IDI-WGPD TRANSREGIONAL PROGRAMME FOR PUBLIC DEBT MANAGEMENT AUDIT

AUDITING PUBLIC DEBT MANAGEMENT

A PRACTICAL GUIDE

As of June 6, 2011

This guide consists of four parts: introduction, planning audit of public debt management, auditing public debt topics, and reporting audit. It focuses practical audit procedures on nine specific public debt management topics.

PREFACE

In 2008 the INTOSAI Development Initiative (IDI) launched a Transregional Capacity Building Programme for Public Debt Management Audit (PDMA) 2008 - 2011. The Programme is in cooperation with the INTOSAI Working Group on Public Debt (WGPD), the Debt Management and Financial Analysis System (DMFAS) Program of the United Nations Conference on Trade and Development (UNCTAD), and the United Nations Institute for Training and Research (UNITAR). The objective of the programme is to enhance professional and institutional capacity of the target SAIs in public debt management audit. One of the outputs of the Programme is the Practical Guide for Auditing Public Debt Management.

The guide aims to provide practical audit procedures to conduct audit on nine specific public debt topics, namely public debt legal framework, organisational arrangement, determination of public borrowing needs, public debt management strategy, borrowing activities, public debt information systems, debt servicing, debt reporting and loan guarantees. The nine topics were those discussed in the PDMA e-learning course and taken by 29 participating SAIs of the Programme as a topic of their pilot audit. The guide also aims to share good practices and results from the pilot public debt audits.

Primarily intended users of the Guide are auditors and supreme audit institutions (SAIs) who possess little or no knowledge and experience of public debt auditing. SAI auditors who are completely new to public debt management auditing are advised to first build their understanding of the subject of public debt before using this guide. One option for this would be study the IDI’s training materials on public debt management auditing. Auditors who already possess knowledge of public debt issues or who have experience in public debt auditing can use this guide to scope their public debt management audits and develop their audit work plans.

We would like to put on record our gratitude to the INTOSAI Working Group on Public Debt, , DMFAS Programme of UNCTAD, UNITAR, Commonwealth Secretariat and the World Bank for releasing their experts to develop the Guide.

INTOSAI Development Initiative

CONTENTS

ACRONYMS

AFROSAI	African Organisation of Supreme Audit Institutions
ARABOSAI	Arab Organisation of Supreme Audit Institutions
ASOSAI	Asian Organisation of Supreme Audit Institutions
EUROSAI	European Organisation of Supreme Audit Institutions
COMSEC	Commonwealth Secretariat
DMFAS	Debt Management and Financial Analysis System
HIPC	Highly indebted poor countries
IDI	INTOSAI Development Initiative
IMF	International Monetary Fund
INTOSAI	International Organisation of Supreme Audit Institutions
ISSAI	International standards for supreme audit institutions
PASAI	Pacific Association of Supreme Audit Institutions
SAI	Supreme Audit Institutions
TPDMA	Transregional Programme for Public Debt Management Audit
UNCTAD	United Nations Conference on Trade and Development
UNITAR	United Nations Institute of Training and Research
WB	World Bank
WGPD	Working Group on Public Debt

PART ONE

INTRODUCTION

1 Introduction

This section of the *Guide* helps SAIs to understand the importance of public debt management and auditing, how SAIs should approach the definition of public debt, and an overview of the topics covered in this *Guide*.

1.1 Importance of public debt management

Most governments have large financial needs as they seek to grow their economies and provide for social needs of their citizens. In theory, public borrowing is an effective tool for generating economic development and distributing fairly the debt burden between current and future generations of taxpayers. Public borrowing and debt can expand the production and consumption choices of current and future generations, allowing governments to increase productive investments and distribute the tax burden more fairly between current and future generations.

However, public borrowing and debt entail significant risks if they are not managed properly. An unsustainable public debt can impair the government's ability to reduce unemployment and poverty levels precisely when counter-cyclical budget actions are most needed, during an economic recession or financial crisis

(Diagram from DMFAS: Triangle and Key Functions in Public Debt Management Audit - to be included)

1.2 Roles of different players to promote governance in public debt management

1.2.1 Executive (Ministry of Finance, Central Bank, Debt Management Office)

(insert text: roles of executives – government)

1.2.2 Legislative

(insert text: roles of legislative executives)

1.2.3 Supreme Audit Institutions

Supreme Audit Institutions (SAIs) can play a significant role in improving public debt management and prevent public debt from reaching unsustainable levels. Regular financial audits of public debt are essential elements to guarantee public debt managers are held accountable for their public debt actions. Performance audits of public debt can contribute to enhancing the effectiveness, efficiency and economy of debt management, and provide greater transparency of the risks and benefits of public debt.

According to the *ISSAI Standards and guidelines for performance auditing (ISSAI 3000),* SAIs should consider public debt issues where they have the ability to provide new knowledge, insights and perspective. SAI audit reports should have the potential to influence policymakers and, therefore, result in a significant contribution to improving public debt management. For example, SAIs could (1) enhance public debt transparency and accountability by examining current reporting practices; (2) strengthen internal control in public debt programs to reduce risks of fraud and corruption; and (3) modernize public debt's legal framework by examining best practices identified in ISSAI's public debt audit guidelines. Whether these and other topics can be selected by the SAIs for audit depend critically on their legal mandate.

1.2.4. Donor institutions

(insert text: roles of legislative executives)

1.2.5. Others

(insert text: roles of legislative executives)

1.3 IMPORTANCE SAI's LEGAL MANDATE

The SAI's legal framework is a major contributor to define audit objectives and scope. Some SAIs may have the legal authority to conduct compliance audits of budget resources, but not financial and performance audits of public debt. A clear and explicit legal mandate helps SAIs to gain access to debt officials and records. Thus, the ISSAI 3100 recommends the following:

"The head of the SAI should seek to obtain a suitable legal mandate that comprises the following criteria:

- A mandate to carry out performance auditing on the economy, efficiency and effectiveness of government programs and entities;
- Freedom to select what to audit, when to audit and how to audit, conclude and report on findings;
- Freedom to place the audit results in the public domain;
- Access to all information needed to conduct the audit; and
- Freedom to decide who to recruit."

The Inbox – Legal Mandates to Carry Audits – shows the law in Uganda that grants authority to its Auditor General to conduct performance audits, and the law that grants authority to the Comptroller General of the United States to perform a financial audit of the government's financial statements.

INBOX – LEGAL MANDATES TO CARRY OUT AUDITS

Uganda – *Legal Authority for Performance Audits, National Audit Act of 2008, Section 21:*

"(1) The Audit General may, for the purpose of establishing the economy, efficiency and effectiveness of the operations of any department or ministry, enquire into, examine, investigate or undertake random value for money audits in accordance with Article 163(3)(b) of the Constitution and report as he or she considers necessary…

(a) the expenditure of public moneys and the use of public resources by ministries, departments and divisions of the Government and all public organizations and local government councils..."

United States of America – *Legal Authority for Financial Audit, USC, Title 31:*

"The Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, shall annually prepare and submit to the President and the Congress an audited financial statement…"

"The financial statement of the U.S. shall reflect the overall financial position, including assets and liabilities, and results of operations of the executive branch of the United States Government…"

"The Comptroller General of the United States shall audit the financial statement …Not later than March 31 of 1998 and each year thereafter...'

"The financial statements shall be prepared annually" … "in accordance with the form and content requirements set forth by the Director of the Office of Management and Budget"

Source: various

1.4. PUBLIC DEBT DEFINITIONS

A single, all-encompassing definition of public debt is neither practical nor desirable. Rather, the definition of public debt is dictated by the particular needs of users and by the specific purposes for which public debt information is prepared. The definition of public debt differs from country to country and is bound by the needs of stakeholders in the public debt management process.

Public debt is commonly defined as an obligation of a government entity, including a national government, a political subdivision and government controlled bodies. According to ISSAI 5421, *Guidance on the Definition and Disclosure of Public Debt*, available in www.issai.org, public debt can include liabilities or other commitments incurred directly by public bodies:

- Central government, or federal government, depending on the manner of political organization in a country
- State, provincial, municipal, regional and other local government or authorities
- Owned and controlled public corporations and enterprises
- Other entities that are considered to be of a public quasi-nature
- Liabilities or other commitments incurred by public bodies on behalf of private corporations or other entities.

Within the definition of public debt, the meaning of the terms obligation and government entity would vary across countries and among different speakers within a single country. Thus, it is not appropriate or useful to develop a single, all-embracing definition of public debt.

(Inbox Public Debt Definitions of some participating countries – to be included)

1.5 AUDIT OF PUBLIC DEBT MANAGEMENT

As in the case of any audit, an effective audit of public debt management issues is critically dependent on a thorough understanding of the subject area, and the development of sufficient and appropriate audit question relevant to the objectives and scope of any given audit. The quality of audit questions follows the auditor's depth of understanding of public debt management issues. On the other hand, an inexperienced auditor of public debt can, in fact, gain a reasonable understanding of public debt issues by reflecting on and answering audit questions developed by an experienced public debt auditor. At the same time, the less experienced auditor can contribute to the planning and conduct of a public debt management audit by directly using some of the audit questions developed by an experienced auditor. Thus, the availability of a bank of public debt audit questions can serve as a tool for both learning and action. This is what this guide hopes to achieve. Of course, a guide such as this, must remain a living document and additional audit questions incorporated, based on experiences gained over time and knowledge sharing within the community of auditors. Precise audit questions are important because minor changes to them or to the definition of the problem to be studied can have a major impact on the resources, scope and results of the audit. Therefore the focus of this guide is to provide a bank of researchable audit questions. This guide does not go into the audit procedures to be used for gathering the information required to answer the audit questions. That is simply because, the audit procedures used in public debt management audit are no different from those used in any type of audits, financial, compliance or performance. What distinguishes public debt management audit from audits of other topics is the nature of the subject area, which, in turn, requires the auditor to develop a unique set audit questions. This guide is intended to be a step in that direction for the less experienced auditor of public debt management.

The audit of public debt management covers a number of areas, including nine specific audit topics in this Guide:

1. Legal framework and legal provisions
2. Organisational arrangements
3. Determination of public borrowing needs
4. Public debt management strategy
5. Borrowing activities
6. Public debt information systems
7. Debt servicing
8. Debt reporting
9. Loan guarantees

SAIs may have specific obligations as how and when to audit public debt. In this case SAISs will perform those audits following the rules they are subject to. Otherwise it is not recommended that a single audit cover all the above-mentioned areas. It is likely to be more effective to cover one or a limited number of areas in each audit based on risk assessment, competence and experience of the audit team, time available, and expectations of key stakeholders. It might be a good idea to also prepare a multi-year plan which allows for audit of most of the above areas over a period of time.

The auditing of public debt may be performed as part of the audit of financial statements, as a compliance audit separately from the audit of the financial statements or as a performance audit. In any case the planning procedures and the conducting of the audits should follow the INTOSAI standards namely ISSAI 1000-1999 (Guidelines on financial audit), ISSAI 4000-4999 (Guidelines on compliance audit) and ISSAI 3000-3999 (Guidelines on performance audit), respectively. ISSAI 5400-5499 (Guidelines on audit of public debt) are also to be followed when performing an audit of public debt.

This guide is the result of a cooperation program among the IDI, INTOSAI Working Group on Pubic Debt, the Debt Management and Financial Analysis System (DMFAS) Program of the United Nations Conference on Trade and Development (UNCTAD) and United Nations Institute for Training and Research (UNITAR). Consequently, the contents are aligned with the International Standards for supreme Audit Institutions (ISSAIs) and other good practices in public debt management auditing, including those withdrawn from the pilot public debt audit experience..

PART TWO

PLANNING AUDITS OF PUBLIC DEBT MANAGEMENT

2 Planning Audits of Public Debt Management

This section of the *Guide* presents audit steps that Supreme Audit Institutions (SAIs) must take when they plan audits of public debt management. Most steps are similar for all types of audits – performance (value-for-money), financial (regularity) and compliance (legality) – but performance audits focus on the effectiveness, efficiency and economy of public debt activities or programs, rather than financial accounts and compliance with specific legal conditions.

2.1 Similarities and Differences of Performance, Financial and Compliance Audits

In planning all types of audits, SAIs should: (1) communicate with debt management officials to reach agreement on the audit; (2) gain an understanding of public debt operations; (3) conduct risk assessments; and (4) prepare an audit plan. In performance audits, SAIs must devote a significant portion of their planning time to define precisely their audit **objectives** and find acceptable audit **criteria**. This *Guide* describes first how to define objectives and criteria in performance audits, and last, the above four common audit procedures.

2.2 Define Audit Objectives

SAIs must plan their audits to obtain sufficient evidence to achieve their **objectives** in an efficient and effective manner. The objectives are different for performance, financial and compliance audits. SAIs are familiar with the specific objectives of financial and compliance audits, but performance audits are less known and have more diverse objectives, as shown in the table below.

Table-2.1 Objectives Vary by Type of Audit of Public Debt

Performance (value-for-money)	Financial (regularity)	Compliance (legal)
Examine Effectiveness, Efficiency and Economy (3Es) in public debt, including its • legal framework • organizational structure, with front, middle and back operations • operations in multiple debt management units • coordination of domestic and external borrowing activities • medium and long-term strategy • coordination with cash operations • accountability and transparency, debt reporting practices • risks identification, measuring, monitoring & reporting • coordination with contingent liabilities, guarantees & fiscal risks	Express an independent audit opinion on the fairness of public debt assertions in financial reports	Determine compliance with debt laws and regulations, loan contracts and grant agreements

Sources: various

What makes performance audits different from other audits? Performance audits are evaluations of appropriate evidence against criteria that support findings and recommendations to assist management and policymakers in improving operations, reducing costs and enhancing public accountability.[1] Specifically, SAIs engage in performance audits in response to demands for reliable, fact-based assessments of the **effectiveness**, **efficiency** and **economy** in public debt activities, known as the three E's.

ISSAI 3000, *Standards and guidelines for performance auditing*, and ISSAI 3100, *Performance Audit Guidelines – Key Principles and Appendix,* provide general definitions of the three E's and guidance to conduct these audits.[2] The three E's are defined in the specific context of public debt activities as follows:

- **Effectiveness**
  In an audit of effectiveness, SAIs assess to whether debt management achieved its objectives and achieved its intended results.
- **Efficiency**
  In an audit of efficiency, SAIs take one step beyond effectiveness to examine the link between resources or inputs used and specific objectives achieved in debt management activities. The main question in an efficiency audit is: are public debt management objectives obtained in a cost-effective manner?
- **Economy**
  In an audit of the economy, SAIs examine whether public debt activities are done in accordance with sound principles of public administration and follow best management practices.

The three E's assessed in performance audits can be viewed as doors that represent a number of potential audit targets. In the planning phase SAIs must select specific activities and establish a sequence of performance audits by weighing carefully the benefits that might be achieved against the audit's costs, complexity and risks.

As shown in the table of audit objectives, performance audits of public debt management can examine several public debt programs or activities:

- Legal framework
- Organizational structure
  - "Front office" – planning, negotiation, external relations, reporting and communication, monitoring internal control
  - "Middle office" – risks analysis, simulations, medium- and long-term strategy
  - "Back offices" – capture and validation of debt data, processing, accounting, information systems
- Multiple debt management units responsible for domestic and external debt operations
- Public debt's medium and long-term strategy
- Public debt and cash management
- Accountability and transparency, public debt reporting
- Public debt risks – identification, measuring, monitoring and reporting
- Contingent liabilities, guarantees & fiscal risks

[1] *Government Auditing Standards* (Yellow Book), 2010, available in www.gao.gov
[2] International Audit Standards for Supreme Audit Institutions are available in www.issai.org .

For SAIs that have not done an audit of public debt management, a critical decision is deciding which area or topic should be examined first, second and so on. Assessment of the benefits of the audit and having a proper legal mandate are important factors in the SAI's decision.

2.3 DEVELOP AUDIT CRITERIA

An important hurdle that SAIs must overcome in the planning phase is the definition of a criterion or standard that can be used to determine whether the performance of public debt management meets, exceeds or falls short of expectation.

In financial and compliance audits, SAIs use criteria that are generally defined in the country's accounting and legal framework. In performance audits, however, audit criteria are not necessarily set in accounting and legal documents, and will vary from one audit to another. In all audits the criteria adopted by the SAI must be clear, relevant, reasonable and generally accepted.

Table below shows sources of audit criteria listed in ISSAI 3000, *Standards and guidelines for performance auditing*, and specific sources in public debt.

Table 2.2 - Sources of criteria for public debt performance audits

National laws and regulations governing public debt activities: -- Accounting standards in government sector -- Organic laws of finance agencies, ministries, and state-owned enterprises with authority to engage in borrowing and guarantees -- Fiscal and public debt legislation **Supra-national legislation, treaties, loan and contract agreements:** -- Obligations to submit to International Monetary Fund's surveillance activities, available in www.imf.org/external/about/econsurv.htm -- Countries' policy intention documents available in www.imf.org/external/np/cpid/default.aspx, prepared by the respective countries for the purpose of setting forth policy intentions in respect of use of IMF resources or staff-monitored programs.
Policies and procedures set by public debt management officials Each country should make publicly available on the Internet the terms and conditions for the sale, issue and redemption of its debt securities, domestic and external. Example: The Uniform Offering Circular (UOC) of the US Treasury sets out the terms and conditions for the sale and issue of marketable Treasury bills, notes, and bonds. The UOC describes these securities, how they are auctioned, including how to submit bids, and the authorized payment methods. The UOC is available in www.access.gpo.gov/nara/cfr/waisidx_10/31cfr356_10.html
International Standards of Supreme Audit Institutions in www.ISSAI.org: ***Performance audits*** • ISSAI 3000, *Implementation Guidance for Performance Auditing* • ISSAI 3100, *Performance Auditing Guidelines: Key Principles and Appendix* ***Public debt audits***

- ISSAI 5410, *Guidance for Planning and Conducting an Audit of Internal Controls of Public Debt*
- ISSAI 5411, *Debt Indicators*
- ISSAI 5420, *Public Debt Management and Fiscal Vulnerability: Potential Role for SAIs*
- ISSAI 5421, *Guidance on Definition and Disclosure of Public Debt*
- ISSAI 5422, *An Exercise of Reference Terms to Carry Out Performance Audit of Public Debt*
- ISSAI 5440, *Guidance for Conducting a Public Debt Audit – The Use of Substantive Tests in Financial Audits*

INTOSAI Public Debt Working Group: www.wgpd.org.mx

Guidance on the Reporting of Public Debt

Criteria used previously in similar audits or by other SAIs

Paradigmatic audits available in INTOSAI Working Group on Public Debt, www.wgpd.org.mx/Publications_guidelines.html

Organizations (inside and outside the country) carrying out similar activities or having similar programs

United Nations Conference on Trade and Development (UNCTAD), Debt Management and Financial Accounting System (DMFAS), guidance available in http://r0.unctad.org/dmfas/:
-- *Effective Debt Management*
-- *Hardware, Software and Training Requirements for DMFAS 6*

Commonwealth Secretariat, Debt Recording and Management System (CS-DRMS), guidance available in http://www.csdrms.org/:
-- *Guidance Note on the Legal Framework*
-- *CS-DRMS 2000 Online Presentation*

Comparisons with best recommended practices

World Bank

World Bank, *Guide to the Debt Management Performance Tool (DeMPA),* available in http://go.worldbank.org/5AHEF2KF70

This document describes 15 performance indicators covering six core areas of public debt management: (1) governance and strategy development; (2) coordination with macroeconomic policies; (3) borrowing and related financing activities; (4) cash flow forecasting and cash balance management; (5) operational risk management; and (6) debt records and reporting.

World Bank, *Guidelines for Public Debt Management* (2003) and *accompanying document,* available in www.worldbank.org

International Monetary Fund

IMF Data Quality Assessment Framework

Many member countries of the IMF voluntarily produce and disseminate information on public debt that meets quality standards in terms of coverage, periodicity of debt compilation and timeliness of public dissemination. The countries that report central government debt are listed in http://dsbb.imf.org/Pages/GDDS/CtgCtyList.aspx?catcode=CGD00&catname=Central+government+debt

IMF *Guide to Fiscal Transparency* provides best reporting practices, available in www.imf.org/external/standards. Examples of best practices: • "A cornerstone for ensuring the timely and uniform availability of fiscal information is that it can be readily accessed free of charge on the Internet" • "Best practice in providing information on liabilities and financial assets is the publication of a government balance sheet as part of the budget documentation" • "It is a requirement of fiscal transparency that national levels of government report publicly on the nature and significance of contingent liabilities"
Public debt studies and general management literature, *Guidelines for Public Debt Management* (2001) *Guidelines for Public Debt Management: Accompanying Document* (2003) *Public Debt Management in Emerging Market Economies: Has This Time Been Different?* (2010) *Managing Public Debt: From Diagnostics to Reform Implementation* (2007) *Sound Practice in Government Debt Management (*2004) *Strengthening Debt Management Practices: Lessons from Country Experiences and Issues Going Forward* (2007) Above studies are available in website of World Bank's Treasury: http://treasury.worldbank.org/bdm/htm/resource_publications.html *Derivatives and Public Debt Management,* by Gustavo Piga, available in International Capital Market Association, www.icmagroup.org

Sources: various

2.4 SIMILAR AUDIT STEPS IN PLANNING PHASE

Although performance, financial and compliance audits pursue different objectives and apply different criteria, they share several similar planning steps that help SAIs to conduct their audits efficiently and effectively. The common audit steps are described in ISSAI 300, *Field Standards in Government Auditing* (available in www.issai.org):[3]

[3] ISSAI 300, *Field Standards in Government Auditing*:

"1.4 The following planning steps are normally included in an audit: (a) collect information about the audited entity and its organization in order to assess risk and to determine materiality; (b) define the objective and scope of the audit; (c) undertake preliminary analysis to determine the approach to be adopted and the nature and extent of enquiries to be made later; (d) highlight special problems foreseen when planning the audit; (e) prepare a budget and a schedule for the audit; (f) identify staff requirements and a team for the audit; and (g) familiarize the audited entity about the scope, objectives and the assessment criteria of the audit and discuss with them as necessary. The SAI may revise the plan during the audit when necessary."

1. SAIs in the planning stage should **communicate with debt management officials** regarding the audit to be performed.
2. SAIs must **gain an understanding of debt management**, including its organization, management style, internal control, and the factors that influence its operating environment.
3. SAIs should **conduct a risk assessment** to identify significant areas for potential audit in performance audits. In financial and compliance audits the risk assessment is conducted for a different purpose, namely, to assess the risk of misstatements in financial reports and lack of compliance with significant legal provisions, respectively.
4. SAIs should **prepare a written audit plan** with effective and efficient audit procedures. SAI's senior management is responsible for approving the necessary staffing and budgeting resources to reach audit objectives. This *Guide* shows how to link audit objectives and common audit procedures in an Audit Design Matrix (ADM).

These four planning steps are discussed in detail below.

2.4.1. Communicate with debt management officials

The SAI should during the planning stage engage in active communication with debt management officials (the Auditee) to define clearly (1) the legal power of the SAI to audit public debt areas; (2) the objectives and scope of the audit, (2) their mutual responsibilities during the engagement. A written communication, commonly known as an engagement letter, is used to record their understanding.

Ideally, the country's legal framework should be sufficiently clear and explicit to allow the SAI and the Auditee to reach a mutual understanding of the audit objective and scope. Reaching a mutual agreement is easier if the legal framework provides clear and explicit answers to the questions **What**, **Who**, **Whe**n, **Where**, and **Why.**

For example, if the performance audit is an assessment of **public debt reporting**, there should be laws to allow the SAI and public debt officials to reach an understanding on:

- **What** are the <u>format</u> and <u>contents</u> of the public debt reports under audit, and the type of audits– performance, financial and compliance – allowed under law?
- **Who** is responsible for producing public debt reports, and who should audit them?
- **When** public debt reports should be published, and how often reports should be audited?
- **Where** is the public debt information available to the SAI, internal and external monitors and oversight institutions? Does the law specify any restrictions to access public debt information?
- **Why** public debt reports are required? What public policy objectives – accountability and transparency – are achieved?

If any gaps exist in the legal framework of public debt management and auditing, the SAI should examine other ways of reaching a clear understanding about the audit objectives and scope with the Auditee. The SAI could also consider whether conducting an audit of the public debt's legal framework should be done first. Guidance for conducting a performance audit of the country's legal framework on public debt is included later in this *Guide*.

As stated earlier, the mutual understanding of the SAI and the Auditee should be documented in writing, such as an engagement letter. Examples of the details included in the engagement letter:

- Responsibilities of the SAI: conduct the audit in accordance with national and international auditing standards, and ensure that debt management has sufficient time to respond to any significant findings and recommendations before the final report is issued
- Responsibilities of the Auditee: making debt records and officials promptly accessible to the SAI

- According to the ISSAI 3000, *Standards and guidelines for performance auditing*, "in some cases it may also prove useful to explicitly clarify what is not going to be audited … to reduce misconceptions or false expectations among stakeholders."

2.4.2. Gain an understanding of the debt management activity under audit

Achieving open and early communications with public debt officials will help SAIs to gain quickly an understanding of the public debt issue under examination. The purpose of gaining this knowledge is different for each type of audit:

- In PERFORMANCE audits, the SAI first identifies materially important areas of debt management that can be examined, and then selects specific areas of public debt where the SAI is likely to add significant value in promoting effectiveness, efficiency and economy.
- In FINANCIAL audits, the SAI seeks to assess the risk of material misstatement of public debt information disclosed in financial reports, whether due to error or fraud, in order to issue an opinion on the fairness of the public debt assertions.
- In COMPLIANCE audits, the SAI would first identify the direct and materially significant provisions of laws and regulations, loan contracts and grant agreements, and then perform tests to determine if debt management has been compliant with the legal provisions.

SAIs increase their understanding of public debt using several audit techniques. A common audit tool used in the three types of audit is to conduct a risk assessment, which is facilitated by examining internal control in specific debt management activities, discussed below.

2.4.3. Conduct risk assessment and examine internal control

Public debt officials are responsible for assessing risks, that is, identifying the major circumstances and events that can prevent achievement of their public debt objectives, and taking effective actions to minimize those risks. A common audit procedure to determine important risks is to examine Internal Control, that is, to determine the existence and effectiveness of policies and procedures that help debt officials to achieve their objectives. The assessment of the internal control at the planning stage provides SAIs information to make preliminary risk assessments, design additional audit procedures and identify potential areas to examine in performance audits.

Auditing the internal control is a familiar topic for SAIs. ISSAI 5410, *Guidance for Planning and Conducting an Audit of Internal Controls of Public Debt*, presents in detail how the auditor should examine internal controls in debt management entities. Internal control is currently defined as the set of procedures and tools that help managers achieve operational, financial, and compliance objectives. Internal control elements are grouped in five categories:

2.4.3.1. Control environment

The control environment is the foundation of internal control by virtue of its influence on the conduct of debt management staff. Senior debt officials are responsible for establishing and nurturing a control environment that promotes ethical values, positive human resource policies, sound organizational structure, and secure information systems.

In the planning stage, the SAIs should document how a particular debt management style manifests itself in (a) how debt activities are managed and (b) how the organization is structured. These factors determine the environment that exists throughout the organization and the extent to which a positive and supportive attitude exists toward the achievement of debt management's objectives.

2.4.3.2. Risk assessment process

Debt management is responsible for assessing risks, that is, identifying the major circumstances and events that can prevent achievement of its objectives, and taking effective actions to minimize those risks. During their examination of internal control in any audit, SAIs should examine the existence and effectiveness of the policies and procedures for managing risks that affect specific objectives.

2.4.3.3. Control activities

Debt management is responsible for adopting positive policies and implementing procedures to ensure that its objectives are achieved. In any audit, during their examination of internal control SAIs should examine the existence and effectiveness of the links between the objectives of debt management, and its positive policies and procedures.

2.4.3.4. Information and communication

Debt management is dependent on information systems for accomplishing most of their important objectives, such as providing to policymakers timely public debt statistics that are complete and reliable. During the planning phase SAIs should examine the main controls of debt information systems, policies and procedures that affect the contents, structure and availability of debt reports and other related communications.

2.4.3.5. Monitoring activities

Debt management should adopt several ways of monitoring its internal control to determine if it is operating as intended and that it is modified as appropriate due to changes in the environment and operating conditions. Having an internal audit staff to monitor staff compliance and an external debt advisory group to monitor debt market trends can help to identify important factors that impact debt objectives.

These five components of internal control can be examined by SAIs using a checklist that should be tailored to the specific public debt issues under investigation. The checklist below provides general questions for the five internal control components.

CHECKLIST 2.1. INTERNAL CONTROL IN PUBLIC DEBT AUDIT

	COMPONENTS	YES / NO
	Control Environment—Integrity and Ethical Values	
1.	Does debt management promulgate a written code of conduct, applicable to management and staff, to act as a benchmark for management and staff attitude and behaviour?	
2.	Does the code of conduct cover conflicts of interest or expected standards of behavior?	
3	Is the code communicated throughout the debt management units?	
4	Do employees periodically acknowledge it?	
5.	Are employees informed of what they should do if they encounter improper behavior?	
6.	Are written policies in place to regulate management's dealings with employees, clients, creditors, and insurers?	

7	Is there a written policy regarding transactions with related parties?	
8	Is there a written policy regarding gifts and hospitality that may be accepted?	
9.	Is there a written policy regarding declaring pecuniary benefits and outside financial interests (such things as sponsorships, commission payments, and directorships) by key public debt officials?	
10.	Are independent checks performed to reveal common ownership, directorships, and family relationships before major public debt transactions or orders are placed?	
	Element of Internal Control: Risks Assessment—Operation Risks	
1.	Is staff responsible for custody of assets (debt securities, cash) separated from accounting?	
2.	Is staff responsible for public debt accounting provided access to cash, debt instruments, or bank accounts?	
3.	Is staff responsible for authorizing public debt transactions separated from the custody of the related assets?	
4.	Is recording of debt transactions separated so that a single staff member is not able to record a public debt transaction from its origin to its ultimate posting in the subsidiary and general ledgers?	
5.	Do the specialists who engage in debt transactions, their supervisors, and the processing staff have comparable technical levels of experience and qualification in the field of debt management?	
6.	Is debt management staff properly trained in valuing, trading, and processing new, complex debt products before they are introduced?	
7.	Are the systems for capturing, processing, and reporting debt transactions reliable? Do they meet the latest technical standards?	
8.	Are the procedures in the debt management units written, predictable, and well designed with proper audit trails maintained?	
9.	Have the debt management units planned for alternative site, computer and communication resources, trading facilities, and other support services in case of disaster?	
10.	Are debt transactions properly covered by well-designed master agreements that are properly executed and supported by appropriate documentation in a timely manner? Are debt transactions executed according to laws and restrictive covenants, including pledging of government assets, use of cash proceeds, and debt restructuring agreements?	
11.	Is debt management staff able to perform an independent market valuation for all debt securities?	
	Element of Internal Control: Information and Communication	
1.	Do senior government officials obtain timely debt information to produce a budget that incorporates a reliable debt service?	
2.	Do debt management officials obtain timely information on the government's daily cash position in order to issue enough debt to guarantee the government's liquidity at reasonable cost?	
3.	Do senior government officials have relevant and reliable debt information to obtain all the benefits of debt reduction and debt restructuring in a timely manner?	

4.	Do public debt reports incorporate the most current information on new issues, debt restructuring, and debt of government-sponsored enterprises guaranteed by the central government?	
5.	Are debt reports presented in accordance with the generally accepted accounting standards of the country and the disclosure standards adopted by the international community?	
6.	How is sensitive business information about debt matters safeguarded to prevent its misuse?	
	Element of Internal Control: Control Activities	
1.	Does the government have current public debt medium- and long-term strategic plans and published borrowing schedule?	
2.	Do debt management units have up-to-date procedures manual for the major cycles involved in public debt activities: planning, contracting, issuance and servicing?	
3.	Are public debt transactions authorized and executed in accordance with senior management directives so as to achieve specific objectives, like guaranteeing sufficient liquidity to pay current obligations, a target average maturity of debt, a desired mix of foreign currency debt, and active domestic capital market?	
	Element of Internal Control: Monitoring	
	INTERNAL AUDITS	
1.	Are there previous internal audit records of public debt transactions? If so, review internal audit recommendations and corroborate if corrective actions have been taken.	
2.	Are internal audit reports submitted to senior debt policymakers?	
3.	Has staff obtained internal audit records and management reports that compare budget with actual performance in terms of public debt borrowings, repayments and interest expenses?	
4.	Are significant variances between budgeted and actual borrowing, repayments, interest expenses, and debt balances reviewed and explained by debt managers?	
5.	If the number of public debt transactions has been small and the amounts involved high, have audit procedures been expanded to trace the cash proceeds of funds from new borrowings into the cash account and cash receipts?	
6.	Are communications from creditors, regulators, and other outside parties monitored for items of significance in debt management?	
	EXTERNAL ADVISORS	
7.	Are there advisory groups composed of debt market and academic experts that meet regularly with public debt officials to review trends in secondary debt markets and interest rates, comment on government's borrowing plans in light of budget developments, identify changes in demand for public debt securities, and recommend changes in strategy?	

Source: various

In performance audits, the results of the above Internal Control assessment will become part of a **preliminary study** that the SAI can use to identify the most promising areas of performance audit.

The results of the risk assessment and examination of internal control will help the SAI to identify a list of potential areas for conducting performance audits. The SAIs can use a checklist to rank the identified areas in terms of their potential for improving the effectiveness, efficiency and economy of public debt management.

CHECKLIST 2.2 POTENTIAL PUBLIC DEBT AUDIT TOPICS

Examples of Public Debt Issues With High Score for Performance Audit	Audit Potential (**H**igh, **M**edium, **L**ow)
Areas of weak internal control identified by external and internal auditors and lack of corrective actions identified in prior audits	
Country's legal debt framework does not specify precisely the legal responsibilities of the SAI and debt management officials	
Debt management operations are conducted under a complex organizational structure, with apparent coordination challenges and unclear managerial responsibilities	
Debt management units lack updated written procedures manual for major debt cycles: negotiating, contracting, analytical, accounting, servicing	
Debt records are maintained in manual, outdated, uncoordinated debt information systems	
Debt management units suffer a lack of qualified personnel responsible for conducting risk analysis of public debt and related government programs that can affect public debt, including contingent liabilities and fiscal risks	
Debt management becomes a critical component in financial management. For example, many governments are introducing an integrated financial management system (IFMS) and planning to issue consolidated financial reports. Since public debt is one of the largest liabilities in government financial reports, SAIs should consider conducting a combined financial-performance audit of public debt as part of their IFMS audit	
Areas of high interest expressed by policymakers, press, experts and the public, such as • Lack of debt reports that provide timely, comprehensive, useful and reliable information to policymakers • Persistent and significant indicators of debt management inefficiency and ineffectiveness • Acts of noncompliance, fraud and corruption • Potential or actual public debt crises and related fiscal risks identified by debt monitoring external agencies, academic studies and debt market experts, where SAI recommendations can result in significant improvement in public debt's sustainability and resiliency	

• Programs that can affect a significant impact on public debt, and have risks that are not defined, measured, monitored, and reported on a timely basis to policymakers. These programs include explicit and implicit government guarantees, contingent liabilities and fiscal risks	
• Areas of debt operations with materially significant monetary amounts, where audit recommendations can result in substantial savings.	
Areas of significant lack of transparency and accountability in debt areas, such as: • Borrowing arrangements and debt instruments with significant risks, terms and conditions that are undisclosed to the public • Procedures used by debt management to select lenders, instruments and methods to raise funds that are not transparent, regular and predictable	

Sources: various

From the above list, SAIs should select specific areas for further audit. As discussed earlier, the SAI's selection would be determined by the potential benefits of carrying out the performance and the SAIs' legal mandate. The third component in the SAI's audit plan is audit resources.

2.4.4. Prepare Audit Plan

ISSAI 3100, *Performance Audit Guidelines – Key Principles*, provide the following advice to SAIs that are planning a first audit of public debt management.

"Performance audits are time consuming, and even more so for newcomers. In order to get performance auditing established, it is advisable to look for some quick wins in one or two subjects that are likely to be of particular interest to stakeholders, but which the SAI has some experience and confidence in dealing with. Such audits should not be too complicated to handle, and not too broad in scope, but still be able to add value."

Staffing. With the above in mind, the plan for a public debt audit that starts small in scale would have 3 to 5 full time equivalent staff. The initial performance audit can be assigned to financial and compliance auditors with experience in finance and budgeting matters who have examined some activities and programs in the Ministry of Finance, the Central Bank and the Treasury.

The selected staff will conduct all the required planning steps described in this section of the *Guide* and, for each of the specific audit areas that have been selected for an audit, will produce an Audit Design Matrix (ADM) to document the links between audit objectives and audit methodology, as shown below. The ADM will be updated as necessary during the audit process.

Table 2.3. AUDIT DESIGN MATRIX (ADM)

Researchable questions	Criteria & information required	Informa-tion sources & design strategy	Evidence gathering methods	Data analysis methods / Data relia-bility	Limitations of audit and analysis	Expected conclu-sions
What do you want to know? Questions should be: 1. Clear and	**What infor-mation do you need to answer the question?** Identify the evidence needed:	**Where is the infor-mation?** Officials, experts to be inter-viewed	**How do you plan to obtain the infor-mation?** Interviews Question-naires	**What do you want to do with the infor-mation?** Descriptive statistics Data reliability	**What is not possible?** What are the caveats? What is the extent of	**What do you expect to find?** List of possible findings Findings related

specific 2. Fair & objective 3. Measurable 4. Doable 5. Classify the questions: Descriptive Normative Impact Prospective	1. Physical 2. Docu-mentary 3. Testi-monial 4. Analytical Are case studies needed? Computer simulations? Modeling? Criteria: Laws Best debt manage-ment principles	Laws and regula-tions Previous audits Internal audit reports Debt reports Debt data-bases	Inspection Walk-throughs Examine Docu-ments Recal-culate Modelling debt dynamics	assessments Qualitative analysis Cost/benefit analysis Inferential statistics Regression analysis	genera-lization? Determine data quality and reliability Are there limitations to access? Are auditors subject to resource constraints: technical resources, travel constraints?	to the sample Extrapo-lations to popu-lation Effect of proposed program changes Cost of imple-menting changes

2.4.4.1 Identify Researchable Questions (ADM Column 1)

What do you want to know? Be clear and specific, fair and objective, state measurable objectives, and determine if the objectives can be achieved with your audit resources. Categorize your questions as descriptive, normative, impact, prospective.

2.4.4.2. List Criteria and Information Required (ADM Column 2)

What information do you need to answer the question? Include in this column the audit criteria (discussed earlier) and the evidence needed to support findings, conclusions and potential recommendations. Audit evidence can be categorized as physical, documentary, or testimonial.

SAIs obtain **physical** evidence when they observe actions taken by public debt officials, visit back office sites to check existence of access controls, and observe auctions of debt securities. **Documentary** evidence is obtained in the form of laws and regulations, loan contracts, debt accounting records and spreadsheets, debt database extracts of electronically stored information. **Testimonial** evidence is obtained through inquiries, interviews of public debt officials, focus groups of debt experts, public forums, or questionnaires of institutional investors. In the planning stage, debt auditors should use **analytical procedures** including computations and comparisons of debt ratios, breakdown of debt into categories, and equations that reconcile borrowing flows during the period to initial and final debt stocks.

2.4.4.3. Provide Information Sources and Design Strategy (ADM Column 3)

The required information will be available in previous audit reports; debt reports produced for internal and external monitors; interviews of debt management officials and market experts; laws and regulations on public debt; and debt information systems.

2.4.4.4. Identify Methods for Gathering Evidence (ADM Column 4)

How do you plan to obtain the information? In order to obtain sufficient evidence in a public debt audit, SAIs would perform procedures that are commonly used in all types of audits. Specifically, SAIs should:

- Make **inquiries** of the public debt staff. The SAI team should ask debt supervisors and staff to explain their debt management duties. Questioning of personnel will help the SAI team to evaluate whether the staff understand their duties and perform procedures as described in the debt procedures manuals.

- **Examine** key debt documents and records in each of the debt activity cycles – planning, negotiating, contracting, issuance, servicing, analysis and accounting. By examining the documents and records, computer files and debt reports, the SAI can evaluate whether the descriptions presented in procedures manual and flowcharts have been implemented.

- **Compare** debt statistics presented in reports issued for different users – external monitoring organizations, debt information in government financial reports, debt data presented in Parliamentary hearings.

- **Observe** control-related activities that do not leave a written audit trail. The SAI audit team should perform a **walkthrough** of the main activities in the cycles of public debt operations – planning, negotiating, contracting, issuance, servicing, analysis and accounting. Walkthroughs are an efficient and effective method of collecting evidence, where the audit team observes activities, makes enquiries and examines documents.

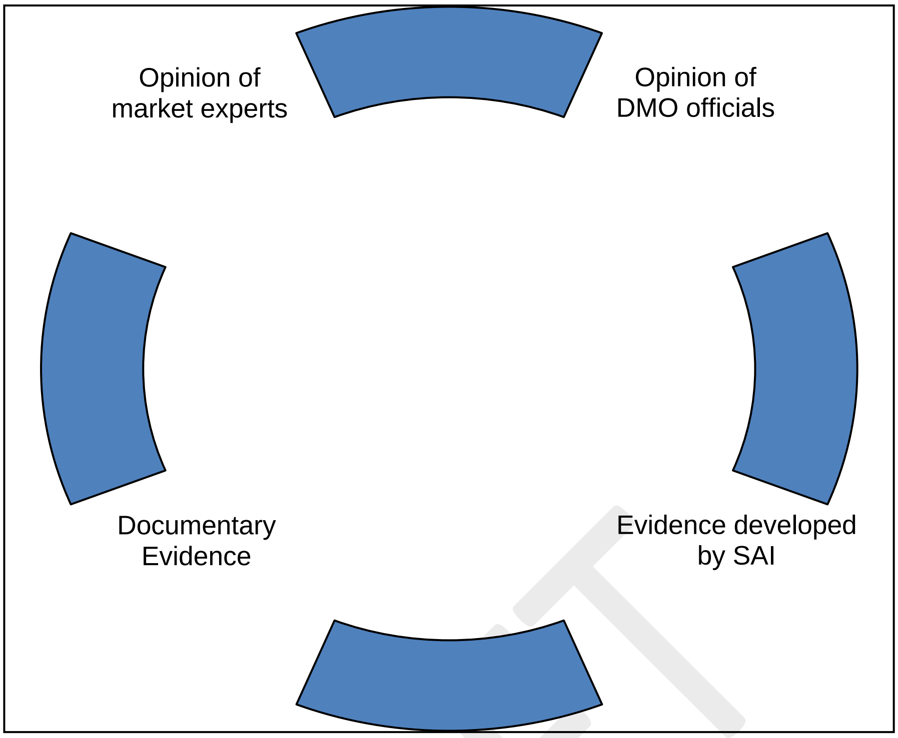
- **Recompute** debt calculations to determine whether debt information systems calculations are correct.
- **Count** the debt documents and records on hand at a given time.

2.4.4.5. Describe Data Analysis/Data Reliability Steps (ADM column 5)

What do you want to do with the information? Audit objectives will dictate what methods are used to analyze the evidence collected by the SAI.

If the audit objective is primarily to verify public debt figures, SAIs should test their accuracy, completeness and validity, similar to a financial audit. In some cases where debt records are too numerous to be counted 100 percent, SAIs may consider the use of statistical sampling.

If the audit objective is to assess performance of a specific debt program or activity, SAI should gather information from several sources, including performance indicators compiled by debt management, in order to answer the audit objectives. The SAI will have to design audit procedures to confirm the validity and reliability of the information. The following diagram illustrates the process of validation of debt information by obtaining corroborating evidence from several independent sources: debt management opinions, SAI's observations, debt market experts and documentary evidence.



SAIs can also seek to compare or benchmark debt management performance across countries. These types of audits are especially useful for analyzing the outcomes of various public policy decisions. In these cases, auditors may perform analyses, such as comparative debt statistics of different jurisdictions or changes in debt performance over time. In these cases, it may be impractical to verify the detailed data underlying the statistics. SAIs in all cases should disclosure clearly to what extent the comparative debt information or statistics were evaluated or corroborated.

SAIs can examine debt trend information based on data provided by the audited entity to different domestic and external monitors. In this situation, auditors should assess the evidence using analytical procedures of underlying debt data, combined with their understanding of the debt information systems or processes used for compiling debt data.

In some performance audits, the SAI may be seeking to find the "causes" that are associated with a sudden jump in public debt levels, such as the 2008 Great Recession. The audit objective of the SAI is to assist policymakers in preventing future debt increases.   In order to produce credible recommendations, the SAI must clearly explain with sufficient evidence and logical reasoning the links between the crisis and the "causes" identified by the SAI.

SAIs may also identify deficiencies in the legal framework and organizational structure of public debt programs as the "causes" of deficient debt management performance.   SAIs may also find significant deficiencies in internal control that are the "cause" of fraud and corruption in public debt matters. In developing these types of findings, the deficiencies in program design or internal control would be described as the "cause." SAIs should carefully analyze the causes of deficient debt management performance, which may be complex and involve multiple factors, in order to identify the fundamental, systemic root causes.

Alternatively, when the audit objectives include estimating the program's effect on changes in fiscal, financial or economic conditions, auditors seek evidence of the extent to which the program itself is the "cause" of those changes. If the audit objective selected by the SAI includes estimating the extent to which a debt management activity or program has caused changes in fiscal, financial and economic conditions, the "effect" would be a measure of the impact achieved by the program. In this case, SAIs would measure the positive or negative changes in actual conditions that can be identified and attributed to the debt management program.

2.4.4.6. Identify Limitations of Audit and Analysis (ADM column 6)

What is not possible to do? What are the caveats? Can the findings obtained from a sample of debt records generalized to all public debt records? Was the debt information verified and found reliable? Were there significant limitations to access debt information and officials that could not be overcome?

2.4.4.7. List Expected Conclusions (ADM column 7)

What do you expect to find? Make a list of possible findings; identify potential findings related to the debt records sample and determine extrapolations to population; make an estimate of the effect of proposed program changes and of the possible cost of implementing program changes.

(An example of Audit Design Matrix – to be included)

PART THREE

AUDITING PUBLIC DEBT TOPICS

This part of the *Guide* presents audit procedures each of nine public debt topics. Each topic is structured by three main sections, namely importance of the topic, audit approach, audit questions, an example of audit design matrix, and list of additional references relating to the topic.

3 Auditing Legal Framework of Public Debt Management

This section of the *Guide* helps SAIs to recognize the importance, objectives and elements of the legal framework of public debt management, and provides questions that SAIs can use to prepare a plan to audit the legal framework.

3.1. Importance of Legal Framework of Public Debt

Examination of the legal framework is a required audit procedure and an important contributor to SAIs' understanding of public debt operations. A clear and explicit legal framework can be a major contributor to achieve lower borrowing costs, and prevent fraud, waste and corruption in public debt management.

Unlike private borrowers, a sovereign borrower has the unique power to define the legal terms and conditions in borrowing/lending contracts. Prudent lenders require a legally binding and enforceable contract to provide funds to any borrower, especially a sovereign central government. When public debt laws are ambiguous or weakly enforceable, creditors may doubt whether they would be able to recoup the full amount of the original loan with interest payments. In these circumstances, it will be either impossible for the government to raise any loans in the market, or only possible at penalizing interest rates that will substantially increase its borrowing cost. Establishing a clear and explicit legal framework for public debt, therefore, serves as a positive signal to creditors that helps countries to reduce borrowing costs over time.

A clear and explicit legal framework can also serve to protect the country against fraud and abuse of borrowed funds. Individuals in positions of Executive power have an opportunity to commit and conceal fraudulent debt transactions when there are no laws that restrict the use of borrowings for a specific public purpose. The possibility of fraudulent debt activities is also reduced when there is a legal requirement to produce regular reports to the Parliament (and other relevant key stakeholders) on public debt matters.

3.2. Audit Approach

SAIs can examine the EXISTENCE of six critical elements that should be clearly and consistently defined in the legal framework of public debt management:

- Delegation by Parliament or Congress to the Executive
- Authorization of the debt management units or offices
- Borrowing purposes
- Debt management goals and objectives
- Debt management strategy
- Debt reporting obligations

3.2.1. Delegation by Parliament or Congress to the Executive

In many countries the ultimate power to borrow on behalf of the central government rests with Parliament or Congress. This power stems from legislature's constitutional power to approve central government tax and spending measures. The first level of delegation of the borrowing power therefore would be from parliament or congress to the executive branch (for example, to the president, to the cabinet or council of ministers, or directly to the minister of finance). In their examination of the delegation clauses in the legal framework, SAIs should determine if the lines of delegation are explicit and clear, both for internal control and for due diligence purposes.

3.2.2 Authorization of the debt management units or offices

In many countries, for practical reasons, it is common for senior government officials to on-delegate borrowing power to an implementing entity (the debt management unit or office) to negotiate and contract on behalf of the central government.

The Finance minister or the deputy minister commonly retains the power to formally approve any foreign currency borrowing and to sign these loan agreements. Approval of borrowings in the domestic market through regular issues of government securities (Treasury bills), however, is normally delegated to the debt management unit or office. Why is there a difference? Treasury bills are commonly issued once every week through an auction procedure; it is essential for a well-functioning market for auction results to be given to the market without any undue delay.

3.2.3. Borrowing purposes

SAIs also examine whether the legal framework clearly and explicitly define the borrowing purposes. This is a safeguard against borrowing for speculative investments and borrowing to finance expenditures that have not been included in the annual budget or approved by legislature.

If the Executive branch of the government were allowed to borrow to finance expenditures not approved by legislature, the legislative budget process will be ineffective, since the legislature will be forced in the future to take fiscal actions to pay interest and service a public debt obligation that was contracted without its direct or indirect approval.

Examples of common borrowing purposes specified in legislation are: finance budget deficits; fill short-term cash gaps; refinance maturing debt; finance investment projects approved by legislature; finance guarantee payments in case of default, add to foreign currency reserves, and support monetary policy objectives (for example, to drain excess liquidity from the domestic market).

3.2.4. Debt management objectives and strategy

SAIs should examine whether the country's legal framework contains public debt goals and strategy that are logically consistent and mutually supporting. Having legal definitions of public debt goals allow a country to formulate a debt management strategy or plan to achieve the debt management goals. SAIs assess whether the goals are prominent, stable and robust enough to serve as an anchor for the debt management strategies. The goals should have a certain robustness to serve as an anchor for debt management strategies. Inbox below contains the public debt management goals adopted by Macedonia.

INBOX – PUBLIC DEBT MANAGEMENT GOALS IN MACEDONIA

"Public debt management objectives shall be to undertake measures and activities by the ministry of finance to the end of ensuring financing of the needs of the State with the lowest possible cost, in the medium and long run, and with sustainable level of risk, and to undertake measures and activities by the ministry of finance to the end of development and maintenance of efficient domestic financial markets."

Source: Macedonia, Public Debt Law (June 2005).

SAIs may use debt management goals as criteria in their performance audits of public debt management. In particular, SAIs can assess whether goals are translated into an operational strategy that defines HOW the goals will be achieved. Discussion of how goals were achieved pursuing specific strategies should be important elements of public debt reports.

3.2.5. Debt reporting obligations

SAIs examine whether clear and explicit legal reporting requirements exist to hold public debt managers accountable to senior debt officials, ministers and boards charged with governance, and legislature. In addition to public debt management reports, the Executive may also publish financial statements and budgetary reports that contain public debt and borrowing activities subject to audit requirements.

3.3. AUDIT QUESTIONS ON LEGAL FRAMEWORK OF PUBLIC DEBT

1. Do laws exist that clearly define the purposes for which borrowing can be undertaken, for example, to finance the budget deficit, if any, as approved by the Parliament?
2. Do laws exist that clearly define public debt management goals and objectives to be achieved?
3. Do laws exist that clearly define the public debt management strategies to achieve the debt management objectives?
4. Is there a clear legal authorization by Parliament to the Executive branch of government (the Cabinet or Council of Ministers, the President, or directly to the Minister of Finance) to approve borrowings on behalf of the central government?
5. Is there a clear legal authorization within the Executive branch of government to a debt management entity or office to undertake borrowing and debt-related transactions?
6. Do laws exist that provide mandatory reporting by the Executive of debt management activities—on at least an annual basis— to the Parliament of the public debt outcomes against stated goals and the determined strategy?
7. Are there instances of debt related laws and regulations not being complied with? If yes, what were the consequences?

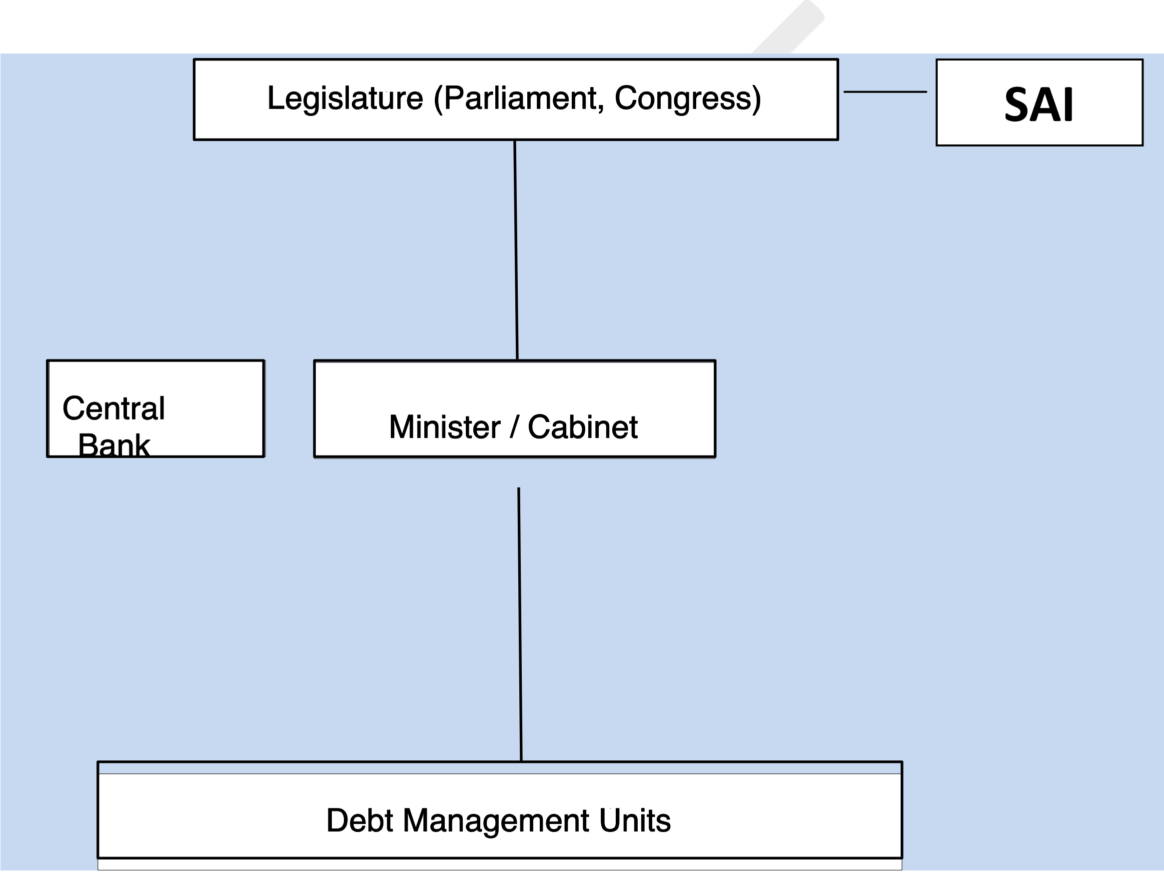
(An example of ADM and List of References – to be included)

4 Auditing Organisational Arrangements in Public Debt Management

This section of the *Guide* helps SAIs to understand the importance of organizational arrangements in public debt management and provides questions that SAIs can use to prepare an audit plan of the organizational arrangements.

4.1. IMPORTANCE OF ORGANIZATIONAL ARRANGEMENTS

In general, organizational arrangements should establish clear roles and responsibilities to ensure the effective execution of debt management activities, provide well-defined coordinating mechanisms and establish a transparent and accountable system of checks and balances. An organizational chart should be used to illustrate these relationships.



4.2. AUDIT APPROACH

After obtaining the legal information on public debt, SAIs should examine the organizational arrangements of public debt management. All organizational arrangements should aim to be efficient and create adequate segregation of duties. In general, the organizational arrangement should provide for the effective and efficient execution of front-, middle- and back-office functions:

Front-office functions are related to mobilizing the financial resources required to meet the government's financial needs. Main front-office functions are:

- Conducting regular communications and consultations with domestic and external lenders

- Negotiating loans
- Establishing clear procedures for the selection of primary dealers and loan syndicates
- Managing auctions
- Conducting debt restructuring operations

Middle-**office** functions are related to technical analysis of risk/return trade-offs. Main middle-office functions are:

- Conducting research and providing input to debt sustainability analyses
- Providing advice in formulating debt management strategies
- Developing operational procedures to reduce operational risks
- Ensuring debt management operations are conducted within stipulated parameters to manage risk exposures

Back-office functions are related to accounting and production of debt reports. Main back-office functions are:

- Registering and validating debt data and records
- Settlement of borrowing transactions
- Monitoring disbursements
- Managing debt servicing
- Producing debt reports

SAI team should obtain the procedures manual and the specific organizational chart that identifies each of the units and their respective roles and responsibilities.

4.3. AUDIT QUESTIONS ON ORGANIZATIONAL ARRANGEMENTS

1. Are organizational arrangements for public debt management properly documented, that is, is there a comprehensive procedures manual?
2. Are the arrangements clearly specified?
3. Are the mandates and roles and responsibilities of the different debt management units well articulated?
4. Does the division of roles and responsibilities promote an effective system of checks and balances? For example, is there a clear division of responsibilities among the Legislature (Parliament), the Executive (President or Council o Ministers) and the technical level (debt management office)?
5. Is there a clear division of roles and responsibilities among the debt management units at the technical level? Which units perform the functions defined in the “front”, “middle” and “back” offices of a debt management office?
6. If there is more than one debt management unit at the technical level, is there a system for coordinating their activities?
7. Is there regular exchange of information among the debt management units?
8. Is there a principal debt management office to ensure proper coordination and exchange of information among the various units?

(An example of ADM and List of References – to be included)

5 Auditing Determination Of Public Borrowing Needs

This section of the *Guide* helps SAIs to assess the process of determining borrowing needs, the importance of this process to keep borrowing costs down, and provides questions that SAIs can use to prepare an audit plan of the process.

5.1. IMPORTANCE OF CORRECTLY DETERMINING BORROWING NEEDS

Determining the net borrowing needs for a defined period is a critical and complex function that requires a significant amount of information and coordination among government agencies. Borrowing more than the actual requirement could put serious pressure on the government's fiscal position, while under borrowing could create an obstacle in implementing the government's developmental plans.

SAIs can, through their performance audits of the factors in this process, help governments to improve their capacity to better estimate borrowing needs.

5.2. AUDIT APPROACH

In general, net borrowing needs are determined by four factors:

1. Debt that comes due in the period, plus
2. Estimate of budget deficit in the period, plus
3. Estimate of contingencies that would be triggered in the period, plus
4. Estimate of net financial assets that would acquired in the period

Of the above four factors, only the amount of debt that comes due in the period is known with relative certainty if the planning period is relatively short in duration, say, one year or less.

The other three factors – budget deficits, contingencies and acquisition of net financial assets – are largely unknown to debt management officials responsible for determining borrowing needs. Thus, the SAIs will have to assess the government's capacity to produce and communicate promptly to debt managers the budget figures – revenues and expenses – for the period; all major contingencies that will be realized; and significant financial asset purchases and sales that will be done during the period.

5.3. AUDIT QUESTIONS ON DETERMINATION OF BORROWING NEEDS

1. Does the debt management office (DMO) have a reliable system for determining the debt that will become due in the period for which borrowing needs are to be estimated? If yes, does it comply with the system in its day-to-day functioning?
2. Does the DMO participate in the government's budgeting process so that the government is properly informed as to the amount that can be reasonably borrowed in domestic and foreign currency, and how much the domestic market can absorb without crowding out the private sector?
3. Does the government's annual budget provide a reliable estimation of the budget deficit?
4. Is there a reliable estimation of contingencies that would be triggered during the given period? Are implicit contingencies included in the estimation? If not why not, and what could be the risks?
5. Is there a reliable estimation of the net financial assets that the government plans to acquire during the given period?

6. Have there been previous instances of over or under borrowing? If yes, what were the reasons? What were the consequences? Were appropriate steps taken to minimize such risks in future?

(An example of ADM and List of References – to be included)

6 AUDITING PUBLIC DEBT MANAGEMENT STRATEGY

This section of the *Guide* helps SAIs to recognize the importance, objectives and elements of an effective public debt strategy, and provides questions that SAIs can use to prepare a plan to audit their effectiveness, efficiency and economy.

6.1 IMPORTANCE OF PUBLIC DEBT MANAGEMENT STRATEGY

Choosing the right debt management strategy is akin to taking the correct direction to reach an important destiny or goal. If public debt management chooses a strategy that turns out to be too risky (e.g. borrow only in foreign-currency denominated debt) or too costly (e.g. borrow only in the domestic debt market) in order to avoid any risk, the budget consequences are much larger than single debt transactions that are mispriced or badly timed. As described in this *Guide,* in the section on auditing the legal framework of debt management, SAIs should examine whether the medium-term debt management strategies are consistent with the country's debt goals or objectives.

6.2 AUDIT APPROACH

Specifically, SAIs can assess to what extent debt goals are supported by debt management strategy for

- Selecting exposure levels to foreign currency risk
- Defining a target debt maturity structure
- Setting the sensitivity of the government's budget to interest rate changes
- Deciding the share of public debt that is indexed to inflation, and
- Developing a plan for developing domestic debt markets.

In assessing a debt strategy, SAIs can assess to what extent debt management has followed a sequence of logical steps in formulating and implementing their debt strategies:

- Identify the objectives for public debt management and scope of the strategy.
- Identify the current debt management strategy and analyze the cost and risk of the existing debt.
- Identify and analyze potential funding sources, including their cost and risk characteristics.
- Identify baseline projections and risks in key policy areas—fiscal, monetary,
- external (exchange rate movement and anticipated balance of payments development), and market (projections for relevant yield curves).
- Review key longer-term structural factors.
- Assess and rank alternative strategies on the basis of the cost-risk trade-off.
- Review implications of candidate debt management strategies with fiscal and monetary policy authorities, and for market conditions.
- Submit and secure agreement on the strategy.

SAIs can examine the frequency of reviews to assess whether the assumptions that support a strategy still hold in light of changed circumstances. Such a review would ideally be undertaken annually, preferably as part of the budget process, and if the existing strategy is viewed as appropriate, the rationale for its continuation should be stated explicitly.

6.3. AUDIT QUESTIONS ON PUBLIC DEBT MANAGEMENT STRATEGY

1. Did the government prepared borrowing plans that are consistent with the debt strategy? If so:
   a) Who was responsible for producing the plan? Were they qualified for the job?
   b) What was the process for collecting information to prepare the plan.
   c) How was the borrowing plan communicated to potential investors?
   d) How was the timing and the amount of the planned issues of Treasury bills and bonds been influenced by the central government cash flow projections?
2. Were the risks embedded in contingent liabilities been taken into account, and how were these risks assessed?
3. Did the government prepared a medium-term debt management strategy? If so:
   a) How was the strategy produced? Did it follow good practice (e.g. the World Bank and IMF guidance on developing a medium term debt management strategy)?
   b) Did debt management consider a range of alternate strategies from a cost and risk perspective before finalizing its strategy?
   c) Did they assess the alternate strategies under relevant risk/stress scenarios?
   d) Did debt management consider what characteristics of debt or debt composition would mitigate key sources of volatility to the budget, and consider the potential costs of achieving that debt composition?
   e) Who was responsible for producing the strategy, and what were their respective roles?
   f) Was the debt strategy approved by a competent authority?
   g) What analysis was undertaken in formulating the strategy?
   h) How was the analysis undertaken? Who was responsible for setting economic and budget parameters, and who was responsible for debt forecasts?
   i) Was the Central Bank consulted in formulating the strategy? Is it consistent with Central Bank's monetary policy implementation?
   j) What is the content of the strategy? Does it clearly state the desired objectives? Does it use appropriate risk indicators?
   k) Was the strategy made publicly available? If so, when was it published, and in what format?
   l) How has the strategy been implemented?
   m) How often is the strategy reviewed and updated?

(An example of ADM and List of References – to be included)

7 AUDITING BORROWING ACTIVITIES

This section of the *Guide* helps SAIs to understand the importance of borrowing activities and provides questions that SAIs can use to prepare an audit plan of borrowing activities.

7.1. IMPORTANCE OF BORROWING ACTIVITIES

In general, central governments can borrow money by issuing marketable debt securities, taking bank loans and selling non-marketable securities to individuals. These borrowing programs can operate domestically and externally. In order to obtain the lowest cost of borrowing over time, the government must have well-trained staff in charge of each borrowing program and coordinate them in a cost-effective manner.

7.2. AUDIT APPROACH

In general, debt managers in developing countries face many more challenges than debt managers in developed countries. Debt managers in developed country mostly borrow using a single source, that is, marketable debt securities denominated in its own currency. In contrast, debt managers in developing countries:

- Coordinate several borrowing programs that operate independently and are used by government agencies to obtain funds exclusively for their own programs
- Manage a complex loan portfolio comprised of hundreds of loans from multiple multilateral and bilateral lenders, with unreliable cash drawdown schedules tied to specific projects
- Borrow at a higher cost in domestic currency to cover short-term gaps and thereby pays a significant price to develop its domestic debt market
- Face foreign-exchange risks in a significant portion of its debt portfolio that is hedged at the cost of accumulating low-yield foreign-exchange reserves

Thus, SAIs in developing countries have many opportunities to help debt managers to achieve significant improvements in the effectiveness, efficiency and economy of debt programs. The following audit questions seek to identify the minimum tools that debt managers should use to conduct their borrowing activities effectively:

- Coordinated, regular and predictable borrowing plans
- Debt strategy aligned with debt objectives
- Well-defined procedures for borrowing loans tied to specific capital projects
- Transparent procedures for conducting auctions and syndications in domestic and external markets, and
- Coordinated cash and debt management operations.

7.3. AUDIT QUESTIONS ON BORROWING ACTIVITIES

1. Does the government have a documented borrowing plan? If so,
   a) Does it include indicative dates of each borrowing and the methods and sources of each borrowing?
   b) Is the plan aligned to the government's debt strategy, if it has developed a strategy?
   c) Is the borrowing plan coordinated with the monetary authority (central bank)?

   d) Is the borrowing plan implemented on a regular and predictable basis? Do debt management officials produce a report on the implementation of borrowing plans? Are there public notices that explain changes in the borrowing plan?

2. What is the process for negotiating and contracting new loans? Which entity is responsible for managing this process?

3. If the government has any of the following strategic benchmarks, determine which one has been complied with:

   a) Share of foreign currency to domestic debt
   b) Currency composition of foreign currency debt
   c) Minimum average maturity of the debt
   d) Maximum share of debt that is allowed to fall due one year
   e) Maximum share of short-term to long-term debt
   f) Maximum share of floating-rate to fixed-rate debt
   g) Minimum average time to interest rate re-fixing

4. Does the annual report on debt management activities contain an evaluation on how they have complied with the government's strategy?

5. What debt instruments are sold in domestic markets, and what techniques are used to issue each instrument?

6. When does the government announce the domestic borrowing plan, and what information is provided? How frequently is this information updated during the fiscal year?

7. In the case of auctions of short-term Treasury bills and medium- and long-term Treasury bonds, identify the steps in the process, roles played by each institution, staff responsibilities, and timetable for conducting auctions. Specifically, describe the following features:

   a) Announcement of the auction
   b) Bidding time-period (opening time and closing time)
   c) Processing of bids
   d) Approval of auction cutoff
   e) Announcement to successful bidders and to the market
   f) Settlement of the auction

8. In the case of syndications and tap issue of Treasury bonds, identify the steps in the process, roles played by each institution, staff responsibilities, and timetable for these methods of placing securities?

9. Is there an information memorandum or prospectus for the sale of each major debt instrument? Is it published, or is a soft copy available on the government or Central Bank Web site? What is the content of the information memorandum or prospectus? How promptly and widely are these materials distributed and made available to relevant stakeholders?

10. Does the debt management office publish operating procedures or guidelines for the issuance of each government instrument? What is the content of the operating procedures? How effectively and widely are operating procedures for sale of debt securities made available to prospective buyers?

11. What debt instruments are sold to external investors, and what techniques are used to issue each instrument?

12. Are there guidelines and limits for non-concessional external borrowing?

13. What is the basis used by debt management officials for selecting funding sources: multilateral, bilateral, and commercial sources?

14. How are the terms and conditions set for each loan, and what scope is there to negotiate these terms and conditions?
15. Were non-concessional loans taken even though the government might have been eligible for concessional funding? If so, what were the reasons?
16. What are the steps in the process, roles of each institution, staff responsibilities, and timetable for contracting or issuing each external debt instrument?
17. When are legal advisors involved in the contracting of new loans? What is their involvement and role, and how much value/experience do they provide?
18. Are technical evaluations carried out for new borrowing proposals to analyze the all-in cost, as well as their impact on the currency composition, interest rate structure, and maturity profile of the overall loan portfolio?
19. Are there documented procedures for borrowing in foreign markets? What is the content of the documented procedures? Are those procedures being complied with? If not, what were the consequences?
20. Is there a formal agreement of roles and responsibilities of primary dealers? Who monitors the participation of primary dealers? Is the agreement with primary dealers revised regularly in response to government needs and changes in debt markets? How the government measures the effectiveness of the agreement with primary dealers?

CASH & DEBT MANAGEMENT

21. Who is responsible for coordinating debt and cash management? Is there a formal agreement with the roles and responsibilities of each party?
22. Who is responsible for forecasting government cash flows? How often are forecasts prepared? How accurate have been the forecasts? If forecasts over the years have been materially inaccurate, what were the reasons and what actions were taken to improve the system of forecasting?
23. Who is responsible for preparing forecasts of the aggregate level of overnight cash balances in central government bank accounts? How often are forecasts prepared, and for what period are these calculated? How accurate have been the forecasts? If forecasts over the years have been materially inaccurate, what were the reasons and what actions were taken to improve the system of forecasting?
24. What are the average overnight balances in government bank accounts? How actively are these balances managed?

(An example of ADM and List of References – to be included)

8 Auditing Public Debt Information Systems

This section of the *Guide* helps SAIs to assess the importance of information systems in public debt management, and provides questions that SAIs can use to prepare an audit plan of the information systems commonly used in public debt.

8.1. IMPORTANCE OF PUBLIC DEBT INFORMATION SYSTEMS

The complex nature of public debt, its dependence on consistent and timely data for accurate analysis, and the increasing amount of debt records and transactions that must be captured by an information system have encouraged many countries to develop or acquire computerized systems.

SAIs that make assessments of debt information systems may find that sometimes the benefits of computerized systems are not commensurate with the investments and expectations of government officials. This gap could be attributed in part to the misconception that purchasing computers can make up for fundamental internal control weaknesses, such as poorly trained staff and weak legal framework, in a debt management system. SAIs can conduct a performance audit to help debt management identify and eliminate the internal control weaknesses and improve the effectiveness, efficiency and economy of debt information systems.

8.2. AUDIT APPROACH

Any public debt information system – manual or computerized – should support the following functions:

- **Recording Function**
  Debt management staff should be able to record cash flows accurately for all debt transactions, and use the input cash flows to generate accurate and complete debt service schedules.
- **Analytical Function**
  Debt management staff should be able to obtain debt ratios and develop "what-if" scenario analysis resulting from hypothetical changes in financial variables. This function should provide up-to-date market information, such as interest rates and foreign exchange required to perform net present value analysis and forward exchange calculations.
- **Reporting Function**
  Debt management staff should be able to generate reports that meet internal and external reporting requirements, such as debt reports for the World Bank's Debt Reporting System (DRS).

In order to carry out recording, analytical and reporting functions effectively, a debt information system must possess strong general and application controls to ensure the security, reliability and completeness of debt data. The following **general controls** provide the framework and foundation on which application controls are built:

- Organization and management controls
- Segregation of duties
- Operational controls
- Physical controls (access and environment)
- Logical access controls
- Program change controls
- Business continuity planning

These general controls are described in ISSAI 5410, *Guidance for Planning and Conducting an Audit of Internal Controls of Public Debt*, in www.issai.org.

After testing general controls, SAIs will assess application controls, which relate to debt transactions. These controls consist of manual procedures carried out by the debt management staff and automated procedures performed by the computer software. Manual procedures include debt data validation to ensure debt data are complete, accurate and consistent.

IT audit experts in the SAI team are generally responsible for conducting appropriate tests of controls to ensure they are operating effectively. SAIs should remember that testing hardware and software applications is only one piece of evidence to determine effectiveness of a debt management system. It is also essential to assess whether senior debt management officials promote an environment of effective internal control.

8.3. AUDIT QUESTIONS ON PUBLIC DEBT INFORMATION SYSTEMS

1. What kind of system is in use? On what basis was the decision taken to acquire/develop that system vis-à-vis competing systems?
2. Are the users sufficiently trained for effective use of the system?
3. Are user guides easily available to the users? Is there a helpdesk system to provide efficient trouble shooting assistance?
4. Is there adequate documentation of the debt processing procedures used in the system?
5. What kind of technical support is available for system maintenance and how cost-effective is that support?
6. Are there effective **general** and **application** controls in place to ensure data completeness, confidentiality, integrity and accuracy? Some examples could include:
   a) Are debt program and debt data secured and checked out only to authorized individuals by a custodian?
   b) Are passwords formally assigned, routinely changed, and protected from use by unauthorized people?
   c) Does the computer system have imbedded rules, such as edit checks, to verify the accuracy of debt information as it is entered into the computer?
7. Are there effective controls for ensuring data security, including virus control?
8. Is there a business continuity plan in case the system is damaged due to natural or man-made disasters? Are backups of debt data, software programs and documentation taken regularly and as per approved data backup procedures?
9. Are the different categories of users of the system satisfied that the system efficiently meets their needs? If not, what challenges do they face?
10. When the system is integrated with the a payment system, does it provide for a workflow process to control payments?
11. If the debt system is integrated, are there sufficient firewalls to prevent wrong information flowing into the debt system through the integration?
12. Is the system being regularly improved through continuous improvements?

(An example of ADM and List of References – to be included)

9 Auditing Debt Servicing Activities

This section of the *Guide* helps SAIs to recognize the importance, objectives and elements of debt servicing activities, and provides questions that SAIs can use to prepare a plan to audit their effectiveness, efficiency and economy.

9.1. IMPORTANCE OF PUBLIC DEBT SERVICING ACTIVITIES

Debt service is the set of operations related to principal repayments, interest payments, commission payments and, if required, penalty-related payments. Paying on time the correct amounts specified in public debt agreements is the main objective of debt servicing activities. It is important for debt managers to adopt sound practices in debt servicing because countries that always pay on time are likely to have higher credit status and lower borrowing costs.

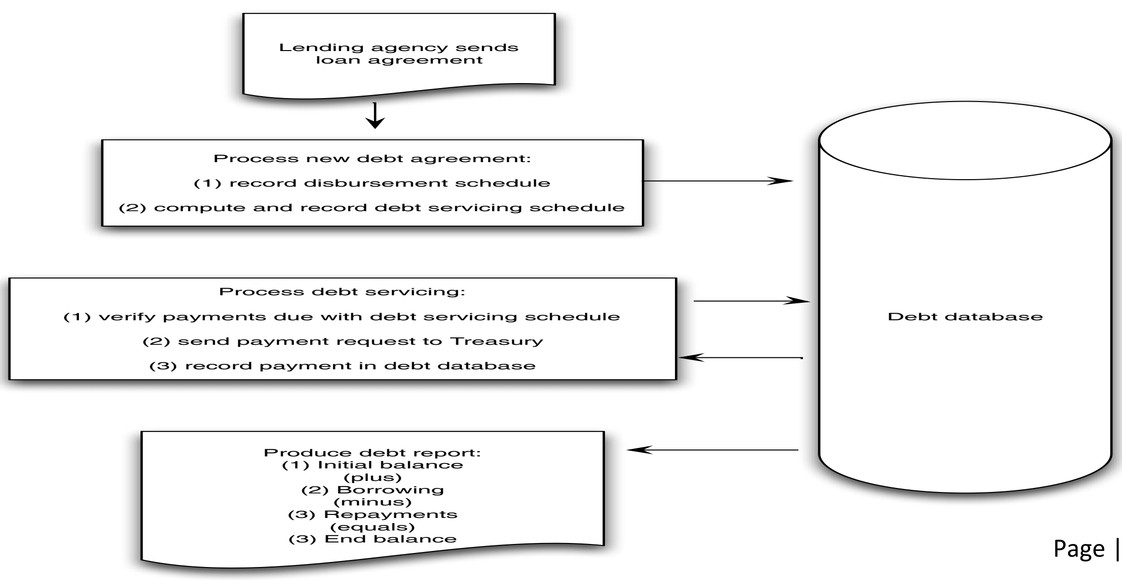
Servicing debt requires active participations of staff in five government entities, namely, the debt management units or offices, the creditors, Ministry of Finance (Budget and Treasury units), Parliament, and the Central Bank (the fiscal agent responsible for the country's foreign exchange reserves and monetary policy). These entities perform two major activities, namely, budgeting and payment of debt service obligations. In the case of debt incurred by state-owned and controlled enterprises, the enterprise's management and directors will also participate in debt servicing activities.

A critical component of an effective debt service operation is a secure, up-to-date and complete debt database. This tool is essential to make risk analyses, such as the detection of large servicing payments in the near future, irrespective of the original maturity of the debt instruments.

A complete, up-to-date debt database is necessary to produce accurate debt-service schedules for policymakers in the Ministry of Finance and the Legislature. Prudent debt managers would produce conservative estimates of feasible future borrowing, and incorporate into their future debt schedules the country's macroeconomic conditions, the country's balance of payments prospects and the government's fiscal position.

9.2. AUDIT APPROACH

In assessing the effectiveness, efficiency and economy of debt servicing activities, SAIs can use flow diagrams that visually represent the exchange of important documents and communications in debt operations, as shown below.



9.3. AUDIT QUESTIONS ON PUBLIC DEBT SERVICING ACTIVITIES

Debt Service Schedule – Checks for completeness

1. Is there a register of all correspondence received at the public debt management unit regarding scheduled payments?
2. Are there any payments scheduled, but in suspense or waiting?
3. At the Budget department, is there a document that records actual expenditures related to debt service? Differences in actual expenditures should be reconciled.
4. At the paying agencies and government-controlled entities, is there a register of all payments made (including penalties and commissions)? Check that payments are also recorded in the debt management office register.
5. Are there any prepayments of debt service? Check that the debt service schedule has been modified to incorporate prepayments.
6. Were all billing statements received prior to due date? Check with creditors if a payment was made in the absence of a billing statement.
7. Were all payments in arrears acted upon? Check with creditors if a payment previously in arrears was already made.
8. What is the status or classification of amounts in waiting that will not be paid or in arrears? Check with creditors if they are write-offs or rescheduled debt.
9. Are draft loans in the pipeline still in the negotiation stage?

Debt Service Schedule – Checks for accuracy

1. Were debt service payments made in accordance with procedures?
2. Were billing statements checked against the debt management office's debt schedule? How many discrepancies were detected?
3. Were billing statements reconciled against the actual debt service payments made? How many discrepancies were detected?
4. Have all payments in waiting cleared within a time period?
5. Are there differences between interest reported by Budget office and interest amounts reported by the debt management office? Have these differences been reconciled?
6. Are there differences between the payment orders registered in the Ministry of Finance / Treasury and the payments made ("debit advices") of the fiscal agents (Central Bank / agent banks)?
7. Did debt management office staff identify the reasons for under- or over-payments reported by the creditors?

Debt Service Schedule – Checks for consistency

1. Are the dates in the schedule of public debt in agreement with the scheduled dates in loan agreements?
2. Have amendments to disbursement dates in loan agreements been recorded in the public debt management information system?

3. Did debt management staff reconcile any discrepancies between the public debt schedule and the public country debt data available in websites of the World Bank, the IMF and other creditors?

Restructured Debts

1. Did the public debt management staff certify that the loan amortisation tables incorporate the terms of each debt rescheduling agreement?
2. Were the new debt agreements confirmed with the creditors?
3. Are the data elements in each loan tranche modified in accordance with the debt rescheduling agreement?
4. Is the new interest rate correct in order to obtain the correct amount of interest to be rescheduled?
5. Are all payments of rescheduled loans clearly identified and recorded as "rescheduled"?
6. Are the negotiated terms in Paris Club document incorporated in the debt management information system?
7. Is each rescheduled loan clearly identified as a rescheduling, for example, with an extension name such as "Paris Club1", "Paris Club2", "HIPC"?

(An example of ADM and List of References – to be included)

10 Auditing Debt Reporting

This section of the *Guide* helps SAIs to recognize the importance, objectives and elements of public debt reporting and helps SAIs to prepare an audit plan to audit debt reporting.

10.1. IMPORTANCE OF PUBLIC DEBT REPORTING

Regular disclosure of audited public debt activities allows legislators, creditors, and other interested parties to have reliable information to assess compliance with debt legislation and determine if debt levels are sustainable. When the audited debt figures are produced on a timely manner, there is a better chance of addressing potential problems before debt levels become unsustainable and avoid risky debt decisions that can exacerbate an economic, fiscal or financial crisis.

10.2 AUDIT APPROACH

There are significant differences in public debt reports, primarily driven by the needs of targeted users. Auditors will aim, therefore, to determine if government officials disclose relevant public debt information in a timely manner. The audit criteria that course participants choose for assessing public debt information would vary by type of public debt report.

Three possible reporting requirements are examined by SAIs:

- If the public debt information is presented in government financial statements, the external auditor should determine whether public debt figures have been disclosed in a fair manner, in accordance with prevailing accounting standards.

- If the external auditor is required to examine public debt statistics which their countries report to multilateral and bilateral lending institutions, such as the World Bank and IMF, they should design audit procedures to determine if the public debt statistics meet the disclosure guidelines that have been agreed upon by the country with each lending institution.

- In some countries, multilateral and bilateral lenders engage the supreme audit institution (SAI) to examine if loan proceeds for specific projects were applied in accordance with the terms and conditions of loan agreements. In this case, auditors should address this specific audit scope by applying audit procedures that assess compliance with reporting requirements stated in each loan agreement

10.3. AUDIT QUESTIONS ON PUBLIC DEBT REPORTING

1. What are the statutory and contractual reporting requirements of your government?
2. How well has your government met those statutory and contractual reporting requirements?
3. Who is responsible for preparing and submitting debt data to the IMF and World Bank (for example, for the Debtor Reporting System)?
4. How are these debt data prepared, and when are they submitted?
5. Are contingent liabilities included in debt reports?

6. What is the process and who is responsible for preparing a debt statistical bulletin or equivalent debt report? How frequently is this debt information published? Is it publicly available? If so, how and in what format?
7. Does the debt statistical bulletin or equivalent include the following?
   - Information on central government debt stocks (by creditor, residency classification, instrument, currency, interest-rate basis, and residual maturity)
   - Debt flows (principal and interest payments)
   - Debt ratios or indicators (or both)
   - Basic risk measures of the debt portfolio
8. What other debt reports are produced by the government or central bank? If so, how and in what format?
9. What is the time period or lag from the debt reporting period to the time when reliable debt reports are produced? What validation measures are used to ensure the accuracy of these reports?
10. Who is responsible for signing off on or authorizing the release of these reports?
11. Are the primary users of debt reports satisfied with them?

(An example of ADM and List of References – to be included)

11 AUDITING LOAN GUARANTEES

This section of the *Guide* helps SAIs to recognize the importance of loan guarantees in public debt management, and provides questions that SAIs can use to prepare a plan to audit their effectiveness, efficiency and economy.

9.4. IMPORTANCE OF LOAN GUARANTEES

In general, governments can promote policy goals by providing direct loans to targeted sectors, commonly known as on-lending programs. Alternatively, governments can offer loan guarantees to private lenders, who then provide funds to the targeted sectors. In order to determine which method – direct loans or guaranteed loans – is most cost effective in achieving policy goals, governments must possess the managerial capacity and collect sufficient evidence on the costs and benefits of each tool. SAIs can, through their performance audits of these programs, help governments to assess their managerial capacity and collect evidence on their costs and benefits.

9.5. CRITERIA & AUDIT TOOLS TO EXAMINE LOAN GUARANTEES

Conducting performance audits of the risks to public debt of loan guarantees must take into account the diversity of guarantee programs that may exist in a country. SAIs should first conduct a thorough investigation of the legal framework under which major loan guarantee programs were established to determine if the laws comply with best legal practices. Next, SAIs should examine the existence and effectiveness of internal control components in guarantee programs. Three critical components of internal control in loan guarantee programs are:

9.5.1. Risk Assessment

SAIs should determine if guarantee programs have procedures to assess credit risk and determine an appropriate level of guarantee fees. These two elements are required to assess whether the government should support a project or a borrower through guarantees, or provide support through other methods, such as direct loans or grants.

9.5.2. Budgeting Risk

SAIs should determine what steps have been taken to reduce the risks to the budget of guarantee programs. An important budget tool is the establishment of a loan guarantee reserve, similar to a loan loss reserve. This reserve is increased by fees collected on the guarantees, and reduced by guarantees that have been paid, thus causing the cost of the guarantee to be recognized in the budget.

9.5.3. Default Risk Mitigation

SAIs should assess whether management has effective risk mitigation strategies that help to reduce losses due to defaulted loans. Risk mitigation actions include:

- Requiring collateral from the borrower
- Ensuring that loan proceeds are used to finance the project being promoted by the guarantee
- Making sure that the project is adequately insured

- Performing adequate due diligence on the loan application, examining the currency choice, interest rate, principal repayments, term of the loan, to ensure the repayment is in line with the revenue streams of the project
- Requiring the creditor to immediately inform the government in case of payment defaults
- Requiring the beneficiary to provide all information requested by the guarantor
- Inserting in the underlying loan or guarantee agreement required ratios for equity/asset for the borrower, default clauses related to the maintenance of value of the collateral and clauses preventing the owners of the beneficiary from "milking the property" through dividends.

9.5.4. *Monitoring*

Once the loan guarantees are issued, the responsible government agency should:

- Monitor the relation between the borrower and the lender to anticipate and, if possible, prevent or mitigate any defaults
- Keep records of the outstanding loan guarantees and update them on a timely basis
- Estimate budget needs to cover any default on payment that may occur during the year
- If called upon to do so, pay on behalf of the borrower
- Receive the guarantee fees, if any
- Disclose information and report on loan guarantees

9.6. AUDIT QUESTIONS ON LOAN GUARANTEES

1. Does the government provide loan guarantees?
2. Is there clear authorization in primary legislation to approve loan guarantees on behalf of government by the Cabinet/Council of Ministers or directly by the Minister of Finance or some other entity? If so, which legislation and what sections or clauses?
3. Are there one or more than one implementing entities?
4. Is there clear authorization in secondary legislation from the executive branch of government to the implementing entity(ies) to issue loan guarantees on behalf of the government? If so, which legislation and what sections or clauses?
5. Does the government charge a guarantee fee?
6. Who is responsible for assessing the credit risks and establish guarantee fees before the approval of any loan guarantees?
7. How is the guarantee fee calculated?
8. Who is responsible for approving and signing loan guarantees or declarations?
9. Who is responsible for monitoring the relations between the lender and the borrower and the risk of loan guarantees, particularly credit risk?
10. Are borrowings by the beneficiary of loan guarantees coordinated with central government borrowing, and how?
11. What sections or clauses in the legislation cover the following:

    a. The eligible borrowers and loans;

    b. The existence of guarantee fees and credit risk assessment;

    c. Reimbursement obligations.
12. Have there been any payments resulting from default situations during the period under examination? If so:

a. What was the percentage of default situations to the total number of loans guaranteed by the government?

b. Were there sufficient budget provisions?

c. How did the actual expenditure compare with the initial budget provisions?

d. Were the payments made in due time?

e. Was there an obligation for the debtor to reimburse the guarantor? If so have the government been reimbursed in due time?

13. Did the government pay any penalty resulting from not complying with some clause of the guarantee agreement?
14. Does the debt recording system record all categories of government debt and loan guarantees together or is there a separate recording system for loan guarantees?
15. Is an annual report on management activities prepared by the implementing entity (ies) and sent to the Cabinet/Council of Ministers or the Minister of Finance?
16. Does the report contain an evaluation on how the management have complied with the government's objectives and assessment of credit risks? Is this report submitted to Parliament? Is this report made available publicly?
17. Are there clear procedures to evaluate risk involved in approving guarantees? Is the risk of default regularly re-evaluated and provisioned accordingly?
18. Has the beneficiary entity a reporting requirement to the debt management office to allow for a reassessment of the likelihood of default and the requirement to obtain funds to repay a defaulted loan?

(An example of ADM and List of References – to be included)

PART FOUR

REPORTING PUBLIC DEBT AUDITS

12 WRITING PERFORMANCE & FINANCIAL AUDIT REPORTS OF PUBLIC DEBT

This section of the *Guide* presents SAI standards and practices in preparing public debt audit reports. Audit reporting standards are generally set by SAIs in their own regulations, commonly known as *Government Auditing Standards*.[4] SAIs also follow international reporting standards in ISSAI 400, *Reporting standards in Government Auditing*. As discussed later, reporting rules of performance reports are generally more flexible than reporting rules of financial reports. The *Guide* presents recent SAI reports to highlight similarities and differences between performance and financial audit reports.

12.1. PURPOSES OF REPORTING AUDIT RESULTS

In general, SAIs issue audit reports for two different purposes: (1) to express opinions on public *debt* disclosures made by government officials and on their compliance with selected laws and regulations; and (2) to communicate the results of their examination of effectiveness, efficiency and economy of public debt activities or programs. Examples of these different objectives are shown in the table below.

Table 12.1 Objectives in Financial and Performance Public Debt Audits

FINANCIAL AUDIT - Bureau of the Public Debt's Fiscal Years 2010 and 2009 Schedules of Public Debt "We are responsible for planning and performing the audit to **provide our opinion** about whether (1) the Schedules of Federal Debt are presented, in all material respects, in conformity with U.S. generally accepted accounting principles; and (2) Bureau of Public Debt maintained, in all material respects, effective internal control over financial reporting … as of September 30, 2010." "We are also responsible for (3) **testing compliance** with selected provisions of laws and regulations that have a direct and material effect on the Schedule of Federal Debt; and (4) **performing limited procedures** with respect to certain other information accompanying the Schedules of Federal Debt."
DEBT LIMIT – Delays Create Debt Management Challenges and Increase Uncertainty in Treasury Market "Our objectives were to (1) **describe** the actions that the Department of the Treasury has taken to manage debt near the debt limit and challenges that arise; (2) **analyze** the effects that approaching the debt limit had on the market for Treasury securities, including Treasury's borrowing costs; and (3) … **describe** alternative mechanisms that would permit consideration of the link between (fiscal) policy decisions and the effect on debt when or before (fiscal) decisions are made."

Sources: GAO-11-52, GAO-11-203, in www.gao.gov

The particular format and contents of audit reports shown next are designed to help SAIs achieve their different audit purposes, make their work less subject to misunderstanding and facilitate follow-up of public debt recommendations. The target audience or users of SAIs reports are principally senior public debt officials and those responsible for public debt governance and oversight, generally members of the Legislature.

[4] For example, see *Government Auditing Standards* issued by Nepal, Office of the Auditor General, (2005) in www.oagnep.gov.np, and U.S Government Accountability Office, *Yellow Book* (2010) in www.gao.gov.

12.2. SIMILAR FEATURES IN AUDIT REPORTS OF PUBLIC DEBT

As shown in next table, public debt audit reports generally have an appropriate title, an executive summary, table of contents, clearly identified addressee, specific date and auditor's signature, a background or overview, sections on audit objectives, scope and methodology, and appendixes.

Table 12.2 Similar and Different Features of Audit Reports

Similar features	Different features
Title Executive Summary Table of Contents Addressee Date Signature Background or Overview Objectives Scope Methodology Appendixes	Financial audits generally have an introductory, scope, opinion, and explanatory paragraph. Specific rules apply to the format and content of the paragraphs. Performance audits follow flexible presentation rules for disclosing evidence, analysis & recommendations.

Source: various

12.2.1 Title

According to ISSAI 400, SAIs should use a suitable title that helps "the reader to distinguish it from statements and information issued by others". In contrast to the "neutral" titles of financial audit reports, SAIs should use titles in performance reports that explicitly convey a "bottom line" message. For example, the Appendix compares titles used in financial and performance audit reports. The financial audit adopts a title that is descriptive and does not show any audit opinion. In contrast, the title of the performance audit report summarizes two main findings and makes the reader expect some SAI recommendations:

- *"FINANCIAL AUDIT - Bureau of the Public Debt's Fiscal Years 2010 and 2009 Schedules of Public Debt"*
- *"DEBT LIMIT – Delays Create Debt Management Challenges and Increase Uncertainty in Treasury Market"*

12.2.2. Addressees & Report Dates

Addressees of requested audit reports would be the members of legislature with oversight authority over public debt. Self-initiated reports are generally addressed to debt management and oversight officials who can take corrective actions in response to SAI recommendations. For example, senior debt management would receive audit reports on internal control and legal compliance. The legislature would act on SAI recommendations to fix deficiencies in the legislative public debt framework.

Dates of audit report are under the control of the SAI and are subject to the completion of audit work requirements. Formally, audit reports are normally signed and dated no earlier than when the SAI senior managers determine that the SAI team obtained sufficient appropriate audit evidence to support the audit opinion, conclusions, and recommendations.

SAIs should identify strategic dates that help to achieve their main audit objective of improving public debt management. For example, SAIs should be cognizant of the dates when senior debt management makes formal announcements on public debt policy. It is possible in both financial and performance audits to issue progress reports that allow public debt officials to take prompt corrective actions in response to SAI recommendations.

12.2.3. Executive Summary

Many SAIs include an Executive Summary (ES) in both performance and financial audit reports. ES are designed for senior debt management officials and oversight policymakers who must rely on brief memos to obtain the bottom-line message of a lengthy audit report. Because it is impossible to convey all the information of a full-length audit report in one page, SAIs must create a distinct format and exercise considerable professional judgment in selecting the main findings and recommendations for the ES. The appendix presents two ES, one for a financial audit and one for a performance audit of public debt.

12.2.4. Background or Overview

At the beginning of the audit report, SAIs should provide minimum background information required to help the readers understand their findings, analysis, conclusions and recommendations. In general the background includes information on the specific public debt program, its significance, organizational structure and statutory basis. SAIs must exercise their professional judgment to decide what is minimum background information, in order to keep short the Background section and avoid distracting users with unnecessary details. Interesting but not essential information can be moved to an Appendix at the back of the report.

12.2.5 Objectives

SAI should explain the audit objectives in clear, specific, neutral and unbiased manner. As explained earlier in this *Guide*, there are significant differences between audit objectives of performance and financial reports. Expressing an opinion on fairness of public debt assertions and compliance with selected legislation are the main objectives in financial audits, while the performance audit objectives are more diverse. The Guide earlier presented an example of different objectives in performance and financial audits done by same SAI.

12.2.6. Scope

SAIs should describe the scope of the work performed and any limitations, so that users of the public debt report can correctly interpret the findings, conclusions and recommendations. In the scope section SAIs define the time period included in the audit, debt management units and their responsibilities (planning, negotiations, approvals, contracting, servicing, accounting, debt reporting, risk monitoring).

SAIs should also report any materially significant scope limitations, such as denials or excessive delays of access to important public debt records and officials.

12.2.7. Methodology

This section of the audit report should be written for knowledgeable and technically proficient readers who want to know sufficient details in order to understand how the SAIs obtained the evidence and used analytical tools to achieve their audit objectives. SAIs in this section should describe their critical assumptions, explain how they arrived at their statistical sampling design; clarify how sample results can or cannot be projected to all public debt records. Important tools to gather evidence and analytical techniques used should be described with sufficient, convincing detail.

12.2.8. Conclusions

Conclusions made by SAIs are logical inferences about the deficiencies in a public debt activity or program, based on the evidence and SAI's analysis. Conclusions should convince a knowledgeable reader that the corrective actions recommended by the SAI are necessary.

12.2.9. Recommendations

SAIs should recommend actions to improve effectiveness, efficiency and economy in public debt management when the potential for improvement is substantiated by their audit findings and analysis. In order to improve their chances for implementation, recommendations should flow logically from the findings and conclusions, be targeted precisely at resolving the cause of debt management deficiencies, and clearly describe the course of recommended action.

Specifically, public debt audit reports should have recommendations that are specific, measurable, achievable, realistic and timely (SMART):

- **Specific** recommendations correctly identify who is responsible for taking clear, corrective action to eliminate a deficiency, and improve a public debt program or activity.
- **Measurable** recommendations can be tracked by SAI's follow-up system. SAIs can determine whether corrective actions were taken and debt management deficiencies were eliminated. When implemented, recommendations should prevent recurrence of findings, and allow the SAI to conduct an independent audit of the new conditions in public debt.
- **Achievable** recommendations are doable in a reasonable time period without major use of financial resources
- **Realistic** recommendations take into account the priorities and operating constraints of the officials who are responsible for implementing them
- **Timely** recommendations are provided to responsible officials in the right moment and manner to facilitate its prompt implementation.

12.2.10. Appendixes

SAIs can use appendixes to provide:

- Additional background
- Details on Objectives, Scope and Methodology for technical readers
- Comments by debt management on the audit report
- Debt management assertions on internal control over public debt reporting.

12.3. REPORTING STANDARDS IN FINANCIAL AUDITS OF PUBLIC DEBT

In general SAIs issue an opinion on government financial reports using a four-paragraph format:

- **Introductory paragraph** identifies the financial statements subject to the SAI's opinion;
- **Scope paragraph** identifies the standards used in performing the audit, and points out the limitations of the audit.
- **Opinion paragraph** is provided that the government financial reports are presented fairly and in conformity with generally accepted accounting principles.
- **Explanatory paragraphs** are used to provide additional relevant information, e.g., whether the SAI applied limited procedures to supplementary information.

SAIs issue four types of audit opinions on financial reports: unqualified (clean), qualified, adverse, and disclaimer of opinion.

12.3.1. Unqualified (Clean) Audit Opinion

According to ISSAI 400, SAIs provide an unqualified opinion when they are satisfied in all material respects that:

"(a) the financial statements have been prepared using acceptable accounting bases and policies which have been consistently applied;

(b) the statements comply with statutory requirements and relevant obligations;

(c) the view presented by the financial statements is consistent with the auditor's knowledge of the audited entity; and

(d) there is adequate disclosure of all material matters relevant to the financial statements."

The next inbox – Unqualified Financial Audit Opinion – shows the format and terms that are used to define precisely four opinions in GAO's 2010 financial audit report on public debt.

INBOX – UNQUALIFIED FINANCIAL AUDIT OPINION

Opinion on the Schedules of Federal Debt

The Schedules of Federal Debt including the accompanying notes present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the balances as of September, 30, 2010, 2009, and 2008 for Federal Debt Managed by the Bureau of Public Debt (BPD); the related Accrued Interest Payables and Net Unamortized Premiums and Discounts; and the related increases and decreases for the fiscal years ended September 30, 2010 and 2009.

Opinion on Internal Control

BPD maintained, in all material respects, effective internal control over financial reporting relevant to the Schedules of Federal Debt as of September 30, 2010, that provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the Schedule of Federal Debt would be prevented or detected and corrected on a timely basis…

Compliance with a Selected Provision of Law

Our tests of BPD's compliance with the statutory debt limit for fiscal year 2010 disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards. The objective of our audit … was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Consistency of Other Information

BPD's Overview on Federal Debt … contains information, some of which is not directly related to the Schedules of Federal Debt. We did not audit and we do not express an opinion on this information. However, we compared this information for consistency with the schedules and discussed the methods of measurement and presentation with BPD officials. On the basis of this limited work, we found no material inconsistencies with the schedules or U.S. generally accepted accounting principles.

Source: GAO-11-52, *Financial Audit, Bureau of the Public Debt's Fiscal Years 2010 and 2009 Schedules of Federal Debt*, in www.gao.gov

12.3.2. Qualified & Adverse Opinions

According to ISSAI 400, SAIs issue a **qualified** audit opinion "where the auditor disagrees with or is uncertain about one or more particular items in the financial statements which are material but not fundamental to an understanding of the statements".

Alternatively, SAIs issue an **adverse** opinion "where the auditor is unable to form an opinion on the financial statements taken as a whole due to disagreement which is so fundamental that it undermines the position to the extent that an opinion which is qualified in certain respects would not be adequate".

In general, SAIs express qualified or adverse opinions in four circumstances: (a) an audit scope limitation; (b) the financial statements are incomplete or misleading; (c) there is an unjustified departure from acceptable accounting standards; or (d) there is uncertainty affecting the financial statements.

Audit scope **limitations** could result from insufficient public debt records, inaccessible public debt officials, or circumstances beyond the control of public debt management. SAIs must assess how important the omitted evidence or procedures were, and if alternative procedures were used to obtain sufficient evidence to form an opinion.

Incomplete financial statements may not provide sufficient information to present fairly the assets, liabilities, net position in conformity with generally accepted accounting standards in the country. In this circumstance, the auditor issues an adverse opinion.

SAIs may **find** significant **departures from generally accepted accounting standards** on public debt and related finance accounts, such (1) inconsistent rules for converting foreign-exchange denominated loans and securities, (2) lack of amortization of discounts and premiums, and (3) non-accrual of inflation adjustments in real debt securities. SAIs should assess the extent and importance of the accounting departure and express either a qualified or adverse opinion.

Finally, SAIs may find financial statements are subject to **significant uncertainties** that are expected to be resolved in the future when conclusive evidence becomes available. For example, material uncertainties can be associated with major financial or public debt crises, when distressed financial markets make it difficult to assign fair values to financial assets and liabilities of strategic enterprises that may have been seized by the government. In these cases SAIs should determine whether the uncertainty is adequately disclosed and if there is sufficient evidence to support recorded debt and asset levels.

The following inbox – Qualified Financial Audit Opinion on Public Debt – shows how lack of and inconsistencies in debt records, and inappropriate application of accounting standards for calculating finance costs, were the contributing factors in the decision by the Auditor General of Uganda to issue a qualified audit opinion to the 2007 government financial statements.

INBOX – QUALIFIED FINANCIAL AUDIT OPINION

In my opinion, except for the effects of adjustments as might have been determined to be necessary had I been able to satisfy myself on the matters noted below, the financial statements (of the government of Uganda) fairly present in all material respects the financial position as at 30th June, 2007, and the results of its operations and cash flows for the year then ended, and comply in all material respects with Generally Accepted Accounting Practices and the Public Finance and Accountability Act, 2003.

"… included in government's consolidated foreign debt portfolio are eleven loans without any supporting documentation such as loan agreements… "

"… finance costs in respect of interest on Treasury repo stocks/transactions were not recognized in the financial statements. This has the effect of understanding the equity…"

"… the variance beween matured treasury bonds that were redeemed and charged in respect of the redemption on the Treasury Bond Investment account was not explained to my satisfaction…"

Source: *Uganda, Audit Report of Auditor General*, in www.oag.go.ug/

12.3.3. Disclaimer Opinion

According to ISSAI 400, a disclaimer of opinion is given “where the auditor is unable to form an opinion on the financial statements taken as a whole due to an uncertainty or scope restriction which is so fundamental that an opinion which is qualified in certain respects would not be adequate”.

The disclaimer should make clear that an opinion cannot be given, and specify clearly and concisely all matters of uncertainty. The inbox below provides a disclaimer of opinion by the Auditor of Belize due to a fundamental scope restriction, namely, absence of sufficient public debt data.

INBOX – DISCLAIMER OF OPINION BY AUDITOR OF BELIZE

The Auditor General of Belize submitted a Disclaimer of Opinion in the 2006/2007 Financial Statement Report:

“This [financial] statement, which reported external and domestic public debt at $1.4 trillion at the end of 2002/2003 financial year, was submitted for audit.”

“However, I am unable to provide an opinion on this statement due to the following:

1. The Principal Ledger of public debt transactions was not presented for the fiscal year under review;
2. Audit [team] was provided a spreadsheet of loans, which when compared to the financial statement, reflected a difference of $17.7 million;
3. As many as 40% of public debt transactions could not be audited because of the absence of source documents.”

Source: Report of the Auditor General for the Year 2006 to March 2007, available in www.audit.gov.bz/

12.4. ILLUSTRATION

This section has illustrations of the main components of a public debt audit report. The examples show a financial audit report and a performance audit report, issued by the same SAI (U.S GAO and some examples from TPDMA’s pilot audits– to be included)

12.4.1 Title, Addressee and Report Date

Exhibit: Titles, Addresses and Report Dates of Performance and Financial Audit Reports

Table 12.3: Title, Addressee and Date in Financial and Performance Audits

FINANCIAL	United States Government Accountability Office
Title:	*FINANCIAL AUDIT - Bureau of the Public Debt’s Fiscal Years 2010 and 2009 Schedules of Public Debt*
Addressee:	Secretary of the Treasury
Date:	November 8, 2010
PERFORMANCE	United States Government Accountability Office
Title:	*DEBT LIMIT – Delays Create Debt Management Challenges and Increase Uncertainty in Treasury Market*
Addressee:	Congress
Date:	February 22, 2011

Sources: GAO-11-52, GAO-11-203, in www.gao.gov

12.4.2. Executive Summary Examples

Exhibit 1: Executive Summary - Performance Audit Report

(Insert the **Highlights** Page of GAO-11-203 and examples from the TPDMA's pilot audit reports)

Exhibit 2: Executive Summary – Financial Audit Report

(Insert the **Highlights** Page of GAO-11-52 and examples from the TPDMA's pilot audit reports)

GLOSSARY

GLOSSARY

This Glossary presents frequently used terms in the field of public debt management and auditing. The terms are grouped by topics:

- Public Debt
- Government Finance / Debt Markets
- Accounting / Auditing / Information Systems

The sources of the terms and definitions are:

- Debt and DMFAS Glossary (2000), in http://www.unctad.org
- *Government Auditing Standards* (2010), in www.gao.gov
- *Federal Information System Controls Audit Manual* (2009), in www.gao.gov
- ISSAI 5410, *Guidance for Planning and Conducting an Audit of Internal Controls of Public Debt,* in www.issai.org
- *Glossary, Australian Office of Financial Management*, in www.aofm.gov/au

SAIs with access to Internet may want to access the following glossaries available in the Internet:

Bond Terms:

The Securities Industry and Financial Markets Association (SIFMA) provides a comprehensive glossary of bond terms in www.InvestingInBonds.com

OECD Glossary Portal:

OECD provides free of charge a portal to search terms in different categories: http://stats.oecd.org/glossary/

Central Banks Websites:

SAIs can check if the terms and conditions that describe public debt activities are defined in the official websites of their central banks. Why the central banks' websites? Because central banks in most countries act as the **fiscal agents** of their government, and manage its debt operations. The websites of the central banks are available in http://www.bis.org/cbanks.htm

PUBLIC DEBT

Agreed Minute

The agreed minute sets out the common terms of a debt rescheduling agreed between creditors of the Paris Club and a debtor country and is signed by representatives of the creditor countries who are obliged to recommend its terms to their governments.

The agreed minute specifies which debt service will be rescheduled and over what period. The rate of interest charged on rescheduled debt is a matter for negotiations leading to a bilateral agreement between the debtor country and each individual Paris Club creditor.

Debt and Debt Service Reduction (DDSR)

Debt restructuring agreements between sovereign states and consortia of commercial bank creditors involving a combination of buy-backs, the exchange of bank loans at a discount for bonds or the exchange of bank loans for bonds at par but that lend below-market interest rates. In most instances, the new financial instruments are secured with U.S. Treasury bonds. Under the Brady Plan of March 1989, these arrangements are supported by loans from official creditors.

Debt Sustainability

A debt position of a country when the net present value of debt to exports ratio and the debt-service to exports ratio are below certain country-specific target levels within ranges of 200 through 250 percent and 20 through 25 percent, respectively. Debt measure includes public and publicly guaranteed debt liabilities.

Debt Sustainability Analysis (DSA)

A study jointly undertaken by IMF and World Bank staff and the country concerned, in consultation with creditors, at the decision point. On the basis of the DSA, the country's eligibility for support under the HIPC will be determined.

Enhanced Surveillance

Under Article IV of its Articles of Agreement, IMF monitors the economic progress of countries that are no longer using IMF resources, but are continuing to receive debt relief under multiyear rescheduling agreements. Countries are authorized to release edited versions of IMF staff reports to their official and commercial creditors.

Export Credits

Loans extended to finance specific purchases of goods or services from within the creditor country. Export credits extended by the supplier of goods are known as suppliers credits; export credits extended by the supplier's bank are known as buyers credits.

Goodwill Clause

This clause was introduced into Paris Club agreements in 1978 for debtors requiring relief beyond the usual consolidation period of 12 to 18 months. Under the standard goodwill clause, the Paris Club creditors agree in principle, but without commitment, to consider subsequent debt relief applications favorably for a debtor country that remains in compliance with its IMF program and that has sought comparable debt relief from other creditors. An improved goodwill clause, first introduced in 1983, goes beyond the standard clause by specifying the future consolidated period.

Grant Element

The measure of concessionality of a loan, calculated as the difference between the face value of the loan and the sum of the discounted future debt service payments to be made by the borrower expressed as a percentage of the face value of the loan. By convention, a 10 percent discount rate is used.

Heavily Indebted Poor Country (HIPC)

An original group of 41 developing countries, including 32 countries with a 1993 gross national product (GNP) per capita of US$695 or less and 1993 present value of debt to exports higher than 220 percent or present value of debt to GNP higher than 80 percent (see table 1 below). Also includes nine countries that received concessional rescheduling from Paris Club creditors (or are potentially eligible for rescheduling). The original HIPC list will change in the context of implementing the HIPC Initiative, and will expand to include more countries that face unsustainable debt situations, even after the full application of traditional debt relief mechanisms, and that have embarked on World Bank/IMF supported adjustment programs.

London Club

A term commonly used for a group of commercial banks that join together to negotiate the restructuring of their claims against a sovereign debtor. There is no organizational framework for the London Club comparable to the Paris Club.

Moratorium Interest

Interest charged for rescheduled debt. In the Paris Club, the moratorium interest rate is negotiated bilaterally by the borrowing country with each individual creditor and therefore differs from one creditor to the next. In the London Club, where all creditors are deemed to have access to funds at comparable rates, the moratorium interest rate applies equally to all rescheduled obligations under a given agreement.

Most Favored Nation Clause

Agreements concluded in the Paris Club that require the debtor to obtain debt relief from creditors outside the Paris Club on terms no more favorable than those obtained from Paris Club creditors.

Naples Terms

Concessional debt reduction terms for low-income countries approved by the Paris Club in December 1994 and applied on a case-by-case basis. Countries can receive a reduction of eligible external debt of up to 67 percent in net present value terms.

Net Present Value (NPV) of Debt

The sum of all future debt-service obligations (interest and principal) on existing debt, discounted at the market interest rate. Whenever the interest rate on a loan is lower than the market rate, the resulting NPV of debt is smaller than its face value, with the difference reflecting the grant element.

Nonconsolidated Debt

This is debt that is wholly or partly excluded from rescheduling and has to be repaid at terms close to the original conditions.

Official Creditors

Public sector lenders. Some are multilateral, consisting of international financial institutions such as the World Bank. Others are bilateral, being agencies of individual governments, including central banks.

Paris Club

This is the forum in which debt restructuring has been provided since 1956 by official creditors. The common feature of participating creditor countries is that they each have a system of export credit insurance, because the primary type of claim rescheduled under the Paris Club is guaranteed (or insured) export credits. The Chairman of the Club and a small secretariat are provided by the French Treasury.

Publicly Guaranteed Debt

The external obligation of a private debtor that is guaranteed for repayment by a public entity.

Pull-back Clause

This clause in a debt restructuring agreement declares that an agreed minute is “null and void” unless certain actions have been taken before specific dates.

Standby Arrangements

An understanding between IMF and a member country that purchases can be made under that country’s credit tranche facilities up to an agreed amount during a specified period -typically 12-18 months. IMF resources are made available under standby arrangements in installments, and, typically, conditions must be met regarding credit policy, government or public sector borrowing, foreign trade policies, and use of foreign credits.

Standstill

This is an interim agreement between the debtor country and its commercial banking creditors that principal repayments of medium- and long-term debt will be deferred and that short-term obligations will be rolled over, pending agreement on a debt reorganization. The object is to give the debtor continuing access to a minimum of trade-related financing while negotiations take place and to prevent some banks from abruptly withdrawing their facilities at the expense of others.

Toronto Terms

Special rescheduling terms for HIPCs that were in effect from October 1988 through December 1991.

Transfer Clause

A provision that commits the debtor government to guarantee the immediate and unrestricted transfer of foreign exchange in all cases in which the private sector pays the local currency counterpart for servicing its debt to the Paris Club creditors.

ACCOUNTING / AUDITING

Accounting applications

The methods and records used to (1) identify, assemble, analyze, classify, and record a particular type of transaction or (2) report recorded transactions and maintain accountability for related assets and liabilities. Common accounting applications are (1) billings, (2) accounts receivable, (3) cash receipts, (4) purchasing and receiving, (5) accounts payable, (6) cash disbursements, (7) payroll, (8) inventory control, and (9) property, plant, and equipment (PP&E).

Accounting system

The methods, records, and processes used to identify, assemble, analyze, classify, record, and report an entity's transactions and to maintain accountability for the related assets and liabilities.

Activity

The actual work task or step performed in producing and delivering products and services. An aggregation of actions performed within an organization that is useful for purposes of activity-based costing.

Analytical procedures

The comparison of recorded account balances with expectations developed by the auditor, based on an analysis and understanding of the relationships between the recorded amounts and other data, to form a conclusion on the recorded amount. A basic premise underlying the application of analytical procedures is that plausible relationships among data may reasonably be expected to continue unless there are known conditions that would change the relationships or the data are misstated.

Annual financial statement

An annual financial statement generally comprises:
- unaudited Management's Discussion and Analysis (MD&A),
- audited basic financial statements, including note disclosures,
- unaudited other accompanying information, if applicable.

Application controls

Controls that are incorporated directly into computer applications to help ensure the validity, completeness, accuracy, and confidentiality of transactions and data during application processing. Application controls include controls over input, processing, output, master data, application interfaces, and data management system interfaces. These controls are sometimes referred to as business process controls. Information System controls include the following additional categories: (1) authorization control, (2) completeness control, (3) accuracy control, and (4) control over integrity of processing and data files.

Appropriation

Budget authority to incur obligations and to make payments from the Treasury for specified purposes. An appropriation act is the most common means of providing appropriations; however, authorizing and other legislation itself may provide appropriations. Appropriations do not represent cash actually set aside in the Treasury for purposes specified in the appropriation acts. They represent amounts that agencies may obligate during the period of time specified in the respective appropriation acts.

Assertions

Management representations that are embodied in financial statements. Assertions are generally grouped in five broad categories:

- Existence or occurrence
- Completeness
- Rights and obligations
- Accuracy/valuation or allocation
- Presentation and disclosure

Assessing control risk

The process of evaluating the effectiveness of an entity's internal control in preventing or detecting misstatements that could be material, either individually or when aggregated with other misstatements, in financial statement assertions on a timely basis.

Assurance, level of

The complement of audit risk, which is an auditor judgment. This is not the same as confidence level, which relates to an individual sample.

Attributes sampling

Statistical sampling that reaches a conclusion about a population in terms of a rate of occurrence.

Audit risk

A combination of (1) the risk (consisting of inherent and control risk) that the balance or class and related assertions contain misstatements that could be material to the financial statements when aggregated with misstatements in other balances or classes, and (2) the risk (detection risk) that the auditor will not detect such misstatement.

Back door authority/ Backdoor spending

A colloquial phrase for budget authority provided in laws other than appropriations acts, including contract authority and borrowing authority, as well as entitlement authority and the outlays that result from that budget authority.

Borrowing authority

Budget authority enacted to permit an agency to borrow money and then to obligate against amounts borrowed. It may be definite or indefinite in nature. Usually the funds are borrowed from the Treasury, but in a few cases agencies borrow directly from the public.

Budget authority

Authority provided by federal law to enter into financial obligations that will result in immediate or future outlays involving federal government funds. The basic forms of budget authority include (1) appropriations, (2) borrowing authority, (3) contract authority, and (4) authority to obligate and expend offsetting receipts and collections. Budget authority includes the credit subsidy cost for direct loan and loan guarantee programs, but does not include the underlying authority to insure or guarantee the repayment of indebtedness incurred by another person or government.

Budget controls

Management's policies and procedures for managing and controlling the use of appropriated funds and other forms of budget authority.

Cause and effect basis

In cost accounting, a way to group costs into cost pools in which an intermediate activity may be a link between the cause and the effect.

Classical probability proportional to size sampling

A type of statistical sampling where the sample is selected with probability proportional to the size (usually dollar amount) of an item and the evaluation is performed using variables methods (not monetary unit sampling).

Classical variables estimation sampling

A sampling approach that measures sampling risk using the variation of the underlying characteristic of interest. This approach includes methods such as mean-per-unit, difference estimation, and ratio estimation.

Combined precision

The achieved precision for all statistical sampling applications.

Common data source

All of the financial and programmatic information available for the budgetary, cost, and financial accounting processes. It includes all financial and much non-financial data, such as environmental data, that are necessary for budgeting and financial reporting as well as evaluation and decision information developed as a result of prior reporting and feedback.

Compliance control

A process, by management and others, designed to provide reasonable assurance regarding the achievement of objectives for compliance with applicable laws and regulations.

Compliance tests

Tests to obtain evidence on the entity's compliance controls for each significant provision of laws and regulations identified for testing, including budget controls for each relevant budget restriction.

Confidence interval

A statistical sample-based estimate expressed as an interval or range of values. The sample is designed such that there is a specified confidence level for which the population value being estimated is expected to be located within the interval. More specifically, it is the projected misstatement or point estimate plus or minus precision at the desired confidence level and is also known as a precision or precision interval.

Confidence level

The complement of the applicable sampling risk. The measure of probability associated with a sampling interval. This is not the same as level of assurance.

Contingency

An existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur.

Contract authority

Budget authority that permits an entity to incur obligations in advance of appropriations, including collections sufficient to liquidate the obligation or receipts. Contract authority is unfunded, and a subsequent appropriation or offsetting collection is needed to liquidate the obligations.

Control activities

One of the five components of internal control, in addition to control environment, risk assessment, information and communications, and monitoring. Control activities are the policies and procedures that help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities, whether automated or manual, help achieve control objectives and are applied at various organizational and functional levels.

Control environment

One of the five components of internal control, in addition to risk assessment, control activities, information and communications, and monitoring. The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. The control environment represents the collective effect of various factors on establishing, enhancing, or mitigating the effectiveness of specific control activities. Such factors include (1) integrity and ethical values, (2) commitment to competence, (3) management's philosophy and operating style, (4) organizational structure, (5) assignment of authority and responsibility, (6) human resource policies and practices, (7) control methods over budget formulation and execution, (8) control methods over compliance with laws and regulations, and (9) oversight groups.

Control risk

The auditor's assessment of the risk that a material misstatement that could occur in an assertion will not be prevented or detected on a timely basis by the entity's controls.

Control tests

Tests of a specific control activity to assess its effectiveness in achieving control objectives. Cost The monetary value of resources used or sacrificed or liabilities incurred to achieve an objective, such as to acquire or produce a good or to perform an activity or service.

Department or Agency or Ministry

Any department, agency, administration, or other financial reporting entity that is not part of a larger financial reporting entity other than the government as a whole. Used in distinguishing inter- and intra-transactions and balances.

Design materiality

The portion of planning materiality that the auditor allocates to line items, accounts, or classes of transactions.

Detection risk

The auditor's assessment of the risk that the auditor will not detect a material misstatement that exists in an assertion.

Entity risk assessment

One of the five components of internal control, in addition to control environment, control activities, information and communications, and monitoring. Risk assessment is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed. An entity's risk assessment for financial reporting purposes is its identification, analysis, and management of risks relevant to the preparation of financial statements that are fairly presented in conformity with GAAP.

Errors

Unintentional misstatements of amounts or disclosures in financial statements.

Expectation

The auditor's estimate of a recorded amount (based on an analysis and understanding of relationships between the recorded amounts and other data) in an analytical procedure.

Expected misstatement

The dollar amount of misstatements the auditor expects in a population.

Expired account

An account within Treasury to hold expired budget authority. The expired budget authority retains its fiscal year (or multiyear) identify for additional fiscal years. After the period has elapsed, all obligated and unobligated balances are canceled, the expired account is closed, and all remaining funds are returned to the general fund of the Treasury and are thereafter no longer available for any purpose.

Financial reporting control

A process, created by management and other personnel, designed to provide reasonable assurance regarding the achievement of financial reporting objectives.

Financial statements

A component of a central government's annual financial statement, which consist of:

- Balance Sheet
- Statement of Revenues and Expenses
- Statement of Cash Flows
- Statement of Reconciliation of Budget and Financial Accounts (if applicable)
- Statements of Trust Funds or Custodial Activity (if applicable)
- Related note disclosures

Fraud

Fraud is an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Two types of misstatements resulting from fraud are relevant to the auditor's consideration in a financial statement audit: misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets.

Fraudulent financial reporting

Intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting could involve intentional alteration of accounting records, misrepresentation of transactions, intentional misapplication of accounting principles, or other means.

Full cost

The total amount of resources used to produce the output. More specifically, the full cost of an output produced by a responsibility segment is the sum of

(1) the costs of resources consumed by the responsibility segment that directly or indirectly contribute to the output and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and by other reporting entities.

Fund Balance with Treasury account

An asset account representing the unexpended spending authority in entity appropriations. Also serves as a mechanism to prevent entity disbursements from exceeding appropriated amounts.

General controls

Management's policies and procedures that apply to all or a large segment of an entity's information systems. General controls help ensure the proper operation of information systems by creating the environment for proper operation of application controls. General controls include (1) security management, (2) logical and physical access, (3) configuration management, (4) segregation of duties, and (5) contingency planning.

Generally accepted accounting principles (GAAP)

The accounting principles promulgated by a standard accounting setter. The principles should provide a hierarchy of accounting standards for financial statements of government entities.

Haphazard sample

A sample consisting of sampling units selected without any conscious bias, that is, without any special reason for including or omitting items from the sample. It does not consist of sampling units selected in a careless manner and is selected in a manner that can be expected to be representative of the population.

Information and communication

One of the five components of internal control, in addition to control environment, entity risk assessment, control activities, and monitoring. The information and communication systems support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their internal control and other responsibilities.

Information Security (IS) controls specialist

A person with technical expertise in information technology systems, general controls, applications, and information security.

IS controls

Internal controls that are dependent on information systems processing and include general controls and application controls.

Inherent risk

The auditor's assessment of the susceptibility of an assertion to a material misstatement, assuming there are no related controls.

Internal control

An integral component of an organization's management systems that provides reasonable assurance that the following objectives are being achieved:

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

Known misstatement

The specific misstatement identified during the audit arising from the incorrect selection or misapplication of accounting principles or misstatements of facts identified, including, for example, those arising from mistakes in gathering or processing data and the overlooking or misinterpretation of facts.

Likely misstatement

A misstatement that:

- arises from differences between management's and the auditor's judgments concerning accounting estimates that the auditor considers unreasonable or inappropriate (for example, because an estimate included in the financial statements by management is outside of the range of reasonable outcomes the auditor has determined).
- The auditor considers likely to exist based on an extrapolation from audit evidence obtained (for example, the amount obtained by projecting known misstatements identified in an audit sample to the entire population from which the sample was drawn).

Limit

Used in performing substantive analytical procedures, the limit is the amount of difference between the expectation and the recorded amount that the auditor will accept without investigation. Therefore, the auditor should investigate amounts that exceed the limit during analytical procedures.

Limitation

A restriction on the amount, purpose, or period of availability of budget authority. While limitations are most often established through appropriations acts, they may also be established through authorization legislation. Limitations may be placed on the availability of funds for program levels, administrative expenses, direct loan obligations, loan guarantee commitments, or other purposes.

Logical Unit

The balance or transaction that includes the selected dollar in a probability-proportional to-size sample.

Materiality

The magnitude of an item's omission or misstatement in a financial statement that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item.

Mean-per-unit approach

A classical variables sampling technique that projects the sample average to the total population by multiplying the sample average by the total number of items in the population.

Misappropriation of assets

Theft of an entity's assets causing misstatements in the financial statements.

Monetary unit sampling

A variables sampling evaluation method that utilizes a probability-proportional-to-size (PPS) sample selection technique. Since the auditor randomly selects the sample from a population of dollars, large-value transactions have more chance of selection and are more likely to be sampled than small-value transactions.

Monitoring

One of the five components of internal control, in addition to control environment, risk assessment, control activities, and information and communications. Monitoring is a process that assesses the quality of internal control performance over time. Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

Multipurpose testing

Performing several tests, such as control tests, compliance tests, and substantive tests, on a common selection, usually a sample.

Nonrepresentative selection

A selection of items to reach a conclusion only on the items selected. The auditor using a nonrepresentative selection (formerly referred to as a nonsampling selection) may not project the results to the portion of the population that was not tested. Accordingly, the auditor applies appropriate analytical and/or other substantive procedures to the remaining items, unless those items are immaterial in total or the auditor has already obtained enough assurance that there is a low risk of material misstatement in the total population. The auditor also uses nonrepresentative selections to test controls through inquiry, observation, and walkthrough procedures and to obtain planning information.

Nonstatistical sampling

A sampling technique for which the auditor considers sampling risk in evaluating an audit sample without using statistical theory to measure the risk.

Operations controls

A process by management and others, designed to provide reasonable assurance regarding the achievement of objectives for the effectiveness and efficiency of operations.

Overall analytical procedures

Analytical procedures performed as an overall financial statement review during the reporting phase.

Planning materiality

The auditor’s preliminary estimate of materiality in relation to the financial statements taken as a whole. It is used to determine design and tolerable misstatement, which are used to determine the nature, extent, and timing of substantive audit procedures. It is also used to identify significant laws and regulations for compliance testing.

Point estimate (estimated value)

Most likely amount of the population characteristic based on the sample.

Population

The items comprising the account balance or class of transactions of interest. The population excludes individually significant items that the auditor has decided to examine 100 percent or other items that will be tested separately.

Precision (allowance for sampling risk)

A measure of the difference between a sample estimate and the corresponding population characteristic at a specified sampling risk.

Preliminary analytical procedures

Analytical procedures performed during the audit planning phase.

Projected misstatement

An estimate of the misstatement in a population, based on the misstatements found in the examined sample items; represents misstatements that are probable. The projected misstatement includes the known misstatement.

Random sample

A sample selected so that every combination of the same number of items has an equal probability of selection.

Ratio estimation

A classical variables sampling technique that uses the ratio of audited amounts to recorded amounts in the sample to estimate the total dollar amount of the population and an allowance for sampling risk.

Reasonably possible

The chance of the future confirming event or events occurring is more than remote but less than probable.

Reciprocal accounts

Corresponding standard general ledger accounts that should be used by a providing/seller and receiving/buyer entity to record like intra-governmental transactions. For example, the providing entity's accounts receivable would normally be reconciled to the reciprocal account, accounts payable, on the receiving entity's records.

Recorded amount

The financial statement amount being tested by the auditor in the specific application of substantive tests.

Regression estimate

An estimate of a population parameter for one variable that is obtained by substituting the known total for another variable into a regression equation calculated on the basis of sample values of the two variables. Ratio estimates are special kinds of regression estimates.

Remote

The chance of potential liability to the entity is slight.

Responsibility segment

In cost accounting, a significant organizational, operational, functional, or process component that has the following characteristics: (a) its manager reports to the entity's top management, (b) it is responsible for carrying out a mission, performing a line of activities or services, or producing one or a group of products, and (c) for financial reporting and cost management purposes, its resources and results of operations can be clearly distinguished, physically and operationally, from those of other entity segments.

Risk of material misstatement

The auditor 's combined assessment of inherent risk and the control risk.

Safeguarding controls

Internal controls to protect assets from loss from unauthorized acquisition, use, or disposition and may include controls relating to financial reporting and operations objectives.

Sample

Items selected from a population to reach a conclusion about the population as a whole.

Sampling

The application of audit procedures to fewer than all items composing a population to reach a conclusion about the entire population. The auditor selects sample items in such a way that the sample and its results are expected to be representative of the population. Each item has an opportunity to be selected, and the results of the procedures performed are projected to the entire population.

Sampling interval

An amount between two consecutive sample items in a systematic sample. The sampling interval is determined by dividing the number of items in the population by the desired number of selections. When used in the context of a systematic sample used to select items for monetary-unit sampling (MUS), it is the tolerable misstatement divided by the statistical risk factor.

Sampling risk

The risk that the auditor's conclusion based on a sample might differ from the conclusion that would be reached by applying the test in the same way to the entire population. For tests of controls, sampling risk is the risk of assessing control risk either too low or too high. For substantive testing, sampling risk is the risk of incorrect acceptance or the risk of incorrect rejection.

Sampling strata

Two or more mutually exclusive subdivisions of a population defined in such a way that each element in the population can belong to only one subdivision or stratum.

Sampling unit

Any of the individual elements, as defined by the auditor, that constitute the population.

Sequential sampling

A sampling plan for which the sample is selected in several steps, with each step conditional on the results of the previous steps.

Standard General Ledger (SGL)

A uniform chart of accounts and guidance for government accounting, with five major sections: (1) chart of accounts, (2) accounts and descriptions, (3) account transactions, (4) SGL attributes, and (5) SGL crosswalks to standard external reports. Transactions should be recorded in full compliance with the SGL Chart of Account; reports produced by the systems provide financial information, whether used internally or externally, should be traced directly to the SGL accounts

Statistical sampling

Audit sampling that uses the laws of probability for selecting and evaluating a sample from a population for the purpose

Stratified random sample

A sample design by first classifying the population into several strata and then taking a random sample from each stratum.

Substantive analytical procedures

Analytical procedures used as substantive tests.

Substantive audit assurance

The auditor's judgment about the probability that all substantive tests of an assertion will detect aggregate misstatements that exceed materiality. Not the same as confidence level

Substantive procedures or tests

Specific procedures, including substantive analytical procedures and substantive detail tests, performed to determine whether assertions are materially misstated and to form an opinion about whether the financial statements are presented fairly in accordance with GAAP.

Supplemental analytical procedures

Analytical procedures to increase the auditor's understanding of account balances and transactions when detail tests are used as the sole source of substantive assurance.

Systematic sampling

A method of selecting a sample in which every **n**th item is selected from a random start.

Tolerable misstatement

The materiality the auditor uses to test a specific line item, account balance or class of transactions. Tolerable misstatement is defined as the maximum error in a population that the auditor is willing to accept.

Tolerable rate

The maximum population rate of deviations from a prescribed control that the auditor will tolerate without modifying the planned assigned level of control risk. For tests of compliance with laws and regulations, the tolerable rate is the maximum rate of noncompliance that could exist in the population without causing the auditor to believe the noncompliance rate is too high. (In statistical terms, margin or bound of error.)

Treasury Financial Manual (TFM)

The Treasury Financial Manual (TFM) is Treasury's official publication for financial accounting and reporting of all receipts and disbursements of the central government. It provides policies, procedures, and instructions for federal departments, agencies, Central Banks, and other concerned parties to follow in carrying out their fiscal responsibilities.

User controls

Controls that are performed by people interacting with IS controls. The effectiveness of user controls typically depend on the accuracy of the information produced by the IS controls.

Walk-through

Audit procedures to help the auditor understand the design of controls and whether they have been implemented. They may also provide some evidence of control effectiveness. Walk-throughs of financial reporting controls include tracing one or more transactions from initiation, through all processing, to inclusion in the general ledger; observing the processing and applicable controls in operation; making inquiries of personnel applying the controls; and examining related documents.

GOVERNMENT FINANCE / DEBT MARKETS

Accrued interest

The accumulation of interest since the last interest payment date. Accrued interest is added to the clean price of a bond to determine the total price (or dirty price) of a bond.

Basis point

One hundredth of one per cent or 0.01 per cent. The term is used in money and securities markets to define differences in interest rates or yields.

Basis risk

The risk that there is a divergence in the price response of financial instruments with similar risk characteristics to changes in market rates (for example, a bond and the corresponding bond futures contract). This is a risk with hedging strategies where a financial position in one particular instrument is hedged with a position in another instrument with similar risk characteristics, such that any loss in one position from changes in market rates is expected to be offset by a corresponding gain on the other position. A hedge may not be as effective as expected if there is a divergence in the price response of the financial instruments.

Bearer securities

A negotiable instrument, akin to cash, which evidences a payment obligation to be met, on presentation, at designated dates. The issuer of the instrument does not record the identity of the security holder, and as such physical possession of the certificate is sufficient proof of ownership.

Bid-offer spread

The difference between the price (or yield) at which a market maker is willing to buy and sell a particular financial product or instrument.

Bid-to-cover ratio

See coverage ratio.

Clean price

The price of a bond excluding accrued interest.

Coupon

The interest payment on a bond. In the case of Treasury Bonds coupon interest is payable semi-annually.

Coverage ratio

The ratio of the total amount of bids received to the amount on offer at a tender for the issue of Commonwealth Government Securities. Also referred to as the bid-to-cover ratio.

Credit risk

The risk of financial loss arising from a counterparty to a transaction defaulting on its financial obligations under that transaction. Credit risk is contingent on both a default taking place and there being pecuniary loss as a result. The Government faces credit risk as a part of its debt management activities in relation to its swap derivative transactions.

Defeasance

Arrangements whereby a set of debt liabilities are held against a set of assets with closely matching and offsetting cost and risk characteristics.

Derivative

A financial contract whose value is based on, or derived from, another financial instrument (such as a bond or share) or a market index (such as a share index). Examples of derivatives include futures, forwards, swaps and options.

Dirty price

The total price payable for a bond calculated as the clean price plus accrued interest.

Discount

The amount by which the value of a security is less than its face, or par, value.

Duration

A measure of the present value weighted average of the cash flows associated with a bond or portfolio of bonds. Quoted in years, duration can be used to measure the sensitivity of the present value of a bond or portfolio of bonds to changes in market interest rates.

Face value

The amount of money indicated on a security, or inscribed in relation to a security, as being due to be paid on maturity.

Financial year

The 12-month period decided upon for financial measurement.

Funding risk

The risk that an issuer is unable to raise funds, as required, in an orderly manner and without financial penalty. For the Australian Government funding risk encompasses both long-term fund raising to cover budget deficits and the short-term funding or cash management implications of mismatches in the timing of government outlays and receipts.

Futures baskets

A collection of like financial products or commodities, grouped together to underpin a particular futures contract. For example, 3- and 10-year Treasury Bond futures baskets consist of a collection of Treasury Bond lines that have an average term to maturity of approximately 3 and 10 years respectively.

Futures contract

An agreement between two parties that commits one party to buy an underlying financial instrument or commodity and one party to sell a financial instrument or commodity at a specific price at a future date. The agreement is completed at a specified expiration date by physical delivery or cash settlement or offset prior to the expiration date.

General government sector net debt

The sum of selected financial liabilities less the sum of selected financial assets on the general government sector balance sheet. It is the sum of financial liabilities in the form of deposits held, advances received, outstanding government debt securities, and other borrowings less financial assets in the form of cash held, deposits and advances paid, debt securities held as an investment, and loans advanced.

Interest rate swap

An agreement between two parties to swap interest payments. It usually involves one party exchanging a stream of fixed interest cash flows for a stream of floating interest cash flows.

Liquidity risk

The risk that arises from the difficulty of selling an asset or buying back a financial liability. The Government faces liquidity risk with respect to transactions in existing Government debt, such as debt repurchases prior to maturity, and restructuring the interest rate swap portfolio it manages.

Market risk

The risk that the price (value) of a financial instrument or portfolio of financial instruments will vary as market conditions change. In the case of a debt issuer, the principal source of market risk is from changes in interest rates. For example, once debt has been issued, interest rates may move such that either debt servicing costs increase directly or the opportunity to reduce debt servicing costs is missed.

Market value

The amount of money for which a security trades in the market at a particular point in time.

Modified duration

A measure of the sensitivity of the market value of a debt security or portfolio of debt securities to a change in interest rates. It is measured as the percentage change in market value in response to a one percentage point change in nominal interest rates. Modified duration is the primary risk parameter used by some public debt management officials. Portfolios with higher modified durations have more stable interest costs through time but have a more volatile market value through time.

Nominal debt

Debt that is not indexed to inflation. Treasury Notes and Treasury Bonds are examples of nominal debt.

Operational risk

The risk of loss, whether direct or indirect, arising from inadequate or failed internal processes, people or systems, or from external events. It encompasses risks inherent in the agency's operating activities such as fraud risk, settlement risk, legal risk, accounting risk, personnel risk and reputation risk.

Overdue securities

Securities which have passed their maturity date but remain unpresented by creditors. The Government repays the amount due when the stock is presented for payment. No interest accrues on the debt following its maturity date.

Principal

See face value.

Redemption yield

The rate of interest at which all future payments (coupons and principal) on a bond are discounted so that their total equals the current dirty price of the bond.

Repurchase agreement (repo)

An agreement under which the seller of a security agrees to buy it back at a specified time and price.

Repricing risk

The risk that interest rates have increased when maturing debt needs to be refinanced. Whenever public debt management enters the market to borrow funds, it is exposed to repricing risk. Similarly, the use of interest rate swaps to reduce the duration of the portfolio, by receiving a fixed rate and paying a floating rate, increases the level of repricing risk.

Risk premium

The difference between the return available on a risk-free asset and the return available on a riskier asset.

Secondary market

Market where securities are bought and sold subsequent to original issuance, which took place in the primary market.

Short-dated exposure

A measure of the proportion of the government's net debt portfolio subject to immediate repricing. After allocating each cash flow within the net debt portfolio proportionally to the nearest two annual pricing points, the share of the portfolio's market value allocated to the zero-year pricing point is the short-dated exposure. For example, a liability due to mature in one day would be allocated almost entirely to the zero-year pricing point, while 50 per cent of a bond with six months to maturity would be allocated to the zero-year pricing point. The net interest cost of debt portfolios with higher short-dated exposures responds more quickly to movements in market interest rates, all else being equal.

Securities Lending Facility

In come countries, public debt management officials lend Treasury Bonds to eligible parties through a securities lending facility. This activity is aimed at alleviating temporary market shortages of specific lines of Treasury Bonds.

Swap

A financial transaction in which two counterparties agree to exchange streams of payments occurring over time according to predetermined rules.

Treasury Bond

A medium- to long-term debt security that carries an annual rate of interest (the coupon) fixed over the life of the security, payable in six monthly instalments (semi-annually) on the face, or par, value of the security. The bonds are repayable at face value on maturity.

Yield

The expected rate of return expressed as a percentage of the net outlay or net proceeds of an investment, not of its face value.

Yield curve

The graphical representation of the relationship between the yield on debt securities of the same credit quality but different maturities.

APPENDIXES

Appendix-1 Case studies – to be included

Appendix-2 Pilot audit reports or summary of the pilot audit report (audit topic, audit objectives, audit findings and audit recommendations) – to be included

Appendix-3 Auditing the Public Debt Information Systems (DMFAS 6 and CS-DRMS 2000+) – to be included