

Strengthening the Internal Audit System in the Royal Government of Bhutan

EXECUTIVE SUMMARY

During the presentation made on the Anti Corruption Strategy to the Hon'ble Cabinet Ministers, where in Auditor General and some secretaries were also present, some raised concerns on the functioning of the Internal Audit System. The Hon'ble Prime Minister then instructed the Auditor General to come up with immediate solutions to the problem. Accordingly, the Auditor General based on discussions held with important and relevant stakeholders including few government secretaries, internal auditors, Policy and Planning Division (AFD) and Administration and Finance Division (AFD) personnel, and limited review of records prepared this Paper identifying problems and recommending measures for enhancing the effectiveness of Internal Audit system.

Findings:

As transpired from discussions held with the stakeholders and reiterated in successive Annual Audit Reports of the Auditor General, Internal Audit System is not effective enough and suffers from many problems. Pertinent problems are as given below:

- Internal Audit is not integrated with the Ministries unlike AFD, PPD, HR functions etc. It is thus not regarded as an integral part of the organization and viewed suspiciously.
- The Chief Executive Officers (CEO) who are responsible for instituting and ensuring effective operations of internal control system within the organization have not been made accountable for effectiveness of internal audit system;
- Internal Audit is a highly professional and specialized function to be able to offer assurance and advisory services on the internal controls, risk management and governance process covering entire arena of organization's activities. However, most internal auditors do not have requisite qualifications and experience. The quality and effectiveness of works rendered thus varied depending on the competence of internal auditors assigned to each ministry;
- The existing strength of internal auditors is not adequate. The allocation is not made on a rational basis based on volume of activities and complexities of operations of the agencies concerned;
- There are no adequate training and HR development initiatives for the internal auditors;
- There is absence of proper guidelines and manuals. There is also no mechanism of providing adequate orientation to new recruits on the job.
- The main roles and responsibilities of internal auditors have not been understood properly. There is thus lack of uniformity and consistency in audit methodologies and procedures as well as services rendered by the internal auditors.
- Strong leadership to ensure effectiveness of internal audit system was also lacking.

Recommendations:

With the view to remedy the deficiencies and strengthen the internal audit system, following recommendations have been made:

- Internal Auditing System should be further decentralized and integrated as integral part of organization like many other functions such as AFD, HR, PPD, etc., so that they will not be viewed suspiciously as the eyes and ears of the Royal Audit Authority (RAA) and Anti-Corruption Commission (ACC). The CEOs and the management must have full trust and confidence on the internal auditors;
- CEOs are responsible to instate and ensure effective operations of internal controls. Internal Auditing being an important element of Internal Control System, CEOs should be made responsible to ensure effectiveness of the internal audit system;
- Internal Auditors must possess requisite qualification, experience and competence to be able to render assurance and advisory services to the executives;
- The Ministry of Finance while responsible for carrying out coordination and administrative functions as required by the Public Finance Act 2007, should delegate some of its responsibilities such as professional development, professional education, audit methodologies development, monitoring quality assurance, upholding professional and ethical code of conducts, etc., to the Accounting and Auditing Standards Board of Bhutan (AASBB). The AASBB which is recently established by the Royal Government and directly reports to the Ministry of Finance, will be better placed to discharge such services through its technical committees and the Bhutan Institute of Chartered Accountants of Bhutan proposed to be established soon;
- The RAA may initially help the Ministry of Finance by providing orientation to the new auditors and assigning its experienced staff on deputation to the ministries and organizations. Such supports will be gradually phased out except the in-house training programmes conducted by the RAA which will be continued to be extended;
- Greater awareness should be created amongst stakeholders on the Internal Audit Charter, the roles, responsibilities and importance of internal auditors in strengthening internal controls, reducing risks and improving the overall government process;
- Allocation of Internal Auditors should be based on the size of ministries and organizations, volume and complexities of activities and their geographical spread; and
- The possibility of establishing a separate internal audit cadre may be looked into for facilitating professional education, career advancement and specialization to enhance the effectiveness of internal audit system.

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1. Background, Purpose and Scope of this Paper

1.1. Background

Recognizing the importance of internal audit function in providing timely and continuous assurance and advisory functions, the Royal Government established the internal audit system in the Ministries in late nineties. The responsibility for the establishment of IA system was initially shouldered by the Royal Civil Service Commission. With the enactment of the Public Finance Act 2007, the responsibility of administering internal audit service and issuing internal audit guidelines was vested on the Ministry of Finance. In 2007, the Ministry of Finance issued an Internal Audit Charter delineating, amongst other matters, the mission, scope, functions, internal audit standards, independence and ethical issues, governance, reporting requirements and quality assurance review of internal audit as well as the roles and responsibilities of the Ministry of Finance.

Effective operations of internal control system in an organisation ensure systematic and orderly conduct of activities and operations, maintenance of accurate and reliable accounting and other records, compliance with laws, rules and regulations, detection and prevention of fraud and errors, safeguarding of assets, reduction of risks, improvement of governance process and attainment of organizational objectives. Internal Audit System is an important element of internal control system. Internal Audit System, as an integral part of the management, through its timely and continuous intervention and presence provides requisite assurance and advisory services to the management in all spheres of an organisation. Besides ensuring continuous polishing of internal controls, internal audit also facilitates timely detection and correction of errors and frauds, operational inefficiencies, non-compliances and other short comings in an organisation. The management is responsible for instituting internal controls and ensuring effective functioning of internal audit system.

In the course of audit, the RAA had observed irregularities of serious nature involving fraud and corruption, shortages of funds, non-compliances of laws, rules and regulations, accounting errors, uneconomical operations and other deficiencies and lapses which had occurred mainly due to inadequacies in the internal control system. In view of the irregularities observed, the Auditor General had time and again in his individual audit reports and successive Annual Audit Reports i.e., AAR 2005, AAR 2006 and AAR 2007 reiterated the need to strengthen the internal control system in particular the Internal Audit System.

During the presentation made by the ACC on the anti-corruption strategies to the Hon'ble Cabinet Ministers and Committee of Secretaries, where in the Auditor General was also present, concerns were raised by government secretaries on the internal control problems in particular the functioning of the internal audit system. The Hon'ble Prime Minister had

than asked the Auditor General to come up with immediate solutions to the problem concerning the Internal Audit System.

As required by the Royal Government, the Auditor General conducted series of discussion and interviews with important stakeholders including the Ministry of Finance, RCSC, Chief ADM and Finance Officers, senior bureaucrats as well as the Internal Auditors to obtain important feedbacks and correct perspective on the function of the internal audit so as to submit a short paper to the government recommending measures to strengthen the Internal Audit System.

1.2. Purpose and Scope of this document

This paper is aimed at identifying the problems confronting the effective functioning of the Internal Audit System and recommend measures for improvement. While recommending measures for the improvement, attempts have been made to align the recommendations with the requirements of the Public Finance Act 2007 and the Internal Audit Charter.

This paper has been prepared on the basis of our limited review of documents available and discussions made with some of the important stakeholders and not based on a comprehensive study on the actual functioning of internal audit system in Bhutan. Our study was confined to roles and responsibilities of internal auditors, problems confronting the IAS, general perception of the stakeholders on the usefulness of IAS and appropriateness of existing corporate governance structure of the IAS and how the IAS system may be strengthened and made effective.

This Paper therefore identifies the objectives and functions of the Internal Audit, effectiveness and problems surrounding the Internal Audit System in Bhutan and possible measures to improve the functioning of the Internal Audit System.

2. Objectives and Functions of Internal Audit

Internal Audit is an integral part of an organization providing assurance and advisory services to the management on a continuous basis. It is an effective management tool and helps management achieve organizational objectives through a systematic and organized process of evaluating and improving the effectiveness of internal controls, risk management and governance system.

The main functions of internal audit are to provide assurance and advisory services concerning:

- Effectiveness of operations of internal controls;
- Effectiveness of the risk management system;
- Compliance with laws, rules and regulations;

- Adequacy of accounting and record keeping;
- Economy, efficiency and effectiveness of activities and operations;
- Accountability and transparency in the decision making process; and
- Special reviews and investigations.

3. Effectiveness of Internal Audit System in the RGoB

Effectiveness of Internal Auditing in an organisation depends on many factors. These include professional competence, qualification and experience of internal auditors, attitude of the Heads of Ministries and Agencies towards internal auditing, legal frame work and government policy directives, corporate governance of internal audit system, leadership, guidance etc.

Existence of a strong and credible internal audit system would provide adequate assurance on the effective operations of internal controls, risk management system and governance process. It also contributes towards economy, efficiency and effectiveness of operations and attainment of organizational goals. Depending on the quality and effectiveness of internal audit, the external auditor such as the RAA can place reliance on the work performed by the internal auditors and reduce the extent of transaction audit. The RAA may than direct its efforts to other important areas such as reviewing the economy, efficiency and effectiveness in the use of resources and the delivery of services. This will minimize unnecessary overlapping and duplication in the works of internal auditors and the RAA.

As mentioned above a comprehensive study on the effectiveness of internal audit system in Bhutan has not been carried out by the RAA. However, as indicated earlier, the RAA had observed irregularities of serious nature involving fraud and corruption cases, violation of laws, rules & regulations, irregular and over payments, uneconomical operations, errors and shortcomings in record keeping etc many of which were found to have occurred repeatedly. The irregularities had occurred mainly due to inadequacies in internal controls. Due to short comings and very limited assurance from the internal controls, the RAA has been directing its considerable time and resources in conducting the transaction audits.

The limited review and feed backs received from various stakeholders including internal auditors indicate that considerable progress and improvements have been made since the start of the internal audit system and internal controls have improved to some extent. Many, however, raised concerns on the effective functioning of the internal audit system. Some even expressed reservations on the need for the Internal Audit System and regarded the IAS as wasteful. There are many shortcomings impeding the effective functioning of the internal audit system.

The deliberations and discussions nonetheless finally concluded that the internal audit system is important and it will make positive contribution in the effective functioning of an

organisation provided that steps are taken to address the problems surrounding the IAS in Bhutan.

The main problems confronting the internal audit system are as follows:

3.1. Legal mandate, policy directives and administrative arrangements

While the Internal Audit Charter issued by the government addresses many of the concerns including those pertaining to legal mandate, roles and responsibilities of internal auditors, overall coordination and administration etc., there are still some concerns and impediments on the affective functioning of Internal Audit System. These include decentralisation and administrative structure of internal audit system, responsibility and accountability of ministries and agencies to ensure effectiveness of IAS as discussed below:

3.1.1. Lack of policy directives

Prior to issuance of the Internal Audit Charter in 2007-08 there were no authoritative documents outlining the responsibilities and functioning of the IAS. Thus the IAS system operated for a considerable period of time without much clarity on many issues affecting their functioning. The Internal Audit Charter issued by the government addresses many of the issues and brings in much needed clarity in the roles and responsibilities of Internal Auditors besides reporting, administrative, staffing and other issues. There are still certain areas including the roles and responsibility as well as accountability of the Heads of Ministries and agencies in ensuring the effective functioning of internal controls in particular the IAS, which have not been covered in the Charter. There has not been any clear policy directives of the government on the importance of internal controls and internal audit and responsibility of heads of agencies to establish effective internal control system including the internal audit system. These are necessary to give added impetus to the importance and credibility of IA system.

3.1.2. Non-integration of Internal Audit system within the organisation

Feedbacks received during the meetings with the stakeholders strongly suggested that lack of requisite trust and faith on the internal audit system is largely attributable to failure of integrating the IAS within the organisation like finance and HR functions. To be more effective and recognized as a part of the organisation and its control system, integration within the organisation seems inevitable.

3.1.3. Perception

The Internal audit as an effective management tool has not been understood clearly. There is a wrong perception that internal audit is an extension of RAA's functions and created to help RAA and ACC and not an integral part of the management. Perhaps due to the existing centralized governance structure, administrative arrangement and lack of proper understanding of their roles and responsibilities amongst the stakeholders, the internal

audit is not considered as an integral part of the management. So much so that many even consider the internal auditors as the eyes and ears of the Royal Audit Authority and the Anti Corruption Commission. It is quite clear that the objectives of IA function are not clearly explained and understood by many

3.1.4. Lack of strong leadership

For an effective internal audit system, strong leadership is inevitable. Lack of strong leadership in the past had impacted the effectiveness of internal audit system. The leadership should, beside coordination functions, establish forums for sharing experiences and best practices, discussing issues of significance concerning work of internal auditors and raising issues and concerns. Leadership should provide overall direction in rendering the internal audit system useful and effective.

3.1.5. Inadequacy of staff and irrational allocation

The existing strength of internal auditors is not adequate enough to carry out their functions comprehensively and effectively. Ministries having huge budgetary allocations and large volume of activities of complex nature will warrant a good number of auditors to be able to carry out meaningful and effective audit. Moreover, the allocation of internal audit strength is not made on a rational basis having regard to the volume of activities of the Ministries.

3.1.6. Inadequate IA coverage (only ministries)

Internal auditors are assigned to the Ministries only. Other agencies including Dzongkhags do not have internal auditors although the volume of activities and budgets of some of the Dzongkhags are more than some of the ministries. The lack of internal audit system in Dzongkhags and other agencies would inevitably impede effective functioning of internal controls.

3.1.7. Absence of system of managing ethical and conflict of interest issues

Given the nature of responsibilities of internal auditors it is imperative that they observe highest standards of ethical and professional code of conduct. Lack of an effective and credible system of reviewing and monitoring compliance of ethical standards may undermine the credibility of the IA function. Thus there is a need for instituting appropriate monitoring mechanism to ensure that the internal auditors uphold the professional and ethical standards and avoid conflict of interest situations.

3.1.8. Prolonged retention of IAs in one agency

Some strongly argued that internal auditors have been retained for too long in the same ministry and that it may result in conflict of interest situations. Long association may result

in development of close relationship that may impair the independence and objectivity of internal audit system.

Whereas some felt that internal audit is a highly professional field and given the peculiarities in the operations, system and functioning of each agency as well as different mandates, internal auditors must have requisite expertise and develop specialized organisation specific skill. Internal auditors must have adequate knowledge and experience about the system and functioning of the organization so that they can offer better assurance and advisory services. Frequent transfer of internal auditors will make it difficult for them to achieve specialization. Thus existing system of transfer of internal auditors ring the careful

The existing system of transferring of internal auditors needs to be rationalized for ensuring that internal auditors acquire requisite level of organisation specific knowledge and expertise.

3.1.9. Lack of incentives and motivation

The nature of internal audit function demands high level of professionalism and integrity. The work entails review of systems, procedures, works performed by others and detection of fraud, errors, lapses, irregularities, shortcomings etc. Thus to make the internal audit attractive and motivate the internal auditors, some form of incentives seem appropriate and necessary. There are, however, no incentives provided to the internal auditors. Lack of incentives and motivation has been one of the main reasons the internal audit function remaining un-attractive.

3.2. Qualification, competence, training and HRD initiatives

Internal auditing is a complex and specialized job. It demands adequately qualified and experienced auditors and continuous professional development initiatives. This is not the case in our IAS set-up and has remained a major concern for the internal audit system to create the desired impact. The pertinent issues are:

3.2.1. Lack of requisite qualification and experience

Internal auditors have been drawn from different agencies with different educational background and experiences. Most of them did not have auditing experience. While some have acquired considerable experience by now, lack of prior experience in internal and external auditing had been a major constraint confronting the effective functioning of IA system.

3.2.2. Lack of orientation

Internal auditors are inducted in the job directly without adequate orientation. Without prior experience and background on internal audit and even in the government financial management system in some cases particularly when internal audit processes and

procedures are not clearly defined and there are no experienced mentors available to guide the new recruits, it will be extremely difficult for the new recruits to learn and carry out their responsibilities competently. This would adversely impact the effectiveness of the IAS. Feedback received during discussion with some of the stakeholders indicated lack of orientation as being one of the main problems.

3.2.3. Inadequate HR policy and continuous professional development initiatives

For an effective IA system it is imperative that there are clearly defined HR policy and continuous professional development strategies. However, at present it appeared that there is no clearly worked out HR Policy and professional development plans for the internal auditors. Proper HR policy and professional development plan having regard to both short term requirement and long term focus is necessary for the internal audit system to deliver the services competently and effectively.

3.3. Audit Methodologies and Approaches

In absence of auditing standards and guidelines the internal audit methodologies and approaches currently being followed are not uniform and consistent and comparable to generally accepted professional practices. Moreover, internal auditors are also engaged for many other functions not compatible with their responsibilities. The shortcomings identified are:

3.3.1. Lack of Standards, Guidelines and Manuals

Internal auditing standards, guidelines and Manuals are necessary for the performance of high quality audit. Lack of adequate standards, guidelines and manuals will adversely impact the quality of internal audit works and impede effective functioning of internal audit. In the absence of requisite standards, guidelines and manuals, a systematic and disciplined approach to the internal audit work will be lacking. Moreover, there will be no benchmarks or standards against which the quality of work performed may be gauged.

3.3.2. Lack of effective planning and absence of strategic focus

Planning of an internal audit needs both short term considerations and long term strategic focus. However, proper planning and long term strategic focus is affected due to inadequate staff strength as well as requisite qualifications, experience, standards, guidelines and manuals. Proper planning is necessary in minimizing unnecessary works and directing resources in important and high risk areas.

Internal auditors should focus more on the review of effectiveness of internal controls, risk assessment, governance process and recommending measures for minimizing business and operational risks and thus helping organizations achieve their operational targets and organizational goals besides reviewing compliances of laws, rules & regulations, systems and procedures.

3.3.3. Overlapping and duplication of efforts

While some degree of overlapping and duplications in the work of RAA and internal auditors may be inevitable, there may be considerable overlapping and duplication of efforts. Many believe that the internal auditors function exactly the way RAA functions by dovetailing the procedures followed by the RAA's auditors. This may be avoided through appropriate co-operation and consultation between the internal auditors and RAA Audit Team. The internal audit normally precedes the external audit and as such the RAA may take note of the works performed by the internal auditors depending on the quality and credibility of internal audit works.

3.3.4. Absence of clearly defined IA reporting process

Existing IA reporting practice suffers from lack of standard approach to reporting as well as accountability for taking actions on IA reports and recommendations. While some follow the RAA's practice of issuing Audit Memos and obtaining written response, others do not follow a system of issuing Audit Memos. While documenting important audit findings, recommendations and actions on them may be desirable, internal audit focus on remedying, correcting and streamlining systems and procedures would be more appreciated by the executives instead of too much paper works. Thus acceptability and effectiveness of internal audit system seemed to have also varied with the approach adopted by Chief Internal Auditors in different ministries. Standard approach to IA reporting covering the following aspects was lacking:

- Issuing initial audit findings
- Obtaining response
- Reporting
- Follow-up
- Accountability for implementing recommendations/taking actions

3.3.5. Internal auditors engaged for other purposes

It transpired that internal auditors are also used for purposes other than the purpose as defined in the Internal Audit Charter. These include attending various Committees including the Tender Committee, writing response to Audit Memos issued by the RAA on behalf of the management etc. Their involvement in the activities that are executive in nature may not only undermine their objectivity and independence but there is risk of losing focus on their main role as internal auditors. Apparently, there is lack of proper understanding on the roles and responsibilities of the internal auditors.

3.4. Quality assurance and monitoring mechanism

Quality assurance review and monitoring procedures are must in ensuring that internal audits are conducted in accordance with generally accepted auditing standards and high quality works are performed. There is, however, no proper quality assurance and

monitoring mechanism in place thereby impeding effectiveness of Internal audit system as indicated below:

3.4.1. Absence of Quality Assurance framework

Internal Audit system currently lacks adequate quality assurance review. Lack of both internal and external quality assurance frame work will have serious ramifications on the quality of work performed by the internal auditors. Although the Internal Audit charter specifies the requirement, the actual implementation will largely depend on the qualification, experience and competence of Head of Internal Audit. Considering the existing scenario and in absence of adequate orientation and training in this regard, it is highly improbable that a satisfactory level of quality assurance procedures in the internal audits will be implemented.

3.4.2. Non- monitoring IA functions

Currently there is no system of monitoring and evaluating the effectiveness of IA functions. Proper mechanism to review the work performed by the internal auditors either within the internal audit system or otherwise may bring in needed improvement in the methodologies and quality of work. Post review by peers would also be useful. Absence of a credible system of monitoring may result in repeated use of inappropriate auditing methodologies and procedures, non-adoption of best practices and ineffective internal audit.

3.4.3. Absence of system of managing non-performances

Internal auditors enjoy requisite functional independence with very little or no interference from the CEOs. Currently there is no system of identifying and managing non-performances. Absence of system of appropriate mechanism of identifying and addressing non-performances may lead to complacency and ineffective internal control system.

4. Recommendations of the Auditor General

The existence of a strong and effective internal control system including the Internal Audit system is a must for proper and effective conduct of an entity's activities. Internal Audit provides assurance and advisory services to the management in strengthening and streamlining internal controls, operations, systems and processes. Strong and continuous presence of Internal Auditors facilitate timely detection and prevention of errors, fraud, omissions, flaws, shortcomings and inefficiencies besides acting as deterrent against occurrences of lapses and irregularities including fraud.

Internal Auditors to be an effective management tool should support CEOs in strengthening the internal controls, system of check and balance and accomplishing organizational mandate lawfully and effectively. Instead of creating problems it must play positive role in improving the functioning of the organizations. Internal auditors should aspire trust and confidence of executives and others in the organization through their professionalism, objectivity, constructive approach and positive problem solving attitude.

The Royal Audit Authority intends to place reliance on the work of internal auditors and reduce the extent of transaction audit performed by it, provided that internal auditors conduct high quality audits. The RAA needs a very high level of assurance from the internal audit system and will work towards strengthening the internal audit.

The RAA's audit reports including various Annual Audit Reports issued in the recent past and limited study conducted on the functioning of the Internal Audit system reveal that internal audit system needs to be strengthened to render it effective and credible. Internal control weaknesses and need for strengthening the internal audit system had been time and again reiterated by the RAA.

With a view to address the shortcomings as pointed out above and strengthen the Internal Audit system, the Royal Audit Authority recommends as follows:

4.1. Policy directives and administrative structure

The existing administrative arrangements need to be appropriately changed to make the IAS system dynamic and more responsive to changing circumstances. Following recommendations are made in this regard:

4.1.1. Policy directives

The government may issue appropriate policy directives on the internal audit reiterating the importance, objectives and functions of IAS as well as redefining suitable governance structure of the Internal Audit system to make it effective and responsive. It should also clearly spell out that internal audit is an internal management tool and effective use of

internal audit system also depends on the attitude and efforts of the Secretaries and Head of Agencies.

4.1.2. Decentralized Structure

In principle a decentralized internal audit system may be appropriate to render the internal audit more acceptable and an effective management tool. Strong external influence or control on internal auditors (recruitment, transfers, promotions etc) might adversely influence the effectiveness of IA functions. On the other hand, a decentralized structure would create environment conducive to the effective functioning of IA system. The IA system will be recognized as part of management structure and internal auditors would be part of their human resource strength. As such as far as possible internal audit system should be decentralized and considered as an integral part of the ministries and agencies with only limited responsibility resting with the Co-coordinating agency i.e., the Ministry of Finance.

4.1.3. Full integration of IAS within the organisation

Unlike Human Resources, PPD, Cultural Officers in Dzongkhags, Internal Audit has not been integrated within the organisation. It is quite clear that HR and PPD functions have gained credence and acceptability upon their complete integration within the organisation. Similarly full integration of IAS within the organisation will enhance their acceptability as part of the system. Once they are fully integrated, they will no longer be viewed suspiciously as working for other agencies like RAA and the ACC.

The concept of internal audit should be understood as an internal control mechanism and effective management tool and must not be compared with external oversight mechanism like the RAA. The internal auditors should not dovetail in their audit procedures what the RAA's auditors exactly perform. This would create duplications, confusion and mistrusts. While performance of similar procedures may be inevitable in some cases, the approach and objectives of internal audit functions should be distinctly recognizable as an internal and integral part of the organisation.

4.1.4. Heads of Ministries and Agencies should be responsible for effectiveness of IAS

Internal Audit system is an important element of internal control system in the organisation and the Heads of Ministries and agencies are responsible for instituting an effective system of internal controls in the organisation. The CEOs should therefore ensure that internal audit system is functioning effectively. While they should not dictate the way the internal auditors should function, they should be instrumental in creating environment conducive to affective functioning of internal audit system.

4.1.5. Administering IAS and issuing Guidelines

Notwithstanding the policy of a decentralized structure, the overall administration and co-ordination of IA function may still rest with the Ministry of Finance. The Ministry of Finance as required under the Public Finance Act 2007 may continue to oversee the internal audit functions as regards administering the internal audit service and issuing guidelines. An Internal Audit Division in the Ministry of Finance may be entrusted with the responsibilities of administering and carrying out other related services. The Internal Audit Division should be responsible for coordinating recruitment and transfers of Internal Auditors besides HR and professional development policies and external quality assurance review arrangements.

The impact assessment of Internal Audit system may be carried out as and when required by the Government either through expertise available within the country or through some form of professional collaboration.

The Ministry of Finance should, however, delegate some of the responsibilities pertaining to issuance of guidelines, professional development, quality assurance review, monitoring of professional and ethical code of conduct to the Accounting and Auditing Standards Board of Bhutan (AASBB) established by the Government as discussed in detail in recommendation 4.3.1.

The services provided by the Division including those to be delegated to the AASBB may be as follows:

- Formulation of policy directives for internal audit system for government approval;
- HR capacity assessment of IA System;
- Professional development initiatives;
- QA review;
- Professional and ethical matters;
- Co-ordination of Transfers & promotions of IAs;
- Development of IA system and profession in the country;
- Overall review of the effectiveness of IA System; and
- Disciplinary matters.

4.2. Roles and responsibilities, audit methodologies and approaches

The roles and responsibilities of internal auditors varied across the ministries in the past. The Internal Audit Charter stipulates the roles and responsibilities of internal auditors. However, in absence of detailed guidelines and manuals and main thrust of internal audit system clearly stipulated, there may still be varying roles performed by the internal auditors. Besides audit methodologies and approaches also lack uniformity. For addressing the problems, the RAA recommends as follows:

4.2.1. Clear understanding should be developed on the main roles and responsibilities of Internal Auditors

The main roles and responsibilities of internal audit are to provide assurance and advisory services concerning the following:

- Effectiveness of operations of internal controls;
- Effectiveness of the risk management system;
- Governance process;
- Compliance with laws, rules and regulations;
- Adequacy of accounting and record keeping;
- Economy, efficiency and effectiveness of activities and operations;
- Accountability and transparency in the decision making process; and
- Carrying out special reviews and investigations

In the course of RAA's consultation meetings with various stakeholders, some strongly felt that internal auditors should mainly endorse transactions and vouchers before they are passed for payment. Such a role of **pre-audit** by the internal auditors may minimize the errors and fraud and thus save many civil servants from administrative and legal actions arising from their negligence, failure or indulgence in malpractices. However, endorsement of transactions being executive in nature may impair the independence and objectivity of internal auditors. Moreover, these are more of operational responsibilities required to be carried out within the administration and finance division at various levels. As such it is advisable that instead of internal auditors endorsing transactions and vouchers, the system of check and balances and process of verification and approval of transactions and claims is strengthened. Nonetheless, internal auditors may observe transactions and process, provide feed backs and recommendations and offer advisory services without being party to the transactions and decision making process in the organisation.

4.2.2. Strategic and operational planning

The Internal Charter issued by the government provides for the requirement for proper strategies and planning. For making the internal audit system affective, it is imperative that internal auditors plan their work with both long term and short term focus and priorities. They should prepare long term strategic plans having regard to the organizational goals and objectives, risk management and internal control system, geographical spread of organization's operations and matters affecting quality and effectiveness of delivery of services. It must consider the relevance, scope and importance of assurance and advisory functions and accordingly prioritize them appropriately. The need of internal audit coverage of the entire operations across the geographical spread of the organization, and the frequency and timing of internal audit intervention should be guided by their relative significance and importance.

While the short run focus may be to improve the effective functioning of controls, risk management system and compliance with laws, rules & regulations as well as detection of errors and frauds, in the long run it should focus on improving operational efficiency, delivery of services and governance process.

Internal auditors while independently preparing their plans should nevertheless consult and get endorsement of their plans at appropriate levels i.e. Secretary or Head of the Agency as may be the case. This will facilitate greater cooperation and enhance the acceptability of the plans and audit findings and recommendations.

4.2.3. Internal Audit Reporting

As an integral part of the organisation and strong element of internal control system, the IA findings and recommendations must be primarily for internal consumption. Since internal auditing is required to continuously police and improve the effective operations of internal controls and risk management system of the organisation, the audit focus should be prevention, corrections and improvement through its continuous presence. Unlike the external audit reports of the RAA, being an independent constitutional body whose primary stakeholders are King, Prime Minister and the Parliament, Bhutanese citizenry at large besides the individual audited agencies and accordingly issued for external consumption; internal audit being an important management tool, it is only appropriate that its output are generated to assist management in conducting the affairs of the organisation in a proper and effective manner. To render the IAS effective, it should be ensured that internal audit findings and recommendations get requisite attention of the management. It is therefore recommended that:

- Internal Auditors should report to the Head of the Ministry and Organizations;
- Head of Ministries and Organizations should ensure that IA reports are reviewed and acted upon;
- CEO of the organisation should establish appropriate forum or Committee to discuss the IA reports and come up with action plans for implementing recommendations. CEO should chair such meetings;
- Head of the Internal Audit should carry out proper follow-up on the implementation of the reports;
- CEO should ensure that findings of serious nature such as fraud and corruption cases are dealt with as per laws of the land;
- Internal audit findings should be adequately discussed with relevant officials and Heads of divisions and Units prior to finalization of the report; and
- Internal Auditors may allow immediate corrections of minor irregularities and errors without having to include in their IA reports, they may maintain log of such issues and correction for future review and reference.

It may not be necessary to endorse copy of IA reports to the RAA. However, as a part of the review of operations of internal controls, the RAA will be required to review the internal

audit reports. As such the RAA will have privy to the Internal Audit Reports as mandated by the Audit Act of Bhutan 2006. The RAA will review the internal audit reports with a view to place reliance on the works of internal auditors and accordingly limit the scope of its own audit procedures.

4.3. Human Resource Development, Orientation, training and quality assurance

Internal Auditing being highly specialized work, it is necessary that internal auditors are appropriately qualified and experienced. Moreover, existence of clear HR policy and continuous professional development programmes must be in place to update the internal auditors of the latest methodologies and enhance the technical competence of the auditors. The RAA makes the following recommendations in this regard:

4.3.1. Professional development and Quality assurance

The Royal Government is in the process of establishing a professional accountancy body within the country. The Accounting and Auditing Standards Board of Bhutan (AASBB) recently established by the Government has been currently working on the development of accountancy profession in Bhutan which includes establishment of Institute of Chartered Accountants of Bhutan and starting of CA course in Bhutan besides its immediate mandate of issuing Bhutanese Accounting Standards. The Institute once becomes operational will take over the responsibility of professional education programme for accountants and auditors. Like other countries, the institute will also regulate accountancy profession; issue guidelines for accountants and auditors, pursue disciplinary matters and prescribe continuous professional development requirements for accountants and auditors.

The Ministry of Finance may delegate part of the internal audit functions managed by the Internal Audit Division particularly the professional development programmes, Development of IA Standards, Guidelines, Manuals and conducting quality assurance reviews to the AASBB.

Until the period that establishment of a full-fledged Institute of Internal Auditors or like body is necessitated, which is very unlikely given the size and requirement of such services in our context, the AASBB through its Internal Audit Committee (TWC) and the Institute of Chartered Accountants of Bhutan shall provide required education and render other services concerning internal audit covering inter-alia:

- Prescribing and running other suitable qualification/courses for internal auditors;
- Running certificate course in accounts, audit, IT application, Information System Audit;
- Issuing internal audit guidelines and Manuals;
- Conducting quality assurance review;
- Issuing Practicing Certificates;

- Pursuing disciplinary matters;
- Developing and issuing professional and ethical code of conducts;
- Organizing Seminars and workshops for internal auditors; and
- Providing on line advisory services to internal auditors.

The AASBB shall have one **Internal Audit Committee** exclusively responsible for the above functions. While Internal Audit Committee shall provide regulatory services, the Institute shall be involved in educational and professional development programmes.

It is also necessary that minimum annual training requirement for each auditor is specified in terms of Continuous Professional Development Programme (CPDP) Units or hours for skill development and keeping abreast of new developments and professional pronouncements. Annual CPDP hours of between 40 to 60 hours may be set for internal auditors as compulsory requirement. There is variety of ways to gain the minimum CPDP hours. The Internal Audit committee may work out the detail requirement and ways and means to achieve the CPDP hours.

4.3.2. Human Resource Policy

The Ministries and agencies should develop their own HR policies concerning recruitment, training and promotion of Internal Auditors in consultation and coordination with the Ministry of Finance. Power to promote up to P1 level may be delegated to the ministries, higher and executive positions may be filled in through competitive procedures as per the Civil Service policies. Like others, Internal Auditors at P1 level may also compete for executive and other higher positions.

4.3.3. Internal Audit Cadre

Internal auditing is a highly professional and specialized job. It is imperative that the internal auditors are professionals and specialists capable of objectively analyzing, evaluation the transactions, processes and activities and offering advisory services.

The Royal Civil Service Commission and the government may look into the possibility of establishing a separate Internal Audit Cadre under the Finance Services. This would render the IA function more attractive and facilitate recruitment and appropriate training arrangements as well as develop professionalism and specialization. Specialist positions may also be created to encourage retention of internal auditors. There should be clearly defined career path for the internal auditors. Considering the nature of their role, the government also consider providing some financial incentives to the internal auditors.

4.3.4. Staff Strength

Strength of internal audit Units should be based on the size and volume of activities of the agencies. Ministries and Dzongkahgs with large budget outlays and activities may have up

to 3 auditors while others could have up to 2 auditors. Smaller organizations having relatively lesser activities may be staffed with only 1 internal auditor.

Some smaller agencies may not even warrant establishment of an internal audit units if scale of their operations do not justify it. In such cases out sourcing of internal audit services on a periodic basis may be a cost effective option. It is expected that such services would be rendered by practicing accountancy firms. Alternatively, such smaller agencies could constitute internal audit team teams on an ad-hoc basis by pooling right mix of staff.

Agencies like the Royal University of Bhutan may establish its internal audit unit comprising two or more auditors covering the operations of the University as well as colleges and institutions under it.

4.3.5. Recruitment and Transfer of internal auditors

As the professional accountancy education and other related courses will be made available within the country, it is expected that there will be no longer shortage of accountants and auditors in the long run. Instead of availability of only fresh candidates, the agencies will have choices in recruitment due to availability of experienced accountants and auditors in the market.

The Ministries and agencies may be allowed to recruit the internal auditors from the market in consultation and co-ordination with the Ministry of Finance. Alternatively Ministry of Finance may recruit the internal auditors in consultation with the ministries or agencies.

Once the internal audit is fully integrated within the organizations, the transfer of internal auditors may not be necessary. As internal audit demands professionalism and organisation specific knowledge and experience, frequent transfer of internal auditors would hinder development of specialized skill. As such transfer of internal auditors should not be encouraged. In cases where transfer is warranted, the Ministry of Finance in consultation with the ministries and agencies concerned may transfer the internal auditors. It shall maintain a roster of internal auditors with full particulars including number of years served in a particular ministry and agency as well as in the ministry/agency currently being served to facilitate transfer of internal auditors.

4.3.6. External Quality Assurance Review

External quality assurance review is necessary for an objective assessment of quality and effectiveness of internal audit. It will promote best professional practices. The following possible arrangements for external quality assurance review may be appropriate:

- As a part of its own normal audit procedure, the RAA will evaluate the quality of works performed by the internal auditors to decide on the degree of reliance it may place on their works and reduce the extent of its own audit procedures;

- Besides, if required, the RAA will also periodically conduct a macro assessment of overall effectiveness of internal audit system and submit report to the government; and
- The government may also commission a separate quality assurance review of internal audit system in the organizations.

4.3.7. Co-operation and assistance by the Royal Audit Authority

If required, the RAA shall provide necessary support for strengthening the Internal Audit System and help the Ministry of Finance in the following way:

- The RAA shall provide on the job training to new recruits for IA functions for one to two years. During the OJT period, the Internal Auditors will be assigned mostly to practical works from planning, execution and reporting, specific class room trainings shall also be organized for them covering advanced aspects of their responsibilities;
- In turn, RAA may assign some of its experienced auditors to augment internal audit functions on deputation for the duration up to two years;

Terms of deputation may be finalized and should have some additional incentives. This would also help inject advanced aspects of auditing particularly risk based audit and reviewing enterprise's risk assessment process, audit of IT system etc.

- Internal auditors may continue to avail in-house and in-country training programmes conducted by the RAA; and
- The RAA will review as a part of its internal control assessment, the quality of works of Internal Auditors with a view to decide on the extent of reliance that can be placed on their work and reduce the scope and extent of its own examination of the transactions and operations of the organisation.

The RAA may also review the effectiveness of internal audit functions in the government on an overall basis and submit a report to the government as it may consider necessary.

The Royal Audit Authority shall gradually phase out some of its supports particularly assigning its auditors on deputation as soon as the supply of accounts and finance professionals are available in the market within the country and the AASBB and the Institute of Chartered Accountants are able to ensure the provision of the above services.

4 Conclusion

Internal audit must be seen as an integral part of the ministries and Organizations and not a parallel system or extension of external audit. Internal audit through continual presence and timely intervention are better placed to arrest and eradicate errors, lapses and deficiencies in all sphere of the organisation and bring in all round improvement. The government should create conducive and enabling environment in that the ministries and agencies will have full trust and confidence on the internal auditors. The success and

effectiveness of internal audit system would largely depend on high level of professionalism, appropriately decentralized governance structure and accountability frame work. While as provided in the Public Finance Act, the Ministry of Finance may be involved in overall co-ordination of IA function, all other functions should preferably be decentralized.

Appendix I - List of organizations and people contacted

Sl. No.	Discussions held with	Organisation	Designations	Dates of Meeting
1.	Lyonpo Thinley Gyamtsho	RCSC	Hon'ble Chairperson, RCSC	27.09.2010
2.	Bachu Phup Dorji	RCSC	Commissioner, RCSC	27.09.2010
3.	Tende Lektsho	Ministry of Education	Chief Internal Audit Officer	
4.	Karma Choeda	Ministry of Foreign Affairs	Chief Finance Officer	
5.	Sabitman Rai	Ministry of Health		
6.	Sonam Dorji	MoWHS		
7.	Sonam Wangdi	MoF	Chief ADM Officer	11.10.2010
8.	Sonam Wangdi	MoEA	Chief ADM Officer	11.10.2010
9.	Aum Dechhen	MoH		11.10.2010
10.	Ghising	MoA		11.10.2010
11.	Rinchhen Dorji	MoA		11.10.2010
12.	Dasho Sonam Tshering	MoEA	Secretary	18.10.2010

Appendix II- Feedbacks/Comments received from Stakeholders

Sl. No.	Feedback
1.	Internal Auditors can save civil servants against administrative actions and from being prosecuted in the Court of Law due to committing errors and irregularities by preventing, timely detection and corrections
2.	Do not enjoy trust and confidence of the CEOs and seen as eyes and ears of RAA and ACC
3.	Absence of strong leadership and clear directives
4.	No guidelines and manuals
5.	Inducted without adequate orientation
6.	Need separate Cadre for Internal Audit
7.	Internal Audit Profession not attractive
8.	Functioning exactly the way RAA functions
9.	Must be part of the organizations
10.	Should carry out pre-audit and endorse transactions before approval for payments
11.	Should be experts on financial matters and be able to offer advisory services
12.	Inadequate support and guidance by the MoF
13.	Used differently in different organisations, no uniformity in internal audit work
14.	Inadequate actions on their reports and recommendations
15.	No meetings organized by the MoF
16.	IA Charter not properly briefed amongst stakeholders
17.	Training support provided only by RAA and ACC
18.	Inadequate strength, inadequate coverage
19.	No problem with following up of RAA's reports
20.	IA findings not appreciated and possible impact on performance ratings
21.	Staff allocation not based on size and volume of activities
22.	Internal auditors in each Dzongkhag may not be appropriate
23.	IA with 2 to 3 members in large Dzongkhags to be appointed on a pilot basis
24.	Against 53 required strength, only 23 approved, many not yet filled
25.	Should be at least graduate
26.	IAS may also review committee's functions
27.	Overlapping of works of RAA and IAS
28.	IAS presence would act as deterrent against fraud and corruption
29.	IAS should be able to independently plan their works in consultation with CEOs
30.	IAS' work plan may be approved by the CEOs
31.	No incentives given to accounts personnel, some form of incentives tied with accountability may be appropriate
32.	IAS should not perform role of finance personnel i.e., pre audit
33.	Internal Audit should happen before RAA audit and correct errors and irregularities
34.	RAA should rely IA's works and see other areas
35.	RAA Team should require the management to provide IA reports
36.	If IAS to be taken seriously, it must be strengthened
37.	Government should allocate adequate resources for IAS
38.	RAA's report for the society as a whole where IA reports are only for the management
39.	MoF should only coordinate, IA reports should not be submitted to MoF as these will be only filed and no actions can be taken

40.	IA Division of the Ministry should promote best professional practices
41.	MoF should come up with career development options for IAs
42.	Elected internal audit leaders get transferred outside IAS and whole process gets disrupted
43.	IA not attractive, many IAs opted out and many are staying in as there is no choice
44.	HRO Plans usually exclude internal auditors
45.	MoF does not have persons having adequate knowledge and experience on internal audit
46.	RIM could also develop and run curriculum for internal auditors
47.	Proper cost benefit analysis of IAS to be carried out and necessity for IAS established
48.	Plenty of scope for improving the IAS in Bhutan
49.	Outside expert advised against considering IAS as wasteful without proper analysis
50.	Government should decide whether IAS should continue
51.	External agencies regard IAS as useful and check whether organizations have IAS
52.	Role of Internal auditors misunderstood and IAs underutilized
53.	IAS not properly integrated as part of organisation like HR, PPD etc
54.	Regarded as parallel system as the RAA
55.	Some ministries had better auditors where as others were not so lucky
56.	IAs should not create problems, they should rather solve the problems and prevent occurrence of errors and irregularities
57.	Relationship with ACC questionable
58.	No Audit Committee, hence IA reports not acted upon
59.	Limited scope as many issues are at policy level and many decisions are taken by the MoF or government outside the line ministry
60.	Good suggestions also viewed suspiciously due to lack of trust and confidence
61.	IAs should no be performing whistle blowing role,
62.	IAs should essentially report to CEOs. CEOs should be made legally responsible and accountable for taking actions on IA reports
63.	May be cost effective to outsource IAS and make only ad-hoc appointments for smaller organizations,
64.	IAs should not be transferred as IAs should be experts and need specialization
65.	Specialist positions should be created to make IAS attractive
66.	Internal Audit/ Internal Auditor may be renamed as the word auditor seems create confusion with RAA audit/auditor
67.	IA Reports should be made available to the RAA's auditors when required
68.	Internal Auditors should not be made accountable to the Ministry of Finance
69.	Some Internal Auditors do not know how to conduct the audit
70.	Internal Auditors should be put under professional category
71.	Out of RCSC selected graduates, IA should form part of Finance Service
72.	RIM should conduct separate course for Internal Auditors.