finance in conformity with the directions of the Anti Corruption Commission. [Compliance]

Requisitions for goods and services are initiated and approved by authorized individuals.
[Authorization & Approval]

Purchase orders and contracts should be based on valid, approved requests and contain identification and proper definition of the key elements of the contract and specifications based on standards and performance requirements. The contract provisions should be properly executed as to price, quantity, and vendor. [Documentation & Approval]

All agencies should undertake the tendering process as per the guidelines outlined in the Procurement Rules and Regulations 2009 and also ensure that all pre-award complaints in public procurement are referred to the appropriate authority or the independent review body established for the purpose. [Compliance]

Agencies must ensure that as per the provisions outlined in the procurement manual, the procurement of works, supplies or services shall not be split or based on unusual or peculiar methods of calculation with the purpose of avoiding the threshold values outlined in the Procurement Rules and Regulations 2009. The Public Procurement Policy Division of the Ministry of Finance must undertake test checks and also call for reports on the strength of internal controls and their application from the concerned agencies, so as to encourage adherence to the provisions regarding non-splitting of contracts or work orders. In the rare cases where capacity to undertake certain works or services is not available in the country leading to division or splitting of contractual works, the approval of the highest competent authority must be taken in a written form. [Compliance & Monitoring]

The pre-bid and bidding process including the formulation of relevant tender committees must be according to the relevant rules and regulations including those outlined in the Procurement Rules and Regulations 2009. [Compliance]

Officials and members involved and participating in the procurement process must maintain the highest ethical standards as well as knowledge of the various provisions governing the procurement process. They must exercise judgement so as to award contracts based on the lowest evaluated bid providing the best value for money rather than the lowest quoted price alone. They must also ensure that integrity pacts and disclosures regarding conflict of interest are incorporated into the procurement process as relevant. [Control environment]

Agencies may establish a list of registered suppliers while keeping the norms of transparency and compliance with the relevant rules in view. The database of vendors or registered suppliers, contractors, consultants etc. should be reviewed annually by independent reviewers. [Information and Communication & Verification]

The officials responsible must verify goods and services received agree with contract/ purchase order terms and maintain a written record of such verification. [Verification]

The received goods should be secured in a safe location and inspected for quality and condition. [Safeguarding of Assets]

Invoices are matched with purchase orders and receiving reports before approval for payment. [Reconciliation]

Invoices must be reviewed for accuracy by comparing charges (e.g. quantity, price, etc.) to amounts indicated in purchase orders, contracts, or other source documents. [Verification]

Periodically compare recent purchases to financial and fixed asset/inventory records (if applicable) to ensure the accuracy and completeness of the transaction.

[Monitoring & Reconciliation]

All purchases should be for necessary goods and services to support the department's mission and programs and in accordance with established budgetary guidelines. All award decisions should be clearly, comprehensively and properly documented at award stage. [Authorization & Documentation]

Employees involved in the purchasing function should not use their position to receive any type of personal benefit from any vendor or contractor, and, any potential conflict of interest should be disclosed to an appropriate supervisor or manager. [Compliance]

Claims are filed promptly for damaged or sub-standard goods.

[Documentation & Safeguarding of Assets]

A specific reporting system should be established based upon relevant data and information norms so as to allow for quarterly reporting to the heads of agencies on procurements undertaken at district and federal level for procurements that are not captured by the proposed national web based system. [Information & Communication]

The officials entrusted with procurement functions should be trained and in turn act as trainers for other officials so as to allow for turnover of officials within a specified number of years as may be determined by the head of the agency and also creating capacities within the government system. [Control environment]

A system of standards for service delivery and payment to contractors/suppliers/consultants must be established so as to prevent unnecessary delays or scope for illegal gratification through the instrument of withholding or delaying payment. These standards and time frames for various phases of the post award procurement process must be outlined clearly by the concerned authorities and monitored by the head of the agency through periodic reports received. The ministries and departments must ensure that payments to the suppliers are made on time and as per the order issued by the Cabinet Secretariat.

[Monitoring & Verification]

In order to ensure that all construction works and related procurements satisfy quality and economy standards and norms, a system of adequate planning, proper feasibility studies and surveys and consultation and coordination among agencies involved must be undertaken prior to the process of award of contracts. [Risk Management & Verification]

Estimates must not be prepared on ad hoc basis for construction projects and detailed scrutiny of designs, drawings and site conditions must underlie all estimates so that there is minimal deviation from the actual quantities of works executed. The heads of agencies should set up standard procedures for the purpose and monitor the same through written reports periodically received. [Compliance]

Contract agreements must contain clear and required clauses accompanied by specific penalty provisions detailing actions to be taken in case of non-adherence to the clauses by the parties involved. [Compliance]

There must be adequate site supervision and monitoring of works by the site engineers and supervising officials so as to avoid instances leading to poor quality works and high cost of constructions. The heads of agencies must receive specific reports of onsite supervisions and take action on the same. The heads of agencies must also specify the maximum number of supervisory visits and sites to be monitored by each official or engineer so as to avoid poor quality supervision and work overload or excessive reliance on a few individuals. [Monitoring]

The heads of agencies must conduct field visits through independent officials not associated with the contracting process so as to check and stop unauthorized subcontracting and fronting which lead to low quality works, delays and rise in construction costs. [Monitoring]

The heads of agencies must satisfy themselves and ensure an effective system of checks and balances and adequate financial, administrative and technical controls so as to prevent financial improprieties, irregular and excess payments, false certification by site engineers and others. These controls must be strictly enforced so as to prevent cases of huge and lavish advances being paid to the contractors or inappropriate mobilization advances, payment of disproportionate secured advance against the materials brought to site, advances paid against inflated running bills etc. with total advances going beyond the actual cost of construction and therefore remaining unadjusted. [Control Environment & Compliance]

The need for engaging private consultancy firms vis-à-vis internal capacity within the agencies must be adequately analyzed and consultancy firms possessing adequate capacity and competence to render the services satisfactorily must be chosen using proper method of pricing and ensuring effective competition in the selection process so as to allow for competitive costs in the procurement process. [Verification & Compliance]

Imposition of Liquidated Damages must be strictly implemented as it is only through this clause that the timely completion of constructions, supplies and services can be ensured. The various ministries and agencies must avoid a general tendency of leniency towards incorporating or in following this particular clause. [Compliance]

Heads of agencies must institute systems and internal controls so that there are no abnormal variations in the costs of similar construction works in different places. Absence of proper system of comparative studies and appropriate mechanisms to address such variations would have caused substantial financial burden to the national exchequer and such lacunae should be avoided. [Verification]

The managers in agencies must ensure that there is no rush of activities towards the end of financial year and that the maximum number of disbursement vouchers or even initiation of construction works is not left till the end of the financial year so as to avoid lapse of fund. The proper pacing of all spending and construction must form part of the risk management and planning process based on internal controls undertaken by the agencies including the Dzongkhags. Proper planning, coordination and financial discipline must be put in place by the heads of agencies so as to avoid poor quality, excessive procurement and blockage of funds. [Risk Management & Compliance]

Senior management in agencies must ensure that there is a reliable quality assurance system in place with adequate facilities to check the quality and acceptability of various construction materials both imported and manufactured within the country. Further, a system of independent monitoring of construction works to ensure adherence to construction standards must be instituted and encouraged. [Compliance]

As part of the Human Resource related internal controls in the area of procurement and construction activities, the engineering professionals must subscribe to and adhere to high professional and ethical codes which are subject to effective monitoring. This would promote their commitment towards public service and maintain high standards of works. Nonobservance of such requirements may increase the possibility of some engineers indulging in unethical and corrupt practices and this should be avoided through required institution of internal control processes. [Control Environment]

Heads of agencies should ensure that there is a proper mechanism to ensure that other engineers, who are civil servants, are not engaged in consultancy works which are prohibited under the BCSR 2006 as part of the separation of duties and ethical standards characterizing internal control procedures. [Separation of duties and Compliance]

All agencies must inculcate the habit of assessing procurement risks and develop appropriate strategies for dealing with the identified risks. [Risk Management]

7. Human Resource Management–Internal Controls and Best Practices

- The head of the agency must ensure that the human resource management is done in accordance with written rules and regulations as outlined by constitutional authorities such as the Royal Civil Service Commission viz. The Bhutan Civil Service Rules and Regulations 2012.

- As specified in the BCSR 2012, the Head of Agency shall be primarily responsible for all Government funds and properties, or any lapse of fiscal responsibility and duties pertaining to his jurisdiction. He should direct and oversee the formulation of policies and plans for the Ministry; guide sectoral departments in preparation of plans and programmes; monitor the implementation of Plans and Policies; monitor and evaluates the ongoing programmes within the ministry and adopt follow-up actions to address the shortfalls; constitute HR Committee in the agency as per clause 2.9.3.2 of BCSR 2012 and as a chair person of HR Committee, regularly convene HR Committee meetings. The head of the agency should also exercise all executive powers as specified in the BCSR 2012 in the areas of recruitment/selection/appointment, in-service training, leave, promotion, transfer, HR planning, travel etc. All such processes and powers as exercised and documented shall form an integral part of human resource management related internal controls.

- The head of the agency should ensure that the transfer/placement policy of officers at various levels provides for rotation of the officers posted at a particular place/post after completing a defined tenure (especially sensitive places/posts) and that this policy is implemented consistently with any deviations from the laid down policy requiring approval of the competent authority. In order to ensure that this policy is adhered to, its counterpart requirement of developing capacity within the agency or government so that sufficient number of trained personnel and officials are available, must be emphasized and undertaken.

- The head of the agency must ensure that a centralized database of officers' posting, durations, and posts held etc. is created so as to enable unbiased implementation of the transfer/posting policy.

- The head of agency must also ensure that there is a policy of rotating the duties of staff so as to prevent the development of vested interests and expand and grow the range of skills of employees by exposing them to different kinds of work (for example in a key seat for not more than 2-3 years and in a section for not more than 5 years)

- The head of the agency should ensure that in the interests of accountability and transparency and in keeping with the prevalent rules and regulations, a system of declaration of assets or of high value transactions etc. should be instituted for the officials and staff.

- The head of the agency should emphasize on the preparation of a manual or flow chart outlining and listing out the steps in various activities or procedures that are specific to its working.

- The head of the agency should institute an effective system in place for monitoring both (i) fresh appointments and (ii) promotions and transfers.

- The head of the agency must ensure that with regard to the upgradation or abolition of posts or creation of new ones, a consistent clearly defined system is followed in consultation with the Royal Civil Service Commission and Ministry of Finance and keeping in view the current environment and requirements of his particular agency. Senior management must also ensure that a database of sanctioned posts and persons in position is maintained and updated at least every five years so as to be relevant to changing work realities/ environment.

- The managers must ensure that a certain specified percentage of service books, leave accounts and seniority lists (if maintained) should be test-checked and inspected annually.

- The head of the agency must try and ensure that all staff are trained periodically in relevant and necessary areas of expertise and that the right candidate is sent for the right training and his posting thereafter is in accordance with the expertise he has developed. In line with HRD Master Plan, the head of the agency should nominate suitable candidate for relevant course for long-term training that matches with the employees' job responsibilities to achieve the objectives of the agency and upon endorsement by the HRC, recommend the eligible candidate to the Royal Civil Service Commission for approval.

- There should be internal controls in place to ensure that staff patterns conform to norms and standards prescribed for the purpose, clear demarcation of functional responsibilities exist among personnel and the principle of separation of duties is followed.

- The head of the agency must also establish systems so as to ensure that allocation and actual deployment of manpower is as per sanctioned strength and controls are available for monitoring efficient and effective utilization of manpower.

- The head of agency must check that proper systems have been instituted for reviewing at periodic intervals the workload and adequacy or otherwise of manpower resources.

- The head of the agency must ensure that when employees leave or are transferred out to other agencies, a separation protocol or procedure is followed so that the State's assets are protected and any department owned property is returned thereby reducing the risk of unauthorized access and use of assets (e.g. equipment, facilities, IT systems, data, etc.), lost, stolen, or damaged assets and unsecured work environment for personnel. The agency should utilize a checklist to ensure a consistent, thorough, and documented procedure when an employee is leaving and keep the checklist as part of its documentation and written record as a strong internal control procedure.

- The senior management should encourage employees to take earned vacation time in order to improve operations through cross-training while enabling employees to overcome or avoid stress and fatigue and also strengthen fraud prevention practices.

8. Information Technology Related Internal Controls and Best Practices

As information technology has advanced, organizations have become increasingly dependent on computerized information systems to carry out their operations and to process, maintain, and report essential information. As a result, the reliability and security of computerized data and of the systems that process, maintain and report these data are a major concern to the management and auditors of organizations.

The use of automated systems to process information introduces several risks that need to be considered by the organization. These risks arise from

- uniform processing of transactions;
- information systems automatically initiating transactions;
- increased potential for undetected errors;
- existence, completeness, and volume of audit trails;
- the nature of the hardware and software used; and recording of unusual or non-routine transactions.

Thus, for example, an inherent risk from the uniform processing of transactions is that any error arising from computer programming problems will occur consistently in similar transactions. Effective information technology controls can provide management with reasonable assurance that information processed by its systems meets desired control objectives, such as ensuring the completeness, timeliness, validity of data and preserving its integrity.

8.1 Information systems imply specific types of control activities. Therefore information technology controls consist of two broad groupings: General Controls and Application Controls

8.1.1 General Controls

General controls are the structures, policies and procedures that apply to all or a large segment of an entity's information systems and help ensure their proper operation. They create the environment in which application systems and controls operate.

The major categories of general controls are

(i) entity-wide security program planning and management,

(ii) access controls,

(iii) controls on the development, maintenance and change of the application software,

(iv) system software controls,

(v) segregation of duties, and

(vi) service continuity.

Thus, the general controls category includes entity wide security program planning, management, control over data center operations, system software acquisition and maintenance, access security, and application system development and maintenance. More specifically:

- Data center and client-server operations controls include backup and recovery procedures, and contingency and disaster planning. In addition, data center operations controls also include job set-up and scheduling procedures and controls over operator activities.

- System software control includes control over the acquisition, implementation, and maintenance of all system software including the operating system, data-based management systems, telecommunications, security software, and utility programs.

- Access security control protects the systems and network from inappropriate access and unauthorized use by hackers and other trespassers or inappropriate use by agency personnel. Specific control activities include frequent changes of dial-up numbers (where relevant); use of dial-back access; restrictions on users to allow access only to system functions that they need; software and hardware "firewalls" to restrict access to assets, computers, and networks by external persons; and frequent changes of passwords and deactivation of former employees' passwords.

- Application system development and maintenance control provides the structure for safely developing new systems and modifying existing systems. Included are documentation requirements; authorizations for undertaking projects; and reviews, testing, and approvals of development and modification activities before placing systems into operation. An alternative to in-house development is the procurement of commercial software, but control is necessary to ensure that selected software meets the user's needs, and that it is properly placed into operation.

8.1.2 Application Controls

Application controls are the structure, policies, and procedures that apply to separate, individual application systems, and are directly related to individual computerized applications, These controls are generally designed to prevent, detect, and correct errors and irregularities as information flows through information systems.

The category of application controls is designed to help ensure completeness, accuracy, authorization, and validity of all transactions during application processing. Control should be installed at an application's interfaces with other systems to ensure that all inputs are received and are valid and outputs are correct and properly distributed. An example is computerized edit checks built into the system to review the format, existence, and reasonableness of data.

General and application controls are inter-related and both are needed to ensure complete and accurate information processing. General control applies to all information systems—mainframe, minicomputer, network, and end-user environments. Application control is designed to cover the processing of data within the application software.

Because information technology changes rapidly, the associated controls must evolve constantly to remain effective.

8.2 Information Technology management related internal control best practices:

The head of the agency must establish the following as the minimum internal controls for information technology in his organization:

(a) Physical security measures restricting access to agents, including vendors, must exist over the servers, including computer terminals, storage media, software and data files to prevent unauthorized access and loss of integrity of data and processing.

(b) Unauthorized individuals must be precluded from having access to the secured computer area(s).

(c) User controls:

1. Computer systems, including application software, must be secured through the use of passwords or other approved means.

2. Procedures must be established and implemented to ensure that management or independent agents assign and control access to computer system functions.

   i. Passwords must be controlled as follows unless otherwise addressed in the standards in this section.

   ii. Each user must have his or her own individual user identification and password. When an individual has multiple user profiles, only one user profile per application may be used at a time.

   iii. Passwords must be changed at least quarterly with changes documented.

   iv. Documentation is not required if the system prompts users to change passwords and then denies access if the change is not completed.

   v. The system must be updated to change the status of terminated users from active to inactive status within 72 hours of termination.

   vi. At least quarterly, independent agents must review user access records for appropriate assignment of access and to ensure that terminated users do not have access to system functions.

   vii. Documentation of the quarterly user access review must be maintained.

   viii. System exception information (e.g., changes to system parameters, corrections, overrides, voids, etc.) must be maintained.

3. Procedures must be established and implemented to ensure access listings are maintained which include at a minimum:

   (i) User name or identification number (or equivalent); and

   (ii) Listing of functions the user can perform or equivalent means of identifying same.

(d) Adequate backup and recovery procedures must be in place that include:

1. Daily backup of data files—

   (i) Backup of all programs. Backup of programs is not required if the program can be reinstalled.

(ii) Secured storage of all backup data files and programs, or other adequate protection to prevent the permanent loss of any data.

(iii) Backup data files and programs may be stored in a secured manner in another building that is physically separated from the building where the system's hardware and software are located. They may also be stored in the same building as the hardware/software as long as they are secured in a fireproof safe or some other manner that will ensure the safety of the files and programs in the event of a fire or other disaster.

2. Recovery procedures must be tested on a sample basis at least annually with documentation of results.

(e) Access records.

1. Procedures must be established to ensure computer access records, if capable of being generated by the computer system, are reviewed for propriety for the following at a minimum:

(i) Accounting/auditing systems;

(ii) Cashless systems;

(iii) Financial bonus systems;

(iv) Voucher systems;

(v) Presence of an audit trail outlining authorizations and access.

2. If the computer system cannot deny access after a predetermined number of consecutive unsuccessful attempts to log on, the system must record unsuccessful log on attempts.

8.3 Strategic Management of Information Technology related Internal Controls:

- The head of the agency must also use Information Technology in a judicious manner so as to increase efficiency, transparency and accountability and monitoring abilities for various programmes being implemented by the agency. Information Technology must be used as a tool to establish Management Information Systems that allow the agency to address critical areas of functioning in a simple, user-friendly, non-discretionary systematic manner where human intervention and discretion is minimized.

- The head of the agency must with requisite inputs frame an IT plan that takes into account the strategic requirements of the agency, the budget available and the training and capacity development necessary so as to allow for all elements of implementation of Information Technology internal controls including the availability of trained manpower, to mesh together.

- The head of the agency must ensure that the hardware and software used by the agency has sufficient back up procedures and agency in house or helpdesk knowledge in place to prevent the system from breaking down or not functioning in case of change of personnel.

- The head of the agency must ensure that the levels of authorization for financial transactions using the Management Information System (MIS) and all other important details regarding the MIS are well laid out in a manual or document that is revised and updated annually or periodically.

- The System Development Life Cycle (SDLC) must be documented with inputs from all concerned user agencies and units and the phases of the SDLC implementation monitored by senior management regularly so as to avoid time and cost overrun and unnecessary adoption of systems and processes that are not required.

- There must be a provision for an audit trail in the MIS that is created and the internal and external auditors must be allowed to contribute their views/inputs and be kept informed of the phases of the IT implementation.

- The head of the agency must ensure that there are internal controls in place to ensure the integrity of the data that is fed into the system and that the MIS generates reports that are useful for top management by including pertinent and specific details rather than mere printouts of all data available with the particular level of the organization. Moreover, to reiterate, all attempts to use information technology for reporting must be accompanied by discussions and agreement between internal and external stakeholders, establishment of an audit trail and free flow of information and harmonizing with other agencies and within the agency.

- All attempts to establish online reporting systems and web based modules using information technology must be accompanied by a proper strategy, time frame for completion and a System Development Life Cycle document that is accepted by the senior management.

- There should be proper general and application controls in place and management must have access to required manuals and the source code for any application developed.

- Over reliance on one person to maintain or create an Information Technology based online management information system or database must be avoided. The head of the agency must ensure that there are alternate options and trained personnel available so that work or systems do not breakdown in the event of individual error, fraud or withdrawal of technicians and individuals from the IT project or MIS.

9. Internal Audit Related Internal Controls and Best Practices

- The head of the agency should ensure that there is an arrangement for internal audit and that internal audit's independence and prevention of conflict of interest must be safeguarded and protected.

- The internal audit work should encompass all important functional areas and desks and not merely be confined to accounts or financial matters.

- The duties relating to internal audit must be different from those relating to financial advice, receipt, disbursement and accounting functions.

- The head of internal audit or the internal auditor in an agency must consistently report directly to the Secretary or the Head of the agency.

- The internal audit wing or section must be adequately staffed by qualified and trained personnel.

- Internal audit officials must be given adequate training in internal audit work and periodical in-service training to update their knowledge and skills.

- Internal audit officials must possess adequate skills and experience in the functional areas they are supposed to audit. If these are not in place, then teams of auditors should be made responsible for such audits, with a mix of experienced and relatively new auditors.

- Internal auditors must be retained in the internal audit wing as specialists and not transferred out to other wings or given executive charges. This is essential so as to maintain their independence and objectivity.

- The head of office must lead by personal example and deal with internal audit objections and findings thereby establishing the tone at the top. These audit objections must not remain outstanding for long.

- The internal auditors must not be made solely responsible for responding to external audit queries as the primary responsibility for dealing with these lies with management, though they may assist the management in monitoring the action taken on external audit observations.

- The head of the agency must make the best use of his internal auditors and ensure that the frequency of internal audits is adequate.

- The planning of internal audit work, allocation of time and periodicity of audit must be based on risk assessment which is also an integral part of the internal control framework. The head of agency while approving the internal audit plan must satisfy himself that all key risks are identified and categorized and examined with reference to their likelihood and impact.

- The head of the agency should call for reports to ensure that all units or offices planned for internal audit in a specified period were covered and there is no shortfall.

- The head of the agency should institute controls to ensure that adequate follow up action is taken in respect of the findings and recommendations of internal audit.

- The head of the agency should hold quarterly audit committee meetings to ensure follow up on the recommendations of the internal audit.

- The head of the agency should also encourage the internal auditor to include substantive findings as well as recommendations to improve the deficiencies noticed and not merely minor procedural lapses in his report.

- The internal auditors report should contain issues pertaining to internal controls, compliance, fraud awareness and prevention and performance related observations. These are quality observations the head of the agency must look for and encourage and make use of to improve organizational productivity, efficiency and effectiveness.

- Internal audit reports must be issued in the specified written form to the head of the agency and the same must be followed up by him and action called for in writing as well, so as to maintain a record of action taken and accountability fixed.

- The internal audit manual must be updated at periodic intervals so as to continue to be relevant and impactful.

- There should be synergy and coordination between internal audit and constitutional external audit with institutional mechanisms in place to ensure common understanding and sharing of audit techniques and methods and sharing of training where possible.

10. Sources referred to for drafting the framework

1. INTOSAI (International Organization of Supreme Audit Institutions)–Guidelines for Internal Control Standards
2. Internal Controls Evaluation Manual-Office of the Comptroller and Auditor General of India
3. Standards for Internal Control in the Federal Government (1999)-Government Accountability Office
4. Institute of Internal Auditors-Standards for the Professional Practice of Internal Auditing
5. Self-Assessment of Internal Control- Department of Financial Management, Vermont April 2013
6. International Good Practice Guidance: Evaluating and Improving Internal Controls in Organizations-Executive Summary -International Federation of Accountants
7. Internal Control Standards: A Guide for Managers – Department of Finance and Management, Vermont
8. The Constitution of the Kingdom of Bhutan, 2008
9. National Anti Corruption Strategy Framework, 2009
10. Public Finance Act of Bhutan 2007
11. Public Finance Amendment Act 2012
12. Bhutan Civil Service Rules and Regulations 2012
13. Good Governance Plus Document of the Royal Government of Bhutan 2005
14. Royal Audit Authority of Bhutan- AG's Advisory Series 2007
15. Royal Audit Authority of Bhutan- AG's Advisory Series 2011
16. Procurement Rules and Regulations 2009
17. Property Management Manual, Royal Government of Bhutan 2001
18. Websites of the Anti Corruption Commission, The Royal Audit Authority, The Ministry of Finance.